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Bottlenecks in the Present Institutional Credit Delivery System with respect to Non-farm Unorganized Sector: Potential Role of Microfinance Institutions

Dr. D K Yadav[1]

Abstract

Unavailability of working capital has been identified as one of the biggest problems faced by non-farm unorganized sector. In spite of consistent effort of government to cater to the credit requirement of this sector, it is still facing huge shortage of institutional credit. This paper is an effort to understand the nature of credit issues faced by the non-farm unorganized sector. It critically analyzes the present institutional structure of credit delivery and its underlying problems. The main cause that has been identified in this paper is the mismatch between demand and supply of product portfolio of traditional institutions (like banks) and it thus recommends the role of Microfinance Institutions (MFIs) for filling the gap. It also assesses the problems in development of MFI sector in India and recommends for separate independent regulatory body to ensure the healthy competition and enabling environment.

1. Introduction

Presently, India is following multi-agency system to extend the credit to non-farm unorganized sector, where SIDBI (Small Industries Development Bank of India) is playing the leading role. In addition to that, the Commercial Banks, Co-operative Banks, Regional Rural Banks (RRBs) and Micro Finance Institutions (MFIs) are other major institutions involved in providing credit to non-farm enterprises. Credit advances to micro, small and medium enterprises are being considered as priority sector lending. Along with SIDBI, role of NABARD as a refinance agency, monitoring

[1] Assistant Professor, Department of Economics, Babasaheb Bhimrao Ambedkar University, Lucknow.

the overall rural credit (farm and non-farm), has increased sharply in the post reform period. NABARD has focused on SHGs (Self Help Groups) as a channel to extend the credit for unorganized non-farm sector. It is noteworthy that in spite of crediting many institutions in non-farm unorganized sector, NABARD's share in the institutional credit is very low and is declining with time, particularly in the post reform period. Share of non-farm unorganized sector in total institutional credit declined from 15% in 1991 to 6% in 2006. Declining share of institutional credit for the non-farm unorganized sector demands a relook into present institutional structure of financial system, more so because of its contribution in Indian economy in terms of employment creation, poverty alleviation and transformation of rural economy. Nearly 20% jobs of unorganized sector in rural areas are contributed by non-farm activities. Looking at the stagnant growth and underproductive employment in agriculture; non-farm unorganized sector is being considered as an alternative and potential sector for gainful employment in rural areas. In this context the relevant questions that arise are given below:

- Why formal financial institutions failed to provide the credit to this sector?
- Was it because of mismatch in demand and supply of product portfolio?
- If yes, what is the structure of demand and what is the structure of supply of product portfolio and how are both different from each other?
- If the above mentioned difference exists, what kind of change and reform should be made to address it? What may be the role of MFIs in this concern?
- What are the special characteristics of MFIs that address the needs of the poor as well as their economic activities?
- What went wrong in the development process of MFI sector in India and how it can be corrected for inclusive and holistic development of the sector?

Rest of the paper is organized into six sections. Second section discusses the present structure of financial institutions and causes of their reluctance to extend the credit to rural non-farm unorganized activities. Characteristics of MFIs and their suitability to micro-enterprises are discussed in the third section. Fourth section presents the experiences of microfinance movement in Bangladesh. Evolution process of MFIs in India is discussed in the fifth section. Sixth section is the analysis of what went wrong in development processes of MFIs in India and lastly the seventh section includes the conclusions and policy prescriptions.

2. The Flow of Credit to Rural Non Farm Sector: An Overview of the 3rd SSI and 68th NSS Survey Reports

As it has been said earlier, India is following multi-agency structure to extend the credit to non-farm sector. Since independence, different kind of experiments through different kind of institutions have been made to increase the credit flow to the non-farm unorganized sector. Initially, co-operative banks were assigned major responsibility to extend the credit to non-farm sector, along with its prime responsibility of financing agriculture and other related primary sector. Primary co-operative banks had started lending to handloom; power looms; village small, micro and tiny enterprises along with similar other kinds of unorganized rural non-farm activities. But this process weakened with deteriorating financial health of co-operative banks, due to government's increasing intervention in their activities and internal decision making. Vested interest of politicians, which was because of channelizing funds of government welfare policies through the co-operative banks, damaged the efficiency and autonomy of co-operative banks. It was reflecting in the form of high NPA of co-operative banks.

