

REPORT OF
THE STEERING COMMITTEE ON

MICRO-FINANCE AND
POVERTY ALLEVIATION

THE ELEVENTH FIVE YEAR PLAN
(2007-08 - 2011-12)

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Contents

	Pages
Chapter I Historical Background and Present Status of Micro-Finance in India	
1.1 Major initiatives in Rural Credit	08
1.1.1 Shivaraman Committee (1978)	08
1.1.2 Reserve Bank of India's All India Rural Credit Surveys	10
1.1.3 Formal/Banking sector initiatives	11
1.1.4 SEWA Co-operative Bank (1974)	12
1.1.5 Self Help Groups (SHGs)	12
1.1.6 National Bank for Agriculture and Rural Development	13
1.1.7 Rashtriya Mahila Kosh (RMK), 1993	13
1.1.8 Small Industries Development Bank of India (SIDBI), 1994	13
1.1.9 SHG-Bank Linkage Programme (1996)	14
1.1.10 Microfinance Development and Equity Fund (MD & EF), 2001	14
1.1.11 Micro Finance Programme(MFC), 2004	15
1.1.12 Micro Finance Bill (2006)	15
Chapter II Models of Micro-Finance in India	
2.1 Bank-SHG's Linkage Programme	18
2.2 MFI Models	19
2.2.1 Agency model of MFI	20
2.2.2 MFI Bulk Lending Model	21
2.3 Micro Finance and PACS	21
2.4 Post Office Network and Banking Services	23
2.5 Business Facilitator & Correspondent Models	24
2.6 Micro Credit Models in Other Countries	25

2.7	Role of Technology and Micro-Finance	26
	2.7.1 Information and Communication Technology (ICTs) and Micro-Finance Activities.	26
	2.7.2 Common Service Centres	27
	2.7.3 Computer Munshi System	28
Chapter III Issues of Micro-Finance in India		
3.1	Legal Issues	29
3.2	Gender Issues	30
3.3	Increasing accessibility of the poor	30
3.4	Rate of interest	30
3.5	Unbalanced Geographical Growth	31
3.6	Choice of productive activities	32
3.7	Assessment of Demand	33
3.8	Subsidy	33
3.9	Capacity building	33
3.10	Records Maintenance	34
3.11	Auditing	34
3.12	Transparency	35
3.13	Absence of Policy	35
3.14	Absence of information/statistics	35
Chapter IV Recommendations		37
References		45
Annexure: Constitution/Composition of the Steering Committee		47

PREFACE

Microfinance means providing very poor families with very small loans (micro credit) to help them engage in productive activities /small businesses. Over time, microfinance has come to include a broader range of services (credit, savings, insurance, etc.) as we have come to realize that the poor and the very poor who lack access to traditional formal financial institutions require a variety of financial products.

The Eleventh Five Year Plan aims at inclusive growth and faster reduction of poverty. Micro Finance can contribute immensely to the financial inclusion of the poor without which it will be difficult for them to come out of the vicious cycle of poverty.

The report acknowledges the fact that in order to enable the poor people to access credit, there is a need to strengthen all the available channels of providing credit to the poor such as SHG- Bank Linkage programmes, Micro Finance Institutions, Cooperative Banks, State financial corporations, Regional Rural Banks and Primary Agricultural Credit Societies. While appreciating the need for adequate regulation and standardization of the various processes and practices adopted by the Micro Finance Institutions, the report underlines the fact that the strength of the micro finance industry lies in its informality and flexibility which should be protected and encouraged.

The Report puts forward a number of recommendations for the orderly growth and management of the micro finance sector which, I hope, would be useful for Policy makers.

It is my pleasure and privilege to thank all the members of the Steering Committee for their valuable contributions without which it would not have been possible to prepare this report.

I am also thankful to the officers and staff of the Development Policy Division, Planning Commission for their contribution in preparing this Report. The contributions made by Dr. Arvind Virmani, Pr. Advisor (DP & IE) who headed the Working Group on Competitive Micro Credit Market in India, Dr. Sharat Kumar, former Director (DP) Shri N.D.George, Director (DP); Shri V. Sreenivas Former, SRO; Shri R.K.Gupta, SRO and Shri Tinu Joseph, Consultant are acknowledged.

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Abbreviations

NABARD- National Bank for Agriculture and Rural Development.

MFIs- Micro Finance Institutions.

SHGs- Self Help Groups.

RRB- Regional Rural Bank.

DRDA- District Rural Development Authority.

SIDBI- Small Industries Development Bank of India.

RBI- Reserve Bank of India.

NBFCs- Non-Banking Financial Corporations.

LABs-Local Area Banks.

NGOs- Non-Governmental Organisations

FLDG- First Loss Default Guarantee.

ICT- Information and Communication Technology.

SGSY- Swarnajayanti Gram Swarozgar Yojana.

MFOs- Micro Finance Organisations.

IRDP- Integrated Rural Development Programme.

JLG- Joint Liability Group.

MFDEF- Microfinance Development & Equity Fund.

PACS- Primary Agricultural Cooperative societies.

RMK- Rashtriya Mahila Kosh.

RRB- Regional Rural Bank

SBLP- SHG Bank Linkage Program.

SEWA- Self-Employed Women's Association.

SFMC- SIDBI Foundation for Micro credit.

Chapter I

Historical Background and Present Status of Micro-Finance in India

While technology and finance hold the key to ameliorate poverty, the poor in India do not have adequate access to the formal banking sector. Inaccessibility of the poor to the formal/institutional banking sector is mainly due to the following reasons:

(a) Lack of good retail outlets offering banking services, (b) lack of assets with the poor that could be used as collaterals and (c) illiteracy of the poor. The credit requirement of the poor in India has been estimated by the World Bank to be around Rs.50,000 crore per annum in 2002. Against this requirement, the credit outstanding of the poor with the formal banking sector is stated to be Rs.5000 crore or ten per cent of the total demand.

The poor require finance for both production and consumption purposes. Production loan may be of three types, viz. (a) short term (for periods up to 15 months), (b) medium term (from 15 months to 5 years) and (c) long term (for periods above five years). Economic activity in rural areas may relate to the various sectors of crop husbandry, animal husbandry, poultry, fishery, cottage & village industries, handicrafts, transportation, repair shops, and trade & services. But the recent strategy is to ensure flexibility in lending and in repayment based on the capacity of the borrower to earn enough to repay- whether it is daily, weekly, monthly or seasonal. Short term loans may be required by the poor for purchasing (HYV) seeds, fertilizer and for irrigating a leased-in land etc. Medium term loans may be required for purchase of bullocks (or a boat) and for purchase of machinery and equipment. Long term loans may be required for repayment of

loans, for constructing a shed/shop and for purchase of land etc. What needs to be appreciated is that all the three kinds of production loans are relevant to the poor.

About two-thirds of the estimated credit requirement of the poor is said to be on account of consumption needs. Nearly three-quarters of this consumption need (Rs.25, 000 crore) is stated to meet emergencies like illness and household expenses during the lean seasons. It is worth mentioning that due to lack of employment, and incomes during the lean seasons, the poor are often not in a position to buy subsidized food grains from the Targeted Public Distribution System (TPDS). If consumption loan could be made available through the formal banking sector, the poor will benefit not only by way of lower interest rate but also in terms of realizing the subsidy on food grains/items of TPDS. Alternatively, food grains credit could be provided directly under TPDS. It is important to note that consumption loans are also as relevant to the poor as production loans.

Availability of finance, moreover, tilts the employment scenario in favour of self-employment vis-à-vis wage employment. An added dimension is the empowerment of women with easier availability of micro-finance to them. Going by the estimates provided earlier, the demand for production credit in the country today is equal to Rs.17000 crore per annum whereas the total credit outstanding under micro-finance is merely Rs.5000 crore. Thus, there is definitely a need to increase the flow of credit, both for consumption and production, to the rural sector.

