

Chapter 10

Sustainability and development: Evaluating the performance of Indian micro-finance

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The introduction to this book draws attention to the fact that most Indian practitioners of micro-finance have always worked from the assumption that developmental objectives need to be combined with financial sustainability. It also acknowledges that providing financial services to the millions of poor people in developing countries needs mass intermediation and that this can only be achieved through sustainability. Since all organisations must cope with changes in their operating conditions over time, organisational sustainability is not only important, but is an essential precondition for long-term financial sustainability.

At the same time, no account of micro-finance practice in India is complete without also considering the development agendas of the organisations providing or facilitating micro-financial services. These agendas include poverty alleviation at their core but also encompass livelihood promotion, empowerment (particularly of women), building people's organisations and changing the institutional environment.

This chapter seeks to address these different dimensions by bringing together analysis of the performance of the Indian micro-finance sector in terms of financial and organisational sustainability and of the available evidence on micro-finance organisations (MFOs) fulfilling their developmental agendas.

The first part of the chapter sets out the results on sustainability emerging from the rating of MFOs in India ('MFOs' in this context refers to organisations involved directly in the

provision of financial services). As described in Box 10.1, the rating of MFOs is an innovative service introduced for the first time in late 1998 by Micro-Credit Ratings International Limited (M-CRIL), an organisation established by us for this purpose. It has, virtually for the first time in the world, enabled a systematic, detailed and standardised assessment of the performance of a large number of MFOs.

The latter part of the chapter examines the evidence available on the success of micro-finance in relation to wider developmental agendas. It discusses the challenges of assessment beyond the financial and organisational dimensions of providing micro-financial services, explores new trends in approaches to impact assessment and describes two current initiatives which build on these trends.

Box 10.1: Micro-Credit Ratings International Limited (M-CRIL)

An innovative organisational mechanism for Asian micro-finance

The issue of sustainability has become particularly important in micro-finance, not least in India, in recent years. This has happened as micro-finance portfolios have started to shift from being almost exclusively donor-funded to be significantly financed through debt. Loan funds are sourced increasingly from apex-level non-governmental organisations (NGOs), development banks and even, in a few cases, from commercial banks. Prominent amongst the organisations lending to micro-finance organisations (MFOs) in South Asia are the Palli Karma Sahayak Foundation (PKSF) and Sonali Bank in Bangladesh, the Pakistan Poverty Alleviation Fund, Friends of Women's World Banking-India (FWWB), and the Small Industries Development Bank of India (SIDBI). The encouraging experience of these organisations in revolving wholesale funds for micro-finance has led to growing interest in this activity, to more apex-level NGOs operating as wholesale lenders and to the involvement of banking organisations.

Since lending activity inevitably generates concerns about the borrower's cash-flows, viability and sustainability, the availability of skills for MFO appraisal and risk-analysis has, increasingly, become an issue. The response of the apex NGOs wholesaling development funds in micro-finance has been to

attempt to develop the skills internally. Banks with large portfolios but relatively miniscule outstandings to the micro-finance sector have been more reluctant to undertake appraisals as purely internal exercises.

There are two reasons for this. First, as custodians of commercial rather than development funds, they need a quality of risk-analysis that is more sophisticated than is customary in the development sector, at least in South Asia. Second, it is difficult for a bank with a loan-portfolio worth a billion dollars or more, invested in a diverse range of industrial and agricultural activities, to persuade many of its staff to specialise in MFO appraisals when the micro-finance portfolio is likely to be no larger than US\$10-20 million in the immediate future. Yet, the potential for micro-finance lending in India alone is estimated to be in the range of US\$6-8 billion if only the substantial (and liquid) resources of the banking system could be channelled in its direction.

Thus, the micro-finance funding situation in the region can be characterised as one of information asymmetry between banks that have funds but not the skills and experience to understand micro-finance operations, on the one hand, and MFOs that have a high demand for funds but many of which have doubtful records on issues like sustainability and viability. It is in this context that EDA Rural Systems Private Limited, an organisation with the reputation of a highly professional and competent provider of technical services to the development sector in South Asia, decided to develop a service for the credit rating of MFOs.

After around 18 months of research and field-testing, a credit-rating service for MFOs was introduced in South Asia, almost for the first time globally, by Micro-Credit Ratings International Limited (M-CRIL), a subsidiary company established by EDA Rural Systems specifically for this purpose.

In the three years since the launch of its credit-rating service in late 1998, M-CRIL has built up a specialised team for rating consisting of seven professionals. It has an active board of directors comprising professionals and academics with an intimate knowledge and experience of Asian micro-finance, and also uses the services of professionals as part of its Rating Committee to provide independent oversight of the ratings undertaken by the organisation. This vetting mechanism has served to ensure that no issues of prejudice, conflicts of interest or sins of omission arise to cloud the judgements made

(Contd)

(Box 10.1 Contd)

by M-CRIL's team. As a result, M-CRIL's MFO rating-service is increasingly accepted in the region as a highly reliable assessment of MFO credit-worthiness.

Until September 2001, M-CRIL had undertaken ratings of around 90 MFOs in South and South-East Asia. The ratings, based on intensive visits to MFO head-offices and clients in the field, have provided the detailed, independently verified information on MFO operations that financial investors need to make judgements on credit-worthiness. The opinions of M-CRIL as a professional organisation specialising in assessing the capacity of MFOs have served as a key factor in supplementing these judgements. In doing so, M-CRIL's innovative service has greatly accelerated the rate at which wholesale lending has emerged as a means of funding MFOs, particularly in India.

Lessons on sustainability from the rating experience

The M-CRIL database sample

Until the end of November 2000, some two years after its launch, M-CRIL had completed 53 rating assignments. Of these, one was a July 2000 update of a large Indian MFO first rated in March 1999 and another was the rating of an on-lender with many of its borrowers already included in the sample. At the end of November 2000, M-CRIL's database therefore contained information on 51 MFOs in the region. While the cross-sectional data for the 51 organisations covered by this analysis does not relate to a fixed point of time, it does serve the purpose of providing a broad picture of micro-finance in the region as seen through M-CRIL's rating activity.

The 51 MFOs rated by M-CRIL included 44 MFOs in India, four in Nepal and three in Bangladesh. This discussion focuses on the information available for the Indian MFOs, although much of the data incorporates information from the entire database. These MFOs have an average age of just six years (although a few are over 20 years old) and follow different models of delivering micro-financial services. For the purpose

of analysing the information in the database the following typology has been used for the sample MFOs.

- (1) Pure Grameen-Bank type: Those following the model developed by the Grameen Bank of Bangladesh which essentially lends to individuals, but all borrowers are members of groups within which peer-pressure is a major factor in ensuring repayment. Collecting loans takes place at meetings of sets of seven to 10 groups, while disbursement is mostly from the branch-office and is made to clients as individuals (for more details, see Chapter 7).
- (2) Individual-banking programmes (IBPs) where the relationship with clients is either fully individual or via joint-liability groups. The loan officer undertakes collection individually at the client's doorstep but disbursement is from the branch-office. These include cooperative societies and cooperative banks (such as the Self-employed Women's Association [SEWA] Bank described in Chapter 3) as MFOs as well as organisations that undertake predominantly individual lending through joint-liability groups (such as BASIX described in Chapter 4). It is a diverse category and performance issues here therefore need to be analysed carefully.
- (3) Micro-finance organisations promoting and supporting self-help groups (SHGs, which function as informal village funds with support from the MFO). Here, SHGs borrow from the MFO and on-lend these external funds as well as revolve the savings of members amongst themselves. Whilst this is, in theory, the most economical of the micro-finance methodologies, in practice, the substantial capacity-building effort needed to ensure that SHGs function well (see Chapter 8) is very costly in the short to medium term. Further, the SHG methodology is predominantly used by MFOs with much wider development agendas, including both a strong focus on poverty alleviation and on building civil society, and this adds to the capacity-building effort required (see Chapter 5).

As described in Chapter 7, the major involvement by commercial banks in Indian micro-finance is through the SHG-bank

linkage programme pioneered by the NGO MYRADA, and promoted by the National Bank for Agriculture and Rural Development (NABARD). This programme entails direct lending by banks to SHGs without financial intermediation by MFOs.

Some of the largest and best known NGOs in the country, such as MYRADA and PRADAN, have therefore focused on the promotion of SHGs as part of the linking programme but have specifically avoided becoming involved in financial intermediation. These NGOs have emphasised the civil society objective of ensuring that the banking system fulfils its social responsibility of providing financial services to poor people. Their strategy has, therefore, been to promote SHGs as autonomous local groups with self-governance capabilities that can act as local intermediaries for the financial services provided by the banking system.

Since the rating of thousands of SHGs by a single organisation is not possible at economically practical rates, M-CRIL's ratings have not covered them, and the SHG-bank linkage programme does not figure in this discussion. Even for MFOs working as financial intermediaries channelling funds to SHGs, M-CRIL's analysis covers the financial transactions conducted by the MFO as an intermediary rather than the sum of the financial transactions conducted by the members of the SHGs it serves. This is because most MFOs do not monitor SHG-level transactions that are not covered by funds intermediated by them. Any attempt by M-CRIL to include them in the analysis would, therefore, require an uneconomical, time-consuming effort with only a small bearing on the credit-worthiness of the MFO as an intermediary. To this extent, it is apparent that this analysis cannot fully reflect the financial services becoming available to members of SHGs as a result of the MFOs serving them.

Based on the above typology, Table 10.1 provides the coverage of MFOs in M-CRIL's database sample.

M-CRIL's rating incorporates a weighted scoring of key indicators on governance, management systems and financial aspects of an MFO's functioning. Based on this, at the time of assessment, only nine of the 51 sample organisations were able to reach the levels of performance (α or $\alpha +$ grades awarded by M-CRIL) to classify as highly credit-worthy, another

Table 10.1: MFOs rated by M-CRIL up to November 2000

Type of programme	Typology	No. of MFOs	Members	Active clients
Grameen Bank model	Grameen	10	212,000	150,000
Individual banking programmes	IBPs	10	139,000	67,000
Programmes working with self-help groups	SHG programmes	31	345,000	83,000
Total		51	696,000	300,000

22 were moderately credit-worthy (α - or β + grades), nine were marginal (β) and the remaining 11 were not credit-worthy.

Outreach: Grameen MFOs are dominant but total loans outstanding to clients are small

The outreach of the 51 sample MFOs is to some 700,000 people, although only 300,000 of these are borrowers from the MFOs. Others are all savers with MFOs, although some may also be borrowers from SHGs. The MFOs' total loans outstanding to client members amount to just US\$23.7 million (see Table 10.2), a very small amount compared to the potential. Within the sample, the distribution is highly skewed; the best 10 MFOs of the sample in terms of performance (called Top 10 by M-CRIL)—also broadly but not invariably the largest—account for 64 per cent of this portfolio.

By model, the Grameen MFOs are dominant and account for nearly 50 per cent of the outstanding portfolio. Though this is partly on account of three relatively large Grameen programmes rated outside India, there are two or three fast growing Grameen programmes within India as well. Individual-banking programmes and mature SHG programmes (more than seven years old) in the sample each account for 22 per cent of the total portfolio.

Among MFOs in India, the number of new MFOs using the SHG model is quite substantial. This number should far exceed the 18 maturing organisations (three to seven years old) that make up a substantial part of the sample but, inevitably,

Table 10.2: M-CRIL sample totals

	M-CRIL		
	Full sample	India	Top10
Sample size: number of MFOs	51	44	10
Membership: number of members	696,000	520,000	304,000
Loans outstanding: Rs crore	109.0	70.4	69.4
US\$ million	23.7	15.3	15.1
Savings: Rs crore	56.7	46.0	35.8
US\$ million	12.3	10.0	7.8
Staff: number	3,451	2,272	1,532
Cumulative disbursements:			
Rs crore	287.7	166.3	195.0
US\$ million	62.5	36.2	42.4

most new organisations are not seen as mature enough to justify the cost of rating them. As a result, there are only five new MFOs in the sample and the remaining eight SHG programmes are mature organisations (with micro-finance operations that are more than seven years old). Maturing and new SHG programmes as well as newer IBPs are relatively small organisations with an average of around 5,000 members or clients each. The largest organisation in the sample has some 73,000 clients.

Savings mobilisation: There is potential to place greater emphasis on savings services

Not all MFOs in the sample are able to offer savings services, particularly the four organisations registered as 'for-profit' non-banking finance companies (NBFCs) and, therefore, regulated by the Reserve Bank of India (RBI), India's central bank. Further, the Grameen MFOs traditionally do not place much emphasis, beyond compulsory savings, on providing savings services to their members.

Nevertheless, deposits mobilised directly by the MFOs amount to US\$8 million (or 34 per cent of the total amount lent to clients). Actual mobilisation—including amounts generated by SHGs for internal circulation but not deposited with the MFO—is nearly US\$12.3 million (see Table 10.2) or more than 50 per cent of the amount outstanding.

This confirms the analysis in Chapter 3 by showing the value micro-finance clients place on savings services and demonstrating the potential for raising lending resources locally. As of now, the average savings of just US\$18 per client are well below the US\$26 average for the Top10 and US\$52 for mature IBPs.

The average level of savings deposits with MFOs is mainly a function of three factors:

- implementation strategy
- age
- location

Thus the average savings deposits of Grameen programmes are just two-thirds of those of the IBPs and less than 40 per cent of the deposits of the older IBPs, despite having almost the same average memberships. While it is well known that Grameen programmes have traditionally not given much importance to savings as a source of funds, IBPs place considerable emphasis on this source.

The SHG programmes, by contrast, have compulsory deposit-schemes in which the members themselves determine the amount of the recurring savings deposit. This often results in minimalist norms and leads to deposits that are far lower than the members' savings potential. This is also reflected in the average figures that show that while individual banking clients have savings deposits of around US\$38 each (over US\$50 for mature IBPs), Grameen and SHG clients have saved only US\$10 to 16 each. The Top10 average here of US\$26 is driven almost entirely by the extraordinary performance of SEWA Bank on this indicator (see Chapter 3).

Staff productivity: SHG performance belies the expected efficiency of village banking

The 51 sample MFOs between them employ some 3,500 staff to provide micro-financial services. Staff productivity is highest amongst the mature IBPs, partly because the large ones are urban, slum-based programmes. However, even the newer

IBPs with 135 borrowers per member of staff fare better than the *Microbanking Bulletin (MBB)*¹ sample average of 111.

Grameen MFOs, with 94 borrowers per staff member, are well known to be relatively staff intensive, but it is the SHG programmes' 51 borrowers per staff member that really brings down the productivity profile of the sample. Even the mature SHG programmes are not able to achieve better than 66 borrowers per staff member and this seems to negate the expectation that village-banking programmes can be efficient in the long term as client representatives take over many staff functions.

However, such comparisons are difficult. Self-help groups may engage in many financial transactions that are not directly related to borrowing from MFOs, and may therefore not be captured by this analysis, making staff who promote SHGs appear less productive. Most of the SHGs in any case borrow from banks, not MFOs, which is not reflected in this analysis.

In Chapter 7, Malcolm Harper argues that, overall, SHG programmes are likely to be associated with higher numbers of clients, or at least of client transactions, per staff member. On the other hand, Chapters 8 and 9 make clear that promoting SHGs effectively presents many challenges, which are likely to lower the number of clients per staff member and drive up costs. This is all the more the case because, as described in Chapter 5, SHG programmes may aim to fulfil social objectives such as promoting the self-governance capabilities of members. They may, therefore, not be as strongly motivated to maximise productivity and limit operating costs, especially in the short term.

In terms of the number of loans serviced by MFOs within the M-CRIL sample, the 128 clients and US\$9,900 per staff member of the Top 10 indicates the potential improvement that could be achieved by the others. Yet salary scales and other costs in the region are so low that the US\$14 cost per borrower in the sample is less than one-tenth of the *MBB* sample's US\$150 per borrower.

Portfolio quality: Grameen-type MFOs are the best performers

M-CRIL measures portfolio at risk (PAR) at the 60-day level (loans with overdues more than 60 days beyond the designated

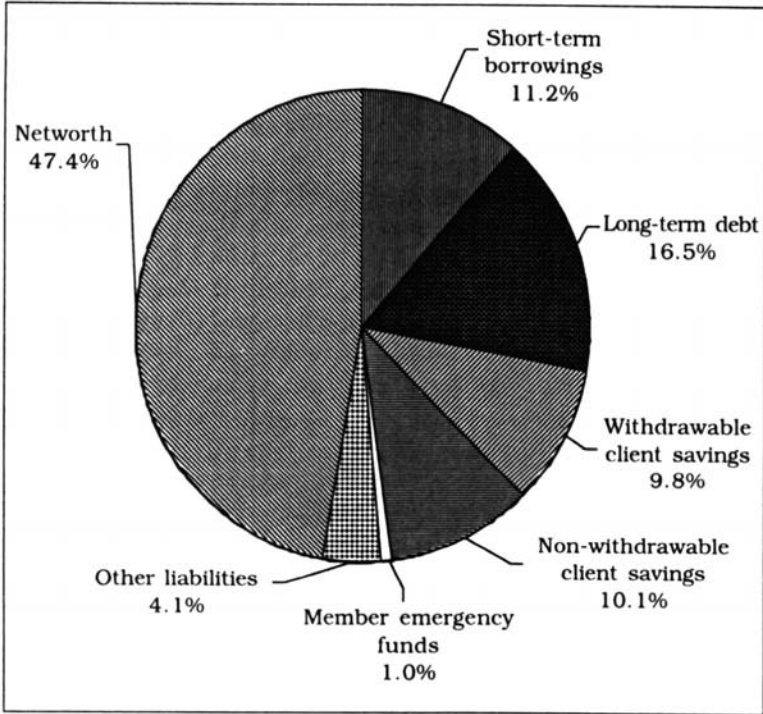
date of payment are regarded as being at risk of default). Grameen MFOs are the best performers in the sample with an average PAR of 3.9 per cent. The poor performers in this case, as in the case of cost coverage, are the mature programmes. This is largely on account of the stronger welfare (rather than commercial) orientation of the early entrants into micro-finance. Many of the older MFOs in the sample place less emphasis on credit-discipline within their financial-service activities.

Some of the newer IBPs have suffered not so much from methodological or ideological constraints as from lack of experience in the management of risk associated with different types of loan products, particularly crop loans. The sample average of 15 per cent and the India average of over 20 per cent are far higher than the MBB sample PAR (>90 days) of 2 per cent and emphasise the impression that MFOs in the region do not pay enough attention to portfolio quality. Further, they are reluctant to write off unrecoverable loans for fear of giving clients the impression that loans remaining unpaid for extended periods of time will not be recovered by the organisation. However, this gives the MFO management an unrealistic picture of its asset quality and tends to confuse decision-making.

