A

DISSERTATION REPORT

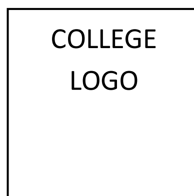
ON

"ISSUE AND SUCCESS FACTORS

IN

MICRO FINANCING"

(SUBMITTED TOWARDS PARTIAL FULFILLMENT OF POST GRADUATE DIPLOMA IN MANAGEMENT)



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Under the guidance of:

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Submitted by:

Your name

PGDM-08/050

COLLEGE ADDRESS

PREFACE

Alignment of the finance with the overall strategy of the company is a very big and toughest challenge for the company.

FINANCE is an important part of any business and managing them is an important task.

Our institution has come forward with the opportunity to bridge the gap by imparting modern scientific management principle underlying the concept of the future prospective managers.

To the emphasis on practical aspect of management education the faculty of COLLEGE NAME has with a modern system of practical training of repute and following management technique to the student as integral part of PGDM.

ACKNOWLEDGEMENT

On the very outset of this report, I would like to extend my sincere & heartfelt obligation towards all the personages who have helped me in this endeavor. Without their active guidance, help, cooperation & encouragement, I would not have made headway in the project.

I am ineffably indebted to **COLLEGE DIRECTOR NAME** for conscientious guidance and encouragement to accomplish this assignment.

I am extremely thankful and pay my gratitude to my faculty guide **FACULTY NAME** for her valuable guidance and support on completion of this project in its presently.

I extend my gratitude to COLLEGE NAME for giving me this opportunity.

I also acknowledge with a deep sense of reverence, my gratitude towards my parents and member of my family, who has always supported me morally as well as economically.

At last but not least gratitude goes to all of my friends who directly or indirectly helped me to complete this project report.

Any omission in this brief acknowledgement does not mean lack of gratitude.

Thanking You

Your name

CERTIFICATE FROM THE FACULTY GUIDE

This is to certify that the project work entitled ***"ISSUE AND SUCCESS FACTORS IN MICRO FINANCING"*** is a bonafide work carried out by ***YOUR NAMR***, a candidate of the PGDM (2008-2010) COLLEGE NAME under my guidance and direction.

Signature of the Guide

FACULTY NAME - GUIDE

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1 EXECUTIVE SUMMARY

Microfinance means providing very poor families with very small loans (micro credit) to help them engage in productive activities /small businesses. Over time, microfinance has come to

include a broader range of services (credit, savings, insurance, etc.) as we have come to realize that the poor and the very poor who lack access to traditional formal financial institutions require a variety of financial products.

The Eleventh Five Year Plan aims at inclusive growth and faster reduction of poverty. Micro Finance can contribute immensely to the financial inclusion of the poor without which it will be difficult for them to come out of the vicious cycle of poverty. There is a need to strengthen all the available channels of providing credit to the poor such as SHG- Bank Linkage programmes, Micro Finance Institutions, Cooperative Banks, State financial corporations, Regional Rural Banks and Primary Agricultural Credit Societies. The strength of the micro finance industry lies in its informality and flexibility which should be protected and encouraged.

Landlords, local shopkeepers, traders, suppliers and professional money lenders, and relatives are the informal sources of micro-credit for the poor, both in rural and urban areas.

The sector which is still in its infancy faces shortage of experienced consultants/manpower/experts. There is a need to have good quality professionals, trained in best practices in governance for effective corporate governance. A need-based capacity building programme to meet the requirements of all categories of Micro Finance Organisations (MFOs) is essential to bring about sustainability in the sector. Some of the important areas where capacity building is needed are transformation, best practices, interest rate management, delivery management, managing growth, risk mitigation, product designing, market research etc.

It is my pleasure and privilege to thank to **FACULTY NAME** for her valuable contributions without which it would not have been possible to prepare this report

2. RESEARCH METHODOLOGY

2.1. Research Objectives

1. Find out the issue of the micro finance

2. Comparative Analysis of Micro-finance Services offered to the poor.

3. How does the client of two main models of microfinance, the SHG and the MFI model, differ?

4. Does the level of indebtedness to moneylenders depend on the type of micro finance model one is client of?

2.2. Type of Research- Exploratory Research

2.3. Data sources: The research is based on secondary data and the data is collected from various websites, Journals, Magazines, Articles and Research Paper.

2.4. Data Analysis:

Abbreviations

NABARD- National Bank for Agriculture and Rural Development.

MFIs- Micro Finance Institutions.

SHGs- Self Help Groups.

RRB- Regional Rural Bank.

DRDA- District Rural Development Authority.

SIDBI- Small Industries Development Bank of India.

RBI- Reserve Bank of India.

NBFCs- Non-Banking Financial Corporations.

LABs-Local Area Banks.

NGOs- Non-Governmental Organisations

FLDG- First Loss Default Guarantee.

ICT- Information and Communication Technology.

SGSY- Swarnajayanti Gram Swarozgar Yojana.

MFOs- Micro Finance Organisations.

IRDP- Integrated Rural Development Programme.

JLG- Joint Liability Group.

MFDEF- Microfinance Development & Equity Fund.

PACS- Primary Agricultural Cooperative societies.

RMK- Rashtriya Mahila Kosh.

RRB- Regional Rural Bank

SBLP- SHG Bank Linkage Program.

3 INTRODUCTION

Microfinance is defined as any activity that includes the provision of financial services such as credit, savings, and insurance to low income individuals which fall just above the

nationally defined poverty line, and poor individuals which fall below that poverty line, with the goal of creating social value. The creation of social value includes poverty alleviation and the broader impact of improving livelihood opportunities through the provision of capital for micro enterprise, and insurance and savings for risk mitigation and consumption smoothing. A large variety of actors provide microfinance in India, using a range of microfinance delivery methods. Since the founding of the Grameen Bank in Bangladesh, various actors have endeavored to provide access to financial services to the poor in creative ways. Governments have piloted national programs, NGOs have undertaken the activity of raising donor funds for on-lending, and some banks have partnered with public organizations or made small inroads themselves in providing such services. This has resulted in a rather broad definition of microfinance as any activity that targets poor and low-income individuals for the provision of financial services. The range of activities undertaken in microfinance include group lending, individual lending, the provision of savings and insurance, capacity building, and agricultural business development services. Whatever the form of activity however, the overarching goal that unifies all actors in the provision of microfinance is the creation of social value.

3.1 Microfinance Definition

According to International Labor Organization (ILO), "*Microfinance is an economic development approach that involves providing financial services through institutions to low income clients*".

In India, Microfinance has been defined by "The National Microfinance Taskforce, 1999" as "*provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards*".

3.2 Strategic Policy Initiatives

Some of the most recent strategic policy initiatives in the area of Microfinance taken by the government and regulatory bodies in India are:

- Working group on credit to the poor through SHGs, NGOs, NABARD, 1995
- The National Microfinance Taskforce, 1999
- Working Group on Financial Flows to the Informal Sector (set up by PMO), 2002
- Microfinance Development and Equity Fund, NABARD, 2005
- Working group on Financing NBFCs by Banks- RBI

3.3 Activities in Microfinance

Microcredit: It is a small amount of money loaned to a client by a bank or other institution. Microcredit can be offered, often without collateral, to an individual or through group lending.

Micro savings: These are deposit services that allow one to save small amounts of money for future use. Often without minimum balance requirements, these savings accounts allow households to save in order to meet unexpected expenses and plan for future expenses.

Micro insurance: It is a system by which people, businesses and other organizations make a payment to share risk. Access to insurance enables entrepreneurs to concentrate more on developing their businesses while mitigating other risks affecting property, health or the ability to work.

Remittances: These are transfer of funds from people in one place to people in another, usually across borders to family and friends. Compared with other sources of capital that can fluctuate depending on the political or economic climate, remittances are a relatively steady source of funds.

Legal Regulations

Banks in India are regulated and supervised by the Reserve Bank of India (RBI) under the RBI Act of 1934, Banking Regulation Act, Regional Rural Banks Act, and the Cooperative Societies Acts of the respective state governments for cooperative banks.

NBFCs are registered under the Companies Act, 1956 and are governed under the RBI Act. There is no specific law catering to NGOs although they can be registered under the Societies Registration Act, 1860, the Indian Trust Act, 1882, or the relevant state acts. There has been a strong reliance on self-regulation for NGO MFIs and as this applies to NGO MFIs mobilizing deposits from clients who also borrow. This tendency is a concern due to enforcement problems that tend to arise with self-regulatory organizations. In January 2000, the RBI essentially created a new legal form for providing microfinance services for NBFCs registered under the Companies Act so that they are not subject to any capital or liquidity requirements if they do not go into the deposit taking business. Absence of liquidity requirements is concern to the safety of the sector

4 SERVICES PROVIDED BY MICRO FINANCE BANK:

So many services provide by MFI. Providing loans; car financing; home financing, personnel loans, taleemi loans.

PROVIDING LOANS:

The important service is provided by Mf is given loan. These loans are provided from some productive activities like; starting new business, expansion of business; improving life etc.

CAR FINANCING:

MFI also assist those people who cannot pay total amount at once. So, these MFI gave them car on installments like UBL car financing scheme is too popular and too many people taking advantage from this scheme.

HOME FINANCING:

Pakistan is a poor country. Purchasing power of Pakistan is very low. So many people are living on rent. They cannot have too many amounts to purchase homes. MFI's provide loans be considering their job stability and take security for it.

PERSONNEL LOANS:

MFI also obtain personnel loans. Those people who have permanent employment and stable jobs. This credit facility depends on the income of an individual.

TALEEMI LOANS:

MFI also provide financial aid to the students who cannot bare educational expenses but want to study. MFI assist them in return of some security and it would have to pay after completing the education.

