

# **Strategies to Counter Microfinance Delivery Challenges**

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## **ABSTRACT**

Financial inclusion has been challenging with respect to the economically weaker sections of society residing in rural and urban areas. Microfinance can be described as extending small loan to the poor for self employment enabling them to earn money for themselves and their families. It includes a broad range of services like credit, savings, insurance products, payment and remittance services, transfer services et al. Various regulatory and operational hurdles are a great hindrance to its growth as they are jeopardizing the smooth functioning of Microfinance Institutions (MFI). It appeared that the main hindrance faced by MFIs (including banks) in financing the very poor was the comparatively high transaction cost and low profitability in reaching out to the populace who need very small amounts of credit at frequent intervals. This paper focuses on strategies to take on the challenges as indicated and the effective implementation of microfinance delivery modes. Attempt has been made to understand the operational difficulties faced by MFIs in extending microfinance. The paper also discusses the means of reaching the necessary credit to a majority of the rural population.

## **INTRODUCTION**

In the financial world today Microfinance has emerged as a very significant discipline. There is no stopping to the importance it is gaining not only in India but also at the international level. Microfinance is considered to be revolutionary because it aims at servicing the poorest of the poor, who were up till now considered unfit for financing of any kind except charity. The idea of it arose in Asia as a reaction to the dismal poverty rampant in rural areas of India and Bangladesh. Some of the well-known institutions involved in this activity include the Grameen Bank and BRAC of Bangladesh and the Janasakti Bank in Srilanka. In India, over the last five years, Andhra Pradesh led the way in the formation of self-help groups (SHGs) by non-governmental organisations (NGOs), and by the government development machinery.

Currently India is considered to be the largest emerging market for microfinance. It has been growing in India at a steady pace over the past decade. Although no MFIs in India has reached anywhere near the scale of the well-known Bangladeshi MFIs, it is characterized by a wide diversity of methodologies and legal forms. However, only very few Indian MFIs have achieved sustainability. Since 2000, commercial banks including Regional Rural Banks have been providing funds to MFIs for on-lending to poor clients. Though initially only a handful of NGOs were 'into' financial intermediation using a variety of delivery methods, their numbers have increased considerably today. While there is no published data on private MFIs operating in the country, the number of MFIs is estimated to be around 800. One set of data indicates that about a dozen MFIs have an outreach of 100,000 microfinance clients. A large majority of them operate on much smaller scale with clients ranging between 500 to 1,500 per MFI. It is estimated that the MFIs share of the total institution based microcredit portfolio is about 8% (Thorat, 2006). With a population of over 1 billion; India has nearly 400 million people within the precincts of an austerely defined poverty line. Thus, approximately

75 million households need micro-finance. Of these, nearly 60 million households are in rural India and the remaining 15 million are urban slum dwellers. It is worth noting that the current annual credit usage by the same households is projected to be Rs 495,000 million or US\$ 12 billion!

## **WHAT IS MICROFINANCE?**

Micro-Finance is a new word and is very much part of the vocabulary today. It constitutes two words: micro and finance, which could mean small credit or “microcredit”. However, the concept of micro-finance goes far beyond small credit and it is to be noted that not all small credit is micro-finance. Microfinance is an emerging phenomenon that opens access to capital for individuals previously shut out from financial services (Khavul, 2010).

Micro-Finance constitutes various financial services, which mostly includes savings and credit. It also contains other services like insurance, directed to ultimately benefit the poor or disadvantaged section of the population, especially those who are economically poor. This is often backed up with a variety of support services such as motivating and organising the poor and helping them build backward and forward linkages with other support institutions. The aim was to provide resources to help the poor to attain self sufficiency. They had neither resources nor employment opportunities to be financially independent, let alone meet the minimal consumption needs (Ghosh, 2006)

## **RESEARCH METHODOLOGY**

The methodology used for carrying out the research is discussed briefly here:

### **Objective**

To understand the macro and micro challenges with reference to delivery of micro-finance in rural India.

To focus on the operational difficulties faced by MFIs and commercial banks in providing micro-credit to the people of rural India.

To create innovative and simple workable strategies to counter these delivery challenges.

