Micro Finance in Sustainable Development: A Descriptive Study on Indian Experience

Ananda. S.
College of Applied Science, Stanate of Oman
Email: anand_su66@gmail.com

Abstract

Micro-Finance in India is emerging as an effective instrument for poverty alleviation, women empowerment and sustainable development. In India, Non-Governmental Organization (NGO) led micro credit is proved as an effective and financially viable alternative to address rural poverty through the provision of credit without collateral, unleashing human creativity and endeavor of the poor people. Micro finance institutions are operating through banks linkage program aimed at providing a cost effective mechanism for providing financial services to the 'unreached poor'. Banks lend micro-credit through Self-Help Groups (SHGs) and to local Micro-Finance Institutions (MFIs) based on the philosophy of peer pressure and group savings as collateral substitute. In India, the micro-Finance concept has been successful in not only designing financial products meeting needs of the rural poor, but also in strengthening collective self-help capacities of the poor at the local level, leading to their empowerment. At macro level, the self help group is a useful instrument for savings mobilization and enhancing access to credit for the rural, unreached poor for their productive investment. In this paper an attempt has been made to describe how micro credit is effective and financial viable method of addressing sustainable rural development through provision of micro credit to rural poor for productive activities.

Keywords: Empowerment, micro finance, micro credit, poverty alleviation, self help group, sustainable development

JEL Classification: A053, G21

1. Introduction

Microfinance as a concept has exploded around three decades ago to support financial services for the previously marginalized. The microfinance progamme was first initiated in the year 1976 in Bangladesh with promise of providing credit to the poor without collateral, alleviating poverty and unleashing human creativity and endeavor of the poor people. Microfinance has also been taken as one of the important tools for development and poverty alleviation in India. As the distribution of land in India remains skewed, the majority of the rural population is left with an inadequate resource base for production. Micro-credit has been claimed to be a solution to most of the problems that originated out of the state's efforts to alleviate poverty using the instrument of credit. In the beginning, the micro finance sector was led by local NGOs. But of late, this sector is sponsored by government, often in collaboration with foreign government, international NGOs and donors. The NGO led micro-credit is proved as an effective and financially viable alternative in India to address rural poverty through the provision of credit and empowerment of especially women in rural part of India.

The paper provides an overview of the microfinance market space in India and the issues in development policy with special reference to rural India. This paper explains about the development that encourages productive or entrepreneurial activity for the poor through access to a micro credit. In this paper an attempt has been made to describe how micro credit is effective and financial viable method of addressing sustainable rural development through provision of micro credit to rural poor for productive activities.

2. Background

India has one of the largest networks of bank branches in the world, but the hundreds of millions of poor in the country are largely out of it. With more than 65,000 commercial bank branches, around 15,000 branches of regional rural banks and about 120,000 cooperative bank branches, the country is teeming with institutions that should be able to meet the credit needs of the people. In India about 75 million households depend on moneylenders to meet financial needs; almost 90 per cent of people in rural India have no access to insurance; 50 million households are landless and need small credit to start some economic activity. And even families earning INR 4,000-5,000 a month in urban areas spend huge portions of their earnings to service debt.

After the nationalization in 1969, commercial banks in the country took upon themselves a massive task of improving access of the poor to formal credit and accelerate the flow of credit to the rural economy. Their role in poverty alleviation was more appreciated when the Government, as a major paradigm shifts through its special employment generation strategies and productive asset creation programs like Integrated Rural Development Program (IRDP). As a part of this strategy, a multi-agency rural credit delivery structure comprising Commercial Banks, Regional Rural Banks and Cooperative Banks, with a large network of more than 1,53,000 retail credit outlets (one for every 4,100 population) was established across the country. Despite of this, reaching the poorest, whose credit requirements are very small, frequent and unpredictable was found to be difficult. Further, the emphasis was on providing credit rather than financial products and services, including savings, insurance, etc to the poor to meet their simple requirements. The mismatch in perception regarding how the poor actually use and value financial services of those who demanded and supplied financial services, even resulted in some undesirable adverse impression in the minds of service providers regarding the credit worthiness of the poor. Further, the systems and procedures of banking institutions with emphasis on complicated qualifying requirements, tangible collateral, margin also resulted in a large section of the rural poor shying away from the formal banking sector. It was not possible for prudent banking to allow a population of close to 300 million even if poor to remain outside the fold of its business. The search for an alternative mechanism for catering to the financial service needs of the poor was thus becoming imperative.