5 CHALLENGES AND OPPORTUNITIES OF MICRO FINANCING:

The Government has indicated its willingness to speed up the pace of structural reforms to meet the major challenges of

REDUCING POVERTY:

The basic motto of the government to eliminate the poverty and bring prosperity in the country. MFI providing small loans and other credit facilities to the poor and low-income groups; which are beginning positive changing like their standard of living group and earning have increased

IMPROVING SOCIAL INDICATORS:

Inadequate access to productive resources and social services has resulted low social indicators and low employment opportunities. This situation is compounded in rural areas; where access is more difficuilt. So, by providing small loans and credit facilities they can over come this issue and can improve social indicators.

IMPROVING THE FISCAL AND BALANCE OF PAYMENTS POSITIONS:

Pakistan is a poor country whose balance of payment always in deficit, because of low productivity, lack of resources and lack of productive men's power. If MIF provide loans new business can be established. And export of Pakistan can be improved which create balance of payments.

RESTORING INVESTOR CONFIEDENCE:

Due to poor economy of Pakistan investors are hesitating to invest their money in Pakistan but MFI's can boost up. Because provide loans to local people new business will stable. Economy will go up and this situation may motivate to them for investing their funds.

6 PRINCIPLES OF MICRO FINANCE

- **Poor people need a variety of financial services, not just loans**.

Like everyone else, the poor need a range of financial services that are convenient, flexible, and affordable. Depending on circumstances, they want not only loans, but also savings, insurance, and cash transfer services.

- **Microfinance is a powerful tool to fight poverty**.

When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor households use microfinance to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education.

- **Microfinance is about building permanent local financial institutions**.

Finance for the poor requires sound domestic financial institutions that provide services on a permanent basis. These institutions need to attract domestic savings, recycle those savings into loans, and provide other services. As local institutions and capital markets mature, there will be less dependence on funding from donors and governments, including government development banks.

- **Micro credit is not the best tool for everyone or every situation**.

Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements. Where possible, such services should be coupled with building savings.

- **The role of government is to enable financial services, not to provide them directly**.

National governments should 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.

- **The key bottleneck is the shortage of strong institutions and managers**.

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.

7 FUNCTIONS OF MICRO FIANANCE

- Small loans, typically for working capital;
- Informal appraisal of borrowers and investments;
- Access to repeat and larger loans based on debt capacity and repayment performance;
- Secure savings products.
- To provide financing facilities, with or without collateral Security
- To accept deposits
- To encourage investments in such cottage industries and income generating projects for poor persons as maybe prescribed;
- To mobilize and provide financial and technical assistance and training to micro enterprises
- To invest in shares of anybody corporate, the objective of which is to provide microfinance services to poor persons

8 MICRO FINANCE IN INDIA

At present lending to the economically active poor both rural and urban is pegged at around Rs 7000 crores in the Indian banks' credit outstanding. As against this, according to even the most conservative estimates, the total demand for credit requirements for this part of Indian society is somewhere around Rs 2,00,000 crores.

Deprived of the basic banking facilities, the rural and semi urban Indian masses are still relying on informal financing intermediaries like money lenders, family members, friends etc.

Table 1: Distribution of Indebted Rural Households: Agency wise

Credit Agency	Percentage of Rural Households
Government	6.1
Cooperative Societies	21.6
Commercial banks and RRBs	33.7
Insurance	0.3
Provident Fund	0.7
Other Institutional Sources	1.6
All Institutional Agencies	64.0
Landlord	4.0
Agricultural Moneylenders	7.0
Professional Moneylenders	10.5
Relatives and Friends	5.5
Others	9.0
All Non Institutional Agencies	36.0
All Agencies	100.0

Source: Debt and Investment Survey

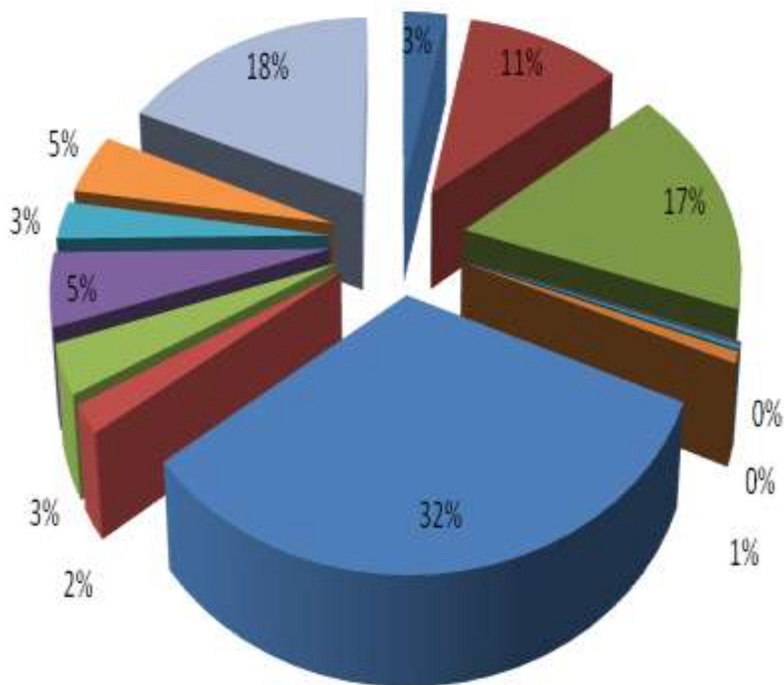


Figure 1: Percentage of Rural Household according to the Distribution Agency

Seeing the figures from the above table, it is evident that the share of institutional credit is much more now.

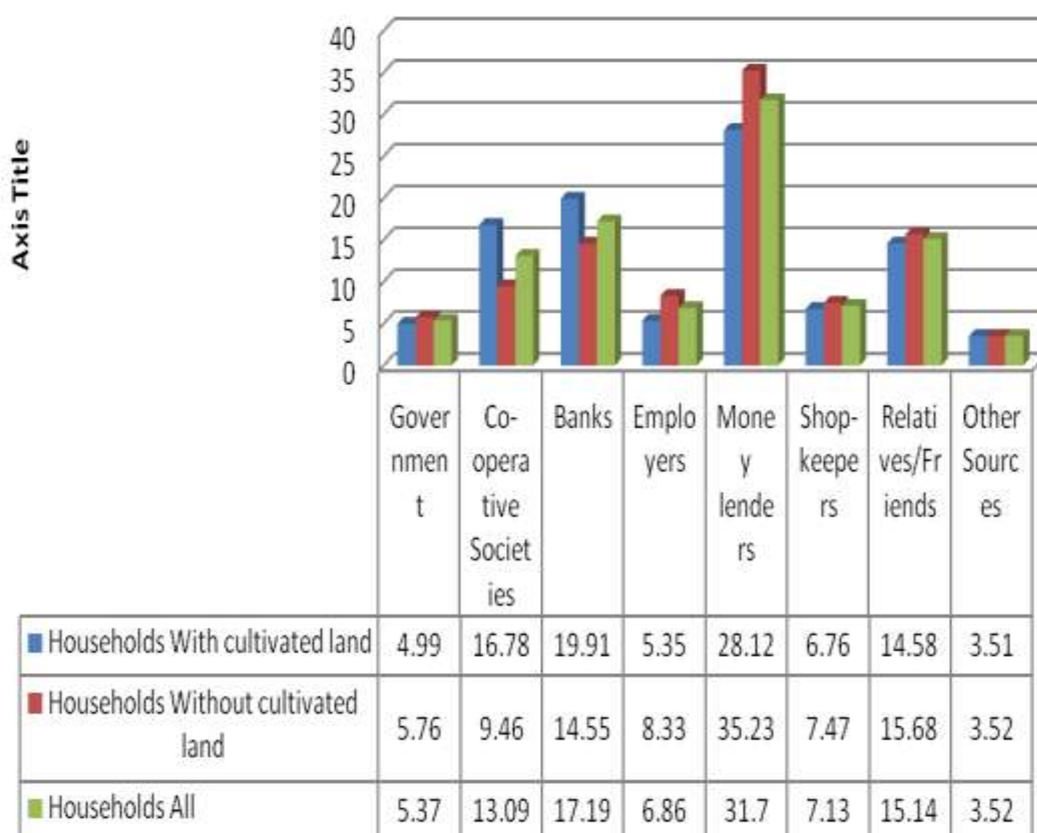
The above survey result shows that till 1991, institutional credit accounted for around two-thirds of the credit requirement of rural households. This shows a comparatively better penetration of the banking and financial institutions in rural India.

Table 2:Percentage distribution of debt among indebted Rural Labor Households by source of debt

Sr. No.	Source of debt	Households		
		With cultivated land	Without cultivated land	All
1	Government	4.99	5.76	5.37
2	Co-operative Societies	16.78	9.46	13.09
3	Banks	19.91	14.55	17.19
4	Employers	5.35	8.33	6.86
5	Money lenders	28.12	35.23	31.70
6	Shop-keepers	6.76	7.47	7.13
7	Relatives/Friends	14.58	15.68	15.14
8	Other Sources	3.51	3.52	3.52
	Total	100.00	100.00	100.00

Source: Rural labor enquiry report on indebtedness among rural labor households (55th Round of N.S.S.) 1999-2000

The table above reveals that most of the rural labour households prefer to raise loan from the non-institutional sources. About 64% of the total debt requirement of these households was met by the non-institutional sources during 1999-2000. Money lenders alone provided debt (Rs.1918) to the tune of 32% of the total debt of these households as against 28% during 1993-94. Relatives and friends and shopkeepers have been two other sources which together accounted for about 22% of the total debt at all-India level.



