Conditions in Which Microfinance has Emerged in Certain Regions and Consequent Policy Implications

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Abstract

The paper looks at some macro data on the availability of infrastructure, economic growth, density of population and the availability of formal financial services to examine if any of these factors explain the growth of microfinance in certain regions, while the other regions lag behind. For the study, data from the four southern states and three states from the western part of the country have been examined.

We find that most of the indicators are not significant enough to explain the regional disparity in the growth of microfinance. However, anecdotal evidence and a perusal of the state policy pronouncements explain that the role of the state could be significant in promoting some of these initiatives. In case of Karnataka, we also find that the banking system seems to have played an additional role in rolling out microfinancial services.

The paper concludes by indicating that possibly the sector is still insignificant in the rural economy to establish causality with macro variables. However, there could be possibility of growth in states like Rajasthan where most of the parameters that could foster microfinance seem to exist and with policy intervention on the routing of developmental projects, the movement could get a big boost. We also indicate that the existing network has the potential of unleashing more finance and financial products, and that initiative should be seized forthwith.

Conditions in Which Microfinance has Emerged in Certain Regions and Consequent Policy Implications[1]

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Background

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to poor and low income households and their micro-enterprises. India has two strands of microfinance – the "mutual" strand, where microfinance is organized around the concept of mutuality covering an entire range of experiments such as informal self-help groups and formal thrift and credit cooperatives incorporated under cooperative legislation. The other strand may be termed that of "providers", wherein an external agency commonly known as an MFI offers the financial services without opening up its own governance structure to the clients. SHGs provide scope for a two way transaction, starting on the base of small savings – rotating that and later linking for loans that could address the issue of livelihoods. In some places attempts are being made to provide exclusively designed risk mitigation products for the poor and vulnerable. Microfinance has become an attractive mechanism to reach financial services to the poor and the methods evolved reduce certain types of transaction costs, eliminate basic problems of incorrect client identification and mitigate repayment risks to a great extent (Sriram, 2002)[4]. Therefore there is great enthusiasm amongst various players in the financial services market to participate in this sector.

While there are some places where men participate in microfinance type of activities, by design, the movement has been women centric. Though the "mutuals" have been in the country for about two decades and the "providers" have been operating for over a decade, the movement has not spread throughout the country. We find that microfinance activities seem to happen only in certain pockets of the country, irrespective of whether they follow the "mutual" or the "provider" strategy. While microfinance has had the patronage of successive governments irrespective of party affiliation at the centre, the regional spread of the movement is very disparate. Even within states, we find that certain pockets develop as microfinance pockets. We would like to understand if there are specific reasons or external conditions that are conducive to the growth of microfinance in certain regions that are not there elsewhere. For the purposes of analysis, we shall focus only on "mutuals". While it is possible to recognize some thought leaders in the design of "mutuals", the spread of the movement cannot be attributed either to a small set of individuals or organizations. Therefore these "mutuals" operate with different parentage, diverse funding sources, different cost absorption models and different operational details that foster trust and bondage. However the common thread amongst all these are that the participants meet regularly, undertake financial transactions and try to scale up as they go along.

A Primer on "Mutuals" in India

In India, the statistics put out by NABARD attribute three types of parentages to the mutuals. The first set where the bankers themselves help in formation of these groups and then finance them. Under this

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3 Associate, Ernst and Young, Mumbai. Graduate of IIMA class of 2005. This paper is written on the basis of the original work done by Kumar when she was at IIMA.
4 Sriram, MS (2002): Information Asymmetry and Trust: A Framework for Studying Microfinance in India. IIMA Working Paper Series 2002-09-02. Ahmdeabad: IIMA.

model the cost of the formation is usually borne by the bank, and possibly treated as an investment for a good business with moderate risk. Alternatively the bank might do this as a part of its contribution towards social responsibility. The second set of mutuals are those promoted by an external party other than the banks, but eventually linked to banks. Most of these would be promoted by non-governmental organizations (NGOs) and the cost would have been met by developmental funding. The third set of mutuals are those that are not only promoted by NGOs, but also funded by them. In such cases the NGOs get linked with the financing institutions or banks and interact with the mutuals themselves.

