CHAPTER–II

MICROFINANCE AND SUBSIDIZED MICROFINANCE: IMPACT OF SUBSIDY ON SUSTAINABILITY (A BRIEF REVIEW OF LITERATURE)

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2.1. Introduction

Detailed review of literature forms the basis of any good research. This provides enough clues for the study to be undertaken. It helps to identify the problem areas for further scrutiny. Though a summary of such review is already presented in chapter one, the present chapter furnishes a detailed version. This chapter begins with the review of literature on the proliferation of microfinance across the globe in general and India in particular with special focus on their outreach and on the importance of microfinance in alleviating rural poverty. The global emergence and spread of the subsidized microfinance are covered in the next section with special reference to India. The sustainability issue of various microfinance programmes and subsidized microfinance programmes are also an indispensable part of the study wherein the impact of microfinance with special focus on impact of subsidy on sustainability is studied. Methodological issues with regard to the impact assessment of microcredit and impact of subsidy on sustainability are covered at the end.

2.2. Proliferation of Microfinance

Provision of credit to the poor is always considered as a primary objective by the government of a respective country and has been given due importance by the policy makers. To deliver the smooth credit to these huge poor, the role and function of the Commercial Banks (CBs), especially the Regional Rural Banks (RRBs) and Cooperative Banks (CoBs) are strengthened from time to time. But on account of non-fulfillment of banking norms by the poor, especially in case of collateral, the banks in many parts of the world are still far behind in achieving the target of full financial inclusion. The exclusion of the poor from formal financial institutions is more
throughout the world. The degree of exclusion ranges from partial to full or nearly full exclusion in developed and lesser developed countries (Dev, 2006).

In the pursuit of achieving broader financial inclusion, the provision of microfinance to the poor has been accepted as one of the powerful tools to alleviate poverty worldwide. The past few decades have witnessed and accepted this mechanism as an effective and popular measure to fight against poverty, enabling those without access to lending institutions to borrow at bank rates, and start small business. All these are visible in the research studies conducted at the various parts of the world where it has been shown that the poor who are basically considered as non-bankable can be served by way of making micro-credit accessible to them. Micro financial services to the poor can be the magical formula in lifting them up from poverty and also to mainstream them with country’s economic activity (Park, 2001; Shaw, 2004; Ahmed et al., 2006; Coleman, 2006; Haitt & Woodworth, 2006). The study of seven Indian states (Sinha, 2005), including Assam and Manipur has shown that micro credit helps in providing direct loan to the poor and microfinance as a whole has increased the borrowing options for the poor clients in the country. During the last few decades, many countries have given due preference to this powerful tool and started including as one of the main components in their policy framework. In many developed and developing countries, the interventions of microfinance through various governments’ supported programmes have been seen as one of the well accepted tool to fight against poverty. Apart from the government, many other agencies like Donors, NGOs, Financial Institutions and different Community Development Bodies have also accepted and supported this tool as poverty alleviation, employment generation, job creation and self empowerment through the setting up of small enterprises for income generating activities. Stephen, J.K. (2005) has narrated the role of NGOs and added that they can play a decisive role as an effective delivery mechanism in rural development as they have innate advantage to involve people and ensure their participation in the agencies.

In its continuous proliferation, different microfinance programmes, including, subsidized microfinance in the recent past have shown as one of the best ways to use scarce development funds to achieve the objectives of poverty alleviation. Further, certain microfinance programmes
have gained prominence in the development field and beyond. They have been accepted as one of the best approach for the development of entrepreneurship both in rural and urban areas. By helping in developing a broad base of micro entrepreneurs, the programme helps in sustenance of growth and development process of an economy (Hamry, 2000).

The initial micro credit interventions in Bangladesh, Bolivia and Indonesia\(^5\) demonstrated the success of micro lending to poor without collateral requirements. Rhyne (2001) observes that these interventions demonstrated techniques for lending to the poor with better outreach and cost recovery. The success of these innovations was mainly led to their common principles of reliance on each other and 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. It is claimed that this new paradigm of unsecured small scale financial service provision helps the poor people to take advantage of economic opportunities, expand their income, smoothen their consumption requirement, reduce vulnerability and also empowers them (Littlefield, Morduch, & Hashemi, 2003; ADB, 2004). Realizing the strength of microfinance to assist the poor, the World Bank had also taken major steps in its development. The significant landmarks in this field were the formation of CGAP\(^6\) in 1995 as a consortium of 33 Public and private development agencies and establishment of MAFMI\(^7\) in 2003. CGAP acts as a “resource center for the entire microfinance industry, where it incubates and supports new ideas, innovative products, cutting-edge technology, novel mechanisms for delivering financial services, and concrete solutions to the challenges of expanding microfinance”\(^8\). CGAP has been instrumental in grant-making to MFIs, fostering national level policy on microfinance and setting guiding principles to microfinance industries. MAFMI was established with support of CGAP and Open Society Institute for meeting the technical and managerial skills required for microfinance sector. Apart from world

\(^{5}\) Grameen in Bangladesh, PRODEM in Bolivia and Bank Rakayat in Indonesia (BRI)

\(^{6}\) Consultative Group to Assist the Poor.

\(^{7}\) Microfinance Management Institute.

\(^{8}\) http://www.cgap.org/portal/site/CGAP/menuitem.8d0ec8712cb72d1eae6c6210591010a0/
Bank, the other regional multilateral development banks like Asian Development Bank (ADB, 2000) also favored the concept of microfinance as unique mechanism of fighting against poverty and has outlined its policy by saying “to the poor, access to service is more important than the cost of services” and “the key to sustainable results seems to be the adoption of a financial-system development approach”. Also, ADB in its theme chapter on microfinance cites access to financial services as critical for eliminating poverty and reaching Millennium Development Goals (MDGs). International Fund for Agriculture Development (IFAD) along with Food and Agriculture Organization (FAO) and the World Food Programme (WFP) declared that it would be possible to achieve the eight Millennium Development Goals (MDGs) by the established deadline of 2015 if the developing and industrialized countries took action immediately by implementing plans and projects, in which microcredit could play a major role.

In addition, microfinance programmes have been found to be evolved as a need based policy and programmes to cater the neglected target groups’ that is women, the poor and those who do not have access to credit. In the last few decades, the provision of microfinance, especially the micro lending has depicted its development substantially in the Asian region. Microfinance Institutions (MFIs), such as GB\(^9\) and BRI\(^10\) in early seventies and eighties showed that they could provide small loans and savings services profitably on a large scale. About 21 percent of the GB borrowers and 11 percent of the borrowers of the BRAC\(^11\), managed to lift their families out of poverty within about four years of participation (Khandker, 1998). Again, without exclusively targeting the poor, the BRI has also assisted hundreds of households in lifting themselves out of absolute poverty over the past decade (Sugianto, 1998). The other innovative approaches that

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\(^9\) http://www.truthforce.info/index.php?q=node/view/760

\(^10\) GB (Grameen Bank) Project was born in the village of Jobra, Bangladesh, in 1976. In 1983 it was transformed into a formal bank under a special law passed for its creation. Its focus is to provide microfinance services to the poor and help them in taking income generating activities.

