

# Microfinance Industry in Bangladesh and India: International Perspectives

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## Abstract

The study explores the microfinance industry in Bangladesh and India. Grameen Bank proved that financial inclusion of low-income households is the way out of poverty and that lending to poor can be profitable to both the borrower as well as the lender. Since then many microfinance institutions came up either following the same operating model as Grameen Bank or some form of its derivative. Many microfinance institutions (MFIs) in India started as non-profit NGOs and soon became for-profit non-banking financial companies (NBFCs) reflecting the financial viability of these institutions. With high returns, promising growth and portfolio diversification capabilities, microfinance industry in India has become a hotspot for foreign as well as local investors. Apart from widely known benefits, the study also highlights the criticism and challenges faced by the microfinance industry worldwide.

Keywords: microcredit, remittance, collateral, securitization, private equity, IPO

## 1 Overview

Microfinance is a tool which offers poor people access to basic financial services such as loans, savings, and money transfer services and micro-insurance who are generally not considered as profitable by commercial banks and hence not catered. People living in poverty, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption, and manage risks. Poor people usually address their need for financial services through a variety of financial relationships, mostly informal. Credit is available from informal moneylenders, but usually at a very high cost to borrowers. Savings services are available through a variety of informal relationships like savings clubs, rotating savings and credit associations, and other mutual savings societies.

Poor people are not considered creditworthy by commercial banks because banks find it more profitable to lend big loans in small numbers as it minimizes administrative costs, rather than lending many small loans. Besides, they look for collateral with clear ownership title and sometimes a verifiable credit history which most low-income households do not have. Finally, the financial strength and future earnings prospect of poor people are not convincing enough and therefore are deemed highly risky imposing high information monitoring cost. Therefore, low-income households cannot meet even the most minimal qualifications to gain access to traditional credit.

Microfinance refers to financial intermediation between microsavings and microcredit, and includes a broader range of services, such as loans, savings, insurance and transfer services (remittances) targeted at low-income clients. A variety of institutions can provide these services, including NGOs, credit unions, cooperatives, private commercial banks, non-bank financial institutions (some that have transformed from NGOs into regulated institutions) and parts of state-owned banks. Microcredit which is an integral part of microfinance refers to very small loans given to low income people with little or no collateral provided by legally registered institutions. Over time, the microfinance industry recognized that the poor who lack access to traditional formal financial services required a variety of financial products to meet their needs not just microcredit prompting the evolution of microcredit into microfinance.

Though started as productive lending to help establish sustainable microenterprises, microfinance loans serve the low-income population in multiple ways by: (1) providing funds to buy assets to start a business; (2) providing working capital to expand businesses; (3) infusing credit to smooth cash flows and mitigate irregularity in accessing food, clothing, shelter, or education; and (4) cushioning the economic impact of shocks such as illness, theft, or natural disasters. Moreover, by providing an alternative to the loans offered by the local moneylender priced at 60% to 100% annual interest, microfinance prevents the borrower from remaining in a

debt trap which exacerbates poverty.

Grameen Bank established in 1976 by Dr. Muhammad Yunus in Bangladesh, microfinance institutions (MFIs), Community banks, Self help groups (SHGs), NGOs and grassroots savings and credit groups around the world have shown that there exists huge untapped potential at the base of the socio-economic pyramid and these microfinance services can be profitable for both the borrowers and the lenders.

## 2 Global microfinance industry

The microfinance industry traces its roots to the mid-1970s, when the first microfinance institutions (MFIs) were established in South Asia and Latin America. During the same period, the successful model of Grameen Bank in Bangladesh was accepted and adopted by other MFIs around the globe. The industry has since expanded throughout the developing world and has become one of the most significant areas targeted by the socially responsible and private and public equity investors. The United Nations declared 2005 the "International Year of Micro-Credit". One year later, Prof. Muhammad Yunus, the founder of Grameen Bank in Bangladesh, and Grameen Bank were awarded the 2006 Nobel Peace Prize.

The microfinance industry has experienced rapid growth since mid 1990s and spans the developing world of Latin America, Africa, Eastern and Central Europe, Arab countries, South Asia, East Asia and Pacific. MFIs have evolved from donor-dependent credit NGOs and credit cooperatives to licensed financial institutions, non-bank financial institutions and niche banks. Driven by high return and portfolio diversification potential coupled with social inclusion have attracted both local and global investments including private equity and capital markets. MFIs in Middle East offer microfinance services that are shariah (Islamic law) compliant. To date, there have been several successful initial public offerings by pure microfinance institutions, including: Bank Rakyat Indonesia (Indonesia) in 2003, Equity Bank Limited (Kenya) in 2006, Banco Compartamos (Mexico) in 2007 and SKS microfinance (India) in 2010.