It is due to the increasing disappointment with co-operative banks to provide the credit and advances to rural farm and non-farm unorganized sector, that the government tried the commercial banks model to extend the credit to the sector. 14 major commercial banks, in 1969 and 6 more banks in 1980 were nationalised towards this objective. Credit extended for this sector was considered as priority-sector lending and interest rate subsidy was provided on it. Rural penetration of commercial banks in terms of branches increased rapidly, which helped in mobilization of savings and to some extent in meeting the credit requirement of rural unorganized activities, particularly of agriculture. Though, the credit provided for rural non-farm unorganized activities was also considered as priority-sector lending, but very limited and small part of total credit was given by banks to this sector. The third census data of SSI units revealed that only 20.1% of registered and 5.48% of unregistered units had reported outstanding loans and out of that only 14.26% of the units in the registered sector availed the bank finance, while only 3.09% of the unregistered units had access to bank finance. Since most of the unorganized non-farm units are unregistered, it might well be assumed that only 3% to 4% of the unorganized units avail bank finance and the same has been confirmed from the NSS 55th survey data, which shows that a similar percent of un-organized enterprises have access to institutional finance.

Low credit advancement to SSI units is mainly because of wrong policy formulation of priority-sector lending. Under priority-sector lending policy, 40% of Net Bank Credit (NBC) is earmarked for the priority sector, viz., agriculture and small scale industries. Out of 32% allocation by the foreign bank, 10% has been earmarked for the SSI sector. Any shortfall in such lending by the foreign banks has to be deposited by the Small Industries Development Bank of India (SIDBI). However, the domestic bank has been given the liberty in such cases. Unlike foreign banks, there is no such provision of sub-target to SSI sector for the Indian public and private banks. The Indian banks are not required to deposit the shortfall in lending to SSI sector like SIDBI. In case of the Indian banks, 18% is earmarked for agriculture and 10% for weaker sections of the society as sub-targets within priority-sector lending. In order to fulfill the priority-sector target, soft target provision in the form of subscription of the bonds of SFCs, NABARD, National Housing Banks, Rural Electrification Corporation, Housing and Urban Development Corporation etc. have been made, instead of lending to SSI sector by domestic banks. Now even retail credit provided in the form of car loan, housing loan, education loan etc. are being considered as priority-sector lending. Dilution of definition of priority-sector lending is affecting the credit allocated for SSI and other real priority-sectors. Flow of credit from commercial banks to SSI sector has decelerated in the post-reform period. Share of SSI sector in total net bank credit was 15.17% in 1994-95 declined to 6.66% in 2005-06.

Not only do the private or foreign banks ignore the SSI sector, even Public Sector Banks (PSBs) tend to do the same. Credit flow to SSI sector from PSBs has declined from 17.5% (of NBC) as in 1998 to 8.5% in 2006. More alarming problem is declining share of tiny units within the credit allocated for the SSI sector. As per the guideline of RBI, 60% of credit allocated or disbursed for the SSI sector should be given to tiny industries, but commercial banks have never achieved this target and situation worsened with time.

Reasons for Low Credit to SSI Sector

Policy ignorance (both in terms of policy formulation and policy implementation) with respect to SSI sector is the major reason behind the declining share of institutional credit to this sector. In spite of very strategic importance of this sector, the government has given more importance to the agriculture sector in terms of allocating the credit under priority-sector lending policy. In 1969 the share of agriculture and SSI sector were 5.4% and 8.5% respectively. But in subsequent years the comparative position of sectors has changed drastically.

While share of agriculture in NBC increased nearly 3 times from 5.4% to 15.7% in 2005, SSI sector has registered very minimal growth from 8.5% to 9.4%. If we further divide the whole period into sub periods; situation worsened mainly in the post reform period. Up to 1991 both sectors registered growth in their respective shares in total NBC; however the rate of growth for agriculture was greater than the SSI sector. In the post reform period situation became worst. Share of SSI sector which increased from 8.5% to 16.1% in 1991, declined to 9.4% in 2005 and further 8.5% in 2006. Though the share of agriculture remained almost constant with neither decrease nor incremental increase in the post reform period, the shares clearly indicated that under the priority-sector lending policy, the government was more keen to support agriculture with negligence towards the SSI sector.