1.1 Major initiatives in Rural Credit

Government's initiative to reduce poverty by improving access to financial services to poor started since independence. India's overwhelming majority of poor is located in rural areas and this motivated the government to give special attention to rural credit. Following the report of All India Rural Credit Survey in mid 1950's, the State took crucial steps in reviewing Cooperative structure including the partnership of State in cooperatives. Also the policy initiative of 'social banking' concept described as "the elevation of the entitlements of previously disadvantaged groups to formal credit even if this may entail a weakening of the conventional banking practices" led to the nationalisation of commercial banks in 1969, adoption of direct lending programmes to rural areas and development of credit institutions such as Regional Rural Banks (RRBs). Government initiatives during the Fourth Plan focused on marginal farmers and agricultural labourers bringing individual family as the basic borrowing unit. Integrated sustainable income generating activity was promoted through subsidized lending under Integrated Rural Development Programme (IRDP) and its subsequent variations including the current self-employment programme known as Swaranjayanti Gram Swarozgar Yojana (SGSY).

1.1.1 Shivaraman Committee (1978)

Looking into all aspects of consumption credit for the poor, the Expert Committee on Consumption Credit (Chairman: Shri B. Shivaraman, Member, Planning Commission) recommended for allowing a line of credit to poor households by the formal banking sector. Examining the consumption need of the poor in 1976, the Committee recommended a line of credit equal to Rs.750 per household. The specific consumption demands identified by the Committee were: (a) medical expenses (33%), (b) marriage (33%), (c) education (13%), (d) birth, death & religious purposes (10%) and (e) general consumption (10%).

The co-operative credit structure was to be the main pillar of this drive. The Committee further recommended for legislative reforms in all states for universal membership in all the Primary Agricultural Cooperative Credit Societies (PACS) across the country. In regard to the rate of interest, the Committee observed that the rate charged by both cooperative banks and commercial banks on consumption loans should be the same as crop loans. It further observed, 'The cost of servicing the consumption loans will perhaps be even higher than the agricultural loans, therefore, to expect the societies to operate on smaller margins than on the agricultural loans will be unrealistic'.

On the premise that the risk to the banking sector in the case of consumption loan is higher than the production loan, the Committee recommended for a higher percentage (10%) of risk cover by the Government than usually done for other (rural) loans extended by the co-operative and commercial banks. On the estimated demand for consumption loan of Rs.170 crore (in 1976), it provided for Rs.17 crore as Risk Fund. This fund, moreover, was required to be shared equally by the Central and the State Governments.

However, despite all its moorings there was not much progress in regard to flow of consumption credit to the poor by the formal banking sector. Legislative reforms vis-à-vis universal membership in PACS was introduced; but the co-operative banks themselves became weaker and weaker in the subsequent years. The introduction of bank-SHG linkage programme in the 1990's has in some ways addressed the need of consumption credit of the poor. Under this system, the banks lend to the SHGs who, in turn, are free to disburse loan to their members in their best judgement, whether for production or for consumption purposes.

1.1.2 Reserve Bank of India's All India Rural Credit Surveys

The All India Rural Credit Surveys conducted by the RBI during the various years, show the following transformation in rural credit, viz.,

- (i) The share of non-institutional sector in rural credit that was 91 per cent in 1951 went down to 45 per cent in 1991.
- (ii) The share of institutional sector that stood at 9 per cent in 1951 went up to 53 per cent in 1991.
- (iii) The share of credit cooperatives in rural credit that was 4.6 per cent in 1951 went up to 29 per cent in 1981, but declined subsequently to 19 per cent in 1991.
- (iv) The share of commercial banks in rural credit that was 1.1 per cent in 1951 went up to 29 per cent in 1981 and has remained at the same level in 1991.

The above mentioned percentages are, however, based on aggregate figures and do not throw much light in regard to transformation in rural credit vis-à-vis micro-finance. There has not been any rural credit survey at the all-India level since 1991. A survey was, nevertheless organised by the World Bank & NCAER in 2003. It utilised a sample of 6000 households (in Andhra Pradesh and Uttar Pradesh) and throws light on the condition of micro-finance as well. According to this study, around 87 per cent of marginal farmers /landless labourers do not access credit from the formal banking sector. In other words, the share of non-institutional sector in micro-credit remains, more or less, the same as during 1951. Most of the benefits of the so called extensive banking infrastructure have gone to the relatively better-off people; around 66 per cent of large farmers have a deposit account and 44 per cent have access to credit.

1.1.3 Formal/Banking sector initiatives

Various programmes were initiated by banks to inculcate savings habit and to provide financial assistance. The initiatives are as follows-

1. Pigmy deposit scheme – The Pigmy deposit scheme intended to collect tiny deposits from the depositors from their doorsteps. The scheme was implemented by a few banks by engaging local people. The experience of the banks was not encouraging as there were large scale cash leakages, frauds and reconciliation problems. Most banks found the scheme unattractive.
2. Mobile banks – Some of the banks started mobile banks in rural areas. The location and time of operation are usually synchronized with the market days so that the large number of people could transact its business. This programme was dropped because of the man power constraints.
3. Regional Rural Banks (RRBs) were intended to serve the people not covered by co-operatives and commercial banks. But they were not able to serve the purpose as they were more focused on profitability and strong balance-sheets. In spite of this, it was found that the RRBs are better equipped than the commercial and co-operative banks to undertake micro finance operations because of the understanding of the local conditions. As on 2005, there were 196 RRBs, covering 516 districts and a client base of 6.27 crore.
4. Local area banks (LABs) aimed to mobilize rural savings by local institutions and makes them available for investment locally. They were set up in private sector and regulated by RBI. The working of LABs was not very encouraging. One serious drawback was absence of refinancing

facility. Krishna Bhima Samrudi, the local area bank in Andhra Pradesh is only one into the business of micro finance on a large scale.

India to-day has an extensive banking infrastructure comprising over 30,000 rural and semi-urban branches of commercial banks, over 14,000 branches of Regional Rural banks (RRBs), around 12,000 branches of District Cooperative Credit Banks (DCCBs) and 1,12,000 Primary Agricultural Credit Societies (PACS) at the village level (around 66,000 PACS are stated to be functional; the remaining are dormant).

1.1.4 SEWA Co-operative Bank (1974)

The implementation of formal lending programmes towards the poor suffer from the difficulties such as of exact targeting, screening problems of distinguishing good and bad borrowers and usually lending agencies won't be able to ensure the productive usage of loans. Also, the high transaction costs incurred in lending to the poor made the formal lending agencies leave the poor un-banked.

The Indian cooperative credit structure meant to empower the poor was not very successful as it was captured by a few powerful and because of excessive governmental interference and regulation. The search for an alternative to the formal banking sector and an effective financial system to cater to the needs of the poor, especially the rural poor, continued. The origin of microfinance can be traced to the establishment of the SEWA cooperative bank in 1974, to provide banking services to the poor women employed in the unorganised sector in Ahmedabad in Gujarat.

1.1.5 Self Help Groups (SHGs)

Government initiatives during seventies and the Fourth Five Year Plan focussed on small and marginal farmers and agricultural labourers. Integrated

sustainable income generation activity was promoted under Integrated Rural Development Programme. Inadequacies inherent in running programs focussed on individual households called for shift to a group based approach. The first step towards setting up self help groups (SHGs) was taken by MYRADA and it built upon rural chit funds and informal lending networks to evolve a credit management group.

1.1.6 National Bank for Agriculture and Rural Development

In 1991-92, NABARD launched the SHG-Bank Linkage Programme on a pilot basis to finance SHGs across the country through the formal banking system. High repayment rates by the SHGs encouraged the banks to finance SHGs.

