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**Two Decades of Indian Microfinance:  
Trajectory and Transformation**

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## **Abstract**

Over the past two decades since its official debut in the country in the late 1980s microfinance has traversed quite an eventful journey. Along the course, its role and relevance has been contested seriously in the circles of academia and development practice. It has been over-hyped for what it has done and severely under-rated for what it could not. It has been interpreted and examined in myriad ways – as an antipoverty strategy, as an approach to empower women, as a method for financial inclusion and as a way to nurture interaction between formal-informal financial sectors. The debates on Indian microfinance reflect the myriad imaginations and perceptions that surround its identity. Despite such inconclusive discourses, the reach of microfinance has expanded substantially across the country appropriating the spaces available within development planning and democratic politics. This paper critically reviews the major trends in the trajectory of evolution of Indian microfinance since the early 1990s.

**Keywords** : microfinance, bank linkage, SHG, MFI, financial innovation

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## Contents

	Page No
Abstract	i
Acknowledgements	i
Contents	ii
1. From Targeted Credit to Micro Credit: Shift of Paradigms	1
2. Group Lending as Financial Innovation	4
3. Substituting Social Banking: The Indian Experiment with Linkage Banking	7
4. From Informal Financial Arrangements to Power Groups: The Changing Identity of SHGs	11
5. Emergence of MFIs as Direct Providers of Microcredit	15
6. Moving towards Formalisation: Genesis of Microfinance Companies	18
7. Institutional Structure	20
8. Unravelling the Dynamics of Indian Microfinance: The Larger Issues	24
References	30

# Two Decades of Indian Microfinance: Trajectory and Transformation

Tara S. Nair

Trying to tell the story of how microfinance ushered, took roots and expanded in India is no mean task. Over the past two decades since its official debut in the country in the late 1980s microfinance has traversed quite an eventful journey. Along the course, its role and relevance has been contested seriously in the circles of academia and development practice. It has been over-hyped for what it has done and severely under-rated for what it could have. It has been interpreted and examined in myriad ways – as an antipoverty strategy, as an approach to empower women, as a method for financial inclusion and as a way to nurture interaction between formal-informal financial sectors. The debates on Indian microfinance reflect the myriad imaginations and perceptions that surround its identity. Despite such inconclusive discourses, the reach of microfinance has expanded substantially across the country appropriating the spaces available within development planning and democratic politics. This paper critically reviews the major trends in the trajectory of evolution of Indian microfinance since the early 1990s.

## 1. From Targeted Credit to Micro Credit: Shift of Paradigms

The idea and technology of microfinance made its debut in India under peculiar circumstances. On the one hand the directed credit programmes<sup>1</sup>

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<sup>1</sup> Targeted credit programmes formed an important component of the priority sector as defined by the Reserve Bank of India (RBI) subsequent to the first nationalisation of banks in 1969. As per the priority sector stipulations the commercial banks should earmark at least 40 per cent of their advances for the priority sectors (of which 18 per cent for agriculture and 10 per cent for weaker sections). This was an important step in the direction of asserting the developmental role of banks. The major design features of these programmes included targeting (poor in general, and Scheduled Castes/ Scheduled Tribes [SC/ST], weaker sections and women in particular), focus on self employment, mix of subsidy and institutional credit, non insistence on collateral/ third party guarantee for obtaining bank loans, insistence on the purpose of loan use and concessional interest rates. Savings has not been an integral component of any of these programmes. Many studies have shown that bank nationalisation brought in noteworthy progress in agricultural credit (which rose by 133 per cent between 1969 and 1972) and impressive increase in advances to small scale industries as also smaller accounts (Torri, 1975). Later studies too found convincing evidence to establish positive association between nationalization and reduction of poverty and expansion of banking outreach. See, for instance, Nair (2000) and Burgess and Pande (2005).

implemented since the 1970s in the country had come under serious criticism for their patently political and grossly inefficient ways of channelising financial resources to farmers and rural poor. It must be noted that starting from 1973 a series of research studies steered by a group of economists and funded by the United States Agency for International Development (USAID)<sup>2</sup> systematically projected the theme of the failure of state intervention in the financial markets of low income countries<sup>3</sup>. They questioned the legitimacy and efficiency of state owned development financial institutions in reaching out to sectors like agriculture in particular and rural poor in general. The findings of these studies entered the global discourse on financial systems development through publications like the World Development Report of the World Bank and had a significant influence on the policy thinking of countries that were also dependent on international aid in financing their development.

In India, three broad streams of critique had emerged out of the studies that interrogated the process of implementation as also the impact of the Integrated Rural Development Programme (IRDP), which was introduced during the Sixth Five Year Plan period (1980-85) as the flagship targeted antipoverty programme. The enquiries pointed to many design and delivery problems with respect to the Programme like faulty identification of beneficiaries and economic activities, inadequate financial assistance, delays in providing actual assistance, poor loan recovery, corruption, lack of motivation among bureaucracy, lack of local level planning and bankers' indifference towards the poor (Kurien, 1987; Saxena, 1987; Swaminathan, 1990). The inability of the beneficiaries to differentiate between grants and loans, channelisation of resources to the poor who lack the ability to handle such resources and the tendency on the part of banks to avoid the costly process of appraisal and monitoring in the case of low value advances are some of the specific factors highlighted by the evaluation studies as having led to poor performance of directed credit programmes (Wilson, 2002).

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<sup>2</sup> These studies were undertaken as part of USAID's Spring Review of Small Farmer Credit Programmes. See, USAID United States Agency for International Development (1973).

<sup>3</sup> See Hulme and Mosely (1996) for a fairly elaborate discussion of the intellectual legacy of this group, known popularly as the Ohio School.

The second set, though sparse in number, has delved deeper into the public policy aspects of IRDP. Rath (1985) questioned the very relevance of using assets and subsidy as strategies for helping the rural poor escape poverty. "Only a small proportion could be helped; what is equally true is that only a very small proportion can be helped in this manner..... In a multipronged attack on rural poverty this approach surely has a legitimate place, but it cannot be the mainstay of such a programme" (p.245). Presenting some interesting evidence on the performance of IRDP, Dreze (1990) raised a few pertinent questions about the strategy of using subsidized loans for poverty alleviation. He argued that the obsessive concern of public policy with making the poor self reliant by extending them subsidized loans had led to the diversion of attention from a number of important influences on the living conditions of the poor. What they need is income, neither assets nor subsidy. Public policy should, hence, focus on the creation of more employment opportunities at least at the basic subsistence wage rate and public provision in health and education and social security measures.

The third critique was concerned with the commercial viability of banks if such programmes continued to be financed through bank loans. Many studies have argued that subsidy and concessions eroded the portfolio quality of the banking system and resulted in the neglect of monetary saving facilities in the rural sector. The other factors highlighted by these studies included leakage of benefits to undeserving households and underestimation of the ability of the poor to save or pay 'market rate of interest' (ACRC 1993; Mahajan and Gupta Ramola, 1996; Yaron et al., 1997). It must also be noted that by the early 1990s the policy-induced social banking phase had resulted in a rather uncomfortable relationship between the fiscal and financial systems wherein the former could arm-twist the latter to support even the overtly political agendas of the parties in power. As pointed out by the successive rural credit committees, the misuse of the financial system by the fiscal system in doling out politically motivated financial subsidies had led to the widening of the geographical and emotional gaps between rural clientele and banking bureaucracy. The following observation made by the Agricultural Credit Review Committee (1993) in its report throws ample light on the crisis of confidence that resulted from the fiscal-financial overlap.