But out of necessity and enterprise, those locked out of the banking world have found a way out. It is called micro credit, the extension of small loans to individuals who are too poor to qualify for traditional bank loans, as they have no assets to be offered as guarantee. In India, micro credit has worked largely through self-help groups. Predominated by women, these are formed with simple rules - save, accumulate and give loans to each other. Globally, it is proving one of the most effective strategies to neutralize poverty. Micro credit lending institutions are currently estimated to reach some two million households in India.

3. Poverty trend

According to the estimates of Rural Poverty Report 2001, globally about 1.2 billion people live in extreme poverty (defined as subsisting on less than one dollar a day) of which 44 per cent are in South Asia; 75 per cent live in rural areas. By the World Bank poverty line of $1.25 (INR 56.13) per day, the estimated number of poor in India in 2004-05 was 456 million, 41.6 per cent of the population. Using the $1.35 per day Asian poverty line of ADB, the number of poor in India is 622 million, which is 54.8 per cent of the population. The third estimate is official poverty estimate by the Planning Commission, Government of India for 2004-05, which is 27.5 per cent of the population, or 301 million. A more recent estimate showed that a poverty level in India is around 26 per cent in the year 2007.

About 260 million people in India are under below poverty line. With low per capita income, heavy population pressure, prevalence of massive unemployment and underemployment, low rate of capital formation, misdistribution of wealth and assets, prevalence of low technology and poor economics organization and instability of output of agriculture production and related sectors have posed major challenges for the rapid growth of Indian economy. Today India is facing major problem in reducing poverty.

India falls under low income class according to World Bank. It is second populated country in the world and around 70 per cent of its population lives in rural area. 60 per cent of people depend on agriculture, as a result there is chronic underemployment and per capita income is only USD 3262. This is not enough to provide food to more than one individual. The obvious result is abject poverty, low rate of education, low sex ratio and exploitation. The major factor account for high incidence of rural poverty is the low asset base. According to Reserve Bank of India, about 51 per cent of people possess only 10 per cent of the total asset of India. This has resulted low production capacity both in agriculture (which contribute around 22 to 25 per cent of GDP) and manufacturing sector. Rural people have very low access to institutionalized credit from commercial bank. It is estimated that worldwide it would require US $21.6 billion to provide micro finance to 100 million of the world's poorest families.

4. Micro finance concept and operational mechanism

The micro-finance scene in India is dominated by SHGs through Banks linkage program with an attempt to build financial relationship between informal groups of people and formal agencies like banks for catering to the financial service requirements of the poor, especially women. SHG-Bank linkage model has emerged in India as a core strategy for the banking system to extend their outreach to the poorest among poor. The SHG – Bank Linkage Programme started as a partnership model between three agencies, viz, the SHGs, banks and NGOs.

- SHGs were to facilitate collective decision making by the poor and provide doorstep banking

- Banks as wholesalers of credit, were to provide the resources and

- NGOs were to act as agencies to organize the poor, build their capacities and facilitate the process of empowering them.

Intervening to forge a linkage, National Bank for Agriculture and Rural Development (NABARD) was instrumental in the emergence of a very strong microfinance movement in the country. The linkage program combines the flexibility, sensitivity and responsiveness of the informal credit system with the technical, administrative capabilities and financial resources of the formal financial sector. It is a design relying heavily on collective strength of the poor, closeness of NGOs to people and large financial resources of banks. Further, the SHGs have also undertaken effective social mobilization functions contributing to an overall empowerment process. The banks have externalized what would otherwise have been high transaction costs for mobilizing savings of the poor, appraisal and sanction of loans and improved loan recovery through the financial intermediate role played by SHGs.

A significant feature of the micro-finance movement in India is that it has relied heavily on the existing banking infrastructure, in the process obviating the need for a new institutional set-up. Most of the leading practitioners of micro-finance activities follow the Grameen model: group solidarity to manage risk and train recipients, repayment at regular meetings, and flexible repayment schedules. Banks lend micro-credit through self-help groups (SHGs) and to local micro-finance institutions (MFIs) that have contacts in small villages. The benchmark model for many NGO sponsored micro credit programme is Grameen Bank which:

a. Lends only to the very poor (mostly women)

b. Deals with creditors in groups

c. Required creditors to deposit savings in the bank

d. Uses the peer pressure of the group to ensure loan and repayment, and

e. Requires good credit standing to secure subsequent loans.

