CHAPTER: 1

INTRODUCTION TO MICROFINANCE

1.1 Introduction

The Indian state put stress on providing financial services to the poor and underprivileged since independence. The commercial banks were nationalized in 1969 and were directed to lend 40 percent of their loanable funds at a concessional rate, to the priority sector. The priority sector includes agriculture, and other rural activities and weaker section of society in general. The aim was to provide resources to help the poor to attain self sufficiency. They had neither resources nor enjoyment opportunities to be financially independent, let alone meet the minimal consumption needs.

The existing credit institutions and the initiatives taken by the authorities have not helped the rural poor to improve their standard and welfare. With regard to the provision of credit there seems to be a big gap between the requirements of poor people and their convenience. The outreach of banking institutions, undoubtedly, has been a rapid progress with 48% of their branches catering to a population of 23,000 per branch, 31% of their deposit accounts and 43% of their borrowed accounts in rural areas. The statistics shows the availability of banking services only to the tune of 18.4% of rural population through savings/accounts and a still lower percentage of 17.2% of rural households through loan accounts. The unfavourable situation of low productivity, deficiencies of other credit agencies and inaccessible banking sector services have led the rural areas into doldrums looking up to the expensive and exploiting money lenders for loans.
Fighting the marginalization and stigmas of the poor is an important value in development aid. Access to financial services is very often reserved for people being part of “establishments”, and the poor are excluded. Offering these services to poor does not only provide an opportunity of improving the livelihood, it also contributes in improving the self-esteem of many. By meeting the requirements put forward by a professional microfinance institution, many clients have experienced that they are capable of making a difference for themselves and their family, without any “free” help from benevolent donors, the focus is shifted to own resources necessary to meet the requirements from the microfinance institution. Improved self-esteem comes as result of being taken seriously and treated with respect.

Microfinance is an option to resolve this problem of poor people. Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro enterprises. Microfinance is an approach that has been proven to empower people around the world to pull themselves out of poverty. Relying on their traditional skills and entrepreneurial instincts, recipients of small loans, other financial services, and support from local organizations called microfinance institutions (MFIs) to start, establish, sustain, or expand very small, self-supporting businesses.
A key to microfinance is the recycling of loan rupees. As each loan is repaid usually within six months to a year the money is recycled as another loan, thus multiplying the value of each rupee in defeating global poverty, and changing lives and communities.
1.2 Definitions

Microfinance, according to Otero (1999, p.8) is “the provision of financial services to low-income poor and very poor self-employed people”. These financial services according to Ledgerwood (1999) generally include savings and credit but can also include other financial services such as insurance and payment services. Schreiner and Colombe (2001, p.339) define microfinance as “the attempt to improve access to small deposits and small loans for poor households neglected by banks.” Therefore, microfinance involves the provision of financial services such as savings, loans and insurance to poor people living in both urban and rural settings who are unable to obtain such services from the formal financial sector.

Microfinance (MF) focuses on very poor families, with very small loans to help them engage in productive earning activities or grow their tiny business. Microfinance has come to include new in broader range of service and as I have came to realize that the poor and very poor, that lack access to traditional formed financial institutions require a variety of financial product. Microfinance is not merely extending credit, but extending credit to those who require most for the family’s survival. It cannot be measured in term of quantity but due weight to quality measurement. How credit availed is used to survive and grow with limited means. Microfinance is also Known as Unorganized sector, Micro Finance Institutes, Informal sector, Underground activity, co-operative activity, Self helper groups (SHG’s), Non government organization (NGO), Micro credit, etc.
The terms microcredit and microfinance are often used interchangeably, but it is important to highlight the difference between them because both terms are often confused. Sinha (1998, p.2) states “microcredit refers to small loans, whereas microfinance is appropriate where NGOs and MFIs supplement the loans with other financial services (savings, insurance, etc)”. Therefore microcredit is a component of microfinance in that it involves providing credit to the poor, but microfinance also involves additional non-credit financial services such as savings, insurance, pensions and payment services (Okiocredit, 2005).

1.3 The History of Microfinance

Microcredit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to Robinson (2001) and Otero (1999). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidized rural credit programmes. These often resulted in high loan default, high loses and an inability to reach poor rural households (Robinson, 2001). Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grammeen Bank and BRI2 began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term “microcredit” came to prominence in development (MIX3, 2005). The difference between microcredit and the subsidized rural credit programmes of the 1950s and 1960s was that microcredit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by
focusing on clients who were dependent on the informal sector for credit (ibid.). It was now clear for the first time that microcredit could provide large-scale outreach profitably. The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale” (Robinson, 2001, p.54). Dichter (1999, p.12) refers to the 1990s as “the microfinance decade”. Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these other services (MIX, 2005).

The importance of microfinance in the field of development was reinforced with the launch of the Microcredit Summit in 1997. The Summit aims to reach 175 million of the world’s poorest families, especially the women of those families, with credit for the self-employed and other financial and business services, by the end of 2015 (Microcredit Summit, 2005). The UN, as previously stated, declared 2005 as the International Year of Microcredit.

1.4 Creation of Microfinance

In business there are two classes, one who have surplus money where to invest it. Second who required money for mention current balance? Some financial agencies help second class business entrepreneur to satisfy there need to operate business, with the commitment (promise) to replace fund (loan) in future, microfinance (enterprise) are working as information.
Microfinance Institutes (MFIs) collected information who is calling to supply money and who is calling to borrow money. MFIs have all this information.

