

# Limitations and Challenges:

## The unfinished agenda

The microfinance movement in South Asia has permanently changed the face of the financial sector by challenging conventional thinking and introducing innovations. The limits of the microfinance model emerge, however, when it comes to serving many more poor people who are still excluded and capturing a larger share of the financial service business of the existing clientele.

### Financial Needs of Low-Income Families

Recent research shows that although MFI outreach among various categories of the poor in Bangladesh has been impressive, the MFIs took a rather small proportion (however measured) of the microfinance business of households.<sup>22</sup> There were five times as many interest-free loans as MFI loans reported during the year. Because almost all these MFIs were following the classic Grameen model, this phenomenon can be understood as an outcome of the fact that MFIs can give only one loan per year per client. Even so, this one MFI loan could be expected to be significantly bigger than the average informal loan, many of which might be assumed to be trivial matters of a few dollars passing between friends or relatives. But this assumption turned out to be false; the MFI share of the total transaction flow (their share of the \$839 borrowed per household per year) was only 15 percent – counting all outflows of loans and savings withdrawals, and inflows of repayments and saving deposits. It does not seem that the MFIs feature strongly on the household balance sheets, because the MFI share of household financial assets at the end of the research year was just 13 percent and accounted for only 21 percent of financial liabilities.

Other research in India has shown that, in a sample of more than 3,000 MFI clients, the median outstanding amount owed to MFIs was \$68. Conversely, for the 32 percent of clients who had borrowed from friends and relatives, the median amount owed was \$91, and for the 36 percent who had borrowed from moneylenders and other costly informal sources, the median amount owed was significantly higher at \$159.<sup>23</sup>

Another study of financial transactions undertaken by low-income households in India showed that the frequency of transactions, both borrowing and lending, is far higher than the typical MFI methodology caters to. According to Ruthven (2001), *...the financial needs of the low income respondents...entail frequent transactions—both inflows (borrowing and savings withdrawals) and outflows (repayments and savings accumulations or deposits)—within a fairly narrow range (in terms of amounts of money) which is closely related to the family's income level. An examination of the disaggregated financial diary information shows that some of the transactions take place because people, invariably, try to minimize their costs and*

<sup>22</sup> Rutherford 2003.

<sup>23</sup> EDA 2003, chapter 9.

*maximize their security (and returns) by shifting money from one sort of financial device to another. This nimble, if economically rational, financial behaviour of the diary respondents—and the reasons for it—have been well covered in other papers emerging from this research.*<sup>24</sup>

Essentially, when faced with an array of financial devices with different characteristics in terms of costs, returns, security, accessibility, and flexibility, people opt for a range that suits their needs at a given point of time. Their tendency to shift between these devices over time is dependent on their (often variable) income flows and expenditure needs as well as on the accessibility and suitability of a particular device.<sup>25</sup>

MFIs have added to the options available to low-income families and have contributed to the diversity of the options they can access to manage their financial assets. They have not yet replaced the moneylender, however, nor are all MFIs, or the microfinance sector as a whole, able to affect poverty to the extent that some microfinance proponents would like to believe. Ideally, low-income families need financial services in small amounts, transacted frequently—a need that continues to be catered to by the village- and slum-level service provider—because more formal MFI operations have yet to develop the technology, systems, and risk-spreading mechanisms to replace them.

## The Limits to Informal Financial Services

For the poor in South Asia, largely excluded from the cooperative system and unwelcome at the banks, the only recourses available (until the advent of microfinance) were traditional informal sources of credit. These included personal sources, such as friends and relatives; revolving savings and credit associations (ROSCAs) or chit funds; private non-bank finance companies (NBFCs); and costly informal sources, such as pawn shops, moneylenders, large landowners, and trade creditors. The study cited earlier<sup>26</sup> connects the terms under which each of these options is available to the typical microfinance client in India. This study shows that for loans less than Rs 25,000 (\$550) the MFI (with a cost range of 18 to 47 percent) is a cheaper alternative to informal sources (for which the interest range is 26 to 200 percent) unless a family has sufficient social capital to borrow from friends and relatives (the cheapest source). Much the same pattern applies in other countries across the region.

Banks are not meeting microfinance demand to any significant extent, and MFIs are not yet able to satisfy the demand from low-income families. In fact, aggregate calculations made for the number of poor families in the region indicate a substantial shortfall in the availability of microcredit in the region. The estimated credit requirement for meeting the needs of poor families in the region are presented in table 2.1. Compared with a total credit outstanding amount of some \$2.3 billion from microfinance sources, the conservatively estimated requirement to meet the immediate (rather than long-term) investment needs of poor families in the region amounts to more than \$15 billion. This suggests that just 15 percent of the total requirement to meet the needs of the poor is available in South Asia, with the proportion of needs being met ranging from 2 percent in Afghanistan to 55 percent in Bangladesh.<sup>27</sup>

<sup>24</sup> Ruthven 2001; Patole and Ruthven 2001; and Ruthven and Kumar 2002.

