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EDITORIAL

Micro Finance: The So-Called Revolution Going Haywire!

- Piyush Pant

'Microfinance' has remained a key word in the developmental parlance along the neo-liberal march of capitalism. This has been so particularly in the context of addressing the alleviation of rural poverty through empowerment of women. In the early 1990s, Microfinance emerged as a major strategy for removing poverty by the neo-liberal State which had already started reducing public spending on welfare programmes. Creation of self-help groups (SHG) and linking them to banks and government schemes was seen as a way of offsetting the problem of the limited outreach. It was also seen as a tool to mobilize capital for self-employment and other income generation programmes, though microfinance as poverty reduction device has been in use by the Indian government since Independence itself. The commercial banks were nationalized in 1969 and were directed to lend 40 percent of their loan able funds, at concessional rate, to the priority sector comprising agriculture and other rural activities, besides the weaker strata of society, in general. The objective was to provide resources to the poor for attaining self-sufficiency. To fulfill this objective Integrated Rural Development Programmme (IRDP) was launched in 1980. But these were basically supply-side programmes which ignored the demand side of the economy. Thus helped by corruption and leakages, they achieved little. The result was that the vacuum continued to be filled by the village money-lenders who charged interest rate of 2 to 30 per cent per month.

Amidst such a dismal rural scenario, the seeds of microfinance revolution were strewn throughout India. It started in 1980s with the formation of pockets of informal Self Help Groups (SHGs) engaging in micro activities financed by Microfinance, though country's first Microfinance Institution was set up as an urban co-operative bank by Self Employed Women's Association (SEWA) soon after the group was formed by Ms. Ela Bhatt in 1974. It was named 'Shri Mahila SEWA Sahkari Bank'. In fact, the development strategies in the late 1980s and early 1990s became major determinants in the growing popularity of Microfinance. It is said that Bretton Woods Institutions and United Nations Agencies, in particular, adorned microfinance with many virtues in fight against poverty. Events such as Micro-credit Summit Campaigns, the International Year of Micro-credit or the Microfinance India Conference led to the development of "higher common principles" such as the "fight against poverty" or the drive "to reduce the nuisance of private money lending".

But over the years, the profit earning motive of Microfinance institutions took the better of poverty alleviation objective of the microfinance programmes in the country. So much so that they have been accused of making huge profits and ensuring their own topline growth at the cost of the poor whom they aim to help with easy and affordable credit. Allegations have also been made that MFIs often use coercive tactics to ensure weekly repayments and charge steep interests, sometimes over 40 per cent.

This issue of **Infopack** focuses on Microfinance scenario in India.

Profit Empowerment: The Microfinance Institution's Mission Drift

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Bird's Eye View

In this 29-page document the authors try to raise caution against consequences of the overwhelming drive for microfinance institutions to become financially self-sustainable. Focusing on India, they discuss the extent to which donors influence the microfinance sector and identify the role that international organizations play in pushing microfinance institutions away from their primary objective of delivering financial services to the poor. Revisiting the microfinance crisis which erupted in India in March 2006, the document reveals a fundamental problem: the zeal of private and public actors, driven by motives that are hard to relate to the fight against poverty, a new commercial niche for the former and a collection of vote banks for the later.

The document contains five sections. These are: Introduction, Dependency on Donors, Mission Drift: Practitioners between Injunctions and the Neo-liberal Myth, the Crisis in Andhra Pradesh and Conclusion.

1. Introduction

In the introduction, the document says that the term 'microfinance' has been widely employed for the last two decades, both in the discourse of international organizations and by politicians and actors in the field. It is seen as the tool to eradicate poverty and has developed into the donors' favourite means of doing so.

It says that the focus of development strategies in the late 1980s and early 1990s can be singled out as one of the major determinants in the growing popularity of microfinance. Bretton Woods Institutions and United Nations Agencies, in particular, adorned microfinance with may virtues in the fight against poverty. Numerous events such as the Micro-credit Summit Campaigns, the International Year of Micro-credit or the Microfinance India Conference led to the development of "higher common principles" such as the "fight against poverty" or the drive "to reduce the nuisance of private money lending".

The document, in this context, points out that key player in microfinance were non-profit, socially motivated leaders seeking to reach as many disadvantaged clients with credit as they were able to, given their limited budgets. Often coming from the big social movement of the 1970s, the focus of these organizations was explicitly on reducing inequality and inducing social change. In the process they demonstrated that through the use of new lending technologies such as joint liability contracts and dynamic incentives, a portion of this new market could in fact be provided loans profitably. Such realization has drawn profit-motivated lending institutions into these markets and donors have begun to question the need for continued subsidies, resulting in the recent focus on "institutional sustainability" in the microfinance sector.

Critics of this development fear that MFIs tend to become so overly preoccupied with their own financial sustainability that they move away from the poor as their preferred clientele and tend to start providing bigger loans for those in the low income section of the population instead of deepening their outreach to include the most needy.

The document further says that while no clear consensus has been reached on this debate between outreach to the unbanked versus sustainability, referred by Murdoch as the "microfinance Schism", most would agree that concern lies with institutions that move away from their primary objectives of serving those groups of poor on the fringes of society because of rushing to become financially self-sustainable too quickly. This situation gives rise to questions like "are microfinance practitioners turning their backs on their primary objective? And if so, which factors lead them to do so"? While the legitimacy of microfinance is beyond doubt as a tool of financial inclusion, it is critical not to let oneself be blinded by the surrounding optimism and not

to understand the present weaknesses that can be observed in the midst of the optimism surrounding micro-financiarisation. The writers say that the document goes a step further and identifies the role that international organizations play in pushing microfinance institutions away from their primary objective of delivering financial services to the poor.

They also point out that this document proposes to launch the debate by concentrating on the Indian microfinance sector with special focus on the State of Andhra Pradesh because India has been and continues to be one of the leading countries pushing the development of the microfinance sector forward.

2. Dependency on Donors

The document says that Sinha and Sinha (2002) found in their performance analysis of Indian microfinance that "dependence on subsidies in high". They found that about 47% of the sampled organizations' net worth is made up of donated equity. A more recent estimate by Micro-Credit Rating International Limited (M-CRIL) - 2007 shows a sharp decline in the percentage over recent years. The latter estimates that in 2003, 30% of microfinance funds were grants, 8% in 2005, and only 3.4% in 2007. Nevertheless, there was still a huge increase in international debt (34.4%) in 2003, 62.2% in 2005 and 75.4% in 2007). And in these numbers, no distinction was made between "normal" and "soft" loans. The report also shows that the general trend in the area remains, with South asia receiving on average 22.5% of its funds as grants and South East Asia, 29.7% (again, soft loans are not included in these numbers) Sinha and Sinha's comment remains valid. Titus (2002) also makes this point: "most of the promotional resources for developing micro-finance services still come from donors, often based abroad. Many domestic sources are restricted to funding state-promoted organizations. In terms of resources for promotion, NGOs and other agencies promoting Self Help Groups (SHGs) have at best received Rs. 250 million or US $5 million from domestic resources over the past decade. Compare this to the over US $150 million of the grants and soft loans that the Grameen Bank alone has received."

In this context, the document also points out that not only are the limited domestic resources available for non-state promoted organizations low but also the regulatory environment makes it very difficult for organizations to start operations without foreign equity. In the current Indian context, microfinance institutions have to register as non-banking financial companies (NBFCs), being obliged to be in possession of start-up capital of about Rs. 20 million.

In 2007, a microfinance bill was introduced by Finance Minister, P. Chidambaram, with two broad objectives. One is the promotion and regulation of the Indian microfinance sector and the second is to permit microfinance organizations to collect deposits from eligible clients. But some argue that small Institutions especially will be hit by being forced to comply with new guidelines - guidelines that larger players are already following. Institutions will, for example, be required to meet more stringent accounting standards - all this forcing them to put focus on the financial aspect of the institutions. The document further says that based on such observations and the fact that the provision of microfinance services in itself is expensive, it is no surprise that foreign donations play a major role in the financial situations of microfinance organizations and that "microfinance has been largely a donor-driven phenomenon, everywhere."

Over the last two decades, NGOs and MFIs have increasingly established ties with and received funds from international agencies and foreign governments. While this interest of bilateral and multilateral donor agencies helps NGOs to attract more funding and increase their activities, it also poses a dilemma for the organizations since, by extending their dependence on official funds, they risk losing their autonomy and their identity as a non-governmental institution. A consequence of this growing dependence on funding is that NGOs increasingly prioritize economic programmes (mainly microfinance) over activities such as social programmes. Funders emphasize financial viability. The document points out that microfinance programmes are currently caught up on a "financial self-sustainability paradigm". This can be illustrated by the case of the Nampula Artisanal Fisheries Project (NAFP), a project introduced by CARE in 1993 with funding from International Fund for Agricultural Development (IFAD) to service the needs of poor fishing communities. The proposed project is a high priority in the poverty reduction strategy of the GOM (Government of Mozambique) and it is consistent with the Bank Group vision as well as the Bank Group strategy for Mozambique. Nevertheless, despite this excellent development potential and sought-after social impact, the programme was discontinued by CARE for sustainability reasons. Milgram argues that rushing to self-sufficiency forced MFI to be at odds with its original mission of targeting people economically and socially excluded and consequently had serious repercussions on development work at field level. The donors expect quick result. The document says that the DTI expects MFIs to be commercially oriented, and sees no value in a long-term strategy of institutional development.

3. Mission Drift: Practitioner between Injunctions and the Neo-Liberal Myth

The document goes on stating that when asking how MFIs manage to get high repayment rates that make financial institutions in developed countries go green with envy, how they can offer loans at rates way below

those of money lenders, and how they can secure operations in a business as risky as serving the poorest strata of society, one would typically hear keywords such as group lending, joint liability, dynamic incentives, and peer pressure.

Group lending is a mechanism that allows the poor borrowers themselves, those without any physical collateral, to act a guarantor for each other. It was this innovative joint liability condition that allowed the Grameen Bank to grow explosively. Practitioners, policy-makers, and academics alike have been intrigued by Grameen's contracts.

Dynamic incentives are another often-stated method of assuring repayment. For one, only those clients who successfully repaid their loan are eligible to re-apply. And, after showing reliability, loan sizes are gradually increased. Such incentives are observed to ensure on-time repayment by the customer.

Other "micro-finance tricks" such as small and high frequency installments and door-step collection help to make micro-finance a successful way of reaching and serving the poor.

The document says that many people are highly concerned about the interest rates that MFIs charge. Due to high transaction costs, rate of 24-36% and higher are no exception, but all too often and all too easily, such rates are dismissed as much too high to effectively serve the poor. However, it is generally acknowledged that comparisons with rates charged by commercial banks are inappropriate.

It is common practice in microfinance to quote a "flat interest rate" rather than the Annual Percentage Rate (APR), or effective interest rate, as is the banking standard in the developed world. Flat interest refers to charging interest on the full original loan amount, rather than on the declining balance. For example, with group-based loans, an interest rate is about 3% per month, flat, for 4 months. This means that a US $100 principal amount lent is multiplied by 3%, and the by 4 months to come up with US $12 in interest. Thus, US $112 would be repaid over 4 months' installments. Based on how frequently the principal is collected (weekly, monthly, or at the end of the term), and assuming no additional fees, the above loan has an APR of between 39% and 71%.

The bottom line is that customers are repeatedly deceived by the use of flat interest rate, which, depending on the terms of the loan, can result in as actual interest rate twice as high. A study undertaken by the Andhra Pradesh Mahila Abhivruddhi Society (APMAS), interviewing 130 Self-Help groups (SHGs) from 12 villages in 7 mandals, finds that "most of the members (two thirds) don't know about the effective rate of interest, method of calculation, or any other loan operational charges due, sometimes, to their inability to understand the information provided by the MFI and, sometimes, to a lack of transparency in MFI operations".

The document points out that a further point of discussion when talking about practices related to the costs of a loan are the amounts collected at the time of loan sanctioning: administrative charges are applied and most often a deposit is collected. This latter amount, the security deposit, is raised by the borrower in order to have access to a line of credit from the MFI and is generally given back to the borrower upon completion of the transaction - unless in the case of default. It has been observed that the deposit is often the first resort of the MFI in case of default and hence serves as a means to secure repayment and increase repayment rates. Furthermore, this security deposit is often as high as one loan installment, making it necessary for many clients to use part of the loan itself to cover the cost, reducing the loan size by a considerable amount.

An extreme example of these issues comes from the Andhra Pradesh Rural Poverty Reduction Project, called, "Velugu", whose key institution building strategy is to promote Self-Help Groups formation through the bank linkage model. The programme is heavily funded by the World Bank.

The acknowledged success of the SHG approach in reducing poverty led to a huge amount of money being channeled into the programme. Yearly, targets increased tremendously, even doubled in certain areas, which left DRDAs (District Rural Development Agency) with the task of linking too many groups in too short a time. In order to still meet these targets, SHGs were being advised to repay their current loan by taking out a new and bigger loan, but in many cases only 80% of the amount was (and is) actually disbursed. The remaining amount was kept as a security deposit, with no documents given, but with the full loan showing up in the Saving Account Passbook and members expected to repay the whole amount, which they had not really taken out.

These practices have a considerable impact on the actual interest rate of a loan, the actual amount of loans disbursed and also on the increase in debt-burden, which not only results from the new "bigger" loan but also from the debts incurred in order to repay the previous loan, which then allowed the new big loan to be taken.

