Synopsis

The maturing of Indian microfinance

Findings and policy implications from a national study

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Foreword and acknowledgements

This study forms a part of the National Microfinance Support Project (NMFSP), being implemented by SIDBI Foundation for Micro-Credit (SFMC), a department of Small Industries Development Bank of India (SIDBI), in collaboration with the Department for International Development (DFID), UK and the International Fund for Agricultural Development (IFAD), Rome.

The research was commissioned and funded by SIDBI as a baseline study and forms the first part of a longitudinal design to coincide with the seven years of NMFSP. The study covers a sample of 20 MFIs of SIDBI and explores key impact questions, exploring issues of outreach, use of microfinance services and their contribution to different dimensions of poverty reduction. The data presented in the baseline report will be used as a panel data for comparison through an endline survey. The main report with details of the research methodology, statistical tables and case studies, is available on the SIDBI and EDA websites.

The synopsis of the study, presented through this document, highlights the main elements of the research, some of the key findings and the implications for policy and practice. It will be of interest to policy makers, financial institutions and donors (seeking to expand access to financial services), to practitioners (looking at issues in improving the delivery of financial services), to researchers (thinking about the methodological issues of tracking impact) and to many others, we hope, entering the world of microfinance and considering the goals and promises being made.

The report results from the ideas, energies and hard work of many people: the MFIs who were part of the sample for this study, local field researchers, our associates and members of our Advisory Committee. EDA is extremely grateful for their involvement and guidance. Above all we thank the clients, and of course the non-clients too, who gave us their time and patiently put up with our questions. EDA accepts responsibility for any gaps and limitations.

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MFIs participating in the research

APDMACS	Andhra Pradesh Dalitbahujan Mutually Aided Cooperative Societies Federation	Andhra Pradesh
ASA	Activists for Social Alternatives	Tamil Nadu
BSFL	Bhartiya Samrudhi Finance Ltd. (BASIX)	Andhra Pradesh
CFTS	Cashpor Financial and Technical Services	Uttar Pradesh
IASC	Indian Association for Savings and Credit	Kerala/Tamil Nadu
LEAD	League for Education and Development	Tamil Nadu
LHWRF	Lupin Human Welfare and Research Foundation	Rajasthan
Outreach		Karnataka
Pustikar	Pustikar Laghu Vyaparik Pratishthan Bachat and Sakh Sahakari Samiti limited	Rajasthan
RASS	Rashtriya Seva Samithi	Andhra Pradesh
RGVN	Rashtriya Grameen Vikas Nidhi	Assam
Shramik Bharati		Uttar Pradesh
SIFFS	South Indian Federation of Fishermen Societies	Kerala
SKS	Swayam Krishi Sangam	Andhra Pradesh
SNF	Sarvodaya Nano Finance	Tamil Nadu
Spandana		Andhra Pradesh
SWD-MACTS	Swayamkrushi Women's Development Mutually Aided Cooperative Thrift Society	Andhra Pradesh
VSSU	Vivekananda Seva Kendra O Sishu Uddyan	West Bengal
VWS	Village Welfare Society	West Bengal
YVU	Youth Volunteers Union	Manipur

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Abbreviations

BPL	Below Poverty Line
EIR	Effective Interest Rate
FGD	Focus Group Discussion
HDFC	Housing Development Finance Corporation
HH	Household
IB	Individual Banking
IGA	Income Generating Activity
LIC	Life Insurance Corporation of India
MFI	Micro Finance Institution
M-CRIL	Micro-Credit Ratings International Ltd.
NABARD	National Bank for Agriculture and Rural Development
NGO	Non Governmental Organisation
NMFSP	National Micro Finance Support Project
OSS	Operational Self Sufficiency
PAR	Portfolio At Risk
ROSCA	Rotating Savings and Credit Association
SFMC	SIDBI Foundation for Micro Credit
SHG	Self Help Group
SIDBI	Small Industries Development Bank of India

$ exchange rate applied: ~Rs44

1 Microfinance context: MFIs in India

In India there is a diversity of approaches to microfinance, involving banks, government agencies, NGOs, cooperatives. There are now specialised microfinance institutions (MFIs), many still registered as NGOs or cooperatives, a few 'transformed' into Non-Banking Finance Companies or Section 25 Companies. Their purpose is to extend the provision of financial services (credit, savings, insurance) whilst building their own financial sustainability.

Over 100 MFIs in India have been credit-rated. These MFIs have a combined outstanding portfolio of Rs380 crores ($87 million) with cumulative disbursements of Rs1,560 crores ($360 million). Total clients of these MFIs are an estimated 2.3 million.[1]

MFIs in India (M-CRIL database December 2004)

MFI model	No. of MFIs	No. of clients	% clients by model	MFI borrowers as % of clients
SHG	76	1,434,900	62%	30%
Grameen	19	783,400	34%	79%
Individual	9	91,500	4%	67%
Overall	**104**	**2,309,800**	**100%**	**47%**

Most MFIs use groups as intermediaries for financial transactions, but there are different ways of working with groups. These may be broadly classified as the Self Help Group model (SHG) and Grameen replicators and Cooperatives. The SHG model predominates with 62% of total clients. The Grameen model covers a smaller proportion (34%) of total clients but has a larger share of outstanding portfolio, and a higher number of borrowers, due to its more regular cycle of loan disbursements. The Individual Banking (IB) model accounts for 4% of clients.

Study sample: 20 MFIs

Model	MFIs
SHG	APDMACS IASC LEAD OUTREACH RASS SNF SWDMACTS LUPIN Shramik Bharati
GRAMEEN	ASA SKS Spandana CASHPOR RGVN VWS
INDIVIDUAL BANKING/ SECTOR COOPERATIVE	BASIX SIFFS Pustikar VSSU YVU

MFIs in the NMFSP

The MFIs associated with the National Microfinance Support Project (NMFSP) of SIDBI Foundation for Micro-Credit (SFMC), represent the more established microfinance institutions in the country. As at March 31, 2005, SIDBI had a loan portfolio of Rs199.36 crores ($ 46 million) with over 70 partner MFIs.[2]

This study has sampled 20 of these MFIs. Most follow the SHG model and have microfinance experience of at least 4 years, and up to 10 years. Based on data for the sample MFIs, some operational features that are typical of the three different models are presented (over page) showing variations in approach, focus and type of products.

1 This data (for December 2004) is from the database of Micro-Credit Ratings International Ltd, a specialist microfinance rating agency. Established in 1998, M-CRIL has carried out nearly 300 ratings of MFIs in India and neighbouring countries of South, South-East and Central Asia. M-CRIL is an associate company of EDA.

2 SIDBI provides need-based financial assistance by way of loans to partner MFIs for meeting their on-lending requirements. In addition, partner MFIs are provided an annual customised package of capacity building grant to build their operational, financial and institutional capacities and to achieve self sustainability in due course. SIDBI also offers: – short-term loans to its partners for meeting their temporary liquidity constraints; a Transformation Loan product for NGO-MFIs who are transforming their operations into a regulated and formal entity; and equity funding to eligible MFIs

Operational features of microfinance models in India

Operational features	SHG	Grameen	Individual Banking
The 'model'	10-20 member groups save regularly: group loans to members from savings; jointly liable for external loans – from MFI or bank	5 clients per group organised into 'centres'; assume joint liability for regular MFI loans	Individual clients receive loans on condition of minimum savings deposit
Main Clients	Women	Women	Men (usually)
Targeting	'The poor'– broadly described as the weaker sections or 'BPL'	'The poor'– specifically defined in terms of housing, other assets, type of employment	General: non-poor and poor
Service focus	Savings and credit	Credit– regular cycle	Credit
Transactions	Monthly meetings	Weekly meetings	Individual – often daily
Savings deposits	Rs20-100 ($0.40 -2.20)/month	Rs5-25 ($0.10-0.60)/week	Flexible, above a minimum (usu. 10% of loan amount)
Interest on savings	Bank rate (4.25%) + profit share	6-9%	6%
Initial loan size (MFI)	Rs5-10,000($110-225)[a]	Rs2-5,000($45-110)	Rs5-15,000 ($110-330)
Effective interest rate (usual range)	24-28%	32-38%	23-38%
Insurance	At a preliminary stage: usually loan linked; sometimes linked to national companies		
Development services	Some linked programmes	A few small projects	Enterprise support (occas.)

Source: Data for sample MFIs
[a] Also, internal group loans range from Rs200-2,000 ($5-45) in new groups; up to Rs10,000 ($225) in established groups

Credit rating information for the sample MFIs at the time of the field study, show by model that: the Grameen MFIs are larger scale and growing extremely fast, with 30,000 clients on average, 23,000 borrowers. Sustainability was high (average Operational Self Sufficiency of 106%)[3] with moderate portfolio quality (PAR_{60} 7%)[4] resulting in an average rating of . SHG MFIs are longer established organisations, with an average 24,000 clients but lower incidence of borrowing from the MFI (4,000 active borrowers on average). This is reflected in lower OSS ratios (68% on average) and, with lower portfolio quality; the average rating is . IB MFIs are relatively young with 13,000 clients on average, 10,000 active borrowers and high sustainability resulting in an average rating of though portfolio quality is variable.