Microfinance services are provided by three types of sources:

- Formal institutions, such as rural banks and cooperatives;
- Semiformal institutions, such as non-government organizations; and
- Informal sources such as money lenders and shopkeepers.

1.5 Micro Finance Institutes (MFIs)

Quite simply, a Micro Finance institution is an organization that offers financial services to the very poor. Most MFIs are nongovernmental organizations committed to assisting some sector of the low income population. Almost all of these offer micro credit and only take back small amounts of savings from their own borrowers, not from the general public. Within the Micro Finance Industry the team Micro Finance Institution has come to refer to a wide range of organizations dedicated to providing these services – NGOs, credit unions, co-operatives, private commercial banks and non-bank financial institutions some that have transformed from NGOs into regulated institutions) and parts of state owned banks.

Microfinance has proven powerful in combating poverty, but extra care is required if, a microfinance institution is to establish services in area of very disperse population or an unstable social context. Being it post war, lack of basis social and physical infrastructure, a society seriously hit by epidemics in high risk for future crisis, successful microfinance, scale, outreach and financial sustainability these are crucial elements in order for
an MFI to top into the financial market the only market with enough resource to serve the world demand for microfinance services.

When it comes to the millennium development goals, microfinance contributes through reducing the poor vulnerability towards income and expenses fluctuations. A stronger household economy enables poor families to meet expenses for schooling, nutrition and health in better way.

A range of institutions in public sector as well as private sector offers the micro finance services in India. Based on asset sizes, MFIs can be divided in to three categories:

1) 5-6 institutions which have attracted commercial capital and scaled up dramatically when last few years. The MFIs which include SKS, and Grammeen Style program but after 2000, converted into for-profit, regulated entities mostly Non-Banking Finance Companies (NBFCs).
2) Around 10-15 institutions with high growth rate, including both News and recently form for-profit MFIs. Some of MFIs are Grammeen Koota, Bandhan, sks etc.
3) The bulk of India’s 1000 MFIs are NGOs struggling to achieve significant growth. Most continues to offer multiple developmental activities in addition to microfinance and have difficulty accessing growth trends.

Private MFIs in India, barring a few exceptions, are still fledging efforts and are therefore unregulated. They secure micro finance clients with varying quality and using different operating models. Regulatory framework should be considered only after the sustainability of MFIs Model as a banking enterprise for the poor is clearly established.
### 1.6 Some of the Primary investment in Indian MFIs

Table No. 1.1: Primary investment in Indian MFIs

<table>
<thead>
<tr>
<th>year</th>
<th>MFI</th>
<th>Investment ($millions)</th>
<th>Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-10</td>
<td>Bandhan</td>
<td>11.0</td>
<td>Small Industries Development Bank of India</td>
</tr>
<tr>
<td>Dec-09</td>
<td>Utkarsh</td>
<td>0.7</td>
<td>Aavishkaar Goodwell, IFC</td>
</tr>
<tr>
<td>Nov-09</td>
<td>Sonata</td>
<td>4.4</td>
<td>Bellwether, Michael and Susan Dell Foundation</td>
</tr>
<tr>
<td>Nov-09</td>
<td>Grammeen Koota</td>
<td>6.0</td>
<td>Microventures, Incofin, Aavishaar Goodwell</td>
</tr>
<tr>
<td>Oct-09</td>
<td>Spandana</td>
<td>47.1</td>
<td>Temasek</td>
</tr>
<tr>
<td>Oct-09</td>
<td>Equitas</td>
<td>0.1</td>
<td>Sequoia</td>
</tr>
<tr>
<td>Sep-09</td>
<td>Asmitha</td>
<td>5.5</td>
<td>Blue Orchard</td>
</tr>
<tr>
<td>Sep-09</td>
<td>Asirvad</td>
<td>1.5</td>
<td>Lok</td>
</tr>
<tr>
<td>May-09</td>
<td>Suryoday</td>
<td>1.0</td>
<td>Aavishkaar Goodwell</td>
</tr>
<tr>
<td>Feb-09</td>
<td>Equitas</td>
<td>11.0</td>
<td>Bellwether, Microventures</td>
</tr>
<tr>
<td>Jan-09</td>
<td>ASA-GV</td>
<td>4.4</td>
<td>Microvest</td>
</tr>
<tr>
<td>Dec-08</td>
<td>BASIX</td>
<td>7.1</td>
<td>Lok, Aavishkaar Goodwell</td>
</tr>
<tr>
<td>Dec-08</td>
<td>Asomi</td>
<td>0.6</td>
<td>Incofin</td>
</tr>
<tr>
<td>Nov-08</td>
<td>SKS</td>
<td>80.3</td>
<td>SVB Financial Group, Kismet</td>
</tr>
<tr>
<td>Date</td>
<td>Name</td>
<td>Amount</td>
<td>Investor(s)</td>
</tr>
<tr>
<td>---------</td>
<td>-----------</td>
<td>--------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Nov-08</td>
<td>Ujjivan</td>
<td>20.6</td>
<td>Lok, Sequoia, Existing</td>
</tr>
<tr>
<td>Nov-08</td>
<td>Spandana</td>
<td>21.9</td>
<td>Valiant</td>
</tr>
<tr>
<td>Sep-08</td>
<td>Asmitha</td>
<td>5.5</td>
<td>Blue Orchard</td>
</tr>
<tr>
<td>Jul-08</td>
<td>MMFL</td>
<td>6.0</td>
<td>Unitus</td>
</tr>
<tr>
<td>Jun-08</td>
<td>Arohan</td>
<td>1.4</td>
<td>Lok</td>
</tr>
<tr>
<td>Apr-08</td>
<td>Sonata</td>
<td>0.4</td>
<td>Bellwether</td>
</tr>
<tr>
<td>Dec-07</td>
<td>ASA</td>
<td>2.6</td>
<td>Unitus</td>
</tr>
<tr>
<td>Dec-07</td>
<td>SKS</td>
<td>32.3</td>
<td>Sandstone</td>
</tr>
<tr>
<td>Aug-07</td>
<td>Spandana</td>
<td>10.7</td>
<td>Lok, JM Financial</td>
</tr>
<tr>
<td>Aug-07</td>
<td>Satin</td>
<td>1.1</td>
<td>Lok</td>
</tr>
<tr>
<td>Mar-07</td>
<td>SKS</td>
<td>10.6</td>
<td>Unitus, Sequoia</td>
</tr>
<tr>
<td>May-06</td>
<td>Ujjivan</td>
<td>0.5</td>
<td>Bellwether, Unitus</td>
</tr>
</tbody>
</table>