	Government	Co-operative Societies	Banks	Employers	Money lenders	Shop-keepers	Relatives/Friends	Other Sources
Households With cultivated land	4.99	16.78	19.91	5.35	28.12	6.76	14.58	3.51
Households Without cultivated land	5.76	9.46	14.55	8.33	35.23	7.47	15.68	3.52
Households All	5.37	13.09	17.19	6.86	31.7	7.13	15.14	3.52

Figure 2: Percentage distribution of debt among indebted Rural Labor Households by source of debt

The institutional sources could meet only 36% of the total credit requirement of the rural labour households during 1999-2000 with only one percent increase over the previous survey in 1993-94. Among the institutional sources of debt, the banks continued to be the single largest source of debt meeting about 17 percent of the total debt requirement of these households. In comparison to the previous enquiry, the dependence on co-operative societies has increased considerably in 1999-2000. During 1999-2000 as much as 13% of the debt was raised from this source as against 8% in 1993-94. However, in the case of the banks and the government agencies it decreased marginally from 18.88% and 8.27% to 17.19% and 5.37% respectively during 1999-2000 survey.

Table 3:Relative share of Borrowing of Cultivator Households(in per cent)

Sources of Credit	1951	1961	1971	1981	1991	2002*
Non Institutional	92.7	81.3	68.3	36.8	30.6	38.9
Of which:						
Moneylenders	69.7	49.2	36.1	16.1	17.5	26.8
Institutional	7.3	18.7	31.7	63.2	66.3	61.1
Of which:						
Cooperative Societies,etc	3.3	2.6	22.0	29.8	30.0	30.2
Commercial banks	0.9	0.6	2.4	28.8	35.2	26.3
Unspecified	-	-	-	-	3.1	-
Total	100.0	100.0	100.0	100.0	100.0	100.0

*** All India Debt and Investment Survey, NSSO, 59th round, 2003 Source: All India Debt and Investment Surveys**

Table shows the increasing influence of moneylenders in the last decade. The share of moneylenders in the total non institutional credit was declining till 1981, started picking up from the 1990s and reached 27 per cent in 2001.

At the same time the share of commercial banks in institutional credit has come down by almost the same percentage points during this period. Though, the share of cooperative societies is increasing continuously, the growth has flattened during the last three decades.

Table 4:Distribution based on Asset size of Rural Households (in per cent)

Household Assets (Rs '000)	Institutional Agency	Non-Institutional Agency	All
Less than 5	42	58	100
5-10	47	53	100
10-20	44	56	100
20-30	68	32	100
30-50	55	45	100
50-70	53	47	100
70-100	61	39	100
100-150	61	39	100
150-250	68	32	100
250 and above	81	19	100
All classes	66	34	100

Source: Debt and Investment Survey

The households with a lower asset size were unable to find financing options from formal credit disbursement sources. This was due to the requirement of physical collateral by banking and financial institutions for disbursing credit. For households with less than Rs 20,000 worth of physical assets, the most convenient source of credit was non institutional agencies like landlords, moneylenders, relatives, friends, etc.

Looking at the findings of the study commissioned by Asia technical Department of the World Bank (1995), the purpose or the reason behind taking credit by the rural poor was consumption credit, savings, production credit and insurance.

Consumption credit constituted two-thirds of the credit usage within which almost three-fourths of the demand was for short periods to meeting emergent needs such as illness and household expenses during the lean season. Almost entire demand for the consumption credit

was met by informal sources at high to exploitive interest rates that varied from 30 to 90 per cent per annum. Almost 75 per cent of the production credit (which accounted for about one-third of the total credit availed of by the rural masses) was met by the formal sector, mainly banks and cooperatives.

Banking Expansion

Starting in the late 1960s, India was the home to one of the largest state interventions in the rural credit market. This phase is known as the "Social Banking" phase.

It witnessed the nationalization of existing private commercial banks, massive expansion of branch network in rural areas, mandatory directed credit to priority sectors of the economy, subsidized rates of interest and creation of a new set of regional rural banks (RRBs) at the district level and a specialized apex bank for agriculture and rural development (NABARD) at the national level.

The Net State Domestic Product (NSDP) is a measure of the economic activity in the state and comparing it with the utilization of bank credit or bank deposits indicates how much economic activity is being financed by the banks and whether there exists untapped potential for increasing deposits in that state.

E.g. In the year 2003-2004 the percentage of bank deposits to NSDP is pretty high at around 75%-80% in Bihar and Jharkhand or these states are not as under banked as thought to be.

9 Microfinance Social Aspects

Micro financing institutions significantly contributed to gender equality and women's empowerment as well as pro poor development and civil society strengthening. Contribution to women's ability to earn an income led to their economic empowerment, increased well being of women and their families and wider social and political empowerment.

Microfinance programs targeting women became a major plank of poverty alleviation and gender strategies in the 1990s. Increasing evidence of the centrality of gender equality to poverty reduction and women's higher credit repayment rates led to a general consensus on the desirability of targeting women.

India to-day has an extensive banking infrastructure comprising over 30,000 rural and semi-urban branches of commercial banks, over 14,000 branches of Regional Rural banks (RRBs), around 12,000 branches of District Cooperative Credit Banks (DCCBs) and 1,12,000 Primary Agricultural Credit Societies (PACS) at the village level (around 66,000 PACS are stated to be functional; the remaining are dormant).

Availability of finance, moreover, tilts the employment scenario in favour of self-employment vis-à-vis wage employment. An added dimension is the empowerment of women with easier availability of micro-finance to them. Going by the estimates provided earlier, the demand for production credit in the country today is equal to Rs.17000 crore per annum whereas the total credit outstanding under micro-finance is merely Rs.5000 crore. Thus, there is definitely a need to increase the flow of credit, both for consumption and Production to the rural sector.

10 Major initiatives in Rural Credit

Government's initiative to reduce poverty by improving access to financial services to poor started since independence. India's overwhelming majority of poor is located in rural areas and this motivated the government to give special attention to rural credit. Following the report of All India Rural Credit Survey in mid 1950's, the State took crucial steps in reviewing Cooperative structure including the partnership of State in cooperatives. Also the policy initiative of 'social banking' concept described as "the elevation of the entitlements of previously disadvantaged groups to formal credit even if this may entail a weakening of the conventional banking practices" led to the nationalisation of commercial banks in 1969, adoption of direct lending programmes to rural areas and development of credit institutions such as Regional Rural Banks (RRBs). Government initiatives during the Fourth Plan focused on marginal farmers and agricultural labourers bringing individual family as the basic borrowing unit. Integrated sustainable income generating activity was promoted through subsidized lending under Integrated Rural Development Programme (IRDP) and its subsequent variations including the current self-employment programme known as Swaranjayanti Gram Swarozgar Yojana (SGSY)

10.1 SEWA Co-operative Bank (1974)

The implementation of formal lending programmes towards the poor suffer from the difficulties such as of exact targeting, screening problems of distinguishing good and bad borrowers and usually lending agencies won't be able to ensure the productive usage of loans. Also, the high transaction costs incurred in lending to the poor made the formal lending agencies leave the poor un-banked.

The Indian cooperative credit structure meant to empower the poor was not very successful as it was captured by a few powerful and because of excessive governmental interference and regulation. The search for an alternative to the formal banking sector and an effective financial system to cater to the needs of the poor, especially the rural poor, continued. The origin of microfinance can be traced to the establishment of the SEWA cooperative bank in 1974, to provide banking services to the poor women employed in the unorganised sector in Ahmedabad in Gujarat.

10.2 Self Help Groups (SHGs)

Government initiatives during seventies and the Fourth Five Year Plan focused on small and marginal farmers and agricultural labourers. Integrated sustainable income generation activity was promoted under Integrated Rural Development Programme. Inadequacies inherent in running programs focussed on individual households called for shift to a group based approach. The first step towards setting up self help groups (SHGs) was taken by MYRADA and it built upon rural chit funds and informal lending networks to evolve a credit management group.

10.3 National Bank for Agriculture and Rural Development

In 19991-92, NABARD launched the SHG-Bank Linkage Programme on a pilot basis to finance SHGs across the country through the formal banking system. High repayment rates by the SHGs encouraged the banks to finance SHGs.

10.4 Rashtriya Mahila Kosh (RMK),1993

The success of the concept of micro-credit through self help groups (SHGs)

has encouraged the Government of India to establish a National level Micro

Credit organization /Rashtriya Mahila Kosh (RMK) (National Credit Fund for Women) under the Ministry of Women and Child Development in 1993, with an initial corpus of Rs.31 crore. The objective was to help women organise income generating activities to improve their socio economics status. RMK had disbursed cumulative loan of Rs 151 crore up to July 2006, benefiting 5.50 lakh women and the recovery rate is above 91%.

10.5 Small Industries Development Bank of India (SIDBI), 1994

In 1994, Small Industries Development Bank of India (SIDBI) launched a pilot scheme to provide financial assistance by way of loans to NGO's for providing credit to the poor households, especially women. A small amount of grant also accompanied the loans so as to build capacity of the intermediates and end-users. The programme did not achieve the desired objective. A large number of NGOs were not able to up scale their lending operations because of difficulties like interest rate cap on lending, security stipulations etc. SIDBI reoriented its Micro Finance Programme in 1999 by addressing the weakness of the pilot scheme, with an objective to create a national network of large and viable Micro Finance Institutions from the formal and informal sector. The programme provides need based

assistance by way of term loans to partner institutions for meeting their on lending fund requirements. Its programme took off slowly. The bank was able to improve its portfolio by 100% each year for the last three years in a row. It had sanctioned Rs.320 crore financial assistance during 2006 as against Rs 189.73 crore during 2005.

10.6 SHG-Bank Linkage Programme (1996)

In 1996, Reserve Bank of India included financing of SHGs as a main stream activity of banks under the priority sector lending programmes. The SHG Bank linkage programme covered over 24.3 million families by March 2005. Under the Bank-SHG Linkage Programme 2.24 millionSHGs were linked, up to 31st March 2006, of which 90 percent are women's groups.

