MICROFINANCE: THE INDIAN SCENARIO

“Every single individual on earth has both the potential and the right to live a decent life. Across cultures and civilizations, Younus and Grameen Bank have shown that even the poorest of the poor can work to bring about their own development.”
Norwegian Nobel Committee (2006)

“Micro-credit is a critical anti-poverty tool, a wise investment in human capital. When the poorest, especially women receive credit, they become economic actors with power to improve not only their own lives, but in a widening circle of impact, the lives of their families, their communities and their relations.”
– Kofi Annan, Secretary General, United States.

2.1 INTRODUCTION

Finance is observed to be an indispensable input for economic activity, growth and development of any nation. If finance through own accumulated resource or equity is neither available nor sufficient, debt forms to be the only way out. The financial institutions play an important role in this regard by channelising funds from surplus sectors to deficit sectors. However, these institutions being commercial organizations work for profitability and sustainability. They do not show much enthusiasm to direct their resources in the rural and the backward areas for the benefit of the poorer people. At the same time, these rural and backward areas lack infrastructure, entrepreneurship, opportunities and the people are victims of exploitation and ignorance. Consequently the transaction cost of investment by the financial institutions and credit risk are high and the return on capital by the borrowing investors is not attractive.
In addition to this the rural economic agents find the formal urban institutions inaccessible while the Formal Financial Institutions (FFIs) observe the characteristics and personal circumstances of the rural agents not very acceptable. For both the groups there exists an information gap. ‘Borrowers do not desire to disclose all relevant personal and project information’\(^1\). And when market imperfections persist, lenders face the problem of managing the risk of loan default \(^2\), and raising the interest rate does not resolve the problems either \(^3\). Reaching the rural agents is found to be very difficult task by the urban financial institutions, while the rural agents hesitate to come forth the urban financial institutions.

On the other hand the rural borrower and the informal lender know each other quiet well. The information gap is easily eliminated since both the transactors operate in the similar socio-cultural and economic environment. This keeps the informal financial markets functioning in the rural areas. As a result, capital formation and the development process take a back seat in the rural areas. Besides, if land, labour and money market are interlocked, there arises a vested interest among the powerful class to thwart the development process and perpetuate indebtedness and poverty \(^4,5\). The informal moneylenders thus are found to dominate the rural financial sector.

A growing body of research from around the world shows that well developed and inclusive financial systems are associated with faster growth and better income distribution \(^6,7\). Finance helps the poor catch up with the rest of the economy as it grows. It helps the basic survival of range of individuals, households and firms and also reduces damaging concentration of economic power. By and large, it is microfinance that can give ordinary people and the poor access to opportunity and the ability to escape ossified social structures. It is with this realization that ‘building inclusive financial systems that work for the poor’ was the objective of the United Nations International Year of Micro Credit, 2005.
2.2 CREDIT NEEDS OF THE RURAL POPULATION

The dynamics of rural economy have resulted in rapid sectoral changes of far reaching magnitude. The growth of the service sector is observed to be very fast and the rural marketing emphasis of MNCs and Indian companies is now bearing fruits. Rural areas now have access to better transportation and communication media. Consequently, the rural and the urban divide are gradually diminishing. Commercialization of agriculture with increasing emphasis on cash crops has given way to a new breed of moneylenders in the rural economy. These traders supply seeds, pesticides and fertilizers to the rural farmers on credit or on deferred payment basis. They also advance money towards the purchase of output from farmers and thus undertake forward trading. These credit arrangements are all on voluntary basis as the formal banking system does not readily finance these types of transactions. The non-banking finance companies have also entered the rural areas where they are popularly known as the ‘blade companies’.

Another need of the rural poor is in the form of consumption credit needed for meeting urgent religious, social, educational and medical needs. Banks do not provide loans in the normal course for such purposes. There appears to be a mismatch between the services provided by the formal rural finance sector and the loan requirements of the rural poor and hence the need for parallel credit systems which are better able to meet the genuine credit needs of rural people.

A World Bank study (1995) reveals that 67% of the credit needs of poor people in India are for consumption and of the consumption credit required 75% was for short periods for emergencies like illness, household expenses during the lean monsoon seasons. It was estimated that 75% of production credit (comprising 33% of total credit) was met by banks while 100% of the consumption credit requirements were met by informal sources at interest rates ranging from 30% to 90% per annum. As no collateral is offered banks could not sanction such consumption loans as per current norms.
Indian agriculture is also undergoing a sea change. The traditional cereal production is being replaced by new sectors like poultry and fish culture. There is an increase in the product diversification. Multiple occupations are being adopted by the rural people to enhance incomes, thus creating hurdles in credit monitoring by banks. Rural prosperity is very uneven in the wake of commercialization and diversification. On the other hand, the rural economy of the tribal areas is largely non-monetized. Due to underemployment and seasonality of incomes, the landless poor people may need more consumption credit but the institutional arrangement to meet these needs is inadequate. In addition to this, the formal banking system is transferring funds from rural areas to urban areas, as is evident from the low credit-deposit ratios. There is a need for formal or informal credit markets which will retain rural money for developing areas.

2.3 EVOLUTION OF RURAL CREDIT DELIVERY SYSTEM IN INDIA

The rural credit needs being fulfilled under the influence of usurious money lending practices are very well documented from the colonial period. The Central Banking Enquiry Committee (CBEC) report (1929) and its associated provincial reports are considered to be important evidences. Of these, the Madras Provincial Banking Enquiry Committee (MPBEC) report is regarded as a classic. As per the MPBEC report, the farmers were compelled to sell their crop for the repayment of debts which many times would lead to part payment only. The balance loan amount would become a pro-note debt. In the course of time if the farmer failed to repay, it would become a mortgage debt. The creditor would then take a bulk of the produce and leave the farmer unable to repay the debt. To meet his pending debts the debtor would be forced to borrow again. The MPBEC found that repayment of prior debts was a major motivation for borrowing among the rural poor.

The 1935 report on agricultural indebtedness provides instances of moneylenders who kept accounts but never revealed them to the debtors, and neither provided receipts to them. The moneylenders indulged into all sorts of ill practices like recording higher
interest rates than actually charged, charging higher ‘penal’ interest rates in case the
debtors failed to repay within the stipulated time period\textsuperscript{12}. This led to oppression and
exploitation of the rural poor from the moneylenders, making the poor poorer. The
poor would be inextricably trapped in debt to never come out of it.

The colonial administration took several efforts to solve these problems. A step ahead
was the enactment of the Deccan Agricultural Debtors’ Relief Act, 1879. This act
authorized the courts to stop charging usurious interest rates and sale of land as a
result. Similar land alienation acts were passed in Punjab, United provinces and
Central provinces and Berar\textsuperscript{13}.

Furthermore low interest rates were provided after the Land Improvement Loans Act,
1883, for the short term needs. But, these loans remained extremely sparse and
ineffective. The success of the co-operative movement in Europe led to the Co-
operative Credit Societies Act of 1904. This was later supported by the government
with the more comprehensive Co-operative Societies Act of 1912. After the 1915
Maclagen Committee on co-operation, provincial co-operative banks were established
in almost all major provinces by 1930\textsuperscript{14}. But these co-operatives could not go far in
the Indian context. The sharp socio-economic disparities in rural India marred the
very idea of co-operation. According to Baker (1984), the Co-operative Credit
societies were run in most cases by rich landlords and moneylenders\textsuperscript{15}. Another study
by Catanach (1970), on rural credit in western India observes that co-operatives only
became an addition to the dealings of the rural moneylender, not an alternative to
him\textsuperscript{16}. The Co-operative Credit societies being influenced by the rich landlords and
moneylenders could not serve the basic purpose for which they were set i.e. of
providing smooth credit flow to rural India.

The steep fall in agricultural prices during the Great Depression of 1930s opened the
floodgates of legal suits for attachment of lands of borrowers. In response to this the
various Debt conciliation Acts were formulated during 1933 to 1936 by the
governments of the central province and Berar, Punjab, Assam, Bengal and Madras.
On this B.V. Narayanswami Naidu concluded in his enquiry report, “after existing for about seven years, the debt conciliation boards were abolished as not having been of any considerable practical utility”17. The major reasons for the poor performance of these boards were the complicated administrative machinery and lack of coercive powers.

The above discussion indicates that the strength of the debt mechanisms remained largely unimpaired by the activities of the colonial state. The complete scenario is depicted in the famous statement by Malcolm Darling (1925) as “the Indian peasant is born in debt, lives in debt and dies in debt”. It can also be observed that the government made serious attempts to nurture the co-operative movement in the pre-independence period and the general thinking was in favour of promoting primary credit co-operative societies in the rural areas. But, the major emphasis of the rural credit was on preventing the usurious exploitation of the poor by the moneylenders rather than promoting capital formation in agriculture.

2.3.1 ROLE OF CO-OPERATIVES IN RURAL CREDIT DELIVERY

The Commercial bank operations were confined to financing trade and exports and had no interest in agricultural operations of the farmers. The Royal Commission on Agriculture (1928) and the Central Banking Enquiry Committee had emphasized the need of co-operatives for rural credit. This led to the establishment of the Agricultural Credit Department (ACD) in the RBI in 1935 mainly to promote and assist the co-operative credit development.