Irrespective of the parentage, the mutuals have the following salient features:

1. The mutuals usually have between 10 to 20 members. Each of the promoting agencies would have criteria that specify how these groups should be formed. The basic consideration being that they have to be cohesive, able to save and borrow and eventually conduct meetings and maintain books.
2. All mutuals would meet regularly. These meetings happen at the frequency of a week, fortnight or a month depending on the promoting agency's advise and the type of activity they carry out.
3. The mutuals start their activity by all the members saving a specified amount to be remitted every week. This would be compulsory thrift. In addition some groups might have voluntary savings schemes as well. The money collected is lent to some members within the group as per the norms. The interest rate charged on loans is decided locally. Some groups pay interest on deposits, some pay year end dividends based on savings and some just accumulate these as group funds.
4. The mutuals typically start their external borrowing programme after six months of rotating savings. This is termed as the linkage programme. The banks typically lend a multiple of the group fund, usually not exceeding four times.
5. In areas where there are multiple mutuals within a given area, they might form into cluster organizations and/or federations. In such cases the federal institutions usually deal with the bank and do financial intermediation for the mutuals.
6. Mutuals are more liberal than the "providers" in terms of discipline. Repayment terms could usually be more friendly and genuine default treated with compassion. Mutuals do not usually report a 100% recovery rate, unlike most "providers".

With the above features it can be assumed that there have to be certain conditions for mutuals to flourish. Since most mutuals are externally triggered, it may be important to have a promoting agency that does the initial work of group forming and stabilization. In states that have been in the forefront of this model of microfinance it is possible to identify some large organizations that do the promotional work. In Karnataka and parts of Tamil Nadu we have MYRADA one of the original thinkers of the mutual model. Apart from this, Dhan Foundation in Tamilnadu, has been promoting mutuals in a big way, for a long time. In Andhra Pradesh, it is difficult to identify one single organization that has an encompassing size, but it could be safely said that the Government has been one of the largest promoters of this movement. This phenomenon is what triggers similar efforts in North Rajasthan – Alwer where PRADAN has had a big role to play in promoting these activities. The same applies to Jharkhand where PRADAN is active.

For the purpose of this paper, we undertake a comparative analysis of southern states – Karnataka, Andhra Pradesh, Tamilnadu and Kerala with that of the western states of Maharashtra, Gujarat and Rajasthan, to see whether there are some natural conditions that seem to explain the development of these mutuals only in certain pockets. We have deliberately left out the northern and eastern parts of the country, because there are so many extraneous factors that come to play and we may not be able to isolate factors that foster the mutuals.

Broad Parameters

We start by looking at the broad parameters of the states we are examining. Table-1 gives the growth in State Domestic Product in percentage terms from 1961-62 onwards.

Table-1 Growth in Net State Domestic Product (per cent)				
State	1961-62 to 1970-71	1971-72 to 1980-81	1981-82 to 1990-91	1991-92 to 2000-01
Andhra Pradesh	3.11	3.46	6.58	5.52
Karnataka	4.36	3.38	5.09	7.51
Kerala	4.00	2.30	3.34	5.74
Tamil Nadu	2.59	2.10	5.71	6.25
Gujarat	4.83	4.31	5.99	6.34
Maharashtra	2.95	4.51	6.12	5.74
Rajasthan	5.78	4.10	4.35	4.47
Source: Bureau of Applied Economics and Statistics, Government of India				

From the table it is evident that Rajasthan is one state that has been growing at a slow pace, in the decades starting 1981-82. We therefore will have to treat Rajasthan as an outlier in all our analysis and look at that state carefully as far as the roll out of financial services is concerned. Possibly the issue of financial services in Rajasthan will be closely linked to broader developmental parameters and an isolated intervention might not have a big impact unless the other issues are addressed. The only other state that has grown slow in net terms is Kerala, but it has also caught up in the decade of 1991-92.