The SHG model is the most prominent in India. It has some similarities with the village bank model, but is less structured. SHGs have around 20 members. They are based primarily on the principle of lending their members' savings, but also seek external funding to augment these resources. The SHGs themselves determine the terms and conditions of loans to members. A number of NGOs specialize in promoting and motivating SHGs, but the goal is for SHGs to become autonomous institutions. Some NGOs operate as financial intermediaries, while others confine themselves to social intermediation, seeking to link SHGs to regulated banks or other funding agencies. The SHG model is well suited to combining microfinance with other interventions in areas such as health and education, but the relatively loose structure makes it harder to increase outreach quickly and to maintain high standards of performance. Microfinance is firmly established as a cost-effective approach for poverty reduction. Because microfinance builds on self-help principles as well as on social capital foundations, it is proving to be sustainable as well.

5. Group loan model

The group lending is the preferred model of micro credit in India. The primary reason is that those taking micro-credit loans are unable to offer collateral and, hence, the group mechanism is viewed as a substitute for the collateral. The groups themselves vary in the level of formalization of the joint liability concept. In some cases, while the joint liability of the loans is documented, in others it is more implicit. In India, there are primarily two group loan models - the Grameen Bank type and the SHG model. The former originated in Bangladesh, while the latter, a model that originated in India, is an independent unit of 10-20 members. The main concern of any lender when lending without collateral is that of repayment. The commonly stated advantages of group lending are that the problems of adverse selection (selecting risky borrowers), moral hazard (inability to monitor) and enforcement (in case of default) are addressed by the group mechanism. The issue of adverse selection is addressed by the fact that groups are formed by self-selection. The information asymmetry that banks face with regard to micro-finance borrowers is addressed, as the screening is not done by the banks, but by those who know more about the individual and the group members. The problem of moral hazard is addressed by the fact that individuals who are part of the same group monitor each other on a continuous basis, not formally but by various informal means. Enforcement is again ensured by the joint liability nature of the loan, which results in social pressure on the defaulting borrower (sometimes referred to as social collateral).

6. Micro credit risk management

One of the important ways of reducing micro credit risk in the absence of collateral is to insist that borrowers demonstrate habitual savings for a certain period before a loan is sanctioned. The SHG-Bank Linkage model, India's homegrown micro-finance model, uses this technique in conjunction with group lending. Other means to incentivize repayment is to give dynamic incentives in the form of progressive lending (loan sizes get bigger with each repeat loan) and disincentives in the form of credit denial in case of default. However, the latter would be difficult to enforce in an environment where there is competition among lenders. Some lenders have repayments in groups so that non-payment becomes public knowledge even when there may not be joint liability. Interestingly, the Micro Finance Institutions' recovery rate is high at 99.5 per cent. Banks should have some kind of understanding to increase rural financing through micro-finance institutions.

7. Role of micro finance

The role micro finance in poverty alleviation and empowerment of the weaker sections has gained recognition in many developing countries and even in a few developed ones. Today, it is active in more than 100 countries and is said to have helped more than 100 million people take their steps to reduce poverty. Micro finance is an effective lending mechanism to the very poor as such investments.

- Promote the free market, lessening the influence of centrally planned economies

- Bypass the corruption and inefficiency of governments when credit is channeled through NGOs

- Promote democracy and a strong middle class

- Reduce dependency of poor people

- Safe and cost effective

Microfinance is the supply of loans, savings, and other basic financial services to the poor. People living in poverty, like everyone else, need a diverse range of financial instruments to run their businesses, build assets, stabilize consumption, and shield themselves against risks. Financial services needed by the poor include working capital loans, consumer credit, and savings, pensions, insurance, and money transfer services.

Micro finance enjoys broad acceptance, support from large and influential institutions and a potentially important role in deepening the formal sectors in Indian economy. In short, Micro finance complements bottom-up development now in vogue. Sound bottom-up development policy requires a long-term increase in human capabilities. People need education. Businesses need infrastructure, a regulatory environment, a financial sector that can meet the needs of the smallest and the largest players in the market. Ultimately, development must be sustainable on a national scale. Programms undertaken at the village level are important, especially in a bottom-up development model.