The Rural Banking Enquiry Committee(1949) found that the co-operative infrastructure was quiet satisfactory and that the commercial banks had shown no interest in agricultural and rural credit and had not gone beyond taluka headquarters. The All India Rural Credit Survey (1954), however, pointed out that the development of the co-operative credit movement was inadequate in coverage and recommended that the co-operative structure be strengthened by providing a three-tier structure. The
Committee on Co-operative Credit (1960) recommended the development of a strong and stable institutional framework for co-operative societies. It suggested that the co-operatives need to follow sound business methods, distribute assets properly, maintain fluid resources, attract local deposits, improve lending norms etc.

**TABLE 2.1**

**Share of rural household debt by source of credit, All India, 1951-1991**

(Figures in %ges)

<table>
<thead>
<tr>
<th>Year</th>
<th>Institutional</th>
<th>Non-Institutional</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Banks</td>
<td>Co-Operatives</td>
</tr>
<tr>
<td>1951</td>
<td>1.1</td>
<td>4.6</td>
</tr>
<tr>
<td>1961</td>
<td>0.3</td>
<td>10.4</td>
</tr>
<tr>
<td>1971</td>
<td>2.4</td>
<td>20.1</td>
</tr>
<tr>
<td>1981</td>
<td>28.6</td>
<td>28.6</td>
</tr>
<tr>
<td>1991</td>
<td>29</td>
<td>18.6</td>
</tr>
</tbody>
</table>

*Source: All India Rural Credit Survey & All India Debt & Investment surveys (AIDIS)*

*Others include non-institutional sources other than friends, relatives and moneylenders like traders, agriculturist moneylenders, landlords etc.*

The first significant move to plan for the rural credit was taken when the RBI set up the All India Rural Credit Survey Committee (AIRCS) in the year 1951-52. The survey carried out by AIRCS in 1954 confirmed that the formal credit institutions including the co-operatives and the banks provided less than 9% of rural credit needs in India, in contrast to the domination of the informal credit suppliers contributing almost 91% of the total rural credit needs (Table no.2.1). While assessing the role of co-operatives, the committee found that the co-operatives supplied only 4.6% of the total rural household debts. It therefore, recommended an integrated reorganization of the co-operative credit system, which envisaged state partnership through contribution to the share capital of the cooperative credit institutions. It also called for coordination between credit and other economic activities, especially marketing and
processing and administration through adequately trained and efficient personnel responsive to the needs of the rural population.

The 1950s and 1960s focused mainly on co-operatives leading to a rise from 4.6% in 1951 to 10.4% in 1961 and 20.1% in 1971 (Table no.2.1). It continued with the increasing trend till 28.6% in 1981 (Table no.2.1). But the decade of 1980s shows a downfall of the cooperatives contribution as it reduces to 18.6% (Table no.2.1).

There were many committees which made various recommendations for the development of the co-operative segment. For instance the Hazari Committee recommended integration of short term and long term structures. The Bawa Committee (1971) recommended setting up Large Multi-purpose Cooperatives in tribal areas. The National Commission on Agriculture (1976) recommended setting up Farmers Service Cooperative Societies with the active collaboration of the nationalized banks.

The co-operative credit system today comprises both short term and long term structures. The short term structure has at its base the Primary Agricultural credit Societies (PACSs), federated into District Central Cooperative Banks (DCCBs) which, in turn, are federated at the state level into State Cooperative Banks (SCBs). At the long term level are the Land Development Banks (LDBs) which are unitary in some states and in some federated. The general consensus of the past working groups has been that cooperative banks have not done well. It has also been said that cooperatives in India have experienced operational problems because they are both state sponsored and patronized, thereby negating democratic management. The basic principle of cooperative banking i.e. reliance on resources mobilized locally and lesser dependence on higher credit institutions, has historically been absent from the Indian system. The lower tiers look up to the higher tiers and the government for refinance, while the higher tiers ignore the interests of the lower tiers. This has led to an ever increasing state control over the cooperatives thus depriving them of their democratic and autonomous character. This ‘borrower driven’ system is beset with
conflict of interest and has led to regulatory arbitrage, recurrent losses, deposit erosion, poor portfolio quality and a loss of competitive edge for the cooperatives\textsuperscript{18}.

2.3.2 ROLE OF BANKS IN RURAL CREDIT DELIVERY

The role of banks in the rural credit delivery system can be looked upon with an analytical eye since independence on the basis of the various institutions established with the initiative of the Government of India and the RBI. An attempt has been made to analyse the major institutional network in the form of commercial banks, regional rural banks, and specialized agencies like NABARD and others.

A. COMMERCIAL BANKING SYSTEM

The AIRCS found in 1951 that the share of banks in rural credit was less than 1\% (Table no.2.1). It was then that the AIRCS expected the involvement of banks in agricultural marketing and processing but not directly in farm output. Rural branches of the commercial banks were few despite the 1954 directive of RBI to open at least one branch in the unbanked rural and semi urban areas for every branch opened in previously banked area\textsuperscript{19}. The Imperial Bank of India was nationalized in 1955 and the new SBI was asked to open 400 branches in semi-urban areas and start agricultural lending, even if at loss. Until the end of the 1960s, a major share in the commercial bank credit was that of the industry (62\%) and trade and commerce (26\%). Within industry, the distribution of credit was skewed in favour of large borrowers\textsuperscript{20}. It can thus be observed that the banks continued to have an urban bias throughout the 20 years after independence.

The National Credit Council Study Group headed by Prof.D.R.Gadgil, on organizational framework for the implementation of the social objectives in 1968 recommended that the main aim of future national credit policies should be to involve commercial banks in providing rural credit\textsuperscript{21}. It would be appropriate to mention that
government control over banking was the norm in most low-income countries in the four decades after the first world war.\textsuperscript{22}

The need to improve financial access for India’s poor, the majority of whom are concentrated in rural areas, motivated the establishment of a vast network of rural co-operative credit banks in the 1950s. This was then followed by a drive to nationalize Commercial banks in 1969. Nationalization had four goals as follows:\textsuperscript{23}:
1. To prevent a few corporations from controlling all the banks;
2. To mobilize the savings of the public;
3. To limit the concentration of wealth and economic power by using resources mobilized by banks to achieve egalitarian growth; and
4. To pay more attention to priority sectors (agriculture and small industry).

The 1961 census indicated that nearly 50\% of India’s towns and almost none of its villages had bank branches. In 1969, the National Credit Council formed to guide the branch expansion programme, found that only less than 1\% of Indian villages were being served by commercial banks. It also observed that industry which contributed only 15\% to the national income held a share of 67\% in the commercial bank credit. On the other hand, agriculture which added almost 50\% of GDP virtually got nothing from the banks. Therefore, the nationalization of fourteen major banks in 1969 and six more commercial banks in 1980 was a milestone towards controlling the commanding heights of the economy.

The nationalized banks became important instruments for development of rural banking in addition to co-operatives and the State Bank of India. After nationalization, branch expansion was deliberately skewed towards previously unbanked or under-banked rural and semi-urban areas. In 1970, the RBI formulated its first socially coercive licensing criterion. Accordingly for every new branch in an already banked area, each bank would have to open at least three branches in the unbanked rural or semi-urban areas. This ratio of 1:3 was further intensified by raising to 1:4 in 1977.
Between 1969 and 1980, thousands of new branches were established across rural India. Throughout this period, the banking strategy was shaped by the goal of ‘serving better the needs of the development of the economy in conformity with the national policy and objectives’. The social benefit rather than profitability was the overriding objective. The strategy during 1970s and 1980s gave the lead role to the nationalized commercial banks, which led to loosening the grip of traditional informal sector moneylenders through the use of targeted, low-priced loans. Credit planning, including quantitative credit targets and subsidized credit, became the order of the day. The banks were required to direct large proportions of their credit to priority sectors including agriculture, small scale industries and others which were identified to be critical for bringing about economic and social change in the rural areas. Consequently as is evident from table no.2.1, the banking sector contributed to almost 28.6% by 1981 which was almost 26.36 times the contribution of banks in 1951. It further remained stable at 29% in 1991. Thus, the nationalization of banks was a major step towards the planned development of rural credit delivery system.

B. AGRICULTURAL REFINANCE CORPORATION

The third five year plan, which began in 1961, emphasized the urgent need to step up agricultural production and to create an institution to provide funds by way of refinance to financing institutions. As a result in 1963 the Agricultural refinance corporation (A.R.C.) was established. This marked the beginning of a systematic effort for agricultural development banking. The role of the private sector was quite dominant in development of resources like ground water and was catalysed by the A.R.C.’s refinancing and development role in areas like minor irrigation, plantation and horticulture.

C. LEAD BANK SCHEME

To examine the area approach rural development the RBI constituted a committee under F.K.F Nariman in 1969. This committee recommended the introduction of the
Lead Bank scheme. The scheme involved commercial banks, cooperative institutions, government and semi-government agencies in the process of economic development. The lead banks were responsible for surveying credit needs, developing a branch network and extending adequate credit facilities in cooperation with other banks. This was a major step taken by RBI in expanding the rural banking network and in providing adequate credit for priority sectors and weaker sections of the society.

D. AGRICULTURAL REFINANCE AND DEVELOPMENT CORPORATION

The committee further recommended for a more active and bigger role for the ARC to emphasize its developmental and promotional role in rural banking. As an outcome of this recommendation the ARC was renamed as the Agricultural Refinance And Development Corporation in 1975.

