Chapter 2

Micro-finance
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Micro-finance

2.1 Concept

As per RBI (2011)\(^1\), “Microfinance is an economic development tool whose objective is to assist the poor to work their way out of poverty. It covers a range of services which include, in addition to the provision of credit, many other services such as savings, insurance, money transfers, counselling, etc.” The range of services is expanded in the Asian Development Bank’s definition which defines microfinance as the provision of a broad range of services such as deposits, loans, payment services, money transfers, and insurance to poor and low income households and their microenterprises (ADB, 2000)\(^2\). Robinson (2001)\(^3\) defines microfinance as “small-scale financial services, primarily credit and savings, provided to people who farm, fish or herd” and adds, “it refers to all types of financial services provided to low-income households and enterprises.” The microfinance revolution, as Marguerite Robinson\(^4\) (an influential votary of microfinance) puts it, is the “large scale, profitable provision of microfinance services - small savings and loans - to economically active poor people by sustainable financial institutions.” In the Indian context there are some value attributes of microfinance as suggested by Sriram and Upadhyayula (2004)\(^5\). They feel that micro-finance is an activity undertaken by the alternate sector (NGOs) and is something done predominantly with the poor. However, they add that these MFIs running in the alternate sector may not always be developmental in incorporation. The authors emphasise that microfinance is given with a laudable intention and has institutional and non-exploitative connotations. Hence, microfinance cannot be defined by form but by the intent of the lender. Accordingly, commercial organisations and for profit companies cannot justify micro-finance operations. Also, the non poor do not qualify for micro-finance as per their definition.

2.1.1 Objectives of Micro-finance

Empirically, micro-finance was designed to alleviate the conditions of poor and give them access to financial resources. However, in implementation it was unearthed that micro-finance had other far reaching effects and one of them was empowering the women who availed these services. This was reinforced by the World Bank (1995, 2000/2001)\(^6\) which stated that there was substantial evidence that organizing women
around thrift and credit services was one of the most effective methods, not only for alleviating poverty but also for empowering women. These objectives assumed a lot of importance as the United Nations (UN) also promoted them. UN is known for putting concerted efforts in uplifting the conditions of people. In 2000, world leaders came together at the UN and following the vision of creating a world free from extreme poverty and promoting human development, framed the eight Millennium development goals\(^7\) as follows:

- To eradicate extreme poverty and hunger
- To achieve universal primary education
- To promote gender equality and promote women
- To reduce child mortality
- To improve maternal health
- To combat HIV/AIDS, Malaria and other diseases
- To ensure environmental sustainability
- To develop a global partnership for development

Hence, it is apparent that the two objectives laid down for micro-finance were essential to improving the quality of life. In the Indian context, women empowerment has already been recognised as an area which needs attention, in response to which the year 2001 was also observed as “Women Empowerment Year”. Again, poverty is an equally disturbing area as suggested by The Millennium Development Goals Report 2014\(^8\). India is seen holding the first position as one third of the world’s 1.2 billion extreme poor live here. Moreover, the Government of India puts a lot of emphasis on financial inclusion being the need of the hour, which can effectively be met with the help of the micro-finance sector. This role was highlighted when the United Nations General Assembly declared the year 2005 to be the “International Year of Microcredit” in an effort to help poor countries achieve the Millennium Development Goals. A year later, in 2006, the profile of microcredit was further elevated when Dr. Muhammad Yunus and the Grameen Bank won the Nobel Peace Prize\(^9\) (Khan, 2009)\(^10\). UN acknowledged that, unlike top-down development
initiatives such as debt forgiveness or international aid, microfinance stands out for its bottom-up approach. It emerges locally and enables micro-borrowers to improve their situation through their own efforts rather than relying on external development strategies. In their collectivism, micro-loans lead to large-scale economic improvements and foster growth in target countries (Dieckmann, 2007). The exact methodology employed by microfinance programs differs from one organization to another, but most organizations with a development or poverty reduction agenda seek to achieve a ‘double-bottom line’ in their microfinance activities (Christen, Robert, Rosenberg, and Jayadeva, 2004). A double-bottom line refers to the goal of achieving financial self-sufficiency within the MFI itself, while at the same time maintaining a focus on client-level social impact (Hashemi, 2007). Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to looking out for future needs, investing in better nutrition, improving their living conditions, and safeguarding children’s health and education. Hence, essentially microfinance operations have a three-pronged strategy in mind, viz, reach, impact and sustainability. The microfinance institutions (MFIs) need to reach out to the financially excluded lot, provide them resources for overall development and put in efforts to sustain their efforts for a long-term impact on their clients. The achievement of these goals is difficult, keeping in mind that the target customers are poor, illiterate and vulnerable.

There is extensive evidence that microfinance has a positive impact on the first Millennium Goal: that the number of people living in extreme poverty (defined as those living on less than $1 per day) will be reduced by half between 1990 and 2015 (Morduch and Haley, 2002). Several studies in the international and national context have reported that the income of participants of microfinance is higher than non-participants, thereby finding a positive impact as far as the objective of poverty eradication is concerned (Hossain, 1988; Chen and Snodgrass, 2001; Barnes, 2001; Dunn, 2001). Planning Commission (2011) in its impact study carried out in Uttar Pradesh and Uttarakhand also cites that microfinance interventions have been recognised as effective tools for poverty alleviation and upliftment in socio-economic status of recipients, especially the rural poor. Puhazhendhi & Satyasai (2000) in their study commissioned by NABARD covered 223 SHGs spread over 11 states across
India. The study found that 58.6% of sample households registered an increase in assets after becoming a part of SHG, an additional 200 economic activities were taken up by sample households and there was a decrease in the percentage of sample households with annual income levels of Rs. 22500 from 73.9% to 57%. Another study commissioned by NABARD in 2002 with financial assistance from Swiss Agency for Development and Cooperation (SDC), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH and International Fund for Agricultural Development (IFAD), covered 60 SHGs in Eastern India. The findings of this study aligned with the findings of the earlier evaluation with 23% rise in annual income and 30% increase in asset ownership among 52% of sample households. Similar findings were reported by the Rural Finance Access Survey (RFAS) done by World Bank in association with National Council for Applied Economic Research (NCAER) which covered 736 SHGs in the states of Andhra Pradesh and Uttar Pradesh. The findings indicated 72% average increase in real terms in household assets, shift in borrowing pattern from consumption loans to productive activities and 33% increase in income levels (Misra, 2006).

Microfinance for women has been a popular poverty-alleviation strategy among development agencies since the mid-1980s. It has also been considered an effective vehicle for women's empowerment. Support consists most typically of the provision of small loans, either to individuals or groups (Leach and Sitaram, 2002). Women entrepreneurs have attracted special interest from MFIs because they almost always make up the poorest segments of society, they have fewer economic opportunities, and they are generally responsible for child-rearing, including education, health and nutrition. Given their particularly vulnerable position, many MFIs seek to empower women by increasing their economic position in society. Experience shows that providing financial services directly to women aids in this process. Women clients are also seen as beneficial to the institution because they are seen as creditworthy. Women have generally demonstrated high repayment and savings rates (UNDP, 1999). Views on the potential of micro-finance programmes to contribute to women's empowerment currently fall into four main (not necessarily mutually exclusive) camps:

* those who stress the positive evidence and are essentially optimistic about the possibility of sustainable micro-finance programs world-wide that empower women;
• those who recognize limitations to empowerment but see the question as one of program design and seek to identify models and strategies that minimize negative impacts and to enhance their contribution to empowerment;
• those who recognize limitations in the potential to promote empowerment but see cost-effective micro-finance programs as important in themselves within a strategy to alleviate poverty, and see empowerment as an issue to be addressed by other means;
• those who see the limitations as inherent, and the current emphasis on microfinance programs as a misplaced diversion of resources (Mayoux, 1998)25.