1.1.7 Rashtriya Mahila Kosh (RMK),1993

The success of the concept of micro-credit through self help groups (SHGs) has encouraged the Government of India to establish a National level Micro-Credit organization /Rashtriya Mahila Kosh (RMK) (National Credit Fund for Women) under the Ministry of Women and Child Development in 1993, with an initial corpus of Rs.31 crore. The objective was to help women organise income generating activities to improve their socio economics status. RMK had disbursed cumulative loan of Rs 151 crore up to July 2006, benefiting 5.50 lakh women and the recovery rate is above 91%.

1.1.8 Small Industries Development Bank of India (SIDBI), 1994

In 1994, Small Industries Development Bank of India (SIDBI) launched a pilot scheme to provide financial assistance by way of loans to NGO's for providing credit to the poor households, especially women. A small amount of grant also accompanied the loans so as to build capacity of the intermediates

and end-users. The programme did not achieve the desired objective. A large number of NGOs were not able to up scale their lending operations because of difficulties like interest rate cap on lending, security stipulations etc. SIDBI reoriented its Micro Finance Programme in 1999 by addressing the weakness of the pilot scheme, with an objective to create a national network of large and viable Micro Finance Institutions from the formal and informal sector. The programme provides need based assistance by way of term loans to partner institutions for meeting their on lending fund requirements. Its programme took off slowly. The bank was able to improve its portfolio by 100% each year for the last three years in a row. It had sanctioned Rs.320 crore financial assistance during 2006 as against Rs 189.73 crore during 2005.

1.1.9 SHG-Bank Linkage Programme (1996)

In 1996, Reserve Bank of India included financing of SHGs as a main stream activity of banks under the priority sector lending programmes. The SHG Bank linkage programme covered over 24.3 million families by March 2005. Under the Bank-SHG Linkage Programme 2.24 million SHGs were linked, up to 31st March 2006, of which 90 percent are women's groups.

1.1.10 Microfinance Development and Equity Fund (MD & EF), 2001

Government of India, in 2001 re-designated the existing Micro Finance Development Fund as Micro Finance Development and Equity Fund with the objective of facilitating and supporting the orderly growth of the microfinance sector, by especially assisting the women and vulnerable sections of the society and also by supporting their capacity building. The size of the fund was also enhanced from the existing Rs.100 crore to Rs.200 crore. The additional amount was to be contributed by Reserve Bank of India, NABARD and the commercial banks in the proportion 40:20:20.

1.1.11 Micro Finance Programme(MFC), 2004

In March 2004, the Ministry of Small Scale Industry introduced the Micro Finance Programme along with the SIDBI. The Government provides funds for Micro Finance Programme to SIDBI, called "Portfolio Risk Fund (PRF)". This fund is used for security deposit required of the MFIs/ NGOs to get loan. At present SIDBI takes fixed deposit equal to 10% of the loan amount. The share of MFIs/ NGOs is 2.5% of the loan amount (i.e 25% of security deposit) and balance 7.5 % (i.e 75% of security deposit) is adjusted from the funds provided by the Government of India. The MFIs/ NGOs avail of loan from SIDBI for further on lending on the support of the deposit. Upto December 2006, 39 MFIs have been disbursed loan to the tune of Rs. 102 crore, thereby utilizing an amount of Rs.7.64 crore from the PRF. This has benefited approximately 3.20 lakh beneficiaries, mainly women.

1.1.12 Micro Finance Bill (2006)

The Micro Financial Sector (Development &Regulation) Bill was recently introduced in the Parliament. The silent features of the draft Micro Finance Bill (2006) are as follows:

- (a) Enactment of the bill will give the NABARD explicit powers to regulate the micro finance and so ensure greater transparency, effective management and better governance. This will facilitate the flow of Micro Finance Services in a more efficient way to the un-banked population.
- (b) The Bill defines the Micro Finance services as provision of financial assistance to the eligible clients either directly or through group mechanism for small and tiny enterprise, agriculture, allied activities including consumption, upto an amount not exceeding Rs. 50,000/- in aggregate and upto Rs. 1,50,000/- for housing purpose or such other amounts for the above purpose or such other purposes as specified by the NABARD from time to time.

- (c) Micro Finance Organization is defined as an Organization carrying on the business of extending Micro Finance Services and includes Society registered under the Societies Registration Act, 1860 or a Trust created under the Indian Trust Act, 1880 or Public Trust registered under any State enactment or a Cooperative Society engaged in Micro Finance service excluding a Cooperative Bank as defined under the Banking Regulation Act, 1949.
- (d) It differentiates between Organizations accepting thrift and those not accepting thrift. Thrift receiving organizations will be kept under sharp focus. No micro finance Organization would be able to accept thrift unless it obtains a certificate of registration from the NABARD subject to fulfilment of certain conditions. It will require MFOs accepting thrift to create a Reserve Fund.
- (e) It provides for the creation of a Micro Finance Development Council for advising the NABARD on formulation policies.
- (f) It provides to facilitate constitution of a Micro Finance Development and Equity Fund to provide loans, refinance, grant and seed capital to MFOs.
- (g) It will provide a redressal mechanism through a Scheme of Micro Finance Ombudsman.
- (h) It will provide penalties for violation on the provisions of the Act.
- (i) It will authorise the Central government to make rules and authorise the NABARD to formulate regulations with the previous approval of Central Government.

Chapter II

Models of Micro-Finance in India

Landlords, local shopkeepers, traders, suppliers and professional money lenders, and relatives are the informal sources of micro-credit for the poor, both in rural and urban areas. Some of the perceived advantages of informal loans are (a) contractual flexibility, (b) lower discrepancies between loan sanctioned and loan received and (c) less reliance on collateral.

Emphasis on collateral security is, however, not totally absent under informal loans as money lenders keep jewellery and kitchen ware as physical security and are known to mortgage land and house against loans. An overwhelming majority of (landless) agricultural labourers attached to landlords have been borrowing money based on pledging “self-labour” as collateral. This category of borrowers is the most vulnerable as harsh contracts linking labour to loans are imposed. Bonded labour is the extreme form of this collateral.

The interest charged on informal loans is stated to vary between 24 per cent to 48 per cent per annum (or 4 per cent per month). In certain regions, it goes up to 120 per cent per annum (or 10 per cent per month). The Money Lender's Acts enacted by various states are intended to check the exploitation of the poor by the money lenders. They cannot charge exorbitant rates of interests; in fact, in most cases there is an upper ceiling on interest rates and the total recoveries cannot exceed twice the amount of ‘the principal’. However, such provisions are rarely enforced due to various reasons.

There are two main models of micro credit in the country and they are ‘banking model’ and the ‘MFI model’. In the case of the banking model Self Help

Groups are formed and financed by banks. In some cases SHGs are formed by formal agencies/NGOs and financed by banks. In the 'MFI model' SHGs are formed and financed by the MFIs that obtain resource support from various channels. In India, majority of micro credit activity is under the 'Banking model'(NABARD's Bank-SHG Linkage) and 10-15% of the activity is through 'MFI model'.

2.1 Bank-SHGs Linkage Programme

The Self-Help-Groups (SHGs) have emerged as a tier below PACS. SHGs comprise a group of 15-20 members. The groups begin by savings that are placed in a common fund. In a way, SHGs are co-operative (credit) societies linked to a commercial bank rather than an apex cooperative bank. Once linked to the bank, the SHGs may access a given multiple of the pooled savings for disbursement to its members. Group selects its leader and the selection of the leader is based on rotation. The SHGs have, moreover, emerged as a form of "social collateral" substituting other forms of 'collateral security' insisted upon by banks. High repayment rate has encouraged banks to institutionalize SHGs under the bank-SHG linkage model. According to RBI Guidelines, banks may give loans to SHGs up to Rs. 5 lakh without insisting on 'collateral safety'.