10.7 Microfinance Development and Equity Fund (MD & EF), 2001

Government of India, in 2001 re-designated the existing Micro Finance Development Fund as Micro Finance Development and Equity Fund with the objective of facilitating and supporting the orderly growth of the microfinance sector, by especially assisting the women and vulnerable sections of the society and also by supporting their capacity building. The size of the fund was also enhanced form the existing Rs.100 crore to Rs.200 crore. The additional amount was to be contributed by Reserve Bank of India, NABARD and the commercial banks in the proportion 40:20:20.

11 SELF HELP GROUPS (SHGs)

Self- help groups (SHGs) play today a major role in poverty alleviation in rural India. A growing number of poor people (mostly women) in various parts of India are members of SHGs and actively engage in savings and credit (S/C), as well as in other activities (income generation, natural resources management, literacy, child care and nutrition, etc.). The S/C focus in the SHG is the most prominent element and offers a chance to create some control over capital, albeit in very small amounts. The SHG system has proven to be very relevant and effective in offering women the possibility to break gradually away from exploitation and isolation.

How self-help groups work NABARD (1997) defines SHGs as "small, economically homogenous affinity groups of rural poor, voluntarily formed to save and mutually contribute to a common fund to be lent to its members as per the group members' decision".

Most SHGs in India have 10 to 25 members, who can be either only men, or only women, or only youth, or a mix of these. As women's SHGs or sangha have been promoted by a wide range of government and non- governmental agencies, they now make up 90% of all SHGs.

The rules and regulations of SHGs vary according to the preferences of the members and those facilitating their formation. A common characteristic of the groups is that they meet regularly (typically once per week or once per fortnight) to collect the savings from members, decide to which member to give a loan, discuss joint activities (such as training, running of a communal business, etc.), and to mitigate any conflicts that might arise. Most SHGs have an elected chairperson, a deputy, a treasurer, and sometimes other office holders.

Most SHGs start without any external financial capital by saving regular contributions by the members. These contributions can be very small (e.g. 10 Rs per week). After a period of consistent savings (e.g. 6 months to one year) the SHGs start to give loans from savings in the form of small internal loans for micro enterprise activities and consumption. Only those SHGs that have utilized their own funds well are assisted with external funds through linkages with banks and other financial intermediaries.

However, it is generally accepted that SHGs often do not include the poorest of the poor, for reasons such as:

(a) Social factors (the poorest are often those who are socially marginalized because of caste affiliation and those who are most skeptical of the potential benefits of collective action).

(b) Economic factors (the poorest often do not have the financial resources to contribute to the savings and pay membership fees; they are often the ones who migrate during the lean season, thus making group membership difficult).

(c) Intrinsic biases of the implementing organizations (as the poorest of the poor are the most difficult to reach and motivate, implementing agencies tend to leave them out, preferring to focus on the next wealth category).

Sources of capital and links between SHGs and Banks

SHGs can only fulfill a role in the rural economy if group members have access to financial capital and markets for their products and services. While the groups initially generate their own savings through thrift (whereby thrift implies savings created by postponing almost necessary consumption, while savings imply the existence of surplus wealth), their aim is often to link up with financial institutions in order to obtain further loans for investments in rural enterprises. NGOs and banks are giving loans to SHGs either as "matching loans" (whereas the loan amount is proportionate to the group's savings) or as fixed amounts, depending on the group's record of repayment, recommendations by group facilitators, collaterals provided, etc.

How SHGs save

Self-help groups mobilize savings from their members, and may then on-lend these funds to one another, usually at apparently high rates of interest which reflect the members' understanding of the high returns they can earn on the small sums invested in their micro-enterprises, and the even higher cost of funds from money lenders. If they do not wish to use the money, they may deposit it in a bank. If the members' need for funds exceeds the group's accumulated savings, they may borrow from a bank or other organization, such as a micro-finance non-government organization, to augment their own fund.

The system is very flexible. The group aggregates the small individual saving and borrowing requirements of its members, and the bank needs only to maintain one account for the group as a single entity. The banker must assess the competence and integrity of the group as a micro-bank, but once he has done this he need not concern himself with the individual loans

made by the group to its members, or the uses to which these loans are put. He can treat the group as a single customer, whose total business and transactions are probably similar in amount to the average for his normal customers, because they represent the combined banking business of some twenty ‘micro-customers’. Any bank branch can have a small or a large number of such accounts, without having to change its methods of operation.

Unlike many customers, demand from SHGs is not price-sensitive. Illiterate village women are sometimes better bankers than some with more professional qualifications. They know that rapid access to funds is more important than their cost, and they also know, even though they might not be able to calculate the figures, that the typical micro-enterprise earns well over 500% return on the small sum invested in it (Harper, M, 1997, p. 15). The groups thus charge themselves high rates of interest; they are happy to take advantage of the generous spread that the NABARD subsidized bank lending rate of 12% allows them, but they are also willing to borrow from NGO/MFIs which on-lend funds from SIDBI at 15%, or from ‘new generation’ institutions such as Basix Finance at 18.5% or 21%.

SHGs-Bank Linkage Model

NABARD is presently operating three models of linkage of banks with SHGs and NGOs:

Model – 1: In this model, the bank itself acts as a Self Help Group Promoting Institution (SHPI). It takes initiatives in forming the groups, nurtures them over a period of time and then provides credit to them after satisfying itself about their maturity to absorb credit. About 16% of SHGs and 13% of loan amounts are using this model (as of March 2002).

Model – 2: In this model, groups are formed by NGOs (in most of the cases) or by government agencies. The groups are nurtured and trained by these agencies. The bank then provides credit directly to the SHGs, after observing their operations and maturity to absorb credit. While the bank provides loans to the groups directly, the facilitating agencies continue their interactions with the SHGs. Most linkage experiences begin with this model with NGOs playing a major role. This model has also been popular and more acceptable to banks, as some of the difficult functions of social dynamics are externalized. About 75% of SHGs and 78% of loan amounts are using this model.

Model – 3: Due to various reasons, banks in some areas are not in a position to even finance SHGs promoted and nurtured by other agencies. In such cases, the NGOs act as both

facilitators and micro- finance intermediaries. First, they promote the groups, nurture and train them and then approach banks for bulk loans for on-lending to the SHGs. About 9% of SHGs and 13% of loan amounts are using this model.

Table 5: Comparative Analysis of Micro-finance Services offered to the poor

Parameter	Money Lender	Commercial Banks	Govt. Sponsored Programs	Financial products of MFIs
Ease of Access	High	Low	Low	High
Transaction cost of Access	Low	Very High	Very High	Low – Medium
Lead time for Loans	Very Short	Extremely Long	Extremely long	Short
Repayment Terms	Fixed and Rigid	Fixed and Easy	Fixed and Easy	Flexible
Interest Rates	Exorbitantly High	Low and very Affordable	Low, Affordable and Subsidised	Reasonable and Affordable
Incentives	None	None	None	Repeat and larger loans, Interest Rebates
Repeat Borrowing	Possible	Possible but not likely	Possible but not likely	Stream of credit is assured
Loan Access Procedures	Very Quick	Extremely Time Consuming and complicated	Extremely Time Consuming and complicated	Simple and Quick
Loan Application Procedures	Informal but exploitative	Exhaustive and Complex	Exhaustive and Complex	Simple and Informal
Collateral and Demand Promissory Note	Mandatory	Required but hypothecation of asset may suffice	Not required although a charge on the asset becomes automatic	Not required – social collateral is used for physical collateral

Source: R. Arunachalam - Alternative Technologies in the Indian Micro- finance Industry

<u>Life insurances for self-help group members</u>

The United India Insurance Company has designed two PLLIs (personal line life insurances) for women in rural areas. The company will be targeting self-help groups, of which there are around 200,000 in the country, with 15-20 women in a group. The two policies are

(1) the Mother Teresa Women & Children Policy, with the aim of giving to the woman in the event of accidental death of her husband and to support her minor children in the event of her death, and

(2) The Unimicro Health Scheme, giving personal accident and hospitalization covers besides cover for damage to dwelling due to fire and allied perils.

Source: http://www.hinduonnet.com/2002/12/05/stories/2002120501172100.htm

12 MICRO FINANCE MODELS

12.1 Micro Finance Institutions (MFIs):

MFIs are an extremely heterogeneous group comprising NBFCs, societies, trusts and cooperatives. They are provided financial support from external donors and apex institutions including the Rashtriya Mahila Kosh (RMK), SIDBI Foundation for micro-credit and NABARD and employ a variety of ways for credit delivery.

Since 2000, commercial banks including Regional Rural Banks have been providing funds to MFIs for on lending to poor clients. Though initially, only a handful of NGOs were "into" financial intermediation using a variety of delivery methods, their numbers have increased considerably today. While there is no published data on private MFIs operating in the country, the number of MFIs is estimated to be around 800.

Table 6: Legal Forms of MFIs in India

Types of MFIs	Estimated Number*	Legal Acts under which Registered
1. **Not for Profit MFIs** a.) NGO – MFIs	400 to 500	Societies Registration Act, 1860 or similar Provincial Acts Indian Trust Act, 1882
b.) Non-profit Companies	10	Section 25 of the Companies Act, 1956
2. **Mutual Benefit MFIs** a.) Mutually Aided Cooperative Societies (MACS) and similarly set up institutions	200 to 250	Mutually Aided Cooperative Societies Act enacted by State Government
3. **For Profit MFIs** a.) Non-Banking Financial Companies (NBFCs)	6	Indian Companies Act, 1956 Reserve Bank of India Act, 1934
Total	700 - 800	

Source: NABARD website

12.2 Bank Partnership Model

This model is an innovative way of financing MFIs. The bank is the lender and the MFI acts as an agent for handling items of work relating to credit monitoring, supervision and recovery. In other words, the MFI acts as an agent and takes care of all relationships with the client, from first contact to final repayment. The model has the potential to significantly increase the amount of funding that MFIs can leverage on a relatively small equity base.