Hence, as indicated by the previous study, impact reports of micro-finance on women empowerment are also dichotomous in nature. Several studies, again in the international and national context have seen a positive impact on major dimensions, namely economic and social perspectives of women empowerment (Mizan 199326; Hashemi, Schuler and Riley, 199627; Pitt, Khandker and Cartwright, 200328; Manimekalai and Rajeshwari, 200029; Venkatesh and Kala, 201030; Kamble and Sonar, 200631; Rao and Ahir, 200932; Palani and Selvaraj, 200933). At the same time, there are studies which also indicate that micro-finance has not been instrumental in bringing about all-round development and empowerment of women (Johnson and Kidder, 199934; Mayoux 199935; Kabeer 199836; Titus, 200037).

2.2 Evolution

Micro-finance, a financial innovation, originated in Bangladesh, when Prof. Mohd. Yunus changed the lives of millions of Bangladeshis by creating the concept of micro loans. The idea came to his mind by involving himself in fighting poverty during the 1974 famine in Bangladesh. Besides teaching through the traditional methods, he wanted to understand the practical aspects of economics. He gave $27 as the first loan from his pocket to a villager living near his University Campus and discovered that villagers were quickly repaying money by selling their goods in the market; and there evolved the concept of micro-finance with the establishment of Grameen Bank in 1976. Prof. Yunus earned a Nobel Peace Prize in 2006 for his most valuable credit to the financial system for the poor. Similar experiments of providing micro-credit were also being carried out in Bolivia and Indonesia which proved that the model of
providing credit to poor without collateral was successful. Despite the contextual
differences, the connectivity of these early innovations lay in their certain common
principles like reliance on character or peer pressure rather than collateral as loan
security, leveraging social capital, positive incentives for repayment and interest rates
that approached or covered cost. These innovations acted as catalysts for replication
across the globe and their underlying principles continue to form the bedrock of
microfinance interventions till date (Misra, 2006)\textsuperscript{38}.

2.2.1 Introduction in India

The post-nationalization period in the banking sector, circa 1969, witnessed a
substantial amount of resources being earmarked towards meeting the credit needs of
the poor. There were several objectives for the bank nationalization strategy including
expanding the outreach of financial services to the neglected sectors (Singh, 2005)\textsuperscript{39}.
In line with this strategy of providing credit, the Central and State Government also
announced several subsidised credit programs, especially for the poor. In the early
1980s, the GoI launched the Integrated Rural Development Program (IRDP), a large
poverty alleviation credit program, which provided government subsidized credit
through banks to the poor. It was aimed that the poor would be able to use the
inexpensive credit to finance themselves over the poverty line. However, the benefits
of the program did not drill down to the targeted audience, which were the people
living at the bottom of the pyramid. The Government found out that the main problem
was of reach. Hence, to overcome this problem, it was required that the existing rural
infrastructure be put to use. The National Bank for Agriculture and Rural
Development (NABARD) was entrusted with the tasks of framing appropriate policy
for rural credit, provision of technical assistance backed liquidity support to banks,
supervision of rural credit institutions and other development initiatives (Reddy and
Manak\textsuperscript{40}).

NABARD initiated certain research projects on Self-Help Groups (SHGs) as a
channel for delivery of microfinance in the late 1980s. Amongst these the Mysore
Resettlement and Development Agency (MYRADA) took the initiative and sponsored
action research project on "Savings and credit management of SHGs" with partial
funding from NABARD in 1986-87. In 1988-89, in collaboration with some of the
member institutions of the Asia-Pacific Rural and Agricultural Credit Association
(APRACA), NABARD undertook a survey of 43 NGOs in 11 states in India, to study the functioning of microfinance SHGs and their collaboration possibilities with the formal banking system. These studies also showed that the existing banking policies, systems and procedures, and deposit and loan products were perhaps not well suited to meet the most immediate needs of the poor. It also appeared that what the poor really needed was better access to these services and products, rather than cheap subsidized credit. Against this backdrop, a need was felt for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms, which would fulfill the requirements of the poorest, especially of the women members of such households. The emphasis therefore was on improving the access of the poor to microfinance rather than simple provision of micro-credit. Both these research projects threw up encouraging possibilities and NABARD initiated a pilot project called the SHG-Bank linkage project. The three year action-research project which started with linking 500 SHGs nationwide to nationalized commercial banks, eventually culminated in the mainstreaming of SHG banking as a corporate strategy of banks in 1996. The SHG-Bank Linkage programme followed broadly three models of credit linkage of SHGs with banks. However, the underlying design feature in all remained the same i.e. identification, formation and nurturing of groups either by NGOs/other development agencies or banks, handholding and initial period of inculcating habit of thrift followed by collateral free credit from bank in proportion to the group’s savings. In accordance with the flexible approach, the decision to borrow, internal lending and rate of interest were left at the discretion of group members. The programme has come a long way since 1992 passing through stages of pilot (1992-1995), mainstreaming (1995-1998) and expansion phase (1998 onwards) and emerged as the world’s biggest microfinance programme in terms of outreach, covering 6.5 crore clients as on March, 2013 (State of the Sector Report 2013). About 85 per cent of the SHGs linked to banks under the SHG-bank linkage scheme comprise women's groups (Status of Microfinance in India, 2012-13). The Government on its end also supported through its time to time initiatives. In 1996, RBI decided to include micro-credit as priority sector lending. The GOI launched a program called Swaranjayanti Gram Swarozagar Yojana (SGSY) in 1999, under which subsidized credit would be provided to the poor through the banking sector to generate self-employment through a self-help group approach and the program has grown to an enormous size. To give further impetus, in
2000, RBI allowed banks to lend to MFIs and treat this as part of priority sector lending. In 2004, the National Common Minimum Program of the UPA Govt. urged expansion, particularly in backward and economically fragile areas. The Union Budget of 2005-06 re-designated the Microfinance Development Fund (MFDF) as Microfinance Development and Equity Fund (MFDEF) with an increase in corpus 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. Since then, the micro-finance industry has experienced a booming growth. However, due to lack of uniform regulations across the country, the industry suffered a backlash, especially in Southern India. In midst of brewing controversies regarding the sustainability of the sector, The Microfinance Institutions (Development and Regulation) Bill was passed in the Parliamentary session of 2012.

