

# Addressing Financial Exclusion through Microfinance: Lessons from the state of Madhya Pradesh, India

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## Abstract

In India more than half of the poor are financially excluded from the country's formal banking sector. The situation is similar in other developing countries. This article analyzes the state of financial inclusion using the case of Madhya Pradesh, one of the poorest states in India, and suggests microfinance as a tool for successful financial inclusion. Through various interviews with the stakeholders of financial inclusion in Madhya Pradesh, the author identifies the obstacles and challenges faced by banks, microfinance institutions, and non-governmental organization in their efforts to scale up.

## I. Introduction

In India and other developing countries, most poor people are excluded from participation in the formal financial sector, whether it is from access to credit, savings, or insurance. The purpose of this article is to present important lessons for policymakers and various stakeholders who are eager to solve the problem of financial exclusion in their respective countries.

The United Nations defines financial inclusion as easy access to safe savings, appropriately designed loans for poor and low-income households and for micro, small and medium-sized enterprises, and suitable insurance and payments services (United Nations 2006). Belonging to a well-functioning financial system empowers people economically and socially, especially the poor, and allows them to better integrate into their country's economy, actively contribute to their development and protect themselves against economic shocks. Nevertheless, financial inclusion (FI) alone does not guarantee welfare improvement for the poor. Thus, efforts to increase financial inclusion need to be accompanied by governmental enhancement of infrastructure, education and health services. This article recommends that policymakers use microfinance, and preferably so-called livelihood models, as a tool to achieve greater financial inclusion.

This is a case study undertaken to analyze the status of efforts in financial inclusion by banks, India Post, microfinance institutions (MFIs) and non-governmental organizations (NGOs) in the state of Madhya Pradesh (MP) in India. As such, this paper is not a comprehensive analysis of the microfinance sector. It has the dual

objective of examining factors that hinder efforts toward financial inclusion in MP, as well as applying some of the lessons learned in MP to future microfinance initiatives.

## II. Context of Financial Inclusion in India

The financially excluded sector in India consists largely of marginal farmers, landless laborers, self-employed small vendors (hawkers), unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities, senior citizens and women. About 36 percent of the Indian population lives on less than \$1 per day. Most of this population lives in the states of Bihar, Madhya Pradesh, Rajasthan, Chhattisgarh, Jharkhand, Uttaranchal and Uttar Pradesh, which are collectively known by the acronym BIMARU.<sup>5</sup> According to the Summary Recommendations of the Committee on Financial Inclusion, 51.4 percent of farming households in India are financially excluded from both formal and informal sources of credit, and only 27 percent of total farming households have access to formal sources of credit. This situation is worse in the Central, Eastern and Northeastern regions where 64 percent of farmer households are financially excluded (NABARD 2008).

When people do not have access to bank accounts and formal credit markets, they are forced to approach informal and often exploitative financial markets. For

<sup>5</sup> India's five 'poorest' states, according to the Planning Commission's 1999-2000 figures, were Orissa, Bihar, Madhya Pradesh, Sikkim and Assam.

example, in Jabalpur District of MP, clients of Sonata<sup>6</sup> report that, in the case of an emergency, they are forced to take loans from moneylenders who charge anywhere from 5 to 10 percent weekly interest (equivalent to 240 to 480 percent annually)(NABARD 2008).

Empirical evidence suggests that access to financial services helps the poor and has a positive impact on nutrition and health outcomes, demand for education and the status of women within a household (Littlefield 2003). In the beginning of 2008, the Indian government's Committee on Financial Inclusion set a goal to provide access to comprehensive financial services to at least 50 percent of the excluded rural households by 2012 and to cover the remaining households by 2015. For the past few years, there has been a noticeable effort by the Indian government to bridge the gap of financial exclusion through new outreach mechanisms like "no-frills saving accounts" —saving accounts with zero or low minimum balances—Smartcards, Business Correspondent (BC) and Business Facilitator (BF) models, bank alliances with the post office system and other initiatives. Such efforts in Madhya Pradesh are discussed in detail in Section III of this paper.

Nevertheless, comprehensive financial services should go beyond providing access to consumption credit and no-frills accounts, which have been used recently by the formal banking sector as a solution for reaching targets on financial inclusion. Financial products delivered to the unbanked population should be aimed at overcoming market imperfections and providing vulnerability-reduction and risk management for the poor.

