MICROFINANCE

O.C. Rana
Director (T&P) cum Assistant Professor (Management),
Sri Sai University, Palampur (H.P).
Formerly Assistant General Manager,
State Bank of India
&
Chairman, RRB.

Hem Raj
Assistant Professor (Management),
Sri Sai University, Palampur (H.P).
Dedication

As Sons
We dedicate this book on ‘Microfinance’ to Our Beloved Parents.

As Professors
To Our Students.

As Indians
To Poor Masses.

As Authors
To Bankers and Microfinance Beneficiaries.
Preface

Microfinance has emerged as an independent branch of study, an industry, a development strategy and a revolution recently. The purpose of this book is to acquaint the MBA Finance students, Diploma for Microfinance Professionals and Diploma/Certificate Examination in Rural Credit students with the contents and latest developments in field of Microfinance. Though primarily meant to be a textbook on Microfinance for management students, the book promises to be of interest to management practitioners, administrators, executives as well in the banking, finance, micro credit and rural credit sector.

The book has been written based on the syllabus from some universities where Microfinance is a subject in MBA or includes Microfinance as a Unit in Financial Management. Besides, the book covers the syllabus of Diploma Examination in Microfinance. The book covers latest topics on Financial Inclusion, Self Help Group, Financial Literacy, Financial Counselling, RSETIs, Women Empowerment, MUDRA and SETU.

The Case Studies with suggestive answers in all the chapters and sub-chapters link theoretical concepts with the real world scenarios and make this book extremely student-friendly. At the end of each chapter, multiple choice questions with most appropriate answers, short answer type questions and descriptive questions have been given to enable the students to test their post-reading acquisition of knowledge. Each chapter contains precise chapter contents/objectives and brief introduction. The book is knowledge based, industry experienced based, teaching experienced based and research based. The volume of the text has intentionally being limited to suit the time, need and syllabus of the readers.

The book will also prove to be useful for the officials of the Public and Private Sector Banks in general and the RRB and Cooperative Sector Banks in particular, who are according priority for expansion in rural areas and promoting microfinance.

We express our sincere appreciation to all those whose work and ideas have been helpful in writing this book. A text book is always to some extent the product of other good and prestigious works and we owe acknowledgement of all such works. We are thankful to the publisher for bringing out the book in such a good form. We express our sincere appreciation to all, whose work and ideas have been helpful in writing this book. Suggestions for improvement are welcome from the readers to make the book more useful.

Authors
Acknowledgements

We express our sincere thanks to Er. S.K. Punj, Chancellor, Sri Sai University, Palampur and Chairman SSGI Badhani and Mrs. Tripta Punj, Managing Director, SSGI Badhani to establish this wonderful University in Palampur, introducing Microfinance as an elective subject in Management and providing us a platform to work in this field. The scenic beauty and serenity prevailing in the university campus has contributed largely to the successful completion of this book.

We acknowledge gratefully the inspiration received from Prof. (Dr.) Balram Dogra, former Vice Chancellor and Dr. Naresh Nagpal, present Vice Chancellor of Sri Sai University, Palampur to write the book on Microfinance which is emerging an innovative field in Financial Management. We express our special thanks to Dr. R.K. Seth, Pro Vice Chancellor and Dr. K.K. Parmar, Dean (SW) cum HoD Management to encourage us and provide an opportunity to teach Microfinance subject in Management.

An idea of writing this book was supplemented by the demand from our students of Management to write a simpler and comprehensive version on the subject for whom no other book covering entire syllabus is available.

The first author places on record the opportunity provided to him by State Bank of India and Regional Rural Bank sponsored by SBI, to work intensively and extensively in the Microfinance sector as Chairman RRB. This assignment enabled him to have close liaison with RBI, NABARD and State Government higher officials in Board of Directors, Empowered Committee and State Level Bankers Committee meetings. He appreciates his wife Mrs. Suresh Rana, son Er. Gaurav Rana and daughter-in-law Dr. Sheetal Rana, who have been his constant source of support and strength in this endeavour.

