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I am grateful to the organizer Mr. Vipin Sharma, CEO of the Access Development Services for inviting me to this distinguished international and national gathering of professionals, academics and activists at the second Microfinance India Summit, 2008. I understand that the microfinance sector, from a modest beginning on a pilot basis in 1992 has expanded its reach over the decade and a half to 50 million clients who belonged to what the Management Guru Professor Prahlad called the bottom of the pyramid. This is a remarkable progress over a short period. The last year's Summit discussed the challenges of depth and breadth facing the microfinance institutions. These discussions resulted in further updated State of the Sector Report this year that is going to be released in this session. It focuses on the growth and consolidation of the microfinance sector. Appropriately, the theme of this year's Summit, "The Poor First", takes the discussion to the next stage by bringing in the all-important perspective of the ultimate clients that the microfinance sector is expected to serve. The two-day programme of the Summit is packed with six plenary sessions with three breakaway sessions in each for a comprehensive coverage of diverse problems that have a direct bearing on the theme of the Summit. An impressive array of national and international experts who know the sector much more closely than I do would be reflecting on the theme. They would cover the existing state of the sector; expanding its outreach to complementary important areas like contributory micro pensions, micro insurance and spreading financial literacy among the clients; urgent need to focus on the distinct problems of the urban poor whose share among the poor is expected to rise; setting all-important fiduciary standards of servicing the bottom of the pyramid clients; implications of the current global meltdown in the international financial markets for microfinance; instrumental use of microfinance for empowerment of women and discriminated social groups; and finally, sustainability and impact of the dominant modality of supplying microfinance, namely, SHG Bank Linkage Programme in which, among others, the problems of delivering complementary non-financial products and services to the poor are addressed. This is truly a very impressive organizational effort and I deem it to be a privilege to be associated with it.

My long time interest in the evolution of poverty alleviation programmes in India predates the emergence of the microfinance sector. I would, therefore, use this opportunity to reflect on the role of microfinance institutions in the alleviation and eradication of poverty and flag certain

problems for your consideration in the context of the theme of the Summit, namely, “The Poor First”.

The first basic question that needs to be addressed is the diagnosis of the causal forces underlying the perpetuation of poverty at the household level. Although India has been one of the ten fastest growing economies in the world in the last two and a half decades, its per capita income in purchasing power parity terms still lies among the bottom third of the countries ranked in descending order of per capita GDP. Low per capita GDP implies low average absolute productivity per worker and the poor households are located at the lowest end in the dispersion around the low average labour productivity. In other words, poverty is the result of low productivity of mostly self-employed economic activities engaged by the poor households. Low productivity, in turn, is caused by inadequacy of or total lack of access to human capital (education, skills) and physical resources including land and use of backward and often out dated technology. Sustained poverty eradication at the household level, therefore, requires sustained rise in productivity of economic activities undertaken by the poor households by making up inadequacy of physical resources combined with technology up-gradation in the short run and development of human capital base in the medium run by skill up-gradation and educational advancement. Credit is indeed the lifeline of any economically productive activity and it is well recognized that the poor households are excluded from affordable and timely availability of institutional sources of finance and consequently, they are also excluded from the participation in the normal growth process. It is important to underline, however, that credit is merely one of the constraints on low productivity and its access would not help poverty alleviation in the face of non-financial constraints like absence of able-bodied worker in a poor household or lack of access to growing markets. In other words, access to affordable and timely finance in adequate quantity would help in those cases where availability of credit is a binding constraint on raising the low productivity of economic activities of the poor households.

