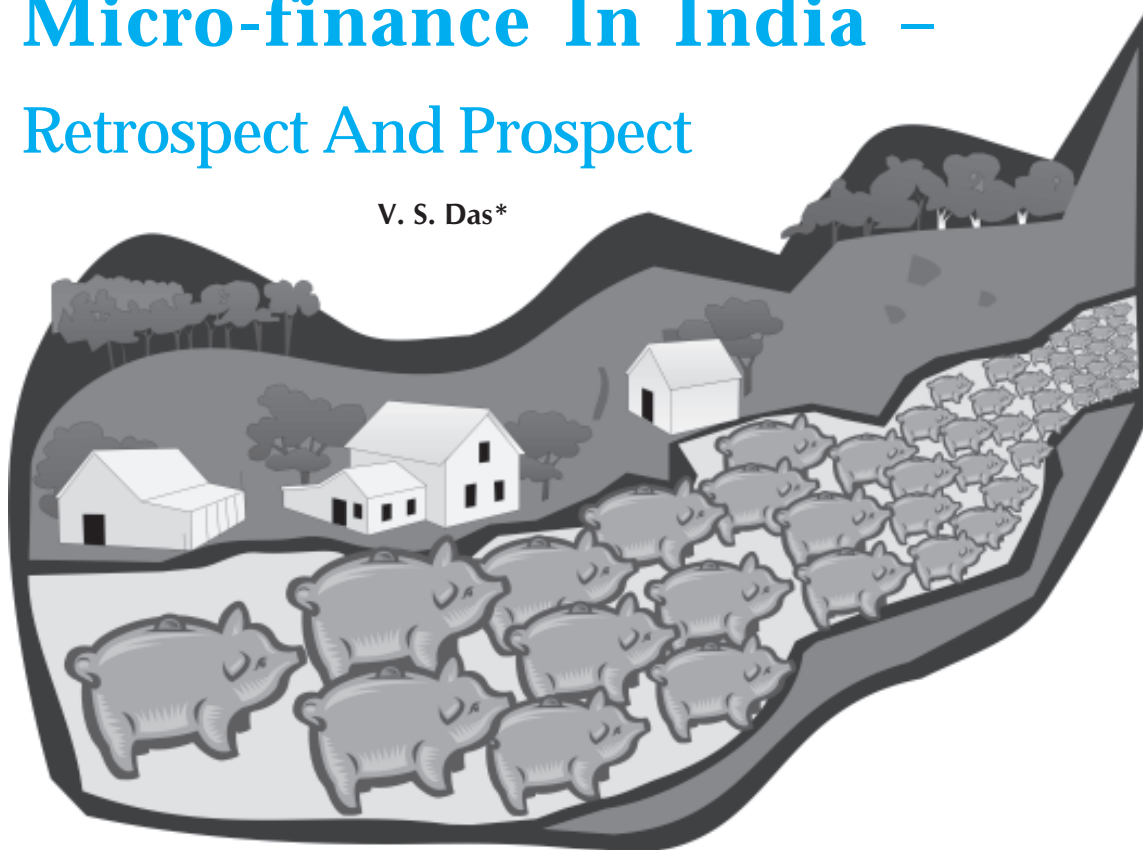


Up-scaling Micro-finance In India – Retrospect And Prospect

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It gives me great pleasure to be in the midst of this august gathering today and deliberate on issues relating to Micro Finance. We, in the SAARC countries, share the grave concern about the incidence of poverty in this region and the fact that, in spite of actions initiated at all levels, it still remains a serious problem. About 900 million or 68 per cent of the world's poor live in Asia, of which about 500 million live in South Asia. While each country has been dealing with the issue in its own way, there are some examples that stand out by virtue of their originality and effectiveness in addressing the problem. The experience of countries like Bangladesh has shown that, given the right kind of resource support through credit and capacity building, the poor themselves can turn around their own situation. Institutions such

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as the Grameen Bank, BRAC, ASA and PROSHIKA have been instrumental in bringing about significant socio-economic transformation. Indeed, the Grameen model is a showpiece in micro finance and has received worldwide acclaim.

