CHAPTER 1
INTRODUCTION
1.1 Microfinance background & History in world

Over the past centuries, practical visionaries, from the Franciscan monks who founded the community-oriented pawnshops of the 15th century to the founders of the European credit union movement in the 19th century (such as Friedrich Wilhelm Raiffeisen) and the founders of the microcredit movement in the 1970s (such as Muhammad Yunus and Al Whittaker), have tested practices and built institutions designed to bring the kinds of opportunities and risk-management tools that financial services can provide to the doorsteps of poor people. While the success of the Grameen Bank (which now serves over 7 million poor Bangladeshi women) has inspired the world, it has proved difficult to replicate this success. In nations with lower population densities, meeting the operating costs of a retail branch by serving nearby customers has proven considerably more challenging. Hans Dieter Seibel, board member of the European Microfinance Platform, is in favour of the group model. This particular model (used by many Microfinance institutions) makes financial sense, he says, because it reduces transaction costs. Microfinance programmes also need to be based on local funds.

The history of microfinancing can be traced back as far as the middle of the 1800s, when the theorist Lysander Spooner was writing about the benefits of small credits to entrepreneurs and farmers as a way of getting the people out of poverty. Independently of Spooner, Friedrich Wilhelm Raiffeisen founded the first cooperative lending banks to support farmers in rural Germany.

The modern use of the expression "microfinancing" has roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Muhammad Yunus, were starting and shaping the modern industry of microfinancing. Another pioneer in this sector is Akhtar Hameed Khan.

1.2 In India, The evolution of Indian MF can be broadly divided into four distinct phases:

Phase 1: The cooperative movement (1900-1960)

During this phase, credit cooperatives were vehicles to extend subsidized credit to villages under government sponsorship.

Phase 2: Subsidized social banking (1960s – 1990)

With failure of cooperatives, Government focused on measures such as nationalization of Banks, expansion of rural branch networks, establishment of Regional Rural Banks (RRBs) and the setting up of apex institutions such as the National Bank for Agriculture and Rural
Development (NABARD) and the Small Scale Industries Development Bank of India (SIDBI), including initiation of a government sponsored Integrated Rural Development Programme (IRDP). While these steps led to reaching a large population, the period was characterized by large-scale misuse of credit, creating a negative perception about the credibility of micro borrowers among bankers, thus further hindering access to banking services for the low-income people.


The failure of subsidized social banking triggered a paradigm shift in delivery of rural credit with NABARD initiating the Self Help Group (SHG) Bank Linkage Programme (SBLP), aiming to link informal women's groups to formal banks. The program helped increase banking system outreach to otherwise unreached people and initiate a change in the bank’s outlook towards low-income families from ‘beneficiaries’ to ‘customers’. This period was thus marked by the extension of credit at market rates. The model generated a lot of interest among newly emerging Microfinance Institutions (MFIs), largely of non-profit origin, to collaborate with NABARD under this program. The macroeconomic crisis in the early 1990s that led to introduction of the Economic Reforms of 1991 resulted in greater autonomy to the financial sector. This also led to emergence of new generation private sector banks that would become important players in the microfinance sector a decade later.

Phase 4: Commercialization of Microfinance: The first decade of the new millennium

Post reforms, rural markets emerged as the new growth drivers for MFIs and banks, the latter taking interest in the sector not only as part of their corporate social responsibility but also as a new business line. On the demand side, NGO-MFIs increasingly began transforming themselves into more regulated legal entities such as NBFCs to attract commercial investment. MFIs set up after 2000 saw themselves less in the developmental mould and more as businesses in the financial services space, catering to an untapped market segment while creating value for their shareholders. This overriding shift brought about changes in institutions' legal forms, capital structures, sources of funds, growth strategies and strategic alliances.

The MF sector as it exists today essentially consists of two predominant delivery models – the SBLP and MFIs. In the financial year 2007-08, MF in India through SBLP (21 million clients) and MFIs (14 million clients) served over 33 million clients, up by 9 million over the previous financial year. By 31st March 2008, the outstanding micro-credit portfolio of India
MF was about US$ 4.4 bn, 75% are accounted for by SBLP, 20% by large MFIs and 5% by medium and small MFIs. However, approximately 90 million low income households remain under-served. Four out of five MF clients in India are women.

In India institutional credit agencies (banks) made an entry in rural areas initially to provide an alternative to the rural money lenders who provided credit support, but not without exploiting the rural poor. There are 3 main factors that count to the bringing up of Microfinance as a Policy in India:–

1. The first of these events was Indira Gandhi’s bank nationalization drive launched in 1969 which required commercial banks to open rural branches resulting in a 15.2% increase in rural bank branches in India between 1973 and 1985. Today, India has over 32,000 rural branches of commercial banks and regional rural banks, 14,000 cooperative bank branches.