The document further talks about 'how to secure repayment and high repayment rates'. It says that in the event a customer is not able to repay an installment, one of the first measures taken (particularly in SHGs) is to charge fine. The amount of this fine is often decided by the groups themselves and can range from rupees one to eighty. In case of continued delay, pressure is exerted. This can take several forms but usually starts with group's leader or a MFI staff member visiting the defaulting borrower. Such a visit can already have the desired effect since other village members become aware of the borrower's inability to repay, which strongly influences his or her socio-economic status as well as other credit opportunities in society. Another method of damaging defaulter's

reputation is to publicly announce the failure of that borrower. One consequence that is frequently observed as a means to avoid such public humiliation is that the poor take up a second loan in order to repay the first one, which leads them to going deeper and deeper into debt. In case where public announcement or 'simple visits' are not enough, other methods are being used to pressure defaulters. These can range from sending a whole "recovery team" to harass the defaulter to hiring others to take over the bullying. In fact, recruiting some hired hand to recover loan installment is not rare, and private money-lenders, commercial banks, landowners and contractors all turn to this practice instead of instituting legal proceedings from time to time.

In some cases, even physical force and manhandling are used as indicated in the APMAS study initiated by the District Rural Development Agency (DRDA) and Indira Kranti Patam/Velugu (IKP) in 2006. The last recovery method is the non-asset-based collateral. Such collateral includes, for example, promissory notes. A promissory note is simply a written promise by the borrower to pay a stated amount of money in accordance with certain terms, which include the principal amount of the loan, a specified rate of interest, and a maturity date. If the lender is free to fill in any amount, this can put immense pressure on the borrower since severe consequences would result. For example, of the 130 borrowers interviewed in the APMAS study, on-third reported having signed empty papers. According to the author, it is evident from their responses "that most of the members think that non-asset based formalities are part and parcel in the loan documentation process. Because of their illiteracy and pressing financial needs, they do whatever is required to avail a loan. Members did not understand what would happen with those documents and because of the lack of transparency in loan documentation, were not told so by the loaning institution".

The document further says that even worse than the unwritten promises is the fact that some institutions make the borrowers sign blank cheques. Besides the fact that these institutions have unlimited assets and hence liabilities on the balance sheet, such cheques can be extremely dangerous for the borrowers, because whoever obtains the cheque could write in any amount and would legally be able to cash it, as could the MFI. One might wonder why MFI staff would involve themselves in such underhand practices, knowing that the account does not contain such funds and that consequently the money could not be obtained - the cheque would bounce back. But it would not simply bounce back: when a cheque bounces, the police immediately get involved and pay the owner of the bank account a visit. In the worst case, the client ends up in prison. This threat is highly efficient in making the customers repay - whatever it takes and, hence, is seen as an effective tool to be (unofficially) used by MFIs.

It has also been observed that the moment an outstanding loan appears, it is easier for the agent to grant a new loan to cover the outstanding one than to try solving the problem. This makes it possible to ensure repayment above 95%. But when a crisis appears, when the possibilities for new loans are exhausted, when the interest on the debt cannot be paid anymore, it is moneylenders and pawnbrokers who are more personal, more present in the village, more flexible - not the MFIs and their field agents.

4. The Crisis in Andhra Pradesh

The document, in this section, points out that it was the problem of debt and debt burden that triggered a tremendous amount of talk in the Indian Media about the wrong doings of microfinance in February and March 2006. The Times of India pointed out in its 15th March 2006 edition that some MFIs charged usurious interest rates, which caused 10 to 60 suicides in the Krishna District (Andhra Pradesh State). The document here gives a detailed account of the events. It says that in November 2005, a couple committed suicide by consuming cyanide. The wife, Kumari, had borrowed Rs. 25,000 from MFI for her husband's business. To compensate for the financial difficulties encountered by her husband, Kumari took on two loans for the same amount from two other MFIs. The situation quickly became difficult and the repayment of the loans turned out to be impossible. With the increasing pressure from the other group members as well as from the organizations, the couple committed suicide. Not far away, a woman, Rennu, died by asphyxiation while she hid in a rice drum to flee the visit of the credit agent who had come to collect the monthly loan payment. Some weeks later, two SHG women who hanged themselves from a tree were saved in time by a farmer. The Media also reported several cases of credit agents advising those clients who could no longer mange to pay, to apply for a new loan. With time, the situation degenerated and repayment became impossible. Instances of verbal and sexual harassment culminating in prostitution, imprisonment and confiscation of goods were the dire consequences.

The writers say that while we do not want to argue here that the suicides were caused by micro-finance institutions, we do believe that they played a role in a very complex process and that these events clearly exemplify the possible consequences of using the recovery methods described in order to be able to report high repayment rates and secure the portfolio.

The most important thing that has been pointed out here is the fact that the calamity experienced in Andhra Pradesh also underlines the dire consequences of not facing the real costs of providing micro-finance services. It was the issue of interest rates that had been at the heart of this crisis. This crisis is basically a fight between

public and private micro-finance over the interest rates. To understand how such a fight could come about, one needs to know the basic conditions of the micro-finance sector in the State of Andhra Pradesh. In fact, during the process of banking sector reforms in the early 1990s, micro-finance in India became an important part of bank intermediation, and Andhra Pradesh is today the Indian State with the most extensive micro-finance network in the country. The variety of micro-finance models that took hold there - SHGs, Grameen, Cooperatives and micro-banks - and the growth of this movement, gave Andhra Pradesh a prime spot on the world micro-finance map. Together, public micro-finance - mainly in the form of the SHG model - and private micro-finance - mainly in the form of the micro-finance institution model - secure an unprecedented linkage of the poor to the formal financial sector.

The two main micro-finance delivery models in Andhra Pradesh are the SHG model and the micro-finance institution model: the former dominated by the public sphere and the latter by the private one. In the aforementioned crisis, these two clashed - the gist of the clash boiling down to the issue of interest.

The document further says that given the pressure exerted by the media and the public in reaction to the farmer suicides, on March 11, the administration of Krishna District in Andhra Pradesh, under the influence of the District Collector, Navin Mittal, made the decision to close 50 agencies of two MFIs, Share Microfin Limited (SML) and Spandana. Besides, accusing MFIs of resorting to strong-arm methods to recover their loans, their recourse to excessive interest rates was the principal reason invoked.

To understand how this political power struggle links to the issue of interest rates, it is necessary to go back to the late nineties, when the then Chief Minister of Andhra Pradesh, Chandrababu Naidu, established partnerships with the World Bank in order to create a network of SHGs throughout the State. Through this project and others, the World Bank established for itself a very influential role in the State, driving in a lot of international donor money. It had already been mentioned that the programme started in the late nineties in the context of securing the portfolio by means of extremely high security deposits - deposits that, if taken into account when calculating real interest rates, would drive the rates up by a considerable percentage. Leaving this point aside, loans granted through Velugu are highly subsidized, which allows low interest of around 9% per annum. The row between public and private actors first began at the time of the 2004 elections when the new government of Rajshekhar Reddy set up the famous Pavala Vaddi programme. The programme was introduced to supplement the Velugu subsidies, making it possible to offer credit to SHGs no longer at 9%, but at 3%. The state wanted to go even further and, therefore, invited SHGs to pay only 3% directly. The State would pay off the remainder.

And indeed, comparing 9% to the official average rate of 24% charged by micro-finance institutions, one can easily understand the worries of private institutions - by also how a point could be made about these private organizations charging excessively large, basically exploitative interest rates. The general manager of the Society for the Eradication of Rural Poverty (SERP), and thereby SERP itself, went accusing private MFIs of not having followed a strategic vision but rather a random development strategy. The Congress Party leader P. Venkat Rao told the press that "the government should have taken measures against these companies five years ago, when they organized the "pillage" of the lending activity in the name of micro-finance. The government must identify the micro-finance companies which misled people and acted fraudulently to get their loans repaid". For others, Pavala Vaddi was a very good media coup in view of the elections, but did not make sense financially.

5. Conclusion

In the conclusion, the document states that in the context of India, micro-finance crisis is just the tip of the iceberg. In 1997, India experienced its first spell of farmer suicides - a reaction to number of agricultural hardships that led to the irreversible indebtedness of small and marginal farmers. Rising costs of cultivation, degenerating input quality, rapidly decreasing prices of farm products, and lack of formal credit for small farmers, which drove them to alternative and much more expensive lending sources, were some major determinants of the crisis. Between 1997 and 2006, more than 9,000 Indian farmers committed suicide due to bad harvests and their inability to keep up with debt repayment schedules.

The document further points out that the micro-finance crisis that, on the one hand, originated from the generally hard conditions for India farmers reflects, at the same time, a frenzy of private and public actors, driven by motives that are hard to relate to a fight against poverty. A new commercial niche for the private actors and a collection of vote banks for public actors. Micro-finance is far from being the panacea it is made out to be by media and international organizations. Being subject to reinterpretation and re-appropriation, micro-financial services are permanently distorted - resulting in their being pushed to move away from their social objectives.

One needs to ask whether the crisis in Andhra Pradesh is a minor phenomenon or whether it reveals that the "micro-finance machine" has gone berserk. Whatever the answer, this is an occasion to trigger a collective and widespread reflection on the dysfunction of micro-finance, not only in India but the worldwide sector as a whole.

The Micro-finance (Development and Regulation) Bill 2010

Bird's Eye View

The document states that the Central Government has drafted a 'Micro-Finance (Development and Regulation) Act 2010' which will apply to all micro-finance organizations other than:

a) Banks;

b) Co-operative Societies engaged primarily in agricultural operations or industrial activity or purchase or sale of any goods and such other activities;

c) NBFCs other than licensed under section 25 of the Companies Act, 1956; and

d) Co-operative Societies not accepting deposits from its members having voting rights or from those members who will acquire voting rights after a stipulated period of their making deposits as per the law applicable to such co-operative societies.

It says the proposed Act provides that the Central Government will constitute a Micro-Finance Development Council to advise National Bank of Agriculture and Rural Development (NABARD) on the formulation of policies, schemes and other measures required in the interest of ordinary growth and development of micro-finance services.

The proposed Act also provides that a micro-finance organization which is providing thrift services or which intends to commence the business of providing thrift services should be registered with NABARD.

NABARD has the responsibility under the proposed Act to promote and ensure orderly growth of micro-finance services provided by the organizations covered by the Act. In furtherance of this responsibility, it has the power to issue directions to such organizations and to carry out inspection of such organizations.

The document further points out that according to the opinion of the Sub-Committee of the Central Board of Directors of RBI, the following matters need consideration:

a) We are in agreement with the purpose of the proposed Act "to provide for promotion, development and regulation of the micro-finance organizations in rural and urban areas". In this context, it is necessary to note that it is estimated that 58% of the outstanding loan portfolio is owned micro-finance sector is owned by the SHG Bank linkage model and 34% of the portfolio is owned by the NBFC-MFIs. Both Banks and NBFCs are outside the scope of the proposed Act, and are in fact regulated by Reserve Bank.

b) Therefore, the organizations which are not regulated by the Reserve Bank account for an estimated 8% of the outstanding Micro-Finance loan portfolio. Since co-operative societies which have voting rights to members are excluded from the provisions of the proposed Act, this percentage may be even lower.

c) These residual entities will have a wide variety of constitutional forms, namely, trusts, societies, partnership, sole partnership, etc. each governed in some form by different regulatory authorities.

d) If these entities are not regulated, a regulatory gap would be created and therefore they support the proposal in the proposed Act that these entities be regulated. In order that this regulation is in place, there should be a specific provision in the proposed Act for such entities to be registered with the regulator. However, given the large number of entities, suggestion has been made that registration should be made mandatory only for entities which have an outstanding micro-finance loan portfolio of Rs. 10 crore or more.

e) The proposed Act provides that NABARD shall be the regulator for the

entities covered by the Act. In their opinion, the following need consideration:-

i) NABARD currently is not only the agency responsible for the development of the micro-finance sector but is also a participant, in that it finances the sector. There may be a perceived conflict of interest if NABARD is also a regulator. If therefore, NABARD is to act as a regulator, it may be required not to participate in the financing of the sector.

ii) If NABARD is to remain the regulator as provided in the proposed Act, then it is necessary that there should be close co-ordination between Reserve Bank and NABARD in the formulation of the regulations issued by each regulator. This is very necessary to ensure against the risk of entities taking advantage of regulatory arbitrage.

f) There are serious concerns regarding permitting entities to carry on the business of providing thrift services and thereby attracting public deposits. At present, the size of the loan portfolio owned by such entities is small but there is a real risk that micro-finance institutions which are currently NBFCs may use this facility to do business through non-NBFC entities and gather large public deposits. It could in time create a systemic risk. There is also the risk that once this facility is given to entities governed by the Act, pressure will build up from NBFC-MFIs that they mush also be given similar facilities and it may prove difficult to resist this pressure.

The document further says that disagreeing with the Sub-Committee Smt. Rajagopalan feels that given the small number of entities likely to be brought within the ambit of such a law, union government may reconsider introducing such a law. It may recommended to state governments instead to introduce grievance redress mechanisms in state money lending laws, for all such MFIs entities that are currently proposed to be covered by the draft Bill - that is, MFIs that do not fall in the ambit of RBI regulation or state cooperative laws. Further, as money lending and cooperatives are matters for states to legalize on, she felt that it might be inappropriate for Parliament to enact a law in this matter. At any rate, she is in full agreement with the Committee that public saving ought not to be accessed by any such entity and that a regulator cannot also be a market player.

Therefore, subject to Smt. Rajagopalan's reservations, the following recommendations are made. The recommendations are:

a) The proposed Act should provide for all entities covered by the Act to be registered with the Regulator. However, entities where aggregate loan portfolio does not exceed Rs. 10 crore may be exempted from registration.

b) If NABARD is designated as the regulator under the proposed Act, there must be close co-ordination between NABARD and Reserve Bank in the formulation of the regulations applicable from registration.

c) The micro-finance entities governed by the proposed Act should not be allowed to do the business of providing thrift services.

The Andhra Pradesh Micro-Finance Institutions (Regulation of Money Lending) Act, 2010

The document says that the Andhra Pradesh Micro-Finance Institutions (Regulation of Money Lending) Act, 2010 was passed by the Andhra Pradesh Legislative Assembly on 14th December 2010. It replaces the Ordinance in the same matter issued on 15th October 2010. The Act applies to NBFCs.

