Abstract

More than subsidies poor need access to credit. Absence of formal employment make them non `bankable'. This forces them to borrow from local moneylenders at exhorbitant interest rates. Many innovative institutional mechanisms have been developed across the world to enhance credit to poor even in the absence of formal mortgage. The present paper discusses conceptual framework of a microfinance institution in India. The successes and failures of various microfinance institutions around the world have been evaluated and lessons learnt have been incorporated in a model microfinance institutional mechanism for India.

1. Micro-finance and Poverty Alleviation

Most poor people manage to mobilize resources to develop their enterprises and their dwellings slowly over time. Financial services could enable the poor to leverage their initiative, accelerating the process of building incomes, assets and economic security. However, conventional finance institutions seldom lend down-market to serve the needs of low-income families and women-headed households. They are very often denied access to credit for any purpose, making the discussion of the level of interest rate and other terms of finance irrelevant. Therefore the fundamental problem is not so much of unaffordable terms of loan as the lack of access to credit itself (Kim 1995).

The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low-income households. For example, commercial lending institutions require that borrowers have a stable source of income out of which principal and interest can be paid back according to the agreed terms. However, the income of many self employed households is not stable, regardless of its size. A large number of small loans are needed to serve the poor, but lenders prefer dealing with large loans in small numbers to minimize administration costs. They also look for collateral with a clear title - which many low-income households do not have. In
addition bankers tend to consider low income households a bad risk imposing exceedingly high information monitoring costs on operation.

Over the last ten years, however, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grassroot savings and credit groups around the world have shown that these microenterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

To the extent that microfinance institutions become financially viable, self sustaining, and integral to the communities in which they operate, they have the potential to attract more resources and expand services to clients. Despite the success of microfinance institutions, only about 2% of world's roughly 500 million small entrepreneur is estimated to have access to financial services (Barry et al. 1996). Although there is demand for credit by poor and women at market interest rates, the volume of financial transaction of microfinance institution must reach a certain level before their financial operation becomes self sustaining. In other words, although microfinance offers a promising institutional structure to provide access to credit to the poor, the scale problem needs to be resolved so that it can reach the vast majority of potential customers who demand access to credit at market rates. The question then is how microenterprise lending geared to providing short term capital to small businesses in the informal sector can be sustained as an integral part of the financial sector and how their financial services can be further expanded using the principles, standards and modalities that have proven to be effective.

To be successful, financial intermediaries that provide services and generate domestic resources must have the capacity to meet high performance standards. They must achieve excellent repayments and provide access to clients. And they must build toward operating and financial self-sufficiency and expanding client reach. In order to do so, microfinance institutions need to find ways to cut down on their administrative costs and also to broaden their resource base. Cost reductions can be achieved through simplified and decentralized loan application, approval and collection processes, for instance, through group loans which give borrowers responsibilities for much of the loan application process, allow the loan officers to handle many more clients and hence reduce costs (Otero et al. 1994).

Microfinance institutions can broaden their resource base by mobilizing savings, accessing capital markets, loan funds and effective institutional development support. A logical way to tap capital market is securitization through a corporation that purchases loans made by microenterprise institutions with the funds raised through the bonds issuance on the capital market. There is atleast one pilot attempt to securitize microfinance portfolio along these lines in Ecuador. As an alternative, BancoSol of Bolivia issued a certificate of deposit which are traded in Bolivian stock exchange. In

Savings facilities make large scale lending operations possible. On the other hand, studies also show that the poor operating in the informal sector do save, although not in financial assets, and hence value access to client-friendly savings service at least as much access to credit. Savings mobilization also makes financial institutions accountable to local shareholders. Therefore, adequate savings facilities both serve the demand for financial services by the customers and fulfil an important requirement of financial sustainability to the lenders. Microfinance institutions can either provide savings services directly through deposit taking or make arrangements with other financial institutions to provide savings facilities to tap small savings in a flexible manner (Barry 1995).

Convenience of location, positive real rate of return, liquidity, and security of savings are essential ingredients of successful savings mobilization (Christen et al. 1994).

Once microfinance institutions are engaged in deposit taking in order to mobilize household savings, they become financial intermediaries. Consequently, prudential financial regulations become necessary to ensure the solvency and financial soundness of the institution and to protect the depositors. However, excessive regulations that do not consider the nature of microfinance institution and their operation can hamper their viability. In view of small loan size, microfinance institutions should be subjected to a minimum capital requirement which is lower than that applicable to commercial banks. On the other hand, a more stringent capital adequacy rate (the ratio between capital and risk assets) should be maintained because microfinance institutions provide uncollateralized loans.

Governments should provide an enabling legal and regulatory framework which encourages the development of a range of institutions and allows them to operate as recognized financial intermediaries subject to simple supervisory and reporting requirements. Usury laws should be repelled or relaxed and microfinance institutions should be given freedom of setting interest rates and fees in order to cover operating and finance costs from interest revenues within a reasonable amount of time. Government could also facilitate the process of transition to a sustainable level of operation by providing support to the lending institutions in their early stage of development through credit enhancement mechanisms or subsidies.

One way of expanding the successful operation of microfinance institutions in the informal sector is through strengthened linkages with their formal sector counterparts. A mutually beneficial partnership should be based on comparative strengths of each sectors. Informal sector microfinance institutions have comparative advantage in terms of small transaction costs achieved through adaptability and flexibility of operations (Ghate et al. 1992). They are better equipped to deal with credit assessment of the urban poor and hence to absorb the transaction costs associated with loan processing. On the other hand,
formal sector institutions have access to broader resource-base and high leverage through deposit mobilization (Christen et al. 1994).

Therefore, formal sector finance institutions could form a joint venture with informal sector institutions in which the former provide funds in the form of equity and the later extends savings and loan facilities to the urban poor. Another form of partnership can involve the formal sector institutions refinancing loans made by the informal sector lenders. Under these settings, the informal sector institutions are able to tap additional resources as well as having an incentive to exercise greater financial discipline in their management.

Microfinance institutions could also serve as intermediaries between borrowers and the formal financial sector and on-lend funds backed by a public sector guarantee (Phelps 1995). Business-like NGOs can offer commercial banks ways of funding microentrepreneurs at low cost and risk, for example, through leveraged bank-NGO-client credit lines. Under this arrangement, banks make one bulk loan to NGOs and the NGOs packages it into large number of small loans at market rates and recover them (Women's World Banking 1994). There are many on-going research on this line but context specific research is needed to identify the most appropriate model. With this in mind we discuss various possible alternatives of formal-informal sector linkages in India.

In this context, following strategic, institutional and connectivity issues related to microfinance arise.

**Strategic Issues**

- Is there a prevailing paradigm for micro-finance?
- Are there clearly visible pattern across the country?
- Is there a clearly defined foundation building blocks such as organizing principles, gender preferences and operational imperatives?
- What are methodological issues?

**Institutional Issues**

- Is there a need for a new institution?
- Should it operate all India or in a state?
- Where should it be located?
- Who can lead an institution of this sort?
- What will its contextual interconnections be?
- Who will be its beneficiaries?

**Connectivity Issues**

- How should the Corporate Financial Sector be involved?
- What is the role of donor agencies?
- How should communities be involved?
• Are there political issues that should be explicitly considered?
• Are there government policy issues?

2. The Formal Sector Institutions:

Traditionally, the formal sector Banking Institutions in India have been serving only the needs of the commercial sector and providing loans for middle and upper income groups. Similarly, for housing the HFIs have generally not evolved a lending product to serve the needs of the Very LIG primarily because of the perceived risks of lending to this sector. Following risks are generally perceived by the formal sector financial institutions:

• Credit Risk
• High transaction and service cost
• Absence of land tenure for financing housing
• Irregular flow of income due to seasonality
• Lack of tangible proof for assessment of income
• Unacceptable collaterals such as crops, utensils and jewellery

As far as the formal financial institutions are concerned, there are Commercial Banks, Housing Finance Institutions (HFIs), NABARD, Rural Development Banks (RDBs), Land Development Banks Land Development Banks and Co-operative Banks (CBs).

As regards the Co-operative Structures, the Urban Co.op Banks (UCB) or Urban Credit Co.op Societies (UCCS) are the two primary co-operative financial institutions operating in the urban areas. There are about 1400 UCBs with over 3400 branches in India having 14 million members, Their total lending outstanding in 1990-91 has been reported at over Rs 80 billion with deposits worth Rs 101 billion.

Similarly there exist about 32000 credit co.op societies with over 15 million members with their total outstanding lending in 1990-91 being Rs 20 billion with deposits of Rs 12 billion.

Few of the UCCS also have external borrowings from the District Central Co.op Banks (DCCBs) at 18-19%. The loans given by the UCBs or the UCCS are for short term and unsecured except for few which are secured by personal guarantees. The most effective security being the group or the peer pressure.

The Government has taken several initiatives to strengthen the institutional rural credit system. The rural branch network of commercial banks have been expanded and certain policy prescriptions imposed in order to ensure greater flow of credit to agriculture and other preferred sectors. The commercial banks are required to ensure that 40% of total credit is provided to the priority sectors out of which 18% in the form of direct finance to agriculture and 25% to priority sector in favour of weaker sections besides maintaining a credit deposit ratio of 60% in rural and semi-urban branches. Further the IRDP introduced in 1979 ensures supply of credit and subsidies to weaker section beneficiaries. Although these measures have helped in widening the access of rural households to
institutional credit, vast majority of the rural poor have still not been covered. Also, such lending done under the poverty alleviation schemes suffered high repayment defaults and left little sustainable impact on the economic condition of the beneficiaries.

3. The Existing Informal financial sources:

The informal financial sources generally include funds available from family sources or local money lenders. The local money lenders charge exhorbitant rates, generally ranging from 36% to 60% interest due to their monopoly in the absence of any other source of credit for non-conventional needs. Chit Funds and Bishis are other forms of credit system operated by groups of people for their mutual benefit which however have their own limitations.