\(^11\) BRI (Bank Rakyat Indonesia) is one of the oldest and most established banks in Indonesia, dating back to 1895. Its focus from its inception has been on delivering the best banking services possible to micro, small and medium-sized businesses especially in the agriculture segment.

\(^12\) BRAC (Bangladesh Rural Advancement Committee) is a microfinance institution and is currently (May 2010) the world’s largest Non-Governmental Development Organization based in Bangladesh. It was established in 1972 by Sir Fazil Hasan Abed, shortly after the independence of Bangladesh from Pakistan. BRAC has its existence in all the districts of Bangladesh serving over 7 million borrowers. The organization operates in 14 countries around the world, mostly in South Asia and Africa.
have been used successfully in the Asian regions are BAAC, of Thailand, ACLEDA of Cambodia, BTB of Bangladesh, SEWA Bank in India and AI in Malaysia.

The interventions of microfinance by various institutions along with the MFI's have benefited not only the disadvantaged group of the society but also encouraged the formation of more MFI's to help the poor in reducing the vulnerabilities and increasing their standard of life. An accelerated growth in formation of MFI's and an increased emphasis on reaching scale were seen in 1990 (Robinson, 2001). These MFI's along with other programmes of the government have adopted different models of microfinance for smooth delivery of small loans to the poor. The leading models of microfinance found across the globe to address the poor are: (i) Grameen Model- initially promoted by the GB of Bangladesh. Grameen MFI's undertake individual lending but all borrowers are members of a 5 member joint liability group which in turn gets together with 6-9 other such groups from the same village or neighbourhood to form a ‘centre’. Within each centre, peer pressure and the desire to maintain credit-worthiness in order to qualify for a larger loan in the next cycle are the key factors which ensure payments. The most of the Solidarity

13 BAAC (Bank of Agriculture and Agriculture Cooperatives) was established in Thailand as a specialized agricultural credit institution on November 1st, 1966. BAAC’s main aim and objective are to promote the improved social and economic well being of Thailand’s farming population through the provision of financial assistance in the form of loans for agricultural production, investment and marketing purposes.

14 ACLEDA (Association of Cambodia Local Economic Development Agencies) was established in January 1993 in Cambodia, as a national NGO for micro and small enterprises development and credit. It had turned into Financial Institution basically to provide financial help to the Poor in March, 1996.

15 BTB (Buro-Tangail of Bangladesh) is an independent, sustainable and cost-effective Micro Finance Institution (MFIs) in Bangladesh and has been operating since 1990. It is basically dedicated to the economic development of the poor in Bangladesh.

16 SEWA (Self-Employed Women's Association) is a women’s self-help organization, established in Ahmadabad (India) in December 1971 and registered as a trade union in April 1972. In 1974, 4,000 self-employed women established the SEWA Bank as a cooperative bank with the specific objective to provide credit to self-employed women with a view to empower them and reduce their dependence on money sharks. The SEWA Bank works only with poor women and loans are only available for economic activities and not for personal use.

17 AI (Amanah Ikhtiar) of Malaysia is a private trust that was established in 1987. The institution operates as a Micro Finance Institution (MFI) that provides capital financing, savings and healthcare financing assistance to the needy section of the society.
Group Models in Latin America, Philippines and Nepal have been following this Methodology. (ii) Self-Help Group is a collection of 15-20 members and its operations are based on the principle of revolving the members’ own savings. Such resources are many a times augmented by funds borrowed from MFIs or banks. The volume of individual borrowings is determined either by the volume of member savings or by the savings of the group as a whole. The best examples of this type of methodology are the Self-help groups-bank linkage programme in India (SBLP), the PHBK¹⁹ project in Indonesia and the Chikola groups of K-REP in Kenya²⁰. Variants of these approaches also exist in a number of other countries, including Indonesia, Nepal, Pakistan, and Sri Lanka. (iii) Individual Banking provides provision of financial services to individual clients. These may sometimes be organized into joint liability groups, cooperatives or even SHGs. In the case of cooperatives, all the borrowers are the members of the organization either directly or indirectly by being members of primary cooperatives or associations which are members of the apex society. Creditworthiness and loan security are the function of cooperative membership within which member savings and peer pressure are assumed to be the key factors. These technologies are predominant in the BRI-Unit Desa in Indonesia²¹ as well as priority sector lending by banks in India especially the RRBs and CoBs. (iv) Community Banking treats the whole community as one unit, and establishes semi-formal or formal institutions through which microfinance is dispensed. Such institutions are usually formed by extensive help from NGOs and other organizations that train the community in various financial activities of the community bank. These institutions may have savings components and other income-generating projects included in their structure. A prominent example of this type of microfinance institution central Asia. (v) Credit Unions and Cooperatives Credit Unions are member-owned

¹¹ Solidarity Groups are the programmes that do not anticipate the eventual graduation of the borrower group from the lending institution. Participants are considered long-term “clients” of the program. One of the most famous examples of the solidarity group model is the Grameen Bank

¹⁹ PHBK (a programme linking banks and NGOs) has been operated by Bank of Indonesia and the German Agency GTZ.

²⁰ K-REP in Kenya is a Kenya Rural Enterprise Programme.

²¹ The Bank Rakyat Indonesia (BRI), with its unit desa system, is a successful rural financial institution with a large microfinance portfolio.
organizations providing credit and other financial services to their members. The apex body is the Village Bank of FINCA\textsuperscript{22} in Latin America, which had been replicated in Africa and provides technical and financial support to the federating units. SANASA\textsuperscript{23} of Sri Lanka is a successful example of rural credit cooperative as microfinance service provider (Das, et al., 2000).

Microfinance services through group lending, particularly to women group, have been found to be very effective for the lending institutions in terms of reducing transaction costs and better recovery rate. A study on Indonesia (Panjaitan-Drioadisuryo et al., 1999) suggests that when agencies, government and non-government in a developing country, make credit available to low income women, they can substantially reduce the cost of delivery, increase repayment rates and greatly improve the well-being of the poor families. The group lending strategy of microfinance as experienced from Bangladesh Grameen Bank has brought benefit in terms of lowering down the transaction cost of the financial institutions in one hand and high repayment rate by the poor on account of peer pressure on the other. Microcredit is found helpful to the poor if different intermediaries are coordinated properly in the process of delivery mechanism. Both banking and non-financial sectors of an economy can prove themselves vital in improving the business and achieving the long term sustainability by way of smooth micro financial services to the poor. Thus, there is a huge scope to improve the businesses of rural banking branches in one hand and the several non financial sectors such as intermediary institutions, NGOs and SHGs on the other hand can generate more income for their sustainability (Mishra, et al., 2004).

\textsuperscript{22} FINCA (The Foundation for International Community Assistance) is a non-profit, Micro Finance Organization (MFO), founded by John Hatch in 1984 in Latin America. FINCA is the innovator of the village banking methodology in microcredit and is widely regarded as one of the pioneers of modern day microfinance. With its headquarters in Washington, DC., FINCA has 21 affiliated host-country institutions (affiliates), in Latin America, the Caribbean, Africa, Eastern Europe, the Caucasus and Central Asia. Along with Grameen Bank and Accion International, FINCA is considered to be one of the most influential MFO in the world.