8. Achievements

The SHG - Bank Linkage programme has come a long way from the pilot stage of financing 500 SHGs promoted by NGOs in the mid-1980s across the country. In India, the micro-finance sector has grown to over 2.9 million SHGs. Of the total SHGs formed more than 1.6 million have been linked with 35,294 bank branches of 560 banks in 563 districts across 30 States of the Indian Union. Cumulatively, they have so far accessed credit of INR 6.86 billion. About 24 million poor households have gained access to the formal banking system through the programme. The SHG-bank linkage programme of NABARD accelerated the growth of the sector. The Government of India and Reserve Bank of India have laid greater focus on the micro-finance sector to increase the access of the poor to financial services.

As per the estimates of World Bank, there are about 7000 MFIs are operating around the developing world of which around 1600 are in India. Out of these, 720 are involved in NABARD's NGO-SHG-Bank Linkage Programme, 20 are partners of Grameen Trusts, and there are 860 Mutually Aided

Table 1: Status of micro credit in India

Year	Cum. disbursement of micro-credit through SHG linkages mainly with NABARD refinance	Micro credit extended by MFIs funded by RMK, SIDBI, HDFC and directly by SEWA, BASIX.CDF-MACTs and MACT
1992: NABARD linkage project	Nil	Rs 100 million, 50,000 borrowers
2000	Rs 1500 million 150000 SHGs 2.25 million members	Rs 2000 million, 500000 borrowers
2008: Terminal year of NABARD Project	Rs 50000 million 1 million SHGs 15 million members	Rs 5000 million, 2 million borrowers

Source: NABARD Annual Report 2009

Cooperative Societies, 3 Non Banking Finance Companies.

The present status of microfinance in India is presented in Table 1.

As stated earlier, 75 million households are requiring micro finance; 60 million in rural India and 15 million urban households. The annual credit usage can be put around Rs 500,000 million assuming INR 6,000 as average rural and INR 9,000 as average urban household usage.

The Women's Self Help Group movement in India is bringing about a profound transformation in rural areas, the government wants to strengthen them by enrolling at least 50 per cent of all rural women in India as members of SHGs over the next five years and link these SHGs to banks. There are over 2.2 million such groups linked with banks now.

A recent microfinance impact studies conducted by NABARD in India (2005) have revealed the following facts:

- Microfinance helps poor households meet basic needs and protects them against risks.

-The use of financial services by low-income households leads to improvements in household economic welfare and enterprise stability and growth.

- By supporting women's economic participation, microfinance empowers women, thereby promoting gender-equity and improving household well being.

- The level of impact relates to the length of time clients have had access to financial services.

Another study on 'Is the rural household any better off, by gaining access to micro finance?' conducted by NABARD (2005), which covered 560 SHG member households from 223 SHGs, spread over 11 states showed the following positive results:

- Average value of assets increased by 72 per cent, from INR 6,843 to INR 11,793.

- Average annual savings per household registered over threefold increase from INR 460 to INR 1444.

- The average borrowing per year per household increased from INR 4,282 to INR 8,341. Nearly 70 per cent of loans taken were used for income-generating activities.

- Average net income increased per household increased by about 33 per cent.

In addition to savings and credit, these systems would offer a wider range of microfinance services including agricultural microfinance, micro insurance and intermediation of remittances.

9. India's experience

In India, economic reforms with a human face have been accepted as the guiding principle of sustainable development. The preferred form of micro-finance loan in India is group lending. According to a study by *Sa-Dhan* (Industry Association of Community Development Finance Institutions in India), only 7 per cent of micro-finance loans in India is to individuals. Many of the large micro finance institutions provide individual loans to clients who have a track record and have improved their economic status; the provision of individual loans to first-time borrowers is not common. India's bank-SHG link programme is now the biggest in the world. The overall review of various macro level project studies conducted by NABARD and other agencies has revealed the fact that microfinance has been performed as a powerful instrument initiating a cyclical process of growth and development in India. The major findings are:

- Microfinance activity improved access of rural poor to financial services, both savings and credit. Increased access signifies overcoming isolation of rural women in terms of their access to financial services and denial of credit due to absence of collateral.

- Microfinance has reduced the incidence of poverty through increase in income, enabled the poor to build assets and thereby reduce their vulnerability. Microcredit programs stimulate savings among poor people.

- It has enabled households that have access to it to spend more on education than non-client households. Families participating in the programme have reported better school attendance and lower dropout rates.