E. REGIONAL RURAL BANKS

The new strategy of high yielding technology in agriculture was scale-neutral and not resource-neutral. The rural power structures dominated the cooperative system, which also suffered from structural weaknesses and poor management. The commercial banks lacked rural development orientation. In such a scenario the fear of bypassing the weaker sections was pre-dominant. Hence it became necessary to have a mechanism that would combine the advantages of the cooperatives’ familiarity with rural problems and the commercial banks’ ability to mobilize deposits and function with a modern outlook. This was done with the setting up of Regional Rural Banks (RRBs). In 1975, the RRBs were created to offer targeted lending in the rural areas. The RRB Act states that RRBs were set up to develop the rural economy by providing “credit and other facilities particularly to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs”.

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F. NABARD

RBI, at the instance of Government of India (GOI) appointed a Committee to review arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD), under the chairmanship of Shri B. Sivaraman, in 1979. CRAFICARD conceived and recommended the establishment of the National Bank for Agriculture and Rural Development (NABARD). The Indian Parliament through the Act 61 of 1981 approved the setting up of NABARD. The Bank which came into existence on 12 July, 1982, was dedicated to the service of the Nation by the then Honourable Prime Minister, Smt. Indira Gandhi on 5 November, 1982. NABARD took over the functions of the then Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of RBI and Agricultural Refinance and Development Corporation (ARDC).

NABARD was established as a development Bank, in terms of the Preamble of the Act, "for providing and regulating Credit and other facilities for the promotion and development of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity of rural areas and for matters connected therewith or incidental thereto." This was a major boost provided to the rural credit. Over the last twenty five years, refinance disbursement by NABARD to the commercial banks, state cooperative banks, state cooperative agricultural and rural development banks, RRBs and other eligible financial institutions has aggregated over Rs.8600 crores.

G. PRIORITY SECTOR LENDING

The report of the Study group of the National Credit Council headed by Prof.D.R.Gadgil in 1968 put forth the concept of priority lending for the first time. It came to be further elaborately defined in 1972 on the basis of ‘the report of informal study group on statistics relating to advances to the priority sector’ constituted by RBI
in May 1971. The advances made to road and water transport operators, retail trade, small business professional and self employment and education also found a place in priority lending along with agriculture and small scale industries. In November 1974, the banks were advised to increase their priority sector lending to 33.33% of their aggregate advances by March 1979. Further in March 1980, the banks were advised to step up the proportion of their advances to priority sectors to 40% of their total advances by 1985.  

The Narasimham Committee on Financial System further recommended modification in the concept of priority sector in 1991. It suggested that the priority sector concept need incorporate small and marginal farmers, tiny sector industries, small business and transport operators, village and cottage industries, rural artisans and other weaker sections. It recommended that the credit target for this redefined priority sector should henceforth be fixed at 10% of aggregate credit. The basic objective of this liberal approach to priority lending is to extend institutional finance to the weakest of the weaker sections. The various steps taken by the Central Government and the Reserve Bank of India are summarized as follows:

a. 50% of direct agricultural advances to go to the weaker sections by 1983;
b. 40% of the priority sector lendings or 16% of the total lending to go to agriculture by 1985;
c. 12.5% of total lending to go to the small scale industries sector by 1985;
d. 1% of the total aggregate advances of commercial banks in the previous year to be available for lending at 4% of interest under the Differential Interest Rate Scheme;
e. non-insistence on security for small loans upto Rs.5000;
f. branch expansion policy favouring opening of branches in rural and semi-urban centers and giving priority to Regional Rural Banks.

The progress of the priority sector lending approach is quiet visible from table 2.2 below. The fact that the priority sector advances of public sector banks increased from mere Rs.441 crores in June 1969 to Rs.52945 crores during March 1994 itself is
a better proof for the growth. At the same time the number of accounts too showed a substantial rise from 2,60,000 accounts in June 1969 to 3,48,59,000 in March 1991.

Table No.2.2

**Advances to Agriculture and Other Priority Sectors by Public Sector Banks**

(Accounts in ‘000)

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Number of Accounts</th>
<th>Amount Outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>----------------------------------</td>
<td>-----------</td>
<td>------------</td>
</tr>
<tr>
<td>Agriculture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Direct Finance</td>
<td>160</td>
<td>19735</td>
</tr>
<tr>
<td>b. Indirect Finance</td>
<td>4</td>
<td>564</td>
</tr>
<tr>
<td>SSI</td>
<td>51</td>
<td>2830</td>
</tr>
<tr>
<td>Setting Industrial Estate</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>Transport operators</td>
<td>2</td>
<td>751</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>33</td>
<td>4629</td>
</tr>
<tr>
<td>Small Business</td>
<td>...</td>
<td>3459</td>
</tr>
<tr>
<td>Professional &amp; Self Employed persons</td>
<td>8</td>
<td>2367</td>
</tr>
<tr>
<td>Education</td>
<td>1</td>
<td>70</td>
</tr>
<tr>
<td>Consumption Loans</td>
<td>...</td>
<td>153</td>
</tr>
<tr>
<td>S.S.C’s organisation</td>
<td>...</td>
<td>8</td>
</tr>
<tr>
<td>S.S. Organisation</td>
<td>...</td>
<td>4</td>
</tr>
<tr>
<td>Housing Loans</td>
<td>...</td>
<td>288</td>
</tr>
<tr>
<td>Total Priority sector Advances(%)</td>
<td>260</td>
<td>34859</td>
</tr>
<tr>
<td>Total Bank Credit</td>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>

*Source: Reserve Bank of India*
However it can also be observed from table 2.2 that the number of accounts reduced to 3,46,15,000 in March 1994. As a matter of fulfilling the mandatory requirements under the priority sector lending approach the priority sector advances which contributed a mere 14.61% in June 1969 in total bank credit increased to 39.52% in March 1991. This share of priority advances reduced to 38.18% by March 1994 (Table No.2.2). Another interesting fact that can be observed from the table no.2.2 is that the consumption loan accounts of the priority sector increased from zero to 1,53,000 by March 1991, later reduced to 1,02,000 accounts by March 1994. The reduction in the consumption loan accounts can be observed to have led to rise in the moneylenders’ contribution to fulfilling the rural credit needs.

2.3.3 ROLE OF MONEY-LENDERS IN RURAL CREDIT DELIVERY

The private moneylenders and other informal sources of finance have been in existence over years together. They operate either as individuals (eg. Relatives, rural money lenders, agricultural traders and pawn brokers) or as groups of individuals organized for mutual interest, such as rotating savings and credit associations (ROSCAS) also known as Chit Funds.

From the table 2.1 it is clear that as per the AIRCS, 1951 the share of non-institutional sources including relatives, money lenders and others was pre-dominant in the rural household debt almost upto 91.2%. This reduced to 38.8% in 1981. During the same period the institutional share witnessed a phenomenal increase from 8.8% to 61.2%.

It can however be observed that the non-institutional sources showed a rise from 38.8% in 1981 to 46.7% in 1991 (table no.2.1). Inspite of the rapid growth of rural credit from institutional sources in South Asian countries, particularly over the past twenty years, the percentage share of the money lenders and other informal sources of credit has not appreciably reduced. In the Indian context the Central and the State governments have played a vital role over the years, whereby India shows a low
percentage share of the informal rural credit system to the total credit outstanding. Determined efforts have been made over past five decades to wean the rural borrowers away from the money lenders and build up an alternative rural credit delivery system that would provide for cheap credit from institutional sources. But, despite of these all efforts the money lenders continue to exist and dominate in modified forms.

The rural credit markets of South Asia are still influenced heavily by money lenders even though the interest rates may exceed 75% per month and in certain periods may not be available. The proportion of farmers served by agricultural financial institutions continues to be poor, except in Pakistan (80%). A symposium on ‘Imperfect Information and Rural Credit Markets’ (World Bank Economic Review, 1991) concludes:

‘Creation of institutional alternatives has failed to drive traditional money-lenders out of the market and whatever competition it has provided; interest rates charged by traditional money-lenders remain high.’

The informal credit markets provide for a major source of working capital to the rural credit sector. The popularity of these markets is mainly because of the ability of these markets to reduce the discrepancies in the allocation of credit from institutional sources. The formal lenders tend to lend only in areas where farmers have firm land titles and other collateral. On the other hand the informal lenders tend to give more credit for consumption and other needs. Consequently credit from informal sources is seen as being more reliable due to its easy availability and availability of credit for consumption purposes. Also informal credit is more readily available to borrowers, whose credit needs are neglected by the formal sector for reasons like high risk involved, lack of collateral and high cost of administering small loans.
2.4 RURAL FINANCE ACCESS SURVEY, 2003

These have been the major initiatives with regards to the banking development in India. But a critical analysis of the same is impervious. Since 1991, no official survey of rural access to finance has been conducted. However, a recent survey by the World Bank and the National Council of Applied Economic Research (NCAER) --- the Rural Finance Access Survey (RFAS), 2003 --- provides for the analysis of trends between 1991 and 2003. This RFAS covers 6000 rural households in the two Indian states i.e. Andhra Pradesh and Uttar Pradesh. The major findings of this survey can be summarized as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>All India</th>
<th>UP</th>
<th>AP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Formal</td>
<td>Formal</td>
<td>Formal</td>
</tr>
<tr>
<td>Percent of households indebted</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AIDIS-1991</td>
<td>15.6</td>
<td>12.5</td>
<td>16.5</td>
</tr>
<tr>
<td>RFAS-2003</td>
<td>---</td>
<td>19.4</td>
<td>24.0</td>
</tr>
<tr>
<td>Average debt per household</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AIDIS-1991</td>
<td>1221.0</td>
<td>1521.0</td>
<td>1691.6</td>
</tr>
<tr>
<td>RFAS-2003</td>
<td>---</td>
<td>6376.0</td>
<td>4313.0</td>
</tr>
</tbody>
</table>


Relative to the findings of the AIDIS-1991, the incidence of indebtedness (i.e. proportion of households with debt outstanding to a formal finance institution) had further increased by 2003, indicating greater access and the ability to borrow. Under the assumption that households "prefer" formal borrowing and were earlier rationed due to inadequate supply of such debt, the increase in formal indebtedness could be viewed as an improvement. (table 2.3).
According to the RFAS-2003, around 41% of rural households have a deposit account and 21% of rural households have access to credit from a formal source. This brings to light the grave fact that majority of rural India is unbanked. Amongst formal
institutions, commercial banks are by far the most dominant source of formal finance for rural households. They account for 51% of household deposit and are also the most important source of credit for those rural households who have access to the formal sector. Regional Rural Banks account for 34% of household deposits and 31% of credit. Other formal sources, such as cooperatives and post office branches appear to play a modest role in providing savings and credit services to rural households. (Charts 2.1 and 2.2).