\textsuperscript{23} SANASA (Sakasuruwam ha Naya Ganudenu Pilibanda Samupakara Samithiya), is the Sinhala acronym for the movement of Thrift and Credit Co-Operative societies in Sri Lanka. It is the only micro finance cooperative network in Sri Lanka covering all provinces with 8424 primary societies.
Access of credit to the poor to fight against poverty has always remained a core element in the Indian planning system. The public policy for rural finance from 1950 till date has been witnessing this issue in the form of increased allocation of funds to the rural sector. India, in the late 1960s, witnessed a “Social Banking” phase by way of one of the largest interventions in rural credit market. Also the decadal period saw the nationalization of existing private commercial banks, massive expansion of branch network in the rural areas, mandatory directed credit to priority sectors of the economy, subsidized rates of interest, creation of a new set of rural banks at district level and Apex bank called NABARD\textsuperscript{24} at national level. These measures resulted in impressive gains in the rural outreach and the volume of credit. As a result, between 1961 to 2000, the average population per bank branch fell tenfold from about 140 thousand to 14000 (Burgess & Pande, 2005). So, the proliferation of banking services to rural areas paved the way of reaching the poor and particularly through the delivery of small finance.

The growth of microfinance has also been seen in terms of financial sector reforms in India starting from 1991 and the global emphasis on commercialization of the sector. The financial sector reforms in India have focused on fostering a market based financial system by increasing competition and improving the quality of financial services. The new approach has been deeply influenced by the reorientation among international rural financial policy makers centering on concepts such as self-help, self sustained growth and institutional viability. The study of Dasgupta (2001) and Namboodiri and Shivani (2001) traced the development of the microfinance programme in India through SHGs model, initiated by the NGOs after which the concept of group lending has created its unique position in terms of accessing small credit by the poor. The different NGOs such as MYRADA\textsuperscript{25}, SEWA\textsuperscript{26}, and PRADAN\textsuperscript{27} are found to be

\textsuperscript{24} NABARD (National Bank for Agriculture and Rural Development) is established in 1982, by an Act of Parliament and is an Apex Development Bank with a mandate for facilitating credit flow for promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts in India. It also has the mandate to support all other allied economic activities in rural areas, promote integrated and sustainable rural development and secure prosperity of rural areas in India.

\textsuperscript{25} MYRADA (Mysore Resettlement and Development Agency) is an NGO that has had extensive experience in incubating, developing and managing savings and credit programmes in Southern India.

\textsuperscript{26} SEWA (Service for Economic welfare and Awareness) is a Mumbai based Charitable Foundation NGO, creating awareness in three areas: i.e. (i) Unethical practices of recovery of dues used by lending organizations: (ii) Information support to patients and (iii) Sustainable environment protection measures.
pioneered in group formation, nurturing, and group lending activities. These NGOs are found developing the habit of saving mobilization among the groups to start different micro-enterprises for income generation activities. All these activities have shown a new hope of financial sustainability for NGOs and MFIs on the one hand and most needed provision of credit for the poor on the other. Also, these phenomena have injected the idea among government agencies and policy makers to go for further research for its adoption as one of the core elements for rural development. In this context, NABARD, as an apex institution of the country has officially initiated some research projects on SHGs as a channel for delivery of microfinance since 1980.

The proliferation of microfinance in India has been traced with NABARD’s initiation of linking Self Help Groups (SHGs) with the banks. The programme is popularly known as SBLP has its own models of credit linkage of SHGs with the banks with the underlying feature of “Identification”, “Formation” and “Nurturing” of groups either by NGOs/other Development Agencies or Banks. The programme has been continued for a long period since 1992, passing through the 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. The design features of the programme emphasize that it does not envisage any subsidy support from the government in the matter of credit and charges market related interest rates based on the premise that sub-market interest rates can spell doom; distort the use and direction of credit (Kropp & Suran, 2002). High recovery rates under the programme are used to justify the dictum that ‘poor need timely and adequate credit rather than cheap credit’. It occupies a pre-eminent position in the sector, accounting for nearly 80% market share in India. The concept has slowly been extended to CBs, RRBs and CoBs for its adoption and implementation. Along with the existence of mutually aided cooperative societies at different levels for the provision of microfinance, there are also several Micro Finance Institutions (MFIs) operating in different corners of the country following various approaches and mechanism of provision of credit to the poor.

27 PRADAN (Professional Assistance for Development Action) is a non-governmental developmental organization registered in 1983.
The programme of providing credit to the poor through SHGs and NGOs as an intermediary has proved as an attractive proposition for lending institutions. The formal banking sector has found this technology appropriate to expand its business portfolio for microenterprises at low transaction costs and risk costs (Satish, 2005). The SHGs and NGOs as intermediaries for channelizing fund to the poor were found to be the attractive proposition for banks due to high recovery rates (varies between 80-95 percent), and low transaction costs. The outsourcing of costs that is associated with monitoring and appraisal of loans tend to reduce transaction costs substantially for the lending institutions. A study conducted by Puhazhendi, 1995 for costs incurred by banks in India to lend to the rural poor directly and through NGOs and SHGs as intermediaries concluded that lending through NGOs and SHGs reduced transaction costs for the banks in screening, client selection and contract enforcement. The study undertaken in four states revealed the fact that transaction cost of lending to SHGs might be slightly more than the normal lending for the first loan, but in case of subsequent loans, it was observed that reduction in transaction cost was substantial. Another study on the commercial aspects of the SHG-bank linkage in India also found substantial cost advantage of microfinance programme (Seibel, et al., 2002). Further, a study in Assam (Purkaystha, 2004) concluded that the high recovery rate from SHGs had encouraged many banks to provide microcredit through SHG route which ultimately led to the microcredit movement in the state.

2.3. Subsidized microfinance

Importance of rural finance has been witnessed since 1950 in most of the developing economy of the world. Agriculture input subsidies were found to be a common element for the development of agriculture in poor rural economies between 1960s and 1970s. The government’s policy of supplying credit to the rural sector was based on the delivery of subsidized credit through state controlled or directed institutions to rural segments of the population. Expansion of credit coverage through state interventions was based on various theoretical assumptions. Seibel and Parhusip (1990) mention that this approach was based on the premise that rural micro-entrepreneurs are unable to organize themselves; they need subsidized credit for increasing their income and are too poor to save. Yaron, Benjamin, and Piprek (1997) have
traced this traditional approach in rural finance leaning heavily towards direct interventions to Keynesian influence. Under this approach, in addition to the assumptions listed above, the key problem areas visualized in rural financial markets included a lack of credit in rural areas, absence of modern technology in agriculture, low savings capacity in rural areas and prevalence of usurious moneylenders. The conventional argument for subsidies in agricultural development is to promote adoption of new technologies and thus increase agricultural productivity (Ellis, 1992).