In this context, the document further mentions below the terms of this Act-

a) every MFI has to register before the Registering Authority of the district;

b) no member of a SHG can be a member of more than one SHG;

c) all loans by MFIs have to be without collateral;

d) all MFIs have to display the rates of interest in their premises;

e) the recovery towards interest cannot exceed the principal amount;

f) no MFI can give further loan to a SHG or its member without the approval of the registering authority where there is an outstanding bank loan;

g) there has to be a standard form of the loan contract;

h) every MFI has to give to the borrower a statement of his account and acknowledgements for all payments received from him;

i) all repayments have to be made at the office of the Gram Panchayat or at a designated public place;

j) MFIs cannot use agent for recovery or use coercive methods of recovery;

k) All MFIs have to submit to the Registering Authority a monthly statement giving specified details;

l) In each district, a Fast-Track Court is to be established for protection of debtors and settlement of disputes;

m) These are penalties for failure to register and for coercive acts of recovery; and

n) Loan recoveries have to be made only by monthly installments.

The statement of objects and reasons states that the MFIs-

a) Are using SHGs to expand their borrowers.
b) Are charging usurious rates of interest.
c) Are using weekly recovery system, recovery agents and coercive methods.

It also refers to a letter dated 19th July 2010 of the Governor, Reserve Bank of India which has confirmed certain malpractices in MFI functioning for which banks have been asked to take corrective actions and which also states "State Government is the best agency for regulation of the interest rates".

As regards the reference in the Reserve Bank letter to the fact that the State Government should control irregularities in regard to coercive interest rates, what is perhaps intended is to say that as a matter of policy the Reserve Bank does not mandate interest rates charged by different entities in the financial system. Incidentally even the Act does not make any mention of interest rates except that the total interest cannot exceed the principal amount of the loan. On the other hand, a "margin cap" and a ceiling on individual loans which will reduce the effective rate of interest to very reasonable levels have specially been recommended.

While we can understand the circumstances in which the Andhra Pradesh Government felt it necessary to promulgate the Ordinance of 15th October 2010, we would request that the Act be withdrawn for the following reasons:

a) Experience has shown that the State is often not the best agency to act as a regulator and this task is best left to an independent regulator. This is because the actions of bureaucrats may be subject to political pressures or seen to be subject to such pressures even when no such pressure exists. Therefore, there is a better acceptance to decisions of independent regulator.
b) When regulations are enshrined in legislation, they acquire certain rigidity and change, even when desired, is sometimes not possible. If freedom to regulate is given to an independent regulator, she/he can react faster to changing circumstances.
c) There are serious problems when the responsibility for regulation is given to more than one agency and there are grave risks that those who are regulated will take advantage of regulatory arbitrage. The responsibility for regulating NBFCs has been given to the Reserve Bank under the Reserve Bank Act and therefore the Reserve Bank is already the regulator for NBFC-MFIs. If there is also going to be regulation of the sector by the State Government under the Act, there will be risks of regulatory arbitrage.
d) The problems get multiplied several-fold when we consider that the example of the Andhra Pradesh Government could be followed by the State Governments. If there are separate regulations governing NBFC-MFIs in individual states, the task of regulation by Reserve Bank of India, MFIs operating in more than one state will become impossible.
e) Ideally there should be a single regulator regulating micro-finance activity in the whole country. Considering the fact that banks through the SHG-Bank Linkage programme and the NBFC-MFIs together cover over 90% of the micro-finance sector and the fact that the Reserve Bank regulates both the banks and the NBFCs, the next best approach is for the Reserve Bank to be the sole regulator for NBFC-MFIs.
f) If there is still remain some areas of concern, the recommendations point out that these can be resolved through a co-ordination committee consisting of representatives of the State Government, the Reserve Bank and NABARD. Such a co-ordination committee has proved very effective in the case of Urban Co-operative Banks.

Therefore, it has been recommended that if the recommendations are accepted, the need for a separate Andhra Pradesh Micro-Finance Institutions (Regulation of Money Lending) Act will not survive.

Transitory Provisions

If the recommendations are accepted, the MFIs, the banks and the Reserve Bank as regulator will have to make organizational arrangements for which time must be given. However, it has been also recognized that the borrowers are currently suffering some hardships for which relief must be provided at an early date.

Therefore, in these contexts, the recommendations are:

a) 1st April 2011 may be considered as a cut-off date by which time the recommendations, if accepted, must be implemented. In particular, the recommendations as to the rate of interest must, in any case, be made effective to all loans given by an MFI after 31st March 2011.
b) As regards the other arrangements, the Reserve Bank may grant such extension of time as it considers appropriate in the circumstances. In particular, this extension may be necessary for entities which currently have activities other than micro-finance lending and which may need to form separate entities confined to micro-finance activities.

NABARD and Micro-Finance

www.nabard.org/microcredit

Bird's Eyeview

The 20-page document says that the Self-Help Group (SHG) - Bank Linkage Programme is the flagship Micro-Finance intervention of National Bank of Agriculture and Rural Development (NABARD). The launching of pilot phase of the programme in 1992 could be considered as a landmark development in the banking with the poor. The informal thrift and credit groups of poor came to be recognized as bank clients under the pilot phase. The pilot phase was followed by setting up of a Working Group on NGOs and SHGs by the Reserve Bank of India in 1994, which came out with wide ranging recommendations on internationalization of the SHG concept as a potential intervention tool in the area of banking with the poor. The Reserve Bank of India accepted most of the major recommendations and advised the banks to consider lending to the SHGs as part of their mainstream rural credit operations.

In section seven, the document talks about the SHG in details. It says that SHG is a small voluntary association of poor people, preferably from the same socio-economic background. They come together for the purpose of solving their common problems through self-help and mutual help. The SHG promotes small savings among its members. The savings are kept with a bank. This common fund is in the name of the SHG. Usually, the number of members in one SHG does not exceed twenty.

As regards, the objectives of the SHG, it says that the SHGs comprise very poor people who do not have access to formal financial institutions. They act as the forum for the members to provide space and support to each other. It also enables the members to learn to cooperate and work in a group environment. The SHGs provide savings mechanism, which suits the needs of the members. It also provides a cost effective delivery mechanism for small credit to its members. The SHGs significantly contribute to the empowerment of poor women.

The document says that the SHG-bank linkage programme is targeted to reach the poorest sections, which are bypassed by the formal banking system. Therefore, it is essential that only the very poor be considered as the target group for the SHG-bank linkage programme.

An SHG can be all-women group, and all-men group, or even a mixed group. But it has been the experience that women's groups perform better in all the important activities of SHGs. Mixed group is not preferred in many of the places, due to the presence of conflicting interests.

Training can contribute significantly to the success of the SHG bank linkage programme. Appropriate training (formal or informal) at each stage of SHGs' growth is one of the essential inputs required.

Ideally, the group size may be between 15 and 20, so that the members are participative in all activities of the SHG. In a smaller group, members get opportunity to speak openly and freely. However, the membership may not be too small so that its financial transactions turn out to be insignificant.

It is important that all financial and non-financial transactions are transparent in an SHG. This promotes trust, mutual faith and confidence among its members. Maintenance of books of accounts as also other records like the minutes book, attendance register, etc., are important.

The habit of thrift (small savings) is fundamental to the SHG and helps in building up a strong common fund. Once an SHG has accumulated sizeable amount in the form of savings say for a period of about 3-6 months, the members may be allowed to avail loans against their savings for emergent consumption and supplementary income generating credit needs.

As soon as the SHG is formed and a couple of group meetings are held, an SHG can open a Savings Bank Account with the nearest Commercial or

Regional Rural Bank or a Cooperative Bank. This is essential to keep the thrift and other mony of the SHG safely and also to improve the transparency levels of SHG's transactions. Opening of SB account, in fact, is the beginning of relationship between that bank and the SHG.

By initially managing their own common fund for some time, the SHG members not only take care of the financing needs of each other, but develop their skills of financial management and intermediations as well. Lending to members also enhances the knowledge of SHG members in setting the interest rate and periodic loan installments recovering the loan, etc.

Mainstreaming of SHG Bank Linkage Programme

The document points out that based on very successful feedback of the pilot run programme, NABARD in 1998 crystallized its vision for providing access to one third of the rural poor through linkage off one million SHGs by 2002. What followed was massive scaling up of the training and capacity building awareness programmes by NABARD covering a large number of officials and staff NGOs, banks, government agencies and rural volunteers in SHG promotion, nurturing, appraisal and financing.

NABARD provided inputs in capacity building for banks and partner agencies, promoted the idea of organizing thrift and credit groups among the NGOs as an ad-on activity and encouraged linking them with banks, provided loanable funds to banks and financial support to eligible MFIs, to ease the fund flow position to the sector.

The document here gives the **highlights of SHG-Bank Linkage programme as on 31st March 2004**.

- During the period April 2003 to March 2004 - 361,731 new SHGs were financed by banks to a tune of Rs. 18.55 billion (US $412 million) by way of loans.
- Cumulatively, banks have lent Rs. 39.04 billion (US $ 867 million) to 1,079,091 SHGs.
- NABARD has extended a refinance of Rs. 7.06 billion (US $ 156 million) to banks during 2003-04 bringing the cumulative refinance amount to Rs. 21.24 billion (US $ 472).
- 35, 294 branches of 560 banks (commercial banks - 4; Regional Rural Banks - 196; and cooperative Bank - 316) situated in 563 districts in the 30 states of the country are participating in the programme.
- About 16 million poor households have gained access to formal banking system through SHG bank linkage programme.
- About 16 million poor households have gained access to formal banking system through SHG bank linkage programme.
- Nearly 90% of the groups are only women groups.

During 2003-04, about 26,200 bank officials, 7,300 NGO staff, 5,900 government officials and 159,000 SHG members of various banks' training establishments were also trained. Cumulatively, 687,000 persons have been trained through various SHG related capacity building programmes.

Micro-Finance - NABARD's Vision and Mission

The document says that the vision of NABARD is to facilitate sustained access to financial services for the unreached poor in rural areas through various micro-finance innovations in a cost effective and sustainable manner.

Under **mission**, the document mentions about 'Mission Accomplished' and Mission Ahead'. Under Mission Accomplished - Provision of financial access to 16.7 million poor families through formation and credit linkage of 1,079,091 self help groups as on 31st March 2004.

Under Mission Ahead - Formation and credit linkage of 585,000 new self help groups by the year 2007 with 60% of them coming from 13 priority underdeveloped states of the country. Facilitate mature SHGs to graduate form micro-finance for consumption or production credit to micro-enterprises.

Micro-Finance - NABARD's Strategy

In section 3, while talking about the overall strategy the document says that forming and nurturing small, homogeneous and participatory self-help groups (SHGs) of the poor has today emerged as a potent tool for human development. This process enables the poor, especially the women from the poor households, to collectively identify and analyze the problems they face in the perspective of their social and economic environment. It helps them to pool their meager resources, human and financial, and prioritize their use for solving their own problems. The emphasis on regular thrift collection and its use to solve immediate problems of consumption and production not only helps to meet their most urgent needs, but also trains them to handle larger financial resources more skillfully, prudently and with a more lasting impact.

Encourage SHGS to become a forum for many social sector interventions.

SHG-Bank Linkage Programme

This programme facilitates SHGs to access credit from formal banking channels. The document says that SHGs

- Bank Linkage programme has proved to be the major supplementary credit delivery system with wide acceptance by banks, NGOs and various government departments.

Region-Specific Programme

NABARD has intensified its efforts for roping in new partners for promotion and linkage of groups in regions where the growth of groups has not been commensurate with potential. Priority has been assigned to awareness building and for identification of NGOs and other partners in priority states, which account for 70% of rural poor in the country.

Capacity Building Initiatives

The document points out that NABARD has supports/sponsors capacity building programmes for various partners in the field of micro-finance to sensitize and equip them with concept and nuances of SHG bank linkage programme. Upto the end of March 2004 about 687,000 persons have been trained.

NABARD provides training inputs on SHG financing to training establishments of participating banks, to help them to internalize the training requirements at their level.

NABARD gives technical support to banks to evolve suitable intermediate structures like Farmer's Club (Vikas Vahili Programme of the National Bank) to increase the outreach of their branches in promotion and linking SHGs.

NABARD supports and helps banking institutions (especially RRBs and Cooperative Banks) to take on the role of Self-Help Promoting Institutions (SHPIs).

Support to Government

The document says that necessary assistance is provided to the governments by NABARD for dovetailing micro-finance practices with the poverty alleviation programmes.

NABARD also encourages the association of Panchayati Raj Institutions (PRIs) in adopting group processes for maximization of empowerment.

NABARD, in association with Lal Bahadur Shastry National Academy of Administration, Mussoorie conducts tailor-made exposure programme on SHG and micro-finance for senior and middle level offices of Indian Administrative Services (IAS) who are posted as District Collectors/Chief Executive Officers of local administrative set ups (Zilla Parishad).

Support to NGO Partners

Several steps have been taken by NABARD for capacity building of NGOs which partner in promotion and nurturing of SHGs. The emphasis is on involving a large number of NGOs. Special focus is on NGOs participating in watershed development, health, literacy and women development, to encourage them to take up promotion, nurturing and linkage of SHGs as an 'add-on' activity.

NABARD has a scheme of part-financing the cost of promotion of groups by NGOs. NABARD has developed specialized programmes for use by CEOs of NGOs for appropriately envisioning this as an add-on concept. Separate programmes have also been designed for NGO field staff to appreciate the nuances of SHG functioning.

Alternate Micro-Finance Practices

The document further says that the NGOs and other local bodies at village, block and district levels in the North Eastern States are encouraged to take up alternative micro-credit delivery mechanisms through direct funding.

Formation and operation of SHG Federations is supported and encouraged by NABARD. Similarly, networking of NGOs is also encouraged.

