INCLUSIVE FINANCING THROUGH MICROFINANCE

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"Microfinance in India: A State of the Sector Report, 2006", a report prepared by Prabhu Ghate and published by Microfinance India and jointly sponsored by Care, Ford Foundation and Swiss Agency for Development & Cooperation, says that 'microfinance in India has emerged as a powerful tool for financial inclusion, reaching out to a fifth of all poor households who have yet to be reached by the formal financial sector. The larger of the two main models, the self-help group bank linkage programme (SBLP) covered about 143 million poor households in March 2006 and provided *indirect access to the banking* system to another 14 million. The other, microfinance institution (MFI) model, served 7.3 million households, of which 3.2 million were poor.' Apart from the scorching pace of growth, the report highlights several trends in Indian microfinance. First and, perhaps, most important, the rapid spread of microfinance has provided competition to rural money lenders. "ICICI Bank has catalyzed the creation of over 100 microfinance partners and has been able to extend micro-loans from 20000 clients in 2003 to 3 million clients by March, 2006. Microfinance will emerge as an important development tool that will enable the financial inclusion of rural and urban poor (Mor 2007).Microfinance has gained a lot of significance and momentum in the last decade. Indian model of microfinance offers greater promise and potential to address poverty as it is focused on building social capital through providing access to financial services through linking with the mainstream. Most of the microfinance institutions (MFIs) works towards promotion of community banking programme based on the principles of self help, mutuality and ownership by poor women.Prof. Mohammad Yunus, the founder of the Grameen Bank and the celebrity patron of the burgeoning global micro credit movement asserted and has repeatedly articulated in his speeches and writings, "The poor themselves can create a poverty-free world......credit can create self-employment instanteously. Why wait for others to create a job for you?" (Yunus 2005). Yunus's compelling oratory has, over the years, fore grounded appealing images of the hardworking poor carving a niche for themselves within the formalized segments of market economies. Images of poor women who initiate and sustain tiny, often home based enterprises in harsh economic environs and strive for upward mobility even as they unfailingly repay micro-loans have become to constitute the staple public perception of the global micro-finance industry and have no doubt, influenced the Nobel Committees to recognize both the institution and the individual and therefore, the idea they jointly represent – that access to micro-credit, is one of the means by which "large population groups find ways in which to break out of poverty (Nobel Peace Price Citation). As of May 2006, the Grameen had provided loans worth TK 290.03 billion to 6.67 million borrowers (97 percent female) through 2,247 bank branches in over 72000 villages, accounting for 86 percent villages in Bangladesh (www.grameen-info.org).The Nobel Peace Prize has been awarded to the Grameen Bank at an interesting phase in its institutional history, given that if re-invented itself in 2001 and announced a shift from the older Grameen to Grameen II in response to a series of crises such as borrower boycott of weekly group meetings and cessation of loan repayments, in protest against certain rigid programme features (Kalpana 2006). The fall in repayment performance was worsened by Bangladesh's disastrous floods of 1998 when borrowers found themselves unable to repay older loans alongside the new, relief-oriented ones offered by the Bank (Yunus 2002).The institutional trajectory of the Grameen Bank, since its inception as an experimental project launched in 1976 by Prof. Yunus to target collateral free credit to the poor organized into small borrower group, owes much to the early support from the Central Bank of Bangladesh, which authorized the Grameen project to function as a bank through a special character in 1983.