Financing: Donor funds are pre-eminent; efficiency in the deployment of funds needs improvement

Micro-finance organisations in the region have historically been heavily dependent on donor funding for financing both their portfolios and their operations. As much as 47 per cent of the total of US\$38.1 million currently deployed in the sample MFOs consists of the organisations' net worth, made up primarily of donated equity (see Figure 10.1). Accumulated losses amounting to US\$3.2 million in 42 of the 51 organisations have contributed to erosion of the equity.

Some 21 per cent of the funds deployed in micro-finance by sample MFOs could be described as member-funds consisting of both withdrawable and non-withdrawable savings and emergency funds accumulated to cover loan losses due

Figure 10.1: MFOs' sources of funds

to disasters affecting MFO clients.² While a large proportion of these savings is generated by cooperative organisations with a legal mandate to generate these funds for lending to members (for examples see Chapters 3 and 5), in South Asia even MFOs with charitable status are able to generate savings for on-lending purposes. There are three reasons for this. First, the regulatory authorities accept that there is a dearth of financial services for poor people. Second, they recognise their own inability to regulate hundreds of MFOs in any effective manner, and third, there has not so far been any significant case of default or misappropriation by any MFO in the region.

Given that a large proportion of the best MFOs have been rated so far, our analysis shows that micro-finance in the region has a long way to go before it can achieve any form of commercial viability. However, M-CRIL's experience also

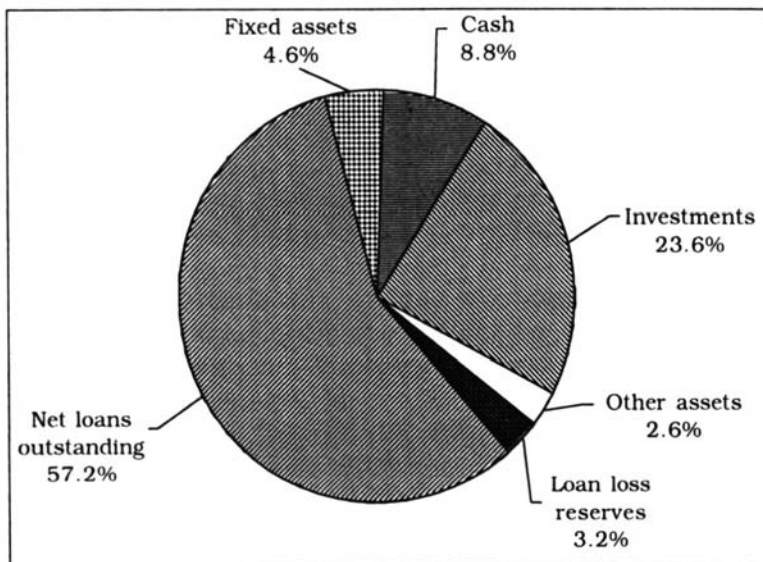
shows that the importance of donor funds is declining and that MFO managers are increasingly aware of the need to obtain more resources both from members and from various types of institutional lenders.

Since MFOs in the region generally do not see themselves as commercially viable entities, their preference is to obtain resources from development loan funds on 'soft' terms. Therefore, it is not surprising that 28 per cent of the funds raised by MFOs for their activities are accounted for by soft loans from development banks and dedicated micro-finance wholesalers. The share of commercial banks in this total is negligible.

As mentioned earlier, the commercial banks' involvement in micro-finance is currently mainly under the NABARD promoted SHG-bank linkage programme. According to information published by NABARD, the banks had provided Rs 1.93 billion (US\$42 million) as loans to 82,000 SHGs and 1.9 million families under this programme until March 2000 (NABARD, 2000). Unfortunately, these figures are cumulative and the numbers for outstanding loans are not available, so they cannot be compared directly to the M-CRIL sample. Since 2000 the cumulative figures have also increased sharply. As Chapter 7 makes clear, some 300,000 SHGs have borrowed from banks.

It is striking that only 57 per cent of the total resources of US\$38 million available have been deployed by sample MFOs in loans to clients, while as much as 23 per cent has been placed in short- and long-term investments, mainly with banks (see Figure 10.2). These investments, even in long-term bank deposits, earn no more than 8 to 11 per cent. Yet the conditions on MFO loans to clients amount to annual effective interest rates of 18 to 45 per cent and could potentially yield them very high returns. It is apparent that MFOs are being inefficient in sourcing debt finance and then failing to apply it to the intended purpose of lending to clients.

Many MFOs have discovered that it is difficult to lend to clients beyond animal husbandry and consumption loans. Typical micro-finance clients find it difficult to enhance or launch business activities and often require technical support services that MFOs are generally not able to provide (for an exception, see Chapter 4). In addition, savings products tend to reduce the demand for consumption and emergency

Figure 10.2: Utilisation of funds by MFOs

loans since both perform the same role. In the case of savings, clients set aside small amounts in advance; in the case of loans they pay small amounts in arrears (see the introduction to Chapter 3).

Portfolio management: IBPs manage funds well

The efficient, effective and prudential management of an MFO's assets is also important for achieving financial sustainability. Such management depends on a number of factors:

- the use of member deposits as a (relatively cheap) source of funds;
- the minimisation of the need for fixed assets relative to total assets;
- the maximum investment of financial resources either in the loan portfolio or in high return, long-term investments; and

- limiting the risk associated with the MFO's financial assets to levels consistent with the organisation's own funds or net worth.

M-CRIL's analysis of the management of the sample MFOs' assets shows that IBPs are amongst the most efficiently managed, the mature ones particularly so. The mature IBPs are savings-based organisations with high deposit-credit ratios (200 per cent), reasonable fixed to total assets ratios (4 per cent) and low ratios of liquid to total assets (3 per cent).

While the average for the total sample of 5 per cent fixed assets is reasonable, 9 per cent liquid assets is relatively high and, as the earlier discussion showed, the deposit-credit ratio of 34 per cent could certainly be improved. Another important concern here is that at least four, not very small MFOs, have actually eroded their equity to the extent that they have negative net worth.

Operating performance: Operating costs are low but portfolio yields are even lower

Surprisingly, in the context of many management deficiencies within MFOs in the region, the database shows that operating efficiency compares well with international best-practice norms. Operating-cost³ ratios of many of the rated MFOs are less than 30 per cent. Though Grameen-type MFOs record a slightly higher average operating-cost ratio of 27 per cent, the sample average is just 23 per cent and the average for Indian MFOs less than 20 per cent. This compares with the equivalent average of 31 per cent for the *Microbanking Bulletin* (MBB) sample of 90 MFOs.

On the other hand, the average portfolio yield (the actual revenues generated from lending to clients as a proportion of the average portfolio) for the M-CRIL sample is just 17 per cent (India only 14 per cent) compared to the MBB's 40 per cent. So low is the portfolio yield, indeed, that the financial spread⁴ being earned by MFOs in the region is less than 8 per cent, leaving a 15 per cent gap between it and the operating cost level of 23 per cent of average portfolio.

but in part depend on the socio-economic context and the extent of market distortions and imperfections.

Return on assets: In a bleak scenario, the newer IBPs perform better

The lack of commercial viability of MFOs in the region becomes clear in considering the return on their assets. The sample average loss of 4.8 per cent on total assets is much worse than the *MBB* sample profit of 1.5 per cent. The M-CRIL Top 10 average of -1.3 per cent indicates the ground that MFOs in the region still have to cover in comparison with the *MBB* sample's 6.2 per cent profit for fully sustainable organisations.

The situation is not uniformly bleak, however. The disaggregated information from the database shows that four MFOs in the M-CRIL sample earn more than 3 per cent returns on loanable funds and as many as 13 MFOs earn positive returns. On account of their relatively good fund management, the IBPs perform better than other types of MFOs and have average losses of just 0.6 per cent of total assets.

Dependence on subsidies is high

Operational self-sufficiency (OSS) measures the ability of an MFO to meet all its operational and financial costs out of its income from operations. As expected from the above discussion, IBPs as a group are fairly close to full OSS (96 per cent), although the distribution of 10 such MFOs indicates that three of them are still quite far from that target. Of the Grameen programmes, four are still quite far from self-sufficiency but two of the 10 are able to cover all their costs. Out of the 31 SHG programmes, only seven are approaching self-sufficiency while just one is able to cover all its costs.

A calculation of the Subsidy Dependence Index (SDI) shows that the average subsidy dependence of newer IBPs is the best at 37 per cent. Unlike the case of OSS, however, the SDI of Grameen programmes (58 per cent) is better than that of mature IBPs (91 per cent).

The average of 72.7 per cent for OSS and 83.4 per cent for SDI for sample MFOs in the region compares poorly with the MBB average of 129.7 per cent OSS for 63 fully sustainable MFOs and 106.6 per cent for the full sample of 92 MFOs. The Top 10 MFOs in the region have an average OSS of 91.4 per cent and SDI of 48.9 per cent. However, with relatively low operating cost ratios, there are still enough MFOs in the M-CRIL sample with positive returns to provide grounds to hope for better overall performance in the future.

Organisational issues: The sustainability of MFOs is critically affected by the self-perception of the promoting NGOs

It is apparent from the discussion in this chapter that the performance of the rated MFOs in India in terms of financial sustainability has been relatively weak. Though systematic information on sectoral trends is not presently available, the experience of M-CRIL's team with the performance of MFOs in the region over the past few years indicates that the message of sustainability is starting to permeate through the micro-finance sector. Consequently, there is a positive trend in overall performance both in terms of sustainability and in terms of growth.

There are, however, a number of organisational and systemic issues that affect the sustainability of MFOs in the region. These issues include staff quality, scale of operations and geographical focus, the quality of information systems, financial control systems and, above all, the orientation of most CEOs of MFOs within a development perspective.

Staff quality. Many of the staff of MFOs do not have the skills and incentives necessary to work in a more productive and cost-effective manner. By and large, remuneration in the sector is uncompetitive with the public sector and significantly lower than much of the private commercial sector. This results in a high turnover of competent junior staff and a capacity mismatch at supervisory levels. The few organisations that have introduced appropriate remuneration and incentive systems are also the best functioning MFOs in the region.

Scale of operations and geographical spread. The typical number of borrowers of sample MFOs in India is no more than 3,000 to 4,000 with average loan sizes of just US\$100 to 125. While M-CRIL is convinced that their scale is not the only cause of low financial sustainability of MFOs in the region, it is certainly a factor. For this reason, 27 (53 per cent) of the 51 MFOs in the sample were urged by M-CRIL to expand their lending activities.

At the same time, in many cases, there is a concern that the geographical spread of programmes affects their operational efficiency. Many MFO leaders, in their concern to work with particular communities or reach especially poor regions, spread their programmes over distances—often in excess of a 100 km radius—which, for small organisations, substantially adds to the cost of operations and hampers managerial supervision.⁵ M-CRIL has recommended consolidation of operations in 19 (37 per cent) cases within the sample. Five of the sample MFOs were found to be both small and spread thinly over a wide area.

MIS and portfolio quality. Amongst the least satisfactory aspects of MFO operations in the region is the quality of management information systems (MIS). A number of organisations do not have adequate systems even to track basic member and borrower information in a manner that will enable an accurate enumeration of clients served. Others suffer from inconsistencies at various levels of operation so that appropriate information is either not available at head-office level or at branch level. Many do not even collate information on the quality of their portfolio.

Only eight of the sample MFOs were found by M-CRIL to have a fully effective MIS, while 18 (35 per cent of the total) have adequate systems for tracking portfolio quality. In the latter case, this is related to the predominant (and inappropriate) use of the cumulative repayment rate as an indicator of the quality of the portfolio. In this scenario, greater than 90 per cent repayment rates are regarded as satisfactory on the part of MFO managers and breed complacency despite being (often) associated with a 15 to 20 per cent portfolio-at-risk ratio.

Financial control systems. Overall accounting systems in sample MFOs are reasonably satisfactory. However, only 39 per cent have internal audit mechanisms in place, a risky situation in the context of the failure of most (62 per cent) even to undertake any formal budgeting or cash-planning. As discussed earlier, liquidity management is also an area of concern in the operations of many MFOs with inefficiencies in the sourcing of funds from lenders or donors, in the transfer of cash between branches and head-office, and in placing idle funds in short-term investments.

Development orientation of CEOs. This approach to micro-finance management is largely a reflection of the social-development oriented background of most MFO CEOs who may not have recognised the full potential of micro-financial services as a business, albeit with a social purpose.

Most MFOs in India have either evolved from NGOs undertaking a wide range of development activities or continue to be divisions of such organisations. In this situation, discussion with CEOs during assessment visits revealed that the development orientation of such leaders tends to be strong and, though there is an increasing recognition of the need for sustainability as well, this is yet to become a priority in the practice of micro-finance in the region. The potential to achieve sustainability and thereby reach larger numbers of people is therefore considerable, but such a goal may conflict with other developmental agendas of the promoters.

The analysis of developmental objectives set out in this book brings this issue to the fore. Some promoters may not pursue a limited focus of delivering micro-financial services to the largest number of people as their primary goal (although all would probably subscribe to the need in the Indian context to reach out to a large number of poor people, and therefore increasingly understand the need for greater sustainability). They may well add other inputs, for example, around the quality of self-governance, that may inevitably drive up costs and slow down expansion, at least in the short term. This brings us critically to the issue of a more refined understanding of the purpose of micro-financial services and their impact.

The difficult task of assessing impact

Why impact assessment?

Complementary to financial and organisational performance are questions relating to development impact. As this book demonstrates so clearly, for most if not all actors in India—NGOs, MFOs, donors, even bankers—micro-finance is not only about the efficient and sustainable delivery of micro-financial services. Micro-finance is a means, not an end. The ultimate goal is to reduce poverty. And, in India, the development strategy includes (for many NGOs) savings and credit management by SHGs not as a system for delivering micro-financial services *per se* but as a tool for building people's organisations and empowering women (Chapter 5).

Impact assessment in this context implies questions about outreach and effectiveness in meeting development objectives. What changes does micro-finance lead to? Are providers of micro-financial services reaching poor people? If so, do they serve to move poor people out of poverty? What is the role of women in micro-finance—is it empowering and how is that defined? How strong are the groups as social organisations?

Micro-finance is often defined in terms of the local provision of financial services in small amounts that meet the needs of the poor with a special focus on women. In the early days, it was sometimes assumed, given the nature of the service, that data on client outreach, the involvement of women and timely repayments were adequate indicators of impact. The argument for this assumption went something like this: only poor people are interested in small ('micro') amounts, therefore they must be the clients; clients exercise market choice and therefore an increase in clients means that the service is meeting their needs on acceptable terms, whilst the ability to repay on time and take repeat loans must mean that the loan was being used productively and profitably, enabling an increase in income. Moreover, the involvement of women as clients with direct access to financial services implied a significant contribution to gender equity and women's empowerment.

Such assumptions have been explored and questioned as researchers and practitioners have looked more closely at these issues. Evaluations and case-studies in different parts of the world have highlighted some important issues:

- the fungibility of finance at the household level in the context of varying financial needs and strategies which are not only enterprise related; what then is the role of micro-finance in relation to these needs?
- gender issues: does the role of women as clients for micro-financial services translate into empowerment for them or is this merely a pragmatic means of ensuring repayments and group discipline (see further the analysis in Chapter 5)?
- different levels of poverty: is micro-finance reaching mainly the moderately poor, and not the more vulnerable?

The issue of impact assessment has therefore assumed significance, and has been expanded to address questions not only of what is being achieved by micro-financial services, but also, as in this book, how micro-finance can be more effective in achieving development objectives. In other words not only (or even!) *proving* impact but also *improving* practice for better impact (Hulme, 1999).

Proving or improving

Seeking to prove the impact of an intervention involves distinguishing cause and effect and this is conventionally done through large-scale sample surveys (of clients and a 'control group' of non-clients, before and after an intervention) and statistical analysis of the different data sets. This kind of assessment is data intensive, it takes time for the results to emerge and, even then, it is not clear how to interpret the results: what do the numbers really mean? who understands them?

Increasingly, therefore, there has been a shift to adapting and down-scaling survey techniques and using different (more qualitative and participatory) tools. The aim here is to arrive at results more quickly and to explore (assess rather than measure) dimensions of change that are relevant to local stakeholders (practitioners and the community).

In terms of the extremes, different approaches to impact assessment can be categorised as in Table 10.3 (compare Simanowitz, 2001 and Noponen, 2001).

Table 10.3: Different approaches to impact assessment

	The 'old' way	New trend
Why?	Proving: establish change due to the programme, to know what is happening and to justify funding	Improving: information relevant and useful for improving programme practice; strengthening organisations through a process of self-evaluation
What?	Structured survey: results quantified (numbers, averages, frequencies)	Participatory process: qualitative understanding (patterns, differences, perceptions)
When?	One-off cross-sectional study	Long-term process: on-going monitoring as well as longitudinal studies
Who?	External consultants	Clients, staff, all stakeholders
How much?	Main focus on programme activity only, i.e., micro-enterprise	Wider set of impact indicators on individuals, households, communities

The practice of impact assessment must lie in-between these extremes, with a pragmatic mix of both approaches, as donors (to some extent) and researchers become more interested in the alternatives, whilst practitioners (NGOs, MFOs) look for information about their programmes for their own use and to serve their development objectives.

So what is the impact?

Reports of impact assessment available from India are relatively few. Table 10.4 summarises eight available studies. They relate to some of the most reputed organisations engaged in micro-financial services in the country, and reflect different micro-finance models and contexts.