Total 295.3

(Source: Lok Capital, 2010)

1.7 Need for Microfinance

Microfinance aims at assisting communities of the economically excluded to achieve greater levels of asset creation and income security at the household and community level. Access to financial services and the subsequent transfer of financial resources to poor women enable them to become economic agents of change. Women become economically self-reliant, contribute directly to the well being of their families, play a more active role in decision making and are able to confront systematic gender inequalities. Access to credit has long been considered a major poverty
alleviation strategy in India. Micro credit has given women in India an opportunity to become agents of change. Poor women, who are in the forefront micro credit movement in the country use small loans to jump, start a long chain of economic activity.

Microfinance is accessing financial services in an informally formal route, in a flexible, responsive and sensitive manner which otherwise would not have been possible for the formal system for proving such services because of factors like high transaction cost emanating from the low scale of operation, high turnover of clients, frequency of transaction etc. (Vijay Mahajan and G. Nagasri, 1999). Micro finance and Self Help Group (SHG) must be evolved to see that SHGs do not charge high rates of interest from their clients and improve access to those who cannot sign by making their use through thumb impression. The current literature on micro finance is also dominated by the positive linkages between micro finance and achievement of Millennium Development Goals (MDGs). Micro Credit Summit Campaign’s 2005 report argues that the campaigns offers much needed hope for achieving the Millennium Development Goals especially relating to poverty reduction. IFAD along with Food and Agriculture Organization (FAO) and the World Food Programme (WFP) declared that it will be possible to achieve the eight MDGs by the established deadline of 2015 “if the developing and industrialized countries take action immediately” by implementing plans and projects, in which microcredit could play a major role (Alok Misra, 2006)
1.8 As a tool for combating poverty

A decade or two ago, the expectation for microfinance as the decisive tool in combating poverty were high. Empowerment or marginalized groups in general, with special focus on women, was among the non monetary impacts on hoped M.F. would bring about. By providing access to credit at reasonable conditions it was believed that poor people would increase their income, create more jobs and gradually lift themselves away from poverty after the “first love” had drift away, there has been a gradual shift towards building sustainable institutions that through a strong focus on financial sustainability would assure the permanent of these services to the poor. As mentioned in the general report from the micro credit summit campaign.

One financial services sometime think about own share or benefit and secondly there is biggest difference between demand and supply. The world demand is so high that it is unrealistic to think that this can be met by donor capital. The push for financial viability might challenge the wish to reach the poor. Basic economics tells me that lending a small amount of money to a person with no collateral.

Considering recent development in the field, data from micro credit summit held in Washington in November 2009, suggests that the number of clients reached with micro finance products have increased considerably over the last years. Considering the fact that the industry has matured, and that more funds have been made available also through commercial channels this should not come as a surprise. The interesting thing mentioned in this report is the increase in the number of poor reached through micro finance activities.
After focusing more on reaching the poorest it seems now that many factors are spending less effort on distinguishing between the poor and poorest among Norwegian actors the question have been raised whether a micro credit scheme is more apt for ‘second’ poorest and that one through fomenting micro entrepreneurs can generate a certain trickledown effect benefiting the very poorest M.F. should probably not reach everybody but saving process are for every one there should be no doubt about the fact that M.F. remains a very powerful tool in improving the livelihood for many poor.

1.9 Types or services product of M.F

Microfinance is for many they must well know product. Many institutions worth only with credits and there are many experiences showing its power.

A credit can take many forms the most common are:

(i) Purely individual loans
(ii) Individual loans with group collateral and group loan
(iii) A typical credit is small with a relatively short payback period.
(iv) Saving
(v) Micro insurance

Saving is the other main product. A variety of studies show that the demand for adequate saving produce often exceeds the demand for credit. This highlights the fact that the demand for credit and saving basically stem from the same need, the need of access to larger lump – sums of money. Coping with life cycle events seasonality in income and expenses, smoother consumption and investment opportunities can be done through saving small amounts prior to (= saving) or after (=credit) the lump sum is needed
Micro insurance is a more recent development that aims at reducing poor people vulnerability towards unforeseen event like major illness, death of main income generator, loss of crop etc. In addition an increasing number of MFI are entering into partner with health insurance providers. In the latter case the client will pay the premium.

