

**Opening address by Smt Ranjana Kumar, Chairperson, NABARD at the High Level Conference on Microfinance in India on 3 May 2005, New Delhi**

**Good Morning Ladies and Gentlemen,**

1. It is indeed my pleasure to welcome all the national and international delegates to this High Level Conference. SDC & GTZ have collaborated with NABARD for many years now and also on this occasion we at NABARD are pleased to work together with them through this Conference.
2. We are fortunate to have Dr. Rangarajan as our Chief Guest today, an internationally reputed economist, a well-known banker and as the Governor of Reserve Bank of India during early nineties he was at the helm, guiding the economic reform process in this country. He has served and held several important positions both in India and abroad, including the important constitutional post of Governor of the State of Andhra Pradesh. Currently, he is performing the coveted role of Chairman, Economic Advisory Council to the Hon'ble Prime Minister. Sir, we are honoured by your august presence. I welcome you on behalf of NABARD, Swiss Agency for Development Cooperation (SDC), and German Agency for Technical Collaboration (GTZ) and thank you for having accepted our invitation and consented to grace this function, and to inaugurate the programme.
3. Over the past decade, microFinance has taken on an increasingly significant role in the development strategies of developing economies. MicroFinance is seen as a tool to reach the poorest sections of society, and to provide them with services and resources that will uplift their economic well being. This has caused increased attention to be paid to this sector from relevant quarters and warranted the need of additional resources to be allocated to it. As a result, in many countries, including here in India, microFinance is a fast growing industry, increasing its outreach among poor households.
4. As you are aware, NABARD has been playing a key role in the development of rural areas, primarily addressing the issues of (i) facilitating access to financial services to the rural families in the unorganized sector, and thereby accelerating the flow of institutional credit (ii) building entrepreneurial and technical skills of the rural poor, (iii) facilitating market linkages and (iv) improving the productivity of agriculture in dryland areas, which sustain the largest proportion of the rural poor, through application of watershed development, focus on tribal population development, and other such Development Initiatives.
5. The microFinance approaches, evolved and implemented by NABARD in Partnership with various stakeholders like formal banks, NGOs, MFIs, and government agencies, have demonstrated that some of the problems faced by the poor could be effectively addressed, and on a sustainable basis. By addressing the

problems of access of the rural poor to financial services, capital formation in the form of both own savings and income generating assets, and setting in the process, social and economic empowerment of poor, these approaches have come to be recognized as the last visible ray of hope. I am happy to share with you that during the just concluded fiscal year 2004-05.

- 7,78,501 Self Help Groups comprising 5,18,713 of new SHGs, and 2,59,788 of existing SHGs, have accessed credit to the tune of Rs.29.62 billion (2962 crore) from the entire banking system.
  - The average bank loan per new and existing SHG was to the tune of Rs.32,963 and Rs.48,215 respectively.
  - Cumulatively, 1.59 million (15.9 lakh) SHGs comprising 23.96 million (2.396 crore) rural poor families have been credit linked to banks and cumulative disbursement of credit was of the order of Rs.68.65 billion (6865 crore). Nearly 42 per cent of the credit linked SHGs are from the non-southern region as compared to 27 per cent as on March 2001.
6. The SHG movement is thus no longer a phenomenon confined to the southern states but has also successfully spread to the other parts of the country.
7. Assuming, on an average, saving of Rs.5,000 per group, the savings with the banking system could be estimated at Rs.8.00 billion (800 crore). Various impact studies have revealed that the on-time repayment of SHG loans was around 95 per cent. Almost 90 per cent of the SHGs formed and financed are of women groups. It has been very rightly observed that the programme has played a significant role in 'feminisation of credit portfolio of the banks'. High repayment rates have evolved an overall good recovery climate, giving a comfort to the formal credit delivery system encouraging it to expand the outreach.

