CHAPTER 11

CONCLUSION

AND

POLICY RECOMMENDATIONS
There is a view that microfinance can, at minimum, serve as a quick way to deliver finance in the interim, the idea is to then graduate microfinance clients to formal finance institutions where they can access standard “individual” loans, possibly on a fully commercial basis. If the idea of graduation is a serious one in India, strong efforts must be made now to reform the rural finance markets and institutions with an eye to improving the efficiency of the sector and designing services and products appropriate for small clients. An immediate challenge is for formal sector institutions to introduce products and services that are not only reliable available on a continuous basis, but is also flexible and convenient, and also to introduce measures that allow for low-cost ways of reaching the rural poor. Small rural clients prefer to borrow frequently, and repay in small instalments; banks could usefully explore the possibility of offering new and more flexible loan products, like those offered by microfinance. While small rural borrowers seek savings and lending services, they also seek insurance: bank branches in rural areas would do well to explore opportunities to offer composite financial services. Simplification of procedures to open a bank account, access credit, etc. could also go a long way in encouraging the poor to bank with the formal sector, by reducing clients’ transaction costs. The high recovery rates of microfinance are associated with staffing policies that allow recruiting staff from the local area who understand clients’ needs and a focus on desktop banking. Banks ac use technology to drive down their transaction costs. Beyond these measures, government can also play an active role to facilitate increased efficiency of rural finance markets. Better laws and regulations governing financial transactions, a judiciary that can enforce contracts, the demarcation of property and improvements in land tilling, better credit information and enhanced regulatory, supervisory and legal framework to support the development of price insurance products, price derivative instruments and commodity futures markets can go a long way in helping India’s rural poor access finances on better terms.

Finance helps the poor catch up with the rest of the economy as it grows and reduces damaging concentrations of economic power. Microfinance highlights the ‘empowerment’ dimension of finance and gives the poor access to opportunity and the ability to escape ossified social structures. The real poor have irregular income and expenditure needs and hence prefer to borrow frequently and repay in small instalments. Micro financiers can offer composite financial services to small rural borrowers seeking savings and lending services. Microfinance solves the problem of small borrowers as they are unable to provide collateral.
One premise of microfinance is that most clients are too poor to be able to offer collateral. Loans are thus ‘secured’ through non-traditional means like group lending. But in practice some microfinance lenders do require collateral like Indonesia’s BRI. But BRI take a non-traditional view of collateral. While BRI requires collateral in general, the bank is flexible in the assets that it will accept, and in practice collateral is not a major constraint when seeking poor clients. BRI’s view is that the resale value of collateral is far less important than the judgement that the pledged items should be particularly problematic for households to give up. Thus, household items may be considered collateral of they have sufficient personal value for borrowers, even if they are worth relatively little in the hands of BRI. The idea breaks with the traditional banker’s view that collateral should be valuable enough so that banks can sell the collateral to cover the costs of problem loans. For example, land without a certificate of title, is impossible to sell without the cooperation of the borrower and the local community. But BRI sees such collateral as potentially valuable. Microfinance also resolves the mismatch between the services provided by the formal rural finance sector and the loan requirements of the rural poor. It provides a parallel credit system which is better able to meet the genuine credit needs of rural poor, such as consumption needs, emergencies such as illness and household expenses. By providing regular access to savings, credit and insurance services, microfinance programme is able to rescue many poor people from the clutches of moneylenders and arrest the income drain. In addition, the programme also helps rural poor to enhance their income and create assets through employment generating productive activities. Thus microfinance provides ways for borrowers to build up financial assets and then to base lending on those assets. For example, microlenders require that borrowers show that they can save regularly for a period before they become eligible to borrow. Demonstrating the ability to save demonstrates characteristics like discipline and money management skills that correlate with being a good borrower. But saving also leads to deposits in the banks, and that can help directly by providing security for loans. These deposits can function as collateral because if the borrowers get into repayment trouble, then the microlender can hold on to the deposits to minimise their exposure to the full extent of the default. But if the outstanding loan is larger than the funds on deposits, the lender remains exposed to the possibility of default on the difference. Since borrowers have to pay higher interests on the money that they borrow than on the money they receive as interest on their deposits, the scheme can also add substantial ‘hidden costs’ to borrowing. Individuals prefer to borrow even at relatively high interest rates than to draw down the savings that they have
diligently built up over the years. The bottomline is that using financial collateral can be an effective way to facilitate lending but it depends on special assumptions about borrower’s psychology and other constraints that do not hold true for everyone at all times. The programme also meets social and developmental needs of rural poor by addressing problems of alcoholism, gender issues and community development. It challenges long held assumptions about what poor households can and cannot achieve and more, broadly, shows the potential for innovative contracts and institutions to improve conditions in low-income communities. Microfinance is a clear improvement over the development banks that emerged in the 1960s, but the implicit ‘promise’ to achieve complete financial self-reliance has been far from fulfilled.

