The Microfinance Crisis: A Political Economy Perspective

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1. Introduction

Microfinance in India and elsewhere is in a deep crisis. It is a multi-faceted crisis of credibility, relevance and sustainability needing a solution at a more fundamental level. At one level it is a crisis self-induced by at least a section of the sector which has drifted from some of the primary goals, at another level microfinance has become a ‘victim’ of the influence of the larger forces of development being unleashed under the current neo-liberal paradigm of development. The crisis has been manifest both in its role as a financial intermediation mechanism and as a tool of development for poverty alleviation and empowerment. The current impasse in the working of the microfinance institutions (MFIs) in the state of Andhra Pradesh in the wake of the new legislation passed or the crash in the share price of the MFI which had gone public in the country or the frequent protests against microfinance practices or even the large scale closure of deposit taking MFIs in Nigeria are some of the evident signs of the underlying crisis faced by microfinance. These events have been triggered by issues like prevalence of high rates of interest and adoption of several undesirable practices of lending, recovery and savings by microfinance agencies which underlie the failure/limitation of microfinance in its financial intermediation role for the poor. As a developmental tool, the crisis is seen in terms of the increased scrutiny over its almost evangelized role in poverty alleviation and the emerging evidences about many of the negative consequences or impact on the poor and women. Apart from the long held allegation that microfinance agencies are using women as conduits for business interests causing unbearable burden on them, more grave charges that have come up recently are the suicides of microcredit borrowers due to excessive debt burden, and the crass profiteering by MFIs. While some of these allegations may need a stronger evidence than what is available, but the very morality and relevance of microfinance practices have been seriously questioned.

Many of the above issues are only symptoms of the basic contradictions faced by microfinance per se and the larger financial and economic system of which it is a part. Microfinance and its crisis cannot be seen in an isolated or a superfluous way. Microfinance has become in many ways part of the larger system operating at global and national level. Only a broader perspective which can help understand the political economy under which microfinance operates can throw light on the real nature of the crisis. This essay makes an attempt to look at critically the political economy of microfinance in terms of its praxis and the linkages with the broader forces and actors involved along with their material interests having a bearing - positive or negative, on the working of microfinance and its outcomes. The focus is on India which has seen a phenomenal

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1 I am highly grateful to the organizers for the opportunity given to participate and share my thoughts in the seminar. This is a preliminary working draft presented here for discussion only. The paper will be finalised with further work and analysis. Those interested in the final paper may email me at hss@irma.ac.in.
growth in microfinance and is unique in terms of the diverse forms microfinance present in it being even at loggerheads despite the common interest.

Based on some of the available evidence and my own understanding, I would like to propose an argument or hypothesis here that the microfinance drift is the result of the alignment it has sought for furthering its cause with the very forces it had confronted in its emergence. Microfinance came in response to the failure of state and market forces to meet the financial services needs of the poor. Microfinance through mutual co-option has tried to work with the very state and market forces which had failed the poor in many ways. The co-option has brought irreconcilable contradictions leading to the drift of microfinance from its original mandate and form.

2. The poor and their interests

Let me start with the poor – the primary stakeholders, for whom the whole movement started more than three decades ago. As per the revised official estimates despite the decline in poverty ratio, the absolute number of poor has gone up from 321 million in 1973-74 to 407 million in 2004-05 in the country with the rural poor constituting the bulk of them. Socially and economically, the poor have been a heterogeneous group. Socially the poor belonged to historically deprived and backward sections like dalits, tribals and other backward communities. Economically, the poor largely consists of groups like landless labourers, small and marginal farmers, artisans, fishermen, and destitutes. Deprived of development due to failure of trickle-down and state-led programmes, poor in general have been compelled to eke out living through self-employment and wage-labour largely in the informal or un-organised sector. Incurring debt has been an important source of survival and sustenance for them due to low income and other vulnerabilities.

The failure of the ‘institutional’ credit promoted by the state has made them historically depend upon informal sources like moneylenders, traders, and friends and relatives to meet their credit needs. Given the weaker economic and social status, obtaining credit in an affordable and dignified way has not been easy for them both with the formal and informal sources. Usary and bonded labour system are the two examples of the difficulty faced by the poor in obtaining easy credit. Poor have tended to use debt for variety of purposes. Income and employment vulnerabilities and social customs have compelled them to use considerable part of the debt they incur for consumption and other non-production activities. Coupled with the need to invest in livelihood generation and self-employment activities, the debt needs and the resultant burden have been generally increasing for the poor. Thus, poor have been vulnerable to debt and its consequences. The structural adjustment and the economic reform programmes taken up in the recent decades under the neo-liberal framework have further compounded the credit problems of the poor. On the one hand, the general withdrawal of the state in social sectors like health and education has been forcing the poor to meet these needs even by incurring debt. On the other, the reform programme have resulted in the constriction of lending by formal agencies in rural areas forcing poor to look towards alternative sources to meet their debt needs.
In the absence of reliable sources in the formal sector, they have looked towards variety of informal sources even it meant paying excessive interest rates not to mention of their readiness to pledge themselves or their children to obtain credit. Using the compulsion and desperation, the informal sources have not hesitated to trap the poor into exploitative bindings in land, labour and commodity markets to extract as much surplus as possible on a sustainable basis.