2 Research design

The study aims to document impact of microfinance services at the end user level and improve practice by understanding the processes of MFIs' intervention and their relevance. Impact is defined as *'change that can be plausibly associated with involvement in a microfinance programme'*.

3 Operational Self Sufficiency = Ratio of total income (interest on portfolio, other income – fees, investments) to total costs for the year (cost of funds, operating expenses)

4 Portfolio at risk at 60 days (PAR_{60}) = Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 60 days to the total loans outstanding on a given date

The research questions are:

(1) Who is being served by microfinance? Are the poorest getting left out?

(2) How is microcredit used? Does microfinance contribute to enterprise growth and incomes?

(3) Does microfinance lead to a reduction in poverty: is it sufficient to move poor families out of a situation of poverty and vulnerability? Indirectly, does it enable the better off to provide employment opportunities to the very poor?

(4) Does women's role as microfinance clients translate into their empowerment? Or is there focus on women clients instrumental i.e. a means to ensure repayments and group discipline?

(5) What effect does microfinance have on other systems or sources of finance both formal (local banks) and informal (moneylenders, traders)?

(6) Which products and services are effective in reaching the poor and responding to their financial needs?

In line with recent developments in impact assessment and poverty analysis methodologies, the research combines quantitative and qualitative tools. Questionnaire data enables us to quantify and correlate results on different indicators. Qualitative information (from Focus Group Discussions and Case Studies) helps us to ground the data in an understanding of the situations that people face, how they use and perceive microfinance.

Poverty Analysis

Different methods (PRA, household asset index, estimated household income) were combined to arrive at a household wealth rank. The wealth ranks assigned are comparable in different areas whilst reflecting local perceptions and a range of indicators (including housing quality, assets, type of employment, incidence of ill health, alcoholism). Four wealth rank categories were applied: very poor, poor, borderline, non-poor.

Indicators for different wealth rank categories

	Very poor	Poor	Borderline	Non-poor
Housing	Small *kuccha* (thatched) houses	Mostly small houses, either *kuccha* or mixed (tin)	Medium size, usually mixed or *pucca* (concrete)	Mostly large, *pucca houses*
Assets	No major assets, basic utensils only	Marginal land (<1 acre), few small animals, cot, radio, cycle	Small (1-5 acre) land holding, 1-2 milch cattle, small animals, B&W TV, fan, bicycle, radio, some furniture, old two-wheeler	Large (> 5acres) landholding, >2 milch cattle, tube well, TV, phone, fridge, motorcycle, car
Food security	Usually one meal a day – basic cereals only	Just able to manage two meals a day – but variable	2 meals a day but sometimes face problem (a few weeks in a year)	Regular family diet – (2 meals/day and 'quality' items)
Income sources	Low paid casual wage labour, single earner	Regular wage labour, one-two earners	Seasonal business; low paid jobs; May sometimes depend on skilled wage labour	Assured regular income e.g. establd. business or high pay job
Poverty line	Below[a]		Above: may slip into poverty in case of an 'income shock'	Above

[a] The poverty line is based on rural and urban levels for each State, estimated by the Planning Commission, updated to 2003-4 prices using the appropriate consumer price index (rural agricultural labourers, urban industrial workers); for the time of the field survey, the estimates for the study States were Rs9.26-13.20 (rural) and Rs12.31-18.31 (urban) per capita per day. The international poverty line ($1.08/day at purchasing power parity) works out to Rs14.54 (rural/urban 33 cents) which is roughly comparable to the local poverty line.

The 20 MFIs sampled for the study reflect the main models of microfinance delivery and their relative presence in different regions of India. The sample covers the States of Andhra Pradesh, Tamil Nadu, Karnataka and Kerala in the South and Uttar Pradesh, Rajasthan, Assam and Manipur in the North/East.

From each MFI, two to six clusters (villages or urban areas) were randomly selected from village/area lists. All MFI clients within a cluster were surveyed for a client sample size of at least 130 per MFI providing a statistical confidence level of 95%. Non-clients were sampled as a comparison group. The large baseline sample provides strong evidence for the study findings.

Study sample: > 5,000 households

- 4,000 clients [74% rural]
- 1,400 non clients
- 280 dropouts
- 150 case studies
- 200+ focus group discussions

3 Outreach

Hypothesis: MFIs are extending financial services to the poor and other disadvantaged people not reached by formal sector finance

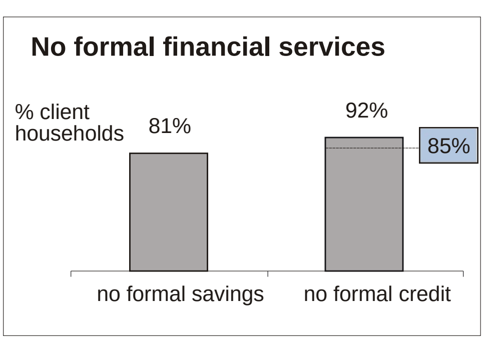
MIXED FINDINGS

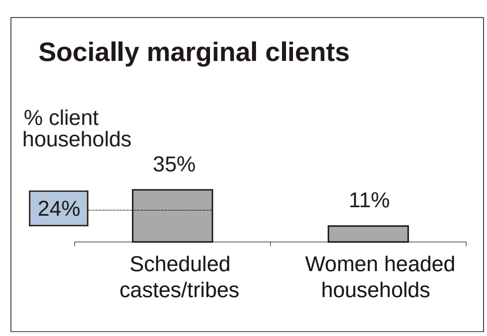
MFIs are:

- *mainly operating in more developed areas of the country*
- *reaching the unbanked*
- *serving all castes and communities including socially marginal groups (Scheduled Castes)*
- *reaching women headed households*
- *catering to all economic levels, not only the poor*

Microfinance is more concentrated in the South of India: Based on national data for the NMFSP, the majority of microfinance clients (89%) are in the more developed Southern region districts of the country, including some in the West; just 11% of clients are in the less developed North and East. Programmes are mainly rural with 77% rural clients (90% in the case of Grameen and IB model MFIs)

Depth of outreach: Based on sample data, MFI services are 'reaching the unreached' – 81% do not have formal savings in a bank or post office, 92% have not had a bank loan.[5] The client profile includes vulnerable and socially marginalized groups such as scheduled castes, scheduled tribes and women headed households.

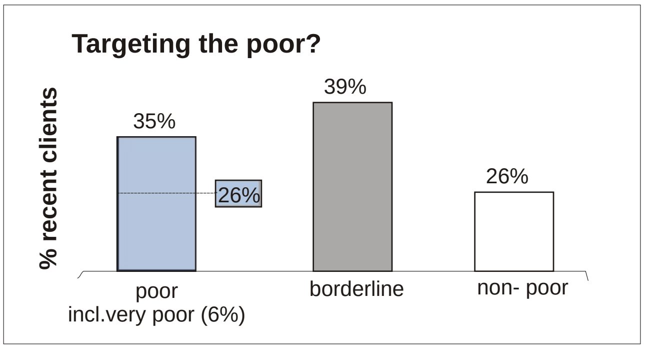




Key: —·· % All India (from secondary Sources: All India Debt and Investment Survey, Census, Planning Commission)

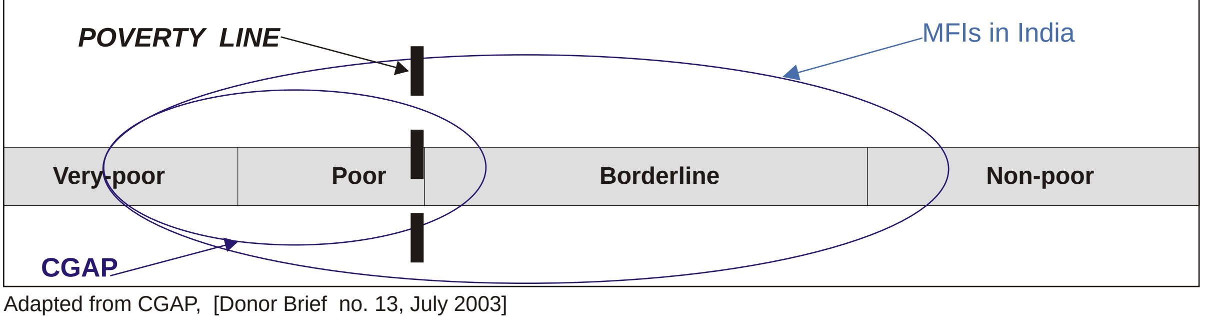
[5] Overall percentages here and in subsequent tables are the weighted average based on client distribution by model (SHG = 0.62, Grameen = 0.34 , Individual Banking = 0.04)

Nevertheless the data shows that MFIs are catering to a mixed clientele that includes both poor and non-poor. Given the very limited outreach of formal financial services, it cannot be assumed that all those without access, and needing financial services, are poor.