Chart 2.3

![Chart 2.3: Rural Households without access to Finance](image)

**Source:** RFAS 2003

*Note: Commercial HH: with or without land but with income from non farm sources exceeding half of total household income*

While achievements over the past decades should not be underestimated, *poorer* households in rural areas in India still have very little access to formal finance. As per RFAS-2003, around 58% of rural households do not have a deposit account and 79% of rural households have no access to credit from a formal source (Chart 2.3).
Within the rural households also a wide disparity is observed. The RFAS further indicates that the rural banks serve primarily the needs of the richer rural borrowers: some 66% of large farmers have a deposit account; 44% have access to credit. Meanwhile, the rural poor face severe difficulties in accessing savings and credit from the formal sector. Almost 70% of marginal/landless farmers do not have a bank account and 87% have no access to credit from a formal source. Another segment that faces serious problems in accessing formal finance is the commercial household segment. 83% of the commercial households do no have access to credit.

<table>
<thead>
<tr>
<th>Agency</th>
<th>Bank</th>
<th>RRB</th>
<th>Cooperatives</th>
<th>Schemes</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Rate (median) % p.a.</td>
<td>12.5</td>
<td>11.0</td>
<td>11.0</td>
<td>14.0</td>
<td>14.0</td>
</tr>
<tr>
<td>Loan amount received as % of amount applied</td>
<td>91.8</td>
<td>88.2</td>
<td>83.5</td>
<td>86.6</td>
<td>93.9</td>
</tr>
<tr>
<td>% households reporting Bribes</td>
<td>26.8</td>
<td>27.0</td>
<td>9.7</td>
<td>27.3</td>
<td>23.2</td>
</tr>
<tr>
<td>Bribe as % of amount approved</td>
<td>10.1</td>
<td>18.2</td>
<td>19.9</td>
<td>42.3</td>
<td>8.3</td>
</tr>
<tr>
<td>Processing time (weeks)</td>
<td>33.0</td>
<td>28.5</td>
<td>24.0</td>
<td>89.0</td>
<td>14.3</td>
</tr>
</tbody>
</table>

*Source: RFAS, 2003*

For the minority with no access to finance from a formal source, transaction costs are high. The RFAS 2003 indicates that all types of formal institutions demand bribes before approving loans. On an average 26.8% of sample households who borrowed from RRB, 27% who borrowed from a commercial bank and 10% of the households who borrowed from a credit cooperative, had to pay a bribe to get a loan.
The bribe amounts are quite heavy ranging from 10% to 20% of the loan amount. In addition the formal procedures for opening an account or getting a loan are cumbersome and costly both with a high rate of rejection. On an average it takes almost thirty three weeks for a loan to be sanctioned by a commercial bank. Such longer processing time spans and heavy bribes together cause high effective costs for the small borrowers (Table no.2.4).

The following table presents the incidence and size of informal borrowing by household category (% of households):

<table>
<thead>
<tr>
<th>Households</th>
<th>Marginal Farmers</th>
<th>Small Farmers</th>
<th>Large Farmers</th>
<th>Commercial Households</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowed in past 12 months</td>
<td>48.24</td>
<td>39.84</td>
<td>35.9</td>
<td>39.07</td>
<td>42.82</td>
<td>44.06</td>
</tr>
<tr>
<td>Loans currently outstanding</td>
<td>44.58</td>
<td>34.79</td>
<td>31.45</td>
<td>36.13</td>
<td>39.90</td>
<td>40.07</td>
</tr>
<tr>
<td>Av.Debt/borrower(Rs.)</td>
<td>9152</td>
<td>12523</td>
<td>18752</td>
<td>13075</td>
<td>17885</td>
<td>11136</td>
</tr>
<tr>
<td>Av.Debt/household(Rs.)</td>
<td>4332</td>
<td>4834</td>
<td>6373</td>
<td>5007</td>
<td>7495</td>
<td>4790</td>
</tr>
</tbody>
</table>

Source: RFAS, 2003

Access to formal credit is particularly a problem for meeting unforeseen expenditures for the rural poor. It is herein that the family sources and the local moneylenders dominate. The RFAS reports around 44% of the rural households surveyed have borrowed informally at least once in the preceding 12 months (Table no.2.5). As per the RFAS the main source of informal borrowing is moneylenders (56%) followed by friends or relatives (21%). The largest uses of informal loans are for meeting family emergencies (29%) and social expenditures (19%) arising from events such as births, marriages, deaths. A mere 13% of the borrowers report using informal loans for investment purposes.

It thus can be identified that informal borrowing is very important for the poorest that are the most deprived of formal finance. Other significant features that make informal loans more attractive to the poor include flexible repayment, the convenience and
frequency with which these loans can be availed. Also lesser reliance on the collaterals is reported to make informal loans more popular over formal financing. The RFAS reports only 16.5% of the sample households providing collateral against the loan. On the contrary 89% of the households who borrowed from RRBs and 87% of the households who borrowed from commercial banks reported that they had to provide collateral.(RFAS 2003)

Newer sources, such as the recently introduced Kisan Credit Cards, are still statistically insignificant. Access to other financial services, such as insurance, also remains limited for the rural poor, although many would like to have access to insurance. Over 82% of households surveyed in RFAS-2003, did not have any insurance, and practically none of the poorest households surveyed had insurance.

**2.5 NEED FOR NEW FINANCE DELIVERY APPROACH**

The failure of the formal financial institutions to serve the rural poor effectively led to a review of the informal financial systems and lending groups35.” The traditional assessment of the informal sector has been that it is exploitative, usurious and dysfunctional and newly established institutional credit is thus often aimed at dismantling the informal sector. Such an approach may result in policies which displace informal lenders without offering alternate sources of institutional credit. In these circumstances, rather than substitute for these informal arrangements, supplement and strengthen informal credit sources, and compete with informal lenders. Moreover newly introduced systems could also learn from the informal sector.”36 It has been observed by various researchers that the informal sector stands to be a legitimate part of the rural financial markets and it is a better policy to accept them than to deplore the fact37.

In the Indian context the performance of formal financial institutions especially in lending to poor has been unsatisfactory. A large number of rural households are with limited land resources and small economic activity accompanied with poor
technology. But their demand for credit has been rising due to growing family size, increased consumption requirements, social obligations etc. But the institutional agencies lacked the required mechanism to assess their credit needs and often even overlooked their demand for credit on the ground that their needs are for non-productive purposes. Besides, perceived high risks, high transaction costs involved in small scale rural lending and absence of collaterals have contributed to keep the poor away from the fold of formal financial sector.

This has led to the prime need of devising such financing approaches which would overcome the drawbacks of both formal and informal lending and instead would provide for the maximum benefits of the both. Thus the need of the hour was suggested to have a financial system that would be featured with less transaction costs, minimal information gap and flexibility in operations. In addition it would also provide for credit at cheaper rates without any collateral.

With this background the emergence of microfinance was looked upon to be an oasis in the desert. Mainly as a result of the inaccessibility of the formal banking system to the poor, micro financial institutions emerged, which act as an impetus to community action. Microfinance in fact has proved that lending to poor people is both possible and profitable.

2.6 BACKGROUND AND IMPORTANCE OF MICROFINANCE

Micro-Finance has, in recent times, come to be recognized and accepted as one of the new development paradigms for alleviating poverty through social and economic empowerment of the poor, with focus on empowering women. Experiences of different anti-poverty and other welfare programmes within the country and elsewhere have shown that the key to its success lies in the participation of community based organisations at the grass root level.
2.6.1 CONCEPT OF MICROFINANCE

To most, microfinance means providing very poor families with very small loans (microcredit) to help them engage in productive activities or grow their tiny businesses. Over time, microfinance has come to include a broader range of services (credit, savings, insurance, etc.) as we have come to realize that the poor and the very poor who lack access to traditional formal financial institutions require a variety of financial products. Microcredit came to prominence in the 1980s, although early experiments date back 30 years in Bangladesh, Brazil and a few other countries. The important difference of microcredit was that it avoided the pitfalls of an earlier generation of targeted development lending, by insisting on repayment, by charging interest rates that could cover the costs of credit delivery, and by focusing on client groups whose alternative source of credit was the informal sector. Emphasis shifted from rapid disbursement of subsidized loans to prop up targeted sectors towards the building up of local, sustainable institutions to serve the poor. Microcredit has largely been a private (non-profit) sector initiative that avoided becoming overtly political, and as a consequence, has outperformed virtually all other forms of development lending. Traditionally microfinance was focused on providing a very standardized credit product. The poor, just like anyone else, need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. Thus, we see a broadening of the concept of microfinance.