In the literature/discourse on rural and microfinance there has been a strong argument, especially by those advocating neo-classical logic for mobilizing savings, from the poor. There are even romanticized description of poor and their monies. No doubt savings can be a good instrument for risk mitigation, given the general low income and vulnerabilities of wide fluctuations own savings has not fully taken care of the growing demand for credit by the poor. Insurance like savings while is a useful measure at times of crisis, there has been almost a total failure of state and market in providing affordable insurance for the poor. Hence, credit which is relatively ‘easy’ to obtain has been the key service demanded by the poor. This is the reason as to why the poor in general have welcomed and latched-up microcredit innovation. Their desperation and the indignity involved in obtaining credit has made NGOs working with the poor to innovate and replicate microcredit.

The poor though are large in numbers but are not organized to be a force. There have been efforts to mobilize them only sporadically but not as a class in a massive way to be able to push their economic interest. Neither they have been able to compel the state to come up with radical initiatives which can take care of their needs. Nor the state has been proactive in taking initiatives to address the needs of the poor, be it land or credit. Though there are attempts by few political parties, the mobilization has been largely based on identity and local issues. The NGO mobilization has been local and issue based. The poor in general have not been able to exert any strong influence on the state as such. As they constitute a significant vote bank, as a result of which the state at has come with interventions of only palliative and reformist nature in various sectors including rural credit.

It is very well established in the literature that microfinance serves mainly the better-off poor. A considerable proportion of the microfinance households are from the non-poor category who are relatively better-off in terms of their economic status. The very poor or hard core poor are generally not covered by the microfinance interventions. The hard core poor have been excluded and the non-poor have been covered significantly both by the default and design. The relatively better-off poor are included as it helps the microfinance to do viable loan transactions. Such non-poor also lack access to formal sources and hence microfinance institutions are more than willing to accept them. The hard core poor tend to self-exclude themselves from the microfinance operations which do not suit their needs. The MF programmes also tend to exclude them again due to their remoteness and perceived non-viable transactions. The inclusion of non-poor especially from different social groups and castes to an extent would have weakened the cohesiveness of microfinance members for any collective influence. Another dimension in this regard is the inclusion of women under microfinance. Like elsewhere, even in India an overwhelming proportion of MF participants are women. Women are considered to be the worst affected section among the poor. The inclusion of women which is mainly by design by the microfinance programmes has resulted in the creation of members who have a double
disadvantage. The need of women is not only their own emancipation as they are socially and economically discriminated as a gender but also the well-being of their households. How far women as a group having such a dual disadvantage would be able to withstand any anti-poor or anti-women stances rooted in microfinance has been a moot question.

3. NGOs/MFIs: Their role and interests

The NGOs which innovated microfinance and replicated it under the above mentioned circumstances are another key stakeholders in the movement. To a great extent the drift observed in microfinance is attributable to the transformation that took place in the nature and role of NGOs in general and in the area of microfinance in particular. In a sense NGOs are both the ‘culprits’ and ‘victims’ of the drift.

Though the provision of credit to the poor had been going on under various state-led interventions, the credit for innovating microcredit concept goes to the NGOs. The initial motivation came from their first hand observation of the problem of indebtedness of the poor due to the state and market failures. The initial attempt by the NGOs was to work with the banks to convince them to lend to the poor even by standing as their guarantors. The compelling need to end the indebtedness of the poor to free them from the clutches of moneylenders as well as promote livelihood generation activities made NGOs to take-up lending to poor as a part of their developmental activities. The initiative was almost purely altruistic. The NGOs were also keen to ensure that they pursue microcredit only to demonstrate to the banking system that poor are bankable and banks take on microcredit on their own. However, the continued reluctance of the banks to lend to the poor, other than under government subsidy based schemes made NGOs to explore creating alternative institutions for the poor. The examples of SEWA Bank and Grameen Bank were already there before them to emulate. Lending was to be done on an altruistic and not-for-profit basis. This was the situation during the 1980s. The initial success of the NGO-led microcredit movement made the state and donor agencies to take note and initiate measures to support the NGOs further. The creation of the RMK by government and FWWB by the civil society agencies aided by donors to fund NGOs were the examples from India about NGO need recognition.

Globally, NGOs started gaining prominence in the developmental policies of the multilateral and bilateral donor agencies with the structural adjustments programmes gaining ground in the 1980s and 90s. NGOs were being seen as agencies which can work with the state to bring about reformed development with human face. NGOs started receiving support for several developmental projects in the areas of health, agriculture, watershed, forestry, women development, etc. Simultaneously, globally driven issue specific developmental agenda was also gaining ground like development of women, for example. The donors were keen that NGOs participate in these developmental initiatives.