Without risk management and vulnerability-reducing products, loan defaults often result in institutions refusing to lend to the poor in the future, once again leaving them in debt and financially excluded. In addition, including the poor in the financial system without addressing structural causes that result in the failure of their livelihoods may also lead to greater exclusion, especially in rural areas. Linkages of credit to livelihood activities, ability to absorb and repay credit, infrastructure, and financial education should all be taken into account in the course of financial inclusion. Microcredit alone will not lead to significant

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<sup>6</sup> Sonata is an MFI in Madhya Pradesh that offers microfinance-only services similar to SKS and Samhita, which are discussed in detail later in this paper.

accumulations of physical, financial or human assets, which are the most productive in poverty alleviation. "Livelihood finance," which includes the provision of risk-mitigating financial services, is necessary to increase income-generating capabilities (Arunachalam 2008). This paper uses as an example the current state of financial inclusion and its challenges in Madhya Pradesh, one of the poorest Indian states.

### **III. Madhya Pradesh (MP) and Its Current State of Financial Inclusion**

Madhya Pradesh is one of India's largest states, in which 74 percent of the population lives in rural areas. Overall, farming supports about 44 percent of the population in BIMARU states (Arunachalam 2008). Such dependency makes the rural population vulnerable to climate shocks. Frequently, during monsoon season, the roads become inaccessible and villages are often temporarily cut off from the outside world. Thus, lack of accessibility is one of the biggest challenges for MFIs and NGOs that provide services in remote areas of MP.<sup>7</sup> Most crops are highly dependent upon the weather, which increases the risk for farmers who borrow to invest in agriculture. Spinning and weaving are the principal industries, followed by the steel, chemical and electrical industries, respectfully (Empowerpoor 2007).

Although MP occupies 9.7 percent of the country's total land area, it comprises only 5.8 percent of India's population. Lower population density deters many banks and MFIs from opening branches in sparsely inhabited regions of the state. Among Indian states, MP has the highest concentration of tribal populations, 20.2 percent, and the combined Scheduled Caste/Scheduled Tribe (SC/ST)<sup>8</sup> groups comprise more than 35 percent of the total population of the state. The poverty rate is much higher in MP than India's average of 26.1 percent. Table 1 shows that there are 24.5 million people living below the poverty line (37.4 percent of the total population). In addition, the incidence of poverty is higher in urban areas than in rural areas (Srinivasan 2007).

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<sup>7</sup> Interviews by the author conducted in Madhya Pradesh from July 4<sup>th</sup> to July 26<sup>th</sup> 2008.

<sup>8</sup> The Scheduled Caste (SC) and Scheduled Tribe (ST) population in India according to the 1991 census are 13,82,23,277 and 6,77,58,380 respectively, constituting 16.33 percent and 8.01 percent of India's total population respectively.

**Table 1: Mid-year estimates for 2005 in millions, percentages in parentheses.**

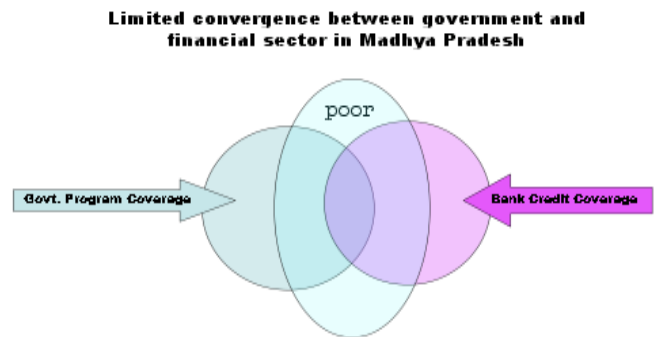
Population	65.6
Number of poor (37.4%)	24.53
Number of families (5 per family)	13.12
Number of poor families (5 per family)	4.9
Number of financially excluded farmer families	4.26
Poor families who have access to credit (57%)	2.62
Number of SHGs linked to banks	0.12
Number of MFI clients	2.5

Source: Access Development Services “Vision Microfinance 2012.”

According to the interim report of the Committee on Financial Inclusion, at least 4.26 million farmer households in MP are financially excluded. The banking system network in the state consists of 3,771 rural/semi-urban branches and 1,026 urban branches for a total of 4,797 branches (the second highest among BIMARU states). According to the “MP Vision” report by Access, a local NGO focused on increasing financial inclusion, in order to achieve total financial inclusion, the number of accounts per branch would have to be quadrupled to about 2,300 (Srinivasan 2007). The best estimate of microfinance coverage is around two million people through Self-Help Groups (SHGs) and about half a million people through MFIs. It is apparent then, that in order to achieve the goal of total financial inclusion by 2015, state government, banks, MFIs, NGOs and regulators will have to work together.