2.2.2 Products

2.2.2.1 Micro-Credit

According to RBI\(^1\), “Microcredit is defined as 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 living standards.” As the definition suggests, these loans of small amounts are given to people who are poor, do not have any kind of physical collateral, steady employment or verifiable credit history, due to which they are categorized as unbankable. However, they are bankable because they are an economic lot, self-employed and looking forward to some help which can give a thrust to their incomes. Hence, loans are provided with a purpose that they be used for productive purposes and not for consumption alone. For example, SEWA Bank in India provides loans to self-employed women for various purposes like (i) repayment of old debts, (ii) rescue of mortgaged/pledged assets, (iii) purchase or repair of house, (iv) working capital for business\(^43\), etc. Thus, microcredit is a subset of microfinance, which consists of a hoard of financial products and services.

2.2.2.2 Micro-Savings

Savings can be referred to as a tool for planning future needs and it also serves as a life-line in case of any contingency. According to SEWA Bank, India, “Poor women
do not have a basic instinct for savings. They can and do save, if motivated and facilitated.” According to Rutherford (2000)\textsuperscript{44}, there are mainly four needs of the poor: (i) Life cycle needs like weddings, funerals, education, etc. (ii) Personal emergencies like sickness, unemployment, theft etc. (iii) Disasters including natural and man-made calamities, and (iv) Investment opportunities for expanding business, buying land, home improvement, etc. As the poor do not prefer saving, they always remain in a cash-crunch and hence, tend to borrowing money from the local money-lenders, and other sources. At such times, savings comes in handy, and they realize the importance of thrift.

2.2.2.3 Micro-Insurance

Churchill (2006)\textsuperscript{45} defines micro-insurance as “the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. This definition is essentially the same as one might use for regular insurance except for the clearly prescribed target market: low-income people.” To elaborate further, an in-depth meaning of micro-insurance is provided by the Micro-insurance network of organizations\textsuperscript{46}, which says, “The term “micro-insurance” typically refers to adapting insurance services mainly to clients with low income and no access to mainstream insurance services. More precisely, micro-insurance is a means of protecting low income households against specific risks in exchange for a regular payment of premiums whose amount is proportional to the likelihood and cost of the relevant risk.”

Micro-insurance is a highly diversified sector:

- **Stakeholders:** Micro-insurance is developed by commercial insurers, mutual funds, microfinance institutions, NGOs, governments or semi-public bodies.

- **Products:** Micro-insurance covers an extreme broad variety of services like, for example, life insurance, health, invalidity, cattle breeding, crop and asset insurance.

- **Portfolio size:** A micro-insurer may cover dozens as well as millions of policyholders.

Micro-insurance works as a win-win arrangement for the clients as well as the MFIs. This is so because on one hand, any loss or unplanned contingency of the client is covered by insurance, and hence, they save themselves from falling in the debt trap,
and on the other hand, the MFIs are also ensured of timely payment of their dues. It is also observed that some MFIs integrate micro-insurance with micro-credit, and hence the instalment consists of premium payments as well.

### 2.2.3 Services

#### 2.2.3.1 Financial Intermediation

Financial intermediation refers to the process of facilitation in the provision of microfinance products (Panda, 2009). The facilitation is done by intermediaries known as MFIs, which can take up any legal form like Bank, NBFC, NGO, Trust, etc. The SHG-Bank Linkage Programs, payment transfers are illustrations of this service.

#### 2.2.3.2 Social Intermediation

Social intermediation refers to the process in which the social and human capital is built for successful financial intermediation (Ledgerwood, 1999). Thus, social intermediation involves building self-reliant groups by providing them training in participatory management, accounting skills and basic financial and management skills.

#### 2.2.3.3 Business Development Services

Business development services refer to the provision of non-financial services which facilitate the enterprise development, with the objective that if the business prospers, income of the owner shall improve and likewise the MFI shall also benefit. These services are broadly categorised into two, (i) Enterprise formation programs, offering training in sector-specific skills such as weaving as well as training for persons who might start up such businesses, and (ii) Enterprise transformation programs, providing technical assistance, training, and technology to help existing microenterprises make a quantitative and qualitative leap in terms of scale of production and marketing.

#### 2.2.3.4 Social Services

Social services refer to the non-financial services which focus on well-being of microfinance clients or people as a whole. The social services include health care, education, literacy, women empowerment, etc. Social services require a constant flow of grants and subsidies, which are normally provided by Government, development
agencies or other donors. These services like business development services should be kept distinct from the delivery and management of financial intermediation services. Furthermore, it is not reasonable to expect that revenue generated from financial intermediation will always cover the costs of delivering social services. Normally, NGOs which double up as MFIs prefer providing social services, coupled with other financial services.

**FIGURE 2.1**

**Ratio of Social to Financial staff**

![Ratio of Social to Financial Staff](image)

(Source: Paxton, 1996a)

It is evident from the above graph that NGOs take the lead in provision of social services as compared to banks, which clearly indicates their priorities and objectives.

**2.3 Review of Legal Framework of Micro-finance Institutions (MFIs)**

Micro-finance providers exist in the formal sector, semi-formal sector and informal sector. The following figure briefly illustrates the institutional arrangement for disbursement of micro-finance in India.

**FIGURE 2.2**

Institutional arrangement for disbursement of micro-finance in India
1. The **formal sector** includes apex financial institutions like National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), Rashtriya Mahila Kosh (RMK), Friends of Women World Banking (FWWB), Housing Development Finance Corporation (HDFC), Housing and Urban Development Corporation Limited (HUDCO), and Rashtriya Gramin Vikas Nidhi (RGVN), banks (Public and Private commercial banks, Regional Rural banks, Co-operative banks, Postal savings banks) and NBFCs (Non-banking financial companies, term-lending institutions).

2. The **semi-formal sector** includes saving and credit cooperatives, multipurpose cooperatives, NGOs, registered SHGs and development projects.
3. The informal sector includes organizations outside the Government regulation and supervision. These include saving associations, non-formal financial firms, non-registered SHGs, money-lenders, traders and shop-keepers.

Broadly, MFIs in India are registered as one of the following entities:

2.3.1 Non Government Organizations engaged in microfinance (NGO-MFIs), comprised of Societies and Trusts

NGOs are mostly registered under the Societies Registration Act, 1860. Since these entities are established as voluntary, not-for-profit development organisations, their microfinance activities are also established under the same legal umbrella. There are several advantages attached to MFIs registered under the Societies Act like simple process of registration; simple record keeping and even simpler regulations; low possibility of interference by the regulator; (largely) exemption from tax due to the overtly charitable nature of operations; and appropriate for taking up micro-insurance (as an agency) on behalf of insurance companies. However, on the other hand there are certain disadvantages as well, like being a charitable institutional form, in essence is inappropriate to the for-profit, financially sustainable strategic goal of microfinance operations; tax-exemption for surpluses can be (and is) challenged on the question of whether provision of microfinance services is a charitable activity; no system of equity investment or ownership, thereby, making it less attractive for commercial investors interested in microfinance; commercial investors generally regard the investments in such entities risky primarily on account of their lack of professionalism and managerial practices and are, therefore, reluctant to commit large volumes of funds to such MFIs. In accordance with Section 45S of the RBI Act, 1934, no unincorporated bodies are allowed to accept deposits from the public. Organisations registered under the Societies Registration Act and the Trust Act are considered unincorporated bodies. Therefore, according to the law, they are not even allowed to collect savings from their clients; and also vulnerable to the use of ‘usurious interest prevention acts’ of various state governments as the status of microfinance is debatable as a charitable activity. Hence, these MFIs have to largely depend on donations for carrying out micro-financing activities or they act as facilitators only.

