MICROFINANCING EXPERIENCE IN INDIA: STRUCTURE, GROWTH AND PERFORMANCE

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MASTER OF PHILOSOPHY

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CERTIFICATE

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IN FOND MEMORY OF MY BELOVED

"FATHER"

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LIST OF ABBREVIATIONS

Acronyms	Definition
AIAMED	All India Association of Micro-Enterprise Development
AIMS	Assessing the Impact of Microenterprise Services
AMCCS	Annapurna Mahila Credit Coperative Society Ltd
APDC	Asia Pacific Development Centre
ASA	Activists for Social Alternatives
CMG	Credit Mangement Group
DCCB	District Central Cooperative Banks
DFID	Department for International Development
DWCRA	Development of Women and Children in Rural Areas
FFI	Formal Financial Institutions
IRDP	Integrated Rural Development Programme
MFI	MicroFinance Institutions
MYRADA	Mysore Resettlement and Development Agency
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Finance Companies
NGO	Non-Government Organisation
PRADAN	Professional Assistance for Development Action
RBI	Reserve Bank of India
RMK	Rashtriya Mahila Kosh
ROSCA	Rotating of Savings and Credit Association
RRB	Regional Rural Banks
SCB	State Cooperative Banks
SEWA	Self Employed Women's Association
SHARE	Society for Helping and Awakening Rural Poor through Education
SHG	Self-Help Group
SIDBI	Small Industries Development Bank of India
TRYSEM	Training of Rural Youth for Self -Employment
USAID	US Agency for International Development

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CHAPTER - I
GENESIS OF MICROFINANCING

1.1 Introduction

The role of financial sector is crucial to the process of development of a nation. Availability of finance and its end targeting have gone through different phase of changes. In 1960s it accorded 'top-down' policy as a panacea for development. However, in the beginning of 1990s, it was felt that this policy prescription has failed in achieving the objective of poverty alleviation. This phenomenon is more apparent in many developing countries. Though formal financial institutions have been given importance during the entire period, still there exist a lot of deficiencies in their methodological operation and outreach to poor. The rigidities in the operations of the formal financial institutions, in rural credit market are not in tandem with the needs of the poor. Moreover, the poor also has not been able to comply with the terms and conditions of banks, in order to get access to financial services provided by them. Consequently, the formal financial institutions have not been successful in achieving greater outreach to the poor.

Access of credit to poor in general and rural poor in particular created concern for the developing countries and subsequently, many governments formulated policies targeting the poor through involvement of formal financial institutions in delivering credit. These policies of the developing countries came as subsidized credit delivery programmes to poor such as integrated rural development programme in India. Unfortunately, these strategies were not able to achieve their commitment; rather, it aggravated the problems of financial institutions by mounting non-performing assets, because small loans bear high transaction cost for the banks and the banks suffer from information asymmetry in the rural credit market as well.

Many governments and international organizations realized that the real needy and deprived sections are remaining out of the spectrum of benefit in this 'top-down' policy. Then, the world summit on micro-finance (1997) and the consultative group to assist the poorest (CGAP), along with other international donors.

supported the new paradigm of micro financing to combat poverty as well as to develop sustainable micro finance institutions for the economically active poor to fall back upon.

As an alternative source of finance in the informal sector, the MFIs emerged with innovated methodologies of operation, which have made them more relevant for the financial needs of the poor. In course of evolution of MFIs their objectives have undergone positive changes and in the recent times they have focused upon twin objectives of poverty alleviation as well as financial sustainability. The demonstration of Grameen Bank and BRAC in Bangladesh, BANCOSOL in Bolivia, BRI in Indonesia and SEWA in India revalidated this bottom-up financing process as a solution. However, in accomplishing their objectives, MFIs also differ within their approach depending upon the local area of operation and their objective. Just as new agricultural technologies spawned the green revolution in the 1970s and 1980s, new financial technologies are producing a micro finance revolution in the 1990s.

1.2 Background of the study

Micro finance has been the cynosure of all eyes in the recent past, particularly in the context of reaching the world's poorest families in a more effective way. Academicians, researchers, policy makers and practitioners in the developmental activities across the world have acknowledged micro finance as a key tool in fulfilling the objective of reducing or eliminating poverty and economic dependence. The concept of micro finance refers to small-scale financial services – primarily credit and savings – provided to people who work in agriculture; fishing and herding; who operate small enterprises or micro enterprises; who provide services; who work for wages and commission and other individuals and groups at the local levels belonging to the underserved low income community of developing countries in both rural and urban [Robinson, 1996]. Understandably, these activities do not figure in the formal/organized sector of the economy.

Institutions such as GRAMEEN Bank of Bangladesh, the BKK of Indonesia and BANCOSOL of Bolivia have achieved higher loan recovery rates than those achieved by commercial banks in the same country, in spite of lending to poor and

uncollaterised individuals, making it appear that a reliable organizational technology for lending to the poor of developing countries now exists. The common elements generally observed with these institutions are; freedom to charge interest rates which cover costs of lending; the provision of savings for the poor; and the adaptation of financial services to potential demand through mobile banking. Various institutional initiatives, including the World Bank based consultative group to assist the poorest (CGAP), the micro credit summit 1997, the Dhaka based Grameen Trust and Asia's CASHPOR network, have been taken to diffuse this technology, on the premise that doing so will make a large contribution to reduce the level of world poverty.

The effectiveness of micro finance services provided by such institutions has been revalidated by the micro credit summit held in February 1997 in Washington, DC which was considered the first step of a decade long campaign that seeks to ensure delivery of credit for self employment by 2005 to 100 million of the world's poorest families especially the women of those families. According to the draft declaration of the summit, micro finance has been defined as "programmes that provide credit for self-employment and other financial and business services, including savings and technical assistance, to the very poor persons", [Micro Credit Summit –1997, Draft Declaration and Plan of Action]. It also argued that the poor does not need only credit, rather, they need 'credit plus services' to which formal financial institutions are incapable of providing them. Therefore, there exists a need for alternative financial institutions, which can serve the interests of the poor as well as accumulate profits.

The CGAP, a donor consortium housed within World Bank, has been formed with a motto of promoting 'sustainable banking with the poor'. It believes micro finance institutions (MFIs) that follow principles of good banking will be able to alleviate poverty in a better manner. Consequently, micro finance promises both to combat poverty and to develop the institutional capacity of financial systems through finding ways for cost-effective lending money to poor households. International donor organizations like CGAP and USAID (United States Agency for International Development) have contributed a lot for the development of micro finance practices. They have argued that MFIs will be able to serve more poor

people than by the programmes fuelled by subsidies. These organizations also argue that poor households demand 'access' to credit, not 'cheap' credit. Besides that they have also envisioned and circulated a series of 'best practices' for sustainable build up of MFIs.

1.2.1 Need for Microfinance

Formal sector Banks believe that poor are non-bankable, or in other words poverty denies access to credit. Other way around inaccessibility of credit also aggravates poverty. When asked, what does poverty mean in Ethiopia women say, "We live hour to hour". Unfortunately, poverty exists in all its teeth and nail for 1198.9 million people around the world in the year 1998. The reality is that it has risen from 1183.2 million people level in 1987, although, in percentage terms it has fallen from 28.3 percent to 24 percent over the same period. In the south Asian region in headcount terms more than 48.4 million people have been added to the army of poor in just the span of one decade, i.e. 1987 to 1998, in the sub-Saharan region the addition is 73.5 million people. However, in East Asia and Pacific region 141.8 million people have overcome this trap. A question arises why so many people are languishing under poverty line. One cannot foolishly blame governments' sincerity. Perhaps somewhere it is the approach and mechanism to deal with this poverty is failing. The existence of around 1200 million persons below poverty line, which happens to be $1/4^{th}$ of total World Population. It only denotes that there exists an enormous demand for credit (Table 1.1).

Table 1.1: People Living on Less than one dollar (US) a day

(Millions/percent)

Region	1987	1990	1993	1996	1998
East Asia and Pacific	417.5 *26.6%*	452.4 *27.6%*	431.9 25.2%	265.1 14.9%	278.3 15.3%
Excluding China	114.1 *23.9%*	92 *18.5%*	83.5 15.9%	55.1 10%	65.1 11.3%
Europe and Central Asia	1.1 *0.2%*	7.1 1.6%	18.3 4%	23.8 5.1%	24 5.1%
Latin America and the Caribbean	63.7 *15.3%*	73.8 16.8%	70.8 15.3%	76 15.6%	78.2 15.6%
Middle East and North Africa	9.3 4.3%	5.7 2.4%	5 1.9%	5 1.8%	5.5 1.9%
South Asia	474.4 44.9%	495.1 44%	505.1 42.4%	531.7 42.3%	522 40%
Sub-Saharan Afirca	217.2 46.6%	242.3 47.7%	273.3 49.7%	289 48.5%	290.9 46.3%
Total	1183.2 28.3%	1276.4 29%	1304.3 28.1%	1190.6 24.5%	1198.9 24%
Excluding China	879.8 28.5%	915.9 28.1%	955.9 27.7%	980.5 27%	985.7 26.2%

Source: World Development Report, 20001, pp. 23, Table 1.1.

This is not a scale that can be reached by government or donor-funded institutions. Micro finance demand can be met on a global scale only through the provision of financial services by self-sufficient institutions, such as MFIs. They have not only made a dent in penetrating deep outreach but also became sustainable by their operational prudence. The experience of 'Grameen Bank' in Bangladesh and 'BancoSol' in Bolivia like institutions have been the source of inspiration in stepping such activities forward. Considering the need of the hour, the expansion of outreach to 100 million poor households has been targeted by 2005 [Microcredit Summit, 1995, Draft Declaration and Plan of Action].

1.2.2 Deficiencies in Institutional Credit Market for the Poor

In the process of development of an economy financial institutions have been given due importance, on a global scale, and importantly, access to credit has been considered as the seed to foster the sustainable growth of economy. Understanding the importance of needs various government programmes have been implemented,

by many developing countries around the world, to direct credit to the poorer section of the population,. In spite of that, financial institutions in many developing countries have failed to make a dent in reaching the needs of poor or the low-income clientele.

However, the main problem with formal lenders is that they often do not have personal knowledge regarding the characteristics and activities of their clientele. These formal institutions may not be able to monitor the activities of the borrower always. For example, a loan taken for productive purpose may have the chances of being misutilised in celebrations like marriages. This sort of information asymmetry regarding the exact purpose of loan as well as the lack of information regarding repayment decisions creates a major hindrance in delivering credit to the poor [Besley, T. 1995].

Banks also have to face difficulty regarding the choice of project lending depending on the amount of risk involved in it, for which banks resort to take the safer side by increasing the interest rate. Consequently, that debars the safe type borrower from assessing loans. Imagine two types of potential investors; one is risky type and the other is safe type. The risky type fails more often than the safe type, but the risky types have higher returns than safe types. Both types want to invest in a project with an uncertain outcome that requires one unit of capital. If they choose not to undertake the project, they can earn wage income m. The risky investors have a probability of success P_r and net return R_r. the safe investors have a probability of success P_s and net return R_s. When either type fails, the return is zero. Returns are statistically independent.

Risky types are less likely to be successful ($P_r < P_s$). Assuming net returns are equal for both safe and risky types $P_rR_r = P_sR_s = R^*$. The project will be socially profitable if $R^* - \rho > m$, where, ρ is cost of capital and m is wage income if project is not undertaken.

Neither type has assets to put up as collateral, so the investors pay the bank nothing if the projects fail. To break even, the bank must set the interest rate high enough to cover its per-loan capital cost, ρ. If both types borrow, the equilibrium interest

rate under competition (r) will then be set so that $rP = \rho$, where P is the average probability of success. Since the bank can't distinguish between borrowers, all investors will face interest rate, r. As a result, safe types have lower expected returns than risky types – since $(R^* - rP_s) < (R^* - rP_r)$ – and the safe types will enter the market only if their expected net return exceeds their fallback position: $R^* - rP_s > m$. Understandably, if the safe types enter the market, the risky types will too.

But the safe types will stay out of the market if $R^* - rP_s < m$, and only risky types might be left in the market. In that case, the equilibrium interest rate will rise so that $rP_r = \rho$. The risky types will thus drive out the safe type investors. The risky types lose the implicit cross-subsidization by the safe types, while the safe types lose access to capital. That implies only the risk types will borrow and the bank benefits from the project if it goes well. The bank will lose all money if the project does not go well. Hence, the bank would like to prevent this risk from being taken, though often it cannot. Banks also cannot discriminate interest rate for the borrowers who they think they are risky. This *Screening as well as enforcement Problem* of banks creates a major barrier in delivering credit to poor [Hulme & Mosley, 1996].

However, it is observable that if the borrower could somehow be made to repay the loan under every contingency, formal financial institutions would not have hesitated to take on credit delivery services to the poor. In practice, this can only be possible in case of rich borrowers only. They can dig into their pockets if the project goes badly. This is one of the important reasons for which the profit motive formal financial institutions are reluctant to give access to poor or in other words they discriminate against poor borrowers.

Institutional credit agencies thus insist on collateral before advancing a loan. For poor peasants, this usually makes formal credit an infeasible option. Moreover, it is not that they lack collateral, but that their collateral is often of a very specific kind. A farmer may have a small quantity of land that he is willing to mortgage, but the bank may not find this acceptable collateral, simply because the cost of selling the land in the event of a default is too high. Likewise, a landless laborer

may seek funds to cover a sudden illness in the family and pledges his labor as collateral. But the banks never accept any such collateral.

These rigidities in the formal market brought in the role of informal moneylenders, traders, landlords, and shopkeepers to do a much better job. The informal moneylenders have the ability to accept the collateral provided by the borrowers as well as they have much better information regarding the activities and characteristics of their clientele. For example, a trader who advances loans for working capital often has first claim on the former-borrower's output. A landlord has better chance of knowing what his client is doing with a loan than the Commercial Bank. However, had there existed perfect competition and smooth functioning of the market, equilibrium position in demand and supply of credit would have been met. Unfortunately, there exists no institutional mechanism with the informal credit providers, for which rural credit markets are far removed from perfect competition [Besley, 1995]. Besides imperfect information there happens to be 'segmentation'[1] in the credit market.

Segmentation often takes place along occupational lines and the complementarity of some production relationship. That causes interlocking[2] of market which is a representative of market imperfection as well. This is also a factor, which causes interest rate variation because the lenders can easily play their monopoly practice. Hence, the rural credit market is governed by such kind of imperfections, importantly, screening problem[3] and enforcement problem[4] [Hulme & Mosley, 1996].

[1] Segmentation of the market implies that there exists a credit relationship based on personal relationships and which takes time to build up.
[2] Interlocking of market implies people deal with the same trading partners, in different markets, and with same terms and conditions prevailing in one market.
[3] Most institutions regard low income households as 'too poor' to save, while potential lenders, faced with borrowers who they do not personally know, who do not keep written accounts or 'business plans' and who want to borrow small and uneconomic sums, are exposed to very high risks every time they lend. This has been termed as screening problem.
[4] Institutions are unable to shield themselves against those risks by means of familiar expedients of banks in industrialised countries, since borrowers, by hypothesis, too poor to offer collateral, the courts too weak to repossess any collateral which is offered, and insurance against the commonest hazards which afflict small producers in developing countries – for example, drought, livestock disease, breakdown of implements etc. – is generally unavailable. It is called enforcement problem.

Banks generally assume that providing small loans and deposit services would be unprofitable because of high transaction costs and high risk involved in delivering at the local level. The poor need credit mainly for financing income consumption gap or tiding over occasional crises and emergencies whereas the thrust of formal banking lies on productive loans. The need and the terms and modes of delivery do not match very often.

The emergence of microfinance institutions is believed to be instrumental in innovating methodologies which can overcome the difficulties faced by formal institutions to get access to poor and on the other hand, in designing services, especially for the poor, so that MFIs will obtain maximum outreach, without compromising for sustainability.

1.2.3 Do MFIs Provide a Solution?

The repeated failures of the formal financial intermediaries appeared to validate that poor households are neither bankable nor able to save much. Moreover, subsidized credit was often diverted to politically favoured non-poor households. In such a gloomy situation, now it is believed amongst various World Organizations that MFIs can show a way out from this mess. MFIs in its very core believe that the poor are not non-bankable, rather innovative approach should be applied to reach them in sustainable mode. So to understand MFIs in their targeted pursuits, their mechanisms particularly group lending will be analyzed here in brief.

(i) Peer Selection

Group lending scheme brings a solution to screening problem by providing incentives for homogeneous borrowers to group together [Morduch, J, 1999]. In other words, the group cannot be a mix of risk as well as safe type borrowers. Suppose the groups are formed, individuals invest independently but the contract is written to create joint liability[5]. The contract is that each borrower pays nothing if the project fails and an amount r* if the project became successful. In addition the

[5] Joint liability implies that in the contract group members are responsible for helping to pay off the loan.

successful borrower pays a joint liability payment C* if the other member of the group fails. Thus, the expected net return of a safe type teamed with a risky type borrower will be $R - P_s \{r^* + (1 - P_r) C^*\}$, where $(1-P_r)$ is the probability of failure for risk type borrowers. Since $P_r < P_s$, it is observable that the safe types are in a relatively inferior position than they would have been, if they had grouped with similar safe type borrowers.

Therefore, the safe type borrowers will be teamed with other safe types to receive a return of $R - P_s \{r^* + (1 - P_s) C^*\}$, and the risk types with other risk type borrowers in the group will get a return of $R - P_r \{r^* + (1 - P_r) C^*\}$. Hence, if r* and C* are set appropriately the group lending contract can provide an effective way to price discriminate, even if r* and C* are same for both, which is impossible in the individual lending contracts of formal banking sector. This influences the safe type borrowers back to the market and therefore, average repayment rate rises. It will also induce the banker to maintain a relatively low interest rate r*.

(ii) Peer Monitoring

Group lending may also provide benefits by inducing borrowers not to take risks that undermine the banks profitability [Stiglitz, 1990; Besley and Coate, 1995]. Consider the same situation, as discussed above, and the same two type of borrowers, safe and risk type. Instead of physical return, the expected utility level is considered for analyzing the moral hazard problem involved in the type. It is also assumed that the risk type investment will have higher expected utility than the safe type investment. If everyone did the safe activity then the bank will charge a interest rate of $r = \rho / P_s$ and breakeven. Since, bank cannot see which activity is chosen, the borrower may switch over to risk type activity to enjoy a higher return from the project. That may lead to failure of the project and the bank will lose money. Then, the bank increases interest rates to $r = \rho / P_r$ (since $P_s > P_r$, as discussed above). In such situation the borrower's utility level will be worse than with the lower interest rate before.

In other words, Group lending contract can create a mechanism that gives borrowers an incentive to choose to safe activity. The borrowers in each group have the ability to enforce contracts between each other and they jointly decide which types of activities to undertake. It is found that if the joint liability payment is set high enough, borrowers will always choose to do the safe activity [Stiglitz, 1990].

Thus through exploiting the ability of neighbours to enforce contracts and monitor each other – even when the bank can do neither – the group lending contract again offers a way to lower equilibrium interest rates, raise expected utility and raise expected repayment rates. In other words, by introducing 'social enforcement' bank will be able to solve the enforcement problem [Hulme and Mosley, 1996].

(iii) Dynamic Incentives

High repayment rates can be obtained by providing dynamic incentives to the borrowers [Besley, 1995]. In other words, incentives are enhanced further if borrowers can anticipate a stream of increasingly larger loans. Generally, the initial loans are given small in size and then the loan size increases depending upon the satisfactory repayment of the borrower. The repeated nature of the interactions and the credible threat to cut off any future lending when loans are not repaid can be exploited to overcome information problems and improve efficiency, whether lending is group based or individual based. The incentives may be in the nature of providing successive loans with concessional interest rates as well. This is otherwise termed as 'Progressive Lending Operations of MFIs' [Hulme and Mosley, 1996].

However, dynamic incentives work better in areas with relatively low mobility than in urban areas. BRI in Indonesia faced greater problem securing repayments in their urban programs than in their rural ones, which maybe due to greater urban mobility. Furthermore, if the lending relationship has a clear end, borrowers have incentives to default in the final period. In this respect, dynamic incentives too have limited scope. It is to be noted that the advantages of progressive lending is the ability to test borrowers with small loans at the start and experiment. In fact, it has been found that targeting women clients have proved better performances,

which is partly due to their relatively less mobility, fewer alternative sources of borrowing than men [M. Goetz and R. SenGupta, 1995].

(iv) Regular Repayment Schedules

The innovative feature adopted by many successful MFIs around the world is that repayments start nearly immediately after disbursement. In a traditional loan contract, the borrower gets the money, invests it, and then repays in full with interest at the end of the term. But at Grameen style banks, terms for a year long loan are likely to be determined by adding up the principal and interest due in total, dividing by 50, and starting weekly collections a couple of weeks after disbursement. Many programmes like BancoSol and BRI tend to be more flexible in calculating repayment periods and volumes as well. However, the advantages are many. The repayment schedules screen out undisciplined borrowers. They give early warning to loan officers and peer group members about emerging problems. Moreover, it allows banks to get hold of cash flows before they are consumed or otherwise diverted [Rutherford, S, 1998].

However, it has certain disadvantages like; the repayment process begins before investments bear fruit, which implies that the household must have an additional income source. This is beneficial for the MFI but the very poor may not reap the opportunity of getting a loan, as it is unlikely that those households have alternate earning source. Further, that does not work for farm worker who has seasonal earnings.

(v) Collateral Substitutes

Some MFIs require collateral, while many have substitutes. Programmes following the Grameen model require that borrowers contribute to an emergency fund in the amount of 0.5 percent of every unit borrowed. The emergency fund provides insurance in cases of default, death, disability etc. in the amount proportional to the length of membership. They also charge a 'group tax' over the loan amount in addition to the interest. The SHGs in India also do not charge any collateral rather they require a compulsory group saving. BRI's *unit desa* programme requires

collateral while BancoSol stresses the role of solidarity groups in assuring repayments.

1.2.4 Different Approaches of MFIs

Badan Kredit Desa (BKD) village banks and Bank Dagang Bali (BDB) in Indonesia, Self-Employed Women's Association (SEWA) in India, ACCION affiliates in Latin America, various NGOs, Credit Unions and Cooperatives in various countries are considered as the pioneers in developing the financial systems approach to micro finance. Since 1970s these institutions have developed innovative lending methodologies and demonstrated that micro credit provided at interest rates that enable full cost recovery could be delivered with high repayment. Furthermore, the Grameen Bank experience of Bangladesh inspired the NGOs and Voluntary Development Organisations to take on the job of providing finance to the poor. The innovative methodology, based on the old methodology followed by Rotating of Savings and Credit Associations, adopted by the Grameen Bank successfully demonstrated that the poor are bankable.

However, presently there exists a variety of MFIs adopting methodologies congenial to the contextual and socio-economic factors of the locality. Usually, they follow the local methodologies banking upon their knowledge of the area of operation. Hence, the methodologies vary widely across the regions as well as among the MFIs within the region. Broadly, they can be grouped under the categories mentioned as follows, [Ledgerwood, 1998]:

(i) Grameen Bank Group Lending Approach

The Grameen Bank of Bangladesh with a motive to serve rural, landless women wishing to undertake income-generating activities, pioneered this lending model. This model has got the widest replication in many developing countries across the world. Under this group lending method, peer groups of five are self formed and incorporated into village centers of up to 8 peer groups. As per the method, savings must be contributed for 4 to 8 weeks prior to receiving a loan and must continue for the duration of the loan term. The group fund is managed by the group and may

be lent out within the group. Group members mutually guarantee each other's loans and are held legally responsible for repayment by other members. No further loans are available if all members do not repay their loans on time. No collateral is required for granting a loan.

The Grameen Bank has now over two million borrowers, 95 percent of whom are women, receiving loans that total $30 to $40 million per month. The initial loan amount is roughly $100 and the reported repayment rates average 97 to 98 percent [Morduch, 1999]. Major institutions replicating Grameen model are Bangladesh Rural Advancement Committee (BRAC), PREM in India, Vietnam Women's Union etc.