### **Data Collection**

*Primary Data:* Collection has been made through extensive interviews conducted with Micro finance institutions like the Gujarat based NGO, SEWA (Self Employed Women's Association) which is carrying out extensive micro credit activities through both SEWA Bank and its various micro credit trusts, and micro credit associations. Extensive interviews were held with the Head – Rural Operations –'Rural Operations Group', Central Operations, Mumbai of ICICI Bank, which is carrying out pioneering work in the area of micro credit.

*Secondary Data:* Here the sources has been collected from the activities carried out by prominent Microfinance organiations like BASIX, SEWA and research done by IFMR. (Institute of Financial Management and Research, Chennai.)

### **Research Approach**

The survey was carried out through the interview method. The data so collected, along with secondary sources has been qualitatively analysed and our research findings have been checked whether it can be implemented with the Rural Operations Head of ICICI Bank.

## **MICROFINANCE IN INDIA**

### **Institutional Structure of Microfinance in India**

Microfinance evolved in India in the early 1980s with the formation of informal Self Help Group (SHG) for providing access to financial services to the needy people. The MFIs are

organized under three models: SHGs, Grameen model/Joint liability groups and Individual banking groups as in cooperatives (Kothari & Gupta, 2008)

With over 500 MFIs in India, their geographical area of operation are in the states like Rajasthan, Uttar Pradesh, Bihar, Orissa, Andhra Pradesh and Tamil Nadu. Microfinance is lent through Self Help Groups (SHGs), like the Kosh - Gram Sabha Nidhi Foundation, Credit Unions like ASSIST, MACTS (Mutually Aided Thrift and Credit Cooperative Society), Grameen banks like SEWA Bank, SHARE, ASA and through direct individual lending by institutions like BASIX and Lupin. They are legally registered as NGOs (ASSIST, Lupin, and ASA), Cooperatives (YCO, Swayamkrushi), NBFCS (BASIX, Kosh) and Banks (SEWA Bank and RRBs).

**Table 1: Prominent MFIs operating in India**

<b>Summary of 12 Prominent MFIs operating in India</b>												
Sl. No	Name	Period of Operation	Credit Delivery	Group Size	Avg. Loan Size	Lending Rates	Re-payment Rates	Cumulative Borrowers/ Members	Cumulative Disbursement	Loans Outstanding	Estimated Credit Demand for 2-3 years	Remarks
		Years			Rs.				Rs. in Million			
1	SEWA Bank	25	Credit union/bank	-	10000	18%	95%	200,000	n.a	86	0	India's only MFI licensed as a bank.
2	BASIX	3	Various	-	7000	24%	95%	20,000	130	60	100	Professionally managed MFI with aggressive growth plans.
3	SHARE	7	Grameen	5	3000	15% flat	100%	14,000	130	43.9	100	Promising growth, transforming to NBFC
4	Kosh	10	SHG	10-15	5000	14%	67%	100,000	225	100	30	Unique. Fund manager for people's federations at village level
5	PREM	17	SHG	15-20	2000	10% to 30%	90%	20,000	n.a	20	5	First federation of SHGs in Orissa
6	ASA	10	Grameen variation	5	4500	15% flat	98%	6,000	23	7	60	Promising. Needs to increase operations to become viable
7	Lupin	11	SHG, direct	15-20	4000	12%	90%	2,000	11.5	0.6	5	Micro-credit is one of the several programs.

												Potential for more focused management.
8	FWWB	17	Wholesaler	n.a	400000	13.50%	88%	146	80	40	30	Wholesaler: clients widespread. Capacity building is strong.
9	YCO	13	SHG	10	5000	various	78%	6,300	9.8	4	4	Organised a MACTS
10	Adithi	11	SHG	10-20	5000	12% flat	90%	5,000	10	7.5	15	Operates in Bihar, planning to set up a cooperative bank
11	ASSIST	14	SHG	15-20	3000	12%	n.a.	4,000	n.a.	4.5	20	Planning to set up a MACTS
12	UPBSN	3	SHG facilitator	20	9000	12	n.a.	40,000	n.a	n.a	n.a	UP Govt owned. Path breaking work at ground and policy level
13	Jamuna Grameen Bank	2	SHG	20	6000	12%	100%	852	0.6	0.4	0	RRB trying to increase its SHG portfolio
13												

Source [www.basixindia.com](http://www.basixindia.com)

## LENDING PROCEDURES

It is observed that four different patterns of lending procedures are being used by different groups / Microfinance Institutions in the state.