<sup>25</sup> EDA 2003, chapter 9.

<sup>26</sup> EDA 2003, chapter 9.

<sup>27</sup> In Sri Lanka's case, the proportion exceeds 100 percent because of the large number of borderline non-poor included in the figure for microcredit availability.

**Table 2.1. Estimate of Credit Requirement for Poor Families in South Asia**

Country	Poor Families <sup>a</sup> millions	Microfinance Clients millions	MFI Credit Outstanding		Credit Requirement		Outstanding Requirement %
			US\$ per family	Aggregate\$ millions	US\$ per family	Aggregate \$ millions	
Afghanistan	2.0	0.12	70	8	200	400	2
Bangladesh	13.0	16.00	60	960	133	1,733	55
India	60.0	15.00	70	1,050	182	10,909	10
Nepal	1.6	0.50	60	30	133	213	14
Pakistan	8.5	0.58	90	50	200	1,700	3
Sri Lanka	1.0	2.50	90	225	200	200	113
<b>South Asia</b>	<b>86.1</b>	<b>34.7</b>	<b>67</b>	<b>2,323</b>	<b>176</b>	<b>15,156</b>	<b>15</b>

Source: Authors' estimates based on M-CRIL and EDA studies and on secondary information.

Note: The estimates in the table for poor families are based on the population of the country, the size of families in that country, and the poverty ratio as indicated in sources such as the World Development Report. Average credit outstanding for each country is estimated from M-CRIL's rating database and the credit requirement is based on a conservative estimate of the immediate (rather than long-term) investment needs of poor families in each country.

a. poor families = families subsisting on less than government-defined poverty thresholds.

The magnitude of the gap between the conservatively estimated requirement and the present supply of microcredit is just one indication of the huge microfinance task that remains in South Asia, even without taking the borderline non-poor into account. Including the latter, which MFIs invariably do, not only is desirable for the process of inclusion in the financial system, but also is necessary to meet the needs and reduce the vulnerability of families at this level.

Although microfinance has taken great strides in South Asia over the past 30 years—in the process, beginning to address a gap that other efforts had failed to address and contributing much to the worldwide microfinance movement—the unsatisfied financial services needs of those at the “bottom of the pyramid” are enormous and much remains to be done.

## Outreach Revisited

The discussion above has explained the origins and growth of microfinance in South Asia and outlined the nature of the microfinance activity in the region, including a sense of the direction in which it is moving. This section provides an overview of the numbers entailed in considering microfinance activity in South Asia and discusses the quality of that outreach in terms of the depth of coverage of poor (as opposed to low-income) clients. The outreach information is summarized in table 2.2, which relates the data to the estimated poverty ratios of each country.

The [Bangladesh](#) situation is marked by very high coverage by credit, if not deposit services. To the extent that microfinance clients cannot

necessarily be classified as poor, table 2.2. estimates that around 50 of the microfinance clients in the country are poor. In many parts of Bangladesh, the operations of different MFIs overlap substantially, resulting in multiple memberships by clients. This occurs despite the fact that, until recently, Bangladeshi MFIs attempted to ensure exclusive participation in their programs. Given this extensive overlap in the membership of MFIs among microfinance clients, the 62 percent estimate of coverage of poor families appears realistic. In addition, this information suggests that significant numbers of clients with incomes above the poverty threshold, many of whom could be classified as near-poor, are also receiving services from

**Table 2.2. Breadth of Microfinance Outreach in South Asia (estimates)**

Country	Population <sup>a</sup> millions	Poverty Ratio %	Poor Families <sup>b</sup> millions	MF Clients millions	MF Poverty Outreach %	MF Coverage of Poor Families <sup>b</sup> %
Afghanistan	22	55	2	0.12	50	3
Bangladesh	143	50	13	16	50	62
India	1100	30	60	15	35	9
Nepal	26	35	1.6	0.5	45	14
Pakistan	155	33	8.5	0.58	35	2
Sri Lanka	20	25	1	2.5	25	63
<b>South Asia</b>	<b>1,466</b>	<b>33</b>	<b>86.2</b>	<b>34.7</b>	<b>41</b>	<b>17</b>

Source: Authors' estimates based on data available from ADB and others.

Note: Poverty information for India and Bangladesh match World Bank information; informed estimates for other countries. Poverty outreach from EDA studies for Bangladesh and India; for other countries, informed estimates based on secondary sources.

a. Population figures from World Bank Web site (updated from 2004 to 2005)

b. poor families = families subsisting on less than government-defined poverty thresholds. Poor families are estimated using family size 5 for Sri Lanka; 5.5 for India, Bangladesh, and Nepal; 6 for Pakistan and Afghanistan.