A sub - variation of this model is where the MFI, as an NBFC, holds the individual loans on its books for a while before securitizing them and selling them to the bank. Such refinancing through securitization enables the MFI enlarged funding access. If the MFI fulfils the "true sale" criteria, the exposure of the bank is treated as being to the individual borrower and the prudential exposure norms do not then inhibit such funding of MFIs by commercial banks through the securitization structure.

12.3 Banking Correspondents

The proposal of "banking correspondents" could take this model a step further extending it to savings. It would allow MFIs to collect savings deposits from the poor on behalf of the bank. It would use the ability of the MFI to get close to poor clients while relying on the financial strength of the bank to safeguard the deposits. This regulation evolved at a time when there were genuine fears that fly-by-night agents purporting to act on behalf of banks in which the people have confidence could mobilize savings of gullible public and then vanish with them. It remains to be seen whether the mechanics of such relationships can be worked out in a way that minimizes the risk of misuse.

12.4 Service Company Model

Under this model, the bank forms its own MFI, perhaps as an NBFC, and then works hand in hand with that MFI to extend loans and other services. On paper, the model is similar to the partnership model: the MFI originates the loans and the bank books them. But in fact, this model has two very different and interesting operational features:

(a) The MFI uses the branch network of the bank as its outlets to reach clients. This allows the client to be reached at lower cost than in the case of a stand–alone MFI. In case of banks which have large branch networks, it also allows rapid scale up. In the partnership model, MFIs may contract with many banks in an arms length relationship. In the service company model, the MFI works specifically for the bank and develops an intensive operational cooperation between them to their mutual advantage.

(b) The Partnership model uses both the financial *and infrastructure* strength of the bank to create lower cost and faster growth. The Service Company Model has the potential to take the burden of overseeing microfinance operations off the management of the bank and put it in the hands of MFI managers who are focused on microfinance to introduce additional products, such as individual loans for SHG graduates, remittances and so on without disrupting bank operations and provide a more advantageous cost structure for microfinance.

13 Role, Functions and Working Mechanism of Financial Institutions

13.1 ICICI Bank

ICICI's microfinance portfolio has been increasing at an impressive speed. From 10,000 microfinance clients in 2001, ICICI Bank is now (2005) lending to 1.2 million clients through its partner microfinance institutions, and its outstanding portfolio has increased from Rs. 0.20 billion (US$4.5 million) to Rs. 9.98 billion (US$227 million). A few years ago, these clients had never been served by a formal lending institution.

There is an increasing shift in the microfinance sector from grant-giving to investment in the form of debt or equity, and ICICI believes grant money should be limited to the creation of facilitative infrastructure. "We need to stop sending government and funding agencies the signal that microfinance is not a commercially viable system", says Nachiket Mor, Executive Director of ICICI Bank.

As a result of banks entering the game, the sector has changed rapidly. "There is no dearth of funds today, as banks are looking into MFIs favorably, unlike a few years ago", says Padmaja Reddy, the CEO of one of ICICI Bank's major MFI partners, Spandana.

Partnership Models

A model of microfinance has emerged in recent years in which a microfinance institution (MFI) borrows from banks and on-lends to clients; few MFIs have been able to grow beyond a certain point. Under this model, MFIs are unable to provide risk capital in large quantities, which limits the advances from banks. In addition, the risk is being entirely borne by the MFI, which limits its risk-taking.

The MFI as Collection Agent

To address these constraints, ICICI Bank initiated a partnership model in 2002 in which the MFI acts as a collection agent instead of a financial intermediary. This model is unique in that it combines debt as mezzanine finance to the MFI (Mezzanine finance combines debt and equity financing: it is debt that can be converted by the lender into equity in the event of a default.

This source of financing is advantageous for MFIs because it is treated like equity in the balance-sheet and enables it to raise money without additional equity, which is an expensive financing source.).The loans are contracted directly between the bank and the borrower, so that the risk for the MFI is separated from the risk inherent in the portfolio. This model is therefore likely to have very high leveraging capacity, as the MFI has an assured source of funds for expanding and deepening credit. ICICI chose this model because it expands the retail operations of the bank by leveraging comparative advantages of MFIs, while avoiding costs associated with entering the market directly.

Securitization

Another way to enter into partnership with MFIs is to securitize microfinance portfolios. In 2004, the largest ever securitization deal in microfinance was signed between ICICI Bank and SHARE Microfin Ltd, a large MFI operating in rural areas of the state of Andra Pradesh. Technical assistance and the collateral deposit of US$325,000 (93% of the guarantee required by ICICI) were supplied by Grameen Foundation USA. Under this agreement, ICICI purchased a part of SHARE’s microfinance portfolio against a consideration calculated by computing the Net Present Value of receivables amounting to Rs. 215 million (US$4.9 million) at an agreed discount rate. The interest paid by SHARE is almost 4% less than the rate paid in commercial loans. Partial credit provision was provided by SHARE in the form of a guarantee amounting to 8% of the receivables under the portfolio, by way of a lien on fixed deposit. This deal frees up equity capital, allowing SHARE to scale up its lending. On the other hand, it allows ICICI Bank to reach new markets. And by trading this high quality asset in capital markets, the bank can hedge its own risks.

Beyond Microcredit

Microfinance does not only mean microcredit, and ICICI does not limit itself to lending. ICICI’s Social Initiative Group, along with the World Bank and ICICI Lombard, the insurance company set up by ICICI and Canada Lombard, have developed India’s first index-based insurance product. This insurance policy compensates the insured against the likelihood of diminished agricultural output/yield resulting from a shortfall in the anticipated normal rainfall within the district, subject to a maximum of the sum insured. The insurance policy is linked to a rainfall index.

Technology

One of the main challenges to the growth of the microfinance sector is accessibility. The Indian context, in which 70% of the population lives in rural areas, requires new, inventive channels of delivery. The use of technologies such as kiosks and smart cards will considerably reduce transaction costs while improving access. The ICICI Bank technology team is developing a series of innovative products that can help reduce transaction costs considerably. For example, it is piloting the usage of smart cards with Sewa Bank in Ahmedabad. To maximize the benefits of these innovations, the development of a high quality shared banking technology platform which can be used by MFIs as well as by cooperatives banks and regional rural banks is needed. ICICI is strongly encouraging such an effort to take place. Wipro and Infosys, I-Flex, 3iInfotech, some of the best Indian information technology companies specialized in financial services, and others, are in the process of developing exactly such a platform. At a recent technology workshop at the Institute for Financial Management Research in Chennai, the ICICI Bank Alternate Channels Team presented the benefits of investing in a common technology platform similar to those used in mainstream banking to some of the most promising MFIs.

The Centre for Microfinance Research

ICICI bank has created the Centre for Microfinance Research (CMFR) at the Institute for Financial Management Research (IFMR) in Chennai. Through research, research-based advocacy, high level training and strategy building, it aims to systematically establish the links between increased access to financial services and the participation of poor people in the larger economy. The CMFR Research Unit supports initiatives aimed at understanding and analyzing the following issues: impact of access to financial services; contract and product designs; constraints to household productivity; combination of microfinance and other development interventions; evidence of credit constraints; costs and profitability of microfinance organizations; impact of MFI policies and strategies; people's behavior and psychology with respect to financial services; economics of micro-enterprises; and the effect of regulations.

Finally, the CMFR recognizes that while MFIs aim to meet the credit needs of poor households, there are other missing markets and constraints facing households, such as healthcare, infrastructure, and gaps in knowledge. These have implications in terms of the

scale and profitability of client enterprises and efficiency of household budget allocation, which in turn impacts household well-being. The CMFR Microfinance Strategy Unit will address these issues through a series of workshops which will bring together MFI practitioners and sectoral experts (in energy, water, roads, health, etc). The latter will bring to the table knowledge of best practices in their specific areas, and each consultation workshop will result in long-term collaboration between with MFIs for implementing specific pilots

13.2 Bandhan

Bandhan is working towards the twin objective of poverty alleviation and women empowerment. It started as a Capacity Building Institution (CBI) in November 2000 under the leadership of Mr. Chandra Shekhar Ghosh. During such time, it was giving capacity building support to local microfinance institutions working in West Bengal.

Bandhan opened its first microfinance branch at Bagnan in Howrah district of West Bengal in July 2002. Bandhan started with 2 branches in the year 2002-03 only in the state of West Bengal and today it has grown as strong as 412 branches across 6 states of the country! The organization had recorded a growth rate of 500% in the year 2003-04 and 611% in the year 2004-05. Till date, it has disbursed a total of Rs. 587 crores among almost 7 lakh poor women. Loan outstanding stands at Rs. 221 crores. The repayment rate is recorded at 99.99%. Bandhan has staff strength of more than 2130 employees.

Operational Methodology

Bandhan follows a group formation, individual lending approach. A group of 10-25 members are formed. The clients have to attend the group meetings for 2 successive weeks. 2 weeks hence, they are entitled to receive loans. The loans are disbursed individually and directly to the members.

Economic and Social Background of Clients

- ✓ Landless and asset less women
- ✓ Family of 5 members with monthly income less than Rs. 2,500 in rural and Rs. 3,500 in urban
- ✓ Those who do not own more than 50 decimal (1/2acre) of land or capital of its equivalent value

Loan Size

The first loan is between Rs. 1,000 – Rs. 7,000 for the rural areas and between Rs. 1,000 – Rs. 10,000 for the urban areas. After the repayment, they are entitled to receive a subsequent loan which is Rs 1,000 - 5,000 more than the previous loan.