In rural credit markets borrowers are typically poor and have few other options to get capital, while interest rates are typically well above those found in the formal banking sector. Moneylenders are routinely characterised as exploitative monopolists who systematically squeeze the poor. The poor, for their part, are seen as vulnerable, driven to pay usurious rates out of desperation. The enmity is long standing. In present-day low-income communities, moneylenders remain an important part of the financial landscape. One of the hopes for microfinance is that it will facilitate the start of new businesses and the adoption of new practices. Bhaduri (1973) argues, moneylenders strengthen their bargaining power in order to tighten the squeeze. According to this view, exploitation is possible since moneylenders have local monopoly power. The power is ‘protected’ because potential competitors lack the necessary information and connections to break into local markets. Getting rid of moneylenders could actually make matters worse for villagers if the moneylenders provide valuable and unique services. High interest rates charged by moneylenders reflect the high costs of doing business i.e., costs associated with screening the borrowers, monitoring the use of loans and enforcing repayments. Those costs may not be small, particularly when potential borrowers do not offer collateral and when legal enforcement mechanisms are weak. Rural credit markets are far more competitive than typically imagined (Adams, 1984). If the market is truly competitive, microfinance providers will do little to improve access to credit, unless they can figure out a way to cut costs relative to moneylenders. If microfinance providers are inappropriately subsidised, they may squeeze out moneylenders, worsening overall access to financial services for poor households. The debate about moneylenders and market structure can be sorted out if supporting microfinance improves efficiency. Robinson (2001) concludes
that if much of informal money lending can be explained by a form of monopolistic competition, then it can be argued that banks can cost effectively gain reliable information about borrowers that is far broader in scope than the information to which informal lenders have access. The reason, she suggests, is that money lenders only really get know their own small segments of the market. Microfinance institutions on the other hand, aim to serve many clients on a large scale, pushing existing barriers out of the way as they proceed. Thus intervention in financial markets through creation of microfinance institutions should be based on clear understanding of how the efficiency and equity of outcomes will change.