- **Group lending:** This is where the loans are given to a group, which in turn lends to its members. The group is responsible for repayment and will enter into any kind of arrangement when its own sub-borrowers default.
- **Group guaranteed individual lending:** This is where the loans are made to individual borrowers where each guarantees the repayment by the other. If there is any default by any one member, it will lead to stoppage of further loans to all others.
- **Individual lending:** This is with or without collateral security and without any group guarantee.

Group Lending is popularly known as the Self-Help Group (SHG). For example Groups comprising of 15-20 women from nearly homogeneous socio-economic background form a group. They know and have frequent interactions with each other and act as the financial intermediary. They meet periodically (once a week, fortnight, or month) and agree to contribute a specified amount per meeting to the common pool. Usually an SHG elects a President, a Secretary and a Treasurer and they maintain the books of account and minutes. Once the monthly "thrift" contributions add up to a reasonable amount (after some months), they start lending to some of their members. The decision is taken collectively based on the need, repayment capacity, and funds availability. There are times when SHG members need more funds that exceed the thrift amount accumulated by them. In this case they try to access funds from various external sources specializing in micro-finance funding such as the RMK, NABARD, SIDBI, FWWB, or the Government Departments like the Social Welfare Department, DRDA, or other financial institutions like commercial banks or the non-banking finance companies.

### **Commonly Practised models of Group Lending:**

Many SHGs in one village federate to form a Village Organisation, e.g. UNDP SAPAP in Kurnool, Ananthpur and Mahaboobnagar. In some cases, the village level federation is registered as MACS (Mutually Aided Credit Society), e.g. groups promoted by CDF. Many SHGs in nearby villages form a cluster association, e.g. CARE, Chevella, Many SHGs promoted by a DRDA in a *mandal* (a revenue circle) form a federation, e.g. Padmavathi Mahila Sangham, Chitoor. In some cases, all the Village Organisations within a *mandal* have federated together to form a MACS or Mandal Samakhyas. Many SHGs promoted in different parts of the state federate together as MACS at the state level, e.g. Mahila Vikasa Mutually Aided Co-operative Thrift Societies Ltd.

## **DELIVERY CHALLENGES FACED BY MICROFINANCE INSTITUTIONS & BANKS**

For better understanding the challenges have been bifurcated into Macro and Micro Issues:

### ***MACRO CHALLENGES***

#### ***1. Assumptions in conduct and delivery of Micro-Finance***

The major challenges to delivery and conduct of Micro-Finance is the set of assumptions related to this activity. These assumptions are as follows:

**Self-employment is what the poorest wish for:** Those who support the strategy of eradicating poverty through micro-credit make the explicit assumption that the poor would like to be self-employed. There are poor people who like to take up micro-scale farming, processing, manufacturing or trading activities, but usually they do so to support their income from wage-employment. A majority of them and particularly the poorest (such as landless labourers) want steady wage-employment, whether they be on- or off-farm.

**The main financial service needed by the poor is credit:** Most Microfinance institutions assume that all that the poor need is credit, but this is not entirely true. As an example, SEWA Bank's experience shows that women value a safe place to park their savings as an important service. However, the field in general does not effectively emphasize other financial services like savings and insurance.

Savings are particularly crucial as they provide the 'Equity' for borrowing. Savings also act as a cushion for sudden demands of cash like illness in the family or natural disasters. Besides this, it may act as a guarantee for repayment of loans where savings are deposited with lenders.

**Credit can automatically translate into successful micro-enterprises:** Microfinance cannot be considered a sufficient condition for microenterprise promotion. Other inputs such

as identifying livelihood opportunities, business & production training, establishing market linkages, and policy reform are also required.

**People slightly above the poverty line do not need micro-credit and giving it to them amounts to mis-targeting:** This assumption has come from the Grameen Bank experience, of successfully reaching microcredit to the poorest. Almost all other programs mainly reach the upper layers of the poor and some of those above the poverty line. Yet access to credit by those who are not among the poorest is not necessarily better than the poorest. Moreover those above the poverty line when helped through microfinance, generate the much needed wage employment opportunities for the poorest. Therefore it is certain that those above the poverty line need micro-credit.