At this juncture it might be useful to look at the other parameters of development that might impact the emergence of mutuals. Table-2 gives some statistics on connectivity. We assume that regions that are well connected should have more formal institutions and regions that are not well connected would have the propensity to promote their own local solutions. If this proposition were to be true, then the ideal candidates for the spread of local institutions should have been Kerala and Rajasthan where the number of connected habitations is low on percentage terms. However Kerala presents a contradictory picture of having the highest density of roads, where connected. This possibly represents a significant number of habitations that are sparsely populated and are not connected by road, or might be because they are connected by waterways. There seems to be no relationship between the habitations that are connected, the road length and the spread of microfinance. We cannot even use the counter argument that if the connectivity is high, then the external agencies would have easy access and therefore there is a natural tendency for microfinance to grow.

Table-2 Statistics on Connectivity					
State	Road Length (Kms) (31 Mar 2002)		Connectivity May 2001		
	Per 100 Sq. kms. of Area	Per 1 Lakh of Population	No. of Villages/ Habitations	No of Connected Habitations	Percent
Andhra Pradesh	65.2	239.0	67505	60681	89.9%
Karnataka	79.2	294.4	56682	45167	79.7%
Kerala	381.7	462.1	10820	6928	64.0%
Tamil Nadu	117.7	249.3	77923	72411	92.9%
Gujarat	47.6	195.3	23104	19734	85.4%
Maharashtra	124.1	422.3	40412	38245	94.6%
Rajasthan	41.2	266.3	37889	15903	42.0%
Source: www.indiastat.com					

The other aspect we need to examine is if there is an explanation in figures such as density of population, overall poverty ratios that trigger external agencies to come in and work with these sections of the population. If the poverty ratios are high, then naturally the development oriented organizations would like to make an intervention in such areas. At the same time, in order to be more effective they might want to work in areas where the population is dense. Getting to form groups and transact would need a natural meeting place for the beneficiaries and therefore density and the way the local society is organized might make a difference. Table-3 gives some data that could be used in our analysis.

Table-3 Population Density and Incidence of Poverty		
State	**Population density (per sq km - 2001)**	**Rural Poverty Ratio (1999-2000)**
Andhra Pradesh	275	11.05
Karnataka	275	17.38
Kerala	819	9.38
Tamil Nadu	478	20.55
Gujarat	258	13.17
Maharashtra	314	23.72
Rajasthan	165	13.74
Source: Population Density from www.indiastat.com Poverty Ratio from Planning Commission, Government of India		

From Table-3 using the poverty incidence, Maharashtra and Tamilnadu would be the destinations for developmental oriented organizations to operate. Surprisingly the incidence of poverty in Rajasthan seems to be lower than many of the other states and almost comparable to Gujarat. Possibly why Rajasthan scores low on other parameters is because of it population density. With such sparse population, it possibly does not make sense to form groups. Even in the non-desert areas of south Rajasthan groups do not get naturally formed because of the way the tribal society is organized. Therefore promotion of microfinance in Rajasthan possibly would need and out-of-the box model.

Specific Parameters

If we were to look at some specific parameters that have a bearing on the development of financial markets, particularly of the nature that we are discussing we will have to look at how the formal markets have emerged and what sort of gaps they have left on the rural landscape. The first question that we ask is whether mutuals naturally emerge in places where the formal markets have failed to reach out to the poor. The formal sources of savings and credit would include bank branches and co-operatives. The macro trends indicate that across the country, the formal sources are moving away from the poor – the share of neighbourhood outlets such as co-operatives is falling and the average size of the loans disbursed by the banks are going up, with number of accounts in the rural areas actually falling. In addition after the branch licencing policy was modified in 1991, there has been a fall in the rural and semi-urban branches of commercial and regional rural banks (World Bank, 2003)[5]. Therefore the question is whether mutuals emerge in areas where the formal sources have either failed or are having a shrinking role.

