SWOT Analysis of Microfinance Credit As Financial Stability Model In Rural India

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INTRODUCTION

Microfinance, a financial innovation, originated in Bangladesh when Prof. Mohd. Yunus changed the lives of millions of Bangladeshis by creating the concept of micro loans. The idea came to his mind by involving himself in fighting poverty during the 1974 famine in Bangladesh. Besides teaching through the traditional methods, he wanted to understand the real life economics also. He gave $27 as the first loan from his pocket to a villager living near to his university campus and discovered that villagers are quickly repaying the money by selling their goods in the market; and there evolved the concept of microfinance with the establishment of Grameen Bank in 1976. Prof. Yunus earned a nobel peace prize in 2006 for his most valuable credit to the financial system for the poor.

Astonishing growth rates in Bangladesh, particularly during 1990s created a new dimension for microfinance worldwide as microfinance institutions grew to include millions of clients. In India, a substantial microfinance system based on self-help groups (SHGs) progressed during 90s.

CONCEPT

Microfinance is a financial model specially designed for serving the poor. Microfinance programmes provide tiny loans to poor people for self-employment projects. The system is for-

"Building financial systems that serve the poor"

"Microfinance is a provision of thrift, credit and other financial services and products of very small amounts provided to the poor in rural areas, semi-urban areas and urban areas. Anyone availing this facility has to engage in some productive activities that will generate some income."

It includes financial products like micro-credit, micro-savings, micro-insurance, etc. Besides, technical assistance, capacity building, social and cultural programmes can also be considered as supporting activities.

The term "Micro" is used differently. It may be understood according to size of loans or size of target users or deployment of funds for small goals or it may be due to easy and flexible terms and conditions.

Microfinance is not limited to micro-credit but also aims to provide a broad range of financial services like: deposits, loans, payment services, money transfers, insurance to poor and low-income households and their micro-enterprises.

COMPONENTS OF MICROFINANCE

MICRO- SAVINGS

Mico-savings is an important part of micro-finance.Voluntary savings usually serve as security against unpredictable risks, such as infectious diseases or epidemics, natural disasters, etc.In general, small businesses use the option of micro-savings.

MICRO-CREDIT

Micro credit is the extension of very small loans (**microloans**) to the unemployed, to poor entrepreneurs and to others living in poverty that is not considered bankable. These individuals lack collateral, steady employment and a verifiable credit history and, therefore, cannot meet even the most minimal qualifications to gain access to traditional credit. Microcredit is a part of microfinance, which is the provision of a wider range of financial services to the very poor.

Microcredit has successfully enabled extremely impoverished people to engage in self-employment projects that allow them to generate an income and, in many cases, begins to build wealth and exit poverty. Due to the success

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of microcredit, many in the traditional banking industry have begun to realize that these microcredit borrowers should more correctly be categorized as pre-bankable; thus, microcredit is increasingly gaining credibility in the mainstream finance industry and many traditional large finance organizations are contemplating microcredit projects as a source of future growth.

MICRO-INSURANCE

Micro-insurance is a term increasingly used to refer to insurance characterized by low premium and low caps or low coverage limits, sold as part of a typical risk-pooling and marketing arrangements, and designed to service low-income people and businesses not served by typical social or commercial insurance schemes. Microinsurance products are mainly targeted at low income groups in the unorganised sector- farmers and craftsmen. The amount of premium in these schemes ranges between Rs. 200 to Rs. 500. The coverage provided by these products is in the range of Rs. 5000- Rs. 50000. These products are available in various categories such as health insurance, personal accident cover, crop insurance and insurance for equipments. The Finance ministry recently considered two schemes - Aam Admi Bima Yojana to extend death and disability insurance and Rashtriya Swasthya Bima Yojana, a health insurance scheme for below poverty line (BPL) families which provides benefits upto Rs. 30000. The premium in the second scheme is partially borne by centre and state government.

NEED FOR MICROFINANCE

The importance of microfinance lies in that fact that the formal/institutional banking sector has not lived up to its social responsibility of meeting the financial needs of the poor due to lack of adequate branch network in the rural areas, inability of the poor to offer satisfactory collaterals for the loans and lack of education and awareness among the poor.

This is in spite of the fact that India today has an extensive banking infrastructure. The requirement of the poor in India has been estimated to be around Rs 50,000 crore per annum. Against this requirement, the credit outstanding of the poor with the formal banking sector is stated to be Rs 5,000 crore or 10% of the total demand.

World Bank and NCAER (2003) reported that in Andhra Pradesh and Uttar Pradesh, around 87% of marginal farmers/landless laborers do not access credit from the formal banking sector. Most of the benefits of the so called extensive banking infrastructure have gone to the relatively better off people; around 66% of large farmers have a deposit account and 44% have access to credit.

SCOPE OF MICROFINANCE IN INDIA

India, with the population of more than 1 billion, had approximately 70% percent population living in rural areas with almost 26.1% (that translates to 260.25 million) people living below the poverty line in the year 1999-00. Thus, India seems to be a natural candidate for experimenting with microfinance as a financial tool for poverty alleviation.