The second author expresses his thanks to his parents to support his Research Studies which encouraged him to work in the Microfinance field.

We express our thanks to the publishers Himalaya Publishing House Pvt. Ltd. for decently and timely publishing the book.

Authors
Contents

Unit I
Introduction to Microfinance

1 Microfinance – An Introduction 3 – 9
2 Demand and Supply of Microfinance 10 – 15
3 Microfinance – A Development Strategy and an Industry 16 – 21
4 Role of Grameen Banks in Microfinance 22 – 28
5 Microfinance Innovative Concepts, Approaches and Financial Inclusion 29 – 37

Unit II
Financial and Operational Evaluation

6 Analyzing and Managing Financial Performance of MFIs 41 – 46
7 Analyzing and Managing Financial Statements of MFIs/RRBs 47 – 53
8 Financial Ratios, Capital Adequacy, IRAC and Provisioning Norms 54 – 59
9 (A) Revenue Models of Microfinance 60 – 63
9 (B) Role of Subsidies and Donors in Microfinance 64 – 66
9 (C) Benchmarking and Rating of MFIs 67 – 70
10 Microfinance – Operational Evaluation 71 – 75
11 Business Planning – Impact Assessment – CVP Analysis 76 – 85
12 Cost Volume and Profit (CVP) Analysis – Microfinance 86 – 90

Unit III
Other Evaluation of Microfinance

13 Market Evaluation of Microfinance – Products and Services 93 – 98
14 Pricing of Financial Services 99 – 104
15 Legal and Regulatory Compliance in Microfinance 105 – 108
16 Social Evaluation of Microfinance 109 – 113
17 Role of Ethics in Microfinance 114 – 117
## Unit IV
**Microfinance in India**

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>18</td>
<td>State Intervention in Rural Credit</td>
<td>121 – 126</td>
</tr>
<tr>
<td>19</td>
<td>Bank Linkup and Programme</td>
<td>127 – 131</td>
</tr>
<tr>
<td>20</td>
<td>Governance and the Constitution of the Board of Various Forms of MFIs in India</td>
<td>132 – 135</td>
</tr>
<tr>
<td>21</td>
<td>Intermediaries for Microfinance</td>
<td>136 – 140</td>
</tr>
<tr>
<td>22</td>
<td>Microfinance Delivery Models and Banks Linkages Programme</td>
<td>141 – 145</td>
</tr>
</tbody>
</table>

## Unit V
**Issues, Trends and Frontiers of Microfinance**

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>Emerging Issues in Microfinance</td>
<td>149 – 156</td>
</tr>
<tr>
<td>24</td>
<td>Gender Issues in Microfinance</td>
<td>157 – 162</td>
</tr>
<tr>
<td>25</td>
<td>Role of Technology in Microfinance</td>
<td>163 – 167</td>
</tr>
<tr>
<td>26</td>
<td>Micro Credit as Priority Sector Advance</td>
<td>168 – 171</td>
</tr>
<tr>
<td>27</td>
<td>Impact of Microfinance on Empowerment of Women</td>
<td>172 – 177</td>
</tr>
<tr>
<td></td>
<td>Bibliography</td>
<td>179</td>
</tr>
<tr>
<td></td>
<td>Model Test Paper</td>
<td>180</td>
</tr>
</tbody>
</table>
1.0 Chapter Contents / Objectives

- To introduce the concept of microcredit and microfinance.
- To know the initiation of microcredit.
- To understand the concept of microfinance.
- To understand the meaning of microcredit and microfinance.
- To differentiate between microcredit and microfinance.
- To know as to why microfinance is needed.
- To explain the role of microfinance.
- To examine the characteristics of microfinance clientele.
- To discuss the benefits of microfinance.
- Case Study

1.1 Introduction

The money lenders used to provide credit to the poor people in India and around the world, at an exorbitant rate of interest since long. Gradually, this type of informal and unorganized type of credit attained the shape of microcredit and was further supplemented by many credit associations, co-operatives and banks. The concept of microfinance initiated as an introduction by Muhammad Yunus (2006) in the form of Grameen Bank in Bangladesh. The Microfinance has been transforming rapidly in the broader sense to include savings, credits, insurance and funds transfer which has assumed the shape of a revolution in the rural finance. Hence, understanding the Microcredit and Microfinance is very important. The year 2005 was declared “The UN Year of Microcredit” by the United Nations. Mr. Mohammad Yunus and Grameen Bank Bangladesh were given Noble Peace Prize in the year 2006 for their efforts to create economic and social development below through microfinance.