"The targets are achieved mainly because the banks have been compelled to do so. In fact, considerable importance has been attached by government of India and other authorities to ensure that IRDP targets are achieved by banks without fail and this message has percolated to the field level. Several relaxations have been made by

RBI in respect of eligibility criteria, procedures, rate of interest, collateral security and guarantee for the loan, etc, in view of the special status accorded to IRDP loans and these concessions have been extended despite the fact that viability of many of these loans is open to question”.

These concerns received resounding support in the recommendations of the Committee on Financial System (1991: Chairman: N. Narasimham). The report underlined the need to enhance competitive efficiency, productivity and quality and range of banking services. The Committee expressed deep concern about the deterioration in portfolio quality and erosion of profitability of banks and held directed credit, directed investment and fixed interest rates largely responsible for these. Hence, it recommended phasing out of directed credit programmes and redefinition of the priority sector to restore the depositor and investor confidence<sup>4</sup>. While acknowledging the impressive growth of banking business in the post-nationalisation years, the Committee expressed its disapproval of “micro credit direction bordering on behest lending” (Narasimham, 1996-97:224). As Narasimham puts it, the irresponsible and politicised lending operations during this period “made the credit system the subject of competitive populism and a hostage of electoral politics” (p.224).

In short, the policy thinking in India around rural finance in the 1980s came to be heavily tilted against state intervention in financial markets, which, in turn prompted the development finance institutions like NABARD to look for institutional innovations that increase the outreach of credit without any rise in costs.

## **2. Group Lending as Financial Innovation**

The experience of India with respect to directed credit programmes was shared by many low income countries in Asia, Africa and Latin America. Several of them had adopted the method of group lending to expand the flow of rural credit from formal financial institutions. Under this method, unsecured loans were given to informal groups with membership ranging from 5 to 30, which, in turn are distributed among members who hold joint liability for repayment (Adams and Ladman, 1979). The proclaimed advantages of group lending over individual lending were (i) reduction in the lending costs of financial institutions; (ii) use of peer pressure to reduce delinquency; (iii) low per farmer

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<sup>4</sup> See Narayana (1992) for a detailed critique of the Narasimham Committee's recommendations on directed credit programmes.

cost of delivering technical assistance; (iv) lower transaction costs for borrowers; and (v) increase in outreach without any escalation in costs (Ladman and Afcha, nd.; Adams and Ladman, 1979).

A series of enquiries into group lending implemented by public sector development finance institutions in countries like Bolivia, Mexico, Ghana, Malawi, the Dominican Republic and the Philippines led mainly by the researchers of the Ohio School and funded by the USAID generated an interesting debate on the advantages and limitations of group credit in the late 1970s<sup>5</sup>. While appreciating the rationale of group loans using peer pressure/ joint liability these studies largely concluded that “it is most common that they (i.e., group lending programmes) fail to live up to expectations” (Ladman and Afcha, nd: 2.). In many instances the transaction costs were reported to be far greater than that of informal lenders. A major reason for the limited success of group lending innovation, according to these researchers, was the concessionary interest rate policies followed by the low income countries that make it unviable for financial institutions to carry on with a high cost innovation. Flexible interest rate policies, it was argued, would provide a more healthy economic and political environment for financial innovations like group lending (Adams and Ladman, 1979).

The merits of group lending scheme as an arrangement that helps to both counter the limitations of informal finance and circumvent the problems associated with borrower selection and cost of lending had been rediscovered in the international development making circles with the success of Grameen Bank (GB) of Bangladesh. Started as an experimental project in 1976 it turned into a formal financial institution in 1983 defying every single tenet of prudent banking by substituting individual lending by lending to small groups with carefully crafted norms – poor women borrowers, small loans, market rates of interest and no collateral<sup>6</sup>. The GB model was the reigning

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<sup>5</sup> See Adams and Ladman (1979) for a review of some of these studies.

<sup>6</sup> The main components of the Grameen methodology included, among other things, (i) provision of small, short-term loans, (ii) compulsory and regular savings and repayments, (iii) gradual building up of individual and group funds to act as loan collateral and to meet emergencies, (iv) priority for production loans, (v) group lending to reduce transaction costs for the MFI and to encourage peer pressure, (vi) graduated access to increasing loan sizes, (vii) strong management information systems, and (viii) loan officers who are locationally and socially accessible to clients and have clear incentives and delegated authority. See, Doward (2005).

paradigm of poverty lending in the 1980s through the 1990s. Its methodology came to be accepted unquestioningly as the sure-shot success formula for any rural credit initiative to be pro-poor and pro-women. The small group-based microcredit approach employed by GB stipulates pooling of all the potential consumers whose risk profiles are assumed to be the same. They are offered loan contracts on identical terms. The important design feature GB approach is 'peer monitoring system' that involves incentives to the groups to monitor the actions of their members (Stiglitz, 1990). Joint liability and denial of loans to groups with defaulted members were the incentives provided within the model for timely repayment. All these require careful formation of groups "to weed out bad borrowers who could jeopardize the creditworthiness of the group as a whole. ....and this induces a form of *self-selection* that no individual-based banking scheme can mimic" (Ray, 1998: 579). These attributes of the GB have come to be hailed by development economists as efficient methods of information use (*ibid*) and price discrimination (Ghatak, 1999) that are impossible within individual lending.

Starting around 1995, there were serious signs of widespread disaffection on the part of Grameen clients due mainly to the rigid rules the programme had been following. The resultant crisis in repayment led the leadership to redesign the methodology around 2000. The new methodology called the Grameen Generalised System or Grameen II is a complete antithesis to its predecessor. Yunus describes the new system thus: "...gone are the general loans, seasonal loans, family loans, and more than a dozen other types of loans; gone is the group fund; gone is the branch-wise, zone-wise loan ceiling; gone is the fixed size weekly instalment; gone is the rule to borrow every time for one whole year, even when the borrower needed the loan only for three months; gone is the high-level tension among the staff and the borrowers trying to steer away from a dreadful event of a borrower turning into a "defaulter", even when she is still repaying; and gone are many other familiar features of Grameen Classic System"<sup>7</sup>. In nutshell, while the earlier system uses a one-size-fits-all kind of methodology, the new one emphasises the importance of custom-made credit.

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<sup>7</sup> See Yunus, 'Grameen Bank II', [http://www.grameen.com/index.php?option=com\\_content &task=view&id=30&Itemid=99999999](http://www.grameen.com/index.php?option=com_content&task=view&id=30&Itemid=99999999) (accessed 13 May 2011).

### **3. Substituting Social Banking: The Indian Experiment with Linkage Banking**

Three major developments may explain the rise of group lending based microfinance activities in India by the beginning of the 1990s. Firstly, many NGOs in India, especially in the southern states, had by then come to acknowledge group based saving/ credit activities as the fulcrum of their development activities. In states like Andhra Pradesh, they had been working closely with the governments for the mobilisation self help groups (SHGs) for the implementation of the scheme Development of Women and Children in Rural Areas or DWCRA (a group based anti poverty scheme piloted as part of IRDP in 1982-83) (Narayan and Glinskaya, 2007). Secondly, several replicators of the GB model had emerged in India as in other countries financed mainly by foreign donor money<sup>8</sup>. Thirdly, the senior management of NABARD was inspired by the idea of linkage banking as an innovative alternative to increase outreach.

Being mandated 'to provide focused and undivided attention to the development of rural India by facilitating credit flow for promotion of agriculture and rural non farm sector' NABARD had undertaken some enquiries in the mid-1980s, which highlighted the need for rural households to safe-keep thrift and access loans to meet production and consumption related expenditure (Kropp and Suran, 2002; Wilson, 2002). Within the Bank there was a thinking that if a product were introduced which could reduce the transaction costs and provide substitute collateral, banks would come forward to lend to these farmers<sup>9</sup>. At the regional level GTZ had already been supporting a pilot project in Indonesia (started in 1988) linking groups with banks. The project was a unique innovation in that the central bank had authorized its public and private banks to accept informal groups as customers and lend to them without physical collateral (Seibel, 2005). It

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<sup>8</sup> The pioneering Grameen replicators in India were Grameen bank Uttar Pradesh/ CFTS (Uttar Pradesh), Activists for Social Alternatives (Tamil Nadu), SHARE (Andhra Pradesh) and Rural Development Organisation (Manipur). They received financial and technical assistance from the Grameen Trust in the early stages of their development.