The growth of professional NGO movement which had started in 1980s received further boost in the wake of the ‘new development agenda’. The number of NGOs also started increasing. Most of these NGOs were also started by the middle-class educated youth. The NGO movement in India which was largely due to voluntarism and social movements gained a new rationale. The
increased developmental support from donor and governmental agencies made NGOs to shed some of their characteristics of voluntarism and assume professional form needed for scaling-up of projects and ensuring accountability. The NGO movement also came to be seen as a source of employment by the educated youth and leading NGOs even started attracting professionally qualified graduates.

Microcredit came in handy for the NGOs keen on scaling-up their activities besides being a good complementary activity for the on-going developmental activities. For newer NGOs promoted during 1990s microcredit through group formation itself became good starting point of their intervention. Some mainstream financial institutions like SIDBI initiated programmes to support NGOs to pursue microcredit for micro-enterprise development. The Microcredit Summit organized by civil society groups in 1997 to globally scale up microcredit as a tool of poverty alleviation gave a further fillip and legitimacy to NGOs to pursue microcredit in a bigger way. The Microcredit summit resulted in microcredit being recognized by the UN which called upon state, civil society and private agencies to participate and support in scaling up microcredit globally.

The microcredit summit and the global recognition received by microcredit in many ways galvanized the civil society agencies. In India, there were proactive efforts by NGOs to mobilize further support for scaling up microcredit from state and the banks. Despite over a decade of their involvement, NGOs were unable to scale-up microfinance in significant way. Most were carrying out microfinance activity in small pockets largely as a non-for-profit activity combined with other activities. Only a few had managed to grow big with support from donors and financial institutions.

The NABARD’s Taskforce on MF (1999) while recognizing the role played by NGOs recommended regulation of NGOs to enable them to pursue microfinance in a more systematic way. The Taskforce also recommended various other support including banks to lend to NGOs to scale-up. The Taskforce consisted of many members who hailed from civil society and had experience of microcredit. Parallely, SIDBI which created a separate window called SFMC decided to fund NGOs for scaling up under a donor financed programme. SIDBI under the influence of its donors had decided to adopt a more commercial approach expecting NGOs to emerge as strong and self-sufficient MFIs. SIDBI also decided to support the creation of a rating agency to scrutinize NGO working as MFIs before they are financed. Rating which was hither to an instrument used in the conventional finance area came to be applied to NGOs. For successful rating NGOs were supposed to develop governance and operational systems which can help in carrying out lending in a sustainable way. Thus, the transition of NGOs into NGO-MFIs was complete by now. In the meanwhile, NGOs also had come to play the role of SHG promoters for NABARD which was trying to scale-up its own microfinance programme launched in 1992 by involving banks and co-operatives. Given their strength in mobilizing the poor, NABARD sought the help of a large number of NGOs to form and nurture SHGs for linkage with the financial institutions. NGOs were given some financial support for this role.

The beginning of the new millennium brought few more challenges to the NGOs. The donor and government support for their developmental activities became uncertain and even started
dwindling considerably. The Government of India had expressed reluctance to accept bilateral support for its own reasons. Large number of NGOs which had sprung up during 1980s and 1990s started feeling the pinch of the uncertain funding scenario. Sustaining themselves as well as their own programmes became a challenging task for the NGOs. It is here many of the NGOs started looking towards microfinance as an activity which can help them sustain as development agencies. NGOs began to specialize as microfinance institutions. Many NGOs in Bangladesh had already taken-up microfinance as a specialized activity and some like BRAC were even tapping surplus generated from microfinance to fund their other activities.

Thus, microfinance became both a developmental agenda and a self-fulfilling prophesy for the NGOs. NGOs had transformed into MFIs willing to pursue an activity started as a charitable one on for-profit basis. Following SIDBI many commercial banks started financing NGOs. Bankability was the major consideration in funding these NGO-MFIs. The banks having come under the influence of global commercial microfinance agenda started insisting that NGO-MFIs attain financial sustainability for receiving larger funds. Even donor agencies providing capacity building support to these NGO-MFIs emphasised strengthening their systems to become financially sustainable.

Having adopted microfinance for self-sustenance also, NGOs in general had no qualms or dilemma in accepting the goal of financial sustainability to receive larger funds for scaling-up. This meant that NGO-MFIs start charging interest rates (service charges) which help recover all costs of sustainability involved in lending. This is one of the primary reasons which rationalized higher interest rates charged by the NGO-MFIs. Being civil society institutions and not regulated by the central bank, NGOs also had the freedom to charge higher rates of interest.

The NGOs which had already undergone a transformation into NGO-MFIs, underwent another type of transformation during last decade. The sustainable microfinance launched with the support from banks and financial institutions started facing several challenges. Many of large MFIs which could scale-up their operations as a result of bank financing, set ambitions to grow even further. Many started growing beyond their state/region of origin. Multi-state operations became quite common especially among the larger NGO-MFIs. However, funds remained a constraint. In the absence of any major financing from the state, NGOs were forced to depend upon the banks and financial institutions. Banks also began seeing financing of MFIs both as a lucrative and an easy option to fulfill their priority sector targets specified by RBI.