(ii) BancoSol Group Lending Approach

Banco Solidario (BancoSol) of urban Bolivia also lends to groups but it's methodology is little different from Grameen's group lending approach. It gives loans to all the members in the group, simultaneously, and the solidarity group can be formed of three to seven members. The members cross-guarantee each other's loans to replace the traditional collateral system. This model was originally developed by ACCION international in Latin America.

Unlike Grameen Bank, BancoSol focuses sharply on banking, rather than social service. It therefore charges higher interest rate than the former in case of Bangladesh. Therefore, it does not rely on subsidies. Moreover, the repayment schedules are flexible allowing some borrowers to make weekly repayments and others to do so monthly. Borrowers are better off than in Bangladesh and the loans are larger with average loan balances exceeding $900. Thus, it is seen that BancoSol serves the poor clients who are among the richest of the poor and clustered just above the poverty line. However, BancoSol has proved itself as a financially sustainable MFI. This model has been adopted by many MFIs like, PROSEM in Guatemala, Asociacion grupos solidarios de Colombia, etc.

(iii) Individual Lending Approach

Individual lending is defined as the provision of credit to individuals who are not members of a group that is jointly responsible for loan repayment. Bank Rakyat Indonesia *unit desa* has demonstrated this model. BRI lends to 'better off poor' and non-poor households and has also become financially sustainable. The average loan size of BRI is $1007 during 1996. Unlike Grameen or BancoSol, BRI does not use group-lending method. Also, unlike others, it requires collateral, which excludes the accessibility of very poor borrowers. This may be reason for which it has registered a record recovery rate of 97.8 percent in 1998 [McGuire, 1998]. It also charges higher interest rate but gives concession to loans that are paid with no delay, which may be attributed to the high recovery rates of the Institution. SEWA Bank in India belongs to this category.

(iv) Village Banking

Village banks are community managed credit and savings associations established to provide access to financial services in rural areas, build a community self help group, and help members accumulate savings [Otero & Rhyne 1994]. The model was developed in the mid 1980s by the Foundation for International Community Assistance (FINCA), Mexico. Membership in a village bank usually ranges from 30 to 50 people, most of who are women. Membership is based on self-selection. The bank is financed by internal mobilization of members' fund as well as loans provided by the MFIs. Members' savings are tied to loan amounts and are used to finance new loans for collective income generating activities. No interest is paid on savings. However, members receive a share from the bank's re-lending or investment profits. FINCA in Mexico and Costa Rica, CARE in Guatemala, Save the Children in El Salvador, Freedom from Hunger in Thailand, Burkina Faso, Bolivia, Mali and Ghana etc have replicated the village banking model.

The group consists of large numbers of members. Even then Village Banks are able to harness local information and peer pressure on clients. The loans are made to members starting at around $ 50 with a four-month term, with subsequent loan sizes tied to the amount that members have on deposit with the bank. They charge

interest rate around 4 percent per month. However the Village Banks are able to cover just 70 percent of their total cost. The reason is that village banks are situated in such areas that focus on outreach rather than scale.

(v) Self-Reliant Village Banks

Self-reliant village banks are established and managed by rural village communities. They differ from village banks in that they cater to the needs of the village as a whole, not just a group of 30 to 50 people. This model was developed by a French NGO, The Centre for International Development and Research, in the mid 1980s. This programme identifies villages where social cohesion is strong and the desire to set up a village bank is clearly expressed. The villagers – men and women together – determine the organization and rules of their banks. These banks provide individual short-term loans by securing collaterals. Importantly, it is village trust and social pressure that ensures high repayment rates.

1.2.5 Issues Governing Operation of MFIs

(i) Savings-first vs. Credit-first Approach

MFIs often come across the dilemma over adopting saving-first approach or credit-first approach in overcoming the ground difficulties for their sustainable operations. Several advantages of both the approaches have been identified, as follows;

Advantages of Savings-first Approach:

- Savings mobilization generated internal source of funds
- It facilitates the MFI in screening and monitoring of clients
- Effectively decides the credit worthiness of the customer
- Importantly, they encourage voluntary savings
- MFI can evaluate the potentiality of the borrower since the latter has developed depositor relationship with the MFI
- They have to develop sound banking practices because they are depended on internally generated funds.

However, Savings-first programmes have been criticized on the ground that they only target middle-income clients and do not reach very poor people. Question also arises regarding their capability to mobilize savings as well as attaining financial self-sufficiency.

Advantages of Credit-first Approach:

- Large outreach can be possible in a relatively short period due to reliance on external funding and technical assistance
- Credit is targeted and depth of outreach tends to be high
- Reduces transaction costs of mobilizing internal funds within a group
- Organize clients into solidarity groups. These groups have been instrumental in overcoming information asymmetries and thus, leading to effective internal screening and monitoring of clients.

Credit-first programmes suffer from the drawback that they rely on donor funds which makes them dependent and thereby, distant them from integrating into formal financial sector[6].

Experts have challenged the sustainability and magnitude of delinquency in the credit-first approach as well as the conservative and limited outreach nature in the savings-first approach. However, advocates have synthesized the validities of both the approaches and over the past few years, many institutions have adopted the synthesis of the two

(ii) Minimalist vs. Integrated Approach

MFIs offering only financial intermediation are referred to as minimalists. Financial intermediation involves transfer of capital or liquidity from those who have excess at a particular time to those who are short at that time. Moreover, financing is the primary role of MFIs. All the players in the field of micro finance satisfy this prime characteristic. Some MFIs also provide financial intermediation in savings mobilisation, insurance services, and payment services etc. The choice of which financial service to provide and the method of providing these services

[6] A case study of 8 MFIs undertaken by World Bank, *Sustainable Banking with the Poor,* in Sub-Saharan African countries have been taken into consideration for evaluating the efficacy of both the approaches. It has been found that the Credit-first programmes have shown relatively more dependence on subsidy than the Savings-first programmes.

depends on the objectives of the MFI, the demands of its target market and its institutional structure.

Generally, the target clientele of MFIs include poor or low income and illiterate borrowers who are unable to start a profitable micro enterprise business. Only credit service does not help them in overcoming the difficulties for sustained earnings. That has been already experienced in many countries for government programmes undertaken through subsidized credit delivery mechanism for which a role 'credit plus' services is required. These services include: (a) Social intermediation (b) Enterprise development services (c) Social services. Social intermediation involves group formation, leadership training and cooperative learning. Similarly, enterprise development services educate them regarding marketing, business training, production methodologies and subsector analysis. And also, social services like education, health and nutrition, and literacy training prepares them to look forward in their struggle for survival.

The MFIs such as; BancoSol, SEWA, BRI unit desa, BKK, Grameen Replicators etc. have adopted the former approach. The credit plus approach has become popular by the involvement of NGOs, which are turning into the field of micro financing. A World Bank study examined the array of financial and nonfinancial services offered by two hundred MFIs around the world, which reveals that NGOs were more active in providing services and training relating to health, nutrition, education and group formation [Fruman and Paxton, 1997]. However, the success of micro finance services as well as the sustainability of the MFIs lie in understanding the micro realities and, thereby, providing appropriate services.

1.2.6 The Indian MFI Situation

Micro finance, as discussed in the earlier section, is being practised as a tool to attack poverty the world over. India is also one among the earliest beginners in this field. The old paradigm of micro finance consisted of assistance from formal institutions like Nationalised Commercial Banks; Regional Rural Banks; the Co-operative and the National Bank for Agriculture and Rural Development (NABARD). Various bank credits linked subsidized government programmes for

alleviation of poverty like IRDP, PMRY and SGSY etc. also help the poor to access credit from the formal institutions. But, these programmes have never been successful in producing desired result, as that has happened in most of the developing countries. However the institutional developments in informal sector, for proving micro finance services, have created the new generation MFIs such as; SEWA Bank, FWWB and MYRADA etc. the new paradigm of micro finance has also been given a boost by the pioneering role of NABARD in its pilot project of self-help group (SHG) and bank linkage model. Furthermore, a joint taskforce of RBI and NABARD was set up for the regulation, supervision and proper functioning of MFIs in 1999. The taskforce defines micro finance 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 improving their living standards."

1.2.7 RBI Policy on MFIs

Micro credit has been a thrust area with RBI, though the vehicles of credit extension have been under constant evolution over a period of time [Capoor, J, 2001]. As a part of the overall financial sector reforms in the country, the interest rates applicable to loans given by banks to micro credit organisations or by the micro credit organisations to the Self-Help Groups/member beneficiaries has been totally left to their discretion. The banks have been given complete freedom to formulate their own models or choose any conduit/intermediary for extending micro credit. Micro credit extended by banks to individual borrowers directly or through any intermediary is now being reckoned as part of their priority sector lending. Banks in India are also now free to prescribe their own lending norms keeping in view the ground realities. The intention is to provide maximum flexibility in regard to micro lending, keeping in view the prevalent local conditions and the need for provision of finance to the poor.

RBI has also issued certain guidelines to commercial banks, such as, micro credit should form an integral part of the bank's corporate credit plan and should be reviewed at the highest level on a quarterly basis. A simple system requiring minimum procedures and documentation is a pre-condition for augmenting flow of

micro credit. The loan application forms, procedures and documents should be made simple. It would help in providing prompt and hassle-free micro credit. Savings mobilisation being a major issue in micro finance provision, certain major relaxations have been issued regarding requirement of registration, maintenance of percentage of assets and reserve fund for Non-profit Non-banking Finance Companies (NBFC) – Micro Finance Institutions (MFIs). The Micro Finance Institutions registered as not-for-profit NBFCs have been exempted from registration and prudential requirements.

Keeping in view these initiatives for enabling the micro finance movement in our country to gain momentum, the Government of India has recently allowed foreign direct investment in micro/rural credit to encourage foreign participation in micro finance projects. MFIs are significantly different from commercial banks both in terms of institutional structure and product portfolio. Hence, there needs to emerge an evolution of a self-regulating mechanism. These institutions should now get together and come out with a set of proposed self-regulatory norms. Information dissemination, research, database creation and experience sharing among the micro finance practitioners would be the initial step to setting out on the self-regulation path. With a view to facilitating smoother and more meaningful banking with the poor, a pilot project for purveying micro credit by linking SHGs with banks was launched by NABARD in 1991-92. The Reserve Bank had then advised commercial banks to actively participate in this linkage programme. The scheme has since been extended to the Regional Rural Banks (RRBs) and co-operative banks also. The number of SHGs linked to banks aggregated 1,21,744 as on September 30, 2000. This translates into an estimated 1.9 million very poor families having been brought within the fold of formal banking services. More than 85 percent of the groups linked with banks are exclusive women groups [Capoor,J., 2001].

Furthermore, there exists an urgent need for micro credit providers to shift from a minimalist approach – that is offering only financial intermediation – to an integrated approach to poverty alleviation taking a more holistic view of the client including provision of enterprise development services like marketing infrastructure, introduction of technology and design development. In this context,

the setting up of the Micro Finance Development Fund marks an important step. Finance Minister in his budget speech for the year 2000-01, this fund has been created in NABARD to support broadly the following activities: (a) giving training and exposure to SHG members, partner NGOs, banks and government agencies; (b) providing start-up funds to micro finance institutions and meeting their initial operational deficits; (c) meeting the cost of formation and nurturing of SHGs; (d) designing new delivery mechanisms; and (e) promoting research, action research, management information systems and dissemination of best practices in micro finance. This fund is thus expected to address institutional and delivery issues like institutional growth and transformation, governance, accessing new sources of funding, building institutional capacity and increasing volumes.

1.2.8 Demand and Supply of Microfinance

India is bearing more than 1 billion population form among which around 320 million people or about 60 million households are living below poverty line, as shown in Table1.2. It is further estimated that of the 320 million households 244 million households constitute to rural areas. Though formal sector's role in delivering credit to rural households has been increasing over time, still a sizable portion (36%) of the households have no access to credit from this sector (Table 1.3). Furthermore, a group of micro finance practitioners have estimated the requirements of micro credit, including rural and urban poor families, to the tune of over 45,000 crores per year [Mahajan, V., 2001].

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Table1.2: Poverty Ratio and Number of Poor in India

Year	Poverty Ratio (%)			Number of Poor (million)		
	Rural	Urban	Combined	Rural	Urban	Combined
1973-74	56.1	49	54.9	261.3	60	321.3
1977-78	53.1	45.2	51.3	264.3	64.6	328.9
1983-84	45.7	40.8	44.5	252	70.9	322.9
1987-88	39.1	38.2	38.9	231.9	75.2	307.1
1993-94	37.3	32.4	36	244	76.3	320.3

Source: Government of India, 'Ninth Five Year Plan (1997-2002)', Vol. 1.

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Analyzing microfinancing in Indian context, the demand for micro credit arises from three segments. At the bottom most level are the landless casual labourers, manual labourers in forestry, mining, household industries, construction and transport. They require mostly credit for consumption purposes or for purchasing livestock.

The next market segment constitutes small and marginal farmers and rural artisans, weavers and those self-employed in the urban informal sector as hawkers, vendors and workers in household micro enterprises. This segment needs credit s crop loans or for working capital requirements.

The third market segment constitute to the lower middle income households like; small and medium farmers producing commercial crops, people engaged in dairying, poultry, fishing etc. these people live barely above poverty line and also suffer form inadequate access to formal credit. One market segment that is of great importance to micro credit is women. The 1991 census figures reveal that out of 2.81 million marginal workers, 2.54 million were women. More interesting figure is given by the fact that out of a total of 2.67 million rural marginal workers, 2.44 million were females [Census of India, 1991]. The figure also shows that many women were seeking part time or full time job, for which they needed initial finance too. The success of MFIs in other countries has also revealed that women are credit worthy and they should be considered as potential borrowers.

However, the supply from formal institutions falls short of the demand. The informal sources provide much of the finance to the needs of the rural population. The magnitude of the dependence of the rural poor on informal sources of credit can be observed from the findings of the All India Debt and Investment Survey, 1992, which shows that the share of the non-institutional agencies (informal sector) in the outstanding cash dues of the rural households was 36 percent. Among the formal institutional sources, banks and co-operatives provided credit support to almost 56 per cent of the rural households, while professional and agricultural moneylenders and landlords were providing credit to more than one fifth (21.5%) of the rural households (table1.3).

Table 1.3: Sources of Credit for Rural Households – 1991

Credit Agency	% of Rural Households
Government etc	6.1
Cooperative societies	21.6
Commercial Banks and RRBs	33.7
Insurance	0.3
Provident Fund	0.7
Other Institutional Agencies	1.6
All Institutional Agencies	64.0
Landlord	4.0
Agricultural Money lenders	7.0
Professional Money lenders	10.5
Relatives and Friends	5.5
Others	9.0
All Non-institutional Agencies	36.0
All Agencies	100

Source: 'All India Debt Investment Survey – 1992', RBI Bulletin – February 2000.

Furthermore, by classifying households into asset groups (table1.2) it reveals that 58 percent credit obtained by the households in the lowest asset group flows from non-institutional credit agencies whereas in case of highest asset group (Rs. 2.5 lakh and above) only 19 per cent of their credit is obtained from non-institutional sources. This implies that there exists still a high amount of dependence of poor class people to depend on non-institutional sources.

Table 1.4: Share of Debt from Institutional and Non-Institutional Sources by Asset Holding

Household Assets ('000)	Institutional Agency	Non-Institutional Agency
< 5	42	58
5 – 10	47	53
10 – 20	44	56
20 – 30	68	32
30 – 50	55	45
50 – 70	53	47
70 – 100	61	39
100 – 150	61	39
150 – 250	68	32
> 250	81	19
All Classes	66	34

Source: 'All India Debt Investment Survey – 1992', RBI Bulletin – February 2000.

1.3 Objectives of the study

The objectives of the present study are

1. To study the structure and growth of microfinance in India.
2. To study the operational methodologies of MFIs in India.
3. To assess the performance in terms of outreach, cost-effectiveness and financial sustainability of MFIs.

1.4 Importance of the present study

The Indian microfinance sector is complex in its structure. It not only constitutes of formal and informal sectors but also there exists linkage between the two. The size and complicacy of the microfinance sector in India has made the topic intellectually hot. Furthermore, the potential benefits of an appropriate MFI functioning in the Indian context necessitates deep academic endeavor. Notwithstanding such obvious benefits no prior attempt has been made to measure the outreach and performance of the MFIs operating in India. Furthermore, no prior study has examined the efficacy of various approaches at aggregate level in India as far as MFIs are concerned. In such an event the present study attains paramount importance as it not only analyzes the structure of MFIs but also measures the outreach and performance of various MFIs operating in India.

1.5 Context and organization of the study

The present study attempts to examine the existing structure and growth of microfinance sector in India. It also attempts to measure the functional outreach of MFIs according to the different approaches that are operational in Indian context. Furthermore, the study also evaluates their performance to find out the effectiveness of a particular model. The structure and growth of microfinance in the formal sector in India has been studied for the period 1980-81 to 1999-00. However, owing to severe data constraint pertaining to informal sector microfinance institutions operating in India, the study could not analyze the trend. Rather all the analysis relevant to the informal sector has been carried out at a point of time (year 1999-2000).

The rest of this study is divided into three chapters (chapter 2 – chapter 4). The structure and growth of Microfinance in India have been discussed in detail in chapter II. Chapter III analyses the operational framework of MFIs (lending and savings products) in India. The performance of MFIs has been evaluated in brief in chapter 4. Finally, the concluding remarks of the study are presented towards the end of this study.

1.6 Concluding remarks

Because of the various reasons mentioned above MFIs in India retain their significance. Furthermore, no prior study has attempted to deal with the topic in detail as far as evaluation of the various approaches to MFIs and their efficacy in the Indian scenario is concerned. In such a scenario the current study attempts to integrate various operational approaches to the functioning of MFI and furthermore attempts to evaluate their appropriateness in the Indian context with regard to various dimensions like structure, growth and outreach. However, the current study does not intend to give any immediate short or long run solutions to the operational problems of MFIs in India. Rather, it is inspired from the consistently nagging criticism of the operational efficiency of MFIs in India.

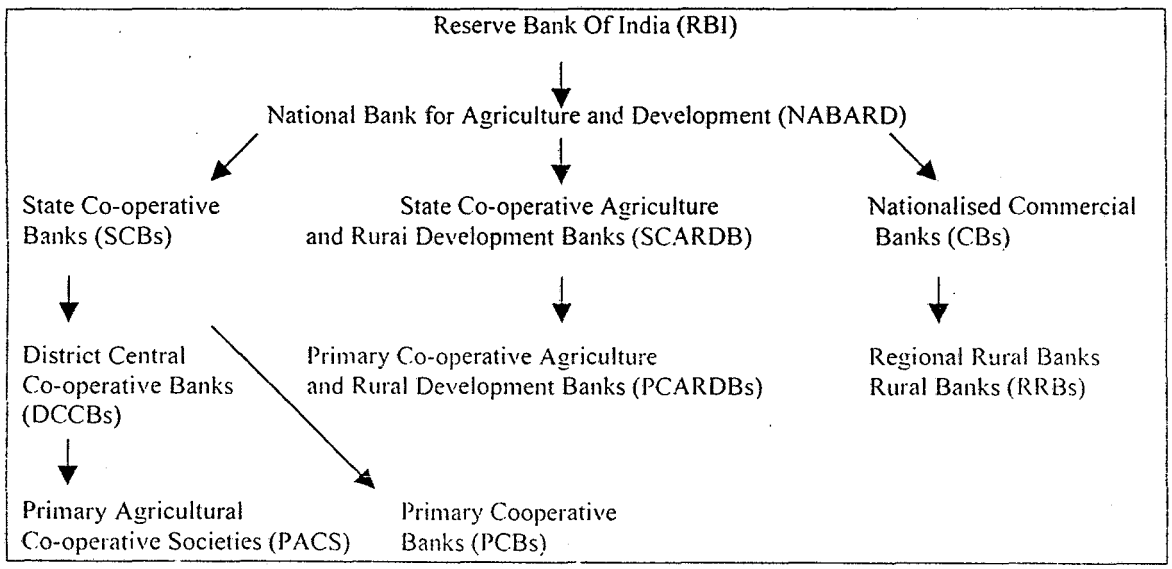
CHAPTER II

STRUCTURE AND GROWTH OF MICROFINANCE

2.1 Structure of Microfinance

Microfinance, as discussed earlier, attributes to both the farm and non-farm sector targeted poor households, with small loan amounts as well as encouragements for savings mobilisation. As the poor in India at large are rural and semi-urban dwellers, the existing market for microfinance in India is referred as largely rural. Therefore, the financial services delivered to the poor, especially rural poor exhibit a dualistic structure of operation through the mix of formal and informal institutions in the country. Chart-2.1 represents the channel of formal financial intermediation that includes Co-operatives, Commercial Banks (CBs) and Regional Rural Banks (RRBs).

Chart – 2.1: Channel of Formal Financial Intermediation in India.



The institutionalisation of credit delivery system in India initiated by the creation of Co-operatives through the legislation of Co-operative Societies Act, 1904. This process was intensified further following the recommendation of the Rural Credit Survey Committee, constituted by RBI, in 1954. Afterwards, the nationalisation of Commercial Banks in 1969 and the formation of Regional Rural Banks in 1975 stepped up the magnitude and coverage of credit delivery to the poor as well. Both the Co-operatives and Commercial Banks including RRBs have been actively involved in delivering credit to the targeted under various government programmes.

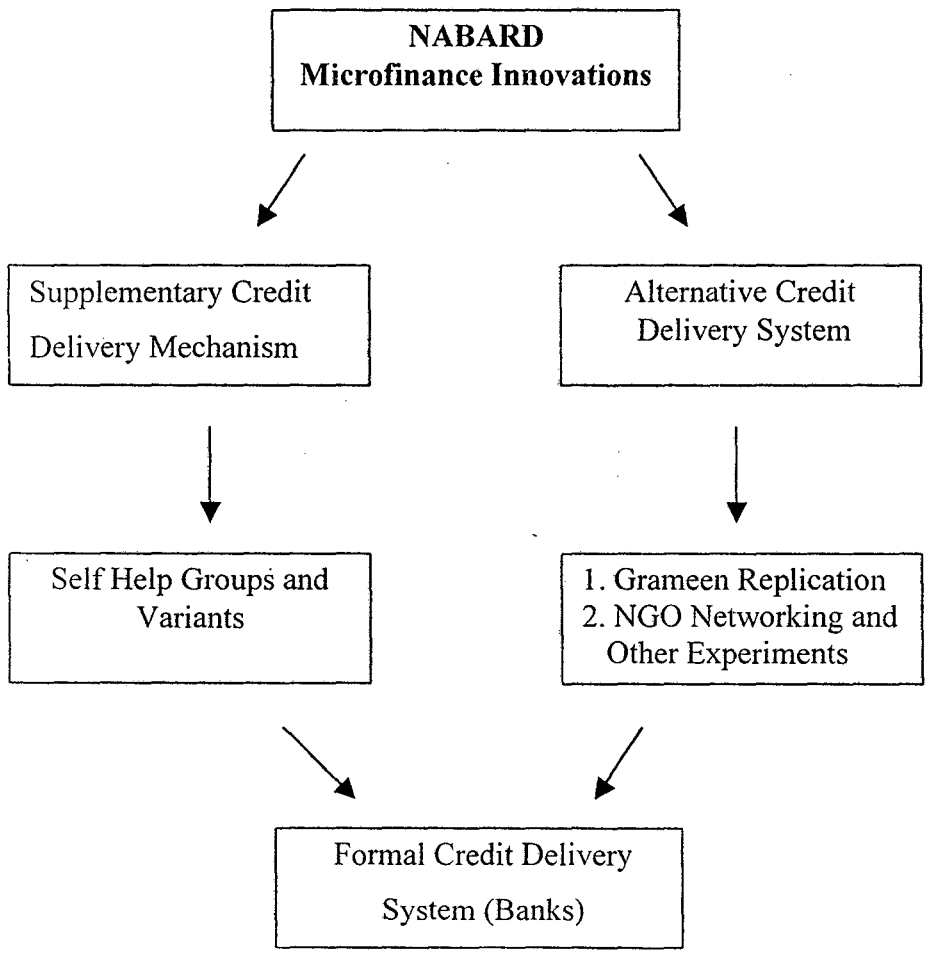
In spite of a comprehensive expansion of formal financial institutions, the informal sector also plays a greater role in targeting the needs of poor, as discussed in the earlier chapter[1]. Traditionally, the informal sector credit delivery consists, mainly of Rotating Savings and Credit Associations (ROSCA), traders, merchants, contractors, commission agents, local moneylenders etc. In recent times the NABARD initiative has further brought various additional constituents particularly, NGOs and SHGs into the informal financial sector of the country. In fact, the new microfinance revolution has emerged in India through these institutions. Organisations like SEWA, BASIX, SHARE, FWWB and similar NGOs earlier involved in developmental activities and termed as Voluntary Development Organisations (VDOs), have also extended their service to microfinancing, as they found it the most promising weapon in the alleviation of poverty. Moreover, many organisations in the line of Grammeen Bank in Bangladesh have come up to the diaspora of microfinancing. These organisations can be referred as Microfinance Institutions (MFIs).