### **SHG – Bank Linkage Programme**

8. Let me give you a curtain raiser on this success story. As you all are aware, formal banks comprising commercial banks, regional rural banks, cooperatives, were purveying small loans to the poor under various programmes, including government sponsored poverty alleviation programmes. The banks have disbursed massive volume of credit to the rural areas. Notwithstanding the proactive role of banks in purveying credit, the economic empowerment through capital transfer could not gather the desired momentum. The rural banking suffered from low returns on micro credit operations due to high transaction costs and improper identification of borrowers under subsidized programme of the State, and they thus became apprehensive in providing the much needed impetus to this socially and financially important sector.

9. In the above backdrop, NABARD initiated a series of action research studies during the eighties to assess as to why a majority of the poor were bypassed by the formal banking system / and whether the products and services offered by the banking system were appropriate to the requirements of the poor.
10. These studies confirmed that a very large number of the poorest of the poor continued to remain outside the fold of the formal banking system. These studies also showed that the existing banking policies, systems and procedures, and deposit and loan products were not well suited to meet the most immediate needs of the poor. The study findings also showed that what the poor really needed was a better access to these services and products, rather than cheap subsidized credit.
11. Thus began a search for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms, which would fulfill the requirements of the poorest, especially of the women members of such households. The emphasis therefore was on improving the access of the poor to microFinance rather than just micro-credit. As village based network of bank branches already existed, it focused not on creating alternate organizations, but on finding ways and means to improve the access of the poor to the existing banking network. Thus emerged the Self Help Group (SHG) – Bank linkage model as the core strategy that could be used by the banking system in India for increasing their outreach to the poorest of the poor who were hitherto getting by-passed by them. The strategy involves forming small, cohesive and participative groups of the poor, encouraging them to pool their thrift regularly and using the pooled thrift to make small interest bearing loans to their members, and in the process, learning the nuances of financial discipline and also to ignite an empowerment process for the members of the SHGs.
12. It was under this scenario that the SHG – Bank Linkage Programme was launched by NABARD in 1992. Encouraged by the positive results in the pilot stage, Reserve Bank of India advised banks in 1996 to cover SHG – Bank linkage as a mainstream programme. The programme acquired a national priority from 1999 through Government of India budget announcements. With the support from both the Government of India and the Reserve Bank of India, NABARD successfully spearheaded the programme through partnership with various stakeholders in the formal and informal sector. The SHG concept is unique because of the several factors.
  - Firstly, it is built around both formal and informal systems.
  - Secondly, it seeks to promote both social capital and financial capital that are prerequisite for any meaningful development.
  - Thirdly, it allows for flexibility (e.g. interest rates, repayment schedules, instalments size etc.) around certain core principles.

- Fourthly, it allows for interaction between professionalism of bankers and wisdom and local knowledge and experience of the group.
13. I must however, admit that up scaling of SHG – Bank Linkage Programme, retaining its qualitative dimensions does pose a few challenges. These include, training of a large number of stakeholders, maintaining the quality of groups, ensuring proper book keeping at the SHG level, further innovations in savings and credit products by dovetailing insurance and other services, graduation from livelihood enterprises to economic enterprises, establishing market linkages for products produced by members of SHGs, and, managing expectations from the SHG movement.

### **Role of MFI**

14. With the current phase of expansion of the SHG – Bank Linkage Programme and other microFinance initiatives in the country, the MFI sector in India is now beginning to evolve. There are a variety of MFIs providing microFinance in India. The MFIs can be broadly sub-divided into three categories of organisational forms namely 'not for profit MFIs', 'Cooperative MFIs', and 'for-profit MFIs'. While there is no data base in regard to the number of MFIs operating in the country, it is estimated that their number could be around 800. An overwhelming majority of MFIs are, however, small in size and are from NGO sector with clients ranging anywhere between 500 to 1000. The large MFIs are NBFC MFIs typically belonging to the 'for profit' category. In short, India has a large number of MFIs with diverse legal forms, varying significantly in size, outreach and credit delivery methodologies.
15. Banks lending to MFIs for further on lending to SHGs and other than SHG mechanism has been recognized as a legitimate financial intermediation activity by the Reserve Bank of India. It must be said, however, that this recognition from the Central Bank is limited to lending by MFIs to its micro-credit clients through on-lending funds provided to it by banks, donors, or apex agencies, and does not include provision of savings services by them in any form.
16. Presently, there is no regulatory mechanism in place for MFIs except for those that are registered as NBFCs. As a result, MFIs are not required to follow the standard rule and this has allowed many MFIs to be innovative in their approach, particularly in designing new products and processes. But the flip side is that the management and governance of MFIs generally remains weak, as there is no compulsion to adopt widely accepted systems, procedures and standards. Because the sector is unregulated, not much is known about their internal health. The regulation would therefore help in improving the growth of MFIs in an orderly approach. But, to our mind, regulation is required to be implemented in a phased manner as many MFIs are not prepared for it, and would therefore require huge investments in capacity building and recognition of its relevance. I am certain