BOX NO.1

| Microfinance may be defined as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards" (NABARD) |

A good definition of microfinance as provided by Robinson⁹ is, ‘Microfinance refers to small-scale financial services for both credits and deposits — that are provided to
people who farm or fish or herd; operate small or microenterprises where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries, in both rural and urban areas’

Mark Malloch Brown, Administrator, UNDP (2004) stated that,

“Microfinance is much more than simply an income generation tool. By directly empowering poor people, particularly women, it has become one of the key driving mechanisms towards meeting the Millennium Development Goals, specifically the overreaching target of halving extreme poverty and hunger by 2015.”

BOX NO.2

| Micro Credit has been defined as the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their living standards. Micro Credit Institutions are those, which provide these facilities. (Reserve Bank of India) |

2.6.2 ADVANTAGES OF MICROFINANCE

Experience shows that microfinance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change. Poverty is multi-dimensional. By providing access to financial services, microfinance plays an important role in the fight against the many aspects of poverty. For instance, income generation from a business helps not only the business activity expand but also contributes to household income and its attendant benefits on food security, children's education, etc. Moreover, for women who, in many contexts, are secluded from public space, transacting with formal
institutions can also build confidence and empowerment. Recent research has revealed the extent to which individuals around the poverty line are vulnerable to shocks such as illness of a wage earner, weather, theft, or other such events. These shocks produce a huge claim on the limited financial resources of the family unit, and, absent effective financial services, can drive a family so much deeper into poverty that it can take years to recover.

2.6.3. GOVERNMENT ROLE IN SUPPORTING MICROFINANCE

Governments have a complicated role when it comes to microfinance. Until recently, governments generally felt that it was their responsibility to generate development finance, including credit programs for the disadvantaged. Twenty years of insightful critique of rural credit programs revealed that governments do a very bad job of lending to the poor. Short term political gain is just too tempting for politically controlled lending organizations; they disburse too quickly (and thoughtlessly) and they collect too sporadically (unwillingness to be tough on defaulters). In urban areas, governments never really got into the act, and subsidized microenterprise credit is still relatively rare when compared to its rural counterpart. Now that microfinance has become quite popular, governments are tempted to use savings banks, development banks, postal savings banks, and agricultural banks to move microcredit. This is not generally a good idea, unless the government has a clear acceptance of the need to avoid the pitfalls of the past and a clear means to do so. Many governments have set up apex facilities that channel funds from multilateral agencies to MFIs. Apex facilities can be quite complicated and there are few successful examples in microfinance. Successful apex organizations in microfinance tend to be built on the backs of successful MFIs, not the other way around. Finally, governments can also get involved in microfinance by concerning themselves with the regulatory framework that impinges on the ability of a wide range of financial actors to offer financial services to the very poor.

It was announced in the Union Budget for 2005-06 that the Government of India intends to promote micro-finance institutions (MFIs) in a big way. For this purpose,
the Micro-Finance Development Fund (MFDF) was redesignated as Micro-Finance Development and Equity Fund (MFDEF) and the corpus of the fund was increased from Rs.100 crore to Rs.200 crore. MFDEF is expected to play a vital role in capitalizing the MFIs and thereby improving their access to commercial loans.

The Central Government is considering the need to identify and classify the MFIs and rate such institutions to empower them to intermediate between the lending banks and the clients. To facilitate the process of rating of MFIs, NABARD has decided to extend financial assistance to commercial banks and RRBs by way of grant to enable them to avail the services of credit rating agencies for rating of MFIs.

2.6.4. MICROFINANCE AND THE RESERVE BANK OF INDIA

In view of the new paradigm shift in microfinance, the Reserve Bank decided to revisit the issue of micro-finance in a comprehensive manner. Accordingly, several initiatives were taken in the recent period.

- First, consultations were arranged with several representatives of microfinance institutions in select centres to obtain their views.
- Second, based on such consultations, a Technical Paper on Policy relating to development, Regulation and Supervision of Micro-finance Services was prepared and was discussed with the representatives of MFIs on July 18, 2005. The recommendations of the Paper are being considered in consultation with the Government.
- Third, an Internal Group of the Reserve Bank on Rural Credit and Micro-Finance (Chairman: Shri H.R. Khan) was set up to examine the issues relating to microfinance. The final version of the Report was placed on the website of the Reserve Bank in July 2005.
2.6.5. MICROFINANCE IN INDIA

Microfinance finds its origin in micro credit. Micro credit held a limited scope confined to only supply of credit to the unbanked poor. However, this did not suffice the developmental needs of the poor. Expansion in the scope of micro credit became indispensable and Microfinance a much broader concept came into existence. Mf encompasses micro credit, micro savings, micro insurance and payment services.

The microfinance sector in India has experienced a tremendous growth in the last decade due to the efforts of various agencies, including government, international donor agencies and development banks. There is now a reasonably good supply of loan funds in the microfinance sector; lately there have also been positive changes in the policies affecting the microfinance sector. Despite all these efforts, the outreach of microfinance services in India is still considerably small in comparison to the demand for such services.

The microfinance market in India has not quite matured in terms of number of clients, range of services and variety of institutional models. The Planning Commission has estimated in 2004-05 that almost 27.5% of the Indian population lived below the poverty line. As pointed by Somnath V.S. almost 7.5 million poor households in India still are in dire need of access to financial services. India’s demand for microfinance is Rs. 500 billion and only Rs.18 billion of this amount has been generated so far. The potential for the microfinance industry in India is still vast.

The Govt. of India, since independence, has been making concerted efforts to provide financial services to the poor at affordable cost in its endeavour to solve the problems of poverty and unemployment. It laid special emphasis on expanding the network of banks all over the country in order to provide credit to the poor and weaker sections of the society. Besides, the Government also launched several subsidized wage and self-employment programmes for the benefit of the poor. Despite all these efforts, there still exists a massive gap between the demand for credit by poor households and the supply of credit by formal financial and social
institutions. According to an estimate by Menon (2005) India’s demand for micro-
credit is Rs.500 bn. and only Rs.18 bn. of this amount has been generated so far. Bhatt mentions that there is an annual credit need of Rs.6000 per household for 80 million families in India while microfinance has been able to suffice only ten percent of the total demand. Of the 75 million poor households in India, of which 60 million are rural households and 15 million urban households, it is estimated that the total annual requirement of credit for rural households would be at least Rs.120 bn. on the basis of Rs.2000/- per family. Another estimate for micro finance services, excluding housing, is Rs.500 bn. assuming that annual average credit usage is Rs.6000/- per rural poor household and Rs.9000/- per urban poor household. Housing credit requirement is estimated at Rs.10 bn. every year. In addition, the clients require saving and insurance services. The dependence of poor on informal and non-
institutional sources of credit still remains very high.

2.6.6 MICROFINANCE INSTITUTIONS IN INDIA

A range of institutions in public sector as well as private sector offers the micro
finance services in India. They can be broadly categorized in to two categories namely, formal institutions and informal institutions. The former category comprises of Apex development Financial Institutions, Commercial Banks, Regional Rural Banks, and Cooperative Banks that provide micro finance services in addition to their general banking activities and are referred to as micro finance service providers. On the other hand, the informal institutions that undertake micro finance services as their main activity are generally referred to as micro Finance Institutions (mFIs). While both private and public ownership are found in the case of formal financial institutions offering micro finance services, the mFIs are mainly in the private sector.

2.6.7 MICROFINANCE SERVICE PROVIDERS

The micro finance service providers include apex institutions like National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), and, Rashtriya Mahila Kosh (RMK). At the retail level,
Commercial Banks, Regional Rural Banks, and Cooperative banks provide micro finance services. Today, there are about 60,000 retail credit outlets of the formal banking sector in the rural areas comprising 12,000 branches of district level cooperative banks, over 14,000 branches of the Regional Rural Banks (RRBs) and over 30,000 rural and semi-urban branches of commercial banks besides almost 90,000 cooperatives credit societies at the village level. On an average, there is at least one retail credit outlet for about 5,000 rural people. This physical reaching out to the far-flung areas of the country to provide savings, credit and other banking services to the rural society is an unparalleled achievement of the Indian banking system. In the this paper an attempt is made to deal with various aspects relating to emergence of private micro finance industry in the context of prevailing legal and regulatory environment for private sector rural and micro finance operators.

### 2.6.8 EMERGENCE OF PRIVATE MICRO FINANCE INDUSTRY

The micro finance initiative in private sector can be traced to the initiative undertaken by Ms. Ela Bhat for providing banking services to the poor women employed in the unorganised sector in Ahmedabad City of Gujarat State. Shri Mahila SEWA (Self Employed Women’s Association) Sahakari Bank was set up in 1974 by registering it as a Urban Cooperative Bank. Since then, the bank is providing banking services to the poor self-employed women working as hawkers, vendors, domestic servant etc.