- It has empowered women by enhancing their contribution to household income, increasing the value of their assets and generally by giving them better control over decisions that affect their lives.

- In certain areas it has reduced child mortality, improved maternal health and the ability of the poor to combat disease through better nutrition, housing and health - especially among women and children.

- Helped in strengthening poor families' resistance to external shocks and reducing dependence on moneylenders.

- Improved the living standard of rural poor by providing support for their consumption needs.

- The predominance of borrowing for crop cultivation reflects support for meeting working capital needs. Microcredit programs help borrowers work their way out of poverty.

- It has offered space for different stakeholders to innovate, learn and replicate. As a result, some NGOs have added micro-insurance products to their portfolios, a couple of federations have experimented with undertaking livelihood activities and grain banks have been successfully built into the SHG model in the eastern region. Microcredit programs become vehicles for a variety of desirable social developments.

Some of the leading commercial banks, such as ICICI Bank, HDFC Bank, Axis Bank and the State Bank of India, have begun focusing on this sector aggressively. Even some of the multinational banks operating in India, such as ABN Amro, Standard Chartered, HSBC and Citibank, have moved into the sector. There is a growing realization among commercial banks that micro-finance is a bankable proposition. The award of the Peace Nobel to Prof Yunus and Grameen Bank is expected to provide a big boost to micro-finance activities in India. ICICI Bank an active and innovative player in the micro-finance segment has intended to thrust on the micro-finance area to address rural India's poverty issues. The bank intends to provide loans to the extent of $10 billion by the year 2010. The bank also started Grameen Capital India jointly with Grameen Foundation US and ITCOT Consulting.

10. Growing recognition

In a country with significant sections of unbanked population and regions, financial inclusion is vital for sustaining long term equitable development. In this direction, the government has further relaxed the rules for opening small and rural banking facilities by Scheduled Commercial Banks. As part of the financial inclusion drive, scheduled commercial banks have been opening 'no frills' accounts either with 'nil' or very low minimum balances. These banks have opened 30.3 million such accounts so far. The Reserve bank of India has announced a further relaxation in this direction by allowing the scheduled commercial banks to set up off-site ATMs without prior approval, subject to reporting.

The banks who used to see the poor women rural as well as urban as unworthy of credit, and is only slowly awakening to the possibilities. The SEWA Bank at Ahmedabad in India which mainly has self employed street vendors as account holders. The bank has started as the women demanded it. They wanted a place to put their savings. The banking sector earlier never respected self-employed women. Today, the SEWA bank in Ahmedabad is a model for others to replicate. It has deposits of over INR 1 billion got from nearly 250,000 women. It is the biggest poor women's bank in the world.

It has been increasingly recognized that women are better managers of credit as women have plans for themselves, for their children, about their home, the meals. The important point is that SHGs enabled the rural poor women even to save small amounts regularly and as a matter of discipline. In the absence of the SHG mechanism, it would have not been possible for the rural women to make deposits of a small amount of INR 30 per month in a Bank. Even for the banks, it would not have been viable to transact such small amount deposits. Not only was the saving regular, the SHGs had managed even to increase their monthly savings. This can be viewed as an indicator of continued mutual trust among members and increasing desire to save. Moreover, the pooled savings were managed very well by the SHG members, initially for internal lending among themselves and later, to establish a credit linkage with banks and avail larger group loan.

The size of loan accounts is very small as nearly about 91 per cent loan accounts were in the size class below INR. 3000. (60 US$). Even in the case of amount of loan taken, nearly 64 per cent of the loans were below INR 3000 indicating preponderance of small loans. Catering to such ‘small’ demand has been virtually impossible for the formal banking system in the past, mainly due to the high transaction and process costs involved.

The performance of organizations like SEWA in Western India and SHARE and BASIX in Southern India has convinced that microfinance can indeed make a difference in India as well. Over the past decade, NABARD’s “SHG-Bank Linkage Program” aimed at connecting self-help groups of poor people with banks, has, in fact, created the largest microfinance network in the world. The central government has recognized the advantages of group lending and has adopted the approach in its battle against poverty.

Government of India has passed a legislation to regulate the micro finance institutions. The legislation focused on developing and nurturing the micro finance movement in India. If things go well, micro finance will soon replace the informal channels of credit borrowing and lending in rural India. The legislation also brings hope for a regulatory body for the sector.