The evolution of subsidized microfinance in India is traced way back to the period of 1900-1960 with the involvement of different credit cooperatives for the disbursement of credit to the rural mass. During this period, the subsidized finance was provided to the poor by these credit cooperatives under government sponsorship but these cooperatives were unable to bring the desired result as expected and ultimately ended with losses. With the failure of these credit cooperatives, Government of India has started adopting different mechanism to address the rural poverty and has given due importance on nationalization of existing private commercial banks, expansion of rural branch networks, establishment of RRBs and the setting up of apex institutions such as the NABARD and SIDBI. Besides, the subsidized scheme in the name of IRDP has also been launched by the government to help the poor with subsidized finance. This phase (1960-1990) of general and subsidized micro finance in India is basically characterized by “subsidized social banking.” All these steps of the Government, though led to greater outreach, a large scale of credit were misused by the people creating a negative perception about the credibility of micro borrowers among bankers. The subsidized scheme of IRDP was also turned out to be a fizzle as it was found that the programme benefited the non-poor. (Adams et al., 1984).

The failure of subsidized social banking triggered a paradigm shift in delivery of rural credit with NABARD initiating the Self Help Group (SHG) Bank Linkage Programme (SBLP), aiming to link informal women’s groups to formal banks. The program helped to increase banking outreach for the poor and would initiate a change in the bank’s outlook towards low-income families from ‘beneficiaries’ to ‘customers’. This period was thus marked by the extension of credit at market
rates. The model generated a lot of interest among newly emerging Microfinance Institutions (MFIs), largely of non-profit origin, to collaborate with NABARD under this program. The macroeconomic crises in the early 1990s that led to introduction of the Economic Reforms of 1991 resulted in greater autonomy to the financial sector. Realizing the potential, of late GoI (Government of India) has also started intervening micro credit with its Swarnajayanti Gram Swarozgar Yojana (SGSY). The scheme launched in April, 1999. This programme as it has already been mentioned, is a subsidy driven programme which at the first place has attracted the poor to form SHGs. With the implementation of this scheme, many poor have been attracted towards the formation of SHGs just to avail subsidy from it. The growth rate of credit linked SHGs in the last five years that is from 2006-07 to 2010-11 reflected the fact that the number of SGSY SHGs had increased at the rate of around 11 percent as against 9 percent of Non-SGSY SHGs (SLBC Annual Report, 2006-07 to 2010-11).

2.4. Sustainability issues in microfinance

Sustainability can be defined as the ability to repeat performance through time. Covering of operating cost through efficient running of business is the key to sustainability of any business. Among the other factors, efficient utilization of loan funds, recovery of loan on time, reduction of operating cost and increase in income over time are important. Again, to realize the sustainability and poverty reduction potential of microfinance, efficient institutional and market mechanisms are needed whereby funds can be borrowed and allocated scientifically through properly designed and priced services to the poor for profitable investment in micro-enterprises. Cull et al. (2008) have defined the sustainability by the traditional financial ratios of Operational Self-sustainability (OSS) and Return on Assets (ROA).

Investment in microfinance can be seen as a part of integrated programme for poverty reduction for poor households on the one hand and as a means of providing financial self sustainable programs that increase access to finance for a large number of the poor on the other. Microfinance programmes though brought benefit to the poor; it demands continuous support from the donor agencies to be viable and sustainable in the long run. There are different degrees
or parameters to measure the sustainability (Schreiner, et al., 2002). Most of the discussions regarding sustainability in many countries are taken to mean full cost recovery or profit making, and is associated with the aim of building Micro Finance Institutions that can last into the future without continued reliance on Government subsidies or donor funds (Conning, 1998). From bankers’ perspective, a microfinance institution is said to have reached sustainability when the operating income from the loan is sufficient to cover all the operating costs. This perspective of sustainability of microfinance institution includes both financial viability and institutional sustainability (self-sufficiency) of the lending institution (Sharma et al., 1997). The frames of reference in banker’s definitions are more financial, administrative and institution focused and sticks to ‘accounting approach’ of sustainability. In its broader perspective, the concept of sustainability refers to ‘obtaining of funds at market rate and mobilization of local resources” which indicate that the performance assessment criteria for the financial viability of any microfinance related financial institutions are: repayment rate, operating cost ratio, market interest rates, portfolio quality, and ‘demand driven’ rural credit system in which farmers themselves demand the loans for their project (Shah, 1999).

Sustainability is a key to success for any MFI to deliver continuous support to the poor and underprivileged section of the society. Efficient financial performances of the MFIs always contribute to their sustainability. Many research organizations have viewed the sustainability of MFIs through their financial performance. Even microfinance professionals, bankers, governments and donor agencies consider sustainability as the benchmark in evaluating the performance of microfinance institutions (Brau & Woller, 2004; Baumann, 2004).

The issues with regard to sustainability of microfinance have several dimensions which are interrelated and complementary to each other. The three main interrelated sustainability issues in microfinance, especially in microcredit are: (1) Microcredit borrower’s viability - is measured by several direct/indirect indicators. Increase in income, formation of income earning asset, changes in income portfolio, increased ability to manage larger amount of financial leverage; return on investment of borrowed money may be some of the direct indicators. Dropout rate, savings rate, loan recovery rate, income and occupational mobility, program’s effect on wages, and
improvement in social indicators (For instance, literacy rate and social awareness) are examples of some of the indirect indicators. (2) MFI’S financial and economic viability - an MFI is considered to be financially sustainable if its operating income equalizes with that of operating expenditure. The cost of operations include cost of fund, cost of administering the program and loan loss provision. The indicators related to this issue will circle around quality of portfolio, cost of fund, efficiency in administering the program in terms of productivity and rate of service charge/interest. Nevertheless, the long term viability of MFIs depends on achieving economic viability which indicates the subsidy free operation of MFIs. The most relevant and accepted indicator worldwide in this regard is Subsidy Dependence Index (SDI) (Yaron, 1992). (3) MFI’s institutional viability - it relates to the organizational capability of implementing its microcredit program on a sustained manner. The essential components of the organizational capability are well-institutionalized systems, adequate and appropriate policies in place geared to achieve its prime objective-poverty alleviation/eradication. The indicators related to this issue may be aimed at reflecting the status of MFI’s program placement, program implementation, governance (external and internal), HRD, Financial management, internal control system and institutional culture.

Taking into account all the considerations, the sustainability of MFIs/SHGs plays a pivotal role in terms of functioning of smooth delivery of finance, covering at least the operating cost, widening the outreach both in terms of increasing the number of beneficiaries and depth of poverty and most importantly, subsidy free operation of the business for long period of time. Researchers across the globe have drawn different views with regard to sustainability of MIF’s/SHGs. Along with the above mentioned indicators, many of them have commented towards the issue of organizational structure. A study conducted by Hollis and Sweetman in 1998 suggests that micro credit organisations can indeed be sustainable, even financially successful, in very poor countries for a long period of time, and that the key to such success is getting the organisational structure right. A good institution can be successful in attracting local depositors, who in turn serve to protect the health of the organisation.
A study on the impact of governance on outreach and sustainability of microfinance institutions in Central and Eastern Europe and the Newly Independent States (Hartarska, 2005) indicates that performance-based compensation of managers is not associated with better-performing MFIs; lower wages suggested for mission-driven organisations worsen outreach, while managers’ experience improves performance. The results also identify tradeoffs between MFI outreach and sustainability depending on stakeholders’ representation on the board and provide strong support for independent boards with limited employee participation. In the study region, external governance mechanisms seem to play a limited role.