This pattern of outreach is much broader than that generally assumed: that most microfinance clients fall in a band around the poverty line. In the current debate about focusing on the poor, we do not believe that this finding necessarily represents a negative feature. As a practical strategy for operational sustainability, MFIs are tending to diversify their clientele, whilst at the same time including poorer clients. A more critical issue, as we see later, is the scope to provide services that meet clients' varying financial needs, including for poorer clients.

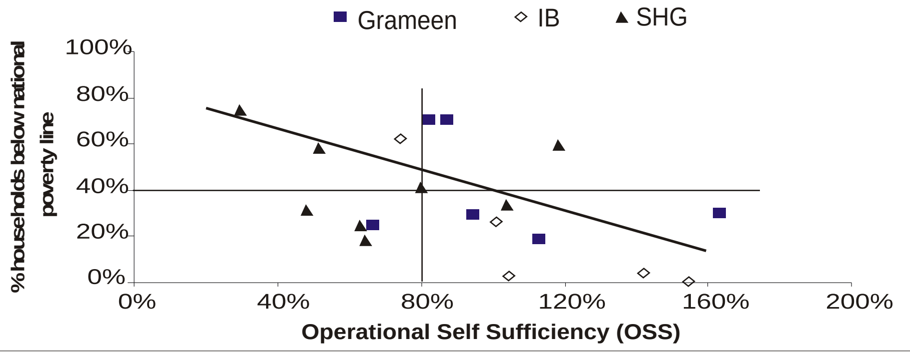
Pattern of microfinance outreach



Adapted from CGAP, [Donor Brief no. 13, July 2003]

Depth of outreach and MFI performance: The data broadly supports the general perception that there is a trade-off between outreach to the poor and operational self-sufficiency. Most clearly in the case of IB MFIs, strong OSS is combined with low depth of outreach. Both SHG and Grameen MFIs have considerable range of outreach. On OSS, the sample SHG MFIs are weaker (due to smaller portfolios relative to scale of operations) while the Grameen MFIs tend to be stronger (large portfolios, high staff productivity in terms of client:staff ratio). Yet, there are interesting exceptions: 2 SHG MFIs and 2 Grameen MFIs combine sustainability with substantial depth of outreach.

Operational self sufficiency and depth of outreach (recent clients)



OSS line at 80% (approaching Operational Self-Sufficiency) Depth of outreach line at 40% of clients below national poverty line. Trend line overall: $R^2 = 0.24$

Source: Survey data & M-CRIL reports (19 MFIs, OSS data not available for one MFI (SHG/South)

At least part of the explanation for greater outreach to the poor lies in operations in a poor region combined with effective targeting. In the two SHG examples, both sustainability (lower costs of group formation, higher staff productivity) and depth have been achieved (in a relatively short time) through providing microfinance services to SHG groups established under long standing NGO programmes.

Depth of outreach and MFI products: The data does not support another assumption, that small loans and lower interest rates are determining factors for deepening outreach. They may suit the poor, but do not in themselves serve to exclude the non-poor. Rather it is responsiveness to client financial needs in terms of the range of products offered that is the main factor (along with operations in poor areas).

4 Microfinance and enterprises

4.1 Use of microfinance

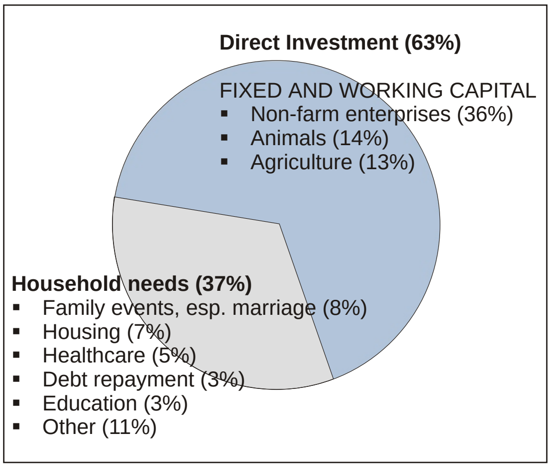
Hypothesis: Micro-credit is used for investment and for other household needs
SUPPORTED
- *focus on direct investment*
- *more diverse use in SHG model, including internal lending from group savings*

The main use of MFI loans is direct investment, although the actual use is slightly less than the recorded use (85%). There is greater focus on such investment in Grameen and IB model MFIs, compared to SHGs. The Figure shows client use of total micro-credit borrowed over the previous two years, including internal lending from group savings in the SHG model. 'Investment' refers to directly productive use – in non-farm enterprise, animal husbandry and agriculture. Micro-credit is also being used for a range of 'other household purposes' – including family events (especially marriage costs), housing, medical care, household purchases and schooling. These 'other' purposes also represent a form of investment but they are usually considered separately by MFIs (and by SIDBI).

Such use is partly due to 'fungibility', depending on household credit requirements at the time of loan disbursement, despite MFI insistence on loan use for enterprise although some MFIs are now introducing other products.

The use of micro-credit for direct investment increases with wealth rank. Poorer clients use a higher proportion of micro-credit for other household needs (48% compared to 28% by the non-poor).

Use of micro-credit
(MFI loans and internal group lending)



4.2 Micro-credit support to enterprises

Hypothesis: Microfinance increases enterprise activity

SUPPORTED

- *new and expanded non-agriculture enterprises with some increase in (self-) employment*
- *contributes to reported increase in enterprise income*

Different scales of enterprises

Enterprise type	Income Generating Activities - IGA	Micro-enterprise ME	Small enterprise SE
Scale	Low investment [Rs2-15,000($45-330)] Part-time Seasonal Family labour Supplementary income	Investment up to Rs35,000 ($800) Full-time Some seasonality Mainly family labour Secondary/primary income source	Investment up to Rs2 lakhs ($4,500) Full-time Regular Some hired labour Primary income source
Examples	Animal husbandry (small animals, 1-2 dairy animals) Seasonal vending Home based tailoring/ petty shops	(A few larger scale animal units) Provision shops Tea shops/tiffin centres Transport (cycle rickshaw) Repair units - cycle Home based manufacturing	Large scale trading/business Repair units - electrical Separate manufacturing units Powerlooms
MFI model support	SHG and Grameen, some IB		IB, some Grameen

Enterprises of different scales –requiring different levels of capital (fixed and working) – are using micro-credit. Group-based MFIs provide small loans for use in 'income generating activities' and 'micro-enterprises'. IB MFIs usually provide larger loans for 'small enterprises'.

The majority of supported enterprises are rural. The main sector is non-farm. The Grameen and IB MFIs support a high proportion of non-farm enterprises. Animal husbandry is common in more remote rural areas, where there are fewer alternative opportunities for enterprise.

Enterprises using micro-credit

Selected enterprise parameters		By model			Overall [wted avg]
		SHG	Grameen	IB	
% By sector					
	non-farm	29%	66%	80%	44%
	animal husbandry	42%	21%	8%	34%
	agriculture	29%	13%	12%	23%
% New enterprises		28%	45%	7%	32%
Employment[a]/supported enterprise		1.05	1.25	1.66	1.14
	family	0.99	1.13	1.26	1.05
	hired	0.06	0.12	0.40	0.10
% Reporting increase in income		55%	82%	81%	64%
% Closed down		7%	11%	2%	8%

[a] 'Employment' includes self-employment

Nearly one third were new enterprises started with micro-credit, primarily by poor and by borderline clients. This proportion is higher for the Grameen model and in animal husbandry. Enterprises with credit from group based MFIs are usually owner-operated, sometimes involving more than one member of the family, often part-time (they are typically IGAs and micro-enterprises). Small enterprises - which typically have IB credit - have more employment that is mostly full-time and partly hired. New employment – both women and men - has been generated mainly through new enterprises (not expansion of existing enterprises). New employment has been generated mainly through new enterprises. Half of the additional employment is of women, 5% is of children less than 15 years.

Client households reported an increase in income following micro-credit support in two thirds of supported enterprises. This proportion is significantly higher in the Grameen and IB models reflecting more non-farm enterprises supported in these models, and a regular cycle of credit. Income increase was mainly due to expansion and improved quality and range of products or services. Lower reported increase in the SHG model partly reflects more uncertain returns to agriculture (which is more prominent in SHG lending).

Diversifying income sources through micro-credit

Prabhavati and her husband were both agricultural labourers. After she joined the MFI group (Grameen) in 2001 she invested her first loan of Rs5,000 ($115) in a *tiffin* business for which there was good local demand. The business did well and Prabhavati has reinvested some of her earnings to buy sheep. Both livelihoods provide a year round income. Prabhavati no longer works as an agricultural labourer. She is proud of the fact that she is running her own business and not working for anybody. And, life is more stable without the difficulties she used to face during lean agricultural seasons. *[Borderline, Grameen client, rural South India]*

Nevertheless, micro enterprises are susceptible to risks. Risks may relate to personal situations (especially illness and cash flow difficulties), market constraints and competition, natural conditions, and other wider factors (technological change, political or regulatory factors). Clients reported problems in over 30% of supported enterprises (36% of non-farm, 25% of animal units). Problem incidence was higher for the very poor and poor who are more likely than other wealth ranks to report illness, have less experience in enterprise activities and (in case of the very poor) are less likely to report an income increase. The rate of closure is 8%, again higher for poorer clients, especially those who used micro-credit to start new enterprises, as reflected in the higher rate of closure for the Grameen model.

