Chapter 1 Introduction

Micro-credit has become a major tool of development, and is fast developing as an international industry, with its own trade associations, dedicated finance, training and other support organisations, research and journals. In a phase in the international development endeavour in which ideology is out of fashion, the search is on for practical, workable solutions to the deep-seated challenges of poverty. Micro-credit seems to provide just such a solution.

By delivering financial services at a scale, and by mechanisms, appropriate to poor people, micro-credit can reach them. By providing poor people with credit for micro-enterprise it can help them work their own way out of poverty. And by providing loans rather than grants the micro-credit provider can become sustainable by recycling resources over and over again. In other words micro-credit appears to deliver the 'holy trinity' of outreach, impact and sustainability. No wonder the development sector has become so excited.

International debate has been dominated by two schools of thought, which we call the finance school and the poverty school. Sometimes these schools have been in conflict with each other. The former celebrates the mainstreaming of micro-credit as a financial service (BancoSol, a micro-finance bank in Bolivia, has sold certificates of deposit on Wall Street), the latter emphasises the need to reach poor people and may be suspicious of financial sustainability, believing it is likely to lead a micro-finance provider away from its focus on poorer clients.

The micro-credit industry has sought to resolve the tensions between a focus on poverty and a commitment to sustainability by integrating them within a matrix defined by two axes, of outreach (or access) and financial sustainability.

Figure 1.1: Combining outreach and sustainability
(Source: Mahajan and Ramola, 1996)

High Sustainability

Low Access	2. Sustainable financial services with low access by target clients	1. Sustainable financial services reach target clients	**High Access**
	3. Highly subsidised financial services with low access by target clients	4. Highly subsidised financial services reach target clients	

Low Sustainability

The formal financial sector may achieve financial sustainability, but has little outreach to poor clients (quadrant 2). Traditional efforts by non-governmental organisations (NGOs) may reach poor clients, but are often unsustainable (quadrant 4). Good micro-finance practice, on the other hand, combines both outreach and sustainability in the virtuous quadrant 1. Such practice is perhaps most clearly embodied in the micro-finance bank, which marries the best of the formal financial sector in terms of sustainability with the outreach to poor clients of the development NGO.

This book argues that if such a framework is allowed to dominate debate and practice, as it often has, it will severely limit the potential developmental ends to which micro-finance, as a means or instrument, can be put. The industry has become dominated by a techno-managerial perspective, with a large number of technical manuals and courses on how to manage micro-financial services and financial sustainability, and how to achieve outreach.[1] In the process, the development impetus which first gave rise to micro-finance is often lost (except in the narrowest sense of outreach to poor people).

It is time to put development back into the provision of micro-financial services, and for this we need to go beyond micro-credit. Going beyond micro-credit has usually been framed in terms of including micro-financial services other than credit for micro-enterprise: savings, consumption loans and insurance in particular (Rutherford, 2000). In other words, micro-finance can embrace a range of financial services that seek to meet the needs of poor people, both protecting them from fluctuating incomes and other shocks, and helping to promote their incomes and livelihoods (Rogaly *et al*, 1999).

In this book we seek to explore developmental purposes to which micro-finance can be put that go well beyond integrating a range of micro-financial services for poverty alleviation. We include livelihood promotion, developing the local economy, empowerment, building democratic people's organisations, and changing wider systems or institutions within society. We elaborate on the practice of using micro-finance to address these developmental objectives in the first part of the book.

Putting development back into micro-finance presents challenges to all those involved in micro-finance. Technical experts in micro-finance need to see there is more to the provision of micro-financial services than technical and managerial inputs to enhance performance and efficiency. Micro-finance organisations may be well managed financial organisations, but are they developmental? Indeed, if micro-finance is to achieve any developmental outcomes, the nature of these inputs must be shaped and guided by a clear understanding of the developmental outcomes sought.

The same applies to those who have apparently resolved the tension between the demands of development on the one hand and of managing financial services on the other by combining outreach with sustainability. With millions of poor people in developing countries still unbanked, there is clearly a need for the provision of micro-financial intermediation at a mass-scale, and this can often only be achieved through sustainability. In this sense, the combination of outreach and sustainability is developmental. However, there is much more to development than the provision of financial services. Micro-financial services on their own are clearly not going to solve poverty, but can only serve as a complementary tool within a broader strategy to reduce poverty.

