Microfinance in India - A Tool for Poverty Reduction*

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Abstract

This working paper traces the evolution of the Microfinance revolution in India as a powerful tool for poverty alleviation. Where institutional finance failed Microfinance delivered, but the outreach is too small. There is a question mark on the viability of the Microfinance Institutions. There is a need for an all round effort to help develop the fledgling Microfinance Industry while tackling the trade-off between outreach and sustainability. Recent events in India have brought a fresh focus upon the problem of regulation in the field of micro finance. This paper delineates the three distinct aspects where government needs to play a role. The first is to protect the rights of the micro-borrower, the consumer of micro-financial services. The second is that of prudential oversight of risk-taking by firms operating in microfinance, since this could have systemic implications. The third is a developmental role, emphasising scale-up of the microfinance industry where the key issues are diversification of access to funds, innovations in distribution and product structure, and the use of new technologies such as credit bureaus and the UID. Each of these roles needs to be placed in an existing or a new regulatory agency. There is a case for creating a new regulatory agency which unifies the consumer protection function across all financial products. The context for this paper also derives from the current overriding emphasis on microfinance in rural finance discourse and its celebration as the new 'magic wand' in the fight against poverty. The paper discusses the factors and theoretical position associated with evolution of microfinance and its global acclaim based on it being a Win-Win proposition for both Micro Finance Institutions (MFIs) and Clients. The paper brings out the missing link of impact assessment in the Indian context, which is a precondition for poverty reduction on account of the influence of new paradigm of Institutional viability under commercial microfinance. The paper argues for mainstreaming impact assessment in evaluation of programmes for realizing the full potential of microfinance in achievement of Millennium Development Goals (MDGs).

Keywords: Microfinance, Poverty Alleviation, Microfinance Institutions, Rural Finance, Magic Wand, Millennium Development Goals.

Microfinance background

History

Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women's Association ("SEWA") of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganised sector in Ahmadabad City, Gujarat. The microfinance sector went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. From humble beginnings, the sector has grown significantly over the years to become a multi-billion dollar industry, with bodies such as the Small Industries Development Bank of India and the National Bank for Agriculture and Rural Development devoting significant financial resources to microfinance. Today, the top five private sector MFIs reach more than 20 million clients in nearly every state in India and many Indian MFIs have been recognized as global leaders in the industry.

The Government of India and the RBI have a stated goal of promoting financial inclusion

According to recent RBI estimates, there are over 450 million "unbanked people" in India, most of who live in rural areas. The term "unbanked" refers to people who have no access to formal financial services, but rather must rely on either family, or informal providers of finance, such as the village moneylender. It is undisputed that access to finance is critical for enabling individuals and communities to climb out of poverty. It is also generally agreed that relying on the limited resources of village moneylenders exposes the poor to coercive lending practices, personal risks and high interest rates, which can be a much as 150%. Therefore the Indian Government and the RBI have a policy of "financial inclusion". As part of this policy, the government requires Indian banks to lend to "priority sectors", one of which is the rural poor. Until recently, banks were happy to lend money to MFIs who would then on-lend funds, primarily to poor women across rural India. The banks have welcomed this policy because historically they tended to charge MFIs average interest rates of 12-13% and benefited from 100% repayment rates. Thus, by lending to MFIs, banks have been able to meet their "priority sector" lending requirements with what historically has amounted to a risk-free and very profitable arrangement.

The goal of financial inclusion must include the private sector

Microfinance in India is currently being provided by three sectors: the government, the private sector and charities. These three sectors, as large as they are, have only a small fraction of the capital and geographic scale required to meet the overwhelming need for finance amongst India's rural poor.

The top 10 private sector microfinance providers in India together serve less than 5% of the unbanked population of India – approximately 20 million clients. For

example, SHARE Microfin Limited ("SHARE") and Asmitha Microfin Limited ("Asmitha"), two of the five largest MFIs in India, have almost Rs 4,000 crore ($900MM) loaned to over 5 million poor women in 18 Indian states (prior to the crisis, the combined outstanding loan portfolio had been as high as Rs 6,750 crore ($1.525BN)). Yet, despite the size of MFIs like SHARE and Asmitha, only a fraction of the overwhelming need is being met.