In order to overcome the shortcomings of the formal financial system to cater to the financial needs of the rural poor, NABARD sponsored an action research project in 1987 through an NGO called MYRADA. For this purpose a grant of Rs. 1 million ($22,222) was provided to MYRADA for an R&D programme related to credit groups. The results of the group based approach for lending to the poor were quiet encouraging. Consequently NABARD launched a pilot project in 1991-92 in partnership with Non-governmental Organisations (NGOs) for promoting and grooming self help groups (SHGs) of homogeneous members and making savings
from existing banks and within the existing legal framework. Steady progress of the pilot project led to the mainstreaming of the SHG-Bank Linkage Programme in 1996 as a normal banking activity of the banks with widespread acceptance. The RBI set the right policy environment by allowing savings bank accounts of informal groups to be opened by the formal banking system. Launched at a time when regulated interest rates were in vogue, the banks were expected to lend to SHGs at the prescribed rates, but the RBI advised the banks not to interfere with the management of affairs of SHGs, particularly on the terms and conditions on which the SHGs disbursed loans to their members.

‘The uniqueness of the micro finance through SHG is that it is a partnership based approach and encouraged NGOs to undertake not only social engineering but also financial intermediation especially in areas where banking network was not satisfactory. The rapid progress achieved in SHG formation, which has now turned into an empowerment movement among women across the country, laid the foundation for emergence of mFIs in India’

2.6.9 MFIs AND LEGAL FORMS

With the current phase of expansion of the SHG – Bank linkage programme and other mF initiatives in the country, the informal micro finance sector in India is now beginning to evolve. While there is no published data on private mFIs operating in the country, the number of mFIs is estimated (Advisory Committee 2004) to be around 800. However, not more than 10 mFIs are reported to have an outreach of 100,000 micro finance clients. An overwhelming majority of mFIs are operating on a smaller scale with clients ranging between 500 to 1500 per mFI. The geographical distribution of mFIs is very much lopsided with concentration in the southern India where the rural branch network of formal banks is excellent. Based on the data collected from 304 MFIs, the position of different categories of mFIs in terms of their number and credit flow achieved is presented in table no. 2.6 below:
### Table 2.6

**Category-wise break up of mFIs**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Regulated by RBI</th>
<th>Not regulated by RBI</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>NBFCs</td>
<td>Trusts</td>
<td>Societies</td>
</tr>
<tr>
<td>1</td>
<td>No. of mFIs</td>
<td>5</td>
<td>28</td>
<td>167</td>
</tr>
<tr>
<td></td>
<td>%ge to total</td>
<td>2</td>
<td>9</td>
<td>54</td>
</tr>
<tr>
<td>2</td>
<td>Loan outstanding (Rs. Crore)</td>
<td>398.3</td>
<td>29.5</td>
<td>152.4</td>
</tr>
<tr>
<td></td>
<td>%ge to total</td>
<td>60</td>
<td>5</td>
<td>23</td>
</tr>
</tbody>
</table>

*Source: Unpublished data from NABARD, Mumbai*

It can be observed from table 2.6 that MFIs are broadly classified into two categories. One set comprises of institutions registered under diverse legislative frameworks and not regulated by RBI. These institutions amount to a voluminous proportion of 98% of total MFIs under study while their share in total credit is only 40% which is insignificant. On the other hand only five MFIs (2%), for which data is available and which are registered as NBFCs and regulated by RBI, account for 60% of the total credit provided by MFIs.

The MFIs in India can be broadly sub-divided into three categories of organizational forms as given in Table 2.7 below:
### Table no.2.7
**Legal Forms of mFIs in India**

<table>
<thead>
<tr>
<th>Types of mFIs</th>
<th>Estimated Number*</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>400 to 500</td>
<td>Societies Registration Act, 1860 or similar Provincial Acts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Indian Trust Act, 1882</td>
</tr>
<tr>
<td>b.) Non-profit Companies</td>
<td>10</td>
<td>Section 25 of the Companies Act, 1956</td>
</tr>
<tr>
<td>2. Mutual Benefit mFIs</td>
<td>200 to 250</td>
<td>Mutually Aided Cooperative Societies Act enacted by State Government</td>
</tr>
<tr>
<td>a.) Mutually Aided Cooperative Societies (MACS) and similarly set up institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. For Profit mFIs</td>
<td>6</td>
<td>Indian Companies Act, 1956</td>
</tr>
<tr>
<td>a.) Non-Banking Financial Companies (NBFCs)</td>
<td></td>
<td>Reserve Bank of India Act, 1934</td>
</tr>
<tr>
<td>Total</td>
<td>700 - 800</td>
<td></td>
</tr>
</tbody>
</table>

* The estimated number includes only those mFIs, which are actually undertaking lending activity.

*Source: [www.nabard.org](http://www.nabard.org)*

**i. NGO mFIs:**

There are a large number of NGOs that have undertaken the task of financial intermediation. Majority of these NGOs are registered as Trust or Society. Many NGOs have also helped SHGs to organize themselves into federations and these federations are registered as Trusts or Societies. Many of these federations are performing non-financial and financial functions like social and capacity building activities, facilitate training of SHGs, undertake internal audit, promote new groups,
and some of these federations are engaged in financial intermediation. The NGO mFIs vary significantly in their size, philosophy and approach. Therefore these NGOs are structurally not the right type of institutions for undertaking financial intermediation activities, as the byelaws of these institutions are generally restrictive in allowing any commercial operations. These organizations by their charter are non-profit organizations and as a result face several problems in borrowing funds from higher financial institutions. The NGO mFIs, which are large in number, are still outside the purview of any financial regulation. These are the institutions for which policy and regulatory framework would need to be established.

ii. Non-Profit Companies as mFIs:

Many NGOs felt that combining financial intermediation with their core competency activity of social intermediation is not the right path. It was felt that a financial institution including a company set up for this purpose performs better banking function. Further, if mFIs are to demonstrate that banking with the poor is indeed profitable and sustainable, it has to function as a distinct institution. On account of these factors, NGO mFIs are in recent years setting up separate Non-Profit Companies for their micro finance operations. The mFI is prohibited from paying any dividend to its members. In terms of Reserve Bank of India’s Notification dated 13 January 2000, relevant provisions of RBI Act, 1934 as applicable to NBFCs will not apply for NBFCs:

(i) licensed under Section 25 of Companies Act, 1956,
(ii) providing credit not exceeding Rs. 50,000 ($1112) for a business enterprise and Rs. 1,25,000 ($2778) for meeting the cost of a dwelling unit to any poor person, and,
(iii) not accepting public deposits.

iii. Mutual Benefit mFIs (Co-operative mFIs):

The State Cooperative Acts did not provide for an enabling framework for emergence of business enterprises owned, managed and controlled by the members for their own development. Several State Governments therefore enacted the Mutually Aided Co-
operative Societies (MACS) Act for enabling promotion of self-reliant and vibrant co-operative Societies based on thrift and self-help. MACS enjoy the advantages of operational freedom and virtually no interference from government because of the provision in the Act that societies under the Act cannot accept share capital or loan from the State Government. Many of the SHG federations, promoted by NGOs and development agencies of the State Government, have been registered as MACS. Reserve Bank of India, even though they may be providing financial service to its members, does not regulate MACS.

iv. For Profit mFIs:

Non Banking Financial Companies (NBFC) are companies registered under Companies Act, 1956 and regulated by Reserve Bank of India. Earlier, NBFCs were not regulated by RBI but in 1997 it was made obligatory for NBFCs to apply to RBI for a certificate of registration and for this certificate NBFCs were to have minimum Net Owned funds of Rs. 25 lakhs and this amount has been gradually increased. RBI introduced a new regulatory framework for those NBFCs who want to accept public deposits. All the NBFCs accepting public deposits are subjected to capital adequacy requirements and prudential norms. There are only a few mFIs in the country that are registered as NBFCs. Many mFIs view NBFCs more preferred legal form and are aspiring to be NBFCs but they are finding it difficult to meet the requirements stipulated by RBI. The number of NBFCs having exclusive focus on mF is negligible.

2.6.10 CAPITAL REQUIREMENTS OF MFIs

NGO-mFIs, non-profit company mFIs, and mutual benefit mFIs are regulated by the specific act in which they are registered and not by the Reserve Bank of India. These are therefore not subjected to minimum capital requirements, prudential norms etc. NGO mFIs to become NBFCs are required to have a minimum entry capital requirement of Rs. two crores. As regards prudential norms, NBFCs are required to achieve capital adequacy of 12% and to maintain liquid assets of 15% on public deposits.
2.6.11 FOREIGN INVESTMENT

Foreign investment by way of equity is permitted in NBFC mFIs subject to a minimum investment of US$ 500,000. In view of the minimum level of investment, only two NBFCs are reported to have been able to raise the foreign investment. However, a large number of NGOs in the development - empowerment are receiving foreign funds by way of grants. At present, over Rs.40, 000 million ($ 889 million) every year flows into India to NGOs for a whole range of activities including micro finance. In a way, foreign donors have facilitated the entry of NGOs into micro finance operations through their grant assistance.

2.6.12 DEPOSIT MOBILISATION AND BORROWINGS

Not for profit mFIs are barred, by the Reserve Bank of India, from mobilizing any type of savings. Mutual benefit mFIs can accept savings from their members. Only NBFC mFIs rated by approved credit rating agencies are permitted to accept deposits\textsuperscript{48}. The quantum of deposits that could be raised is linked to their net owned funds.