Except for a very few, bulk of the MFIs were legally in NGO form. They were not in a position to mobilize savings from their clients or group members. Large scale financing of NGOs was found to be a risky preposition in the absence of risk fund (equity) and proper regulation. Hence banks and financial institutions stated insisting NGOs to go for transformation into a for-profit regulated form. As the government was not forth coming with any separate law for regulation, many NGOs-MFIs began contemplating transformation of their legal form into regulated for-profit NBFC. NBFC form would enable them to raise equity based on which they could leverage for larger and possible cheaper funds for scaling up. Given the minimum start up equity requirements of Rs. 2 crore to start an NBFC not all NGO-MFIs could transform themselves easily. Only some bigger and high profile NGOs which could mobilize funds for equity from

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variety of sources like external funding agencies, members or clients and transformational loans from some financial institutions went in for transformation. Some of the NGOs which were unable to raise equity to the level required to start a new NBFC even bought dormant NBFCs promoted earlier by other private individuals. A few also transformed themselves into not-for-profit section 25 companies. But most of the transformation was in the form of for-profit NBFCs and a fairly significant number of NBFCs came to be created with in short period changing the face of the NGO-MFIs. Many of these transformed MFIs retained their original NGO organization for pursuing developmental work. A few of them also tried to give ownership stakes to members (clients) by offering shares in the transformed company.

Transformation into NBFCs allowed these NBFCs scope for unfettered growth. As these NBFCs are fully regulated, scaling-up requires mobilization of equity (risk fund) as per the rigid capital adequacy norms prescribed by RBI for NBFC form of organization. A few NBFC form MFIs which had come up earlier had already shown the avenues from which equity could be mobilized. To meet the equity needs of fast growing MFIs, few MF focused venture funds came to be created with contributions from sources like donor agencies, development financial institutions and institutional investors. Some of these funds claimed themselves to be social investors primarily interested in promoting the social cause of the MF sector. Then followed many purely private equity investors looking towards MF as a potential sector of returns. These private investors struck equity deals by paying exorbitant prices for the shares of certain selected MFIs growing at fast pace in India. One of the leading MFIs also went public by going in for IPO which enabled it to mobilize considerable equity. This was a benchmark event which made other MFIs to consider exploring IPO route for mobilizing equity. In this process certain evidence has emerged that many of the original MFI promoters and employees gained substantially by garnering or allotting part of the shares for themselves even by dubious means.

Transformation coupled with mobilization of commercial equity apparently has driven many of the MFIs on a growth and profiteering spree. Drive for growth has brought huge competition among the major MFIs resulting in several undesirable consequences. Poaching of borrowers of other microfinance programmes, multiple lending and coercive recovery became a common practice among growth driven NGOs. A few transformed MFIs almost came to establish a kind of an oligopolistic position by capturing a significant share of the MF market. MFIs despite the competition continued to charge high rates of interest which became a contention issue. The hope and the promise of scale economy helping MFIs to reduce interest rates had not materialized. The fragmented intermediation with inability to mobilize savings and the drive to earn profit to be sustainable as well as meet the expectation of the equity investors had rendered these MFIs to become highly aggressive and commercial in their orientation.

But at the same time, there were many NGOs conscious of their original mission and the drift that was taking place in the sector tried in their own way to tread an alternate path. Many of them have tried this by promoting member-owned organizations wherein women are able to exercise their control either through co-operatives or federations of SHGs. Some have consciously decided to transform into not-for-profit companies only to take advantage of the organizational form instead of being an NGO. However, the main challenge or problem faced by these NGOs or their CBOs is that though are large in number but are smaller in the outreach.
These NGOs in general neither are able to offer universal service nor able to reduce effective interest rates charged to members.

The NGOs/MFIs faced with many adverse conditions have formed their own associations/networks in India and elsewhere to protect their own interest and advance the cause of microfinance with the governments, regulators, donor agencies and public in general. These associations have taken up promoting self-regulation among the members with the growing criticism about many of the undesirable practices adopted by many of the MFIs. The associations/networks also receive support from by donor/ other agencies making them vulnerable, partly or fully, to the agenda of their funders.

4. The State

The state is another major stakeholder in this context. A developmental state has the onus of taking care of various needs of the poor and the deprived. Promoting institutions of credit, savings and insurance is an important need especially in a capitalist form of a society where even poor and petty producers require capital to be part of the production-market system. While the institutional economists have called the Indian state a ‘soft state’, the radicals have called it a reformist state driven by its elite/capitalist class bias, in either case highlighting the ineptitude of the state for strong or radical action.

