Developmental Issues in Micro Credit*

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At Reserve Bank of India, we are keenly interested in purveyance of credit to all those who need it, more for the small borrowers and the poorest of the poor the most. Micro Credit, therefore, has been a thrust area with us though the vehicles of credit extension have been under constant evolution over a period of time. Without a supportive regulatory environment, a continuum of institutions providing micro finance cannot flourish and it is thus imperative to promote linkage and integration of micro credit providers with the formal financial system. As the apex-level facilitator, the Reserve Bank's concern has always been to create an environment that enables micro credit providers to evolve into institutions capable of achieving wider outreach and critical mass in operations. The regulatory environment has, therefore, been reviewed from time to time to make it easier for these micro credit providers to pursue a process of institutional development.

In this context, the Reserve Bank had set up a Micro Credit Special Cell in April 1999. Earlier, the National Bank for Agriculture & Rural Development (NABARD) had appointed a Task Force on Supportive Policy and Regulatory Framework for Micro Finance in November 1998. Considering the broad thrust of their reports, we have issued detailed guidelines in February 2000 to banks for mainstreaming micro credit provision in India. It will not be out of place to recount their salient features :

- In keeping with the reform of the interest rate regime as part of the overall financial sector reforms in the country, the interest rates applicable to loans given by banks to micro credit organisations or by the micro credit organisations to the Self-Help Groups/ member beneficiaries has been totally left to their discretion.

- The banks have been given complete freedom to formulate their own models or choose any conduit/ intermediary for extending micro credit. They have been permitted to choose suitable branches/pockets/ areas where micro credit programmes can be implemented. Micro Credit extended by banks to individual borrowers directly or through any intermediary is now being reckoned as part of their priority sector lending.

- The criteria for selection of micro credit organisations have also not been prescribed. We have only indicated that it may be desirable for banks to deal with micro credit organisations having proper credentials, track record, system of maintaining accounts and records with regular audits in place and manpower for closer supervision and follow-up.

- Banks in India are now free to prescribe their own lending norms keeping in view the ground realities. They may devise appropriate loan and savings products and the related terms and conditions including the size of the loan, unit cost, unit size, maturity period, grace period, margins, etc. The intention is to provide maximum flexibility in regard to micro lending keeping in view the prevalent local conditions and the need for provision of finance to the poor. Such credit, therefore, may cover not only consumption and production loans for various farm and non-farm activities of the poor but also include their other credit needs such as housing and shelter improvements.

- We have asked banks to include micro credit in all their credit plans right from the branch to the state level. While no target has been prescribed for micro credit, they have been asked to accord utmost priority to the micro credit sector in preparation of these plans. Our guidelines also make it clear that micro credit should form an integral part of the bank's corporate credit plan and should be reviewed at the highest level on a quarterly basis. It is our view that maximum transparency in both credit design and delivery is necessary as opaque procedures result in suboptimal benefits. This is imperative as active involvement of the Top Management of the bank leads to a more flexible process approach with the policy delivery framework strengthened by building the capacity of appropriate institutions, both formal and traditional and local dialogue being maintained in the countryside.

- A simple system requiring minimum procedures and documentation is a pre-condition for augmenting flow of micro credit. We have, therefore, advised banks to ensure that they should strive to remove all operational irritants and make arrangements to expeditiously sanction and disburse micro credit by delegating adequate sanctioning powers to branch managers. The loan application forms, procedures and documents should be made simple. It would help in providing prompt and hassle-free micro credit. In fact, banks must make all-out efforts to cut down the cost of financial intermediation and reduce disbursement lags. In order to have a faster feel of the ground-level micro credit disbursement movements, we have also put a revised MIS in place.

- Savings mobilisation being a major issue in micro finance provision, we have introduced certain major relaxations regarding requirement of registration, maintenance of percentage of assets and reserve fund for non-profit non-banking finance companies (NBFC) - Micro Finance Institutions (MFIs). The Micro Finance Institutions registered as not-for-profit NBFCs have been exempted from registration and prudential requirements. As for deposit-accepting-profit-oriented MFIs, the continued insistence on ratings is primarily to ensure depositor protection, which, especially when it involves savings of people, is an overriding concern.

Keeping in view these initiatives for enabling the micro finance movement in our country to gain momentum, the Government of India has recently allowed foreign direct investment in micro/rural credit to encourage foreign participation in micro finance projects.

We have recently taken a review of how these guidelines have impacted provision of micro credit in the country. While the progress has been uneven, it is satisfying to note that some significant strides have been made in up-scaling the purveying of micro credit across the country.