Service Charge

Bandhan charges a service charge of 12.50% flat on loan amount. Bandhan initially charged 17.50%. However from 1st July 2005, it has slashed down its lending rate to 15.00%. Then it was further reduced to 12.50% in May 2006. The reason is obvious. As overall productivity increased, operational costs decreased. Bandhan, being a non profit organization wanted the benefit of low costs to ultimately trickle down to the poor.

Monitoring System

The various features of the monitoring system are:

- ✓ A 3 tier monitoring system – Region, Division and Head Office
- ✓ Easy reporting system with a prescribed checklist format
- ✓ Accountability at all levels post monitoring phase
- ✓ Cross- checking at all the levels
- ✓ The management team of Bandhan spends 90.00% of time at the field

Liability structure for Loans

When a member wants to join Bandhan, she at first has to get inducted into a group. After she gets inducted into the group, the entire group proposes her name for a loan in the Resolution Book. Two members of the group along with the member's husband have to sign as guarantors in her loan application form. If she fails to pay her weekly installment, the group inserts peer pressure on her. The sole purpose of the above structure is simply to create peer pressure.

13.3 Grameen Bank

The Grameen Model which was pioneered by Prof Muhammed Yunus of Grameen Bank is perhaps the most well known, admired and practised model in the world. The model involves the following elements.

! Homogeneous affinity group of five
! Eight groups form a Centre
! Centre meets every week
! Regular savings by all members
! Loan proposals approved at Centre meeting
! Loan disbursed directly to individuals
! All loans repaid in 50 instalments

The Grameen model follows a fairly regimented routine. It is very cost intensive as it involves building capacity of the groups and the customers passing a test before the lending could start. The group members tend to be selected or at least strongly vetted by the bank. One of the reasons for the high cost is that staff members can conduct only two meetings a day and thus are occupied for only a few hours, usually early morning or late in the evening. They were used additionally for accounting work, but that can now be done more cost effectively using computers. The model is also rather meeting intensive which is fine as long as the members have no alternative use for their time but can be a problem as members go up the income ladder.

The greatness of the Grameen model is in the simplicity of design of products and delivery. The process of delivery is scalable and the model could be replicated widely. The focus on the poorest, which is a value attribute of Grameen, has also made the model a favourite among the donor community.

However, the Grameen model works only under certain assumptions. As all the loans are only for enterprise promotion, it assumes that all the poor want to be self-employed. The repayment of loans starts the week after the loan is disbursed – the inherent assumption being that the borrowers can service their loan from the ex-ante income.

13.4 SKS Microfinance

Many companies say they protect the interests of their customers. Very few actually sit in dirt with them, using stones, flowers, sticks, and chalk powder to figure out if they will be able to repay a $20 loan at $1 a month. With this approach, this company has created its own loyal gang of over 2 million customers.

Its borrowers include agricultural laborers, mom-and-pop entrepreneurs, street vendors, home based artisans, and small scale producers, each living on less than $2 a day. It works on a model that would allow micro-finance institutions to scale up quickly so that they would never have to turn poor person away.

Its model is based on 3 principles-

1. **Adopt a profit-oriented approach in order to access commercial capital-** Starting with the pitch that there is a high entrepreneurial spirit amongst the poor to raise the funds, SKS converted itself to for-profit status as soon as it got break even and got philanthropist Ravi Reddy to be a founding investor. Then it secured money from parties such as Unitus, a Seattle based NGO that helps promote micro-finance; SIDBI; and technology entrepreneur Vinod Khosla. Later, it was able to attract multimillion dollar lines of credit from Citibank, ABN Amro, and others.
2. **Standardize products, training, and other processes in order to boost capacity-** They collect standard repayments in round numbers of 25 or 30 rupees. Internally, they have factory style training models. They enroll about 500 loan officers every month. They participate in theory classes on Saturdays and practice what they have learned in the field during the week. They have shortened the training time for a loan officer to 2 months though the average time taken by other industry players is 4-6 months.

3. **Use Technology to reduce costs and limit errors-** It could not find the software that suited its requirements, so it they built their own simple and user friendly applications that a computer-illiterate loan officer with a 12th grade education can easily understand. The system is also internet enabled. Given that electricity is unreliable in many areas they have installed car batteries or gas powered generators as back-ups in many areas.

Scaling up Customer Loyalty

Instead of asking illiterate villagers to describe their seasonal pattern of cash flows, they encourage them to use colored chalk powder and flowers to map out the village on the ground and tell where the poorest people lived, what kind of financial products they needed, which areas were lorded over by which loan sharks, etc. They set people's tiny weekly repayments as low as $1 per week and health and whole life insurance premiums to be $10 a year and 25 cents per week respectively. They also offer interest free emergency loans. The salaries of loan officers are not tied to repayment rates and they journey on mopeds to borrowers' villages and schedule loan meetings as early as 7.00 A.M. Deep customer loyalty ultimately results in a repayment rate of 99.5%.

Leveraging the SKS brand

Its payoff comes from high volumes. They are growing at 200% annually, adding 50 branches and 1,60,000 new customers a month. They are also using their deep distribution channels for selling soap, clothes, consumer electronics and other packaged goods.

14 Marketing of Microfinance Products

1. Contract Farming and Credit Bundling

Banks and financial institutions have been partners in contract farming schemes, set up to enhance credit. Basically, this is a doable model. Under such an arrangement, crop loans can be extended under tie-up arrangements with corporate for production of high quality produce with stable marketing arrangements provided – and only, provided – the price setting mechanism for the farmer is appropriate and fair.

2. Agri Service Centre – Rabo India

Rabo India Finance Pvt Ltd. has established agri-service centres in rural areas in cooperation with a number of agri-input and farm services companies. The services provided are similar to those in contract farming, but with additional flexibility and a wider range of products including inventory finance. Besides providing storage facilities, each centre rents out farm machinery, provides agricultural inputs and information to farmers, arranges credit, sells other services and provides a forum for farmers to market their products.

3. Non Traditional Markets

Similarly, Mother Dairy Foods Processing, a wholly owned subsidiary of National Dairy Development Board (NDDB) has established auction markets for horticulture producers in Bangalore. The operations and maintenance of the market is done by NDDB. The project, with an outlay of Rs.15 lakh, covers 200 horticultural farmers associations with 50,000 grower members for wholesale marketing. Their produce is planned with production and supply assurance and provides both growers and buyers a common platform to negotiate better rates.

4 Apni Mandi

Another innovation is that of The Punjab Mandi Board, which has experimented with a 'farmers' market' to provide small farmers located in proximity to urban areas, direct access to consumers by elimination of middlemen. This experiment known as "Apni Mandi" belongs to both farmers and consumers, who mutually help each other. Under this arrangement a sum of Rs. 5.2 lakh is spent for providing plastic crates to 1000 farmers. Each farmer gets 5 crates at a subsidized rate. At the mandi site, the Board provides basic infrastructure facilities. At

the farm level, extension services of different agencies are pooled in. These include inputs subsidies, better quality seeds and loans from Banks. Apni Mandi scheme provides self-employment to producers and has eliminated social inhibitions among them regarding the retail sale of their produce.

15 Success Factors of Micro-Finance in India

Over the last ten years, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grass root savings and credit groups around the world have shown that these microenterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

A. For NGOs

1. The field of development itself expands and shifts emphasis with the pull of ideas, and NGOs perhaps more readily adopt new ideas, especially if the resources required are small, entry and exit are easy, tasks are (perceived to be) simple and people's acceptance is high – all characteristics (real or presumed) of microfinance.

2. Canvassing by various actors, including the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), Friends of Women's World Banking (FWWB), Rashtriya Mahila Kosh (RMK), Council for Advancement of People's Action and Rural Technologies (CAPART), Rashtriya Gramin Vikas Nidhi (RGVN), various donor funded programmes especially by the International Fund for Agricultural Development (IFAD), United Nations Development Programme (UNDP), World Bank and Department for International Development, UK (DFID)], and lately commercial banks, has greatly added to the idea pull. Induced by the worldwide focus on microfinance, donor NGOs too have been funding microfinance projects. One might call it the supply push.

3. All kinds of things from khadi spinning to Nadep compost to balwadis do not produce such concrete results and sustained interest among beneficiaries as microfinance. Most NGO-led microfinance is with poor women, for whom access to small loans to meet dire emergencies is a valued outcome. Thus, quick and high 'customer satisfaction' is the USP that has attracted NGOs to this trade.

4. The idea appears simple to implement. The most common route followed by NGOs is promotion of SHGs. It is implicitly assumed that no 'technical skill' is involved. Besides, external resources are not needed as SHGs begin with their own savings. Those NGOs that have access to revolving funds from donors do not have to worry about financial performance any way. The chickens will eventually come home to roost but in the first flush, it seems all so easy.

5. For many NGOs the idea of 'organising' – forming a samuha – has inherent appeal. Groups connote empowerment and organising women is a double bonus.

6. Finally, to many NGOs, microfinance is a way to financial sustainability. Especially for the medium-to-large NGOs that are able to access bulk funds for on-lending, for example from SIDBI, the interest rate spread could be an attractive source of revenue than an uncertain, highly competitive and increasingly difficult-to-raise donor funding.

B. For Financial Institutions and banks

Microfinance has been attractive to the lending agencies because of demonstrated sustainability and of low costs of operation. Institutions like SIDBI and NABARD are hard nosed bankers and would not work with the idea if they did not see a long term engagement – which only comes out of sustainability (that is economic attractiveness).

On the supply side, it is also true that it has all the trappings of a business enterprise, its output is tangible and it is easily understood by the mainstream. This also seems to sound nice to the government, which in the post liberalisation era is trying to explain the logic of every rupee spent. That is the reason why microfinance has attracted mainstream institutions like no other developmental project.