The state in India has taken historically several initiatives to address the credit needs of the rural households. The colonial state introduced the formal co-operatives in 1904 to provide credit and other services to rural community who have been vulnerable to exploitation by the informal sources. Post-independent state also has taken several measures on this regard. Some of the significant initiatives include strengthening credit co-operative through state support, nationalization of commercial banks and prescription of priority sector lending policy to support the needy segments/sectors, establishment of NABARD to provide affordable funds to the rural financial institutions. The state also has taken few focused measures to address the needs of the poorer sections. These include the DRI scheme under which banks have to fund 1 per cent of their loans to poor at a highly subsidized rates, creation of RRBs to specifically provide services to the poor and weaker sections, launching of several credit and subsidy based poverty alleviation and self-employment schemes (like SFDA, IRDP, SGSY, SEEUY and DWACRA), and provision of collateral free loans up to Rs. 1 lakh to tenants and other assetless poor.

As a result of these initiatives there was an impressive growth in rural banking network in the country especially after the launch of the green revolution programme. The outflow of credit from these sources helped increase the role of institutional credit and curtailment of the spread of non-institutional agencies. However, a major lacuna identified with the institutional agencies is that they have failed in general to reach out to the poorer sections and have largely remained confined to serving the landed and other better-off sections in the rural areas. The pro-poor initiatives also have suffered from many limitations. These initiatives have been top-down in nature and have followed largely target-based approach resulting in lack of sustained access to poor and leakage of the benefits to the non-poor. The launch of banking reforms has forced banks to weaken their commitments on these programmes as they have found them to be
unviable. With reform process several of these initiatives got diluted or even were reversed. RRBs became regular banks giving up their original mandate of serving the poor. Public sector banks considerably reduced their rural outreach by closing down their branches in rural areas in the post-reform period. Banks also faltered on their priority sector targets during 1990s, making RBI to change certain provisions to help banks meet their targets.

It was under these circumstances, the state in India started looking towards microfinance as potential intervention for supplementing and complementing some of the pro-poor initiatives taken earlier. Given the growing popularity as well as the potential shown by microfinance programmes all over the world, the state in India co-opted microfinance into its fold. Some of the prominent micro-credit based initiatives include creation of RMK to fund the microcredit NGOs and the launch of the SHG-Bank Linkage Programme (SBLP) in 1992.

NABARD had initially approached a well-known NGO in south to experiment with the SHG concept as a bankable proposition. Based on the success of the project and similar experiences elsewhere, NABARD started its SBLP on a pilot basis. The progress of the SBLP however was not as per the expectation. Banks being conventional institutions found it difficult to deal with informal groups for lending. The RBI intervened by recognizing bank lending to informal groups, and categorizing SBLP under priority sector lending to induce banks to become proactive. NABARD which had participated in the MCS made its commitment to scale up MF in India by involving banks and co-operatives. Banks were still reluctant to whole-heartedly participate in SBLP. NABARD even introduced the concept of SHPI to promote groups to help banks in the SHG linkage. Given that banking sector reforms had produced negative results during 1990s for the rural sector, government of India decided to give a push to SBLP by making banks to treat it as a part of their corporate policy and streamline SHG linkage on a target-driven basis. SBLP was advocated both as a banking and social proposition. Meanwhile, GOI recast its earlier major poverty programme IRDP into SGSY. SGSY prominently adopted group approach successfully tried out by microcredit NGOs, giving fillip to group formation for linkage under SBLP. Because of all these efforts, SBLP started growing quantitatively in the country. By 2010 nearly 69.53 lakh SHGs had been formed and linked with financial institutions for savings and credit purpose. Of the total SHGs, nearly 48.85 lakh had been credit linked with a total outstanding loan of Rs. 28,038 crores by March 2010. About 25% of the SHGs linked under SBLP were formed under SGSY. SBLP which NABARD claims as the world’s largest MF programme, has helped to bring large number of poor into the fold of banking sector through informal groups. However, SBLP also has faced many limitations. A major one being its skewed spread in different parts of the country. In a paradoxical way the spread has been largely seen in the southern states which are relatively developed, socially and economically. Several studies point out the general hesitation on the part of the financial institutions to adopt SBLP whole-heartedly. The banks continue with many rigid policies of lending constraining SHGs in fully tapping the potential visualised. The quality of SHGs also has been a matter of concern. Due to inadequate support for SHG capacity building the sustainability of SHGs has suffered. However, one positive aspect of the SBLP is the emergence of a large number of SHG ‘federations’ which are a type of member-based organizations in which women members of SHGs are able to exercise ownership and control. These ‘federations’ having diverse legal forms are faced with several constraints in meeting the needs of their members. While many of
these ‘federations’ are trying to emerge as full-fledged financial intermediaries or MFIs, they are largely found to be acting as intermediaries between banks and SHGs.