While the country is experiencing a faster growth in its gross domestic product (GDP) of around 8.5%, a major concern that needs to be addressed is how to obtain balanced growth to bridge the gap between the rich and poor. According to RBI statistics, over 40% of Indians do not even have bank accounts. The actual figure must be more than this. Another disappointing fact estimated by national sample survey states that out of the total cultivator households, only 27% have received credit from formal sources, 22% from informal sources while the rest 51% who are mostly poor farmers, have no access to credit. They have been the subject of exploitation by money lenders whenever they needed money for their livelihood security, either for agricultural needs or for setting-up of a small scale business or household's needs. Extreme poverty leads to farmers' ending their own lives as well as their families' lives. More than 17000 farmers have committed suicide in the mineral rich cotton belt of central India during the past six years (Dooner, Shrinivasan, 2008). Faced with accumulating massive debt and loss of their land to local money lenders, they have no other alternative but to end their lives by consuming pesticides. The bank and financial institutions did not meet the credit requirements of the poor and thus, poor people in villages were forced to fall back on moneylenders for credit who are charging interest rates as high as 200% to 500%. Though banking operations are quite regulated in the hands of RBI and RBI has tried to cater to the needs of the rural poor by establishing regional rural banks and co-operative banks, but this measure was not successful primarily because of the shift in the focus of banks from rural and high cost segment to low cost segment to become commercially viable.

To fill this gap, microfinance approaches have been tried in India. The microfinance programme has been under implementation since 1993 in India. Microfinance provides an important method to balance the outreach amongst the rural poor, while keeping the cost of lending low.

The scheme of microfinance has been found to be an effective instrument for lifting the poor above the level of poverty by providing them with increased self-employment opportunities and making them credit worthy.

Sa-Dhan (in 2008) surveyed that in the coming decade, the potential micro-finance client base in India is likely to be at 300 to 400 million. By 2012, an annual demand of at least Rs 250,000 million can be expected; micro-finance institutions may be able to meet funding needs along with lenders, investors, and savers, through a four-pronged strategy based on the current growth trends (economictimes.com).

In spite of efforts of various institutions, the outreach of micro finance services in India is still considerably small in comparison to the demand for such services. The microfinance market in India has not quite matured in terms of number of clients, range of services and variety of institutional models. The potential for the micro finance industry in India is still vast.

MICROFINANCE MODELS

Several non-government and co-operative organizations initiated savings and thrift led models for helping the poor; demonstrating that the poor have the urge to save and enjoy the gains of their savings through collective and mutually beneficial credit and microfinance arrangements.

SELF-HELP IS THE BEST APPROACH

Most of the microfinance models are working through financing directly or indirectly to self-help groups (SHGs). The SHGs constitutes 15-20 likeminded poor people living below the poverty line. Often, people belonging to neighborhood communities, sharing thoughts and problems with one other form into Self Help Groups.

Members of SHGs save equal amounts as decided by their groups. They open an account in either a bank or post office in the name of the group and authorize a member to operate the account. These groups are quite disciplined in their approach. In India, women SHGs have become the ray of hope for the development practitioners as they found that women are the best agents to touch the core of poverty.

Successful experiments outside India such as Grameen Bank of Bangladesh demonstrated that small groups of poor women could become successful entrepreneurs through a combination of small savings & microfinance. SEWA, an association of Self Employed Women Workers is the most suitable example of this approach. This organization targets self employed women workers in the informal sector and has a goal to ensure full employment and self-reliance for its members including work and income security as well as access to social security- which is healthcare, childcare, shelter, insurance and food security. SEWA now reaches more than 5, 30,000 women in Gujarat alone with new initiatives in 5 other states.

There are approximately 2.3 lakhs SHGs in the country covering about 35 million below poverty line households which approximates to 50% of uncovered (not covered by formal sources of finance) population.

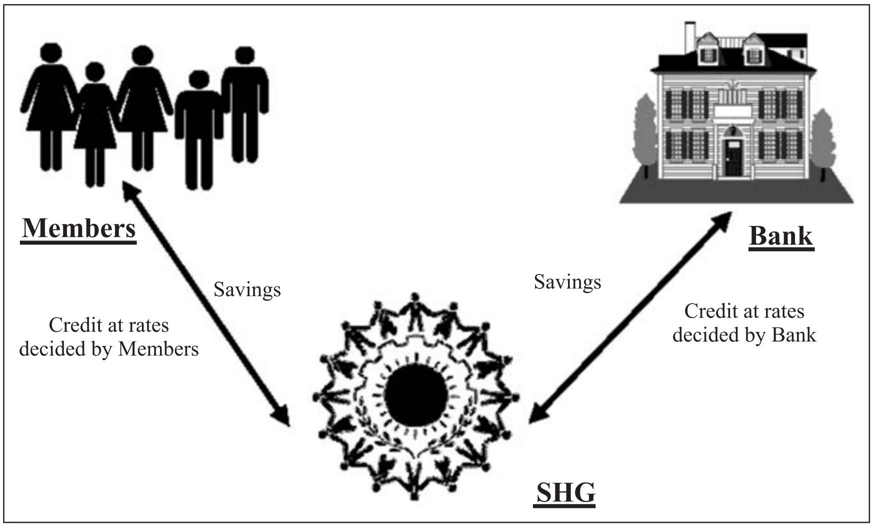
Microfinance has been adopted with different financial structures in India. Few of them are summarized below:

1. **SHGs** are promoted and financed by various agencies like banks, financial institutions, government, non-government organizations, societies, federations, microfinance institutions, etc.
2. Individuals are directly financed by **Micro Finance Institutions**.
3. **Urban Co-operative Banking** model.
4. **Non-Banking Financial Corporation** approach.

SHG-BANK LINKAGE MODEL

Amongst various models for delivery of micro-finance, the SHG-Bank Linkage programme has emerged as a major micro-finance model in the country. SHG-Bank Linkage programme was launched by NABARD for purveying micro credit by linking Self-Help Groups (SHGs) with banks in 1991-92 with a view to facilitate smoother and more meaningful banking with the poor. The SHG-Bank Linkage programme aims at connecting SHGs of poor people with banks and in process, created the largest microfinance network in the world.