1.10 Other product and types

For millions of poor families, a transfer from family members abroad is there main source of income. Thus, reliable and effective ways of transfer is important. In Bolivia, Prodem provides both transfer and smart card facilities for microfinance clients. It is an important element in lifting the social status of marginalized group, and thus increasing the level of participation and respect micro leasing is another example of an innovative product. MFI handle transaction of people income live pensions and subsidies to pay the expenses like, water bill, electricity bill, telephone bill etc. MFI as a delivery channel for all kinds of financial services, either by passively passing on products and services provided by others or as active partners in selling new products / services.
<table>
<thead>
<tr>
<th>No</th>
<th>Particulars</th>
<th>Commercial MFIs</th>
<th>Specialized MFIs</th>
<th>Specialized NGOs</th>
<th>Multipurpose NGO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Strategy and goals</td>
<td>- expansion into new markets</td>
<td>- profitability</td>
<td>- Social impact</td>
<td>- Social impact</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Institutional image</td>
<td>- Social impact</td>
<td>- Cost coverage</td>
<td>- Initial cost coverage</td>
</tr>
<tr>
<td>2</td>
<td>Clients</td>
<td>- various micro enterprise in minority</td>
<td>Micro and small enterprises</td>
<td>Micro enterprises</td>
<td>Micro enterprises</td>
</tr>
<tr>
<td>3</td>
<td>Legal form</td>
<td>- Banks</td>
<td>- Banks</td>
<td>NGO’s</td>
<td>NGO’s</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Financial Companies</td>
<td>- Financial Companies</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Credit unions</td>
<td>- Credit unions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Methodology</td>
<td>- Individual lending</td>
<td>- Individual and/or solidarity group lending</td>
<td>Individual and/or solid group</td>
<td>Individual and/or solid group</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Instruments vary according to segment</td>
<td>leasing, leasing</td>
<td>lending</td>
<td>lending</td>
</tr>
<tr>
<td>5</td>
<td>Sustainability</td>
<td>The FFIs as a whole is sustainable</td>
<td>Saving towards profitability and efficiency</td>
<td>Striving towards operational</td>
<td>Difficult to isolate Micro</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>efficiency</td>
<td>Enterprise activities</td>
</tr>
<tr>
<td>6</td>
<td>Capital sources</td>
<td>- capital</td>
<td>- capital</td>
<td>- Bank loans</td>
<td>- Few bank loans</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- certificates</td>
<td>- certificates</td>
<td>- Subsidized loans from private</td>
<td>- subsided loans from private</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- interbank loans</td>
<td>- interbank loans</td>
<td>organizations</td>
<td>organizations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- savings</td>
<td>- savings</td>
<td>- social funds</td>
<td>- social funds</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- donor funds</td>
<td>- donor funds</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Source: http://nabardindia.com)
The no. of org. increases from left to right, where the multipurpose NGOs by far outnumber the other groups.

### 1.11 Donors

**Donor agencies**

Provide funds for capital through donations and soft loan investigations product and institutional development and technical assistant.

**Donor NGOs**

Their role is often similar to the one of donor agencies funding of pilot projects including new products. These around often work more closely with the microfinance institutions (MFI) than agencies.

**Professional investors**

Motivated by social responsibility or pure economics will typically be looking for existing MFI with a proven record of financial viability provide capital at (semi) commercial conditions.

Microfinance is one of the tools in development. Some year ago one could get the feeling that M.F. cues perceived as the solution and “everyone” wanted to get involved with it, regardless of experience, context and target group. As of today, the belief in M.F. as an important tool remains firm. One important question to ask before entering into microfinance is whether or not this is the most adequate tool to achieve the specific development goals in a given context.
1.12 Frame Work of Microfinance

To supplement these efforts, the credit scheme integrated rural development programme was launched in 1980. But these supply side programs aided by computer and leakages, achieved little further, the share of the formula financial sector in total rural credit was 56.6% compared to the informal finance art 39.6% and unspecified source at 3.8%. Not only had formula credit flow been less but also uneven. The collection and paperwork based system shield away from the poor, the vacuum continued to be filled by the village money lender who charged interest rates of 2 to 3% per month. Seventy percent of land less farmers did not have a bank account and 87% had no access to credit from a formal source.

It was in this cheerless background that the M.F. revolution occurred worldwide. In India began in the 1980s with the formation of pockets of informal self help groups (SHGs) engaging in micro activities financed by M.F. But India’s first micro finance institution Shri Mahila Sewa Shahkari Bank was set up as an urban co-operative bank by the self employed woman’s association (SEWA) soon after the group (founder Ms Ela Bhatt) was formed in 1974.

The first official effort materialized under the direction of NABARD. The Mysore resettlement and development agency sponsored project on saving and credit management of SHGs was partially financed by NABARD 1986-87”. Basically the MFIs in India of three categories (i) Next for profile MFIs, which include the WGO, (ii) mutual benefit MFIs, which include mutually aided co-operative credit and (iii) for profit MFIs which include the non banking financial companies. NABARD refines the
financial institution engaged in M.F. to the extent of actual disbursement. NABARD, SIDBI are “bulk financiers” who cleverly leverage resources obtained from a variety of sources.