The analyses of moral hazard and adverse selection provide two tools for analysing market imperfections. Both are based on problems posed by informational asymmetries- the borrowers have better information on their credit worthiness and risk taking than the lender. In moral hazard, inefficiencies arise when the lender cannot deter borrowers from taking excessive risks that increase the probability of default. Inefficiencies due to adverse selection arise when lenders cannot adequately distinguish safer borrowers from riskier borrowers. Both these problems could be solved if borrowers could credibly collateral to secure their loans. But borrowers do not have adequate collateral. The microfinance innovations provide ways around these problems. One of the major innovations of the microfinance movement is group lending. In principle, the group lending contract provides a way to achieve efficient outcomes even when the lender remains ignorant or unable to effectively enforce contracts. Group lending methodology can potentially promote social capital, and thus further enhance efficiency. Group lending with joint responsibility is far from the only innovation in microfinance. Successfully creating dynamic incentives and creating products that are built around households’ cash flows have been as important. Good dynamic incentives are creative through attractive long-term relationships. When forward-looking customers know that default means risking and losing the relationship, incentives to work hard are strengthened. Weekly or monthly repayment schedules, although a sharp break from traditional banking practices, have been particularly critical in allowing customers to repay loans in manageable bits. Strategic micro lenders often attempt to break repayment instalments into pieces that are small enough that customers can, if needed, repay loans from household funds other than profits from the given investment project. The bank’s risks are considerably reduced as a result. In group lending, customers meet as groups and make public repayments. Public repayment schemes have several advantages for the lender. First, without the ability to secure
collateral, micro lenders can use the avoidance of social stigma as an inducement for individual borrowers to promptly repay loans (Rahman, 1999). Second, by meeting as a group of borrowers at specific locations and at scheduled times, some transaction for bank staff might be reduced, even if it adds to clients’ costs. Third, the group is often a useful resource through which staff can directly elicit information about errant borrowers and create pressure as needed. Fourth, group meetings can facilitate education and training which might directly help to improve financial conditions of the family or help indirectly like improving level of health. Fifth, micro lenders are able to reduce opportunities for fraud due to public repayments. Sixth, borrowers become comfortable and are encouraged to approach micro lenders which are institutional organisations such as branches of District Central Cooperative Bank Ltd. or Primary Agricultural Credit Societies.

But according to some, microloans themselves may actually be sources of risk because the proposed solution to the problem of low earning power worsens the problem of vulnerability. According to Dale Adams (1995), micro lenders provide loans not gifts, and this creates obligations. When misfortune strikes, those obligations cannot always be met, putting the borrower into even greater jeopardy. The persistent efforts of micro lenders to make sure that borrowers repay their loans can mean tough on clients in some cases. Due to this clients run into difficulty repaying and thus seek help from others including money lenders. This can lead debt spirals as described by Matin (1997) i.e., customers turned to money lenders for help, borrowed more from micro lenders to pay money lenders and so forth until the amount of unrepaid debt became too unmanageable. The bottom line is that while the microfinance providers tend to stick by hard and fast rules in order to reduce costs and enhance transparency, costs can be imposed on clients. On the other hand, money lenders are much more flexible and sometimes borrowers may opt to pay more to a money lender in exchange because the money lender will extend the loan duration at times of difficulty. On a more positive note, traditional group lending may foster mutual insurance relationships so that before the micro lender intervenes, problems are addressed by group members bound together in a group contract. Drawing on contract theory, Sadoulet (2003) argues that group lending can foster mechanisms in which borrowers can get help from fellow group members. If this is so, borrowers do better when groups are more diversified. Sadoulet and Carpenter (2001) show that in a sample from Guatemala, borrowers do sort themselves into fairly diverse groups. A different way that micro loans may help to reduce risk is by allowing
customers as individuals to reduce exposure to income fluctuations by diversifying income streams and facilitating borrowing for consumption purposes. Thus micro finance practitioners and policy makers are coming around to the view that facilitating savings may often be more important than finding better ways to lend to low-income customers. This is a welcome shift in that many poor households have strong desires to save but lack convenient and secure deposit facilities. The micro credit experience shows the advantage to allowing households to make frequent, small-sized transactions, rather than repaying loans in lump sum amounts. The microcredit experience also shows the importance of building strong institutions. Regulation and diversification are thus far more imperative when it comes to savings. High frequency savings refers to saving and borrowing with the purpose of obtaining insulation from the vagaries of income. Access to consumption loans is an important complement to flexible opportunities to save. These micro saving initiatives are a positive step towards the success of micro finance.