Figure 1: SHG-Bank Linkage Model



Source: www.gdrc.org

SHG-Bank Linkage Model works on the principle of thrift, lending and peer pressure. The savings of members are deposited in a bank and on the basis of it, the bank lends to SHGs for productive exercises at low rate of interest, normally after six months of account opening in the ratio of 4:1 of credit to saving (Figure 1).

The statistics show that 2.9 million SHGs were linked to banks, covering a total flow of credit of Rs.18040 crore during the financial year ending March 2007 (Table 1). During the year 5, 52,992 new SHGs (excluding SGSY) were credit linked with banks and bank loans of Rs.2, 541.98 crore were disbursed, taking the cumulative number of SHGs credit linked to 34, 77,965 as on 31 March 2008. In addition, 1, 86,883 existing SHGs were provided repeat loan of Rs.1, 685.60 crore.

Table 1: Progress of SHG-Bank Linkage Programme

YEAR	TOTAL SHGs FINANCED BY BANKS		BANK LOANS	
	(Nos. IN '000)		(Rs. CRORE)	
	DURING THE YEAR	CUMULATIVE	DURING THE YEAR	CUMULATIVE
1	2	3	4	5
1992-99	33	33	57	57
1999-00	82	115	136	193
2000-01	149	264	288	481
2001-02	198	461	545	1026
2002-03	256	717	1022	2048
2003-04	362	1079	1856	3904
2004-05	539	1618	2994	6898
2005-06	620	2238	4499	11397
2006-07	686	2924	6643	18040
2007-08	553	3477	2542	20582

Source: nabard.org

Around 14 million poor families access micro-finance through 8, 81,154 SHGs linked to over 30,000 branches of 504 banks comprising of commercial banks, regional rural banks and co-operative banks. Another astonishing fact is that 90% SHGs are all women (Ranjana, chairperson, NABARD, 2004).

Linkage of SHGs to the banks has thus become an effective way of channelizing micro-credit to the poor. RBI guidelines (rbi.org.in) states that banks can lend upto Rs. 5 lakhs to SHGs without any collateral. This model helps enhancing savings by members of the SHGs.

The success of the model depends critically on the task of promoting, nurturing, strengthening and monitoring SHGs.The growth of this model in India is remarkable with the initiatives of the banks to enter into this sector but outreach remains modest in terms of proportions of poor households served.

SHG-Bank Linkage model is to be scaled -up to offer mass access to finance for the rural poor by giving more attention in promotion of high quality SHGs that are sustainable; clear targeting of clients, and ensuring that banks linked to SHGs price loans at cost-covering levels.

Other linkage models include NGO linkage, IFAD linkage or DRDA linkage.

NGO LINKAGE MODEL

This model may have different methods as described below:

Method 1: Members save and get credit from SHGs, which link with banks. NGO provides technical support to SHGs and facilitate bank linkages. Example: UPLDC follows method 1.

Method 2: Members save and get credit from SHGs. SHGs link with financial NGOs that provide financial services and finally, NGOs in turn get funds from banks. Example: SEWA in Gujarat is working with this approach.

Method 3: Members save and get credit from SHGs which link with banks. NGO provides technical support and business development services to SHGs. In Lucknow, SEWA is using this method.

Several alternative models of the SHG-NGO bank relationship have emerged in the recent years. One such model has been adopted by Shramik Bharti, Kanpur. The first SHG formed by them was way back in 1989 at Kulgaon. During the initial years, the emphasis was on expanding the outreach of the movement and enabling more people to get dignified access to credit. Today, according to Shramik Bharti, the SHGs functioning under them are seen as an ideal idea for connecting with the larger number of communities, enabling them in sharing and growing their emergence as vibrant community based organizations, working for the larger benefit of their region.

IFAD LINKAGE MODEL

IFAD (International Fund for Agricultural development) linkage model operates as members save with groups and get loans from banks. Technical services are provided to both the group and individual members. Tamil Nadu, UP and Maharashtra have adopted IFAD project.

DRDA LINKAGE MODEL

DRDA (District Rural Development Agency) linkage model works on the principles of **Swarnjayanti Gram Swarozgar Yojana** (SGSY). This model is quite unique in India. The SGSY envisions the increasing outreach of microfinance through small and informal SHGs formed with the support of 5 to 20 people from relatively homogeneous backgrounds. Microfinance is extended under this programme to only those SHGs which have passed a subjective grading test and are involved in regular thrift and credit activities for not less than six months. Tripathy & Tripathy (2007) analysed the performance and outreach of SGSY model and found that the number of SHGs assisted under this programme increased more than three fold from 26,317 in 2001-02 to 79,787 during 2005-06.

ENHANCING PENETRATION OF MICROFINANCE IN INDIA

ROLE OF BANKS AND FINANCIAL INSTITUTIONS

In the last two years, the Indian microfinance industry attracted a lot of large institutional players. Bankers have been increasingly talking about financial inclusion and no-frills accounts. The intent within government circles is to reach banking services to the unbanked. MFIs are in the best position to cover the last mile for banks.

- ICICI Bank has announced plans to expand its rural exposure to 25% of its total loan portfolio within two years. Currently, ICICI Bank already has more credit exposure to the rural microfinance space than any other private sector bank. ICICI Bank has also formed partnerships with three microfinance funds to extend seed capital to start-up MFIs.
- Development Credit Bank has also unveiled a microfinance-oriented division. World Bank arm, IFC, the

Netherlands Development Finance Company (FMO) and Deutsche Bank have announced a joint investment in Aavishkaar Goodwell.