1.13 Legal forms of MFIs in India

Table No. 1.3 Legal forms of MFIs in India

<table>
<thead>
<tr>
<th>Types of MFIs</th>
<th>Estimated numbers</th>
<th>Legal Acts under which registered</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Not for profit MFIs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) NGO-MFIs</td>
<td>2400 to 2500</td>
<td>Societies Registration act, 1860 or similar principal acts Indian trust act, 1882</td>
</tr>
<tr>
<td>b) Non profit companies</td>
<td>80</td>
<td>Section 25 of the companies act, 1956</td>
</tr>
<tr>
<td>2) Mutual benefit MFIs: Mutually aided co-operative societies (MNCs) and similarly setup institutions.</td>
<td>2000 to 2500</td>
<td>Mutually aided co-operative societies act enacted by state government.</td>
</tr>
<tr>
<td>3. For profit MIFs</td>
<td>60</td>
<td>Indian companies act, 1956, reserve bank of India Act. 1934</td>
</tr>
<tr>
<td>Total</td>
<td>4540 to 5140</td>
<td></td>
</tr>
</tbody>
</table>

(Source: http://nabardindia.com)
1.14 Assessment of Microfinance

Assuming that a need assessment process concludes that there is excess demand for microfinance products and services, and that the situation is such that setting up a microfinance institution is adequate, what are the main steps forward? Considering the fact that a wrong set up might do more harm than good there are several considerations to be done.

1) Market Analysis, competition and products.

2) Institutional capacity and competence.

3) Plan for reaching financial sustainability

4) Funding.

5) Monitoring system

6) Reporting, audit and rating,

7) Structure and ownership

1) Market Analysis

Various tools for market analysis have been developed. The main challenge is to capture the demand from potential clients and address actual and potential competition.

2) Institutional capacity

Seen from a donor’s point of view, the first step would be to consider the potential in working with already existing organizations. Do they have the capacity of providing what the market asks for in a professional way, or is setting up a new institution a better way As indicated above, most of the organizations involved in microfinance are multipurpose, and have microfinance as one of their activities, Sewa then need to verify how they
are organized, and if necessary challenge them to separate microfinance from other activities. It is of crucial importance to identify real costs and income on microfinance activities, regardless of the level of financial sustainability. Some argue that due to the nature of target groups, local economics etc. financial sustainability is merely a dream, indicating the need for subsidizing operations also in the longer run. Regardless of this argument, it is necessary to separate flow of capital due to loan activities from other transactions. In any case, if sustainability is not perceived as a possible end goal, reengineering of the institution and/ or abandoning microfinance activities should be considered.

3) Financial Sustainability
Financial sustainability is must be a long term goal for a MFL. In order to address this issue, a checklist for budget for microfinance activities is useful.

- Identify operational costs.
- Projection on financial cross (Interests losses)
- Projections on income (donor funding operations)
- Define horizon for back even.
- Calculate interest rate.

Professional partners must be willing to charge interests rates that in the long run can make the institution sustainable. Micro credit services are expensive because of the costs involved of handling a large amount of small clients. A sustainable interest level is therefore likely to be above the local interest level in the formal market.
4) Funding
In the initial face, most MFI have received donor funding for setting up the organization. The long run goal must be financial self sufficiency, but in order to reach a large number of clients it would generally be necessary to access loans from capital providers on commercial terms. Thus the analysis of funding includes both potential donors as well as financing partners.

5) Monitoring System
In Norway, in a joint effort by the Norwegian Development Network (Bistandsorget) NORAD and the Ministry of Foreign Affairs (MFA) guideline for appraisal and monitoring of microfinance projects have been elaborated (Clausen 2002) These build among other on the more elaborate Cgap tools, and aim at combining the need for specific information with the necessity of a tool that is not too complicated nor costly to use.

The development was based on their basic criteria;

- The formers should be simple with information strictly on a “need to know” basis
- The information required should be easily available by microfinance projects to limit the transaction cost for them in meeting donor appraisal and monitoring requirements.
- The performance indicators should be simple and easy to interpret but at the same time provide comprehensive overviews of overall performance of the microfinance project.
Three sets of indicators must be considered.

- Outreach indicators: efficiency number of clients and poverty bracket (using average loan in percent of GDP per capita). Savings can be added when pertinent.

- Institutional indicators: focus on effectiveness; defined as productivity of staff (loans per staff), financial productivity (Administrative costs per loan) and efficiency. (Administrative costs over portfolio)

- Financial performance: portfolio risk that is sustainability books at operational sustainability (income versus expenditures) portfolio yield and portfolio quality. (arrears)

All of the above indicators do provide important information regarding the different aspects of an MFI.

Due to the variety of contexts in which MFI operate, there are no global standards for most of the indicators compare whether a microfinance project is performing well or not. However, the micro Banking presents at regular intervals some of these indicators for a samples of MFI. When it comes to outreach, a project with a strong poverty focus should have a low number for average loan in percent of GDP per capita. Regarding financial sustainability based on many empirical studies, it is becoming a common understanding that an arrear, default rate above 5% will make a long run sustainability of the MFI very unlikely.