Second reason for less credit allocation for the SSI sector is its high Non-Performing Assets (NPA) in comparison to other priority and non-priority sectors. NPA of SSI sector in 2001 was 22.4%, which is higher than the 16.9% NPA in Agriculture and 15.3% in large scale industries and non-priority-sector in the same year. However, there is a decline in NPA ratio of each sector but relative position remains unchanged in succeeding years as well. In the year 2004, NPA ratio of SSI sector was almost double (15.1%) to NPA ratios of other sectors (8% for agriculture & 8.3% for large scale industries). Because of high default ratio, commercial banks hesitate to lend to the SSI sector. It is the peak time to understand why the NPA ratio is higher in this sector than other sectors. The National Commission for Enterprises in the Unorganized Sector (NCEUS) set up a Task Force on Access to Finance, Raw Material and Marketing in 2012 which identified some of the important factors behind the high NPA of SSI sector. Their report said, “One of the main factors leading to the high NPAs in the SSI sector is the problem of delayed payments of dues from buyers particularly the large units and public sector undertakings. Another reason is the problem faced in the marketing of the products due to increased competitions - given the high cost and poor quality of goods”. Reasons identified by the task force are related to product quality and payment processes for the sold products. But both the factors are not directly related with credit system, they are external factors and could be solved by appropriate regulatory, marketing and production initiatives. Before zooming into external and advanced staged problems it is important to see whether there is any role of internal and more fundamental factors in increasing the NPA in SSI sector or not?

Institutional structure and governance, lending methodology, product portfolio, credit delivery mechanism and the basic principles of functioning of the Indian banking system, are also some factors that need to be considered and analysed. Traditional banking system believes in typical collateralized commercial and consumer lending. It restricts to individuals and organizations which have physical or non-physical qualitative collaterals to borrow from banks or the qualitative collaterals in terms of efficient organizational structure and future prospectus to satisfy the banks. This is one of the important factors which restricts credit flow towards SSI sector.

Institutional structure and governance of commercial banks working in rural areas is also responsible for low credit flow to SSI sector. Commercial banks follow the centralized top-down management processes. Ground workers, employees and branches have very less liberty to change the rule or processes to meet the credit requirement of borrowers. Rural society which is very heterogeneous in nature, due to socio-cultural & economic factors, does not fit in the set rules of commercial banks for borrowing and other financial services. Decentralization and contextualized formulation of policies is very important for extending credit to the SSI sector.

Commercial banks have very few financial products which are designed according to the needs of rural micro-enterprises. Commercial banks tried to sell the products designed for large scale industries or agriculture to the SSI sector. This further restricts micro-enterprises to purchase these products, and/or return the amount purchased through these products. Small and micro-enterprises need small amount for borrowing, ranging from INR 3000 to 15000 and flexibility in return policies like small, frequent and in short period of time, weekly instalments etc. Most of the branches of commercial banks are concentrated in urban or semi urban localities like Tehsil, Thana (Police Station), Blocks etc. and the opportunity cost of coming to these branches is very high for the people involved in rural micro-enterprises. Financial services should be made available at their door step. It is only possible when bank employees themselves reach villages and the people who are involved in these small venture activities. While real situation is just reverse; banks insist that the people should come to the bank. Reaching to the rural enterprise at their door step is not only important to provide the financial services but also to help them in their non-financial problem, which is equally important. Due to their socio-economic problems, static and underdeveloped business environment and the rural entrepreneurs cannot understand the future prospectus and business viability of activities in which they are involved. Without helping on these aspects, which are non-financial in nature, financial services may not be commercially viable.

Another very important factor related to high NPA, which is also reported by NCEUS task force, is the high cost of credit. Prime interest rate charged by commercial banks to SSI sector is close to 15%, which is just double the interest charged to large scale industries, i.e. 7 to 8%, on the pretext of credit worthiness. If we include the other costs like processing cost and bribes offered to the bank employees and management because of unwelcome attitude from banks, actual cost will be much higher than the prescribed interest rate. This cost differential, ultimately leads to the high cost of SSI products resulting in the increase of NPA for commercial banks.

Factors discussed altogether show western-styled traditional finance approach of commercial banks, which do not fit in the Indian rural society and the micro-enterprises in it. It needs to be shifted towards Asian/Indian approach of trust and confidence.