Under the title of Micro-Finance Regulation and Supervisory Aspect, the document states that this section looks at the emerging requirement for regulation and supervision of micro-finance institutions in India and introduces the issues and policies related to it.

Emerging Micro-Finance Institutions (MFIs)

- Banks provide mF services as one of the many services provided by them, along with their other conventional business. Therefore, banks can be classified as 'mF service providers".
- There are other agencies and institutions which provide mF service for the poor, as a predominant activity. These institutions are called micro-Finance Institutions (mFIs).
- NGO have, over the past two decades, started financial intermediation as an add-on activity, to enhance acceptability of their social welfare programmes. Over the years they have emerged as the major microfinance Institutions, although most of them continue with their social sector interventions.
- Three broad categories of mFIs are:

  1) Not for Profit mFI, comprising NGOs, Trusts and Not-for-Profit Companies;

2) Mutual Benefit mFIs, mostly State and National level Cooperatives; and
3) Not-for Profit mFIs, which are classified as non Banking Financial Companies?

It is estimated that more than 500 NGOs are providing mF services to the poor till that time.

Similarly, 2155 NGOs have participated in SHG-credit linkage programme till March 2002.

A task Force was set up by NABARD to look into the entire gamut of mF and mFIs to catalyze their growth.

Transformation of Donorship into Ownership of mFIs

Recognition of NGO-mFIs

- Although not legally recognized as such, the role of NGOs as providers of financial services has been accepted by Government of India and RBI.
- There are however, certain restrictions in the financial activities of the NGO-mFIs as regards-
  - Mobilization of saving
  - Lack of equity concept for leveraging bank loan
  - Uncertain status as regards taxation on interest earned
  - Inability to transfer resources to form a new company
  - With a view to professionalizing mF, certain NGO have promoted exclusive Non-Banking Financial Companies for mF.

Entry of Foreign Capital into mF

1. At present, certain restrictions are imposed on entry of foreign equity into rural credit and microfinance.
2. The minimum capital requirement even for an mF-NFC is Rs. 20 million, the same as for other company.

Areas for Transformation of mFIs

- Development of systems for resource mobilization by the mFIs in a sustainable manner.
- Building managerial competence and creating qualified manpower.
- Managing transition from a subsidy-dependent culture to a commercial culture.
- Provison of sufficient protection in the laws for Non-Profit Organizations

Organization and Economics of Supervision

- Banks as mF service providers are supervised by RBI and NABARD as part of their overall banking business.
- The mF activities of the NGO mFIs are unregulated and unsupervised.
- Only mFIs registered as Cooperatives and NBFCs are presently regulated.

Need for Regulation

- Savers with mFIs are legally not 'member' of the mFIs, but only "clients".
- Protection of the savings of the poor is needed.
- Infusion of Financial discipline into the credit activities of mFIs is necessary. Task Force of mF considers formation of "Self-Regulatory Organizations" (SROs) to be the best suited for regulation of mFIs. Such SROs will have to emerge from suitable associations of mFIs. The following functions have been envisaged for the proposed SROs:
  1. Registering of mFIs
  2. Setting of minimum performance standards
  3. Evolving accounting systems for mFIs
  4. Conducting audit and inspection of mFIs
  5. Representing mFIs in the different forum

Recommendations of Task Force on Regulation of mFIs

Norms of regulation to comprise -

- Registration
- Reserve requirements
- Prudential accounting norms
- Periodic Reporting
- All mFIs to register with Regional or National Authority designated by RBI
- mFI with savings above a cut-off level (Rs. 2.5 million at any time in a year) to register with RBI
- One year lead time to be given to all existing mFIs to decide their future course regarding savings mobilization
- RBI to decide separately on NGOs providing financial services to non-poor.

- All donors, banks and DFIs to ensure authentic registration of mFI before assisting.
- There are certain limitations of NGO-mFIs (and SHG Federations) needs to be retained for getting their beneficial services along with financial services for the poor.
- Task Force on mF has recommended to RBI that a lenient view may be taken in regard to mobilization of savings by NGOs and to modify the relevant Rule.
- Non NGO-mFI (like NBFC) may be regulated as existing arrangements.

Supervision of mFIs

- Only off-site surveillance may be conducted through appropriate MIS returns, for-
  - mFIs not mobilizing savings and not availing bank loan.
  - For others, both onsite supervision and offsite surveillance may be conducted with a periodicity of 2 to 3 years.

Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI sector

By

Reserve Bank of India

January 2011

Bird's Eyeview

Introduction

This document states that the Board of Directors of the Reserve Bank of India, at its meeting held on October 15, 2010 formed a Sub-Committee of the Board to study issues and concerns in the microfinance sector in so far as they are related to the entities regulated by the Bank.

The terms of reference of the Sub-Committee were as under:

1. To review the definition of 'microfinance' and 'Micro Finance Institutions (MFIs)' for the purpose of regulation of non-banking finance companies (NBFCs) undertaking microfinance by the Reserve Bank of India and make appropriate recommendations.
2. To examine the prevalent practices of MFIs in regard to interest rates, lending and recovery practices to identify trends that impinge on borrowers' interests.
3. To delineate the objectives and scope of regulation of NBFCs undertaking microfinance by the Reserve Bank of India and the regulatory framework needed to achieve those objectives.
4. To examine and make appropriate recommendations in regard to applicability of money lending legislation of the States and other relevant laws to NBFCs/ MFIs.
5. To examine the role that associations and bodies of MFIs could play in enhancing transparency disclosure and best practices.
6. To recommend a grievance redressal machinery that could be put in place for ensuring adherence to the regulations recommended at 3 above.
7. To examine the conditions under which loans to MFIs can be classified as priority sector lending and make appropriate recommendations.

The Microfinance Sector

In this section the document refers to the definition of MFI and its objectives. It says that 'microfinance' is an economic development tool whose objective is to assist the poor to work their way out of poverty. It covers a range of services which include, in addition to the provision of credit, many other services such as savings, insurance, money transfers, and counseling. But the Sub-Committee has confined itself to only one aspect of Microfinance, namely, the provision of credit to low-income groups.

The document points out that the essential features of credit for Microfinance which have evolved are as under:

a) The borrowers are low-income groups.
b) The loans are for small amounts.
c) The loans are without collateral.
d) The loans are generally taken for income-generating activities, although

loans are also provided for consumption, housing and other purposes.

e) The tenure of the loans is short.

f) The frequency of repayment is greater than for traditional commercial loans.

The players in the Microfinance sector can be classified as falling into three main groups.

1. The SHG-Bank linkage Model accounting for about 58% of the outstanding loan portfolio.
2. Non-Banking Finance Companies (NBFCs) accounting for about 34% of the outstanding loan portfolio.
3. Others including trusts, societies, etc., accounting for the balance 8% of the outstanding loan portfolio.

The document further says that

1. The SHG-Bank Linkage Model was pioneered by National Bank for Agriculture and Rural Development (NABARD) in 1962. Under this model, women in a village are encouraged to form a Self Help Group (SHG) and members of the Group regularly contribute small savings to the Group. These savings are lent by the group to members, and are later supplemented by loans provided by banks for income-generating activities and other purpose for sustainable livelihood promotion. NABARD provides grants, training and capacity building assistance to Self Help Promoting Institutions (SHPI), which in turn acts as facilitators/intermediaries for the formation and credit linkage of the SHGs.
2. Under NBFC model, NBFCs encourage villagers to form Joint Liability Groups (JLG) and give loans to the individual members of the JLG. The individual loans are jointly and severally guaranteed by the other members of the Group. Many of the NBFCs operating this model started off as non-profit entities providing micro-credit and other services to the poor. However, as they found themselves unable to raise adequate resources for a rapid growth of the activity, they converted themselves into for profit NBFCs.
3. Others entered the field directly as for-profit NBFCs seeing this as a viable business proposition. Significant amounts of private equity funds have consequently been attracted to this sector.

The Need for Regulation

Under this section, the document says that all NBFCs are currently regulated by Reserve Bank under Chapters III-B, III-C and V of the Reserve Bank of India Act.

The need for a separate category of NBFCs operating in the Microfinance sector arises for a number of reasons.

First, the borrowers in the Microfinance sector represent a particularly vulnerable section of society. They lack individual bargaining power, have inadequate financial literacy and live in an environment which is fragil4e and exposed to external shocks which they are ill-equipped to absorb. They can, therefore, be easily exploited.

Second, NBFCs operating in the Microfinance sector not only compete amongst themselves but also directly compete with the SHG-Bank Linkage Programme. In a representation made to the Sub-Committee by the Government of Andhra Pradesh, it has been argued, that the MFIs are riding "piggy back" on the SHG infrastructure created by the programme and that JLGs are being formed by poaching members from existing SHGs. A state of Sector Report 2010 says that there are many reports of SHGs splitting and becoming JLG to avail of loans from MFIs. The A.P. Governement has also stated that as the loans given by MFIs are of shorter duration than the loans given under the programme, recoveries by SHGs are adversely affected and loans given by the SHGs are being used to repay loans given by MFIs.

Thirdly, credit to the Microfinance sector is an import6ant plank in the scheme for financial inclusion. A fair and adequate regulation of NBFCs will encourage the growth of this sector while adequately protecting the interests of the borrowers.

Fourth, over 75% of the finance obtained by NBFCs operating in this sector is provided by banks and financial institutions including Small-scale Industrial Development Bank of India (SIDBI). As on 31st March 2010, the aggregate amount outstanding in respect of loans granted by banks and SIDBI to NBFCs operating in the Microfinance sector amounted to Rs. 13,800 crores. In addition, banks were holding securitized paper issued by NBFCs for an amount of Rs. 4200 crores. Banks and Financial Institutions including SBIDBI also had made investments in the equity of such NBFCs. Though this exposure may not be significant in the context of the total assets of the banking system, it is increasing rapidly.

Therefore, the document says that **it has been recommended that a separate category be created for NBFCs operating in the Microfinance sector, such NBFCs being designated as NBFC-MFI.**

The Sub-Committee therefore recommends that a NBFC-MFI may be defined as "A company (other than a company licensed under Section 25 of the Companies Act, 1956) which provides financial unsecured basis, mainly for income-generating activities, with repayment schedules which are more frequent than those normally stipulated by commercial banks and which further conforms to the regulations specified in that behalf".

Regulations to be Specified

1. Most MFIs consider a low-income borrower who belong to a household whose annual income does not exceed Rs. 50,000/-.
2. Currently, most MFIs give individual loans which are between Rs10,000/- and Rs15,000/-. However, some large NBFCs also give larger loans, even in excess of Rs. 50,000 for special purposes like micro-enterprises, housing and education.
3. it is, therefore, suggested that the size of an individual loan should be restricted to Rs.25,000/-. Further, to prevent over-borrowing, the aggregate value of all outstanding loans of an individual borrower should also be restricted to Rs.25,000/-.
4. MIFs normally give loans which are repayable within 12 months irrespective of the amount of the loan. However, the larger the amount of the repayment installment and a large installment may strain the repayment capacity of the borrower resulting in multiple borrowing.
5. It is, therefore, suggested that for loans not exceeding Rs.15,000, the tenure of the loan should not be less than 12 months and for other loans the tenure should not be less than 24 months. The borrower should however have the right of prepayment in all cases without attracting penalty.
6. Low-income borrowers often do not have assets which they can offer as collateral, and it is important to ensure that in the event of default, the borrower does not lose possession of assets which he/she may need for his/her continued existence.
7. It is, therefore, suggested that all loans should be without collateral.
8. It is often argued that loans should not be restricted to income generating activities but should also be given for other purposes such as repayment of high-cost loans to moneylenders, education, medical expenses, consumption smoothing , acquisition of household assets, housing , emergencies etc. at the same time there is powerful arguments why loans by NBFC-MFIs should be confined to income-generating activities. The arguments are:
   a) Firstly, the main objective of NBFC-MFIs should be to enable borrowers, particularly women to work their way out of poverty by undertaking activities which generate additional income. This additional income, after repayment of the loan and interest, should provide a surplus which can augment the household income, enable consumption smoothing and reduce dependence on the moneylenders.
   b) Secondly, if the loans are not used for repayment of high-cost borrowing, but are used for consumption, they will in fact add to the financial burden of the household as there will be no additional source from which the loan and interest thereon can be repaid.
   c) Thirdly, borrowing for non-income generating purpose may tempt borrowers to borrow in excess of their repayment capacity.
   d) Finally, if there is no identified source from which interest and installment can be paid, the rate of delinquency will increase. The additional cost will push interest rates upwards and may even result in the use of more coercive methods of recovery.
   e) Therefore, the Sub-Committee suggests that not more than 25% of the loans granted by MFIs should be for non-income generating purpose.

The document further states that currently some MFIs recover loans by weekly installments while other MFIs recover loans by monthly installments. The rules made under the Ordinance issued by the Andhra Pradesh Government specify that recovery should be made only by monthly installments.

In a representation made by the Government of Andhra Pradesh to the Sub-Committee it has been argued that borrowers often have uncertain levels of income flows and they are put to great hardship to mobilize, accumulate and service a weekly repayment commitment. On the other hand, others have argued that some income-generating activities provide a constant flow of cash and leaving idle cash in the hands of borrowers increases the risk that the cash may be diverted to purposes other than repayment of loans. A weekly repayment schedule also means that the effective interest can be reduced. However, N. Srinivasan in the 2010 Microfinance India Report argues that there is enough evidence to suggest that repayment rates do not materially suffer if the repayments are set at fortnightly or monthly intervals.

Therefore, the repayment pattern should not be rigid but should be so designed as to be most suitable to the borrower's circumstances.