Lately, few of the NGOs engaged in activities related to community mobilisation for their socio-economic development have initiated savings and credit programmes for their target groups. These Community based financial systems (CBFS) can broadly be categorised into two models: Group Based Financial Intermediary and the NGO Linked Financial Intermediary.

Most of the NGOs like SHARAN in Delhi, FEDERATION OF THRIFT AND CREDIT ASSOCIATION (FTCA) in Hyderabad or SPARC in Bombay have adopted the first model where they initiate the groups and provide the necessary management support. Others like SEWA in Ahmedabad or BARODA CITIZEN's COUNCIL in Baroda pertain to the second model.

The experience of these informal intermediaries shows that although the savings of group members, small in nature do not attract high returns, it is still practised due to security reasons and for getting loans at lower rates compared to that available from money lenders. These are short term loans meant for crisis, consumption and income generation needs of the members. The interest rates on such credit are not subsidised and generally range between 12 to 36%. Most of the loans are unsecured. In few cases personal or group guarantees or other collaterals like jewellery is offered as security.

While a census of NGOs in micro-finance is yet to be carried out, there are perhaps 250-300 NGOs, each with 50-100 Self Help Groups (SHG). Few of them, not more than 20-30 NGOs have started forming SHG Federations. There are also agencies which provide bulk funds to the system through NGOs. Thus organisations engaged in micro finance activities in India may be categorised as Wholesalers, NGOs supporting SHG Federations and NGOs directly retailing credit borrowers or groups of borrower.

The Wholesalers will include agencies like NABARD, Rashtriya Mahila Kosh-New Delhi and the Friends of Women's World Banking in Ahmedabad. Few of the NGOs supporting SHG Federations include MYRADA in Bangalore, SEWA in Ahmedabad, PRADAN in Tamilnadu and Bihar, ADITHI in Patna, SPARC in Mumbai, ASSEFA in Madras etc. While few of the NGOs directly retailing credit to Borrowers are SHARE in Hyderabad, ASA in Trichy, RDO Loyalam Bank in Manipur.
4. Mechanisms Adopted in Other South Asian Nations In Targeting Programmes for the Low Income Groups

The Grameen Bank in Bangladesh

The concept is the brainchild of Dr Muhammad Yunus of Chittagong University who felt concern at the pittance earned by landless women after a long arduous day's work labouring for other people. He reasoned that if these women could work for themselves instead of working for others they could retain much of the surplus generated by their labours, currently enjoyed by others.

Established in 1976, the Grameen Bank (GB) has over 1000 branches (a branch covers 25-30 villages, around 240 groups and 1200 borrowers) in every province of Bangladesh, borrowing groups in 28,000 villages, 12 lakh borrowers with over 90% being women. It has an annual growth rate of 20% in terms of its borrowers. The most important feature is the recovery rate of loans, which is as high as 98%. A still more interesting feature is the ingenious manner of advancing credit without any "collateral security".

The Grameen Bank lending system is simple but effective. To obtain loans, potential borrowers must form a group of five, gather once a week for loan repayment meetings, and to start with, learn the bond rules and "16 Decisions" which they chant at the start of their weekly session. These decisions incorporate a code of conduct that members are encouraged to follow in their daily life e.g. production of fruits and vegetables in kitchen gardens, investment for improvement of housing and education for children, use of latrines and safe drinking water for better health, rejection of dowry in marriages etc. Physical training and parades are held at weekly meetings for both men and women and the "16 Decisions" are chanted as slogans. Though according to the Grameen Bank management, observance of these decisions is not mandatory, in actual practice it has become a requirement for receiving a loan.

Number of groups in the same village are federated into a Centre. The organisation of members in groups and centres serves a number of purposes. It gives individuals a measure of personal security and confidence to take risks and launch new initiatives.

The formation of the groups - the key unit in the credit programme - is the first necessary step to receive credit. Loans are initially made to two individuals in the group, who are then under pressure from the rest of the members to repay in good time. If the borrowers default, the other members of the group may forfeit their chance of a loan. The loan repayment is in weekly instalments spread over a year and simple interest of 20% is charged once at the year end.

The groups perform as an institution to ensure mutual accountability. The individual borrowing member is kept in line by considerable pressure from other group members. Credibility of the entire group and future benefits in terms of new loans are in jeopardy if any one of the group members defaults on repayment.
There have been occasions when the group has decided to fine or expel a member who has failed to attend weekly meetings or wilfully defaulted on repayment of a loan. The members are free to leave the group before the loan is fully repaid, however, the responsibility to pay the balance falls on the remaining group members. In the event of default by the entire group, the responsibility for repayment falls on the centre.

The Grameen Bank has provided an inbuilt incentive for prompt and timely repayment by the borrower i.e. gradual increase in the borrowing eligibility of subsequent loans.

A survey has shown that about 42% of the members had no income earning occupation (though some may have been unpaid family workers in household enterprises) at the time of application of the first loan. Thus, the Grameen Bank has helped to generate new jobs for a large proportion of the members. Only insignificant portion of the loans (6 per cent) was diverted for consumption and other household needs.

About 50 per cent of the loans taken by male members were for the purpose of trading and shopkeeping. 75 per cent of loans given to female members were utilised for livestock, poultry raising, processing and manufacturing activity.

**Savings Programme**

It is compulsory for every member to save one Taka per week which is accumulated in the Group Fund. This account is managed by the group on a consensual basis, thus providing the members with an essential experience in the collective management of finances. Amounts collected from fines imposed on members for breach of discipline is also put into this account. The amount in the Fund is deposited with Grameen Bank and earns interest. A member can borrow from this fund for consumption, sickness, social ceremony or even for investment (if allowed by all group members). Terms and conditions of such loans, which are normally granted interest free, are decided by the group.

Factors behind success of the Grameen Bank are: participatory process in every aspect of lending mechanism, peer pressure of group members on each other, lending for activities which generate regular income, weekly collection of loans in small amount, intense interaction with borrowers through weekly meetings, strong central management, dedicated field staff, extensive staff training willingness to innovate, committed pragmatic leadership and decentralised as well as participatory style of working.

The Grameen Bank experience indicates the vital importance of credit as an entry point for upliftment programme for rural poor. If a programme is to have an appeal for people living in abject poverty, it must offer them clear and immediate prospects for economic improvement. Thereafter, it is easier to sell other interventions of social development, however unconventional they may appear, once improvements in standard of living are demonstrated.
The Grameen Bank clearly shows that lack of collateral security should not stand in the way of providing credit to the poor. The poor can utilise loans and pay them if effective procedures for bank transactions with them can be established. In case of the Grameen Bank, formation of groups with a small group of like minded rural poor has worked well, and group solidarity and peer pressure have substituted for collateral security.

**Linking Banks with Self-Help Groups : A Pilot Project from Indonesia**

In Indonesia, financial liberalization since 1988, disenchantment with traditional subsidised credit programs and an openness to innovative approaches led the Central Bank to support a pilot project in which 13 participating banks, with the assistance of 12 NGOs, have lent to about 420 self-help groups (SHGs) in the first phase, to be onlent to their members.

Some of the principles underlying the project and the guidelines that were issued to the implementing groups are listed below:

- The SHGs are to use part of their funds (almost 60%) for lending to their members and the rest for depositing in a bank to serve as the basis for refinancing from the bank.
- Savings are to come first: no credit will be granted by the SHG without savings by the individual members of the SHG. These savings are to serve as partial collateral for their loans.
- The joint and several liability of the members is to serve as a substitute for physical collateral for that part of loans to members in excess of their savings deposits.
- Credit decisions for onlending to members are to be taken by the group collectively.
- Central Bank refinance is to be at an interest rate equal to the interest rate at which the savings are mobilised.
- All the intermediaries (the Central Bank, banks, NGOs and SHGs) will charge an interest margin to cover their costs.
- Interest rates on savings and credit for members are to be market rates to be determined locally by the participating institutions.
- Instead of penalties for arrears, the banks may impose an extra incentive charge to be refunded in the case of timely repayments.
- The ratio of credit to savings will be contingent upon the creditworthiness of the group and the viability of the projects to be implemented, and is to increase over time with repayment performance.
- SHGs may levy an extra charge on the interest rate for internal fund generation (which would be self-imposed forced savings).

Within the first ten months of the implementation period, by March 1990, 7 private banks and 11 branches of government banks had made 229 group loans to SHGs, which had retailed them to about 3500 members. Loans totalling about $0.4 million had been disbursed, on an average of about $2000 per group and $118 per member. SHG savings
deposits with the bank amounted to about $400 per group, giving a credit to savings ratio of about 5. NGOs have received loans from the banks at 22 to 24 per cent which is only slightly higher than the refinancing rate of large to small banks. Rates to end users have been between 30 to 44 per cent after the NGOs and SHGs have added their margins to cover costs and build funds to cover joint and several liability. Only one of the participating banks had sought a guarantee under the scheme from the Central Bank.

Pag IBIG Fund - Philippines

Pag IBIG Fund, is one of the most financially stable Government owned-and-controlled Corporations in Philippines today. Pag - IBIG, is an acronym for Pagtulungan sa Kinabukasan (Partnership for the Future), Ikaw (You), Banko (Bank) Industriya (Industry) Gobyerno (Government). To date, it has a total of 1.2 million members with a fund base of US $800 million. The fund is a provident savings fund and a housing credit system for the wage earners.

To make the fund a better instrument for the National Shelter Program (NSP) a Presidential Decree was signed in December 1980 establishing the Home Development Mutual Fund (HDMF) as a separate entity to administer the provident fund for housing.