- Reliance plans to fund MFIs in Gujarat and Maharashtra in the first phase and subsequently, have a national presence. The company is joining hands with two Gujarat-based microfinance institutions — MAS Financial Services and Vardan Trust — for the project. The project, aimed at enhancing penetration of microfinance in the country at the grass roots level, was kicked off by handing over the first disbursement cheques.
- In September 2007, Morgan Stanley announced the formation of the Morgan Stanley Microfinance Institutions group and JP Morgan too is setting up a social sector finance unit.

ROLE OF GOVERNMENT AND APEX INSTITUTIONS

Recognizing the potential of microfinance for poverty alleviations, various state governments and apex institutions in India have initiated microfinance programmes. The SHG-Bank linkage programme initiated by NABARD, state initiated programmes such as Velgu in Andhra Pradesh and Kudumbashree in Kerala, are some examples. Here, the major actors- government officials, NGOs and local self governance institutions play the role of 'facilitators' or 'patrons' instead of financial service providers running an enterprise.

Few of the initiatives by government in different parts of the country are illustrated in Exhibit 1.

Exhibit 1: A Snapshot of Government's Role In The Microfinance Sector

2000-01	Rs. 100 crore Fund has been created in NABARD for (a) giving training and exposure to self-help group (SHG) members, partner NGOs, banks and govt. agencies; (b) providing start-up funds to micro finance institutions and meeting their initial operational deficits; (c) meeting the cost of formation and nurturing of SHGs; (d) designing new delivery mechanisms; and (e) promoting research, action research, management information systems and dissemination of best practices in micro finance support.
January, 2005	Rs 2.20 crore granted to SHGs by Commercial Taxes Minister Konathala Ramakrishna.
November, 2005	Rs.2.5 crores along with subsidy will be given to 1,000 self-help groups in Theni district.
October, 2007	Financial Inclusion Fund and Financial Inclusion Technology Fund of Rs 500 crore each.
January, 2008	Under micro-insurance sector Aam Admi Bima Yojana and Rashtriya Swasthya Bima Yojana launched by UPA government for rural poor. The schemes are kept out of service tax net. The latter' premium is partially paid by government.
February, 2008	A fund of Rs. 5000 crore in NABARD to enhance its refinance operation to short term Co-operative credit institutions.
February, 2008	Two funds of Rs. 2000 crore each in SIDBI, one for Risk Capital financing and other for refinance capability to MSME sector.

The local and national governments have an important role to play in ensuring the growth and improvement of microfinance. First and foremost, the market should be left to set interest rates, not the state. Ensuring transparency and full disclosure of rates including fees is something the government should ensure, and something that new technologies as well as reporting and data standards are already enabling.

Furthermore, government regulators should set clear criteria for allowing MFIs to mobilise savings for on-lending to the poor; this would allow for a large measure of financial independence amongst well-managed MFIs — as the Grameen Bank of Bangladesh has achieved in recent years through an aggressive and highly successful savings initiative.

SIDBI AND NABARD

In India, Micro-credit programmes are run primarily by NABARD in the field of agriculture and SIDBI in the field of Industry, Service and Business (ISB). The success of Micro-credit programmes lies in diversification of services.

SMALL INDUSTRIAL DEVELOPMENT BANK OF INDIA (SIDBI)

Micro Finance Scheme of SIDBI is under operation since January, 1999 with a corpus of Rs. 100 crore and a network of about 190 capacity assessed rated MFIs/NGOs. Under the programme, total amount of Rs. 191 crore had been sanctioned upto 31st December, 2003, benefiting over 9 lakh beneficiaries.

SIDBI Foundation for Micro Credit (SFMC) was launched by the Bank in January 1999 for channelizing funds to the poor in line with the success of pilot phase of Micro Credit Scheme. SFMC's mission is to create a national network of strong, viable and sustainable Micro Finance Institutions (MFIs) from the informal and formal financial sector to provide micro finance services to the poor, especially women. The launch of SFMC by SIDBI has been with a clear focus and strategy to make it as the main purveyor of micro finance in the country.

SIDBI Foundation identifies,nurtures and develops select potential MFIs as long term partners and provides credit support for their micro credit initiatives. The eligible partner institutions of SIDBI Foundation, therefore, comprise of large and medium scale MFIs having minimum fund requirement of Rs. 10 lakh per annum.

SFMC has decided that need-based capacity building support in the form of grant be provided to the partner MFIs, in the initial years, to enable them to expand their operations, cover their managerial, administrative and operational costs and provide technical support besides helping them achieve self-sufficiency in due course. SFMC would also be providing direct credit to SHGs/ solidarity groups/ individual clients of the select MFIs. In order to build and strengthen a new set of intermediaries for Micro Enterprise Loans, the Bank has formulated a new scheme for Micro Enterprise Loans. Institutions/ MFIs with minimum fund requirement of Rs. 25 lakh p.a. and having considerable experience in financial intermediation/ facilitating or setting up of enterprises/ providing escort services to SSI/ tiny units/ networking or active interface with SSIs etc. and having professional expertise and capability to handle on-lending transactions shall be eligible under the dispensation. During the year 2005-06, SFMC sanctioned an aggregate financial assistance of Rs. 340 crore as against Rs.189.73 crore during the previous year (Table 2).