Formal sector commercial banks tend to favour men, mainly because men run the larger businesses that commercial banks favour, and men tend to control the assets that banks seek as collateral. Micro finance often involves self-employment in the informal sector businesses. On the demand side, women tend to be more credit-constrained than men and, therefore more likely to select themselves into micro credit contracts with all kinds of strings attached—namely small loans, training sessions, weekly meetings and joint responsibility. From the micro lender’s point of view, serving women has at least three potential advantages. First, women are often more conservative in their investment strategies and are often more easily swayed by peer pressure and the interventions of micro lenders, therefore women are more reliable about repayments. Second, women tend to be more concerned about children’s health and education than men and thus aiming resources to women deliver stronger development impacts. Third, as women are often oppressed by the male counterparts of the family and prevailing social norms, they would benefit the most through micro credit. Lending to women may enhance efficiency in a broader economic sense—poverty, labour mobility and risk. First, women are poorer than men. Under the standard neoclassical assumptions about the production function, if women have less access to capital than men, returns to capital for women should therefore be higher than for men. Thus, endowing women with more capital may be growth-enhancing. Second, women tend to be less mobile than men and therefore can monitor women at a lower cost. Less mobility facilitates delegated monitoring under group
lending methodologies and reduces the incidence of strategic default under the fear of social sanctions. Third, women tend to be more risk averse than men and more conservative in their choice of investment projects. This makes it easier to secure repayments and create a reputation for reliability.

Microfinance can increase women’s bargaining power and provide protection to women within the household thus acting as a deterrent against domestic violence and as an instrument for women to promote their rights. Rising household incomes also diminish conflicts between husbands and wives by loosening constraints. Microfinance helps unskilled women who have very few working opportunities outside the household to make the most out of traditional activities that they are restricted from in the short-run. It helps them to acquire new skills and accumulate resources that improve their family’s living conditions. Microfinance participation can affect households in many ways. It may make households wealthier, yielding an income effect which would increase total consumption levels. It would also increase the demand for children, health, children’s education and leisure. But if microfinance helps in generating productive activities such as running microenterprises would yield substitution effect and this would counterbalance the effects of increased income. As female employment increases time for rising children can become costlier in terms of forgone income thus reducing fertility rate. This would decrease schooling levels as children would have to stay at home to carry out the household chores usually done by women. It would also reduce leisure for women because the working hours rise. Micro lenders may also make direct, non-financial interventions by organising programmes and meetings to stress the importance of schooling and good health practices, thus taking advantage of group meetings to hold communal discussions and training sessions.

Credit cooperatives play an increasingly active role in the microfinance market today by mobilising local resources. The design of cooperatives encourages peer monitoring and guaranteeing the loans of one’s neighbours. The level of peer monitoring is not necessarily optimal from a social standpoint, however- which is a lesson that carries over to group lending in microfinance. The role of cooperative banks in West Bengal is noteworthy. Cooperative banks play a pivotal role in SHG-Bank-Linkage programme in Hooghly district of West Bengal. They act as microfinance institutions directly through its branches or through Primary Agricultural Credit Societies. NGOs as microfinance institutions in Hooghly are insignificant. The mission of reaching financial services to the poor with an eventual goal of
promoting livelihoods of the poor and empowering them is fulfilled by the cooperative banks very successfully. The District Central Cooperative Bank either through its branches directly or via Primary Agricultural Credit Societies (PACS) have reached a wide client base. As rural West Bengal is dominated by small and marginal farmers therefore the need for micro credit is of utmost importance. There is no official estimate of microcredit and so we have considered the amount to be not more than Rs. 20000. Hence this type of credit can be availed by both members of individual liability and joint liability credit contract system. The members of individual liability credit contract system can directly get their agricultural loan from respective PACS using ‘Kisan Credit Card’ as the main objective of PACS is to lend short-term and medium-term credit for agriculture and allied activities. PACS also lend to self-help groups as they act as microfinance institutions in Hooghly district for production as well as consumption purposes. The groups are formed, nurtured and monitored by PACS or branches of Hooghly District Central Cooperative Bank Ltd. Lending by PACS or branches of HDCCB Ltd. in Hooghly district, particularly in the two blocks of Chinsurah-Mogra and Tarakeshwar is in smaller amounts not exceeding Rs. 20000, both to individual liability and joint liability credit contract systems. Therefore PACS was able to reach every household through these two credit contract systems. As the male counterpart of the household was already a member of PACS having entitlement to ownership of land, women were targeted for formation of self-help groups to strive towards a more inclusive financial system. The ignorant and illiterate rural women were thus given an opportunity to undertake economic transaction with a formal financial institution and also learn to maintain accounts of deposits and loans, initially done with the help from SHG coordinators. Thus an effort to reach out the poor and widen the client base and reduce the dependence of rural poor on informal finance is noteworthy. As collateral free loans could be obtained from formal financial institutions such as PACS and for consumption purpose, it benefitted the poor rural households and saved them from the clutches of moneylenders because the rate of interest charged by PACS for joint liability loans was much less compared to the exorbitant rates of interest charged by moneylenders. The growth rate of SHGs in these two blocks of Hooghly district is phenomenal which clearly shows that SHG-Bank-Linkage programme was effective as it was successful on making the rural poor people bankable. The propensity to save in small amounts was emphasised thus allowing it to accumulate and add
to group funds thereby increasing cooperation among group members and making SHGs sustainable.