**All micro-credit institutions can become financially self-sustaining:** There is support for overall financial self-sustainability, but the assumption that this can be possible for all micro-credit institutions, is questionable and therefore needs to be examined. Even the best cases are either still not there (e.g. Grameen) or have got there by detaching their NGO identity which needed early subsidies (e.g. Bancosol/PRODEM).

## ***2. Conversion of microfinance as a savings and credit movement.***

This is best understood by taking the case of Andhra Pradesh. The organizational energy that grew with the total literacy campaign lead to the anti-arrack movement of the women. Later on this movement was channeled to steer the savings and credit movement. Many organisations, government and non-government, took part in this. A sizable number of women got organised around thrift and credit, forming a very large number of women's group. This experience clearly demonstrates that it is possible to make financial services available to the people at large from and primarily women. In other states savings and credit activities have not yet taken the form of a movement but do recognise that extending

financial services is a critical step towards poverty alleviation. At this juncture, it may be worthwhile to take a look at some of the factors that has made it possible in AP.

***3. The difficulty faced by MFIs under the existing policy and regulatory framework is the challenge of achieving high access by the poor and at the same time the maintenance of sustainability.***

Besides, the mainstream Financial Institutions also find it difficult to significantly expand into micro-finance due to the following reasons:

- i) It is over hundred years that attempts have been made to get farmers out of the clutches of moneylenders. This stems from Policy makers' view of the market for microfinance services.
- ii) Micro-finance has historically been seen as a social obligation rather than a potential business opportunity.
- iii) There are specific problems with legislation: for example the NABARD Act does not allow it to refinance any private sector FI and do any direct financing (NABARD's direct lending to micro-finance NGOs so far has been out of donor funds) NABARD also refines commercial banks/RRBs/cooperative banks who lend to MFIs.

Whether it is escaping the clutch of moneylenders, or viewing it as a potential business opportunity, or having legislative problems, it is necessary to see it beyond government institutions. It is important for the development and expansion of market-based microfinance services because to serve clients who are outside the frontier of formal and semiformal finance, MFIs must have access to funding far beyond what external agencies and governments can provide (ADB, 2010).

***4. Institutions Involved in Micro-Finance and the Capital Adequacy Problem.***

It is an irony that although the NGOs created micro-finance they are not the best type of agencies on a long-term sustainable basis. This is because the funds of the NGOs are grants, which are very limited. Moreover, NGOs cannot carry out lending activity as they will violate section 11(4) of the Income Tax Act and can lose their charitable status under section 12. As such microfinancing, to whomsoever it may concern, is not a charitable activity under section 2(15) of the IT Act. The other thing is that NGOs as such do not have the appropriate financial structure to undertake micro-finance activities. NGOs are registered as societies or trusts; they don't have any equity capital and the concept of capital adequacy does not apply to them.

***5. Bringing Millions of People under Micro Finance is not Easy.***

According to a survey by the NCAER (National Council of Applied Economic Research) in 1994-95, the bottom three income categories with per capita income up to Rs 250 per month and accounting for 31.7 percent of all rural households, reported incomes below expenditures. This made them net dis-savers. The inadequacy of livelihood opportunities, which would otherwise generate a living wage and an income surplus, is the major problem. Infact the survey revealed that the poor comprising 32% of rural household are all agricultural labourers and non agricultural wage labourers. This makes it all the more difficult to bring them under the fold of micro-credit. This is also going to be a major challenge.

***6. Demand and Supply Gap in Provision of Microcredit and Micro-savings in Rural Areas.***

Various initiatives taken by authorities and financial institutions have not helped the rural poor to improve their living standards and create welfare. Looking at the provision of rural credit, there appears to be a big gap between the needs of rural people related to savings and credit options, and the receipt of the same from various financing institutions. According to the Banking Statistics (RBI, 2003), and the Rural Population Census India, 2001, the

availability of banking services to the rural population is just 18.4% through saving accounts. The availability of rural loans is still lower at 17.2% coverage of the rural population. It is obvious now that there is a huge gap in the supply of both savings and credit facilities to the rural population. This really needs to be covered by the Micro-finance institutions.