Table 2: Assistance Under Micro Credit

	2004-05	2005-06	Growth (%)
A. Sanctions			
Term Loan Assistance	169.30	324.90	91.91
Capacity Building Grant Assistance	15.78	8.67	-
Transformation Loan Assistance	3.00	4.00	33.33
Liquidity Management Support	0.65	1.43	120
Equity Assistance	1.00	1.00	-
Aggregate	**189.73**	**340.00**	**79.20**
B. Disbursements			
Term Loan Assistance	132.05	250.56	89.75
Capacity Building Grant Assistance	8.24	10.34	25.49
Transformation Loan Assistance	3.50	4.25	21.43
Liquidity Management Support	1.27	1.43	12.60
Equity Assistance	-	1.00	-
Aggregate	**145.06**	**267.57**	**84.45**
Source: www.sidbi.in			

The cumulative assistance of SIDBI's micro finance initiatives as at the end of March 31, 2006 aggregated Rs. 761.81 crore through 227 MFIs, benefiting approximately 26.25 lakh poor, mostly women.

NATIONAL BANK OF AGRICULTURAL AND RURAL DEVELOPMENT (NABARD)

NABARD in 1998 crystallized its vision for providing access to one third of the rural poor through linking 1 million SHGs by 2007 after the successful completion of SHG-Bank linkage model pilot project initiated in 1990's. It was followed by massive scaling up of the training and capacity building awareness programmes by NABARD, covering a large number of officials and staff of NGOs, banks, government agencies and rural volunteers in SHG promotion, nurturing, appraisal and financing. The vision of linking 1 million SHGs was achieved in the year 2004.

NABARD has extended a refinance of Rs 10.68 billion to banks during 2005-06, bringing the cumulative refinance amount to Rs 41.60 billion. During 2005-06, bank officials numbering 30,363 and 4339 NGO staff, 8331 government officials and 2, 03,431 self help group members have been trained with grant support from NABARD.

Cumulatively, 1.3 million participants have been trained through various SHG related capacity building programmes since inception of the programme from 1992.

Several steps have been taken by NABARD for capacity building of NGOs which partner in promotion and nurturing of SHGs. The emphasis is on involving a large number of NGOs. Special focus is on those NGOs participating in watershed development, health, literacy and women development, to encourage them to take up promotion, nurturing and linkage of SHGs as an 'add-on' activity.

NABARD has a scheme of part-financing the cost of promotion of groups by NGOs. It has developed specialized programmes for use by CEOs of NGOs for appropriately envisioning this as an add-on concept. Separate programmes have also been designed for NGO field staff to appreciate the nuances of SHG functioning.

NABARD has been extending micro credits to self-help groups (SHG) in Tamil Nadu through post offices. A pilot project has been implemented in two or three districts, which has been extended throughout the state and replicated in other parts of the country based on the success of the scheme.

The post offices have been acting as an intermediary between the bank and the SHGs, which are made to extend loans at a nine percent simple interest rate annually, retaining an interest margin of three percent. The loan products are in the form of term loans repayable in 24 months. As per the agreement, NABARD bears the risk in case of default in payment. Firstly, corpuses of funds are allotted to post offices, which pass them on to local SHGs after appraising their credit worthiness. Initially, Rs. 34 lakh has been given to 116 post offices each in Sivaganga and Pudukkotai.

Out of the Rs. 270-crore worth of loans issued to SHGs last year, the repayment rate has been as high as 98 per cent. As many as 3.15 lakh SHGs are covered by NABARD in Tamil Nadu. It has facilitated credit links between 10,000 SHGs.

NABARD coordinates the microfinance activities in India at international/ national/ state / district levels. These include organizing international/national Workshops, Seminars, etc. for experience sharing, Organizing National and State level Meets of Bankers and NGOs etc. and dissemination of best practices in SHG / microfinance.

Block/district/state level review meetings are organized or co-organized by NABARD. The relative documentation and database is also carried out by NABARD. In addition, periodical monitoring studies are conducted through NABARD/Bank Officers. Internal Impact Studies are conducted by NABARD periodically.

Necessary assistance is provided to the governments by NABARD for dovetailing microfinance practices with the poverty alleviation programmes. NABARD also encourages the association of Panchayati Raj Institutions (PRIs) in adopting group processes for maximization of empowerment. Besides, in association with Lal Bahadur Shastry National Academy of Administration, Mussoorie, it has conducted tailor made exposure programmes on self help group and microfinance for senior and middle level officers of Indian Administrative Services (IAS) who are posted as district collectors/ Chief Executive Offices of local administrative set ups (Zilla Parishad).

The microfinance bill passed in 2007 has designated NABARD as a regulator of microfinance sector and seeks to empower NABARD to frame a scheme for appointment of microfinance ombudsman for settlement of disputes between eligible clients and Microfinance organizations (Devprakash, 2007). Registration, compliance to norms framed, periodical submission of returns, subjecting themselves to audit and special audit are some of the means by which the regulation is sought to be put in effect.

The other initiatives of NABARD can be listed as further:

- Micro Enterprise Development Programme (MEDP) for Matured SHGs.
- Distance education programme in collaboration with IGNOU, New Delhi.
- Refinance support to banks for financing MFIs.
- Scheme for financing matured SHGs for Farm Production and Investment activities.
- Scheme for Capital/ Equity Support to Micro-Finance Institutions (MFIs) from MFDEF.