The Bank-SHG linkage programme is noticed to have encouraged thrift/savings amongst the poor. According to one case study, while the average savings per member more than tripled, the increase in assets was about 72 per cent. Out of 234 BPL households surveyed under the particular case study, 122 households were noticed to have been lifted up from poverty. There was, furthermore, a decline in the share of consumption and crop loans and increase in loan for allied agricultural activities and small businesses.

Formulation of SHGs is, however, dependent on the intervening agency, who has so far been NGOs/MFIs, RRBs, Banks and DRDAs. SHGs are being

promoted primarily under the two separate schemes of NABARD/Ministry of Finance and the Ministry of Rural Development. During some years, the SHGs formed by the Ministry of Rural Development under SGSY scheme have been twice the number of those formed by NABARD under their bank-SHG programme. The total number of SHGs formed is reported to be approximately 2.3 million that covers nearly 30-35 million BPL households (more than 50 per cent of all BPL households).

There is another important difference between the two. While the SHGs promoted by the Ministry of Rural Development enjoys credit-linked subsidy, those promoted by NABARD do not have any such facility. Despite this, the credit disbursed to SHGs under the NABARD programme has been more than under SGSY. The subsidy level, moreover, determines the standard loan size irrespective of what the project needs to be viable.

2.2 MFI Models

The specialized MFIs or micro-finance movement since the 1990's is a new avenue of reaching the poor for their micro-credit needs. Some of the MFIs are based on the Grameen Model, which entails formation of a Centre comprising eight solidarity groups of five borrowers. Members of each solidarity group mutually guarantee each other loan. Ten Centres form a Cluster and seven clusters form a (bank) branch [and several branches together presumably form the Bank]. This is typically based on the model of Grameen Bank of Bangladesh¹. All members save regularly and loan proposals are approved by the Centre; all loans are, moreover, repayable in 50 weekly instalments.

MFIs in India register themselves either as societies (under the Societies Registration Act, 1960), as trusts under the Trust Acts, as Non-Banking Financial

¹ In contrast to the top-down approach of credit cooperatives (banks) formed in India, this is a bottom-up approach of forming a co-operative bank. Credit cooperatives in India, moreover, became credit agencies rather an agent of both thrift and credit.

Companies (NBFCs), or as Local Area Banks (LABs). All NBFCs requiring registration with the Reserve Bank of India should have a minimum capital of Rs.2 crore. NBFCs intending to accept public deposits have to satisfy stipulated criteria and have to obtain specific authorisation from the RBI. The issue of covering of NBFCs' deposits by Deposit Insurance and Credit Guarantee Corporation (DICGC) was examined several times, and it was found neither desirable nor feasible to extend such coverage.

Sa-Dhan, an association of MFIs have argued for a new category of NBFCs, namely, Micro Finance Company with a minimum equity capital requirement (capitalization) of Rs.25 lakh. Such MFIs are designed to provide credit only; mobilization of savings is restricted to members and borrowers. The ratio of savings to net owned funds is recommended to be 1 : 1 initially, which may go up to 5 : 1 subsequently. This may, however, pose a problem of supervision by the regulator (RBI) if there are a large number of MFIs. A Micro – Finance Development Council was therefore proposed for performing the task of regulating such MFIs. The Government has, however, not favoured this idea.

2.2.1 Agency model of MFI

The Internal Group on Rural Credit and Micro Finance of RBI (July, 2005), came to the conclusion that parking of funds with MFIs is faced with two sets of exposures, namely, once at the MFI/NGO level and thereafter at the level of SHGs/individual borrower level. The RBI has, nevertheless, favoured the Agency model of MFIs. Under this model, in addition to the MFIs, CSOs etc., only those NBFCs which are incorporated under Section 25 of the Companies Act, 1956 are permitted to be appointed as 'Business Facilitators' (BFs) or as 'Business correspondents' (BCs). In the former case, the MFIs provide the non-financial services, such as, identification of borrower, processing and submission of applications to banks etc. In the latter case, the MFI provide financial services as "pass through" agents for disbursement of small value credit, recovery of principal /

collection of interest or sale of micro insurance / mutual fund products etc. The loan amount, however, remains in the books of the bank. The banks need not obtain prior permission from RBI for appointing BCs and BFs. They are required to conduct thorough due diligence before appointing BFs/BCs, and as principals, are responsible for customer service and control operations. The banks also need to have operational guidelines for the purpose. The MFIs, moreover, provide First Loan Default Guarantee (FLDG) equal to 8 – 15 per cent of the limit sanctioned in the form of security deposit with the bank so as to maintain its stake in the loan portfolio. The banks appear to have positive experience under this model as the MFIs have helped them overcome the problem of outreach in rural areas and have also reduced their transaction cost. In brief, the agency model of MFI is bank driven.

2.2.2 MFI Bulk Lending Model

While the Agency model may appear more appropriate in the case of small MFIs, the larger MFIs may like to operate independently of banks (e.g. as LABs). This category of MFIs belong to MFI Bulk Lending (Equity Participation) model whereby they can access funds in the form of cheaper loans, subordinated debts, equity or quasi-equity from agencies, such as, the Rashtriya Mahila Kosh, the SIDBI Foundation for Micro-Credit (SFMC), the Micro-Finance Development and Equity Fund (under the chairmanship of NABARD) as well as the FWWB.

2.3 Micro Finance and PACS

The share of primary agricultural credit societies (PACS) in rural credit stood at 18.6 per cent in 1991. A good deal of this amount went to people who were relatively better-off, that is, to those who do not belong to the BPL households. Notwithstanding this, a certain percentage of the credit flow has benefited the poor. According to the World Bank NCAER study (2004) the share

of PACS in micro-credit is as high as 30 per cent or one-third. PACS are, as such, yet another important channel of micro-finance.

In terms of retail outlets, the PACS are ahead of the banks and the MFIs at the all-India level, although they are observed to have greater concentration in Maharashtra and Kerala and very low in North Eastern states. The total membership of PACS is reported to be 120 million. The Scheduled Castes and Scheduled Tribes who generally comprise the weaker sections of the society constitute as high as 36-37 per cent or approximately 45 million PACS members. This is much higher membership than under the SHG-Bank linkage programme, (currently around 30 million BPL households) and under the MFIs/LABs/NBFCs (around 1 million clients).

The co-operative structure is ideally based on the norm of “one man, one vote”. The concept of ‘social collateral’ or ‘group guarantee’ holds good for the co-operatives as well. Group guarantee is supposed to be stronger in the cooperatives (of the poor) and the guiding principle is “one for all and all for one”. What appears to work best under this model is greater proximity of PACS to its members and the credit history that determines the credit worthiness of the clients.

A large number of PACS in rural India have been, however, dominated by the powerful. The prudential norms of banking have also been ignored and loans have been extended to defaulting members. Besides, records are not maintained properly and accounting and book keeping of most PACS are very weak. Political interference of one kind or the other, instead of improving the situation, has only contributed to the decline of PACS. Refinancing facility from apex organisations has consequently declined/stopped and in the absence of emphasis on thrift, the PACS have hardly sufficient funds for credit activity.

Successive Committees constituted to suggest measures for revitalisation of PACS have recommended for enactment of the Model Law of Cooperatives. It is an enabling Law that would make the credit cooperatives free from the State's prerogative to override the management (the control of the Registrar of Cooperatives). The recommendations also include diversification of credit portfolio by PACS / Cooperative Banks beyond crop loans. The credit cooperatives may thus also give consumer loan, housing loan and provide finance for services sector as well as distribute insurance products. This would call for capacity and infrastructure building of PACS and observance of prudential banking norms by PACS. The revitalisation package proposed is, moreover, restricted only to viable PACS and any new infusion of funds by the apex banks will be linked to signing of a MOU.