To reach a larger number of the poor in terms of the outreach and depth of poverty, an organization need to be characterized by viable, self-sufficient and sustainable in the long run. More particularly, where resources are limited, without self-sufficient financial institutions, there is a little hope for reaching the number of poor firm households that are potential borrowers and depositors (Gonzalez-vega, 1998). Many microfinance organizations, around the world, are found to be sustainable because they are receiving concessional funds at regular interval from donor agencies or from the government under various government runs subsidized programmes like SGSY and others. But once the subsidy stops, these organizations become less cost effective in delivering the credit to the poor. In Bangladesh, it is held that most of the traditional/secular NGOs / MFIs are not able to operate at break-even level without subsidies from outside sources and hence these organizations are not able to provide less cost effective credit/investment program. The interest rates on loans charged (20% - 35%) by the traditional NGOs including Grameen Bank are high by any standard (Rahman, 1999). It is also alleged that micro-lending initiatives of Interest-based MFIs have a self-perpetuating character and the borrower is seldom rid of his/her indebtedness (Bhuyan, 2006). In this perspective, it is very much clear that “financial sustainability” of MFIs plays a critical role to provide less cost-effective lending/investment facilities to the needy poor in any region like Bangladesh and other developing countries.

India as a huge populated country and characterised by diverse culture amongst the world’s developing nations have started giving privilege on providing financial services to the poor and underprivileged since independence. The commercial banks were nationalized in 1969 and were
directed to lend 40% of their loanable funds at a concessional rate to the priority sector. The priority sector included agriculture and other rural activities and the weaker strata of society in general. The aim was to provide resources to help the poor to attain self sufficiency. The launching of the various microfinance programmes such as TRYSEM, SITRA, IRDP and others have shown little significance in lifting the poor segments of the society from poverty line. Finally, the failure of all these programs led to the birth of microfinance with the formation of pockets of informal Self Help Groups (SHGs) engaging in micro activities financed by Microfinance institutions. Looking at the potential, many other MFIs are also found to take birth in different corners of the nation. Since their inception, all the MFIs are trying to serve the poor by way of providing sustainable finance to them. However, the sustainability of the MFIs are primarily given due importance to provide sustainable finance to the poor. Also, it is felt that the government’s favourable policies towards these institutions will always help to grow themselves and attain the two fold objectives of outreach and sustainability. Fisher et al. (2002) focused on the development of the whole MF sector in India and emphasised on the organizational efforts of micro credit institutions to improve their outreach and sustainability.

To be viable, rural financial institutions are required to have sufficient margin between lending rates and the cost of funds raised for lending in order to cover non-financial transaction costs (Agarwala, et al., 1997). “A financial institution is considered to be sustainable if it can cover all risks and transaction costs, loan losses, and cost of capital through interest and other earnings without external subsidies. Based on these criteria, none of the rural, formal financial institutions in India can be considered sustainable as they are hassled with huge arrears and incur high transaction costs in providing financial services. Loan losses and transaction costs are invariably higher than earnings, such that they require constant refinancing and recapitalization by the apex institutions” (ADB, 2000a).

A study conducted on 10 important MFIs (NGOs) in India (Quinones, 1997) reveals that several of these are not sustainable. They are only operationally sustainable in covering operating costs with interest income. Out of 10 MFIs, only one is financially sustainable in terms of covering loan losses, inflation risks, and operating costs with interest income. None of them could cover
the cost of funds and become subsidy free. Although resources to fund MFIs may not be a problem, the capacity of MFIs to utilize the resources effectively and provide sustainable services is inadequate. The apex operations as chalked out at Micro Credit Summit in 1997 have not made a significant impact in creating vibrant and sustainable MFIs in the country (Nagarajan & Gonzalez-Vega, 1998).

2.5. Impact assessment of microfinance

Impact assessment refers to a systematic practice where assumptions, methods and results are presented in such a way that it can be tested by analysts as and when required. Hulme (1999) has defined impact assessment as a measurement of the difference in the values of key variables between the outcomes on agents who have experienced an intervention (that is, clients or members of the programme), against those agents who are not exposed to the intervention (that is, non clients). The impact of microfinance could be judged by way of change in personal, economic and social well being of the clients’ position in pre and post period of intervention of microfinance services. Provision of microcredit to the poor is considered as one of the important components for the impact assessment of microfinance programme as it gives good result in terms of taking up small enterprises by the poor for income generating activities on the one hand and also shows their operational and financial sustainability on the other. The impact assessment of microfinance largely depends upon the design of microfinance models and choice of units for the impact measurement. Common units of assessment are the household, the enterprise or the institutional environment within which agents operate. Occasionally, studies have attempted to assess impact at an individual level (Peace & Hulme, 1994; Goetz & Sen Gupta, 1996), but this is relatively rare.

The studies that are conducted in Bangladesh among which the impact assessment conducted with Grameen Bank reveals that there is a significant increase in the income of Grameen clients than the Non-Grameen clients (Hossain, 1998). With the substantial increase in income, the Grameen clients were found to be in better position in terms of taking income generation activities and other personal affairs than those of Non-Grameen clients. Some studies have
attempted to assess impacts at a number of levels, such as Hulme and Mosley (1996) looked at microenterprise, household community and institutional levels. The findings of their studies reveal that there is a positive correlation of gains in income from microfinance. They also make this point when they refer to the “naivety of the belief that every loan made to a woman contributes to the strengthening of the economic and social position of women”. However, with careful planning and design, women’s position in the household and community can indeed be improved. Many of the studies do reflect the fact that in most of the countries, poorest of the poor are yet to benefit from microfinance programmes partly because most MFIs do not offer products and services that are attractive to this category.

The USAID’s\(^{28}\) AIMS Project has made a comprehensive impact study of microfinance on the poor. Through a Household Economic Portfolio Model (HEPM), it seeks to assess impacts at household, enterprise, individual and community levels and thus produce a fuller picture of overall impacts (Chen & Dunn, 1996). The other popular variables, as suggested in different literatures, are patterns of expenditure, consumption and creation and holding of assets among which the creation and holding of assets are considered as very useful indicator of impact assessment because their level does not fluctuate as highly as other economic indicators and is not simply based on an annual estimate (Barnes, 1996). The social indicators that became popular in the early 1980s (For instance, educational status, access to health services, nutritional levels, anthropometric measures and contraceptive use) have been extended into the socio-political arena in an attempt to assess whether microfinance can promote empowerment (Mayoux, 1997; Goetz & Sen Gupta, 1996; Schuler & Hashemi, 1996; Hashemi et al., 1996). This has led to the measurement of individual control over resources, involvement in household and community decision-making, levels of participation in community activities and social networks and electoral participation.