6) Reporting and Audit Procedures.
Proper reporting is an intrinsic part of a well designed monitoring system. In addition to this external audits are necessary to establish institutional
credibility. In many cases this will be a legal requirement; it is also becoming more and more a precondition for potentially new financing partners. Credit rating is gradually becoming a part also of the microfinance industry. A proper rating, carried out by professional rating institutions is likely to become a prerequisite in order for a MFI to attract professional investors in the future. A list of qualified rates by IABD and CGAP is found at www.mfrating.org. / mf_institutions /qualified _raters, html Electronic Information Systems and internal control routines are two crucial points in professional microfinance and should therefore be included in all kinds of business planning for MFI.

7) Structure and Ownership
When a MFI grow, the question of structure and ownership becomes more important. As in any business or organization, the main stakeholders will determine the long run. Strategy and the way the organization is structured and managed will be determinate for the long run performance. Thus these are key factor in assuring the permanent provision of financial services.

1.15 Microfinance and the Millennium Development Goals (MDGs)
The goals as defined by the UN are the leading star for the development community in the years to come. Donor agencies are relating their policy and programming to the achievement of these goals, the question of how microfinance relate to this highly relevant. I would like to remind of the fact that microfinance and the impact it produces, goes far beyond business loans.
The Millennium Development Goals

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education.
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS malaria other diseases
7. Ensure environment sustainability

1.16 Leading Models of Microfinance

The leading models of microfinance include

- Grammeen banking, perhaps the most widespread, with characteristic forms of small group organization and strict procedure.
- Self help groups, with larger and more autonomous groups and a mixture of social and financial intermediation.
- Regulated financial institutions, usually small and operating in favorable regulatory environments.
- Credit cooperatives, some of which, as in Sri Lanka, have made an effort to include the poor.

In India, a range of microfinance models exists. An important model is self help groups (SHGs). These are larger and much more autonomous than borrower groups in the Grammeen Model. SHGs are based primarily on the principle of lending their members saving but they also seek external funding to augment these resources. A number of non government organizations (NGOs) specialize in promoting and motivating SHGs with an
important distinction between NGOs, which operate as financial intermediaries, and those, which confine themselves to social intermediation. An estimated 400 to 500 NGOs are engaged in microfinance but total outreach is estimated at fewer than 1.5 million households, very small in relation to the number of poor households in the country. While some NGOs emphasize sustainability, in many cases interest margins are far too low for this to be achieved and the institutions remain heavily dependent on donor assistance.

Supply of microfinance services in India are done through the following models.

Chart No.: 1. Supply of microfinance services in Indian models.

Following is different model given from 1.1 to 1.7

1. 1. Model of Banks promote SHGs and finance them directly
1.2. Model of NGOs facilitate the promotion of SHGs and Banks
Finance SHGs

1.3. Model NGOs Borrow Funds from Banks / FIs and Provide Services
to SHGs / Clients
Model: 1.4. Model NBFCs (Non Banking Financial Corporations)

Mobilize equity and loan funds from Banks / FIs and Provide Services to SHGs / Clients

1.17 Role of SHGs or NGOs

A self help or mutual aid group is defined as a group constituting of people who have personal experience of a similar issue or life situation, either directly or through their family and friends. Sharing experiences enables them to give each other a unique quality of mutual support and to pool practical information and ways of coping. Some groups will hold regular meetings – on a weekly, monthly, quarterly basis. Meetings may be in public venues, such as community centers, or in members’ homes. Other groups will maintain support through letter writing, or through a network of telephone contacts or through internet news groups and e-mail.
A SHG is generally formed with 10-20 members and in India about 90% of the SHGs are women’s groups. SHG is linked to a commercial bank, regional rural bank or cooperative bank for the credit needs. Before a loan is granted to SHG, it must prove its ability to save, learn bookkeeping skills, and commit to continue as a cohesive group, holding regular meetings etc. usually 6-12 months observation period is kept to comply with the above conditions.

1.5. Model of linkages between SHGs & Bank

There are three variants of linkage between SHGs and a bank.

a) SHGs formed and financed by banks. About 20% of the SHGs are of this type.

b) SHGs formed by NGOs and formal agencies but directly financed by banks. Majority (about 72%) of the SHGs fall under this category.

c) SHGs financed by banks using NGOs and other agencies as financial intermediaries.
Viability

- Banks lend to SHGs at interest rates ranging from 8.5% to 15%.
- Refinance from NABARD at 5.5% - 6.25%, mostly availed by co-operative banks.
- Despite low interest charged by banks, one study finds positive profitability of SHG banking in terms of operational self sufficiency (operating income / operating expenses incl. cost of funds) largely due to zero NPL.
- However, another study indicates that all inclusive cost of lending to SHG (incl. cost of group formation) would translate into interest rates of 22% - 28%.
- Given very low NPL level, and small amount of SHG lending in a bank’s portfolio it is possible to cross subsidize now.

1.18 Role of MFIs and Commercial Banks

Micro entrepreneurs (the self employed poor) have little access to the formal financial system in developing economies. At best, formal financial institutions reach the top 25 percent of the economically active population, which leaves the bottom 75 percent without access to formal financial services. Asia pacific region has six micro finance giants. Out of which only Reserve Bank of India is a commercial bank. There are other regulated institutions, which provide financial services to micro entrepreneurs such as rural banks and credit union. The commercial banks undertook microfinance lending only because their governments required it. These commercial banks can be classified as Government subsidized lending programs, government mandated lending targets. The analysis done on the basis of high portfolio quality and significant scale of outreach to the poor showed that government
mandated lending commercial banks were failures. They must have well designed products for micro enterprises, which can be encouraging and profitable. An appropriate regulatory and prudential framework by the government may encourage the commercial banks to become involved in microfinance.