11. Major criticism

Despite the progress made by the microfinance movement in India over the past three decades, it must be admitted that, at the macro level, the sector has not been able to make much of an impact. The total micro-credit disbursed to poor families amounted to just about INR 70 billion by March 2005.

The average loan amount per beneficiary works out to just about INR 2,000 which is too small to enable the poor families to cross the threshold of poverty. To start even a tiny enterprise that could generate some regular income, the amount of micro-credit should be at least INR 20,000-25,000.

Though no precise figures are available, the total demand for micro-credit in India is estimated at INR 2000 billion. Against this, the actual disbursal of about INR 70 billion can hardly be expected to make any dent in the poverty situation. The coverage of the sector also a remains limited; over 60 per cent of the sector is concentrated in Andhra Pradesh, Tamil Nadu, Karnataka and Kerala states. Extension of coverage is constrained by poor rural infrastructure and the lack of marketing support.

Commercialization of micro finance is the latest development in the Indian economy. Critics have also pointed out that quite a few MFIs have been charging relatively higher interest rates on the loans given to poor families. This is perceived by many as exploitative and against the spirit of micro-credit. Since most MFIs deliver their services at the doorstep of villagers rather than requiring the clients to come to bank branches, and have lower business volumes, their transaction costs are much higher than those of the formal banking channels.

12. Major challenges

Nearly 7.5 million poor households in India desperately want access to financial services to meet immediate needs. Almost 36 per cent of the country's rural households have to look for credit outside the formal sector. A World Bank study of over 6000 families in Andhra Pradesh and Uttar Pradesh, two of India's largest states, shows that 87 per cent of them have no access to credit, 85 per cent had no access to insurance and 56 per cent borrow from moneylenders. The poor need banking services more than credit, as they need to safely secure their little savings or remittances coming from their men folk who migrated in search of work.

Evidently, the challenges facing the sector are quite formidable. Despite the progress made by the micro-finance sector in recent years, the market penetration of service providers is still low. There is a skewed distribution of SHGs across States; in those which have a larger share of the poor, the coverage is comparatively low and, in many cases, quite insignificant.

The present form is not in a position to address the livelihood problems of the poor. Hence, there is a need to broaden the paradigm from micro-credit to `livelihood finance' by extending the services to include savings, insurance cover, nutrition, health, education, and vocational training. This will require more funds and, may be, some public subsidies.

According to the World Bank, for successful provision of micro-finance in India, it would be necessary to focus on improving governance, professionalizing management and improving internal transparency. It would also be necessary to expand beyond credit to meet the diverse needs of borrowers, and improving the financial infrastructure to scale up.

13. Outreach and sustainability

Microfinance sector has witnessed a burgeoning outreach under MFI model in recent days. Though the repayment rate for the MFIs is greater than 95 percent, yet outreach and sustainability are two critical issues within the microfinance sector. In India, an estimated about 500 NGOs are engaged in microfinance but total outreach is estimated at fewer than 1.5 million households, which is very small in relation to the number of poor households in the country. While some NGOs emphasize sustainability, in many cases interest margins are too low for this to be achieved and the institutions remain heavily dependent on donor assistance. There has been large-scale delivery of subsidized credit, intended for poor households, by the government directly and through government-owned banks.

MFIs are subsidized in different ways and hence, the sustainability of the programs poses a big question. Even though MFIs have experienced a high repayment rate, but still depend on subsidies due to higher value towards social sector.

The other reason for continued dependence on subsidies is an unwillingness to charge the legally allowable interest rates that covers as much expense and risk cost as possible from operations. Subsidy is a crucial issue which is viewed as imperative as well as constraint in attaining sustainability of MFIs.

Despite the rapid growth of MFIs in recent years, their outreach remains very small compared with the potential demand. The Consultative Group to Assist the Poorest suggests that they reach fewer than 2 percent of micro entrepreneurs. About 95 percent of households in India still have little access to institutional financial services. MFIs have concentrated mostly on providing credit facilities. Savings mobilization and other financial services such as insurance and money transfers have yet to receive adequate attention. Hence, the potential demand for microfinance remains very large. The microfinance sector taken as a whole has considerable outreach; there are still many poor and low income households that do not have access to financial services. Nevertheless, outreach remains low compared with potential demand.