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Writing on the Punjab peasant, Malcolm Darling remarked that the "Indian peasant is born in debt, lives in debt and dies in debt (Darling, 1925). The national sample survey on the situational assessment of farmers undertaken in 2003 reported that on an average 48.6 percent of farmer households in the country were indebted, with the percentage being as high as 82 percent in Andhra Pradesh (NSSO 2005).After the nationalization of banks, government's policy of "Social and Development Banking" sought to extend banking to uncovered rural areas, outreach activities and disadvantaged groups. In 2000-01, the total lending under the self help group (SHG) bank linkage programme was less than half on one percent of the total amount that was disbursed for agriculture and allied activities by the banking system" (Kalpana 2004). According to the NABARD annual report for 2005-06, starting in 1992, by March 2006, there were 2.2 million SHGs covering 32.98 million households, total credit disbursement by these SHGs was Rs. 1,13,980 million compared to the annual estimated demand of Rs. 1,00,000 crore, NABARD defined micro-finance as the "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas enabling them to raise their income levels and improve living standards." The declaration of the micro-credit summit held in Washington DC in 1997 defined micro credit programmes as those, "extending small loans to poor people for self-employment projects that generate income, allowing them to care for themselves and their families". Microcredit is usually associated with: (a) very small loans (b) no collateral (c) the formation of borrower groups (d) borrowers from among the rural and urban poor, (e) loans for income generation through market based self-employment and (f) privatization, generally through the mechanism of NGO control over disbursement and determination of the terms and conditions attached to each loan (Swaminathan 2007).Some NGOs, like Accion, have succeeded in building multinational business. Acting as an agent for large micro-finance NGOs, Accion has loaned $9.4 billion to 4 million people in 22 countries, with a historical repayment rate greater than 97%. In 1992, Accion helped create the first bank in the world dedicated solely to micro enterprise – BancoSol in Bolivia. Several of Accion's partners have made the transition from being charity-dependent organizations to becoming banks or other regulated financial institutions. Accion has also helped commercial banks – such as Segebank in Haiti,B del Pichincha in Ecuador and Banco, ABN AMRO Real in Brazil lend to the self employed poor (Brugmann & Prahalad 2007).Rural poor is being perceived by corporates as biggest consumer group. Eminent management scientist C.K. Prahalad viewed poor community as 'bottom of the pyramid'. Reactions to competition at the bottom of the pyramid can be complicated. ICICI bank became the biggest manager of micro-credit operations in the South India state of Tamilnadu by co-opting the women's micro credit groups or self-help groups that NGOs developed. Many NGOs are resigned to this; ICICI offers a larger range of banking services and provides greater opportunities for entrepreneurs. However, other groups are unhappy that ICICI has taken over their role and the women's self help groups that they had designed for broader social development purposes. Some are reluctant to forge business relationships with the bank as a result (Brugmann & Praahlad 2007).

LANDMARKS:

The Indian cooperative credit structure meant to empower families in all sectors (Agriculture, processing and small industry, artisan activity etc.) has over time, with elite capture and excessive governmental interference and regulation, degenerated into a political minefield incapable of serving its original purpose of banking together smaller borrowers to create successful production units capable of functioning in a market environment. The search for alternative structure started as far back as the 1970s. Between 1972 and 1974, self employed women's association (SEWA) achieved the first break through in the rigid institutional barrier that excluded smaller borrowers from formal sector financing and set up a bank owned by small women entrepreneurs. Integrated sustainable income generation activity was promoted through subsidized lending under integrated rural development programme. Inadequacies inherent in running programmes focused on individual households called for shift to a group based approach:

- Larger projects are more viable and can generate higher income levels,
- The asset base of the group as a whole could provide collateral for the required amount of credit,

- A wider pool of literacy and other skills and higher motivation levels would be available to start and sustain income generation activity.
- Transaction costs for appraising, monitoring and enforcing small loan agreements as well as risks would be reduced for lenders.
- Groups would provide their members flexibility in the use of credit for different needs depending upon poverty levels and immediate emergent requirements.