Nevertheless, the major institutional sources of bulk credit for microfinance in India are the NABARD and the Small Industrial Development Bank Of India (SIDBI). There is also a government initiated NGO – the Rashtriya Mahila Kosh (RMK) under the department of women and child development – that extends credit support to NGOs and Women Economic Development Corporations. Thus, in the microfinance sector, the formal funds get into the non-formal channels before they reach the desired segments of the clientele. The entry of these new set

[1] The avenues for urban poor for their betterment are many vis-à-vis their rural counterparts. Hence microfinance has a greater qualitative role to play in case of rural poor.

of players in the financial system has definitely eased a lot of delivery obstacles, by externalising a part of banks' responsibilities in the spheres of identification of clients, assessment of their risk profile, loan monitoring and recovery, which, in turn, has resulted transaction cost[2] reduction. **Chart** – 2.2 focuses on the emergence of the new MFIs, structure in India.

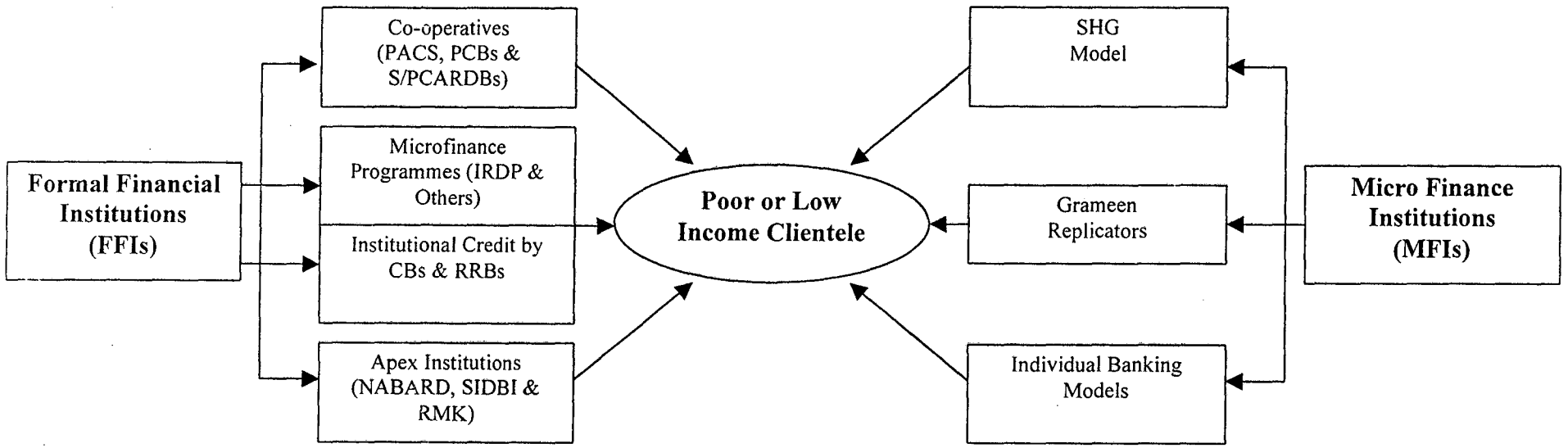
Chart 2.2: Channel of non-formal financial MFIs Structure in India



The structure of MFIs in India, despite NABARD's initiatives to promote linkage between the formal and non-formal sectors, exhibits dualistic characteristics. The overall institutions involved in the field of microfinancing in India can be represented as Formal Financial Institutions (FFIs) and MFIs, as depicted in **Chart**-2.3.

[2] According to a study conducted by NABARD, there has been a 40 percent reduction in transaction cost due to SHG intermediation and consequent reduction in time spent by the bank staff. Similar is the case for the borrower as well. See www.soc.titech.ac.jp/icm/nanda-5.html

Chart 2.3
Structure of Micro Finance Sector in India



FFIs providing credit support to poor consists of:

- Co-operatives (PACS, S/PCARDB & PCBs)
- Microfinance programmes (IRDP, TRYSEM & Others)
- CBs & RRBs
- Apex Institutions (NABARD, SIDBI & RMK)

And, the various models adopted by MFIs operating[3] in India consists of:

- SHG Models
- Grameen Replicators
- Individual Banking

The classification is based on the operational mechanism of the various organisations[4].

2.2 Co-operatives and Microfinance

The co-operative credit structure comprises of both short-term (Production credit) and long-term credit (Investment credit) by nature. The short-term credit structure comprises of Primary Agricultural Credit Societies (PACS) at the base level, District Central Co-Operative Banks (DCCBs) at the intermediate level and State Co-operative Banks (SCBs) at the apex level. There also exists Primary Co-operative Banks (PCBs) or Urban Banks to serve the credit needs of the urban poor. The long-term co-operative credit structure came into existence as central Land Mortgage Banks in the twenties, primarily as purveyors of credit for redemption of debt. It evolved over the years to meet investment credit needs of the farmers over the years and later came to be known as State Co-operative Agriculture and Rural Development Banks (SCARDBs). They have unitary structure with branches in some states or a federal structure supporting the primary co-operative agricultural and rural development banks (PCARDBs). However, the DCCBs and SCBs are not involved much in lending to individuals, hence not reckoned generally for the purpose of measuring outreach of these institutions.

[3] See M-CRIL report, 2000
[4] Ibid.

2.2.1 PACS and Microfinance

The primary agricultural credit societies at the village level form the base of co-operative credit structure. The number of PACS stood at 92,682 by end of March 1996 with a membership of around 966 lakhs; [Satyasai, K. J. S., & K. C. Badatya, 2000] among which number of borrowers were more than 240 lakhs[5]. PACS provide mainly crop loans, which are of short period (less than over year) in nature. Some medium term loans (15 months to 5 year) are also provided for various purposes such as purchase of cattle, installation of pump sets, construction of bounds, improvement of land etc. The loan operation of PACS is presented in table 2.1.

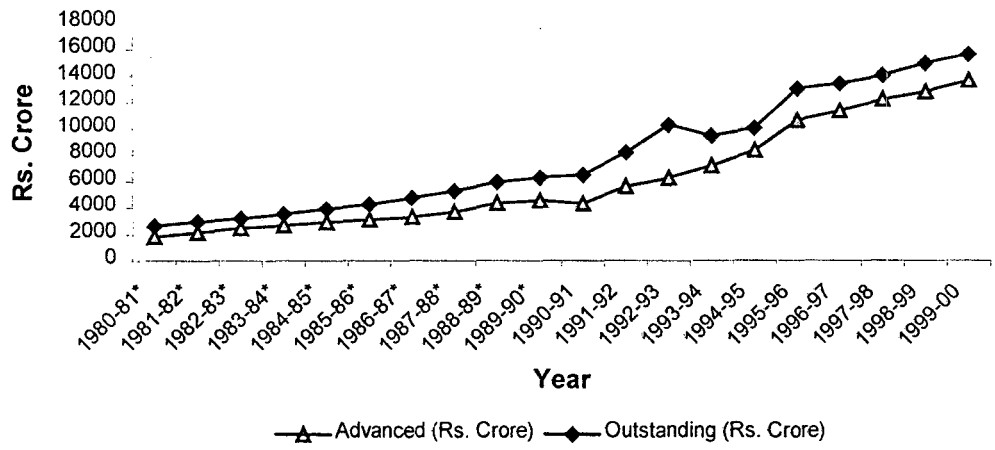
Table 2.1: Status of PACs (loan operation) 1980-81 to 1999-2000.

	PACS		
Year (End Mar)	No. of Borrowers (Lakhs)	Amount Advanced (Rs. crore)	Amount Outstanding (Rs. Crore)
1980-81*	200	1769	2621
1981-82*	210	2134	2951
1982-83*	200	2439	3201
1983-84*	200	2632	3522
1984-85*	190	2915	3904
1985-86*	190	3111	4263
1986-87*	180	3304	4732
1987-88*	200	3688	5242
1988-89*	210	4364	5949
1989-90*	180	4513	6284
1990-91	170	4311	6486
1991-92	190	5575	8177
1992-93	240	6223	10245
1993-94	140	7158	9399
1994-95	170	8312	9996
1995-96	240	10552	12980
1996-97	--	11292	13345
1997-98	--	12137	13994
1998-99	--	12743	14894
1999-00	--	13592	15607
Trend GR 1980-81 to 1989-90		**10.35**	**10.33**
Trend GR 1990-91 to 1999-00		**13.62**	**9.50**

Source: Computed from the Report on the Trends and Progress of Banking in India, RBI, 1999-2000.

[5] RBI/NABARD: Statistical Statements Relating to Co-operative movement in India, 1996.

Fig: 2.1: Trend of Loan Amount Advanced and Outstanding by PACS (Rs. Crore)



The amount of credit advanced by PACS was only Rs. 22 crore in 1950-51, which has gone up to Rs. 1769 crore in 1980-81. At the end of March 2000, it exceeded Rs. 13 thousand crores. At the same time, loans outstanding with PACS have gone up from Rs. 29 crore in 1950-51 to Rs. 2621 crore in 1980-81 and above Rs. 15 thousand crore in 1999-2000. Thus, in absolute terms loan advanced by PACS have gone up by 5.9 times during the 1950-51 to 1999-00 period, whereas loan outstanding during the same period has only gone up by 1.5 times. This implies that the recovery rates of loans, more or less go in tandem with the advancement rates. In fact, it appears that there has been better recovery of loans. However, it is difficult to accept such generalisation for the entire period under study. Because over the years there has been several phases of economic ups and downs due to policy changes. Hence, a better picture may emerge if a period wise analysis is done after taking the policy changes into account.

The growth rates of credit advanced and outstanding (in nominal terms) of PACS for the two periods such as 1980-81 to 1989-90 (first period) and 1990-91 to 1999-00 (second period) are also depicted in table 2.1. The first period may be considered as the pre-liberalised period and the second as the post-liberalised period. The trend growth rate of credit advanced in the second period shows an improvement over that of the first period. On the contrary, the trend growth rate of

amount outstanding has come down from 10.33 per cent during the first period to 9.5 per cent during the second period.

Thus, compared to first period, during the second period, there has been an expansion of financial outreach by the PACS and the recovery rate has also improved.

2.2.2 PCBs and Microfinance

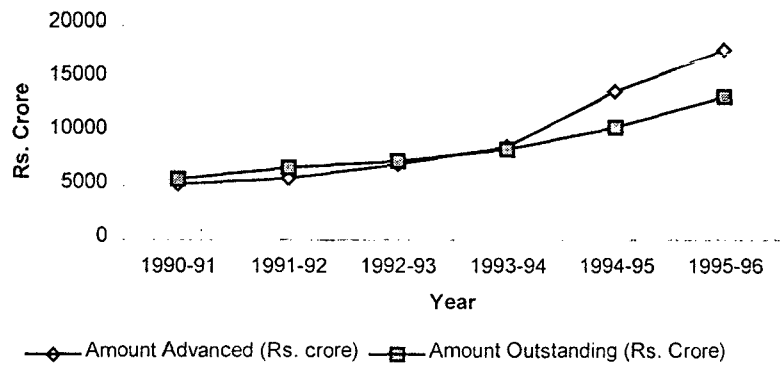
Primary co-operative banks or urban banks were designed to serve the credit needs of the urban poor. The data pertaining to the PCBs, is presented in the following table 2.2.

Table 2.2: Growth of PCBs from 1990-91 to 1995-96.

Year	Number	Membership* (in lakh)	Amount Advanced (Rs. crore)	Amount Outstanding (Rs. Crore)
1990-91	1124	125.58	5175.8	5679.7
1991-92	1194	145.08	5693.1	6725.1
1992-93	1192	146.61	7035.9	7337.2
1993-94	1187	151.57	8617.3	8396.4
1994-95	1048	126.31	13737.4	10396.6
1995-96	1373	149.42	17668.7	13265.5
Trend GR 1990-91 to 1995-96			**29.27**	**17.63**

Source: Computed from Statististical Statement Relating to Co-operative Movement in India, Respective Years, RBI/NABARD.

Fig: 2.2: Amount Advanced and Outstanding of the PCBs (Rs. Crore)



As shown in the above table 2.2, there existed 1373 PCBs, with membership of 149.4 lakh in the year 1995-96. Total credit disbursed has increased at a rate of

29.3 per cent from 5175.8 crores in 1990-91 to 17668.7 crore in 1995-96. Similarly, the amount outstanding has also grown for the same period at a rate of 17.6 per cent from 5679 crore to 13265 crore. A comparison of the relative roles of PACS vis-à-vis PCBs for the period for which data is available reveals that the volume of loans advanced and its growth is far higher in case of PCBs than that of PACS. From this, it can be inferred that there exists urban bias in the provision of microfinancing by the formal financial institutions (FFIs). This has occurred in spite of the fact that the rural area account for higher share in the total population living below the poverty line.

2.2.2 S/PCARDB and Microfinance

The primary cooperative agriculture rural development banks and the state cooperative agriculture rural development banks constitute the grass root level term lending financial institutions among the Rural Credit cooperative institutions (RCCI)[6]. The P/SCADB, also lend largely in small amounts only with exception of financing to tractors and transport vehicles. Table 2.3; shows the operation of PCARDB, and SCARDB[7], over the last two decades respectively.

[6] Op. cit. 7.
[7] Due to the constraints of data availability for SCARDB, the period taken is 1986-87 to 1999-00.

Table 2.3: Operational Status of PCARDBs and SCARDBs from 1980-81 to 1999-00.

Year	PCARDB		SCARDB	
	Amount Advanced (Rs. crore)	Amount Outstanding (Rs. Crore)	Amount Advanced (Rs. crore)	Amount Outstanding (Rs. Crore)
1980-81	362	1609		
1981-82	373	1716		
1982-83	425	1934		
1983-84	410	1755		
1984-85	504	1846		
1985-86	595	2685		
1986-87	354	1657	203	301
1987-88	356	1574	190	8
1988-89	422	1978	275	626
1989-90	351	1925	421	1406
1990-91	376	2014	384	1348
1991-92	444	2143	300	30
1992-93	542	2480	415	1906
1993-94	612	2701	469	2091
1994-95	651	2709	566	2500
1995-96	1219	4098	1798	6857
1996-97	1455	4936	2151	8016
1997-98	1593	5840	2295	9182
1998-99	1692	6820	2431	10443
1999-00	1822	7602	2503	11578
Trend GR 1980-81 to 1989-90	**-0.35**	**1.09**	**29.15***	**145.57***
Trend GR 1990-91 to 1999-00	**21.54**	**17.47**	**31.99**	**55.86**

Source: same as table 2.1

* The period relates to 1986-87 to 1989-90

During the period from 1980-81 to 1989-90, as the trend shows, growth rate of amount advanced was negative, however, it increased significantly to 21.5 per cent during the period, 1990-91 to 99-00. In respect of SCARDB, the credit disbursement shows higher trend growth rates of 29.15 for 1986-87 to 89-90 and 31.99% during 90-91 to 99-00. In nominal terms, total credit disbursement has increased from 362 crores in 1980 to over 182 crores in 99-00 for PCARDB. Similarly, total credit disbursement for SCARDB, has also shown an increasing trend, from 203 crores in 1986 to over 2500 crores during 99-00. The corresponding trend growth rates for total outstanding amount for both the PCARDB, and SCARDB, show very high rates over the period. The outstandings of PCARDB, increased from 1609 crores in 1980 to 2014 crores in 1990 and over 7600 crores in 99-00. In case of SCARDB, the total outstanding was 301 crores in

1980 which increased to 11578 crores in 99-00. The pattern of growth of both amount advanced and amount outstanding are shown in table 2.3.

2.3 Microfinance Programmes

Integrated Rural Development Programme (IRDP) is considered as one of the largest poverty alleviation programmes[8] in the post-independence era. It was launched during the sixth plan, for providing self-employment opportunities for the poor by way of asset creation supported by subsidized credit supply. Under the programme, 54 million families have been assisted (till February 1999). Total credit mobilized under IRDP amounts to Rs. 220 billion. Table 2.4, summarises the growth of microfinancing programmes under IRDP, from 1980 – 81 to 1998 – 99.

Table 2.4: Growth of Microfinancing Programme under IRDP, from 1980-81 to 1998-99.

Year	Number of families assisted (million)	Credit mobilised at ground level (Rs. In million)	Total investment (Rs. in million)	Credit per family (Rs.)
1981-82	5.44	7,566.4	11,799.0	1,391
1982-83	3.45	7,139.8	10,735.7	2,067
1983-84	3.68	7,735.1	11,796.0	2,099
1984-85	3.98	8,574.8	13,296.8	2,154
1985-86	3.06	7,301.6	11,712.6	2,386
1986-87	3.75	10,148.8	16,282.6	2,709
1987-88	4.25	11,753.5	19,027.9	2,767
1988-89	3.77	12,316.2	20,000.9	3,265
1989-90	3.35	12,205.3	19,859.6	3,642
1990-91	2.90	11,900.3	19,988.9	4,106
1991-92	2.52	11,332.6	19,342.5	4,502
1992-93	2.07	10,368.0	17,309.6	5,012
1993-94	2.54	14,084.4	23,650.9	5,565
1994-95	2.21	14,505.8	24,588.9	6,549
1995-96	2.09	17,013.3	27,784.9	8,164
1996-97*	1.92	19,691.6	31,011.6	10,235
1997-98*	1.71	19,966.4	30,416.4	11,697
1998-99**	1.27	16,419.7	25,163.2	12,949
Total	**53.95**	**220,023.6**	**353,768.0**	
* : Provisional ** : upto February 1999				
Trend GR 1981-82 to 1989-90	**-2.38**	**7.88**	**8.89**	**10.52**
Trend GR 1990-91 to 1998-99	**-7.71**	**7.71**	**6.19**	**16.71**

Source: Computed from Annual Report, Ministry of Rural Areas and Employment, GoI, Various Issues.

[8] The other programmes relate to providing rural wage employment through the Jawahar Rojgar Yojana, Employment assured scheme, million weres scheme, providing food at subsidized rate through PDS etc.

The assistance from the banks and the subsidy provided by the government had resulted in investment of Rs. 354 billion at the ground level. The average credit disbursed to a beneficiary family under the programme during 1998-99 was Rs. 12,949, while the average investment (credit of subsidy) works out to be Rs. 17,771. In fact, the Commercial Banks and Regional Rural Banks are the channels linked with these government programmes for delivery of credit.

The growth of number of families assisted under IRDP shows a decline, during 89-90 as well as 91-99. Importantly, the growth rate during 90-91 to 98-99 was –7.71 as compared to –2.38 during the last decade (Table- 2.4). A possible reason for this might be the huge NPA occurred under these accounts of commercial Banks, thereby, made lending to poor unviable. On the other hand, the growth of credit mobilization has shown a stagnant rate of nearly 8 per cent in both the periods.

In spite of the coverage[9] under IRDP and other employment generation programmes, the officially accepted modified expert group methodology estimates the number of poor to the tune of approximately 448 lakh families, when we assume the average size of the family to be five. The number of rural families below poverty line continues to swell in view of the population growth, thereby, neutralizing whatever little effect the IRDP had with a small number of beneficiaries having crossed the poverty line as per the findings of the recent concurrent evaluation studies[10].

2.4 Commercial Banks and Microfinance

The responsibility of meeting the credit needs in the rural area was entrusted primarily with the cooperatives until about the mid-1960s. Till then the commercial Banks in rural areas were mostly in agri-business and marketing. As

[9] Under TRYSEM, a total of 42.34 lakh youth have been trained till Nov. 1999, of which 23.43 lakh are gainfully employed. Further, against the target of covering 50 percent of SC/ST youths and 40 per cent of women under the programme, the achievement was 42.84 per cent (18.24 lakh) and 46.24 per cent (19.58 lakh), respectively. Under the DWCRA programme a total of 2.45 lakh groups have been formed and 38 lakh women were benefited till 1998-99.

[10] The results of the last concurrent evaluation, conducted during 1992-93 revealed that 14.87 of the old beneficiaries assisted under the programme could cross the revised poverty line, i.e. Rs. 11,000 at 91-92 prices, while 50.4% of the families were able to cross the earlier poverty line of Rs. 6,400. The IRDP assets had generated an incremental income of more than Rs. 2000 for 56.6% of the assisted families at the national level. Further, in about 29.3% of the cases, the assets had not generated any income (see concurrent Evaluation of IRDP, GOI (1996)).

the green revolution started gathering momentum, it was expected that the commercial Banks would play an important role in rural credit market through branch expansion and direct lending. After nationalization of commercial Banks in 1969, RBI made it mandatory for the commercial banks to maintain at least 40% of their advances for the priority sector. In fact, one of the major objectives of the nationalization was to improve the flow of formal institutional credit to rural households, especially to poor[11]. Since then, commercial Banks (including RRBs) in terms of accounts and amount outstanding have emerged as a major financing institution in rural areas. However, commercial Banks lend micro as well as non-microfinance loans. They also provide loans for all type of activities, viz. agriculture and non-agriculture and large loans also. Since, the data published by Banking Statistical Return is not very clear regarding microfinance, data estimated by the survey of Small Borrowal Accounts (loan amount less than Rs. 2500) by RBI in 1993 and 1996[12] are used for the present analysis[13].

Looking at the trends in Small Borrowal Accounts (SBAs), one can assess the extent of assistance offered by formal banking institutions towards the lower ends of the economy.

[11] Nair T.S., 'Rural Financial intermediation and Commercial Banks', EPW, Jan. 29, 2000, pp. 299-306.

[12] Considering the average Micro credit size in international level several studies have prescribed that in Indian context Rs. 25,000 qualify for being leveled as Microfinance (see Kaladha K, 1997).

[13] RBI, Monthly Bulletin, Jan-Feb 1996 & Feb. 1999.

Table 2.5: Trends in Number and Amount Outstanding of Small Borrowal Accounts.

	Number of Accounts (Lakh)			Amount Outstanding (Crore)			
Year	All Accounts	SBAs	Share of SBAs(%)	All	SBAs	Share of SBAs(%)	Outstanding Per SBA Account(Rs)
Jun-84	295	282	95.5	43326	8897	20.5	3154
Jun-85	336	321	95.6	49995	10028	20.1	3124
Jun-86	388	371	95.8	56182	12615	22.5	3400
Jun-87	434	416	95.8	63727	15444	24.2	3713
Jun-88	480	459	95.6	71285	17954	25.2	3912
Jun-89	521	497	95.4	88027	22330	25.4	4493
Mar-90	539	512	95.0	104312	24147	23.1	4716
Mar-91	619	588	94.9	124203	27323	22.0	4647
Mar-92	659	625	95.0	136706	29945	21.9	4791
Mar-93	621	585	94.2	162467	32091	19.8	5486
Mar-94	596	558	93.6	175891	32188	18.3	5768
Mar-95	581	539	92.8	210939	34060	16.2	6319
Mar-96	567	519	91.6	254692	36253	14.2	6985
Mar-97	556	500	89.9	284373	37446	13.2	7489
Mar-98	535	468	87.5	329944	41095	12.5	8781
Mar-99	523	427	81.6	382425	38285	10.0	8966
CGR 1984 to 1990		**10.5**			**18.1**		**6.9**
CGR 1991 to 1999		**-3.9**			**4.3**		**8.6**

Source: Computed from Survey of Small Borrowal Account by RBI (1993 & 1996), RBI Bulletin, February 1999

Table 2.6: Distribution of SBAs by Size of Outstanding Credit (Rs. Lakh)

Category	199	1997
<1000	14.	8.3
1001-2500	22.	14.7
2501-5000	2	24
5001-7500	15.	17.1
>7500	19.	35.9
<=7500	80.	64.1

Source: Same as table 2.6

Table 2.5 shows that, the rate of increase in SBAs has not kept pace with the overall growth in credits. This is despite the increase in disbursements under IRDP as depicted in the Table 2.5. This implies that growth in small loans would have been much slower if IRDP advances were not made. It is also pertinent to note that there was a clear shift in SBAs, in the amount of loan outstanding, towards size classes of credit above Rs. 75000, between 1993 and 1997 (Table 2.6). This shows a significant fall in formal banking sector's contribution to the lower income

segments of the population. Interestingly, one thing can be deduced from the above analysis is that there exists a close correspondence between anti-poverty programmes and commercial banks' outreach to poor. In other words, commercial banks do not show belief in the bankability of the poor[14]. In fact the increase is not because of the interest of the commercial banks in SBAs, rather it is because they had to meet the targets set by the Govt. authorities.