<sup>9</sup> Personal interview with Y.C. Nanda, former Managing Director and Chairman, NABARD, 17 February 2012, New Delhi.

received widespread publicity through the Asia Pacific Rural and Agricultural Credit Association or APRACA<sup>10</sup>. Between 1984 and 1986 the major discussion on the APRACA platform was how to use informal financial institutions like SHGs to improve credit access to rural poor and micro producers in cost efficient ways (Kropp and Suran, 2002).

In 1986 with APRACA's recommendation a study team was formed under the leadership of NABARD to identify and survey the existing self help groups in India and plan for action research with focus on savings mobilization and channelisation of credit through linking banks to such groups. The team undertook case studies of 46 SHGs promoted by 20 agencies in 11 states (NABARD, 1989). The survey excluded informal institutions working in various parts of the country<sup>11</sup> from its purview reflecting a rather limited vision of the Bank regarding SHGs as collectives formed and nurtured by self help promoting agencies<sup>12</sup>. Many such initiatives were being piloted in India during the time including the SHG-based women's empowerment programme of the Tamil Nadu Corporation for Development of Women (TNCDW) funded by the International Fund for Agriculture development (IFAD) and the projects by Professional Assistance for Development Action (PRADAN) in Rajasthan and Madhya Pradesh.

Formal credit linkage was found negligible among the groups selected for the survey; whatever existed was individual lending. According to the study report the three major bottlenecks faced by the poor in accessing bank loans were (i) cumbersome loan processes which were made further difficult

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<sup>10</sup> APRACA is an association of rural finance and agricultural credit institutions in the Asia-Pacific region set up in 1977 to promote cooperation and facilitate mutual exchange of information and expertise in the field of rural finance.

<sup>11</sup> Like the *Marups* of Manipur, the *bishis* of Maharashtra or the chit funds in south India.

<sup>12</sup> The foreword of the report justifies the exclusive inclusion of NGO promoted groups thus: "The Seventh Five Year Plan has emphasised the need for associating voluntary agencies closely with rural development programmes, particularly the poverty alleviation efforts. This report points out that the initiative of formation of self-help groups owes its origin primarily to the efforts of certain voluntary agencies. In a sense, this Study represents a contribution to understanding how the voluntary agencies have promoted the development of target groups through the instrument of self-help".

by the indifference and often outright hostility of village/block/bank officials, (ii) the time lag between application and actual receipt of loans, and (iii) corruption. Procedural and attitudinal factors were found to be acting as barriers on the part of bankers while dealing with poor households and SHGs. The features of successful SHGs as summarized by the study included homogeneity of members in terms of caste and economic activity, trust-based lending, informality in working, democratic decision making based on deliberation and collective consensus, creation of common funds out of savings, internal lending, small loan size, provision of loans in successive dozes and small amounts, exclusive women membership and involvement in development agencies in formation and promotion of groups.

Even as the linkage banking innovation was being piloted in India, the methodology of group lending received the stamp of approval from the international financial institutions as a plausible promise that could eventually ease the credit supply constraints faced by non-corporate borrowers in developing countries. Patent repercussions of this thinking were manifest in the World Development Report 1989 which devoted a chapter to discuss the strengths and limits of various informal and semi formal financial arrangements (World Bank, 1989). The Report presented an array of options to build on the existing informal arrangements by linking them to formal institutions.

The launching of a pilot project in 1992 by NABARD (with financial support from the Swiss Agency for Development and Cooperation or SDC) to link SHGs with banks, obviously, had been influenced by these developments. Being a pilot project only a limited number of SHGs – 500 - were promoted in this phase by NGOs, banks and other agencies. As per the guidelines issued by NABARD the pilot project aimed to develop a hybrid credit delivery strategy that combines “the flexibility, sensitivity and responsiveness of the informal credit system with the strength of technical and administrative capabilities and financial resources of the formal credit institutions” in order to serve the needs of the rural poor<sup>13</sup>. Promoting formal banking activity among unreached populations and building trust and confidence among bankers and rural poor were the other two objectives

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<sup>13</sup> NABARD, 'Guidelines for the Pilot Project for Linking Banks with Self Help Groups', Ref. No. NB.DPD.FS.4631/92-A/91-92 Circular No. DPD/104, 26 February 1992.

of the pilot project. The guidelines elaborated the explicit benefits of the partnership between banks and SHGs, the non-formal credit agencies, thus:

“Under linkage project the main advantage to the banks would be externalisation of a part of the work items of the credit cycle—assessment of credit needs, appraisal, disbursal, supervision and repayment—reduction in the formal paper work also in the margins would lead to wider coverage of the target group. A larger mobilisation of small savings would be equally advantageous. For the groups the advantages lie in the access to a larger quantum of resources as compared to their meager corpus generated through thrift, access to better technology and skill upgradation through different schemes of the banking sector and a general improvement in the nature and scale of operations that would accelerate economic development”<sup>14</sup>.

The project envisaged direct provision of credit by banks to formal or informal groups. In case this is not possible either because of the diffidence of banks or unwillingness of SHGs, banks can resort to bulk financing of voluntary agencies and other self help promoting institutions. NABARD offered to refinance all the lending to the SHGs. As per the guidelines, the purpose of lending, rate of interest payable by the ultimate borrower and the loan repayment period are completely left to the group’s ‘common wisdom’. The project was expected to be implemented in pockets given the area specific nature of working of groups and NGOs. Importantly, the guidelines were meant to be flexible enough to “enable participating banks and field level banks to innovate and contribute to building and strengthening the project concepts”<sup>15</sup>. Such openness to new ideas and expression of willingness to learn from the process of implementation rendered the conceptualization of linkage model the aura of a unique experimentation in banking.

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<sup>14</sup> *Ibid.*

<sup>15</sup> TThe RBI directives issued to all the commercial banks (Ref. No. RPCD. No. Plan BC.13/PL-09.22/90-91 July 24, 1991) urging them to participate in the pilot project too had emphasized flexibility in actual operationalisation. It stated: “While the present norms relating to margin, security as also the scales of finance and unit cost will broadly guide the banks for lending to the SHGs deviations there from can be made by the banks, where deemed necessary”.

A working group appointed by the RBI in 1994 (Chairman S.K.Kalia) reviewed the performance of the pilot project and opined that linkage banking is a cost effective, transparent and flexible solution to the problems of low recovery and high transaction costs faced by banks while lending to rural areas and dealing in small loans. The Group hence recommended that formation of SHGs and their linking to banks should be encouraged by the latter as part of their service area approach and as a business strategy under priority sector obligations.

The RBI accepted the recommendations of the working group in 1996 and decided to “extend the SHGs linkage programme beyond the pilot phase as a normal business activity of banks to improve the coverage of the rural poor by the banking sector”<sup>16</sup>. Lending to SHGs and NGOs under the programme was added to the priority sector definition as part of lending to the weaker sections. The official circular clearly mentioned that the purpose of borrowing would not matter in such advances. As per the circular the banks have the flexibility to define the scope of SHG lending while the SHGs/ NGOs have the freedom to approach bank branches they are comfortable dealing with. It specifically mentioned that “the SHG linkage is a credit innovation and not a targeted credit programme”.