***7. There is Lack of Women Orientation in Marketing, Evaluation and Delivery of Micro-Finance:***

It has been observed for a long time that generally the main consumers of microcredit and the micro savings are the rural women. One of the reasons being the social system and culture of rural India. Men of rural India usually don't approach SHG or NGOs for small amount of credit or savings. And the other thing is that the men being busy with agricultural operations are unable to find the time to spend with an SHG/MFI. Therefore, MFIs to succeed, need to address women in their schemes for savings and lending. Their evaluation process for giving credit has to be based on the status of women in the rural areas. To have women oriented approach in marketing Microfinance would be worthwhile. International aid donors, governments, scholars, and other development experts have paid much attention to microfinance as a strategy capable of reaching women and involving them in the development process. The microfinance industry has made great strides toward identifying barriers to women's access to financial services and developing ways to overcome those barriers (Cheston & Khun, 2003). Women orientation overcoming barriers has been the root of success looking at the Andhra Pradesh Microfinance Model.

***MICRO CHALLENGES***

***Operational Factors That Impede Extension of Rural Credit***

**1. High Transaction Costs:** When it comes to amount being saved or required in rural areas, it is often miniscule. The provision of it through the conventional banking system or other financial institutions has not proved to be cost effective.

**2. Document/Collateral based lending:** The mainstream is based on documentary evidence of identity and income streams. But generally both of these are not available with the poor in rural areas. Under conventional banking some assets have to be pledged with the lender as a security. This ensures that the loan would be repaid. If there is a default, the lender has the right to amortise the asset to recover the losses. Rural folk hardly own any assets (land, jewellery) and as such are left out by the conventional banking system.

**3. Issues Related to Repayment:** As such micro-credit is not based on documentary evidence, so repayment tracking becomes a huge operational task. Further, in times of emergencies like natural disasters where the entire rural economy is affected, the FIs are faced with a situation of write-off of the entire portfolio as there is no alternative to risk mitigation.

**4. Removal of money lenders:** A majority of the rural people are dependent on the local money lenders for fulfilling their temporary fund requirements. The poor still continue to depend largely on informal sources of credit and these sources account for 40% to 60% of the household demand. The challenge for the mainstream banking institutions and the MF sector is how to bridge this huge gap (Das, 2006). Moreover, moneylenders provide the temporary fund, without basing it on any particular need. Therefore, MFIs have the challenge of lending to the same population without referring the loan under specific title, or for that matter offering micro loans for general purposes. This is to replace the role of the money lenders.

## **STRATEGIES FOR MACRO CHALLENGES**

### ***1. Challenge of Savings and Credit Movement***

There is great need to increase the accessibility and reach of the MFI activities to a large number of rural poor, especially the poorest. Therefore, the challenge of creating this activity into a savings and credit movement can be fulfilled by involving the State machinery. The polity not only supports the movement, but also gets the bureaucracy involved in the effort, besides giving it the necessary freedom. As both financial and non-financial resources are at the command of the State, it could give a major impetus to the movement. Apart from giving the size, involvement of the State also gives it the legitimacy. The Andhra example has adequately proved what has been said above.

### ***2. Strategy for Capital Adequacy***

Capital adequacy issues faced by NGOs can be solved by using the model of Banks-NGO-SHG Linkage, where banks both the public and the private lend capital to the NGOs. These NGOs are actively involved in lending funds to SHGs and other institutions providing micro-credit. Funds can also be raised from national and international development bodies, which lend credit for the same purpose. This has been successfully practiced by leading organizations like BASIX, which has borrowed from banks like HDFC, ICICI, SIDBI and developmental institutions like the Swiss Agency for Development Corporation and Shorebank Corporation of USA, etc. The same has lent to NGOs and SHGs in Andhra Pradesh for providing micro-credit. Today one has the opportunity to bring in private capital to fund outreach programmes. The private capital could be used as the equity component of Micro-finance institutions.

### ***3. Wage Workers and Micro Credit Strategy***

Micro-credit programs can be re-engineered to target the poor and indeed some non-poor micro entrepreneurs. This is so because commercial farmers and micro entrepreneurs run businesses which generate the much needed wage employment opportunities for the poor and the poorest. There is no harm in supporting the poorest - first of all with wage employment before they become self-employed. The moment they get wage employment, they would automatically get into micro savings and then perhaps go for micro-credit. Besides, MFIs and banks working through the NGO-SHG linkage model can also fund NGOs for enhancing their activities related to providing opportunities for wage employment or for becoming micro entrepreneurs.