It has been observed that some MFIs operate not merely as providers of credit but also provide other services such as acting as insurance agents, acting as agents for the suppliers of mobile phones and telecom services, acting as agents for the sale of household products, providing agricultural advisory services etc, to borrowers and others. While these service can profitably be provided by MFIs along with the supply of credit, there is a risk

that given the vulnerable nature of the borrower and his/her inadequate power, an element of compulsion may creep in unless the provision is regulated. It is therefore, necessary that the regulator limits the nature of services which can be provided, as also the income which can be generated from such services.

Areas of Concerns

The document in this section points out that the advent of MFIs in the Microfinance sector appears to have in a significant increase in reach and the credit made available to the sector. Between 31st March 2007 and 31st March 2010, the number of outstanding loan accounts serviced by MFIs is reported to have increased from 10.04 million to 26.7 million and outstanding loans from about Rs.3800 crores. While this growth is impressive, a number of studies both in India and abroad have questioned whether growth alone is effective in addressing poverty and what the adverse consequences of a too rapid growth might be. In particular, in the Indian context, specific areas of concern have been identified. These are:

a) unjustified high rates of interest
b) lack of transparency in interest rates and other charges
c) multiple lending
d) upfront collection of security deposits
e) over-borrowing
f) ghost borrowers
g) coercive methods of recovery

Pricing of Interest

The document says that there is universal agreement that the pricing of interest charges and other terms and conditions should be affordable to clients and at the same time sustainable for MFIs.

1. The difficulty in maintaining a balance between the two arises because the costs of credit delivery are relatively flat, that is, the delivery cost per loan remains more or less the same, irrespective of the size of the loan, whereas the income generated by the loan varies with its size. Therefore, when a uniform rate of interest is used, larger loans will yield a profit while smaller loans will show a loss. In the circumstances the options before a regulator are limited.
2. Given the vulnerable nature of the borrowers, it becomes necessary to impose some form of interest rate control to prevent exploitation. The easiest and simplest form of control would be an interest rate cap but this has its own drawbacks, as it could result in MFIs not providing services where the loss is unsustainable, or the mix of services being skewed in favor of larger loans. However, to prevent exploitation in individual cases, a ceiling on the rate of interest charged on individual loans is desirable.
3. Another system is to have a margin cap which provides a cap on the difference between the amount charged to the borrower and the cost of funds to the MFI. While this, too, suffers from the drawbacks of an interest cap, it is fairer to the MFI since it is not exposed to the risk of volatility of cost of funds. It also recognizes that the cost of funds can vary between different MFIs. Therefore, it has been suggested that such a cap be mandated.
4. The document further says that it may be mandated that the margin cap should be 10% over the cost of funds for the larger MFIs i.e. those with loan portfolio exceeding Rs.100 crores and 12% over the cost of funds for the smaller MFIs i.e. those with a loan portfolio not exceeding Rs.100 crores. This margin cap may be considered slightly low in the context of the present structure, it can be justified on the following grounds:
   a) There is no reason why the cost of development and expansion included in the present costs should be borne by current borrowers.
   b) As the size of the operations increase, there should be greater economies of scale and consequent reduction in costs in the future.
   c) In the last few years, not only has the growth of MFIs been financed out of interest charged to borrowers but they have also made profits which are in excess of what can be considered as reasonable, given the vulnerable nature of the borrowers.

The margin cap must be considered on an aggregate level and not as applicable to individual loans. The MFIs must be given the freedom to devise individual products and the price them differently as also apply different rates in different regions so long as the aggregate margin cap is maintained. This will also facilitate monitoring by the regulator on the basis of the Annual Financial Statements. If the regulator finds on examination of the Annual Financial Statements that the average margin has exceeded the 'margin cap' the regulator can take such action as it considered necessary.

However, in addition to the overall 'margin cap', there should be a cap of 24% on the individual loans.

Transparency in Interest Charge

1. The document says that MFIs generally levy a base interest charge calculated on the gross value of the loan. In addition, they often recover a variety of other charges in the form of an upfront registration or enrolment fee, loan protection fee, etc. They also recover an insurance premium. It is important in the interest of transparency that all stakeholders in the industry including borrowers, lenders, regulators, etc. should have a better understanding of comparative pricing by different MFIs.
2. The document further points out that the purpose of the insurance premium is to protect the MFI in the unlikely event of the death of the borrower during the tendency of the loan. The premium should be recovered as a part of the loan repayment installment and not upfront and there should be regulations for the proper disposal of the policy proceeds in the event of death of the borrower or maturity of the policy or for its assignment on the settlement of the loan. It has been also noticed that some MFIs levy and insurance administration charge. MFIs should recover only the actual cost of insurance.
3. It has also been observed that some MFIs recover a security deposit in cash from the borrowers and no interest is paid on this deposit is recovered up front from the amount of the loan. This amounts to charging interest on the gross value of the loan when only the net amount is disbursed. This practice of security deposit, which is not permissible by the RBI Act, distorts the interest rate structure and should be discontinued.

Transparency and comparability would be considerably enhanced if MFIs use a standard form of loan agreement.

Therefore, it has been recommended that:

a) There should be only three components in the pricing of the loan, namely (i) a processing fee, not exceeding 1% of the gross loan amount, (ii) the interest charge and (iii) the insurance premium.
b) Only actual cost of insurance should be recovered and no administrative charges should be levied.
c) Every MFI should provide to the borrower a loan car which (i) shows the effective rate of interest (ii) the other terms and conditions attached to the loan (iii) information which adequately identifies the borrower and (iv) acknowledgments by the MFI of payments of installments received and the final discharge. The card should show this information in the local language understood by the borrower.
d) The effective rate of interest charged by the MFI should be prominently displayed in all its offices and in the literature issued by it and on its website.
e) There should not be any recovery of security deposit. Security deposits already collected should be returned.
f) There should be a standard form of loan agreement.

Multiple-lending, Over-borrowing and Ghost-borrowers

In these contexts the document says that it has been suggested that with the development of active competition between MFIs there has been a deluge of loan funds available to borrowers which has fuelled excessive borrowing and the emergence of undesirable practices. It is also claimed that the emergence of ring leaders as key intermediaries between MFIs and potential customers has distorted market discipline and good lending practices. There are reports that ghost loans have become epidemic in some states, resulting in over-borrowing. Default rates have been climbing in some locations.

Following are three major reasons for multiple-lending and over-borrowing:

a) The loans are given for income-generation but often there is inadequate time given to the borrower between the grant of the loan and the commencement of the repayment schedule. This gives her/him insufficient time to make the institutional arrangements necessary to be in a position to generate income. In the absence of such a period of moratorium, it is likely that the first few installments, particularly when repayment is weekly, would be paid out of the loan itself, thus reducing the amount available for investment or paid out of additional borrowing.
b) MFIs often use existing SHGs as the target to obtain new borrowers. This not only increases profit but also reduces their transaction costs. These borrowers are, Therefore, tempted to take additional loans beyond their repayment capacity.

Therefore, the suggested recommendations are:

a) MFIs should lend to an individual borrower only as a member of a JLG and should have the responsibility of ensuring that the borrower is not a member of another JLG.
b) A borrower cannot be a member of more than one SHG/JLG.
c) Not more than two MFIs should lend to the same borrower.
d) There must be a minimum period of moratorium between the grant of the loan and the commencement of its repayment.
e) Recovery of loan given in violation of the regulations should be deferred till all prior existing loans are fully repaid.

The document further points out that 'ghost borrowers' generally arise in two sets of circumstances:

a) When borrower on record is a benami for the real borrower and

b) When fictitious loans are recorded in the books.

The first type of Ghost Borrower is often used as a device for multiple lending or over-borrowing.

The second type of Ghost Borrower can pose a much greater systemic problem as it would create fictitious assets and is often used to record fictitious repayments and thus hide the actual level of delinquencies.

It has, therefore, been recommended that all sanctioning and disbursement of loans should be done only at a central location and more than one individual should be involved in this function. In addition, there should be close supervision of the disbursement function.

The essential element in the prevention of multiple-lending and over-borrowing is the availability of information to the MFI of the existing outstanding loan of a potential borrower. This is not possible unless a Credit Information Bureau is established expeditiously.

The issue is what can be done until such a Bureau starts functioning. Until that time, MFIs should have the responsibility to make reasonable enquiries to find out a prospective borrower's outstanding loans.

Coercive Methods of Recovery

There are reports that MFIs or their employees and agents have used coercive methods of recovery and similar complaints have been made by many of the organizations. Coercive methods of recovery are, to some extent, linked with the issue of multiple-lending and over-lending.

The document further says that coercive methods of recovery also surface when the growth of MFI is faster than its ability to recruit the required staff of the right quality and to provide them adequate training.

It has been suggested that coercive methods of recovery have been encouraged by the practice of enforcing recovery by recovery agents visiting the residence of the borrowers. The Andhra Pradesh Micro Finance Institutions Act 2010 drafted by the State Government includes a list of actions which constitute 'coercive action'. This includes "frequenting the house or their place where such person resides or works, or carries on business, or happens to be". It also provides that "all trenches of place designated by the District Collectors only". There are advantages in requiring recovery from the group as a whole at a central location and this may be specified by the MFI. This will ensure that the privacy of the group is respected and that there is sufficient peer pressure on the borrower to make repayments.

Therefore, the suggested recommendations are:

a) The responsibility to ensure that coercive methods of recovery are not used should rest with the MFIs and they and their managements should be subject to severe penalties if such methods are used.

b) The regulator should monitor whether MFIs have a proper Code of Conduct and proper systems for recruitment, training and supervision of field staff to ensure the prevention of coercive methods of recovery.

c) Field staff should not be allowed to make recovery at the place of residence or work of the borrower and all recoveries should only be made at the Group level at a central lplace to be designated.

d) Each MFI must establish a proper Grievance Redressal Procedure.

e) The institution of independent Ombudsmen should be examined and based on such examination, an appropriate mechanism may be recommended by RBI to lead banks.

Customer Protection Code

Between the MFIs and the borrowers, the MFIs have an immeasurably superior bargaining power. It is, therefore, essential that MFIs are committed to follow Customer Protection Code.

Improvement of Efficiency

The purpose of regulation should not be confined merely to the prevention of abuses but should also examine methods by which the efficiency of operations can be improved. This will benefit both the MFIs and the borrowers as it will reduce costs and consequently interest charges and also increase the volume of business.

The key areas in improving efficiency are:

a) Better operating systems

b) Simplification of documentation and procedures

c) Better training

d) Better corporate governance.

Support to SHGs/JLGs

The document says that the purpose of the formation of SHGs and JLGs cannot be merely to share the liability.

More importantly the group is to be seen as the vehicle through which skill development and training are imparted to the members of the group as a loan would not help in improving their livelihood.

It is also necessary as pointed out in Microfinance India 2010 report, that, after the formation of groups, handholding is required to insure that the group functions within the framework of group discipline and financial discipline. Groups formed without professional inputs and without the requisite handholding cannot sustain the financial content and can lead to an increase in default and consequent abuses in the system.

In a communication dated November 22, 2006 to the banks, the Reserve Bank has also noted that many MFIs supported by the banks were not engaging themselves in capacity building and empowerment of the groups to the desired extent and as a result, cohesiveness and a sense of purpose were not being built up in the groups formed by these MFIs.

In a submission made by the Ministry of Rural Development, it has been suggested that in order to make branchless banking work, banks need to re-engineer front end processes and establish a support architecture to provide back-stopping for cash management, technical training and trouble shooting, back-end business processing and channel control functions.

Corporate Governance

MFIs have twin objectives, namely to act as the vehicle through which the poor can work way out of poverty and to provide reasonable profits to their investors. These twin objectives can conflict unless a fair balance is maintained between both objectives. This makes it essential that MFIs have good systems of Corporate Governance in accordance with rules to be specified by the Regulator.

Maintenance of Solvency

The document says that while NBFC-MFIs do not accept public deposits, they have a very large exposure to the banking system. It is estimated that more than 75% of their source of funds comes from banking system. It is, therefore, necessary to ensure that there are adequate safeguards to maintain their solvency. This may be examined in following areas.

Firstly, there should be appropriate prudential norms. Currently, since MFIs are not considered as a separate class of NBFCs, no separate set of prudential norms have been prescribed.

Given the small size of individual loans, their large number, their short tenure, the frequency of repayment and the lack of collateral, it is clear that the existing prudential norms for the provision for loan losses are inadequate and must be replaced by simpler norms which apply to the universe of loans and not to individual loans.

Secondly, currently all NBFCs are required to maintain Capital Adequacy Ratio to Risk Weighted Assets of 12%. Considering the greater risks in the Microfinance Sector, the high-gearing, and the high rate of growth, it is necessary that this ratio should be suitably increased.

Need for Competition

While regulations are important, they cannot by themselves be the sole instruments to reduce interest rates charged by MFIs or improve the service provided to borrowers. Ultimately, this can only be done through greater competition both within the MFIs and without from other agencies operating in the Microfinance sector.

The agencies operating in the Microfinance Sector can be grouped in two classes namely:

a) The SHG-Bank Linkage Programme (SBLP)
b) MFIs including NBFC-MFIs, trusts, societies, etc. whereof NBFC-MFIs hold more than 80% of the outstanding loan portfolio.

The document further says that the reasons for the increasing dominance of the MFI Group vis-à-vis bank linkage need to be examined. Five possible reasons have been suggested.

a) First, it is believed MFIs have been able to achieve a deeper reach as they tend to have a more informal approach as opposed to banks which still operate through traditional branches.
b) Second, MFIs are said to be more aggressive in securing business as they use more of the local population as field workers which gives them better access to borrowers as opposed to banks which still largely use traditional staff.
c) Third, the procedures used by MFIs are said to be simpler and less time-consuming whereas the procedures used by banks tend to be bureaucratic and laborious.
d) Fourth, bank loans to SHGs have a longer repayment period and during that period if SHG members need loans, they approach MFIs.
e) Finally, it is believed that banks find it easier to use MFIs to meet their priority-sector targets. This is particularly true, near the year end where banks invest in securitized paper issued by MFIs to meet targets.