5 Microfinance and poverty reduction

Hypothesis: Microfinance contributes to a reduction in poverty

MIXED FINDINGS
- *improvement in economic indicators: financial, productive and physical capital*
- *more diversified income sources*
- *for social capital: some evidence for higher enrolment of children at primary level, but not at secondary level or above, where gender imbalance continues*
- *substantive conclusions will depend on endline comparison of clients/non-clients*
- *nevertheless, over one-third of older clients (with microfinance programme >5 years) are still poor, some very poor*

The data shows that microfinance can directly improve access by the poor to finance that supports productive activities and asset development. Micro-credit has enabled client households (all wealth ranks, including the poor and very poor) to invest in productive assets (37% of client households invested in the previous two years, compared to 17% non-clients) and to diversify their livelihoods (73% of client households have multiple sources of income, compared to 59% of non-clients). Sixty percent of households who acquired a productive asset have reported income increase. On other (non-income) dimensions, client households have been able to build financial capital (savings), physical capital (household assets and improved housing though the difference with non-clients here is not so large) and human capital in terms of sending children to primary school (but no increase seen in girls' attendance or in education at secondary levels and above).

On practically all indicators, a comparison with non-clients shows more significant effects for poorer households.

Poverty reducing effects						
Households	Very Poor & Poor			Borderline		
	Client	Non client	Difference	Client	Non client	Difference
Income related indicators:						
% acquiring a productive asset in last two years	36%	14%	*21%*	41%	17%	*24%*
% with multiple sources of income	67%	50%	17%	77%	62%	15%
Dependency ratio [a]	2.70	2.93	-0.23	2.58	2.84	-0.26
% reporting increase in HH income	45%	26%	19%	48%	35%	13%
Financial capital						
% with savings	98%	28%	70%	97%	55%	42%
Physical capital						
% investing in housing in last two years	23%	20%	3%	23%	22%	1%
% acquiring a household asset in last two years	23%	17%	6%	34%	31%	3%
Human capital						
% girls (6-14 years) going to school	82%	76%	6%	89%	87%	2%
% boys (6-14 years) going to school	89%	83%	6%	90%	85%	5%

[a] Total number of members (including earning members) per earner in the household

Direct poverty effects are prominent in the Grameen model, which combines substantial poverty outreach with a focus on credit for direct investment. The IB model has a similar focus, whilst catering more to the borderline and non-poor. In this model the use of micro-credit to promote small scale enterprises that hire non-family labour can have an indirect poverty effect by supporting income-earning opportunities for non-clients, though the data shows that any increase in labour is mostly for family members joining the enterprise and less in terms of hired labour.

Poverty reducing effects by model				
Client households	SHG	Grameen	IB	Overall [wtd avg]
acquiring a productive asset in last two years	23%	51%	39%	33%
with multiple sources of income	67%	82%	71%	72%
reporting increase in HH income	41%	70%	67%	52%
investing in housing in last two years	21%	25%	32%	23%
acquiring a household asset in last two years	29%	33%	44%	31%
supported enterprises with hired labour	4%	6%	25%	6%

Microfinance is contributing to livelihoods but is it sufficient to move households out of poverty? More will be known about the impact of microfinance through a client/non-client comparison at the endline stage of the study. Cross-sectional analysis of the baseline data (comparing older with more recent clients) suggests movement of client households into less poor wealth rank categories in four MFIs, with a possible shift out of poverty (to non-poor) for around 20% of the sample in these MFIs.

This is supported by case-study examples.

MFI loan helps a widow to grow her business and plan future expansion

When Saraswathiamma's husband died she was forced by her son and daughter-in-law to live separately and fend for herself. She borrowed Rs1,000 ($25) from her neighbours (interest-free) and opened a tiffin centre in her house where she serves idli/sambar and tea, seven days a week. Business was good and she soon repaid the startup capital. She was looking for more credit to expand the enterprise when some of her neighbours suggested she join the MFI group.

She joined a new group of the MFI in 2000. Within the same year she took a loan of Rs4,000 ($90) which she used to purchase an electric grinder, to save her time, allowing her to do several other tasks. The second loan of Rs5,000 ($110) she used to purchase material in bulk, enabling a discount from the retailer, involving one weekly visit to the market in town, instead of the earlier daily visits. Saraswathiamma has repaid both loans on time. Now she is thinking of starting a new hotel outside the village (on main road), though not for herself but for her son.

[(Now) non-poor SHG client in rural South India]

Client's husband invests a series of MFI loans in his manufacturing unit

For over 25 years **Mataprasad** worked as a carpet weaver – employed on other's looms for export. He was earning Rs2,500 ($55) a month quite regularly until carpet exports declined and many carpet units closed down. For a year or so, the family managed on his occasional earnings – with difficulty (they could not afford a school uniform for their growing son every year; they did not replace their cow when it died). The alternative option was unskilled labour. But, weaving was the skill that Mataprasad knew, and over the years he had developed connections in the industry. But to set up his own loom, he needed credit, and he did not have the collateral for a loan - whether from a bank or a pawnshop.

Then, when his wife Sita joined an MFI group (Grameen) in 2001, she was able to obtain a loan of Rs6,000 ($135). Adding Rs2,000 ($45) from his savings, Mataprasad used the micro-credit to purchase a loom. This was the start of his carpet-manufacturing unit and, with two more MFI loans, he added another two looms. Now, Mataprasad has a bank account, the family owns a cow, and his son has two new sets of uniform each year. And Mataprasad employs six other men from his village - weavers who had earlier lost their jobs, just like him.

[Borderline, Grameen client in rural North/East India]

Nevertheless, even in these four MFIs, for which the sample includes a substantial number of clients with the microfinance programme for 5 years or more, 30% of such 'high involvement' clients are below the local poverty line (including 12% very poor). Across the entire sample, one third of high involvement clients are still poor. Involvement in microfinance therefore may reduce poverty for some clients, but not for all, the greatest challenge remaining to reduce the poverty of the poorest.

6 Microfinance and vulnerability

Hypothesis: Microfinance builds the capacity of individuals, households and enterprises to manage risks

MIXED FINDINGS:

- *'ex ante': livelihood diversification and physical capital helps build resilience*
- *weak protective role (savings not withdrawable, insurance services not yet developed)*
- *'ex post': significant contribution to small scale emergency credit needs, (especially from internal lending in SHG model) but limited contribution when large sums required for emergencies*

Vulnerability is intrinsically linked to poverty both as cause and symptom. It is defined as susceptibility to risk, risk being understood as the chance of a loss (in income, livelihood, health, housing) or the loss itself. In case of risk, micro-credit strengthens the coping strategies of its clients *ex ante* (in advance) mainly through livelihood diversification and asset building. Protection through financial intermediation is weaker.

Ex post (after risk occurs), client households, especially the poor and the very poor continue to borrow to meet the costs of risk related needs. These include medical costs, marriage, debt redemption and emergency needs (such as for food, house repair). Micro-credit contributes quite substantially to the latter needs, especially through the small flexible loans usually available in the SHG model, and specific products of some (mainly Grameen) MFIs, as well as through general products that may be used for such needs (fungibility). Given the (small) size of micro-credit, it is not surprising that it contributes less to larger needs (marriage, medical costs). Clients are going to moneylenders for such loans, but the dependence on them in case of risk is less compared to that of non-clients.

Role of microfinance in coping strategies

	Very poor	Poor	Borderline	Overall
% client households borrowing for risk	66%	64%	53%	53%
Median borrowed (Rs)	2,000 ($43)	3,000 ($65)	4,000 ($90)	4,000 ($90)
% HHs borrowing for risk from moneylenders:				
client	28%	35%	37%	34%
non-client	52%	62%	56%	53%
Use of micro-credit for risk needs	**SHG**	**Grameen**	**IB**	
% risk borrowings - MFI	6%	26%	14%	
- group	42%	-	-	

Survey data for 17 MFIs, excluding 2 MFIs with co-variate risk and one IB MFI in which a significant number of clients (all non-poor) are borrowing very large amounts for marriage expenses.

Microfinance contributes to the coping strategies of its more vulnerable clients (the very poor, scheduled castes, women headed households). Though the most vulnerable (those with irregular income sources, existing indebtedness) are also the least creditworthy. Such households do sometimes struggle as MFI clients (illustrated by the story of Chinnapillai later in Section 9) and their vulnerability can lead to dropout. In case of enterprise risks, microfinance support is marginal, if any. In fact, where micro-credit is being provided for enterprise use to clients with limited skills or previous experience, this is contributing to increased vulnerability.