Putting development back into micro-finance also presents challenges to the poverty school. Too often debates on poverty and micro-finance have been limited to the number of clients reached, to income and the gendered control of resources within the household, and to impacts on different categories of poor people, from the destitute to those just below the poverty-line. The poorest people have been a particular focus of attention, even though many others also have valid and developmental financial needs.

A narrow focus on micro-financial services for poor people has therefore often hidden the range of development purposes to which micro-finance as an instrument can be used. As just two examples, we illustrate micro-finance practice that suggests the need to lend to the non-poor to generate wage employment for poor people (Chapter 4), and that an exclusive focus on poor people may work against the development of effective local democratic organisations (Chapter 5).

Research on outreach and impact on poor people has also not contributed significantly to better product development (Rutherford, 2000: 109) or how to combine micro-finance provision with developmental outcomes for poor people that go beyond access to financial intermediation (however necessary the latter is).

Finally, putting development back into micro-finance presents a challenge to the growing number of critics of micro-finance. Development is concerned, on the one hand, with ideology and processes that underlie current economic structures, and, on the other, with practical solutions to address both the immediate needs of poor people and to change the underlying structures. Ideological critiques are only helpful if they contribute to the process of finding such practical solutions.

This book explores practical initiatives to use micro-finance instrumentally to address a range of developmental needs. This is the key challenge for the micro-finance industry: to find how micro-finance as an instrument can be combined *in practice* with appropriate developmental objectives to achieve positive change.

This challenge can only be met by organisations that seek to combine micro-financial services with clear development missions. Such organisations fall into a category that is sometimes referred to as 'development enterprises' and increasingly (at least in the industrialised world) as 'social enterprises'.

The organisation of micro-finance is therefore at the heart of this book, both in Part One and then in Part Two, from small local savings and credit groups to developing the micro-finance sector in India. The organisational challenges of combining often broadly conceived developmental goals with the technical delivery of micro-financial services are of course a key theme of the analysis. Organisational sustainability, including sustaining a focus on development mission, is as challenging as achieving financial sustainability!

While the micro-finance industry generates many manuals on how to manage the technical delivery of micro-financial services, genuine analysis of either micro-finance organisations, which goes beyond managing a board of directors or staff for example, or of development entrepreneurs who are by and large responsible for founding and leading micro-finance organisations, remains very weak. This applies in particular to analysis that can help practitioners when they confront, often on a daily basis, the tension between their developmental objectives and the demands of micro-finance as a technical tool.

Fortunately, micro-finance practice in India has much to offer on these dilemmas. Indian practice is extraordinary in its diversity, and not least in the development missions with which micro-finance is combined. As suggested above these include poverty alleviation, livelihood promotion, developing the local economy, empowerment, building people's organisations, and changing wider systems and institutions within society.

India is also fast becoming one of the largest micro-finance markets in the world, especially with the growth of women's savings and credit groups (known in India as 'self-help groups') which are set to reach 17 million women by 2008 at the latest and which we explore in depth, and from a range of different perspectives, in this book.

In India, an exclusive focus on micro-credit for micro-enterprise is the exception rather than the norm. It is no surprise that Ela Bhatt, India's micro-finance pioneer who founded SEWA Bank in 1974, chaired a working group that produced a paper for the Micro-credit Summit entitled 'Beyond micro-credit: Structures that increase the economic power of the poor' (Bhatt, 1996). Indian practice therefore makes much clearer the diversity of potential developmental agendas for micro-finance, that go well beyond a financial tool.

At the same time, most Indian practitioners have always worked from the assumption that developmental objectives need to be combined with financial sustainability. Take the example of SEWA Bank again, the oldest micro-finance organisation in India. The bank has been sustainable throughout its history, because it is based on savings, while its mission is clearly focused on the empowerment of woman slum-dwellers.

The Cooperative Development Foundation (CDF) provides another example of integrating some of the polarities and tensions we have drawn attention to. CDF's primary purpose is to promote cooperatives as local democratic organisations, and has discovered that micro-financial services are a particularly good activity around which to organise cooperatives. In this way micro-financial services have been used as an instrument for democratic organisation. At the same time CDF is passionate about the smallest technical detail for cooperatives to manage micro-financial services. Without effective management by local people there can be little empowerment.