As of December 31, 2009, there were 1,395 MFIs globally with an estimated borrower base of 86 million with a total outstanding portfolio of over \$44 billion as reported by the MFIs to the Microfinance Information Exchange or "MIX Market", excluding MFIs that do not report to MIX Market. From 2003 to 2008, the global industry experienced a growth in borrowers at a CAGR of 12% and a portfolio outstanding CAGR of 34%. Inter-regionally, South Asia, East Asia and the Pacific region had the highest growth rates in terms of borrowers, and Sub-Saharan Africa, Middle East and North Africa have experienced the slowest growth. Latin America

continues to lead in terms of portfolio outstanding with \$16 billion or 36% of the total global portfolio; however, South Asia has the lead in terms of borrowers with over 50% of the global borrower base. The disparity between these two trends is explained by the variance of average loan sizes in the two regions, which is a product of their economic well-being and the business models followed by their respective microfinance sectors.

## 3 Grameen Bank

Grameen Bank was started as an action research Project by Dr Muhammad Yunus in the village of Jobra, Bangladesh, in 1976 to examine the possibility of designing a credit delivery system to provide banking services targeted at the rural poor. In 1983 it was transformed into a formal bank under a special law passed for its creation. With the mission to help the poor help themselves it embraces the following objectives; (1) to extend banking facilities to poor families; (2) eliminate the exploitation of the poor by money lenders; (3) create opportunities for self-employment for large number of unemployed people in rural Bangladesh; (4) to empower women who is more committed to family ties; (5) to end the vicious cycle of low income, low savings and low investment. Dr. Yunus received the Nobel Peace Prize in 2006 for his work.

Grameen bank is owned by the borrowers whom it serves. Borrowers of the Bank own 95% of its shares, while the remaining 5% is owned by the government. Total number of branches, as of 2010, stand at 2,565 branches with 8.36 million borrowers, of whom 97% are women. Its operations cover 81,378 villages with a total staff of 22,277. Total amount of loan disbursed by Grameen Bank since its inception, is USD 10.38 billion out of which USD 9.20 billion has been repaid with a loan recovery rate of 97.32%, higher than any commercial bank in the country. Monthly average loan disbursement over the past 12 month was USD 117.63 million. It has an annual growth rate of 20% in terms of its borrowers. Besides, the bank has been profitable ever since it came into existence except for years 1983, 1991 and 1992. A portion of the profit is distributed as dividends among its shareholders who are also its borrowers. In 2006, the dividend paid was 100% of the profit while in 2009 it was 30%.

The Bank has four tiers, the lowest level being branch office and the highest level being the head office. The branch office supervised all the ground activities of the bank such as organizing target groups, supervising the credit process and sanctioning loans to members. For every 15-22 villages, a branch is set up with a manager and several centre managers. An area office supervises around 10-15 branch offices. Program officers assist the area office to supervise the utilization of loans and their recovery. All area offices are under the purview of

a Zonal Office. Each zonal office supervises around 10-13 area offices and all zonal offices report to the head office situated in Dhaka.

The bank gets its funding from different sources, and the main contributors have shifted over time. In the initial years, donor agencies like World Bank, Ford Foundation used to provide the bulk of capital at very cheap rates. In the mid-1990s, the bank started to get most of its funding from the central bank of Bangladesh. Grameen Bank believes that the sustainability of the credit model is enhanced if it is intermediated by savings or deposits and a greater proportion of its loans are financed by the deposits of the bank itself. Moreover, the bank stopped taking any donation funds, the last being in 1998. The deposits of the bank have been sufficient to meet the growing demand of loans. More recently, Grameen has started bond sales as a source of finance. The bonds are implicitly subsidized as they are guaranteed by the Government of Bangladesh and still they are sold above the bank rate.

Grameen Bank follows Group lending and progressive loan model without any material collateral. Borrowers are organized in groups of five and subsequent loan to a member is sanctioned only when the previous loan has been paid off. Though the bank makes use of peer pressure and collective responsibility to receive back the loan payments i.e. no credit is given to other members of the group in case one member defaults, it does not impose any sort of group guarantee or joint liability i.e. group members are not responsible to pay on behalf of a defaulting member.