An important factor in the spread of SBLP across different parts of the country is the role played by the state governments. A great part of the spread of SBLP in southern states is attributable to the initiatives of the state governments. Under their own programmes launched for poverty alleviation and women empowerment, these states have integrated SHGs as an important component of these programmes and invested resources in the formation and linkage of SHGs on a large scale. The case of Andhra Pradesh (AP) is revealing in many ways. AP was one of the prominent states in India which initiated group-based programmes much early and proactively supported their scaling up. An externally supported poverty alleviation scheme started in 2000 emphasising on self-reliance based poverty alleviation using SHG concept gave a boost to SHG formation and linkage. AP created a separate organization called SERP to implement this programme on a mission mode in the state. The state proactively tried to involve its line agencies like DRDAs and banks in the implementation of the programme. As a result, AP became the leading state in SHG formation and linkage. The SHGs of AP accounted for a significant proportion of the SHGs formed in the country. The growth of SHGs also saturated the coverage of poor as even non-poor came to be included under the groups. Further, the SHGs were integrated through formation of federations at different levels. The state government announced a scheme to subsidize the interest rate paid by the SHGs. The parallel rapid growth of MFIs in AP brought a conflicting situation between the two streams of microfinance. The state government accused the MFIs that they are poaching into the SHGs steadfastly built over the years by the state and creating a situation of excessive indebtedness through usurious interest rates, multiple lending and coercive recovery leading to many suicides by the borrowers. The AP government brought an ordinance (law) to regulate the lending and recovery practices of MFIs.

One can observe an ambivalent position of the state in terms of promoting or supporting the NGO-MFI stream. Even though there was general growing perception about the need for regulation of NGO-MFIs, the state mainly adopted a policy of trying to work with the existing laws. The Task Force on microfinance though had recommended regulation of NGO-MFIs much early using a layered approach, the Government of India after a long wait-and-watch policy introduced a bill only in 2007. The NGO-MFIs which started growing rapidly were finding the existing regulatory system not conducive for their working. As many NGOs were keen to transform themselves, they were hoping for a proactive legislation from the government. The legislation was expected to help them in emerging as full-fledged intermediaries able to offer complete services and possibly bring down interest rates on which a major controversy was building up in the country. The association of the NGO-MFIs which had come up also was lobbying for the MF regulatory law. The government of India meanwhile relaxed few norms of regulation especially for NGO-MFIs trying to transform. The NBFCs were allowed to raise foreign equity capital up to 51 percent of the total. The section 25 companies were relieved of any registration with RBI for their MF activity. However, MFIs were not allowed to raise deposits except those having co-operative form. The clamp-down on few MFIs by the government of AP in 2005 because of their alleged usurious practices, intensified the demand for a separate legislation. Many MFIs as they were growing fast were keen to come under RBI’s
regulation rather being regulated or ‘harassed’ by the state governments. The bill that was introduced in 2007 could not be passed as it raised criticisms from several quarters. The bill had aimed at regulating mainly NGO-MFIs and cooperatives. The NBFC form of organizations were kept out of the purview as they are already regulated by RBI. NABARD was designated as the regulator of the MFOs identified by the bill. The bill was criticized for being intrusive especially for NGOs and cooperatives and was opposed. The government could not pass the bill and referred it to a selected committee. A new version of the bill has been prepared which the government hopes to get passed in the present parliament. Overall, because of the contradictory and even complacent attitude of the state no systematic and relevant regulation could be put in place in the country for the NGO and MFIs, forcing them to stray in their microfinance programme.

Meanwhile, many MFIs had decided to take the NBFC route and started attracting investments from internal and external sources. The passing of the said ordinance by the AP government to regulate the excessive practices of the MFIs forced RBI to constitute a sub-committee of its governing members to look into the issue of regulation of MFIs and their practices which had come under the scanner of state governments, civil society and some political parties. In appointing the sub-committee, the RBI also had the compulsion of addressing the concerns of the banks-public and private, and equity investors which had put their funds in several of the MFIs in the country.

The RBI committee came with a regulatory framework under which a separate category of NBFC-MFIs are to be created. A strict regulatory and governance provisions have been proposed to bring in transparency and accountability. The committee even proposed a cap on the interest rate charged by the MFIs, a paradoxical step under the liberalised policy environment. The RBI has accepted the major recommendations which are operationalised starting from 2011-12 credit policy. The new recommendations also recognize the instruments like securitization and assignment of portfolios and bank lending which have become a significant source of MFI funds as a part of the priority sector norm subject to MFIs satisfying the new norms laid out for them. The industry associations and banks are called upon to oversee the functioning of MFIs and ensure that self-regulatory mechanisms are put in place to protect the interest of the clients. The NBFC-MFIs and their promoters have generally welcomed the new policy of the RBI, while there have been criticisms against measures like cap on rate of interest and recognizing the commercialization of MFIs. But meanwhile the working of the MFIs has been severely hampered in the country, especially in AP.

Overall, the role of the state has been of a highly of a vacillating nature lacking in conviction for the interest of the poor. The state has co-opted the microfinance and its methods in many ways. Given that it has embarked on banking sector liberalization which has resulted in many negative consequences for the poor, has initiated its own microfinance programme as a double-edged goal. Banks which have become restrictive of lending to poor are expected to internalize SBLP both as a banking and social proposition with all the inherent contradictions going with it. The microfinance methods also have come in handy for the state to align its own poverty programmes based on self-reliant and sustainable principles in tune with current paradigm of development. With regard to the MFI stream of microfinance, the state has not taken any major
proactive steps to support or regulate them allowing them to be driven by global and market forces.