2. The second national policy that has had a significant impact on the evolution of India’s banking and financial system is the Integrated Rural Development Program (IRDP) introduced in 1978 and designed to be ‘a direct instrument for attacking India’s rural poverty.’ This program is interesting to this study because it was a large program whose main thrust was to alleviate poverty through the provision of loans and it was considered a failure.

3. The last major event which impacted the financial and banking system in India was the liberalization of India’s financial system in the 1990s characterized by a series of structural adjustments and financial policy reforms initiated by the Reserve Bank of India (RBI).

The systems and procedures of banking institutions was emphasizing on complicated qualifying requirements, tangible collateral, margin, etc., that resulted in a large section of the rural poor shying away from the formal banking sector. The banks too experienced that the rapid expansion of branch network was not contributing to an increasing volume of business to meet high transaction costs and risk provisioning, which even threatened the viability of banking institutions and sustainability of their operations.

At the same time, it was not possible for them to allow a population of close to 300 million - even if poor - to remain outside the fold of its business. The search for an alternative mechanism for catering to the financial service needs of the poor was thus becoming imperative.

Many credit groups have been operating in many countries for several years, for example, the "chit funds" (India), tontines (West Africa), "susus" (Ghana), "pasanaku" (Bolivia) etc. Besides, many formal saving and credit institutions have been working for a long time throughout the world. During the early and mid 1990s various credit institutions had been
formed in Europe by some organized poor people from both the rural and urban areas. These institutions were named Credit Unions, People's Bank etc. The main aim of these institutions were to provide easy access to credit to the poor people who were neglected by the big financial institutions and banks. In the early 1970s, few experimental programs had started. The poor people had been given some small loans to invest in micro-business. This kind of microcredit was given on the basis of solidarity group lending, that is, each and every member of that group guaranteed the repayment of the loan of all the members.

Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women’s Association (“SEWA”) of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganised sector in Ahmedabad City, Gujarat. The microfinance sector went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. From humble beginnings, the sector has grown significantly over the years to become a multi-billion dollar industry, with bodies such as the Small Industries Development Bank of India and the National Bank for Agriculture and Rural Development devoting significant financial resources to microfinance. Today, the top five private sector MFIs reach more than 20 million clients in nearly every state in India and many Indian MFIs have been recognized as global leaders in the industry.

India's GDP ranks among the top 15 economies of the world. However, around 300 million people or about 60 million households, are living below the poverty line. It is further estimated that of these households, only about 20 percent have access to credit from the formal sector. Additionally, the segment of the rural population above the poverty line but not rich enough to be of interest to the formal financial institutions also does not have good access to the formal financial intermediary services, including savings services.

A group of micro-finance practitioners estimated the annualised credit usage of all poor families (rural and urban) at over Rs 45,000 crores, of which some 80 percent is met by informal sources. This figure has been extrapolated using the numbers of rural and urban poor households and their average annual credit usage (Rs 6000 and Rs 9000 per annum respectively) assessed through various micro studies.
1.3 Microfinance Defined

Microfinance can be defined as any activity that includes the provision of financial services such as credit, savings, and insurance to low-income individuals which fall just above the nationally defined poverty line, and poor individuals which fall below that poverty line, with the goal of creating social value. The creation of social value includes poverty alleviation and the broader impact of improving livelihood opportunities through the provision of capital for micro enterprise, and insurance and savings for risk mitigation and consumption smoothing.

So, Microfinance is the provision of broad range of financial services such as deposits, loans, payment services, money transfers and insurance to poor people and low income households and their micro enterprises. It is an effective tool for making the banking services accessible to the rural unbanked areas. Improved access and efficient provision of savings, credit and insurance facilities would enable the poor to set up micro enterprise, build up economic assets, manage the risks better and enhance income earning capacity and resultantly improve their standard of living.

**Microfinance** is usually understood to entail the provision of financial services to micro-entrepreneurs and small businesses that lack access to banking and related services due to the high transaction costs associated with serving these client categories. The two main mechanisms for the delivery of financial services to such clients are (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group.

In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking.

For some, microfinance is a movement whose object is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers." Many of those who promote microfinance generally believe that such access will help poor people out of poverty. For others, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Although microcredit is one of the aspects of
microfinance, conflation of the two terms is endemic in public discourse. Critics often attack microcredit while referring to it indiscriminately as either 'microcredit' or 'microfinance'. Due to the broad range of microfinance services, it is difficult to assess impact, and very few studies have tried to assess its full impact. Proponents often claim that microfinance lifts people out of poverty, but the evidence is mixed. What it does do, however, is to enhance financial inclusion.