Private sector MFIs have an essential role to play if the goal of financial inclusion is to be realized, as neither the government nor charities have the capital nor business model required to meet the insatiable demand for finance in rural India. As the public listing of SKS Microfinance underscored, private sector institutions are able to attract increasingly large amounts of private capital, in order to accelerate the growth of the industry, which is essential to expanding financial inclusion as far and as fast as practicable.

Legatum Ventures' contribution to the microfinance sector in India

Legatum is a multi-billion dollar investment organization with a 25 year heritage of allocating capital successfully around the globe. Legatum has been one of the largest private portfolio investors in India since 2005. Legatum has invested billions of dollars in some of India's leading companies, primarily focusing on banks and other financial institutions. In addition to its investment business, Legatum has a very active philanthropic arm, the Legatum Foundation, which has since its inception provided over $100 million to over 1,200 humanitarian projects in over 100 countries, including India. The Legatum Foundation supports local grass-roots community-based initiatives that focus on issues ranging from health, education, financial inclusion and human trafficking. Our investment in the microfinance sector was an effort to combine our investment and philanthropic efforts to demonstrate that "good business is good development".

In 2007, Legatum Ventures invested $25 million in SHARE, which was at the time the single largest private equity investment globally in microfinance, to help the company scale its operations to reach more clients while also improving its governance and operations. At that time, SHARE was in distress due to the "Krishna crisis" (where local politicians told borrowers they no longer needed to repay MFIs). With Legatum Ventures' equity infusion, SHARE was able to survive the Krisha crisis and grow. Over the last four years, SHARE, together with its sister organization, Asmitha, has expanded from under one million clients to over five million. The combined company has grown from operating in 3 states to 18 across India. As of the beginning of March 2011, the combined company had an outstanding loan portfolio of almost Rs 4,300 crore ($970MM) and 10,000 employees.

Legatum introduced world-class corporate governance standards and ensured that SHARE's operations met with the highest ratings from CRISIL and other agencies, while also overseeing SHARE's transition to a "Big Four" audit firm (S. R. Batliboi & Co., a member of Ernst & Young). SHARE has historically had one of the

lowest interest rates of the large MFIs in India and also one of the lowest operating expense ratios of just 7%.

'Microfinance refers to small scale financial services for both credits and deposits- that are provided to people who farm or fish or herd; operate small or micro enterprise where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries in both rural and urban areas'- Marguerite S. Robinson. The Indian state put stress on providing financial services to the poor and underprivileged since independence. The commercial banks were nationalized in 1969 and were directed to lend 40% of their loan able funds, at a concessional rate, to the priority sector. The priority sector included agriculture and other rural activities and the weaker strata of society in general. The aim was to provide resources to help the poor to attain self sufficiency. They had neither resources nor employment opportunities to be financially independent, let alone meet the minimal consumption needs.

To supplement these efforts, the credit scheme Integrated Rural Development Programme (IRDP) was launched in 1980. But these supply side programs (ignoring the demand side of the economy) aided by corruption and leakages, achieved little. Further, 'The share of the formal financial sector in total rural credit was 56.6%, compared to informal finance at 39.6% and unspecified sources at 3.8%. [RBI 1992]. Not only had formal credit flow been less but also uneven. The collateral and paperwork based system shied away from the poor. The vacuum continued to be filled by the village moneylender who charged interest rates of 2 to 30% per month (Rural Credit and Self Help Groups- Microfinance needs and Concepts in India- K.G.Karmakar 1999). 70% of landless/marginal farmers did not have a bank account and 87% had no access to credit from a formal source.(World Bank NCAER, Rural Financial Access Survey 2003).