5. Other Forces

MF has come under the significant influence of many forces other than state and local NGOs. These are as diverse as multilateral and bilateral agencies working at global level, international civil society and a host of forces working in the domain market both at global and local level trying to promote the interest of the capital owners. The trajectory of microfinance including the drift identified has been considerably influenced by these forces. We discuss some of them here under two broad heads:

a) Global Development Agencies: The majorly growth of microfinance all over has coincided with the certain broad developmental trends/agendas. These include the globalization, structural adjustment and liberalization programmes, development of women, and millennium development goals, etc. Any intervention unfolding during the same period cannot remain unaffected by these broad trends. Similarly, agencies involved in promoting and implementing these programmes would like to co-opt any other parallel programme or intervention if it can serve their goal or agenda. This is what has happened to microfinance.

A major watershed mark in the growth of microfinance is the global Microcredit Summit (MCS) organized in 1997 in the U.S.A. The MCS as mentioned earlier is a forum essentially consisting of several global civil society agencies, some of whom in their own way successfully experimented with microcredit (like Grameen Bank, SEWA Bank) and wanted the same to be recognized by all major national and international development agencies and work towards its scaling-up globally. Many representatives of state and NGOs from India also participated in MCS. The MCS campaign organized quite effectively by involving relevant and high profile leaders and agencies did succeed in getting the due recognition. The MCS not only declared microcredit as a powerful tool for poverty but emphasized on adoption of financially sustainable ways to reach out to 100 million poor, especially women by 2005. The result was the immediate recognition accorded by UN through a resolution which called upon all the concerned within and outside UN system to support in scaling-up microcredit intervention as a part of its ongoing poverty strategy. This gave a major thrust to the issue of scaling up microcredit as a tool of poverty eradication and empowerment. Following UN resolution the development arms of UN like UNDP, FAO and IFAD, the World Bank and its affiliates, bilateral and other donor agencies, and international NGOs started integrating microcredit in their policies and programmes of development. Some came with exclusive strategies and action plans (like World Bank) for microcredit, others incorporated it with their ongoing or new programmes of development. The MCS convened in 2005 to assess the progress of its 1997 declaration claimed success in globally reaching 100 million households. It set a new goal of reaching 175 million households by 2015 and to bring up 100 million above poverty line by using microcredit and other services.

The millennium development goals declared by UN in 2000 for eradication of poverty and other problems to be realized by 2015 also identified microcredit as an instrument to be used by
concerned agencies. Microcredit even came to be linked with issues or goals of health, education, sanitation, women development, etc. Further, UN declared the year 2005 as the year of microcredit to reinforce the ongoing efforts globally in replication of microcredit.

The Norwegian Nobel Committee gave the ultimate recognition to microcredit as a most important tool in poverty alleviation along with other methods when it awarded Nobel Peace Prize in 2006 to Prof. Mohammad Yunus and Grameen Bank of Bangladesh for their contributions in grassroots based development by using microcredit.

All these global events and recognition helped pitch-fork microcredit as an ‘acclaimed’ tool of development. This not only rationalized the ongoing efforts in the field of microcredit and even gave impetus for its further spread. At the same time in several quarters concerns were raised against the uncritical acceptance of the microcredit as a tool of poverty alleviation and women’s empowerment given the limitation faced by the debt based strategy.

In various efforts to scale up microfinance, one which was carried out by the World Bank and its group is also worth noting. The World Bank which was championing the cause of structural adjustment programme (SAP) along with IMF came to adopt an approach typical of its broader policies and strategies with regard to microfinance. These programmes all over the world have been blamed for their anti-poor and pro-rich stances. The World Bank declared an action plan for MF in which it emphasized on building a commercially sustainable and strong microfinance sector for scaling up. It essentially called for using a marked based strategy for scaling-up in line with the SAP. The World Bank not only tried to apply its strategy of in all its projects on microfinance development directly financed by it but also used its arms like IFC, ADB, and CGAP to further the cause of its strategy.

IFC which funds commercial and private sector projects, came up with microfinance projects to be implemented on a financially sustainable basis. IFC invested in funds and institutions keen on providing debt and equity to MFIs on a commercial basis. The ADB took up assessment as early as 2000 in several countries of Asia to push commercial microfinance as a strategy of scaling up.

The role played by CGAP became even more crucial in furthering commercialization of microfinance. CGAP which is a consortium of a select few bilateral and other donors created to act as a think-tank for donors in the field of microfinance came to be based in World Bank strategically. A body whose legitimacy itself is not fully in associating with a multilateral agency like the World Bank came up with principles and strategies for legitimising the commercial approach to microfinance. CGAP declared in its principles of microfinance that financial sustainability is an essential requirement for scaling-up and that only liberal policies like curtailing subsidies and removal of interest caps on loans for the poor can help in attaining such sustainability. The CGAP called for creating regulation which can help promote commercially strong and sustainable MFIs. CGAP and the World Bank tried to build and propagate extensive knowledge pertaining to commercial microfinance in a systematic way. Besides supporting capacity building of MFIs CGAP has also tried to show-case several best practices having potential for sustainable microfinance. The principles of CGAP (which it
claims as ‘consensus guidelines’) have almost become the dictum or mantra to be followed by all multilateral, bilateral agencies and financial institutions supporting especially commercial microfinance programmes. CGAP has almost come to establish its theoretical hegemony for pushing the commercial microfinance. Most NGOs, MFIs, banks and financial institutions, rating agencies have overwhelmingly tried to adopt and operationalise microfinance on the lines advocated by these global agencies.