A study by Cohen (1999) in Latin America examined the role of microfinance in reducing the vulnerabilities of the rural poor, especially its role in enhancing their risk coping capabilities, in detail with data from microfinance programme. The study found that the programmes outreach

\[^{28}\text{USAID (United States Agency for International Development) is established in U.S in 1961. It is the U.S. Government’s repository of expertise in international development.}\]
plays more of a role in helping clients protect against risks ahead of time than in case of coping with shocks after they occur. Versluysen (1999), in a cross country study on the impact of microfinance, concluded that those poor households who had access of microfinance services show significant increase in asset accumulation.

The researchers’ and practitioners of microfinance generally viewed microfinance as an effective tool to alleviate poverty. Many of them supported the technique and recommended the ways and means to improve further which may enable to give service in a scientific and an efficient way. In a study of 16 different MFIs from all over the world, it is found that improved access and provision of credit, savings and insurance facilities in particular can enable the poor to smoothen their consumption, manage their risk better, gradually build their asset base, develop their micro-enterprises, enhance their income earning capacity, and enjoy an improved quality of life as well as stable family units (Robinson, 2001). Littlefield, Murduch and Hashemi (2003) state that access to microfinance from MFIs can empower women to become more confident, more assertive, more likely to take part in family and community decisions and be able to confront gender inequities. The Women’s Empowerment Program in Nepal found that 68% of its members were making decisions on buying and selling property, sending their daughters to school and planning their family. All these decisions were made by their husbands in the past. However, they also state that just because women are clients of MFIs does not mean they will automatically become empowered.

Chowdhury and Bhuiya (2004) assessed the impact of BRAC’s poverty alleviation programme from a “human well-being” perspective in a programme in Bangladesh. They examined seven dimensions of ‘human-well being’. The project included the provision of microfinance and training of clients on human and legal rights. The study noted that the project led to a better child survival rates, higher nutritional status, improvement in the basic level of education, and increased networking in the community. Children of BRAC clients suffered from far less protein-energy malnutrition than children of non-members, and the educational performance of BRAC member’s children was also higher than that of children in non-BRAC households.
BRAC member households spent more on consumption of food items than poor non-members. Also the per capita calorie intake was significantly higher with BRAC members.

Services provided by microfinance though has shown that it can reach the poor very effectively and can show a positive impact on specific socioeconomic variables such as children’s schooling, household nutrition status and women’s empowerment (Johnson & Rogaly, 1997), some of the studies do not support these inferences and advocate that many of the vulnerable segments of the poor are yet to be benefited from microfinance services. The comprehensive study of 13 microcredit schemes in Asia, Africa and South America indicates unanimously that the benefits of microcredit schemes under study were not scale neutral (that is the upper and middle income poor tended to benefit more than the poorest of the poor) (Hulme & Mosley, 1996). The study concluded that the limited impact on paid employment is a natural result of limited technological change that would demand more labour, and the risks associated with bringing in additional paid workers. The impacts of paid employment are minimal among poorer borrowers and among first time borrowers. The relationship between income and assets leads to a buildup of assets over time and the structure of assets shifts in favour of more productive assets, but the real income increases marginally (Montgomery, et al., 1996). The rigid designs of traditional microcredit programmes and the limited range of financial services offered have made the arena of microcredit project a difficult terrain to negotiate with the poorer sections (Jain & Moore, 2003).

Indian experiences in the context of impact assessment reveal that the beneficiaries of microfinance are benefited in many ways. Puhazhendhi and Satyasai (2000) in their study commissioned by NABARD, covered 223 SHGs spread over 11 states across India. The study concluded that there is an increase in the assets of households from pre to post SHG period. They have also taken up more economic activities. Another study (Puhazhendhi & Badatya, 2002), commissioned by NABARD with financial assistance from SDC\textsuperscript{29}, GTZ\textsuperscript{30} and IFAD\textsuperscript{31} covered 60 SHGs in Eastern India. The findings of this study also

\textsuperscript{29} SDC (Swiss Agency for Development and Cooperation).
\textsuperscript{30} GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH).
\textsuperscript{31} IFAD (International Fund for Agricultural Development).
corroborate the findings of earlier evaluation. World Bank survey on rural finance (RFAS\textsuperscript{32}) in association with NCAER\textsuperscript{33} covered 736 SHGs in the states of Andhra Pradesh and Uttar Pradesh and also points out the positive economic impact.

According to Littlefield, Murduch and Hashemi (2003), various studies in Indian project witnessed an increase in income and assets and decrease in vulnerability of microfinance clients. For instance, a report on a SHARE project showed that three quarters of the clients saw significant improvements in their economic well-being and that half of the clients were graduated out of poverty. Following a three-year study of 906 clients, ASA\textsuperscript{34} an MFI working with 60,000 rural women in Tamil Nadu, found that their project had many positive impacts on their clients (Noponen, 2005). The programme was having a “positive impact on livelihoods, social status, treatment in the home and community, living conditions and consumption standards”.

Generally, microfinance studies in India are found to be an effective tool to reduce the vulnerabilities of the poor strata of the society but some of the available literatures on the impact of microfinance are not supporting these inferences. In one of the studies on the functioning of microfinance programmes conducted by Rajasekhar and Madheswaran (2005), where they analyzed economic and social benefits of the programme based on a study of the project areas of two NGOs in Karnataka and Andhra Pradesh has concluded that the economic benefits of the programme are region specific. Further, they found that microfinance benefits were not significant in case of members belonging to the landless and SC/ST categories and they concluded that “the microfinance programme do provide access to credit for the poor and enable them to undertake income generation activities. Given that the formal banks have not very well succeeded in the past in improving the access to credit for the rural households, the strategy of supporting the formation and nurturing of micro-finance groups is to be supported”. A recent study of the NCAER (2008) on the impact of SHGs on 4,600 households from six states in India measures the impact as the compound annual growth rate of the outcome measure from pre to

\textsuperscript{32} RFAS (Rural Finance Access Survey).
\textsuperscript{33} NCAER (National Council of Applied Economic Research, New Delhi, India).
\textsuperscript{34} Activist for Social Alternatives
post SHG participation. They find that income increases 6 percent, assets increase 10 percent, and participants are more empowered. In India, Self Help Groups (SHGs), play a role of rudimentary banking. In modern trends, SHGs in India are emerging as strong groups to replace private microfinance institutions. Recent figures indicate that SHG members (47.1 million) comprise more than three times of those of MFI members (14.1 million) (Srinivasan, 2009).

2.6. Impact of subsidy on sustainability

Subsidy is the opportunity cost of subsidized resources over and above the payment made by microfinance organization. The resources entrusted by donors to microfinance organizations below the opportunity cost are known as subsidized resources. According to the World Bank (1996), NGOs involved in microcredit activities receive 70 per cent of their funds from donors. The resources from the donors are all subsidized and transferred to MFIs with a view to help MFIs in providing subsidized credit to the poor to fight against the poverty and to help increasing standard of life of the neglected and disadvantaged section of the society. There are a number of donors existing and operating across the world for supplying subsidized credit to the needy poor and also for the development of financial system. They engage themselves in providing funds for new product development, providing technical assistance, taking risks on promising innovations or institutions, promoting stakeholder dialogue, supporting appropriate regulation and supervision.