The document also point out that the Reserve Bank has recently taken a number of steps for furthering financial inclusion through mainstream financial institutions by offering a minimum of four financial products, namely, (a) a saving cum over-draft account, (b) a remittance product, (c) a pure savings product-ideally a recurring deposit, and (d) a general purpose Credit Card or Kisan Credit Card.

Banks are permitted to utilize intermediaries to extend penetration outreach by providing financial and banking services through the use of business facilitators and business correspondents, including SHGs.

Domestic scheduled commercial banks including Regional Rural banks have been permitted to freely open branches in Tier 3 to Tier 6 centers with population of less than 50,000 persons.

Banks are required to draw-up a road map whereby banking service will be provided by March 2012 to 72,825 un-banked villages which have population in excess of 2000 persons.

Priority Sector Status

Currently all loans to MFIs are considered as priority sector lending. It has been suggested that there is no control on the end use of these funds and that there is significant diversion of these funds from the purposes intended to other purposes. It is also suggested that in determining priority sector lending what needs to be considered is not the availability of credit but rather the availability of affordable credit. Considering the high rates at which MFIs lend funds, it has been suggested that advances to MFIs should not qualify as priority sector lending.

There are existing Reserve Bank guidelines for lending to the priority sector. It may be necessary to revisit these guidelines in the context of the recommendations.

Therefore, it has been recommended that bank advances to MFIs should continue to enjoy "priority sector lending" status. However, advances to MFIs which do not comply with the regulation should be denied "priority sector lending" status.

Funding of MFIs

The document further points out that it has been suggested that the entry to private equity in the microfinance sector has resulted in a demand for higher profits by MFIs with consequent high interest rates and the emergence of some of the areas of concern which have been discussed earlier.

Without expressing any opinion on the matter, it is necessary to understand the circumstances in which private equity has entered the sector. On the one hand, there was a huge unsatisfied demand for microfinance credit and on the other; there was a limitation on the capacity of non-for-profit entities to meet this demand. When for-profit entities emerged, microfinance was seen as a high-risk entity but venture capital funds are not allowed to invest in MFIs and private equity rushed in to fill this vacuum.

Monitoring of Compliance

The document says that the responsibility for compliance with the regulations will have to be borne by four agencies as mentioned below.

First, the primary responsibility for compliance must rest with the MFI itself. It will, therefore, have to make organizational arrangements to assign responsibility for compliance to designated individuals within the organization and establish systems of internal control and inspection to ensure that compliance exists in practice. Allied to this, there has to be, as stated earlier, a system to levy penalties both on the MFI and on individual members of the management in the event of non-compliance.

Secondly, (a) industry associations must also assume greater responsibility in ensuring compliance.

Thirdly, banks which lend funds to MFIs and which purchase securities paper also have a role to play in compliance. Reserve Bank communication of November 22, 2006 to banks specifically states that banks, as principal financiers of MFIs do not appear to be engaging with them with regard to their systems, practices and lending policies with a view to ensuring better transparency and adherence to best practices nor in many cases is there a review of MFI operations after sanctioning the credit facility. In the case of securitized loans, banks are the owners of the loans and the MFIs are their agents for have therefore every right to enforce compliance.

Lastly, as Regulator, the Reserve Bank has a role to play.

a) As on 31st March, 2010, the top 10 MFIs owned 64.48% of the total loan portfolio and the top five owned 49.94% of the total loan portfolio. Therefore, supervision of the larger MFIs which are few in numbers, Reserve Bank can actively supervise a large part of the Microfinance sector financed by MFIs.
b) The nature of this supervision should be both off-site and on-site. To give further strength to this supervision, the Reserve Bank should have the power to remove the CEO and/or the directors in the event of persistent violation of the regulations quite apart from the power to deregister the MFI and thereby prevent it from operating in microfinance sector.

c) Since the industry association is one component of the compliance system, the Reserve Bank should also inspect the industry associations to ensure that their compliance mechanism is functioning.

d) If the Reserve Bank is to adequately discharge its responsibilities to ensure compliance of the NBFC-MFIs with its regulation, it will also need to considerably enhance its existing supervisory organization dealing with NBFC-MFIs.

Money-lending Acts

The document says that there are Acts in several states governing money lending. They do not specifically exempt NBFCs thought they do exempt banks, statutory corporation, co-operatives and financial institutions.

It also says that as aTechnical committee of the Reserve Bank has pointed out despite the legislation, a ;arge number of money lenders operate without license and even the registered money lenders charge interest rates much higher than permitted by the law, apart from not complying with other provisions. The report states that "Signs of effective enforcement of the legislation are absent".

The technical committee has recommended that since NBFCs are already regulated by the Reserve Bank, they should also be exempted from the provisions of the money lending acts.

It has been, therefore, recommended that NBFCs should be exempted from the provisions of the Money-Lending Acts, especially as interest margin caps and increased regulation are being recommended.

Concluding Observation

In the conclusion, the document says that there have been many surveys, both in India and abroad as to the impact of microfinance on the lives of the poor people. It is intended to reach. The results have been both conflicting and confusing. These surveys report many success stories, but they also create fears that microfinance has in some cases created credit dependency and cyclical debt. Doubts have also been expressed as to whether lending agencies have in all cases remained committed to the goal of fighting poverty or whether they are solely motivated by financial gain.

It further says that in a recent study commissioned by Grameen Foundation and published in May 2010, Dr.Kathleen Odell has made a survey of several significant microfinance impact evaluations released or published globally between 2005 and 2010. Her general conclusion is that while these studies suggest that microfinance is good for micro business, its "overall effect on the incomes and poverty rates of microfinance clients is less clear, as are the effects of microfinance on measures of social well-being such as education, health and women empowerment". The lesson, therefore, is that mere extension of micro credit unaccompanied by other social measures will not be an adequate anti-poverty tool.

These are conflicting estimates regarding the total demand for microfinance in the country and the extent of penetration. However, all these estimates confirm the fact that the present amount of microfinance provided by both SHGs and MFI is a small portion of the total demand.

The document further says that the growth in the combined loan portfolio of both SBPL model and the MFI model was 51% in 2009-09 and 32.53% in 2009-010. The MFI model alone grew by 97.07% and 56.33% in those years. The rate of growth of the SBPL model was therefore much smaller.

It is therefore, obvious that (a) the over- all penetration of microfinance in the country is inadequate, (b) there is undue concentration of effort in the southern Region to the relative neglect of other regions and (c) in the SBPL model a much more sustained effort is needed by banks both through this model and directly.

It is reported that the high rate of growth achieved by MFLS has been accompanied by the emergence of several disturbing features such as unaffordable high rates of interest, over- borrowing and coercive recovery practices. The recommendations are directed towards mitigating these adverse features. There is a need for moderation of the rate of growth of the MFI model and for great efforts in those regions which have hitherto been neglected.

MFIs need to find the right balance between the pursuit of the social objective of microfinance and the interest of their shareholders. Responsible finance has meaning only in the context.

The document also points out that while making the recommendation it has been recognized the need to protect the borrowers who represent a vulnerable section of society. It has been observed that MFIs can only function effectively in a proper business environment. This means that while the lender has a responsibility to provide timely and adequate credit at a fair price in a transparent manner, the borrower also has the responsibility to honour his commitment for payment of interest and repayment of principle.

Microfinance is an important plank in the agenda for financial inclusion. The future cannot be left entirely to the stating of good intentions. It, therefore, calls for strong regulation.

The Impact of Micro-Credit on Social Status: A Critical Investigation of Bangladesh

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Bird's Eyeview

The 45-pages document critically examines how micro-credit affects the creation and modification of social capital of poor rural women micro-credit borrowers of Bangladesh. It specially explores what type of social capital (bridging, bonding and linking in one hand and positive and negative on the other) is created and/or modified by micro-credit and what are the structural conditions under which micro-credit creates and /or modifies social capital. Whether micro-credit creates or modifies social capital and whether the social capital induced by it is positive or negative are largely determined by the structural conditions under which micro-credit impacts upon social capital: micro-credit institutional design at organizational level, gender hierarchy at societal level, legal-political factors at state level and neo-liberalism at global, political and economic levels.

The document is divided into four chapters. After the introduction, the second chapter deals with 'key concepts and their causal relationships'. The following chapter is the empirical one that presents the case study of Bangladesh on micro-credit's creation and modification of social capital preceded by a general introduction to group based micro-credit. The last chapter draws some general conclusions.

In the introduction, under the sub-title "Problem Statement"' the document points out that although there is little doubt that micro-credit and social capital are closely linked, there are disagreements about the nature of their linkage. It is often observed that micro-credit operation processes, in fact, create new social capital and even add with or modify existing stock of social capital in a community.

Van Bastaeler (2000:2) observes that social capital is the solution of information uncertainties in finance market for the poor. He informs that many credit programmes for the poor based on individual collateral saw low repayment as the incentives' structure was weak and the delivery process was mired in bureaucratization and politicization. However, micro-credit based, instead, on social collateral showed that credit for poor can also be financially viable. Van Bastaeler identifies two main elements: joint liability for loans of small, self-selected and homogenous borrowers' groups and 'contingent renewal principle' or denial of access to future credit to all group members in case of default by any group member.

The document says that Bangladesh is the case country for this for a least four particular reasons. First, the country is the pioneer of micro-credit and one of its biggest laboratories so far both in terms of population covered and number of MFIs. Three of the worlds biggest MFIs, ASA, BRAC and Grameen Bank are all based in Bangladesh. Second, micro-credit as usually practices in Bangladesh is generally known as a development programme but usually functions as a financial industry, effectively making it a hybrid of business and development work, presenting an instance of social capital leading to economic capital. Third, micro-credit pioneered in Bangladesh is based on neo-liberal economic and social principles. Fourth, micro-credit as a neo-liberal development innovation of Bangladesh NGO is being replicated throughout global south as well as northern countries.

In **Chapter II**, the documents points out that with the arrival of Post Washington Consensus (PWC), another phase of neo-liberalism, micro-credit received open endorsement of the whole international development hierarchy: the bank, the fund, the regional development banks and the donors, micro-credit is deemed to connect neo-liberalism discipline at global level with individual level within communities through state configuration.

Micro-credit as distributed by the MFIs is a kind of intermediary loan that is broadening financial market by introducing new financial instruments/products catering financial service demands of new users.

The document further says that the instrumentality of social capital for neo-liberalization becomes apparent with prioritization of financialization in proposal for PWC followed by emphasis on social capital in the requisite development strategy. If micro-credit instrumentalises social capital in social embedding of financial liberalization, social capital formation is subordinated to economic capital formation/expansion. The consequence may not be developmental and emancipator for micro-credit borrowers with outcome in terms of social capital being suboptimal or negative or even regressive in the long run.

In **Chapter III**, the paper discusses about scope and nature of group based micro-credit in general and particularly in Bangladesh.

It says that microfinance in general and particularly micro-credit has become the crux of NGO led development and poverty reduction programme in Bangladesh. Grameen Bank is the global pioner of micro-credit in the country. Together with Association for Social Advancement (ASA) and Bangladesh Rural Advancement Committee (BRAC), the three are the country's largest NGOs and Micro Finance Institutions (MFIs). According to Palli Karma-Sahayak Foundation (PKSF), the public sector apex body for microfinance sector, there are currently 233 MFIs in Bangladesh in addition to the above three. Between 1995 and 2007, Grameen Bank disbursed an accumulated micro-credit worth BDT 3,56,798 million to 7.41 million credit group members from 80,678 villages. On the other hand, in 2008 along, the total micro-credit disbursed by the 233 partner organizations (POs) of PKSF was BDT 24,342,869,043. In FY 2007-08, the total number of credit group members of these POs were 1,11,65,235 of whom 90.06% were women.

Morduch (200:619) notes mainly three sets of problems with institutional design of credit programme targeting poor households prior to micro-credit. They are: high transaction costs per loan as opposed to small scales, particular difficulty of determining the riskiness of potential borrowers and monitoring the progress of clients as they are poor and belong to informal sector, and, lack of such assets in low-income households that can be used as collateral. These problems in fact became the points of departure in new institutional designs that marked micro-credit operations of Grameen Bank and its followers.

The paper further mentions that the innovative institutional design of micro-credit that enabled it to address the aforementioned problems of transaction cost, information asymmetry and collateral is based on social international of an economic exchange as micro-credit. Throughout the three stages of credit transaction, pre-loan disbursement, loan disbursement and post-loan disbursement, micro-credit incorporates a group based lending approach unlike individual lending of traditional banking operations.

The rationale and utility of the group based lending is well manifested in case of Grameen Bank according to Hashemi (2997:110) "since collateral is not required, the Bank relies on the group mechanism to ensure effective repayments. The group mechanism transfer risks of non-payment from the Bank to the group itself. The problem of asymmetrical information (the bank having limited information on borrowers) is resolved through selection of members by the group (screening out high risk borrowers), and through imposition of joint liability on the group".

Micro-Credit: Creation and Modification of Social Capital in Bangladesh

The document states how micro-credit is creating and modifying social capital (bonding, bridging and linking) intermediated by structural conditions namely micro-credit institutional design, gender hierarchy, legal-political factors and neo-liberalism.

It is observed that social capital formed/enhanced through micro-credit groups is facilitating access and use of economic capital for poor rural women that is resulting into income earning opportunities, asset ownership and capital accumulation subsequently leading to economic emancipation and social change. Though largely true, this is not the whole truth. Ethnographic study in Goetz and Sen gupta (1996:53) show that women's access to micro-credit loans cannot necessarily result empowerment without their control over loan use within a household. Their evidence suggests that "for any household, the gendered division of labour in production, gendered differences in consumption patterns, will affect the way credit is used". Therefore, it is seen that the positive new stock of bonding (norms and networks from credit groups) is undermined by a negative existing stock (oppressive family relationships) dictated by gender hierarchy.