ROLE OF RESERVE BANK OF INDIA (RBI) IN MICROFINANCE

The pilot project for purveying micro credit by linking Self-Help Groups (SHGs) with banks which was launched by NABARD in 1991-92 with a view to facilitating smoother and more meaningful banking with the poor is supported by RBI. RBI had then advised commercial banks to actively participate in this linkage programme. The scheme has since been extended to RRBs and co-operative banks. The number of SHGs linked to banks aggregated to 4,61,478 as on March 31, 2002. This translates into an estimated 7.87 million very poor families brought within the fold of formal banking services as on March 31, 2002.

In 2000-01, a Rs. 100 crore fund had been created in NABARD to support various microfinance activities. RBI and NABARD have contributed Rs. 40 crore each to this Fund. The balance Rs. 20 crore were contributed by 11 public sector banks.

RBI facilitated MFIs to raise debt through External Commercial Borrowing (ECB) scheme, which has been considerably simplified by the RBI over the years. However, in 2002, the RBI stopped allowing MFIs to raise funds through the ECB route as also from donor agencies. MFI representatives argue that RBI should consider allowing NGO-MFIs access to ECB, provided they meet certain pre-agreed criteria.

Realizing the importance of credit in the development process, the RBI has taken various steps in this regard and has encouraged banks to make timely and adequate finance available to poor for agriculture as well as allied activities, providing institutional credit for the poor.

MICROFINANCE INSTITUTIONS IN INDIA

India has seen many MFIs entering the market and those present are growing at a fast clip though none of them have yet reached the level of the better known MFIs in Bangladesh such as Grameen Bank and ASA. Nevertheless, Indian MFIs have penetrated rural areas and successfully helped poor women. Some of the important MFIs operating on a large scale in India can be listed as follows:

- Varanasi-based **Cashpor Microcredit** is a MFI that delivers its services only to below poverty line (BPL) women in Uttar Pradesh and Bihar.
- **The Max Wealth Trust**, **a** MFI promoted by the Institute of Chartered Financial Analysts of India (ICFAI), is the latest entrant into the area of microfinance. Within one year of its existence, the Trust has already extended microcredit to the tune of Rs 2.50 crore to about 3500 women beneficiaries residing in the slums of Hyderabad and Secunderabad in Andhra Pradesh.
- **LHWRF (LUPIN Human Welfare and Research Foundation)** is a NGO registered as a trust and is actively working in the sector of rural development for more than 12 years. Since its inception in 1988 in Rajasthan's Bharatpur district, it is working for the accomplishment of its mission which is aimed to promote the process of sustainable development through an approach of participatory planning and management. The outstanding work done by the foundation in upliftment of downtrodden in Rajasthan motivated the Government of Madhya Pradesh to extend an invitation to the Foundation to undertake a similar development programme there.
- **BASIX,** a Hyderabad based MFI established in 1996 has around 2 lakh active borrowers in about 13 states, with an average loan size of Rs 5000.
- **SKS Microfinance**, launched in 1998, is considered as one of the fastest growing microfinance organizations in the world, having provided over Rs 425 crore with an outstanding of Rs 170 crore in loans to 320,000 women clients in poor regions of India. This MFI is working on the same model of Grameen Bank, Bangladesh.
- **Bandhan** — a fledgling MFI that operates as a society in some of the country's most poverty-stricken pockets upstaged several domestic and international stalwarts to make it to the second position on Forbes magazine's first-ever listing of the World's Top 50 Microfinance Institutions. Bandhan was among the seven Indian MFIs that made the cut, the largest from any country. Bandhan still works only in the area of microcredit. It keeps a simple reporting structure and uses automation only to drive down costs.

Leading MFIs in India presently have an estimated 9.76 million clients, up from 0.76 million clients in 2003. This figure is estimated to touch the 50 million mark by 2012. While loan portfolio is pegged at about $769 million, assets are pegged at $915 million dollars in 2007. For top 10 MFIs in India, the return on equity is over 60% a year. So by 2012, around $6 billion would be required for capital in MFIs in India.

SWOT ANALYSIS OF THE MICROFINANCE INDUSTRY

STRENGTHS

- Microfinance enhances options available to the poor. Micro credit not only improves the opportunity to save but also increases opportunity to acquire a productive asset, reduces dependency on moneylenders and interest burden on total borrowings. As a result of microfinance business, the average annual savings per household increased 3 fold from Rs 460/- to Rs 1444/- .At the same time, average borrowings per year per household increased from Rs 4282/- to Rs 8341/- due to lower interest rate and average value of assets (livestock, consumer durables etc.) per household increased to 72.3% from Rs 6843/- to Rs 11, 793/-(NABARD, 2000).

- Microfinance supports clients, particularly women, in developing strategies to cope up with various financial challenges. Women are disadvantaged by lack of exposure to the world of business and enterprise, and by perceptions about what women can do and where. Targeting financial and technical consultancy services, especially for women SHGs, is a good start on the road to women's empowerment, thereby enhancing opportunities for their individual growth, economic activity, decision-making in the household and the community. The Indian School of Microfinance for Women, an organization based in Ahmedabad, is a unique initiative in the discipline of Microfinance. The school has been set up with the purpose to strengthen and spread microfinance as a strategy for poverty alleviation through development of appropriate knowledge and skilled human resources. Members of women's self-help groups engaged in milk procurement and quality testing at an ISO-certified Bulk Milk Cooling Unit in Penumur can be seen as the best example of women self-employment in Figure 2.