#### **4. From Informal Financial Arrangements to Power Groups: The Changing Identity of SHGs**

It must be noted that the directives from the NABARD and the RBI amply showcased the emphasis placed by the project on flexibility and restraint while ‘mainstreaming’ the implementation of the linkage programme. But as it turned out later in the absence of a focused, long term vision<sup>17</sup> the

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<sup>16</sup> Reserve Bank of India (RBI), RPCD. No. PL.BC.120/04.09.22/95-96 April 2, 1996, ‘Linking of Self Help Groups with banks - Working Group on NGOs and SHGs - Recommendations - Follow-up’, <http://www.nabard.org/pdf/publications/reports/Annexure-III.pdf> (accessed on 20 February 2012).

<sup>17</sup> According to Y.C. Nanda, Former Chairman of NABARD, who played a very important role in the formulation of SBLP, there was inadequate appreciation on the part of the project champions of the challenges to repeat lending to SHGs. It was thought then that “once the bank linkage is established, things will happen on their own”. Further, with mainstreaming, “organisations that know only credit and had no understanding of empowerment and organisations that did not do any credit and knew only empowerment all got mixed up to create a new “cocktail’, while none invested in group development”. Personal interview with Y.C. Nanda, former Managing Director and Chairman, NABARD, 17 February 2012, New Delhi.

rather straightforward identity of SHGs a transaction-reducing innovation as envisaged by the apex institutions got seriously compromised. Two developments seem to have contributed to this. Firstly, thanks to the involvement of NGOs in their forming and nurturing, SHGs have come to be seen more as social networks and less as a financial innovation. As social networks, they are supposed to be driven by the larger agenda and galvanized by a felt need of collective management of resources including financial resources with a view to enhance the economic status and wellbeing of individuals, families and communities. Secondly, the concept of SHG caught the imagination of all – local/national/international development agencies, central and state governments and even corporate entities - as a potentially efficient institutional arrangement to deliver finance-centric development programmes primarily using women as conduits and instruments. In this way SHGs became the easiest victims of the target approach followed by the central and provincial development administration structures that resulted in massive mobilization of women and, to a limited extent in some parts, men too. The inadequate financial assistance to NGOs to carry out group formation as an “add on” activity eventually resulted in poor and deserted groups as bank linkage in most of the cases remained sporadic and often one-time.

The involvement of the central government in SHG promotion started in 1999 with the launching of the rural self employment programme - *Swarnajayanti Gram Swarozgar Yojana* (SGSY) - targeted at poor households. SHGs of women and those belonging to weaker sections are given priority for support in this scheme that combines credit with subsidy (50 per cent of the project cost subject to a ceiling of Rs. 1.25 lakh per group or per capita subsidy of Rs. 10,000 whichever is less)<sup>18</sup>. The evaluation studies of SGSY have brought forth several lacunae in its implementation and performance, the most important of which are inadequate investment in capacity building, weak and incomplete linkage with banks and the consequent gaps in mobilisation of credit. Lately the government of India has decided to restructure and rechristen SGSY as the National Rural Livelihoods Mission (NRLM) and announced its implementation in ‘a mission mode’ across the country<sup>19</sup>.

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<sup>18</sup> See RBI / 2010-11 /56 RPCD. SP. BC. No. 7 /09.01.01/2010- 11 July 01, 2010 Master Circular on Priority Sector Lending- Special Programmes- Swarnajayanti Gram Swarozgar Yojana (SGSY).

<sup>19</sup> See, NRLM Framework for Implementation, [http://sgsy.gov.in/ upload Circular.do?method=showViewNRLM](http://sgsy.gov.in/upload/Circular.do?method=showViewNRLM).

Coming to provincial governments, as mentioned earlier, the government of Tamil Nadu has been promoting SHGs through its *Mahalir Thittam* programme since 1989 to advance the agenda of women empowerment. However, it is the state of Andhra Pradesh that has legitimized an antipoverty approach based on SHGs and bank linkage in the country. It may be noted that the state's involvement in microfinance began in the mid-1990s, when, under the aegis of the South Asia Poverty Alleviation Project (SAPAP), the poor households in three selected districts started getting mobilised into SHGs. The SAPAP was introduced with the purpose of helping the poor access public resources and services by facilitating interaction between them and the government. The project also envisaged strengthening the institutional power of the poor with the help of which they can demand government accountability (Radhakrishna and Ray, 2005).

As the poverty eradication approach of the state evolved, SHG and liberal cooperative movements (which received an impetus thanks to the passing of the Andhra Pradesh Mutually Aided Co-operative Societies Act, 1995) have been converged to create an innovative institutional arrangement. The state poverty alleviation project, *Indira Kranthi Patham* (IKP)<sup>20</sup>, follows a three-tier federation model of SHG organisation, a model that it inherited from SAPAP. As per this, the different components of the project are carried out by at the grassroots level by community based organizations – village organizations (or VOs or federation of all SHGs in a village) and the *mandal samakhyas* (federation of many VOs). Though the VOs and samakhyas were meant to be unregistered and informal federations as per the original World Bank specifications, by around 2003 the implementing officials at the field level encouraged them to register as cooperatives under the Andhra Pradesh Mutually Aided Cooperative Societies Act (Stuart, 2007). It is worth noting here that a working group constituted by the state government in 2002 suggested that the institution building methodology “has to ensure that SHG remains the building block of the Federation, even while it operates

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<sup>20</sup> Being implemented by the Society for Elimination of Rural Poverty (SERP), *Indira Kranthi Patham* (IKP) focuses on rural poor families in all the 1097 rural *mandals* (a sub-district level administrative unit similar to block in other parts of India) in the 22 rural districts of the state. It has evolved out of two projects – the Andhra Pradesh District Poverty Initiatives Project (APDPIP), known popularly as *Velugu* and the Andhra Pradesh Rural Poverty Reduction Project (APRPRP), launched in 2000 and 2002 respectively. These receive partial external financial assistance from the World Bank. The overall coverage of IKP is estimated as 30 lakh households.

within the ambit of AP MACS Act 1995”<sup>21</sup>. Thus VO under the IKP is registered as a cooperative society under the MACS Act, 1995, while the MS is registered as a federation of cooperatives. The role of samakhya is key in that it mediates negotiations with government agencies, financial intermediaries and other resource agencies.

Though the gender and developmental outcomes of these programmes are still a matter of serious debate, it is certain that through these programmes women have been successfully coopted into the political game plans in these states<sup>22</sup>. States like Orissa and Rajasthan too have taken to the SHG strategy subsequently in a big way; but the groups have remained either the handmaidens of NGOs helping them to access government funds or convenient channels for government departments to distribute targeted subsidies. Gujarat is the latest to have announced its intention to mass promote SHGs, mainly in rural areas. Named as *Sakhi Mandal Yojana* launched by the government in 2007, 1,56 lakh groups had been reportedly formed within three years of its announcement.

It must be mentioned that successful experimentations have been carried out though in limited pockets to scale up the linkage banking model by federating groups and building community organizations. The federations work as intermediary structures that take over the responsibility of service provision and monitoring of SHGs (Nair, 2003). The Kalanjiam Community Banking Programme initiated by DHAN Foundation, a trust based in Madurai, Tamil Nadu in 1990 is a case in point (Vasimalai and Narender, 2007). With the enactment of mutually aided/ self reliant cooperative society legislation in several states an interesting avenue was opened up for SHGs to register themselves as cooperative societies under these laws to

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<sup>21</sup> See Annexure to G.O.Ms.No.237 Date: 30-07-2003; Panchayat Raj and Rural Development (RD. III) Department.

