

NOTE ON MICRO FINANCE & SME SECTOR

Importance of Micro Finance

Though certain sectors of Indian economy have seen impressive development and growth but still it seems to be quite insufficient for the elimination of poverty in India. Therefore, it is all the more necessary to expand and improve the micro finance sector in order to provide maximum benefit to the poorest section of the society and thus a national policy on micro finance is need of the hour.

Microfinance is powerful, but it is clearly no panacea. Our experience in the business world has taught us that solutions marketed as cure-alls to complex societal problems rarely if ever pan out as promised. Microfinance does not directly address some structural problems facing Indian society and the economy, and it is not yet as efficient as it will be when economies of scale are realized and a more supportive policy environment is created.

Loan products are still too inflexible, and savings and [insurance services](#) that the poor also need are not widely available due to regulatory barriers. Insufficient data exists on client-level impact, though new tools such as the Poverty Progress Index of Grameen Foundation and the work of Sa-Dhan (the association of Indian MFIs) on measuring client satisfaction are addressing this gap.

Still, microfinance is one of the few market-based, scaleable anti-poverty solutions that is in place in India today, and the argument to scale it up to meet the overwhelming need is compelling.

Role of MFI's

The impressive accomplishments of MFIs and their clients in one state — Andhra Pradesh — provides a glimpse as to what is possible country-wide. In 2000 three leading MFIs — SHARE, SKS and Spandana — reached far fewer than 100,000 families.

With support from SIDBI, [ICICI](#) Bank, HDFC, Citigroup, Grameen Foundation (and its new joint venture, Grameen Capital India), Friends of Women's World Banking, Unitus, and others, these three organisations now serve

more than 1.5 million families, most of them very poor when they started accessing micro-financial services.

SHARE, led by the extraordinary microfinance pioneer Udaia Kumar, alone reaches 900,000. SKS has emerged as the fastest growing microfinance institution in the world and its founder, Vikram Akula, was recently honored as one of the top 100 people "who shape our world" by Time magazine.

Economies of scale and imaginative uses of technology have brought costs and [interest rates](#) down in Andhra Pradesh, as one would expect.

The rest of India is catching on and catching up. According to Sa-Dhan, the overall outreach is 6.5 million families and the sector-wide loan portfolio is Rs 2,500 crore.

However, this is meeting only 10% of the estimated demand. Importantly, new initiatives are expanding this success story to the some of the country's poorest regions, such as eastern and central Uttar Pradesh.

A new institutional capacity-building collaboration between American Express Foundation and Grameen Foundation will be critical in ensuring that progress is nationwide and sustainable.

Professionally-run, full-service MFIs can and do complement the self-help group movement, which has its own impressive track record. Indian MFIs, through Sa-Dhan, are raising standards, most recently by proposing an industry-wide consumer protection code that most MFIs have already agreed to in principle.

Role of Government

The local and national governments have an important role to play in ensuring the growth and improvement of microfinance. First and foremost, the market should be left to set interest rates, not the state. Ensuring transparency and full disclosure of rates including fees is something the government should ensure, and something that new technologies as well as reporting and data standards are already enabling.

Furthermore, government regulators should set clear criteria for allowing MFIs to mobilise savings for on-lending to the poor; this would allow for a large measure of financial independence amongst well-managed MFIs — as the Grameen Bank of Bangladesh has achieved in recent years through an aggressive and highly successful savings initiative.

Each Indian state could consider forming a multi-party working group to meet with microfinance leaders and have a dialogue with them about how the policy environment could be made more supportive and to clear up misperceptions.

There is an opportunity to make a real dent in hard-core poverty through microfinance. A new paper, "Measuring the Impact of Microfinance: Taking Stock of What We Know "(which can be downloaded for free from website, shows that in most countries where quality microfinance programmes have been scaled up, poverty has been reduced, sometimes dramatically.

With one state leading the way, we need to build on a successful model. By unleashing the entrepreneurial talent of the poor, we will slowly but surely transform India in ways we can only begin to imagine today.