About 60% of India’s population is statistically unbanked. Even out of the banked population, only 15% of the account holders have access to credit. Majority of the transaction are conducted in cash. Domestic credit provided by the financial sector in India is at 77% of GDP as compared to Japan 366.5%, USA 240.5%, and U K 184%. Due to the recent initiatives like Financial Inclusion, Aadhar Enabled Payments, Business Correspondent Model and PM Jan Dhan Yojana taken by Government of India, the coverage of microfinance is considerably increasing. The Union Budget (2015) proposed establishment of Micro Units Development Refinance Agency (MUDRA) Bank and setting up of Self Employment and Talent Utilization (SETU) mechanism which are likely to boost microfinance.
1.2 Initiation of Microcredit

The money lenders, who used to provide small amount of loans to the poor and needy people of India and around the world, are the oldest informal and unorganized form of microcredit. The interest rate charged by them is so high that the poor people remain in their clutches and face vicious cycle of poverty. Further they provide loan at their own stipulated terms. Gradually, Rotating Saving and Credit Associations (ROSCAs) based on informal understanding among friends and relatives emerged, where in interest and costs are comparatively low but the social costs and other obligations are considerable. These associations pool the savings of friends, relatives, near relatives and neighbours in a systematic way and extend credit to the poor and needy families. In India ROSCAs exist in the form of commercial chit funds.

The cooperatives emerged as group type institutions with formal constitution and legal status to some extent, which pooled the rural poor savings and provided low amount of credit to the needy people.

In 1971, Bangladesh won its war for independence but there were huge floods in the country resulting into famine, killing large number of people. Muhammad Yunus (1976) started lending small amount to the poor people in the nearby village Jobra in Bangladesh by opening bank branch there to cater needs of the poor. In the year 1978, a small group of young people joined to fight against rural poverty by creating a new and dynamic organisation, which served nearly six million villagers by the year 2008 in Bangladesh. This group is now known as Association for Social Advancement (ASA), targets poorest villagers particularly women to start self employment vocations in Bangladesh. ASA is expanding financial markets by creating self employment opportunities and bringing social change. ASA is providing small loans, pooling small savings providing micro insurances and other financial services to the poor and low income communities. It has emerged as global microfinance institution creating larger impact.

Muhammad Yunus (2006), Nobel Prize winner, introduced the concept of microfinance in Bangladesh in the form of Grameen Bank. In India, NABARD initiated the concept of microfinance as per this idea and established link between Self Help Group (SHGs), Non Government Organizations (NGOs) and Banks. The SHGs are formed and nurtured by NGOs. On attaining maturity the SHGs get credit from banks and extend to members. By 2006 in India more than 22 lakh SHGs were financed by Commercial Banks, RRBs and Cooperative Banks. The microfinance movement has multiplied and large number of SHGs, NGOs, Microfinance Institutions (MFIs), and Non Banking Financial Companies (NBFCs) has emerged to provide microfinance to the poor and needy rural people. Thus the microfinance has emerged as a movement and established an industry.

The Microcredit is the provision of small loans to the poor people at low interest rate for general purpose and productive activities like agriculture and allied activities, artisans and handicraft, small business and self employment activities in rural, semi urban and urban area. The loans extended by the Banks to the Self Help Groups (SHG) for onward lending to members constitute the micro credit.