The mutuals could be treated as semi-formal sources while the informal sources could include externally triggered ROSCAS and local finance companies and money lenders. It would be useful to look at some numbers from the supply side. While the development of mutuals serve the dual purpose of providing avenues for savings as well as purveying of credit, we focus on the access to credit to start with. Table-4 has statistics about the number of outlets of formal sources and mutuals.

From the figures it is evident that Maharashtra has the maximum number of formal sector outlets, largely owing to the spread of primary non-agricultural credit societies (PNACS). The PNACS perform a role similar to mutuals, and though are formally registered with the Registrar of Co-operative societies, have similarities with ROSCAs and mutuals in their operation. The studies by Thorat (no date)[6] and Bouman (1989)[7] demonstrate these similarities. In a way it might be appropriate to club these PNACS with mutuals. The limited growth of mutuals in Maharashtra may perhaps be

[5] NCAER/World Bank (2003): Rural Finance Access Survey. New Delhi: World Bank
[6] Thorat YSP: Rural Financial Services Market: Findings from a Field Study. (mimeo)
[7] Bouman, F.J.A. (1989), Small, Short and Unsecured: Informal Rural Finance in India. Delhi: Oxford University Press.

explained by the fact that there are a large number of PNACS. As we can see Maharashtra has the largest number of formal sector outlets, and these outlets are predominantly neighbourhood institutions such as co-operatives. So it might be possible to explain why the microfinance movement has not gained momentum in this state. This possibly holds true for Gujarat which has the penetration of formal sector though not as intensive as Maharashtra. By the same argument, it appears that Andhra Pradesh and Tamilnadu which have the least penetration on the basis on number of households to be serviced per outlet of formal institutions naturally become fit candidates for microfinance to naturally emerge. This leaves three states that do not fit into the pattern. Karnataka, where the formal sector has a better presence also has a good network of microfinance activities. One is not sure if this is to be explained by the extraneous factor of the presence of a promoting institution like MYRADA. Kerala stands out as a state where the banking penetration is not as deep as Karnataka, but at the same time, microfinance has not emerged in a big way. This might be due to the presence of non-formal institutions such as chit funds that are not captured in the statistics, while Rajasthan may be explained by general backwardness.

Table-4 Number of financial services outlets

State	Rural HHs (million) #	Rural/ SemiUrban Bank Branches@	Number of outlets as on March 2002*				
			PACSs	PNACSs	Formal sector Outlets	SHGs	Total Outlets
AP	12.68	3652 (1.4)	4104 (1.6)	3761 (1.5)	11517 (4.5)	243714 (95.5)	255231 (100)
Karnataka	6.2	3237 (6.82)	4653 (9.81)	2528 (5.33)	10418 (21.95)	37032 (78.04)	47450 (100)
Kerala	5.01	2748 (13.45)	1914 (9.36)	1017 (4.98)	5679 (27.78)	14759 (72.21)	20438 (100)
Tamil Nadu	8.28	3001 (4.22)	3609 (5.08)	1749 (2.46)	8359 (11.76)	62709 (88.24)	71068 (100)
Gujarat	5.88	2367 (10.31)	6785 (29.55)	4313 (18.78)	13465 (58.64)	9496 (41.36)	22961 (100)
Maharashtra	11.17	3390 (5.30)	20598 (32.18)	20405 (31.87)	44393 (69.35)	19619 (30.65)	64012 (100)
Rajasthan	7.05	2629 (12.70)	4780 (23.10)	720 (3.48)	8129 (39.28)	12564 (60.72)	20693 (100)
		No of Households to be serviced per outlet					
State		Bank Branches	PACSs	PNACSs *	Formal Sector	SHGs	All Outlets
AP		3474	3090	3374	1101	52	50
Karnataka		1915	1332	2452	595	167	131
Kerala		1823	2618	4926	882	339	245
Tamil Nadu		2759	2294	4734	991	132	116
Gujarat		2484	867	1363	436	619	256
Maharashtra		3294	542	547	252	569	174
Rajasthan		2682	1475	9792	867	561	341

#Data from Primary Census Abstract based on 2001 Census.
@ Statistical Tables Relating to Banks in India, 2002 published by RBI. Only rural and semi urban branches have been considered in the analysis.
* The data for PACS and PNACS is from the database of NAFSCOB. PNACS Data pertains to 1999-2000.
Figures in Parentheses are percentages.