These are very different studies in terms of scope and approach, depending partly on the type of organisation, the impact questions they seek to answer and the amount of time and money spent on the studies. They usually include one or more of the following impacts: effects on the poverty of

Table 10.4: Summary of impact assessment studies of micro-finance in India

Context	SEWA	FWWB	NABARD	MYRADA	BASIX	SHARE	ASA	CDF
Registered status	Cooperative bank	Apex MFO-society	Apex bank	Society	NBFC	NBFC	MFO-society	Trust
Type of client	Individual savers and borrowers	MFO partners (study is of four MFOs)	Banks who lend to SHGs	SHGs linked to banks	Mainly individual borrowers; also lending through intermediaries and SHGs	Grameen model groups of borrowers	Grameen model groups of borrowers	Thrift and credit cooperatives
Approach	Banking services plus gender empowerment	Loans and capacity-building of MFOs	Refinancing	SHG capacity-building of poor people	Micro- and other finance, with technical assistance and support services	Micro-finance	Micro-finance plus community empowerment	Enhancing women's skills for cooperative management
Date started	1974	1991	1992	1984	1996	1993	1993	1990
Date of study	1998-99 & 2000-2001	2001	1999-2000	2001	1999	2000-2001	2000	1995-96
Outreach: members at time of study	120,000		1.9 million	77,500	10,200	84,000	12,000	12,500

Context	SEWA	FWWB	NABARD	MYRADA	BASIX	SHARE	ASA	CDF
Study method	Questionnaire; Case-studies; panel data	Case-studies; focus groups; questionnaire	Recall: Questionnaire	Recall: (i) participatory assessment; (ii) questionnaire	Recall: Questionnaire and focus groups	Questionnaire	Practitioner-led AIMS tools; Case-studies (recall)	Case-studies (recall)
Sample	Clients: 600 Control: 300 Panel: 800 Case-studies: 12	Case-studies: 20 Survey: 125 clients	560 members of more than 220 SHGs in 11 states	(i) 6 groups (ii) 64 groups	187 clients	125 mature clients; 104 new clients	40 clients	2 primary coops
Basis for poverty assessment	(i) 'Local' poverty line (ii) 'US\$1' / day	Income—but poverty level not specified	'Official' poverty line	(i) Participatory wealth ranking (ii) 'Official' poverty line	Poverty index (survey based)	Poverty index and relative ranking (survey based)		Not applicable—open membership

(Contd)

(Table 10.4 Contd)

Findings	SEWA	FWWB	NABARD	MYRADA	BASIX	SHARE	ASA	CDF
Poverty outreach (% sample)	By (i) ~10% By (ii) 45%*	~46%	42%*	100%	52%	100%*	-	-
Poverty reduction	Between rounds 1 and 2; change of less than 1% increase in average household income by 14% (mainly attributed to male salaries)	Graduation to a sustainable or increased level of income less likely than providing a 'safety net' and reducing vulnerability	22% moved above poverty line Increase in assets (59%), savings (x3), annual income (from Rs 20,000 to 26,800)	(i) 75% have improved status to middle or upper poor after three years (least change for the poorest) (ii) 86% cross poverty line after five years	Inconclusive: 61% report some increase in incomes at household level and 29% report some increase in employment, but magnitudes not estimated	38% no longer poor; 38% shifted from very poor to moderately poor; high correlation with number of household earners and sources of income	Increased income through new/expanded income generating activities; increase in food intake; improved housing condition; purchase of household assets	
Financial services	Informal debt continues at similar levels; overall debt increases by borrowing from SEWA	More than half of MFO clients continue to borrow from money-lenders	Decline in average interest rate of borrowings; improvement in repayment of bank loans	Groups increasingly linked to banks, or ready to be linked	Additionality: increased volumes of credit (by ~24%) to client households, with 4% reduction in overall cost of credit; 20% now access formal credit	Client suggestions for MFO services from separate 'client satisfaction' focus group discussions	Client suggestions for MFO services from separate 'client satisfaction' focus group discussions	Women appreciate easy access to money at reasonable rates; helps to reduce interest rates of informal credit

Findings	SEWA	FWWB	NABARD	MYRADA	BASIX	SHARE	ASA	CDF
Empowerment	Women have personal savings accounts and plans for the future Overall self-image same for clients as for control group		Attitude changes (self-worth; ability to communicate) Object to, e.g., alcohol and wife-beating Decline in domestic violence (37%)	Groups increasingly involved in social problem solving and maintaining village infrastructure; members elected to local <i>panchayats</i> Increase in self-confidence among members; learn to sign, approach bank, speak to visitors Increased predominance of wives in household decisions regarding purchase of assets			Improved self-confidence (mobility, dress, jewellery, ability to plan, decisions for self and family) Access to medical facilities Take action on social issues Increase in inter-caste interaction	Women can spend on own needs Able to manage personal finances better Self-confidence and respect Awareness of community issues

* 'before' participation in MFO or group, or at time of baseline. Other figures relate to study results.

client households, on financial services (in terms of access and terms), and on empowerment for women clients.

The study approaches include questionnaire-based surveys only, or a mix of survey questionnaires, focus group discussions and case-studies, or only the last (to capture empowerment issues). All base their assessment of change on recall of 'before' and 'after' joining a programme, except for the SEWA Bank study which has used panel data at two different points in time.

These studies indicate that outreach to the poor among most of the MFOs studied is about 42 to 52 per cent, that is, around half of the sample are categorised as poor when they joined the programme; in two cases 100 per cent are assumed to be poor.

Evidence for reductions in poverty is mixed. Three studies quantify significant shifts from 'poor' to 'non-poor', of 22 per cent in the case of the NABARD study after three years and 38 per cent in the case of SHARE. The SHARE study also differentiates between different categories of the poor, and shows a similar 38 per cent shift from being 'very poor' to 'moderately poor'.

In the case of MYRADA, two studies are available. The survey-based study of 64 groups shows 70 per cent of the sample crossing the poverty line after three years, and 86 per cent crossing in five years. The participatory wealth-ranking of six groups, on the other hand, suggests somewhat differently that 75 per cent of members have improved their status over five years, but have not moved out of poverty.

In the case of BASIX (see Chapter 4), a high proportion of the sample (61 per cent) report an increase in household incomes, and 29 per cent report some increase in employment. However, the magnitude of the increases is not estimated and the study is not conclusive in relation to effects on levels of poverty.

The study of SEWA Bank (see Chapter 3), using panel data over a period of two years (a baseline carried out in 1998 and a follow-up survey in 2000) reports marginal changes in poverty status (of less than 1 per cent). There has been an increase in average real household income of 14 per cent, but this increase is attributed largely to the increase in salaries

of male members of the clients' household rather than to participation in SEWA Bank.

Overall, across all the studies, a significant proportion of clients remain poor, however poverty is defined. This lends credence to the observation of the FWWB study (of four of its partner MFOs) that graduation to an increased and sustainable level of income (poverty reduction) is less likely than micro-finance providing a safety net and thereby helping clients to reduce vulnerability (see Box 10.2 and Chapter 3).

Box 10.2: Clients have diverse credit needs (FWWB, 2001)

Credit needs for activities not related to income-generation are as important as ones with potential for bringing in higher economic returns. Therefore, clients are likely to continue to access loans from multiple sources, through different modes for a wide range of consumption needs. As one elderly respondent put it (ibid.: 75):

When the river is dry one fetches water from several sources and collects in larger containers to use for different purposes. What matters is its judicious use at home for so many tasks, and not who carries it home and from where. Money raised through loans from moneylenders, pawn-brokers, relatives, friends, neighbours, employers or whoever, is like this pooled water which gets used as the needs arise.... correctly used, it quenches your thirst and wrongly used, it spills away.

Enterprise effects are not specifically covered in these studies, but tend to be subsumed within an assessment of changes in household income. However, the SHARE study links evidence for shifts out of poverty to a reduced dependency burden and an increase in productive assets, and these are assumed to result from the micro-finance activities.

The SEWA Bank study, on the other hand, tested hypotheses on increased revenues, fixed assets and employment at the enterprise level, but did not find the links significant: micro-enterprises operated by women generally raised their revenues between rounds of the survey, but the increase was smaller than the rise in household income and was not clearly linked to participation in financial services.

The impact on financial services for the client is seen partly in terms of additionality. Thus the BASIX study reports increased volumes of credit (by up to 24 per cent) to client households with a 4 per cent reduction in the overall cost of credit (based on interest rates), and an increase (20 per cent) in clients accessing formal bank credit.

Other studies found similar results with the NABARD study reporting a 29 per cent increase in bank repayments, and MYRADA having 1,400 groups already linked to banks, and another 2,000 ready to be linked. Two studies (FWWB and SEWA Bank) comment on the continuing indebtedness of MFO clients to informal providers of finance, due to diverse credit needs related not only to productive activity but to a wide range of consumption needs.

Evidence of impact in terms of empowerment indicators comes from four of the studies (for the case of MYRADA see Chapter 5). Changes for clients as individuals are reported in all four in terms of improved self-confidence and mobility contrasting with rural traditions. For example, women say they are now able to sign their names, go to a bank, speak to visitors and government officials, talk in meetings; they can spend on their own needs (health-care, clothing, jewellery) and play an enhanced role in household decision-making. In the case of MYRADA and Activists for Social Alternatives (ASA), there is also evidence of empowerment at the community-level in terms of inter-caste interaction, women taking action on social issues and members being elected to local *panchayats* (village councils).

The SEWA Bank study (which covers urban working women) found little difference between clients and the control group in the survey, but found significant evidence of impact in the detailed case-studies. These tend to reflect the supporting activities of the SEWA union (collective bargaining for increased piece-rates, a scholarship for a daughter, subsidised housing) and also mention appreciation of a secure place to save money ('out of the reach of a gambler husband'). This strongly confirms the integrated strategy that SEWA pursues, as described in Chapters 3 and 6.

Emerging issues

The variations between these studies suggest we need to look more closely at certain issues in order to understand the impact of micro-finance in practice.

A central issue is the question of poverty, in impact assessment no less than in development strategy, which is also reflected in national-level debate in India. How can we understand and measure poverty and poverty reduction? Who are the poor? When does a poor person become non-poor? What about vulnerability? Is the non-poor status sustainable?

The standard methods (income or expenditure measurements) pose a number of methodological problems. Even when incomes are measured, who are the poor? The SEWA study rejected the local poverty line in favour of the World Bank's US\$1 a day as being more 'plausible'.

Participatory wealth-ranking is more interesting, as it reflects local realities, indicators and perceptions, and captures significant aspects of the quality of life apart from income and expenditure. However, whilst capturing relative poverty, it does not necessarily reflect absolute poverty, as in the MYRADA example where all categories are poor.

The SHARE study uses a four-indicator index (sources of income, household-dependency burden, productive assets, and housing quality—all easier and quicker to measure than income or expenditure) with three categories: non-poor, moderately poor and very poor. The category cut-offs are calculated based on a broad relative profiling of a control population, divided into equal thirds as follows: top 33 per cent = 'non-poor', bottom 33 per cent = 'very poor', middle 33 per cent = 'moderately poor' (as in the Consultative Group to Assist the Poorest [CGAP] poverty-assessment tool). This proxy index is a handy tool, but the categories remain relative ones, and the impact may be over-reflected when some of the indicators are effectively direct inputs of the MFO.

A related question is what time-scale is appropriate: how long does it take for change to take place; change that is sustainable? Is the two-year time frame of the SEWA Bank study sufficient to assess impact? Or are even three years

not sufficient to assess sustainable change, as noted in the MYRADA study? At the very least, the impact assessment must include the period clients have been involved with the programme as part of its analysis.

Impact is also linked to organisational performance: how does programme design or micro-finance methodology affect impact? Does a focus on the financial sustainability of an organisation reduce its outreach to poor people and other development impacts? In Chapter 8, Mathew Titus analyses convincingly that the socio-economic context and organisational design and performance have a strong impact on the costs of operations. It is thus highly likely that they will also affect the overall impact of any programme.

Other issues relate to the selection of tools for impact assessment. There is a tendency to assume that quantitative surveys using standardised sampling and statistical techniques are more reliable and rigorous (accurate) but are high-cost and time-consuming, in comparison with qualitative methods that provide more in-depth information more quickly. The challenge is to have a judicious mix of both. Quantitative techniques can provide a useful assessment of scale and patterns. Qualitative techniques are necessary for a deeper understanding of context, processes and issues such as perceptions of poverty, empowerment and client priorities.

Whatever the approach, rigour is important. The reliability and utility of surveys depends on representative sampling with careful analysis and use of data. The same goes for qualitative techniques (focus group discussions and case-studies) which need to be rigorous in terms of selecting participants (i.e., sampling), exploring issues, triangulation, documenting what people say, recording differences and analysing patterns. Similarly, truly participatory processes that involve clients in analysing their own situation and defining their own needs require balance and facilitation.

None of the studies we feature here covered dropouts. There are usually some people who drop out of the programme because it is not useful for them, or because they cannot cope with the demands of the programme. There are also people who graduate, who use micro-financial services and then move on. All are relevant to an assessment of outreach (is it

the poorest who drop out and why have they dropped out?) and impact. Similarly, it would be useful to include case-studies of less successful clients alongside the success stories.

New initiatives

Market research is increasingly seen as a significant aspect of impact assessment. BASIX commissions periodic 'Customer Satisfaction Audits' carried out as a market survey by external consultants. An alternative approach is for staff themselves to explore customer satisfaction through focus group discussions. For example, ASA has used the customer satisfaction tool (one of the Assessing the Impact of Microenterprise Services [AIMS] [2000] tools intended for use by micro-finance practitioners) to obtain detailed feedback on its products (Hishigsuren, 2000). This is an approach that has now been developed in more detail and is being promoted as participatory market-research by Microsave Africa through its training programmes.

The new trend in impact assessment includes an interest in impact monitoring by the practitioner as part of an internal system, implemented by existing staff, that tracks trends over time and is part of the regular information system of the organisation. Examples of such systems come from outside India: the client monitoring system (Jamaica) uses an access database that provides baseline data on health, education and financial status of individual clients at the time of the first loan and at subsequent points thereafter; the monitoring and evaluation system developed by the Small Enterprise Foundation in South Africa is based on regular questions to borrowers by loan officers, complemented by more detailed case-studies and surveys. There are no examples yet of such systems in India, although a few NGOs are experimenting with pictorial diaries used by group members (Chaitanya) and as part of an integrated learning system which is aggregated upwards (ASA again) (Noponen, 2001).

Alongside many interesting on-going initiatives by individual organisations, two wider initiatives have been recently launched in India.

One is Improving Impact of Micro-finance on Poverty (Impact), an action research programme funded by the Ford Foundation. Part of an international three-year project and steered for India by the Institute of Development Studies (IDS) at the University of Sussex in the UK, the aim of this research programme is to improve and develop impact assessment systems, building on the priorities and agendas of micro-finance organisations, and empowering these organisations to be more pro-active in developing their own learning systems, both to inform internal decision-making and to satisfy the requirements of external stakeholders. Three Indian organisations (of about 20 globally), including PRADAN and SHARE are participating in the programme and are being facilitated by resource persons from IDS to think through their objectives in undertaking impact assessment, reviewing alternative tools and methodologies, and applying these effectively within their own management systems. This represents a significant attempt to strengthen practitioner systems for impact assessment in order to improve their impact.

The second initiative is a national impact assessment of the micro-finance support programme of SIDBI's Foundation for Micro-Credit, supported by the Department for International Development (DfID) (UK). This is being carried out by EDA Rural Systems in association with the Institute for Development Policy and Management at Manchester University in the UK. This exercise is a longitudinal study, incorporating a number of features:

- consultations with different levels of stakeholders (practitioners, clients as well as funders) on their objectives and priorities, the impact hypotheses to be explored, and the indicators that are relevant to them (similar to a social or development audit approach);⁶
- a sample drawn from different regions of the country, reflecting different micro-finance models and approaches, levels of organisational sustainability as well as variations in socio-economic context;
- equity analysis drawing on participatory wealth-ranking in all sample areas and comparing local indicators across areas to arrive at a comparable assessment of poverty levels;

- tracking panel data over a seven-year period, with a baseline in the first two years, followed by revisits to the same areas and samples in subsequent years;
- extensive use of focus group discussions with qualitative and participatory methods, carefully documented, to inform and provide depth to a full-scale sample survey;
- involving local staff of MFOs in field-level research, to the extent that MFO resources permit;
- reporting back to all stakeholder levels.

Both these initiatives are in an early 'pre-test' phase. They hold considerable potential for increasing our understanding of the outreach and impact of micro-finance in India, and developing capacity to assess this.

Conclusions

This chapter presents a number of challenges to micro-finance practice in India. While the book has primarily focused on the developmental purposes for which micro-financial services can be used, issues of sustainability and measuring impact cannot be avoided.

The performance in terms of financial sustainability of the rated MFOs in India, likely to be among the better performers, has been relatively weak. Likewise, little systematic analysis of impact, whether on incomes, vulnerability, empowerment, people's organisations, institutional change or any other variables, is available. The limited evidence of impact is also quite mixed, from significantly positive outcomes to almost no change at all.

This does not mean that wider developmental purposes and impacts are not important. It would be foolhardy to suggest that because they cannot be measured easily they should not be a focus of on-going attention. Previous chapters have illustrated many cases of good practice and also positive impacts. In this chapter we have made clear that the earlier reliance on proxy indicators (like outreach and repayment rates) is not sufficient to support good micro-finance practice, with all its potential for such varied impacts. Even

straightforward costs may vary dramatically according to different market contexts (see Chapter 8).

Part of the apparent divergence between the analysis in this chapter and the case-studies in previous chapters is that many of the latter have deliberately been selected to illustrate some of the best practice within India. It is these that can lead the way, that can open up space and possibilities for others to follow, especially when the best-practice organisations have been able to dissolve some of the tensions between developmental purpose and organisational efficiency, for example. As suggested in Chapter 5, for instance, people's organisations cannot be empowering unless they are well managed.

At the same time, this chapter makes very clear that all practitioners, including from among the best-practice organisations, need to enhance their standards of financial and organisational sustainability, and of assessing impact to improve their practice to achieve greater and better impact.

Fortunately, as the micro-finance sector grows in India, so do systems that can help organisations and practitioners in these endeavours. The emergence of a rigorous rating agency, and the launch of two major initiatives, one to strengthen organisational systems for impact, the other a long-term study widely defined to include a range of assessment tools and potential impacts, will significantly enhance understanding and hopefully practice. Results from all these studies over the next few years will provide a wealth of information that will help to deepen the understanding of the reality of micro-finance as a tool for poverty reduction.

Notes

1. The *Microbanking Bulletin* is a CGAP-sponsored six-monthly publication that *inter alia* collates data from MFOs around the world. The *MBB's* sample of more than 100 MFOs contains information that is mostly self-reported by (usually) the better known and more successful MFOs. M-CRIL's information, on the other hand, is obtained from MFOs that have applied for loans, are not necessarily the best ones and, most importantly, have had their data subjected to the close scrutiny and verification that is typical of a rating exercise. The comparisons made between the two sets of averages, therefore, need to

be viewed with caution. The M-CRIL averages may appear significantly worse than the status of MFOs in the South Asian region relative to global micro-finance.