The services offered by the donor agencies through appropriate channels of MFIs, NGOs and SHGs in terms of outreach and giving benefit to the poor are many but the review of literatures from various corner of the world raised a number of questions about their weak operation in terms of their financial performance. This is in turn raised a big doubt on their long term sustainability. It has been argued that MFIs are showing profit in their financial statement because of subsidy. But, once subsidy is removed, the picture of the same statement will be understated. A much sharper criticism of subsidized credit programs is that they cannot sustain and carry their business over a long time. Only a few low income entrepreneurs are being benefited from subsidized credit leaving behind the number of failures in terms of benefiting and
reaching to the poor strata of the nation. Nancy Barry (1995) of Women’s World Banking argues that “microenterprise financial intermediaries have learned that they cannot depend on governments and donors as reliable, long-term sources of subsidized funding.”

A majority of microfinance programmes created by NGOs have yet to reach self-sufficiency. One survey shows that poverty-focused programmes with a “commitment” to achieving financial sustainability cover only 70 per cent of their full costs (Christen & MacDonald, 1998). Morduch (1999) narrated about the speculation of a few observers and stated that if subsidies are withdrawn and costs cannot be reduced, 95 per cent of the current programmes will eventually have to close down. The remaining 5 per cent will be drawn from the larger programmes, and they will help to fill the gaps in financial markets. In fact, it is estimated that only 5 per cent of all programmes will ever become self-sufficient (Morduch, 2000). Subsidized microfinance programmes often face the issue of sustainability due to its subsidy component in it. According to the estimation of CGAP\textsuperscript{35}, about 5 percent of MFIs worldwide are financially sustainable till 2002 while the IMF\textsuperscript{36} in the year 2005 put the figure at 1 percent.

The lower interest rate is one of the key factors of subsidized credit programmes. Many credit programmes are criticized as they set interest rates below market rates and provide credit without mobilizing savings (Adams et al., 1984). However, raising the interest rate may not be a suitable solution. It has been observed from the research that rural credit markets are often ridden by a lack of information and erratic regulations. Therefore, raising interest rates will not necessarily improve loan recovery rates, and targeted loans may not reach target households even if the interest rate is right (Stiglitz & Weiss 1981, 1983).

Subsidized credit programmes have witnessed a number of drawbacks in terms of outreach and eradicating rural poverty around the world. It has always been argued that the programme cannot reach the poorest strata of the nation. ADB (2000a) notes that about 95 percent of the

\textsuperscript{35} CGAP (Consultative Group to Assist the Poor)- a multi donor effort of 25 western donor countries and international agencies formed by the World Bank to address the problems facing microfinance.

\textsuperscript{36} IMF (International Monetary Fund).
180 million poor households in the Asia-Pacific region still have little access to institutional financial services, providing thereby the evidence of insignificant outreach. It also notes that, with a few exceptions, MFIs have concentrated mostly on providing credit facilities. Savings mobilization has yet to receive adequate attention, while other financial services such as insurance and money transfers have received even less attention.

Subsidized lending is usually associated with high default rates. It absorbs scarce public resources that need constant replenishment. It distorts markets, hampering the development of sustainable lenders, and can encourage rent-seeking behavior. Despite positive outcomes on many developmental aspects, the performances of the various government-run institutions have been disappointing (Holf & Stiglitz, 1990). Most of the programmes were unsustainable because they were expensive and collected very little revenue. Even worse, a substantial portion of the subsidies were captured by the people who were not poor. (Adams & Pischke, 1992). The bankers usually hesitate to lend very small borrowers at the first instance; and also to SHGs because there is no established accounting practices for them as well as because of inadequacy of effective legal framework to regulate them. There is also a claim that the Grameen Bank of Bangladesh usually excludes the poorest (Sebstad & Cohen, 2000) and even when micro-credit reach the poorest, it may not increase as much as smooth consumption and diversify income (Murdoch, 1998b).

Evidence of sustainability in modern micro-credit organizations is very rare across the globe (Buckley, 1997). In India too, the sustainability study on MFIs/SHGs are not found in good numbers. The early decade of eighties had witnessed the introduction of some of the subsidized credit programmes to tackle the issue of rural poverty. The performances of these subsidized credit programmes have not shown significant result in terms of their financial performance. The IRDP, introduced by the government of India to tackle the issue of poverty showed a loan recovery rate of 10-55 percent only and had tended to benefit better segments of the rural population, rather than poorer groups. The other study on the same programme showed that only 11% of all IRDP borrowers borrowed more than once (Pulley, 1989). The programme could not prove to be a successful and turned out to be a fizzle. The subsidy component of the
scheme was not found to be attractive for the poor households in their micro investment. A study (Seabright, 1989) on ‘Failure of Livestock Investment under IRDP’ in two villages of Tamilnadu suggest that even when subsidies are included, the benefits to households of investing in livestock through the IRDP scheme have been significantly below than those of non-IRDP scheme.

In general, loan losses and transaction cost of the rural, formal financial institutions in India are invariably higher than the earnings, such that they require constant refinancing and recapitalization by the apex institutions (ADB, 2000b). The association of high transaction costs in the lending procedure to the rural mass tends to discourage the bankers and financial institutions in providing micro loans to them. The viability of rural banking system is found to be critically affected on account of the presence of high transaction costs in the lending system, though various studies reveal that lending through SHGs and NGOs bear the least cost to the lenders when compared to other types of banking lending (Srinivasan & Satish, 2001). Chavan and Ramkumar, 2002 have used costs of default, administrative costs and dependence on subsidies as the factors for the study of viability of rural credit institutions. The empirical analysis made by them for many MFIs in developing countries reveals that the financial viability of micro-credit institutions has been fragile in nature. Moreover, organization that depended on charitable funding were more fragile and tended to lose their focus more quickly than those that obtained funds from depositors (Hollis & Sweetman, 1998).

2.7. Methodological issues related to impact of subsidy on sustainability

Literatures around the various corners of the world follow and suggest different models of microfinance in delivering the financial services to the poor. They also show different methods of finding impact of subsidy on sustainability. However, none of them are in the opinion that a particular model is the best model in terms of providing microfinance to the poor in a given operating environment. Apart from the popularity of a few microfinance as well as subsidized microfinance programmes in terms of their sustainability, a comprehensive and scientific research and methodologies are always in demand to find out the real impact of such
programmes. As Hulme (2000) states, “knowledge about the achievements of such initiatives remain only partial and is contested.” The scientific impact assessment in general and statistical evaluations in particular have been limited so far because of the view that evaluations are a waste of time and money and a deviation from running the programmes themselves. Besides this, detailed evaluations many times bring difficult statistical issues such as selection bias, non-random programme placement, lack of instrument variables and dearth of properly collected data.

One of the major problems in impact assessment of microfinance programmes, with regard to its sustainability, relate to the attribution of specific effects (impacts) to specific causes (microfinance interventions). Another problem is attributed with the interchangeability of loans. Interchangeability of loans implies the use of loan by someone else other than the actual borrower or use of loan for a purpose other than the one for which the loan was given in the first place. Bias in measuring the impact of microfinance programmes can also be introduced by the non-random placement of the programmes. If the programmes are deliberately set up in areas with a history of weak financial service, it may introduce a downward bias on the impact results. Alternatively, if the programmes are set up in areas with good existing infrastructure, it may result in an upward bias on the impact. In order to control ‘non-random participation’ (resulting in what is referred to as “selection bias”) and ‘non-random programme placement’, data of both before and after programme participation could be collected. However, potential biases due to time-varying unobservable still remain (Heckman & Smith, 1995).