Some MFIs are registered under the Indian Trust Act, 1882 either as public charitable trusts or as private, determinable trusts with specified
beneficiaries/members. The advantages and disadvantages of having this structure are more or less similar to that of Societies.

### 2.3.2 Cooperatives registered under the conventional state-level Cooperative Acts, the national level Multi-State Cooperative Legislation Act (MSCA 2002), or under the new state-level Mutually Aided Cooperative Acts (MACS Act)

Many states have brought amendments in their cooperative societies acts thereby making the functioning of cooperatives more autonomous and free from government interference, to make the structure convenient for delivery of micro-finance services. This act was first passed in Andhra Pradesh and has functioned as a model for many states which have brought fresh legislations to effect changes in their state cooperative society acts. The advantages include ease of formation and management; ability to accept deposits; minimal interference from regulators – unlike cooperative societies formed under the traditional cooperative laws; and client centric and therefore mobilise equity also from the clients. Hence, these MFIs find it relatively easier to procure funds for mobilisation as compared to NGOs. Certain disadvantages also exist like virtually there is no regulation which may lead to risk-taking behaviour by the promoters/managers resulting in the collapse of the institution; scaling up becomes difficult, as cooperatives are not perceived as a trustworthy organisational form by the formal financial sector; and unlike other entities like societies or trusts, they do not have the advantage of tax-exemption.

### 2.3.3 Section 25 Companies (not-for-profit)

An organisation given a license under Section 25 of the Companies Act 1956, is allowed to be registered as a company with limited liability without the addition of the words ‘Limited’ or ‘Private Limited’ to its name. It is also eligible for exemption from some of the provisions of the Companies Act, 1956. For companies that are already registered under the Companies Act, 1956, if the central government is satisfied that the objects of that company are restricted to the promotion of commerce, science, art, religion, charity or any other useful purpose; and the constitution of such company provides for the application of funds or other income in promoting these objects and prohibits payment of any dividend to its members, then it may allow such a company to register under Section 25 of the Companies Act. The advantages include tax-exemption, increased capacity to take debts as it is treated like a company and
comparatively they are subject to easier processes and lower regulator influence. However, they face restrictions in deposit mobilization and certain characteristics like absence of dividend distribution deter equity investors from investing in these legal entities.

2.3.4 For-profit Non-Banking Financial Companies (NBFCs)

NBFCs have played an important role in the Indian financial sector for a long time, fulfilling the gap in the demand and supply of financial services, particularly from small clients. The growth of NBFCs is driven by their localised presence, a higher level of customer orientation than banks and lower documentation requirements albeit at higher interest rates for borrowers. Conversely, depositors earn substantially higher rates of interest as compared to the traditional savings instruments of banks. In this way, NBFCs are able to attract a large volume of deposits from the general public. However, it needs to be noted that not all NBFCs are allowed to accept deposits. Moreover, in light of the new regulations issued by RBI, NBFC-MFI\(^{52}\) is defined as a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets. Lower entry barriers and high returns (in relation to banks) from the NBFC business attract lots of entrepreneurs. There have been incidents of scams, which alerted the RBI, and now RBI has taken NBFCs under its ambit. The surveillance measures include mandatory regulation of companies offering financial services by the RBI, compulsory credit rating of deposit taking NBFCs and imposition of prudential norms. The several advantages are increased trust and confidence of the investors since they are well-regulated, attractive option for social investors; ease in regulation provided the NBFC does not accept deposits and up-scaling becomes comparatively easier. However, the regulations and controls do play a part in compromising the reach of these set-ups, and restrictions on FDI and venture capital also can deter the progress of such MFIs.

2.3.5 Nidhi Companies

Section 620 of the Companies Act allows for the formation of a special type of company called ‘Nidhi’ company also known as ‘Mutual Benefit Society’. Certain provisions of the Companies Act have been modified under this section. Accordingly, provisions on the service of documents, issue of additional capital, annual returns, dividends, loans and remuneration to directors and winding up processes have been
modified for companies recognised as Nidhi or Mutual Benefit Society. Nidhi companies provide very liberal provisions in terms of compliance with several regulatory norms of the Companies Act and, in the sense that they are allowed to accept deposits from members, represent for MFIs a way around the problem of NBFCs needing to be registered with the RBI and then waiting two years or more to get an investment grade rating. However, the requirement that such company should lend only against substantial collateral makes them unsuitable as a legal form for MFIs, which must advance loans without collateral. Further, their inability to hold any share capital brings them on par with societies and trusts in other ways. Therefore, they are also subject to the some of the disadvantages of societies and trusts in the matter of fund mobilisation and management. Further, they have the advantage of being governed by the Companies Act, 1956 and that allows them to be a corporate agent of a life insurance and a non-life insurance company. In case they are functioning as MFIs, they can avail of the Foreign Direct Investment facility recently announced by RBI. Apart from this, they can also obtain donated equity from abroad; provided they have necessary clearance under Foreign Contribution Regulation Act (FCRA).

2.3.6 Cooperative Banks

Under the Banking Regulation Act only the State Cooperative Banks, District Central Cooperative Banks and Primary Cooperative Banks (Urban Cooperative Banks — UCBs) are recognised as cooperative banks. The State Cooperative Banks and Central Cooperative Banks form part of the three-tier rural cooperative credit structure promoted by the state governments and NABARD. The relevant category of cooperative banks suitable for MFIs is Primary Cooperative Banks (UCBs). The advantages are ability to accept demand and time deposits; low-capital requirement; and access to clearing-house functions. The disadvantages are duality of control of the state act and the RBI; poor public image of cooperative banks following recent governance and management problems resulting in the failure of a number of such banks; and as an outcome of these failures it is now also extremely difficult to obtain new licenses from the RBI.
2.3.7 Producer Companies

Amendments in the Companies Act 1956 have provided for a new type of company to be owned by the primary producers. Primary producer is defined as a person engaged in any activity connected with or related to any primary produce. Primary produce could relate to produce of farmers, produce of people engaged in handlooms, etc. The advantages are similar to those of co-operatives like simple process of registration; record-keeping and even simpler regulations; low possibility of interference by the regulator; and member-focused approach. The relevant disadvantages are as a member-owned organisation, bound to face the problems related to professional management and governance; also the profit-centric approach necessary for the long term sustainability of the microfinance program may take a back seat; Tax exemption for surpluses not likely; and commercial investors could shy away as equity investment may not be possible in such organisations.