1.4 Role of microfinance

Traditionally, banks have not provided financial services, such as loans, to clients with little or no cash income. Banks incur substantial costs to manage a client account, regardless of how small the sums of money involved are. For example, although the total gross revenue from delivering one hundred loans worth $1,000 each will not differ greatly from the revenue that results from delivering one loan of $100,000, it takes nearly a hundred times as much work and cost to manage a hundred loans as it does to manage one. The fixed cost of processing loans of any size is considerable as several things—assessment of potential borrowers, their repayment prospects and security; administration of outstanding loans, collecting from delinquent borrowers, etc.—have to be done in all cases. There is a break-even point in providing loans or deposits below which banks lose money on each transaction they make. Poor people usually fall below that breakeven point. A similar calculation resists efforts to deliver other financial services to poor people.

In addition, most poor people have few assets that can be secured by a bank as collateral. As documented extensively by Hernando de Soto and others, even if they happen to own land in the developing world, they may not have effective title to it. This means that the bank will have little recourse against defaulting borrowers.

Seen from a broader perspective, the development of a healthy national financial system has long been viewed as a catalyst for the broader goal of national economic development (see for example Alexander Gerschenkron, Paul Rosenstein-Rodan, Joseph Schumpeter, Anne Krueger). However, the efforts of national planners and experts to develop financial services for most people have often failed in developing countries.

Because of these difficulties, when poor people borrow they often rely on relatives or a local moneylender, whose interest rates can be very high. An analysis of 28 studies of informal moneylending rates in 14 countries in Asia, Latin America and Africa concluded that 76% of moneylender rates exceed 10% per month, including 22% that exceeded 100% per month.
Moneylenders usually charge higher rates to poorer borrowers than to less poor ones. While moneylenders are often demonized and accused of usury, their services are convenient and fast, and they can be very flexible when borrowers run into problems. Hopes of quickly putting them out of business have proven unrealistic, even in places where microfinance institutions are active.

several types of needs

- Lifecycle Needs: such as weddings, funerals, childbirth, education, homebuilding, widowhood and old age.
- Personal Emergencies: such as sickness, injury, unemployment, theft, harassment or death.
- Disasters: such as fires, floods, cyclones and man-made events like war or bulldozing of dwellings.
- Investment Opportunities: expanding a business, buying land or equipment, improving housing, securing a job (which often requires paying a large bribe), etc.

Poor people find creative and often collaborative ways to meet these needs, primarily through creating and exchanging different forms of non-cash value. Common substitutes for cash vary from country to country but typically include livestock, grains, jewellery and precious metals.

The obstacles or challenges to building a sound commercial microfinance industry include:

- Inappropriate donor subsidies
- Poor regulation and supervision of deposit-taking MFIs
- Few MFIs that meet the needs for savings, remittances or insurance
- Limited management capacity in MFIs
- Institutional inefficiencies
- Need for more dissemination and adoption of rural, agricultural microfinance methodologies

The proposed Microfinance Services Regulation Bill defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for :
i. an amount, not exceeding rupees fifty thousand in aggregate per individual, for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual) or

ii. an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing purposes, or

iii. such other amounts, for any of the purposes mentioned at items (i) and (ii) above or other purposes, as may be prescribed.”

The proposed regulations further define an MFI as “an organisation or association of individuals including the following if it is established for the purpose of carrying on the business of extending microfinance services:

i. a society registered under the Societies Registration Act, 1860,

ii. a trust created under the Indian Trust Act, 1880 or public trust registered under any State enactment governing trust or public, religious or charitable purposes,

iii. a cooperative society / mutual benefit society / mutually aided society registered under any State enactment relating to such societies or any multistate cooperative society registered under the Multi State Cooperative Societies Act, 2002 but not including:

- a cooperative bank as defined in clause (cci) of section 5 of the Banking Regulation Act, 1949 or
- a cooperative society engaged in agricultural operations or industrial activity or purchase or sale of any goods and services.”

India is a country of villages even today but on account of lack of infrastructure resulting in lack of opportunities for the population migration of youth continues unabated. The urban centers are getting flooded with masses. To stop this migration we have to provide opportunities to underprivileged people of rural areas. Microfinance is a major tool available to create opportunities and help people to raise their quality of life. Although this fact is well established and understood the approach taken to achieve is yet to prove itself and hence despite huge money being made available for these projects success is nowhere visible. The business correspondent and business facilitator model envisioned by RBI and commercial banks needs major revamp.

In the development paradigm, microfinance has evolved as a need-based policy and programme to cater to the so far neglected target groups (women, poor, rural, deprived, etc.). Its evolution is based on the concern of all developing countries for empowerment of the poor and the alleviation of poverty. Development organizations and policy makers have included
access to credit for poor people as a major aspect of many poverty alleviation programmes. Micro-finance programmes have, in the recent past, become one of the most promising ways to use scarce development funds to achieve the objectives of poverty alleviation. Furthermore, certain micro-finance programmes have gained prominence in the development field and beyond. The basic idea of micro-finance is simple: if poor people are provided access to financial services, including credit, they may very well be able to start or expand a micro-enterprise that will allow them to break out of poverty. Thus, micro-finance has become one of the most effective interventions for economic empowerment of the poor.