1.19 Indian Scenario
These microfinance models lacked scalability and hence ICICI bank came up with the following model.

1.6. Model of ICICI Bank Model

Some of the key differentiating points of this model from other are:
- Intermediary assumes fraction of the credit risk (to the extent of risk sharing), leading to reduction in capital required.
- Bank prices on basis of underlying asset rather than rating of intermediary.
- Transition from lending to organization to asset based lending.
- ROE of intermediary significantly improves with portfolio quality remaining unchanged.
- Scope for leverage of 10-12 times compared to 2-3 times previously.
1.7. Model of The value chain of others Bank

(Banks)

Loans

(Federal Loans)

Savings

(Clusters)

Loans

Savings

(SHGs)

Savings

(Members)

(Source: http://nabardindia.com)
1.19 a) Impact of SHGs - Bank linkage

SHGs bank linkage program is effective in targeting poorest households as majority of beneficiaries are from among the poorer groups – landless and marginal farmers. But there has been little robust evidence available on the impact of the program on reducing poverty. There are shortcomings in methodology, insufficient time period to assess some of the impacts on poverty alleviation etc.

A study of SHGs having completed at least one year of bank linkage was conducted by NABARD in eastern areas (Orissa, Jharkhand and Chhattisgarh) and the following observations were made.

- Employment, average net income and value of assets increased in the period after SHGs bank linkage program was implemented.
- Average savings as well as loan repayment rates increased.
- Empowerment of women, greater assertiveness and participation in decision making.

1.19 b) Microfinance & Role of Banks

The existing credit institutions and the initiatives taken by the authorities have not helped the rural poor to improve their standard and welfare. With regard to the provision of credit there seems to be a big gap between the requirement of rural people and their convenience. The outreach of banking-institutions, undoubtedly, has seen a rapid progress with 48% of their branches catering to a population of 23,000 per branch,
31\% of their deposit accounts and 43\% of their borrowed accounts in the rural areas (Banking Statistics, RBI, 2003). The statistics show the availability of banking services only to the tune of 18.4\% of the rural population (Rural Population, India, Census 2001) through savings/accounts and a still lower percentage of 17.2\% of the rural households through loan accounts.

The unfavorable situation of low productivity, deficiencies of other credit agencies and inaccessible banking sector services have led the rural areas into doldrums looking up to the expensive and exploiting money lenders for loans. The purpose of this is to emphasize that there is need for a more prominent role to be played by the banking institutions through devices that could improve the rural lot. In recent times there have been frequent discussions and deliberations going on with regard to the importance of microfinance facilities and services by the banks in the rural areas.

The present article aims at establishing the fact that the credit gap prevailing in the rural areas could be better met only by banks through microfinancing facilities and services. For this purpose, initially, there is a depiction of the current rural scenario with the mentioning of the need for microfinance in the rural areas. In this context some of the international experiences which will be suitable to Indian conditions have been discussed. After a brief analysis of tried out modes along with their limitations,-the need for utilization of available potential in the rural areas has been emphasized through the expression of the prevailing strengths and weaknesses. The conclusion reiterates the fact that the improvement of millions and millions of people in the rural areas depends upon the effective
mode by which banks are going to make up for the credit gaps through microfinance facilities and services.

1.19 c) Rural Indian Economy

In the rural dominant Indian Economy rural areas consist of artisans, agricultural laborers and entrepreneurs besides farmers and cultivators. There is also migration of people from rural to urban areas and also within and outside India necessitating remittance services. Rural people need all kinds of protection from adversities and natural calamities. What is required is the provision of all kinds of financial services to safeguard them from all types of risks besides pension products. There should be a definite inclusion of the rural people within the purview of the formal financial system.

In this context there cannot be another opinion than the general consensus for asking the banks to come forward in a big way in the provision of microfinance facility to the rural areas to improve millions and millions of poor people.

1.19 d) Need for Microfinance by Banks

There are significant reasons why rural people remain outside the real of banking services. The high transaction cost to be incurred by the banks, the complex formalities involved, lack of suitable and ideal products, hassles of the formal system and the general impression of indifferent attitude of the banks deserve special mention.

In the present day context of the credit deposit ratio of banks having gone up to more than 100% and with the growth of the untapped rural potential there is plenty of scope for the banking sector to play a lead role in the extension
of financial services to the rural demanders of credit for various purposes which would also help the banks to increase their business besides spreading their risk. There has been wide recognition of the fact that there is a very good opportunity for banks to do retail loan business. With the growth of the NGOs and SHGs and their linkage with the bankers, there is ample scope to facilitate micro financing activities in the rural areas. On these lines the Union Budget 2010-11 contains the Finance Minister's request to the RBI "to examine the issue of allowing banks to adopt the "agency model" by using the infrastructure of civil society organizations, rural kiosks and village knowledge centers, to provide credit support to rural and farm sectors. "The Finance Minister has also stated that "commercial banks may appoint MFIs as "banking correspondents" to provide transaction services on their behalf."