The above information suggests that there are problems faced by each type of set-up in India. While societies and trusts provide an initial breakthrough to start microfinance operations; these structures are not appropriate for supporting the scaling-up of operations. MACS and producer companies may offer better options, but their lack of professional governance raises serious doubts in the minds of investors. Mobilising equity support for such institutions is also a problem. These factors hamper the scaling-up of operations as these entities would find it hard to mobilise the substantial volumes of funds required for expansion. Section 25 companies also suffer from such lacunae – though their problem is related mainly to equity mobilisation and thereby to the leverage capacity of such institutions. This brings the discussion to the two remaining options – NBFCs and cooperative banks. Following the problems with the cooperative banks over the last few years, RBI has been extremely reluctant to provide fresh licenses for such entities. NBFCs have a similar problem; RBI has been very reluctant to offer registration to new NBFCs for one reason or another, compounding the problem of raising the substantial capital requirement to Rs. 5 crore. The RBI has recently shown some willingness to provide registration to NBFCs established by MFIs. NBFCs established by Spandana in Guntur and SKS in Hyderabad have been registered during 2004-05.
2.4 Review of Lending Models used by Micro-finance Institutions (MFIs)

Various models are used worldwide for catering micro-finance services. Some MFIs use pure models, while some others customize the models to include features of more than one model, such that it suits the local context and target audience. The literature lists down the numerous models\textsuperscript{53} which are described in details below.

2.4.1 Association Model

This is where the target community forms an 'association' through which various micro-finance activities are initiated. Associations or groups can be composed of youth, women; 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. The Indian SHG model is an offshoot of this model.

2.4.2 Community Banking Model

Community Banking model essentially treats the whole community as one unit, and establishes semi-formal or formal institutions through which micro-finance 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. A prominent example of this type of microfinance institution is the Village Bank of FINCA in Latin America, which has been replicated in Africa and central Asia. This model is closely related to the Village Banking Model.

2.4.3 Cooperative Model

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, known as financial cooperatives.
The major characteristics of financial cooperatives are: (i) clients come from lower to middle level income group, (ii) capital is self-generated, (iii) services are majorly financial in nature and (iv) activities are self-governed. SANASA of Sri Lanka is a successful example of rural credit cooperative as microfinance service provider.

### 2.4.4 Credit Union Model

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 pre-determined and reasonable rates of interest. 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.

### 2.4.5 Rotating Saving and Credit Association Model (ROSCA)

Rotating Savings and Credit Associations or ROSCAs, are essentially a group of individuals (from 5 to 50 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. After having received the lump sum amount when it is his (borrower) turn, 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. However, ROSCAs suffer from several limitations such as unavailability of loan in emergency, inflexibility in structure and operations, fixed amount of loan and risk of member drop-outs, defaults and fraud.

### 2.4.6 Village Banking Model

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, collect payments and savings. Their loans are not backed by physical collateral but by moral collateral: the promise that the group stands behind each individual loan. The Village Banking model is closely related to the Community Banking and Group models.
2.4.7 Bank Guarantee Model

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.

2.4.8 Individual Lending Model

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. These technologies are predominant in the BRI-Unit Desa in Indonesia as well as priority sector lending by banks in India especially the regional rural banks and cooperative banks.

2.4.9 NGO Linkage Model

NGOs serve as intermediaries in linking the members or groups to the banks for disbursement of micro-finance services. The linkages of the NGOs and the members are also further classified into three models:

- **NGOs as facilitators**: SHGs are formed by NGOs and linked to banks. Banks directly provide micro-finance to SHGs with the recommendation of NGOs.

- **NGOs as facilitators cum financial intermediaries**: SHGs are formed by NGOs. Also, NGOs perform the role of financial intermediation as on-lender to SHGs after sourcing loans from banks. Here, NGO is responsible for repayment of bank loan as well as payment of interest.

- **NGOs as other service providers**: SHGs are directly linked to the banks, wherein the banks assume the role of NGOs. NGOs at the most provide technical support and business development services. However, they do not deal in any kind of financial intermediation.
2.4.10 Small Business Model

The prevailing vision of the 'informal sector' is one of survival, low productivity and very little value addition. But this has been changing, as more emphasis is laid on small and medium enterprises (SMEs) and micro-enterprises - for generating employment, for increasing income and providing services which are lacking. Policies have generally focused 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 in these programs 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.

2.4.11 Grameen Joint Liability Group Model

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

(i) 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 familiarize 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. (ii) Groups of five prospective borrowers are formed; in the first stage, only two of them are eligible for, and receive, a loan. (iii) 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, the other members of the group become eligible for a loan. Also, if one member defaults, the other group members are required to cover the loan from their own resources, and if they do not, they lose access to future loans. It is thus in each member’s interest to ensure that the other members pay. Because of these restrictions, there is substantial group pressure to keep individual records clear. In this sense, collective responsibility or in other words joint liability of the group serves as collateral on the loan. The repayment period varies from 6 to 15 weeks, based on the discretion of the MFI using this model. Most of the
Indian NBFCs engaged in microfinance use the Grameen JLG model with certain changes in the repayment schedule. The programmes of Banco Sol in Bolivia and most of the solidarity group models in Latin America also follow this methodology.

2.4.12 Self-Help Group Model

According to RBI54, “A Self-Help group (SHG) is a registered or unregistered group of micro entrepreneurs having homogenous social and economic background voluntarily, coming together to save small amounts regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis. The group members use collective wisdom and peer pressure to ensure proper end-use of credit and timely repayment thereof. In fact, peer pressure has been recognized as an effective substitution for collaterals.”

Thus, an SHG, both by definition and in practice is a group of individual members who by free will, come together for a common collective purpose. In practice, SHGs comprise individual members known to each other, coming from the same village, community and even neighbourhood. That is, they are homogeneous and have certain pre-group social binding factors. In the context of microfinance, SHGs are formed (and sometimes old SHGs established with a certain purpose converted) around the theme of savings and credit. A small group of individuals (15 members on an average but may vary from 12 to 20 members) pool their savings on a regular basis to form a collective fund. This fund is then rotated as credit amongst the members through self generated norms. The setting of terms and conditions and accounting of the loan are done in the group by designated members. Hence the basis of the SHG is the mutuality and trust in depositing individual savings in group funds. Once the initial trust is established, the incentive or motivation for a member is the access provided to financial services through the common pool fund, which is higher than the individual fund saved. In cases where the groups have been given a reasonable operating shape by promotional agencies like non-government organisations, and an SHG thus formed is stabilised, (through repeated rotations of their own savings converted to mutual credit), it is possible to introduce external funds. This completes the cycle of SHG and microfinance. Even though conceptually, the microfinance-based SHG is fairly simple, its management in a sustainable manner is quite complex and investment intensive.
Best examples of this type of model are the Self-Help Groups-bank linkage programme in India, the PHBK project in Indonesia and the Chikola groups of K-REP in Kenya. In India, SHG model is mostly practiced by NGOs with a motive of social development and poverty alleviation.

The small beginning of linking only 500 SHGs to banks in 1992, had grown to over 0.5 million SHGs by March 2002 and further to 8 million SHGs by March 2012, enabling over 103 million poor households’ access to a variety of sustainable financial services from the banking system as quoted by NABARD in The State of the Sector Report, 2011-1255.

SHGs have also federated into larger organizations. Typically, about 15 to 50 SHGs make up a Cluster with either one or two representatives from each SHG. Depending on the geography, several clusters come together to form an apex body or an SHG Federation. Sometimes, these federations become very powerful and act as strong legal entity, taking up business activities of high standard. The following figure illustrates the structure of a typical SHG federation.