1.3 Micro Finance

Micro Finance refers to the provision of affordable financial services such as small loans, small savings, micro insurance and funds transfer facilities extended to socially and economically poor and disadvantaged segments of the society to enable them to increase their income levels and improve standard of living. The main aim of microfinance is to provide small loans to poor people particularly living below poverty line, who are not able to raise loan for productive purposes from other sources and to improve their standard of living by increasing their earning and saving covering associated risks.
Microfinance is universally recognized as a just and sustainable solution in alleviating the universal wide spread poverty by financing the poor people for carrying out viable and productive activities and projects thereby generating economic surplus and hence encouraging small savings for investments.

The poor people need minimum financial services. They need to open saving bank account in the bank to keep and multiply their small savings by carrying out productive activities and getting small loans from banks to purchase the assets and increase the level of their activities. In order to cover the life and activities risks, they require micro insurance facilities. They also require funds deposit and transfer facilities at their nearby places. In order to improve the quality and earning, they need some basic training facilities. The provision of these minimum financial services is covered in microfinance.

According to International Labour Organization, “Microfinance is an economic development approach that involves providing financial services through institutions to low income clients”

Microfinance has been defined by the National Microfinance Taskforce, 1999 in India as “Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi urban and urban areas for enabling them to raise their income levels and improve living standards.”

The poor people do not have access to capital which is required to start and grow their economic activities. Microfinance is the provision of basic financial services like small loans, small savings, funds transfer and micro insurance. With these services, some non financial services like business and activity training is required. By carrying out some economic activities, they can earn income and can afford food, clean water, proper shelter, education for their children and necessary health services.

Microfinance (Microfinance helps in breaking poverty cycle)

<table>
<thead>
<tr>
<th>Bank/MFIs</th>
<th>Microcredit, Micro Insurance</th>
<th>Training &amp; Funds Transfer</th>
<th>Projects, Net Returns Cash Accruals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual/SHG, NGO</td>
<td>Social &amp; Economic up Liftment</td>
<td>Reinvestments</td>
<td>Repay Interest &amp; Installments</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Savings</td>
<td></td>
</tr>
</tbody>
</table>

The provision of these financial services helps to increase in the income, saving and investment which results into economic and social up-liftment of the poor people.

### 1.4 Micro Credit and Microfinance – Difference

Micro credit refers to very small loans for poor people with little or no collateral security provided by legally registered institutions like MFIs and Banks. Microfinance refers to micro credit, small savings, insurance and money transfers of poor and low income people. Microfinance is a broad category of financial services which includes micro credit also. Micro credit is the provision of credit
services to the poor people and is a part of Microfinance. Micro credit consists of providing a financial service, i.e., micro credit. Micro finance is the provision of financial services like savings, micro credit, micro insurance and funds transfer.

1.5 Why Microfinance?

The banks have been more or less hesitant in providing microfinance to the poor people with little or no cash income as they incur substantial amount to manage the borrower’s accounts e.g. pre sanction, assessment, disbursement of loans, inspection follow-up, recovery of loans, handling of accounts and hardly cover break-even point.

The poor people have no or few assets to offer as collateral security for the loans to the banks. Thus bank fear having little recourse against the defaulting borrowers.

The majority of the poor people does not have saving bank account in the bank and bank need proper identity and address proof before providing microcredit to them. The lack of knowledge, initiatives and collateral securities are the hindrances in getting the credit from banks. The people need microfinance to carry out their economic activities in commercial manner.

Microfinance is needed for the economic growth and transformation of the nation. Microfinance is needed to eradicate poverty and record development of the nation. Microfinance is needed to meet the life cycle needs, emergency needs and investment needs of the people. Microfinance is needed for economic and social up liftment of the people. Microfinance is needed for women empowerment through development.

1.6 Role of Microfinance

(i) Microfinance provides finance to the poor people for carrying out their economic activities and helps them to meet the basic needs of life.

(ii) Microfinance helps the poor people to increase their income, savings and standard of living.

(iii) Microfinance provides employment to the poor people by providing self employment opportunities in various sectors and activities.

(iv) Microfinance protects the poor people against the risks by providing life insurance and assets insurance.

(v) Microfinance helps in alleviating poverty by providing affordable financial services.

(vi) Microfinance helps in increasing economic growth and development in the country.