The first step towards setting up SHGs was taken by Mysore Resettlement & Development Agency (MYRADA), which built upon rural chit funds and informal lending networks to evolve a credit management group. After a pilot project with MYRADA in 1991-92, NABARD worked actively to frame the legal and financial structure for SHGs and bankers to develop and adopt fresh lending strategy.Currently, NGOs are facilitators of SHGs; they help to form, train, and link them to banks. Typically, NGOs are the self help promoting institutions (SHPIs) and banks are the providers of finance. There are speculations that a bill is likely to be presented in the parliament: the National Bank for Agriculture and Rural Development (Amendment) Bill, which would amend the NABARD Act, 1981 (amended thereafter 1985, 1988, 2000 and 2003). The rationale of the proposed amendment is that the micro finance sector has brought much needed financial services to the poor, and the sector lacks a formal framework which would be provided by the proposed amendment.Those who have examined the impact of micro finance from a gender perspective have long alleged that the participation of women in these programmes needs to be examined in "a distinctly political light-raising issues of power, not just productivity and that women's own leadership and accountability does not even appear as a concern (Premchander & Chandambarnatham, 2007). The proposed amendment does not take a gender or empowerment perspective but rather a supply dominated perspective of micro finance. With the objective of extending the outreach of microfinance, the bill seeks to enable trusts and charitable societies to take deposits from individuals and SHGs subject to their authorization by NABARD as MFOs. Currently, NGOs typically facilitate group formation and bank linkages. Women's SHGs deposit their money in bank accounts, and/or rotate it as loans among themselves. This scenario will change when NGOs themselves are authorized to take women's savings as deposits.

CORPORATES WORKING ON FINANCIAL INCLUSION:

When companies have succeeded in bottom-of-the pyramid markets, we found, they have most often alone if by leveraging the competencies, networks, and business models that were developed as part of their corporate social responsibility initiatives or by NGOs, ABN AMRO has entered the micro finance business in Latin America with some help from the NGO Accion International. Barclays has built a successful micro banking operation in Ghana in partnership with 4000 indigenous moneylenders and their national association (Brugmann & Prahlad 2007).In India, the CSR initiative took place way back before independence. Gandhii's 'Trusteeship theory', is closely linked to CSR. CSR stated as a way for companies to gather intelligence about NGOs and manage their reputations, and it has wound up providing them with the tools they need to pursue business opportunities in untapped markets. For NGOs, CSR began as a means of persuading companies to change their ways, and it has become a means for them to develop the competencies and confidence to go into business themselves. CSR therefore laid some of the foundations on which corporations and social groups each started experimenting with new business model. Aditya Birla group company Hindalco Industries Ltd. started its CSR activities in nearby 146 villages when Birla Sun Life Insurance Co., another group company, started insurance business it utilized the vast network of social groups, rural development workers. Now Birla Sun Life is working with NGOs to sell insurance products. NGOs like the self employed women's association (SEWA) are working with Indian insurance companies such as ICICI Prudential. Some NGOs are positively thriving where state-owned or multinational companies have failed. Two years ago, when the Indian insurance giant, Life Insurance Corporation, found it difficult to collect premiums and pay claims in rural areas in the sate of Andhra Pradesh, micro credit federations took over the business. Their extensive knowledge of customers and their superior reach allowed the NGOs to grow the market rapidly. They operate quite profitably, earning an average gross margin of 27% (Brugmann & Prahalad 2007).The genesis of SHGs was due to the dangers inherent in politicized and overregulated cooperatives; they are based on informal and non-statutory organizational mechanisms. But, lack of a reliable legal registration and monitoring system has its own short falls. For a start, it is not possible to obtain an accurate figure of the number of SHGs since this methodology has been used by various departments and agencies under domestic and externally aided projects to deliver the benefits of government programmes. NABARD Rashtriya Mahila Kosh reports figures of groups that have been linked to banks under its own schemes. State Bank of India and many others nationalized banks have started micro finance programmes linking SHGs. Small Industries Development Bank of India (SIDBI) established. SIDBI Foundation for micro credit to assist SHGs under its micro credit programme. The department of rural development depends on what is reported by DRDA. International agencies are providing support to NGOs for the promotion of microfinance through SHGs for the promotion of microfinance through SHGs. There is substantial overlapping among members of groups as well as double counting of groups under programmes of different departments and agencies. This even leads to facilitators used to form groups using the same groups to claim fund releases under more than one scheme. ICICI, UTI, HDFC and many other banks are playing lead role in micro finance through SHGs. Institutional advantages expected by using SHGs for releasing outcomes under poverty alleviation programmes are being obtained. But the poorest households are least equipped to access credit and other kinds of assistance under government programmes and improve their income earning capacity on a sustainable basis by acquiring the right kind of asset or selecting the most suitable activity. Not surprisingly, statewide data reported to the ministry of rural development relating to SHGs indicates that low income states have still a long way to go regarding formation of the groups and access to credit for economic activity. Impact assessment studies of schemes run by the ministry of rural development also confirm that benefits of self employment programmes accrue to slightly better off rural households while those of wage employment programmes are more likely to reach the poorest families (EPW 2007).