“MP vision 2012” uses Visual A to demonstrate financial exclusion. Here, the efforts of financial service providers and government are not fully coordinated. This means that finance often does not accompany governmental programs. On the other hand, government programs are frequently not available where finance is being provided. Furthermore, many of the poor are left out of coverage by both sectors (Srinivasan 2007). In the past few years there has been a significant effort to scale up financial inclusion nationwide and statewide. MP is still behind many other states in its financial inclusion goals, but it has the potential to extend financial services to a large number of excluded populations due to many progressive initiatives undertaken by the government, banks, MFIs, and NGOs.

**Visual A**



**IV. The Role of Microfinance in Financial Inclusion**

For decades, conventional financial institutions all over the world overlooked the poorer segments of the market due to the high cost of small transactions. However, the emergence of microfinance over the past two decades in most developing countries has shown that the poor clients can be served despite the higher transaction cost. The Monterrey Consensus adopted in 2002 by numerous countries at the International Conference on Financing for Development explicitly recognized that “microfinance and credit for micro, small and medium enterprises; as well as national savings schemes, are important for enhancing the social and economic impact of the financial sector” (Conroy 2008). This statement reflects the belief that microfinance strategies that embrace savings, deposits, remittances, micro-insurance and pensions, are among the most powerful tools available for reducing financial exclusion.

Various interviews with microfinance stakeholders around MP revealed that household access to financial services is impeded by geographic isolation in rural areas due to bad or absent roads; low population density; law and justice problems; high poverty levels; livelihoods dependent on agriculture; unwillingness of banks to serve the poor and cooperate with MFIs; financial illiteracy; and gender inequality. Importantly, the demand for financial services is huge, but the supply is inadequate. To meet credit requirements for livelihood activities, marriages and illnesses, the poor turn to local moneylenders, who often charge exorbitant interest rates. Unfortunately, these types of moneylenders are often the only source of credit for the financially excluded rural poor all over the world. Access to credit with much lower interest rates through microfinance is a better alternative.

In India, microfinance is promoted mostly in the form of Self-Help Groups (SHGs)<sup>9</sup>, Common Interest Groups (CIG), and Joint Liability Groups (JLGs). There is very little individual lending from microfinance organizations. In MP, the SHG model is the most common, as it has been supported by the state government for many years and is preferred by the majority of stakeholders of financial inclusion because it mandates savings. The JLG model is usually utilized by MFIs, and does not require savings.

Many SHGs were formed and promoted under government programs in MP. MP’s regional office of the National Bank for Agriculture and Rural Development (NBARD) in Bhopal has estimated that about 250,000 previously formed SHGs remain unlinked to any banks, despite that fact that some of these groups are several years old. This is important because SHGs require help beyond the formation stage if they are to be successful. Newly formed groups often fall apart in the absence of continuing guidance, training and assistance. Because of a lack of continued monitoring and support, many of these groups are no longer functional (Srinivasan 2008).

Table 2 shows the number of groups linked at the end of each year in the priority states selected by the NBARD. The table demonstrates the low level of effort in MP, which is lagging behind the other states in terms of growth of SHG linkages (only 57 percent growth over three years).

MFIs prefer lending to Joint Liability Groups (JLGs)<sup>10</sup> and most do not target SHGs nor facilitate their linking to banks. MFIs prefer JLGs because they guarantee more efficient social peer pressure and facilitate monitoring for timely loan repayment. Clients benefit from being a member of a JLG through faster access to credit because

<sup>9</sup> SHGs typically consist of 10-20 women with a common socio-economic background from the same village, which are facilitated into a group formation for the purpose of mobilization of savings. Usually, the group is able to take a loan from the bank with the help of NGO or some other organization or program after about six months of regular meetings and collective savings.

<sup>10</sup> JLGs are much smaller than SHGs, usually groups of 5 women.

**Table 2**

State	2005	2006	2007	Growth % 2007 over 2005
Maharashtra	71146	131470	225856	217
Rajasthan	60006	98171	137837	130
U P	119648	161911	198587	66
W Bengal	92698	136251	181563	96
Orissa	123256	180896	234451	90
M P	<b>45105</b>	<b>57125</b>	<b>70912</b>	<b>57</b>

Source: Access Development Services “Vision Microfinance 2012.”

there is no six-month requirement of savings mobilization, and the majority of poor people find it very difficult and burdensome to save.

Despite the rapid growth and effectiveness of MFIs in the state, there are large areas of MP where microfinance is still absent. The Northeast and Northwest have large tribal populations, who are the poorest and most financially excluded of India’s ethnic groups. The only poor people who have access to formal sources of finance in these areas are SHG members who were linked to the banks with the help of NGOs. For example, in Dindori District, where there are no MFIs, a small NGO, Professional Assistance for Development Action (PRADAN), serves over 260 SHGs, 52 of which are linked to a bank. Although SHG formation and bank linking are slow and tedious processes, they are important steps because they help groups become more sustainable.<sup>11</sup>

It is clear that, despite formidable obstacles, microfinance is reaching clients who were previously excluded from the formal financial sector. The progress being made in the state by advocates of financial inclusion demonstrates the promise for various microfinance strategies, as well as the challenges ahead.