The most telling figure in Table-4 is that with the penetration of microfinance – particularly in the case of Andhra Pradesh, we find an outlet for every 52 households. If these outlets are used as a base network, the potential for penetration of credit and other financial services would be immense.

The next question we need to examine is whether there is any correlation between the number of mutuals and the amount of loans that flow through these channels. Are the states that have more formal channels getting more credit per household than those that are dependent on informal sources or mutuals. Table-5 has the total amount outstanding against each of the outlets. We have chosen to take the stock figure instead of the flow figure because the stock figure would perhaps give a more stable picture.

Table-5 Amounts outstanding by different outlet types

State	Rural HHs# (million)	Total amount outstanding as of March 2002 (Rs. Million)					
		Bank Branchesϖ	PACSs	PNACSs *	Formal Sources	SHGs	Total
AP	12.68	9607 (13.98)	49762 (72.42)	4133 (6.01)	63502 (92.41)	5213 (7.59)	68715 (100)
Karnataka	6.2	10793 (25.20)	23150 (54.05)	8173 (19.08)	42116 (98.33)	715 (1.67)	42831 (100)
Kerala	5.01	12758 (14.16)	73385 (81.44)	3623 (4.02)	89766 (99.62)	340 (0.38)	90106 (100)
Tamil Nadu	8.28	10509 (15.90)	48425 (73.27)	5127 (7.76)	64061 (96.93)	2027 (3.07)	66088 (100)
Gujarat	5.88	6837 (19.53)	25367 (72.47)	2714 (7.76)	34918 (99.76)	85 (0.24)	35003 (100)
Maharashtra	11.17	11083 (8.95)	59850 (48.35)	52441 (42.36)	123374 (99.66)	423 (0.34)	123797 (100)
Rajasthan	7.05	6125 (37.51)	9869 (60.44)	102 (0.63)	16096 (98.58)	232 (1.42)	16328 (100)
State		Amount outstanding per Household (Mar 2002)					
		Bank Branches	PACSs	PNACSs *	Formal Sources	SHGs	All sources
AP		758	3924	326	5008	411	5419
Karnataka		1740	3734	1318	6793	115	6908
Kerala		2547	14648	723	17918	68	17986
Tamil Nadu		1269	5848	619	7736	245	7981
Gujarat		1163	4314	462	5939	14	5952
Maharashtra		992	5358	4695	11045	38	11083
Rajasthan		869	1400	14	2283	33	2316

#Data from Primary Census Abstract based on 2001 Census.
@ Statistical Tables Relating to Banks in India, 2002 published by RBI. Only rural and semi urban branches have been considered in the analysis. In calculating the outstandings, we have deducted the amount outstanding from SHGs, as that is reported as a separate category. Since the data is sourced from RBI, the outstandings of SHGs are essentially what the banks have lent to the groups. Infact the credit extended by SHGs out of their own revolving funds have not been captured here and the amounts available to the ultimate client from this source is expected to be larger than what is depicted in the table.
* The data for PACS and PNACS is from the database of NAFSCOB. PNACS Data pertains to 1999-2000.
Figures in parentheses are percentages.