2. This refers specifically to funds deployed by MFOs (and taken on their balance sheets) rather than those managed and rotated internally amongst members of SHGs.
3. Staff, travel and other expenses incurred in MFO operations (excluding financial costs) as a proportion of the average loan portfolio.
4. Portfolio yield minus financial costs (the total cost of funds for the period plus loan-loss provision expenses divided by the average portfolio).
5. Some programmes, however, deliberately concentrate their operations within a confined geographic area. See Chapter 6 for the examples of the Cooperative Development Foundation and the DHAN Foundation, which seek to saturate their areas of operations to enhance the overall impact on the local economy.
6. See www.edarural.com (DA resources).

Chapter 11

Rising to the challenge of scale in India: Growing the micro-finance sector

Mathew Titus

The focus of the book so far has primarily been on micro-finance organisations (MFOs) and various community-based savings and credit groups, which the Indian association Sa-Dhan calls 'community development finance institutions'. It would be extremely optimistic to expect such specialised and community-based intermediaries alone to meet all the demand for micro-savings, credit and insurance.

This draws attention to the particular challenges for increasing outreach in a systematic manner in India. To begin with, it is important to recognise, as the literature on enterprise promotion also suggests, that promoting individual organisations is often not sufficient or effective. Promoting the micro-finance sector, within which a large number and diversity of providers of micro-financial services can flourish, therefore requires a different approach.

The approach requires the active participation of a range of different stakeholders, including regulators, policy-makers, investors, retailers, MFOs, community-based service-providers and their support organisations. Only when all these stakeholders are working effectively for the growth of micro-finance will there be any hope of meeting the pressing need for financial services among the large number of poor people in India.

The contribution of different stakeholders in affecting the success and potential expansion of micro-financial services across different market segments is therefore critical if progress is to be systematic and sustained. This demands

debate on key factors affecting growth, and recognition and encouragement of the roles of different stakeholders.

The demand for micro-financial services

The first step in any mapping of roles is to understand the demand for micro-financial services. The potential demand in India is huge (see Chapter 2 for more details and Mahajan and Nagasri [1999] for the figures quoted here). While banks have provided access to deposit facilities for large numbers of small depositors, total demand is far from being met, especially for more flexible micro-savings. This is clear from the fact that many poor people continue to turn to informal service-providers or financial companies, many of which are unreliable (as illustrated in Chapter 8).

As for credit, credit *usage* among poor households in 1998 was estimated to be almost Rs 50,000 crore (500,000 million) or US\$11 billion. It is clear from the rapid growth of self-help groups (SHGs) and other community-based intermediaries that if credit were more readily available, credit usage would only go up, suggesting that much demand for credit among poor households is also not being met.

The supply of insurance services to poor people is increasing, including low-premium schemes covering death, accidents, natural calamities, loss of assets, etc. However, attributes of these products are often not appropriate (for example, for illiterate clients) and poor people therefore face significant risks in purchasing insurance (see Chapter 8 for illustrations). Moreover, much of the expansion has been driven by government schemes, such as the Integrated Rural Development Programme (IRDP), while crop and livestock insurance are largely unavailable to poor households.

Not only is the total current demand for micro-financial services not being met, but there is likely to be significant additional latent demand. Market imperfections, such as the inability of poor people to assess the reliability and quality of deposit or insurance providers (see Chapter 8 again), and market distortions such as subsidised credit which has negatively influenced both lender and borrower behaviour, mean

that many poor households will not express their demand for micro-financial services until such market imperfections and distortions are overcome or removed.

In addition, demand needs to be enhanced by supporting the growth of micro-producers and community-based organisations that will enhance their need and capacity for absorbing credit, as well as other financial services. While systematic livelihood interventions are still not well understood (Datta et al., 2001), interventions like those of the National Dairy Development Board that has influenced the lives of nine million dairy farmers and of the Bharatiya Agro-Industries Foundation's cattle cross-breeding programme supporting one million livelihoods, can have a significant impact on demand for financial services, whether for credit, (live-stock) insurance, or enhanced savings. Likewise, reviving the cooperative infrastructure throughout India, as CDF and BASIX have started (see Chapters 4 and 6), could also have a huge impact on demand.

It is clear, therefore, that there is no lack of demand for micro-financial services. However, in addition to strategies to meet that demand, market imperfections and distortions need to be overcome and further demand built through systematic livelihood interventions.

The supply of micro-financial services

The total outreach of specialised providers of micro-financial services is estimated to fall well below 1 per cent of credit usage by poor households (Mahajan and Nagasri, 1999). While banks have given a very large number of small loans, the proportion of rural credit usage supplied by the formal sector stood at 56.6 per cent in 1991, and much lower for the poorest households. The latter accessed 58 per cent of their debt from informal sources (see Chapter 2, note 1). Moreover, banks have not delivered effective micro-financial services, but been driven by mandatory targets and subsidies resulting 'in low repayment rates, leading to a vicious cycle of non-availability

and non-repayment' (Mahajan and Nagasri, 1999: 4). The number of small loans they are extending is also falling.

As described in Chapter 7, bank lending to SHGs is increasing, and some 300,000 groups have now taken a bank loan. Mahajan and Nagasri estimate that if the National Bank for Agriculture and Rural Development (NABARD) meets its target of one million SHGs borrowing from banks by 2008, that will absorb at least Rs 5,000 crore (50,000 million) worth of funds, or about 10 per cent of current credit usage. As suggested above, this can only act as a conservative estimate of demand for micro-financial services. Whether even this target is achieved will depend on the cooperation of the increasingly independent and profit-oriented banks in NABARD's 'linkage' programme.

In terms of refinance or other capital available to banks, MFOs and non-governmental organisations (NGOs) for micro-financial services, current outstandings are around Rs 320 crore (3,200 million), of which Rs 250 crore (2,500 million) from NABARD's linkage programme are with banks, and the balance with MFOs and NGOs. Both could expand significantly, with NABARD's programme expanding and SIDBI investing more of its new corpus fund of Rs 200 crore (2,000 million). However, even with such expansion, refinance capital would cover only well under 2 per cent of total current credit usage! Moving outstandings close to meeting even 10 or 20 per cent of the needs of poor households will require something more than just letting operations drift along as they currently exist.

Developing the supply of micro-financial services

Specialised MFOs alone cannot meet the total demand for micro-financial services in India. Instead, a three-track approach is required (Mahajan and Nagasri, 1999) to:

- incentivise existing mainstream financial-service providers;
- encourage new MFOs with a supportive policy and regulatory framework and financial resources to enlarge and expand their services; and

- to build, from the grassroots up, a network of community-based financial intermediaries.

All of these will clearly require better regulation and policy to create the appropriate enabling environment.

Policy

Perhaps the most immediate policy initiative that is required is the transformation of the repayment culture. Any expansion of micro-financial services will need not only appropriate and efficient micro-products on a very large scale, but also customers who are willing to pay the full costs of those services. This will not be easy for politicians and bureaucrats, and the many vested interests, who are addicted to subsidies and targets, rather than developing a genuine market. Moreover, as a result, many bankers have become cynical about lending to poor people because of the low repayments of government-subsidised loans, attitudes that are only just beginning to change with experiences of lending to SHGs. Bankers must therefore also change their attitude towards small loans to poor people, including poor women, from seeing them as a social obligation to treating them as potential business opportunities.

Equally important, policy-makers need to recognise the potential of micro-financial services to support investment and growth in key economic sectors and hence to contribute significantly to national economic growth. It is only such a recognition that will draw the necessary attention, skills and resources to understand, disseminate information and invest in these markets. The rural non-farm sector has the most potential to grow (see Fisher and Mahajan, 1997), especially services which now contribute close to half of India's gross domestic product.¹ However, the non-farm sector cannot thrive if the agricultural sector and rural demand generally, especially among poor people, stagnate.

Policy, however, needs to go much further than just recognising lending for micro-finance as priority-sector lending, to address the ultimate engine driving demand for

micro-credit, which are micro-enterprises themselves. This will require identifying and understanding growth and emergent sub-sectors within the economy, from the national to the local level, and enabling and supporting the entry and growth of micro- and small-entrepreneurs, including those who employ poor people. Finance itself will not provide adequate support for this. For example, beyond a particular scale of operations a micro-business may be more constrained by entrepreneurial ability or the lack of access to non-local markets, which restricts the ability of many borrowers to move to larger loans. Micro-enterprises also face a wide range of policy and economic risks.

Such a strategy will further strengthen the micro-finance sector by generating wider knowledge about the linkages that exist in particular sub-sectors and about critical points at which effective interventions can be made. Such information can then enable a more informed engagement by mainstream financial intermediaries and MFOs.

Regulation

Regulation of micro-financial services is often necessary (Fisher et al., 2001). As Mahajan and Nagasri (1999: 7) argue, regulation

helps in long-term sustainability, even though MFOs may chafe under it in the initial years. The need for regulation and supervision of MFOs arises from several considerations like protecting the interests of small savers, ensuring proper terms of credit, instilling financial discipline and having a proper reporting and supervision system. Regulation and supervision ensure that MFOs are run prudently and cases of poor people losing their money due to fraud or incompetence are minimised.

Significant progress in the regulatory environment for micro-financial services has already been achieved. For example, micro-credit was recognised as a specific strategy in the credit policy announced in 1999, and new organisational forms, like the Local Area Bank (LAB), have been created. Most interest rate ceilings have also been removed.

However, there is still a long way to go. For example, interest-rate ceilings still apply to the smallest loans below Rs 200,000, even though, because of cost structures, interest rates on micro-loans are going to be higher than on larger loans.

All the different micro-finance providers therefore face significant obstacles to developing their services. In terms of banks, in addition to the restrictions on interest rates on small loans, the Regional Rural Banks (RRBs) cannot take any private equity, and the cooperative acts of all states only allow the state government to set up district-level cooperative banks. The result of these laws is that rural credit has been a monopoly of state-owned intermediaries. Private finance 'companies' are not allowed to take deposits, and due to their unincorporated status, they cannot borrow from banks to grow their operations (Mahajan and Nagasri, 1999).

Non-profit MFOs face the following constraints:

- In most states the Registrar of Societies has not recognised micro-finance as a permitted activity for societies.
- The Income Tax Act (Section 2[15]) does not define micro-finance as a charitable activity, so that NGOs engaging in micro-finance risk losing their charitable status.
- The Income Tax Act (Section 11[5]) does not allow NGOs to promote mutual-benefit or commercial MFOs as they are not allowed to invest in equity.
- The Foreign Contribution Regulation Act is ambiguous about receiving funds for micro-finance, whether the foreign funds are used as grants or loans.
- Non-profit MFOs have difficulty in raising deposits without contravening the Reserve Bank of India (RBI) Act.

Moreover, both societies and not-for-profit companies (Section 25 companies) do not recognise their capital. Subsequently, lenders have difficulty assessing the levels to which they should take an exposure to them, the kind of collateral that they must ask for and most importantly, how to assess the soundness of the operations for which the organisations are borrowing funds.

Mutual-benefit MFOs also face significant constraints. To begin with, since 1995 only five states have enacted liberal

acts for mutually-aided cooperatives free of government control (Andhra Pradesh, Bihar, Madhya Pradesh, Jammu and Kashmir and Punjab; see Chapter 6). Even though there are now many savings and credit cooperatives registered under these acts, NABARD does not extend refinance to them, nor has the RBI amended its rules to support such progressive cooperatives. Other mutual benefit structures (such as *nidhis*)² also need to be encouraged.

Commercial MFOs that seek to attract loan and equity funds operate in an uncertain environment, and the RBI needs to create a policy for such commercial entities. Currently they have to register as non-banking finance companies (NBFCs), requiring minimum start-up equity of Rs 2 crore (20 million). The RBI prohibits deposit-taking by NBFCs that do not have ratings by two different rating agencies, both of which must be above investment grade, which obviously takes a significant time to achieve. This makes the NBFC route very difficult for MFOs, unless they can attract foreign equity.

However, not only are there few Indian sources of equity (for example, NABARD is not allowed to make equity investments), taking foreign equity has been fraught with legal and bureaucratic obstacles. Likewise, tax benefits available to housing and infrastructure finance companies, and some to banks (under Sections 10 and 36 of the Income Tax Act), are not available to commercial MFOs.

Even the apex finance institutions are constrained. For example, NABARD cannot refinance any private-sector financial intermediary or any bank lending to SHGs in urban areas, while SIDBI cannot extend loans to the agricultural and allied sectors, even though many members of SHGs are engaged in such activities. And HUDCO is restricted to lending for housing only.

There has been some progress in these areas. For example, non-profit (Section 25) companies were exempted from regulations for NBFCs in January 2000, which was taken further in February 2000 to allow any organisations, of whatever legal form, working with poor people and providing them financial services to access loans, refinance and other capital to on-lend to their clients in whatever way they choose (legal form neutrality, product diversity). Lending for micro-finance was

classified as priority-sector lending at the same time, and foreign equity allowed in August 2000.

Further progress needs to be made, for example, in lifting interest-rate ceilings on all loans, and above all in developing a more enabling environment for savings. Effective micro-savings products are urgently needed to meet the security needs of poor people and to raise adequate capital to lend to them. Most MFOs that offer flexible savings products, as well as banks, have discovered that the pool of savings that can be accumulated from poor micro-savers often exceeds their capacity to absorb credit (see Chapter 3).

However, because of restrictions introduced to curb corrupt finance companies, most MFOs, including those registered as NBFCs, are unable to raise deposits. A regulatory structure allowing degrees of regulation as the number and amounts of deposits grow would be a more appropriate response. A new form of micro-finance company requiring less start-up capital would also help. In either case, MFOs would have to be able to distinguish themselves clearly, not least to their poor clients, from corrupt or inefficient service-providers.

All of these issues relate to the regulation of micro-finance as a whole, which has not yet been resolved in the Indian context (Sa-Dhan, 2001). Should MFOs fall under mainstream regulation, enjoy special regulation under a new chapter in the RBI Act of 1934 (as proposed by the micro-finance task force, NABARD [1999b]) or a new act altogether, regulate themselves, or come under a graduated regulatory framework depending on the scale of their operations? Should MFOs which provide only credit be regulated at all?

A graduated framework might be appropriate to ensure only light regulation on the smallest micro-finance providers, including NGOs, with regulation intensifying as operations expand, requiring conversion to a more appropriate status like a cooperative or company.

The emergence of a large number of SHGs (as described in Chapters 5 and 7 to 9) will also need attention. Many of the SHGs that started 5 to 10 years ago have moved on to enlarge their operations. They are borrowing much more and collecting higher levels of deposits from their members. What are the financial and operational risks emerging within these

groups? And who is responsible for some form of supervision, the promoting NGO, the bank lending to the SHG, any federations of SHGs, or some other body?

As democratic local organisations, members are of course primarily responsible, and the fate of cooperatives should warn officials off seeking to interfere, which will lead to the inevitable stagnation of the movement. However, attention to the performance of SHGs, and on how to protect micro-savers from corrupt promoters, will become an ever more important issue.

Resources

Equally important as the overall policy and regulatory environment are the availability of promotional resources and how the delivery of these is organised. Most of the promotional resources for developing micro-financial services still come from donors, often based abroad. Many domestic sources are restricted to funding state-promoted organisations.

As suggested above, there are also severe restrictions on accessing equity (whether domestic or foreign), key apex financial intermediaries are restricted in what they can refinance, and, because of the overall reputation of NBFCs, micro-finance providers incorporated as NBFCs have significant difficulties in accessing debt finance from banks and other financial intermediaries. Micro-finance, in contrast to other financial services, is also not eligible for tax incentives. Unblocking these many restrictions could significantly enhance the resources available to the sector.

In terms of resources for promotion, NGOs and other agencies promoting SHGs have at best received Rs 25 crore (Rs 250 million or US\$5 million) from domestic resources over the past decade. Compare this to the over US\$150 million of grants and soft loans that the Grameen Bank alone has received, and to the Rs 250 crore (2,500 million) of outstanding loans from banks to SHGs.³

The growth of bank loans to SHGs suggests that, in addition to members' savings, the capital needed for growth of micro-finance in India will be resourced from within the formal financial sector. However, where will the resources for

promoting SHGs and other community-based providers come from? With massive expansion, NGOs and other promoting agencies will also face the challenge of whether to rely entirely on donor grants, or progressively to move towards first identifying (see Chapter 8) and later attempting to cover their own costs.

With massive expansion, the performance of SHGs also becomes ever more critical, especially as many SHGs are being promoted by governments and banks. Ensuring good performance and sustainability across such a vast number of small local organisations is a real challenge, and will require significant resources for support and development.

Likewise, as specialised MFOs grow, whether NGOs, cooperatives or companies, they will require increasing resources not just for capital, but also for organisational and human resource development to ensure they become effective financial and developmental organisations. Such resources will have to come from a range of organisations, including donors, the mainstream financial sector, NGOs and training institutes. The emergence of support organisations like the Andhra Pradesh Mahila Abhivruddhi Society (APMAS) for capacity-building for savings and credit groups is a promising sign of developments here. As the sector grows, the effectiveness of such resources will also have to be assessed.

Even within the formal sector, RRBs have been going through significant change, but investment in organisational development will need to continue if they are to become effective providers of micro-financial services.

A further challenge is that the vast majority of resources are channelled through public agencies, which can be slow, rule-bound and risk-averse. Almost no attempt has been made to build more independent organisations for resourcing and supporting providers of micro-financial services that must emerge if the sector is going to massively expand and develop.

It is even more unfortunate that the provision of these funds has been made to organisations that are ostensibly credit-disbursing organisations. This often dilutes the intensity of the credit contract the lending organisation has with the borrowing organisation and leads to potential conflicts of interest between the management of loan funds on the one

hand and capacity-building funds on the other. Indeed, the patient and slower investments and risks required for developing a wide range of MFOs do not come easily to lenders. Ironically, this strategy among public support agencies mixes credit with other development activities, even though the very same donors and promotional agencies generally encourage MFOs at the retail level to focus more clearly on one or the other.

Capacity and performance of MFOs and community-based intermediaries

Critical to the expansion of micro-financial services is the ability of retail organisations to grow. This however is easier said than done. As this book demonstrates, most agencies are pursuing distinct strategies in developing financial services for poor people. Reinforcing effectiveness and improving efficiencies will therefore require skill in weaving appropriate measures into the diverse fabric of existing operations and innovation.

Developing any new and innovative instruments of support must therefore be based on a systematic understanding of the requirements of the service-providers which incorporates their socio-economic context, their developmental objectives, governance structures, management quality and functional competencies. Such understanding will enable a set of good practices, appropriate to different providers, to emerge. These good practices and their constant improvement can perform a critical function in enhancing effectiveness and efficiency, and provide the basis for instruments and support that can strengthen retail organisations, in terms of both the scale and quality of their services.