Flexibility and discipline could be offered in separate products accessible simultaneously to clients. They could also be offered simultaneously through two distinct savings products, such as flexible passbook account and a disciplined commitment savings account. Clients would use a passbook savings account to deposit daily and to have fast liquidity access, while commitment savings account would provide the structure necessary to accumulate a large lump sum for some future planned expenditure. Globally the microfinance industry still faces a large supply gap. But in an increasing number of sub-markets, situations of oversupply emerge which have the potential to be detrimental to microfinance customers and lending institutions alike. With regards to borrowers, they experience impoverishment from over-indebtedness. They may also experience sociological consequences such as peer pressure, domination in the household, loss of social networks. It also leads to a reduction in the borrower’s personal freedom of choice. From MFI’s point of view, over-indebtedness can result in increasing operating costs, reduction of market size and reduced income. There can also be spillover effects on other MFIs and stakeholders.

Provision of credit to poor people is a major concern of microfinance institutions, here PACS. While providing credit PACS have to incur cost of lending which includes both direct and indirect cost. There is also some amount of risk cost in terms of overdue interest reserve both for individual liability and joint liability credit contract systems. Overdue interest reserve is due to non-performing assets. Lending to the poor by formal financial institutions is costly as there are chances of non-repayment or default. It has been clearly observed in my study that cost of lending agricultural credit is higher than cost of lending to groups and therefore this acts as an incentive for PACS to lend to SHGs even without collateral. In my study the only exception was Vivekananda Krishi Unnayan Samiti Ltd. in (t+1)th period where cost of lending for agricultural purpose was less than the cost of lending to SHGs. During this year the amount of deposits by SHGs in this particular PACS increased and therefore the amount of borrowing increased which is a positive sign for joint liability credit contract system. This led to an increase in the amount of interest paid by PACS to group members for their deposits and the amount of interest paid to HDCCB Ltd. for refinancing SHG loan. Thus it was estimated that it is profitable for PACS to lend for agricultural purpose except Digsui Union Large Sized Primary Agricultural Credit Society where it is profitable to lend for SHG loan.
But since cost of lending for agricultural loan is greater than SHG loan, PACS prefer to lend to SHGS even though it is uncollaterised loan. SHG loans have a high repayment rate due to peer pressure and group dynamics. Financial performance of these PACS judged on the basis of three indicators viz. sustainability, asset quality and efficiency reveals that they are sustainable and efficient (except VKUS) with respect to KCC as well as SHG loan but asset quality is low.