India therefore has much to offer, not only in terms of international debate on micro-finance, but also in terms of combining micro-finance with development, and how organisations can achieve this in practice. In the process, for over 25 years Indian micro-finance organisations have developed a range of innovative products and services: insurance services; linking savings and credit groups to banks; integrating micro-finance into agendas for women's empowerment and local democratic organisation; using money-lenders as intermediaries to change market prices; etc. In spite of all this, Indian practice is little known beyond the circles of Indian practitioners and those who have worked along side them.

To those who are familiar with India, the diversity, flexibility and integration of its micro-finance practice will come as no surprise, and for three reasons. First, India itself is as diverse as many continents. Second, its integrationist culture has often led practitioners, from Gandhi to humble village workers, to integrate new ideas and methods and make them their own rather than see them as irreconcilable polarities. Thirdly, India remains the largest democracy in the world, and democratic issues have been at the heart of many developmental initiatives, including micro-finance.

At the same time, India has a long tradition of attention to entrepreneurial and organisational development. Indeed, India has been a major home of the growth of these professional disciplines.[2] This makes it appropriate that this book reviews some of the organisational challenges that face micro-finance organisations, from an organisational development perspective rather than from a technical perspective that sees them purely as financial organisations.

This book in fact arises out of a four-year organisational development project, managed by the New Economics Foundation in London, for four major micro-finance organisations in India (see the appendix). It would be presumptuous to suggest that either the project or this book have provided simple guidelines to manage these organisational tensions, but at least they place them at the heart of practice rather than burying them under a heap of technical manuals.

The project also provided the insights that underpin the analysis in this book, an encompassing and integrating analysis that ranges from the diverse developmental motives of development entrepreneurs to hard analysis of costs in promoting micro-financial services at the community level; from detailed attention to the dynamics of individual savings and credit groups to developing the micro-finance sector to meet the challenge of scale that India always presents; from the need to achieve financial sustainability in order to serve and empower poor people to a diverse range of potential impacts that micro-finance can have on them, for example in terms of their security and democratic voice.

In many chapters in this book we challenge a narrow focus on the technical ‘solutions’ that micro-finance seems to offer. At the same time we challenge weak performance by taking a hard look at sustainability and impact issues (Chapter 10). We challenge the dominant understanding of efficiency as a highly unsophisticated measure (Chapter 8). We also challenge some of the ideals of local democratic organisation by looking at the hard realities of how small savings and credit groups within poor communities work (Chapters 8 and 9).

Indian practice of micro-finance has taught us not to see irreconcilable differences but to recognise the value of different perspectives and to seek to integrate them into a more coherent rather than compartmentalised whole. The point is not to decide, for example, between pursuing financial sustainability or developmental impact, between offering credit or savings and insurance, between addressing poverty or building democratic organisations. All of these may be needed in a given developmental context or a given community.

The point is to recognise and understand the complexity of the developmental challenges within that context or community, to see how a range of appropriate strategies can be combined in practice to meet those challenges, and how the tensions that are likely to arise within an organisation embracing different strategies may be managed effectively. This approach is more in tune with the complex daily realities that poor people face, and with the complex daily realities of most micro-finance practitioners we know!

Beyond micro-credit: an outline of the book

Some issues

The link between micro-credit and poverty reduction has not been proven. Among the range of possible micro-financial services, micro-credit has predominated, on the assumption that it will deliver higher incomes and increased assets to the poor through micro-enterprise. Far less attention has been paid to the need to reduce risk, perhaps the most pressing need especially for the poorest households. Indeed, injecting capital into existing micro-enterprises, or creating new ones, may enhance the risk that their poor owners face. There is indeed evidence that as a result a proportion of micro-credit clients have become worse off after accessing micro-loans (Hulme and Mosley, 1996). The reduction in risk is why many poor people would prefer regular wage labour than managing their own micro-enterprise, if only such opportunities were available (Mahajan, 1997).

Micro-credit providers cannot of course take their poor borrowers for a ride. While most providers emphasise investments of working or fixed capital in micro-enterprises, the reality is that many clients use the credit for consumption-smoothing, especially as most funds are fungible within a household. Such consumption-smoothing can allow households to cope more effectively, but it also runs the risk of pushing them further into debt if they cannot repay the loan out of enhanced income streams. More appropriate financial products for this purpose are savings, insurance and loans to allow poor people to repay their high-interest loans to money-lenders and to meet emergency expenditure. And yet these have received far less attention than micro-credit for micro-enterprise. At the same time, while such products to enable consumption-smoothing can stabilise a poor household's condition, they cannot propel them out of poverty.