**FIGURE 2.3**

**Illustrative structure of SHG Federation**

(Source: Reddy and Manak (APMAS)56)
Research suggests that the group cohesion, joint liability, incentives to share information, and social development programs that serve to differentiate group-lending programs from banks or individual-lending institutions are an important part of microcredit programs' success (McKernan, 2002).57

2.5 Spread of Micro-finance

2.5.1 International Context

Many international NGOs, such as Foundation for International Community Assistance (FINCA), Americans for Community Cooperation in Other Nations (ACCION), Freedom from Hunger, Opportunity International, Co-operative for Assistance and Relief Everywhere (CARE), Consultative Group for Assisting the Poor (CGAP), etc. are promoting microfinance programs for creating new businesses and combating poverty in a sustainable way. Over the past few decades, microfinance has been experimented in many developing countries. Bank Rakyat Indonesia (BRI) in Indonesia, Bancosol in Bolivia, Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand, Grameen Bank, and Bangladesh Rural Advancement Committee (BRAC) of Bangladesh, NABARD in India, Amannah Ikhtiar Malaysia (AIM) of Malaysia, Agriculture Development Bank of Nepal (ADBN), K-Rep in Kenya and Mibanco in Peru have yielded encouraging results in alleviating poverty and empowering the poor through microfinance. The spread of micro-finance can be judged from the statistics of 2012 as depicted in Table 2.1.

<table>
<thead>
<tr>
<th>Region</th>
<th>Total MFIs</th>
<th>Active Borrowers</th>
<th>Gross Loan Portfolio (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia &amp; the Pacific</td>
<td>142</td>
<td>12.8 mln</td>
<td>34.6 bln</td>
</tr>
<tr>
<td>Africa</td>
<td>271</td>
<td>7.4 mln</td>
<td>7.9 bln</td>
</tr>
<tr>
<td>Eastern Europe and Central Asia</td>
<td>185</td>
<td>2.6 mln</td>
<td>6.9 bln</td>
</tr>
<tr>
<td>Region</td>
<td>Number</td>
<td>Borrowers</td>
<td>Loan Portfolio</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>--------</td>
<td>------------</td>
<td>----------------</td>
</tr>
<tr>
<td>Latin America and the Carribean</td>
<td>364</td>
<td>19.3 mln</td>
<td>35.3 bln</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>34</td>
<td>1.9 mln</td>
<td>1.1 bln</td>
</tr>
<tr>
<td>South Asia*</td>
<td>183</td>
<td>50.4 mln</td>
<td>8.6 bln</td>
</tr>
</tbody>
</table>

(Source: Mix Market (Accessed on Oct 18, 2014)

*Inclusive of India (93 MFIs; 27.8 mln active borrowers; 4.49 bln USD gross loan portfolio)

2.5.2 Asian & Indian Context

The Mix Market 2011 figures show that the Asian market for microfinance consists of 74 million borrowers with an outstanding loan portfolio of 34 billion USD. 91% of these loans are used to fund micro-enterprises. 32 million depositors have mobilized 15 billion USD in deposits. 7 out of 10 borrowers of Asia live in either India or Bangladesh. The growth of micro-finance market in South Asia is the fastest as compared to other regions. In India, the borrowers have increased by five folds in the last six years. However, the SKS crisis in Andhra Pradesh has significantly hampered the growth of Indian MFIs. The most recent figures (Jun 30, 2014) as updated by Mix Market (Accessed on October 18, 2014) in the context of India boast of micro-finance operations spread over 36.1 million borrowers with a gross loan portfolio of USD 6 billion and 9.3 lakh depositors with total deposits amounting to USD 116.5 million.

The top five MFIs as per outstanding loan portfolio are Bandhan (1.04 bln), Shri Kshetra Dhamasthala Rural Development Project (SKDRDP) (0.54 bln), SKS (0.50 bln), Spandana (SSFL) (0.36 bln) and Janalakshmi Financial Services Pvt. Ltd. (JFSPL) (0.34 bln) which constitute 46% of the total loan portfolio in India. SEWA Bank which is a significant MFI of Gujarat depicts a loan portfolio of USD 13 million over roughly 30,000 active borrowers.
2.5.2 Gujarat Context

The Status of Microfinance in India Report 2012-13\textsuperscript{42} published by NABARD gives details of savings, loans disbursed and loans outstanding for each state of India. Since, Gujarat does not fall in the high priority state, numbers communicate the same story. The following table depicts agency-wise savings, loan disbursement and loan outstanding of SHGs with Banks done in Gujarat as on 31\textsuperscript{st} March 2013.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>No. of SHGs &amp; Amount (Rs. Lacs)</th>
<th>Commercial Banks</th>
<th>Regional Rural Banks</th>
<th>Cooperative Banks</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Savings</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of SHGs</td>
<td>118320 (2.90%)*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount (Rs. Lacs)</td>
<td>11442.29 (2.07%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Loans Disbursed</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of SHGs</td>
<td>9304 (1.26%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount (Rs. Lacs)</td>
<td>7353.40 (0.55%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Loans outstanding</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of SHGs</td>
<td>51525 (1.95%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount (Rs. Lacs)</td>
<td>15861.17 (0.60%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Source: Status of Microfinance in India 2012-13)\textsuperscript{42}

*Figures in parentheses indicate percentage to total (India)*
Looking at the above figures, we can say that the micro-finance has not penetrated to a deeper extent in Gujarat as compared to the rest of the states in India. If we take up savings done under the SHG-Bank linkage program, Gujarat’s share is only 2.14% of the whole of India. Gujarat forms a part of the Western Region, wherein Maharashtra is the dominant player with a share of 6.25%. Andhra Pradesh and Karnataka of course lead in this segment with a share of 30.9% and 14.07% respectively. Under the segment of loan disbursement, share of Gujarat has declined from previous year (0.79%) to current year (0.58%), while in the Western region, Maharashtra takes up share of 2.80%. The figures are skewed in the favour of Southern region, with Andhra Pradesh and Tamil Nadu taking the lead with a share of 54% and 14% respectively. As expected, Gujarat has a meagre share of 0.56% in India when it comes to loans outstanding portfolio. Maharashtra has the maximum share in the Western region of 3.12%, as compared to Goa and Gujarat. Almost 70% of this portfolio is contributed by the Southern region, and in that Andhra Pradesh alone occupies almost 63% share of the loan portfolio. As per Sa-Dhan\textsuperscript{60}, the total number of MFIs in Gujarat is 17 (of which 5 have their HQ in the state) as on March 31, 2013, serving around 17 districts of Gujarat (Kutch, Banaskantha, Sabarkantha, Panchmahals, Dahod, Bharuch, Patan, Mehsana, Gandhinagar, Ahmedabad, Kheda, Anand, Surat, Amreli, Surendranagar, Rajkot and Jamnagar), with 5 districts (Banaskantha, Sabarkantha, Panchmahals, Dahod, Bharuch) being recognised as the poorest districts. The total number of banks providing micro-finance in Gujarat is 43 further classified into 18 Public Banks, 4 Private banks, 3 RRBs and 18 DCCBs. In addition to the outstanding loan portfolio under the SHG-Bank Linkage Program (SBLP) (Rs. 22,038.63 lakhs), MFIs have generated a loan portfolio of Rs. 55,731.89 lakhs. Hence, the total outstanding credit portfolio for Gujarat under micro-finance comes to Rs. 77,770.52 lakhs.