<sup>22</sup> See, Young (2010a) for an insightful narrative of some aspects of this process of cooption in Andhra Pradesh.

undertake group-based saving and lending activity<sup>23</sup>. These Acts provide for voluntary formation of cooperative societies as accountable, competitive, self-reliant business enterprises, based on thrift, self-help and mutual aid and owned, managed and controlled by members for their economic and social betterment. Given the legal and regulatory vacuum that surrounds the informal SHGs, the self-reliant cooperative law may be considered as an important institutional innovation as it provided a broader regulatory framework for cooperatives<sup>24</sup> and SHGs to synergise their distinct strengths<sup>25</sup>.

## 5. Emergence of MFIs as Direct Providers of Microcredit

A large section of the NGOs that started promoting SHGs as 'add on' activity since 1996 soon found it difficult to sustain the bank linkage established initially. While many of them stopped the self-help promotion activity, several moved on to become direct intermediaries of microcredit deriving their working principle from the financial system perspective which emphasise the building of sustainable, specialized financial institutions out of NGO-based programmes by tapping into commercial sources of funds (Rhyne, 1994). Such NGOs have come to be known as microfinance institutions (MFIs). Whereas the bank-linked SHGs follow a savings-led model of microfinance, the MFIs, which are legally prohibited from collecting public deposits follow a credit-led model of partial financial intermediation. The method of microfinancing implicit in the SBLP has a clear focus on gradually building the poor households' financial discipline and credit history

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<sup>23</sup> Between 1995 and 2003 nine states – Andhra Pradesh, Bihar, Jammu and Kashmir, Madhya Pradesh, Chhattisgarh, Karnataka, Rajasthan, Orissa and Uttaranchal – passed separate self-reliant cooperative Acts. These Acts allow for the formation of mutually aided cooperative societies (MACS) which are prohibited through their byelaws from raising share capital from the government (Nair and Gandhe, 2011). The MACS Act is distinct in terms of three aspects: (i) autonomy of governance of societies; (ii) clearly specified risks and responsibilities of members; and (iii) restrictions on the powers of the Registrar and the government (Stuart, 2007).

<sup>24</sup> Discussing the Andhra Pradesh Mutually Aided Co-operative Societies Act, 1995, Stuart (2007) argues that the Act not only marked 'a radical departure from the top-down, statist management of cooperatives', but also radically altered 'the rights, responsibilities, and risks of cooperative members' (p.182)

<sup>25</sup> Between 1995 and 2003 nine states – Andhra Pradesh, Bihar, Jammu and Kashmir, Madhya Pradesh, Chhattisgarh, Karnataka, Rajasthan, Orissa and Uttaranchal – passed separate self-reliant cooperative Acts.

by involving members' own money saved over time – the 'warm' money - in the lending operations. Once the groups attain the maturity to handle finances, the banks are encouraged to lend them 'cold money' without any collateral and at market interest rates. The terms of internal lending are expected to be decided by the groups and not imposed by external agencies (Wilson, 2002). Ideally, SHGs are supposed to evolve into credible and capable micro institutional structures that ensure its members access to regular loan and saving services without many hassles. However, as we have observed earlier, an evolution of this nature was effectively thwarted by the course of its development. As of now, SHGs have come to assume the status of 'hold-all' institutions that anchor the values of democratic politics, sustainable development and women empowerment, while attempting to reduce the incidence of poverty. As against this, MFI-NGOs and MFI-NBFCs, being "embedded in a commercial framework" (Weber, 2002: 540), have a minimalist agenda of purveying only credit.

The Small Industries Development Bank of India (SIDBI), the national level financial institution mandated to promote, finance and develop micro, small and medium enterprises (MSMEs) launched a pilot development project by name Micro Credit Scheme in 1994 with the purpose of supporting MFIs involved in microcredit provision to poor rural women (Chopra, nd.). According to SIDBI, by the end of the pilot phase in 1998 it had 'learnt' that (i) MFIs and the supporting financial institution should charge market rate of interest; (ii) the credit absorption capacity of the MFI is critical as the lending is non-collateralised; (iii) microfinance provision requires specialized institutions rather than NGOs; (iv) these specialized institutions must be supported with equity and intensive capacity building. The scheme was reviewed in 1999, followed by the initiation of the National Micro Finance Support Project (NMFSP) the major objective of which was to develop a 'more formal, extensive and effective' microfinance sector in the country to serve the poor, particularly, women' (ibid). A special set up called the SIDBI Foundation for Micro Credit (SFMC) was also created for the implementation of the project. In its efforts to deepen and broaden the microfinance market, SIDBI is supported by grants from the Department for International Development (DFID), UK and loans from

the International Fund for Agricultural Development (IFAD)<sup>26</sup>, Rome and KfW, Germany.

Apart from SIDBI, two other initiatives - the DFID supported CASHE (Credit and Savings for Household Enterprises) Project of CARE India (1999-2005) and the 'partnership model' innovated by the ICICI Bank (2002) – helped the growth MFIs in India since the early 2000s.. CASHE Project invested resources – in the form of both revolving credit assistance and capacity building grants - in about 25 NGOs in the states of Andhra Pradesh, Orissa, West Bengal and Madhya Pradesh to transform them into MFIs and linking them with formal financial institutions. The Project teamed up with the ICICI Bank which was in search of good MFIs to expand its 'partnership model'. Under this model (initiated in 2002) loan contracts were directly drawn between the bank and the borrowers, whereas the MFIs continued to shoulder the responsibility of servicing the clients until the loans matured. Clients paid the MFIs a service charge apart from the interest rate. The MFIs shared the risk with the bank by way of providing the first loss default guarantee (FLDG)<sup>27</sup>. Under the CASHE project, the ICICI Bank had entered into five partnerships wherein the Bank-funded MFIs 'merely held the loans in trust' and passed them on to the actual borrower groups and individuals with whom the Bank entered into detailed agreements (Harper, 2005). The partnership model ushered the phase of off-balance sheet financing of MFIs in India and opened up sources of debt capital other than bank finance to the expanding MFIs. More sophisticated debt instruments like securitization were introduced in the sector with the rise in importance of microfinance as 'an interesting asset class'. It is argued that

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<sup>26</sup> It must be mentioned here that apart from extending financial assistance to SIDBI, both IFAD and DFID along with the World Bank have been actively working towards creating financial services markets for the poor across the country (like Tamil Nadu, Andhra Pradesh, Maharashtra, Rajasthan, Uttar Pradesh, Madhya Pradesh, Orissa, Bihar, Jharkhand, Chhattisgarh, Uttaranchal and Meghalaya) through programmes that involve SHGs, especially of women, and microfinance as critical components.

<sup>27</sup> See, for operational details of the partnership model, 'ICICI Bank and its Partnership Linkages in India: A Case Study', written by Malcolm Harper and Mariè Kirsten as part of the Ford Foundation-sponsored study of links between banks and MFIs carried out by the Food and Agriculture Organization. Available at [http://media.microfinancelessons.com/resources/ICICI\\_bank\\_case\\_study.pdf](http://media.microfinancelessons.com/resources/ICICI_bank_case_study.pdf) (Accessed August 18, 2011). Also see Ananth (2005).

the peculiar attributes of microfinance like high repayment rate, high frequency of repayment, more stable returns, well diversified portfolio of small size loans across a wide variety of areas (or the quality of 'granularity') and low correlation with other asset classes make it an eminently desirable site for asset backed securitization deals (Fernandes, 2011).