With such a strong focus on micro-credit for micro-enterprise, it is perhaps surprising that less attention has also been paid to linking poor people to growing market opportunities and to enhancing the control they can exercise over their economic environment.

Enterprise promotion was a focus of development activity until the early 1990s. Many involved in those endeavours feel that the growth of minimalist micro-credit has diverted attention from the on-going challenges of creating or strengthening enterprise. An important conclusion of initiatives to promote enterprises had in fact been that finance is often not the ruling constraint, and yet thinking and practice on the wider needs of enterprises has progressed little since the early 1990s. It is gradually resurfacing under the name of 'business development services'.

Another important conclusion was that assisting individual enterprises was often not effective, whether through minimalist micro-credit or integrated with business services. A more systematic approach, often encompassing a sub-sectoral focus, was needed to impact a wider range of enterprises or local or regional economies as a whole (Dichter and Mahajan, 1990; USAID, 1987).

In terms of greater control within the economic environment, the ownership of assets in particular can significantly reduce risk to households in the face of fluctuating incomes or expenditure demands. However, as individual micro-entrepreneurs, most micro-credit clients remain as vulnerable to economic circumstances as they did before taking any micro-loans. Economic development is therefore as much about empowerment, of individuals and groups, as about incomes and individual assets.

For many poor people the only route to empowerment is through collective endeavours that can overcome the severe limitations imposed by individual isolation. This immediately brings in issues of collective ownership, including of the organisation delivering micro-financial services. This is such a fundamental issue in a development context, where unequal access to and ownership of assets often underpins the unequal distribution of power, that it is surprising that debate on the ownership and governance of micro-finance organisations has so often ignored it.

Outline of the book

These are some of the issues that lead into the first part of this book (Chapters 3 to 6). After a short introduction to the Indian financial sector (Chapter 2), for those unfamiliar with the context of practice analysed in this book, we take the first step beyond micro-credit to embrace a range of micro-financial services (savings, credit and insurance) to provide social and economic security to poor people (Chapter 3). We illustrate this through the case of SEWA Bank, as well as other micro-finance organisations innovating micro-financial products, from savings to credit for housing and education to insurance for women to cover a broad range of diseases, including gynaecological disorders, occupational health and maternity benefits, and for farmers against crop failure.

In Chapter 4 we analyse the work of BASIX in promoting rural livelihoods. BASIX goes beyond minimalist micro-credit by integrating the provision of micro-credit with a wide range of technical assistance and support services, including in highly cost-effective ways. However, BASIX also seeks to go beyond such integration of financial and non-financial services by developing them as instruments within wider strategies for livelihood promotion, which also involve, for example, supporting small enterprises to generate wage employment, intervening in promising sub-sectors and engaging a range of relevant market actors, and reviving moribund rural infrastructure and organisations.

In Chapter 5 we go beyond micro-credit to look at the democratic functioning of groups providing micro-financial services. We go beyond the concept of 'social intermediation' as a process to prepare potential clients to access micro-financial services and turn the argument on its head. Micro-financial services are a tool or instrument around which to build social capital through democratic people's groups and organisations. We illustrate this through the savings and credit or self-help groups, and through detailed analysis of savings and credit cooperatives promoted by the Cooperative Development Foundation (CDF).

With its focus on democratic organisations, this chapter tackles the issue of who owns the assets and profits that arise from the provision of micro-financial services. The analysis therefore takes us beyond the efficient delivery of micro-financial services to embrace issues of accountability, ownership and control.

In exploring women's empowerment through micro-finance, we also go beyond an exclusive focus on poor people to recognise the broader (village) community and its democratic organisations. We also go beyond the traditional focus on who controls loans within the household to look at opportunities for women emerging out of savings and credit groups to engage in informal and formal democratic processes.