In the evolution of anti-poverty programmes in India since Independence, the focus in the 1950s was on rural indebtedness and the institutional alternative to privately owned commercial banks with little rural presence was sought in the development of cooperative credit and non-credit institutions with considerably uneven success in reaching the poor households. With nationalization of scheduled commercial banks in 1968

and the rural branch expansion programme that followed, certain target-group-oriented programmes were evolved such as marginal and small farmer development agencies, programmes for desert and semi-arid areas and the development agencies for the scheduled tribes. The focus shifted to Integrated Rural Development Programme (IRDP) in the 1980s under which identified *individual* poor rural households were given subsidized loans from the commercial banks to acquire a productive asset in an effort to transform them into viable enterprises. The programme was mainly supply-driven under which nationalized commercial banks were given targets each year to extend subsidized loans to the poor households. The programme was fraught with all the problems associated with supply-driven quantitative target-oriented programmes : dilution of quality in order to meet quantitative targets, undesirable intermediaries appropriating the subsidies, assets wherever acquired from the loans being sold to repay the debts and rise in indebtedness. Taking inspiration from the success of the grameen banks in Bangladesh, the experiment with the self-help groups (SHGs) that was started in 1992 is the latest stage in the evolution of anti-poverty programmes to improve upon IRDP by correcting its deficiencies. It is distinct from IRDP in at least three basic characteristics. Unlike IRDP, it is demand-driven rather than supply-driven so that it aims at satisfying the felt-need for credit rather than credit being forced on a poor household to meet a quantitative target. Secondly, the focus shifts from lending to an individual household to group-lending where monitoring the utilization and repayment of loan is undertaken by the group thereby reducing the risk of default. Thirdly, each member has a stake, however small, in the SHG activities before credit was delivered and not a mere recipient of subsidy. However, it increased the need for organizational input for the formation of SHGs and connecting them to the organized institutional banking system. To my understanding, the emergence of microfinance institutions (MFI), although they are serving a wider set of clients and performing a wider set of functions, is critical in this context of meeting the need for effective intermediary between the final stage clients, namely, the grass root community organizations of the poor and the organized institutional banking system. For the commercial banks, the presence of a dependable intermediary would minimize the transactions costs of serving a large number of small borrowers, reduce the individual-specific behavioural risk of default as also the costs of monitoring the implementation and recovery of loans under the credit-linked anti-poverty programmes. For the ultimate clients, they facilitate an easy access to the institutional sources of finance which involve lower interest costs and hence are more affordable than the

alternative sources credit in the informal credit markets. For the small-scale poor borrowers, they also perform a critical function of linking the primary producers with mainstream markets by supplying non-financial services such as organizing the self-help groups with the required handholding and nurturing activities, identifying potential borrowers by undertaking preliminary appraisal and marketing of other financial products. Given the wide variety of financial and non-financial services that they provide, MFIs take a diverse variety of organizational forms including NGOs, functional cooperatives, IT-enabled rural outlets of corporates, postal agents, insurance agents and so on. They also take all possible diverse institutional forms -- non-profit institutions, mutual benefit societies and professional for-profit organizations.

I am happy to note that this Summit is providing an important forum for the discussion of the problems faced as well as exchange of experiences in evolving inclusive and innovative solutions for enabling the poor to overcome poverty. The focus on smaller MFIs in tiers II to IV as also on underserved areas is particularly welcome in view of the current inadequate coverage of the areas with high density of the poor population. Finally, let me seek your indulgence to sound a couple of cautionary notes briefly. One, with reference to 'lift and shift' model, it is important to keep upfront the shift part which requires that the aim should be to make the client independent of handholding and nurturing before shifting and avoid making the client dependent on the support. Secondly, while charity is and would remain important for supporting the poverty-alleviating activities of the MFIs especially in the current extraordinary situation of international financial meltdown, the limited magnitude of coverage of the poor households so far requires that MFIs also generate funds from commercial activities that can be added to the funds available from the donors in expanding the reach of MFIs. In my view, the focus on upscaling and sustainability challenges of the service-providing MFIs is as important as that on the perspectives of the clients with regard to the services provided.

Finally, I again wish to express my gratitude for giving me an opportunity to be here.

Thank you.

[Text of the speech at the Inaugural Session of The Microfinance India Summit 2008 on November 11, 2008 at Ashoka Hotel.]