The state of Gujarat is also home to another scheme known as ‘Sakhi Mandals’ which offers financial resources to poor families, especially women in rural areas, with the objective of improving their access to resources and quality of life. The various objectives of this scheme were aimed at empowering women, since it included formation of groups like SHGs in the primary stage and giving access to finance. The scheme also arranged for training programs to enhance decision-making skills in women. The scheme was implemented from 2007 to 2010 and Anganwadi workers were given the role of facilitators in formation of SHGs.\textsuperscript{61} According to the report
given by Commissionerate of Rural Development of Gujarat State, this scheme was instrumental in forming around 2 lakh sakhi mandals with 24.8 lakh women members and a savings of Rs. 231.9 crores was generated. About 1.6 lakh groups were linked with banks, which availed a credit of 1083.84 crores collectively. Hence, this scheme which was designed in the lines of micro-finance operations also contributed immensely towards ameliorating the conditions of the poor in rural Gujarat.

2.6 Benefits & Issues of Micro-finance

2.6.1 Economic Benefits

- Access to credit
  Micro-finance has been able to expand and reach the rural areas while maintaining financial sustainability, as both these factors are at odds most of the time. It allows the poor to receive a loan from a formal source. Traditionally, the poor have been unable to receive loans because they don’t have anything to offer as collateral. As a result, they get stuck in a vicious cycle of poverty, living and working in poor, rural areas. In adverse situations, they simply don’t have the means to overcome them. Micro-finance allows the poor to get the loans they need to save, invest, and create a sustainable lifestyle of financial independence and growth. These loans are used productively by the poor to create their own businesses, grow their assets, and get out of poverty once and for all.

- Availability of loans at relatively cheaper rates of interest
  The most disturbing aspect of financial exclusion is that such people are compelled to approach the informal sources of finance, where they are exploited economically. The interest rates charged by local money-lenders range anywhere from 30% to 120%. Such usurious rates only ensure that the poor never come out of the debt trap. Moreover, in most cases the loans are used for consumption purposes, thereby yielding a greater liability on the shoulders of the poor. Micro-finance has come as a boon for such people wherein the ideal rate of interest hovers around 24%, and emphasis is laid on utilization of loans for productive purposes.

- Long-term financial independence
  Micro-finance institutions aim at giving loans mainly for productive purposes. Micro-credits help create sustained impact by educating recipients on how to develop their
own businesses and how to properly manage and grow their money. This results in long-term financial independence for the borrowers.

- Access to other financial products
  
  Micro-finance is a bundle of financial products including other than credit, thrift, deposit and savings, insurance, etc. Hence, the poor benefit from this package of financial services. For instance, micro-insurance has grown tremendously as premiums are low and policies and beneficiaries are customized as per the rural needs. By themselves, the poor would never take any kind of insurance or risk management initiatives, and ultimately incur higher costs in case of emergencies. This gap has been addressed by micro-finance service providers.

2.6.2 Social Benefits

- Gender equality
  
  The track record of micro-finance suggests that most micro-credits are given to women for productive purposes, and the repayment rates have also been high. The NABARD report on Status of Microfinance in India 2012-13\(^42\) suggests that 83% credit is given to exclusive women SHGs (loans outstanding as on Mar 31, 2013 for exclusive women SHGs are 32840 crores against total of 39375 crores). This indicates the growing significance of treating women as entities equivalent to men, even on financial grounds.

- Greater say in decision-making
  
  Another outcome of providing microfinance to women is that other than financial independence, women have gained a respectful status in their homes, community and society. Initially, rural women were always left out of decision-making, but now, they have proved their might. Women are consulted when taking important decisions at home and also in other social groups. This improves their self-esteem and boosts their confidence levels.

- Vocational Training
  
  Many microfinance institutions also engage in providing vocational and other related training to the poor, so as to develop their skill-sets. This is extremely beneficial as most credits as mentioned earlier are provided for productive purposes, and yet the assumption that everyone is an entrepreneur at heart is baseless. Lending alone,
without any training leads to losses in business and entrapment in the vicious cycle of
debt. However, MFI{s ensure that the borrowers are equipped with the basic skills of
marketing and operating their ventures.

- Awareness regarding education, health and sanitation
  Most NGOs which provide microfinance services, also aim at creating awareness
  among the poor regarding the importance of education, health and sanitation. Murthy
  et al.\textsuperscript{63} found that members of SAPAP self-help groups in Andhra Pradesh reported
  improvements in regularity of meals, levels of child nutrition and lower levels of
  infant mortality in the past five years. Pitt, Mark, Khandker, Chowdhury and Millimet
  (2003)\textsuperscript{64}, for instance, found that a 1 per cent increase in loans to women borrowers
  with the Grameen Bank increased the probability of school enrolment by 1.9 per cent
  for girls and 2.4 per cent for boys while a 1 per cent increase in credit to male loan
  holders increased boys' enrolment by 3.1 per cent but had no effect on girls. Hence,
  community development is also a by-product of such microfinance institutions.

2.6.3 Issues

- Rate of Interest
  The rate of interest charged in the micro-finance sector includes the cost of funds,
delivery of credit, collection and payment, provision for bad debts and profit margins.
  Typically, what happens is that NABARD funds commercial banks at 7.5 per cent per
  annum, banks on-lend to MFI{s at 10-15 per cent, MFI{s then lend to SHGs at 12-24
  per cent and the groups lend to individual members at 24-36 per cent. The sector as a
  whole has been criticized for charging interest rates higher than the prevailing formal
  bank rates. However, in the light of Microfinance Bill passed by the Parliament,
  things may improve as the ceiling for interest rate is capped at 24%.

- Accessibility of the poor
  The growth of SHGs has led to an increased availability of credit to the poor in rural
  areas. However, drilling down the benefits of credit to the poorest households is still
  a challenge faced by the Government programs and the MFI{s. They are not able to
  improve their income earning capacity by acquiring the right kind of assets or
  selecting the most suitable activity. The consensus appears to be that the majority of
  organisations do not reach, and sometimes actively exclude, the extreme poor (Hulme
and Mosley, 1996). This is supported by recent studies carried out by the Consultative Group to Assist the Poorest (CGAP) in a number of countries which found that a sizeable percentage of households that had newly joined an MFI (i.e. before they had benefited from access to financial services) were not drawn from the poorest 30 per cent of the population in the context in which the organisation worked. About 50 per cent of SHG members and only 30 per cent of MFI members are estimated to be below the poverty line. According to Ghate (2008), approximately 75 million households in India are poor and about 22 per cent of these poor households (i.e. 16.5 million) are currently receiving microfinance services. Hence, there is a huge gap between the demand and supply of micro-finance, which needs to be met with.