## **6. Moving towards Formalisation: Genesis of Microfinance Companies**

An important aspect of the evolution of Indian microfinance through the last two decades is the transformation of MFIs from not for profit to for profit organisations. Some of the MFIs emerged in the early 1990s had developed into mammoth financial institutions by the end of the decade of the 1990s and started transforming themselves into licensed for-profit non-banking finance companies or going 'commercial', to borrow a term used generally to denote this phenomenon (Christen and Drake, 2002). With commercial banks becoming more responsive to the demands of the microfinance sector, guided largely by the credit policy directives of the RBI, most of the MFIs could access debt funds more easily than in the earlier years. This has helped them reduce the dependence on the sporadic flows of subsidised funds and grants and evolve a market for microfinance. Since the NGOs are not legally permitted to hold shares in the transformed entities, they stepped aside to make way for actual investors that included venture capital firms, investment funds, and specialised financial intermediaries like the Small Industries Development Bank of India (SIDBI) altering dramatically the structure of ownership, control and management of microfinance. As Postmus (1999) argues private equity investors were attracted to the microfinance sector mainly because of the perception that the microfinance sector can deliver high rates of return that are not sensitive to the vagaries of global economic cycles. Thus ushered the phase of commercialization of Indian microfinance, a phase wherein MFIs 'manage on a business basis as part of the regulated financial system' (Christen and Drake, 2002) and by accessing 'commercial markets of the world' (Lennon and Richardson, 2002). Unlike their NGO predecessors, NBFC-MFIs look at themselves as specialised lending institutions with their primary focus on developing viable and efficient businesses so that they are 'financially able' to fulfill their 'social mission'.

It must be mentioned here that internationally microfinance became a great site of interest for the global financial capital in the 1990s. According to Conroy (2010) international agencies (like the International Finance Corporation and KfW) started in the 1990s by extending loans at near commercial rates to MFIs. Private foundations, social investors and charitable foundations of international commercial banks supplemented these efforts. They encouraged MFIs to adopt professionalism and commercial outlook and transported the financial technologies available with the mainstream capital markets to the world of microfinance. Thus they caused “financialisation of pure-lending micro credit” and it with the complex instruments of investment vehicles, securitisation, collateralised debt obligations and structured finance as also other risk-management tools with the support of specialized service providers like the rating industry. The culmination of the financialisation motive came with the couple of initial public offerings (IPO) that the industry witnessed in Mexico in 2007 by Banco Compartamos and in India in 2010 by SKS microfinance that signaled lucrative opportunities for private equity investors to make profits<sup>28</sup>.

The trend towards commercialization has changed the way in which microfinance is conceptualized, designed and delivered in India. The major changes occurred in the pattern of financing of operations and the structure of ownership. On the positive side one may argue that the transformation of ownership “has brought broader competencies to microfinance” (*Ibid*: 13). On the flip side, as Christen and Drake (2002) would point out, the founders and core staff got marginalized in the transformed structures while trying to accommodate the investors’ demand for outreach and returns. Or, as argued by some researchers the strategic focus of commercial microfinance has shifted from the satisfaction of the financial needs of poor borrowers to fulfilment of the economic interests of promoters and maximization of profits from operations (Sriram, 2010; Nair, 2010).

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<sup>28</sup> The MFI leaders countered the apprehensions of the skeptics of IPO by pointing to the limitations of conventional financing, both by banks and donors. According to Vijay Mahajan, a pioneer of Indian microfinance and president of the Microfinance India Network, “When we are growing 75 percent year-on-year, the sort of equity we need to maintain 15 percent capital adequacy ratio cannot come from old-fashioned sources such as philanthropists or banks. So we’ve had to move to new sources like PE, the capital market and debt instruments. This is something to be celebrated”. See, <http://www.reuters.com/article/2010/04/09/us-microfinance-india-ipo-analysis-idUSTRE63814G20100409>.

## 7. Institutional Structure

It is evident that Indian microfinance cannot be considered as a monolithic site. Institutional and methodological diversity is a crucial defining feature of the microfinance system in the country. The bank-linked SHGs, transaction specific joint liability groups, for-profit companies, mutually aided thrift and credit societies and SHG federations coexist within the system along with banks that follow the classic individual lending model. Such diverse streams of microfinance practice have developed a high degree of interdependence and increased competition within microfinance markets as also in the domestic funds market. A part of this system – the commercial MFIs - has also got increasingly complex and become wedded more closely to international financial markets. However, the sector still lacks institutional coordination and clear policy direction resulting in the disorderly development trajectory it has followed so far.

From the very beginning the RBI, the regulator and supervisor of the financial system, assumed the role of a facilitator and has abstained from taking any proactive steps to bring the sector under its regulatory fold. It must be noted that the NGOs started working with microfinance at a time when there was hardly any clarity as to their legitimacy of delivering microfinance as, by legal definition, they are barred from indulging in profit making activities. They continued with microfinance activities by not showing profits in their books and redeploying the entire surplus generated in further lending. The ‘legal awkwardness’s of this situation could be overcome to some extent when the RBI issued instructions to the banks in April 1996 to treat lending to SHGs as a normal banking activity and to allow them to open bank accounts, irrespective of their status of legal incorporation<sup>29</sup>. This no doubt had eased much of the operational discomfort on the part of both banks and NGO-MFIs and facilitated faster growth of microfinance. The issues of legality and regulation of microfinance activity, however, remained unaddressed.

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<sup>29</sup> This directive was based on the recommendations of an RBI-constituted Working Group (under the chairmanship of S.K.Kalia) that looked into the functioning of SHGs and NGOs. The apex bank advised the banks that “they may consider lending to SHGs as part of their mainstream credit operations both at policy and implementation level. They may include SHG linkage in their corporate strategy/ plan, training curriculum of their officers and staff and implement it as a regular business activity and monitor and review it periodically”. See, ‘The Master Circular on Micro Credit’, RBI/2005-06/84, RPCD. No. Plan. BC.24/04.09.22/ 2005-06, dated July 30, 2005, p. 4.

The unsuitability of the charitable/voluntary organizational structure for the delivery of microcredit and saving services was quite apparent by the end of 1990s. The Task Force on Supportive Policy and Regulatory Framework for Microfinance set up by NABARD in 1999 (under the chairmanship of Y.C.Nanda), while laying down the structure of a desirable policy framework, did acknowledge the need for regulation and supervision of NGO-MFIs mainly to protect the interests of the small savers and to ensure an orderly development of the sector. It recommended that till the time a proper regulatory framework emerges a self regulatory organization or SRO can oversee the conduct of the sector. As per the committee's view regulation of MFIs may cover aspects like registration and other critical aspects of financial business (like reserve requirements, prudential norms and operations and reporting standards). Importantly the Task Force recommended a special dispensation for the NBFCs that take up microfinance activity as a step for professionalizing the sector. It even suggested appropriate amendments in the legislations relevant to the not-for-profit sector that would allow them to float specialised microfinance companies and hold equity in them. None of these recommendations were translated into subsequent policy directives by the RBI<sup>30</sup>. The MFIs have been given the freedom to self regulate even as the central bank has tried 'to push the official financial system further into the interior' as part of the financial inclusion mission.