Within this broad approach there are areas that require specific attention. Prominent among these is the development of products and services. Evidence emerging from the different interventions presented in this book suggests that overcoming market imperfections and distortions is a difficult and challenging task, as is the appropriate use of resources, both subsidised and commercial. In many cases this has been

achieved through the development of robust methodologies within existing programme designs. Such innovations, with their resulting modifications in product design and pricing, need to be adopted more widely.

This applies equally to the growing understanding of the financial needs of poor people and not least the development impacts of micro-finance on them, an important focus of this book. As Rutherford points out (in Oberdorf, 1999: 88–89), such understanding has rarely led to better product design to enhance the performance and impact of MFOs. It is urgent that this gap between research on needs and impact on the one hand and the technical design of products on the other is closed.

Another critical area is upgrading the skill levels of staff. For example, Chapters 5, 8 and 9 have demonstrated the importance of high-quality staff to promote effective SHGs, and illustrated the wide variations that can exist not just between different NGOs but even within the same NGO.

Any strategy to upgrade skills needs to begin by seeking to understand the quality of human resources the MFOs are currently recruiting, and the quality available to them in the long term. On the basis of such understanding, it is possible to design programmes to upgrade skills that equip staff first with the necessary minimum level of understanding, and thereafter enable them to constantly improve their skills and the effectiveness of the services they provide. Some of the specific skills that require enhancement are the ability to integrate financial-service provision and developmental objectives, to mobilise resources, to identify and manage elements of costs, and to maintain financial discipline.

The challenge here is that, while many micro-finance initiatives have emerged, there are as yet few agreed standards. Some issues are achieving greater clarity. Few practitioners would argue anymore in favour of subsidised credit if it undermines lending and means, for example, that savings and credit groups or cooperatives managed by members themselves cannot achieve sustainability and hence independence from external support. However, the challenge of standards and measurement that adequately address the great diversity of micro-finance practice in India, as we illustrate in this

book, remains. Financial performance can be measured using a range of ratios. However, their meaning can remain contested and means of assessing development impact illusive.

Overcoming these obstacles is important not only for individual retailers, but also for the development of micro-finance markets generally. First, it will enable retailers to adopt good practices from each other. In particular, methodological innovations that reduce costs will enable many more service-providers to enter the market, from mainstream banks to NGOs.

Second, the understanding achieved through these means will also enhance the ability of promotional agencies, of third parties such as auditors, rating agencies and others and not least of regulators to better support and enable the sector through appropriate and effective measures. This is critical to support good practice more widely and enable the expansion of micro-finance markets that is essential if a larger proportion of the many poor people that need them in India is to benefit.

The role of different stakeholders

Table 11.1 summarises and develops this analysis by providing an assessment of the different stakeholders involved in the micro-finance sector in India, their respective actions, and how these help or restrain the healthy growth of the sector. Building on the table I briefly outline the key roles of each stakeholder.

Government

The government is one of the most powerful stakeholders, with overall responsibility for policy and policy instruments. It is clear from the analysis above that there are specific measures that the government needs to introduce.

In broad terms, the government has to withdraw from credit disbursal, whether directly or through the banking system, which has caused severe market distortions. Product design has been wrong, costs have gone up, rent-seeking and

Table 11.1: The role of stakeholders in developing the micro-finance sector

Stakeholder	Action	Constructive	Distortive
Government	<p>(1) Policy priorities: (a) Identifying areas in line with political preferences (b) Monitoring efficiencies</p> <p>(2) Policy instruments (a) Policy measures (b) Resource allocation (c) Incentives such as tax-breaks</p>	<ul style="list-style-type: none"> • Allocating appropriate resources • Defining priorities and increasing allocations • Sharing knowledge and information with other stakeholders 	<ul style="list-style-type: none"> • Only working with government-owned agencies • Expecting diverse competencies from single agencies rather than seeing the need for a wider range of diverse organisations within the sector • Concentrating resources • Piece-meal and reactive policy-making structures • Not focused on markets and demands of poor clients
Regulators	<p>Regulation and supervision, including defining financial and legal forms</p>	<ul style="list-style-type: none"> • Removing distortions (interest rates, etc.) in markets • Increasing acceptance of the diversity of financial intermediaries that is neutral to the model adopted and also allows product diversity • Investments in understanding entities and their assets and liabilities 	<ul style="list-style-type: none"> • Primary reliance on mainstream ideas and primary attention to formal mainstream intermediaries, both of which may not be appropriate to micro-finance organisations • Lack of investment in internal capacity among regulators and supervisors
Apex bodies	<p>Resource flows for</p> <ul style="list-style-type: none"> • public goods • debt • equity 	<ul style="list-style-type: none"> • Sharpening organisational competences. Develop skill-sets to match objective of instruments and resources (e.g., through bank linkage programme) 	<ul style="list-style-type: none"> • Conflict of interest between different resource functions, such as lending, capacity-building and supervisory functions

Banks	Providing debt and equity	<ul style="list-style-type: none"> • Monitoring and improving asset quality • Improving service quality and costs • Potentially taking up equity positions 	<ul style="list-style-type: none"> • Many of the same distortive characteristics that apply to government also apply to the publicly owned apex bodies • Only understand collateral-based debt appraisal • May view lending to micro-enterprises as an obligation rather than business opportunity
Donors	Resource flows for <ul style="list-style-type: none"> • public goods • debt • equity 	<ul style="list-style-type: none"> • Increasing flows to appropriate bodies and intermediaries • Resources for specialisation 	<ul style="list-style-type: none"> • Limited instruments for interventions • Concentrating both loan and development funding in the same organisations • Limited allocation of resources for learning-by-doing
MFOs, community-based service-providers	Service provision	<ul style="list-style-type: none"> • Innovative and risk-taking • Focus on expansion, targeting, experimentation, etc., with client-group • Building of skills and products to suit client-group 	<ul style="list-style-type: none"> • Weak MIS and monitoring • Limited learning from operations and peers • Inadequate attention to micro-enterprise demand and to demand constraints
Support (third party) organisations	Bridging different experiences; Audit and data verification, rating; Organisation and human resource development; Evaluation, impact assessment; etc.	<ul style="list-style-type: none"> • Verifying information and data • Establishing quality benchmarks • Investing in research and refinement 	<ul style="list-style-type: none"> • Limited specialisation • Inappropriate application of tools and methods

corruption have become widespread, and bankers have become cynical about lending to poor people. The government needs to establish an enabling environment for a diverse range of providers, not deliver credit itself.

Second, the government needs to give the micro-finance sector greater attention, in particular seeing its potential to support poverty alleviation, economic development and even local democracy, but not in the traditional interventionist and controlling way. It needs to free up the regulatory environment, for example ensuring many more states adopt liberal cooperative laws. It also needs to understand the diversity of service-providers, and hence avoid simplistic and standardised solutions.

Attention to micro-financial services must be part of a wider policy engagement with poverty alleviation and, as I suggested above, with micro-enterprise, including a deep understanding of their role in providing livelihoods and contributing to national economic development.

In terms of resources targeted at the micro-finance sector, these are required not only for strengthening existing providers, whether MFOs or their support organisations, but also, if massive expansion is to be achievable, for promoting many new ones.

Critical for such an endeavour is the better allocation of resources, in particular moving significant resources from public sector entities, that are sitting on huge resources for capacity-building, to effective service-deliverers and their promoters in the private, non-profit or community sectors, whether banks, specialised MFOs, cooperatives, NGOs or SHGs. Developing a strong tier of support organisations will be critical. Allocation of resources can be done through budgetary allocations as well as incentives, for example through the tax system.

Changing or clarifying tax laws is in fact critical. For example, NGOs must have the confidence that micro-financial services are regarded as charitable if they are going to expand their operations beyond being mere financial service boutiques. The tax laws must not undermine the building of reserves and other provisions to contribute to financial strength.

Regulators

The Reserve Bank of India and NABARD have both worked on developing a more favourable regulatory environment for micro-finance (NABARD, 1999b). However, much change is still needed. Choices on how best to regulate providers of micro-financial services need to be taken, which do not hamper the development of existing providers or the entry of new ones, but do protect poor savers in particular. Such regulation must recognise the need for a great diversity of service-providers if the sector is to have any chance of meeting the huge demand for micro-financial services among poor people.

Equally important, the micro-finance sector continues to be buffeted by regulatory changes introduced to address the needs of the mainstream financial sector, but that do not take their impact on MFOs into consideration. This needs to change. Regulation must be developed based on a clear understanding of micro-finance providers, their diverse developmental goals, legal and governance structures, management capacities, clients, activities and future growth plans. Only then will regulation not only provide the necessary protection for clients but also actively contribute to the development of the sector that provides an essential service to them.

The focus of regulation must therefore be on the soundness of the diverse range of MFOs, rather than trying to accommodate them into existing regulatory provisions that may not be appropriate. The key principles underlying such regulation must be:

- maintaining the interests of clients;
- making a range of services available;
- creating a stable image for the sector that can provide confidence to clients;
- providing access to investment funds and refinance;
- increasing the capacity and performance of service-providers;
- supporting their sustainability in the broadest sense set out above;
- pre-empting any repressive action by politicians, bureaucrats or regulators.

One further essential regulatory change, controlled by the government rather than the Reserve Bank, is to facilitate the flow of investments in micro-finance from abroad, which are more readily available and at cheaper cost. A new scheme, possibly called 'External Developmental Borrowings (EDB)', could be established on the lines of the External Commercial Borrowings (ECB) scheme.

Apex financial institutions

Apex financial bodies need to perform a range of specialised functions, including lending (debt), providing technical services, providing capacity-building inputs as well as playing supervisory roles. The key point to emphasise is that these are all specialised functions in their own right, often requiring highly specialised skills. It is inappropriate to mix them within one agency, which tends to create tensions and conflicts. Sound lending requires a very different approach from effective capacity-building, for example.

Unfortunately, policy-makers and donors have tended to prefer a small number of apex bodies to interact with and support, saddling them with a wide range of objectives and functions, which makes it challenging for them to deliver these objectives and functions effectively, however laudable they may be.

Apex bodies also have an important role in building up relevant knowledge. Analysis of their portfolios, for example, would yield very useful information and insights into performance among MFOs, which, if shared, could assist in building the sector as a whole.

Banks and other mainstream intermediaries

The banking sector to date has done a commendable job in the bank-SHG linkage programme. The total number of SHGs that have received loans from banks exceeds 300,000. The programme involves over 300 banks and 1,000 NGOs, and cumulative loans from the banking system exceed Rs 500 crore (Rs 5,000 million or some US\$95 million) (see Chapter 7).

It is important therefore that, as this programme expands rapidly, the linkage mechanism improves. Some new efforts are emerging, such as internal appraisal tools that can help bankers differentiate the good from the bad. New and innovative instruments for lending and support are also emerging, for example, bulk lending through federations and marketing support. What is still lacking is the emergence of more equity-based products. In addition, the challenge of expanding such activities to a very different scale of operations remains, as does the need to understand the enterprises poor people invest in and that ultimately determine the soundness of the emerging portfolio. Such information and learning-by-doing can contribute dramatically to enhancing the quality and the scale of the overall linkage programme.

It would be wrong, however, to suggest that the role of banks is limited to loans to SHGs. Self-help groups can only address a distinct segment of the market, and are not appropriate, for example, to larger micro- and small-enterprise lending. Likewise, the analysis in Chapter 10 suggested that SHGs encourage only limited savings, well below the savings capacity of many poor people. Ultimately, if the demand for micro-financial services—savings, credit and insurance—is to be met more than marginally, the mainstream financial sector will have to engage much more extensively in providing such services.

It is therefore essential that banks develop more appropriate and flexible savings products and a far greater range of loan products that can meet the diverse needs of poor people. These could be delivered directly or in collaboration with specialised MFOs. Likewise, insurance companies need to develop services that not only incorporate appropriate products but also ensure their delivery is intelligible and secure for poor people, even those who are illiterate, for example.

The case of Bank Rakyat Indonesia (BRI) suggests that it is possible for mainstream financial intermediaries to develop such services as part of their commercial operations. It is critical therefore that the mainstream financial sector understands the business opportunities in micro-financial services.

Donors

Donors play a critical role in providing resources, and are in some cases better able to take on the risks of supporting innovation in pursuit of their developmental objectives. Most donors also recognise the diversity of stakeholders (regulators, policy-makers, bankers, NGOs, etc.) and their needs that require attention if markets for micro-finance are to develop. Their contribution in calling attention to the need for developing the competencies of different stakeholders is therefore significant.

However, translating this understanding into a viable strategy for their own interventions has proved more challenging. Any large funds are usually placed with public-sector organisations, and often require such organisations to take on multiple roles that may conflict with each other. For example, enabling the same agency to both lend and provide capacity-building inputs to MFOs can lead to serious conflicts in their strategies and operations. Donors need to develop a greater diversity of investment channels for their funds, as well as a range of non-financial interventions, that are in tune with their understanding of the organisational diversity and complexity among the sector's many different stakeholders.

Donors, who are accustomed to give grants, also urgently need to develop more alternative mechanisms to provide debt and equity support, like the programme-related investments of the Ford Foundation. The Government of India should encourage such alternative mechanisms as a valuable source of capital.

Retail providers of micro-financial services

As outlined in Chapter 2, there are three different types of specialised retailers outside of the mainstream financial sector:

- Not-for-profit MFOs such as societies and trusts (legal forms of NGOs) that lend to borrowers, usually organised into groups (SHGs or Grameen-style).
- Mutual-benefit MFOs, especially cooperatives; a few urban cooperative banks like SEWA Bank and a growing number

of mutually-aided cooperative societies (MACS) under the new cooperative acts.

- For-profit MFOs incorporated as non-banking financial companies such as BASIX and SHARE Micro-finance Limited.

In each of these categories MFOs need to grow and enhance the quality of their services. The data on the bank-SHG linkage programme suggests that there are at least a thousand small and large NGOs involved in the promotion of SHGs. The quality of their work varies significantly, as evidence from this book shows. The need to enhance the promotional capacities of these NGOs is therefore urgent if the SHG movement is to grow, and above all if SHGs are to provide high-quality services and sustain them effectively into the future.

In addition, some of the NGOs are not just linking SHGs to banks but also providing them credit directly. Such credit is drawn from a variety of sources, mostly government bodies and banks. This requires a very different range of skills, not least for managing their own financial-service operations, which many of these NGOs do not currently have, as the evidence from Chapter 10 makes very clear.

It is important that the emphasis on meeting the demands of poor clients does not cloud understanding of the need to build not just SHGs but also the NGOs that promote and support them.

Mutual-benefit MFOs are expanding rapidly, especially under the new mutually-aided cooperative acts. However, there is a long history of cooperatives being undermined by external entities. These MFOs will therefore have to build their internal capacities to withstand such interference and take on the full responsibilities that come with owning and managing one's own organisation. At the time of writing, urban cooperative banks were facing major challenges, so for the time-being they are unlikely to serve as an effective avenue for the expansion of micro-financial services.

Finally, there are still very few for-profit MFOs registered as NBFCs and only one LAB committed to micro-finance. Finding effective ways of expanding this segment is therefore a priority.

For all categories, the need to develop standards is essential, as has begun to happen through the association of MFOs, Sa-Dhan.

Support organisations

Support organisations are central to the performance of the sector. There are a range of them, such as auditors, consultancies, rating agencies, providers of technical services, organisation development experts, etc. One of their key contributions is to intermediate in the demand for information and skills.

For retail agencies, they provide a road map, set standards, draw attention to difficulties, highlight opportunities and contribute to enhancing their operational abilities. For investors, they demystify operations, translate them into categories that make sense, thereby enabling investments. For regulators, they provide essential market information, not least on financial performance, and signal dangers. In performing these tasks, they can provide independent assessments that provide the crucial affirmation to information supplied by the retail providers themselves.

The main challenge is their limited numbers. As in the case of apex bodies, such a shortage can give rise to the concentration of too many resources and too many different functions in a few organisations, and some functions can conflict with each other. Far too little attention has been paid to such organisations and to initiatives to help them improve and expand their skills and services. Most of these organisations will also be in the private sector, not the public sector, making it more difficult for them to attract development resources while the sector is still emerging.

For all the stakeholders set out above, gathering and sharing market information is critical. This responsibility falls to the government, the mainstream financial intermediaries, including at the apex level, the MFOs (especially through their association) and the support organisations that are often well placed to process the information (see, for example, the analysis provided in Chapter 10). Without sound market information, the sector will not be able to grow effectively.

Conclusion

This chapter argues that the optimum expansion of the market for micro-financial services can only come about as a result of active participation by all the relevant stakeholders. It suggests that there are roles different agencies must play, for example, in overcoming information asymmetries, strengthening organisations at the retail level, and increasing the flow of resources, both for capital and organisation development.

Much progress has already been made. As the sector has shifted from its nascent to its growing phase, mainstream financial intermediaries have become more engaged, an association has emerged, supporting organisations are coming up for training, capacity-building and rating, for example, and discussions on performance standards are under way.

While there is increasing support for developing the micro-finance sector in this way, there is also a dangerous trend of concentrating or appropriating too many roles around a few lead agencies. Building or improving the institutional efficiency of all stakeholders, including regulators, policy-makers and retailers as well as support agencies in the private sector, is a necessary and concomitant task that is not attracting sufficient attention and resources.

The opportunity provided by such an approach is of course that the impact can extend across all providers of micro-financial services, whether banks and other mainstream financial intermediaries, specialised MFOs or community-based financial intermediaries. Only such a three-pronged strategy has any chance of making progress in meeting the vast need for micro-financial services among poor people in India.

Such a sectoral strategy needs to balance the need for greater standardisation to ensure significant impact, replication and projection with the need to ensure diversity to meet a wide range of needs and engage a wide range of creative energies of social entrepreneurs.

As this book demonstrates very clearly, the need for diversity extends well beyond the diversity of particular models, systems and technologies. Perhaps two factors stand out in

particular: the diversity in socio-economic environments and the diversity of developmental missions espoused by different MFOs. For example, it makes little sense to assess the performance of MFOs according to the ratio of their staff to clients, if the number of staff needed varies significantly according to literacy levels among clients.

This also suggests that the overall design of a sectoral strategy must be informed by the development of an effective market, for which interventions on the demand side are as important as supply-side measures. Appropriate policy and support for livelihoods, micro-enterprises and community-based organisations are therefore as important as resourcing the suppliers of financial services.