Microfinance is the supply of loans, savings and other financial services to the poor. The term —micro is in reference to the small amounts typically involved in the practice. These services are small micro because a person who does not have a lot of money most likely will not need a loan of several thousand rupees. However, a loan of a few hundred rupees may make a huge difference in their lives, giving them the ability to purchase livestock for a small farm, a sewing machine to help make accessories and clothes, or supplies for a small store.

The poor throughout the developing world frequently are not part of the formal employment sector. They may operate small businesses, work on small farms or work for themselves or others in a variety of businesses. Many start their own —micro businesses, or small businesses, out of necessity, because of the lack of jobs available.

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 micro enterprise 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’- Marguerite S. Robinson. India puts stress on providing financial services to the poor and underprivileged since independence.

The commercial banks were nationalized in 1969 and were directed to lend 40% of their loanable funds, at a concessional rate, to the priority sector. The priority sector included agriculture and other rural activities and the weaker strata of society in general. The aim was to provide resources to help the poor to attain self sufficiency. They had neither resources nor employment opportunities to be financially independent, let alone meet the minimal consumption needs. To supplement these efforts, the credit scheme Integrated Rural Development Programme (IRDP) was launched in 1980. But these supply side programs
(ignoring the demand side of the economy) aided by corruption and leakages, achieved little. Further, the share of the formal financial sector in total rural credit was 56.6%, compared to informal finance at 39.6% and unspecified sources at 3.8%. [RBI 1992]. Not only had formal credit flow been less but also uneven. The collateral and paperwork based system shied away from the poor.

The vacuum continued to be filled by the village moneylender who charged interest rates of 2 to 30% per month. 70% of landless/marginal farmers did not have a bank account and 87% had no access to credit from a formal source. It was in this cheerless background that the Microfinance Revolution occurred worldwide. In India it began in the 1980s with the formation of pockets of informal Self-help Groups (SHG) engaging in micro activities financed by Microfinance. But India’s first Microfinance Institution shri Mahila SEWA Sahkari Bank was set up as an urban co-operative bank, by the Self Employed Women’s Association (SEWA) soon after the group (founder Ms. Ela Bhatt) was formed in 1974.

The first official effort materialized under the direction of NABARD.(National Bank For Agriculture And Rural Development). The Mysore Resettlement and Development Agency (MYRADA) sponsored project on — Savings and Credit Management of SHGs was partially financed by NABARD during 1986-87. Section II: MFIs, Self Help Groups , Income Generation and Women Empowerment Under the microfinance programme, loans are extended to the ‘Self Help Groups (SHG)‘ who pool a part of their income into a common fund from which they can borrow. The members of the group decide on the minimum amount of deposit which ranges from Rs 20 to Rs 100 per month depending upon the size of the group. The group funds are deposited with a Micro Finance Institution (MFI) against which they usually lend (The deposits are usually placed with a bank by the MFI) at a credit deposit ratio of 4:1 but the ratio improves with account performance record i.e. prompt repayment of loans. The group fund is the way micro savings are enforced, though it may seem like collateral. The loan ticket sizes are usually Rs 2000/- to Rs 15,000/-. 

The MFIs stress on asset creation by the SHGs and extend loans for production and provides training for the same. If any member needs credit beyond the stipulated limits they are allowed to draw from group funds and the amount is settled in the periodic (monthly) group meetings. SHGs consisting of poor members with identical socioeconomic backgrounds are usually more sensitive to the credit needs of the poor. Though loan repayment is a joint liability of the group but, in reality, individual liability is stressed upon. Maintaining group reputation leads to the application of tremendous peer pressure.
Loans obtained from MFIs are utilized in agriculture and small businesses. Independent incomes and modest savings have made women self-confident and helped them to fight poverty and exploitation.

In India and other Asian countries the majority of SHGs consist of women because, in these countries, Self Employment through Microfinance was perceived as a powerful tool for emancipation of women. It has been observed that gender equality is a necessary condition for economic development. The World Bank reports that societies that discriminate on the basis of gender are in greater poverty, have slower economic growth, weaker governance, and lower living standards.

1.4 Micro-Finance Institutional Structure in India
The different organisations in this field can be classified as "Mainstream" and "Alternative" Micro Finance Institutions (MFI).

a. Mainstream Micro Finance Institutions
NABARD, Small Industries Development Bank of India (SIDBI), Housing Development Finance Corporation (HDFC), Commercial Banks, Regional Rural Banks (RRBs), the credit co-operative societies etc are some of the mainstream financial institutions involved in extending micro finance.

b. Alternative Micro Finance Institutions
These are the institutions, which have come up to fill the gap between the demand and supply for microfinance. MFIs were recently defined by the Task Force as "those which provide thrift, credit and other financial services and products of very small amounts, mainly to the poor, in rural, semi-urban or urban areas for enabling them to raise their income level and improve living standards."