**1.19 Indian scenario**

There are very few reliable aggregate data available for the Indian microfinance market and no comprehensive database or directory of microfinance institutions. However, India presents an obvious scope for microfinance in general and housing finance in rural India. Urban sector has traditionally been less attractive to the microfinance institutions as compared to the rural areas:

1) High migration in urban areas increases the default risk of microfinance portfolio, unsecured.

2) MFIs operating in urban area suffer comparison with commercial banks on interest rates.
3) Various methodologies of group formation and peer pressure are not as successful in urban areas as in rural areas.

4) Urban population mostly have a tendency of service or organized employment as compared to self employment in rural areas thereby increasing the probability of loan being utilized for consumption purposes in urban areas.

In spite of various challenges, some MFIs are now accelerating their expansion in urban areas.

1.19 a) Consumer needs in rural India

Table No.:1.4 Consumer needs in rural India

<table>
<thead>
<tr>
<th>Consumer needs in Rural India</th>
<th>Present Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flexibility in timings</td>
<td>Timings and procedures are rigid and inflexible</td>
</tr>
<tr>
<td>Doorstep banking</td>
<td>There is high cost to service delivery</td>
</tr>
<tr>
<td>Timely availability of services</td>
<td>Conventional model might not work</td>
</tr>
<tr>
<td>Low value and high volume transactions</td>
<td>High transaction cost for customers</td>
</tr>
<tr>
<td>They require simple processes with minimum documentation</td>
<td>Expansion of branch network to these areas is expensive and time consuming</td>
</tr>
</tbody>
</table>

(http://mfi.cgap.in)

1.19 b) General Analysis of Schemes in India

The Pigmy Deposit Scheme of collection at the door steps on daily/weekly basis has been resulting adversely in cash leakage, frauds and accounting and reconciliation problems and ultimately closure of such schemes. The
mobile banking schemes also did not seem to have worked well because of the manpower constraints and inadequate volumes to cover cost. Regional Rural Banks (RRBs) continue to be still the prominent Microfinance Institutions in the rural areas -196 RRBs covering 196 districts and serving a client base of 6.27 cr. The Local Area Banks (LABs), four in number in the private sector and regulated by the RBI seem to be providing "efficient and competitive financial intermediation "in their area of operation. Except for one such LAB, Krishna Bhima Samruddhi, the others do not have the refinancing facility.

- **OBC Grammeen Project**

Oriental Bank of Commerce (OBC) was one of the first Commercial Banks to pioneer microfinance under their "OB Grammeen Project" in Uttaranchal and Rajasthan. What is considered to be a unique feature and also a revolutionary approach of this system is that the bank officials go to the groups on the pre-determined dates. The NGO/MFI bulk lending model represents SIDBI, Friends of Women's World Banking and the Rashtria Mahila Kosh (RMK) working along with some Public Sector and Private Sector commercial banks providing online facility directly to SHGs or groups in Grammeen mode or even to individuals.

- **The partnership model**

The new generation private banks were responsible for the assistance in as much as they could overcome the constraints of capitalization of the MFI and the problem of double exposure faced by the hanks.
• **Kisan credit card**

Currently, Kisan Credit Card (KCC) is most popular across the country and considered to be a financial product innovation of far reaching, significant of recent times. The main advantage to the farmers is the flexibility in the management of the cash flow along with the reduction in the documentation cost besides transport cost. There are also advantages to the banks in terms of reduced workload and reduction in paper work. Above all, there is the maintenance of banker-client relationships. Many banks seemed to have innovated on these lines and developed variants by "integrating Term Loans and Crop Loans- and providing other features akin to 'General Purpose Credit Card'." The National Council of Applied Economic Research while highlighting the benefits of the scheme has also pointed out the restrictions imposed with regard to the issuance of the cards.

The SHG-bank program is considered to be a successful one with the percentage coverage of 3.4 million groups with a cumulative Average credit flow of Rs. 6,300 at the end of March 2010 from the banking system. The linkage program seems to have the advantage of combining the flexibility, sensitivity and responsiveness of the informal credit system with the technical administrative capabilities and financial resources of the formal financial sector. Considering the advantages in terms of better business and identification of risks, most banks have a corporate policy to expand their Micro-credit operations under the SHG-Bank Linkage Mode.
1.20 International Experiences

There has been a wide recognition among the academicians, bankers, researchers and policy makers regarding the need for deepening and widening the financial services to the rural poor. The Bangladesh Grammeen Bank Model and the Microfinance Programs of BRAC and ASA in Bangladesh have been studied and the microfinance experience of Philippines has been familiarized with and though they represent the "path breaking and innovative efforts" they have been used in some form or the other in India; The most talked about experience appears to be that of Brazil. "The Brazilian model is largely technology driven and uses kiosks or Automated Teller Machines (ATMs) by such agents to accept payment, opening of accounts, without a cheque book, collection of small deposits, provision of micro credits, selling of savings bonds and insurance". Another initiative indicated is that "Post Offices network and Post Office staff to deliver banking services through Banco Postal". It is also worth mentioning here that the "Brazilian Central Bank extended microfinance program by allowing banks to draw on 2% of the reserves deposited with them and lend it to individuals and small businesses at concessional interest rates".

The international experiences indicate that micro savings are important for micro-credit. BURO Tangail ah MFI of Bangladesh uses a unique saving product "Contractual Saving Agreement". Kenya has developed the "Jijenge Savings Account" a contractual saving’s Product. Further there is the facility of mobile subscribers making micro payments made possible by the Commercial Bank of Africa.