All types of banks in India have to abide by the same prudential norms generally. As far as MFIs are concerned, there are at present about 700 NGOs under the SHG-bank linkage programme of NABARD either in social intermediation like formation of SHGs and entrusting them to banks or financial intermediation like routing bank credit through SHGs. As MFIs are significantly different from commercial banks both in terms of institutional structure and product portfolio, application of the same set of regulatory and prudential guidelines to MFIs, in our view, not only runs the risk of distorting the emerging market but it may also reduce the efficiency of these institutions. We, therefore, consider it desirable and appropriate to support evolution of a self-regulatory mechanism for MFIs which would prescribe codes of conduct and ground rules. These institutions should now get together and come out with a set of proposed self-regulatory norms. Information dissemination, research, database creation and experience-sharing among the micro finance practitioners would be the initial step to setting out on the self-regulation path.

With a view to facilitating smoother and more meaningful banking with the poor, a pilot project for purveying micro credit by linking SHGs with banks was launched by NABARD in 1991-92. The Reserve Bank had then advised commercial banks to actively participate in this linkage programme. The scheme has since been extended to the Regional Rural Banks (RRBs) and cooperative banks also. The number of SHGs linked to banks aggregated 1,21,744 as on September 30, 2000. This translates into an estimated 1.9 million very poor families having been brought within the fold of formal banking services. More than 85 per cent of the groups linked with banks are exclusive women groups.

There is now an urgent need for micro credit providers to shift from a minimalist approach – that is offering only financial intermediation – to an integrated approach to poverty alleviation taking a more holistic view of the client including provision of enterprise development services like marketing infrastructure, introduction of technology and design development. In this context, the setting up of the Micro Finance Development Fund marks an important step. Pursuant to the announcement of the Union Finance Minister in his budget speech for the year 2000-01, this Fund has been created in NABARD to support broadly the following activities : (a) giving training and exposure to SHG members, partner NGOs, banks and government agencies; (b) providing start-up funds to micro finance institutions and meeting their initial operational deficits; (c) meeting the cost of formation and nurturing of SHGs; (d) designing new delivery mechanisms; and (e) promoting research, action research, management information systems and dissemination of best practices in micro finance. This Fund is thus expected to address institutional and delivery issues like institutional growth and transformation, governance, accessing new sources of funding, building institutional capacity and increasing volumes.

In the wake of this post-reforms autonomy given to banks to formulate and adhere to sound credit practices and respond to market signals, banks may have to initiate demand side assessment of the rural market entailing household surveys to determine use of available credit, sources, terms and conditions, transaction costs, household savings, level of indebtedness, impact of technological change, production, employment and income. Coupled with this, they should also take up supply side studies to take a look at their own branch network and commensurate NGO capabilities. This is important as the actual loan products need to be designed according to the target market. It is also imperative that banks beef up their internal supervisory mechanism with training inputs and technical backstopping like a revamped MIS.

The stated end result – reducing poverty – is measurable only in direct relationship to the lives of human beings, the number and permutations of possible intervention effects. Choosing the correct objectives and pursuing them to the appropriate extent, concerns the problem of alternative perceptions of poverty. It is in this context that dialogue-based studies on micro finance providers in India acquire critical importance in the fast-emerging and relatively uncharted area of micro credit delivery. In fact, without the insights of the poor people, who have a long-overlooked capacity to contribute to the analysis of poverty, we may apprehend only part of the reality of poverty and its causes. We are now trying to fashion and sharpen our response initiatives factoring in the survival strategies of the poor as brought out in such intensive interaction with them. Further, our recent studies have also thrown up important HRD issues like posting of banking personnel to areas for which they have an affinity to secure greater involvement and build local capacity better.

The study of the role of central banks in the micro finance sector brings out the commitment, or otherwise, of the policy planners to assisting development of sustainable micro finance in the developing economies. It also demonstrates the importance of good policy as an essential pre-requisite for good practice. Recent policy trends in India happily are pointers to a healthy attitudinal shift and an unmistakable commitment of the central bank towards the financial systems development approach to micro finance.

I am glad that this panel discussion attempts to identify regulatory thresholds for micro finance activities and affords an opportunity to deliberate on the role of central banks vis-à-vis micro finance as an important tool in national anti-poverty strategies, especially so as such policy responses have been country-specific. While I can assure you that the policy environment in India will remain supportive of healthy growth and development in the micro finance sector with accent on more operational flexibility, I am sure that as healthy financial institutions, MFIs would also observe internal or voluntary guidelines for risk management and put in place appropriate systems to track compliance with regulatory policies and procedures.

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* Address by Shri Jagdish Capoor, Deputy Governor, Reserve Bank of India, at the Asia Pacific Region Micro Credit Summit Meeting of Councils at New Delhi, on February 3, 2001.