The MFIs can broadly be classified as:
1. NGOs, which are mainly engaged in promoting self-help groups (SHGs) and their federations at a cluster level, and linking SHGs with banks, under the NABARD scheme.
2. NGOs directly lending to borrowers, who are either organised into SHGs or into Grameen Bank style groups and centres. These NGOs borrow bulk funds from RMK, SIDBI, FWWB and various donors.
3. MFIs which are specifically organised as cooperatives, such as the SEWA Bank and various Mutually Aided Cooperative Thrift and Credit Societies (MACTS) in AP.
4. MFIs, which are organised as non-banking finance companies, such as BASIX, CFTS, Mirzapur and SHARE Microfin Ltd.
1.5 The Problems Associated with Mainstream MFIs
To enable the reach of micro finance services to the needy, the problems associated with the legal, regulatory, organisational systems and the attitudes should be addressed to and the desired changes brought in these, to make them more effective.

1. Borrower Unfriendly Products and Procedures
With a majority of the customers being illiterate, and a majority of them needing consumption loans and a majority of them requiring high documentation and collateral security, the products are not reaching the rural poor.

2. Inflexibility and Delay
The rigid systems and procedures result in lot of time delay for the borrowers and demotivate them to take further loans.

3 High Transaction Costs, both Legitimate and Illegal
Although the interest rate offered to the borrowers is regulated, the transaction costs in terms of the number of trips to be made, the documents to be furnished etc. plus the illegal charges to be paid, result in increasing the cost of borrowing. Thus, making it less attractive to the borrowers.

4 Social Obligation and not a Business Opportunity
Micro-finance has historically been seen as a social obligation rather than a potential business opportunity.

1.6 Problems for Alternative Micro-Finance Institutions
The main aim with which the alternative MFIs have come up is to bridge the increasing gap between the demand and supply. A vast majority of them set up as NGOs for getting access to funds as, the existing practices of mainstream financing institutions such as SIDBI and NABARD, is to fund only NGOs, or NGO promoted SHGs. As a result, the largest incentive to enter such services remains through the non-profit route. The alternative finance institutions also have not been fully successful in reaching the needy. There are many reasons for this:

- Financial problems leading to setting up of inappropriate legal structures
- Lack of commercial orientation
- Lack of proper governance and accountability
- Isolated and scattered

The Government of India and the RBI have a stated goal of promoting financial inclusion. According to recent RBI estimat, there are over 450 million “unbanked people” in India, most of whom live in rural areas. The term “unbanked” refers to people who have no access to formal financial services, but rather must rely on either family, or informal providers of finance, such as the village moneylender. It is undisputed that access to finance is critical for
enabling individuals and communities to climb out of poverty. It is also generally agreed that relying on the limited resources of village moneylenders exposes the poor to coercive lending practices, personal risks and high interest rates, which can be a much as 150%

(i) The goal of financial inclusion must include the private sector. Therefore the Indian Government and the RBI have a policy of “financial inclusion”. As part of this policy, the government requires Indian banks to lend to “priority sectors”, one of which is the rural poor. Until recently, banks were happy to lend money to MFIs who would then on-lend funds, primarily to poor women across rural India. The banks have welcomed this policy because historically they tended to charge MFIs average interest rates of 12-13% and benefited from 100% repayment rates. Thus, by lending to MFIs, banks have been able to meet their “priority sector” lending requirements

(ii) currently being provided by three sectors: the government, the private sector and charities. These three sectors, as large as they are, have only a small fraction of the capital and geographic scale required to meet the overwhelming need for finance amongst India’s rural poor.

The top 10 private sector microfinance providers in India together serve less than 5% of the unbanked population of India – approximately 20 million clients. For example, SHARE Microfin Limited (“SHARE”) and Asmitha Microfin Limited (“Asmitha”), two of the five largest MFIs in India, have almost Rs 4,000 crore ($900MM) loaned to over 5 million poor women in 18 Indian states (prior to the crisis, the combined outstanding loan portfolio had been as high as Rs 6,750 crore ($1.525BN)). Yet, despite the size of MFIs like SHARE and Asmitha, only a fraction of the overwhelming need is being met.

Private sector MFIs have an essential role to play if the goal of financial inclusion is to be realized, as neither the government nor charities have the capital nor business model required to meet the insatiable demand for finance in rural India. As the public listing of SKS Microfinance underscored, private sector institutions are able to attract increasingly large amounts of private capital, in order to accelerate the growth of the industry, which is essential to expanding financial inclusion as far.

1.7 MFIs go for NBFC licences

An increasing number of microfinance institutions (MFIs) are seeking non-banking finance company (NBFC) status from RBI to get wide access to funding, including bank finance.