Role of the banking system

Rural credit policy In India has at its core the twin goals of bringing an increasing number of people within the formal financial system and using credit as an instrument of poverty alleviation and rural development in conjunction with other measures by expanding the outreach of the banking system and adoption of lending policies that are aimed at facilitating flow of credit to the hitherto neglected sectors of the economy, called the “priority sectors”. The Indian banking system has today an impressive penetrative outreach and there is now a bank branch fulfilling the need of every 16 thousand of the population. Although micro finance, in the way it is understood today, started in India in the early nineties, the banking sector in the country had been providing credit to the weaker sections of the society for productive purposes even earlier. The cooperative societies, which were established since the early years of the last century, have been providing credit mainly to the disadvantaged sections. The commercial banks have also been encouraged to extend credit to the weaker and disadvantaged sections. The Regional Rural Banks (RRBs) were set up in 1976 with a view to providing credit, mainly to the weaker segment of the rural population. As a result of these initiatives, there has been a substantial broadening of the infrastructure for credit delivery, resulting in increased outreach and reduction in the influence of informal agencies, as evidenced by the increase in the share of institutional sources in the cash debts of rural households from less than 10 per cent in the early 1950s to more than 60 per cent in 1991.

The quest for financial inclusion

In spite of the rapid expansion and progress of the banking sector, there are still wide gaps as banking services, particularly in the rural areas, are not availed of by a large chunk of the poor population. Therefore, the Reserve Bank of India, in its Annual Policy Statement for the year 2005-06, urged banks to review their existing practices to align them with the objective of financial inclusion. In the Mid Term

Review of the Policy (2005-06), with a view to achieving greater financial inclusion, RBI exhorted the banks to make available ‘no frills’ banking accounts, either with nil or minimal balances and simple and hassle free account opening formalities with a view to making banking services accessible to a sizeable population which has hitherto not availed of banking services.

Development of micro finance

As a large section of population in the unorganized sector, particularly in the rural areas, remained outside the formal credit structure, a need was felt for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms which would fulfill the requirements of the poorest, especially of the women members of such households. The emphasis, therefore, was on improving the access of the poor to micro finance.

Micro finance models in India

a) The SHG-Bank Linkage Programme

In 1992, a pilot project of linking Self Help Groups (SHGs) with commercial banks was launched under the aegis of National Bank for Agriculture and Rural Development (NABARD), which is the apex bank for rural and agricultural credit in the country. Subsequently, other categories of banks, viz., co-operative banks and the Regional Rural Banks (RRBs) also participated in delivery of micro finance services under the programme. During all the three phases of this programme, viz. pilot testing phase (1992-95), mainstreaming phase (1995-98) and the current expansion phase (1998 onwards), active policy support was provided by the Reserve Bank of India which allowed banks to open savings bank accounts by such informal groups and relaxed interest rate, margin, security, etc. norms wherever necessary for lending to the SHGs financed under the programme. Interest rates on loans by banks to micro-credit organisations and by micro-credit organisations to their members/ beneficiaries were left to their discretion. Government of India have also been supporting the SHG-bank linkage programme through budgetary announcements, inter alia, regarding the number of SHGs to be linked to banks and other policy issues.

6. Three different models of linkage have evolved based on variations in the delivery mechanism. They are: -

Model I

SHGs formed and financed by banks

Under this model, banks themselves act as Self Help Promoting Institutions (SHPI), i.e., forming and nurturing the groups, opening their savings accounts and providing them bank loans. As at March 2005, 21 per cent of the total number of SHGs financed was from this category.

Model II

SHGs formed by NGOs and other agencies but financed directly by banks

This appears to be the most popular model amongst the bankers. Under this model, Non-Governmental Organisations (NGOs) and other agencies in the field of micro finance act as facilitators and banks in due course link the groups by directly providing loans to them. About 72 per cent of SHGs linked to banks as at March 2005 was under this model.

Model III

SHGs financed by banks using NGOs as financial intermediaries

In this model, NGOs assume the dual role of facilitators and financial intermediaries. They help in the formation of SHGs, nurturing them, training them in thrift and credit management and then approach banks for bulk loan assistance for on lending to these SHGs. The proportion of SHGs linked to banks under this model is relatively small, i.e., 7 per cent as at March 2005.

The advantage of the linkage programme is that it enables the banks to externalize part of their credit cycle of identifying the borrowers and also helps in recovery of loans with the on-time repayment reported at over 95 per cent.