It appears that the coordination between RBI and NABARD with regard to the microfinance sector was disrupted around 1999, the time when the central government started taking an active interest in the SHG-linkage programme. However, the government started acknowledging the existence of MFIs only after a few years. In the budget speech of February 2005, the then finance minister announced the intention of the government "to promote MFIs in a big way'. But, the government vision of MFIs as revealed from the budget speech is that they are institutions that intermediate between the banks and the beneficiaries. Hence, promotion of MFIs would mean "to identify MFIs, classify and rate such institutions, and empower them to intermediate between the lending banks and the beneficiaries. Commercial banks may appoint MFIs as "banking correspondents" to

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<sup>30</sup> The only steps taken included exempting NBFCs engaged in microfinance, Section 25 companies and non deposit taking NBFCs from the purview of certain of the RBI Act 1934. The sections pertain to registration, maintenance of liquid assets and transfer of profits to reserve fund.

provide transaction services on their behalf”<sup>31</sup>. In a speech that he delivered earlier in the same year he said: “I do not see any compelling arguments for MFIs to become credit institutions and accept deposits. There is enough loanable resources with banks. What is lacking is proper intermediation. You must examine whether intermediation could be your predominant role”. He also stated that the government does not have a positive view on the need expressed by MFIs to access foreign equity and changes in tax laws to help them augment their capital base<sup>32</sup>. The thinking of RBI was no different. As Y.V Reddy, the then Governor of RBI stated “the approach of RBI has been to emphasise the informality of microfinance and focus on the developmental aspects....On the suggestion for bringing the micro-finance entities under a system of regulation through a separate legislation, the RBI felt that microfinance movement across the country involving common people has benefited immensely by its informality and flexibility. Hence, their organisation, structure and methods of working should be simple and any regulation will be inconsistent with the core-spirit of the movement. It was also felt that ideally, the NABARD or the banks should devise appropriate safeguards locally in their relationship with the MFIs, taking into account different organisational forms of such entities. In any case, if any statute for regulation of MFIs is contemplated, it may be at the State-level with no involvement of the RBI as a banking regulator or for extending deposit-insurance”<sup>33</sup>.

Notwithstanding the apparent reluctance on the part of the central bank and the central government to fully endorse the growth aspirations of MFIs as independent financial entities, by mid-2005 microfinance became a burgeoning business spearheaded by hyper active MFIs at least in select pockets of the country, the foremost among which was Andhra

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<sup>31</sup> Budget 2005-2006 Speech of P. Chidambaram, Minister of Finance, February 28, 2005, Part A. <http://indiabudget.nic.in/ub2005-06/bs/speecha.htm> (accessed on 09 March 2012).

<sup>32</sup> Address of P Chidambaram, Minister of Finance, Government of India at the Conference on *Regulatory Framework of MFIs*, Delhi, January 20, 2005, as reported in *Hindu Business Line*, ‘Enough Resources with Banks, No Need for Foreign Equity: Be Intermediaries, Government Tells Microfinance Institutions’, January 21, 2005.

<sup>33</sup> ‘Micro-Finance : Reserve Bank’s Approach’, address by Dr Y V Reddy, Governor of the Reserve Bank of India, at the Micro-Finance Conference organised by the Indian School of Business, Hyderabad, 6 August 2005.

Pradesh, the state that was home to four top ranking commercial MFIs and a mammoth government poverty reduction programme using the SHG methodology. The period 2006-10 witnessed the maximum growth of commercial microfinance in India. During this period some of the large MFIs registered average growth rates ranging from 700 per cent to 7000 percent (Nair, 2011).

The creation of competing constituencies of state-run SHG programmes and privately managed MFIs has further handicapped the efforts to make meaningful policies to facilitate orderly growth of microfinance activities. Also, an ideological divide within the practice of microfinance – community-led versus market-led microfinance – has come to be deeply embedded in the political and policymaking structures. The subtle signals of a serious conflict of policy opinion between the central and provincial governments cannot also be ignored. For the provincial political regimes, understandably, SHGs constitute an attractive platform for mass mobilization given the components like cash subsidies and subsidized interest rates. For the bureaucracy, the close ally of political leadership, SHG-based development programmes yield the best results in terms of achievement of targets over definite time periods. Any competition from competing structures like MFIs, hence, needs to be thwarted at the grassroots level. On the other had, for the macro policy makers whose mission is to doggedly follow market reforms, commercial microfinance is one component in the financial services sector that performs seemingly efficiently under the current, relatively open policy environment. And any measure to control the working of MFIs would go against the logic of reform<sup>34</sup>.

The ‘ideological’ conflict between commercial and community centric microfinance has played out the most eloquently in Andhra Pradesh, the state that witnessed the maximum growth in both the models experienced two crises – one in 2006 and the other in 2010. The crisis of 2006 broke out in Krishna district where allegedly the strict and “barbaric” debt recovery

<sup>34</sup> It must be noted that the institutional differentiation within the sector also came to be addressed in the writings on microfinance by the mid-2000s. While Vasimalai and Narender (2007) vouched for the superiority of the linkage model and its focus on building social capital over the financial delivery approach of MFIs, Satish (2005) argued that the SHG programme has multiple advantages like the scope to leverage mainstream financial resources by the poor, avoidance of donor funding for portfolio build up and redundancy of a separate regulatory set up for microfinance. Thus the financial technology of SHGs ‘obviates the need for creating new financial institutions to provide microfinance services’ (p. 1736).

methods used by the MFIs growing their operations at ‘explosive’ rates had led as many as 200 borrowers to end their lives (Kumar, 2006). Several branches of MFIs were made to close operations in the district. The state reacted quickly and sharply by entrusting the task of overseeing the functioning of MFIs with the ‘people’ at the village and mandal levels. The industry lobby, on its part, came to the rescue of MFIs by proposing a code of conduct for them, with a plea to the government not to harm the prospects of the booming industry. The MFIs also offered to reduce their interest rates.

Apparently, the MFIs failed to put into practice many of the promises made in 2006 (Reddy, 2010), which reportedly led to a spate of borrower suicides during the last quarter of 2010. This time round the state government did not resort to any benign fire fighting programme, but came up with the Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Ordinance, 2010 that tightly restricts the freedom of operation of the MFIs in the state. The ordinance, among other things, requires MFIs to register themselves, and prevents lending in cases where loans are already out-standing. It allows for only monthly repayments and demands the display of interest rates charged by the MFIs. Even as the RBI constituted a committee to look into issues relating to MFIs, the Andhra Pradesh assembly ratified the ordinance on 15 December 2010, thus, paving the way for a new law governing the functioning of MFIs in the state. Some have considered the crises as the much-needed brakes on the unhealthy and aggressive market growth of for-profit microfinance NBFCs without any coordination with the state government (*ibid*). For some, the crisis is born of government intervention and not of flaws in microfinance itself (Banerjee et al., 2010). The state administration in Andhra Pradesh clearly identifies MFIs as ‘moneylenders’ and<sup>35</sup> strongly advocates the inclusion of their activities within the purview of money lending regulations prevalent in the states as they have the legislative competence to regulate the activity.

## **8. Unravelling the Dynamics of Indian Microfinance: The Larger Issues**

It is clear that any assessment of microfinance in India tends to be highly complex due to the vastness of the market and the coexistence of multiple

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<sup>35</sup> ‘The Micro Finance Institutions (Development and Regulation) Bill 2011: Comments of Government of Andhra Pradesh’, [www.rd.ap.gov.in/MFI/comments%20on%20the%20parliamentary%20Bill%20revised.pdf](http://www.rd.ap.gov.in/MFI/comments%20on%20the%20parliamentary%20Bill%20revised.pdf) (accessed 20 December 2011).

models/ institutional arrangements and methods as also to the wide interregional disparities that characterize the country's development experience. Despite these challenges, a large number of studies have sought to explore the working of the sector since the mid-1990s. The early studies (1995-2002) were more in the nature of ground-breaking enquiries largely dealing with issues like regional growth patterns of SHGs, working practices of microfinance, potential threats and challenges to SHG scaling up, comparison of different lending methodologies and broad policy concerns (Gain and Satish, 1995; Rao et al., 1999; Basix, 1999; MYRADA, 1999; Puazhendi and Satysai, 2000; Satish, 2000; Srinivasan and Satish, 2000; Harper, 2002; Puhazhendi and Badatya, 2002; Wilson, 2002). It must be noted that much of the published research on microfinance during this period was undertaken by professionals from or commissioned by NABARD and its allied training institution, the Bankers Institute of Rural Development (BIRD). These studies, as expected of them, attempted to endorse the SHG model while making recommendations to further improve their reach and efficacy.