Increasing client outreach provides economies of scale that in turn makes the MFI operationally more efficient and sustainable. But, reaching clients in remote areas for MFIs is relatively expensive. This is the real outreach challenge for MFIs because it requires innovative viable business models and processes, including technological innovation. Substantial continuing resources are required to provide institutional microfinance services to the potential clients who are currently outside formal finance in India. Efficient institutional and market mechanisms are needed whereby funds can be sourced and allocated efficiently through appropriately designed and priced services to the poor for profitable investment in MFIs.

14. Future outlook

There is a need to provide other financial services similarly built around small amounts of money, such as micro insurance. There is tremendous scope to design well-adapted insurance products for the poor in the insurance sector as well; this will reduce their vulnerability to environmental influences - weather and pests - as well as diminish the risk should they - or their livestock - become ill unexpectedly. Such additional products will expand the micro finance platform, and even encourage more new directions. Credit schemes specifically tailored for urban areas can also help; urban micro finance, unlike its rural counterpart, has not mushroomed despite the rising numbers of urban poor.

The potential of micro credit to tackle poverty should not blind us to the fact that lending to the poor has to be regulated just like other lending, perhaps even more carefully considering their already weak economic standing. As the movement spreads and grows, it will be apt to have a regulator in place. With such large amounts and widespread participation come inevitable government responsibilities to check unethical practices. There is a need of some ground rules. The movement must not be allowed to degenerate as it expands. But many others are wary of regulation, and remind us that micro finance must be allowed to blossom without any interference that could choke off its potential. The greatest challenge is to keep politicians out of the way as the movement grows, as they will just see it as a way to distribute money and not empower people.

Assuming the entire poor population of India is potential microfinance clientele, the market size for microfinance in India is in the range of 58 to 77 million clients. This translates to an annual credit demand of USD 5.7 to 19.1 billion (INR 230 to 773 billion) assuming loan sizes between USD100 and 250. If we assume that the low-income but economically active population including small and marginal farmers, landless agricultural laborers, and micro-entrepreneurs, are also potential microfinance clients, the annual credit demand goes further up to an estimated 245.7 million individuals and USD 51.4 billion (INR 2.1 trillion) in annual on-lending requirements. Considering the increased competition in the field of micro-credit in India and the pressure to reduce interest rates, it is time for Indian micro-finance practitioners to seriously consider moving beyond group lending. One approach is to take non-traditional collateral. For example, the lender may accept the borrower's degree certificate, driver's license, marriage certificate and such other documents as collateral. The logic being that what matters most is the value the borrower attaches to losing the item than what the lender expects to recover from selling them.

15. Conclusion

No doubt, Micro Finance is a concept that has gained widespread acceptance by development agencies in India. Micro-credit has assumed a special significance in the context of increased emphasis on poverty alleviation, women empowerment and rural development in India. Micro credit is viewed in India as a powerful method for linking the formal and informal sectors of Indian economies to increase the reach of the formal sector. The concept of microcredit through SHG has increased economic well being of especially the rural poor and women India. The success of micro finance model in India in achieving sustainable development has inspired the governments, banks, voluntary agencies and individuals to strengthen and expand the microfinance sector. In time to come, the microfinance sector is expected to growth further in term of reaching out to more families and would include more services for the poor. To provide an enabling environment for realizing the potential of micro-finance in India, a close scrutiny of issues that are constraining the growth of the sector is required. Further, a strategy needs to be prepared for strong and consistent growth so that a majority of the poor have access to institutional financial services.

The experience of micro finance model in India revealed the fact that the economic benefits derived are particularly sustainable. Saving rates are higher; group-life is more intensive; repayment rates are remarkable; enterprise growth and graduation is stronger; and there are measurable improvements in child nutrition and education, family health, household sanitation and shelter, and general household welfare.

The impact of microfinance has allowed the microfinance institutions to grow, to become financially robust, to mature in terms of governance, ownership and management, and to obtain solid ratings. The challenge now is to develop sustainable microfinance systems, enabled by inclusive rural finance market policies within a sound financial sector policy context. Keeping the poor at center stage, the policies need to be reoriented so as to develop and optimize the potential of such a large segment of the population and enable them to contribute in the growth process significantly in terms of output, income, employment and consumption.