Microcredit as a major tool against world poverty is polarised over the debate of the virtues of individual versus joint liability loan contract system. Joint liability claims to overcome information asymmetries and solves the problem of adverse selection leading to positive assortative matching. The problem of moral hazard can also be mitigated through group lending. Since cooperatives via PACS play an effective role in including the poor both through individual and joint liability loan contract system, the rural households have the option of choosing whether to become direct member of PACS on an individual basis or form self-help groups to borrow from PACS. They also have the option of not joining any of the loan contract systems. Therefore, Multinomial Logit Regression model was used to identify the factors which influence or increase the probability of a rural household to either join any of the loan contract systems or stay away from them. The factors identified were size of land, adult equivalent dependency ratio, income from other sources, age of the borrower, education level of the respondent and borrowing from other sources by the respondent. Size of land owned by the respondent and higher income from other sources play a significant role in individual liability loan contract system whereas adult equivalent dependency ratio, age of the respondent, education level of the respondent and borrowing from other sources by the respondent do not play any significant role in individual liability loan contract system. Size of land and direct membership of PACS are positively related i.e., more is the size of land, the respondents are more prone to take direct membership of PACS. But higher income from other sources decreases the probability of rural household to take direct membership of PACS. For joint liability loan contract system, age and education level of the respondent play a significant role in decision-making. The other explanatory variables, i.e., size of land, adult equivalent dependency ratio, income from other sources and borrowing from other sources by the respondent fail to influence the decision-making of an individual regarding joint liability loan contract system. Higher age and higher education level of the respondent discourages an individual to join self-help groups. But the opportunity and ability to save in small amounts
and borrow without any collateral and at low rates of interest act as the driving force for becoming a member of joint liability loan contract system. But inspite of so many advantages some households who have no land and thus are poor cannot become members of PACS also do not join self-help groups because they do not want to face peer pressure and group dynamics.

As it has already been stated that credit given directly to individuals also form a part of microfinance technology because majority of the farmers in West Bengal are small and marginal and therefore their credit requirement is also small as agricultural credit is a function of the size of land owned. On the other hand, the concept of microcredit delivery through self-help groups is one of the commendable efforts made by HDCCB Ltd. via PACS in West Bengal. In order to understand how effective both the credit contract systems are in improving the economic conditions of rural participants and thus make a comparative appraisal of both the systems, I have used difference-in-difference method and first differenced method. The sample respondents were surveyed twice for the impact study. The outcome variables are change in average monthly income and change in average monthly adult equivalent per capita consumption expenditure of the \( i \)th sample household. The explanatory variables are adult equivalent dependency ratio, size of microcredit for income generating activities, size of microcredit for non-income generating activities and outstanding microcredit. Outstanding microcredit is a dummy variable in this case. For individual liability loan contract system, using first-differenced method, it is observed that there is no significant change in average monthly income and average monthly adult equivalent per capita consumption expenditure (MPCE) of the \( i \)th sample household. MPCE experienced few marginal drops. The reasons identified for insignificant improvement in average monthly income are size of land, no improvement in irrigation facilities and other farming inputs and no improvement in terms of multiple cropping. On the other hand, due to an increase in cost of cultivation, scale of finance increased leading to an increase in amount of repayment which forced rural households to curtail household budget thus leading to a fall in MPCE. Hence to improve the conditions of small and marginal farmers they should be provided with support services and better irrigation facilities and rate of interest charged by PACS on small and marginal farmers should be different from those of large farmers. Farmer’s club should be more effectively involved and there should be more people’s participation in the decision-making of PACS. For joint liability credit contract system, both difference-in-difference
method and first differenced method are used to understand the effectiveness of microfinance. Results reveal that microcredit programmes under joint liability credit contract system is ineffective and fail to improve the economic conditions of the members of SHGs in the two blocks of Hooghly district under study. Lack of proper initiative for investment in income generating activity, lack of skill-based training for women, lack of marketing facilities and availability of alternative avenue for skill-based training programmes through Swarnajayanti Grameen Swarojgar Yojona (SGSY) are the major factors responsible for inefficiency of microcredit programmes in case of joint liability loan contract system. But the only positive aspect is that the members of SHGs are saved from the exploitation of moneylenders. Therefore it is found that microcredit is totally ineffective for both the credit contract systems as the number of people living below the poverty line did not change even after microcredit participation programme. In order to understand the effectiveness of microcredit both the credit contract systems are compared to the control group i.e., individuals who did not participate in any form of microcredit programme and it is observed that microcredit is totally ineffective in improving the economic conditions of poor rural households.