Census of Small Scale Industries (SSI sector) 2001-02 shows that among 4,445,868 SSI units, 99.5% (4,425, 587) units are tiny units, which require more attention, monitoring and supervision than the large or medium size industries. Ross and Savanti (2005), in their primary survey study of micro enterprises in Tamil Nadu and Uttar Pradesh, found that 69% people involved in traditional micro enterprises were not willing to change the nature of their enterprise even after receiving the training to set up some other enterprise. 31% people, who showed interest to change the economic activity they were involved in, did not have any idea about the kind of training they required. In other words, they demonstrated no business idea or strategy, but desired something other than their current activity. Similar responses were found when they were offered money instead of only trainings. Nearly 43% said they would change activity, while 57% said they would not. Out of those wanting to change their activity, 22% said they had no idea of activity they would move into and 37% said they would move into some form of trading such as grocery, tea, paan or kirana shop. Findings of the survey indicated orthodox approach and low level of awareness and information of the people involved in micro-enterprises in rural areas. In this given situation providing fund alone does not help in the development of micro-enterprise, unless active involvement and interest is shown by financial institutions; which commercial banks are not able and willing to do. Now the question arises as to what may be the probable ways for commercial banks to not only provide credit for micro-enterprises but also take active interest in providing external support services (for eg. training and facilitating them to access market for their products)? Changing scenario, evolving financial market, and experiences of our own and other developing countries provide evidence that Micro-Finance Institutions (MFIs) may do this challenging task and substitute the commercial banks. But the recent happenings, particularly development of Andhra Pradesh (regulatory action to control activities of micro-finance Institutions) and their limited capacity to extend the credit because of infancy phase of development, raise serious doubt about their role as substitute of commercial banks in the rural credit market. Given the penetration and work profile, which is contextualized according to the demands of rural credit market, co-operative banks may substantiate and compensate to the under-developed stage of micro-finance institutions. To understand this further the next section analyses the role of micro-finance institutions in providing credit to the SSI sector.

3. Micro-Finance Institutions (MFIs) and SSI sector

Success of micro-finance institutions in Bangladesh, particularly Muhammad Yunus's Grameen Bank, has attracted worldwide attention as potential mode of poverty reduction and substitute of formal financial institutions viz. commercial banks. Most of the developing countries including India are implementing this model for poverty reduction and employment generation. But experiences and results in terms of above mentioned objectives are varying from country to country. In India, while southern states are doing very well, it is not so good in case of north and north eastern states. Moreover, recent emerging issues like high interest charged by MFIs and limited outreach to very poor and vulnerable sections of society, raise serious doubts about their effectiveness and sustainability. Recently State government of Andhra Pradesh has banned some of the activities of top MFIs working in India, and termed them equal to money lenders who are exploiting the poor people and small farmers. In this context it will be interesting to analyze what are the special characteristics of MFIs which suit the need of poor including the need to sustain and enhance their economic activities. And at last what went wrong in development process of MFIs that they got the image of exploiter rather than institutions for the poor?

3.1 Characteristics of MFIs and their Suitability to Micro-Enterprises

MFIs differ from traditional financial institutions in terms of their lending methodology, client base, administrative cost, portfolio composition, and institutional structure & governance. Actually, the evolution of Micro-finance institutions took place to fill the gap generated by the traditional financial institutions and informal sources of credit. While on one hand, lack of physical collateral restrict the poor from accessing the formal sources of finance, usurious interest rate of informal sources block poor micro-entrepreneur to access credit from informal market. Poor micro-entrepreneur also require broader package of services viz. skill training, technical assistance, and marketing services along with credit, which neither traditional financial institutions are willing to offer nor informal sector is in a position to provide because of their limited capacity. Micro-finance institutions fill these gaps by their special characteristics, which is pro-poor. It is interesting to study how MFIs overcome these problems and fill this gap. MFIs are hybrid of traditional financial institutions and informal lenders. These are more organized structures like formal institutions than informal lenders and more flexible in their operation like informal lenders than formal financial institutions. Unlike commercial banks, MFIs do not believe in physical collateral based lending. In place of physical security, MFIs use social security for lending. They do not lend directly to individuals but group of individuals, which ensure the collective responsibility of group to monitor the fund borrowed from the MFIs and ensure its repayment. Groups have freedom to select their members and decide the rules to disburse the borrowed amount among the members. Next instalment of borrowed fund is issued only in case of repayment of the previous instalment. It generates peer pressure on the member of a group, who has utilized the previous instalment to repay the loan. Group based lending, while reduces the monitoring cost on one hand, it also solves the problem of asymmetric information on the other.