APPENDIX TABLES

Appendix table 1: Geographical distribution of MFIs

Region	Number of MFIs	%
Asia-Pacific	1,652*	48%
Sub-Saharan Africa	959*	28%
Latin America & Caribbean	584**	17%
Eastern Europe & Central Asia	196**	6%
Middle East & North Africa	51**	1%
North America & Western Europe	35*	1%
Total	3,477	100%

*Source: * Microcredit Summit Campaign Report 2006. ** Microfinance Information Exchange (MIX) database 2007.*

Appendix table 2: Top ten MFIs by outreach (2006)

Sl. No.	MFI	Country	Number of active borrowers
1	Grameen Bank	Bangladesh	6,908,704
2	ASA	Bangladesh	5,163,279
3	VBSP	Vietnam	4,695,986
4	BRAC	Bangladesh	4,550,855
5	BRI	Indonesia	3,455,894
6	Spandana	India	972,212
7	SHARE	India	826,517
8	Caja Popular Mexicana	Mexico	643,659
9	Compartamos	Mexico	616,528
10	BANTRA	Peru	563,805

Source: MIX Market

Appendix table 3: Status of micro credit in India

Growth of Indian Microfinance Sector						
Year ending March 31st	2004	2005	2006	2007	2008	2009
Outstanding Portfolio ($ millions)	$80	$252	$496	$824	$1,535	$2,346
Growth Rate		215.00%	96.80%	66.10%	86.30%	52.80%
Borrowers (million)	1	2.3	4.9	7.9	14.2	22.6
Growth Rate		130.00%	113.00%	61.20%	79.80%	59.20%

Source: Microfinance India, State of Sector Report 2009

ANNEXURE

Annexure 1

No. Of Farmer Households (HH) in Lakh									
Region	**Total HHs**	**Indebted HHs**	**% to total HHs**	**Non Indebted HHs**	**% to total**	**Indebted to formal sources**	**% to total HHs**	**Excluded by formal sources**	**% to total HHs**
Northern	109	56.26	51.4	53.2	48.6	27.423	25.05	82.04	74.95
North Eastern	35.4	7.04	19.9	28.36	80.1	1.448	4.09	33.95	95.91
Eastern	211	84.22	40	126.39	60	39.467	18.74	171.14	81.26
Central	271	113	41.6	158.29	58.4	60.814	22.41	210.52	77.59
Western	104	55.74	53.7	47.92	46.3	45.586	43.98	58.07	56.02
Southern	162	117.5	72.7	44.11	27.3	69.072	42.75	92.49	57.25
Group of UTs	1.48	0.49	33.1	0.99	66.9	0.15	10.14	1.33	89.86
All India	894	434.2	48.6	459.26	51.4	243.96	27.3	649.54	72.7
NE, C & E Regions *	517	204.3	39.49	313.04	60.51	101.73	19.66	415.61	80.34
Share to All- India (%)	57.9	47.05		68.16		41.7		63.99	
* NE = North Eastern Region, C = Central Region, E = Eastern Region									

Source: Microfinance India, State of Sector Report 2009

Annexure 2

Categories of Providers	Legal Framework governing their activities
(a) Domestic Commercial Banks, Public Sector Banks, Private Sector Banks & Local Area Banks	(i) RBI Act 1934
	(ii) BR Act 1949
	(iii) SBI Act
	(iv) SBI Subsidiaries Act
	(v) Acquisition & Transfer of Undertakings Act 1970 & 1980
(b) Regional Rural Banks (RRB's)	(i) RRB Act 1976
	(ii) RBI Act 1934
	(iii)BR Act 1949
(c) Co-operative Banks	(i) Co-operative Societies Act
	(ii) BR Act 1949 (AACS)
	(iii) RBI Act 1934 (for sch. Banks)
(d) Co-operative Societies	(i) State legislation like MACS
(e) Registered NBFC's	(i) RBI Act 1934
	(ii) Companies Act 1956
(f) Unregistered NBFC's	(i) NBFC's carrying on the business of a FU prior to coming into force of RBI Amendment Act 1997 whose application for CoR has not yet been rejected by the Bank
	(ii) Sec. 25 of Companies Act 1956
(g) Other providers like Societies, Trusts, etc.	(i) Societies Registration Act, 1860
	(ii) Indian Trusts Act
	(iii) Chapter IIIC of RBI Act, 1934
	(iv) State Moneylenders Act

Source: Micro Credit in India: Overview of regulatory scenario by Vinod Kothari and Neha Gupta

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