It was in this cheerless background that the Microfinance Revolution occurred worldwide. In India it began in the 1980s with the formation of pockets of informal Self Help Groups (SHG) engaging in micro activities financed by Microfinance. But India's first Microfinance Institution 'Shri Mahila SEWA Sahkari Bank was set up as an urban co-operative bank, by the Self Employed Women's Association (SEWA) soon after the group (founder Ms. Ela Bhatt)was formed in 1974. The first official effort materialized under the direction of NABARD.(National Bank For Agriculture And Rural Development).The Mysore Resettlement and Development Agency (MYRADA) sponsored project on "Savings and Credit Management of SHGs was partially financed by NABARD during 1986-87.['Mainstreaming of Indian Microfinance'- P.Satish, 2005]

The rural finance policy pursued in most developing countries beginning from 1950s was based on providing subsidized credit through state controlled or directed institutions to rural segments of population. Expansion of credit coverage through state interventions was based on various theoretical assumptions. Seibel & Parhusip

(1990)[1] mention that this approach was based on the premise that rural micro-entrepreneurs are unable to organize themselves, they need subsidized credit for increasing their income and are too poor to save. Yaron, Benjamin & Piprek (1997)[2] have traced this traditional approach in rural finance leaning heavily towards direct interventions to Keynesian influence. Under this approach, in addition to the assumptions listed above, the key problem areas visualized in rural financial markets included a lack of credit in rural areas, absence of modern technology in agriculture, low savings capacity in rural areas and prevalence of usurious moneylenders.

These distortions and imperfections in rural credit markets were sought to be addressed through Government interventions. With difference of range and degree, most developing countries from 1950s to the 1980s were home to interventions ranging from establishing state owned financial institutions, interest rate ceiling on deposits and credit, credit subsidy, directing credit to particular sectors and nationalization of private banks.

This 'supply led' approach in rural finance caused various qualitative issues such as concerns about financial viability of institutions on account of high rate of loan delinquency, cornering of subsidy by well off people in what has been described as 'rent seeking' behaviour, continued presence of moneylenders, inability to reach the core poor and led to a reorientation in thinking around 1980s. United State's Agency for International Development's (USAID) spring review of Small Farmer Credit in 1972/73, covering 60 reports on specific farm credit programmes in developing countries followed by a World Conference on Credit for Farmers in Developing Countries in 1975 organised by FAO were the first landmark events pointing the deficiencies of directed and subsidized credit approach. These thoughts got crystallised during the 'Colloquium on Rural Finance in Low Income Countries' by USAID and World Bank in 1981 and shaped the emergence of new thinking in rural finance. Hulme & Mosley (1996)[3] credit the counter revolution against Development Financial Institutions (DFIs) which were a prime symbol of Government intervention in rural credit markets to 'Ohio school' as the economists[4] at Ohio State University provided the theoretical underpinnings to the critique of past approach and contributed to transfer of these ideas into operational policies of World Bank.

On account of the above developments, the resultant shift in rural finance discourse and operational paradigm is shown in Table on next page.

Features	Old paradigm	New Paradigm
Problem Definition	Overcome market imperfection	Lower risks and transaction cost
Role of financial Markets	Imperfect state plans Help the poor	Intermediate Resource Efficiency
View of users	Beneficiary	Clients
Subsidies	Create subsidy dependence	Create independent institutions
Sustainability	Largely ignored	A major concern
Evaluations	Credit impact on beneficiaries	Performance of financial institutions
Source: Adopted from Meyer and Nagarajan (1996) [5]		

Emergence of micro credit[6] in late 1970s and early 1980s in the backdrop of growing world attention on deficiencies of earlier approach in rural finance explains much of its dominant theoretical underpinnings. The initial micro credit innovations in disparate settings of Bangladesh, Bolivia and Indonesia[7] demonstrated the success of micro lending to poor without collateral requirements. Rhyne (2001)[8] observes that these interventions demonstrated techniques for lending to the poor with better outreach and cost recovery. Despite the contextual differences, the unifying thread of these early innovations lay in their certain common principles like reliance on character or peer pressure rather than collateral as loan security, leveraging social capital, positive incentives for repayment and interest rates that approached or covered cost. These innovations acted as catalysts for replication across the globe and their underlying principles continue to form the bedrock of microfinance interventions till date.

The universal appeal of microfinance stemmed from its ability to reach the poor without social collateral and generation of near full recovery rates through what has been described as a Win-Win proposition. The mainstreaming of microfinance worldwide and its global acceptance in development community is based on this Win-Win proposition. This concept of provision of sustainable financial services at market rates has been termed as 'Financial System' approach or 'Commercial microfinance'. The progress report submitted by Micro credit summit campaign[9] indicates that as of Dec.31, 2004, 3,164 microcredit institutions have reached 92.27 million clients translating into microcredit interventions having reached 333 million poor families worldwide. The obsession with microfinance in development sector is succinctly captured by Remenyi (2000, p30) [10], "every bilateral donor and NGO seems to believe that it too must be involved in microfinance if it is to retain credibility as a development agency with an option for the poor".