Two MFIs in the sample are examples of co-variate risk. In these MFIs, all clients are affected by adverse economic conditions (prolonged drought in one case, increasing costs of production in the other). When clients in substantial numbers default (on both loan repayments and saving payments) or need large credit sums to meet investment costs, an MFI's portfolio is constrained and cannot respond to the additional financial needs of its clients.

7 Microfinance and women's empowerment

Hypothesis: Microfinance contributes to women's empowerment at individual, households and community levels

MIXED FINDINGS - *MFI approach instrumental rather than transformative*

- *opportunity to save, access credit and earn – a first for many women*
- *supports women managed enterprises – mainly IGAs*
- *women benefit from peer interaction and support in mature groups*
- *enhanced status within household for some women but constrained by patriarchal relationships*

All group based MFIs, and some IB MFIs and Sector Cooperatives, target women as clients of microfinance.

Women clients of microfinance

	SHG & Grameen	Sector Coop.	IB	Total
% clients who are women	99%	54%	23%	95%
Number of women clients (million)	2.20	0.006	0.02	2.22

Source: M-cril data base (Dec.2004)

In practice, this does not necessarily reflect an empowering strategy for women in the fullest or *transformative* sense of enhancing women's capabilities and addressing fundamental gender inequalities. Rather, MFIs may target women because it is easier to organise women than men and thereby increase programme outreach and impose discipline. This reflects a *neutral* or instrumental approach to women's empowerment. The SHG model – which promotes more autonomy and responsibility within women's groups - shows more scope for *support to* developing women's opportunities and skills.

Approaches to women's empowerment			
	Neutral	Supportive	Transformative
Orientation	Women as clients for financial transactions	Support to women clients to build skills to take advantage of new opportunities	Transforming gender relations which reflect patriarchal values
Assumptions	Women are easier to organise, will come to meetings and be disciplined about repayment	Women benefit from specific support (through group interaction/ responsibilities and skill development); need to build confidence and abilities as part of an empowering process	Ensuring women's access to and control over an economic resource (finance) is part of a transformative process to give women an equal say within the household, in their communities and within financial institutions
By model, typically:	Grameen and IB	Some SHG MFIs	[none in the sample]

This study explores women's empowerment largely through indicators identified by women clients, and using data for women clients and their households. (Data on indicators of women's empowerment in households of men clients shows little change).

An underlying theme is the difference between the north and the other regions of the country. The scope for women's empowerment and economic activity is conditioned significantly by socio-cultural factors and livelihood opportunities which are more favourable in the south, and in urban areas. This is reflected in differences in women's involvement in economic activities.

In terms of individual empowerment, targeting women as clients of microfinance has provided for many women (including women heads of households) an option to save and access credit for the first time. However, basic awareness of micro-finance related issues (products and terms, banking procedures) appears to be limited, particularly for very poor women. An aspect linked to low literacy rates 60% of women clients have had little or no schooling.Women like to be part of a group. They draw moral support from their peers and develop a sense of confidence from interaction at group meetings. The group mechanism thus contributes to women's options, mobility and skill development, though this contribution is strongest for group leaders, and in the SHG model.

What women say

Women's priorities

A better quality of life that will come only if:

- employment and incomes are stable
- children are educated, and
- social evils – such as alcoholism – are eradicated

Indicators of change for women through microfinance

Objective

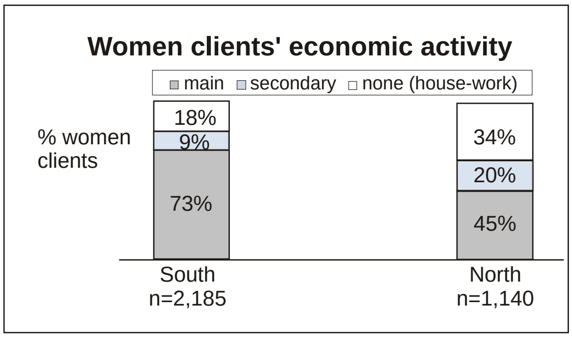
- Ability to save and access loans
- Opportunity to undertake an economic activity
- Mobility – opportunity to visit nearby towns
- Increased financial awareness
- A role in community activities (some MFIs)

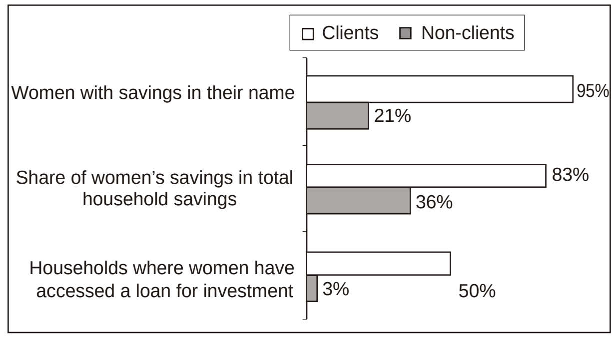
Subjective

- Increased self-confidence
- Ability to command respect within the household and have a say in household decision making

Source: FGDs

At the household level, involvement in microfinance is contributing to women's recognised owership of assets (mainly for productive assets, to some extent for housing); women are involved in the management of enterprises for which they obtain micro-credit, especially in the southern sample though typically in activities that are micro-scale, require low investment and are home-based (animal husbandry, petty trading). A number of enterprises depend on 'joint management' with the common pattern being that men negotiate the more public markets and handle major cash transactions (for example purchasing a milch animal, buying stocks from wholesale markets).





There are also cases of 'loan pass': 27% of supported enterprises in the southern sample, over half of the northern sample. In such cases, women are pleased to be contributing to household income. For women themselves, it is less important who manages an enterprise activity, than that it generates additional income for the household. Thus, gender roles remain the same, with women continuing to be dependent on their husbands for money for repayments and savings deposits.

Indicators of women's status at household level

	Clients n=3,128		Non-clients n=1,141	
	South	North	South	North
% of productive assets purchased in women's name	43%	31%	22%	9%
% of housing assets purchased in women's name	19%	10%	12%	6%
Loan pass - % enterprises supported by loan in women's name, but not involving women in management or employment	27%	53%	-	-

Survey data for 16 MFIs that target women clients

On subjective aspects related to a woman's 'status' in the household, the qualitative information gathered through case studies and FGDs suggests that many women clients have a sense of self-worth that arises from an enhanced ability to earn, to save and to contribute to the welfare of the household.

Micro-credit helps women to contribute to household income

Behind the scenes….

Jabamani's husband was running a small tiffin centre in the village in 1998. But he ran into debts, sold the shop and worked as a labourer in a brick kiln. Jabamani earned a small income from beedi rolling. By 2001, they had saved enough to restart the tiffin centre. Her husband manages the tiffin centre, Jabamani prepares the food items and cleans the place. Every day around 50 people come for tiffin. Tea is a key item for the centre for which they require around 11 litres of milk everyday. Her husband decided to buy a cow for which Jabamani took a group loan (Rs3,000/$70) and he added another Rs3,000 ($70) from their earnings. Jabamani is proud of her contribution to the enterprise and her husband is openly appreciative.

[Borderline,SHG client in rural South India]

Increased status…

Saraswati's family used to depend on their one-acre land (growing jute and rice) and her husband's seasonal casual employment. The income was barely sufficient to meet the needs of the family including her young son and in-laws. Three years ago, she joined an MFI and within six months took a loan for Rs2,000 ($45). She and her husband decided to use it to start a home-based silver ball-making unit (used for making artificial jewellery). Her husband spent some time with other units in the area to pick up the technique. The business has expanded with two more loans from the MFI (last loan Rs5,000/$115). Repayments have been on time and the business yields a monthly income of ~Rs2,000 ($45). Saraswati works about six hours each day in the unit along with her husband (no longer going for casual labour). She and her mother-in-law have also started husking paddy as an additional income source. Saraswati's husband is respected in the community as a successful entrepreneur. Saraswati also feels that her status in the family has improved as she is part of family decisions on enterprise or other family matters. With the next MFI loan cycle she has plans to expand the business further.

[Borderline, Grameen client in rural North/East, India]

The picture though is mixed. It seems most positive in clients of mature SHG groups in the South, and especially for group leaders. And in Grameen clients (South and North-East) who have been able to use credit to enhance their economic activity. For these women, access to micro-credit has helped them to a sense of financial responsibility, sometimes even autonomy; and discussions during group meetings have given them more awareness about financial matters and opportunities (though this could be increased further). But the path to enhanced status is not clear-cut or uniform. Other women clients (in the North, but in the South too) say that they do not perceive any change in their role in decision-making. Men continue to take all decisions; including those regarding financial matters and women may or may not be consulted on other household decisions.

Case studies also illustrate the barriers that women face when they have to make a living for themselves. Women are disadvantaged by lack of exposure to the world of business and enterprise, and assumptions about what women can do and where. In such situations, credit may be available but credit alone is not a solution.

Micro-credit … may only lead to micro-earnings but what are the options?