2.4 Post Office Network and Banking Services

The existing extensive formal banking structure is still not sufficient to meet the growing demand of rural credit. Lack of sufficient number of retail outlets of formal banking sector has been a big handicap in reaching the poor. There are approximately 1,55,000 post-offices in India, which is more in number than the combined outlets of all the banks and the (functional) PACS put together. Post-offices have been already into the business of collecting small deposits from people and have been providing services of transferring money. Post-office network could very well be considered for increasing the outreach of banking services, especially in remote and rural areas.

One of the important principles of micro-finance is to provide door-step and timely delivery of financial service. The scheme of pigmy deposits pioneered by some banks in the past met these criteria. This experiment, however, failed because of unscrupulous agents who indulged in fraud. The post-offices are also known to have experimented with similar schemes and had a greater

measure of success. They have a regular and paid staff and with little training and incentives, their services could be utilised very usefully.

2.5 Business Facilitator & Correspondent Models

The Reserve Bank of India, in January 2006 issued an order to ensure greater financial inclusion and increase the outreach of the banking sector, through Business Facilitator Model and Business Correspondent Model. This enabled the commercial banks, including the RRB to use the services of NGOs, SHGs, MFIs and Civil Society Organization as intermediaries to provide financial and banking services through Business Facilitator and Correspondent Model. Under the Business Facilitator Model the Post Offices can also be used as intermediaries for providing services like (i) identification of borrowers and fitment of activities (ii) collection and preliminary processing of loan applications including verification of primary information/data ; (iii) creating awareness about savings and other products and education and advice on managing money and debt counselling;(iv) processing and submission of applications to banks; (v) promotion and nurturing Self Help Groups/Joint Liability Groups; (vi) post-sanction monitoring ; (vii) monitoring and handholding of Self Help Groups/Joint Liability Groups/ Credit Groups/ others; and (viii) follow-up for recovery.

Under the Business Correspondents Model NGOs/MFIs, Cooperative Societies, section 25 companies, registered NBFCs, not accepting Public Deposit and Post Offices may act as Business /correspondent. In addition to the activities listed under the Business Facilitators Model the scope of activities of the Business Correspondent included (i) disbursal of small value credit, (ii) recovery of principal/collection interest (iii) collection of small value deposits (iv) sale of micro insurance / mutual fund products/pension products/other third party products and (v) receipt and delivery of small value remittances / other payment instruments.

The banks are expected to act diligently in employing the Business Facilitators and Correspondents. Both the Business Facilitators and Correspondents may be paid reasonable commission/fee by the banks. No fees can be directly charged by them for the services rendered to the customers. The banks are to specify clearly the role of the Business Facilitators and Correspondents and also give wide publicity both in electronic and print media. The banks are also to constitute Grievance Redressal Machinery within the banks for addressing the complaints about services rendered by the Business Correspondents and Facilitators.

However, no major headway has been made in this direction. It was found that the banks have not employed both the Business Facilitators and Correspondents to meet the increasing rural credit requirements.

2.6 Micro Credit Models in Other Countries

There are, however, two models of bank-post office linkage, namely (a) the service model of Brazil's Banco Postal and (b) Post Bank model of the Netherlands. Under the first model, the post offices work as 'business facilitators' and as 'banking correspondents'. In return, they receive commissions from the banks. The RBI, vide its circular of 25th January, 2006 has approved of post office functioning as business facilitators to banks and as bank correspondents.

The second model (Post Bank model of Netherlands) on the other hand, postulates a kind of a merger of the post office with the bank/banks. The post-office network in the Netherlands is jointly owned by TPG Post and Post bank (each of them having a 50 per cent stake). Post Bank is claimed to be one of the most advanced postal banking networks in the world.

2.7 Role of Technology and Micro-Finance

Micro-finance is not only about credit. It is as much about thrift (or savings), remittance services and micro-insurance. In a way, even credit may be looked at as one's own savings made available at advance. There is need to put in place a workable system, technologically and managerially, for collecting savings from the poor in small amounts, at regular intervals and at their door step. In the case of the urban poor, in particular, it is observed that they suffer from high income drain on account of many avoidable practices. There is, as such, a great need for plugging this income drain through diverting their resources to savings. The economically active urban poor may be encouraged to own 'debit card' and banks may introduce ATM machines in the residential colonies of the poor. Besides this, the urban wage earners separated from their rural families require to send money home. NBFC-MFI network could devise a mechanism to deliver the money at their doorstep. There are, similarly, many upcoming technologies suitable for the rural poor. 'Gramteller', a rural ATM could be explored for their successful usability in rural areas. Introduction of (bio-metric) smart cards is also expected to revolutionise the micro-finance sector and bring down the transaction costs.

2.7.1 Information and Communication Technology (ICTs) and Micro-Finance Activities.

ICTs can be effectively used to provide information about micro finance organisations and their services. Though many web sites provide information on micro financing, there is dearth of information on the terms and conditions, institutions that provides micro finance etc. This information can be provided both in English and also in other Indian languages.

ICTs can be effectively utilised to monitor the various Micro Finance activities. The various schemes implemented by the Department of Rural

Development are monitored physically through various impact assessment studies. RURALSOFT (<http://ruralsoft.nic.in>.) is software used to monitor the schemes on a monthly basis. At present assessments are done only up to district or block level because of the consolidated data. Details that truly reflect the success of the schemes are not currently captured because of non-availability of ICT infrastructure in rural areas and the information about individual beneficiaries. The information required to assess the schemes at the grass root level can be out sourced to the self help groups. This information can be fed into the Ruralsoft for detailed monitoring of the schemes.

ICTs can be used to provide access to wider markets and better prices. ICTs can be used to enhanced the economic returns for the micro finance activities by provide access to global markets at better prices. At present RURALBAZAR (<http://ruralbazar.nic.in>) the application software has been conceptualized to assist market needs of products produced by rural people. It offers internet web to show case there products to the world. It appears some of the states like Tamil Nadu, Goa and Tripura have successfully adopted the software. However, efforts should be made to ensure quality of the products produced by rural producers and to provide logistic support like appropriate packages and timely delivery to the products.

2.7.2 Common Service Centres

Department of Information Technology, Government of India has proposed to set up a network of more than 100000 internet enabled Information and Communication Technology (ICT) access points termed as Common Service Centres (CSC). They are meant to provide high quality and cost effective video, voice and data content by the end of 2007. The Goal is to empower the rural community and catalyze social change through modern technologies. It endeavours to provide economical access to information and services to rural citizens and improve governance at cheaper cost. It envisages a collaborating

model that allows public and private enterprises to integrate their goals of profit and social objective into a sustainable business model for achieving rapid socio-economic change. The scheme proposes a three tier structure where at the first level a Village Level Entrepreneur (VLE- a franchise), at the middle level a Service Centre Agency (SCA- franchiser) and at the third level a State Level Agency (SLA) to facilitate implementation of the scheme with in the state. The SLA will be responsible for implementation of the scheme through the franchiser (SCA) and the franchisee (VLE).