this conference would deliberate on the issues concerning regulation of MFIs at greater length.

17. Also, unless appropriate delivery mechanisms are used by MFIs, the transaction costs for handling small amounts of credit would be high, and MFIs do tend to cover them through high interest rates. Their own sustainability versus the sustainability of their clients then comes in to direct conflict. This is a dilemma which many MFIs are facing in the country. In so far as the poor are concerned, rates of interest may not be an immediate area of concern as long as they get quick access to smaller but adequate and short duration loans. Yet cost of credit is indeed an important issue, and therefore once their credit needs graduate to a higher level for undertaking activities – entailing larger investment outlays repayable over longer periods, one cannot ignore the affordability aspect of servicing such loans by the poor. Even the risk costs will tend to rise in this scenario. The MFIs absorbing default risks generally associated with lending for investment purposes would come in the way of their sustainability. MFIs also lack the capacity to cross subsidise their operations even in the short run, and having small loan portfolios in a small geographical area, reduces their risk bearing capacity almost totally. The policy environment to be created for MFIs needs to address this crucial issue.

### **The Years Ahead**

18. NABARD looks at the future of its microFinance interventions from the perspective of all-inclusive approach.

Firstly, by strengthening the existing institutional set up of rural financial institutions by marketing efficient tools of banking with the poor, thereby expanding their outreach on a major scale, and,

Secondly, by creating a conducive and supportive environment for MFIs to access commercial funds for bridging the gaps in the delivery of financial services.

19. In pursuance of the first expectation, NABARD had initially set for itself an ambitious mission of providing access to micro financial services to one third of the rural poor through linking 1.00 million (10 lakh) SHGs with the banking system by the year 2007. Having achieved this mission, three years ahead of the target date, i.e. March 2004, NABARD now aims to cover 140 million (14 crore) poor through linking 2.00 million (20 lakh) SHGs by the year 2007 and hopefully 225 million (22.5 crore) poor through linking 3.00 million (30 lakh) SHGs with the banking system by the year 2010. NABARD interventions in this regard would continue in the form of investments in the development of human capital through large scale training of SHGs, NGOs, government departments and agencies, also other SHG promoting agencies, banks and other stake holders,

system design, monitoring and infrastructural capacity building of the microFinance sector.

20. Having achieved success with the SHG – Bank Linkage Programme, NABARD intends to play a similar role in the orderly growth of the microFinance institutions in the country. The budget announcements for the current year have provided for expansion of the scope of the NABARD managed Micro Finance Development Fund by including equity contributions to MFIs and also increasing the Fund size from Rs.1000 million (100 crore) to Rs.2000 million (200 crore). As a first step towards promoting MFI sector, NABARD would soon be undertaking the lead role of identifying, classifying and grading of MFIs in the country. Further, to increase the flow of bank finance to MFIs, NABARD has decided to provide financial assistance to banks for grading of the MFIs by a reputed credit rating agency. The Advisory Board to Micro Finance Development and Equity Fund would also examine and suggest regulatory and supervisory framework for the orderly growth of the MFIs in the country. Further, RBI has recently enabled non-governmental organizations engaged in microFinance activities to access external commercial borrowings upto US \$ 5 million during a financial year as an additional channel of resources mobilization.

\*\*\*\*