Low potential profitability is another problem which restricts banks to lend poor entrepreneurs. Banks consider them commercially unviable because of high costs, high risk, low income and profit opportunity in micro-enterprises. At the individual level, such borrowers generally do not have steady or adequate income or any asset to seize, and they face great economic and cultural barrier to earn income. MFIs solve this problem by active involvement in micro-enterprises. Providing credit is part of a broader package which includes training & skill development of individuals andtechnological support & marketing of products. It helps poor entrepreneurs in their consistent growth of income and also solves the problems generated by social, economic and cultural constraints. Regular savings is another very important characteristic of group based lending which helps in minimizing and managing the risks involved in lending to rural non-farm sector. The policies related to insurance products and emergency funds also help to overcome the problem of portfolio diversification and risk containment.

Moreover, fundamental philosophy and business approach in which MFIs believe, also helps to overcome the problems linked to the rural non-farm sector. Sound banking principles, basic economic premise, theory of price and poverty are some fundamental business approaches of MFIs. It is believed that timely and hassle free availability of credit is more important for the poor in comparison to credit on subsidized rate of interest; which generates vested interests, lengthy processing and documentation affairs. MFIs provide credit at the door step of poor entrepreneurs in very less time, low documentation and processing cost and at market rate of interest. They intuitively believe that the poor are basically honest in repaying their loans irrespective of collaterals. Among the poor they target the women on the basic premise that women are more responsible than men in making payments. Implicitly they also believe that poor work hard to maximize their income and repay the loan in addition to improving their poverty situation. Over 98% repayment rate in case of Bangladesh's Grameen Banks, which is an MFI, is strong evidence in favour of above arguments.

Fundamental philosophy of MFIs is derived from an old Chinese proverb which states - "To a hungry man don't give your fish, give a fishing rod". They believe that subsidies given in the form of lower prices or income transfers, rarely reduces poverty; rather they sustain and perpetuate it. Instead of augmenting income-generating capacities, subsidies put the recipients on clutches and generate dependency. Number of evidences, both from within the country and outside are available that show that providing fish has not solved the problem of starvation and poverty. MFIs are potential institutions to experiment with this model of development.

4. Experience of Bangladesh's Microfinance Movement

Bangladesh has been considered as a role model for South Asian countries as well as for other developing countries vis-a-vis microfinance activity and its role in poverty alleviation. Muhammad Yunus's Grameen Bank (GB) has been propagated as the best suited model for providing credit to poor and marginalized sections of society. Confirmation of Nobel prize for Grameen Bank and its founder Muhammad Yunus, further recognized their contribution in this area. Looking at Grameen Bank and other MFIs working in Bangladesh together with their policies, procedures and impact on poverty alleviation, may be helpful in designing the policies for the development of the sector in our country.

Empirical studies show that GB has significantly contributed in income enhancement, poverty alleviation and improving the social and economic conditions of the poor in Bangladesh. Impact study done by Tazul Islam shows that income earned by GB members from different economic activities, is significantly higher than by non-members of project village and control villages. Impact on income is more obvious in non-farm activities. Another very important result which the study shows is that GB members have least dependence upon wage labour in comparison to other two groups. Table.1 indicates that non-members of project village and control village are earning more wages than GB members. From this it may be concluded that GB credit is helping its members in becoming self-dependent.

Table.1
Impact on income after joining GB

Income Component	GB Members (Group 1)	Non - participants		Difference	
		Project Villages (Group2)	Control Villages (Group 3)	Group 1 over Group 2	Group 1 over Group 3
1 Agriculture	**11,230**	**10,506**	**13, 469**	**6.9**	**-16.6**
1.1 Crop cultivation	5392	4125	5013	30.7	7.6
1.2 Homestead Garden	1143	756	999	51.2	14.4
1.3 Livestock and fisheries	2083	1683	1700	23.8	18.4
1.4 Agricultural wage labour	2612	3942	5757	-33.8	-54.6
2. Non Agriculture	**26888**	**20262**	**14315**	**32.7**	**87.8**
2.1 Processing & Manufacturing	9453	5936	2988	59.2	216.4
2.2 Trade	7977	5736	3134	39.1	154.5
2.3 Transport	2795	1335	1300	109.4	115.0
2.4 Non Agriculture wage labour	1461	1683	1528	-13.2	-4.4
2.5 Other non-agricultural	5202	5572	5365	-6.6	-3.0
Household income	**38118**	**30768**	**27784**	**23.9**	**37.2**
Per capita income	**6930**	**6032**	**5292**	**14.9**	**30.9**

Source: Household survey of GB Project and control villages (1998) and Tazul Islam (2007)

More clear and strong impact on income from non-farm sector activities is also reflecting as changing occupations of borrowers, from farm to non-farm activities, after joining the Grameen Bank.