Two Grameen clients [in rural, North /East India]

Surata is 30 years old, and a widow since her husband Haider Ali died of cancer. The family had to mortgage their one-acre land with a moneylender to meet the costs of Haider Ali's treatment. And since her husband died, Surata has had to earn, finding work as a casual labourer. An MFI client for one year, she has taken her first loan of Rs1,000 ($25) which she on-lent to a shopkeeper. He pays her interest of Rs40 ($1) per week, leaving her Rs6 (10 cents) after paying the weekly MFI instalment of Rs34 (80 cents). Not much of a difference. She is thinking about the next MFI loan and wants to use it for a more substantial enterprise, but she is not sure what that might be… *[Very poor]*

Dipti Das (50) is a widow, living with her daughter and her family. Her son-in-law works in a jewellery shop. Dipti used to work as a casual labourer but shifted to making puffed rice (*muri*) at home for sale. She has been an MFI client for 3 years and has used loans through 3 cycles (Rs2,000-5,000/$45-110) both for her rice processing and for household needs. Costs are low, but the returns are not high either, maybe up to Rs250 ($6) a week, and often with sales on credit. Even with further credit, Dipti does not see how she can expand her business (many women in the area are selling *muri* now) nor what could be an alternative enterprise option for a woman. *[Poor]*

At community level, the study found just a few examples of group based action in the community (one in the urban south – for cementing a road, one in the rural north – an unsuccessful attempt to stop liquor sales in the village). We found no instances of women clients getting actively involved in wider community forums (such as *panchayati raj*). New initiatives are however opening up new responsibilities for women at an institutional level – in SHG Federations (SHG model) and in Mutual Benefit Trusts (at a very preliminary stage in some Grameen MFIs).

8 Alternative financial services

Hypothesis: Microfinance improves the terms, conditions and accessibility of other local financial services

MIXED FINDINGS:

- *increase in access to bank services mainly through bank-SHG linkage programme*
- *few instances of change in terms and conditions available from informal lenders , at present level of MFI activity*
- *informal moneylenders, though costly, provide timely and flexible credit*

Alternative financial services are available through various formal and informal delivery channels. Variety and access is greater in the south (both rural and urban) where banks offer loans against gold deposits, and the informal sector includes small pawnshops, finance companies, ROSCAs and chit funds. In the north/east, the options are fewer.

As a credit provider, moneylenders have a strong presence, generally seen to be exploitative and high cost (with annual interest rates as high as 200%, and lump sum repayments which are difficult to make) but nevertheless meeting diverse credit needs for large numbers of people. Personal informal sources (relatives, neighbours) are also a source of credit - usually at no or very low cost. Banks and post offices have a widespread infrastructure, but they continue to be relatively inaccessible. Banks do attract savings (from the better-off) and offer relatively large loans at notionally low cost (~12% annual interest), but credit-deposit ratios are low especially in rural areas. Microfinance is an additional 'semi-formal' financial service that lies in between the formal and informal in terms of cost and availability.

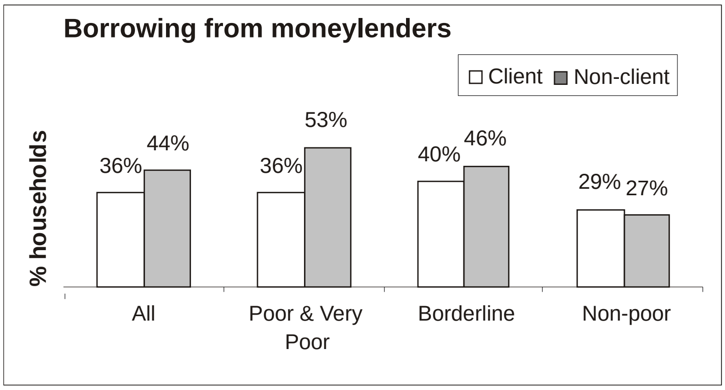
Use of alternative credit options client households/last 2 years

		Formal Banks	Microfinance MFIs/govt programmes	Moneylenders	Friends/ relatives
Effective Interest Rate		8-29%	18-47%	60-200%	~0%
% households borrowing		8%	82%	36%	34%
Median borrowings (Rs)		13,000 ($300)	3,000-8,000 ($65-180)	10,000 ($220)	5,000 ($110)
Share in total borrowings		10%	42%	30%	18%
Share by use	Investment	11%	61%	20%	8%
	Housing	18%	25%	34%	23%
	Household needs	4%	28%	41%	27%

Few client households have access to formal financial services (as individual savings and credit accounts). Individual access is higher for the better-off, but does not increase with involvement in microfinance. Primarily as a result of NABARD's initiatives for SHG-bank linkage, bankers are positive about extending services to the poor through groups. They are comfortable about lending to groups promoted by MFIs, but there are emerging issues relating to: the level of guidance/escorting required for the groups, who should provide this, for how long, the costs involved, and competition with MFIs on interest rates.

An important feature of microfinance as a financial service is the concern to reduce the need to borrow from costly informal moneylenders. A comparison with non-clients shows that fewer client households are borrowing small loans from moneylenders, and their average interest burden is lower (a difference especially significant for the poor, though we should bear in mind that high outstanding debt can be a reason for not being able to join a microfinance programme).

Nevertheless, over one-third of client households continue to borrow from moneylenders, especially for larger amounts (needed for example to meet marriage obligations) or for amounts needed urgently (for example for medical costs). Microfinance, so far, has not reduced either the business or the terms of moneylenders. There is some evidence for the reverse, that microfinance may in fact increase informal money lending, if clients need to 'top up' micro-loans, or borrow to repay according to the instalment schedule.



A vulnerable group member turns to a moneylender

Chinnapillai, is a widow living by herself in a small unelectrified hut on one side of the village. She has seen better days. When her husband was alive, they lived in a *pucca* house and traded rice from the local mill to the main city market. Now her son and his wife have taken over the house. Chinnapillai supports herself working in a rice mill, the evening shift – 7 p.m. to 4 a.m. She earns Rs30 (70 cents)/day, but the work is seasonal. So there are certain months (April and May) when there is no work. At this time she has to borrow to meet her daily needs. She borrows from a moneylender under a '10-week scheme', paying 25% interest for the period, deducted up front.

When SHGs were being formed 2 years before, the opportunity to save and get small loans seemed ideal. Chinnapillai joined, but, she says the group does not lend to her since they doubt her ability to pay: "*When I can borrow from a moneylender and repay why can't I repay a group loan? The moneylender is more flexible, he lends me money when I need it and would expect my son to repay if necessary.*" Maybe part of the problem is that she can't make it regularly to the evening meetings. She has been to 2 of the monthly meetings in the past year. In the other months, she gives her savings deposit (Rs50/$1.10/month) separately to the group leader. However, she does not know her savings, since the group leader keeps all the passbooks. She would like to be able to draw on her savings at times when the rice-mill closes – but savings are not withdrawable for 5 years. Ironically, Chinnapillai did become eligible for a larger MFI loan (Rs3,000/$70). But she didn't need such a large sum – so the loan was allocated to another member. In the meantime, she has borrowed Rs400 ($9) from the moneylender.

[Very poor , SHG client in Rural, South India]

Informal sources continue to play an important role on account of their almost immediate accessibility and speed, and flexibility in purpose (how the credit can be used), amount and terms, even though costs may be high.

Comparing different providers on these parameters, microfinance scores over banks (on all parameters barring cost) and over moneylenders (on cost and repayment terms). MFIs score less well on credit purpose and timeliness, and sometimes on repayment terms. Overall, the Self Help Group mechanism emerges as a preferred option, if the group is managed well. For, as groups mature and the savings fund accumulates, members are able to obtain internal group loans of varying amounts, quite fast and for whatever they need at a relatively low cost (with the interest going back into the group fund).

9 Feedback on MFI services

Feedback on microfinance services was obtained through FGDs and open-ended questions in the questionnaire – from clients and drop-outs.

By model, SHG services score well, especially through the flexibility of internal group lending and clients appreciate the system of monthly repayments. In the Grameen model, clients say the strict schedule of weekly payments is sometimes difficult to meet in the context of varying cash flows; and in all but one MFI in the sample, find the flat interest rate high. In both group based models, clients are not clear about the interest payable on their savings and would like to be able to withdraw some of their savings.

In the IB model, clients appreciate the range of savings options available (in 3 MFIs in the sample) and loan availability and terms, (which can include daily doorstep transactions). The less positive feature in this model from the client perspective is the guarantor requirement and loan processing charges.

Across all models, insurance is an issue. MFIs introducing insurance products tend to impose compulsory premium payments as an additional payment or packaged as an upfront loan deduction. Clients are not fully aware of the terms and conditions, and do not necessarily perceive a future benefit to themselves from paying the premium. This is partly because they are not provided records of the premiums they have paid, also there are not many examples of successful insurance claims as yet.