DELIVERY MECHANISM:

In the present context, NGOs or MFIs are the biggest authority to control disbursement. The reason, behind the increasing involvement of NGOs in the delivery mechanism is near 100 percent repayment. This achievement is not costless. A system based on quick repayment of very small loans does not allow for funds to go into income generating activities that have a gestation period of any significance. Only business activity with very quick and high rates of return relative to the tiny investment can meet existing repayment schedule. The repayment record of NGO-controlled micro finance projects slackens as the size of the loan increases and as the frequency of borrowing rises. To take the example of the Grameen Bank once again, the default rate was 0.4 percent among first time borrowers, 1.2 percent among second-time borrowers, 6.6 percent among third-time borrowers and 9.5 percent among fourth time borrowers. Further, when the pressure to repay is as overbearing as it often is, borrowers have had to borrow from money lenders in order or repay NGO – advanced loans (Rahman 1999, cited in Chavan & Rajkuman 2002). Andhra Pradesh is regarded as the 'Mecca' of Indian micro finance. In March 2006, government raided and temporarily closed down nearly all the branches of MFIs functioning in Krishna district. It threw up a number of issues relating to the functioning of the MFI model. These stemmed from the rush to grow at the cost of more client centred consumer protection objectives, such as transparency in dealing with borrowers. While extending the depth and breadth of outreach is clearly central to micro finances mission of making an impact on poverty through financial inclusion. The collector of Krishna district seized the records and closed about 57 branches of Spandana and SHARE, the two largest MFIs in the country. Borrowers were given the impression that they need not repay MFI loans since the MFIs had violated a number of laws. While many of the branches were reopened soon, MFI field staff was reluctant to continue operations in view of the hostile atmosphere created by a frenzy of negative stories in the press. During a visit of the chief minister to neighbouring Guntur district in April 2005, complaints by MFI borrowers were brought to his notice by local politicians and officials of DRDA.In August 2005 after the annual conference of Sa-Dhan, the main network of MFIs in India, Sa-Dhan board members and prominent MFI leaders met with principal secretary rural development and emphasized the need for preventing conflict situations arising out of lack of understanding and suggested a broader debate on the activities and operations of MFIs, including 'the need for MFIs to plough back some of their profits for development activities'. In subsequent months there were a series of further news reports in the local papers critical of MFIs. It appeared that collector of Krishna district moved on to the MFIs to prevent the conflict which was realized in the demonstration involving stone throwing by a group of irate borrowers led by a local politician outside a SHARE branch demanding the return of house title deeds retained as security for housing loans SHARE was making.Consequent upon this, Sa-Dhan initiated damage control by issuing an interim code of conduct to be followed by member MFIs, which was publicized through a press conference. The RBI expressed its concern to the state government that the action it had taken could have wider repercussions by vitiating the MFI repayment culture in other parts of the state, jeopardizing a reported Rs. 680 crore outstanding on loans made by the banks to MFIs in Andhra Pradesh. It set up a coordination forum to discuss issues of concern to stakeholder and resolve them as soon as possible. At a meeting of the forum on April 20 it was claimed by government representatives that the MFIs were "eating into SHG movement" and that their practices were 'barbaric' and posed a serious law and order situation. Spandana and SHARE announced a reduction in their interest rates below even those suggested in the code of conduct, including those on current bans outstanding to 15 percent (Ghate 2007).MFIs are working in the society having social and financial mission. Financial performance can be measured through various measures like repayment rates, prosperity