The main objectives of the HDMF are:

- To promote self-reliance and self-determination among workers through membership in an integrated nationwide savings system
- To invest the provident savings of its members taking into consideration the profitability and safety of the funds as a means of providing them provident benefits upon termination of their membership in the Fund.
- To promote home ownership through the establishment of an affordable and adequate housing credit system for its members
- To provide small and short loans and other benefits to its members.

For the effective working and success of the Fund it was decided to make membership to the Fund mandatory and it was also based on the conviction that people deserve higher incomes and in the process they themselves must be savers and as savers they themselves be the capital base of the nation. Waivers were granted to employers who prior to the creation of the Fund already had superior retirement and provident plans for their employees or employers whose plans are similar to those of the fund or who are incapable of paying counterpart contribution due to financial losses.

Savings and Housing are closely intertwined and the first step was to take care of the members basic need for housing. The Fund instituted a systematic, regular and easy savings system and tapped new groups of savers who could not be reached by commercial banks and became a major source of funds for developing the economy.

Membership to the fund was made voluntary in 1987. A member could withdraw his accumulated savings upon maturity of his membership after 20 years, permanent
departure from the country, total disability, retirement or separation from service due to health.

Housing loans were the Fund's greatest attraction, for which reason, a Trust Fund Agreement with the National Housing Mortgage and Finance Corporation (NHMFC) was entered into. The agreement allows the Fund to direct its lending through the NHMFC Secondary Mortgage Market System, where mortgage instruments are traded by NHMFC. The Fund was guaranteed a fixed return making it possible for the Fund to lend to its members at 9% p.a. and declare dividends.

The Government also established the Housing and Urban Development Coordinating Council (HUDCC) as the sole authority and policy making body on housing, to take charge of identifying and redefining the mandates of housing agencies. The HUDCC was to act as the lead funding agency and extend funding commitments to financial institutions who could act as loan originators for the home buyers.

To meet its major objective of assisting low and middle income families in meeting their housing requirements through the provision of appropriate and affordable housing loan packages, the HUDCC offers loan packages with interest rates ranging from 9% to 16% per annum depending upon the loan amount. Maximum loan amount per borrower is 46 times his monthly income, consisting of his monthly basic salary plus cost of living allowance plus the monthly equivalent of the weighted average of other income during the last three years. Maximum loan repayment period is 25 years but shall not go beyond the age of 70 for the principal borrower.

There was also an Appliance and Furniture Loan Programme (AFLP) that granted short term loans. The loan amount was computed based on the length of the membership and the applicant's salary. The 2 year loan carries an interest of 10.75% p.a. Later the AFLP was expanded into the Multi Purpose Loan Program (MPL) which covers various needs: educational, medical & hospitalisation, livelihood, minor home improvement, purchase of appliances and furniture etc. To qualify for a Multi Purpose Loan, a member must have made at least 24 monthly contributions, must be an active Fund member and there must be a commitment from both employer and employee to continuously remit contributions at least for the term of the loan. The loan bears an interest of 10.75% p.a., paid in advance for the first year of the loan period. The second year interest is spread and paid equally over the 24 month term of the loan. The MPL continues to lend to members on a regular basis, it enables a member to borrow again after 50% of the outstanding loan has been repaid.

Thus Pag-IBIG helps every Filipino to have his own house by pooling the savings of its members and channeling them for the long term financing requirement of housing. Urban Community Development Office of Thailand: The People's Bank

Urban Community Development Office (UCDO) was established in 1992 as a government sponsored organization with the mandate of enhancing the capacity of slum dwellers and urban poor, through credit provision process, to generate income on a stable
basis and to obtain adequate housing with secure rights and improved living environment. UCDO facilitates the formation and strengthening of savings and credit organizations in urban poor communities through technical assistance and training on organization and management of the savings groups.

The office provides wholesale loans to these member organizations to on-lend to individuals to support community development. Therefore, it serves as a bank for urban poor. To be eligible for UCDO loan, the saving group must have been engaged in savings activities for at least three months and demonstrate a clear management structure. Credit is provided as a tool to unleash communities' potential for self improvement.

The credit from UCDO consists of general purpose revolving loans to meet immediate household or community needs with a maximum three year, income enhancement loans for up to five years to support equipment purchase and working capital, and housing loans of a maximum 15 year maturity to finance group housing projects including land purchase and non-project housing loans for up to 5 years. As of Mach 1996, $ 17.8 million of credit was disbursed to the benefit of about 3000 families in 62 communities. Housing loans accounted for $12.6 million, followed by income enhancement loans ($3.8 million) and general purpose loans ($1.4 million).

All committee members of a community group must sign their names as guarantors for a loan. In the case of housing projects, land titles or the housing may have to be put as collateral as well. The lending rate is set based on cost of funds and provision for bad debts and a markup for community organizations. Current rates are kept below commercial rates thanks to UCDO's access to low cost funds. The community can decide upon the loan amount and the repayment period within the prescribed maximum terms. The community or savings group may repay daily, weekly, fortnightly or monthly. The method of repayment is flexible and arranged according to the needs and process decided by the community. The repayment rate stands at 98.7%.

5. Credit Mechanisms Adopted by HDFC (India) for Funding the Low Income Group Beneficiaries

HDFC has been making continuous and sustained efforts to reach the lower income groups of society, especially the economically weaker sections, thus enabling them to realise their dreams of possessing a house of their own.

HDFCs' response to the need for better housing and living environment for the poor, both, in the urban and rural sectors materialised in its collaboration with Kreditanstalt fur Wiederaufbau (KfW), a German Development bank. KfW sanctioned DM 55 million to HDFC for low cost housing projects in India. HDFCs' approach to low-income lending has been extremely professional and developmental in nature. Negating the concept of dependence, HDFCs' low cost housing schemes are marked by the emphasis on peoples participation and usage of self-help approach wherein the beneficiaries contribute both in terms of cash and labour for construction of their houses. HDFC also ensures that the newly constructed houses are within the affordability of the beneficiaries, and thus
promotes the usage of innovative low cost technologies and locally available materials for construction of the houses.

For the purpose of actual implementation of the low cost housing projects, HDFC collaborates with organisations, both, Governmental and Non-Governmental. Such organisations act as co-ordinating agencies for the projects involving a collective of individuals belonging to the Economically Weaker Sections. The projects could be either in urban or rural areas.

The security for the loan is generally the mortgage of the property being financed.

The construction work is regularly monitored by the co-ordinating agencies and HDFC. The loans from HDFC are disbursed depending upon the stages of construction. To date, HDFC has experienced 100% recovery for the loans disbursed to various projects.

6. Strengths of Informal Sector

A synthesis that can be evolved out of the success of NGOs/CBOs engaged in microfinance is based on certain preconditions, institutional and facilitating factors.

Preconditions to Success:

Those NGOs/ CBOs have been successful that have instilled financial value/ discipline through savings and have demonstrated a matching value themselves before lending. A recovery system based on social intermediation and various options including non-financial mechanisms has proved to be effective. Another important feature has been the community governance. The communities in which households are direct stakeholders have successfully demonstrated the success of programs. A precondition for success is to involve community directly in the program. Experience indicates that savings and credit are both critical for success and savings should precede credit. Chances of success more with women: Programs designed with women are more successful.

Operating Indicators:

The operating indicators show that programs which are designed taking into account the localized and geographical differences have been successful. Effective and responsive accounting and monitoring mechanisms have been an important and critical ingredient for the success of programs. The operational success has been more when interest rates are at or near market rates: The experience of NGOs/CBOs indicates that low income households are willing to pay market rates. The crucial problem is not the interest rates but access to finance. Eventually in absence of such programs households end up paying much higher rates when borrowing from informal markets. Some NGOs have experimented where members of community decide on interest rates. This is slightly different from Thailand experience where community decides on repayment terms and loan amount. A combination of the three i.e. interest rates, amount and repayment period if decided by community, the program is most likely to succeed. A program which is able
to leverage maximum funds from formal market has been successful. Experience indicates that it is possible to leverage higher funds against deposits.

The spreads should be available to meet operational costs of NGOs. Most of the directed credit program in India like Kfw have a ceiling on the maximum interest rate and the spread available to NGOs. A flexible rate of interest scheme would indicate a wider spread for NGOs. Selected non-financial services, viz. business, marketing support services enhance success. Appropriate incentives for borrowing and proper graduation of credit has been essential component of success. A successful program can not be generalized for all needs and geographical spread. The programs which are simple and replicable in similar contexts have contributed to success.

Betterment in quality of life through better housing or better economic opportunities is a tangible indicator of success. The programs which have been able to demonstrate on some measurable scale that the quality of life has improved have been successful. To be successful the program productivity with outreach should match. The credit mechanism should be flexible meeting multiple credit needs: The programs which have taken care of other needs such as consumption, marriage etc. besides the main shelter, infrastructure or economic needs are successful.

**Facilitating Factor**

Another factor that has contributed to the success is the broad environment. A facilitative environment and enabling regulatory regime contributes to the success. The NGOs/CBOs which have been able to leverage funds from formal programs have been successful. An essential factor for success is that all development programs should converge across sectors.

7. **Weaknesses of Existing Microfinance Models**

One of the most successful models discussed around the world is the Grameen type. The bank has successfully served the rural poor in Bangladesh with no physical collateral relying on group responsibility to replace the collateral requirements. This model, however, has some weaknesses. It involves too much of external subsidy which is not replicable Grameen bank has not oriented itself towards mobilising peoples' resources. The repayment system of 50 weekly equal instalments is not practical because poor do not have a stable job and have to migrate to other places for jobs. If the communities are agrarian during lean seasons it becomes impossible for them to repay the loan. Pressure for high repayment drives members to money lenders. Credit alone cannot alleviate poverty and the Grameen model is based only on credit. Micro-finance is time taking process. Haste can lead to wrong selection of activities and beneficiaries.