The SHG-bank linkage has shown significant growth in terms of number of groups linked to banks. Starting from only 255 SHGs linked to banks in the year 1992-93, the number increased to 0.5 million SHGs linked during the year 2004-05. Cumulatively, the number of SHGs linked to banks aggregated 1.6 million as at the end-March 2005. This translates into an estimated 24.3 million poor families brought within the fold of formal banking services. Ninety per cent of the groups linked with banks are exclusive women's groups. Cumulative disbursement of bank loans to SHGs stood at over Rs. 68 billion as on March 31, 2005 with an average loan of Rs. 42,600 per SHG and over Rs. 3,000 per member. A total of 573 banks including 47 commercial banks, 161 RRBs and 330 co-operative banks are now associated with the SHG-bank linkage programme. While 572 out of 603 districts of the country in 31 states/ Union Territories have

been covered under this programme, the total number of NGOs presently involved in this linkage is around 4,500.

b) Bank-MFI Bulk Lending Model

An alternative delivery model for micro finance is the bulk-lending model, where funds are placed at the disposal of NGOs or MFIs for on lending. SIDBI, Friends of Women's World Banking (FWWB) and the Rashtriya Mahila Kosh (RMK) have followed this route along with some private, foreign and public sector commercial banks. The on lending could be to SHGs or groups in Grameen model or even to individuals.

c) The Bank-MFI Partnership Model

This model has been popularized by the new generation private sector banks in the country. Here, the MFI evaluates, recommends, originates the loans, helps in disbursal and, subsequently, tracks and collects the loans. However, the loans are accounted for in the books of the bank and not of the MFIs. This model has overcome the constraints of

capitalization of the MFIs and the double exposure that the banks are exposed to. For the services that the MFIs provide, a service charge is collected from the borrowers by the MFI. It also provides First Loan Default Guarantee (FLDG) to the bank to a certain extent (8 – 15 per cent) of the limit sanctioned in the form of a security deposit with the bank so as to maintain its stake in the loan portfolio. Since MFIs find this deposit amount too large to mobilize, further innovation by providing the FLDG amount as an overdraft limit to the MFI has also been tried out.

d) Grameen Bank Model

Some NGO-MFIs in the country have adopted the Bangladesh Grameen Bank model for providing micro finance to poor women. Available data show that the outstanding loans given by these MFIs aggregated Rs 5.1 billion as at the end of March 2005.

The policy framework for micro finance

Under the multi-agency system existing in India, different types of institutions are at present engaged in delivery of micro credit. These include, apart from the banking institutions, micro finance institutions (MFIs), such as non-banking finance companies (NBFCs), cooperative societies and other entities set up as societies and trusts. While there is no published data on MFIs operating in the country, the number of MFIs is estimated to be around 800, an overwhelming majority of which is operating on a smaller scale with clients ranging from 500 to 1,500 per MFI. An estimate from the largest association of MFIs indicates that, as on March 31, 2005, outstanding loans disbursed by their members amounted to Rs 10.63 billion.

While the banks are regulated by Reserve Bank of India, the cooperative societies, which are not banks, are regulated by the State Governments concerned under the provisions of the respective State Cooperative Societies Acts. Micro finance institutions, which are registered as companies, come under the regulatory purview of RBI. While Non-Banking Financial Companies (NBFCs) accepting public deposits are subjected to rigorous supervision by RBI, those not accepting public deposits are regulated in a limited manner. There are, however, only a few MFIs in the country that are registered

as NBFCs. Further, companies which are:

- i. engaged in micro financing activities (with credit cap of Rs. 50,000/- for a business enterprise and Rs. 1,25,000/- for meeting cost of a dwelling unit);
- ii. licensed under Section 25 of the Companies Act, 1956 (i.e., not for-profit companies); and
- iii. not accepting public deposits

are exempted from the key regulatory/ statutory requirements, viz., registration, maintenance of liquid assets and transfer of minimum percentage of profits to the Reserve Fund.

Reserve Bank of India has been striving to create an enabling environment for the growth of micro finance in the country. The pilot project of SHG-bank linkage launched by NABARD in 1992 received full policy support from RBI and it advised the commercial banks to actively participate in linkage programme which has since been extended to the RRBs and cooperative banks. The progress of SHG linkage was reviewed in 1995 by a Working Group set up by the RBI, based on which guidelines were issued to banks in April 1996 for financing the SHGs beyond the pilot phase. Based on the report of the Micro-credit Special Cell which was set up in the RBI pursuant to the Monetary and Credit Policy announcement in April 1999 and the Task Force on Supportive Policy and Regulatory Framework for Micro finance, set up by the NABARD, in February, 2000, RBI issued a comprehensive circular to banks to initiate steps for mainstreaming micro-credit and increasing the outreach of micro credit providers. Micro credit was defined as the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards and the micro credit institutions as those that provide these facilities. The Reserve Bank set up four informal groups in October 2002 to examine (i) structure and sustainability issues, (ii) funding issues, (iii) capacity building issues and (iv) regulatory issues relating to micro finance. The Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Vyas Committee) appointed by the RBI also examined various issues in micro finance.