Finally in Part I, we look at how micro-finance organisations have sought to bring about wider system-level or institutional change (Chapter 6), taking us beyond a focus on individual micro-finance organisations to their role in wider systems. We briefly review the impacts that micro-finance can have on the local economy as a whole, beyond financial services or individual clients. We look in detail at the practical strategies of BASIX and the Indian association of micro-finance organisations, Sa-Dhan, in influencing the policy and regulatory environment for micro-finance, at the integration of micro-financial services within the trade union SEWA's broad strategy to promote the recognition and rights of poor self-employed women, and at CDF in changing the legal environment for cooperatives throughout India, for which CDF is putting its savings and credit cooperatives to good instrumental use.

It is in Chapter 6, as well as Chapter 8, that we introduce the only technical language in this book, drawing on economic theory to distinguish carefully between institutions and organisations. Institutions are not formal organisations of some significance, but the rules of the game that shape human interaction by providing the structure for transactions and incentives. Because of this distinction we refer throughout this book to micro-finance organisations (MFOs) rather than micro-finance institutions (MFIs). Few micro-finance organisations could claim to be institutions even as commonly understood as formal organisations of some significance beyond their immediate operations, although Chapter 6 shows how those who aspire to such a role strive to do so in practice.

Part 2 of the book then focuses in greater depth on the organisational and institutional issues confronting micro-finance. The first three chapters (7 to 9) analyse self-help groups in detail.

Chapter 7 compares Grameen Bank groups with the self-help groups emerging in large numbers in India, contrasting the greater 'regimentation' of Grameen-style operations to the more autonomous and democratic groups in India, placing each within their institutional context and investigating how the differences may influence costs, sustainability and empowerment outcomes. This chapter makes a significant contribution in unpacking the diversity in group mechanisms in practice that are often lumped together as one micro-finance tool.

Chapter 8 looks at self-help groups operating in urban slums, which takes us beyond the traditional reliance on community and kinship ties, which are often regarded as critical to any group mechanisms, to see how groups fare when such ties may not exist. The chapter places self-help groups within the context of other financial services available to slum-dwellers, and shows how fragile groups can be.

Above all this chapter challenges a prevalent but simplistic approach that assumes costs simply reflect organisational efficiency, demonstrating that many factors contribute to the costs of promoting self-help groups, only some of which are under the control of the promoting organisation. These different costs have to be recognised if more efficient and appropriate micro-finance practice is to develop.

The analysis also challenges negative attitudes towards NGO ideology, which often regard such ideology as incompatible with the efficient delivery of micro-financial services, to show how it can in fact enhance efficiency by significantly reducing transaction costs.

Chapter 9, on the other hand, goes beyond the use of groups as channels for financial services to analyse the development stages of self-help groups, their tasks and processes, and in particular leadership and social entrepreneurship within them. Like Chapter 8, this chapter demonstrates the wide variations in performance of self-help groups, even when promoted by the same organisation. This is perhaps inevitable given that self-help groups are autonomous organisations which determine their own policies and processes within widely different contexts. For such groups, leadership is clearly a vital function, and the chapter explores entrepreneurial traits and qualities among leaders, and the costs and rewards of such leadership.

In Chapter 10 we then go beyond financial sustainability and outreach, first by incorporating organisational as well as financial parameters into a sophisticated rating mechanism for micro-finance, and second by looking at evidence of wider developmental impacts, as well as reviewing evolving methods in India for measuring such impact. Thus this chapter both takes a hard look at the financial and organisational performance of micro-finance and pays detailed attention to developmental outcomes.

Drawing on all this analysis, we shift focus in Chapter 11 to the sectoral level, looking at measures that are needed to promote the micro-finance sector in India to address the vast demand for micro-financial services at an appropriate scale. For this all the different stakeholders in the sector have to play clear and distinctive roles.

To conclude, Chapter 12 draws out some emerging lessons and challenges, on micro-financial services as an instrument of development; on the adaptation of those services to their context; on the distinct role of NGOs; on systems and especially on how the fast emerging movement of savings and credit groups in India urgently requires system-wide attention. Finally this chapter draws on the insights developed in the book to take up the additional challenge of capacity-building, a topic that has often failed to attract sufficient reflective analysis, and provides a framework for capacity-building that places development at the heart of micro-finance practice.

[1] For examples, see especially www.cgap.org, as well as the *Microbanking Bulletin*, Ledgerwood (1999) and those cited in Rutherford (2000: 121).
[2] See for example, McClelland and Winter (1969), Lynton and Pareek (1992) and Lynton (1998: 159-60).