1. Exemptions granted to NBFCs engaged in microfinance activities
The Task Force on Supportive Policy and Regulatory Framework for Microfinance setup by NABARD in 1999 provided various recommendations. Accordingly, it was decided to exempt NBFCs which are engaged in micro financing activities, licensed under Section 25 of the Companies Act, 1956, and which do not accept public deposits, from the purview of Sections 45-IA (registration), 45-IB (maintenance of liquid assets) and 45-IC (transfer of profits to the Reserve Fund) of the RBI Act, 1934.

2. MFI’s & SHG-Bank linkage programme

In a joint fact-finding study on microfinance conducted by the Reserve Bank of India and a few major banks, the following observations were made:

- Some of the microfinance institutions (MFIs) financed by banks or acting as their intermediaries or partners appear to be focusing on relatively better banked areas, including areas covered by the SHG-Bank linkage programme. Competing MFIs were operating in the same area, and trying to reach out to the same set of poor, resulting in multiple lending and overburdening of rural households.

- Many MFIs supported by banks were not engaging themselves in capacity building and empowerment of the groups to the desired extent. The MFIs were disbursing loans to the newly formed groups within 10–15 days of their formation, in contrast to the practice

3. Obtaining in the SHG – Bank linkage programme, which takes about six to seven months for group formation and nurturing. As a result, cohesiveness and a sense of purpose were not being built up in the groups formed by these MFIs.

- Banks, as principal financiers of MFIs, do not appear to be engaging them with regard to their systems, practices and lending policies with a view to ensuring better transparency and adherence to best practices. In many cases, no review of MFI operations were undertaken after sanctioning the credit facility.

3. RBI relaxes norms for NBFCs

NBFCs registered with the Reserve Bank of India may take part in the insurance agency business on a fee basis and without risk participation or the need to seek the bank's approval.
In a notification issued, the RBI said such NBFCs should obtain permission from the Insurance Regulatory and Development Authority and comply with IRDA regulations for acting as a "composite corporate agent" with insurance companies.

1.8 Microfinance standards and principles

Some principles that summarize a century and a half of development practice were encapsulated in 2004 by CGAP and endorsed by the Group of Eight leaders at the G8 Summit on June 10, 2004:

1. Poor people need not just loans but also savings, insurance and money transfer services.
2. Microfinance must be useful to poor households: helping them raise income, build up assets and/or cushion themselves against external shocks.
3. "Microfinance can pay for itself." Subsidies from donors and government are scarce and uncertain and so, to reach large numbers of poor people, microfinance must pay for itself.
4. Microfinance means building permanent local institutions.
5. Microfinance also means integrating the financial needs of poor people into a country's mainstream financial system.
6. "The job of government is to enable financial services, not to provide them."
7. "Donor funds should complement private capital, not compete with it."
8. "The key bottleneck is the shortage of strong institutions and managers." Donors should focus on capacity building.
9. Interest rate ceilings hurt poor people by preventing microfinance institutions from covering their costs, which chokes off the supply of credit.
10. Microfinance institutions should measure and disclose their performance—both financially and socially.

Microfinance is considered as a tool for socio-economic development, and can be clearly distinguished from charity. Families who are destitute, or so poor they are unlikely to be able to generate the cash flow required to repay a loan, should be recipients of charity. Others are best served by financial institutions.
1.9 Microfinance and social interventions

There are currently a few social interventions that have been combined with micro financing to increase awareness of HIV/AIDS. Such interventions like the "Intervention with Microfinance for AIDS and Gender Equity" (IMAGE) which incorporates microfinancing with "The Sisters-for-Life" program a participatory program that educates on different gender roles, gender-based violence, and HIV/AIDS infections to strengthen the communication skills and leadership of women "The Sisters-for-Life" program has two phases where phase one consists of ten one-hour training programs with a facilitator with phase two consisting of identifying a leader amongst the group, train them further, and allow them to implement an Action Plan to their respective centres.

Microfinance has also been combined with business education and with other packages of health interventions. A project undertaken in Peru by Innovations for Poverty Action found that those borrowers randomly selected to receive financial training as part of their borrowing group meetings had higher profits, although there was not a reduction in "the proportion who reported having problems in their business".

Types of MF Providers

The different legal forms under which MF can be provided in India are:

- Commercial Banks
- Cooperative Banks
- Regional Rural Banks (RRBs)
- Local Area Banks (LABs)
- Cooperative Societies, SHGs and Federations
- Societies
- Trusts
- Section 25 (Not-for-Profit) companies
- Non-Banking Finance Companies (NBFCs)
- Organizations under Business Facilitator/Business Correspondent guidelines of the Reserve Bank of India
Among these, the MFIs can either take up the form of a Society, Trust, Co-operative Society, Section 25 Company or NBFC. However, estimates have put it anywhere between 800 and 1,200. The overwhelming majority of MFIs are societies and trusts, followed by cooperative and section 25 companies. Among the large MFIs, most are NBFCs. It is estimated that top 20 MFIs account for 80% of the total portfolio.