Feedback summary

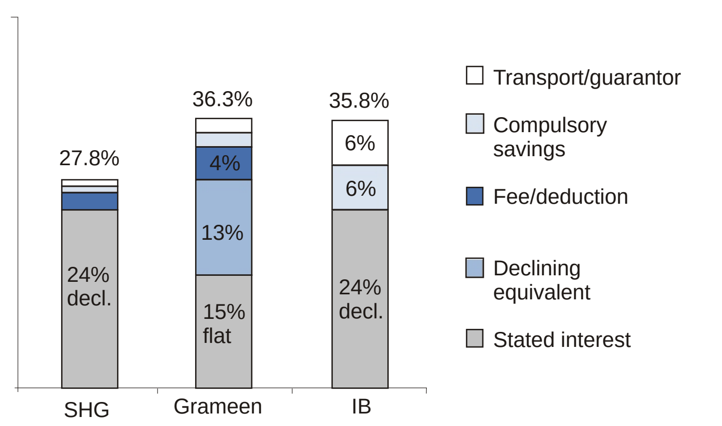
Positive aspects	SHG	Grameen	IB
Savings			
A convenient option to save	↑	↑	↑
Loans - low interest	↑	-	↑
- availability	↑	↑	↑
- easy repayments	↑		↑
Group interactions (women)	↑	-	-
Less positive aspects			
Savings			
Not withdrawable	↓	↓	-
Not clear about interest payable	↓	↓	-
Loans			
Lack of flexibility in purpose	↓	↓	↓
Lack of flexibility in amount	↓	↓	-
Size does not suit credit need	↓	↓	
High cost	-	↓	↓
Strict weekly repayments	-	↓	-
Insurance			
Compulsory - inadequate information	↓	↓	↓
Time spent in microfinance (est. hours/year)			
Clients	17	53	16
Group/centre leaders	102	95	NA

Source: Survey data and FGDs * group loans, not MFI loans

Estimates of time spent in microfinance transactions indicate the highest amount of time for ordinary Grameen clients (54 hours/year due to weekly meetings), and highest of all cover 100 hours/year for group or centre leaders in both group-based models.

In terms of costs to clients, the SHG loan at 27.8% has the lowest EIR. The Grameen loan, repaid in equal instalments at a 'flat' rate of interest, has a higher EIR of over 36%, largely from the conversion into a declining interest rate, but also from relatively high service charges. The IB model loan has a relatively high EIR on average at 35.8% due to the savings collateral requirement and the costs associated with having a guarantor (obtaining a letter from a government employee, paying for the guarantor to accompany the client to the MFI office). Time as a transaction cost is not included here.

EIRs for typical loan products



Loan sizes: SHG and Grameen – Rs5,000($115), IB – Rs 15,000 ($340)
Source : MFI information and FGD

Overall, group-based models appear relatively standardised, although a few MFIs are beginning to introduce different products and the internal group lending of the SHG model provides flexible access to credit, especially as groups mature. IB MFIs appear the most responsive, if not innovative, service providers, with a range of products adapted to clients' different (investment) needs and cash flows. IB MFIs are more likely to assess the economic viability of the enterprises they support and adapt loan products accordingly.

Finding out why clients dropout, and who they are, is another form of feedback on a microfinance programme. The concept of 'dropping out' is applicable to all MFIs that aim to retain members and build their transactions. (Of course, there could also be 'fly-outs' as graduates to formal banking, though none such in this sample). The drop-out rate in the sample clusters (calculated as ratio of number of dropouts in the previous two years to the total number of clients (+dropouts) at the time of the survey) was a relatively low 6%, with not much difference between models, but a somewhat higher rate amongst the very poor (8%). There was often a combination of reasons for dropping out, including (for the sample of 229 ex-clients): unable to save regularly (50%), default on loan repayments (30%), group disagreements (23%), and no time for meetings (15%).

10 Implications for Practice

Outreach to different types of clients

MFIs need to review their strategies in relation to the following:

- They are effectively catering to a range of clients, with different livelihoods and financial needs and capacities. This translates into a variety of savings and credit needs; clients may or may not need credit for investment, and, if they use credit for enterprise, different scales of investment may be appropriate;

- Rural and urban contexts directly affect livelihood options and financial needs. MFIs operating across different contexts need to segment their markets and adapt their products accordingly;

- The very poor and the poor are more likely than the better-off to need small sums for consumption smoothening; flexible and withdrawable savings would be a useful facility for this, and small seasonal loans;

- The very poor and the poor are also interested in credit for investment. However, and especially when they are undertaking new enterprises for the first time, there is considerable risk involved. Specific elements of risk (for example, market saturation for certain enterprises, quality of a dairy animal purchased) need to be identified and combined with the finance strategy in order to ensure viability. In this context, insurance may be a fall-back but is not the solution;

- The group mechanism has proved to be an effective strategy for accelerating outreach whilst targeting women. The viability of the groups was not a specific focus of this study, but there are emerging issues relating to ensuring effective management, accountability and impartial leadership, and the level of facilitation required to achieve this;

- The drive for growth is likely to involve some degree of a trade-off between catering to existing clients (consolidating the client base, diverse and larger loan sizes) or catering to more, new, clients (usually starting with smaller loans). In some MFIs there is a danger of playing the numbers game, that is achieving outreach, but at the expense of improvement in services to existing clients and potential impact;

- On the other hand, as part of an exit strategy, MFIs operating successfully with clients over a number of years should consider graduating established, better-off clients to formal sources of credit.

Providing a responsive financial service

The basic challenge facing MFIs, whatever their mission or model, is to balance what is practical and sustainable for them as service providers with what is responsive to their clients' needs (including the needs of poorer clients). Suppliers of microfinance services need to maintain manageable and cost-effective systems (e.g. few products, same terms, equal repayment instalments, higher revenue, emphasis on credit discipline and repayments). But this contrasts with clients' preferences that include: flexibility, match with household cash flows, lower cost and hassle.

Supplier (MFI) and client needs		
Services	**What suits practitioners**	**What clients prefer**
Savings Amount	**One size fits all** - same amounts at same intervals – simplifies accounting	**Flexible** amount so that they can save according to varying cash flow patterns (taking into account irregular income sources and varying expenditure needs at different times of year)
Withdrawability	**Compulsory**, **unwithdrawable** savings provide low cost and steadily accumulating funds for portfolio lending	Though clients appreciate the option to save, they would prefer savings to be **withdrawable**
Interest	Lower interest reduces portfolio costs	Higher interest
Credit Purpose	**Enterprise/direct investment use** assuming repayment from resulting income flows; some housing loans for established clients (with low cost funds from HDFC)	Credit not just for direct investment, but to meet **a range of different needs**, regular or emergency (food/consumption smoothening, school costs, medical expenses); repayments are possible from existing income sources
Size	"**One size fits all**" - helps to streamline loan administration, simplify decision making and operations, minimise operational costs	**Variable loan sizes, based on need and repayment capacities** - small for the poor and larger for those with higher repayment capacity
Interest rates; associated processing and service charges	Interest rates (and associated charges) should be **high enough to cover costs**, incl. risks, cost of funds, operational costs and growth	**Lower** effective interest rates - (especially when savings in group/MFI not withdrawable)
Repayment terms	**Standardised** repayments - easy for clients and MFI field staff to understand, simplifies accounting and MIS	**Variable** repayment terms that match cash flows of available income sources (not only from the micro-credit supported enterprise)
System of guarantee	(a) group based models: group savings are the basic collateral (b) IB MFIs ask for a guarantor - either a government officer or an existing client with adequate savings in the MFI	(b) IB clients who are not so well off or know the right people, would prefer a less costly alternative
Insurance	Make insurance **compulsory** since coverage of a client's life, health and asset risks represents a security against loan default, especially if repayment of outstanding loan is the first call	Insurance which could be quickly provided when required would be ideal; **benefits not perceived if there is no call** and premiums have to be renewed without accumulating as a form of savings - or as a compulsory upfront deduction on loans
Programme related: Group meetings	Meetings planned at various times during the working day, to **suit times and security of the MFI field staff** who, especially in the Grameen model, have to cover several clusters in a day	Schedule meetings at times which are **convenient to clients** - and especially for those who are casual labourers, need not lead to loss of a day's earnings

Some suggestions of how these could be balanced are listed below.