2.7.3 Computer Munshi System

PRADAN evolved the Computer Munshi System to improve the book keeping of the self Help groups (SHGs). So as to improve transparency, equity and longevity of its groups. The model basically aims to improve the accounting and book keeping of the SHGs. A member, acceptable to all the members and capable, of the group is selected and trained in book keeping. He is the Group Accountant (GA). He is supported by a Computer Munshi (CM), who is equipped with a computer and printer in a central location with power connection. A CM is expected to serve about 300 groups. Regular Monthly Transaction Statement (RMTS) consisting of the weekly savings and credit transactions and balances, including expenditure and income statement is delivered to the CM. The CM enters these accounts in the computer and sends back the corrected statement to the GA. The system is designed to be self corrective, as the GA is warned each week about the discrepancies, if any. Similarly the CM is also warned of discrepancies every week. Monthly trial balance for the group is prepared by the CM which is discussed in the monthly meetings of the group. The group pays a fee to both the GA and CM. As on March 2005, there were 48 CMs saving about 2000 groups. The model is cost effective, helps in timely preparation of accounts and identifying the discrepancies at the initial stages. PRADAN was provided with grants by NABARD, SIDBI, and DFID.

Chapter III

Issues of Micro-Finance in India

3.1 Legal Issues

The various Money Lending Acts enacted by the different states have not been successful in ensuring any discipline on the non-formal banking sector. Illegal (loan) contracts, though not judiciable, are enforced by the money lenders through the muscle power tactics as well as the desire of the poor themselves not to lose credibility for taking loans in the next cycle. In a way, the money lenders are themselves at risk, both legally and socially. They may, therefore, also need to be rehabilitated. This would require operating ethically and within the permissible limits. As per the Money Lender's Acts which are in force at present, registration and license for money lending are mandatory. As an incentive, the professional money lenders who are so registered may be allowed access to refinancing facility, same as the MFIs, if they allowed their accounts to be audited by the authorised regulator regularly.

Under the Constitution of India (Seventh Schedule), money lending is a State Subject. Any other law enacted in this context is, therefore is subservient to the law passed by the state legislature. The Seventh Schedule does not mention Private Money Lending. As such, all kinds of money lending whether through institutional or non-institutional sources can get covered. A particular Money Lending Act (of a state) may thus come in conflict with another Act, enacted let us say, on behalf of RBI. One way to overcome this difficulty, may be the Centre preparing a model "Money Lending Act" and passing it down to the states for enactment of a similar legislation.

3.2 Gender Issues

Feminisation of poverty has been associated with absence of economic opportunities and lack of access to economic resources such as credit for the women. The women face numerous problems like low level of assets ownership, illiteracy, inability to identify suitable activity, participation in low-return sectors, restricted business avenues, limited access to technology, lack of access to market, poor access to formal sector, poor capacity –building etc.

Therefore, direct involvement of women in the economic activities is imperative to achieve sustainable development and to alleviate poverty. An important component of the development strategy is empowering women economically and micro finance is emerging as an important measure in this development strategy.

3.3 Increasing accessibility of the poor

The positive result of the growth of self help groups is an increased availability of credit to poor household in rural areas. However, the poorest households are still not able to access credit and assistance provided by government programmes. They are not able to improve their income earning capacity by acquiring the right kind of assets or selecting the most suitable activity. Impact assessment studies of the schemes implemented by the Ministry of Rural Development confirm the benefits of self employment programmes accrue to slightly better off rural households.

3.4 Rate of interest

The rate of interest charged in the micro finance sector depends on the cost of funds, cost of delivery of credit, cost of collection and payment, cost of

providing for bad debts and profit margins. At present, the rate of interest charged is between 21 to 30%. The sustenance and economic viability of micro finance organisations depends on charging interest at the rate of 21-24%. Sa-Dhan, (an association of MFIs) has laid down model mutual Code of Conduct for Micro Finance Institutions. It advocates interest rate of 21-24%. The sector as a whole has been criticised for charging rates higher than the prevailing formal banking sector rates. To counter the criticism of high interest rates there is an urgent need for creating awareness about the need for charging cost-recovering interest rates. The microfinance organisations reach roughly one fifth of the poor households and small percentage of non-poor households. Sustenance of these institutions and their continued support to the poor households depends on charging cost recovering rate of interest. The performance of the sector cannot be judged purely on the basis of rate of interest charged. The sector has numerous advantages like outreach, delivery and collection of loans, etc, which makes it more attractive than the formal sector. Loans are delivered and collected virtually at their door step and at intervals convenient to the borrower. It is therefore advisable not to put a cap on the interest rate and to encourage competition among service providers and leave it to the market to determine the interest rates with in a range of 15-24 percent.

3.5 Unbalanced Geographical Growth

The sector has witnessed an exponential growth during the last couple of year's especially in southern part of the country. Some of the small scale NGOs have grown into large corporate institutions with some of them having more than one lakh membership. Some of them are offering technology based, demand based products and services to their members. However, eastern, northern, north-eastern and western states are lagging behind on account of absence of conducive socio-economic and political set-up required for such interventions. Absence of local institutions to start, manage and upscale credit programmes,

lack of focus on the part of FIs/ banks, lack of social services providers etc. are some of the major problems.

To overcome this unbalanced geographical growth, NABARD in 2005 identified 13 priority states accounting for 70% of India's poor for special efforts. As a result the share of the new loans of the four southern states came down from 49 to 46 % in 2006. Number of new loans also came down sharply in A.P from 107351 in 2005 to 48589 in 2006 and repeat loans from 153903 to 134234. The number of new SHGs formed went up to 54% in north –east, 45% in west and 44% in the east when the national average was 25.4%. The growth in the central, northern and southern states ranged from 15 to 20%. Growth in these States, particularly in Uttaranchal and Assam was achieved basically by diversifying the use of partners. Partners like formal agencies, NGOs and banks were granted assistance for formation, training and nurturing of groups.

3.6 Choice of productive activities

The poor households have limited choices while identifying productive activities. The SGSY programme unfortunately has not been a successful scheme. It emphasised on a cluster approach where ten key activities were identified per block and promoted. It does not take into consideration the market demands or capabilities of the beneficiaries. In some cases, the activities are selected just on the basis of what can be supplied by the poor households. Government departments and agencies, even NGOs have not succeeded in understanding the market demand and creating fresh demand for the products and services delivered by the Self-Help groups. Less importance is given to improve the quality, branding and packaging. The poor households adopt the activity recommended by the government functionaries without access to external expertise or guidance.

3.7 Assessment of Demand

Professional assessment of market demand must be made before hand. Suitable strategies should be evolved by involving trained persons before adopting the cluster approach. Guidance and counselling must be made available to the families to choose their skills and the activities they would like to undertake. Multiple activities should be offered, finances provided must also be flexible to meet their needs for consumption, production, housing, etc.

3.8 Subsidy

Subsidy is used to make self employment programmes for poorer households viable. Sometimes this leads to promotion of unviable products which fail once the subsidy component is withdrawn. The policy of providing credit-linked subsidy to SHGs and individuals may be given up. A similar recommendation was made earlier in the Approach Paper to the Tenth Five Year Plan. The budgetary support can be better used for providing infrastructure to the micro finance organisations.

3.9 Capacity building

The sector which is still in its infancy, faces shortage of experienced consultants/manpower/experts. There is a need to have good quality professionals, trained in best practices in governance for effective corporate governance. A need-based capacity building programme to meet the requirements of all categories of MFOs is essential to bring about sustainability in the sector. Some of the important areas where capacity building is needed are transformation, best practices, interest rate management, delivery management, managing growth, risk mitigation, product designing, market research etc.

3.10 Records Maintenance

Good quality group records help in transparency within the groups and also help the banks in loan appraisals and monitoring. In a recent study conducted across four states, it was found that only in 15 percent of the cases the quality of records maintained were found to be 'good', in 39 percent of cases, it was 'moderate' and it was 'weak' in 40 percent of the cases. The highest proportion of weak records, more than 50 percent, was found in groups promoted under the government agencies, whereas it was less than 50 percent in the case of groups promoted by NGO s or banks.