When we look at the amounts outstanding, Kerala and Maharashtra stand out as states that have a high outstanding per household from the formal sector. In case of Kerala, most of the money is flowing through the primary co-operatives, while in Maharashtra it is the PNACS that are playing a significant role. Rajasthan shows low amounts of formal credit as well as microfinance. This might be due to the overall backwardness of the state. Gujarat presents a surprising figure of lower per-household credit outstanding than Karnataka and Tamilnadu. Andhra Pradesh in comparison maintains the pattern where the penetration of formal sources is lower than the other states (except Rajasthan) and therefore a place where alternate channels emerge. What is clear from the above table is that wherever the penetration of microfinance is high, the average loans through the mutuals have also been higher than the rest. This may indicate that the network developed in Andhra Pradesh, Tamil Nadu and Karnataka can actually bear more credit and effectively supplement the formal channels. However, as a word of caution it may not be appropriate to look at the statistics pertaining to all channels including SHGs as there could be an element of double counting – the mutuals in most cases have been financed by banks and those numbers could be subsumed in the overall outstandings of the banks. Therefore it might be better to look at figures pertaining to the formal sources as far as amounts are concerned.

The other figure that is regularly used in order to find out if the banking system is performing its role locally is the Credit-Deposit (CD) ratio. The policy makers get unduly worried if the CD ratios of certain regions are not favourable, indicating certain skewness in just collecting deposits or disbursing loans. It has been known traditionally that the regulators get worried in areas where the CD ratios are low, thereby indicating a flight of capital from the local area to the outside world. There have been task forces set up to look at adverse CD ratios, particularly in the north eastern region and states like Kerala, West Bengal and Rajasthan. We present the figures of the CD ratios of the selected states in Table-6. However a look at the figures in the Table-6 gives no indication as to whether this could be the trigger for spread of alternative channels of finance. Andhra Pradesh has the best performance on CD ratios on its rural branches and almost is number one in semi-urban branches. What could this mean? Since we maintained that the SHG loans are subsumed in the overall figures, do we then assume that the funding for microfinance has swung the CD ratio in favour of banks in these states? Prima facie, it appears so, when we look at the CD ratios in the states where microfinance has spread fast – AP, Karnataka and Tamilnadu. Gujarat and Kerala are behind. Maharashtra is an outlier, and Rajasthan indicates a double failure of the banking system as well as that of the microfinance.

Table-6 Credit Deposit Ratios of Banks in various states

Year	**2000**		**2004**	
State	**Rural branches**	**Semi Urban branches**	**Rural branches**	**Semi Urban branches**
Andhra Pradesh	76.0	52.2	84.3	54.7
Karnataka	69.0	55.1	74.6	61.7
Kerala	54.7	34.3	58.1	37.8
Tamilnadu	61.9	51.3	61.6	55.2
Gujarat	43.8	31.4	32.0	26.3
Maharashtra	58.4	43.3	76.5	43.6
Rajasthan	45.7	32.9	54.6	39.8
Source: Banking Statistics of RBI.				

However, if we did arrive at the conclusions that in states where the CD ratio is good, it could be a result of better spread of microfinance, we might be attributing more than the due share of glory to microfinance. This is because the overall numbers in terms of deposit collected and credit disbursed through microfinance might not be large enough to significantly impact the CD Ratios. From Table-4 it is evident that the share of SHGs in the overall financing of the rural and semi-urban households is usually a very small percentage, except in AP where it is around 7 percent. If we assume this figure to be the one we have resorted to double counting, this could not have an overbearing impact on the direction of the CD ratios, particularly when the funding by the banks is a small multiple of the group funds generated.

The above data might actually indicate the relative failure of the banking system in these areas, where, the disbursement of credit is generally impressive on the base of the deposits, but the deposits themselves might not have been collected in a significant manner.

The other issue that would possibly impact the emergence of microfinance, particularly the "mutual" model might be the presence of post offices. Post offices do not provide credit services, but they do provide savings services. In a recent study it was found that in the states of Andhra Pradesh and Uttar Pradesh, only 2% of the sample households surveyed had an account in the post office, and it also had the maximum overlap with people who had transactions elsewhere in the formal sector (NCAER/World Bank, 2003)[8]. Therefore this data is to be treated with caution. However, it might be worthwhile to examine the data on the penetration of post offices. The data is readily available from the 1991 census and it indicates a deep penetration of post offices in Kerala. However, the figures are low from Maharashtra and Karnataka (see Table-7).

[8] NCAER/World Bank (2003): Op.Cit.