As women are an important part of the community, building their capabilities to manage communities should be enhanced. Advocates argue that microfinance can increase women’s bargaining power within the household. Women will become empowered and enjoy greater control over household decisions and resources. Microfinance is likely to provide protection to women within their households as group lending entails peer monitoring by other borrowers in the same group. Microfinance through self-help groups are considered as social networks where trust and reciprocity operate and are referred to as social capital because people learn to work together for a common purpose in a group or organisation. Therefore in order to understand the impact of microfinance on women empowerment through social capital, Women Empowerment Index has been estimated using Principal Component Analysis and the impact is studied using difference-in-difference estimator. Here, members of joint liability loan contract system are included because all the groups considered are women groups. Members of individual liability loan contract system are ignored because all members of PACS are normally men as they have the entitlement to ownership of land. Thus members of joint liability loan contract system are compared to control group. Results reveal that microfinance programme is able to influence empowerment of women positively among
members of joint liability loan contract system even though it failed to reduce the level of poverty among the members of SHGs in the two blocks of Hooghly district. Women’s access to savings and credit has given them a greater economic role in decision-making thereby maximising their own and household’s welfare. Women are able to spend much of the income on household well-being including children’s education and their health. There is an increased confidence and awareness among women. Trust and cooperation act as the lubricant among the members of SHGs and thus foster diffusion of information and knowledge.

Managing microfinance is made particularly challenging by the fact that, unlike other businesses, most micro lenders pursue multiple objectives in making decisions- financial sustainability on one hand and social impact on the other. Micro lenders also work with populations that have traditionally scared away commercial banks for fear of excessive costs and risks. Combined micro finance (CMF) can enhance various economies of scope which lead to a better efficiency and productivity of the Micro Finance Institutions and can be stimulating for the broadening of client outreach. Combined Micro Finance can lead to exclusionary mechanisms which negatively impact its depth of outreach to low-income and gender sensitive groups. It can have positive effects on socio-economic results of MFI interventions. Targeting policy has proven to have a significant impact on MFIs’ efficiency while it appears to have no impact on productivity. Client-specific targeting policies in general restrict potential borrowers and thus worsen MFIs’ cost efficiency. MFIs operating in rural environment are assumed to be less productive and efficient given the higher operating costs and staff efforts associated to serving population in remote areas with poor quality infrastructure and narrow scope for cost compression in low population density areas.

Public policies can initiate appropriate regulations and measures which limit market distortions such as information asymmetry. Public interventions should support MFIs to ensure that the design of CMF allows the necessary flexibility and conditions to allow maximum access for vulnerable or unbankable persons. The ultimate goal of pro-poor public policy is hence, in a sustainable way maximising leverage allowing MFIs to reach out to vulnerable clients in their efforts to achieve their most fundamental human development aspirations. Microfinance has strengths and weaknesses, opportunities and threats. Microfinance helps to reduce poverty as the main aim of microfinance is to provide loan to the individuals who are below the poverty line and cannot access commercial banks. There is
a huge networking available due to microfinance. MFIs are available in remote areas for small and medium borrowers who have a huge demand. On the other hand, MFIs are not properly regulated. There are a large number of people still having access to informal sources in many remote areas thus MFIS concentrate on a smaller section of the population in these areas. There is a huge demand and supply gap between the borrowers and lenders. There is a huge opportunity for the MFIs to serve poor people and improve their standard of living. It also helps them to increase the employment opportunity of the poor through provision of loans for their micro enterprises or educating their children and sometimes themselves which yield benefits in the long-run. There is a huge untapped market and the MFIs have an opportunity to meet the demand of the non-served poor. There is an opportunity for private banks to get themselves involved in the SHG-Bank-Linkage programme to serve the poor. But microfinance also faces the threat of competition as more players enter the microfinance industry because transaction costs of MFIs which are already high will rise further. Excess involvement of government in Micro Finance Institutions through waiver of loans is also a serious threat to MFIs. Thus traditional banking modes are up for rethinking as micro lenders battle to keep costs down. The twin objectives of reducing poverty and achieving self-sufficiency via profitability often conflict rather than being complementary.