Global Acceptance of Microfinance

It is claimed that this new paradigm of unsecured small scale financial service provision helps poor people take advantage of economic opportunities, expand their

income, smoothen their consumption requirement, reduce vulnerability and also empowers them (CGAP,2003[11] ; ADB, 2004[12])

Former World Bank President James Wolfensohn said "Microfinance fits squarely into the Bank's overall strategy. As you know, the Bank's mission is to reduce poverty and improve living standards by promoting sustainable growth and investment in people through loans, technical assistance, and policy guidance. Microfinance contributes directly to this objective" [13]. The emphasis on microfinance is reflected in microfinance being a key feature in Poverty Reduction Strategy Papers (PRSPs) [14]

Realising the importance of microfinance, World Bank has also taken major steps in developing the sector. Formation of Consultative Group to Assist the Poor (CGAP) in 1995 as a consortium of 33 Public and private development agencies and establishment of Microfinance Management Institute (MAFMI) in 2003 are significant landmarks. CGAP acts as a "resource center for the entire microfinance industry, where it incubates and supports new ideas, innovative products, cutting-edge technology, novel mechanisms for delivering financial services, and concrete solutions to the challenges of expanding microfinance".[15] MAFMI was established with support of CGAP and Open Society Institute for meeting the technical and managerial skills required for microfinance sector. CGAP has been instrumental in shaping the dominant theoretical orientation of microfinance. The guiding philosophy behind diverse sphere of CGAP activities by way of dissemination of microfinance best practice, grant-making to Micro

Other Regional multilateral development banks like Asian Development Bank also champion the cause of commercial microfinance. ADB (2000, pg 1-2) [16] outlining its policy for microfinance lends support to the logic by saying "to the poor, access to service is more important than the cost of services" and "the key to sustainable results seems to be the adoption of a financial-system development approach". The underlying logic offered in support of this is universally based on twin arguments i.e., a) subsidized funds are limited and cannot meet the vast unmet demand, hence private capital must flow to the sector and b) the ability of the poor to afford market rates. Though, various scholars like Morduch (2000) [17] have brought out the flaws of this Win-Win proposition like belief in congruence between commercial microfinance and poverty outreach, this paper will limit itself to analyzing as to how the focus on commercialization has relegated impact assessment to backstage.

Microfinance & MDG

The current literature on microfinance is also dominated by the positive linkages between microfinance and achievement of Millennium Development Goals (MDGs). Microcredit Summit Campaign's 2005 report argues that the campaign offers much needed hope for achieving the Millennium Development Goals, especially relating to poverty reduction. CGAP (ibid) lends support to this by saying that the growing body of evidence suggests microfinance to be a critical contextual factor in achievement of MDGs. ADB (ibid) in its theme chapter on microfinance also cites access to financial services as critical for eliminating poverty and reaching MDGs. IFAD along with Food and Agriculture Organisation (FAO) and the World Food Programme (WFP) declared that it will be possible to achieve the

eight Millennium Development Goals (MDGs) by the established deadline of 2015 "if the developing and industrialised countries take action immediately" by implementing plans and projects, in which microcredit could play a major role. [18]

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Indian Microfinance Context

Indian public policy for rural finance from 1950s to till date mirrors the patterns observed worldwide. Increasing access to credit for the poor has always remained at the core of Indian planning in fight against poverty. The assumption behind expanding outreach of financial services, mainly credit was that the welfare costs of exclusion from the banking sector, especially for rural poor are very high. Starting late 1960s, India was home to one of largest state intervention in rural credit market and has been euphemistically referred to as 'Social banking' phase. It saw nationalisation of existing private commercial banks, massive expansion of branch network in rural areas, mandatory directed credit to priority sectors of the economy, subsidised rates of interest and creation of a new set of rural banks at district level and an Apex bank for Agriculture and Rural Development (NABARD[19]) at national level. These measures resulted in impressive gains in rural outreach and volume of credit. As a result, between 1961 and 2000 the average population per bank branch fell tenfold from about 140 thousand to 14000 (Burgess & Pande, 2005[20]) and the share of institutional agencies in rural credit increased from 7.3% 1951 to 66% in 1991[21]