<sup>11</sup> Singh, Archana, PRADAN, interview by the author, Dindori, MP, July 26 2008.

## V. Efforts of Various Stakeholders of Financial Inclusion in MP

Madhya Pradesh, like several other Central and Northeastern states, continues to lag behind in the ability to extend financial services to its people. Proponents of financial inclusion in MP offer explanations such as historical backwardness, low population density, bad infrastructure, understaffed rural financial institutions, unwillingness of the banks to open branches in rural areas (not economically viable), lack of cooperation between commercial banking sector and MFIs/NGOs, financial illiteracy, and corrupt local governments.<sup>12</sup> Many institutions interested in financial inclusion have modeled initiatives on the state level after the national example. Commercial and public banks, regulatory institutions and India Post currently appear to take financial inclusion more seriously than they did in the past. In the last three years, various innovative measures and initiatives have been implemented to achieve total financial inclusion by 2015, a target set by the Committee on Financial Inclusion. The specific efforts of two important organizations, Reserve Bank of India and India Post, are discussed below.

### **Reserve Bank of India (RBI)**<sup>13</sup>

RBI started the drive for financial inclusion in 2005, and made the State Level Banking Committees and state lead banks responsible for promoting complete financial inclusion in at least one district in their home state.<sup>14</sup> RBI defined financial inclusion as providing all households in the district with a no-frills savings bank account if they desired one.

In addition to no-frills savings accounts, Reserve Bank of India undertook three other initiatives:

<sup>12</sup> Interviews by the author conducted in Madhya Pradesh from July 4<sup>th</sup> to July 26<sup>th</sup> 2008.

<sup>13</sup> S. K. Sinha, DGM, S. K. Hemnani, and Suresh V. Satpute, RBI, interview by the author, Bhopal, MP, July 14 2008.

<sup>14</sup> The State Level Banking Committee (SLBC) is a committee consisting of representatives from all banks in the state, state government and RBI. The Committee meets regularly to coordinate banking activities within the state. The lead bank in a state is that bank which has the most branches and, thus, outreach in that state. The lead bank is also the Convener of the SLBC.

1) *Kisan Credit Card*: a credit card for agricultural use issued to all poor and marginal farmers, defined as owning two to five acres of land. Although the KCC scheme leaves out farmers with less than two acres of land, it has the ability to reach many excluded small acreage farmers who previously were not able to borrow from the formal banking sector due to the reluctance of banks and MFIs to lend for agricultural purposes.

2) *Business Facilitator and Business Correspondent Model*: this project allows any civil society organization, including NGOs and MFIs, to become a “Business Facilitator and Correspondent” for the banks. This model allows banks to do “cash-in/cash-out” transactions in rural areas where an official bank branch is economically unviable.

3) *Financial Literacy Campaign*: although this is an important component of RBI’s campaign, at present it focuses on the distribution of comic-book style pamphlets and posters in which clients are informed about available banking services and schemes. The main targeted groups are farmers and school children. Considering that a large part of the financially excluded population is illiterate, the written material (even in the form of comic books) may not be sufficient or effective.

### **India Post**

India Post’s reputability, dependability, wide network of branches and century-spanning experience in providing financial services should make it the best institution for scaling up financial inclusion. India Post operates the largest postal network in the world, comprising 155,516 post-offices (the U.S. has 37,159 post-offices and China has 66,393). One of the most notable facts about India Post’s network is that 89 percent of its branches are in rural areas. It has more than twice as many branches than all other banks in the country put together (Vaidyanathan 2007). In MP, for example, there were 4,797 bank branches as of June 30, 2007 and almost twice as many post offices, 90 percent of which are in rural areas<sup>15</sup>.

In spite of this advantage, India Post does not appear to be successful in promoting financial inclusion in MP. The main reason offered by Brajesh Kumar, Director of India Post in MP, is the lack of functional autonomy. Another reason for India Post’s inefficiency might be its staffing

<sup>15</sup> Brajesh Kumar, K.P.Tiwari and Mr.Gupta, India Post, interview by the author, Bhopal, MP, July 16 2008.

problems. In the last two decades, postal manpower decreased by roughly 11 percent, while the number of post office branches increased. Understaffed branches, small fixed salaries and the lack of perks for employees undermine the institution's efficiency.