It is particularly true in case of female borrowers. Before joining the GB there was 49.4% unemployment in female category which has significantly reduced to 17.0% at the time of survey. Major chunk of this population was employed in processing and manufacturing, trading and shop keeping and other similar non-farm activities.

Table.2
Changes in occupation of borrowers after joining GB, 1998

Principle Occupation	Before joining GB			At the time of survey		
	Male (N =144)	Female (N = 156)	All (N = 300)	Male (N =144)	Female (N = 156)	All (N = 300)
Cultivation	8.2	0.6	4.2	6.8	0.6	3.6
Wage Laborer	18.6	1.8	9.9	1.8	0.1	0.9
Livestock and Poultry raising	0.4	0.8	0.6	4.5	9.1	6.9
Processing and Manufacturing	15.2	38.8	27.5	13.5	55.4	35.3
Trading and shop keeping	34.2	6.2	19.6	48.3	13.5	30.2
Transport operation	3.2	0.1	1.6	11.0	0.2	5.4
Construction and other services	11.2	2.3	6.6	14.1	4.1	8.9
Unemployed	9.0	49.4	30.0	0.0	17.0	8.8
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: ibid

Question may be raised that increasing income and changing occupational pattern may be due to development process rather than GB credit. But available evidence provides sufficient support to believe that GB credit has played significant role in increasing income and changing occupational pattern of its members (Table.2). Borrowers who borrowed in progressive ways are benefited accordingly. Those who have completed higher number of loan cycles, their respective size of income was also high (Table.3).

Table.4 shows that the role of credit in increasing the income of GB borrowers also reflects an increased use of working capital by them in their micro-enterprises. It is true across different groups of borrowers and occupations. Absolute amount of working capital increased three fold after joining the GB credit plan by members.

Table.3
Number of loans taken, average size of loans & household income for GB members

Number of loans taken	Number of borrowers (N = 300)	Share of borrowers (%)	Average size of loans (in taka)	Average size of household income (in taka)
First time	88	29.3	3867	32893
Second time	66	22.0	5612	38239
Third time	54	18.0	6668	35908
Fourth time	54	18.0	6668	35908
Fifth time and more	30	10.0	7018	49180
Total	**300**	**100**	**5576**	**38118**

Source: ibid

Increased income of GB members has also helped in alleviating their poverty. The Ginni concentration ratio is comparatively lower among the GB members than the other groups of non-members. Proportion of moderately poor population was standing at 64.1% among the GB members than 78.6% and 74.2% of non members of project village and control village respectively. Similar situation was in the case of those living in extreme poverty. It was 46.1% in case of GB Members, and 63.8% and 60.4% in non members of project villages and control villages respectively (Table.5).

Table.4

Changes in working capital, type of borrower and occupation after joining GB, 1998

Type of borrowers	Number of borrowers	Borrowers reporting working capital		Amount of working capital per borrower	
		Before Membership (%)	At time of survey (%)	Before Membership (Taka)	At time of survey (Taka)
1. Gender					
1.1 Male	144	50.1	72.5	1268	3788
1.2 Female	156	46.2	66.9	1170	3468
2. Occupation					
2.1 Processing and Marketing	104	65.2	83.2	1347	4182
2.2 Trading and Shopkeeping	93	42.1	74.5	1452	4322
2.3 Others	103	36.3	51.5	875	2380
Total	**300**	**48.1**	**69.6**	**1217**	**3607**

Source: ibid

Table.5

Proportion of poor population among participants and comparable non–participants

Variable	**Grameen Bank Members**	**Target group non participants**		**All Households**	
		Project Villages	**Control Villages**	**Project Villages**	**Control Villages**
Gini concentration ratio of income	0.263	0.269	0.289	0.287	0.286
Proportion of moderately poor population	64.1	78.6	74.2	62.8	71.6
Proportion of extremely poor population	46.1	63.8	60.4	53.4	55.2

Source: ibid

Increasing income and reducing poverty is also helping to improve the social welfare indicators of GB members (Table.6). Activity ratio, expenditure on education for children, expenditure on family nutrition and expenditure on health services of GB members are comparatively better than the target group non-members in control villages.