Studies analyzing the impact of microfinance started appearing by the beginning of the 2000s. The first large scale longitudinal impact study was conducted by SIDBI with the help of external agencies during 2001-2007 to assess the performance of MFIs supported by SFMC in terms of poverty alleviation, income and enterprise growth and women empowerment (SIDBI, 2008). Using a qualitative methodology of enquiry the research reported that microfinance had diversified income sources, improved enterprises activities and increased assets and income of borrower households. Considering factors like increased savings, economic participation, joint asset ownership and control over enterprise management, the study concluded that microfinance could enhance women's empowerment to some extent. The study also noted the uneven geographical spread of the sector and inadequate outreach of loans to poorer households. Another study was conducted in 2004-05 by a consortium of agencies to see "what is really happening at group level" (EDA Rural Systems and APMAS, 2006). It attempted to examine the 'financial and social sides' of SHGs and came out with largely inconclusive findings, indicating that the interrelationships between informal women's groups, local politics and social change are too complex to be unraveled through positivist methodologies.

Between 2003 and 2007 several writings on microfinance, mostly the SBLP model, tried to critique the ways in which the programme evolved in different states. For instance, analyzing the experience with select programmes in

Andhra Pradesh, Galab and Rao (2003) reported mixed outcomes. While their findings supported increased access to credit, greater occupational diversification and better household risk management for the poorest and the excluded households, they also observed that some women became worse off due to failure of enterprise and excessive burden of credit. Intergenerational poverty, as per the insights of this study, can be impacted only through expansion of asset base through a holistic model of support in skill building, health and education. The lopsided distribution of SHG programme with the southern states accounting for bulk of the SHG remained a concern for many researchers during this period (Dasgupta, 2005; Basu and Srivastava, 2005). The findings of the Rural Access to Finance Survey conducted by the World Bank in 2003 showed that 28 percent of households in Andhra Pradesh are SHG members, compared to 8 percent for UP. The percentage of households who had borrowed from SHGs constituted 11.5 percent in Andhra Pradesh compared to 3 percent in UP (Basu, 2006). Another enquiry in 2009 by the researchers of the Development Research Groups of the World Bank found SHG participation to result in significant economic impacts for the poorest members of the IKP in Andhra Pradesh (Deininger and Liu, 2009).

The Centre for Microfinance at the Institute of Finance Management and Research set up in 2005 has carried out several studies with the purpose of improving access to financial services for the poor in the country. The method of randomized control trial (RCT) for impact evaluation was made popular through these studies. Given the experimental design of such studies, they deal with only specific organizations. For instance, in their first impact study Banerjee et al. (2009) examined the impact of introducing microcredit by Spandana (an MFI-NBFC based in Andhra Pradesh) in a new market. The study found that 15 to 18 months after lending began in the areas chosen expenditure on durable goods and number new businesses increased, while no impact was observed either in average per capita monthly expenditure or on the measures of health, education and women's wellbeing<sup>36</sup>.

Wading through the written material produced on microfinance in the country over the past two decades one cannot but help wonder about the dearth of analyses that situate microfinance within the complex ecosystem that surrounds and shapes this activity. For instance, precious little is known

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<sup>36</sup> The Centre has undertaken many MFI specific studies on aspects like savings behaviour and repayment schedules. For a listing and description of these studies visit <http://ifmr.ac.in/cmfr/research.html>.

about the ways in which different microfinance approaches have evolved over time interacting with peculiar environments to produce distinct outcomes<sup>37</sup>. Further, studies that are preoccupied with the effect of microfinance on the economic status of individuals or isolated households – incomes, expenditures, assets – or on more personal attainments in areas like decision making, mobility and ‘empowerment’ (a complex analytical category that combines a variety of economic, behavioural and cultural factors) implicitly assume microcredit to make changes only in the sphere of the private. Though they inform microfinance policies and practices in the short run, their ability to throw adequate light on the systemic and long term changes is limited. The best illustration of this is the crisis in Andhra Pradesh which brought the second decade of India’s tryst with microfinance to a tumultuous close. The many enquires conducted into the microfinance sector in the state could throw light neither on the simmering disharmony that characterized the state-MFI relationship nor the discontentment among the clients – real or politically engineered - with respect to microfinance services.

The preoccupation of impact research with the private sphere has not helped in unraveling the underlying development philosophy of micro credit, the key concerns of which are self initiative and individual attainment. Isserles (2003) provides an interesting critique of, what she calls, the neo-liberal ideology and the populist rhetoric of microcredit. She states: “Without blaming the failures of current economic development policies or poverty alleviation programs, microcredit becomes a vehicle through which to stress the importance and need for self-reliance, efficiency, and economic independence” (p. 43). She further critiques the much celebrated peer group dynamics thus: “Transforming individuals into entrepreneurs, according to the precepts of free-market capitalism, requires individuality, competition, and concerns for efficiency and rationality. Such attitudes are encouraged through the co-optation of values that represent a different and antithetical way of thinking and operating - cooperation, solidarity, group interdependency. Microcredit is about using solidarity to foster individuality and competition, advancing values and behavioral patterns which are perhaps insulting and offensive to the borrowers” (p. 53). Rankin (2001) too sees microcredit as representing a state strategy to achieve welfare objectives

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<sup>37</sup> The recent work by Young (2010a and 2010b) and Stuart (2007) on the political economy of Indian microfinance has the potential to open up interesting debates in this respect.

through the rationality of the market, thus constituting social citizenship and women's needs in a manner consistent with a neoliberal agenda<sup>38</sup>. Thus, "their citizenship manifests not through entitlement but through the 'free' exercise of individual choice" (*ibid*: 29). It appears that the assessments of microfinance functioning in India have so far been steered by the same ideological preoccupations that celebrate the capacity of the market and the power of individual initiative to tackle basic endowment failures.

What is then needed are analyses that go beyond the trappings of "lending-savings-efficiency-viability" conundrum to locate microfinance in larger and dynamic contexts using multiple methods of enquiry. While studies that look at changes at the level of the households and individuals are very important for a deeper appreciation of the impact of microfinance, there is also a need for studies that capture the more nuanced and contextualized experiences local economy-wide. In the specific context of India microfinance delivery has predominantly been carried out through groups like SHGs or the more 'managerial' collectives of joint liability groups (JLGs). These collectives get formed and operate within distinct socio-economic realities interacting with multiple institutions, both formal and informal. In the process they learn, evolve, and re-configure their relationships with the members and the environment in distinct ways. Again, within the groups different individuals assimilate the experiences differently. Moreover, all these are influenced by the structure of patronage and support provided by the state and other formal-informal agencies involved in facilitating group formation and functioning. It is naïve to imagine that such a large scale mobilization of people's collectives, however fractured their organization is, has not caused any reordering of the extant institutional arrangements not only in the direction of empowering the poor, but also in terms of reinvigorating the agencies that resist the assertion of voices historically smothered by the power of social and cultural institutions. Can the experiences of the microfinance sector, SHGs especially, be located and analysed in such a context of oppositional forces? They can surely be, provided the impact of microfinance is understood as layered and deeply embedded within local specificities and extant institutional arrangements. Straight-jacketed research designs that help explore "the transformation of the conditions of the poor

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<sup>38</sup> The success of microcredit initiatives in scaling up fast, yet maintaining the repayment 'discipline' among the borrowers have introduced new expressions in the global development lexicon that eulogise the moral uprightness of the poor, especially poor women ('bankable poor' / 'credit worthy poor' / 'honest women').

from a 'vicious circle' to a 'virtuous cycle': credit, investment, profits, more credit, more investments, bigger profits" (Weber, 2004: 364) cannot offer useful pointers to the way in which microfinance, especially group based microfinance, works in rural and urban spaces.

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