A greater preference is given to income-generating venture which has multiplier effect in creating wealth. Interest on conventional bank loans is generally compounded quarterly, while all interests are simple interests in Grameen Bank and may range from 22% for microenterprises to 0% for beggars. Repayment of Grameen loans is made easy by splitting the loan amount in tiny weekly installments making it convenient for its borrowers to pay back. Loans are small, but sufficient to finance the micro-enterprises undertaken by borrowers: rice-husking, machine repairing, purchase of rickshaws, buying of milk cows, goats, cloth, pottery etc. The bank also provides loan insurance, life insurance and pension fund program that goes beyond its role as a financial intermediary between savings and loans.

Grameen Bank introduces social intermediation as an integral part of financial intermediation to improve both social and financial discipline among the poor by encouraging the borrowers to adopt some goals in social, educational and health areas. This is reflected in "Sixteen Decisions" adopted by Grameen borrowers and includes issues like no dowry, education for children, sanitation, planting trees, arranging clean drinking water, extending scholarships and education loans and coping with

disasters and emergency situations. Grameen Bank manages an emergency fund for use as insurance against potential default because of death, disability, or other misfortunes.

Grameen bank has earned a worldwide reputation for its innovative credit delivery to the rural poor. By incorporating group-based lending, mandatory savings and insurance, repayment rescheduling in case of disasters, and similar other schemes has developed a sustainable and effective Economic & Social Development Model. Now, the vision of Grameen bank is to replicate an appropriately customized variation of this model in each and every country of the world where poverty exists. To this end, Grameen Trust was set up to provide the seed capital, training, technical assistance and experience-sharing to economists and bankers of other countries wanting to emulate Grameen Bank's system.

## 4 Microfinance Industry in India

The microfinance industry in India is one of the fastest growing microfinance markets in the world and has become a hotspot in microfinance activity. Several reasons contribute to this development; (1) India houses around 300 million poor population, one of the highest in the world and most of them with little or no access to basic financial services; (2) communities are fragmented with various different groups based on caste, race or economic status which facilitates group lending; (3) extensive network of rural banks like Regional Rural Bank and credible NGOs; (4) dense population which makes access to the borrowing groups time and cost-effective; (5) prospective borrowers are poor, illiterate and marginalized and are vulnerable to exploitation. In India, the micro finance movement has almost assumed the shape of an industry, embracing thousands of NGOs/MFIs, community-based self-help groups and their federations, cooperatives in their varied forms, credit unions, public and private banks.

Among the above mentioned institutions SHG-Bank linkage model and Microfinance institutions (MFI) are more pronounced. SHG-bank linkage model was adopted in early 1990s by NABARD (National Bank for Agriculture and Rural Development). In this model, self-help groups are formed under the guidance and supervision of NGOs which then receive micro-credit from various branches of Regional Rural Bank and other national and commercial banks as subsidized loans. The real growth of MFIs came in the first decade of this century and increasingly, microfinance institutions are perceived as an effective channel for ensuring financial inclusion of the low income population and those in the informal sector. The MFI channel of credit de-

livery, coupled with the national level programme of SHG-Bank Linkage, today, reaches out to millions of poor across the country.

The microfinance sector in India has developed a successful and sustainable business model which has been able to overcome challenges traditionally faced by the financial services sector in servicing the low income population by catering to its specific needs, capacities and leveraging preexisting community support networks. As of March 2009, microfinance institutions (MFIs) in India reached over 22 million borrowers and had a portfolio outstanding in excess of \$2.3 billion. Over the past five years, the sector has delivered a CAGR of 86% in the number of borrowers and 96% in portfolio outstanding whereas the global industry experienced a growth in borrowers at a CAGR of 12% and a portfolio outstanding CAGR of 34%.

One of the interesting features of these MFIs is that they have transformed from non-profit NGOs to regulated for-profit institutions whose mission is to earn profit by empowering poor. For long, these MFIs have limited the scope of their financial services to offering microcredit to individuals or group of poor people without any material collateral which are payable in weekly installments. Microfinance loans in India range in size from \$100 to \$500 per loan with interest rates typically between 25% and 35% annually which is higher than what is charged by Grameen Bank. Recently, with the microfinance sector maturing, it has started to diversify its product and service base to address other unmet financial and non-financial needs of the low income population either directly or by acting as a conduit for third-party providers – savings, insurance, remittance and low cost education and healthcare services.