According to CGAP, "Comprehensive impact studies have demonstrated that:

- Microfinance helps very poor households meet basic needs and protect against risks
- The use of financial services by low-income households is associated with improvements in household economic welfare and enterprise stability or growth;
- By supporting women's economic participation, microfinance helps to empower women, thus promoting gender-equity and improving household well-being;
- For almost all significant impacts, the magnitude of impact is positively related to the length of time that clients have been in the program." (UNCDF Microfinance)

Poor people, with access to savings, credit, insurance, and other financial services, are more resilient and better able to cope with the everyday crises they face. Even the most rigorous econometric studies have proven that microfinance can smooth consumption levels and significantly reduce the need to sell assets to meet basic needs. With access to microinsurance, poor people can cope with sudden increased expenses associated with death, serious illness, and loss of assets.

Access to credit allows poor people to take advantage of economic opportunities. While increased earnings are by no means automatic, clients have overwhelmingly demonstrated that reliable sources of credit provide a fundamental basis for planning and expanding business activities. Many studies show that clients who join and stay in programs have better economic conditions than non-clients, suggesting that programs contribute to these improvements. A few studies have also shown that over a long period of time many clients do actually graduate out of poverty.

By reducing vulnerability and increasing earnings and savings, financial services allow poor households to make the transformation from "every-day survival" to "planning for the future." Households are able to send more children to school for longer periods and to make
greater investments in their children's education. Increased earnings from financial services lead to better nutrition and better living conditions, which translates into a lower incidence of illness. Increased earnings also mean that clients may seek out and pay for health care services when needed, rather than go without or wait until their health seriously deteriorates."

### 1.10 Financing Microfinance

Microfinance is a solution scalable to meet needs large and small. However, resources provided by the international donor community and private philanthropists—traditional sources of funds for microfinance—meet only a small proportion of the market demand. Only the financial markets have the resources readily available to close this gap, especially for those microfinance institutions (MFIs) that focus on the poorest people and who, because of regulatory constraints, cannot provide savings accounts—a potential source for financing that remains out of reach for many MFIs.

Grameen Foundation's **Capital Management & Advisory Center (CMAC)** connects leading, poverty-focused MFIs with both local financial and capital markets, which supports these MFIs’ efforts to make a difference in the lives of as many poor families as possible. CMAC focuses on catalyzing financing for more MFIs and addressing market gaps, namely:

- Most international financing is focused on the top tiered MFIs. According to CGAP, 90 percent of all international financing is to the Tier 1 MFIs and
- Over 70 percent of all international debt financing is in hard currency, exposing the MFI to large foreign exchange risks.

The center makes this possible in three ways:

- Developing and managing a range of Grameen Foundation-branded financial products that are simple yet flexible and meet the needs of MFIs globally, and cater to a variety of risk-return appetites among private funders.
• Establishing microfinance as a commercial investment opportunity by identifying, negotiating, and executing capital market opportunities in local markets, as well as presenting microfinance in terms that commercial investors understand.

• Emphasizing local markets as the primary source of MFI financing and spreading Grameen Foundation capital markets knowledge to and replicating successes in countries with large populations of poor people.

1.11 Microfinance institutions must be able to access capital to grow and continue to meet demand. Despite increasing competition in some areas of the world, microfinance sectors in many regions of the world have reached 10% or less of their potential demand. Grameen Foundation currently has two offerings meant to increase MFIs’ access to capital:

A. Supporting the Growth of High-Performing Microfinance Institutions

Grameen Foundation's Growth Guarantees program is one of the microfinance industry's largest financing efforts dedicated to ensuring local currency financing for rapidly growing MFIs. The structure of Growth Guarantees enables MFIs to borrow in their local currency, which mitigates foreign exchange risk. The program is developed in cooperation with Citigroup and donor-guarantors who provide their names and credit while continuing to earn returns on their individual investment portfolios. The program relies on a pool of $60 million to provide loan guarantees. The program is flexible enough to support high-performing MFIs around the globe that aspire to expand rapidly and are capable of managing sums of commercial financing. We leverage each guarantee dollar on average four times to catalyze large amounts of local financing for MFIs.

Since it began in 2005, our Growth Guarantees program has leveraged $48 million in donor funds into more than $200 million in local-currency funding for 24 MFIs, enabling them to help more than 1.2 million new clients (mostly women).

B. Pioneer Fund

While the Growth Guarantees program targets more mature MFIs – those that are ready and equipped to manage large amounts of commercial financing – GF is now intervening in a systematic way to build up the next generation of MFIs. The Pioneer Fund will bridge the funding gap by providing direct financing to the next generation of microfinance institutions.
that are breaking barriers by working in remote or underserved areas and using innovative products and services that meet the needs of the poor.