Despite these disadvantages, India Post has created some financial inclusion initiatives. Currently, the institution is forming alliances with various banks, where it plays the role of a Business Correspondent. In order for these alliances to be successful, the issue of understaffing must be addressed immediately. Current post office staff are overworked, they cannot be expected to provide additional services with quality and efficiency unless the branches are properly staffed and good incentives are offered.<sup>16</sup>

Another potentially successful partnership is India Post's collaboration with Multi Commodity Exchange of India Ltd. (MCX), a Financial Technologies Group company. The program uses the vast network of India Post to provide market information, warehousing, advisory, and agriculture inputs to the Indian farming community (MCX 2008). The services offered through the India Post-MCX alliance make it possible for farmers to get expert advice on farm-related issues, better market pricing for their produce, better warehousing facilities, funding against warehouse receipts, quality testing and grading facilities. According to Mr. Kumar, when this program becomes commercially self-sustainable it may start offering loans to farmers as well.

Another relatively recent partnership with Western Union allows India Post to generate profits on a cost-plus basis. The service ensures instantaneous availability of money sent from more than 190 countries to recipients in India. It is a cash-to-cash service at both ends that is regulated by the Reserve Bank of India, and is currently being offered at more than 6,800 post-offices (Vaidyanathan 2006). The service is gaining rapid acceptance in remote areas of MP, contributing to a growth rate of 99.7 percent in 2007. In order to become more competitive in this sphere, India Post should start providing an International Money Transfer Service through companies other than Western Union, such as Money Gram, which charges a lower transaction fee. A wider variety of money transfer companies and lower transaction costs will

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<sup>16</sup> Brajesh Kumar, K.P.Tiwari and Mr.Gupta, India Post, interview by the author, Bhopal, MP, July 16 2008.

increase remittances, subsequently leading to greater financial inclusion.

## **VI. Financial Inclusion through Livelihood Microfinance Models: PRADAN and MCM**

The livelihood approach to financial inclusion through microfinance has proven to be very successful in poverty alleviation and offers long-term benefits in comparison to credit-only methods. By providing credit to the poor while simultaneously evaluating their livelihood activities, credit treatments can be made more sustainable with simple innovation, advice or activity diversification. Below are two examples of organizations that are using microfinance combined with livelihood interventions to promote financial inclusion in MP.

### ***Professional Assistance for Development Action (PRADAN)***

PRADAN's model of SHG promotion is one of the best known and most reputable in the country. This NGO focuses on the livelihood approach to microfinance by enhancing productivity in natural resources and promoting home-based micro-enterprises through SHGs. PRADAN assists in forming and training groups, and provides them with suggestions and support for livelihood improvements. In addition, the organization helps groups mobilize for savings and, if possible, link to suitable governmental poverty alleviation programs for financial assistance. For newly formed SHGs, PRADAN organizes visits to successful and well-established livelihood programs in nearby communities and conducts livelihood planning exercises with them.

Typically, SHGs are linked to a bank after six months of saving. The first loans are small, but they grow in size as the group reaches maturity (requiring weekly savings and internal lending for anywhere from six months to year and a half). PRADAN targets the poorest districts in the country in the states of Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Orissa, Rajasthan and West Bengal. More than two-thirds of the targeted families belong to Scheduled Tribes and Castes. In 2008, PRADAN worked with over 150,000 families in 3,408 villages across the seven states. In many communities the NGO promotes informal federations of SHGs. These federations assume various non-financial roles such as rights and entitlement issues, engagement and supervision of service providers, peer-learning exercises and networking with external stakeholders (PRADAN 2008).

In 2006, PRADAN started to promote poultry rearing among poor households in collaboration with the State Government's District Poverty Initiatives Project (DPIP) in the area. The project covers PRADAN's development support costs and provides resources for investments to set up poultry units. The organization also promotes horticulture, farm forestry and plantations in order to provide the best scope for farm diversification. These programs are fast becoming essential components of sustainable strategies for managing natural resources and enhancing rural livelihoods in the hilly regions of MP with limited irrigation potential. PRADAN has also initiated fruit tree plantation programs in MP and the activity has yielded positive results (PRADAN 2008).

With PRADAN's guidance, members of SHGs in MP are able to receive mutual help, financial intermediation, livelihood planning, and social empowerment. For example, one SHG member interviewed in Dindori said that if there is domestic violence in the group, the whole group will talk to the abuser. If this intervention does not solve the problem, the group will report him to police (PRADAN 2008). Recently, NABARD started training responsible SHG leaders to open new groups in the community, which allows for greater scaling-up of financial inclusion. Thus, in addition to receiving access to finance, SHG members are leveraging PRADAN's help to address many social issues such as gender inequity, rights and land entitlements in their communities (PRADAN 2008).