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These impressive gains were not without a cost. Government interventions through directed credit, state owned Rural Financial Institutions (RFI) and subsidised interest rates increased the tolerance for loan defaults, loan waivers and lax appraisal and monitoring of loans. The problem at the start of 1990s looked twofold, the institutional structure was neither profitable in rural lending nor serving the needs of the poorest. In short, it had created a structure, 'quantitatively impressive but qualitatively weak'. Microcredit emergence in India has to be seen in this backdrop for a better appreciation of current paradigm. Successful microfinance interventions across the world especially in Asia and in parts of India by NGOs provided further impetus. In this backdrop, NABARD's search for alternative models of reaching the rural poor brought the existence of informal groups of poor to the fore. It was realised that the poor tended to come together in a variety of informal ways for pooling their savings and dispensing small and unsecured loans at varying costs to group members on the basis of need. This concept of Self-help was discovered by social-development NGOs[22] in 1980s. Realising that the only constraining factor in unleashing the potential of these groups was meagreness of their financial resources, NABARD designed the concept of linking these groups with banks to overcome the financial constraint. The programme has come a long way since 1992 passing through stages of pilot (1992-1995) mainstreaming (1995-1998) and expansion phase (1998 onwards) and emerged as the world's biggest microfinance programme in terms of outreach, covering 1.6 million groups as on March, 2005.[23] It occupies a pre-eminent position in the sector accounting for nearly 80% market share in India.

Under the programme, popularly known as SHG-Bank Linkage programme there are broadly three models of credit linkage of SHGs with banks. However, the underlying design feature in all remains the same i.e. identification, formation and nurturing of groups either by NGOs/other development agencies or banks, and

holding and initial period of inculcating habit of thrift followed by collateral free credit from bank in proportion to the group's savings. In accordance with the flexible approach, the decision to borrow, internal lending and rate of interest are left at the discretion of group members. Its design is built on combining the "collective wisdom of the poor, the organizational capabilities of the social intermediary and the financial strength of the Banks" [24]

The success factors of the programme lie in it being beneficial for both banks and clients – another example of Win-Win proposition. The programme is an attractive proposition for banks due to high recovery rates and lowering of transaction costs by outsourcing costs associated with monitoring and appraisal of loans. Records show a recovery rate as high as 95% for loans extended by banks to SHGs and a study sponsored by FDC, [25] Australia, it was observed that the reduction in costs for the bankers is around 40 % as compared to earlier loans under Integrated Rural Development Programme (IRDP). Similar findings in respect of commercial benefit of SHG lending to banks were reported by Siebel & Dave (2002) [26]

The programme's exclusive focus on reaching those sections of population, who were hitherto out of reach of financial system has increased the coverage of poor. Non reliance on physical collateral and total flexibility in loan purpose and amount has also resulted in increased coverage of the poor and the marginalised.

The programme has received strong public policy support from both Government of India and Reserve Bank of India. The importance attached to it by Government is exemplified by mention of yearly targets by Finance Minister in his annual budget speech as well as introduction of similar group based lending approach in government's poverty alleviation programme. The success of the programme in reaching financial services to the poor has won international admiration. World Bank policy paper[27] hails the programme and states that it is particularly suited to India because the model capitalises on country's vast network of rural bank branches that are otherwise unable to reach the rural poor.

"Financial System' approach – Shifting of 'Goalpost' & its impact

The growth of microfinance in India has also to be seen in the light of financial sector reforms in India starting from 1991 and the global emphasis on commercialization of the sector. The financial sector reforms in India have focused on fostering a market based financial system by increasing competition and improving the quality of financial services. The new approach has been deeply influenced by the reorientation among international rural financial policy makers centering around concepts such as self-help, self sustained growth and institutional viability. Under the new approach, institutional viability is of prime concern and instruments of directed credit and interest rate directives have been totally diluted or been done away with. As a consequence, banks are increasingly shying away from rural lending as well as rationalizing their branch network in rural areas. Burgess & Pande (ibid) have brought out this fact in their study by stating that while between 1977 and 1990 (pre reform period) more bank branches were opened in financially less developed states, the pattern was reversed in post reform period. Thus while, the access of the rural poor to credit through traditional bank lending has reduced in

post reform period, the policy recommendation is to fill this gap through microfinance.