Highlights of the circulars/ guidelines issued to banks in this regard, incorporating the recommendations made by various committees, are as under:

- ◆ Interest rates applicable to loans given by banks to micro credit organisations or by the micro credit organisations to Self-Help Groups/ member beneficiaries have been left to their discretion.
- ◆ Micro credit extended by banks to individual borrowers directly or through any intermediary is reckoned as part of their priority sector lending. Bank loans to SHGs are also treated as lending to the weaker sections.
- ◆ The banks may formulate their own model(s) or choose any conduit/intermediary for extending micro credit. It may be desirable for banks to deal with micro credit organisations having proper credentials.
- ◆ Banks may prescribe their own lending norms keeping in view the ground realities.
- ◆ 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.
- ◆ Banks should strive to remove all operational irritants and make arrangements to expeditiously sanction and disburse micro credit by delegating adequate sanctioning powers to branch managers. The loan application forms, procedures and documents should be made simple.
- ◆ The group dynamics of working of the SHGs may be left to themselves and need neither be regulated nor formal structures imposed or insisted upon.
- ◆ The approach to micro financing of SHGs should be totally hassle-free.
- ◆ MFIs would not be permitted to accept public deposits unless they comply with the extant regulatory framework of the Reserve Bank.

Further, Foreign Direct Investment (FDI) is permitted in the MFI sector, subject to certain norms. NGOs, engaged in micro finance, have been allowed to raise External Commercial Borrowing (ECB) up to USD 5 million during a financial year.

Expanding the outreach of micro finance

Following the Finance Minister's Budget Speech for the year 2004-05 stating, inter alia, that commercial banks may consider adopting 'agency model' by using the Civil Society Organisations (CSOs) and others to expand their outreach in the rural and farm sectors and appointing Micro Finance Institutions (MFIs) as "banking correspondents" to provide transaction services on their behalf, an Internal Group of RBI on Rural Credit and Micro-Finance (Khan Committee) has recently examined the issues relating to expanding the outreach of micro finance through linkage between banks and intermediaries from the formal, semi-formal and informal sectors and leveraging information and communication technology (ICT) for the purpose. On the basis of recommendations made by the Committee, banks have since been permitted to use the services of NGOs/SHGs/their federations, MFIs and other CSOs as intermediaries in providing financial and banking services through the use of (i) Business Facilitator and (ii) Business Correspondent models.

The Business Facilitators will provide non-financial services to the banks, such as, identification of the borrowers and fitment of activities, collection and preliminary processing of loan applications including verification of primary information/data, creating awareness about savings and other products and education and advice on managing money and debt counseling, processing and submission of applications to banks, promotion and nurturing Self Help Groups/ Joint Liability Groups, post-sanction monitoring, monitoring and handholding of Self Help Groups/ Joint Liability Groups/ Credit Groups/ others, and follow-up for recovery.

In addition to activities listed under the Business Facilitator Model, the scope of activities to be undertaken by the Business Correspondents will include (i) disbursement of small value credit, (ii) recovery of principal / collection of interest, (iii) collection of small value deposits (iv) sale of micro insurance/ mutual fund products/ pension products/ other third party products, and (v) receipt and delivery of small value remittances/ other payment instruments. Thus, the emphasis has been on provision not only of credit but also of the entire gamut of financial services at the doorstep of the poor through these agencies.

Role of other apex level institutions

a) NABARD

Apart from being the pioneer in the field of micro finance in India under the SHG-bank linkage programme, NABARD has been promoting the idea of organising thrift and credit groups among the NGOs and encouraging their linkage with banks, providing inputs in capacity building for banks and NGOs, and providing funds to banks and financial support to eligible MFIs to ease the fund flow position to the sector. A Micro Finance Development Fund of Rs 1 billion was established in NABARD in the year 2000-01 for (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 the micro finance sector. The corpus of the Fund has since been raised to Rs 2 billion and it has been renamed as the Micro Finance Development and Equity Fund. The objective of the re-designated Fund is to facilitate and support the orderly growth of the micro finance sector through diverse modalities for enlarging the flow of financial services to the poor, particularly for women and vulnerable sections of society consistent with sustainability (e.g. SHG –Post Office linkage, promotion of Joint Liability Groups, marketing of SHG products).