### ***Mahila Chetna Manch***<sup>17</sup>

Mahila Chetna Manch (MCM) is an NGO that focuses on the promotion and protection of livelihood activities. It has been present in MP since 1984 and is dedicated to the cause of women's dignity, empowerment and participation. Besides addressing a number of gender and equality issues, MCM offers skill development training, support services for women, capacity building to manage income-generating activities, and access to microfinance. MCM believes that the increased participation of women in economic activities will help them to break the cycle of poverty, improve quality of life with access to resources and basic services, and empower them to exercise their rights. MCM mobilizes women through SHGs and is a great example of how female empowerment can be

achieved by sustained advocacy, delivery of information and capacity enhancement.

As of June 30<sup>th</sup>, 2008, MCM had fifteen branches, which cover about 1,200 villages in twelve districts of MP and serve 4,533 microfinance clients. All fifteen branches offer microfinance, and three of them also operate dairy units to which MCM provides technical support for maintenance and management of dairy outlets. Currently, 40 percent of MCM's microfinance portfolio is in animal husbandry. According to Veenal Sukhwani, Director of MCM in MP, dairy production seems to be the most sustainable economic activity for the rural poor, and engagement of women in dairy activities by MCM since 1999 has resulted in a successful economic enterprise. Well-designed interventions in the dairy sector have helped beneficiaries to address critical situations in drought-prone areas in historically backward Chhatarpur district and improved livelihoods in tribal pockets of the Betul District.

MCM receives credit for pioneering the microfinance movement in MP. Originally, financial services were only extended to SHGs by linking them to banks. However, due to slow and inefficient SHG-bank linkages, in 1995, MCM began using its own resources to give small loans to dairy-producing SHGs. Despite this strategic shift, the organization continues to link SHGs to banks to facilitate larger loans for stronger and well-established groups. MCM has also started rendering risk mitigation services, such as life insurance and cattle insurance.

The efforts of PRADAN and MCM are indicative of the work being done in Madhya Pradesh to leverage livelihood microfinance models in pursuit of greater financial inclusion. Despite some successes, though, such organizations face a number of barriers that, if not addressed, may prevent them from scaling their operations. Following are the most important obstacles:

- 1) Most organizations lack skilled human resources, since necessary training is very costly.
- 2) Banks do not understand how microfinance works and create tedious and complicated procedures for loaning to the organizations. In many areas banks do not cooperate with MFIs.
- 3) Many women hesitate to start savings accounts because they do not trust an institution to keep their money safe.

<sup>17</sup> Veenal Sukhwani and Ms. Buch, Mahila Chetna Manch (MCM), interview by the author, Bhopal, MP, July 16<sup>th</sup> 2008.

4) Banks have “for profit only” attitudes and expect to make returns immediately on all clients. Such expectations are not realistic; the poor cannot be profitable for banks until they get out of poverty. Banks should treat no-frill savings accounts as marketing expense or as a long-term investment in future clients.

Organizations that embrace microfinance simultaneously with livelihood promotion have a much higher impact on poverty and can better guarantee long-term sustainability than credit-only groups. Mobilizing women through SHGs, providing them with skills development training, support services, capacity building, and encouraging their participation in local governance, improves well-being of the poor and leads to gender empowerment. According to MCM’s chair, before people can adequately take advantage of microfinance, social objectives have to be prioritized and the poor must be lifted out of poverty. Otherwise, credit alone may not be effective.

#### **VII. Microfinance-Only Models: SKS and Samhita**

In addition to microfinance models that include livelihood initiatives, many MFIs in India and around the world concentrate exclusively on offering small loans to the financially excluded poor. Such microfinance-only models have achieved significant success by increasing financial inclusion. However, if credit is offered without simultaneous risk mitigation through insurance and savings, it can often hurt the poor even more. Moreover, if an MFI’s mission is purely growth-oriented, the poorest of the poor are not targeted. Below are two examples of MFIs in MP that have found successful strategies to address these challenges and create lasting change in the community. Included with each example is a list of barriers they face to scaling their operations. If these NGOs are to continue their expansion into the future, they must find ways to address the issues mentioned.

#### ***SKS Microfinance***

SKS Microfinance started as an NGO in 1998, and today is one of the most successful and fastest growing MFI’s in the world, reaching 1,879,258 clients (SKS 2008). Since 2005 it has experienced 150 percent average annual growth. SKS lends to women borrowers in poor regions of India across 15 states for various income-generating activities including livestock, agriculture, trade (such as vegetable vending), production (from basket weaving to pottery) and “new age” businesses (beauty parlors to photography). Not content with its success thus far, the organization has a goal to reach 4,000,000 members by

the end of 2009. SKS emphasizes growth through a financially sustainable business model and asserts that it is a sustainable institution that will continue to provide permanent and stable access to finance for the poor (SKS 2008).