3.11 Auditing

Absence of good auditing and maintenance mechanism of Self Help Groups (SHGs) is a handicap. The initial enthusiasm in formation and bank linkage fades once government handouts for group formation and training are withdrawn. They tend to stop functioning after some time and the hard earned savings of group members fall into the hands of the last set of borrowers and are then not recovered. There is need to standardize and simplify accounting procedure and improve Book Keeping procedures in such a way that all important information about the SHG are readily available. It would enable the banks to appraise and monitor loan portfolios. There is a need for more detailed, accurate and timely disclosure in financial statements and annual reports. Sa-Dhan, the association of MFIs, is reported to be finalizing with the Institute of Chartered Accountants of India, a standardized set of reporting formats compatible with both MFI requirements, and Indian accounting conventions and law.

3.12 Transparency

In many cases there is absence of transparency regarding interest rate and other charges to the borrowers. As mentioned above, proper records are not maintained and there is no statutory requirement of audit. Some of the studies have shown that certain sections of the society are excluded. In some cases it is self-exclusion and in some, the existing members of the MFO exclude certain sections. Some are excluded because of the anticipated difficulties in meeting savings obligations, lack of understanding and confidence in group processes, etc. These difficulties result in manipulation by a few and failure of organisations. Sa-Dhan, an association of MFIs, appears to be working on detailed code of conduct for transparency in dealings with borrowers and consumer protection issues.

3.13 Absence of Policy

Absence of any explicit policy on Micro Finance adversely affected its growth. However, the 'Micro Financial Sector (Developments and Regulations)' Bill which is presently under consideration is expected to address the issue and the 'regulator' which has been proposed in the Bill is expected to put in place the required policy and regulatory framework.

3.14 Absence of information/statistics

The microfinance sector as a whole is highly decentralized with no single agency responsible for its development. Information/data on the sector is scattered and there are no firm estimates about the sector. Insufficient information impedes understanding and policy formulation. For a better understanding, monitoring and future planning there is a need for collection and compilation of information regarding the number of SHGs/MFIs, the loans disbursed, deposits, interest rates etc. The scattered research carried out by various agencies also requires to be consolidated. Periodic surveys of micro

finance organizations on all India bases may be considered so that all necessary information about the sector could be collected on a continuous basis. The survey can be done jointly by the NSSO and the state governments.

Chapter IV

Recommendations

4.1 Access to Credit

The poor people's access to credit may be significantly improved through all the channels of SHG-Bank linkage programme, MFIs, Cooperative Banks, State Financial Corporations, RRBs and PACS. Some MFIs (i.e. Grameen Bank model/LABS, NBFCs) have been doing very well in selected states with dynamic markets and dynamic individuals. Beyond these jurisdictions, their outreach is non-existent. Any significant up scaling of micro-finance at the all India level will have to depend, therefore, on the large network of banks, the bank-SHG linkage programme and the MFIs. In addition, the post office network in the country may also be used to deliver banking services, especially in remote rural areas. The post offices may be further encouraged to work as "business facilitator" and as "banking correspondent" in accordance with RBI guidelines. The NABARD may consider setting up a Committee, consisting of various private and public sector banks, the Ministry of Rural Development, Small Industries Development Organisation (SIDO) of Ministry of Small Scale Industries (SSI), Rashtriya Mahila Kosh (RMK) of The Ministry of Women and Child Development, Department of Posts, SIDBI, MFIs and the NGOs in the micro finance sector to evolve an effective strategy to implement the Business Facilitators and Correspondents Model. Such a strategy should also take into account special target groups such as the SCs/STs and the minorities through their respective National Finance Corporations. The Eleventh Plan may target to extend micro-finance to at least 80 percent of the BPL households.

4.2 Formation of Consortiums by Banks

Both public and private sector banks have the expertise in financial intermediation. All the banks should come together and formulate a strategy at the national level to cover all regions of the country and to address the needs of the MFOs. The different banks may form 'consortiums' to leverage each other's advantages and work out suitable strategies to address the needs of micro-finance at the national level. Relevant 'Guidelines on Micro-Finance' both for the MFI model and the Bank-SHG linkage model, may be prepared by NABARD for the field level officers. Some incentives may also be introduced to encourage lending to the poor. Internal monitoring may also be further strengthened to check exploitation of the poor by unscrupulous elements.

4.3 Uniform Legal Framework

To facilitate the expansion of micro credit, the Centre should prepare a model Bill on Money Lending and circulate it among the State Governments requesting them to enact similar state legislations. The Reserve Bank has constituted a 'Technical Group for Review of Legislations on Money-lending'. The group is already drafting a model Bill which is expected to be completed by June 30. This draft bill can be used as an input for preparing model bill by the Central Government.

4.4 National Policy on Micro Finance

At present, both Government and the private agencies involved in micro finance have devised their own individual strategies in furtherance of their goals. Absence of comprehensive national level policy has hindered the orderly growth of the sector. There is an urgent need for a concerted effort on the part of the various agencies and the services providers involved in the sector to come together to evolve a coordinated strategy for a faster and smoother growth of the

sector. The proposed bill on micro finance may address some of the issues. The 'regulator' proposed in the 'Bill' may have to come out with a detailed strategy on issues like coordination among various agencies, accounting and auditing, transparency, good governance, consumer protection, micro insurance, statistics & research, rate of interest, subsidies etc., keeping in mind the fact that the strength of the micro-finance industry lies in its informality and flexibility.

4.5 Uneven Geographical Growth

One of the major reasons for the uneven growth of the sector is the absence of conducive socio-economic and political set-up. NABARD introduced special incentives in the north, north-eastern and western states. The Ministry of Rural Development, Ministry of Small Scale Industries, NABARD and SIDBI may devise further need based incentive schemes for a faster and even growth of the sector in all parts of the country in consultation with Ministry of Finance and RBI. SIDBI has also taken positive steps to reach the underserved states through the portfolio risk fund scheme of the ministry of SSI and through its own special efforts.

4.6 Mobilisation of Savings by MFIs

The absence of savings, apart from SHGs and MFI cooperatives, has unfortunately been one of the features of Indian Micro finance and it prevents providing financial service to the poor. The Indian MFIs survive on borrowed funds, unlike other countries where savings fund a large share of lending. The regulatory environment only allows cooperatives to collect savings. The MFIs may be allowed to mobilise savings at least from their members under a regulatory framework monitored by the NABARD. The proposed Microfinance Bill is expected to address this issue.

4.7 Cost Covering Interest Rates

There is a need to create awareness of the need to charge cost-recovering interest rates. The rate of interest charged by the MFIs depends upon the cost of funds, cost of delivery and payment, cost of purchasing bad debts and cost of margins. For economic viability and sustainable growth, the MFIs need to charge interest rate covering these costs. Various studies conducted on this aspect indicate that MFIs normally charge 21-24 % interest rate for their sustenance. Innovative techniques must be identified to reduce the cost and the interest rate. The cost of delivery and collection of payment, which forms a major component of cost, can be reduced substantially by using the proposed Common Service Centres, which can be shared by other agencies also. The sector should make all attempts to reduce the rate of interest by means of efficiency enhancing innovations with the aid of technology.

4.8 Credit-Linked Subsidy

The policy of providing credit-linked subsidy to SHGs and individuals may be revisited. There are SHGs which are borrowing from banks on a continuous basis without claiming subsidies. A comprehensive study may be commissioned to study the incidence and effects of subsidy as part of the 11th Plan and to work out modalities and long term strategies to use the subsidies more productively and effectively.

4.9 Role of Technology

The network of internet enabled Information and Communication Technology (ICT) access points termed as Common Service Centres (CSC), 100000 in number across the country being implemented by the Department of Information Technology (DIT), Ministry of Communications and Information Technology, Government of India also may be utilized for improving the reach

and spread of various Micro-Finance and Poverty Alleviation Schemes in rural areas in the country. Further, the DIT may coordinate with NABARD, Ministry of Rural Development, Sa-Dhan and PRADAN to integrate the 'Computer Munshi System' of accounting into the ICT enabled CSCs.