Table 7: Number of Post Offices and Population Served			
Circles	Population in Villages (2001 Census) (in Million)	No. of Rural POs (as on 31 March 2003)	Population Served by a Post Office in Rural Areas(2001 Census)
Andhra Pradesh	55.22	14857	3717
Karnataka	34.81	8569	4062
Kerala & Lakshadweep	23.6	4195	5626
Tamil Nadu (including Pondicherry)	34.87	10205	3417
Gujarat (including Dadra & Nagar Haveli, Diu & Daman)	31.98	8234	3884
Maharashtra	55.73	11270	4945
Rajasthan	43.27	9648	4485
Source: www.indiastat.com			

With the low penetration of microfinance in Maharashtra, we may not be able to establish the importance of the post offices. Even the NCAER study found that the mean distance from the households surveyed to the nearest post office was the highest amongst all the financial institutions, while the median distance was low. This essentially means that there are some really far flung villages that bring the mean figure to be high and the variability of distance from the location to the post office might be very high. However, it would not be appropriate to focus on the post offices, as they do not offer full fledged financial services.

Conclusions:

All data examined till now indicate that there are no macro economic or demographic reasons as to why microfinance emerges in certain places. Using the summary of the above data, if we were to assume that microfinance naturally emerges in places where the economic growth is slow, the connectivity is low, the poverty incidence is high, with dense population and a failure of formal financial institutions, then the ideal states where microfinance should have naturally emerged would have been Rajasthan, followed by Kerala and Tamilnadu. If we were to consider the singular factor of failure of formal sector outlets, then the data seems to fall in place, as far as Andhra Pradesh and Karnataka is concerned, but this does not explain the growth in Tamilnadu and also why Rajasthan is an outlier.

Table 8: Parameters that could lead to spread of microfinance (√ indicates the hypothesis that the state has the potential to have more microfinance)							
State	Net GDP Growth	Connectivity	Poverty Incidence	Population Density	No. of Formal outlets	Amount outstanding/HH	Post Offices
Andhra Pradesh					√	√	
Karnataka						√	√
Kerala				√	√		
Tamil Nadu			√	√	√		
Gujarat						√	
Maharashtra			√				√
Rajasthan	√	√			√	√	

Table 9: Distribution of SHGs as per the promoting agency			
State	% of SHGs formed & financed by banks	% of SHGs formed by SHPIs but directly financed by banks	% SHGs financed by banks through NGOs
Andhra Pradesh	1%	98%	1%
Karnataka	33%	38%	29%
Kerala	15%	26%	59%
Tamil Nadu	7%	81%	12%
Gujarat	7%	90%	2.5%
Maharashtra	51%	49%	0%
Rajasthan	40%	60%	0%
Source: Micro Credit Innovation Department, NABARD			

In the absence of any statistically significant data to show any one or a group of factors that could explain the presence of mutuals in any one state and absence in another, we decided to look at the data of "parentage" and promoting institutions in the above states. Table-9 gives a break up of the parentage of mutuals.

From the above data, two things emerge clearly. The role of banks in promotion of SHGs seems to be limited, while their role in directly financing them seems to be the preferred route. Except in case of Karnataka, where the SHG movement is strong and the banks have also taken a keen interest in promoting SHGs, in other significant states of Andhra Pradesh and Tamilnadu, there is evidence that NGOs and other agencies have largely assumed the role of promotion of SHGs. The outlier here is Maharashtra, where the role of Banks seem to be significant, but the number of SHGs and the amount disbursed through SHGs are really small. Therefore, it appears that the bank-promotion has largely happened with central targets rather than a natural tendency for the formation of mutuals. This gets further illustrated by Table-10 where we can see the number of partner agencies and the cumulative number of groups that has been promoted and linked by them.