- Dilution of the basic objective of poverty alleviation
  As increasing number of MFIs are transforming themselves into for-profit organizations, there seems to be a radical shift in the basic mission of poverty alleviation. The Andhra Pradesh and SKS crisis have shaken the trust of people from this mechanism. The increased rates of interest, aggressive collection methods and rising professionalism in the sector have left a negative impression on the minds of the rural poor. In many cases, the poor have again resorted to old sources of informal credit.

- Capacity Building
  There is a need for capacity building in the sector, in terms of human resources and infrastructure facilities. There is a lack of experienced consultants for effective corporate governance. Research findings indicate that governance and financial sustainability are closely interrelated. At the same time, there is a lack of sophisticated IT systems which can standardize various processes and reduce cost.

- Repayment setup is not favourable
  The repayment setup is not favourable for the poor, because of the limited time between sanctioning of the loan and payment of first instalment. For example, in Grameen Bank, the first loan repayment instalment is due one week after the loan is disbursed. A similar model is also followed by several NBFCs providing micro-credit in India. For other organizations like the National Rural Support Programme in Pakistan, the first repayment instalment is due one month after the loan is disbursed.
Such a small time gap does not allow people who are starting business from a scratch to settle down properly. Also, they do not have any savings which can help them sail through the initial months till the business starts making profits. Also it prevents risk-averse people from taking up any kind of business activity.

- **Donor-dependence of most MFIs**
  Other identifiable problems with micro-credit lending include the fact that many institutions providing micro-credit services, especially those with an explicit development agenda and an aim to reduce poverty, are currently donor dependent. There is increasing pressure on these organizations to become financially sustainable by increasing their levels of efficiency, their breadth of outreach, and their ability to cut costs. Whereas financial sustainability is of the utmost importance for the long-term provision of financial services, this pressure to reduce costs and generate more income by increasing outreach alters the priorities of the field workers on the ground. As a result, loans are given without a due diligence process, thereby increasing the defaults by the customers. The institution is impacted because of a loan gone bad, and the clients are impacted because they are caught in the debt cycle again.

- **Micro-credit assumes that people have entrepreneurial abilities**
  Micro-credit is given with the objective that the amount be used for self-employment purposes. However, everyone does not possess the skill of being an entrepreneur. Moreover, micro-credit alone, without imparting any kind of marketing or technical skills cannot ensure that the micro-enterprise shall be sustainable.

- **Micro-credit has a potential to trap people in indebtedness**
  This can happen in a couple of different ways: one, individuals may use their loans for consumption purposes or medical emergencies, which leaves people without the income needed to make their loan repayments; or two, the business in which the borrower is engaged fails and he or she has no savings or income to pay back the loan. Hashemi (2007) argues that the high demand for microcredit services, which is used by proponents of microfinance as proof of its effectiveness, may instead be an indication that some people are getting trapped in a debt cycle.

- **Micro-finance not linked directly to social or political activities**
In most programs there is little attempt to link micro-finance with wider social and political activities. In the absence of specific measures to encourage this, there is little evidence of any significant contribution of micro-finance. Micro-finance groups may put severe strains on women’s existing networks if repayment becomes a problem (Noponen, 1990; Rahman, 1999).

2.7 Prospects of Micro-finance

2.7.1 Growth Prospects

The micro-finance sector in India has grown phenomenally over the years, gaining momentum similar to Bangladesh, the place of origin of micro-finance. As per the research conducted by Deutsche Bank (2007), by 2015, institutional and individual investments in micro-finance shall rise sharply to around USD 20 billion. The volume of total micro-finance loans has risen sharply in recent years from an estimated USD 4 billion in 2001 to around USD 25 billion in 2006, and yet there is an estimated funding gap of around 250 billion. Similarly, in India almost 80% of poor households are devoid of financial services. As predicted by Microfinance Market in India 2012-2016 Report, the micro-finance market is expected to grow at a CAGR of 23.49% over the period of 2012-16. The huge untapped market becomes a driving factor for the growth. At the same time, over-indebtedness to micro-finance vendors can pose as a challenge to this growth. Another report titled Microfinance Market Outlook 2015 states that India is on the path of revival post the Andhra Pradesh crisis. The financial inclusion steps taken by RBI supported by a strong one-party Government have improved the GDP forecasts for India (done by IMF) to over 6% in 2015. This in turn has improved the confidence of foreign investors in Indian market and microfinance portfolio growth is believed to exceed 30% in 2015. Thus, micro-finance is slated for healthy growth in India.

2.7.2 Regulatory framework

The Microfinance Institutions (Development and Regulation) Bill was passed in the Parliamentary session of 2012. With the introduction of this Bill, the sector has come under the purview of RBI and shall be formally regulated now onwards. This will ensure proper records maintenance and audit, and will also invite investments from
sources other than donors. The legal framework will help bring transparency and order in the field, especially post Andhra Pradesh crisis.

2.7.3 Customization of products and services

Increasing the breadth and depth of products and services will increase the outreach of micro-finance. Flexibility in repayment schedules based on the economic activity of the clients will help address the untapped audience. This is already seen in the case of loans disbursed for agricultural activities in countries like Pakistan, India, and Madagascar. The loan repayment period is more flexible and takes into consideration both the need to make investments in agricultural inputs ahead of time and the cyclical nature of cash flows. This means that the repayment period often starts after six months, when the crop has been sold.

2.7.4 Technical Innovations

In order to improve the quality of microfinance services some technical innovations may be introduced. A number of electronic devices are being used in different countries to expand the outreach and to improve the microfinance functioning. Some of these devices are mobile phones, ATMs, processor cards, computers etc. A computer with an operator helps the illiterate group members to maintain the records of group financial activities. These computers can also be used to provide important information related to weather conditions, crop inputs, product prices, land records etc. in the villages. Though some of such projects have been started by NABARD on pilot basis, but there is enough scope to use such innovative techniques in microfinance sector in India.

2.8 Conclusion

Micro-finance is not limited to micro-credit, but it is a bundle of financial products like savings, loans, insurance, fund transfer, etc. As a matter of fact, many MFIs also provide ancillary services like financial counselling, trainings on business development and social services, so as to uplift and bring about an overall development of their members. Micro-finance mainly targets people, especially women falling in poor category or low income groups, but are economically active. The main objectives of micro-finance are poverty eradication and women
empowerment. Periodic impact studies convey the progress of micro-finance towards its goals and help the practitioners in planning for the future. Micro-finance institutions follow different legal status and accordingly organize women in groups. These groups could also be of varied types, of which SHGs and JLGs are popular in the Indian context. Several economic and social benefits of availing micro-finance are presented in this chapter followed by several issues in this sector. To draw an idea about the future, prospects of micro-finance have also been identified. The penetration of micro-finance across the countries, in Indian and Gujarat context are also mentioned in the chapter. The next chapter narrates the various paradigms of women empowerment and the literature review of various impact studies carried out in international and national context.

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(Microfinance and Empowerment of Scheduled Caste Women: An Impact Study of SHGs in Uttar Pradesh and Uttarakhal, Government of India, 2011)


46 Panda, D. K. Understanding Microfinance. Wiley India Pvt. Ltd.


http://indiamicrofinance.com/status-microfinance-india-2012-nabard.htm