Some of the available studies have tried to determine the benefits of microcredit by using certain variables such as income, employment, and other socioeconomic outcomes. However, evidence of the causal relation between programme participation and reduction in poverty has proved elusive. The level of loan recovery has been used frequently in the research studies as a common measure of success of microcredit programmes. Hulme and Mosley (1998) explain that many

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As Morduch (1999) explains, an inherent problem in finding the impact is also in finding the answer to the question: Do programmes create entrepreneurship or a propensity for education or do programmes choose communities that have these characteristics? Programmes tend to locate at the extremes – either in the poorest areas or where infrastructure is the best, which skews the true effect of the programme.
impact studies avoid calculations of poverty impact, often treating the fact that small loans are being provided as a proof in itself that the poor are being reached and the fact that loans are being repaid as a proof that incomes have increased. This measure poses problems, because programmes basically use social, peer, and other forms of pressure to maintain high loan recovery rates. Moreover, these high repayment rates reflect the prospect of receiving future loans, not the fact that the benefits of the loans have been great. For the poor who usually have no financial alternative, lower drop-out rates may in fact indicate dependency on programmes. Even more troubling would be the evidence that the poor actually use moneylenders to maintain their good standing with the microfinance lenders (Brahm, 2000).

Controlling of selection bias and non-random program placement are found considering important issues in several articles/research studies. A significant attempt has been made to tackle these phenomena scientifically. The most challenging study about these issues is provided by Pitt and Khandker (1998). They have surveyed 1798 household who were members and non-members of three Bangladeshi MFIs (Grameen Bank, BRAC, and RD-12) and used the fact that all three programs limited membership to those with landholding size of less than one-half acre to calculate that every 100 taka lent to a female borrower increased household consumption by 18 taka. Their mode (“weighted exogenous sampling maximum likelihood–limited information maximum likelihood–fixed effects”) was based on the premise that while there should be no discontinuity in income between people who own just over or just under a half acre of land, participation in the MFIs would be discontinuous because those who were above the cutoff would be rejected from the programs. The conclusions from the findings therefore rely on specific identification assumptions, and the practical implications are also limited such that this methodology cannot easily be replicated in other settings. The use of econometrics in the methodology adds further difficulties for the researchers and users to use in their research. Morduch (1998a), later on challenges this econometric models and identification assumptions in Pitt and Khandker. Using a difference-in-difference model, he finds little evidence for increased consumption but does find reduction in the variance in consumption across seasons. Khandker (2005) refined the earlier model with the benefit of panel data, which addresses many of the concerns that Morduch (1998a) raises. In the newer evaluation, Khandker finds substantially
lower marginal impact on clients. Partially this is because the revised model reduced the estimate of the impact of microfinance, and partially it is because the clients had diminishing marginal returns to credit over time (the first survey was conducted in 1991-92, and the resurvey was performed in 1998-99). In total, Khandker finds an increase in impact-20.5 taka per 100 borrowed versus 18 taka in the earlier paper—because he adds the impacts from both years, 4.2 taka were from current borrowing and 16.3 taka from past borrowing. Poorer clients were found to have larger impacts than the less-poor, and money lent to men was not found to have any impact at all.

Different indicators have been suggested by different authors to find the general impact and the impact of subsidy on sustainability of MFIs. Apart from the general ratios, the sustainability of MFIs can be studied with two specific ratios that is, Operational Self Sufficiency Ratio (OSSR) and Financial Self Sufficiency Ratio (FSSR) (SEEP, 1995). These measures as advocated by Small Enterprise Education and Promotion (SEEP) for studying the sustainability of microfinance organization have been extended to SHGs in the present research. Operational self-sufficiency (OSS) requires MFIs to meet all of its operational cost from operating income. It is computed by dividing financial income by financial cost plus operating cost. The FSSR refers to the extent to which an institution not only covers its operational cost but also preserves the value of its resources by accounting for loan loss and effects of inflation. It is computed by dividing financial income by financial cost plus operating cost plus loan loss provision and imputed cost of capital. A firm is operationally and financially sustainable if its OSSR and FSSR are more than 1. Apart from OSSR and FSSR, the other important ratios such as Operating Cost ratio (OCR), Return on Capital (ROC) and Return on Asset (ROA) as advocated by SEEP have also been extended to the present research to study the sustainability and self-sufficiency of SHGs.

Along with the general business performance ratios and the ratios mentioned above, the impact of subsidy on the sustainability of SHGs is mainly captured through Subsidy Dependence Index (SDI). The SDI is one of the most accepted techniques to assess the dependence of financial institutions on government supported funds. The SDI is the ratio of subsidy to revenue from
lending (Yaron, 1992). It measures how much an MFI would have to increase its present on-lending interest rate to cover all of its costs including adjustments. An SDI of 100 percent would mean the doubling of present on-lending interest rate of MFIs to its members to become viable without the support of subsidy. Rosenberg (2009) also supported the above measures and provided a guide in measuring indicators of MFI sustainability. He identified 5 broad indicators of MFI performance and sustainability. In his opinion, sustainability is measured by the Return on Asset (ROA), Return on Equity (ROE), Adjusted Return on Asset (AROA), Financial and Operational Self-Sufficiency (OSS) and Subsidy Dependency Indicator (SDI). Further, he suggests that OSS and SDI are technically superior to the others in terms of measuring sustainability.

From the above literature, it is told that the services of microfinance are very effective to eradicate poverty. However, the poorest of the poor are yet to receive full potential benefit from these services. It has been claimed that the poor do not get the financial products of their own choice. On the other hand, many of the financial institutions consider the poor as non-bankable mainly because of the involvement of high transaction costs in fulfilling the small financial need of the poor. Taking into account all these constraints, the Governments of the respective countries have often been found intervening with various subsidized and non-subsidized schemes, basically, to help the poor to come out of the poverty line. However, the experience of these programmes vindicates the fact that they have a deleterious effect on the overall sustainability of beneficiaries in the long run. Many of the subsidized schemes, including that of IRDP in India were found to be fizzle as the subsidy was misused and were captured by the local elites who actually were not poor. However, the SGSY is the recent intervention in the field of subsidized microfinance in India.

The impact of subsidy on the sustainability of the beneficiaries has been the prime question that has been asked by many researchers in various forums. The experience from different corners of the globe shows that subsidy has its negative impact on the sustainability of the beneficiaries. Besides sustainability, questions have also been raised on the measurement techniques of sustainability. However, the tools and techniques those recommended by SEEP in 1995 and
Yaron in 1992 have been found widely acceptable for the measurement of sustainability. These techniques have often been used by the Micro Finance Institutions (MFIs) and Development Finance Institutions (IDFIs) for the measurement of their sustainability.

2.8. References


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