of lenders, profit in micro-enterprises supported by MFIs, etc. Unfortunately, social performance is not as easy to measure as financial performance, although a welcome development in India is the new social rating tools being developed by the main MFI rating agency, micro finance credit and ratings international (M-CRIL), to measure social performance defined as the "effective translation of mission into practice, in line with accepted social values". These tools include surveys to obtain feedback on client protection issues, client satisfaction, reasons for dropping out, and similar variables.The Sa-Dhan interim code of conduct was supplemented with a statement of core values released on January 2007, reiterating inter alias that services will be delivered in an ethical, dignified, transparent, equitable and cost effective manner. It is hoped that there will be reduction in abusive collections, unacceptable humiliation, over-borrowing, etc. through the implementation of such code of conduct.It has been reported several times that healthy microfinance activities have become unhealthy. Pouching of borrowers – lending to a borrower when she has a loan outstanding to an existing lender, would advocate respecting her freedom of choice to avail of a larger or timelier loan. 'Double dipping' is said to be widely practiced for the very reason the spread the consumer base i.e. No. of members and SHGs. According to a report in the Economic Times (August 30, 2006), about 10 MFIs have operations in Krishna district with about 1,00,000 borrowers and loans outstanding of Rs. 130 crore. The growing competition is evident that the micro-finance is getting momentum. MYRADA, which experimented NABARDs first microfinance project, developed Sangha Mithra Financial Services to strengthen SHGs. In recent years, the activities of MFIs in particular have come under a lot of adverse criticism on account of high rates of interest charged by them, zero tolerance of repayment delays, coercive methods of recovery of loans, exclusive focus on financial sustainability, low coverage of the core-poor. Sanghamitra and MYRADA promote an SHG model where the group decides whom the loan should be given to, for which purposes, on what terms and at what schedule of recovery. The focus of decision-making is shifted to the group, which provides the members with the opportunity to develop the skills to negotiate, to decide on what is manageable and feasible, to impose sanctions where required and to adjust repayment schedules if circumstances make the previously agreed to schedule impossible to follow.Money lending is common in India, but the involvement of MFIs, NGOs and private sector in the delivery mechanism ensures towards greater financial inclusion. Any view that reduces SHGs to financial intermediaries or makes them the last link in the delivery chain, which ails to understanding their empowering role, fails

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to invest in the institutional capacity building of each SHG or which imposes on them a standard pattern of savings, lending and repayment undermines the basic structure of an SHG. Unless this investment in SHGs is made, one may achieve a limited degree of financial inclusion, but 'social inclusion' and 'market inclusion' will still remain elusive (Fernandez 2007). The mechanisms of the financial system replicate the exclusivity of the market. To expect a financial system to be inclusive, therefore, is unrealistic. Other factors need to be brought into play-policies, supportive implementing systems and pressure from below. Policies are relatively easier to put in place. Hence for policies to be implemented even partially it requires pressure from below – this the empowered SHGs can provide. However, to enable the SHGs to perform their multifaceted, empowerment role, it is necessary that they are operationally and financially managed towards financial inclusion. MFIs should not set high growth targets since it is against the spirit of corporate social responsibility and it excludes the poor who can not respond fast enough. Their business should include the poor, distressed, disadvantaged, resource less. Then only it can be justified a micro finance programme with greater emphasis of 'inclusive financing'.

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