**Suggestions for improving the microfinance sector**

1. Technology can play an important role in the creation of facilitative infrastructure that can propel overall growth of the microfinance sector. Technology will have better access to individual client level information thus making the microfinance assets transparent and easily available for verification and scrutiny. If the information system is robust then microfinance asset can be traded in the primary and secondary capital markets and also help attract private capital from individuals and venture capitalists.

2. Building up the infrastructure and credit-information structure is important as it will help in reducing lending costs associated with information asymmetries and create valuable ‘reputation collateral’ to members as they lack physical assets.

3. Sustained access to the MFI and progressive credit expansion can serve as good enticement tools for borrowers to form joint liability groups. The borrowers will then
be induced to borrow for entrepreneurial activities thus creating self-employment opportunities for themselves.

4. The donors of microfinance should encourage those MFIs who are constantly making efforts to improve regulation, skill-based training programmes and marketing facilities in order to help the country out of poverty. This will make the cooperatives more effective in including the poor in their business and development activities.

5. MFIs should rethink in terms of target clients/recipient. The more well-off should be recipients of loans because the poorest people are not benefitting from the micro loans in terms of improvement in their economic conditions. The loans are being used for consumption purposes and whatever business ventures have been undertaken, they are not sustainable. The relatively better-off can generate employment opportunities for more people and these businesses have the capacity for self-sustainability and revenues. This will enhance growth and development.

6. Microfinance should be used to increase access to public goods so that there is an improvement in the quality of life for people. MFIs should be encouraged to offer low interest rate loans for public goods such as building a well or canal or setting up a school. This will also pave the way towards growth.

7. Government regulation and supervision are very important with regard to deposit-taking institutions because it is important to maintain the public trust and ensure savings deposits are safeguarded. Thus the government should be stricter in their regulatory and supervisory role.

8. Transparency should be fostered within aid agencies because transparency contributes to sustainable microfinance and decreases costs. Financial risk can be reduced thereby enabling MFIs to take and use savings as a low cost source for on-lending thereby creating investment opportunities.

9. The macroeconomic environment must be stable as microfinance does not operate in a vacuum. Stable economic conditions help operations and reduce costs.

10. There is a need to recognise a separate category of Microfinance Non-Banking Finance Companies (MF-NBFCs) which could provide thrift, credit, micro insurance,
remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas.

11. Farmer’s clubs should be given more importance in the microfinance sector because a farmer’s club acts as a support system to expand the banking out-reach with in-built quality safeguards through word of mouth publicity and demonstrable behaviour of volunteers. Word-of-mouth publicity about the services of the farmer’s club will create a climate conducive for customer retention and growth.

12. MFIs, here PACS also acting as SHPIs should be more vibrant and competent to cater to multifarious sectoral needs and also to facilitate and augment various microfinance related issues through lobbying and collective advocacy. Capacity-building, including on-the-job support and exposure visits should be provided to the staff of PACS on an ongoing basis to enhance the functions of PACS. PACS should also play an important role in encouraging client-community participation.

13. PACS should provide micro insurance facilities to members of SHGs just as crop insurance is provided to members of individual liability loan contract system because micro savings, microcredit along with micro insurance can help poor women tread the path of self-reliance. Micro insurance facilities will motivate poor women to undertake entrepreneurial activities which are risky ventures due to lack of marketing facilities. Micro insurance facilities will also reduce the bad debt costs of PACS.

14. More collaborative projects with formal institutions and various development agencies should be encouraged to provide various services needed for the members of SHGs. Such linkages will influence and create identity for people’s organisations and would facilitate long-term sustainability of MFIs, here PACS through availability of resources.

15. There should be setting of minimum performance standards and benchmarks for PACS to ensure viability.

16. The PACs should increase the quantum and quality of portfolio for profitability because higher funds being available for on-lending to SHGs with improved internal capacity and systems would result in achieving sustainability as there is a positive
correlation between profitability and asset quality. Staff efficiency should also be promoted to facilitate SHG-PACS linkage.

17. There should be flexible and effective mechanism of supervision and regulation. The supervision should not be top-down but should produce sufficient quality information. There should be no political interference in the operation of MFIs for a social cause.