Another model is Kerala model (Shreyas). The rules make it difficult to give adequate credit {only 40-50 percent of amount available for lending). In Nari Nidhi/Pradan system perhaps not reaching the very poor.
Most of the existing microfinance institutions are facing problems regarding skilled labour which is not available for local level accounting. Drop out of trained staff is very high. One alternative is automation which is not looked at as yet. Most of the models do not lend for agriculture. Agriculture lending has not been experimented.

- Risk Management: yield risk and price risk
- Insurance & Commodity Future Exchange could be explored

All the models lack in appropriate legal and financial structure. There is a need to have a sub-group to brainstorm on statutory structure/ ownership control/ management/ taxation aspects/ financial sector prudential norms. A forum/ network of micro-financier (self regulating organization) is desired.

8. A New Paradigm

A new paradigm that emerges is that it is very critical to link poor to formal financial system, whatever the mechanism may be, if the goal of poverty alleviation has to be achieved. NGOs and CBOs have been involved in community development for long and the experience shows that they have been able to improve the quality of life of poor, if this is an indicator of development. The strengths and weaknesses of existing NGOs/CBOs and microfinance institutions in India indicate that despite their best of efforts they have not been able to link themselves with formal systems. It is desired that an intermediary institution is required between formal financial markets and grassroot. The intermediary should encompass the strengths of both formal financial systems and NGOs and CBOs and should be flexible to the needs of end users. There are, however, certain unresolved dilemmas regarding the nature of the intermediary institutions. There are arguments both for and against each structure. These dilemmas are very contextual and only strengthen the argument that no unique model is applicable for all situations. They have to be context specific.

<table>
<thead>
<tr>
<th>Dilemmas</th>
<th>Community Based</th>
<th>Investor Owned</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Community Managed</td>
<td>Professionally managed</td>
</tr>
<tr>
<td></td>
<td>Community (self) financed</td>
<td>Accepting outside funds for on-lending</td>
</tr>
<tr>
<td></td>
<td>Integrated (social &amp; finance)</td>
<td>Minimalist (finance only)</td>
</tr>
<tr>
<td></td>
<td>Non profit / mutual benefit</td>
<td>For profit</td>
</tr>
<tr>
<td></td>
<td>Only for poor</td>
<td>For all under served clients</td>
</tr>
<tr>
<td></td>
<td>'Self regulated'</td>
<td>Externally regulated</td>
</tr>
</tbody>
</table>

The four pillars of microfinance credit system (Fig. 1) are supply, demand for finance, intermediation and regulation. Whatever may the model of the intermediary institution,
the end situation is accessibility of finance to poor. The following tables indicate the existing and desired situation for each component.

### DEMAND

<table>
<thead>
<tr>
<th>Existing Situation</th>
<th>Desired Situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• fragmented</td>
<td>• Organized</td>
</tr>
<tr>
<td>• Undifferentiated</td>
<td>• Differentiated (for consumption, housing)</td>
</tr>
<tr>
<td>• Addicted, corrupted by capital &amp; subsidies</td>
<td>• Deaddicted from capital &amp; subsidies</td>
</tr>
<tr>
<td>• Communities not aware of rights and responsibilities</td>
<td>• Aware of rights and responsibilities</td>
</tr>
</tbody>
</table>

### SUPPLY

<table>
<thead>
<tr>
<th>Existing Situation</th>
<th>Desired Situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Grant based (Foreign/GOI)</td>
<td>• Regular fund sources (borrowings/deposits)</td>
</tr>
<tr>
<td>• Directed Credit - unwilling and corrupt</td>
<td>• Demand responsive</td>
</tr>
<tr>
<td>• Not linked with mainstream</td>
<td>• Part of mainstream (banks/FIs)</td>
</tr>
<tr>
<td>• Mainly focussed for credit</td>
<td>• Add savings and insurance</td>
</tr>
<tr>
<td>• Dominated</td>
<td>• Reduce dominance of informal, unregulated suppliers</td>
</tr>
</tbody>
</table>

### INTERMEDIATION

<table>
<thead>
<tr>
<th>Existing Situation</th>
<th>Desired Situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Non specialized</td>
<td>• Specialized in financial services</td>
</tr>
<tr>
<td>• Not oriented to financial analysis</td>
<td>• Thorough in financial analysis</td>
</tr>
<tr>
<td>• Non profit capital</td>
<td>• For profit</td>
</tr>
<tr>
<td>• Not linked to mainstream</td>
<td></td>
</tr>
</tbody>
</table>
FIs
• Not organized

Link up to FIs
• Self regulating

REGULATION

<table>
<thead>
<tr>
<th>Existing Situation</th>
<th>Desired Situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Focussed on formal service providers (informal not regulated)</td>
<td>• include/informal recognise e.g. SHGs</td>
</tr>
<tr>
<td>• regulating the wrong things e.g. interest rates</td>
<td>• Regulate rules of game</td>
</tr>
<tr>
<td>• Multiple and conflicting (FCRA, RBI, IT, ROC, MOF/FIPB, ROS/Commerce)</td>
<td>• Coherence and coordination across regulators</td>
</tr>
<tr>
<td>• Negatively oriented</td>
<td>• Enabling environment</td>
</tr>
</tbody>
</table>

9. Possible Alternatives/Options

The three options that emerge out of above discussion regarding structure of intermediary institution is discussed below.

Option-I

• One possible option is to increase the flow of funds to informal lenders to supplement their own funds. The formal sector will take advantage of the lower transaction costs and risk premia of the informal sector so as to reach the low income group borrowers beyond the profitable reach of the formal sector. As for the beneficiaries, inspite of the transaction cost of the formal and the informal sector being transferred on to them, the cost of borrowing will remain low as compared to what exists through money lenders.

In addition, access to the formal sector funds could promote competition within the informal sector and check the exhorbitant profits being made in this sector. It also promotes allocative efficiency by offering a broader choice for the productive use of savings by beneficiaries, irrespective of which sector they are mobilised by.

Thus this approach of promoting linkages combines the strengths of both sectors to supplement the resources of the informal sector. Here it is
imperative to avoid the pitfall of discouraging informal savings by substituting cheaper formal funds for informal lenders.

The existing modes of borrowing for the low income group through the Co-operative Societies like Thrift and Credit Co.op Societies are already gaining momentum. The Formal Financial Institutions can establish linkages with these co-operative bodies. Funds could be channelised from the formal financial institutions at market rates to the low income group beneficiaries through the intermediaries like the co-operative bodies stated above. The credit worthiness of the intermediaries would be the basic security for the loans advanced by the formal financial institutions. However, the savings mobilised by the intermediaries from the informal sector could also be accepted as collaterals.

The intermediaries could then lend to groups of beneficiaries. The transaction cost of the formal sector would be transferred on to the intermediaries who would pass on the same to the beneficiaries.

In the process, the intermediaries would also charge additional fees to borrowers to cover their costs. It would also aid them in strengthening themselves. However, it would be aimed to make the funds reach the beneficiaries at applicable rates of the two institutions.

The intermediaries would accept the savings from groups as collaterals and would transfer the same to the formal sector for getting the deposits serviced better. Thus the two way flow of funds would benefit both the formal and informal sector.

The beneficiaries would benefit as the cost of borrowing would be low for them and their savings would be safe and would be serviced better.

An analysis of community-based finance systems highlights the high establishment costs of NGOs. They suggest that loan service costs are lower amongst co-operative societies, as compared to NGO-linked CBFIs, because of decentralized loan administration and availability of voluntary staff. The NGO-linked CBFI operations are generally supported by grants from national and international donor agencies.

NGO-linked CBFIs must aim at an adequate scale of operation and while it may be supported by grants to meet establishment costs in the initial period, dependency on such grants should be reduced over time. An adequate interest rate spread must be available to meet the transactions costs. CBFIs should be able to recover all costs through its financial operations, by building up their capacity for financial management, through training and interaction with the Formal sector institutions.
Option-II

- Since it is now being felt that the existing structures are inadequate to meet the housing and economic credit needs of the participating community, an Institution that would combine the strengths of an NGO and the expertise of a financial institution, with participation from the community will be appropriate.

Thus, the concept of Development Association for Savings and Credit (DASC) could be utilised to address the issue of providing better access to housing finance and economic loans for the participating community in the project area. The DASC is built on the strength of the informal groups to create and improve access to skills, resources and markets. These Groups mobilize savings from their constituent members and other formal/informal sources. The funds mobilized are thus used for meeting the credit needs of the members. The DASC is proposed to be a registered company which will affiliate the Groups based on affiliation criteria and have community representation on its decision making body.

The DASC will be initiated with the objective to create an alternate, self-sustainable, community based financial organization appropriate to meet the shelter development and livelihood needs of the weaker section belonging to the rural community.

The long term perspective of DASC will include:

- Establishment of a resource centre for shelter and livelihood development for the weaker sections of the society.
- Demonstration of a viable community based credit system in operation where the communities have access to and control over financial resources based on their own strength.
- Developing group based approach as a sustainable development paradigm for community development.

Option-III

- As mentioned before, a review of the cooperatives and NGOs illustrates a wide variety of arrangements as well as different stages of development of community-based financial institutions. In all cases, the strength of the community based systems is their close rapport and linkages with the community and its members. The broad arrangement involves a bulk loan from the Formal Financial Institution to the Community Based Financial Institution (CBFI) with specified terms and conditions for lending to
households. The CBFI will have the responsibility for loan origination and servicing and therefore would also bear the credit risk.

In terms of specific arrangements, two forms of intermediation are envisaged by the strategy. The multi-tiered structure is one in which the bulk loans from the Formal Sector are routed through a Federation or Apex Agency or an NGO, which in turn lends to a primary CBFI. In the single-tiered structure, the Formal Sector Institution deals directly with the CBFI. It is felt that the administrative costs incurred with lending through the multi-tiered model are much higher than under the single-tier model.