Perhaps the most important factor that got banks involved is what one might call the policy push.
Given that most of our banks are in the public sector, public policy does have some influence on what they will or will not do. In this case, policy was followed by diligent, if meandering, promotional work by NABARD. The policy change about a decade ago by RBI to allow banks to lend to SHGs was initially followed by a seven-page memo by NABARD to all bank chairmen, and later by sensitisation and training programmes for bank staff across the country. Several hundred such programmes were conducted by NGOs alone, each involving 15 to 20 bank staff, all paid for by NABARD. The policy push was sweetened by the NABARD refinance scheme that offers much more favourable terms (100% refinance, wider spread) than for other rural lending by banks. NABARD also did some system setting work and banks lately have been given targets. The canvassing, training, refinance and close follow up by NABARD has resulted in widespread bank involvement.

Moreover, for banks the operating cost of microfinance is perhaps much less than for pure MFIs. The banks already have a vast network of branches. To the extent that an NGO has already promoted SHGs and the SHG portfolio is performing better than the rest of the rural (if not the entire) portfolio, microfinance via SHGs in the worst case would represent marginal addition to cost and would often reduce marginal cost through better capacity utilisation. In the process the bank also earns brownie points with policy makers and meets its priority sector targets.

It does not take much analysis to figure out that the market for financial services for the 50-60 million poor households of India, coupled with about the same number who are technically above the poverty line but are severely under-served by the financial sector, is a very large one. Moreover, as in any emerging market, though the perceived risks are higher, the spreads are much greater. The traditional commercial markets of corporates, business, trade, and now even housing and consumer finance are being sought by all the banks, leading to price competition and wafer thin spreads.

Further, bank-groups are motivated by a number of cross-selling opportunities in the market, for deposits, insurance, remittances and eventually mutual funds. Since the larger banks are offering all these services now through their group companies, it becomes imperative for

them to expand their distribution channels as far and deep as possible, in the hope of capturing the entire financial services business of a household.

Finally, both agri-input and processing companies such as EID Parry, fast-moving consumer goods (FMCG) companies such as Hindustan Levers, and consumer durable companies such as Philips have realised the potential of this big market and are actively using SHGs as entry points. Some amount of free-riding is taking place here by companies, for they are using channels which were built at a significant cost to NGOs, funding agencies and/or the government.

On the whole, the economic attractiveness of microfinance as a business is getting established and this is a sure step towards mainstreaming. We know that mainstreaming is a mixed blessing, and one tends to exchange scale at the cost of objectives. So it needs to be watched carefully.

16 Issues in Microfinance

1. Sustainability

The first challenge relates to sustainability. MFI model is comparatively costlier in terms of delivery of financial services. An analysis of 36 leading MFIs by Jindal & Sharma shows that 89% MFIs sample were subsidy dependent and only 9 were able to cover more than 80% of their costs. This is partly explained by the fact that while the cost of supervision of credit is high, the loan volumes and loan size is low. It has also been commented that MFIs pass on the higher cost of credit to their clients who are 'interest insensitive' for small loans but may not be so as loan sizes increase. It is, therefore, necessary for MFIs to develop strategies for increasing the range and volume of their financial services.

2. Lack of Capital

The second area of concern for MFIs, which are on the growth path, is that they face a paucity of owned funds. This is a critical constraint in their being able to scale up. Many of the MFIs are socially oriented institutions and do not have adequate access to financial capital. As a result they have high debt equity ratios. Presently, there is no reliable mechanism in the country for meeting the equity requirements of MFIs.

The IPO issue by Mexico based 'Compartamos' was not accepted by purists as they thought it defied the mission of an MFI. The IPO also brought forth the issue of valuation of an MFI.

The book value multiple is currently the dominant valuation methodology in microfinance investments. In the case of start up MFIs, using a book value multiple does not do justice to the underlying value of the business. Typically, start ups are loss making and hence the book value continually reduces over time until they hit break even point. A book value multiplier to value start ups would decrease the value as the organization uses up capital to build its business, thus accentuating the negative rather than the positive.

3. Financial service delivery

Another challenge faced by MFIs is the inability to access supply chain. This challenge can be overcome by exploring synergies between microfinance institutions with expertise in credit delivery and community mobilization and businesses operating with production supply chains such as agriculture. The latter players who bring with them an understanding of similar client segments, ability to create microenterprise opportunities and willingness to nurture them, would be keen on directing microfinance to such opportunities. This enables MFIs to increase their client base at no additional costs.

Those businesses that procure from rural India such as agriculture and dairy often identify finance as a constraint to value creation. Such businesses may find complementarities between an MFI’s skills in management of credit processes and their own strengths in supply chain management.

ITC Limited, with its strong supply chain logistics, rural presence and an innovative transaction platform, the echoupal, has started exploring synergies with financial service providers including MFIs through pilots with vegetable endors and farmers. Similarly, large FIs such as Spandana foresee a larger role for themselves in the rural economy ably supported by value creating partnerships with players such as Mahindra and Western Union Money Transfer.

ITC has initiated a pilot project called ‘pushcarts scheme’ along with BASIX (a microfinance organization in Hyderabad). Under this pilot, it works with twenty women head load vendors selling vegetables of around 10- 15 kgs per day. BASIX extends working capital loans of Rs.10,000/- , capacity building and business development support to the women. ITC provides support through supply chain innovations by:

1. Making the Choupal Fresh stores available to the vendors, this avoids the hassle of bargaining and unreliability at the traditional mandis (local vegetable markets). The women are able to replenish the stock from the stores as many times in the day as required. This has positive implications for quality of the produce sold to the end consumer.
2. Continuously experimenting to increase efficiency, augmenting incomes and reducing energy usage across the value chain. For instance, it has forged a partnership with

National Institute of Design (NID), a pioneer in the field of design education and research, to design user-friendly pushcarts that can reduce the physical burden.

3. Taking lessons from the pharmaceutical and telecom sector to identify technologies that can save energy and ensure temperature control in push carts in order to maintain quality of the vegetables throughout the day. The model augments the incomes of the vendors from around Rs.30-40 per day to an average of Rs.150 per day. From an environmental point of view, push carts are much more energy efficient as opposed to fixed format retail outlets.

4. HR Issues

Recruitment and retention is the major challenge faced by MFIs as they strive to reach more clients and expand their geographical scope. Attracting the right talent proves difficult because candidates must have, as a prerequisite, a mindset that fits with the organization's mission.

Many mainstream commercial banks are now entering microfinance, who are poaching staff from MFIs and MFIs are unable to retain them for other job opportunities.

85% of the poorest clients served by microfinance are women. However, women make up less than half of all microfinance staff members, and fill even fewer of the senior management roles. The challenge in most countries stems from cultural notions of women's roles, for example, while women are single there might be a greater willingness on the part of women's families to let them work as front line staff, but as soon as they marry and certainly once they start having children, it becomes unacceptable. Long distances and long hours away from the family are difficult for women to accommodate and for their families to understand.

5. Microinsurance

First big issue in the microinsurance sector is developing products that really respond to the needs of clients and in a way that is commercially viable.

Secondly, there is strong need to enhance delivery channels. These delivery channels have been relatively weak so far. Microinsurance companies offer minimal products and do not want to go forward and offer complex products that may respond better. Microinsurance needs a delivery channel that has easy access to the low-income market, and preferably one that has been engaged in financial transactions so that they have controls for managing cash and the ability to track different individuals.

Thirdly, there is a need for market education. People either have no information about

microinsurance or they have a negative attitude towards it. We have to counter that. We have to somehow get people - without having to sit down at a table - to understand what insurance is, and why it benefits them. That will help to demystify microinsurance so that when agents come, people are willing to engage with them.

6. Adverse selection and moral hazard

The joint liability mechanism has been relied upon to overcome the twin issues of adverse selection and moral hazard. The group lending models are contingent on the availability of skilled resources for group promotion and entail a gestation period of six months to one year. However, there is not sufficient understanding of the drivers of default and credit risk at the level of the individual. This has constrained the development of individual models of micro finance. The group model was an innovation to overcome the specific issue of the quality of the portfolio, given the inability of the poor to offer collateral. However, from the perspective of scaling up micro financial services, it is important to proactively discover models that will enable direct finance to individuals.

FINDINGS

Comparison of alternative microfinance model client

In this study a modest attempt has been made to differentiate between the client characteristics of the two microfinance model prevalent in the study area.

Level of literacy

The head of the households interviewed were illiterate with 42 percent reporting they had never been school.

Housing

Given the rural focus of our study, it comes as no surprise that over 95 percent of our respondents live in the self –owned dwellings.