Flowing out of negative experiences of the earlier state intervention, institutional viability has become the focal point for evaluation of success of credit interventions. The philosophy and design of SHG-Bank linkage programme reflects this new concern vividly by emphasising on full cost recovery in order to become an attractive proposition for banks. Siebel & Dave (ibid, p 5) in their study on commercial aspects of SHG programme succinctly state the new paradigm with focus on institutional sustainability by saying that as against the long standing tradition of government owned banks undermining rural finance with cheap credit "NABARD belongs to the new world of rural finance: it is profit making; and it actively promotes the viability of rural banks under its supervision". The design features of the programme emphasise that it does not envisage any subsidy support from the government in the matter of credit and charges market related interest rates based on the premise that submarket interest rates could spell doom; distort the use and direction of credit (Kropp & Suran, 2002[28]). High recovery rates under the programme are used to justify the dictum that 'poor need timely and adequate credit rather than cheap credit'.

With this shift to parameters of institutional success, the issue of impact assessment has been relegated to the background. Impact assessment is either left for inference through proxy measures like volume of credit, repayment rates and outreach or one-off sample impact assessment exercises. The field research was undertaken to understand the clients perspective and analyse the factors behind repayment rates as well as impact of credit on socio economic well being of clients. The research covered 93 client households from 5 Self Help Groups from three different locations in Western and Central part of India. While statistically the number may look insignificant considering the size of the programme, use of participatory methods of research add to its depth and value. Only groups which have been in the programme for at least two years were studied as groups of less than 2 years of formation may not be best suited to capture impact.

As the size limitations of paper constrain a detailed enumeration of field research findings, only the key findings of the field research[29] having a bearing on the central aspect of the paper are listed -

- All clients were saving regular amounts of money at monthly/bimonthly interval building up the group savings
- Internal loaning of group funds was very high resulting in significant waiting time for members interested in borrowing
- Social awareness index of group members as measured on Likert Scale showed a definite positive trend after joining the group
- Reliance on moneylenders for credit eliminated or decreased in case of approx 2/3 of clients
- No specific benchmarks for group membership leading to inadequate poverty targeting
- Only 6% clients had taken up any economic activity post group formation

- Marginal increase in real term income level after joining the group
- Bank credit to group often a result of banker's zeal to achieve targets rather than based on group demand
- Bank credit as well as loans used overwhelmingly for consumption purpose
- Group members not willing to borrow to take up economic activity on account of credit risk and absence of skills
- Prompt Repayment a factor of group pressure and sourced out of reduced consumption, extra work and borrowing from other sources
- High rates of interest in internal lending among group members (2-3%) was seen by members as prescribed by the group forming agency and accepted as being better than even higher rates of informal sector.

Further summarizing the findings at the cost of over simplification, it can be said that while the programme had definite impact on building of social capital, it had marginal impact on income levels. At this point it is useful to clarify that positive contribution on social sphere is by itself a significant achievement, however the problem lies with extension of positive impact to economic activities. The findings sit uneasily with earlier evaluations of the programme in respect of economic impact, while being in consonance with social impact. Puhazhendhi & Satyasai (2000)[30] in their study commissioned by NABARD covered 223 SHGs spread over 11 states across India. The study found that 58.6% of sample households registered an increase in assets from pre to post SHG situation, an additional 200 economic activities taken up by sample households and decrease in the percentage of sample households with annual income levels of Rs.22500 from 73.9% to 57%. Another study[31] commissioned by NABARD in 2002 with financial assistance from SDC[32], GTZ[33] covered 60 SHGs in Eastern India. The findings of this study also and IFAD[34] corroborate the findings of earlier evaluation with 23% rise in annual income and 30% increase in asset ownership among 52% of sample households. World Bank policy research paper (ibid) 2005 details the findings of Rural Finance Access Survey (RFAS) done by World Bank in association with NCAER.[35] The RFAS covered 736 SHGs in the states of Andhra Pradesh and Uttar Pradesh and also points to positive economic impact. The findings indicate 72% average increase in real terms in household assets, shift in borrowing pattern from consumption loans to productive activities and 33% increase in income levels.

