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**for**

**discussion in the NAC and do not, in all cases,**

**reflect settled conclusions of the NAC**

# Presentation in the NAC on Microfinance in

## India

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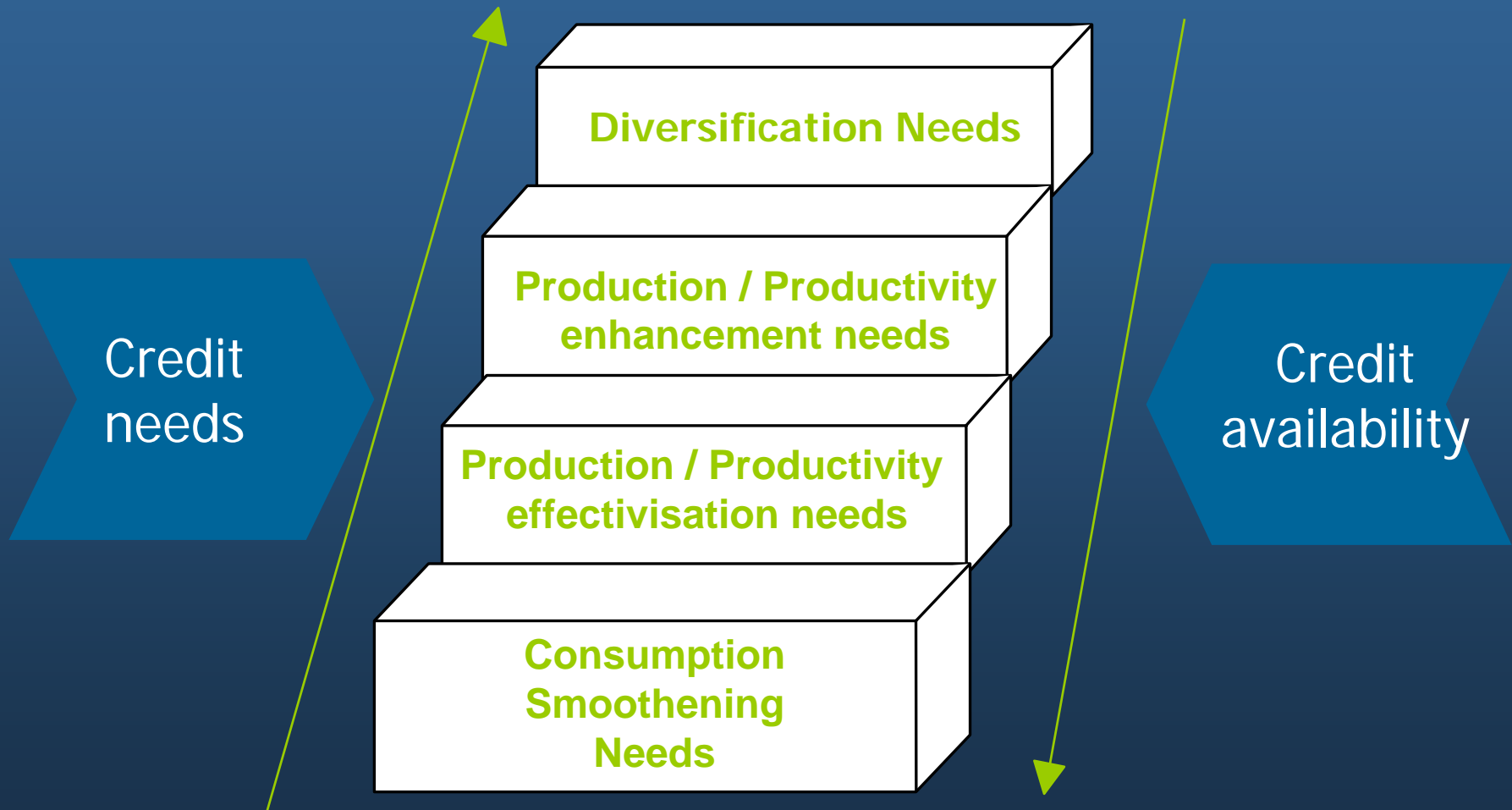
# Understanding Microfinance

**Microfinance means many things - but the contours may be:**

- Piloted by the alternate sector (NGO-MFIs)
- Focused on the poor / women / vulnerable groups
- Having roots in development

(Therefore microfinance statistics and literature usually exclude direct small loans by commercial banks and RRBs)

# Hierarchy of Credit Needs and Availability from Formal Sources



# Access to Finance: Major milestones

1969	Nationalization of Banks
1971	Establishment of Priority Sector lending norms
1975	Establishment of Regional Rural Banks
1982	Establishment of NABARD
1992	Launching of the SHG - Bank Linkage programme
1993	Establishment of Rashtriya Mahila Kosh
1998	NABARD sets a goal for linking one million SHGs by 2008
2000	Establishment of SIDBI Foundation for Microcredit
2005	MFDEF doubled to Rs 200 crores
2005	One million SHG linkage target achieved 3 years ahead of date
2006	Committee on Financial Inclusion
2007	Proposed bill on microfinance regulation introduced in parliament

# Role of formal institutions in rural banking: Commercial Banks

- Improvement in priority sector lending - but growth seen in “other” priority sectors, marginal growth in agriculture
- Targets set for weaker sections [mainstream microfinance] not achieved by a small margin in public sector banks The achievements of private sector banks nowhere near targets
- NPAs in priority sector at 20%, while overall NPAs around 12%

# Role of formal institutions in rural banking: Regional Rural Banks

- Turnaround in overall performance
- Consolidation [From 196 to 96] has brought in size
- Low deployment of credit - CD Ratio of 55.7% [as against the commercial bank CD Ratio of 66% (utilization March 2005) and 72.5% (sanction March 2006)]
- NPAs improving – but still worse off than commercial banks
- Growth of deposits faster than loans - possibly providing useful financial services to the poor - an outlet for their savings
- High growth rate SHG-bank linkage in recent years