4.10 ATMs and Gramteller (rural ATM) may be located in the Post Offices. The Common Service Centres being developed by the Department of Information Technology may also be linked to Post Offices to synergise the technology induction with experience of Posts to handle financial products. The proposed multi-purpose unique ID based smart card system can also be utilised for effective delivery of micro-credit.

4.11 NABARD, SIDBI, Ministry of Rural Development and Sa-Dhan, which is already working to evolve a standard book keeping procedure along with the Institute of Chartered Accountants of India, may come together to evolve a standardized, simplified and book keeping procedure for all forms micro finance organisations, which would not only understand the health of the micro finance organisation but also help in accurate and timely disclosure of financial statements and annual reports. Further, the 'Computer Munshi System' developed by PRADAN and which appears to have been adopted successfully for maintenance of accounts may also be integrated into the overall strategy of simplifying the accounting procedure.

4.12 Maintaining Standard Accounting System

The guidelines/best practices for SHG-Bank linkages and microfinance may be issued by NABARD, covering auditing and monitoring mechanisms. RBI may conduct evaluation studies as and when required.

4.13 Extension Services

Need for extension services in the different economic activities of crop husbandry, animal husbandry, agro & rural industries is being widely recognised for guidance and counselling of SHGs/individuals, to help them choose useful activities and acquire the required skills. These extension services may not always be provided in-house through the line departments of the State Government; rather they may be provided by the private sector (eg. NGOs/MFIs) adopting the PPP model reinforced by viability gap funding. The line departments may, nevertheless, continue to function as apex institutions determining the objectives and terms of contract for the private sector participation.

4.14 Micro Insurance

Micro insurance should be perceived as a key service in the financial needs package of the people and in conjunction with micro savings and micro credit could go a long way in keeping the vulnerable segment away from the poverty trap and could be an integral component of financial inclusion.

The Insurance Regulatory and Development Authority (IRDA) has notified Micro Insurance Regulations in November, 2005 with focus on the direction, design and delivery of the products including tie up with life and non life insurance players for integration of product to address various risks, introduction of a standalone Micro Insurance delivery channel consisting of NGO, SHG and MFIs., enlarging the service activities entrusted to micro insurance agent, issue of Policy documents in simple vernacular language etc.

The IRDA may continue to give adequate priority to the micro insurance sector with focus on removing the constraints and further developing the sector.

Micro insurance is increasingly offered by MFIs acting as agents of the insurance companies. Life insurance is common among MFI members and some of the members are also availing asset insurance, mainly loan financed assets. Insurance is less widespread under the SHG model. MFIs and other civil society organizations are beginning to offer health insurance, which is of greatest relevance for poverty alleviation.

NABARD may consider coordinating with various insurance companies, SIDBI, Ministry of Rural Development, Ministry of SSI, NGOs and their associations to bring out flexible micro insurance schemes, covering not only loan financed assets but also life, health, crop, animal husbandry, etc .

4.15 Capacity Building

Some financial institutions, particularly SIDBI, are tying up with capacity building providers to provide assistance to the microfinance institutions. A need-based capacity building programme to meet the requirements of all categories of MFOs is essential to bring about sustainability in the sector. Some of the important areas of capacity building are transformation, best practices, interest rate management, delivery management, managing growth, risk mitigation, product designing etc. Additional infrastructure for capacity building may be created on PPP basis with appropriate government assistance.

4.16 Formalities to access the credit are required to be simplified to enable semi literate and illiterate customers to access credit. The delivery mechanism also needs to be simplified to provide easy access to both credit and working capital. Activities suitable for women may be identified taking into consideration their traditional skills. A variety of enterprises may be offered to the women to select the best suited for them. Constant feedback on the market would also enable the women entrepreneurs to improve the product designs and marketing.

4.17 Transparency

The borrower needs to be protected from practises like lending without regard for the borrowers ability to repay, deceptive rate of interest and abusive collection techniques. Borrowers /consumer protection laws may be designed to take care of abusive lending and collection practices by defining them and by making provision for effective complaint redressal mechanisms. The consumer protection laws must also provide for transparent discloser of interest rate, cost and other terms of lending. The consumer laws must also educate the consumer on good money management practices for earning, spending, saving, borrowing and investing.

4.18 Availability of Information/Statistics

With a view to developing a detailed data base of the micro-finance sector, it may be desirable to conduct periodic surveys of all the micro-finance organisations in the country and their operations. The survey can be conducted jointly by the NSSO and the state governments.

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**No.20(5)/DP/PC/2005
Government of India
Planning Commission
(Development Policy Division)**

...

**Yojna Bhavan,
Sansad Marg,
New Delhi- 110 001
31st March, 2006.**

O r d e r

**Subject:- Steering Committee on Micro-Finance & Poverty Alleviation,
for the Eleventh Five Year Plan**

...

In the context of the formulation of the Eleventh Five Year Plan, it has been decided to constitute a *Steering Committee on Micro-Finance & Poverty Alleviation*.

The composition of the *Steering Committee* is as follows:

Shri Anwarul Hoda
Member, Planning Commission

--Chairman

Members

1. Secretary, Department of Agriculture & Cooperation
2. Secretary, Department of Rural Development
3. Secretary, Department of Women & Child Development
4. Secretary, Department of Banking, Ministry of Finance.
5. Secretary, Ministry of Social Justice & Empowerment
6. Secretary, Ministry of Tribal Affairs.
7. Secretary, Department of Posts
8. Secretary, Department of I.T.
9. Dy. Governor, Reserve Bank of India
10. Chairman, NABARD
11. Chairman, SIDBI
12. Chairman, HDFC
13. Chairman, SBI
14. CMD, UTI Bank
15. Chairman, IRDA.
16. Ex. Director, ICICI Bank
17. Chairman, Sa-Dhan
18. CEO, BASIX (Vijay Mahajan)
19. Prof. V.S. Vyas
20. Prof. A. Vaidyanathan

21. Dr. Arvind Virmani, Pr. Adviser, Planning Commission. -**Convener**

Terms of Reference:

- (i) To bring synergy in the SHG–Bank linkage system being implemented under: (a) SGSY, (b) Indira Mahila Yojana/RMK, (c) NABARD and (d) specialized Finance Corporations.
- (ii) To identify the critical constraints, which prevent further scaling up the outreach of micro finance to the poor.
- (iii) To recommend appropriate measures, channels and models to scale up the outreach of micro finance to the poor.
- (iv) To examine the role of technology in reducing cost of credit to the poor.

The Chairman of the Steering Committee may constitute Sub-groups and/or co-opt additional members as may be considered necessary,

The expenses towards TA/DA of the official members in connection with the meetings of the Steering Committee will be borne by the respective offices. Non-official members will be entitled to TA/DA as admissible to Grade I Officers of the Government of India and this expenditure will be borne by the Planning Commission.

The Steering Committee shall submit its report by October, 2006.

[R. Sridharan]
Jt. Secretary (Admn.)

To,

The Chairman & Members of the Steering Committee.

Copy also to:

- 1. P.S. to Deputy Chairman, Planning Commission**
- 2. P.S. to MOS**
- 3. P.S. to all Members of Planning commission**
- 4. P.S. to Member-Secretary, Planning commission**
- 5. P.S. to Secretary (Expenditure)), Ministry of Finance.**
- 6. P.S. to Secretary, Ministry of Home Affairs.**
- 7. Advisers/Head of Divisions, Planning Commission.**
- 8. Plan Coordination Division, Planning commission.**
- 9. Admn./Accounts/General Branches, Planning Commission.**
- 10. IFA Unit, Planning Commission**
- 11. Information Officer, Planning Commission.**