Landholdings and sources of income

Only 25 percent of the households were self employed **among** SHG clients. An interesting fact to note is that all the MFI clients were self employed engaged in dairy activities, owning small tea or tailoring shops and working as street hawkers

CONCLUSION

The basic idea of micro financing is simple- if poor are provided access to financial services, including credit, they may very well be able to start a expand a micro enterprise that will allow them to break out of poverty. In totality, its focus is on eradication of poverty form grass level, women upliftment, creating small and medium enterprises and therefore takes care of development of any economy from within

Comparing two microfinance models in the research area reveals that the level of indebtedness to moneylenders is higher in the case of clients of MFI model. Such cases illustrate the difficulties MFI clients' face when they have unproductive financial requirements or they are compelled to ensure prompt and regular loan repayments through further borrowing from even money lenders. This makes poverty worse in the short run, and makes it harder to escape from poverty-and indeed can be source of poverty-and indeed can be source of poverty and inequality "traps"

RECOMMENDATIONS

Access to Credit

The poor people's access to credit may be significantly improved through all the channels of SHG-Bank linkage programme, MFIs, Cooperative Banks, State Financial Corporations, RRB s and PACS. Some MFIs (i.e. Grameen Bank model/LABS, NBFCs) have been doing very well in selected states with dynamic markets and dynamic individuals. Beyond these jurisdictions, their outreach is non-existent. Any significant up scaling of micro-finance at the all India level will have to depend, therefore, on the large network of banks, the bank-SHG linkage programme and the MFIs. In addition, the post office network in the country may also be used to deliver banking services, especially in remote rural areas. The post offices may be further encouraged to work as "business facilitator" and as "banking correspondent" in accordance with RBI guidelines. The NABARD may consider setting up a Committee, consisting of various private and public sector banks, the Ministry of Rural Development, Small Industries Development Organisation (SIDO) of Ministry of Small Scale Industries (SSI), Rashtriya Mahila Kosh (RMK) of The Ministry of Women and Child Development, Department of Posts, SIDBI, MFIs and the NGOs in the micro finance sector to evolve an effective strategy to implement the Business Facilitators and Correspondents Model. Such a strategy should also take into account special target groups such as the SCs/STs and the minorities through their respective National Finance Corporations. The Eleventh Plan may target to extend micro-finance to at least 80 percent of the BPL households.

Formation of Consortiums by Banks

Both public and private sector banks have the expertise in financial intermediation. All the banks should come together and formulate a strategy at the national level to cover all regions of the country and to address the needs of the MFOs. The different banks may form 'consortiums' to leverage each other's advantages and work out suitable strategies to address the needs of micro-finance at the national level. Relevant 'Guidelines on Micro-Finance' both for the MFI model and the Bank-SHG linkage model, may be prepared by NABARD for the field level officers. Some incentives may also be introduced to encourage lending to the poor. Internal monitoring may also be further strengthened to check exploitation of the poor by unscrupulous elements.

Uniform Legal Framework

To facilitate the expansion of micro credit, the Centre should prepare a model Bill on Money Lending and circulate it among the State Governments requesting them to enact similar state legislations. The Reserve Bank has constituted a 'Technical Group for Review of Legislations on Money-lending'. The group is already drafting a model Bill which is expected to be completed by June 30. This draft bill can be used as an input for preparing model bill by the Central Government.

National Policy on Micro Finance

At present, both Government and the private agencies involved in micro finance have devised their own individual strategies in furtherance of their goals. Absence of comprehensive national level policy has hindered the orderly growth of the sector. There is an urgent need for a concerted effort on the part of the various agencies and the services providers involved in the sector to come together to evolve a coordinated strategy for a faster and smoother growth of the

sector. The proposed bill on micro finance may address some of the issues. The 'regulator' proposed in the 'Bill' may have to come out with a detailed strategy on issues like coordination among various agencies, accounting and auditing, transparency, good governance, consumer protection, micro insurance, statistics & research, rate of interest, subsidies etc., keeping in mind the fact that the strength of the micro-finance industry lies in its informality and flexibility.

Uneven Geographical Growth

One of the major reasons for the uneven growth of the sector is the absence of conducive socio-economic and political set-up. NABARD introduced special incentives in the north, north-eastern and western states. The Ministry of Rural Development, Ministry of Small Scale Industries, NABARD and SIDBI may devise further need based incentive schemes for a faster and even growth of the sector in all parts of the country in consultation with Ministry of Finance and RBI. SIDBI has also taken positive steps to reach the underserved states through the portfolio risk fund scheme of the ministry of SSI and through its own special efforts.

Mobilisation of Savings by MFIs

The absence of savings, apart from SHGs and MFI cooperatives, has unfortunately been one of the features of Indian Micro finance and it prevents providing financial service to the poor. The Indian MFIs survive on borrowed funds, unlike other countries where savings fund a large share of lending. The regulatory environment only allows cooperatives to collect savings. The MFIs may be allowed to mobilise savings at least from their members under a regulatory framework monitored by the NABARD. The proposed Microfinance Bill is expected to address this issue.

Cost Covering Interest Rates

There is a need to create awareness of the need to charge cost-recovering interest rates. The rate of interest charged by the MFIs depends upon the cost of funds, cost of delivery and payment, cost of purchasing bad debts and cost of margins. For economic viability and sustainable growth, the MFIs need to charge interest rate covering these costs. Various studies conducted on this aspect indicate that MFIs normally charge 21-24 % interest rate for their sustenance. Innovative techniques must be identified to reduce the cost and the interest rate. The cost of delivery and collection of payment, which forms a major component of cost, can be reduced substantially by using the proposed Common Service Centres, which can be shared by other agencies also. The sector should make all attempts to reduce the rate of interest by means of efficiency enhancing innovations with the aid of technology.

Credit-Linked Subsidy

The policy of providing credit-linked subsidy to SHGs and individuals may be revisited. There are SHGs which are borrowing from banks on a continuous basis without claiming subsidies. A comprehensive study may be commissioned to study the incidence and effects of subsidy as part of the 11th Plan and to work out modalities and long term strategies to use the subsidies more productively and effectively.

Role of Technology

The network of internet enabled Information and Communication Technology (ICT) access points termed as Common Service Centres (CSC), 100000 in number across the country being implemented by the Department of Information Technology (DIT), Ministry of Communications and Information Technology, Government of India also may be utilized for improving the reach and spread of various Micro-Finance and Poverty Alleviation Schemes in rural areas in the country. Further, the DIT may coordinate with NABARD, Ministry of Rural Development, Sa-Dhan and PRADAN to integrate the 'Computer Munshi System' of accounting into the ICT enabled CSCs.

ATMs and Gramteller (rural ATM) may be located in the Post Offices. The Common Service Centres being developed by the Department of Information Technology may also be linked to Post Offices to synergise the technology induction with experience of Posts to handle financial products. The proposed multi-purpose unique ID based smart card system can also be utilised for effective delivery of micro-credit.

NABARD, SIDBI, Ministry of Rural Development and Sa-Dhan, which is already working to evolve a standard book keeping procedure along with the Institute of Chartered Accountants of India, may come together to evolve a standardized, simplified and book keeping procedure for all forms micro finance organisations, which would not only understand the health of the micro finance organisation but also help in accurate and timely disclosure of financial statements and annual reports. Further, the 'Computer Munshi System' developed by PRADAN and which appears to have been adopted successfully for maintenance of accounts may also be integrated into the overall strategy of simplifying the accounting procedure.

Maintaining Standard Accounting System

The guidelines/best practices for SHG-Bank linkages and microfinance may be issued by NABARD, covering auditing and monitoring mechanisms. RBI may conduct evaluation studies as and when required.

Extension Services

Need for extension services in the different economic activities of crop husbandry, animal husbandry, agro & rural industries is being widely recognised for guidance and counselling of SHGs/individuals, to help them choose useful activities and acquire the required skills. These extension services may not always be provided in-house through the line departments of the State Government; rather they may be provided by the private sector (eg. NGOs/MFIs) adopting the PPP model reinforced by viability gap funding. The line departments may, nevertheless, continue to function as apex institutions determining the objectives and terms of contract for the private sector participation.

Micro Insurance

Micro insurance should be perceived as a key service in the financial needs package of the people and in conjunction with micro savings and micro credit could go a long way in keeping the vulnerable segment away from the poverty trap and could be an integral component of financial inclusion.

The Insurance Regulatory and Development Authority (IRDA) has notified Micro Insurance Regulations in November, 2005 with focus on the direction, design and delivery of the products including tie up with life and non life insurance players for integration of product to address various risks, introduction of a standalone Micro Insurance delivery channel consisting of NGO, SHG and MFIs., enlarging the service activities entrusted to micro insurance agent, issue of Policy documents in simple vernacular language etc.

The IRDA may continue to give adequate priority to the micro insurance sector with focus on removing the constraints and further developing the sectoMicro insurance is increasingly offered by MFIs acting as agents of the insurance companies. Life insurance is common among MFI members and some of the members are also availing asset insurance, mainly loan financed assets. Insurance is less widespread under the SHG model. MFIs and other civil society organizations are beginning to offer health insurance, which is of greatest relevance for poverty alleviation.NABARD may consider coordinating with various insurance companies, SIDBI, Ministry of Rural Development, Ministry of SSI, NGOs and their associations to bring out flexible micro insurance schemes, covering not only loan financed assets but also life, health, crop, animal husbandry, etc .

Capacity Building

Some financial institutions, particularly SIDBI, are tying up with capacity building providers to provide assistance to the microfinance institutions. A need-based capacity building programme to meet the requirements of all categories of MFOs is essential to bring about sustainability in the sector. Some of the important areas of capacity building are transformation, best practices, interest rate management, delivery management, managing growth, risk mitigation, product designing etc. Additional infrastructure for capacity building may be created on PPP basis with appropriate government assistance.

Formalities to access the credit are required to be simplified to enable semi literate and illiterate customers to access credit. The delivery mechanism also needs to be simplified to provide easy access to both credit and working capital. Activities suitable for women may be identified taking into consideration their traditional skills. A variety of enterprises may be offered to the women to select the best suited for them. Constant feedback on the market would also enable the women entrepreneurs to improve the product designs and marketing.

Transparency

The borrower needs to be protected from practises like lending without regard for the borrowers ability to repay, deceptive rate of interest and abusive collection techniques. Borrowers /consumer protection laws may be designed to take care of abusive lending and collection practices by defining them and by making provision for effective complaint redressal mechanisms. The consumer protection laws must also provide for transparent discloser of interest rate, cost and other terms of lending. The consumer laws must also educate the consumer on good money management practices for earning, spending, saving, borrowing and investing.

Availability of Information/Statistics

With a view to developing a detailed data base of the micro-finance sector, it may be desirable to conduct periodic surveys of all the micro-finance organisations in the country and their operations. The survey can be conducted jointly by the NSSO and the state governments.

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