In promoting these linkages between the Formal Institutions and CBFIs, directly or through the NGO, it is important that basic financial principles are developed for giving bulk credit to community-based financial institutions. The purpose of the loan, credit terms and underwriting criteria should be clearly defined for the bulk credit that is provided to the CBFI.

It is essential that a delinquency risk fund (DRF) be placed as a deposit with the Formal Institution to cover delinquency risk which may draw against the DRF if the CBFI fails to make a regularly scheduled loan payment. In order to meet the the DRF requirement, CBFIs should be encouraged to start a savings scheme. An appropriate legal status for the CBFI to be able to receive the bulk credit is essential. This may involve a simple registration under the Societies Act. The legal form should permit the receipt of bulk credit for onlending to the individual members.

10. Conclusion

Some valuable lessons can be drawn from the experience of successful Microfinance operation. First of all, the poor repay their loans and are willing to pay for higher interest rates than commercial banks provided that access to credit is provided. The solidarity group pressure and sequential lending provide strong repayment motivation and produce extremely low default rates. Secondly, the poor save and hence microfinance should provide both savings and loan facilities. These two findings imply that banking on the poor can be a profitable business. However, attaining financial viability and sustainability is the major institutional challenge. Deposit mobilization is the major means for microfinance institutions to expand outreach by leveraging equity (Sacay et al 1996). In order to be sustainable, microfinance lending should be grounded on market principles because large scale lending cannot be accomplished through subsidies.

A main conclusion of this paper is that microfinance can contribute to solving the problem of inadequate housing and urban services as an integral part of poverty alleviation programmes. The challenge lies in finding the level of flexibility in the credit instrument that could make it match the multiple credit requirements of the low income borrowers without imposing unbearably high cost of monitoring its end-use upon the lenders. A promising solution is to provide multi-purpose loans or composite credit for
income generation, housing improvement and consumption support. Consumption loan is found to be especially important during the gestation period between commencing a new economic activity and deriving positive income. Careful research on demand for financing and savings behaviour of the potential borrowers and their participation in determining the mix of multi-purpose loans are essential in making the concept work (tall 1996).

Eventually it would be ideal to enhance the creditworthiness of the poor and to make them more "bankable" to financial institutions and enable them to qualify for long-term credit from the formal sector. Microfinance institutions have a lot to contribute to this by building financial discipline and educating borrowers about repayment requirements.

REFERENCES


Micro-Finance in the new economy - India’s Experience

R. Krishnamurthy ¹ and Makarand Ratnaparkhi ²

¹ Chief General Manager, National Bank for Agriculture and Rural Development, Regional Office, Pune, India

² Department of Mathematics and Statistics, Wright State University, Dayton, USA

Micro-Finance is emerging as a powerful instrument for poverty alleviation in the new economy. In India, micro-Finance scene is dominated by Self Help Groups (SHGs) - Banks linkage Programme, aimed at providing a cost effective mechanism for providing financial services to the 'unreached poor'. Based on the philosophy of peer pressure and group savings as collateral substitute, the SHG programme has been successful in not only designing financial products meeting peculiar needs of the rural poor, but also in strengthening collective self-help capacities of the poor at the local level, leading to their empowerment.

IFAD and the National Bank for Agriculture and Rural Development, in association with several other agencies, implemented the 'Maharashtra Rural Credit Project' during 1995-2002, having micro-finance as a crucial component. The official statistics and related MIS for savings and purpose-wise loans to 73,454 members of 4921 Self Help Groups are now available. These data have some unique features. For example, the compositional multivariate time series nature of the savings and loans data is a valuable component of the knowledge base for future. Further, our analysis shows that SHG is a useful instrument for savings mobilization and enhancing access to credit for the rural, unreached poor. Besides consumption smoothing, SHG loaning had supported working capital requirements and other productive investments as well.

Poverty persists

1. Alleviation of poverty, for a long time, has remained a very complex and critical concern among third world countries. It has been at the top of the agenda of policy planners & development specialists and a lot has been written on the subject right from the days of Adam Smith's 'Wealth of Nations' (1776) to Prof. Amartya Sen's 'Public Action to Remedy Hunger' (1991). Today, it virtually denotes the core of all developmental effort. Though conventionally identified with subsistence level of living - linked to lack of adequate food - it is now widely accepted that the problem of poverty is more deep rooted covering several interlocked aspects such as assetlessness, underemployment, uncertain & relatively unproductive employment, low remuneration, lack of bargaining power, economic vulnerability, illiteracy, proneness to disease, social disadvantage and political powerlessness. A large number of government & non-governmental organizations and international funding agencies all over the world have been engaged in this seemingly unending war against poverty using several strategies and instruments.

2. According to the latest estimates, [1] globally, 1.2 billion people live in extreme poverty (defined as subsisting on less than one dollar a day) of which 44% are in South Asia; 75 % live in rural areas. In India, as a result of sustained efforts aimed at poverty alleviation, despite an estimated number of over 300 million people crossing the poverty line during 1973-74 to 1993-94, the official data has maintained that 37.3 % of the population remained poor. A more recent estimate [2] showed a further dip in poverty level down to 26 % in the year 2000. However, the sheer size of the population in the country would indicate that about 260 million people still subsist below poverty line, even if one were to go by the official estimates.
Institutional credit and poverty

3. In India, institutional credit agencies (banks) made an entry in rural areas initially to provide an alternative to the rural money lenders who provided credit support, but not without exploiting the rural poor. After the nationalization in 1969, commercial banks in the country took upon themselves a massive task of improving access of the poor to formal credit and accelerate the flow of credit to the rural economy. Their role in poverty alleviation was more appreciated when the Government, as a major paradigm shift, decided to launch a direct attack on poverty, through its special employment generation strategies and productive asset creation programs like Integrated Rural Development Program (IRDP) [3].

4. As a part of this strategy, a multi-agency rural credit delivery structure comprising Commercial Banks, Regional Rural Banks and Cooperative Banks, with a large network of more than 1,53,000 retail credit outlets (one for every 4,100 population) was established across the country. Yet, reaching the poorest, whose credit requirements are very small, frequent and unpredictable was found to be difficult. Further, the emphasis was on providing credit rather than financial products and services, including savings, insurance, etc. to the poor to meet their simple requirements. The mismatch in perception - regarding how the poor actually use and value financial services - of those who demanded and supplied financial services, even resulted in some undesirable adverse impression in the minds of service providers regarding the credit worthiness of the poor. Further, the systems and procedures of banking institutions with emphasis on complicated qualifying requirements, tangible collateral, margin, etc., also resulted in a large section of the rural poor shying away from the formal banking sector.

5. The banks too experienced that the rapid expansion of branch network was not contributing to an increasing volume of business to meet high transaction costs and risk provisioning, which even threatened the viability of banking institutions and sustainability of their operations. At the same time, it was not possible for prudent banking to allow a population of close to 300 million - even if poor - to remain outside the fold of its business. The search for an alternative mechanism for catering to the financial service needs of the poor was thus becoming imperative.

Micro-finance - Instrument for poverty alleviation

6. Equitable gains from development on a sustainable basis and ensuring viability of financial services are key elements in a strategy of poverty reduction by means of credit support to the poor. As micro-finance is seen to be an approach addressing these concerns effectively, it has assumed significance in all the developing countries as an effective tool in fighting poverty.

7. The micro-finance scene in India is dominated by Self Help Groups (SHGs) - Banks linkage program for over a decade now. As the formal banking system already has a vast branch network in rural areas, it was perhaps wise to find ways and means to improve the access of rural poor to the existing banking network. This was tried by routing financial services through Self-Help Groups [4], formed as grass roots level institutions developed for social/economic and financial intermediation for focusing on the poor. Drawing lessons from experiments carried out in various parts of the world, particularly Asia - Pacific, an attempt was made to build financial relationship between informal groups of people and formal agencies like banks for catering to the financial service requirements of the poor, especially women. Over the years, SHG-Bank linkage model has emerged in India as a core strategy for the banking system to extend their outreach to the poorest among poor. Though SHGs existed even before the linkage program, the banks could not recognize their potential as business clients and both operated independently, without knowing the strength of the other. Intervening to forge a linkage, NABARD was instrumental in the emergence of a very strong micro-Finance movement in the country.
8. The SHG - Banks linkage program was conceived with the objectives of developing supplementary credit delivery services for the unreached poor, building mutual trust & confidence between the bankers and the poor and encouraging banking activity both on thrift as well as credit and sustaining a simple and formal mechanism of banking with the poor. The linkage program combines the flexibility, sensitivity and responsiveness of the informal credit system with the technical, administrative capabilities and financial resources of the formal financial sector. It is a design relying heavily on collective strength of the poor, closeness of NGOs to people and large financial resources of banks. Further, the SHGs have also undertaken effective social mobilization functions contributing to an overall empowerment process. The banks have externalized what would otherwise have been high transaction costs for mobilizing savings of the poor, appraisal and sanction of loans and improved loan recovery through the financial intermediative role played by SHGs.

**Micro-Finance initiatives under Maharashtra Rural Credit Project : donor IFAD**

9. The International Fund for Agricultural Development (IFAD), Rome, since its inception in 1977, has directed it’s financing to benefit the rural poor by using a wide variety of support mechanisms. Guided by the experience that banking with the rural poor is indeed a viable proposal, the Maharashtra Rural Credit Project (MRCP) (1995-2002) was conceived with a large component of micro-Finance built into it. The project has been implemented in 12 districts of Maharashtra State [5] in association with the Government of Maharashtra, Non Governmental Organizations (NGOs) and a number of other para-statal agencies. The National Bank for Agriculture and Rural Development (NABARD) was responsible for Project Management. The project aimed at increasing the outreach of financial services to the rural poor for poverty alleviation and rural development. A unique feature of the project was its participatory approach involving the village community in planning development and forging a strong relationship between the village community and the service area banks. The objectives of the project were sought to be achieved through three components:

i. development of formal financial services,

ii. informal sector savings and credit and

iii. infrastructure support for project implementation.