The involvement of global agencies in microcredit for its scaling up in a way was a turning point in its further progress and trajectory. In many way it gave an opportunity for them to use microcredit not only to drive it in the way they wanted but also to push other agendas like neo-liberalism, reformist development, structural adjustment and liberalization under the garb of poverty alleviation.

In all these, the alternative discourse has been either missing or found to be too weak to be heard. There have been few global players (like the INAFI network) who have identified the limitations of commercial microfinance and have tried to propose alternatives. The INAFI network working for creation of alternative financial institutions for the poor has also come up with its alternative principals of microfinance to counter the CGAP’s hegemony. The INAFI identifies that commercial microfinance is being facilitated by curtailing the flow of public funds and enabling the private funds to take a prominent space in the microfinance sector. This is resulting in MFIs largely adopting anti-poor methods of mirofinancing. The INAFI network hence calls for reversal of the unbridled commercialization of microfinance and adoption of a more integrated approach to make microfinance become accessible, affordable and appropriate for the poor. However, these alternative have faced challenges in operationalising their strategies in the existing dominant milieu.

b) Market Forces: Market forces have entered the field of microfinance in many ways, globally and locally. The commercialization approach advocated by the World Bank and CGAP has significantly influenced the involvement of market forces. The link between market forces and MF sector has emerged to some extent in a mutually accommodative way. The NGOs/MFIs in their zeal to scale up their operations started approaching the market institutions for meeting their debt and equity funds. The market institutions also started looking towards the microfinance sector as a potentially rewarding one given the fast growth that was taking place and the demonstration of sustainable operations by many MFIs.

Over the years, the flow of commercial and external funds has increased significantly in the microfinance sector. A CGAP study showed that the foreign capital investment in microfinance increased from 2 billion USD to 13 billion USD globally during last decade. A Micro Rate supported study identified that in 2009 globally there were 88 microfinance investment vehicles (MIVs) created by a variety of institutions for investing in microfinance. Asia also has started receiving investment from these funds. Private institutional investors were holding nearly 47 per cent of funds in these MIVs followed by DFIs (27.7%) and private individuals (16.6%). It is reported that Indian MFIs during 2007-2009 alone attracted private equity investment of the order of $ 230 million. A major impact of these investments is not only the rapid growth of the
sector but also the changing ownership structure of MFIs. The stakes of players like private and other institutional investors are increasing in the transformed MFIs at the expense of the NGOs.

In India also the increased role of marked players is evident. The Indian scenario is also little unique. One can see a major participation of banks and financial institutions in providing funds to MF sector. The banks both public and private sector have been providing debt funds to MFIs. The banks which are constrained by their low rural branch outreach and the interest limit chargeable to poor, have been providing loan funds to NGOs and MFIs for on-lending purpose at competitive rates. The recognition given to such lending as a part of the priority sector target has been an added incentive for the banks. A private bank even came with an ‘innovation’ called ‘partnership model’ under which it aimed at providing unlimited funds to MFIs for their scaling up. The MFIs were expected to act as partners of the bank and handle on its behalf the operations of lending and recovery, while the loan would be shown as part of the bank’s portfolio. Banks have also been using highly sophisticated and controversial methods like securitization/assignments wherein MFIs sell their loan assets to banks at attractive market determined discount rates to access easier funds. Rating of MFIs and their assets, with all its inherent conflicts, has become an integral part of these operations.

All these efforts have resulted in bringing commercial capital into the field of microfinance in a significant way. The outcome is apparently the commercialization of microfinance hastening the drift identified earlier.

6. By way of conclusion

The paper made an attempt to identify the various forces and actors involved in the genesis and spread of microfinance movement along with their key interests and resultant outcomes to understand the influence of the larger political economy. Microfinance which emerged in response to the failure of market and state agencies to meet the credit needs of poor has, wittingly and unwittingly, tried to align with the same agencies for furthering its cause. The involvement of state (national and global) and market agencies has given scope for them to co-opt microfinance to push their own agenda/interest on it. In the process, microfinance has become an intervention wherein it has to saddle the burden of satisfying the interests of several agencies to the ultimate detriment of the primary goal or mandate it was meant to espouse. The multiple agendas—developmental, financial, and market related, no doubt gave a major recognition to microfinance but brought in irreconcilable dichotomies in its praxis that the drift and crisis in which it finds itself became inevitable. Any resolution of the drift would need a reversal of several of the dichotomies noted in the paper.

References

(This is a working draft quickly put together for the seminar. Hence referencing has not been taken-up at this stage. All errors in the paper are solely mine).