Table 10: Details of number of partner agencies and groups promoted (March 2002)			
State	no of partner agencies	Cumulative no of groups promoted by partner agencies	Of which no of groups promoted by SHPIs
Andhra Pradesh	113	240257	231654
Karnataka	442	126256	76696
Kerala	180	33400	2200
Tamil Nadu	330	109694	721
Gujarat	80	16563	
Maharashtra	21	2365	
Rajasthan	90	31008	20450
Source: NABARD			

From the above table it is clear that in states where microfinance has taken off, the number of agencies involved is not only high, but the number of groups are higher where the NGOs had a larger role to play. The exception to this might be Karnataka, where we have already found that the bank branches have had a significant role in promotion of microfinance (Table 9). From the above analysis, the story that emerges is that it is difficult to find external explanations for the regional development of microfinance in certain regions. One of the reasons why a pattern might not be emerging may be because even after so much of focus on microfinance, the quantum of credit and savings managed by this system – even to the extent of the most optimistic figures that are available – are not significant vis-à-vis the size of the rural financial markets. Therefore it might at this point be difficult to find patterns, unless the numbers and the amounts become significant enough.

However there are a series of anecdotal evidence to suggest that the government and external agencies like NGOs and international development agencies have taken a great deal of interest in the SHG movement in states like Andhra Pradesh. For instance, the Andhra Pradesh has routed several of its poverty reduction schemes via the SHG route. The Velugu program was one of the largest of these. This Rural Poverty Alleviation Program was taken up by the state government in two phases, covering all the districts in the state; the first phase between 2000 and 2005 and the second phase commencing two years after the first. The project had the support of the government at the highest level: the Chief Minister was the Chairperson of the program. The project was supported by the World Bank, cost Rs.2079.12 crores and targeted 29 lakhs people in 22 districts. The Tamil Nadu government has also extended a lot of support to the SHG movement through the support of International Fund for Agriculture Development and the Tamil Nadu Women's Development Programme. In Karnataka, MYRADA was an early collaborator with the commercial banks. With several commercial banks having their headquarters in Karnataka and having had the legacy of looking at rural markets positively, it was possible to get the involvement in a significant manner. Infact numbers suggest that Karnataka had the most significant share in SHGs before the Andhra Pradesh avalanche took it over, with fair amount of state support.

The story of Andhra Pradesh reveals something more. Since the state has been topping the numbers in SHG and bank linkage, the language and syntax of microfinance is understood well there. Therefore there possibly is a natural environment for other models of microfinance to emerge there. That possibly explains why four major microfinance agencies that do not necessarily follow the "mutual" model – BASIX, Share, SKS and Spandana are headquartered there. This could be a cluster effect, but this needs to be studied in greater detail.

Policy Implications:

It seems from the available data that the spread of microfinance hence is possibly not so much a natural movement whose emergence indicates conditions ripe for growth of micro enterprise as is often commonly supposed. Rather it would seem that it in fact requires some degree of sustained external intervention, whether of the local government or of NGOs. While from the above data it appears that Rajasthan seems to be the right state where there should be large scale intervention in microfinance, it would be much more difficult to make it successful, given the geographical conditions and the density of population. However, it could take off in certain pockets of north Rajasthan and then naturally spread across the state. For this, there needs to be systematic and synergistic intervention from three players – the state government, the non-profits operating in the area and the banking systems. If we are thinking of alternative methods of reaching financial services to the poor beyond the existing sources and with the limitations of infrastructure, it is imperative that there has to be some significant external push.

What is even more interesting would be to look at the growth of the movement in states where it has already spread. In these states, the density of outlets that provide savings and credit services have penetrated deep, with Andhra Pradesh claiming to have one SHG for every 50 households. The challenge in these states will be to leverage these outlets to provide greater variety and quantum of financial services.

Limitations and scope for further research:

A serious limitation of the study is that only those self help groups that fall under the NABARD purview have been included. This may not factor in efforts of some large NGOs in the movement. However there is a problem of availability of consolidated data in this respect. A second severe constraint has been that the efforts of NGOs and state governments have been largely understood only through anecdotal evidence. There is no quantifiable way of comparing these data. These and the role of clustering present opportunities for further research. The role of individual commercial banks in spreading the movement in their area of coverage also can be studied.