2.5 Microfinance promotion by Apex Institutions

There exist two apex level financial institutions, which are promoting, supporting and financing microfinance programmes in the country, i.e. NABARD & SIDBI. Besides, there are two government initiated NGOs – the Rashtriya Mahila Kosh (Bank) – that extends credit support to NGOs--, and modern Economic Development Corporation.

2.5.1 NABARD

NABARD's involvement in promoting microfinance through the concept of SHG, started in 1987, with a sanction of Rs. 10 lakh as grant assistance from its R & D fund to MYRADA for providing seed money to the credit management groups (CMGs) promoted by it (Jayaranan B., NABARD, 2001). The objective of providing grant assistance was to facilitate building up a thrift fund and aiding the members of CMG, with margin money to borrow from the formal credit system. The success of this experiment was the precursor to the launching of the pilot project in 1992 for linking 500 SHG, with banks (CMG, NABARD, 1995). This project, known as the Bank -SHG linkage project, was expected to be advantageous to the banking sector from the angles of both fulfilment of its social goal of reaching the targeted and achieving operational efficiency as well. Further, under this relationship banking promoted by NABARD, improvements in the existing relationship between the poor and the banks were attempted with intermediation by the NGOs, either as promoters of SHGs, or as financial intermediaries. In fact, the basic philosophy of the 'linkage models' promoted by NABARD is to establish synergy between the banks, also have the financial

[14] The disbursements on IRDP loans of commercial banks increased because of the fact that considerable importance has been attached by GOI and other authorities to ensure that IRDP targets are achieved (ACRC report).

strength and the NGOs who have the ability to mobilize the poor and build up their capacity to avail loans from banks. Hence, SHGs is the main focus of the linkage model.

The concept of Self Help Group **(SHG)** provides the poor with alternative means for obtaining "economic and social entitlement" to resources through their active participation. SHGs are formed on voluntary basis, perceived appropriately as people's institution, providing the poor with the space and support necessary to take effective steps towards greater control of their lives in private and in society. SHGs are characterised by small size usually limited to less than 20 members per group. Homogeneity in terms of socio-economic conditions and levels of living form the basis for the group formation. Periodic meetings, on a weekly or fortnightly basis, including the habit of thrift, creating common fund through contributing regular saving from the members, on lending to its members, availing credit support from financial institutions with collateral substitute etc., are some of the major binding factors in the group functioning. The process of group formation entails six months to one year and the management of these groups vests with representatives selected from amongst the group members.

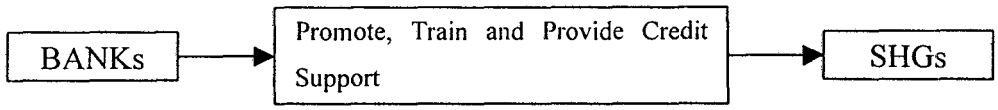
Moreover, NGOs play a catalytic role in preparing the members to participate in the activities through changing their mindset. Training provided by the NGOs to the members further facilitates in enlarging the scope of women in undertaking economic activities. This is also expected to facilitate the poor to graduate to a level from where they can access larger amounts of loan directly from the banks without the intervention of the NGOs.

THE LINKAGE MODEL:

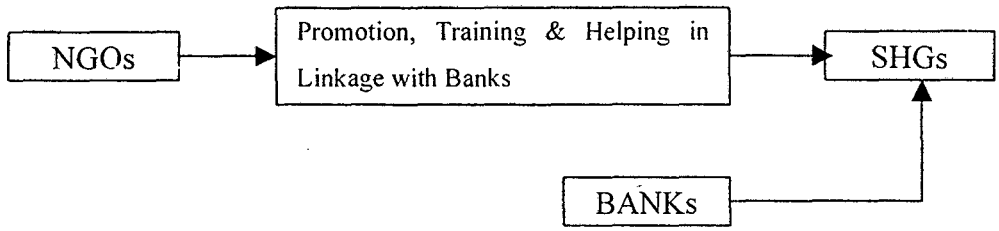
Keeping in view the ultimate goal of accessibility of poor to banking sector NABARD has, broadly constructed three types of linkage models based upon three different principles (model I-III), as shown in chart-2.4.

Chart 2.4: Three linkages Models of NABARD

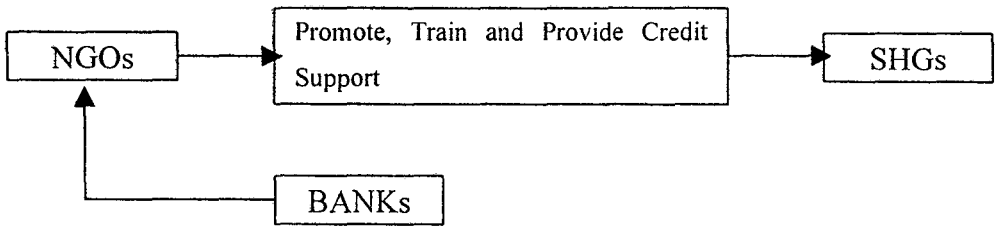
Model - I: NABARD – Bank – SHG – Members (without NGO Intervention)



Model – II: NABARD – Bank – SHG (with NGO or SHPI as facilitator) – Members



Model – III: NABARD – Bank – NGO (as financial intermediary or MFI) – SHG – Members



As per Model-I, the bank itself acts as a self-help group promoting institution (SHPI). Bank takes initiative in forming groups, nurturing them over a period of time, opening their savings account and then providing credit to them, after being satisfied about their maturity to absorb credit. This model formed 14 per cent of the cumulative number of SHG, credit linked up to 31st March 2000. RRBs, are getting involved largely in formulating this type of model (NABARD & microfinance, 1999-00).

In Model-II, facilitating agencies like NGO, government agencies or other community-based organizations forms groups. The groups are nurtured and trained

by these agencies. The banks open savings accounts and then provide credit directly to the SHGs after observing their operations and maturity to absorb credit. Most linkage experience begins with this model with NGO, or other agencies playing the facilitator's roll. The share of SHG, financed under this model constitutes to 70 per cent (cumulative) during 1999-00.

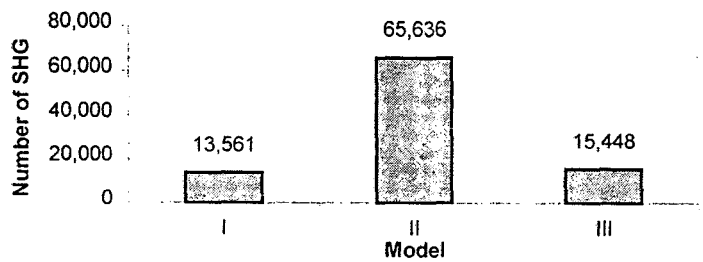
Banks in some areas are not in a position due to various reasons, to even finance SHG, promoted and nurtured by other agencies. In such cases, the NGOs act as both facilitators as well as microfinance intermediaries. They promote the groups, nurture and train them and then approach banks for bulk loans for on lending to SHGs. Under Model-III, NGOs have also been found to federate the SHG, and gradually equip the SHG federations to take on this role. The share of cumulative number of SHG, supported under this model constitutes only 16 per cent.

Table 2.7: Model-wise Linkage of SHGs as on 31 March 2000 (cumulative).

Model	SHGs		Bank Loan		Refinance	
	Number	%	Amount	%	Amount	%
I	13,561	14	339.79	18	228.15	15
II	65,636	70	1,339.95	69	1,087.31	73
III	15,448	16	250.10	13	185.80	12
Total	94,645	100	1,929.82	100	1,501.26	100

Source: Comouted from NABARD & Microfinance, NABARD, (1999 - 2000).

Fig: 2.3: Model-wise Linkage of SHGs as on March 2000



Thus, among all the above models, NGOs as the facilitator model has been very successful in linking NABARD with the SHGs. This has happened mainly because of high degree of financial support by the banks. As shown in table 2.7, bank financing has been up to the extent of 69 per cent in case of the model-II, whereas it is mere 18 per cent and 13 per cent in case of the first and the third model, respectively.

High degree of financial support in case of model II is precisely because of two reasons. One, the effectiveness of NGOs in making the SHGs creditworthy, the

other is the better refinancing situation. As far as the first reason is concerned the role of the banks has been confined only to provide finance to the SHGs. NGOs have done a commendable job in promoting and in providing training to the SHGs, as a result, banks have found it relatively risk free to lend. Interestingly, even if NGOs are directly linked to SHGs in the third model, the developments are not impressive compared to model-II. However, here NGOs play dual role of promoters of SHGs as well as on-lenders of credit to SHGs from Banks. Banks are not providing adequate finances to the NGOs for the promotion and development of SHGs because either they feel that NGOs can not be a substitute for a banking operations or they apprehend that in future the NGOs might turn out to be potential competitors of banks. However, there is scope for the avoidance of apprehensions in the first model, i.e. banks can promote and develop the SHGs. Unfortunately, the performance of the banks in this regard has been very negligible, which is evident from table 2.7. As mentioned earlier, only 14 SHGs have been formed under this model with a bank finance of meagre 15 per cent.

Thus it can be said that banks are abdicating themselves from social responsibility. This is probably due to the prudential norms imposed on the financial sector, which requires that the banks should reduce their NPAs, maintain capital adequacy ratio, etc. Also, there are transaction costs involved in taking such social responsibilities. As far as the second reason (i.e. the refinancing situation) for the high degree of financial support by the banks is concerned, the refinancing is naturally higher. However, the important fact is that the rate of refinancing in case of the second model has been more than the rate of banks loans in case of model II compared to all other models. This implies that it is higher refinancing facility and profitability of such facility, which leads to the success of the Second model in the promotion and development of SHGs.

Progress of the SHG-Bank linkage programme:

The response received from banks and NGOs are encouraging and positive. Besides building mutual trust and confidence between the banks and the rural poor, the linkage is also expected to promote thrift and inculcate credit worthiness and discipline among the rural poor [Nanda, 1998].

NABARD provides 100 per cent refinance to banks at a concessional rate of interest of 6.5 per annum; facilitate training of bank officials and field staff of NGOs providing selective capacity building support to NGOs, SHGs and their federations and other related institutions by way of financial assistance and other support. Table 2.8, aptly describes the progress of this model.

Table 2.8: SHG-BANK Linkage Programme: Physical and Financial Progress

Year	No. of SHGs Linked	Cumulative No. of SHGs	Cumulative Bank Loans (Rs in Million)	Cumulative NABARD Refinance (Rs in Million)	% Change in NABARD Refinance	% Change in Bank Loans
1992-93	255	255	2.89	2.68	0	0
1993-94	365	620	6.53	4.59	71.3	126.0
1994-95	1,502	2,122	24.45	22.93	399.6	274.4
1995-96	2,635	4,757	60.58	56.61	146.9	147.8
1996-97	3,841	8,598	118.36	106.50	88.1	95.4
1997-98	5,719	14,317	237.59	213.89	100.8	100.7
1998-99	18,678	32,995	570.70	520.60	143.4	140.2
1999-00	61,650	94,645	1929.82	1501.26	188.4	238.1
2000-01	118,568	213,213	4808.7	4007.40	166.9	149.2

Source: Computed from SHG - Bank Linkage Programme, NABARD, 1998 & NABARD Annual Report 2000 - 2001

As table 2.8 shows, the programme registered a significant growth both in terms of coverage and the outreach of credit to the poor. Beginning with a modest number of SHGs being linked during 1992-93, a total of 213,213 SHGs were credit linked with banks by March 2001. By the year 2000, it has brought around an estimated 1.9million very poor families within the fold of the formal banking sector [Puhazhendhi and Satyasai, 2000]. Banks have claimed refinance from the National Bank against financing of 118,56 groups by 2000- 2001. The cumulative disbursement of bank loans was Rs.4808.7 million and refinance assistance of Rs.4007.4 million.

The policy support for these efforts was provided by the Reserve Bank of India (RBI), which urged the banks to consider mainstream financing of SHGs as a business activity. The importance and relevance of the SHG-bank linkage programme in India's rural development has also been accepted by the Government of India (GOI) as a novel approach for reaching and empowering the un-reached and under-served poor, and the GOI have since declared the

programme as a national priority. The SHG-Bank linkage programme was further extended to Regional Rural Banks (RRBs) and Co-operative Banks in 1993 and is now permitted by the Reserve Bank of India as a component of priority sector lending.

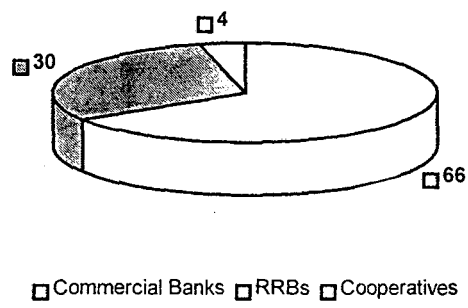
As mentioned earlier, by the end of March 2000, 14 per cent of the total groups linked were promoted and nurtured by bank branches without the involvement of the NGOs. As many as 266 banks (comprising 40 commercial banks, 165 RRBs and 61 co-operative banks) and 718 NGOs are participating in the linkage programme. Among all the above three types of banks, the commercial banks have performed a major role in the formation of SGHs.

Table 2.9: Distribution of SHGs as on 31 March 2000: Agency-wise (cumulative) Rs. In Million.

	SHGs		Bank Loan		Refinance	
	Number	%	Amount	%	Amount	%
Commercial Banks	51,619	55	1,278.33	66	934.04	62
RRBs	38,998	41	574.59	30	513.81	34
Cooperatives	4,028	4	76.90	4	53.41	4
Total	94,645	100	1,929.82	100	1,501.26	100

Source: Same as table 2.8.

Fig: 2.4: Agency-wise % Distribution of Bank Loan to SHGs as on 31 March 2000



As the table 2.9, reveals, 55 per cent of the SHGs were formed through the commercial banks; where as cooperative banks had a meagre share of 4 per cent. The role of the RRBs is no less significant. Obviously, the share in financing of the SHGs also shows a similar trend, and hence the refinances provided through the

NABARD. The linkage programme is estimated to have benefited 1.9 million rural poor families in 362 districts of the country.

Region Wise Progress Of Linkage Programme:

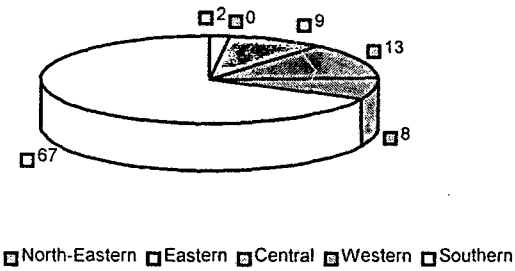
The linkage programme has been extended to different regions of the country.

Table 2.10: Region-wise Progress of Linkage Programme

Region	% share in linkage (cumulative)				
	1995-96	1996-97	1997-98	1998-99	1999-00
Northern	0	4	3	3	2
North-Eastern	<1	<1	<1	<1	<1
Eastern	13	13	13	10	9
Central	10	12	11	11	13
Western	3	7	10	10	8
Southern	69	63	62	65	67
Total	100	100	100	100	100

Source: Same as the table 2.8

Fig: 2.5: Region-wise Progress of SHG- Bank Linkage Programme (%) upto 1999-00



However there does not exist uniformity with regard to its progress across the region. It has been likely successful in the southern region where as in the northeast region and also in the northern region, it is negligible. It is also very low in case of eastern, central and western regions. The high success rate in case of southern region could be attributed to several factors like MYRADA was first adopted in Karnataka and extended to other southern states; major NGOs in microfinancing are operating mainly in southern states compared to other regions and also there exists a high rate of human development in the southern region. The states of human development can more or less be accepted as a precondition for the initiation and development of the SHG model.

2.5.2 SIDBI

The Small Industries Development Bank of India (SIDBI) launched the Micro-Credit Scheme (MCS) in 1994 for extending financial assistance to the rural poor, particularly women, through NGOs for taking up income generating activities at the micro-level. The scheme envisages provision of soft loan assistance at 9 per cent per annum to accredited NGOs for on lending to the poor women (SHGS/Individuals), and amount not exceeding Rs. 25,000 per borrower for promoting micro-enterprises. Savings form an integral part of the programme and members of the SHGs are encouraged to plough back their savings to the group corpus for building up borrowers equity over a period of time. A salient feature of the scheme is the grant assistance extended by the bank for developing the capacity of the NGOs to run credit programme efficiently and to enhance the credit absorption capacity of the borrowers. Till March 1999, the cumulative net effective sanctions since the inception of the MCS aggregated Rs. 307.1 million channelised through 142 MFIs/NGOs spread across 24 states/Union Territories Besides 97 programmes have been supported for providing training to 1,550 NGOs [SIDBI Annual Report, 1990-00].

Considering the satisfactory performance of MCS in the pilot phase, the Bank set up SIDBI Foundation for Micro-credit in November 1998 with an initial corpus of Rs. 1 billion with a view to up scaling the activities under MCS. It extends financial support to well managed Micro-Finance Institutions (MFIs) for on lending to poor (individuals/groups) and for strengthening the MFIs financial, technical and managerial capabilities as well as improving their credit absorption capacity. The MFIs may on lend directly to both SHGs and individuals through smaller MFIs/NGOs to the end users. Unlike, NABARD which extends financial assistance to income generating activities in both the farm and non-farm sectors, SIDBI's financial assistance is restricted to only those activities, which come under the non-farm sector.

2.5.3 Rashtriya Mahila Kosh (RMK)

The National Credit Fund for Women or Rashtriya Mahila Kosh (RMK) was constituted in March 1993 by Government of India (GOI) and registered as a society under the Societies Registration Act, 1860. The RMK was established with the objective of promoting support schemes for improving the facilities of credit to

women, which could be used as an instrument for socio-economic changes and development. It also supports experiments in the formal and informal sectors using innovative methods to reach poor women with credit and other social services. The RMK was established with an initial corpus of Rs. 310 million, contributed by the Department of Women and Child Welfare, Ministry of Human Resource Development, GOI [Annual Report, RMK]. The important schemes under which financial assistance is available are; (a) Main scheme providing loan assistance, (b) revolving fund scheme, (c) scheme for providing financial support for development and stabilization of SHGs, known as the loan promotion scheme.

Under its Main Scheme, loans at concessional rate of interest are made available to Voluntary Organisations and to women below the poverty line. The organization generally gives 25 per cent of the amount by way of medium term (2-5 years) loans and 75 per cent for short-term loans (6-15 months).

The main objective of the 'Revolving Fund Scheme' is to provide lump sum fund to NGOs to supplement their own resources, to recycle loans to poor women in need of credit and to provide more flexibility to the NGOs in the management at the Fund. The ceiling under the Revolving Fund is Rs. 5 million per annum per NGO.

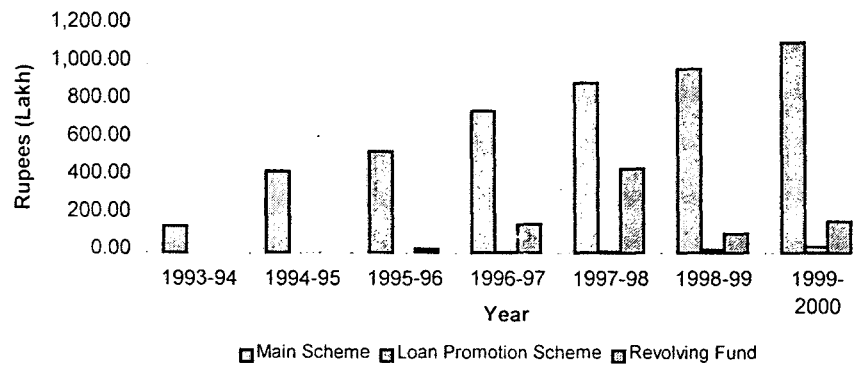
With a view to promote the development and stabilization of SHGs, the RMK provides financial assistance in the form of interest free loans to the NGOs. Each loan is repayable after one-year repayment holiday so as to provide time for stabilization of the SHGs. Progress under the various schemes of RMK for micro credit is shown in the following table- 2.11

Table 2.11: Progress Under Various Schemes of RMK for Micro-Credit

Year	Name of the Scheme	No. of Borrowers	Amount sanctioned (Rs. Lakh)	Amount disbursed (Rs. Lakh)
1993-94	Main Scheme	37,066	439.33	140.82
1994-95	Main Scheme	25,059	512.45	429.54
1995-96	Main Scheme	34,302	788.70	534.13
1996-97	Main Scheme	51,864	1,273.90	748.11
1997-98	Main Scheme	27,761	897.20	898.51
1998-99	Main Scheme	36,850	1,225.20	971.88
1999-2000	Main Scheme	40,230	1,392.00	1,109.69
CAG		**1.37**	**21.19**	**41.07**
1993-94	Loan Promotion	0.00	0.00	0.00
1994-95	Loan Promotion	0.00	0.00	0.00
1995-96	Loan Promotion	200	3.50	1.50
1996-97	Loan Promotion	200	3.50	3.50
1997-98	Loan Promotion	560	12.00	6.00
1998-99	Loan Promotion	1,032	23.00	16.00
1999-00	Loan Promotion	6,456	167.95	34.00
CAG		**138.36**	**163.20**	**118.20**
1993-94	Revolving Fund	0.00	0.00	0.00
1994-95	Revolving Fund	0.00	0.00	0.00
1995-96	Revolving Fund	3,000	60.00	20.00
1996-97	Revolving Fund	39,000	395.00	150.00
1997-98	Revolving Fund	31,300	313.00	444.00
1998-99	Revolving Fund	14,100	141.00	100.00
1999-00	Revolving Fund	11,403	232.00	167.00
CAG		**39.63**	**40.23**	**69.99**

Source: Computed from Annual Reports, 'Rashtriya Mahila Kosh', Various Issues

Fig: 2.6: Scheme-wise Disbursement of Credit by RMK (1993-94 to 1999-00)



As shown in the above table 2.11, among all the three schemes the main scheme has catered to the maximum number of borrowers by the year, 1999-2000. As a

result the total amount disbursed is also the highest in this scheme. However, though the other two schemes were adopted much later than the main scheme, their achievements have been significant. As represented in the table-2.11, the compound average growth rate with regard to number of borrower, amount sanctioned, and amount disbursed is highest in the loan promotion scheme, followed by the revolving fund and the main scheme. The major reason for the high growth rate in case of loan promotion scheme is that under this scheme, loans are provided free of cost, that is, the loans are interest free loans.

2.6 The New Microfinance Institutions (MFIs)

A number of NGOs in the country play an important role, either independently or in collaboration with apex institutions like NABARD, SIDBI, RMK or with banks in promoting microfinance as a viable system for helping the poor and thereby, uplifting them above the poverty line. These organizations have adopted different models, as discussed earlier, depending on their operational mechanism; such as SHG promotion like MYRADA, Grameen Replicators like SHAR and Individual Banking or Co-operative Banks like SEWA.

These organizations belong to the informal sector and these exists no authentic publication of data source. Annual reports of the concerned institution & websites are to be relied upon. Besides, some case studies also provide data on the point, which are personally collected by them. However, the only data source for aggregate data on MFI, is available with the credit rating agency for Microfinance institutions i.e. M-CRIL. They have collected primary data from 44 Indian MFIs, 3 Bangladesh MFI, and 4 Nepal MFI, (see Appendix). These data are aggregated and grouped for the three different types of MFIs separately. Then the average data according to the typology of MFI is considered for analysis.