Development of entrepreneurial skills for promoting micro enterprises, mainstreaming gender concerns and empowerment of women were other salient features of the project.

10. The project was implemented initially in four districts, (Pune, Chandrapur, Yawatmal and Nanded) commencing in 1995. Encouraged by the results, in its second phase (1998) eight more districts (Dhule, Jalgaon, Amravati, Bhandara, Gadchiroli, Thane Beed and Nandurbar), which are backward and tribal dominated, were included. The project resulted in financing 64850 individuals for taking up income generating activities, formation of more than 9000 micro-Finance groups and credit linking 7717 groups with the formal banking system.

**Micro-Finance in MRCP : Database**

11. In order to build up a MIS for the project, an extensive sample survey (virtual enumeration) of 4921 SHGs covering 73,454 individual members, spread over the entire project area was conducted during the year 2001-02 which forms the basis for this paper. For the sake of simplicity, a one page schedule covering key parameters of the functioning of SHGs as on 31 March 2001 was canvassed with the help of trained workers of NGOs promoting the SHGs. Sample surveys of such a large coverage are rare in the literature on micro-Finance. Looking into the savings and borrowing behaviour of such a large number of rural poor groups has been made possible due to this survey. We are using the word sample, primarily to convey ‘a part coverage’ of the total population. (4921 groups out of about 9000 SHGs – 55 %). The coverage of SHGs is
not representative or selective. It is practically an enumeration attempt. The objective of this analysis is to assess the role that micro-Finance groups have played in serving the financial service requirements of rural poor in the project area.

**Survey results**

**Gender & age profile of the sample**

12. Women constituting half the population, have had much less access than men to productive means, including borrowed capital. It has been increasingly recognized that women are better managers of credit as ‘Women have plans for themselves, for their children, about their home, the meals. They have a Vision. A man wants to enjoy himself’[6]. Our sample shows that out of the 73,454 members, 70,384 respondents - nearly 95 %, were women, implying that the benefits from the project were overwhelmingly meant for women. The age profile of the members showed that about 43 % of the members were from the age group of 31 to 40 and nearly 95 % of the members were from the age group of 21 to 50 which is the age for the active work force.

**Coverage of poor and vulnerable sections**

13. The composition of SHGs showed that 58.3 % of the sample members belonged to the poor category (known as Below Poverty Line or BPL) as per the definition of Government of India [7]. Those who are not covered under this category have been termed Non-BPL members [about 42 %]. The size of Non BPL which appears to be on the higher side, is insignificant as the saving and borrowing pattern of the BPL and Non BPL suggests that the dividing line between the two categories is very thin and difference in their economic status is more due to the process of listing BPL which has its own limitations. Moreover, field experience suggests that in a typical Indian rural society, for initiating social mobilization functions, a mixed composition of BPL and Non BPL can be helpful.

14. Nearly 38 % of the sample members belonged to the socially disadvantaged groups, known as Scheduled Castes and Scheduled Tribes (SC/STs) the most vulnerable sections of the population. Within the BPL members, SC/STs constituted a much larger share of 48%. SC/STs membership of SHGs was nearly double their corresponding proportion in the State population (20%).

15. The sample data suggest that the poor and vulnerable sections had not only a sizable share in the membership, but more or less a corresponding share in availing credit as well. The total loans were shared almost equally by the BPL and Non BPL while the SC/STs had a share of about 40 % of funds provided as credit by SHGs to their BPL members.

**Poor can save**

16. Savings by members of SHGs enumerated were around Rs. 4,72,66,484 (Rs. 47.26 million), with average saving per Group working out to Rs. 9605 (US $200 approx.) during the reference period. It is interesting to note that this amount has come out of very small monthly contributions. Data show that in respect of 3922 SHGs (80%) the monthly contribution was upto Rs. 30 (about 0.6 US $) per member. The important point is that SHGS enabled the rural poor women even to save small amounts regularly and as a matter of discipline. In the absence of the SHG mechanism, it would have not been possible for the rural women to make deposits of a small amount of Rs 30 per month in a Bank. Even for the banks, it would not have been viable to transact such small and intermittent deposits. Not only was the saving regular, nearly 89 % of the SHGs had managed even to increase their monthly savings. The increase in savings contribution was upto Rs. 5 (about 16 % of the original contribution) for 73 % of the Groups. This can be viewed as an indicator of continued mutual trust among members and increasing desire to save. Moreover, the pooled savings were managed very well by the SHG members, initially for internal
lending among themselves and later, to establish a credit linkage with banks and avail larger group loans.

**Borrowing by SHG members**

17. Out of the total 73,454 members covered, 50,118 (68 %) were borrowing from the groups, implying access to credit by a large number of members. Those who had borrowed more than once after repaying old loans (active borrowers) constituted 63 % of the borrowers indicating that a substantial proportion of borrowers had used the first loan very well, repaid it and had further access to credit. Total loans mobilized by the members worked out to Rs. 17,87,20,624 (Rs. 178.7 million) with average loan amount per SHG being Rs. 36,318 and the savings to total loan ratio of 3.78. Forty four per cent of this amount was sourced as loans from the banks and the balance 56 % was from internally generated resources indicating the financial strength the SHGs have attained. It is also interesting to note that the poor are able to meet margin requirements of close to 50% from their group savings.

**Preponderance of small loans**

18. To analyze the pattern of borrowing by SHG members, the loans were classified according to different sizes. The size-class of loan accounts and loan amount are shown in the following table:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Range (Loan size)</th>
<th>Number of loan accounts</th>
<th>Amount of loan Rs.</th>
<th>Average loan amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Rs. 0 to Rs.500</td>
<td>46,687 (37.3%)</td>
<td>1,72,52,074 (9.7%)</td>
<td>370</td>
</tr>
<tr>
<td>2</td>
<td>Rs. 500-Rs. 1000</td>
<td>37,125 (29.7%)</td>
<td>3,48,79,579 (19.5%)</td>
<td>940</td>
</tr>
<tr>
<td>3</td>
<td>Rs.1000 to Rs. 3000</td>
<td>3,0382 (24.3 %)</td>
<td>6,16,59,704 (34.5%)</td>
<td>2,029</td>
</tr>
<tr>
<td>4</td>
<td>Rs. 3000 to Rs. 5000</td>
<td>7591 (6.1 %)</td>
<td>3,39,40,225 (19.0%)</td>
<td>4,471</td>
</tr>
<tr>
<td>5</td>
<td>Rs. 5000 to Rs. 7000</td>
<td>1326 (1.1 %)</td>
<td>82,59,600 (4.6 %)</td>
<td>6,229</td>
</tr>
<tr>
<td>6</td>
<td>Rs. 7000 to Rs. 10000</td>
<td>1329 (1.1 5)</td>
<td>1,23,93,264 (6.9 %)</td>
<td>9,325</td>
</tr>
<tr>
<td>7</td>
<td>Rs. 10,000 to Rs. 15,000</td>
<td>366 (0.3%)</td>
<td>48,61,456 (2.7 %)</td>
<td>13,283</td>
</tr>
<tr>
<td>8</td>
<td>Rs. 15,000 and above</td>
<td>229 (0.2 %)</td>
<td>54,74,722 (3.1 %)</td>
<td>23,907</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,25,035 (100%)</strong></td>
<td><strong>17,87,20,624 (100%)</strong></td>
<td><strong>1,429</strong></td>
<td></td>
</tr>
</tbody>
</table>

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

**Utilization of borrowed funds**

19. For obtaining further insight into the borrowing by SHG members, the purposes for which the borrowed funds were utilized were examined. These included meeting urgent consumption needs, agricultural expenses, financing off-farm enterprises and education. The percentage shares of each of these purposes in the total loan accounts and loan amount are given below.
### Purpose

<table>
<thead>
<tr>
<th>Purpose</th>
<th>% share in number of loan accounts</th>
<th>% Share in loan amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumption</td>
<td>35.27</td>
<td>28.99</td>
</tr>
<tr>
<td>Agricultural loans</td>
<td>53.37</td>
<td>57.41</td>
</tr>
<tr>
<td>Off-farm enterprises</td>
<td>7.98</td>
<td>10.95</td>
</tr>
<tr>
<td>Loans for education</td>
<td>3.38</td>
<td>2.65</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

The data show that agricultural loans (crop cultivation expenses) was the most important purpose having a share of about 53% in the loan accounts and 57% share in the loan amount. This was followed by consumption loans which accounted for about 35% in the loan accounts and about 29% in the loan amount. Evidence of some diversification in terms of borrowing for enterprises for non-agricultural purposes is also available. The purpose-wise borrowing pattern for the BPL and Non BPL members remained more or less the same, indicating that such economic segregation between the two categories is only illusory. In real-life situations, money is fungible. Borrowing from the SHGs therefore, had given the borrowers the required flexibility to manage their consumption and working capital needs simultaneously.

20. An attempt [8] was made to assess the volume of demand for loans by the rural poor by developing a model using compositional multivariate time series analysis using our database. It was observed [Fig.1 of 8 mentioned above] that the proportion of agricultural loans in the total loans was the highest during the month of July, which is a busy month as far as the agricultural operations are concerned. The element of seasonality observed in respect of agricultural loans in the multivariate time series and the corresponding lowest proportion of consumption loans during the period suggest that the SHG loans could offer the required flexibility for utilizing their borrowed amount. The volume of demand projected in [8] above also shows that SHGs can be useful financial intermediaries in stepping up the flow of working capital support to very small and marginal farmers in meeting the seasonal agricultural credit requirements. With the total number of SHGs financed by banks in India reaching 3,70,490 as on 31 March 2002, the potential volume could be large.