An interview with Parth Mishra, the SKS regional manager in MP, revealed that SKS started its operations in MP in December 2005, and chose the state because of the absence of competition. In the last three years, SKS opened 61 branches and is presently serving over 150,000 clients in MP.

Even as a relatively large and successful organization, SKS must deal with significant challenges in its efforts to scale-up and provide services to more individuals and families. Among these obstacles are:

- 1) Bad infrastructure makes villages very difficult to reach (especially during the rainy season).
- 2) Low population density. The population density in MP is 196 persons per square kilometer, which is significantly less than the country average of 313 persons.
- 3) Issues with local politicians and moneylenders (who are often the same individuals).
- 4) Corruption at the local level: moneylenders bribe police to keep SKS loan officers away.
- 5) Problems with banking sector. For instance, a lack of national or commercial bank branches in the rural areas, which prevents SKS from opening their own branches. In addition, bank managers in the rural branches often do not want to cooperate with MFIs.
- 6) Poor market linkage and no regular source of income.<sup>18</sup>

SKS is very successful at scaling up financial inclusion in MP. It adds around 10,000 clients every month, achieving 20 percent penetration in its targeted villages. With a little more support and cooperation from the formal banking sector, SKS could grow even faster. On the other hand, SKS cannot reach out to the poorest because it is concerned with its own financial sustainability. According

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<sup>18</sup> Parth Mishra, regional manager, SKS, interview by the author, Bhopal, MP, July 16<sup>th</sup> 2008.

to Phart Mishra, SKS is in the process of creating an NGO division aimed specifically at the ultra-poor, but so far the organization does not offer any products or services for the very poor in the state. In addition, the MFI is planning to pilot high quality private schools in the areas it serves, and is also expecting to add services such as money transfers and mobile banking in the near future.

### ***Samhita Microfinance***

Samhita Microfinance has become a pioneer of microfinance in the Rewa District of MP. After making its first disbursement in December 2007, the organization started its operations in earnest in the slums of Bhopal. Samhita's business model is based on the Grameen joint-liability model, which is adapted specifically for serving very poor people in remote and geographically dispersed regions. Another important aspect of this model is its focus on rapid scalability through the support of state-of-the-art technology solutions. The primary product is a general loan, offered in both rural and urban settings at competitive interest rates. Samhita complements its credit provision with a wide array of health, environmental and educational initiatives provided by the Samhita Community Development Services network partners.

Praseeda Kunam, founder of Samhita MF, chose Rewa District because of the lack of competition in the area. Due to poor infrastructure in the district, target villages are chosen partly based on distance and accessibility during rains. Samhita chooses its clients through a rigorous poverty identification mechanism based on housing quality; land and animal assets; income sources, levels, and stability/seasonality; family size; and absence of luxury consumption items.

Like SKS, Samhita is constantly searching for innovative product ideas. For instance, the organization informally formed a partnership with Rama Krishna Mission Home of Service to offer health education programs to its microfinance clients. In January 2009, Samhita formally launched its Multimedia Health Education program and by February of the same year, it had diversified its product base to include group insurance. The MFI is also planning to focus on micro-enterprise development in the future.

According to Ms. Kunam, her clients have a very high demand for cattle insurance. During the interview, Samhita's clients revealed that although they feel burdened by weekly payments on the loans they took

from Samhita, they are planning to take more loans after they pay off the outstanding balance. One of the women invested her loan into purchasing five goats but, due to heavy rains, two of them died shortly after. This common story indicates that Samhita's clients would greatly benefit if they had access to risk-mitigating financial products such as cattle insurance. Samhita understands that, as credit is offered, major risks associated with entrepreneurial endeavors should be covered simultaneously. As such, the MFI is planning on developing cattle insurance in the future<sup>19</sup>.

According to Samhita leaders, the organization runs into challenges that are similar to SKS's. For these leaders, the most important barriers to scaling up their reach in the community are:

- 1) The geographic terrain is very tough and the area is sparsely populated. Heavy rains make even villages with existing roads inaccessible. According to Samhita's branch managers, it is physically impossible to reach 25 percent of the villages in the district because of the lack of roads. Tribal communities are particularly isolated.
- 2) There is a lack of banks in rural areas and a lack of cooperation when they are present. In addition, most of the banks are skeptical of microfinance. According to Ms. Kunam, banks often refuse to cooperate because cooperation entails significant extra work for them and very little profit.
- 3) Although Ms. Kuman herself does not consider local politics a major barrier to scaling up, her branch managers mentioned that moneylenders occasionally manage to break up newly formed JLGs.
- 4) Corruption is becoming a big problem. Out of principle, Samhita does not pay bribes, which slows down the process of opening new branches.
- 5) Daily electricity shut off in the rural areas of Rewa District (8-10 hours per day) makes it difficult for branches to operate.
- 6) People are used to government subsidies and expect Samhita to give grants instead of loans. Such a mentality creates challenges for repayment collections.