2.6.1 SHG Programmes:

The operations of SHGs are based on the principle of revolving the members' own savings. External financial assistance augments the resources available to group-operated revolving fund. Savings thus precede borrowings by the members. In many SHG programmes, the volume of individual borrowing is determined either by the volume of members' savings or the savings of the group.

The vast majority of MFIs in India have SHG based programmes. Some of these are MYRADA, SPMS, the groups organised by DHAN Foundation in Madurai etc. Many NGOs operate microfinance programmes by organising federations of SHGs to act as the MFI, which channelise the external loan funds to the poor. NABARD programme, as mentioned above, is a little variation of the model; but involves refinance for commercial bank loans direct to SHGs rather than via bulk loans to MFIs.

2.6.2 Individual Banking or Cooperatives:

All borrowers are members of the organisation either directly, or in the case of cooperative banks, indirectly by being members of primary cooperatives or associations, which are members of the bank. Credit worthiness and loan security are the conditions of cooperative membership within which peer pressure is assumed to be a key factor. The magnitude and timing of savings and loans are unrelated, though special effort is made to mobilise savings form members. Some examples of this model are SEWA Bank based at Ahmedabad, the Indian Cooperative Network for Women, Tamilnadu and the cooperative credit societies affiliated to the Hyderabad based Cooperative Development Foundation.

2.6.3 Grameen Replicators:

The Grameen Replicators MFIs follow the model developed by the Grameen Bank of Bangladesh. They undertake individual lending but all borrowers are members of joint liability groups within which peer pressure is the key factor in ensuring repayment. Each borrower's creditworthiness is determined by the overall creditworthiness of the group. Savings are a compulsory component of the loan repayment schedule but do not determine the magnitude or timing of the loan. There exist a few organisations in India known to be following the model. The prominent ones are SHARE in Andhara Pradesh, the ASA Trust in Thiruchirapalli, Tamilnadu etc.

2.7 Findings

Thus, as the above analysis shows, both the formal and non-formal sectors have played a significant role in the provision of microfinance for the poor. In the

formal sector, commercial banks contribution both in terms of people's involvements and loans disbursements has been the highest. However, it has not happened because of the genuine developmental interests of the commercial banks or because of long-term benefits considerations, rather on account of the remunerative refinancing situations. This implies, that the earlier concept of the priority sector lending's is just replaced with the concept of refinancing. On the contrary, the RRBs are turning out to be better players in the microfinancing programmes. As far as the various constituents of the cooperatives are concerned, PACs have done substantial contribution in the post liberalisation period, compared to the pre-liberalisation period. Nevertheless, the matter of concern is that the relative comparison of PACs and PCBs with regard to the loan disbursement reveals some sort of urban bias. The role of the governmental poverty alleviation programmes has not been significant enough in the arena of microfinance. Particularly, because the programmes have not been designed by accommodating the concept of microfinance and in the recent years, there has been severe financial constraint on the implementation of such programmes. In addition, the non-formal sector has also become prominent in the microfinancing programmes. However, the apex organisation, NABARD has taken a lead role to bridge the gap between formal and non-formal financial sectors, in order to expand and make the micro financing programmes successful. This experiment has largely been successful, and it has also been able to expand the micro credit programmes. In recent years, one of the significant developments has been the emergence of the new microfinance institutions. However, the success of the microfinancing programmes in eliminating poverty depends on, how the financial products offered, and the practices of the institutions involved are designed. To put it in other words, it depends on the operational framework of the microfinancing institutions.

CHAPTER III

OPERATIONAL FRAMEWORK OF INDIAN MFIS: LENDING AND SAVING PRODUCTS

3.1 Introduction

In chapter – 2 we had analyzed the structure as well as growth of microfinance sector operating in India. It was observed that growth of SHGs, belonging to formal-informal linkage model, was much higher when compared with other models. However, the growth and structure of MFIs are not the only criteria that determine the efficiency of an MFI. Equally important to the scheme of MFI is the nature of the product offered by MFIs. Because, the nature of products offered by MFIs determine to a great extent the operational framework of MFIs. In the current chapter, we intend to deal with the operational framework of MFIs in detail and bring out a comparative analysis of the various approaches followed by MFIs in India.

The poor and the low-income households, as discussed in the chapter - 1, face formidable barriers in gaining access to formal financial institutions. Moreover, ordinary financial intermediation has not been successful enough in helping them to participate in the formal sector. The lack-luster results of subsidized credit delivery under IRDP and the rigidities faced by the Formal Financial Institutions (FFIs) in providing sustainable financial services to the poor, guided the MFIs to look for innovations in lending designs, savings mobilization as well as insurance services for their sustainable operation.

The practice of ten MFIs belonging to the three different approaches, as discussed in chapter 2, has been taken into consideration for the present analysis. They are:

Approaches		MFIs
SHG programmes	➡	MYRADA, SIFFS, VWS and AMCC
Grameen Replicators	➡	SHARE and ASA Trust
Individual Banking Models	➡	SEWA Bank, BASIX, CFTS and CDF

3.2 The Loan Product Designing

MFIs in India are increasingly graduating themselves to offer loan products that meet a broad variety of consumer needs. Along with the growth and increase in outreach, MFIs loan products have generally developed from a narrow product range to cover a much broader range of activities. Many MFIs are engaged in direct microfinance delivery by deploying member savings, donated funds or borrowed funds. The effectiveness of loan products offered by such institutions can be analyzed broadly in terms of the following design parameters:

- the linkage of loans to volume of savings of the member
- the purpose of the loan
- repayment schedule and conditions
- interest rates
- accessibility
- loan delivery

3.2.1 Volume of savings as a determinant of loan amount

A large number of MFIs (irrespective of the models) in India follow the methodology which links the loan size directly to the quantum of savings accumulated by a member with the MFI. Such products have very often been used as primary instrument by various MFIs in India. Use of this methodology enables MFIs to

- promote savings growth at a faster rate
- reduce risks associated with lending since the savings amount serves as informal collateral

- utilize the savings of members as part of the fund used for rotation as loans which lowers the financial cost of funds for the MFI very significantly and eases the task of raising funds from external sources
- have a regular and secure source of funds
- provide the scope for utilization of the savings of members efficiently and productively.

Among the organizations covered in the study VWS, SEWA Bank, SHARE, CDF and ASA Trust follow this methodology as illustrated in Table 3.1.

Table 3.1: Savings-loan linkage

MFI	Savings – loan linkage
VWS	Offer loans that are multiple of the saving volume of members
CDF and AMCC	Credit disbursement is linked to the savings volume of the members
SHARE and ASA Trust	Require a minimum, regular compulsory saving amount for access to loans
CFTS	Offers a marriage loan that is linked to the saving volume of members

Source: EDA Rural Systems Report, 2000.

It is observable from table 3.1 that, many MFIs place considerable emphasis on savings and for the aforesaid reasons; link loans to at least a minimum level of savings accumulation. Even MFIs that do not have a compulsory savings component or a direct linkage of loans to the savings volume, place an emphasis upon savings as part of the operational methodology. Members of these organizations are encouraged to save regularly. However, the MFI itself has no control over or access to these savings. Organizations like SIFFS promote member savings as a key ingredient of their microfinance services, but unlike the MFIs covered in table 3.1, members of SIFFS save at the group level and the funds are retained there for other operational objectives.

Apart from linking loans to savings, an innovation that spreads across a large number of MFIs is the requirement that members save for a minimum period of time before becoming eligible for loan funds. This condition is then imposed by a

large number of the SHG promotion organizations that begin with savings promotion and then move on to external credit interventions. In this case, the savings condition partly acts as a proxy indicator of member participation in-group processes.

3.2.2 Categorization of loans by purpose

The most common classification of loan products is in terms of the purpose for which loans are provided. Most MFIs find it useful to differentiate loan products based on the intended use of the loan money. Table 3.2 summarizes the purpose wise loan product classifications used by the MFIs covered, in the present study.

Table 3.2: Product classification of MFIs covered

Type: MFI:	Produc-tion-off farm	Housing	Agri-culture	Consum-ption	Land purchase	Debt redemption	Asset purchase
AMCC	X			X			
ASA	X	X	X	X			
BASIX	X		X	X			
CDF	X		X	X	X		
CFTS	X		X	X			
SEWA B	X	X	X			X	X
SHARE	X	X	X	X			
SIFFS	X					X	X
VWS	X			X			

Source: Compiled from Annual Reports of Respective MFIs.

It is clear from the table 3.2, that MFIs generally provide loan products that cover a variety of needs. In fact, to cater to diverse client needs a large number of MFIs have innovated their product range over time and introduced them. MFIs like SEWA Bank, SHARE and ASA Trust, started offering housing loans much after the introduction of their initial production-related loan products. The approach in moving towards a product range that caters to diverse needs is, perhaps, best summed up in SEWA Bank's strategic statement that indicates the Bank's intention to cater to various needs of its clients at different stages of their life cycle.

Production loans are the most common type of loans offered by MFIs. Indeed, a large number of MFIs have such loans as the largest loan category in terms of the proportion of portfolio allocated to that category. Generally, MFIs advance at least 30% of their total portfolio as production loans, which includes animal husbandry loans but excludes agricultural loans. However, MFIs like SIFFS, VWS, SHARE, CFTS and ASA Trust have considerably larger proportions devoted to production loans. Furthermore, the NABARD promoted SHG models reveal that lending pattern is linked to the age of the SHG. In fact, there exists a distinct shift in directing loans from non-income generating purposes to income generating purposes as the groups progressed in age [NABARD study, 1998]. In fact, it has been noted that even within the broad purpose, MFI can have considerable diversity in their loan products. Importantly, loan products offered by MFIs cover not only a broad spectrum of categories, but also have sub-categories of loans that are provided to meet more specific client needs.

BASIX has production loans that can be of a short term or a long-term duration, while VWS has production loans that are further sub-classified into micro enterprise loans and larger loans for shopkeeper groups. SIFFS too has considerably varied sizes in its production loans to cater to differing needs of its clients. Within the consumption category, SHARE provides loans for sanitation purposes. Besides, it also has special loans that are drawn from group savings (which otherwise cannot be withdrawn) whereby members can borrow up to 75% of their savings. CFTS too offers a balance loan that supplements the main loan product (general loan) and is given for the same production activity subject to satisfactory repayment of the general loan [AIAMED Report, 1999].

With all such sub-categories of loans, the innovation and movement towards establishing new additional products basically takes place as a result of field experience as well as client feedback and demand for particular types of loans.

It is clear that, MFIs that offer multiple loan products have had to innovate and move from offering a relatively standard product range to greater diversity. The reason for this transition in allocating loans between varied use categories and

further in terms of offering differentiated products within each category, can be traced to the organizational policy decisions that are based on following norms:

- Clients' demand for loans: Clients' demand for loan of a particular type is based on the activity profile of the area. For example, most loans extended by SIFFS are for production or asset purchase activities for the fishing sector, which is its area of focus. Most other MFIs offer increasingly varied products over time to meet a broader spectrum of client needs. Thus, SHARE and ASA began primarily with loans for income generation activities, i.e., off farm production and agricultural loans, but have now also started offering housing construction and repair loans. Newer categories of loans, such as SHARE's housing loan introduced in 1996, have also enabled it to grow fast and now constitute a little more than 11% of its total portfolio of Rs 83 million [EDA Rural System Report, 2000]. SEWA Bank also introduced housing loan products based on client demand and need which was identified through loan applications and direct discussions with clients.
- Perceived risk profile of the loan category: MFIs vary the degree of concentration in any one category of loan and decide to focus on particular product types based on the risk profile of their members' activities. Thus, ASA has decided to increase its focus on production-based loans and lower the growth rate of agricultural loans. However, this switchover is not always possible. In BASIX's case, a large part of the portfolio is in agricultural loans, since the demand and the economic activity profile of its target clientele is agriculture focused. Thus, despite having a higher risk profile for agricultural loans as compared to micro or small enterprise loans, there will be a minimum limit, below which the proportion of agricultural loans in its total portfolio cannot decline. Thus, in the case of BASIX, a balance has to be found between client demand, organizational portfolio risk and diversification.
- Methodology requirements: MFIs follow different methodologies, which they consider suitable to their policies. In the Grameen MFIs importance is often given to loans for productive activities including

animal husbandry and considerable emphasis is placed on post-disbursement, and utilization checks.

3.2.3 Repayment period and conditions

Repayment period and conditions are always considered as crucial features of loan product design by MFIs. As a result considerable innovations have taken place over years with a general trend towards designing repayments terms and conditions to match borrower cash flows and repayment capacity. At the same time, there are variations in the design of the repayment conditions of different MFIs. While some MFIs have weekly schedules, others have monthly, quarterly, half yearly or even yearly repayment schedules.

ASA Trust uses the standard Grameen-type weekly repayment schedule for most of its loan products. However, for agricultural loans a one-time installment of principal is used along with weekly interest repayments

BASIX uses a cash flow based repayment schedule for all its agricultural loans, which can be of short and long duration. However, for its micro-enterprise loans, it adopts monthly repayments schedule. SIFFS with interventions in the fisheries sector, which is characterized by varying levels of catches in different seasons, needs to account for the seasonality impacts on borrowers. So, SIFFS uses a repayment schedule that is linked to daily catch levels. In most cases, 10% of the daily catch is accounted for – during fish auctions – as a loan repayment to SIFFS. This has historically been found to be a level that enables borrower sustainability and enables loan repayment in around three years, which is the term of SIFFS loans. [Basu and Jindal (eds.), 2000].

Most MFIs vary in the repayment period in relation to the loan and installment size. Thus, larger loans have a longer repayment period and are generally extended only to those borrowers who have demonstrated a sound credit history. For example, SIFFS has an average loan size of greater than Rs 15,000 and uses a three-year loan repayment period.

MFIs have found that poorly designed repayment schedules can lead to delinquency, which, in turn, leads to an increase in transactions and monitoring costs. Many MFIs have, therefore, reworked repayment schedules based on field experience with different loan products. Thus, organizations like SIFFS and SHARE, have modified their repayment terms and conditions for specific loan products.

SIFFS prescribes different repayment schedule for the same product in different fishermen's federations affiliated with the organization. This has happened because of varying levels of catch by fishermen between federations. Therefore, there are varying borrower profiles and cash flows for the same loan product. Another reason is the problem of migration amongst fishermen which necessitates that, in addition to the daily catch related repayment to compensate for low repayment during migration seasons, a flat amount is also repaid every month by the borrowers.

In SHARE's case, a different repayment schedule is used for housing and supplementary loans. Table 3.3 shows SHARE's loan products and their associated repayment terms. For example, the latest loan product offered by SHARE, i.e., supplementary loans, which has a low repayment period as compared to other loan products that were first offered during 1993 – 96. This ensures that borrowers carefully consider the debt burden of an additional loan, and that they repay such loans quickly and become eligible for new loans.

Table 3.3: SHARE's loan products

Product name (& Year of introduction)	**Maximum loan size (Rs)**	**Repayment conditions**	**Interest rate (Per year)**
General (1993) Seasonal (1994) Sanitary (1996)	Between 3,000 – 7,500	50 weekly installments	15% flat
Housing loans (1996)	12,000	200 weekly installment	15% flat
Supplementary loans (1998)	2,000	25 weekly installments	20% flat

Source: Basu and Jindal (eds.), 2000.

It is important to note that the innovation in terms of introducing a new loan product enables good clients to supplement other loans obtained from SHARE and meet any shortfall in undertaking the production activity for which the original loan was obtained or even for meeting consumption and other needs. This is particularly important in the context of the Grameen methodology that specifies, somewhat rigidly, the amounts each member can borrow depending on the number of loan cycles they have completed with the organization. Thus, the new product acts as a response to client needs and also serves as an additional incentive mechanism for ensuring prompt repayment on the original loan.

For SHARE's higher value housing loans, a longer repayment period has been taken to consider the borrower's debt bearing capacity. SHARE is able to provide such long-term loans for housing, since the funds are sourced from housing finance agencies that have appropriately long term repayment schedules. This ensures that SHARE, as also other MFIs that offer long term housing loans, do not face an asset-liability maturity mismatch.

Thus, drawing from the cases discussed above, and from the microfinance models used, other factors that are considered in determining the repayment term and conditions are, risk mitigation considerations in relation to loan purpose, cash flows of borrowers (linked to activity profile), ease of repayment (installment size), transaction costs at the MFI (for recording repayment transactions), seasonality factors, borrower profile (migratory or permanent residents), etc.

3.2.4 Interest rates

The absolute level of the interest rate and the method of calculation of interest rate constitute the crucial design parameters of any financial product. This study shows that there is considerable variation between MFIs but a lower degree of variation in the interest rates between products of a given MFI. The variation in interest rates between MFIs is due to the computation method incorporated. An important aspect of the structure of interest rates is the choice of the computation method for the interest calculation. They can be computed either in flat or reducing balance for

determining the effective interest rates charged to clients. Table 3.4 provides an idea of the variations in interest rates on loan products between and within MFIs.

Table 3.4: Interest rates charged by MFIs

MFI	Interest rate (per year)
AMCC	12 – 15 % declining balance
ASA	24% flat for all loans except housing 12% declining for all housing loans
BASIX	21 – 24% declining balance + 1% fee (3% rebate for on – time repayment)
CDF	18 – 24% declining balance
CFTS	20% flat
SEWA Bank	17% declining balance
SHARE	15 – 20% flat
SIFFS	12 – 18% declining balance
VWS	15% flat + upto 2.5% fee (all loans other than credit card loans) 2% per month + flat fee (Rs 20 per year) for small amounts given as credit card loans

Source: EDA Rural Systems Report, 2000

Since use of a flat rate facilitates computation and client understanding of equal repayment installments, all the Grameen MFIs follow this method of interest computation and are, therefore, able to have standardized and easily understood repayment schedules for their clients. This technique of interest rate computation has a direct impact on the simplicity of the recording or information system employed by MFIs.

Even MFIs not patterned directly on the Grameen model, sometimes use the flat method for ensuring computational ease and higher returns. VWS uses a flat interest rate even while working with SHGs rather than the Grameen type centers. The other aspect that stands out with the VWS pricing structure is the use of fees along with the interest charge, which has a direct bearing on the sustainability of operations.

BASIX also uses fees to supplement its interest earnings from loans. However, unlike VWS, it varies the level of fees according to loan products. This variation is

undertaken to cover processing costs that may be associated only with certain types of loans. In BASIX's case, the lowest processing is required for lending through Joint Liability Groups and therefore, the interest rate is lower and no fees are charged on these loans. BASIX's rate of interest on crop loans with Joint Liability Groups is 21% and on crop loans, agricultural loans; micro enterprise loans it is 24% with an additional fee of 1%. However, on all loans a 3% interest rate is provided for on-time payment [EDA Rural Systems Report, 2000].

Moreover, appropriate use of the computation method enables MFIs, sometimes, to overcome the restriction that may be placed on them in terms of interest rate ceilings. Such barriers to interest rates are normally set in nominal terms and therefore, by charging flat rates that do not exceed the stipulated (nominal) interest rate ceilings specified by donors or lenders, MFIs are able to carry on with their operations unhindered. A number of the MFIs covered by this study have overcome ceilings on on–lending rates in this way.

Most MFIs also link the interest rate with borrowers' capacity to repay, the cost of funds and the loan size. ASA's housing loans – sourced from HUDCO as a long term concessional loan – carry a retail borrower interest rate of 12% on declining balance as compared to an interest rate of 24% flat for all other loan products. This differentiation is significant, since it marks a departure from the traditional features of the Grameen Bank model on which ASA is patterned.

The pricing structure of loan products in various Indian MFIs also highlights the interest rate computation mechanisms adopted by them. BASIX's pricing structure shows considerable innovation. The organization offers a substantial interest rate rebate on its loans for on–time repayment. Thus, delinquent borrowers have to bear a substantially higher interest burden as compared to on–time borrowers. This innovation in pricing means that borrowers are given a very clear incentive to make regular and on–time repayments.

SIFFS's pricing of one of its loan products – alternative loans (loans extended for fish processing and other enterprise activities) – reflects a direct link between interest rates and delinquency risk. SIFFS charges 18% per annum on declining

balances of these loans at least partly since it has faced greater delinquency on these loans in the past. This is compared to an interest rate between 12 – 15% for its production, asset purchase and post-harvest processing loans for iceboxes.

In terms of other innovative practices with regard to interest rate setting, CDF's case is noteworthy. The interest charged on loans by member societies to their borrowers is inversely related to the age of the society. Table 3.5 presents the interest rates charged by CDF – affiliated societies.

Table 3.5: CDF's differentiated pricing scheme

Age of society	Interest rate (per year)
• < 3 years	24% declining balance
• 3 – 7 years	21% declining balance
• > 7 years	18% declining balance

Source: AIAMED Report, 1999.

This differentiated pricing strategy has enabled CDF – affiliated societies to cover both the higher cost of operations of new societies compared to the lower average costs of older and bigger societies and also the higher perceived risk of lending to large proportions of new members. Use of such a strategy has clear implications for the efficiency and growth of MFI operations.

Thus, the key factors that influence interest rate structure of MFI loan products can be summarized as:

- financial return and sustainability
- borrower's ability to pay
- ease of computation and recording (for MFI and client)
- nominal and effective interest rates
- donor/lender restrictions
- levels of risk associated with products
- loan size
- market interest rates or interest rates of competitors
- cost of funds from lenders

3.2.5 Accessibility

A number of MFIs are now working towards providing credit products that improve accessibility. The aim here is to reduce transaction time for both the client and the MFI and also to reduce the time lag between the loan application and disbursement. Most MFIs try to provide quick loan processing and easy access to their members, even while following standard loan processing procedures. Mostly they require group formation and some form of savings activity for a minimum period of time, before members become eligible for loans. In addition, they rely on previous credit history, the knowledge of their field staff and the norms prescribed by the methodology, as in the case of Grameen MFIs. This standardization ensures that members are broadly aware of their eligibility for the next loan, its amount and the likely disbursal schedule. For their clients, in these cases, ease of access does not result from any special loan products or loan design but through quick loan processing and standard appraisal procedures.

Some MFIs go beyond the standard products and offer special products that have even easier access. For instance, VWS offers a credit card facility from one of its unit offices. This provides instant access to cash to any cardholder up to an upper limit of Rs 500. While the amount involved is small, VWS members, mostly urban slum dwellers, have found the service to be quite useful despite the cost in terms of a fee of Rs 50 for the first year (Rs 20 for the second year) and a 2% per month flat interest rate. By end-October 1999 this facility, which was introduced in October 1998, had 135 users and a portfolio of Rs 64,000. While this is quite insignificant (0.8%) compared to its overall portfolio, it is worth mentioning that the facility with greater credit limits and fund availability with the MFI will become more important in the future [EDA Rural Systems Report 2000]. SEWA Bank too is planning to offer a *Jhatpat* (immediate) loan that will be given to clients with sound credit history, almost immediately, on application.

BASIX, a new generation MFI, uses loan appraisal and credit delivery methods that ensure lower transactions costs. Since BASIX works through commission agents, SHGs promoted by other MFIs, agriculture input companies and other intermediaries; loan appraisal is simplified through the innovative use of existing

commercial linkages as channels of credit delivery (see section 3.2.6 also). Use of in-house assessment or rating methodologies for groups and review of credit history already available with the intermediary, enables BASIX to reduce the time between loan application and disbursal quite significantly. This procedure has enabled BASIX to increase its clientele to 10,500 and its portfolio to Rs 89.2 million (September 30, 1999) in just three and a half years of operation [EDA Rural Systems Report 2000].

3.2.6 Loan delivery mechanisms

The design of mechanisms of loan delivery is an area in which considerable innovation has been undertaken by MFIs in India. These mechanisms are closely related to transaction costs for both MFIs and clients as well as to monitoring costs for the former. This design feature also has a bearing on the risk involved in lending. The analysis of delivery mechanisms can be undertaken in terms of the place of delivery and medium or channel of delivery.

In terms of place of delivery, a large number of MFIs undertake loan delivery from the head office or the branch or unit offices. Of the MFIs incorporated in the present study, SEWA Bank, ASA Trust, SIFFS, BASIX, CDF, and VWS, all use the branch or unit or the head office to deliver loans to clients. This enables the MFIs to lower delivery and processing costs and exercise a greater degree of control on disbursements.