Figure 2: Women Self – Employment and Independency

- Microfinance models have proved successful in reducing client's dependence on money lenders, especially in rural India. The farmers in rural areas used to depend on the local moneylenders for agricultural activities and used to charge very high and unbearable interest rates from farmers. With the emergence of microfinance concept, it has put dents in the businesses of local moneylenders, who may charge rates two and three times as high, are not bound by codes of conduct, and do not pay taxes. The Self help group model has proved successful in minimizing the reliance on local moneylenders in rural areas.
- Microfinance is a noble way of crossing the poverty line. Normally, it takes 3 to 4 years of taking their first loan to cross the line. This is because the micro finance loan helps poor to start their own micro (small) enterprise and increases their income. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change.
- Creating self employment opportunities and solving the problems of unemployment can be understood as another major strength of microfinance programme. There are over 24 crore people living below the poverty line in the country. The Scheme of Micro-Credit has been found as an effective instrument for lifting the poor above the level of poverty by providing them with increased self-employment opportunities and making them credit worthy. Total requirement of micro-credit in the country has been assessed at Rs.50,000 crore. Micro-credit programme works through NGOs/SHGs and the merit lies in weekly monitoring and refund of installments.
- Microfinance is a model which has brought financial stability in the Indian financial system through the involvement of not only financial institutions, but also of various other apex institutions like NABARD, SIDBI, etc. for serving the poor and reducing their dependency on informal channels of finance. This in turn resulted in the abridged dependency of the nation on foreign borrowings too, since people learn to save and utilize their own money.

WEAKNESSES

- The disappointing side of microfinance is model specific. The most successful model of Bangladesh- the

Grameen model itself has some weaknesses once it is analyzed with respect to the Indian situation. It involves too much of external subsidy which is not replicable. Grameen bank has not oriented itself towards mobilizing peoples' resources. The repayment system of 50 weekly equal installments is not practical because poor do not have a stable job and have to migrate to other places for jobs. If the communities are agrarian during lean seasons, it becomes impossible for them to repay the loan. Pressure for high repayment drives members to money lenders. Credit alone cannot alleviate poverty and the Grameen model is based only on credit. Micro-finance is a time taking process. Haste can lead to wrong selection of activities and beneficiaries. The other major difficulty can be of the outreach of the programme to rural India.

- Shreyas model of Kerala is also facing difficulty. The rules make it difficult to give adequate credit {only 40-50 percent of amount is available for lending). The Nari Nidhi/Pradan system is perhaps not reaching the very poor.
- Almost all the models lack an appropriate legal and financial structure. There is a need to have a sub-group to brainstorm about the statutory structure/ ownership control/ management/ taxation aspects/ financial sector prudential norms. A forum/ network of micro-financier (self regulating organization) is desired.
- Most of the existing microfinance institutions are facing problems regarding skilled labour which is not available for local level accounting. Drop out of trained staff is very high. One alternative is automation which is not looked at as yet. Most of the models do not lend for agriculture. Agriculture lending has not been experimented.
- Microfinance does not directly address some structural problems facing the Indian society and the economy, and it is not yet as efficient as it will be when economies of scale are realised and a more supportive policy environment is created.

THREATS

- Outreach of the programme to rural people is still a challenge for the microfinance industry. It has a much skewed growth pattern in the country. The programme is largely concentrated in the southern region of the country. It is important that the microfinance programmes spread more evenly, so that the benefits are available, especially in regions where the need is more accurate. Only six per cent of women self-help groups (SHGs) are functioning in the western part of India, which is very low as compared to the overall female population (Mallikarjuna, 2006).
- The continued restrictive loan policies of the commercial banks can be seen as another major threat. The commercial banks took a long time to clearly recognize and internalize the concept. The SHG model is primarily a savings based model. The commercial banks have been following largely 1:4 savings-credit ratios prescribed more as a norm for lending. Even the loan terms are uniformly prescribed. SHGs having lower savings ability find the lending ratio highly restrictive. As a result, many SHGs are unable to access credit adequately. This is forcing SHG members to restrict loan size, period and even amount equally. There are instances of SHG members going back to money lenders. In many cases, banks are also not able to give adequate time to SHGs; forcing SHGs to operate in ways which suits banks rather than the SHGs. If SHGs, whose strengths lie in informality, have to make a better impact, the formal system has to tune itself to the needs of SHGs and their members. This calls for adopting highly proactive and innovative policies to deal with.
- Almost all micro-enterprises operate outside the formal legal systems, contributing to widespread informality. The unorganized and informal firms at the micro-level are moving more into services sector than manufacturing sector. Therefore, at a time when they are unlearning the old, and relearning new ways of doing things, easy access to finance ensuring equal productive opportunities for the poor is extremely important. Rules that constrain market entry and expansion would have a chilling effect.
- Overcoming high transaction costs for small volumes and the large cost of expanding reach is a major challenge. Microfinance is best viewed as a complement and not a substitute for more equitable financial reform and core financial development. There are a number of instances dotted all over the globe- Bangladesh, Afghanistan, Philippines and India, lately, where micro lending has not always been a happy outcome. In the context of less transparent balance sheets of a variety of MFIs, large-scale defaults in microfinance go unnoticed. Hedging high administrative costs and loan losses in interest rate risk cover lead to excessive interest rates. How to establish channels of communication for borrowers independent of the regulator is an important issue.

- Plurality in regulatory mechanism that is presence of RBI, GOI and State Governments is another issue that cannot be overlooked (Raju, 2008). Better late than never if we accept that the Microfinance is a part of the Financial System. It is a known fact that the RBI is the super regulator for the financial system. However, it has been observed that the RBI prefers to be distant from the overall responsibility towards the sector and is more likely to share it with NABARD and other development banks.