### Impact on the banks

21. As has been observed elsewhere [9], the participatory approach to micro-finance has improved the cost-effectiveness of poverty alleviation strategy by substantially lowering transaction costs. While commenting on the performance and impact of the project, the UNOPS Supervision Mission observed: ‘there is a transformation in the attitude and approach of the participating banks to rural financial services and especially rural clients. The innovative methodology of MRCP has taken root and is now being perceived by bankers to be a cost effective, efficient and viable alternative for rural banking. Participating banks have become more confident and skilled in extending credit to the rural poor through groups and to individual clients’. A study of branch level operations conducted by NABARD revealed that the SHGs turned out to be a channel for social mobilization and women empowerment, as also new business with quality clients and significantly increased goodwill. Externalization of operating costs in deposit mobilization, credit management and recovery through Village Development Councils and SHGs were other benefits which had a positive impact on the working results of the branches.

### Lessons learnt

22. In India, economic reforms with a human face have been accepted as the guiding principle of sustainable development. Keeping the poor at center stage, the policies need to be reoriented so as to develop and optimize the potential of such a large segment of the population
and enable them to contribute in the growth process significantly in terms of output, income, employment and consumption. Viewed from this angle, our survey results show that

- Micro-Finance can be a powerful instrument initiating a cyclical process of growth and development.
- Micro-Finance activity improved access of rural poor to financial services, both savings and credit.
- Increased access signifies overcoming isolation of rural women in terms of their access to financial services and denial of credit due to absence of collateral.
- The pool of savings generated out of very small but regular contributions improved access of the poor women to bank loans.
- It could also help in strengthening poor families’ resistance to external shocks and reducing dependence on moneylenders.
- The observed support for consumption smoothing would not have been possible, but for the SHGs internal support.
- The predominance of borrowing for crop cultivation reflects support for meeting working capital needs.
- Possibilities could be explored for using SHGs as a strong conduit for purveying crop cultivation loans to very small and marginal farmers to step up crop loan finance.

**Notes & References**


2. According to the 55th round of the Household Consumer Expenditure Survey of the National Sample Survey Organization (NSSO) covering the period July 1999 to June 2000, the proportion of people below poverty line has fallen to 26.1%.

3. Integrated Rural Development Programme (IRDP) was the single largest credit based poverty alleviation programme of its type anywhere in the world, in terms of magnitude, number of borrowers, level of investment and operational area. IRDP aimed at providing income generating assets and self-employment opportunities for the rural poor below poverty line with specific coverage targets for women (40%) and physically handicapped (3%). Since the inception of the programme till 1998-99, 53.50 million families have been covered under IRDP at an expenditure of Rs.1370 million. Though there have been patches of good performance, broadly speaking, the experience particularly with the credit linked IRDP programme was not found to be as encouraging as envisaged.

4. Self-Help Group (SHG) is a small voluntary association of poor people, preferably from the same socioeconomic 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. The concept of SHGs is based on the following principles viz., Self help supplemented with mutual help can be a powerful vehicle for the poor in their socio economic development; Participative financial services management is more responsive and efficient; Poor need not only credit support, but also savings and other services; Poor can save and are bankable and SHGs as clients,
result in wider outreach, lower transaction cost and much lower risk costs for the banks.

5. Maharashtra is the second largest State in India having 9.37% in the total geographical area & 9.1% in total population. The State occupies a place at the economic & industrial forefront of the Indian economy, having a substantially higher per capita income of Rs. 15410 (at constant 1993-94 prices) as compared to the all India income of Rs. 10204. Despite credentials of an industrially developed State, Maharashtra has a large population living below poverty line (37% in 93/94) with a high rural - urban disparity.

6. Dr. Muhammad Yunus Founder of Grameen Bank, Bangla Desh.

7. According the official definition, a family (of five persons) is said to fall below poverty line if the annual income is less than Rs. 24,000.


9. MRCP Supervision Mission (11-22 September 2001) AIDE MEMOIRE
Microfinance Deal To Benefit 30,000 Poor in India

Grameen Foundation-USA Plays Catalytic Role to Bring Capital to the Industry

By Fiona McDowell, Grameen Foundation USA

After months of analysis, negotiating and planning, GF-USA and its partners completed a securitization agreement that leverages GF-USA’s $325,000 investment by a ratio greater than 12:1, thus generating $4.3 million in micro-loan capital for the poorest of the poor in India.

This securitization deal between ICICI Bank, India’s largest private commercial bank, and SHARE Microfin Ltd. is the largest ever in the history of microfinance and only the second of its kind in the world. It reflects the growing importance and sophistication of the microfinance sector in India.

The agreement, which was signed on January 20, 2004, has received widespread recognition as a landmark achievement for the micro-finance industry. The Economist, in its February 7, 2004 issue, noted the deal’s exceptionally high leverage: “Grameen [Foundation USA] sees its cash deposit multiply twelve-fold on its way to the poverty stricken borrower.”

Janet McKinley, chairman of The Income Fund of America and Vice-Chair of GF-USA’s Program Committee, is enthusiastic about the potential for long-term impact on the industry: “I believe it will encourage more of these types of transactions that can play a strategic role in making microfinance more widely available to the world’s poorest communities.”

Under the agreement, ICICI Bank purchased $4.3 million of SHARE’s outstanding loan portfolio (similar to the way that car loans and home mortgages are resold). The $4.3 million received by SHARE will provide the capital needed to scale up its lending with 25,000 new female clients during the first quarter of 2004 (from 198,000 members as of December 31, 2003). The interest paid by SHARE through this deal is almost four percent less than the rate it typically pays on commercial loans. ICICI Bank will receive and process the payments made by SHARE’s borrowers, absorbing much of the data management duties and easing the flow of capital throughout the loan process. The term of the deal is one year, though SHARE expects to turn over new loan portfolios to ICICI Bank on an ongoing basis in similar arrangements.

This agreement makes good business sense for ICICI Bank, which can now access a hard-to-reach market through SHARE, an experienced microcredit lender. It also helps the bank meet its government-mandated target for lending to the microfinance sector (similar to those required under the Community Reinvestment Act in the U.S.)

GF-USA supplied the two essential elements necessary to reach agreement -- technical assistance and the collateral deposit of $325,000 that accounted for 93 percent of the guarantee required by ICICI Bank.

“What really transformed this innovative use of securitization into a reality was the strategic thinking and determination of all of the participants, grounded in the common goal of reducing poverty among India’s poorest people,” noted Alex Counts, president of GF-USA.
SHARE currently provides micro loans, usually no more than $100, and other financial services to more than 200,000 poor families in the Indian state of Andhra Pradesh (where approximately 45 percent of its 75 million citizens live in poverty) and neighboring Chattisgarh. Prior to this transaction, GF-USA provided SHARE with $322,000 in local currency-denominated loans to support its impressive 230 percent growth between 2001 and 2003. SHARE, following in the footsteps of Grameen Bank’s aggressive expansion in the late 1980s and 1990s, has a long-term goal of providing one million of India’s poorest with micro-finance services by 2007. Through innovative financing arrangements like this one, GF-USA is committed to helping SHARE reach its goals.

What’s Next for India?

India is a country where demand for microfinance services amongst the poor far exceeds supply. Fewer than 10 percent of India’s 75-80 million households that could make use of micro-finance have access to it. One of the greatest barriers is the industry’s lack of capital. GF-USA and ICICI Bank are now incorporating an India-based finance company, Grameen Capital India Pvt. Ltd., to structure similar securitization transactions to bring the much needed capital to Indian micro-finance institutions.

Robert Eichfeld, Chairman of GF-USA’s newly formed Capital Markets Committee and former head of Citibank’s South Asia and Middle East region sees a solution on the horizon: “Grameen Capital India Pvt. Ltd., will break through the capital constraint barrier that has prevented the sector from growing as quickly as it is otherwise capable.”

For more information about GF-USA’s work in India, contact Julie Stahl at: jstahl@gfusa.org

Microloan Brings Borrower Success

D. Ellevva and her husband Durgiah live in a small, dusty village about 60 miles north of the central Indian city of Hyderabad. In a region where the poorest often hire themselves out as day laborers for a pittance (20 rupees (less than 50 cents) per day for a woman, 40 rs for a man), D. Ellevva had little hope of escaping this grinding poverty. Until, that is, a local branch of SHARE Microfin Ltd. started a center in her village. D. Ellevva formed a group with four other women to become eligible for a loan of 5000 rs, which she used to purchase a buffalo. The buffalo gave birth to a calf and now provides milk that D. Ellevva can sell. A second loan of 3000 rs allowed her to buy two goats and vegetables to resell in the local market. Though still in her first year of borrowing, D. Ellevva can see the changes micro-credit has brought to her life: “I am very happy to have taken a loan,” she says. “Now I am in business for myself and get regular income, and don’t have to work as a laborer any more.” She doesn’t plan to stop there, however. With her next loan she hopes to purchase another buffalo or perhaps a bore well to irrigate the crops her husband tends, growing her business and her income in the process.
What sort of dogmatic free-market ideologue would use poor people's (often socially-constructed) desire for credit to justify shrinking the already beleaguered welfare policies of wretched Third World states?

Consider this outlandish claim: 'I believe that "government", as we know it today, should pull out of most things except for law enforcement and justice, national defense and foreign policy, and let the private sector, a "Grameenized private sector", a social-consciousness-driven private sector, take over their other functions.'

Grameen is Bangladesh's 'barefoot bank' specializing in group loans to low-income women. And the Vanderbilt University-trained economist who made that statement, Muhammad Yunus (in his autobiography Banker to the Poor), just won the Nobel Peace Prize.