The Pioneer Fund will initially invest in a select group of high potential early stage MFIs with catalytic financing to support their growth until they are able to access commercial capital and expand their funding base. At the same time, this funding will educate MFIs about the investor management process and help them advance along the funding continuum from reliance on grants or soft loans to the more commercial sources of financing that are critical to future growth. Pioneer Fund loans will go to high potential emerging leaders in the microfinance sector. One key aspect of the Pioneer Fund is to lead financing in markets that have not attracted much commercial capital, especially those in Sub-Saharan Africa, and to invest in MFIs targeting poorer regions.

Microsavings

The poor lead very unpredictable financial lives. Their income arrives in irregular increments and they struggle to build assets, leaving them vulnerable to financial shock. Even if a poor person has access to microcredit, and is funding a small income-generating business through it, a single unplanned event – a healthcare emergency, natural disaster or other unexpected expense – can take away all the gains they’ve made. The poor need access to formal financial tools that allow them to manage risk, build assets and manage daily household cash inflows and outflows.

More one-third of the world’s population – 2.5 billion people – lack access to financial services, including a savings account. Without access to formal savings, poor people use informal and insecure saving methods, such as hiding cash or purchasing livestock. For poor households, especially those living on less than $2.50 per day, formal savings accounts are essential for creating stability and for moving out of poverty.

C. NABARD as Facilitator of microFinance

Besides, conceiving the SHG-Bank Linkage Programme two decades back, NABARD had assigned to itself the role of a facilitator and a mentor of the initiative. The focus was on bringing in various stakeholders on a common platform, building capacity among the stakeholders to take the movement forward while extending 100% refinance to all banks participating in the programme.

A large number of seminars, workshops and training programmes were organised to create
awareness about the microFinance programme among all the stakeholders – the bankers, the Government agencies, the NGO partners and more importantly the SHG members. The NGO sector who played the key role of organising and nurturing the SHGs as the Self Help Promoting Institutions – later joined by many others including the rural financial institutions, Farmers Clubs, etc. – were encouraged by way of promotional grant assistance by NABARD for taking up such work.

The phenomenal growth of SHG-Bank linkage programme during the last 20 years owe a great deal to these promotional efforts actively supported by NABARD and participated by the stakeholders.

The rapid growth of the SHG linkage programme and its success in taking financial services to the poor, led to its recognition as the most important tool for financial inclusion – the main focus of the XI Five Year Plan. Simultaneously, efforts were also on to experiment innovative initiatives in improving the efficacy and reach of the programme with the involvement of all microfinance practitioners facilitated by NABARD. A glimpse of the facilitator role played by NABARD, the ICT initiatives taken, policy changes etc in this sector during 2011-12

### D. Refinance to Banks

During the initial years of the movement NABARD was extending refinance to the extent of 100% to banks for lending to SHGs since the SHG-Bank Linkage Programme was launched. Initially, this was intended to encourage the banks to actively participate in the programme. As the banks gained confidence in lending to SHGs and realised the business potential in extending financial services through SHGs, they have been increasingly deploying their own resources in a mutually beneficial relationship with the SHGs. SHGs had been instrumental in bringing in more business for the financing banks by way of improving credible client base, also promoting rural and inclusive banking. Banks have also extended other financial services like remittance, housing, insurance, etc, though in a limited way, to this segment. As a result, the banks have started “owning up” the movement, as a sound business proposition and became less dependent on promotional support from NABARD. The gap between the total loans issued by banks to SHGs and the refinance extended by NABARD for such loans started widening. The refinance support from NABARD, however, continues to supplement resource mobilisation for the programme. During 2011-12, NABARD extended refinance to the extent of `3072.59 crore as against `2545.36 crore disbursed during the previous year. Cumulative disbursement of refinance by NABARD for SHG lending now stands at `18479.60 crore.
Microfinance is but one strategy battling an immense problem.

In the last two decades, substantial progress has been made in developing techniques to deliver financial services to the poor on a sustainable basis. Most donor interventions have concentrated on one of these services, microcredit. For microcredit to be appropriate however, the clients must have the capacity to repay the loan under the terms by which it is provided. Otherwise, clients may not be able to benefit from credit and risk being pushed into debt problems. This sounds obvious, but microcredit is viewed by some as "one size fits all." Instead, microcredit should be carefully evaluated against the alternatives when choosing the most appropriate intervention tool for a specific situation.

Microcredit may be inappropriate where conditions pose severe challenges to standard microcredit methodologies. Populations that are geographically dispersed or nomadic may not be suitable microfinance candidates. Microfinance may not be appropriate for populations with a high incidence of debilitating illnesses (e.g., HIV/AIDS). Dependence on a single economic activity or single agricultural crop, or reliance on barter rather than cash transactions may pose problems. The presence of hyperinflation, or absence of law and order may stress the ability of microfinance to operate. Microcredit is also much more difficult when laws and regulations create significant barriers to the sustainability of microfinance providers (for example, by mandating interest-rate caps). microfinance can not reach all economic segments of society, it has been shown to reach segments previously un-serviced by other financial markets.