However, even while making disbursements in a more centralized manner, many MFIs use a modified mechanism for the collection of repayments from borrowers. For example, ASA Trust, and VWS use village level meetings to collect repayments of all loans. SEWA Bank has established five different collection centers and has mobile vans that cover 55 areas and undertake loan repayment collections (and savings collections) from the doorstep of clients. The mobile van staff interacts with area leaders who represents a cluster of clients – this mechanism reduces transactions costs for both the MFI and the clients. SIFFS, which uses a federated structure for its interventions (SIFFS-District Federation-Village Societies-Clients), appraises and sanctions loans from the head office.

However, disbursements are made from the district federations and collections – made daily at the village level – are passed on to the federations by village societies on a monthly basis. From the federations, a cheque is credited into the SIFFS local branch account, a mechanism that ensures lower transactions costs for SIFFS and its borrowers, even though delinquency control in this system is not as strong as it should be [EDA Rural Systems Report, 2000].

There are other MFIs that undertake loan delivery at the doorstep of their clients. In line with Grameen methodology, SHARE and CFTS undertake both loan delivery and recovery during village level center meetings.

Thus use of innovative delivery and recovery mechanisms are very important factors for any organization's microfinance operations since this has implications for transactions and opportunity costs for clients. Both these costs can be significantly reduced by the use of such mechanisms.

In terms of the medium or the channel of delivery, BASIX has made considerable innovations. BASIX is a group of non-banking financial companies established to provide sustainable financial services to a rural clientele. At the same time, its aim is to help alleviate poverty through a strategy of facilitating both self and wage employment. BASIX is not engaged directly in traditional group promotion activities. Instead, it uses a variety of channels to reach its clients, such as commission agents at wholesale markets, loans organized by custom service agents, large agricultural input supply and commodity trading companies, small enterprises providing wage employment, informal joint liability groups of farmers or micro enterprises and SHGs promoted by other NGOs or MFIs [AIAMED report, 1999].

In fact, the most innovative of these channels is that of lending through commission agents. The agents are essentially wholesale traders. Their operational mechanism is to facilitate the sale of a farmers' produce at wholesale market in return for a fixed commission (2%) paid by the buyer. Commission agents play an important role in financing agriculture by providing short-term loans to farmers who regularly use their services.

In BASIX's operational area, the commission agents charge a fixed interest of 3% per month on such loans. Those commission agents who obtain funds from BASIX, however, are required to lend to their clients at 2% per month. This channel is controversial and there are concerns amongst observers that BASIX may be providing development funds, making way for 'exploitative' usury relationship between the agent and the poor farmer. BASIX defends its strategy and argues that its funds offered in the *Raichur mandi* in Karnataka have not only augmented the availability of short term finance for farmers, but also put downward pressure on the prevailing market interest rate for such funds there [Annual Report, BASIX, 1999].

In addition to the use of commission agents, another innovative channel used by BASIX is that of the Customer Service Agents (CSAs). A significant proportion of loans are originated by the CSAs, all of whom are contractual staff paid on the basis of portfolio quality and the volume of loans originated. BASIX's innovative use of delivery channels has provided it with considerable operational advantages. These include:

- quick expansion of operations – in terms of lending volumes and numbers of clients – through ready access to a large group of borrowers with established credit histories;
- lower organizational transactions and operational costs for BASIX;
- lower borrower level transactions costs, and
- trickle down income and wage employment generating effects from the greater outreach of loans to farmers for cash crops such as cotton and groundnut [Annual Report, BASIX, 1999].

This has enabled BASIX to expand across all the product categories at a rate, which is much faster than the rate witnessed by microfinance industries in India.

Taking all loan delivery and recovery mechanisms into consideration, it is clear that MFIs have innovated significantly with regard to this parameter. It is also clear that trade–offs in the key parameters that affect delivery design can occur between

different models that are used by MFIs. Thus, where the recovery mechanism is designed for low transactions costs, the trade-off can be between close direct monitoring by the MFI on the one hand, and low transactions and operational costs on the other, which has been followed by SIFFS. Similar trade–offs can occur between transactions costs of the MFI and transactions and opportunity costs of borrowers in determining whether or not branch offices should be the point of disbursement and recovery. To address these trade-offs, MFIs innovate and adopt mechanisms in line with their broader objectives and strategy. Then they draw a balance between the advantages and disadvantages of different options in the design of loan delivery.

3.3 SHG – Bank Linkage Programmes and the Credit-Plus Approach

The vast majority of MFIs in India implement programmes that revolve around SHG formation, savings promotion and circulation of funds as loans, self-management of group activities and linkages with external sources of funds such as donor agencies, Regional Rural Banks (RRBs) and local branches of public sector banks. Apart from the design of loan products and delivery mechanisms, differences between SHG programmes can exist in terms of the nature of intervention by the MFI or intermediary NGO. Some organizations like MYRADA[1] follow the traditional approach of no direct intervention in credit, while others have moved onto the role of directly engaging in micro-lending operations and acting as a financial intermediary between the groups and fund sources.

[1] MYRADA believes in a credit plus approach without involvement in direct microfinance products. This is a point of significant departure from typical MFIs. It involves SHG formation and support of groups of women for a period generally up to 36 months. In the interim period (particularly in the first 15 weeks) MYRADA mainly facilitates group-building processes, helps the group function in its meetings and provides accounts and other training support. Generally after 36 months, MYRADA phases out from the groups totally; this is done when the group is considered strong and independent enough to function on its own [AIAMED Report, 1999].

MYRADA's intervention is a unique and pioneering effort in India, which has been mainly in terms of facilitating the formation of SHGs and the circulation of member funds, while linking the community groups with banks. This indirect financial intervention model has been very successful and is being replicated on a national scale now with the support of the National Bank for Agriculture and Rural Development (NABARD).

Since all decisions are taken at the group level, MYRADA's approach provides members with the highest order of flexibility in designing loan products. This inherent flexibility is reflected in the vast differences that exist between MYRADA promoted SHGs. Some groups charge a 2% per month interest rate on a declining balance basis, while others charge rates ranging from 1% to 3% per month. Groups decide on other rule for lending that takes place from their savings and internally generated profits. With a high degree of group autonomy, simple and informal practices are followed, which include varying the repayment periods according to the size of the loan and varying interest rates by the purpose of the loan as well as reviewing the credit history and funds requirement of each member before deciding on the loan amount. The entire system is characterized by group loan product design geared to the quick processing and disbursement of loans. In this model of savings and credit facilitation, the role of the organization is the keynote in terms of designing loan (or other) products or providing loan funds to groups. Organization has also to ensure that group becomes confident enough to take their own decisions, manage all group activities, keep proper accounts and liaise with banks for meeting any excess demand for funds.

Thus, support to SHGs in these areas is the main role (or "product") offered by the facilitating organization and the "delivery" is mainly in terms of the visits of MYRADA's field staff. The final product design, recording of transactions, decisions on interest rates and fees for loans and interest on savings, are all areas where the groups are guided in such a manner that they are able to take their own decisions.

Clear advantages exist in this model in terms of the empowerment of groups to undertake and manage their own activities including microfinance and enabling, eventually, a withdrawal of the facilitating organization. On the reverse side, the

generation of the costs of group in the initial couple of years can be quite significant. Moreover, institutional problems, such as the non-availability of finance from external sources can result in low impact of the program.

Despite these potential hindrances, the success that organizations like MYRADA, DHAN Foundation and PRADAN have achieved in terms of outreach and establishing a large number of independent groups directly linked to external sources of finance, thereby demonstrates the strength of this model.

At the same time, it is interesting to note that changes in the policy and regulatory environment that could affect the degree of success in linkage with banks can bring forth innovations in savings and credit methodology. SIFFS's experience is a good example. SIFFS used the bank-linkage model from its inception in 1983 till 1995. In this period, it engaged in group formation and strengthening, promoting savings and internal lending within member societies and linking societies to external sources of funds. However, by 1995, technological changes in the fisheries sector necessitated much larger investment requirements from fishermen. Faced with an inadequate supply of funds from banks to societies and the inability of members to meet the heavy collateral requirements of these institutions, SIFFS took on the added role of a direct credit supplier. Since 1995, SIFFS has followed a two pronged strategy in its savings and credit intervention – it works on the MYRADA type bank linkage model in addition to supplying its members directly with loans obtained by it from external lenders. Thus, the specific characteristics and environmental circumstances that affected the SIFFS intervention, have led to innovation and change in the microfinance methodology followed by the organization.

Equally interesting and highly innovative is the intangible services model of credit plus followed by BASIX. As a risk mitigation strategy in its lending to farmers, BASIX has tried to develop its links with agencies providing technical and extension services to agriculture. BASIX has been lending to customers of Sowbhagya Seeds, an input distributor with a long-term vision. Sowbhagya's NGO affiliate, SEVAC, provides technical training to agricultural input dealers who supply to local farmers. It then monitors their sales to farmers to ensure that good

practices are followed. Sowbhagya buys back the farmers' output – of specialized crops like paprika – on behalf of an exporter, Sarpan Agro. BASIX obtains the repayment of its loan from Sowbhagya while the farmer receives the balance of the value of the output after deduction of the loan repayment due to BASIX [AIAMED Report, 1999]. Other similar arrangements have been explored by BASIX – with Nagarjuna Fertilizers and Chemical Ltd for crops such as export grade chillies and long staple cotton and with ITC Agro Tech for sunflower cultivators. BASIX's participation in this system combines the benefits of environmentally conscious yet commercially astute agricultural extension services, organized marketing of the output of high value crops, timely availability of credit for the farmer, more assured repayment to BASIX and lower transactions costs for all participants.

3.4 Designing savings products

Mobilization of savings has been emphasized by the MFIs since the very beginning of financial services delivery and, therefore, it runs parallel with the best practices of MFIs as well. A large number of MFIs in India view savings as a means of group solidarity, empowerment and participatory development. Besides, there are others that regard member savings as an important means of resource generation for augmenting financial services. Furthermore, as a step forward to merge with the formal sector of financial services, MFIs have designed user-friendly savings products, which highlights:

- member access to the facility, frequency of savings deposits;
- product type – related to withdrawal conditions;
- returns – interest rates – levels and structure
- marketing of the MFI as a stable organization and the product as a secure investment.

3.5 Savings as a Means of Solidarity and Empowerment

The main traditional savings product in all SHG model MFIs/NGOs is regular member savings, which are contributed by members to a group fund and used for internal rotation as loans. This is an 'in-house' long-term recurring deposit account in terms of withdraw ability and accessibility. Usually, a member can only access these funds in the form of loans from the group and can withdraw his/her contribution only when he/she withdraws from the group. In many microfinance programs such savings do not even earn interest.

Apart from group level savings, some MFIs also offer more flexible savings account type facilities to their members. While such facility is mostly voluntary, some MFIs specify a minimum level of deposit to be made on a regular basis. This makes the activity a combination of a recurring deposit and a savings account – what might be termed a flexible recurring deposit account.

The accumulation of member savings at the group level is seen by MFIs (or facilitating NGOs) primarily as a means of promoting group solidarity and empowerment. Essentially, the activity inculcates the thrift habit amongst members enabling them to develop a small asset individually and a larger asset jointly, and the management of the group level savings fund establishes a regular group activity and promotes group cohesion by providing members a stake in the organization's activities. In fact, in the large number of MFIs that operate in India on the SHG model, the initial microfinance activity is often limited to savings promotion and rotation of savings deposits through lending within the group.

Thus, organizations like MYRADA and SIFFS, both of which are engaged in establishing group/SHG-bank linkages, promote group level savings activity. While MYRADA leaves decisions – on the volume of savings, interest rate on savings and lending of the savings mobilized by the SHG – to the group, SIFFS has a somewhat different approach. SIFFS, like MYRADA, promotes group level savings that are retained at the village level. However, unlike MYRADA, SIFFS has made it compulsory for members to save 2% of their daily fish catch. This linkage with production is a useful and laudable innovation on the part of SIFFS,

which provides the high working capital requirements in the fishing activity. The compulsory daily 2% deduction from fish sales ensures the development of a regular savings habit and builds a fund base that members can fall back on if necessary. However, these savings may be withdrawn by the members and are kept with the registered village level societies. While the savings are not utilized by SIFFS in any manner, they are used extensively by the member managed village level societies to meet their working capital requirements [AIAMED Report, 1999].

Similarly, group level savings promotion is followed by a large number of other MFIs/NGOs – including CDF, ASSEFA, PRADAN, Dhan Foundation and other smaller organizations – in India that follow the SHG model. SHG level savings promotion tries to:

- inculcate the savings habit in members;
- test the regularity of the members and their level of participation in group activities;
- expose the members to credit discipline through facilitation of rotation of their own funds as loans within the group and
- enable the group to understand the importance of fund management and the need to expand the volume of the fund base available to them. Thus, MYRADA-organised community group members set interest rates (that can vary greatly between SHGs), deposit excess savings in fixed deposits in banks and impose penalties in case of delays in loan repayments.

Though, in theory, most of these take the form of flexible recurring deposits, in practice, the flexibility is limited by the members' reluctance to deposit any funds beyond the compulsory level necessary to maintain their goodwill with the SHG. However, management of group level savings fund enhances the cohesiveness and solidarity among the members to a larger extent. It also serves as a pedestal particularly for the oppressed rural women folk to take decision for themselves and indirectly it promotes participation and leads to empowerment of the members.

3.6 Savings for Resource Generation

3.6.1 Compulsory savings

Most MFIs that do not follow the SHG model of intervention in microfinance generally have a component of compulsory savings. Such compulsory deposits are an important feature of the Grameen methodology but have also become a key ingredient in a large number of other MFIs. Essentially, such deposits are similar in nature to a long-term recurring deposit account. However, they often do not provide savers with much of a return and, given the compulsory nature of such savings, they are more a source of funds for on lending and – particularly in the Grameen model – collateral for MFIs than a savings product for members.

Compulsory savings are the minimum amount of savings on a regular basis required by all members for them to be eligible for the financial services that the MFI offers. Thus, SHARE, ASA Trust, AMMCS and VWS, all require members to save fixed amounts on a regular monthly or weekly basis and to deposit this amount with the organization. Access to this source of funds has led to MFIs – both Grameen and others – generating a significant proportion of their fund requirements from such savings. As table 3.6 shows, selected MFIs have been able to raise from 20% of their portfolios, in the case of SHARE, to 55%for the AMCCS, through the device of compulsory savings deposits. Even BASIX, which has a relatively new NBFC is not yet allowed to raise deposits from the general public, has been able to mobilize funds equivalent to nearly 9% of its portfolio in the form of cash security from its borrowers.

Table 3.6: Contribution of Compulsory Savings to the Portfolio

Organization	Compulsory savings (Rs million)	Interest on savings	Portfolio (Rs million)	Compulsory savings as proportion of portfolio
AMMCS	7.3	5%	13.3	55%
ASA Trust	2.9	5%	9.6	30%
SHARE	16.0	6%	78.0	20%
VWS	2.7	5%	7.3	37%

Source: EDA Rural Systems Report, 2000.

In terms of innovation with regard to compulsory savings, the sliding scale[2] approach introduced by ASA Trust in 1998 is an interesting one. Use of this system, that links compulsory savings to loan sizes, enables savings accumulation at an accelerating rapid rate. In 1998-99 savings per member grew by more than 30% compared to a relatively stable trend in earlier years. Combined with a rapid 63% expansion in membership, this resulted in savings growth of as much as 14% [AIAMED Report, 1999].

ASA Trust's approach is also used in a modified manner by other MFIs that are involved in the mobilization of compulsory savings. The method employed by most of these organizations involves periodic increments in the volume of compulsory savings per member (rather than a direct link to loan size). This too results in the fast growth of compulsory member savings. Table 3.7 depicts the growth of compulsory savings deposits in ASA Trust during the period 1995-96 to 1998-99. SHARE is a good illustration – its compulsory savings pool has increased from Rs 3.7 million in March 1998 to Rs 16 million by end of September 1999.

AMMCS's approach to compulsory savings is also interesting – as soon as the compulsory deposit reaches Rs 1,000, the amount is converted into a fixed deposit in the name of the member. Once the total savings have accumulated to Rs 3,000 the entire amount is placed in a pension scheme provided by the Life Insurance Corporation of India. Thus, AMMCS uses the compulsory savings as a source of funds for its operations in the short term and, in the long term, as a means of empowerment through income security, by providing other financial services to its members [EDA Rural Systems Report, 2000].

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[2] ASA Trust has linked the amount a member must deposit as compulsory savings to the loan cycle. Thus, members save Rs. 5 per week for the first loan cycle (up to Rs. 2,000) but as the loan amount increases (up to Rs. 4,000) in the second loan cycle, the compulsory savings required also increases to Rs. 10 per week. As the loan amount increases (to a limit Rs 6,000) in the third loan cycle the compulsory savings requirement goes up further to Rs. 15 per week. Loans are limited to ten times the savings amount deposited by a member. Prompt savers are also eligible for short-term – one month or three month – loans [ASA Annual Report, 1999].

Table 3.7: ASA Trust: Growth of Compulsory Savings Deposits

Year	1995-96	1996-97	1997-98	1998-99
Numbers of members *Growth*	2,406	2,987 *24%*	4,413 *48%*	7,190 *63%*
Compulsory savings (Rs million) *Growth*	0.6 -	0.92 *53%*	1.2 *30%*	2.9 *141%*
Compulsory savings per member (Rs) *Growth*	1,122 -	1,205 *7%*	1,019 *- 15%*	1,336 *31%*

Source: EDA Rural Systems Report, 2000.

Thus, as evident from this discussion, promoting compulsory savings has important advantages for MFIs. Savings are mostly a low cost source of funds for the MFI. In most cases, the cost of compulsory savings is significantly lower than that of other development funding[3] available to MFIs. Only CDF offers a relatively high interest rate of 12% to members who deposit Rs 20 per month and 15% to members who deposit between Rs 20-100 per month. It is interesting to note that despite offering a high return on compulsory deposits, CDF has still relied extensively (89% of its current portfolio) on this source of funds for its operational requirements, which amounts to 89% of its current portfolio. Further, savings act as a risk mitigation tool and collateral for MFIs – BASIX is only able to use it as cash security (on which no interest is paid). Other MFIs also use the compulsory savings amount that is adjusted against the loan outstanding with the member. This device has been of particular importance in the case of AMMCS though SHARE and other Grameen MFIs also use it.

3.6.2 Voluntary saving

A few Indian MFIs have been offering voluntary savings products for a long time. These voluntary savings are distinct from the group level savings discussed in section 3.6 in that they are retained, rotated and managed by the MFI rather than by

[3] Commercial loans provided by Donor or funding agencies.

groups of its members or clients. However, as compared to the compulsory savings products, that make it necessary for members to save a certain minimum amount periodically, voluntary savings products provide both regular and irregular savings opportunities to members. Such savings products enable members to build up their individual asset bases, and to feel empowered by providing various degrees of flexibility to draw upon that asset base when required, while MFIs have access to a larger pool of on-lending resources.

Most MFIs operating in India (as also in other parts of South Asia) have not directly entered into the provision of voluntary savings products though such products are now becoming increasingly popular. By the very nature of being voluntary, such savings need to be mobilized at market or near market cost, which is higher than the rate at which compulsory savings are generally mobilized. Moreover, in order to be able to generate voluntary member deposits, MFIs must be able to attain an image of financial security. These factors make the provision of voluntary savings services a more challenging task than mobilizing compulsory savings.

SEWA Bank, a leading and pioneering Indian MFI, has built its microfinance intervention around the provision of voluntary banking facilities to its members, who are largely self-employed women living in urban slums. It has placed considerable emphasis on providing a broad range of savings products to its members on the firm belief that savings are a very important confidence-boosting (empowering) asset for its women clients.

SEWA Bank has designed an extremely interesting range of savings products. These products include the provision of savings, current, recurring and fixed deposits to its clients. Between these types of products, members are given a lot of choice in terms of sub-products that provide differentiated features. Drawing from its strategy of addressing the varying needs of its clients in different phases of their life cycle, the organization has designed special products within its range of recurring deposit accounts. The innovative recurring products are:

- *Chintanivaran* scheme: This scheme involves monthly deposits of Rs 40, 80 or 120 for a period of five years. The title of the scheme differentiates the product from other schemes since the need to protect/secure oneself against emergency situations like floods, droughts and riots, appealed to women depositors
- *Bhavi Suraksha* scheme: Long term scheme where women save regularly for a period of 10, 15 or 20 years. At the end of the term members can get a lump sum or a monthly income (similar to an old age pension scheme).

Besides these schemes, SEWA Bank also offers another scheme called the *Riddhi Siddhi* scheme, which is a five-year scheme requiring monthly savings at annually increasing levels. This is targeted as a source of capital for use in children's education, marriage and house repairation or extension.

However, most other recurring deposit products that have specific end uses and are easily understood in terms of their design have been very successful. These include schemes for marriages (*Mangal Prasang* scheme), house repairs (*Ghar Fund* scheme) and the emergency fund (*Chintanivaran* scheme). These products require monthly deposits of a constant amount for the product period that makes them easily conceivable by depositors. In order to lower depositors' transaction costs, SEWA Bank has innovated its savings collection mechanism by using mobile vans and seven collection centers in localities with concentrations of members. Besides varied recurring deposit products, SEWA Bank also offers special fixed deposit products. One of these is the *Swapna Siddhi* scheme. Under this scheme members can deposit a lump sum for a period for 3, 5, 7 or 10 years and earn a compound interest that is credited yearly into the deposit account. Members also have the choice of a fixed deposit scheme that can be given as a gift to others – thus, the maturity value of the fixed deposit is paid in the name of the recipient of the gift [Annual Report, SEWA, 1999].

SEWA Bank has also innovated in terms of the marketing of these products. It uses a variety of promotional techniques that have resulted in the fast growth of deposits in these products. The organization uses pamphlets and direct communication with

clients who come to the bank. In addition, mobile vans used by the organization carry information to the 52 centres they cover. "Lucky draw" schemes are also attached to several recurring deposit products to provide additional incentives to savers [SEWA Annual Report, 1999].

Both the design of SEWA Bank products and the marketing techniques employed are drawn out of the organization's vast practical experience. The design features of these products enable members to identify clearly with the theme behind the products and act as motivating factors, which influence the member's choice and her decision to invest. This is well illustrated in the fact that even those of the Bank's savings schemes that are open only for a limited period of time are able to obtain a large response. For instance, the emergency fund that was opened only for 3 months during June-August 1999 resulted in more than 2,200 new accounts.

SEWA Bank is, of course, an Urban Cooperative Bank, duly registered with and regulated by the Reserve Bank of India. It, thereby, enjoys considerable credibility in the perception of potential depositors. Nevertheless, its experience with voluntary schemes has shown that – given the right combination of institutional framework, responsible governance structure and innovative approach – it is possible for MFIs to establish the level of trust required for members to invest voluntarily. As a result, such savings can contribute significantly to the fund requirements of the organization. Indeed, it is apparent from table 3.8 that SEWA Bank raises much more than its on-lending requirement entirely from member deposits and, therefore, has no need to generate on-lending funds from other sources.

Table 3.8: SEWA Bank's Savings Growth

Year	1995-96	1996-97	1997-98	1998-99
Number of depositors	56,541	70,117	87,779	112,750
Savings deposits (Rs million)	86.3	126.5	152.1	175.4
Savings per member (Rs)	1,524	1,804	1,732	1,555

Source: SEWA Annual Report, 1999.

As table-3.8 shows, both volume of total deposits and the total number of depositors have been increasing steadily from 1995-96 up to 1998-99. While deposits per member have declined in the last two years due to the fact that, large numbers of new members who have joined as depositors in this period, the volume of deposits has registered a considerable increasing trend. Overall, SEWA Bank's experience is that the availability of a variety of savings products moves members from primarily a borrowing culture to a saving culture. In this process, their perception of the organization changes from the MFI as a source of funds to a place to establish an asset base. This enables members themselves to feel more independent and empowered.