The paper further points out that neo-liberalism as the dominant development paradigm through finacialization and marketization also influences bonding capital formation/modification role of micro-credit often in a negative

way. The true extent of the negative impact of neo-liberalization of micro-credit delivery upon bonding social capital is further evident from expansion of money lending business among rural women. The later borrows money from micro-credit lender and then informally lends that in 120% interest to kin and acquaintances.

This brings forward another related aspect of neo-liberal socio-economic market regulation - combination of contract law and social control for profit maximization with collective responsibility of group members for individual loan. The concerned MFI may withhold future loans or force other group members to pay her dues anyhow even if it takes selling off her possessions or assets. Peer pressure is however continuously present as a social control in micro-credit relationships in other forms like peer monitoring. Drawing upon existing social and cultural institutions and power relations embedded in them, peer monitoring tend to regulate day-to-day production and consumption features of borrower women and their households. So much so, that one credit group member is found to outburst in despair: "since we joined the lending groups, everybody in the village can tell us what to eat and what not to eat. When we failed to make weekly repayments our group members asked, why did we eat chicken yesterday?" so it seems that micro-credit is also creating negative social capital through recognition of social surveillance and social control as norms of economic and contractual relationships and subsequent appropriation of existing and new social networks for their execution. In this case, norms and networks resulting from micro-credit are often curtailing economic and social opportunities of borrowers instead of fostering them.

The paper further says that drawing upon changing management ethic of organizational self-sustainability that again is rooted in neo-liberalization process; bridging and linking capital promoted by micro-credit in Bangladesh has often lost emancipator potentials. In the first place, the country is marked by 'deeper structures' like control of political and economic resources, rent seeking and corruption, patron-clientlism, and, patriarchy. Gender hierarchy plays a certain role in determining the level of bridging capital and linking capital made available to poor rural women through micro-credit. As referred earlier in relation to bonding, women are usually the lending medium of micro-credit rather the actual end consumers. In 95% of cases, it is the men of women borrowers' families rather than they themselves who are the end users of their loans. Subordinated by patriarchal social structure and discriminated by gender segregated labour market, women borrowers often cannot work outside home to utilize micro-credit loans themselves. Instead their male kin, generally husband, brother or son, uses the loans to earn for the family as a whole. Women therefore turn into intermediaries and disciplining devices for the MFIs. In order to secure loan repayment installments on a regular basis, and ensure quick and full recovery of defaulted loans, indirect disciplining of end user men through exerting pressure on the borrowing women of their families tends to be more useful. Therefore, when micro-credit is reaching up to poor rural women intermediated by household power structure marked by gender hierarchy, women are often devoid of its full emancipator potentials due to resulting insufficient bridging and linking with multiple other social and economic actors.

So the document mentions that it is seen how formation of bridging and linking capital is negatively affected by patriarchal social structure. Now it will be seen that another such structural impediment, patron-client relationship, has been reinforced and recreated by micro-credit leading to negative bridging and linking. A micro-credit programme stipulates large and consistent membership base to legitimize itself. With imperative of financial sustainability, the stakes got higher from legitimacy to existence for the MFIs. Financial sustainability of micro-credit progamme warranted a loyal client base with consistency in repayment. As the borrowers became instrumental in financial sustainability, their development became apparently secondary in priority list of micro-credit lenders with profitable return of the investment becoming the primary one. It is reflected in how a manager of the Grameen Bank defined her organization to a researcher: "Grameen Bank is a business and not a charity" (Karim 2008:20). What obviously accompanies is nothing more than hallmark of patron-client unequal power relations set in the context of financial market exchange: turf wars between competing micro-credit lenders (Devine 1999), ostracizing of borrowers with poor repayment record (McGregor 1998), target setting before staffs for expanding number of borrowers and credit groups (Fernando 1997).

The document further points out that, lately, state has been active in ensuring compliance obligations regarding micro-credit and enforcing contract between lenders and borrowers of micro-credit. If group mechanism of repayment ever fails, MFIs seek assistance of police and court as last resort of loan recovery. There are instances of cases being filed against defaulting women and their subsequent arrest and jailing till repayment was secured. State support for enforcement of micro-credit contracts can take harsher turn with negative consequences for both borrower and lender. In another instance, one MFI initiated legal proceedings against some defaulters after group mechanism failed loan recovery. Police arrested some defaulters and on way to

the police station, the vehicle carrying the arrested defaulters had an accident and some of them died. This created huge backlash throughout the community, so much so that local people attacked and destroyed the local office of the MFI in violent protest. Such instances manifest negative linking capital implicating state-MFI nexus aimed at smooth running of a financial industry with poor as captive market, not financing for development of the poor. It is pertinent to note in this regard that the first full-fledged Poverty Reduction Strategy Paper (PRSP) of Bangladesh acknowledged need for regulatory framework for micro-credit operations but refrained from suggesting any concrete measures.

The country gradually shifted from a development state to a neo-liberal market state. Simultaneously, the basis of the country's development strategy also shifted from mixed economy to market economy.

The mainstreaming of neo-liberal ideas in state-society relations of Bangladesh reached furthest with micro-credit. Its implication for neo-liberalization is multifaceted that cut across social, economic and political spheres. The neo-liberal foundation of micro-credit renders individual borrowers, the poor rural women of Bangladesh with the role model of an individual entrepreneur, who becomes owner of petty capital, becomes self-employed, owns private property, sells labour on the market - all with the help of micro-credit. Unlike wage labourer, a range of welfare measures like overtime pay, retirement benefits and minimum wage - that make State liable, are not relevant or required for such a self-dependent poor. The state could therefore get rid of its welfare provision responsibilities for poor citizens without much hue and cry. Through micro-credit the vast rural poor of the country has effectively become part of the competitive globalized free market as consumers and producers. They are consuming finance capital, breeder chicken, mobile phones, dairy products, consumer electronics, clothes etc. that are often produced by multinational corporations (MNCs). Again, as petty producers they are purchasing inputs like genetically modified (GM) seeds, chemical fertilizers, pesticides, medicines, feed, etc. that are again sourced from MNCs in most cases.

What is apparent from this discussion so far is that micro-credit is contributing in generating and modifying social capital in Bangladesh particularly among the poor rural women who constitute bulk of micro-credit borrowers.

Concluding Observations

In **Chapter IV**, the document concludes that micro-credit is found to enrich existing stock of bonding social capital of rural Bangladesh women. Micro-credit delivery mechanism through credit group formation by MFIs like Grameen Bank and BRAC enable poor rural women to engage in associational life due to social, cultural and religious reasons. First in the process of group formation and then through day-to-day operation of the group in receiving and utilizing micro-credit loans, the poor rural women's bonds among themselves from shared similarities of gender, class and neighbourhood gets consolidated. Thus micro-credit institutional design is facilitating growth of positive bonding capital among these poor rural women capitalizing which they can take up collective economic and social actions. But positive bonding capital formation is often limited when it cannot existing negative bonding capital due to gender hierarchy. Traditional gender norms that subordinate women within family constrain their collective action scopes and outcomes. Again, financialisation and marketisation in the micro-credit institutional design and its subsequent impact in the wider rural social relations under influence of neo-liberalism lead to formation of negative bonding capital and erosion of positive bonding capital. Peer pressure and peer monitoring to ensure loan repayment and profitable return to micro-credit investment often cost trust, reciprocity and voluntarism among poor rural women. Social relation are instrumented for micro-credit exchange as market relations result into marketisation of bonding relationships. Voluntary financial support by friends and neighbours increasingly turn into informal money lending with high interest charging.

However, in the process of financial sustainability of micro-credit programmes, it is in case of bridging and bonding social capitals that micro-credit is seen to have made more creation of social capital than just modification. At least that is what is evident from existing literature. Bridging capital was indeed a unique contribution in terms of social capital creation for poor rural women who had hardly any supply of bridging capital beforehand. Poor rural women from different areas often from different religious and cultural backgrounds received unique opportunity to interact, build ties and share information by way of inter-group interaction through micro-credit institutional arrangements for credit disbursement. These open new channels of social relations that are useful not only to rip most from use of micro-credit loans but also to obtain various other social and economic opportunities. Micro-credit is also instrumental in building linking social capital for the poor rural women.

The initial positive linking capital connecting MFIs and borrowing women gradually took a downturn into negative linking capital. The initial poverty reduction partnerships were MFI is the dominant service provider patron and poor rural women borrows are service seeking captive and subordinate client. The legal-political framework of state for facilitating financially sustainable micro-credit programmes are often more inclined to secure borrowing women's compliance with micro-credit contracts and penalize breach of contract from their side rather than egalitarian regulation of micro-credit service delivery in general. The existing social structure of gender and patron-client hierarchies is instrumentalised in micro-credit delivery for its utility in peer monitoring and peer pressure for securing loan repayment despite consequent exacerbation and recreation of negative social capital.

Examining Empowerment, Poverty Alleviation, Education Within Self Help Groups

A Qualitative Study

By

NIRANTAR

February 2007

Bird's Eye View

Besides Introduction, Organizational Profiles and Methodology, this 143-page book is divided into three chapters. It also contains three annexures. The first chapter deals with the ground realities of SHGs, Empowerment and Poverty. The second chapter talks about assessing and understanding interventions in the field of SHGs, their Education and Literacy. The third chapter deals with the Logic of Micro-credit.

While introducing the study, the document says that the phenomenon of Self Help Groups (SHGs) in India is increasing at a tremendous rate. An array of powerful players - the States, banks, microfinance institutions, NGOs, corporate, and international players in the development and finance fields - are involved in the promotion of these groups. Put simply, SHGs are microcredit-based groups where women are brought together in order to access and repay loans as a collective. The scale of the phenomenon is notable. The government's SGSY (Swarnjayanti Grameen Swarozgar Yojana) scheme alone sponsors almost 2 million SHGs across the country. About 16 million poor households have gained access to formal banking systems through NABARD's SHG-bank linkage programme.

The document points out that NIRANTAR'S interest in SHGs, however, is better explained by another fundamental characteristic of the group: 90% of all SHGs are comprised solely of women, it is the lives of these women that SHGs claim to most greatly benefit. The diversity of actors using SHGs, and the scale on which they are doing so, ensures that this rapidly growing phenomenon is increasingly affecting the lives of millions of poor women.

It further says that the attractiveness of the SHG model lies in the immediacy of tangible benefits: bringing together women into groups where they could conceivably develop a collective voice, the immediate and increased availability of small credit to those who had little or no access to it outside of moneylenders, and the stories of women who have used loans to start self-sustaining small businesses. There is, no doubt, much at stake, and hopes are riding high on SHGs. Perhaps, for this reason more than any other, it is necessary to understand and interrogate this phenomenon.

There has till recently been very little dialogue and debate within civil society about SHGs. One of the reasons for this according to practitioners in this field of development and gender is the minimalist view that microcredit is enabling poor women to at least 'get something' and that 'something is better than nothing'. The other reason for the lack of debate that has emerged is the fear that any critique of SHGs will cause the entire system to be derailed.

The document further says that NIRANTAR believes that it is necessary

to assess a phenomenon that involves so many women, and claims to have the potential to transform their lives so fundamentally. Access to equitable credit is a person's right, and delivering it to those who are denied it is no doubt a desirable achievement. But neither can credit be the only criteria by which the impact of SHGs on women's lives is assessed nor can the process by which such credit is delivered remain unquestioned.

Its aim is to understand not just the impact of SHGs on the material realities of women's lives, but also the changing discourse around microcredit, gender, and development, all the while recognizing how this new discourse and practice critically shape ground realities.

The document also points out that credit entered this scenario in the 1970s through the initiatives taken by organizations like Self Employed Women's Association (SEWA) and the Working Women's Forum (WWF). Rooted in struggles of economically marginalized women, credit was demanded as a right that women needed to gain advancement in their status. The specific form of microcredit-based SHGs was first initiated by NGOs such as MYRADA in the southern states of India as a means of organizing communities for development, with a focus on the poor. Numerous NGOs and civil society groups then adopted them as the model for delivery of credit and bank linkage across the country.

Once the experiences of organizations such as SEWA and WWF had established the record of women as good re-payers of credit, the State and nationalized banks began to realize the creditworthiness of women. This acted as an important impetus for the formation of microcredit-based SHGs. The collective ensured that there was peer pressure on women to repay loans and the resulting high repayment rates meant that lenders were willing to forgo collateral. Even before credit entered the picture, the State had been mobilizing women into collectives, such as the Mahila Mandals, as part of the community-development initiatives. This approach, however, had failed to benefit women, as evidenced by the Committee on the Status of Women in India, set up in 1975. This worsening condition propelled the Women in Development (WID) approach. It is part of this new thinking that programmes such as Development of Women and Children in Rural Areas (DWCRA) and Support to Training and Employment Programme for Women (STEP) began, both of which created SHGs. These programmes recognized women's need for credit. There was also an emphasis on seeking to promote collective economic enterprises.

The document further points out the needs of Financial Institutions. Following the nationalization of banks in 1969, the Reserve Bank of India promoted the placement of banks in rural areas as a means to advance social objectives. As part of these efforts, more than 5,000 new branches were opened in un-banked rural locations, representing a seven-fold increase in rural locations. This strategy was however abandoned in the early 1990s despite evidence of deepening credit availability to the rural farmer and agricultural sector, since the costs to the banks were quoted as commercially non-viable. This was despite the fact that the social consequences of these earlier measures had reportedly been significant as access was enhanced through these supply-driven initiatives. However, the implementation of banking reforms in the 1990s in the interest of the efficiency of the banking sector had direct and negative effect on rural credit. It was in this context that measures were adopted to promote the microcredit model as an alternative to the bank branches model as a means to enhance the penetration of rural banks at minimal overheads. The era of liberalization has further witnessed the entry of private commercial banks into the micro-lending arena. This includes a range of microfinance institutions that work in myriad ways, charging interest rates over which there is no regulation, and using recovery mechanisms of their own choosing.