Notes

1. As reported in *The Economic Times*, Hyderabad, 27 November 2001.
2. *Nidhis* are mutual-benefit societies, incorporated under an act of 1913 that allowed neighbours to save money and secure loans at favourable rates of interest, made up of poor and middle-class people. They are now incorporated under Section 620a of the new Companies Act.
3. These comparisons are instructive. In spite of receiving far fewer resources, the membership of SHGs is expanding very rapidly. In Chapter 7, Malcolm Harper estimates that, in one year alone (2000-2001), the SHGs that took their first loan from a bank had almost as many members (2.5 million) as the Grameen Bank (3 million +).

Chapter 12

Emerging lessons and challenges

Thomas Fisher

In this concluding chapter, I look at 10 lessons and challenges that emerge from our analysis. I begin with the following five: micro-financial services must be used as an instrument of development; those services must be adapted to their context; non-governmental organisations (NGOs) have a distinct role to play; practitioners and supporting agencies must learn to deal with wider systems; and, building on the last point, the fast emerging savings and credit groups in India make up a system that urgently requires system-wide attention. I deal with each of these in turn in the first half of this chapter. In the second half, I take up five additional challenges of capacity-building, a topic that has often failed to attract sufficient reflective analysis.

Five lessons

At the broadest level, this book suggests that micro-financial services must be integrated into wider strategies and systems. It shows that this can be done effectively in practice to meet the diverse needs of poor people, integrating micro-financial services into broader strategies to achieve developmental outcomes, into existing local markets, into the existing institutional and infrastructural context. Integration is a key concept that underlies many of the specific points I take up below.

It is not a coincidence that the provision of micro-financial services raises such issues. On the one hand, micro-financial services are a 'hard' technical and economic instrument, which brings to the fore tensions with 'softer' developmental

goals. On the other hand, underlying the provision of all financial services, more than any other economic activity, is the need for trust or social capital. 'Credit' after all means 'trust'. Without trust, no financial intermediation would take place. This recognition has been built into the extensive use of groups in micro-financial services, and in the concept of social intermediation explored in Chapter 5.

This book pushes the door opened by the need for trust much further to incorporate a broader range and depth of 'softer' developmental goals. For example, trust or social capital is as important for democratic organisation as for the delivery of financial services. By combining the two, trust developed through the former can help support the latter, and *vice versa*. The analysis in Chapter 5 in fact may reverse the logic of social intermediation. Rather than using social intermediation to prepare for the delivery of financial services, organising poor people around a concrete activity like financial intermediation enables them to build social capital. This leads into my first and most important lesson.

*1. Micro-financial services are a means
or instrument of development,
not an end in themselves*

With the growth of an international micro-finance industry with access to significant resources, and with the attraction of a technical 'solution' or 'fix', micro-finance can all too easily become an end in itself. However, micro-finance by itself is only developmental inasmuch as many poor people clearly need access to financial services through effective financial intermediation. If realistic within a given context, an effective banking system is by far the best way of achieving this developmental end, as has happened to a large extent in Indonesia, for example.

To achieve any other developmental goals through micro-finance, whether enhancing social and economic security, promoting livelihoods, reviving local economies, empowering women and poor people, building democratic organisations or bringing about wider institutional change, micro-finance has to be seen as an instrument within wider strategies. For

example, as both the Cooperative Development Foundation and MYRADA argue, it is the management of financial services, not the financial services themselves, that is empowering. To be empowering in this way, any promotional strategy must incorporate capacity-building inputs to ensure effective ownership, governance and management by poor people of democratic organisations that provide micro-financial services (Chapter 5).

Likewise, Chapters 3 and 4 have shown that micro-financial services can do little in themselves to promote poor people's livelihoods. For this they must be integrated as instruments within wider livelihood strategies. Ironically, the micro-finance industry grew out of wider development efforts to promote enterprises in particular, but the seduction of an easy technical fix that micro-finance provides has meant that practitioners have often lost sight of those wider strategies. As Dichter (2001: 8, 22–23) comments:

For the magic of micro-finance, with its promise to be self-financing while building economic capacity from the grassroots up, is far more seductive than the complex and more conceptually abstract realm of sub-sector analysis, rural infrastructure revitalisation, and technical support to enterprises.... As difficult as micro-finance is, it is not really rocket science and certainly not much an art. If the half dozen or so professional quality micro-finance manuals produced in the last 10 years were all to be followed carefully, many more good micro-finance organisations would now exist. The techniques of micro-finance can be learned, and imitated. In contrast the kind of work BASIX has pioneered in the enterprise development sphere and its continuing experimentation to find the best way of integrating financial services and sector-based enterprise development represents more of an art.

As soon as we entertain the potential instrumentality of micro-finance to meet a wide range of developmental goals, the situation becomes complex. Development after all is complex. It is perhaps not surprising that the leading Indian economist,

Amartya Sen, has deeply challenged existing economic frameworks with their emphasis on income, growth, utility and efficiency (ODI, 2001). How easily the micro-finance industry often slips into such a narrow paradigm. However, Sen draws attention to individual entitlements, capabilities, freedoms and rights as key to economic development.

For example, given income disparities within India, it is unlikely that the economic growth that India is experiencing will by itself enhance the economic security of many of the 400 million poor people in India, unless they can gain entitlements to share in the benefits of such growth. Sen argues that civil and political rights can reduce the risk of major social and economic disasters and thereby significantly enhance poor people's security. Even the World Bank's *World Development Report* for 2000–01 acknowledges 'that poverty is more than inadequate income and human development—it is also vulnerability and lack of voice, power and representation' (ODI, 2001: 2).

To what extent does micro-finance contribute to these wider issues of entitlements, rights, voice, representation, power? An initial response might be to suggest not loading micro-finance with developmental goals that it cannot hope to address. This is perhaps the greatest danger of the approach taken in this book, that MFOs seek to take on a range of different developmental goals, achieving none of them well, rather than focusing strategically on one or two.

However, evidence suggests that, used strategically and in a focused manner, micro-finance can contribute to these wider goals. We have seen in Chapters 5 and 9 how the provision of micro-financial services can be designed in practice to build democratic people's organisations that give women, in particular, greater voice and representation, and in Chapter 6 how micro-financial services can be integrated into coherent strategies to enhance the entitlements and rights of poor producers.

Design inputs required for such interventions, however, go well beyond the efficient delivery of financial services. The key design challenge is integrating financial services within those broader strategies. Again, practice reviewed in this book suggests that this need not be a matter of coupling together disparate objectives and techniques. It is possible to integrate

them into a coherent whole. For example, as suggested above, it is managing financial services well that is empowering. Designing the efficient delivery of micro-financial services can therefore contribute as much to empowerment agendas as to service-provision itself.

2. Adapt the provision of micro-finance to its context

Designing developmental micro-financial services cannot be done without proper attention and adaptation to the environment in which those services will operate; there cannot be a design blueprint to suit every condition. The analysis in this book has made this abundantly clear by reviewing a wide range of different methods for providing micro-financial services already in practice in India, from informal local groups to banks. Here I draw attention to five specific points.

First, any micro-finance interventions need to fit the overall institutional context (Chapter 7). This can apply to cultural and political factors, such as the strong commitment in India to democratic organisation and decentralisation, to diversity and personal independence, which may make the self-help group (SHG) design, rather than Grameen Bank-style groups, particularly appropriate in the Indian context. It also applies to the existence of formal infrastructure that can be tapped, in particular the huge network of bank branches (see further below).

Second, potential micro-finance clients already have access to a range of financial services, both formal and informal. It is not just that any new micro-financial services need to take account of existing provision, and the impact the new services are likely to have on the existing market. The experience of those markets will also deeply influence the willingness of potential clients to engage in any new services, and the way in which they participate. The design of any new services therefore has to take the previous experience of potential clients, and the behavioural patterns that are likely to arise from such experience, into account.¹ These factors may also have a significant impact on the cost of developing micro-financial services (Chapter 8).

Third, it is important to understand the local community. Indian communities are often deeply divided into groups by caste, religion and opinion, and economic power rests with the most powerful groups. Targeting the provision of micro-financial services at the poorer and more disadvantaged groups, as many NGOs in particular do, may therefore be appropriate in many contexts.

However, it should not be assumed that this is always the best strategy. Evidence in this book has shown that SHGs can bring together different groups among the poor and benefit all of them, and that some savings and credit cooperatives have brought together members from across the whole community, from poor to rich, for mutual benefit (Chapter 5). Within a political context that is ever ready to divide one group from another, such interventions may be particularly appropriate in building local democracy.

Fourth, it is equally important to understand the local economy. This goes beyond a deep understanding of local financial markets to embrace other features of the local economy. For example, given the choice, most poor people prefer wage-employment to the risks of self-employment. Supporting small enterprises that can provide wage-employment, even though most will not be managed by poor people, may therefore be an important strategy (Chapter 4).

Likewise, if designed correctly, micro-financial services can have a wider impact on the local economy that benefits almost all economic actors. The Mulkanoor cooperative, providing both agricultural and financial services from which all farmers in the village benefit, has been able to raise purchasing power across the community, which has led to demand for other goods and services provided locally. Strategies that seek to saturate a local economy with micro-financial services are more likely to have these second-order effects (Chapter 6).

Greater understanding of how micro-financial services can impact money-flows and economic activities within the local economy as a whole is thus urgently required.

Finally, mapping the existing community and economy, the provision of financial services and the institutional environment, also provides the baseline information needed to assess impacts on development processes, which I address further below.

3. NGOs have a distinct role to play

Much micro-finance practice was developed by NGOs. However, with the increasing critiques of NGOs in development, not least of their effectiveness, management and efficiency, they have often come to be more tolerated than admired. This is particularly the case within the micro-finance sector, where many doubt the ability of NGOs to manage the provision of micro-financial services, and alternative organisational structures like financial companies and banks are regarded as preferable.

[NGOs] themselves are losing their sense of self and are beginning to see themselves through the criteria of other sectors and organisational forms. The exhortations to 'go to scale', to deliver according to the needs of government, to become profitable—or at least financially self-sustaining—all take their toll. And judged according to these criteria, [NGOs] are found wanting, relegated to the status of bit-players, cast in the mould of naïve and irrelevant youth disturbing the serious and 'real-world' concerns of adults (CDRA, 1996: 9).

It is time to recognise the distinct role of NGOs in micro-finance, rather than forcing them to become what they are not, to emulate the practices of other organisational forms that they will never be able to match. As the Community Development Resource Association (CDRA, 1996: 9) in South Africa puts it, NGOs 'are something more than merely inadequate enterprises or small-scale delivery-vehicles'.

First, in line with the dominant perspective on NGOs, they can provide a useful transitional organisational form that is more flexible than companies or banks. Even BASIX, with its strong commitment to becoming commercially viable and attracting mainstream resources, first developed its portfolio through the non-profit company within the group. The innovation required, the potential losses that might be incurred, and the ability to attract grant and low-cost capital would have been constrained by the legal form of a for-profit company.

Second, in strategies which focus on maintaining the delivery of high-quality micro-financial services in a local area

(rather than going to scale through geographic expansion), some legal form of NGO may be more appropriate, especially if the governance of the NGO can be rooted in the local context.

The governance issue may be more appropriately addressed through mutual ownership at the local level, although it is precisely here that the role of the NGO often becomes so important. The third area where NGOs often enjoy a comparative advantage is therefore in facilitating the emergence and performance of community-based financial organisations such as SHGs and savings and credit cooperatives, the fastest growing part of the micro-finance sector in India. Banks are much more likely to treat SHGs as efficient delivery channels for their loans, a strategy that often fails to deliver many of the potential empowerment impacts that such groups can bring (see Chapter 5). Non-governmental organisations still need to enhance their understanding and skills in finance for playing this role within the micro-finance sector, but the centrality of their value-base, for example of democracy, inclusivity, empowerment, equity and justice, is often conducive to facilitating developmental groups at the community level.

Fourth, the values that NGOs bring to the table should be used as a resource, rather than seeing them only as a hindrance to hard-nosed financial-service delivery. As Mathew Titus illustrates in Chapter 8, a cooperative group ideology facilitated by NGO promoters may prove a highly effective and efficient mechanism to spot violations in financial contracts which could not be detected through other mechanisms given the low computational skills of members. Indeed, financial markets can be severely constrained by inadequate computational skills, and developing literacy and education may therefore be as important to the widespread development of financial services for poor people as to addressing other human needs of theirs. Here again, NGOs are likely to play an important role.

Finally, as analysis in Chapter 6 revealed, NGOs like the Cooperative Development Foundation (CDF) and other non-commercial legal forms like the Self-employed Women's Association (SEWA) union can prove highly effective in creating

a more conducive environment for micro-financial services and their developmental impacts through effective advocacy and other interventions in wider systems and institutions that influence the micro-finance sector.

4. Deal with systems

The need to go beyond individual organisations to systems has in fact become apparent over and over again in this book. For the foreseeable future most MFOs are going to remain very small relative to the wider systems in which they operate. To achieve greater developmental impacts therefore they will have to work out how to influence those wider systems.

In Chapter 6, we explored the strategy of three MFOs to do just this, and noted their ability to conceive of the challenges on a large enough scale, but to locate their work on the ground where the challenges are actually faced, and then to connect their work to wider systems through the strategic use of linkages. In Chapter 11, we also explored the micro-finance sector as a wider system and how each stakeholder group has a distinct and vital role to play if the sector as a whole is to grow.

However, there are many other examples of systems in which MFOs need to intervene.

Micro-finance organisations can influence local markets. For example, if they can capture enough of the local market for credit they may be able to influence the interest rates and policies of other financial-service providers, including moneylenders. Likewise, as I have already mentioned, if they saturate a local economy with micro-financial services, they may be able to enhance purchasing power generally within the local economy.

Micro-finance organisations can also seek to influence economic sub-sectors in order to have a far greater impact on livelihoods than would be possible through the support of individual micro-enterprises alone. Intervening strategically at points of leverage in sub-sectors is a well developed analytical framework (see Datta et al., 2001; USAID, 1987). Chapter 4 also points to the potential to revive rural

infrastructure and organisations that can have a dramatic impact on livelihoods, in part because the costs of creating such infrastructure have already been sunk.

Within the Indian context, the banking infrastructure, including the extensive network of rural branches, is also a large system which has huge resources that could be put to good use in micro-finance. The rapidly expanding 'linkage' programme to get banks to lend to SHGs is particularly exciting (Chapter 7). It not only provides a mechanism for bankers to engage with micro-finance that suits their capacities and incentives, but it is also transforming the way bankers see poor and women borrowers, undoing the damage done by past use of the banking system as a channel for directed and highly subsidised lending. Building systematically on these linkages, and on the new understanding gained by bankers, could lead to huge additional opportunities in the future for the banking system to better serve the needs of poor clients.

In Chapter 5, we also saw that the systems of local democratic governance within India may provide opportunities for achieving developmental goals through micro-finance, by providing a channel for women who have become more empowered through participating in savings and credit groups to achieve greater voice and representation.

All of these examples, therefore, provide cases of wider systems in which micro-financial services can operate, and have wider impacts, if micro-finance practitioners and organisations can find effective ways of connecting their micro-finance operations to influence those systems.

5. Deal with savings and credit groups as a system

The rapid expansion of the SHG movement, as well as of savings and credit cooperatives, is itself becoming a system that urgently needs attention at the system-level, not just at the level of individual groups and loans from their local bank branch. Otherwise they are likely to go the way of credit unions in Latin America (if not necessarily elsewhere):

The original idea behind credit unions was that each one would be a little, self-contained financial [organisation],

and there'd be hundreds of them across a country. But what they found was that the skill development required to do that was so great that they're now promoting the idea of having a few large, strong credit unions that can afford professional management. The lesson is that it's not efficient to have a lot of little, tiny micro-finance [organisations] (Elizabeth Rhyne in Oberdorf, 1999: 32–33).

In India there are already far more than hundreds of tiny savings and credit groups. Self-help groups are of course somewhat different from credit unions, smaller, less structured and more adaptable according to their members' wishes. The savings and credit cooperatives, however, are basically credit unions and have, at least in the case of CDF, performed well. Nevertheless the challenge that Rhyne throws out is still valid to the Indian context of savings and credit groups.

A broad and enabling regulatory and policy framework is already in place, not least through NABARD's linkage programme for SHGs. At least five states have adopted acts for mutually-aided cooperatives free from government interference. Many NGOs are also engaged in the promotion of SHGs and, to some extent, savings and credit cooperatives. Unfortunately, however, this is far from sufficient for the healthy growth of such groups as a system.

As we have seen in Chapters 7 to 9, SHGs in particular can be very fragile organisations, and can easily be captured, both internally by powerful members, and externally by politicians and bureaucrats. The latter is already a clear threat in the state of Andhra Pradesh, where political and government involvement with SHGs is extensive.

The primary strategy to address this threat is perhaps the creation of associations or federations of SHGs, although there is no consensus among NGOs on what mix of roles such higher-tier organisations should play. Indeed, while they provide strength in numbers to individual SHGs, they also make capture of the whole tiered structure all the more attractive to external parties. Bankers must also be mobilised. They have an incentive to protect their loan portfolio and know all too well from long experience how damaging political interference can be on their clients' repayment performance.

Finding effective ways to ensure the performance and quality of the savings and credit groups is an urgent need. Issues extend well beyond the financial performance of such groups to developing effective ownership and management and ensuring that inputs provided by external parties do not jeopardise the autonomy of the groups by making them dependent on external support. Building the groups' capacities both to perform their tasks (financial services, interactions with external bodies such as banks, etc.) and to maintain effective group processes and dynamics are equally important if the groups are to grow and to empower their members (see Chapter 9).

The emergence of a dedicated non-profit capacity-building organisation in Andhra Pradesh (Chapter 6) is a step in the right direction, as are the associations and federations that can also play a significant role in capacity-building and providing supportive services, such as internal auditing. However, the number of SHGs in particular has already grown well beyond the capacity of such organisations and NGOs to support, and strategies to address this gap are urgently needed. The development of organisations that can support the primary groups is therefore as important at this stage as the promotion of the primary groups themselves.

A key part of this challenge is how to spread innovation and good practice within the system. As we saw in Chapter 8, much innovation is happening on the ground within individual SHGs, but there are few mechanisms in place to spread such innovation even within the operations of a single promoting organisation! Likewise, NGOs are experimenting with effective promotional strategies, pursuing both intensive strategies to ensure the highest quality (see Chapter 5) as well as the most cost-effective strategies (see Box 4.1 and Chapter 9). However, there are few mechanisms for other organisations to learn from such experiments that are adequate to the scale of the challenge that one million potential groups present.

The same applies also to the role of the banks, where apex bodies are not particularly effective at sharing best practice emerging within the banking sector, although it is clearly their role to do this. At least the linkage programme is also providing opportunities for the most experienced promoters from NGOs to deliver training to a large number of bankers.