Table.6
Welfare indicators of GB female borrowers

Welfare Indicators	GB Members	Non-members in project villages	Non-members in control villages
Activity ratio	0.50	0.35	0.31
Expenditure on education for children	0.18	0.08	0.06
Expenditure on family nutrition	0.14	0.09	0.09
Expenditure on health services	0.11	0.07	0.09

Source: ibid

Grameen Bank's contribution in reducing poverty and improving welfare indicators through its credit programme and related services for its members, is well documented. But several applied studies have raised questions on its success in terms of reaching to poorest of the poor. Wright (2000), remarks that certainly none of the larger MFIs including the GB, operating in Bangladesh, are serving the poorest of the poor through their mainstream saving and credit activities. However, Grameen Bank has improved a lot in its second phase of development (started in 2000) but its minimalist credit strategy in first phase as well as later, has hampered the effort of alleviating overall poverty. Microcredit, though a very necessary resource, but not sufficient for promotion of micro-enterprises, other resources, like business and production training, establishing market linkages for inputs and outputs, sub-sectoral analysis and policy reform are also required. Integrated approach of credit policy should be given preference over minimalist approach, which fortunately GB has recognized in its second phase of development.

5. Evolution of MFIs in the Context of India and its Regional Differences

Evolution of micro-finance in India is very much different from the evolution of micro-finance in Bangladesh. In Bangladesh, NGOs and MFIs have played leading role in micro-finance movement, while in India role of these institutions are limited. Role of NABARD was pivotal in development of India's micro finance sector. NABARD has tried to link all the existing financial institutions that provide credit to unorganized sector and to self-help groups (SHGs). SHG-Bank linkage model was the most successful programme launched by NABARD with co-operation of government. Though no definite statistics are available, it is estimated that about 90% of micro-credit comes from SHG-Bank linkage programme and only rest 10% from MFI-SHG model or from other sources. However sustainability of SHG-Bank linkage programme in the long run is a big potential question, for further research.

Micro-finance movement (SHG-Bank linkage programme) has registered significant success in southern states and states like Odisha, West Bengal to name a few. But it was not that successful in northern and north-eastern region. The share of southern region in total number of new SHG formed in the period of 2001-02 to 2003-04 was more than 60% while the share of northern, north-eastern and western regions were 5%, 1.2% and 5.3% respectively. Situation is worse when we see the figures of cumulative bank loan utilized by SHGs in different regions. While the share of southern region in cumulative bank loan was 78%, it was merely 3.4%, 0.5% and 3.9% for northern, north-eastern and western region respectively. Now question arises, what are the possible reasons of prevailing huge regional imbalances in SHG formation and their capacity of using the bank credit? Is it because of micro-finance model (SHG- Bank linkage) which India has chosen or because of credit history and culture prevailing in the region? Or is it somehow related to the concentration and intensity of poverty prevailing in the region? And if it is not because of economic factors and real reasons are inherent in social, political factors and value systems of these regions, then what is the possible interpretation of causality lying between non-economic factors and micro-finance movement?

Micro-finance model (SHG-Bank linkage) has been doubted as one of the factors of failure of the movement in northern, north-eastern and western part of the country. The way in which the concept of micro-finance has evolved in Bangladesh indicates that lending agency should have an active involvement in economic activities of the poor. Providing training, technical advice, technological support and help in marketing of products are part and parcel of the credit policy. In SHG-Bank linkage model, though we have chosen SHG channel for extending credit to the poor as an important characteristic of micro-finance, but other aspects mentioned above have been ignored. Access to credit is one part, but utilizing available credit for productive purposes is entirely a different aspect. It needs ancillary services which SHG-Bank linkage model does not provide. Further formation of SHGs depends a lot on performance and experiences of existing SHGs and because existing SHGs are not performing due to lack of ancillary services, their formation is not taking the momentum.

A further question arises, whether this is the reason for this model to be successful in southern region? Probable answer may be prevailing credit culture and credit history in southern region, which is lacking in northern region. It has been observed in northern region of the country that many SHGs exist only on paper. They are the source of drawing money, which is provided by the government in the form of subsidy by influential people of society. People who are socially or politically influential and dominating, form the group by including the people from socially marginalized and economically backward communities to maximize their vested interest. On behalf of the illiterate and ignorant people, they take all the benefits. Studying the socio-economic profile of leaders of the group along with group members might be an interesting topic for further research.

Another probable important reason for the failure of micro-finance movement in northern part may be the low intensity of poverty in comparison to southern part. Though the concentration of poverty in northern India is more than the poverty in southern India, but they are able to manage their basic needs. It also reflects in suicide cases, which are comparatively less in northern region than the southern region of the country. The low intensity of poverty might be a factor for people of northern India to show less interest in micro-finance movement.