Similarly, optional saving of VWS product has been quite successful which is evident from the level of deposit mobilization through this product. The total deposit mobilized over 1.5 years is Rs 1.22 million. This compares very favourably with the level of mobilization of Rs 1.44 million over 4.5 years through the compulsory product [EDA Rural Systems Report, 2000]. The major attraction of the VWS optional savings product is through its design features of interest rate that is 5% per year. It is same as that for the compulsory product, which is a long-term deposit payable annually.

Other MFIs too, like CDF and ASA Trust, have recently started offering voluntary savings products. CDF affiliated cooperatives, which earlier only had compulsory savings, recently introduced recurring savings products for their members. These require a minimum contribution of Rs 50 per month for a period of either one year or two years. The interest on the one-year optional recurring deposit product is 8% per year and that on the two-year product, 9% per year [EDA Rural Systems Report, 2000]. CDF's move in introducing these new products – done in late 1999 – is interesting as it marks a movement towards increasing financial services to members. CDF is now also encouraging affiliated cooperatives to introduce other voluntary savings products in the form of fixed deposit facilities for their members.

In April 1999, ASA, a Grameen MFI, has started offering a wide range of optional savings products. This is a significant innovation over traditional Grameen

methodology. ASA offers a savings account facility (5% interest per year paid annually) that allows free deposits and withdrawals at the village levels during weekly centre meetings [EDA Rural Systems Report, 2000]. This mechanism means low transactions costs for members. Besides these, fixed and recurring deposit products have also been offered, using a SEWA Bank type USP of branding time deposits for specific use such as marriage funds or children's education deposits, etc.

Thus, it is clear from the experience of the MFIs that have ventured into providing optional or voluntary savings products to their clients that, there is considerable demand for such services. Voluntary savings products are attractive to poor clients because of the design features of accessibility, withdrawal facilities, returns on deposits, financial security, provision for high frequency of transactions and identification with future investment needs. For the MFI, provision of such services enables it to expand its product range and mobilize funds.

3.7 Findings

Considering all the design features of loan products discussed above, it has been observed that both types of those MFIs involved in direct on-lending and those using a credit plus or linkage approach have undertaken substantial innovation. They have modified their product designing with respect to the organizational objective, consumer preferences and contextual characteristics of the area of operation. However, they have often deviated from their standard practice model in such cases. Further, it is also found that the links between savings and loans, the purpose of the loan, its repayment period and other conditions, the structure of interest rates as well as accessibility and other loan delivery mechanisms are all factors that need to be taken into account by MFIs in designing their products. Given the available information, it is found that a trend has been established towards appropriately modifying loan products to suit not only client preference but also to fulfill MFI risk mitigation objectives. However, the approach of BASIX in designing delivery mechanisms that incorporate established trading and other intermediary relationship does not give a clear picture regarding its efficacy in getting access to poor or very poor clients. Such approach needs field examination,

to draw any conclusion on that. In any case, it represents a radical change in methodological lending from others, especially from more traditional mechanisms.

Savings products or savings facilitation is mostly used as an entry point for the microfinance. Sometimes it is used as other developmental interventions by many MFIs and NGOs. A large number of organizations in India are engaged in group level savings facilitation, which is retained by members at the village level. This is a predominant methodology that is used by most SHG modeled organizations. However, there are significant numbers of MFIs, including some large and fast growing programs, which offer a variety of savings products to their clients. Such products when offered as compulsory savings, the main purpose are fund mobilization of MFI and risk mitigation. However, MFIs now increasingly also offer voluntary savings products that have considerable variation in features and attraction for members. In the design of these products, interest rates, accessibility, withdrawal flexibility, simplicity of product features, marketing and promotion, financial and transaction costs, are important features that have been the subject of innovation.

In terms of operational savings products, the illustration of SEWA Bank, ASA Trust, CDF and other as discussed above, mark a trend that is expected to become stronger over time with increasing consciousness about improving the range of financial service offered to clients and with growing competition amongst MFIs. Moreover, the realization that savings products can be a very important source of fund mobilization for MFIs in the future is also focusing increasing MFI attention on providing appropriate optional savings products.

APPENDIX- 1

Name of Organizations	Mechanisms
Annapurna Mahila Credit Co-operative Society	Formation of groups of shareholder members' flexible group norms on meetings, compulsory savings with the co-operative group members are provided access to credit by the organization on an individual basis.
ASA Trust	Creation of village level groups based on the Grameen model-groups engages in voluntary and compulsory saving activity. Credit is extended from branch offices and collected at the village level.
BASIX	Individual model; lends through multiple intermediaries including agricultural input and trading companies, NGOs, SHG federations, traders and also through informal Joint Liability Groups and Production Groups
Co-operative Development Foundation	Co-operative model–shareholder members engage in savings and are provided credit by the parent association; all savers can borrow.
Cashpor Financial and Technical Services Ltd.	Creation of village level groups based on the Grameen model-groups engage in savings activity and obtain credit. All collections and disbursements are made at the village level.
MYRADA	SHG- bank linkage model. MYRADA is involved in the promotion and support of village level SHGs. Over time these are left to function as separate entities. Often a linkage to rural and commercial bank branches in the local area to meet the credit needs of the groups accompany this process.
SEWA Bank	Urban co-operative bank- shareholder members save and access credit from the bank. Some members are formed into rural based associations od SHGs that have a common savings accounts and loans from SEWA Bank. The organization is savings driven with a variety of savings products.
SHARE	Creation of village level groups based on the Grameen model-groups engages in compulsory savings activity and in borrowing.
South Indian Federation of Fishermen's societies	Village level fishermen's co-operative societies that engage in production and sales activities. Members engage in savings and obtain credit from district level federations, as also from SIFFS, which is the parent body. Loans are extended to individual members of groups for productive activities.
Village Welfare Society	Village level SHGs engage in compulsory and voluntary saving activities. Loans are extended by VWS based on the level of compulsory savings of the groups.

Note: Data as of 31st March 1999.

Source: EDA Rural Systems Report, 2000.

CHAPTER – IV

AN EVALUATION OF THE PERFORMANCE OF MICROFINANCE PROGRAMMES

4.1 Introduction

The focus of chapter 3 was upon the different kinds of products offered by MFIs in India. Special attention was paid to the operational issues of MFIs. The major finding was the diversion in the product ranges offered by MFIs, even within the same approach. The reasons we could trace out lied in the region specific characteristics. However, to obtain a holistic picture of the various MFIs in India what is desirable is to assess the performance of the same. The indicators considered while evaluating the performance of the MFIs are; outreach, operational efficiency and sustainability. In what follows, we deal with the above mentioned indicators in detail.

Practising the principles of good banking along with poverty alleviation are the two end goals of microfinance programmes [Hulme & Mosely, 1996]. Keeping this in vision microfinance programmes across the world have tried to achieve maximum outreach. However, sustainability of many MFIs has been challenged in terms of their dependence on donor funds or subsidies. Many studies by practitioners as well as academicians have been conducted to measure the efficacy of these programmes. The microfinance programmes exhibit diversity of both design features as well as organisational culture, even within a region. The adoption of local methodologies that are conducive for their operational efficiency as well as obtaining maximum social benefits in the concerned areas has made it difficult for the researchers to evaluate their performance at macro level. However, the Consultative Group to Assist the Poorest (CGAP) – a World Bank Initiative – has prescribed certain international standard tools for measuring the performance of MFIs, such as; portfolio quality, productivity and efficiency, financial sustainability, profitability, leverage and capital adequacy and scale, outreach and growth [Ledgerwood, 1998].

4.2 Performance of MFIs in India

The efficacy of various approaches can be found out if their relative performance is analysed. However, there exist severe constraints on the availability of data. There exists no published macro data regarding the performance indicators of the MFIs. The annual reports of some major organisations like BASIX, SEWA etc. provide information about such indicators whereas the data regarding many other MFIs are not dependable since their cost calculations may be biased. The only source is the M-CRIL Report 2000 and it is available for the year 2000. 51 NGOs of three countries (India, Sri Lanka and Bangladesh) are covered under statistics provided by the M-CRIL Report. Out of those 51 NGOs, 31 have followed the SHG approach, 10 have followed the Individual Banking model and the rest have followed the Grameen Bank model. The above available data is not India specific and whatever is available refers to an aggregate of all approaches in case of India. However there may not be any statistical error if the above data is analysed taking as a representative statistics for India, because:

(a) Out of 51 NGOs covered in the data, 44 are from India, and

(b) India's share in the various categories of aggregate data is nearly 90 per cent or even more than 90 per cent, except for one, i.e. in a cumulative disbursement, which is closed to 60 per cent.

Therefore, the standard data collected by M-CRIL for 51 MFIs[1] have been used for assessing their performance and, thereby, comparison with international average of financially sustainable MFIs is done to get a picture of their effectiveness with regard to the approach they follow. The data regarding the international microfinance institutions (MFIs), incorporated in the present study are collected from the micro banking bulletin.[2]

The following indicators have been chosen, keeping the data availability constraint in mind, to assess the relative performance of MFIs following the three such as SHGs model, Individual Banking Model and Grameen model as discussed in chapter II.

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[1] See M-CRIL report, 2000

[2]. The figures are in average.

The indicators used in the present study for performance assessment of MFI in India are:

- **Outreach**
- **Operating Efficiency**
- **Sustainability**

4.2.1 Outreach: Outreach refers to the accessibility of the needy to the microfinancing programmes. Basically, it implies the number of beneficiaries of the programme. It is measured through number of memberships in general and the number of active borrowers, in particular. The number of members involved in the micro credit programme gives a picture of potential beneficiaries whereas; the number of active borrowers gives a picture of the actual beneficiaries of the programme. A picture of the relative outreach of various approaches in India is presented in the following table 4.1.

Table 4.1: Outreach of MFIs in India

	SHG MODEL	INDIVIDUAL BANKING	GRAMEEN MODEL	TOTAL
No. of Membership	345,047	138,830	211,970	695,847
As a % of Total	49.6	20.0	30.5	100
Cumulative Disbursements (Rs.in Million)	691.2	793. 6	1391.8	2876.6
As a % of Total	24.0	27.6	48.4	100
Loans Outstanding (Rs.in Million)	314.8	251.8	523.3	1090.0
As a % of Total	28.9	23.1	48.0	100
Active Borrowers	82,677	149,717	66,612	299,006
As a % of Total	27.7	50.1	22.3	100
Average Loan Portfolio (Rs. in Million)	10.2	52.3	25.2	87.7
As a % of Total	11.6	59.7	28.7	100
Loan Size (Rs/client)	3,680	6,367	5,177	15,224
As a % of Total	24.2	41.8	34.0	100
Savings Balance (Rs/client)	479	1,741	756	2,976
As a % of Total	16.1	58.5	25.4	100

Source: Computed from M.CRIL. Report, 2000.

As shown in the above table 4.1, SHGs model has the largest share i.e. to the extent of 50 per cent in the total potential beneficiaries in the microfinancing programmes, whereas that in case of the Grameen model has been 30 per cent. This implies that SHGs model has been more successful in terms of people's involvement in their microfinancing programmes in comparison to the others. The major reasons behind the difference in people's involvement could be, differences in savings services, governance capabilities and differences in their nature and extent of lending activities. However, as far as the share in cumulative disbursement is concerned, Grameen model has share of 50 per cent whereas, SHGs have a share of 24 per cent. This implies that in case of Grameen model either the active borrowers are large or each borrower gets a high amount of loan or the both. But the former is not true i.e., the active borrower are very less in number in case of the Grameen model in comparison to the others, which is evident from the figures depicted in the table 4.1. The average size of the loan in case of the Grameen model is higher than that of the SHGs. This is also true in case of the Individual Banking model. Thus, it can be said that the SHGs model of MFIs, which are widely prevalent in India can have a significant impact on poverty reduction, if and only if the size of the loan provided is sufficient enough to reduce the poverty gap.

4.2.2 Operating Efficiency:

Operating cost ratios[3], yield on average portfolio, cost per loan and repayment rates are considered as important measures of operating efficiency. The operating aspect is depicted in the following table 4.2.

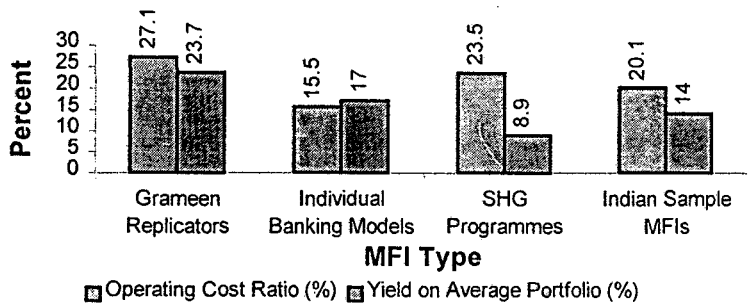
[3] Operating cost ratio is the ratio of operating costs to the average loan portfolio of the year. Operating costs include costs of staffs' salaries, travel expenses, administrative costs and depreciation charges.

Table 4.2: Operating Efficiency of MFIs

Type of MFIs	Operating Cost Ratio (%)	Yield on Average Portfolio (%)	Portfolio at Risk (>60 days) %	Cost per loan (Rs.)	Repayment Rates (%)
Grameen Replicators	27.1	23.7	3.9	669	97.6
Individual Banking Models	15.5	17	20.7	495	90.5
SHG Programmes	23.5	8.9	29.2	770	78.3
Indian Sample MFIs	20.1	14	20.5	589	86.1
Sample Average	23.2	17.4	15.1	658	90.1
Micro Banking Bulletin	31	39	2		

Source: Same as table 4.1.

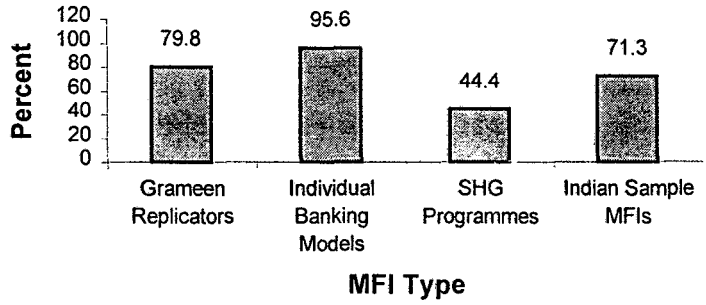
Figure 4.1: Operating Cost Ratio (%) by MFI Types



The operating cost ratios of Grameen and SHGs Model are comparatively higher than that of the Individual Banking Programmes. The respective figures are 27.1%, 23.5% and 15.5% respectively. Though Grameen and SHGs Models are showing a little higher operating cost ratios, they can be compared well with the 31% administrative expense to loan portfolio ratio for the sample reported in MBB. Nevertheless, the cost per loan with the Grameen model is the lowest and it is also close to international average rate (MBB). But in case of others, it is very high particularly for the MFIs in the SHGs model. In case of Grameen model also the repayment rate is the highest and in fact it is higher than that of MBB rate. This implies that overall Grameen model shows a better operational efficiency.

However, the repayment rates are lowest in case of the MFIs working under SHG model. In fact, the new SHG Programmes are very costly to run, i.e., their operating cost ratios mostly exceed 50%. Figure 4.1 and 4.2, shows the comparison of operating costs with the portfolio fields obtained by the sample MFI, across different Models. Individual Banking Programmes are showing very good results, which indicates that proper management of funds will lead to such kind of achievements. However, the fields obtained by the MFI, in the region (17.4%) are well below the international average of 39.9% reported in the MBB.

Figure 4.2: Operational Self Sufficiency by MFI Types (%)



Economies of scale are generally expected in any economic activity. The relationship between the operating cost ratio and portfolio size of individual MFI, also show such inverse relationship between the two. In other words mature programmes with larger portfolio size show lower operating cost ratio and vice versa.

The analyses of the three approaches provide brighter glimpses of Grameen Model followed by Individual Banking Programmes. With regard to SHG, a lot of work is to be done for their strengthening. Thus, implementation of microfinance programmes all over the world in general and India in particular brings out the fact that the poor are bankable.

4.2.3 SUSTAINABILITY:

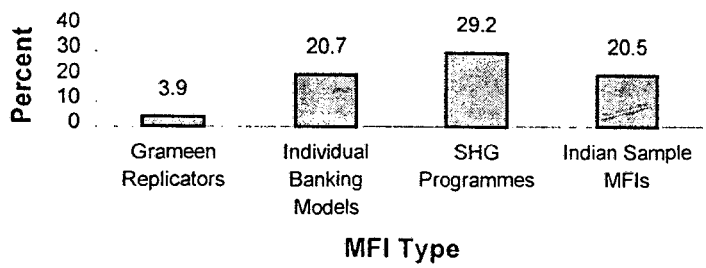
Sustainability is an important performance indicator. During the recent years there has been a growing emphasis on it. It has various dimensions, such as portfolio quality, operational self-sufficiency and dependency on subsidy, which is shown in the following table 4.3

Table 4.3:Sustainability of MFIs

Type of MFIs	Loan Portfolio per Staff	Active Borrowers per Staff	Operational Self suffiency(%)	Subsidy Dependence index(%)	Deposit-Credit Ratio(%)
Grameen Replicators	328,920	94	79.8	58	18.3
Individual Banking Models	987,545	261	95.6	56.4	101.4
SHG Programmes	194,812	51	44.4	234.2	5.8
Indian Sample MFIs	305,138	84	71.3	91.2	39
Sample Average	314,833	86	72.7	83.4	33.9
Micro Banking Bulletin		111	106.6		

Source: Same as table 4.1

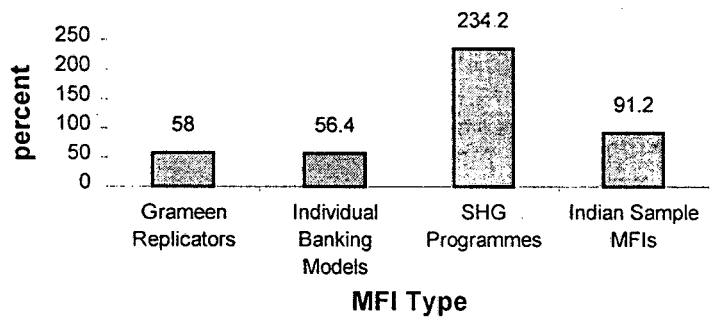
Figure 4.3: Portfolio at Risk (>60 days) by MFI Types (%)



Portfolio Quality: In terms of portfolio quality, the standard tool used is portfolio at risk (>60 days).[4] Grameen MFI, are the best performers with an average PAR (>60 days) of just 3.9% (figure), which measures the amount of default risk in the portfolio. Understandably, lower value indicates lesser default risk in the portfolio. As a benchmark 10% is considered normal. From the figure it is notable that SHG programmes have greater percentage of risk portfolio. Looking at the recovery rate[5], it is also notable that Grameen approach experiences a rate of 98 percent, which is far ahead in comparison to others.

Operational Self-sufficiency: Operational Self-sufficiency[6] measures the ability of an MFI to meet all its operational and financial costs out of its income from operations. The (figure) shows that Individual Banking Programmes are fairly close to full operational Self-sufficiency i.e., 95.6% of the Grameen Programme, four are still far from Self-sufficiency but two of the 10 are able to cover all their costs. Out of 31 SHGs Programmes, only seven are approaching Self-sufficiency while just one is able to cover its costs [M-CRIL Report, 2000].

Figure 4.4: Subsidy Dependence Index of MFI Types (%)



Dependence on Subsidy: The average subsidy dependence index[7] that is calculated for each of the three approaches show that Individual Banking

[4] Ratio of Principal balance outstanding on all loans with over dues greater than or equal to 60 days to the total loans outstanding on a given date.
[5] Repayment rate have referred to ratio of cumulative principal recovered to the cumulative principal due.
[6] Operational Self-sufficiency refers to the ratio of total income to total costs for the year.
[7] The subsidy dependence index broadly measures the net subsidies received as a proportion of income of the organisation. A higher ratio indicates that there is higher level of dependence on subsidies. Subsidies can be in the form of grants or concessional borrowings.

Programmes and the Grameen Models are reasonably better than the SHG Programmes. However, the indices show that neither of the programmes is self-sufficient till date, as shown in figure 4.4. However, the average of 72.7% for operational Self-sufficiency and 83.4% for subsidy dependence index can be compared with the MBB average of 129.7% for 63 fully sustainable MFIs and 106.6% for the operational self-sufficiency of the total 92MFIs.

In India the major state supported microfinancing programme is implemented through NABARD. It has also adopted three important approaches such as the SHG, Individual banking and Grameen models in its microfinancing programmes. Hence, it is worthwhile to analyse the performance of the NABARD programmes.

4.3 Performance of NABARD's Micro Financing Programmes:

The SHG – Bank linkage Programme is the major microfinancing programme of NABARD. It has been experimented through three different types of models mentioned earlier. Puhazhendhi has studied the effectiveness of the models in 1995 on behalf of Foundation for Development Corporation with the financial support of UNDP in India [Puhazhendhi, 1995]. As per the study, the pioneering act of SHG – Bank linkage programme by NABARD has demonstrated wide outreach.

4.3.1 COST-EFFECTIVENESS

In order to assess the cost effectiveness of the microfinancing programmes, the study has adopted the transaction cost approach.

The transaction cost approach: Efficiency can be measured by taking into account the transaction costs associated with the MFIs as well as transaction costs incurred by micro borrowers. Transaction costs of lending and borrowing is a major barrier for the provision of micro credit services for the poor on a sustainable basis, by the formal sector. The emergence of MFIs have witnessed lower transaction costs, both to the lender and the borrower, as compared to the formal financial institutions in case of small loans [McGuire, P B, 1998]. Focussing on India and Philippines, the case study on SHG – Bank linkage programme found that transaction costs were much lower where banks used NGOs, and SHGs as

intermediaries. It is also suggested that the use of such intermediaries significantly improved the commercial viability of lending to the poor for banks.

The transaction costs associated with lending mainly involves costs associated with the activities such as identification of the borrower, field visits, loan appraisal, maintenance of accounts, monitoring, follow-up and recoveries and other costs.[8] Similarly, the transaction costs associated with borrowings mainly involves travel costs, documentation expenses and opportunity cost of time spent in negotiating the loan. However, an innovative form of financial intermediation can reduce these transaction costs by considerable amount as it has been experimented by MFIs operating in different countries as well as in different regions within the countries.

Empirical studies show that microfinance is one of the cost-effective alternatives for reaching credit and other financial services to the poor. In the Indian context, under the SHGs – Bank linkage models, the cost-effectiveness is a result of the synergy between the SHPIs and the Banks, which is reflected, in the following aspects. Firstly, the banks are able to reach a large number of small borrowers at a lower transaction cost and with a lower risk cost due to good repayments. The cost of monitoring the end-use of credit by the borrower is also reduced. Secondly, it facilitates the MFIs in leveraging funds from the banks at a lower cost for financial intermediation. Thirdly, for the poor borrower it reduces the cost of transacting the loan. It also ensures timely availability of credit at his doorstep. Even though loans from the village moneylender have the latter characteristics, the hidden costs are not reflected in the interest rates charged by him.

A study on South India [Puhazhendhi, V., 1995] estimated the average transaction cost of lending for the banks per account at 3.68 per cent of the loan amount, if the loan was given directly to the borrower. The intermediation of the NGOs and SHGs helped banks to reduce this transaction cost by an extent ranging between 21 and 41 per cent. The dynamic nature of the reduction in transaction costs, because of intermediation, effected a downward shift of the marginal cost curve. This was possible due to the active role played by NGOs and SHGs in identification of borrowers, follow-up for ensuring end-use of the loans and its recovery. This

[8] Transaction cost per loan is calculated by multiplying the number of hours spent by the personnel of institution concerned per loan by salary and allowances per hour.

resulted in significant reduction in time spent by the bank staff on these functions. Among the different models of linkages, the most cost-effective transaction was where banks used SHGs as financial intermediaries and NGOs as non-financial intermediaries. Similarly, the intermediation of NGOs and SHGs contributed in reducing the transaction cost of borrowers by about 85 percent, mainly due to the elimination of expenditure in documentation procedures. Such procedures are not only cumbersome in India but also time consuming and costly. The intermediation by the NGOs resulted in a reduction in opportunity cost to the borrowers in terms of the number of visits and the time spent on the bank premises in negotiating the loan. The intermediation of NGOs and SHGs had also proved useful in recovery rates. While the estimated default risk was very high at 22 percent in case of direct lending by banks, it was negligible when there was intermediation by NGOs.