OPPORTUNITIES

Microfinance is fast emerging as a hot opportunity for global players with an estimated $20 billion to be invested globally and around $3 billion in India, by 2010. The volume of total microfinance loans globally rose from $4 billion in 2001 to around $25 billion in 2006 (Deutsche Bank, 2006). The growth of Micro Finance Institutions (MFIs) in India would be even quicker than anywhere in the world in the years to come. India has seen many MFIs entering the market and those present are growing at a fast clip though none of them have yet reached the level of the better known MFIs in Bangladesh such as Grameen Bank and ASA. Nevertheless, Indian MFIs have penetrated rural areas and have successfully helped poor women.

The opportunities for microfinance business can be identified by enlisting the initiatives of various institutions for promoting and developing the different models of microfinance.

MICROFINANCE FIRMS COULD AVAIL OF I-BANKING SERVICES

Big banks like ICICI Bank and Citi have always been meeting fund requirements of big corporates, the focus now is shifting towards the remote corners of the country. Grameen Capital, a venture of Washington-based Grameen Foundation and Chennai-based IFMR Trust, has a total capital base of Rs 5 crore and intends to offer fee-based investment banking (I-banking) services to microfinance institutions (MFIs) in India. It would also help local and global investors identify the right kind of MFIs in which they could invest, depending on their risk profiles.

MICRO-BANKING CAN BE SEEN AS FUTURE OF MICROFINANCE

Micro banking will have the key components of supporting other emerging MFIs, financially and technically, initiate work of agriculture mostly with poor to help them reach a secure livelihood and help them to join the mainstream of the bankable population. The social impact will continue to be on all the operational areas.

INITIATIVES OF INTERNATIONAL AGENCIES

Citi Foundation launches $11.2 million International Microfinance Program. In India, Sa-Dhan, a common platform representing multiple models and approaches for micro-finance, has been selected for receiving Citi Foundation's support. Sa-Dhan will use the funding to develop and implement strategic business plans that focus on expanding ability to provide clients with the products and services they need, enhance their role as advocates for the micro-finance industry, develop industry infrastructure that sets standards and promotes best practices in the field, and engage in peer learning that stimulates innovation throughout the sector.

International Finance Corporation, private lending arm of the World Bank, and Financial Information Network and Operations, is conducting pilot projects with microfinance institutions, banks and government agencies to make use of information technologies in rural banking with the focus on developing banking solutions that will help microfinance institutions automate government payments, banking and other financial services for rural customers. The agency is financially supporting FINO, a multibank-promoted company providing smart card-based solutions for financial services in rural areas. This initiative will help micro insurance providers' process health insurance claims at lower costs and improve the flow of information to the insurer from the field. FINO's smart card-based platform will also make social and pension payments more efficient, reducing the cost of transactions and ensuring that end-users receive payments on time.

Another international agency, **Cashpor**, Headquartered in Malaysia, aims to reduce poverty in the Asian region by providing technical assistance to scale up existing credit and saving programmes. The agency is growing at 100% despite the fact that their clients are poor illiterate women in professions like farming and animal husbandry in India. The demand for microfinance is huge and if funds come in and MFIs are able to not just meet this demand but also ensure that they maintain their service quality levels and recovery rates, it could be a very powerful tool in allowing the poor to access services they have never been exposed to and had to always pay a premium for.

CONCLUSION

Money lending is common in India, but the involvement of MFIs, NGOs and private sector in the delivery mechanism ensures towards greater financial inclusion through SHG financing programmes. However, to enable the SHGs to perform their multifaceted, empowerment role, it is necessary that they are operationally and financially managed towards financial inclusion.

Microfinance is a powerful tool to fight poverty. It means **building financial systems that serve the poor**. In most developing countries, poor people are a majority of the population, yet they are the least likely to be served by banks. Microfinance is often seen as a marginal sector—a “development” activity that donors, governments, or social investors might care about, but not as part of the country’s mainstream financial system. However, microfinance will reach the maximum number of poor clients only when it is integrated into the financial sector. The role of government should be to set policies that stimulate financial services for poor people at the same time as protecting deposits. Governments need to maintain macroeconomic stability, avoid interest rate caps, and refrain from distorting markets with subsidized, high-default loan programs that cannot be sustained. They should also clamp down on corruption and improve the environment for micro-businesses, including access to markets and infrastructure. In special cases where other funds are unavailable, government funding may be warranted for sound and independent microfinance institutions.

There is need for government and RBI to encourage commercial banks to become involved in microfinance through appropriate prudential regulations for this market including capital adequacy ratios, asset quality indicators and unsecured loan limits. There is call for optimal policy.

Microfinance is a specialized field that combines banking with social goals. Skills and systems need to be built at all levels: managers and information systems of microfinance institutions, central banks that regulate microfinance, other government agencies, and donors. Public and private investments in microfinance should focus on building this capacity, not just moving money.

Microfinance is not a panacea for poverty alleviation but, with committed practitioners, a wealth of theoretical work and a surging demand for both international and individual investment. Microfinance is a poverty-alleviation tool that has proven to be both effective and adaptable. Through innovations in group lending and dynamic incentives, MFIs have been able to successfully lend to those traditionally ignored by commercial banks, because of their lack of collateral and credit scores.

Though in 1990s, with the advent of process of liberalization and globalization, India has seen impressive financial sector reforms but the impact and penetration of these reforms have not yet improved the situation of India’s rural population which has limited access to finance from formal banking and financial sources. There is need for considerable amount of work to be done in terms of outreach of financial services to make a dent on poverty and to realize India’s vision for 2020. Hence, the growth of the microfinance sector is the priority of the nation.

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