If the movement of SHGs and cooperatives is to achieve its true potential for delivering micro-financial services to a large number of poor women (at least 17 million is the current target), and for empowering them in the process, then system-wide mechanisms, whether for sharing innovation and good practice, for providing support services, for protecting SHGs from external interference, or any other function, will need to be addressed. In building on a fast and in some cases self-expanding movement, in other words on existing and growing organisational infrastructure, such inputs are likely to be a good investment, even though it is challenging to reach so many small groups.

Five challenges of organisation and capacity-building

A review for the Ford Foundation on the scale, scope and impact of community development finance in the United States and micro-finance in developing countries concluded (Miller and Andrews, 1998: 19):

The authors do not believe a shortage of capital is the biggest constraint facing the [community development finance] field. We suggest that while the growth of [community development finance organisations] has been solid, especially in developing countries, the field is not seeing the formation and maturation of as many [organisations] as are warranted by what has been achieved. This is a very big question to which we do not yet have good answers.

This rings true, both in India and internationally. The lack of professionalism and technical expertise among many organisations providing micro-financial services, which we identified most clearly in Chapter 10, has prevented them from achieving scale, impact or sustainability. It is striking that among the thousands of MFOs operating across the world, only a small proportion are pursuing best practice in the technical aspects of micro-finance provision.

However, the challenges of the organisation of micro-finance provision, and of capacity-building for it, become all the more acute when we incorporate the range of developmental goals for micro-finance that we have covered in this book. At the same time, these challenges open up space for fresh insight and approaches that could resolve some of the tensions and controversies that seem constantly to surround micro-finance, not least on whether it is achieving any developmental impact.

Capacity and organisation building for micro-finance provision is often conceived in terms of staff, the role of the Managing Director, product design, cost control, systems, incentives and bonuses, access to capital, and governance through an effective board. A publication on micro-finance called 'conversations with the experts' from around the world (Oberdorf, 1999) provides some of the most reflective insights on this range of issues, suggesting that on many there is no consensus or clear solution, but nevertheless there is much to learn from these practitioners to aid one's own reflection and practice.

Approaching the challenges of capacity and organisation-building through a list of items helps only to a limited extent to address the developmental purposes of micro-finance. Here broader, less technical approaches are required, and in the rest of this chapter I summarise five of these challenges, based on my own experience of micro-finance in India. These are in addition to some of the approaches I have already set out, like designing micro-financial services that are appropriate to their context, and also working on wider systems that influence the delivery of those services. (See also Sinha [1999] for a good practical overview of the challenges and frustrations of capacity-building for micro-finance in India.)

6. Embrace both financial-service provision and developmental purpose

As suggested above, it is all too easy to see the provision of micro-financial services as an end in itself rather than as an instrument for achieving developmental goals. An exclusively technical approach to micro-finance provision seeks to reduce development to the delivery of resources, which it is not, and to mask the political economy of development, where resources are contested.

The first step to enable the match of micro-finance provision with developmental purpose is to consciously acknowledge and communicate that this is what is being sought. Micro-finance organisations are development enterprises (or social enterprises as they are increasingly called in northern countries). Such enterprises combine developmental aims, and often a strong focus on ethical values, with an enterprise orientation (Social Enterprise London, 2001).²

As development enterprises, MFOs must also recognise and embrace the likely organisational tensions, even contradictions, that their structure will entail, demanding choices or innovative reconciliation. For example, there is often tension between the standardisation that efficiency demands and the diversity and innovation that complex development issues seem to require. Financial parameters and targets can all too easily dominate, not least because they are also reinforced through statutory accounting and auditing requirements, leaving tracking developmental outcomes on the margins of the organisation.

Likewise, operating within a technical financial framework, it may make a lot of sense to access cheaper external capital and then lend this on to clients. On the other hand, if a micro-finance cooperative has been promoted to empower village women to pool and manage their financial resources, then external resources may well undermine this purpose by reducing their stake in the organisation.

Ignoring the potential contradictions between the overall developmental mission of an MFO and the technical demands of delivering financial services efficiently will lead to unresolved tensions. As CDRA puts it, 'when organisational contradictions are dismissed or ignored they sap our energy in spite of ourselves; when they are taken on as a challenge they become a creative force' (CDRA, 1996: 5).

In a series of workshops to help an NGO with its strategy to promote SHGs, the unresolved tension between a vision that saw autonomous SHGs performing a range of different roles for their members within the community, going well beyond micro-finance and enterprise, and the demands for standardising financial-service provision across the NGO's programme to improve the financial performance and efficiency

of the SHGs, kept interfering with and undermining other strategic decisions. Only when the participants had gone through a difficult internal debate, without facilitators, to resolve this issue, could the strategy evolve further.

Sustaining the development mission of the organisation is perhaps one of the greatest challenges. In the micro-finance industry this tension has usually been illustrated by the drift towards larger loans that are likely to make the MFO more sustainable but exclude its poorest clients (see the analysis of this in CGAP [1997a]). This is a genuine dilemma as an MFO struggles to adapt to the growth and changes within its clientele group, for example seeking to maintain its good borrowers. With the more sophisticated understanding of potential developmental purposes this book has encouraged, the challenge for MFOs to maintain their mission and focus becomes all the more complex.

Given that development is as much a process as an outcome, maintaining developmental values is also demanding. As Cheney (1999) suggested of the Mondragon cooperatives, of what value are the characteristics of a development enterprise, if they become indistinguishable from those of mainstream organisations? Where are the additional benefits that justify the efforts to create a different type of organisation?

To take a concrete example from India, Al Fernandez (2001: 6–7) reports on the pressures the NGO MYRADA was placed under to promote Grameen Bank-style groups, rather than autonomous SHGs which require much longer to grow, but, he argues, can deliver better on MYRADA's goals of empowering poor rural people (see Chapter 5).

There are strong historical precedents to demonstrate the validity of such concerns within micro-finance. The history of mutual 'building societies' in Britain goes back to the end of the 18th century when they were set up by poor people pooling their micro-savings to enable them to take loans to build houses. Over time these building societies became very large, any genuine sense of membership was lost and, following regulatory changes introduced in the 1980s, they became indistinguishable from commercial banks, and many have indeed converted themselves into banks. They have long failed to serve any developmental purpose, even though

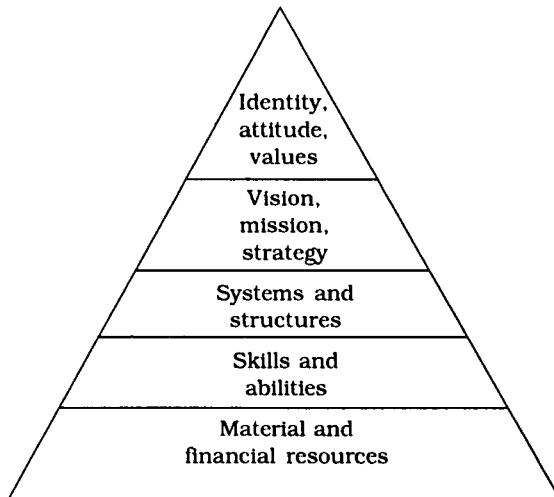
financial exclusion again became an important public issue in Britain in the 1990s.

This example is instructive in other ways. It is often assumed that MFOs are developing markets that mainstream providers can eventually serve. Community development finance organisations in the United States and Britain, for example, have often focused on near-bankable clients, seeking to demonstrate that they can be viable bank customers.

However, as mainstream providers begin to serve such customers, the community development finance organisations are likely to shift the focus of their operations to the next group of clients who are excluded from access to mainstream financial services, rather than competing with the banks. Such shifts may not appear to make the best sense for the sustainability and growth of the organisations concerned, but are in tune with their developmental missions. From this perspective, MFOs should not be seen just as steps on the road to full commercial and mainstream operations,³ but as organisations constantly seeking to bring those on the margins of the economy to access mainstream markets.

Micro-finance practitioners should not imagine that such challenges are not familiar to other organisations. Organisations can be seen as pyramids, as in Figure 12.1, in which

Figure 12.1: The organisational pyramid



each level needs to fit with the other for the whole to be fully functional (adapted from Fowler et al. [1995] as quoted in Eade [1997]). It is simply that the 'hard-nosed' attitudes needed for the delivery of micro-financial services bring the tensions to the fore more explicitly.

How can these tensions be addressed in practice? One of the leading Indian practitioners puts it as follows (Oberdorf, 1999: 21, 70):

... while micro-finance [organisations] need to live up to financial standards, it's not good enough to measure them only by those. You have to have a combination of financial and developmental standards, and you have to fulfil both. That's the challenge.

Leadership is key, and I don't mean just the CEO. The promoters and directors and key investors have to steer that difficult course between, you know, 'Hey, we got 98-percent repayment and an 18-percent return on investment' and those who say, 'Hey, we've reached the poorest of the poor and it doesn't matter whether we're haemorrhaging money'. It's in between these two that you've got to steer the course. And that then gets built into the organisation design. I mean, you need it in your [management information system], you need to monitor both financial and developmental performance. You need to build it into your training and your recruitment. You've got to ensure that you are taking people who are hard-nosed but at the same time empathetic to your plans. It has to run right through the vertical cross-section of the organisation, this concern for dual objectives.

About governance, I'd say the key issue is managing that tension between development and financial sustainability. Investors need to just get that right. I mean, occasionally you can get someone like Shore Bank [in Chicago] who knows both sides, but ideally it's best to balance your board with different people who represent different interests and then be very transparent about the trade-offs.

In embracing financial-service provision and development purpose, we also need to recognise creative opportunities for

integration, where successful development outcomes are essential for financial performance, for example by ensuring the ability of clients to repay, and where, as suggested above, the effective management of financial services leads to positive development outcomes.

We also need to recognise the advantages that MFOs as development enterprises may have, not just the challenges they face. They may be particularly effective at identifying new opportunities to serve those at the margins of the economy, and at diversifying their products to meet the needs of different clients in different local contexts, rather than delivering standardised products regardless of the local context. Indeed, in the midst of complex and dynamic challenges, the strong values and purpose that development enterprises may have can serve as a constant centre of gravity and a clear framework for action (Harding, 1997).

As the analysis in Chapter 8 showed, they may also be good at fostering financial discipline in contexts characterised by information asymmetries, severe market distortions and the lack of a repayment culture. Given the often on-going need for subsidies to genuinely reach and impact poor clients (Miller and Andrews, 1998: 14–15), MFOs as development enterprises may also be better able to attract goodwill and hence the low-cost capital and subsidies required.

7. Put practice at the heart of the organisation

The practice of an organisation 'concerns the particular discipline it offers, its methodology, the way in which it pursues its work in the world' (CDRA, 2000: 8). In the micro-finance sector it is all too easy to slip into regarding the delivery of micro-financial services as the organisation's practice, as though even on a technical level such provision is easy to define. However, in this book we have seen that micro-finance provision is highly diverse, using a range of different organisational structures from informal groups to mainstream banks, being delivered for a wide range of different purposes, from security through livelihoods and developing the local economy to democratic empowerment.

It is here that we find one of the deepest challenges confronting the micro-finance sector if it wants to achieve developmental impact. The technology of delivering financial services resides only in the three lower rungs of the organisational pyramid set out in Figure 12.1. This cannot be seen as the organisation's core purpose or practice, because these have also to be rooted in the organisation's identity, values, vision and mission which define its developmental purpose in particular.

An organisation's practice will differ according to what its core purpose is (CDRA, 2000: 6). The practice of an MFO seeking to provide its members with social and economic security through a full range of financial services will differ significantly from the practice of the MFO promoting livelihoods and not least from the NGO that does not engage in financial service provision at all, but promotes democratic community-based organisations to undertake financial intermediation.

Because such practice is developmental, it is far less precise and more complex than the technology of delivering financial services. There are few manuals, little insightful analysis, that are readily available to practitioners to help in building their developmental practice. Indeed, some practitioners may be scared of such a focus. The delivery of financial services remains in the control of those delivering them; interventions in complex development processes do not.

So what does all of this talk about organisational practice mean in practice for an MFO? As CDRA (2000: 8) says, 'The essence of developmental practice lies at the interface between practitioner and client'. It is at the interface between the MFO's staff, particularly field-staff, and the client or member, whether she is saving, borrowing, purchasing insurance or managing her own group, that the developmental processes an MFO seeks are likely to take place.

In a workshop for an Indian MFO, a role-play on the interaction between field-staff and client revealed the rather domineering, almost patronising, attitude of one field-staff towards the borrower. This may, to a small extent, have been important to signal that this MFO was different from public banks or NGOs which were soft in their lending, to make clear that this MFO would demand repayment. However, it is difficult to see how such an interaction could be developmental for the client.

In all the cases analysed in this book it is the field-staff who interact directly with clients or members who are the key to MFOs achieving their developmental mission. It is the 'hand-holders' at SEWA Bank who go out regularly to visit members in their homes who have the best opportunities to help the self-employed women to enhance their financial security (Chapter 3). It is the Customer Service Agents (CSAs) and Field Executives at BASIX who are most likely to spot the micro-enterprise that can grow to generate employment or provide an essential service in the local economy. It is the Unit Manager who is most likely to identify rural infrastructure or organisations in the area that could be revived through the judicious use of financial services (Chapter 4).

And, as we have seen in Chapters 5, 8 and 9, it is the quality of the field-staff that plays a major role, although by no means the only role, in determining the performance of savings and credit groups. In a workshop for CDF, field-staff spent much of the workshop exploring their relationship with the cooperatives they were promoting. Were they behaving as experts, 'doctors' or facilitators (see Chapter 1 in Schein [1999]), or even activists, in their interactions with the cooperatives? Which role was most helpful, and when, in achieving their developmental mission of high-performing democratic and autonomous people's organisations?

If financial intermediation is the only developmental purpose sought, then it may be possible to do without greater attention to the quality of field-staff. As Stuart Rutherford (Oberdorf, 1999: 28–29) reports on the Association for Social Advancement (ASA) in Bangladesh, '... all its procedures are extremely simple and well documented. ASA has a wonderful combination of maximum delegation with minimum responsibility.... everything's so automatic, it's quite clear whether or not this client is eligible for this loan or not, and of what size.... It's so standardised that it can be delegated to the lowest level.'

However, for most MFOs, because they achieve their developmental purposes at the interface between staff and clients or members, it is here that their organisational practice needs to be built most. In Chapter 4, we provided the following analysis of BASIX:

BASIX has ... faced the constant challenge of translating its complex mission of livelihood promotion for the rural poor into something that can inform and motivate staff throughout the organisation, as well as the Customer Service Agents (CSAs), who are not staff but paid on a commission basis. For them credit delivery has always been at the heart of their work, and BASIX' complex mission around supporting livelihoods has not always been fully understood. They are far more likely to judge a loan application on the basis of the ability and reliability of the borrower to repay than on the potential of the business to achieve livelihood outcomes. This can be serious, as it is precisely the Field Executives and CSAs who need, for example, to spot opportunities for micro-entrepreneurs to graduate to small enterprise and achieve the genuine developmental outcomes that BASIX seeks.

The analysis in this chapter might suggest that the approach needs to be turned on its head. If field-staff are the most likely to facilitate developmental processes on the ground, then they of course need to have their perspectives and insights on development enhanced to do their job more effectively. I have not conducted a workshop for any MFO in India where field-staff were not enthusiastic about enhancing their understanding of developmental processes.

However, the challenge is likely to lie not just with the lack of developmental perspectives among field-staff, assuming they have been well selected, but as much with the lack of organisational mechanisms to acknowledge and value the centrality of development practice, and to help those who need to deliver it on the ground to build that practice.

It is also the organisation's development practice that will provide the necessary learning for the organisation to enhance its developmental impact, and reviewing and learning from that practice must therefore play a key role in designing, reviewing and refining the organisation's strategy (rather than the other way round).⁴

But what space does the organisation provide for field-staff to review, reflect on and learn from their practice on a regular basis, amidst the huge pressures of delivery that most

of them are placed under? Do they have opportunities for reflecting for themselves, with peers or a mentor? How safe is such space for staff? Once you have acknowledged to your peers how you practice, you cannot take that knowledge back, unlike a position in a debate from which you can always retreat (CDRA, 2000: 9). But without such safety and above all trust, reflection and learning cannot take place.

I remember sitting in on a loan committee meeting of an MFO where field-staff presented their loan applications to the committee for review and, they hoped, approval. In the absence of many other organisational mechanisms for this purpose, this committee had become a major vehicle for learning what was going on in the field. However, it was not a safe space for field-staff to be open about their practice. Instead they spent most of their time ensuring that they looked good, and attempting to get as many loans approved as possible, which would reflect well on them. They even calculated the most effective order to present the applications to the committee to ensure that the majority, or at least the really important loans to them, were approved.

In the micro-finance industry, which is often fond of incentives and bonuses, how can these be structured in such a way that they encourage reflection on developmental outcomes, not just on the outputs of financial services? If an MFO is serious about its developmental purpose, it will not hide behind the easy position that developmental outcomes are so much harder to measure than financial parameters.

In Chapter 10, Frances Sinha outlines some emerging methodologies and processes to enable MFOs to better measure their developmental impact. Some of these developments are being supported by funding from the Ford Foundation, in part guided by a paper (Miller and Andrews, 1998: 14) that concluded:

After more than a quarter of a century of [community development finance] we don't yet have enough objective information on impacts.... If we do not assess impact we run the danger of accepting positive output measures as indicators of success, when there is a far more important story to be told. Further, a focus on outputs

risks skewing the field away from its fundamental mission. You get what you measure, and so far we have not been measuring the most important part of our work.

Appropriate methodologies and processes must clearly involve much more than the standard case studies to which so many micro-finance practitioners turn, often it would seem in desperation, to demonstrate their impact (with the often instinctive response from listeners: 'we don't believe you; why do you never show us any case studies of failures?').

The industry needs to move beyond such limited assessment of developmental impact. However, case studies do emphasise that developmental impact must happen among people, whether on their security, livelihoods, empowerment, democratic representation or any other area of their lives. This is about relationships and power. As Muhammad Yunus (1998: 234) puts it, 'credit creates an entitlement to resources.... Since credit creates economic power, and hence social power, the institution which is responsible for deciding who should and should not get credit ... can really make or break an individual, a group of individuals, or even a whole segment of society by favouring them or by rejecting them.'

So how do we move on? This is CDRA's perspective (2000: 11–13) on developmental organisations generally, of which MFOs are part:

It is often said that development—human development—is difficult, even impossible, to measure and for that reason other, related, indicators of success are sought. This is simply not true. In a developmental approach, practitioners intervene into complex development processes; they do not bring them into being. Through whatever resources, projects, or services they bring, they aim to effect change in the power relations of their beneficiaries. These shifts do not come about as a result of the efficient delivery of the resource or service, but through the developmental process employed.