## **STRATEGIES FOR MICRO CHALLENGES**

### **1. Strategies for Reducing Transaction Costs**

As far as recovering transaction costs are concerned, some strategies under micro challenges can be adopted. The post office can play an important role in the delivery of micro-finance as a physical contact point. Every post office can have a nodal agency which can assist the rural people to form an SHG towards securing micro-finance. Besides this, post offices' network and the post office staff can carry out the role of delivering banking services through 'Banko Postal'.

Technological upgradation in operations of the micro and small scale sectors would enhance the efficiency empowering the participants and the administrators. Use of ATMs to accept payment, opening of a/cs, collection of Small deposits, provision of microcredits, selling of saving bonds and insurance may contribute to recovering transaction costs. Besides this, automation in a phased manner will also assist in realizing faster and bigger growth at all levels of financial industry.

Further tie ups with NGOs and SHGs situated in the rural area, could bring down transaction cost, by making them deliver the finance. These institutions with their database and history on the consumers of the area will be effective micro-credit deliverers. This will result in the increase of micro-credit and reach for the MFIs at the same time reducing direct cost of lending.

In a research study, key drivers of direct transaction costs are field worker compensation and number of groups handled per field worker. Collection activity is the single largest contributor to high transaction costs. It is suggested that MFIs, in order to reduce direct transaction costs, increase the number of groups per square kilometer (Shankar, 2007).

## **2. Strategies to Reduce Default and manage Recovery Issues.**

A lending mechanism which is effective through groups should be set up and within it periodic reviews and meetings conducted to monitor the working of the same.

Lending without documentation is a necessity of micro credit. Social collaterals, like group liability/undertaking, can be put into practice for lending to an individual. People in the village are generally concerned about their reputation, so as borrowers do not default when they have the backing of peer and senior groups. That the borrowers default less corroborates with a finding under a study conducted by two Nigerian researchers. Their say that loan recovery surprisingly ranked quite low meaning that fewer banks experienced low recovery problems (Makarfi & Olukosi, 2012). Getting the SHG or NGO involved in lending would therefore be a prudent option for MFIs, as they bring with them the transaction histories of borrowers of the village. Another innovative way to manage repayment issues and default problems is to tie up with the local panchayat or village head (mukhia) and bring them into the lending operations as an Advisory committee. This would ensure personal history of the

individual borrowers being known, as a village is generally a small place, where people know each other. Moreover for the borrowers, when they are being assessed by the village chief, would be on guard about their reputation.

**Lending needs to be coupled with insurance and other services such as training and marketing support, govt. subsidies etc.**

## **CONCLUSION**

**Microfinance is a necessity in India to achieve financial inclusion of the poor in the rural and urban areas.** There is great need to increase the accessibility and reach of the MFI activities to a large number of rural poor, especially the poorest. The study has shown that this could be achieved by following the Andhra example of involving the state machinery to spread a savings and credit movement.

**Microfinance delivery involves macro and micro challenges.** The macro challenges faced by MFIs include the inaccessibility of the micro finance services to the rural poor, the capital inadequacy of the MFIs, the demand supply gap in provision of microcredit and micro savings, and the lack of women orientation in marketing, evaluation and delivery of microfinance.

The micro challenges include the inability to reduce the high transaction cost involved in delivering microfinance, the nonavailability of documentary evidence and collateral among majority of rural poor, difficulty in reducing the dependency of the rural poor on money lenders and lastly the problem of repayment tracking where lending is not based on documentary evidence.

**The major hurdles in successful delivery of microfinance can be overcome through innovation in operational strategies to handle these macro and micro challenges.** As reflected in the study, innovative practices like tying up with local NGOs, and SHGs would help in effective delivery of microfinance. Also the option of involving the post office branches and the local panchayat as nodal agencies for microfinance delivery could be explored for mitigating the challenges relating to delivery.

**The road ahead.** The success of Microfinance activity in the future would be a function of the participatory approach of the MFIs, NGOs, SHGs, and banks. There is a great need for integration and linkage among these institutions for all types of resources including information sharing and delivery.

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