Attitude and perception towards work, particularly low profile work which is considered as inferior, may be another reason for not taking interest in microfinance movement. This reason is linked to value system of society, which has deteriorated very rapidly in north India. People want to earn money without efforts and are attracted towards those activities which are shortcuts to good and easy money like politics, administration and other government jobs. They do not have any attraction towards traditional work and self-employment.

6. The Development Process of MFIs in India:Its Adverse Implications

MFIs movement which started with due social and economic objective to empower the weaker sections of the society lost its path of development in midway. Increasing commercialization of micro-finance institutions has affected their social and economic concerns for weaker sections of society. Flow of private equity funds and entry of other capital market institutions in this sector has further aggravated their concern for return and profit. For increasing the profit, MFIs have raised their rate of interest and focused on grabbing more and more customers. Increasing rate of interest and competition for potential borrowers has led to the result of multiple borrowing by the same customer which has deteriorated the quality of assets created by MFIs.

Another drawback of development process followed by MFIs is that it inhibits the transformation process of MFIs from non-profit making societies, trust and section 25 companies to profit making Non-Banking Financial Companies (NBFCs). Organisational Transformation was the need of the time for increasing the scale of their activity and reaching out to large section of poor population across the region and sectors. But the model followed was not sustainable because of increasing family and individual concern and their vested interest in MFIs. The managerial remuneration of the managing director of SML (Share Microfinance Limited) was around 2.29 crores in 2008-09 which shot up to INR 8.08 crores; by far not only the highest remuneration in the microfinance sector, but way above the remuneration obtained by the CEO of the largest private sector bank - ICICI Bank. Similarly in Asmitha Microfinance, the managing director who is the wife of the MD of SML was to obtain a salary of INR 34 lakhs in 2006-07, which was proposed to be hiked to approx. INR 60 Lakh in 2007-08 and in 2008-09 she was actually paid a salary of INR 1.58 crores and allotted a sweat equity of INR 1.94 crores taking the total remuneration to above 3.5 crores. It has also weakened the professional and corporate governance. Moreover, public funds have been transformed into private assets and wealth in this transformation processes. Rectification of institutional and organizational transformation is a must for ensuring the sustainability of the sector in the long run.

Disparities in regional spread have emerged as a challenging concern for the development process of MFI sector. Most of the MFIs are concentrated in southern region and very few MFIs are expanding their business in northern or north-eastern part of the country. Southern region alone had a share of 54% clients and account 58% of loans.

7. Conclusion and Policy Prescriptions

India's non-farm sector has strategic importance to solve the unemployment problem of rural India. Shortage of working capital has been identified as one of the biggest problems of this sector. Traditional financial institutions, such as banks, are not able to fill this gap. Institutional structure and governance, lending methodology, product portfolio, credit delivery and monitoring mechanism, and more importantly the basic philosophy in which Indian banking system believes, are some important factors behind this. Looking at the experiences of South Asian countries, particularly Bangladesh and within our own country, particularly southern states, MFIs may play a very important role in solving the problem and filling the gap. Hassel free and door step availability of credit, group based lending and active involvement in venture of their borrower, and their fundamental social and economic philosophy for lending to borrowers, are some unique features that suit the small entrepreneurs. Experience of Muhammad Yunus's Grameen Bank, which is an MFI, shows that the model has worked very well to develop the small enterprises in non-farm sectors, by creating employment and reducing poverty in Bangladesh. But India's experience of microfinance evolution is very different from Bangladesh and other South Asian countries. Whereas in other countries it was developed by NGOs and private sector and supported by market demand; in India it was propagated and launched by the government through the NABARD in the form of Bank-SHG linkage model, which was a supply push effort. Though, under this model banks have made group based lending, which is an important characteristics of MFIs, but other ancillary services for the micro enterprises were missing. Results and responses of this model are not very encouraging and have wide regional differences in their outreach and impact. Even the development of Microfinance Institutions (NGOs and NBFCs), which once had a very rapid growth and a conducive environment, is now in its darkest phase. Lack of proper regulatory structures and supervisory norms have given space to some individuals to abuse the public funds and maximize their vested interest at the cost of society. Flow of private capital fund further aggravated their interest for return, which pushes the lending interest rate towards the higher side. Very high interest charged by MFIs is generating social and political consciousness against them because of suicide cases that are taking place in some of the states by the MFI borrowers. It is the peak time for the policy makers to design proper supervisory norms and monitoring structures for the MFI sector to develop a healthy environment and competitive scenario.

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