The mainstream SHG movement has been able to promote the philosophy of financial inclusion to a large extent as 121.5 million poor have been linked to the formal financial institutions. More than 4300 NGOs and other agencies and

the entire banking industry in the country are partners in the movement. Other important initiatives taken by NABARD include putting in place and actively supporting innovative projects, conducting various studies in the field of micro finance, and developing a rating model for MFIs in association with CRISIL, a leading credit rating agency.

b) The Small Industries Development Bank of India (SIDBI)

The Small Industries Development Bank of India (SIDBI) has also been supplementing the efforts at providing micro finance in the country through its SIDBI Foundation for Micro Credit (SFMC) launched in January 1999. The objective is to create a national network of strong, viable and sustainable MFIs from the informal and formal financial sectors to provide micro finance services to the poor, especially women. The cumulative assistance of SIDBI's micro finance initiatives as at the end of March 2005 aggregated Rs. 4.2 billion through 209 MFIs, benefiting approximately 1.51 million poor, mostly women.

c) The Rashtriya Mahila Kosh (RMK)

The National Credit Fund for Women or the Rashtriya Mahila Kosh (RMK), an agency of the Government of India, provides funding assistance to NGOs and SHGs exclusively for benefit of women living below the poverty line. The cumulative loan sanctioned by RMK stood at Rs 1.3 billion in respect of 749 NGOs and other agencies as at the end of March 2004.

Impact Evaluation

Although a large-scale evaluation of the impact of micro finance initiatives on the poor, particularly their sustainable livelihood, is not available, some preliminary studies by NABARD and SIDBI point to positive results. A study by NABARD with reference to the SHG-bank linkage programme reveals that the group members have been benefited both financially as well as socially and it has resulted in a general increase in the level of confidence of the group members who are mostly disadvantaged women. The SIDBI study indicates that the micro finance initiatives have increased non-farm employment of the rural people and women, in particular, have been benefited in terms of economic and social empowerment, their ability to access loan, own productive resources, engage in income-generating activities, decision making and increased mobility.

However, given the degree and dimension of poverty in a country of continental size, we still have a long way to go. Against this background, let me now briefly touch upon the issues and the challenges we face in up scaling micro finance for the financial inclusion of the uncovered and under-covered poor of our country.

The Road Ahead - Issues and challenges

Regional variation

Although more than 24 million poor families have been covered so far since the pilot project for financing of SHGs was launched in the early nineties, a vast segment of the population is still to be covered and wide regional variations exist in spread of SHGs in the country. There is a need to upscale the number of SHGs, particularly in the Northern, Eastern and North-Eastern parts of the country where there is a dearth of good Self Help Promoting Institutions (SHPIs). In some cases, the SHGs have started federations at the District/ Taluka levels and the role of such federations in intermediating between banks and SHGs will have to be watched in the next few years.

Cost of credit

The issue of high interest rates charged by the MFIs is often raised in various fora. In this context, the MFIs' contention is that their cost of operations is quite high due to higher intensity of follow-up and need for continuous contact with the borrowers. Adoption of innovative methods and processes including low cost ICT solutions can be one way for reducing their transaction cost and, hence, the cost of credit to the borrowers.

Promotion of micro-enterprises

Though the SHG-bank linkage programme was intended to provide sustainable access to the unbanked poor, the question often being posed by different stakeholders is 'what next'? Under the SHG-bank linkage programme, the average loan amounts per SHG and per member are about Rs 42,600 and Rs 3,000 respectively. The per member loan amount is too small for any meaningful business activity although often such small doses of finance help the poor household in consumption smoothing. It is imperative that the quantum has to be increased substantially when the SHGs go higher in the ladder to the level of micro-enterprises. More

importantly, the members of the groups need to have access to information and knowledge about appropriate economic activities that can be undertaken by them as well as the various backward and forward linkages available for sustaining such activities.