The divergence of field research findings demands a situational analysis of the field study findings. The study sites exhibited certain common features, which can be said to be true of most of Indian rural landscape. The major occupation of group members was agriculture supplemented by other activities such as farm labour, factory labour and poultry. Being rain fed area, lack of irrigation facilities, declining terms of trade in agriculture and fragmentation of land have accentuated their vulnerabilities over a period of time. The group members lacked any specific handicraft skills and had not received any skills training for undertaking any other non farm activity. In this scenario, post SHG, the group members have been content with using the group savings and bank loan as replacement/reduction of costly borrowings from informal sources. The high rate of internal lending reflected in bank and group records was used by them for meeting their consumption and emergency requirements. Detailed interaction revealed that group members do not have the

confidence to use credit for productive purposes in view of lack of opportunities and partly also ingrained through their past borrowing experience. Irrigation and depressed commodity prices act as deterrent in farm sector investments, while lack of skills and invasion of rural markets by big consumer goods companies reduce the scope for rural micro enterprises. It is striking that while globalization is exerting pressure on national level companies, their penetration into rural markets is reducing the market sphere for rural enterprises.

In this scenario, it seems rather naïve to visualize flourishing of microenterprises through provision of microcredit. Dichter (2006)36 in his paper drawing on African experience rightly draws attention to both these aspects by pointing to the "infertile context" of rural settings and says "if the large majority of us in the advanced economies are not entrepreneurs, and have had in our past little sophisticated contact with financial services, and if most of us use credit, when we do, for consumption, why do we make the assumption that in the developing countries, the poor are budding entrepreneurs….".

Besides acknowledging the positive social outcomes, the field study findings also point to smoothing of consumption needs and marked reduction in dependence of exploitative informal sources of credit. These aspects are in itself a significant welfare gain, however the paper questions the extension of this to economic development which is altogether a different domain from short term crisis management.

In the absence of any significant economic development, the findings logically point to an unmistakable trend of repayments being made out of reduced consumption, increased working time as farm labour and borrowing from relatives, other groups in vicinity or moneylenders in extreme cases. In such a scenario, while loan volume, outreach and repayment may outwardly justify the intervention and make it attractive for bankers, its impact on economic gains for clients gets missed out. The common underlying assumption behind reliance on such parameters is belief in the linear cycle of credit, starting from credit off take followed by economic activities, rise in income/assets and repayment out of additional income.

Reliance on credit off take and recovery as a proxy for positive economic development ignores the critical issue of 'impact assessment' at client level. This aspect of microfinance has received increasing attention. Dichter (ibid) feels that the use of proxies like repayment rate to justify impact is not tenable as it does not examine the source of repayment. Money being fungible, repayment needs to be traced to income from business activity to justify it as criteria. Deubel (2006)[37] citing (Buckley, 1997[38]) states that loan repayment rate as an indicator may show participant's ability to repay but does not take into account the impact of loan on enterprise. Weiss & Montgomery (2004)[39] observe that high recovery rates may be due to intense group pressure and do not reflect capacity to repay.

The focus on financial sustainability has meant that much of the evaluation criteria for microfinance interventions is based on institutional performance. Weber (2006)[40] says that while the virtuous impact of microfinance is used to justify its

expansion, much of this assessment is based on institutional success and avoidance of engaging with impacts. Very significantly he points out this focus by observing "Thus, as long as institutional sustainability obtains, it has been fairly common practice among the policy makers-and their commissioned researchers-to interpret financial viability as indicative of the social, political and economic success of microfinance programmes" (ibid, p 53). He also argues that such an approach constitutes the ideology and practice of neoliberalism as it is based on the ontological premise that competitive financial institutions provide the foundation for entrepreneurial success and are best suited to reduce poverty.

Simanowitz & Walter (2002, p3)[41] correctly observe that "Microfinance is a compromise between social and financial objectives. To date most emphasis has been on financial and institutional performance". In order to bring the social aspect back into microfinance, Imp-Act[42] based on three years of action research covering 30 organisations in 20 countries has been advocating mainstreaming of Social Performance Management (SPM) to improve the effectiveness of microfinance in reducing financial exclusion and poverty.