(vii) Microfinance promotes gender equity by supporting women empowerment and their economic participation and hence improving well being of the poor households.

(viii) Microfinance provides improvements in household economic welfare and enterprise stability and growth.

(ix) Microfinance helps in increasing savings, investments and developments.

(x) Micro finance provides employment opportunities to unemployed people and full employment to the under employed people.

1.7 Characteristics of Microfinance Clients

(i) Microfinance clients are generally poor people living in poverty.
Microfinance clients are generally unaware of the various schemes and products which are available in the banks for the poor clients.

Microfinance clients generally do not have easy access to finance for their activities and most of them do not have saving bank accounts with banks.

Microfinance clients find it difficult to provide collateral security, margin, balance sheets and profit and loss accounts in the banks.

Microfinance clients cannot afford higher rates of interest and various charges levied by banks.

1.8 Benefits of Microfinance

The microfinance industry is fastly growing in India. The recent studies show that the top sixty microfinance institutions in India have nearly ten million customers who have been provided small loans under microfinance. The microfinance aims at removal of poverty, empowering poor, mostly women to start their own economic activities, earn money and achieve financial independence.

The recent studies also show that the recovery in microfinance is as high as 97% which facilitates cycling of banks funds for the productive purposes. Generally, the loan under microfinance is given without any collateral security. Thus the poor are in position to get the loan and come out vicious cycle of poverty.

Microfinance promotes gender equality and empowers women by providing them finance for carrying out economic productive activities. Microfinance helps in creating long term financial independence in the backward and poverty ridden areas.

1.9 Case Study

Harsi Pattan is a large and remote village in district Kangra of Himachal Pradesh. The population of the village is about three thousand five hundred people with 52: 48 male female ratio. The prominent castes are Rajputs, Blacksmiths and Brahmins, followed by scheduled castes. The main economy of the village is agriculture. The density of Antyodaya and IRDP identified families is also large. Most of the people are poor. A defunct NGO and some SHGs are there in the village. Economically and socially the village is poor with some basic problems like stray animals, monkeys menace and lack of irrigation facilities.

You have recently joined as Branch Manager in a Regional Rural Bank branch in the village. Your controlling authority enjoins upon you to initiate microfinance programme in a big way in the village.

In the light of above, please answer the following questions:

(i) Name the major financial services, you would like to introduce in the village for increasing microfinance?

(ii) What are the facilitating factors and hindering factors prevailing in the village for the development of microfinance?

(iii) Suggest some activities you would like to finance in the village?

(iv) What socio-economic changes you intent to bring in the village?

Suggested Solution

(i) As a promising young Manager of RRB Branch and with the help of Branch staff, we would like to introduce the undernoted financial services in the village:
- Opening of Saving Bank accounts at the branch of all the families in the village with minimum formalities to ensure full financial inclusion and microfinance.
- Providing optimum credit to the identified and needy families to finance their economic activities like crop loans and term loans for agriculture and allied activities like dairy, poultry, pisciculture, apiculture, sericulture etc. besides small business, handicraft and small industries.
- Providing micro insurance cover to the beneficiaries for their life and vocations to cover the risk.
- Providing remittance facilities to the people to transfer funds at other places.

(ii) The stated facilitating factors prevailing in the village for the development of micro finance are:
- Large and diversified population of the village.
- Large base of poor and micro credit absorbing families.
- Existence of NGO and SHGs, which can be activated.
- Agriculture and allied activities potential, besides micro and small enterprises can be financed.
- Large number of Antyodaya and IRDP families for financing.
- The hindering factors which can be converted into leads are:
  - Stray animals and monkey menace. Barbed wire fencing and growing suitable crops may be considered.
  - Lack of irrigational facilities. Minor irrigation schemes could be considered for financing.

(iii) We would like to finance the undernoted activities:
- Crop loans in the shape of Kisan Credit Cards to the eligible needy families.
- Agriculture Term loans for agriculture and allied activities.
- Working capital and term loans for small business, handicraft and small industries.
- Micro credit to identified Antyodaya, IRDP and poor families.