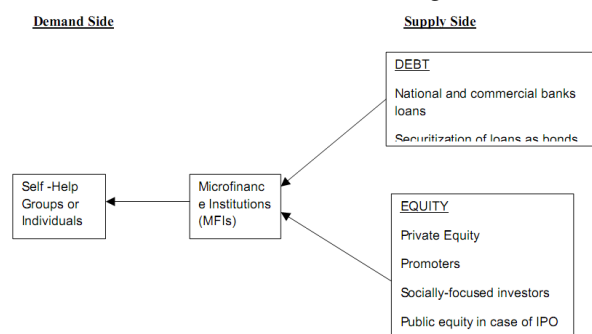
## 5 Business model of MFIs

The Business Model on which most of the MFIs works is solidarity lending or group lending. In this model an MFI lends a small loan to an individual, who belongs to a group of 5 to 20 people. As soon as the individual borrower proves reliable, credit is extended to additional people within the group. This procedure creates an incentive for the group to monitor each other's behavior and to ensure borrower discipline, as the group is jointly liable for the failure of any single member to repay her microloan. These loans are progressive in nature i.e. the subsequent loan amount for a borrower increases only when she has paid all her previous outstanding debt. The Solidarity lending lowers the administrative costs to a financial institution related to assessing, managing and collecting loans, and can eliminate the need for collateral. The above cited Model helps in minimizing the delinquency rate.

The loans are mostly inclined towards income-

generating loans though they can also be made for consumption purposes and are subject to loan utilization checks and are payable in small weekly installments for 6 months to 2 year term. The average loan size starts from USD 100 and can reach several hundred dollars with interest rates typically between 25% and 35% annually. Being for-profit institutions, MFIs command higher interest rate which is in excess of their financial, operational and risk-bearing cost. Though the core service of the MFIs is microcredit, recently they have expanded their services to microsavings, micro-insurance, health and education loans.

The growth of Indian MFIs has been enhanced by the availability of debt financing from both private and public sector banks, which have significantly increased their exposure to microfinance over the last decade. As of March 2009, banks and financing institutions had a total exposure to MFIs of \$2.45 billion. This represents an almost 150% increase from the exposure in March 2008 of \$984.8 million and a 200% increase from the exposure in March 2007 of \$805.6 million. The priority sector lending (PSL) requirements set by the RBI (central bank of India) have encouraged banks to lend to MFIs as a way to satisfy their financial inclusion quotas for lending to agriculture and weaker and more deprived sections of society. As of the end of fiscal year 2008-09, banks and new entrants had capital worth \$100 billion available for lending to MFIs.



Microfinance institutions can broaden their resource base by mobilizing savings, accessing capital markets, loan funds and effective institutional development support. A logical way to tap capital market is securitization through a corporation that purchases loans made by microenterprise institutions with the funds raised through the bonds issuance on the capital market. The equity financing flowing into the industry is reflective of the growth story it has experienced. Microfinance is gaining increasing ground as a viable investment sector. Since 2006, in India more than 25 equity transactions totaling more than \$295 million in primary investments in the microfinance space have been completed. In fact, the current fiscal year has also witnessed the entrance of mainstream private equity firms in the microfinance space, which had been previously occupied singularly by socially oriented investors.

The microfinance business model in India typi-

cally generates a Return on Equity (ROE) of between 20% and 30%, driven by financing from commercial banks, strong operating efficiency and high portfolio quality and an ROA of 3-5 %. To fulfill the growth projections, the microfinance industry continues to rely increasingly on equity versus debt. This need is compounded by the Reserve Bank of India's (RBI) capital adequacy requirement for the sector which has been increased from 12% to 15% in 2010. Commercial banks are the main sources of funding for MFIs. First, some banks directly grant microloans to the poor. Second, other banks such as Citibank or ICICI provide funding to MFIs. Third, banks distribute microfinance investment vehicles, e.g. Credit Suisse offers the Responsibility Global Microfinance Fund and Deutsche Bank distributes db Microfinance- Invest Nr. 1. Lastly, some banks such as ICICI, Deutsche Bank or Citibank have also been active in the securitization of MFIs' loan portfolios

## 6 Difference between Grameen Bank model and Microfinance Institution model

Though there are many similarities in the working models and objectives of Grameen Bank and MFIs, the main difference lies in their Ownership structure. 95% of Grameen bank is owned by its borrowers while MFIs have diverse owners like private equity investors, socially-oriented domestic investors, other commercial banks or shareholders (in case of public listed MFI). This ownership structure of Grameen bank not only helps borrowers by sharing yearly profits as dividends but also help the bank to enjoy higher repayment ratio as borrowers have a sense of belonging. Besides, many MFIs are for-profit institutions; therefore, profits earned by MFIs never go to the borrowers.