Where a shift in relationship becomes the aim of practice, and its measure, neat deliverables and packages cease to occupy centre stage. Instead, measurement

comes to be seen as beginning with the ability to make developmental assessments. This involves analysing and understanding each situation being intervened into as a living, dynamic, changing process with a rich history, a present reality and a future potential. A central component of this assessment includes qualitative and descriptive pictures of the formative relationships surrounding the subject of intervention.... As development practitioners develop the art of describing relationships before and after their intervention, as they learn to tell the stories of change, so their ability to do so with greater precision grows.

The organisation that best supports developmental practice is receptive to these measures and descriptions and makes central use of them in the course of strategising.... Out of various accounts, a picture emerges that isolates the central themes—both in practice and in impact in the field. It is these pictures of the essence of developmental practice that inform further work on practice as well as the next steps in organisational strategy.

Such reflective measuring processes are also likely to motivate and support staff, especially field-staff, rather than proving an additional task or burden for them to deliver.

Key to any such learning are feedback mechanisms and information systems. For example, what mechanisms does the organisation put in place for managers and head-office staff to learn from review and reflection on development practice in the field? When SEWA Bank introduced the system of 'hand-holders' whereby staff visited members regularly at their home to review their finances and their livelihoods (Chapter 3), the staff involved met regularly to exchange their experiences. This was a useful mechanism for peer-learning among colleagues. However, fewer systems were developed for the organisation as a whole to learn and change its operations in the light of insights on developmental processes that emerged from the 'hand-holding' system.

All organisational systems in fact need to be geared towards supporting practice and learning. The check always is on whether organisational systems and procedures support

or hinder the two primary processes: direct contact in the field and learning towards improved practice and strategy' (CDRA, 2000: 16).

8. *Learn by doing*

The environment in which most providers of micro-financial services operate is often messy, with much uncertainty and change, and a complex range of developmental needs, only a few of which can be addressed directly through micro-financial services. The best illustration of this comes from Chapter 8, where the transient nature of temporary slum communities brings the uncertainties and complexities into sharp focus. However, the development context in a village is likely to be equally complex.

In such environments a technical solution by itself is unlikely to deliver the goods. Members or clients may not join, groups may collapse, unforeseen competitors may enter the market, micro-financial services may have unforeseen consequences, within households or within local enterprise markets, the regulatory and policy environment may change, and so on. The more exclusive the pursuit of technical excellence, the less relevant the services provided may become from a developmental perspective.

What is needed is reflective practice. In his book, *The reflective practitioner*, Donald Schon (1983) shows how, across many disciplines, apparent experts muddle through, forever reflecting on their experience, on what they are doing and on what the outcomes turn out to be. In this process of learning by doing, of trial and error, they use much intuition and tacit knowledge, as well as their formal knowledge, and welcome the surprises and puzzlement of unforeseen dynamics or outcomes.

Such a process is much closer to my experience of micro-finance practitioners, and is well illustrated in the development of the Grameen Bank, as described by Muhammad Yunus in Part II of his autobiography (1998).

Two features stand out clearly in this framework. First, the problems need to be set and the ends agreed. With the great diversity of contexts and practice illustrated in this book, it is clear that there will not necessarily be a consensus on the problem that needs solving and the end that needs to be

achieved. The way that this book is structured suggests that the simplistic assumption that the lack of credit is the problem that needs solving requires scrutiny. What other financial services are needed, how will micro-credit benefit livelihoods, how can micro-financial services be empowering, and so on? Going even deeper, why do poor people not have access to financial services? Does this relate to information asymmetries, lack of entitlements or the perspectives of elites managing financial intermediaries? In each case the problem and the end may turn out to be different.

Second is the need for innovation, for learning by doing, for trial and error. Chapter 6 analysed the innovation undertaken by BASIX to promote livelihoods, Chapter 8 revealed cases where learning by doing was an essential prerequisite for high-performing SHGs. Only by finding out who were good borrowers in practice could members recreate groups with good repayment rates.

It is the need to learn from doing that has informed the strategy of a range of different MFOs to hire fresh graduates rather than already experienced recruits, to provide them with only short introductory courses before making them shadow existing workers, and let the good ones rise through the ranks so they know exactly what is involved at the 'coal-face' (Oberdorf, 1999: 9, 27–38). At later stages of their organisational development, MFOs may need to recruit existing professionals from outside the organisation, with all the potential cultural conflicts this can give rise to.

It is only through learning by doing that most organisations will be able to weld together their delivery of micro-financial services and their developmental missions. This should not be seen as an abstract process, or one where research and development is separated out from operations. As Stuart Rutherford rightly laments (Oberdorf, 1999: 88–89),

One of the things that I find curious ... is that if I look at the considerable amount of research that's been done in Bangladesh by academics, very, very little of it is about the product itself. I can read endless reports about where the Grameen Bank members send their children to school, whether they use contraceptives, whether the

women are empowered, whether they have a bigger voice in their households or their communities, et cetera, et cetera. But I don't find much telling me about the product, how people really use it, what is it used for, what if we changed the product?

Learning by doing, in contrast, is based on reflection in action, testing what works and what doesn't, and learning from that to improve operations, systems and products or to refine, even change, developmental objectives in view of experience on the ground. Indeed, nothing of what I outline here should be taken as an excuse for fuzzy development interventions, for woolly thinking or navel-gazing (see Sinha, 1999), attending workshops to bear all about one's practice, and then returning, with a weight off one's mind, to the same old practice! Reflective practice is very different and far more demanding: the quality of reflection can be judged from whether it leads to learning, and learning to changes in practice.

Continuous innovation, adapting to lessons learnt in practice, is challenging for organisations (see Chapter 6). As Schon (1983: 328) writes: 'Significant organisational learning—learning which involves significant change in underlying values and knowledge structure—is always the subject of an *organisational predicament*. It is necessary to effective organisational adaptation, but it disrupts the constancies on which manageable organisational life depends.'

Learning by doing also presents challenges at the system level, as we suggested above. How can learning and innovation be transmitted to other parts of the system? The growing SHG movement, for example, could be seen as a huge research and development programme, but how will lessons learnt spread across small, highly dispersed and autonomous organisations?

This is all the more important as the micro-finance sector matures. While all MFOs must remain reflective and adapt to changing realities, this applies in particular to the innovative pioneers. However, there is little point reinventing the wheel each time. SEWA Bank and the Grameen Bank in many ways muddled along because there was little good practice for them to draw on. A key feature of the development of the Grameen

Bank, as Muhammad Yunus points out (1998: 142), was going slowly. 'A guiding principle of our work is to start low-key and in a small way.' This enables greater learning by doing.

On the other hand, BASIX, coming much later, was able to systematically assess good practice within India and internationally, and build in lessons from such analysis into its organisational design. The Association for Social Advancement (ASA) in Bangladesh in many ways did the same. Given the scale of the challenge of meeting the demand for micro-financial services among poor people in India, such learning processes are essential, and need to be encouraged and facilitated.

9. Move towards resolving the issue of ownership and control

The discussions of the expert practitioners on ownership and governance of MFOs (Oberdorf, 1999) are interesting. Perhaps the best summary is that 'in this sector there are no true investors so far and there are no true owners so far' (ibid.: 86). The practitioners list a range of potential board members for an MFO, from development visionaries to bankers, and including experts, business-people and small investors, and speak of the need to have a board that balances hard-nosed and softer approaches (compare CGAP [1997b], which provides a good overview of some of the challenges of governance).

What is striking is the lack of any consensus, or even detailed attention, to issues of ownership and control. *SafeSave* in Bangladesh is registered as a cooperative, but its promoter does not elaborate at all on any sense of ownership that such a structure might provide, pointing instead to the need for regulators to control financial-service provision on behalf of depositors; 'this is really no different from formal banks, is it?' (ibid.: 71).

Only one practitioner (ibid.: 65) suggests, 'I would like to think that they should be the ones to own it. I mean, the clients', although another warns (ibid.: 70) that

I think it is a pretence to imagine that micro-finance [organisations] such as the Grameen Bank are really

owned and managed by, you know, poor women. I mean, they are basically professional oligarchies ... and we are very lucky that there are people like Professor Yunus running them. But we should be prepared for a situation where, in future if not already, people use the fig leaf of member control to run professional oligarchies. And the best way to control this is not through the presence of member control but through a governance structure where other stakeholders keep the organisation on the straight and narrow. In that sense, it's not very different from large corporations.

At the time of writing, when the huge corporation Enron had just collapsed, such an analogy is perhaps less appropriate. However, this extensive muddling among leading practitioners suggests that ownership and control is very much an unresolved issue in micro-finance.

This is unfortunate, for two reasons as we saw in Chapter 5. First, ownership gives entitlements to benefits, including the profits of micro-finance provision, which can be significant. Second, ownership and control is at the heart of most of the empowerment strategies through micro-finance that are used in India, especially the SHGs and the savings and credit cooperatives.

Above, I argued that the developmental impact of MFOs will be determined largely at the interface between the organisation and its clients or members. The structure of ownership and control is in fact a key parameter in determining different forms of organisation, and therefore the relationship between the organisation and its customers, clients, members or citizens (Mintzberg, 1996). Ownership will therefore also be a key determinant of the development impact of MFOs. At its simplest, the control over resources and the power that this brings are critical in almost any development context. Can micro-finance really afford to ignore it? I suggest three steps that can be taken to explore in practice, to learn from doing, to move towards resolving this issue.

The first step is to acknowledge and support the role and potential benefits of mutual ownership structures within micro-finance, both informal (SHGs) and formal (cooperatives and credit unions). As we illustrated in Chapter 5, all too

often, issues arising from mutual ownership are simply ignored in much of the literature on micro-finance. However, mutual ownership not only brings members potential benefits, but may also overcome information asymmetries and reinforce financial discipline, not least because members are dealing with their own 'hot' money.

Moreover, given that micro-finance is ultimately about development, and that must mean of people, structures that give additional control and empowerment to people deserve attention. 'Development as an outcome is inextricably linked to the processes used in its delivery. This indivisibility of process and product, of cause and effect, [means] that] to "get" development, we have to work in a particular way, that is, developmentally' (CDRA, 2000: 1). Mutual ownership structures may serve well as a development process to deliver micro-financial products.

This is not a call for all MFOs to become mutual entities. However, if the industry is going to learn from practice, from doing, then its portfolio of practice must include mutual ownership, and serious investigation and support for such ownership, to draw out lessons, and to see to what extent such structures meet the developmental needs of members. Chapters 5 and 6 provided examples of what such support might mean in practice, including strategies to promote effective ownership within savings and credit groups and the work of CDF in creating an enabling regulatory framework for cooperatives.

There is also much analysis to draw on. The Cooperative Development Foundation has built an effective cooperative micro-finance practice on the basis of its deep understanding of cooperatives developed over many years. Credit unions of course have a long and chequered history internationally, and have been much studied. In India there has also been in-depth analysis of the functioning of cooperatives, for example, in Shah (1995) and Fisher and Mahajan (1997: Chapter 7), which have also had a chequered history, allowing analysis of both successes and failures. And, as suggested above, the SHG movement can provide a huge scope for exploring issues of ownership and leadership within democratic financial organisations (see Chapters 5 and 9). The industry can no longer hide behind simplistic generalisations, neither that cooperatives

are the only solution to ownership, nor that mutual ownership never works.

A second step is to build more experience on managing equity and other investments, and particularly differentiated rights of control that may come with different forms of investments. Many MFOs are set up by entrepreneurs who have great developmental vision but little financial capital. In traditional equity structures, the sweat equity of the promoters is not recognised, and large investors can all too easily push out others. As one practitioner warns, 'if you've got one very large shareholder with a representative on the board of the [MFO], especially if that [MFO] is majority-owned by that one shareholder, it is very difficult for the other board members to have any significant role. If the one shareholder doesn't like something and would withdraw his funds if the [MFO] goes ahead with it ...' (Oberdorf, 1999: 70–71).

This is particularly unfortunate if it is the developmental promoters who have the greatest commitment to the developmental mission of the organisation, but no capital to allow them to exercise control over the MFO. Equity mechanisms that come with differentiated rights, even recognition of sweat equity, clearly need greater exploration. So do holding company structures, like the equity of Triodos Bank in Europe, for example, that is held by a trust to protect the social and environmental aims of the bank, while the bank itself is regulated like any other bank to ensure sound financial management. This example provides a positive case, as opposed to the crisis that befell Corposal and Finansol so often cited in the micro-finance literature (CGAP, 1997b).

The challenge here is not so much legal (almost any structure of investments and the rights that come with them is already available), but of building experience through individual negotiations between MFOs and their investors, and, through example, expanding the range of rights that investors are willing to accept.⁵ Donors also have a particular role to play here. It is not appropriate to invest in and endow organisations that have no proper investors or owners in the hope that the chickens will not come home to roost too soon. Nor is it appropriate to rely on institutional investors, by directing grants and investments through apex public bodies, who often tend to be conservative and bureaucratic.

A third avenue of practice is to explore what happens when MFOs float their equity on open markets. Some NGOs providing micro-financial services have already converted to banks, some financial companies like BASIX are looking to float on stock-markets in the future. If lessons are to be learnt in practice on how effective the resulting traditional company or banking structures are in maintaining the developmental focus of the MFO, then careful attention and reflection will need to be given to such cases (see CGAP [1997a], for example).

Such suggestions do not provide solutions, but in the spirit of learning from practice, learning from doing, they would enable the industry to move forward constructively on this vital issue.

10. Develop the art of capacity-building

Micro-finance organisations obviously need a range of technical inputs from experts, on systems, accounts, financial management, cost control, and so on. However, a focus on the developmental goals of micro-finance introduces more complex and messier issues for MFOs to deal with, of framing appropriate goals within a given context and strategies to meet them, of tracking progress towards them, of adapting and innovating as the organisation learns from doing and meets with unforeseen consequences of its actions, and all the time maintaining a developmental vision among often rapid changes in the environment, of managing the organisational tensions that arise from change and innovation as well as diversity among staff motivations and skills, and so on.

Here a strongly rational, analytical and technical approach of management may not be adequate. Indeed it may divert attention from the dynamic and unstable challenges of development (and the strong identity and purpose required to address these) by focusing on the security and control that technical models of financial-service delivery appear to provide. Instead, as Schon (1983) argues, professionals must develop an artistry or craftsmanship in their practice which allows them to work constructively and reflectively with the uncertainty, conflicts and unique situations they often face (Harding and Chapman, 2000). As Harding (1997: 4–5) suggests, such an approach is

an art not a science. It requires years of patient practice and experience; the ability to reflect critically on that experience; creativity in response to difficult issues; the ability to bring good intuition and judgement in alongside rational thought; and the qualities and strengths to work well with people, to stay open to learning, and be confident about meeting the unknown.... It is more like white-water rafting (the course is very unpredictable, the ride is rough, change is all around you, you need to adapt constantly and fast, and you need a skilled crew who can think for themselves). White-water rafting is scary—but it can also be exhilarating [!].

This also changes the role of the external consultant, where uncertainty limits the scope of technical expertise. Schein (1999) describes the need for process consultation, the helping relationship, that passes on the skills of how to diagnose and constructively intervene so that organisations become better able to respond on their own to new development challenges. It generates space and opportunities for learning and reflection, so often pushed out by the frenzy of action, for reflection on insights and lessons emerging from practice on the ground where development processes are encountered. It creates a climate where difficulties and mistakes can be surfaced and discussed without fear, as otherwise learning by doing, which necessarily involves mistakes as well as breakthroughs, cannot take place. It facilitates learning, re-thinking and adaptation. It builds on the work and experiences of the organisation, rather than imposing external frameworks and solutions that often demotivate or are simply ignored (Harding and Chapman, 2000).

It draws attention to values, identity and purpose, which are at the heart of any development practice, as well as to the whole picture, and helps organisations explore tensions at this level, for example when they overburden themselves with too many developmental objectives. It may encourage new ways of looking at things. As just one small but pertinent example, one MFO wanted to develop new indicators and generate more information to better assess its performance and impact. Process consultation enabled it to see that it was not the lack of information that was the problem, but its inability

to use the substantial information the organisation's rapidly improving accounting and management information systems were already generating. Technical systems that generate information the organisation cannot process are not an effective strategy for organisational performance or impact.

Process consultation is not an alternative to technical expertise. All the MFOs I know need to upgrade their technical competencies and systems to deliver financial services effectively. However, MFOs also require additional and different skills and inputs if they are to develop their capacity to deliver not only efficient financial services but also development outcomes. BASIX has been able to access and put to good use a wide range of help from technical experts, challenging advisors, experienced board members, process consultants and reflective mentors, as well as formal organisational processes such as an innovative 'organisational learning and evolution process' after the first five years of its operations. It is recognising the help it can derive from all of these in steering a difficult course through complex development situations that has helped BASIX to progress so rapidly.

For some it will come as a surprise to conclude a book about micro-finance with a focus on practice at the interface between staff and clients, on embracing organisational contradictions, on learning by doing, on exploring ownership, on reflective practice and process consultation. However, all of these are critical for building the necessary insight, creativity, capacity and, above all, impact to enable MFOs to move beyond financial-service delivery to achieve genuine developmental outcomes.

Notes

1. This should not imply that in every context new provision is required. Where feasible, building on existing provision is likely to be more efficient than seeking to set up new organisations.
2. It is important to distinguish development or social enterprises from socially responsible business, which is a growing and welcome trend internationally among businesses. India, of course, has a long tradition of such responsible business, with the Tata group of companies perhaps the most celebrated example. The Indian tradition, like elsewhere

in the world, has often been dominated by philanthropic and paternalistic motivations, but there is a gradual trend internationally to placing such responsibilities at the core of the business activity, which is described in a recent publication from the New Economics Foundation called 'The civil corporation' (Zadek, 2001). Development enterprises are different from socially responsible businesses because their primary purpose is defined by their developmental aims, which they have decided to pursue through enterprise (and often profitable) activity, while socially responsible businesses continue to pursue profits as their primary goal but in an increasingly responsible or ethical way.

3. Indeed, the need to raise commercial capital may divert from their developmental purpose, as even the very earliest Rochdale cooperatives discovered (see Cheney, 1999: 39).
4. All too often, strategy is divorced from such review and learning processes, determined centrally for field-staff to deliver, and when the inevitable gaps open up between strategy and implementation, it is the field-staff that are hounded for their underperformance (CDRA, 2000).
5. I am grateful to Bharti Ramola for this insight.