Initially, bulk of the funds required by mFIs for onlending to their clients was met by apex institutions like National Bank for Agriculture and Rural Development, Small Industries Development Bank of India, and, Rashtiya Mahila Kosh. In order to widen the range of lending institutions to mFIs, the Reserve Bank of India has roped in Commercial Banks and Regional Rural Banks to extend credit facilities to mFIs since February 2000. Both public and private commercial banks have extended sizeable loans to mFIs at interest rate ranging from 8 to 11 per cent per annum. Banks are provided with operational flexibility to decide their own lending norms for better performance. The intention is to boost the flow of micro credit through the mFIs. In regard to external commercial borrowings (ECB) by mFIs, not-for-profit mFIs are not permitted to raise ECB. The current policy effective from 31 January 2004, allows only corporates registered under the Companies Act to access ECB for permitted end use in order to enable them to become globally competitive players.
2.6.13 REGULATION & SUPERVISION

India is witnessing the upsurge of a large number of mFIs. These mFIs vary significantly in size, outreach and credit delivery methodologies. Presently, there is no regulatory mechanism in place for mFIs except for those that are registered as NBFCs. Consequently the mFIs are not required to follow standard rule and it has allowed many mFIs to be innovative in its approach particularly in designing new products and processes. But the grave side is that the management and governance of mFIs generally remains weak, as there is no compulsion to adopt widely accepted systems, procedures and standards. Because the sector is unregulated, not much is known about their internal health. Following Committees have examined the road map for regulation and supervision of mFIs:

- Working Group (constituted by Government of India) on Legal Regulation of mFIs, 2002
- Informal Groups (appointed by RBI) on Micro Finance which studied issues relating to (i) Structure & Sustainability, ii) Funding (iii) Regulations and (iv) Capacity Building, 2003
- Advisory Committee (appointed by RBI) on flow of credit to agriculture and related activities from the Banking System, 2004

2.6.14 COMMITTEE OBSERVATIONS

The Advisory Committee (2004) observed that though a few of the MFIs have reached significant scales of outreach, the MFI sector as a whole is still in evolving phase. The following facts confirm the state of mFIs in India:

(i) Desirability of NGOs taking up financial intermediation,
(ii) Unproven financial and organizational sustainability of the model,
(iii) High transaction costs leading to higher rates of interest being charged to the poor clients,
(iv) Absence of commonly agreed performance, accounting and governance standards,
(v) Heavy expectations of low cost funds, including equity and the start up costs, etc.

The development of a regulatory system for the MFIs focuses on three stages. They are as follows:

**Stage one** - to make the MFIs appreciate the need for certain common performance standards,

**stage two** - making it mandatory for the MFIs to get registered with identified or designated institutions and

**stage three** - to encourage development of network of MFIs which could function as quasi Self-Regulatory Organizations (SROs) at a later date or identifying a suitable organisation to handle the regulatory arrangements.

2.6.15 COMMITTEE RECOMMENDATIONS

The Advisory Committee recommended that while the MFIs may continue to work as wholesalers of micro Credit by collaborating with banks and apex development institutions, more experimentation need be done to assure the sustainability of the MFI model. Such experimentation needs to be encouraged in areas where banks are still not meeting adequate credit demand of the rural poor.

In regard to offering thrift products, the Committee felt that, while the NGO-MFIs can continue to extend micro credit services to their clients, they could play an important role in facilitating access of their clients to savings services from the regulated banks.

As regards allowing NGO-MFIs to access deposits from public / clients, the Committee considers that in view of the need to protect the interests of depositors, they may not be permitted to accept public deposits unless they comply with the extant regulatory framework of the Reserve Bank of India. As no depositors' interest
is involved where they do not accept public deposits, the Reserve Bank of India need not regulate MFIs. As regards the high interest rates being charged by the MFIs, the Committee felt that the lenders to MFIs may ensure that these institutions adopt a ‘cost-plus- reasonable-margin’ approach in determining the rates of interest on loans to clients.

2.6.16 MODELS OF MICROFINANCE/ MICROCREDIT LENDING

In Indian context the two microfinance approaches have been experimented with. One is the SHG-Bank linkage approach and the other is the Grameen approach.

Table No.2.8
Features of Microfinance Approaches

<table>
<thead>
<tr>
<th>Features</th>
<th>SHG</th>
<th>GRAMEEN</th>
<th>INDIVIDUAL BANKING</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clients</td>
<td>Primarily women</td>
<td>Primarily women</td>
<td>Primarily men</td>
</tr>
<tr>
<td>Groups</td>
<td>15-20 clients per group</td>
<td>Usually 5 clients per group (organised into centres of 4-6 groups)</td>
<td>Individual clients</td>
</tr>
<tr>
<td>Services</td>
<td>Savings and credit</td>
<td>Credit-regular cycle</td>
<td>Credit</td>
</tr>
<tr>
<td>Role of MFI staff</td>
<td>Guide and facilitate</td>
<td>Organise (groups dependent on staff)</td>
<td>Organise</td>
</tr>
<tr>
<td>Meetings</td>
<td>Monthly</td>
<td>Weekly</td>
<td>Individual transactions — often daily</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>Rs 20-100 / month</td>
<td>Rs 5-25/week</td>
<td>Flexible</td>
</tr>
<tr>
<td>Interest on savings</td>
<td>Bank rate (4.25 %) + profit share</td>
<td>6-9 per cent</td>
<td>6 per cent +</td>
</tr>
<tr>
<td>Initial loan amount</td>
<td>Rs 5-10,000</td>
<td>Rs 2-5000</td>
<td>Rs 5-15000</td>
</tr>
<tr>
<td>Effective interest rate</td>
<td>24-28 per cent</td>
<td>32-38 per cent</td>
<td>23-38 per cent</td>
</tr>
<tr>
<td>Insurance</td>
<td>Sometimes loans linked to health and life insurance</td>
<td>Sometimes loans linked to health and life insurance</td>
<td>Sometimes loans linked to health and life insurance</td>
</tr>
<tr>
<td>Development Services</td>
<td>Some associated programmes</td>
<td>Small social projects</td>
<td>Enterprise support</td>
</tr>
</tbody>
</table>

Source: Adapted from Sinha (2005)
These are designed to combine the safety and reliability of formal finance with the convenience and flexibility of informal finance. A detailed description of three approaches — including the individual banking component — is given in Table 2.8 above.

The progress of microfinance so far has been modest. A notional estimate of the poor benefiting from it is 5 per cent at the all-India level, as compared with 65 per cent in Bangladesh. Of the two approaches, the SHG Bank Linkage dominates the MFI model in scale and outreach.

Microfinance institutions are using various Credit Lending Models throughout the world. Some of the models are listed below.

**i. Associations**

This is where the target community forms an 'association' through which various microfinance (and other) activities are initiated. Such activities may include savings. Associations or groups can be composed of youth, or women; they can form around political/religious/cultural issues; can create support structures for microenterprises and other work-based issues.

In some countries, an 'association' can be a legal body that has certain advantages such as collection of fees, insurance, tax breaks and other protective measures.

Distinction is made between associations, community groups, peoples organizations, etc. on one hand (which are mass, community based) and NGOs, etc. which are essentially external organizations.

**ii. Bank Guarantees**

As the name suggests, a bank guarantee is used to obtain a loan from a commercial bank. This guarantee may be arranged externally (through a donor/donation,
government agency etc.) or internally (using member savings). Loans obtained may be given directly to an individual, or they may be given to a self-formed group. Bank Guarantee is a form of capital guarantee scheme. Guaranteed funds may be used for various purposes, including loan recovery and insurance claims. Several international and UN organizations have been creating international guarantee funds that banks and NGOs can subscribe to, to on lend or start microcredit programmes.

### iii. Community Banking

The Community Banking model essentially treats the whole community as one unit, and establishes semi-formal or formal institutions through which microfinance is dispensed. Such institutions are usually formed by extensive help from NGOs and other organizations, who also train the community members in various financial activities of the community bank. These institutions may have savings components and other income-generating projects included in their structure. In many cases, community banks are also part of larger community development programmes which use finance as an inducement for action.

### iv. Cooperatives

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. Some cooperatives include member-financing and savings activities in their mandate.

### v. Credit Unions

A credit union is a unique member-driven, self-help financial institution. It is organized by and comprised of members of a particular group or organization, who agree to save their money together and to make loans to each other at reasonable rates of interest. The members are people of some common bond: working for the same
employer; belonging to the same church, labor union, social fraternity, etc.; or living/working in the same community. A credit union's membership is open to all who belong to the group, regardless of race, religion, color or creed.

A credit union is a democratic, not-for-profit financial cooperative. Each is owned and governed by its members, with members having a vote in the election of directors and committee representatives.

**vi. Grameen**

The Grameen model emerged from the poor-focussed grassroots institution, Grameen Bank, started by Prof. Mohammed Yunus in Bangladesh. It essentially adopts the following methodology:

A bank unit is set up with a Field Manager and a number of bank workers, covering an area of about 15 to 22 villages. The manager and workers start by visiting villages to familiarise themselves with the local milieu in which they will be operating and identify prospective clientele, as well as explain the purpose, functions, and mode of operation of the bank to the local population. Groups of five prospective borrowers are formed; in the first stage, only two of them are eligible for, and receive, a loan. The group is observed for a month to see if the members are conforming to rules of the bank. Only if the first two borrowers repay the principal plus interest over a period of fifty weeks do other members of the group become eligible themselves for a loan. Because of these restrictions, there is substantial group pressure to keep individual records clear. In this sense, collective responsibility of the group serves as collateral on the loan.
vii. **Group**

The Group Model's basic philosophy lies in the fact that shortcomings and weaknesses at the individual level are overcome by the collective responsibility and security afforded by the formation of a group of such individuals.