The interest rate on Grameen Bank ranges from 0% to 21% loan which is substantially lower than 25-35% charged by MFIs in India. The difference is due to the different lending rates by commercial banks (market rate) in the two countries and higher profit margin sought-after by MFIs in India. Another difference lies in the operational capacity of the two models. Since Grameen Bank enjoys the status of banking finance company, it can offer full financial services including deposits whereas MFIs in India, currently, can get the status of only Non-banking finance company (NBFC) and are restricted to take deposits which is the exclusive right of banks only.

Finally, Grameen bank has a more pronounced social intermediation effect that goes beyond financial inclusion like the bank provides training and skills development programs commensurate with their loan objectives in order to help the borrowers make the most of their loan. Besides, it also

initiates 'sixteen decisions' covering other social issues like sanitation, education scholarship, health etc. These issues are largely not catered explicitly by MFIs though they strive to bring social changes through financial inclusion of poor population.

## 7 Benefits

In the words of Dr. Yunus, the poor remain tangled in the vicious cycle of low income, low investment and poverty because they lack access to basic financial services making them vulnerable to exploitation by private money lenders exacerbating their poor financial condition. Microfinance started with a mission to help poor break this cycle and improve their living standard by adopting social inclusion in conjunction with financial inclusion of poor and under-privileged that are not being catered by mainstream financial institutions.

Micro credit support to productive activities has helped many low-income households to start a new or expand existing enterprises which not only provided better employment opportunities but also increased enterprise income. It also reduces casual labor thereby smoothening fluctuating income flow improving their capacity for coping with risk situations. Besides, it also contributes in the acquisition of fixed assets like cattle, tools which is a measure of improving standard of living. Therefore, microfinance not only invigorates the rural economy but also integrates it with the mainstream economy through broader economic inclusion.

The low-income households are exposed to a number of risks like fluctuating income, unstable employment, emergency situations and natural calamities. In order to mitigate their exposure to these risks, microfinance provides various micro-insurance schemes like crop insurance and life insurance by paying a petty premium for these services. Besides, mobilizing savings made by the borrowers also give some cushioning against adverse circumstances.

It also helps promote gender equality and women empowerment especially in rural areas with preferential lending to women who constitute more than 90% of total borrowers and enabling them to have more control in running family businesses. It enables poor to take advantage of education opportunities for their children by providing educational loans and scholarships. It also helps them to acquire various skills enhancement and training programmes in becoming self-sufficient and provides an array of non-financial services such as agriculture, business development consultation and healthcare services reiterating the needs of poor that go beyond financial intermediation.

Additional services as well as social business models can be built by leveraging microfinance infrastructure. An interesting example is Grameen Shakti in Bangladesh that leverages the brand and

infrastructure of Grameen Bank's nationwide microfinance program to reach rural people with clean and affordable energy in a country where 80% of the people still do not have access to electricity. It was established in 1996 and by 2008 it had installed more than 180000 solar home systems, installing more than 8000 new ones each month.

## 8 Criticism

The success and worldwide recognition of microfinance does not make it a critic-proof model and draws criticism on various grounds including the operating models of these institutions. Milford Bateman, a research fellow in Overseas Development Institute, London and the author of the book "Why doesn't microfinance work? The destructive rise of local neoliberalism" is skeptic about the potential of microfinance for sustainable poverty alleviation and as a sustainable social and economic development model. He considers the success surrounding microfinance as 'Microfinance bubble' and infers it to be counter-productive for the local economy. He justifies his argument by the fact that countries like Bangladesh, Bolivia, Bosnia and many African countries where microfinance has become saturated and yet no significant poverty alleviation is observed.