A study [Gain, Raji. T.S., Malhotra, R. and Dheulekar, N.S. (1998)] of the linkage between the Bank of Baroda and SEWA in Uttar Pradesh indicated that the cost of delivery of credit through NGOs was nearly halved when compared to the direct loaning by the bank branch (Table 4.4). Transaction cost from the point of the borrower was one per cent as compared to 16.8 per cent when the loan was directly accessed from the bank branch.

Table 4.4: Comparative Transaction Costs under the Linkage Programme

Particulars	Loans through NGOs	On-lending by NGOs	Direct loans by branch
Cost of funds	6.83	6.83	6.83
Transaction cost	1.00	0.10	1.43
Risk cost	0.64	0.50	7.46
Loan cost	8.97	7.43	15.72

Source: Basu & Jindal (ed.), *Microfinance Emerging Challenges, (NewDelhi: Tata McGraw-Hill,* 2000), p. 224.

A comparison of the transaction and risk costs between three types of financial intermediation, viz., direct lending to small borrowers, lending under IRDP and lending to SHGs by the bank branches, revealed that transaction cost in the latter case was 0.91 percent compared to 3.76 per cent and 8.20 per cent, respectively in

the former two cases. The recovery was higher at 100 per cent in the case of lending to SHGs, compared to 34 percent and 12 percent in the other types of financial intermediation, reflecting lower risk costs [Srinivasan, Girija. (1998)].

These studies had not taken into account the cost of group formation, which has to be incurred either by the NGOs or by the banks themselves, presumably for the following reasons. Firstly, NGOs had formed groups for other purposes and, therefore, the formation of groups was not treated as an "add-on" cost since no additional cost was involved. Secondly, in the case of groups promoted by the bank personnel, the time spent by them was not accounted for, since the bank incurred no additional cost. Despite these plausible reasons, there are other costs like conveyance, expenses for the initial meetings, supply of ledgers, etc., which are to be borne by the NGOs or by the bank branches. As there are economies of scale in the group formation, the average cost per group, if a large number of groups is promoted, will be a small proportion of the credit business of the branch. This may not adversely affect the cost-effectiveness of the linkage programme.

4.3.2 SUSTAINABILITY

Many MFIs depend on donor funds or avail concessional loans from aid or donor agencies. There is a growing realisation that large scale lending of small amounts cannot be accomplished through dependence on subsidies or grants for an indefinite period. The programmes of microfinance will have to be self-sustainable in the long run. Therefore, the success of the microfinance programmes is to be judged in terms of not only its outreach but also in terms of its financial sustainability. Experience in implementing microfinance programmes reveal that most of them have evolved through a three-stage sustainability. The *first* stage is their dependence on subsidy or grants from either donor agencies or apex refinancing agency. The *second* stage is the achievement of operational sustainability where the programmes/institutions are able to cover all administrative expenses and absorb loan losses from their operating income. The *third* stage is the financial self-sufficiency. In this stage, they are able to cover all administrative expenses, loan losses and financial costs from the operating income,

after adjusting for inflation and subsidies and treating all funding as if it had commercial costs.

In the context of the SHG – Bank linkage programme, which is the major thrust of the microfinance programme in India, the aspect of financial sustainability raises two important questions. The first is the type of institutions or entities that should be subjected to the criteria of financial sustainability. The second is the time frame by which the microfinance operations are expected to graduate to the level of financial sustainability. The criteria of financial sustainability cannot be used for those NGOs, which have assumed the role of SHPIs and are promoting groups for the linkage programme. The cost incurred by the NGOs in promoting, nurturing and capacity building of the groups (till the groups graduate to the stage of directly dealing with the credit institutions) may have to be borne by the banks linked to the groups. In such cases, the social cost-benefit analysis might be a more appropriate tool to judge the performance of the programme while the criteria of financial sustainability may be appropriate for the banks [Jayaraman, B, 2000].

In the case of NGOs directly involved with financial intermediation, attaining financial self-sufficiency is necessary. However, this aspect has not been studied and examined rigorously, probably for the reason that the emphasis initially under the microfinance programmes in the country was on increasing the outreach of these programmes. From the limited information that is available, it was observed that all the 12 branches of SHARE, an NGO replicating the Grameen Bank Model, attained operational self-sufficiency in about five years [Basu & Jindal (eds.), 2000. These branches were able to meet the cost of the funds remitted by the Head Office and their overheads. One of the branches attained operational sustainability in about four years time and financial self-sustainability in five years, after making adjustments towards subsidies and inflation. The cost of lending has been brought down from a level of 42 percent during the first year to 3 percent during the fifth year. This was made possible due to dedicated staff, effective management system, which was used to monitor employee accountability, and borrower repayment. Two of the branches attained financial self-sufficiency in terms of meeting its own overheads and the cost of funds remitted by the Head Office. BASIX is still to achieve financial self-sufficiency although it has attained operational sustainability.

The operational self-sufficiency of BASIX was made possible due to the soft loan assistance from State Industrial Development Corporation (SIDC). Many of the NGOs in the country are still dependent on grants and concessional terms of funding for promoting microfinance among the poor.

The impact of microfinance operations of commercial banks on their financial sustainability is a moot point when viewed against the fact that it constitutes a small proportion of the loan portfolio. Loans up to Rs. 25,000 constituted only 16.2 percent of the loans outstanding of commercial banks by end-March 1998. The fact that the linkage programme is cost-effective to the banks, as discussed earlier, should justify the microfinance operations of the banks. The RRBs, which were initially established as micro-credit institutions catering to the needs of the weaker sections of the society, were observed to be financially unsustainable and a majority of them had been incurring losses. This was attributed to a variety of reasons including the administered regime of interest rates (till the deregulation of interest rates), high cost structure, poor recovery of loans and lack of cross subsidisation opportunities. The linkage programme because of its cost-effectiveness and better recovery performance is expected to improve the financial sustainability of the RRBs. An attempt to estimate the impact of reductions in transaction costs on the viability of banks revealed that if all loans were disbursed through intermediation, RRB branches would become financially viable after wiping out current losses. Commercial banks, both public and private, would improve their viability status further [Puhazhendhi, V. (1995)]. A significant reduction in default risks would have a cascading impact on the profitability of bank branches. Among banks, the SEWA Bank, an urban co-operative bank implementing microfinance programmes exclusively for women, has achieved financial self-sufficiency and is consistently earning profits since 1975-76. The profit during 1998 was Rs. 4.69 million on a working capital of Rs. 275.0 million. The bank's equity consists exclusively of the money of poor self-employed women and is not dependent on grants from external donors. This demonstrates that given the commitment of the NGOs and their track record, it should not be a difficult task to leverage low cost funds for its microfinance operations.

4.4 Impact Assessment of SHG – Bank Linkage Programme in India

The main objective of the microfinance programmes has been large-scale reduction of poverty by microenterprise development initiatives or by employment generation activities. A lot of studies in evaluating the impact of microfinance programmes have been undertaken, examining the different methodologies of operations. Therefore a study by NABARD on the performance of SHGs was undertaken in 2000 [Puhazhendhi, V & Satyasai, KJS, 2000]. The study was conducted for the country as a whole covering 11 States in five different regions. The total number of SHGs selected for the study was 223. The average size of the sample group was 16 members and, as expected, it is found that homogeneity in groups has influenced the cohesiveness among the members. The SHG Model works by taking into account compulsory savings by the members. Understandably, the success of the programme will depend on the savings habit or adaptation of the saving habits by members. It has been found that the savings habits of the SHG members who are directly linked with banks are higher than that of other two Models. The similar is the trend in case of loan disbursement also i.e., average loan amount disbursed is relatively higher for the direct SHG – Bank linkage Model.

Arguably, banks restore greater confidence over direct SHG – Bank linkage programmes. Assessing the economic impact, it has been found that the proportion of asset less households declined in the post – SHG situation compared to the pre – SHG situation. In other words, being a part of the SHG has helped the member to increase its assets.

Regarding the pattern of borrowing it has been noticed that there is a shift in demand for loan products from consumption or cultivation purpose to non-farm activities. It, therefore, reduces pressure on farm sector on the one hand and on the other it augments the non-farm sector, which has further implications for the betterment of the economy.

The repayment rates of SHGs to banks are not published. The case study focusing on this, has brought to notice that the repayment percentage among the sample

households was 94 per cent in the post – SHG situation as compared to 84 percent in pre – SHG situation. Furthermore, the repayment percentage was better in model with direct linkage with banks and lowest in the model with NGO as intermediary. Considering the income impact it has been found that the model where NGO acted as financial intermediary has registered maximum impact and lowest impact when banks lend to SHGs directly. In fact, increase in income has come more from expanding non-farm sector activities than farm activities.[9] Importantly, out of 41.8% BPL households in pre – SHG situation, 22% remained in post – SHG situation.[10]

Financial sustainability, in the case of SHGs, is not an appropriate criteria to judge the performance of these groups. Since the SHGs by themselves do not perform the function of financial intermediation (unlike the credit societies or unions), the bankability of the group is relevant. The banks or MFIs should therefore, primarily be concerned with whether the money lent to the group will be fully repaid to it in time. While the concept of SHGs is sustainable, it will be untenable to expect the individual groups to be a permanent feature in the microfinance scenario. Since a group is formed with the specific objective of leveraging loans from financial intermediaries and improve the economic and social conditions of its members, the group may dissipate after these objectives are achieved. Alternatively, while the group may exist in name only, there may be continuous turn over of members. Rather than be concerned with the sustainability of the groups, lessons have to be drawn from analysing the factors that caused the breaking up of the groups and which had not achieved their objectives.

A study of the various models of microfinance revealed that the most common model was the group approach of lending, practised in Bangladesh, India, Indonesia and Latin American countries. In Bangladesh, specialised institutions were established with the initiatives of NGOs to survey micro-credit due to the non-participation of formal institutions. In India, the Government and the formal

[9] 43 percent of the incremental income was generated from non-farm sector whereas farm activities contributed 28 percent only.

[10] Poverty level of income for the household has been computed by using the state-wise cut off monthly per capita consumption expenditure levels and the number of consumption units in the household.

credit institutions have played a significant role, with the NGOs taking on the mantle of Self-Help Promoting Institutions (SHPIs). The involvement of NGOs in the linkage was crucial to the success of the programme since the groups directly promoted by banks constituted only 17 percent of the nearly 33,000 groups linked and accounted for about 20 percent of the loans disbursed. In Thailand, micro-credit is channelised through agricultural co-operatives to individual and farmers' institutions while in Philippines the approach to microfinance is through ladderised credit.

4.5 Impact Assessment of MFIs: A Global Persepective

Microenterprise finance has generated enormous enthusiasm among aid donors and NGOs as an instrument for reducing poverty in a manner that is financially self-sustaining. Mosley and Hulme by studying 13 MFIs in 7 developing countries test this proposition. Furthermore the study has attempted to relate impact experiences to the designing features of the institutions.

The tools used for measuring financial performance are (a) the proportion of loans more than six months in arrears and (b) the subsidy dependence index, which measure the extent to which interest rate would have to be raised to break even in an environment free of all subsidies. The two measures, as expected, are highly correlated. It implies that the cases with the lowest indices of subsidy dependence have the lowest arrear rates, and vice versa. In fact, these account for the financial sustainability of the institution concerned; the higher these are, the harder it is for the sender to continue in business without subsidy.

Mosley and Hulme grouped the 13 MFIs into two categories, such as less sustainable MFIs with arrear rates above 20% and more sustainable MFIs with arrear rates below 20%, (see table 4.3). They found that financial sustainability correlates not only with the changing of market interest rates and the availability of savings facilities but also with the frequency of loan collection (such result was also expected by the microfinance summit – 1995), and incentives provided to borrowers as well as staffs to maximise repayment rates. Interestingly they did not

find significant correlation with lending to groups, as both individual as well as group schemes came under successful and unsuccessful categories.

Impact has been calculated by comparing the changes in household income and other target variables in a random stratified sample of 100 borrowers with the change in that target variable in a control group of 50 non-borrowers selected with the similar income, asset holdings and access to the infrastructure to the borrower group. It is estimated that all schemes have positive measured effects on income, i.e., in case of BRI's *unit desa* in Indonesia, Bancosol in Bolivia. Moreover, impact for more financially sustainable schemes is found higher than for less financially sustainable schemes with higher arrear rates and levels of subsidy dependence, but the difference is not statistically significant. However, average impact for borrowers below the poverty line is invariably modest across the typology of MFIs.

Mosley and Hulme tried to draw an impact curve showing the relation between average income level and average loan impact across institutions as well as across borrowers within institution. In both cases the relationship slopes upward at a decreasing rate, which implies that it is positive in income but negative in square of income. The regression coefficients on these terms are significant. Higher income households experience an average programme impact than household below poverty line. Furthermore, the slope coefficients for the different institutions differ, i.e., the curves for more financially sustainable institutions lie above the curves for the less financially sustainable institutions.

In contrast, loans to higher income groups are often used for promotional activities such as purchasing assets etc. So also they can access larger loans because of their greater savings capacity. Importantly, the study found that the income impact is negative for the household who are far below the poverty line. This implies that the very poor borrowers may be forced by their greater exposure to sell out their assets, which may lower their earnings.

Finally, it can be concluded that the findings show encouragement as well as warning. Encouragement because impact curves for financially sustainable institutions lie above those of less sustainable institutions. That implies adoption of

micro finance institutions of those designed features may be significantly associated with good financial performances, (see table 4.4). They may be able to increase poverty reducing impact as well as financial sustainability. Nonetheless it is encouraging that the impact curve shows a trade-off between poverty impact and loan impact. On the other hand if the loan impact diminishes with the income and approach, the attempts must be to scale up credit-based solutions in order to mitigate rural poverty.

4.6 Concluding remarks

Despite unavailability of relevant statistics, the performance appraisal of Indian MFIs in the present study reveals interesting facts. The performance of the SHGs model has been the best as far as outreach is concerned. In fact, performance has been better in case of the Individual Banking model, if one looks at it from the angle of operating efficiency. In case of the Grameen model it is close to the international average though it is relatively less in comparison to the Individual banking model. But, the SHGs model has turned out to be highly inefficient in minimising the operating costs, which has been reflected in the form of low sustainability of those models. However, it is not true for the Grameen models. Interestingly, the Grameen model turns out to be highly sustainable. The reason may be due to its low subsidy dependence. Thus, any analysis on the performance depends on the type of indicators chosen.

CONCLUSION

Fifty years of developmental efforts of the state has not made any significant impact on poverty. Developmental efforts of the state have made a long journey from reliance on the trickle down mechanism to the provision of entitlement for the poor. Microfinancing is an important constituent of entitlement provisioning for the poor. In recent years, there has been a growing emphasis on microfinancing. This is particularly because of the end of obsession with the trickle down mechanism.

Microfinancing implies small loans given to the poor in the farm and non-farm sector. Formal institutions like commercial banks, regional rural banks, cooperatives and NABARD have been providing microfinance, since a long period of time. Its provisioning has also been an important aspect of various poverty alleviation programmes; like IRDP, TRYSEM, PMRY, SGSY etc. However, neither the formal financial institutions nor the poverty alleviation programmes have been successful enough in making a significant impact. In recent years, these institutions have diverted their funds from traditional subsidized financing programmes to microfinancing programmes, which is now considered as the thrust area in India as well as in many developing countries around the world. In India, NABARD has taken a lead role in making the microfinance programmes effective. It has taken the help of Microfinance Institutions (MFIs) extensively in order to make its programme fruitful. In fact, the role of NABARD has been to strengthen the various institutions in the formal sector and make their programmes of microfinancing successful.

The pioneering formal-informal linkage model of NABARD has created enthusiasm in the microfinance scenario in India. The basic objective lies in banking with the poor without compromising for profitability and sustainability criteria in the long run. Basically, the formal-informal linkage model or the SHG – Bank linkage model comprises of three distinct types. The first model directly links the commercial banks with the groups of poor. The role of the commercial bank in this model is to promote, lend and to train the SHGs in order to improve their credit worthiness. With the

extensive spread of cooperatives and commercial bank branches in the country, this model is expected to produce greater outreach in the coming years, though it has not resulted in doing so till yet. This model has an advantage over others, since the bank is directly involved in dealing with SHGs. In the second and third models, the role of commercial banks is indirect. In the second model, the NGOs take on the role of only a facilitator in the formation of SHGs. NGOs act as Self Help Group Promotion Institutions (SHPI) and withdraw after the groups become mature enough to access credit form banks. The NGOs not only act as facilitators but also deliver financial services in the third model. Here banks provide finance to SHGs through NGOs.

Comparing the three models, it is observed that the second model has largely been successful in linking the commercial banks with the poor. It has also been found that under the second model, the transaction cost was nearly halved when compared to that of direct loan delivery by banks to SHPIs. Therefore, the success of providing financial access to poor may not be attributed to the developmental considerations of commercial banks; rather it may be attributed to the profitability considerations in terms of cost-effectiveness and prudential compulsions of commercial banks, which have arisen in the wake of financial sector reforms.

NGOs act as SHPIs as well as financial intermediaries between the SHGs and Banks under the third model. It is interesting to note that this model has not been able to achieve greater outreach in comparison to the second model, where NGOs only play the role of SHPIs. One of the reasons may be that financial intermediation needs professionalism both in terms of organizational reorientation as well as efficiency in dealing with such activities. Furthermore, that also involves an amount of risk. Therefore, many NGOs may not be interested to take on the job by paying from their pocket. On the other side, another reason may be lack of interest among banks to promote that model because of lack of confidence in the activities of NGOs. Because of these complexities, this model has not made substantial progress like the second model.

Hence, it can be noted that the NGOs are playing a major role in promoting as well as in functioning of SHGs. The success of second model in terms of outreach as well as cost-efficiency is reflective of the fact that NGOs are working quiet efficiently in achieving the objective of catering credit to the lower echelons of society. However, considering the impact measurement perspective of SHG models, it has been found that the model, where NGOs acted as financial intermediaries, (the third model) has registered maximum income impact and, surprisingly, lowest impact when banks directly lend to SHG. This clearly shows that, the NGOs acting as financial intermediary have greater depth of outreach to the poor. The reason may be that they are local people with adequate knowledge about the requirement of local borrowers and there creditworthiness. On the contrary, banks may need certain presumptions to proceed to deliver credit to the borrower who is often very poor. This might have restricted the very poor borrowers to become a member of SHG that is directly linked with banks. Furthermore, the model with NGO working as intermediary (second model) has been relatively more successful in lifting the people above poverty line (poverty impact) than other models. This shows the expertise and efficiency of NGOs as SHPIs on the one hand, and on the other, it proves the creditworthiness of people below poverty line. However, the NGO intervention has brought success to SHGs, whereas bank's direct intervention has failed. Therefore, it can be argued that, instead of banks getting involved in promoting SHGs, it may be more effective if this responsibility is exclusively rested with NGOs. In any case, the programmes will bear fruit if and only if, they become self-sustainable. Otherwise, it will bring more ills than panacea for the financial system.

It is no doubt that the NGOs play a greater role in microfinance from the distribution point of view. But allocation of funds depends on the major institutional sources like NABARD, SIDBI and RMK. These institutions have been continuously providing support to banks as well as NGOs for on-lending credit to poor. Of course, financial assistance is the major hurdle, which NGOs face in promoting/financing SHGs, and therefore, the sensitivity of donor funds must not be sidelined. RMK is the only government NGO that provides funds for microfinance. It will be more successful, if

government increases its credit fund for microfinance by creating more institutions like this.

As the microfinane movement made inroads around the world, various approaches emerged within it, pertaining to local considerations. However, the methodologies mostly adapted by Indian MFIs are Grameen Bank model, the Individual Banking model and the SHG model. In addition to that, many MFIs have also started providing 'credit plus' services by modifying their product design to suit the poor clients. It is often found that the links between savings and loans, the purpose of loan, its recovery period and other conditions, the structure of interest rates as well as accessibility and other loan delivery mechanisms are the major factors that need to be taken into account by MFIs in designing their product. One of the major decisions pertains to the rate of interest. Many MFIs charge higher interest rates than the prevailing market rate of interest, for covering their costs or in other words, for the issue of sustainability. Their logic is that, if the poor can comply with the moneylender by paying, often, more than 100 percent rate of interest, then they can also pay a relatively higher rate of interest than the bank rate to MFIs. Interestingly, all the models of MFIs show high recovery rate. This proves the hypothesis that the poor are less bothered about the rate of interest than they are about accessibility to credit. Looking at the other side, it may be felt that most of the microfinance programmes are oriented towards lending to individuals using groups as risk reduction mechanism, i.e. these programmes develop 'group dynamics' to the extent that group pressure works as a risk-reducing instrument. However, it is 'social accountability' or 'individual credit worthiness'; a hypothesis still to be tasted by examining empirical evidence comprehensively in the long run.

Furthermore, charging high rate of interest is not the only way of achieving sustainability by MFIs. Sustainability can also be achieved through improving staff productivity, efficient fund management, maintaining financial prudence, innovating methodologies of operation etc. In fact, these will substantially reduce the transaction cost of the MFIs. Analyzing the performance of these three models of Grameen,

Individual Banking and SHG programmes, one can be able to know the relative success of the model in the region. The standard tools for measuring performance are outreach, growth, portfolio quality, productivity, efficiency, profitability and sustainability. However, there is no unanimity of indicators with regard to assess the performance of a model. A model may have higher outreach but low operating efficiency, or high sustainability and likewise. In addition, one of the major constraints of the performance measurement is the unavailability and reliability of reliable data. Nevertheless, the attempted efforts in this regard in the present work, incorporating three indicators, viz., outreach, operational efficiency and sustainability, reveals some interesting facts. MFIs following SHGs model have greater outreach to the poor. Since they follow the simple methodology of group formation, NGOs act as catalysts in linking SHGs with banks and there exists refinance facilities, it is therefore obvious that they obtain greater outreach than other models. MFIs following individual banking models have higher operating efficiency. These organizations are governed by their sustainable issues. They act as formal banking institutions and they have to generate internal funds for their sustainability. Therefore, they lend to comparatively economically well-off sections. More interestingly, Grameen Replicators are found to be highly sustainable because of their strict operational criteria of group dynamics. The sustainability of the Grameen Replicators is reflected in low dependence on subsidy. Prominently, because of these reasons they have not been successful in accessing greater outreach as it is witnessed in case of India. However, SHG models are found to be highly dependent than all other models as they depend on refinance from NABARD. Thinking positively, it should not be a matter of concern at least in the short run. Nevertheless, in future it should be translated in freeing the poor from economic bondage, even from the state. The effective utilization of the credit provided to the poor also depends on the availability of social infrastructure. Hence, micro credit programmes should also be implemented effectively through the poverty alleviation programmes.

The microcredit movement has also reshaped the profile of NGOs. Many of the NGOs have completely changed their strategy of social intermediation - from issue-based

activism to financial delivery – and at varying stages of their evolution as financial intermediaries. Even then, the recognisation of these institutions as purveyors of credit could require general support system and exclusive provisions in the banking status.

The MFIs, although many of them operate in the informal sector, constitute an integral part of the financial system and therefore, it will be necessary to provide a level playing field for them. What is required in this juncture is an effective system of regulating the growth and functioning of the MFIs. The Taskforce on Supportive Policy and Regulatory Framework for microfinance has looked into these aspects and made a number of recommendations. RBI has also recognized microfinance as a challenging field for the banks to step in.

However, there are also some questions raised regarding the viability of microfinance services. Firstly, to achieve sustainability the MFIs often press for high recovery rates by ensuring timely repayment of loan from borrowers. This causes a loan recycling on the part of borrowers to repay the old debt. Secondly, many MFIs around the world are depended upon donor funds or concessional funds provided by international donor agencies. In future, this subsidy has to be withdrawn if the institution is going to be sustainable. But, whether the subsidy should be withdrawn, which will make credit more costly to the poor if the MFI tries to attain sustainability, or the subsidy should continue for the social well-being are the two contradictory issues. Thirdly, the lack of a proper formal institutional regulatory mechanism for microfinance creates market imperfections, even within a region. Hence, in future, the efficacy of microfinance programmes depends on how these challenges are met.

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