Balancing supplier (MFI) and client needs for a more responsive service	
Services	**Some options**
Savings Amount	Flexibility in savings amount (around a minimum compulsory amount over a specific period of say 4 months) – allows clients to save more, depending on their cash flow
Withdrawability	After 1 year, allow withdrawal of interest and a proportion of savings too
Interest	Higher interest already accrues (in theory) in SHG model as a result of the interest on internal loaning; in Grameen and IB model, can a rate above the bank rate be considered, if credit interest is also high?
Credit Purpose	A more flexible mandate which encourages enterprise use but does not exclude other uses; repayment does not only come from a credit supported enterprise, therefore assessment of creditworthiness would take account of different household income sources
Size	Link loan amounts to understanding of specific requirements, as well as creditworthiness; scope will depend on availability of funds to MFI for on-lending and strategy for expansion (larger loans for existing clients or small loans for new clients)
Interest rates; associated processing and service charges	Explore scope for bringing down EIR by reducing associated transaction costs SHG MFIs have reduced their direct costs through linking in to established NGO-based programmes (as banks do in the NABARD linkage model) Grameen MFIs (not linked to NGOs) push for high growth, high repayments and portfolio turnover (strong emphasis on discipline with pressure on field staff)
Repayment terms	Find out more about cash flows of different livelihoods, and see how loan repayment terms can be adapted; dairying is a common loan use, instalments can be adapted to the milking cycle
System of guarantee	(a) Group collateral needs clearer explanation to the groups (as the basis of peer lending) (b) IB models could try joint liability groups with individual savings
Insurance	Try forms of insurance that accumulate as savings (as in LIC); clearer communication is necessary, and may become easier once claims are seen to be honoured; but the challenge will be to enable speedy access whilst retaining prudential norms/checks
Programme related: Group meetings	Draw up the meeting schedule with reference to the time constraints faced by both sides, and obtain agreement of all group members (not just the leader)

Microfinance and vulnerability

This study identifies key risks and financial pressures faced by vulnerable households. Microfinance is supporting the coping strategies of its clients, but it could do more. Currently, it is informal finance (that is moneylenders who can provide different amounts of credit, fast – and at high cost) who are meeting these financial needs, including for older clients, and especially for the poor who are less likely to have the sort of friends and relations who can help.

What can MFIs do to improve the protective role of microfinance and contribute more to the coping strategies of client households, especially the the poor and the very-poor? Some of the options are set out (next page), covering *ex ante* support and *ex post provisioning.* The list necessarily extends to aspects that go beyond the provision of financial services, though for some of these there is not an obvious solution.

Helping households cope with vulnerability – microfinance, and beyond

	Risks	What can microfinance do? Ex ante – promotional/ protective	What can microfinance do? Ex post - provisioning	And beyond microfinance - a *'wish list'*
Household-specific risks	❒ Ill health in the family/accidents	▪ Health insurance – for family (not just client)	Emergency loan for medical expenses	✦ Health awareness ✦ Cost-effective medical services
	❒ Major family events – marriage, death, birth	▪ Savings (special product)	Special life cycle loans	✦ A campaign to reduce social expectations
	❒ Alcoholism and gambling among men and boys	*Collective pressure by groups*		✦ ...
	❒ Loss of husband/main income earner	▪ Savings in woman's name ▪ Withdrawable savings to meet small consumption needs	Investment and flexible small consumption loans *Peer support and example – through group mechanism*	✦ More equitable employment options for women
	❒ Recall of outstanding debts by moneylender		Loans to redeem debts	
Livelihood risks	❒ Loss of enterprise asset (shop burned down, animal dies)	▪ Asset insurance	Additional loan to restart/ repair/replace business	
	❒ Enterprise failure	▪ In case of enterprise loan, link sanction to viability assessment (household skills, market environment) – and assistance, if possible ▪ Asset insurance		✦ Alternative employment
	❒ Loss of job (factory closes/ labour retrenched)		Investment loan	✦ Alternative employment
Co-variate risks	❒ Seasonal difficulties (summer/monsoon)	▪ Withdrawable savings	Seasonal loans	
	❒ Technology change – affecting an economic sector		Larger investment loans – if viable	✦ Alternative employment
	❒ Natural hazards (drought/floods), deteriorating natural resources	▪ Insurance	Limits to MFI viability and therefore ability to respond	? a major challenge beyond financial services

Microfinance and empowerment

In the context of socio-cultural limitations on women's roles and agency, targeting women for financial services is a good start on the road to women's empowerment in terms of redressing the usual inequitable gender balance. Women have certainly become more 'visible' as microfinance clients, but being a client does not translate 'automatically' into her 'empowerment' – her individual growth, her economic activity, her status in the household or the community.

A close look at various microfinance practices, suggests certain strategic features that could make MFI practice more empowering for its women clients. The first and basic requirement is clear and systematic communication on microfinance services and options. A key challenge for MFIs targeting women is that their clients are often illiterate. The majority of women clients (60% in the sample) have had very little or no schooling. Such clients in a few MFIs, have learnt to sign their names (though not necessarily to read them). Though MFIs do claim that they communicate regularly with clients on products and terms, women clients' awareness is not as strong as it should be. The communication flow is either irregular or limited to group leaders who do not pass on the information. Leaving aside a transformative vision of empowerment for women, their understanding of the transactions they are being committed to is a basic requirement for any finance programme that aims to serve its clients.

Other dimensions include support to group development, as well as a 'wish list' of wider issues. These would need to be adapted to different cultural contexts – especially in north. Nevertheless, it is important to realize that there could be powerful synergies between the provision of financial services to women and other non-financial services.

Strategies to support women's empowerment

Strategies	Components – within microfinance	And in addition – a 'wish list'
Support to women as clients	▪ Gender sensitivity of staff (whether men or women) ▪ Clear and systematic communication about the programme to all clients	Economic ✦ guidance on finance management ✦ support to undertake viable enterprises Social ✦ social programmes/guidance Wider social/community participation ✦ exposure/opportunities in new forums
Support to women's groups	▪ Leadership development/ capacity development ▪ Groups guided to have more responsibility/ autonomy	✦ Leadership rotation ✦ Women interact with external financial institutions

The challenge before MFIs that are concerned about women's empowerment is how to build such 'extra' inputs into or around their delivery of financial services.

11 Implications for policy

The provision of financial services by MFIs is beginning to fill the gap between the relatively low cost but inaccessible formal banking sector, and the more accessible, but high cost informal sector. Microfinance represents a range of financial services to large numbers of people without access to the formal banking system. This is happening across the country but predominantly in the Southern region where the NGO base is strong. The North and East are underserved. The **first challenge** is to support the outreach of microfinance to under-served and poorer areas.

Microfinance is essentially a financial service. Its micro scale (small savings deposits, small loans) means that its role may in some situations, for some clients, be promotive (increasing income, reducing poverty) in other situations, for other clients, its role is more protective (consumption smoothening, helping to meet emergency needs). Different clients, especially the poor, need different kinds of finance at different times. The **second challenge** therefore is to enhance the range of products provided under microfinance so as to cater to the different needs of its clients, including the poor.

Substantial numbers of the poor and large numbers of women are microfinance clients, especially in the SHG and Grameen model. This has given rise to strong expectations in terms of poverty reduction and women's empowerment. Given the complexity of both - the multiple dimensions of poverty and the socio-cultural constraints to women's empowerment – it is unrealistic to expect a financial service alone to make the difference, especially a 'micro' one.

At the policy level, this means recognising the serious and continuing need for other development interventions - in infrastructure, cost-effective health care, education, employment. Within microfinance, there are approaches and supporting mechanisms which can be built in as MFIs work on getting to know their clients and their financial needs better. Suggestions on improving practice relating to this are given below. Alongside the process of formalising microfinance institutions, policy makers can support such practices, recognising specifically

(i) the strong supportive role that microfinance can play in providing an accessible option for safe savings – for the poor and for women, and

(ii) if MFIs are to be able to respond to a range of different credit needs and to cover their costs, the rate of interest they charge will be higher than that charged by banks for larger loan amounts.

The role of microfinance in expanding the delivery of financial services, especially to the poor, has been widely discussed and the discussion continues in this 'Year of Microcredit'. Although expectations of poverty reduction and women's empowerment are widespread, key questions about who microfinance reaches and what it can achieve are still open.

This study of 20 Microfinance Institutions reviews these questions in the 'maturing' Indian microfinance industry. Of interest for policy-makers, donors, microfinance practitioners and researchers, the findings highlight the provision of financial services by MFIs as beginning to fill the gap between the banks (low interest rates on credit, but limited access and high transaction costs) and informal moneylenders (higher interest rates, but accessible and fast). The challenges remain of extending provision of microfinance to underserved and poorer areas, and adapting services to cater to the varied financial needs of the poor.

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SIDBI

Small Industries Development Bank of India (SIDBI), an apex financial institution for promotion, financing and development of Small & Medium Enterprises (SMEs) in India, has been, interalia, engaged in providing microfinance services through a network of strong and vibrant financial intermediaries. “SIDBI Foundation for Micro-Credit” (SFMC) – the specialised department of SIDBI responsible for implementing the national-level Micro Finance Support Programme (MFSP) - functions as a nodal set-up to facilitate accelerated and orderly growth of the microfinance sector in India. SFMC provides a complete range of financial and non-financial services such as loan funds, capacity building grant support, equity, quasi-equity and institution building support to the retailing MFIs so as to facilitate their development into financially sustainable entities, besides developing a network of service providers for the sector. Currently, SFMC is providing funds for on lending to over 70 MFIs in India.

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EDA

EDA Rural Systems Pvt Ltd, established in 1983, is a leading development sector consultancy providing professional services in research and capacity building. Focus areas are microfinance and micro-enterprise. EDA has undertaken over 200 assignments across South and South-East Asia. Clients include bilateral and multilateral donors, NGOs, governments and financial institutions.