(iv) We would like to bring the undernoted socio-economic changes in the village:
- Women empowerment in the village by improving the socio-economic position of the women by providing self-employment opportunities through micro finance.
- Increase in income of the families by ensuring economic surplus, hence improvement in their socio-economic status.
- Developing banking habits among families in the village by providing the microfinance products and services.
- Ensuring full self-employment provision in the village by catering their microfinance needs.

**Objective Answer Type**

**Fill in the blanks. (What for the abbreviations stand)**

1. ROSCAs are __________
2. ASA is known as __________
3. SHGs are __________
Microfinance – An Introduction

4. NGOs are ___________
5. MFIs are ___________
6. Mohammad Yunus was given Nobel Prize in the year 2006 for ___________
7. The purposed (Union Budget 2015) MUDRA Bank refers to ___________
8. The purposed (Union Budget 2015)SETU refers to ___________

Answer Key
1. Rotating Saving and Credit Associations
2. Association for Social Advancement
3. Self Help Groups
4. Non-government Organizations
5. Microfinance Institutions
6. Micro financing
7. Micro Units Development Refinance Agency
8. Self Employment and Talent Utilization

Short Answer Type
1. Define and explain Microcredit?
2. Define and explain Microfinance?
3. Differentiate between Microcredit and Microfinance?
4. Why Microfinance is needed?
5. What is the role of Microfinance?
6. What are the general characteristics of Microfinance clients?
7. What are the benefits of Microfinance?
8. How micro credit got initiated?

Descriptive Answer Type
1. What is meant by Microfinance? Differentiate between Microcredit and Microfinance? Explain the role of Microfinance? What are the benefits of Microfinance?
2. Define and explain Microfinance? What are the characteristics of Microfinance client? How the Microcredit emerged and turned into Microfinance?
3. How Microfinance provides economic and social up liftment of the poor people who are in the grip of vicious cycle of poverty?
4. Write short notes on:
   - Micro Insurance
   - Micro Credit
   - MUDRA Bank
   - SETU Mechanism
About the Authors

O.C. Rana, MBA (Finance), M.A. (Economics), CAlIB and pursuing Ph.D. (Management) is presently Director (Training and Placement) cum Assistant Professor (Management) in Sri Sai University Palampur (HP). He is former Assistant General Manager, State Bank of India and Chairman, Regional Rural Bank (PGB). He is Certified Associate of Indian Institute of Banking and Finance. His professional qualifications include certificates in Cooperative Management, Rural Banking, Banking Oriented Hindi and Swift and Net Surf. He is an elected Associate Member of Indian Institute of Bankers and Finance. He is member Editorial Advisory and Reviewer/Associate Editor, Pezzotta Journals. He has been exposed to various training programmes in Management, Finance, HRM, Marketing, Risk Awareness, RTI, Investment Management, ALM, Technology Orientation, Chairmen RRBs in State Bank Academy, Banker’s Institute of Rural Development, State Bank Institute of Information Communication Management and RBI College. He has rich experience of 39 years in banking industry and teaching in various capacities. He has attended many national level conferences and presented research papers including in Microfinance. He has delivered various Guest/Special Lectures in Banking, Finance, Microfinance, MSMEs, IRDP, PMRY, PMEGP, etc. in Himachal Pradesh Institute of Public Administration, Cooperatives Training Institutes, R-SETI and DRC Training forums. His talks in Banking Advances and RRB programmes have been telecasted in Doordarshan and Television Channel. He has passion for teaching, training, writing and research. He teaches Post Graduate Management classes for subjects in Microfinance, Financial Management, Research Methodology, Business Environment, International Business Environment and Finance, Organizational Behaviour, Industrial Psychology, Training and Development, etc.

Hem Raj, MBA (HR), M.A. (English) and pursuing Ph.D. in the Management field. He is presently working as Assistant Professor (Management) in Sri Sai University, Palampur (HP). He teaches MBA, BBA and B.Tech. classes for subjects in Business Policy and Strategy, Human Resource Management, Environmental Studies, Principles of Business Economics and Management, etc. He has passion for teaching, writing and research.