While microfinance may be a winning proposition for banks, the winning evidence on client's side seems doubtful. The institutional approach flowing out of past negative experiences has shifted the goalpost to financial solvency but in the process missed the vital link of credit usage. In this scenario, it can be said with certainty that potential of microfinance to contribute to achievement of MDGs in India, especially reduction of poverty remains suspect. Greeley (2005)[43] rightly notes that in absence of specific poverty targeting and mainstreaming of impact assessment, the claims about the impact of microfinance on the achievement of MDG lacks credibility.

Road Ahead

Indian rural finance sector is at crossroads today. Following the financial sector reforms with its emphasis on profitability as the key performance benchmark, banks are increasingly shying away from rural lending as well as rationalizing their branch network in rural areas. Burgess & Pande (ibid) have brought out this fact in their study by stating that while between 1977 and 1990 (pre reform period) more bank branches were opened in financially less developed areas, the pattern was reversed in post reform period. Thus while, access of credit to the rural poor has reduced in post reform period, the policy recommendation is to fill this gap through micro credit. The SHG-Bank linkage programme has witnessed phenomenal growth and the current strategy is to focus on 13 underdeveloped states as also graduate the existing SHGs to the next stage of micro enterprises.

At this stage, the paper argues that if SHG-Bank linkage programme has to contribute to poverty reduction, there is an imperative need for integrating impact assessment as a necessary design feature of the programme. The significance of bringing the focus back to 'people' from 'institutions' and adoption of localized people centric approach can hardly be overemphasized. In line with the tenets of commercial microfinance, it is critical that scarce public resources are used

judiciously and with better targeting. Adequate emphasis on impact assessment is an integral part of the triangle[44] of factors necessary for judging microfinance intervention. Mainstreaming of impact assessment in the SHG-Bank linkage programme will call for extra efforts and resources as also create conflict with the present focus on numerical growth. Realisation of a substantial trade off between sustainable economic impact and exponential growth, calls for courageous public policy decisions. World Bank policy research working paper (ibid) also points that ensuring preoccupation with achievement of numeric targets does not override attention to group quality will be a key future concern for SHG-Bank linkage programme.

Though, the paper is focused on pointing the missing link of impact in the current paradigm of rural finance focusing mainly on institutional viability, other critical issues having a bearing on impact also merit attention. The SHG Bank linkage programme at present has no explicit social or economic benchmarks for inclusion of members into groups to be credit linked in line with the flexible approach of the programme. However, as seen above the extension of credit in infertile local context has negligible chances of leading to productive investment. Similarly inclusion of core poor in the programme, who had little experience of economic activities, also limits productive use of capital. Segmentation of credit demand based on economic and social status is key to optimum utilization of scarce resources. Robinson (2001) [45] is probably right in observing that commercial microfinance is not meant for core poor or destitute but is rather aimed at economically active poor. She opines that providing credit to people who are too poor to use it effectively helps neither the borrower nor the lender and would only lead to increasing of debt burden and erosion of self confidence and suggests that this segment should not be the target market for financial sector but of state poverty and welfare programmes. In addition to this, irrespective of socio economic status, credit can be put to little productive use in resource deficient and isolated areas. In such areas, credit flow has to follow public investments in infrastructure and provision of forward and backward linkages for economic activities. Homogenization of service delivery without fully taking into account situational context and client needs will continue to have limited impact.

Conclusion

The Indian economy at present is at a crucial juncture, on one hand, the optimists are talking of India being among the top 5 economies of the world by 2050[46] and on the other is the presence of 260 million poor forming 26 % of the total population. The enormity of the task can be gauged from the above numbers and if India is to stand among the comity of developed nations, there is no denying the fact that poverty alleviation & reduction of income inequalities has to be the top most priority. India's achievement of the MDG of halving the population of poor by 2015 as well as achieving a broad based economic growth also hinges on a successful poverty alleviation strategy. In this backdrop, the impressive gains made by SHG-Bank linkage programme in coverage of rural population with financial services offers a ray of hope. The paper argues for mainstreaming of impact assessment and incorporation of local factors in service delivery to maximize impact of SHG –Bank linkage programme on achievement of MDGs and not letting go this opportunity.

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