The collective coming together of individual members is used for a number of purposes: educating and awareness building, collective bargaining power, peer pressure etc.

viii. **Individual**

This is a straightforward credit lending model where micro loans are given directly to the borrower. It does not include the formation of groups, or generating peer pressures to ensure repayment. The individual model is, in many cases, a part of a larger 'credit plus' programme, where other socio-economic services such as skill development, education, and other outreach services are provided.

ix. **Intermediaries**

Intermediary model of credit lending position is a 'go-between' organization between the lenders and borrowers. The intermediary plays a critical role of generating credit awareness and education among the borrowers (including, in some cases, starting savings programmes. These activities are geared towards raising the 'credit worthiness' of the borrowers to a level sufficient enough to make them attractive to the lenders.

The links developed by the intermediaries could cover funding, programme links, training and education, and research. Such activities can take place at various levels from international and national to regional, local and individual levels.
Intermediaries could be individual lenders, NGOs, microenterprise/microcredit programmes, and commercial banks (for government financed programmes). Lenders could be government agencies, commercial banks, international donors, etc.

x. Non-Governmental Organizations

NGOs have emerged as a key player in the field of microcredit. They have played the role of intermediary in various dimensions. NGOs have been active in starting and participating in microcredit programmes. This includes creating awareness of the importance of microcredit within the community, as well as various national and international donor agencies.

They have developed resources and tools for communities and microcredit organizations to monitor progress and identify good practices. They have also created opportunities to learn about the principles and practice of microcredit. This includes publications, workshops and seminars, and training programmes.

xi. Peer Pressure

Peer pressure uses moral and other linkages between borrowers and project participants to ensure participation and repayment in microcredit programmes. Peers could be other members in a borrowers group (where, unless the initial borrowers in a group repay, the other members do not receive loans. Hence pressure is put on the initial members to repay); community leaders (usually identified, nurtured and trained by external NGOs); NGOs themselves and their field officers; banks etc. The 'pressure' applied can be in the form of frequent visits to the defaulter, community meetings where they are identified and requested to comply etc.
Rotating Savings and Credit Associations (ROSCAs) are essentially a group of individuals who come together and make regular cyclical contributions to a common fund, which is then given as a lump sum to one member in each cycle. For example, a group of 12 persons may contribute Rs. 100 (US$33) per month for 12 months. The Rs. 1,200 collected each month is given to one member. Thus, a member will 'lend' money to other members through his regular monthly contributions. After having received the lump sum amount when it is his turn (i.e. 'borrow' from the group), he then pays back the amount in regular/further monthly contributions. Deciding who receives the lump sum is done by consensus, by lottery, by bidding or other agreed methods.

Small Business

The prevailing vision of the 'informal sector' is one of survival, low productivity and very little value added. But this has been changing, as more and more importance is placed on small and medium enterprises (SMEs) - for generating employment, for increasing income and providing services which are lacking.

Policies have generally focussed on direct interventions in the form of supporting systems such as training, technical advice, management principles etc.; and indirect interventions in the form of an enabling policy and market environment.

A key component that is always incorporated as a sort of common denominator has been finance, specifically microcredit - in different forms and for different uses. Microcredit has been provided to SMEs directly, or as a part of a larger enterprise development programme, along with other inputs.
Village banks are community-based credit and savings associations. They typically consist of 25 to 50 low-income individuals who are seeking to improve their lives through self-employment activities. Initial loan capital for the village bank may come from an external source, but the members themselves run the bank: they choose their members, elect their own officers, establish their own by-laws, distribute loans to individuals, and collect payments and savings. Their loans are backed, not by goods or property, but by moral collateral: the promise that the group stands behind each individual loan.

2.7 SUMMITS AND MEETINGS ON MICROFINANCE

Officially, the intervention of microfinance has been heralded world-wide as the best cure for poverty. A series of meetings and summits have been held over the last few years, to design an approach that can be followed by all countries across the globe. The meetings worked towards contributing inputs for the World Micro-Credit Summit Campaign held in February 1997. The South Indian Consultation was held in Hyderabad, India on, 23-24 August 1996. A meeting of 20 practitioner NGOs, development financial institutions and development professionals arrived at a common position and action plan. The Dhaka Declaration of the South Asian Coalition for the Micro-credit Summit articulates the collective consensus among 21 networks and agencies delivering financial services to over 4.5 million poor people across Bangladesh, India, Nepal and Pakistan. It endorsed the importance of microcredit and emphasised that microcredit should be approached as a socially responsible business. Prior to the Washington Summit, a group of NGOs and development finance institutions met in New Delhi on 23, January, 1997. The objective was to review the progress made and to discuss modifications to the draft documents released by the Summit Secretariat in November 1996.
2.7.1 WORLD MICRO CREDIT SUMMIT

The World Micro Credit Summit was held in Washington DC in February 1997. More than 2,900 people representing 1,500 institutions from 137 countries participated in the Summit. The Summit announced a global target of supporting 100 million of the world’s poorest families, especially women, with micro credit for self-employment and other financial and business services by the year 2005. This Summit received impetus in the mid-1990s after the World Summit for Social Development in Copenhagen in March 1995. Four core themes were stressed as part of a 55-page Declaration and Plan of Action as follows:

- **Reaching the poorest:**
  1.2 billion people - some 240 million families – in the world are living in absolute poverty. This is the group that is targeted by the Microcredit Summit. The Summit promotes the use of quality poverty measurements to identify the poorest.

- **Reaching and empowering women:**
  Since women are supposed to be good credit risks, and women-run enterprises yield benefits for their families, micro credit is seen as a tool to empower women.

- **Building financially self-sufficient institutions:**
  This theme is based on the experience of developing countries which have shown that micro credit programs can improve their efficiency and structure their interest rates and fees to eventually cover their operating and financial costs. The Campaign offered daylong courses at global and regional meetings held from 1999 through 2001, which trained practitioners in this regard.

- **Ensuring a positive, measurable impact on the lives of clients and their families:**
  Two impact evaluation studies conducted by an NGO, Freedom From Hunger, showed that current clients of its affiliate institutions in Honduras and Mali had
experienced positive program impact at the individual, household and community levels. The studies showed the higher levels of empowerment of client households as compared to non-client households in terms of larger enterprises, increases in personal income and household food consumption, savings and a feeling of self-esteem.

These four core themes of the Summit Campaign have been used widely as guidelines by practitioners in this sector. After the 1997 Washington Summit, by December 1999 more than 1600 micro credit institutions joined the Summit’s Council of practitioners. In doing so each institution had endorsed the Summit goals and agreed to submit an Action Plan within one year of joining the council. In November 1999, Institutional Action Plan grids were mailed for the year 2000 to the 1,600 institutions. In India the All India Women’s Conference was designated to collect data for this survey.

All practitioner-Action Plans submitted were reviewed by the Summit staff. In an effort to verify the data, the fifty largest institutions in Africa, Asia, and Latin America were asked to identify donor agencies, research organizations and networks that could take up this task. The survey findings from the larger survey of 1,065 micro credit institutions and from the survey of those institutions whose data has been verified are as follows:

- During the two-year period from, Jan 1, 1998 to December 31, 1999, there was an increase of 82 percent more in the number of poorest clients. The numbers increased from 7.6 million at the end of 1997, to 13.8 million at the end of 1999. A total of 512 programs reported a 16 percent increase in the number of poorest women reached during January 1, to December 31, 1999, which meant an increase of 1.4 million women belonging to the poorest groups.

- Two-thirds of the 512 institutions reporting for the year January 1, 1999 to December 31, 1999, used a poverty measurement tool other than an estimate. Of this
group 102 institutions report using one of the two tools from the Microcredit Summit Campaign’s Poverty Measurement Tool Kit (PMTK). The first two measurements included in the PMTK were the CASPHOR House Index for use in rural Asia and the Participatory Wealth Ranking. This tool kit is supposed to aid institutions in assessing the poverty levels of the clients they serve.

2.8 WOMEN AND MICROFINANCE

According to the State of the Microcredit Summit Campaign 2001 Report, 14.2 million of the world’s poorest women now have access to financial services through specialized microfinance institutions (MFIs), banks, NGOs, and other non-bank financial institutions. These women account for nearly 74 percent of the 19.3 million of the world’s poorest people now being served by microfinance institutions. Most of these women have access to credit to invest in businesses that they own and operate themselves. The vast majority of them have excellent repayment records, in spite of the daily hardships they face. Contrary to conventional wisdom, they have shown that it is a very good idea to lend to the poor and to women.

Loans under micro–finance programs are very small, on an average less than $100 by world standards and in hundreds of rupees by Indian standards. Micro–finance continues to target the rural and urban households, with emphasis on women borrowers, provision of finance for creation of assets and their maintenance and bringing in greater quality of services. The beneficiaries are identified by micro–finance providers themselves independently or through NGOs/Self Help Groups and the repayment period is generally very short. The amount is increased based on the borrower’s repayment history. Micro–finance is a novel approach of banking with poor with the distinct advantages of high repayments of loans and low transaction cost. Various micro–finance initiatives have gathered pace in the recent years. In the Indian context, towards spread of micro–finance, NABARD’s role has been twofold, viz., promotional and financial. Promotional efforts assume the form of the SHG –
Bank Linkage programme and facilitating training. Financial involvement is in terms of providing refinance, revolving fund assistance and grants.

Over the last decade micro finance has become an accepted institutional framework for taking financial services to the poor. Micro finance has now evolved into a type of independent financial system of its own and there are a number of variants in micro finance institutions and systems. But broadly they can be classified into two—the individual approach and the group approach. An example of the group approach, where the group itself, not the individual member, is the client, is the Self-Help Group program in India.
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