The critics challenge the fundamental economic model of microfinance where very small loans given to develop and nurture micro-enterprises are perceived as long-term sustainable development model. They argue that the problem with microfinance is that as much as 90%-95% of microenterprises fail over five years, and very few grow to the status of SMEs to support long term employment and wealth creation. They point that Grameen Bank and MFIs rely on expanding the informal sector and on supporting the tiniest businesses limiting to primitive type of businesses and farming activities. They stress more on high success rate of businesses by the loans than the repayment rate of the loans as a measure of long term sustainability and development.

High interest rates compared to market rates are considered no less than 'loan sharking'. Microenterprises established at this high cost of capital are not productive enough to cover the high interest rate of 20- 36% leading to their failure and exacerbating poverty for these supposedly micro-entrepreneurs. Moreover, these tiny businesses, inherently, have less chances of survival due to lack of scale and expertise and the local market in poor countries being saturated with the same products consumed locally and produced by microenterprises.

While the underlying objective of microcredit is to give income-generating and productive loans for developing micro-enterprises, a greater proportion of microcredit was channeled for consumption purposes, to buy food, consumer durables and to ser-

vice other loans which suppresses the multiplier effect of these productive loans. MFIs, particularly, have been criticized for increasingly doling out multiple loans to individuals for consumption purposes without proper scrutiny of the borrowers repayment capability just in hope to earn higher profits. Critics believe, this further pushes poor into poverty and may lead to 'microcredit crises'.

Another criticism targets ways microfinance institutions use for loan recovery. Because field officers are in a position of power locally and are judged on repayment rates as the primary metric of their success, they sometimes use coercive and even violent tactics like seizing their assets to collect installments on the microcredit loans. Recently, a spate of suicides of MFI borrowers in Andhra Pradesh in India testifies the criticism of use of forceful and coercive means for loan recovery. Besides, the management and top executives of MFIs are criticized to pay themselves exorbitantly (high salaries, bonuses, shares options) which is termed as 'wall Street type rewards' by critics. This increases the administrative cost for MFIs and hence the interest rate charged on microcredit shifting the burden on poor borrowers.

The recent trend of MFIs moving to capital markets to raise equity funding has been criticized by both the proponents and opponents of microfinance alike. This move is seen as an exit strategy for the private equity investors and promoters and to make one time balloon profit. This shows greed, profiteering and inefficiency for institutions who cry empowering poor and promoting socio-economic development. The recent IPO of SKS, an MFI in India, gave Vikram Akula, the chairperson and founder of SKS, \$12 million from the sale of only 25% of the share options he had.

Microfinance undermines the growth of formal finance sector through 'race to the bottom of the pyramid' and taking away market share unfairly. Governments in developing countries use microfinance to cut public spending on the poor who are left with no other option than to borrow expensively from MFIs. Besides, critics argue that it is difficult to quantify household benefits resulting from financial services and to demonstrate causality. Moreover, these impact studies are mostly conducted by microfinance industry players which have strong incentive to present a favorable landscape of microfinance and its social impact.

Recently, Bangladesh Government under Sheikh Hasina Wajib has called for investigations for scrutinizing Grameen Bank following reports of exorbitantly high interest rates, coercive means of loan recovery and sinking borrowers especially women. Furthermore, the Central bank accused Grameen bank for violating its charter as a micro-lender by creating affiliates that become successful business entities but did not benefit the bank shareholders who are also the bank borrowers. But many believe that the investigation is politically motivated.

The investigation is also prompted by allegations of an illegal transfer of Norwegian development funds from Grameen to another venture.

## 9 Challenges

Absence of a proper regulatory framework and supervision mechanism, particularly in developing countries, for the sector is a major hindrance in the orderly growth of the sector. Regulators need to acknowledge differences between microfinance and traditional finance while carving the legal framework for microfinance sector which should not be restricted to just extending the existing framework to cover microfinance sector. Regulations of reporting requirements, corporate governance, capital adequacy ratio, CAR (ratio of a bank's capital to its risk) etc should be well-crafted to support the growth of the industry. For an instance, the interest rates should not be high enough to become a burden on borrowers and not low (or capped) enough to drive these institutions out of business.

One major concern for the microfinance industry is the transparency and regulations governing it to satisfy its diverse stakeholders. Transparency is required at all parts of the business model like specific activities and services offered by the institution, dealing with poor clients, loan disbursements and recovery methods, their cost of capital and interest rate offered, social performance of the loans and its results and other ethical conduct. Further, measuring the social impact on loans is a challenge in itself. Given the limited tools available and use of proxies make it difficult to estimate the return on microcredit accurately and reliably.