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<sup>19</sup> Samhita Clients Focus Group Discussion, interview by the author, Rewa District, Madhya Pradesh, July 19 2008.

7) People do not have a steady stream of income in rural areas, which results in challenges for weekly repayments.

Samhita is the first NGO in Rewa District to offer microfinance. Although Samhita adds an average of 250 clients per month, there is still an unmet need for more MFIs.<sup>20</sup> Besides its large contribution to financial inclusion in MP, Samhita's focus on non-financial services shows its genuine concern about its clients' wellbeing and poverty alleviation.

### VIII. Conclusions and Recommendations

Institutions interested in financial inclusion have made significant progress in MP through a variety of initiatives and business models. In particular, the Business Facilitator Model and Business Correspondent Model have the potential to improve financial inclusion outreach in MP, considering the relatively low presence of the formal banking sector in rural areas. If MFIs, NGOs and post offices become widely utilized by banks as Business Facilitators and Correspondents, banks will be able to reach previously excluded people even in very remote areas with relative ease. Additionally, stakeholders of financial inclusion in MP are using technology to help them reach out to many previously excluded populations. Representatives from all of the institutions interviewed in this case study agreed that microfinance is one of the most effective methods available to deliver of financial services to excluded populations. The lessons from Madhya Pradesh's experience should be considered by policymakers in other countries that are willing to embrace microfinance as a tool for financial inclusion.

Microfinance is gradually evolving from a development-focused sector into a sub-sector of the mainstream retail financial services industry with both economic and social outcomes all over the world. For example, with 75 million poor households potentially requiring financial services, the microfinance market in India is among the largest in the world. However, the current supply amounts to only about seven percent of demand in the country (Pillai 2008). MFIs are often able to reach into areas too remote and economically unviable for formal financial institutions, which demonstrates the imminent need to scale up current MFIs and facilitate entry for new organizations to meet the demand for microfinance. Cooperation from governmental agencies and programs

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<sup>20</sup> Kunam, Praseeda, Samhita Microfinance, interview by the author, Rewa District, MP, July 19 2008.

will also be vital in the scaling process; these entities have the opportunity to reach many financially excluded people they otherwise would be unable to help.

Unfortunately, financial inclusion using only credit does not always result in significant poverty alleviation. Most MFIs tend to focus on credit services only because risk mitigation services that are necessary for the poor are less profitable and may not be legally offered directly by the MFIs in many countries. Access to financial services such as savings, insurance and remittances are extremely important for poverty alleviation and development.

Based on first-hand research and this case study of Madhya Pradesh, the author found that there are many other obstacles to financial inclusion besides historical backwardness, low population density, bad infrastructure and understaffed rural financial institutions. Some of the other barriers include:

- Little coordination of efforts among the different stakeholders of financial inclusion
- Lack of livelihood opportunities for the majority of the financially excluded population
- Low level of literacy (financial and literary)
- Shortage of human resources trained in microfinance
- Disconnect in efforts between state governments and central government
- Resistance of bank branch managers to cooperate with MFIs and NGOs
- Little availability of loan funds from banks and financial institutions and capacity building support for MFIs and NGOs
- Corruption
- Unreliable electricity supply
- Scarce public transportation in rural areas

In order to achieve the goal of total financial inclusion, policymakers, banks, MFIs, NGOs and regulators have to work together. In addition to cooperating with other stakeholders, policymakers who believe that microfinance can help them to speed up financial inclusion in their respective countries should fund financial education programs that allow their citizens to realize the economic potential of microfinance. Basic financial literacy programs can help achieve better results in poverty alleviation.

The purpose of this article has also been to demonstrate the importance of risk mitigation services being offered along with credit and provision of livelihood

opportunities for the poor. In India, specifically, India Post represents a critically underutilized resource with a wide network of branches in the rural areas that could be leveraged more efficiently for financial inclusion efforts. In other countries, proponents of financial inclusion should look for similar resources and find ways to incorporate them in their national strategy. Additionally, policymakers should encourage training for bankers to be more supportive and accepting of microfinance. Finally, and most importantly, governments and policymakers should not shun microfinance. On the contrary, they should embrace the system in an effort to provide vital financial services to their citizens who are currently excluded from the formal financial sector.

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