Yunus has a grand self-image, telling a Dhaka press conference last week: 'Now the war against poverty will be further intensified across the world. It will consolidate the struggle against poverty through microcredit in most of the countries.'

Yet this seemingly benign, three-decade old attempt to foster entrepreneurship amongst impoverished women has attracted intense grassroots - and also professional - criticism.

Or did you miss the critiques? Not surprisingly, the establishment press loves Yunus, nearly as much as do Bill and Hillary Clinton. The Financial Times made this outlandish claim, backed by no evident research: 'Microfinance has played a central part in Bangladesh's success in reducing poverty by almost 10 percentage points over the past five years, to 40%, a rate that puts Bangladesh on track to meet its Millennium Development Goal of halving poverty by 2015.' Moreover, 'Grameen's business model is in rude health.'

The Wall Street Journal profiled Yunus on its front page five years ago: 'To many, Grameen proves that capitalism can work for the poor as well as the rich,' having 'helped inspire an estimated 7,000 so-called microlenders with 25 million poor clients worldwide.'

Yet looking more closely, the Journal's reporters - including the late Daniel Pearl (senselessly beheaded by Islamic extremists) - conceded the prevalence of Enron-style accounting. A fifth of the bank's loans in late 2001 were more than a year past-due: 'Grameen would be showing steep losses if the bank followed the accounting practices recommended by institutions that help finance microlenders through low-interest loans and private investments.'

A typical Grameen gimmick is to reschedule short-term loans that are unpaid after as long as two years, instead of writing them off, letting borrowers accumulate interest through new loans simply to keep alive the fiction of repayments on the old loans.

(A Bostonian called Ponzi made this reverse pyramid technique infamous amongst bankers many years ago, and the Bretton Woods Institutions updated the practice during the 1980s during the Third World debt crisis, and continues to lend often simply to permit payments to be made on old debt in arrears.)

Not even extreme pressure techniques - such as removing tin roofs from delinquent women's houses, according to the Journal report - improved repayment rates in the most crucial areas, where Grameen had earlier won its global reputation amongst neoliberals who consider credit and entrepreneurship as central prerequisites for development.

By then, even the huckster-filled microfinance industry felt betrayed:'Grameen Bank had been at best lax, and more likely at worst, deceptive in reporting its financial performance', wrote leading microfinance promoter J. D. Von Pischke of the World Bank in reaction to the WSJ revelations. 'Most
of us in the trade probably had long suspected that something was fishy.'

Agreed Ross Croulet of the African Development Bank: 'I myself have been suspicious for a long time about the true situation of Grameen so often disguised by Dr. Yunus's global stellar status.'

Several years earlier, Yunus was weaned off the bulk of his international donor support, reportedly $5 million a year, which had until then reduced the interest rate he needed to charge borrowers and still make a profit. Grameen had become 'sustainable,' self-financing, with costs to be fully borne by borrowers.

He had also battled backward patriarchal and religious attitudes in Bangladesh, and his hard work extended credit to millions of people. The secret was that poor women were typically arranged in groups of five: two got the first tranche of credit, leaving the other three as 'chasers' to pressure repayment, so that they could in turn get the next loans.

But at a time of new competitors, adverse weather conditions (especially the 1998 floods) and a backlash by borrowers who used collective power of nonpayment, Grameen imposed dramatic increases in the price of repaying loans. And it is here that Grameen Bank's main philosophical position - 'We consider credit as a human right' – was reduced merely to an argument for access, not affordability.

In that regard, Yunus is entirely different from all the rights-based social movements which have demanded 'rights' in terms of free lifeline access to healthcare, education, housing, land, water, electricity and the like.

Although criticism of Grameen 'is still a minority view' and Yunus performed 'miracles' in rolling out credit to the masses, according to Munir Quddus, who chairs the Department of Economics and Finance at the University of Southern Indiana, the hype needs more investigation than apparently was given by the Nobel committee: 'The very nature of setting up groups leaves out the very poor who would be perceived by fellow members to have no ability to generate income and therefore high risk.'

Quddus continues: 'Others have pointed out that micro-credit simply deepens the exploitation of the women since the rates of interest charged by the bank in real [after inflation] terms are quite high; consequently, credit often worsens the debt situation and gives the husbands even more leverage.'

Gaining leverage over women - instead of giving them economic liberation - is a familiar accusation. In 1995, New Internationalist magazine probed Yunus about the 16 'resolutions' he required his borrowers to accept, including 'smaller families'.

When New Internationalist suggested this 'smacked of population control', Yunus replied, 'No, it is very easy to convince people to have fewer children. Now that the women are earners, having more children means losing money.'

In the same spirit of commodifying everything, Yunus set up a relationship with Monsanto to promote biotech and agrochemical products in 1998, which, New Internationalist reported, 'was cancelled due to public pressure.'

As Sarah Blackstock reported in the same magazine the following year: 'Away from their homes, husbands and the NGOs that disburse credit to them, the women feel safe to say the unmentionable in Bangladesh- micro-credit isn't all it's cracked up to be... What has really sold micro-credit is Yunus's seductive oratorical skill.'

But that skill, Blackstock explains, allows Yunus and leading imitators 'to ascribe poverty to a lack of inspiration and depoliticize it by refusing to look at its causes. Micro-credit propagators are always the first to advocate that poor people need to be able to help themselves. The kind of micro-credit they promote isn't really about gaining control, but ensuring the key beneficiaries of global capitalism aren't forced to take any responsibility for poverty.'
Though I have never been to Bangladesh and have only discussed these problems with Yunus once (more than a decade ago when he visited Johannesburg), microfinance gimmickry certainly did damage in Southern Africa.

For example, in 1998, when the emerging markets crisis raised interest rates across the Third World, a 7% increase imposed over two weeks as the local currency crashed drove many South African borrowers and their microlenders into bankruptcy.

Next door in Zimbabwe, a $66 million flood of World Bank financing during the 1980s (in lieu of land reform) revitalized a rural microfinance sector initiated under late 1940s racist Rhodesian rule. The Bank program ultimately reached 94,000 households. But within a decade, the result was a peasant default rate of 80% in the impoverished 'Communal Areas' (equivalent to apartheid Bantustans).

Repayment affordability was a huge factor, since a typical lender's overhead and collection costs represent 15-22% of the amount of a small loan, including incorporation of a 4% default rate. In Zimbabwe, servicing loans of even just a few hundred US dollars represented enormous burdens when, according to one Agriculture Ministry survey in 1989, the average net crop profit per hour of labour was just $0.15.

Michael Drinkwater’s detailed study of central Zimbabwe showed that 'improving farmers' access to credit has placed many of them in serious difficulties' compounded by 'an overzealous launching of a group credit scheme' and the 'doubtful viability of high cost fertiliser packages' inappropriate for the erratic climate. 'The increase in credit use means farmers have to market more to stay solvent... At the household level it is commonly debts not profits that are on the rise.'

To address the crisis, in 1991 the World Bank unsuccessfully promoted even more Grameen-style group credit, albeit with the caveat that 'Zimbabwe's experience to date with group lending has not been favourable. The organisation of groups is initially expensive and time-intensive', and 'major problems have become apparent.'

Not far away, in Lesotho, anthropologist James Ferguson studied a 1975 World Bank report that guided the country's development strategy: 'In a "Less Developed Country", where the cash economy is on such a precarious basis, there must be [according to the Bank] "a conspicuous lack of credit for the purchase of farm inputs," and it is obvious that "credit will play a critical role in all future major agricultural projects."

Rebutted Ferguson, 'It is never explained exactly why the need for credit is so critical. It is true that most Basotho invest very little in agriculture probably due to their intelligent appreciation of the low potential and high risks of capital intensive farming in Lesotho but this is usually not a matter of being unable to obtain the cash to make such an investment. Most families have access to wage-earnings or remittances, and this money most commonly comes in large lumps which could easily be used for agricultural inputs, but for the most part is not. Yet in the "development" picture, the need for credit is almost an axiom.'

Ugandan political economist Dani Nabudere has also debunked 'The argument which holds that the rural poor need credit which will enable them to improve their productivity and modernise production.' For Nabudere, this 'has to be repudiated for what it is ? a big lie.'

Even from inside the World Bank these lessons were by then obvious. Sababathy Thillairajah reviewed the Bank's African peasant credit programmes in 1993 and advised colleagues: 'Leave the people alone. When someone comes and asks you for money, the best favour you can give them is to say "no"... We are all learning at the Bank. Earlier we thought that by bringing in money, financial infrastructure and institutions would be built up ? which did not occur quickly.'

But not long afterwards, Yunus stepped in to help the Bank with ideological support, as it rejuvenated microfinance with a $200 million global line of credit aimed at poor women in August 1995, just prior to the Beijing gender conference.

The global justice movement's Attac group has an excellent Oslo branch, which this week published a
new book, Economic Apartheid. Its members pointed out to me that that Yunus was strongly supported by his friends in the Norwegian ruling class, including a former top finance ministry bureaucrat and leading officials of Telenor, Norway's phone company. Telenor owns 62% of GrameenPhone, which controls 60% of Bangladesh's cellphone market.

At a time when the centre-left Norwegian government has a high profile for partially cancelling illegitimate Third World debt and threatening to defund the World Bank, both of which are applauded by local activists, the people who make these decisions were conscious of how important it is for Norway to project the possibility of capitalism with a human face.

The question is whether they looked hard enough at conflicts generated by credit, at the risk of putting this Nobel in the same category as Peace Prizes granted to Shimon Peres, F.W. deKlerk and Henry Kissinger.

(Patrick Bond's new book, Looting Africa: The Economics of Exploitation, is available from Zed Books.)

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Sudhanva Deshpande
LeftWord, 12 Rajendra Prasad Road, New Delhi 110001
Phones: 2335 9456, 2335 6966 (office), 2526 4822