Another challenge for microfinance is its difficulty in reaching remote areas and serving very poor population. While microfinance institutions have had some concrete results in delivering services to poor, very poor are yet to be reached and benefitted, especially, in hard-to-reach rural areas. Besides, lack of economies of scale due to small size of the loans and being human-resource intensive increases the operating cost and requires them to be highly efficient and use of innovative technologies to keep the interest rates competitive. The challenge also lies in developing support systems for the sector in terms of building a pool of qualified professionals.

## 10 Future

Until today, microfinance is dominated by microcredit, lending small loans to poor. With the microfinance industry getting matured and competitive, players have started expanding their portfolio of services to include insurance and remittances on a large scale to offer complete financial services

to rural and low-income households. Further, institutions have long depended on loans from commercial banks as a source of funds for on-lending. Easy access to commercial loans reduces their willingness to adopt savings-led credit system which makes them dependent on external funds and market liquidity. In order to be more financially sustainable, institutions would take to mobilizing savings and reduce their dependency on external funds.

Microfinance has emerged as a new industry but is moving towards integrating with mainstream financial sector which is witnessed by an increasing exposure of commercial banks to MFIs in the form MFI-bank alliances and mergers, banks acquiring stakes in MFIs or complete buyout and banks directly offering microfinance services to poor population. Besides, a reverse trend is also observable with many MFIs starting as NGO-MFI grow to become MFI-NBFC (Non-banking finance companies). Many of these NBFCs are hoping to become fully fledged banks which would widen their scope of operations and exempt them from several restrictions like taking deposits for a fee.

Microfinance sector is considering advanced telecommunication technologies to solve governance issues, reduce transaction costs due to small loan sizes and to reach the poorest in remote areas. Automated loan system, mobile banking and custom tailored IT system would be required at large scale to expand their reach and impact. Besides, microfinance infrastructure can serve as an alternative distribution channels by companies to reach underserved rural market. Microfinance organizations that have established brands and high quality relationships with local population in remote markets have an interesting possibility to leverage these relationships as a platform for developing and distributing various products and services.

## 11 Conclusion

For long, microfinance services has been delivered by traditional institutions like credit NGOs, cooperatives, community banks, chit funds or rotating savings and credit unions (ROSCA) but operated at small scale and offered limited services leading to insignificant outcomes. Grameen bank, established by Muhammad Yunus, pioneered the microfinance revolution as a tool to alleviate poverty through financial and social inclusion of low income population and inspired many microfinance institutions across the globe. Microfinance gained worldwide recognition and impetus with the Nobel Peace prize 2006 awarded to Muhammad Yunus and Grameen Bank. The success of Grameen Bank and MFIs in various parts of the developing world demonstrates the economic viability of Microfinance in weeding out poverty.

Once synonymous with microcredit, microfinance has expanded to include microsavings, mi-

croinsurance, remittances and health and education loans. India's ever-expanding microfinance industry has witnessed phenomenal growth in the last decade with seven MFIs making way to Forbes 'top 50 MFIs in the world' in 2007. Their success has attracted many global and local private equity investors to invest in India's burgeoning microfinance industry reflecting the financial viability of these MFIs. These MFIs have consistently delivered high ROE and ROA which shows high profitability and operational efficiency of these MFIs respectively. National and commercial banks have also come to play a bigger role by providing not just loans to these MFIs but also offering microfinance investment vehicles (MIV) and securitizing MFIs' loan portfolios.

In spite of huge success, MFIs and Grameen Bank have drawn widespread criticism. The opponents of microfinance challenge the capability of microloans for micro-enterprises as a means to reduce poverty, as most micro-enterprises fail shortly and do not create job opportunities. This further pushes them into poverty owing to high interest rates on these microloans. Besides, the industry is also criticized for high operation cost translating into high interest rates, coercive collection means, delivering consumption loans rather than productive loans and lack of reliable tools to measure social performance.

As the microfinance industry advances, it faces numerous challenges as well. Regulatory provisions, ethical practices, savings-led lending, success of micro-enterprises and high administrative cost, among others, are the issues that require immediate attention for the industry to flourish. Meanwhile, the proponents of microfinance are optimistic about the capabilities and prospects of microfinance in alleviating poverty through financial inclusion of poor.

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