The State encouraged microcredit in the form of policy support to enable SHGs to transact with commercial banks. Public sector and cooperative banks in rural areas, supported by NABARD, have also adopted SHGs as a means to garner savings and enlarge their client base. Corporations have also increasingly begun to use SHGs as forums through which to make inroads into the huge consumer market in rural areas.

It needs to be noted that the microcredit-based SHGs model is specific to India. Though the Indian SHG model precedes the well-known Grameen Bank model, the experience of the Bangladeshi microcredit giant has had a major impact in India. That said, while the Grameen model also has a social justice agenda, it has become increasingly focused on financial efficiency.

The document also says that the focus on credit has been part of neo-liberal framework that sees the provisioning of the input of credit and the related promotion of microenterprise as an effective means to address the problems of development. This, in turn, needs to be located in the larger credit-based model of development as part of which richer countries project the provisioning of credit to developing countries as a key strategy to address problems of underdevelopment. It has been argued that this focus on credit seeks to

deflect attention from the fundamental problems underlying underdevelopment, such as unequal economic and political relations between rich and poor countries.

The fact that microcredit is focused almost exclusively on women appears to reflect a framework in which women are targeted because they are the best re-payers of loans and are viewed as the most efficient means of impacting households and families. The onus seems eternally on the benefit that the institutions, the family, and the economy get from targeting women. The needs of women themselves are not at the centre of microcredit. Further, in the microcredit paradigm it appears that there are a number of players who gain substantially from an arrangement based on poor women's own savings and resources.

In **Chapter III**, the document outlines the 'The Logic of Microcredit'. In it, a picture has emerged from the investigations, in particular, from juxtaposing the views of sponsoring agencies with the perception of the women. Some patterns have become apparent during the course of study, as similarities are seen in the way different organizations grapple with microcredit. These patterns are the core of microcredit which informs day-to-day realities of SHGs. In this chapter, the document also relates to the benefits that accrue to the different institutional players in the realm of SHGs. It is not a coincidence that such patterns exist, and indeed they are informed by powerful vested interests. It is critical to understand these patterns and the factors underlying them if microcredit is to be anything more than a reason for powerful players to make grand claims about women's empowerment and poverty alleviation.

Under the sub-title 'Instrumentality: Why do SHGs target Women?', the document says that by targeting women, the programme ensures repayment, since "women cannot go anywhere, they can be located easily - they cannot runaway, leaving their homes; they can be persuaded to repay easily as they feel shame more quickly and consider non-repayment as a betrayal of family honour". It is not the interests of women but their vulnerability that makes them attractive loan-taker.

Another aspect of the underlying gender ideologies of many microcredit groups is the invisibilisation of women's productive and reproductive roles prior to their involvement with SHGs. There is an assumption that women have 'free time' and that their role is primarily to sustain and support families. Although the programme aims at providing credit at subsidized rates to rural women, nowhere in their articulations did the staff talk about why independent access to credit and savings was significant to women's lives. The refrain, whether in DWCRA or in Swarnjayanti Gram Swarozgar Yojna (SGSY), was constantly in the context of benefits to the household and to family welfare. There is also an acknowledgment that through SHGs, women will gain an increase in income only to supplement the family income. They will not challenge the man's status as the main earner of the family.

The document further says that microcredit follows a 'laissez-faire' approach. In other words, like the free market principle the term alludes to, it neglects deeper structural inequalities and assumes that all are equally able to participate in an 'open market' system. Therefore, for example, as long as women are given money, they are thought to be automatically able to engage in development and income-enhancing activities, regardless of other institutional and social barriers that might prevent such access, or the learning inputs they may need to be able to make such decisions.

The 'laissez-faire approach was also found in the context of women approaching the group for help. The logic is that help will be given if women themselves come for help, and if they choose not to, the question of helping does not arise.

Micro-credit also tends to compel groups to operate on the principle of 'sameness'. Sameness, or homogeneity, is evident in many different spaces: uniform monetary contributions, interest rates and loan repayments schedules as well as uniformity in the caste, class, linguistic, and religious composition of the groups or in their method of functioning and day-to-day activities. In all the interventions studied, members of a group pay equal amounts as monthly savings and are charged a uniform rate of interest. Homogeneity based on identity is thought important to enable peer pressure for repayment.

The document says that homogeneity often results in the exclusion of many categories of women, especially the poorest. The majority of members of SHGs interviewed also expressed a reluctance to acknowledge any differences within group in terms of economic and social status. There is no need considered, nor are any means adopted, to make visible these inequities and deal with them as the basis of planning within the groups, for fear that this may create differences and disharmonize the group.

Under the sub-title 'Empowerment Happens Automatically', the document points out that a case study from an NGO in Orissa supported by Cashe is revealing because it captures the oft-repeated assumption that

access to credit and, thereby increase in income, will lead to empowerment. There is a convenient construction of empowerment. In this paradigm, the issue of dowry does not need to be engaged with at all. The in-laws must indeed be happy - they no longer even need to harass her for dowry.

The neat and highly problematic manner in which the economic and social are separated allows the promoters of microcredit to claim that once economic empowerment happens social empowerment will follow. The separation feeds into the logic that change will happen automatically.

But the observations challenge this new discourse at every level:

- Ground-level realities show that empowerment is not happening automatically.
- One cannot separate the economic from social. Even if we were to go along with the binary approach, the notion of economic empowerment would have to be much broader than mere financial transactions. It would have to engage with issues like women's control over resources. We have seen how women do not have decision-making powers over the use of credit and this is fundamentally linked to the gendered power relations within the family.
- Even in terms of financial change, the agenda does not seem to be fulfilled. There are three aspects of financial change: Women save, they have access to credit, and increase in incomes. In chapter I, it has been discussed that women will save as a group, and that their access to credit or the credit leading to an increase in income cannot be taken for granted.

The document further says that this shift of discourse clearly serve the interest of the State and other institutional players. If the term empowerment can be interpreted in any way, and if the State does not define it, it can't be held accountable. Further, if empowerment and poverty reduction are meant to happen automatically, then the State does not have to invest in other programmes or make policy changes that adequately address these realities or invest in women's capacities in order to address them.

The document further talks about 'The Benefits of Microcredit to Institutional Players'. It says that one of the least discussed aspects of microcredit is the benefits - direct and indirect-that accrue to a host of actors engaged in its delivery. Why is it important to know how the State, NGOs, or banks gain from microcredit. If one understands how and what benefits accrue to actors, one can better understand their motivations for practicing microcredit delivery the way they do. If there is a wish to impact the current focus and discourse on microcredit, the cost-benefit structure that underlies its current configurations must be understood.

While talking about the benefits to sponsoring agencies, the document points out that a senior member of Care-the donor agency funding Peace-said, there is limitations to the extent that gender can be addressed because creating awareness has a financial cost. On the other hand, community-based forums need to sustain themselves. Cashe too is dependent on funding from DFID. DFID wants to support microfinance. The work that Cashe/Peace would do would be part of this. There is no separate grant for gender and rights work. This was similar to the refrain of Velugu officials who said that they had specific aims of creating livelihoods-focused institutions that are self-sustaining, Such as social development, which need consistent inputs and demand support from the workers.

The document also says that in the case of NGOs, micro-credit provides the means to contribute to the sustainability of the organizations themselves. The incorporation of a service charge component in the credit line extended through NGOs ensures that organizations view this as a viable proposition. The context is also one in which there is increasing pressure from funding organizations to get NGOs to move towards greater sustainability. The larger issue that this trend raises is whether it is feasible or desirable for NGOs working with poor, marginalized communities to factor in the need for sustainability in their approach and strategies. The changes necessitated by the logic of sustainability will not necessarily be in consonance with the interest of the poor.

It is also often the case that the need to increase the scale of the interventions is prioritized over enabling processes that need to be pursued with the groups. The greater the number of groups created, the greater the resources that NGOs receive from government programmes or funding organizations. The costs incurred by NGOs in initiating and supporting SHGs reduce with the scale and volume of the financial transactions. The NGOs linked to the Swashakti programme in Gujarat, for instance, are eager to report the volumes and spread of transactions achieved to establish the viability of their intervention. Bankers are also more willing to lend to groups sponsored by lager programmes given the assured repayments of such programmes.

In this context, the document further says that the state-level SGSY functionaries in Gujarat interviewed

were clear about the strategy adopted for the state to benefit from the scheme. In order to avail itself of a larger share of the resources from the centre in the first phase itself, a large number of NGOs were roped in by the state government to help set up SHG groups all over the state. The NGOs were engaged in this task on a pre-group payment basis. There was, however, little possibility of such groups surviving beyond the initial period since there was little support provided to them by the state department functionaries who were meant to take over after the NGOs had formed the groups.

The SHG phenomenon offers real benefits to state governments in terms of access to financial resources that are often not transferred onto SHGs themselves, despite the huge expectations from them. For the purposes of the study, it is important to show the benefits accruing to the State through SHGs because the desire to accumulate these additional financial resources often directly results in the lack of any investment in learning opportunities or capacity-building inputs to ensure the effective implementation and, indeed, sheer survival of the SHGs.

With its claims that microcredit is bringing about women's empowerment and poverty reduction, the State finds a reason to lower its accountability for the implementation of other programmatic or policy-level changes to meet these two objectives. As the context, in which the sponsoring agencies are working, show, there is a wide range of violations of rights that the State needs to address. Some of the many measures that need to be implemented included ensuring that the laws related to minimum or equal wages are enforced, food security through effective implementation of the public distribution system, and the provisioning of sustained literacy and continuing education programme.

The scenario is one in which microcredit justifies the State's insufficient investment in meeting its commitments while poor women struggle to save the resources on which the microcredit phenomenon rests. This allows the State to project itself as the promoter of development while increasingly passing the onus of development to the poor, based on their own resources.

In addition to the saving that the State makes in terms of underinvestment, both in terms of meeting the large needs of the poor as well as within SHG programmes themselves, it is found that SHGs provide the State with the means to deploy free labour of members to meet a range of policy and programme targets. Involving SHGs in these various ways enables the state government to show how it is actively drawing women into processes of development. Instructions are issued to SHGs in order that the women can perform free labour for implementation of the schemes. The women have little say in processes of planning and policy-making is a matter for serious concern. Once more, women are expected to perform stereotypical roles as an extension of their invisible roles in the domestic sphere as caretakers far from addressing women's strategic concerns towards empowerment. This also absolves the State from undertaking roles for which it is responsible in the first place and implies that women are in fact subsidizing the State for its services.

In addition to the material savings that accrue to the State as consequence of SHGs, the document refers to another significant benefit - that of the SHGs being potential vote banks for political parties. All the groups interviewed during the study articulated an awareness of their allurement for political parties as votes on several occasions like - Panchayati Raj elections as well as state and national level elections.

For example, Velegu grassroots workers in Gangavaram mentioned that they had been given the responsibility of disbursing over 7 lakh in their Mandal. They also spoke about being encouraged to promote the incumbent party to the SHGs to ensure the sustainability of the programme. Women joked about how they were pursued for votes during the election campaigns, or about how parties called upon them to campaign for particular candidates. Some of them had also been approached to stand for the elections. They had not had any discussions on the basis of which candidates should be assessed or the possibility of placing their own issues on the political agenda for the candidates to respond to.

According to the book keeper linked to a Peace-sponsored NGO, during the election campaign a lot of benefits were promised, which is why most women switched to DWCRA. The TDP offered each group Rs. 500, the Congress Rs. 1000. They promised loans for less interest in exchange for votes. Women from Backward Caste and Scheduled Caste communities were also offered liquor. They were threatened with violence if they did not accept.

The document then talks about 'Benefits to Banks'. It says that the study provides ample evidence for the failure of the State to invest in women's abilities to engage with the market and other players. It is also clear that the State is continuously pushing a neo-liberal model of development and simultaneously justifying its reduced role in core developmental sectors such as health and education. Liberalization policies have made the entry of formal institutional players and market-driven processes inevitable even in the realm of development.

The microcredit-based model offers the State the attractive option of marrying the two objectives on its path to liberalization. It is opening up the market to the banking sector by providing opportunities for rural banking as well as adopting a market-based model for its own development strategies, while seeming to address people's need of access to developmental resources. In this process, the State colludes with financial institutions that wish to extend their credit base towards ensuring their viability and profitability.

Microcredit-based SHGs have proved attractive to private and public sector banks alike. On the one hand, this strategy allows financial institutions to meet their mandatory priority sector lending goals and, on the other hand, it offers banks a viable option for expanding their client base, with the assurance of high recovery rates.

While the banks are benefiting greatly from their financial interactions with SHGs, and are also claiming to be contributing to the larger social good, they are clearly indifferent about the high degree of inequity in the access to credit between and within groups.

In the vast majority of cases, women had not been provided opportunities to understand the motivations and the role that banks play, they had awareness about whose interests were being served. "The bank is giving loans and taking high interest. The bank is gaining profit from our money by giving it to others. But they are not giving it to us as a loan," said SHG members linked to the SGSY.

During the course of the survey, disturbing information emerged relating to banks that have closed down, in the process swallowing women's savings, made in the hope of credit from the programme.

While talking about the 'Benefits Accruing to Corporations' the document points out that the deployment of SHGs for corporate marketing raises several issues. In a context in which microcredit has not proved its ability to substantively impact the income level of the poor; such marketing constitutes an effort to promote consumerism among a population that continues to be impoverished. That microcredit should promote the further penetration of market forces in rural areas is concomitant with the dominance of the laissez-faire logic of microcredit as it is unfolding within the SHG phenomenon in the country. Consultations with NGOs working in other parts of the country provide evidence for the increasing penetration of the rural market by Amway beauty products in States such as Andhra Pradesh and Maharashtra. These marketing drives are taking place in a context in which women have had no opportunity to understand the processes of globalization and liberalization that are taking place and how they impact the poor.

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