Regulation of MFIs

As regards regulation of micro finance institutions, it has to be kept in mind that major players undertaking micro finance activities in India (viz. banks and NBFCs) are well-regulated entities. The other types of organizations, such as, societies, trusts, etc. which do not accept public deposits are not regulated by the central bank. The Business Facilitator and Business Correspondent models suggested by the Khan Committee will help forge NGO / MFI - bank linkages, leveraging the strengths of semi-formal and informal NGO-MFI sectors with the well regulated entities like banks. The use of MFIs and other intermediaries in accepting small deposits at the doorsteps of the people on behalf of the banks, based on certain norms of due diligence and rating, would ensure safety of poor people's funds on the one hand and provide comfort to lenders, donors and other stakeholders in dealing with such MFIs. In the circumstances, a comprehensive regulatory framework for the large number of non-deposit taking organisations spread across the vast country may not be necessary for the present. Otherwise, many experts have favoured a self-regulatory system at the state level for MFIs that do not fit into the existing regulatory framework. Such SROs may be engaged in evolution of code of ethics, uniform standards of accounting and disclosures, empanelment and training of auditors, capacity building, etc. As regards SHGs, we believe that the group dynamics of working of the SHGs, whose strength lie in simplicity, informality and flexibility may be left to themselves and they need neither be regulated nor formal structures imposed upon them.

Funding support

While talking of MFIs, existence of a proper funding mechanism for such organizations is also important. The Micro Finance Development and Equity Fund established in NABARD is expected to play an important role in providing Equity Capital or Quasi Equity to enhance the capacity of the MFI to undertake financial operations and enhance the comfort level of the lenders, particularly in areas where the

penetration of micro finance movement is still low. There is also support available from SIDBI Foundation for Micro Credit (SFMC) as well as the Rashtriya Mahila Kosh. The banking sector also supports the "Fit and Proper" NGOs/ Self Help Promoting Institutions (SHPIs) in the formation and nurturing of SHGs and other micro finance initiatives. Hence, funding and facilitation support in an environment of good governance and transparency among the NGOs/MFIs/SHPIs may not be a major constraint.

Capacity building and other developmental issues

Capacity building is going to be essential for the large number of NGOs/ MFIs that may be required to be promoted to expand the geographical coverage of the financial services. Efforts of NABARD, SIDBI and associations of the MFIs in this area need to be continued. The national level training institutions like the College of Agricultural Banking (CAB), Pune and the Bankers Institute of Rural Development (BIRD), Lucknow are also involved in the training of banks and MFIs. However, there is still a lot of ground to be covered. While accounting systems of MFIs are fairly well developed, there are no prescribed standards of accounting for SHGs and NGOs. Further, there is need for more stringent disclosure norms for MFIs/NGOs. In the interest of these organizations, proper accounting standards have to be developed and implemented. Product innovation, particularly by harnessing information and communication technology (ICT), will go a long way in improving the efficiency of the micro finance institutions. At present, the database on MFIs in the country is weak and needs to be developed. There is also a requirement of some form of credit information bureau on a localized basis to provide borrower information to banks and the MFIs. In this regard, the Khan Committee's recommendation on a Micro Finance Information Bureau is under consideration. Long-term sustainability of the SHG model, particularly when the number of groups expands rapidly, may require a federal structure without severing the linkages that the SHGs have with bank branches. Such federations, besides providing specialized services like rural housing loans and micro insurance, would improve the quality of the SHGs by tying with common service providers for accounts, human development, capacity building, marketing and other linkages and facilitate credit linkages with banks.

Role of the corporate sector

Corporate India has, of late, shown keen interest in micro finance, as it provides an alternative business opportunity for them besides being a means to actualise its corporate social responsibility objectives. As the poor move from subsistence living to higher standards of living, their demand for newer goods and services besides the traditional items like agri-inputs implements and household consumables grows rapidly. Many corporates have realised that the people at the bottom of the pyramid can be brought into their business model and they can play a critical role in providing market linkage to the products of the rural areas and the informal sectors on a sustainable basis. The challenge lies in quickly identifying the opportunities and putting in place appropriate systems to provide sustainable linkages between the corporate and the micro finance sectors.

Beyond micro finance

Lastly, an important issue that needs to be looked into is the provision of micro finance, rather than micro credit, that is, the availability of other financial services, such as, insurance and remittance to the members of SHGs. The need for development intervention for the poor would not be met unless access is provided to some type of insurance against loss of life or property. Looking still ahead, one can perhaps say that there is a case for going beyond micro finance itself. This will mean provision of comprehensive livelihood support to the poor not only through financial services but also institutional development services, infrastructure development and other facilities, such as, health and nutrition, education, etc. There is also a need for much better convergence of various programmes of the government agencies and the non-government sector to bring about the necessary synergy in the development process.

In conclusion, I would like to assure that we are committed to the philosophy of financial inclusion of the poor and the disadvantaged. In the fast changing socio-economic scenario, care is being taken to shape policies and select options based on continuous learning and feedback in this vital area. With convergence of the approaches and appreciation of the issues among all the stakeholders, one can be confident of a bright future for the micro finance sector in India.