# Role of formal institutions in rural banking: Cooperatives

- Generally in an extended state of sickness
- plagued by political interference
- weak HR capacities
- delivery network through Primary Agricultural Cooperative Societies (over 90,000)
- Vaidyanathan committee may infuse some life into the cooperative sector

# Microfinance-What does it do in this big picture

- At base level the main issue from the client's view point is access
- Transaction size and costs are issues from the provider's view point
- Microfinance institutions try to address this issue by building intermediary cost effective buffers

# How?

- The buffers provide social collaterals
  - SHG, JLG, Group guarantees
- Trust is used as an effective tool
  - Does it always work?
- This should make both the lenders and borrowers happy

# Institutional Forms delivering microfinance

The legal forms of microfinance institutions are

- ❑ Banks
- ❑ Financial Corporations - Specialized entities focusing on specific segments like SC/ST, Minorities
- ❑ NBFCs - Commercial MFIs ( SKS, Spandana, SHARE, SNF, Basix) - regulated by the RBI
- ❑ Societies and Trusts (NGO-MFIs / SHPIs) and Section 25 companies
- ❑ Mutually Aided Credit Society (MACS) - community owned & managed operations - popular in Andhra Pradesh

# The Complex Microfinance World

**Overall objectives of the NGO include:**  
welfare / social activities, economic activities

Spin-off:  
MYRADA -  
Sanghamitra

Overall objectives of the MFO is predominantly economic activity. Example: SIFFS (economic activities for fisherfolk, microfinance services are also provided)

Spin-off:  
SEWA: Sewa  
Bank

**Exclusive microfinance institutions**  
Commercial Funding for lending operations

Sustainability  
Oriented  
BASIX

Poverty focussed:  
SHARE, CFTS

Developmental funding for capacity  
building, some initial pump priming

Other sources of funding for non  
microfinance economic activities

Other sources of funding for  
welfare activities

# Microfinance: delivery models

## ■ Self Help Groups

- Home grown – co-operative like
- Savings based / savings led
- Meeting diverse needs
- largely promoted by NABARD-Public Sector Banks-Self Help Promoting Institutions (NGOs)
- Performance - mixed

## ■ Grameen

- Regimented
- Loan based
- Focussed on enterprise
- Pace of growth might be a cause for concern

## ■ Individual lending – **BASIX** and **MACS**

# Microfinance: Services

microFinance is much broader than just microcredit - it includes other financial services

- Savings
- Remittances
- Risk mitigation products
- Financial counseling
- Lifecycle planning products

These are specialized activities, it is not easy to offer them to the poor in a cost effective manner

## Advantage: Banks

- Spread of activities
  - Big and small clients allowing scope for cross subsidization
- Portfolio of activities
  - These mitigate risks
- Continuous sources of funding
- An array of “Fee” based activities

## Advantage Non Bank-MFIs

- Donor money for start-up
- Goodwill and social capital
- Ability to understand and respond to the borrower

# Key Challenges

- Moving from Micro-credit to microfinance
- Getting the banks there
  - Involving the commercial banks
  - Reforming the rural banks
  - Awakenning the co-operative structure
- Redefining the role of the State
- Addressing sensitive issues that have political overtones
- Addressing the needs of the missing middle
- Regulation and issues in organic & organised growth
  - Will the proposed bill under consideration facilitate growth ?

## Key challenges

- **Regional Skew:** Three states represent 2/5 of the Sector
- **Policy for urban poor**
- **Quality issues in SHGs**
- **lack of diversity in financial services** - savings, microinsurance, micropensions, remittances, microhousing loans...

## Key Concerns

- Pace of growth of independent MFIs
- Is the policy moving forcing us to look at private sector because bringing the public sector nearer markets is not politically correct?
- Quality issues in SHGs – Use of the channel for other programme delivery – co-operativisation of SHGs
- Venture Capitalists in MF

## Wish List: 10 Point Agenda

- Definition of mF: as understandable in the mainstream lexicon – Small Borrowal Accounts could be a good starting point
- Recognition of mF as a specialised activity like leasing or housing finance and creation of a specialized category of NBFC [Amendment to the RBI Act]
- Easing of entry norms for loans only companies (RBI can do it with a notification)

# Wish List: 10 Point Agenda

- Operationalise the Khan committee recommendations. Supervise Banks and allow banks to find mechanisms of more effective outreach. Allow Banks to take this risk. [Can be done immediately]
- Urgently mandate all banks to carry out product costing exercise - they need to understand if they are losing money doing this business
- Do not change the priority sector mandate. Strictly enforce the “weaker section” target. There is no need to have any other mandates like doubling of credit.. It will naturally grow if the overall balance sheet is growing.

# Wish List: 10 Point Agenda

- MF Institutions can be best regulated on “usurious” interest and ethical practices by unleashing the Banking and co-operative sector to provide effective competition. This can happen when the state does not interfere in the commerce of the individual entities.
  - Loan Waivers are bad commerce
  - Interest rate caps [even informal caps] are bad policy interventions
- Mechanism to graduate to microcredit + services as the entity grows. Allow for limited and laddered provision of services and allow strong companies to morph into banks, without changing any extant regulations for entry norms for a full fledged commercial bank. [RBI will have to push the frontier]

## Wish List: 10 Point Agenda

- Ensure that “commercial activities” like microfinance are carried out in commercial forms of organisations when they reach scale. Trusts/Societies are not designed to do commerce. Companies and co-operatives are. However, allow experimentation – possibly with an upper cap.