Table 2.2 illustrates the fact that microfinance outreach is highly variable across the region. The six countries covered by the table can be classified into high- (Bangladesh and Sri Lanka), medium- (Nepal and, perhaps, India), and low-coverage countries (Afghanistan and Pakistan).

MFIs, which are providing better coverage of the financial landscape in that country.

Despite the 700 plus MFIs listed in the statistical bulletin of the national network, Credit & Development Forum (CDF), the bulk of the outreach in Bangladesh is provided by a few large MFIs. At the end of 2004, some 73 percent of the microfinance clients in the country were borrowing from the four largest institutions (Grameen Bank, BRAC, ASA, and Proshika),<sup>28</sup> which count their clients in millions. Only 12 NGO-MFIs had more than 100,000<sup>29</sup> clients.

In **Sri Lanka**, exclusive membership conditions do not necessarily apply, particularly in the case of cooperatives. As a result, the 63 percent coverage of the poor encompasses not only extensive membership overlap but also significant outreach further up the income scale. Thus, substantial numbers of non-poor, otherwise not reached by the banking system, have access to financial services through the

extensive network of CBOs. This results in a broader canvas of coverage of the financial landscape than in any other country of the region.

In **India**, a substantial increase in the outreach of microfinance services in recent years occurred not only because of the phenomenal growth of the bank-SHG link program, but also because of the substantial growth of NGO-MFIs. Within India, there is far greater outreach of microfinance in the south, with an estimated two-thirds of microfinance clients nationally residing in just three southern states (Andhra Pradesh, Tamil Nadu, and Karnataka).<sup>30</sup> Key reasons for higher microfinance penetration in southern India include the following:

- The origination of the bank-SHG link program in Karnataka largely through the initiatives of the MYRADA, an NGO, and the consequent greater participation of Karnataka-based banks such as Syndicate and Canara Banks in the program

<sup>28</sup> Rasmussen, Alamgir, Ahmad, and Ahamed 2005.

<sup>29</sup> CDF 2004.

<sup>30</sup> Author's estimate based on figures available from a large apex organization (SIDBI) and the M-CRIL database.

- Better governance that has enabled the development of a larger number of quality NGOs that in turn have spawned MFIs
- More vibrant local economies in the southern states compared with the less developed states in the north and east
- Higher literacy and participation rates of women in the local economy, making them more suitable clients for MFIs

It seems clear that members of different MFIs and SHGs in India overlap and that all members are not poor. There is substantial competition between MFIs in areas such as the Guntur region of Andhra Pradesh and Thiruchirappalli in Tamil Nadu, also resulting in membership overlap. Furthermore, an extensive impact study undertaken across 20 NGO-MFIs operating in different parts of India has found that, typically, only 35 percent of MFI clients in the country can strictly be classified as poor.<sup>31</sup> This leads to the 9 percent outreach of microfinance services to the poor indicated in table 2.2. Much of this is concentrated in rural areas where MFIs and SHGs tend to operate, although there has been increasing interest in urban areas in recent years. Among the NGO-MFIs, clientele is significantly concentrated—more than 70 percent of approximately 3 million borrowers from MFIs are concentrated in the 10 largest organizations.<sup>32</sup>

The concentration of microfinance in India is matched by that in [Nepal](#). There, the delivery of microfinance services by regional development banks, NGO-MFIs, and cooperatives is concentrated mainly in the terai (southern plain) and, to some extent, the Kathmandu valley. To the extent that microfinance services are available in the hills, it occurs mainly through the diverse Savings and Credit Cooperative Societies (SCCSs) that operate largely in the villages of the lower hills of the western, central, and eastern regions. Such institutions are relatively rare in the more remote midwestern and far-western regions of the country. Given open access to cooperative

membership, it is again unlikely that microfinance outreach in Nepal is entirely to the poor. It can safely be assumed that no more than 15 percent of poor families are included.

Given the recent emergence of microfinance activity in [Afghanistan](#), the low coverage of microfinance clients in that country is not surprising. However, one institution, the well-known Bangladeshi NGO, BRAC, which has established microfinance operations in Afghanistan, has so far dominated the coverage of microfinance clients in the country. BRAC Afghanistan accounts for about 80 percent of total outreach by the 14 MFIs operating there. Other MFIs are mainly local operations of international NGOs, many of which had little previous experience of microfinance in similar conditions. These MFIs are adapting their methodologies and systems to suit local conditions. Conversely, BRAC has registered growth rates on the order of 150 percent per year and has already reached more than 100,000 active clients. MFIs were active in 18 of the 34 provinces in the country by the end of 2005 and are expected to provide services in all 34 provinces by 2008.

[Pakistan's](#) 580,000 microfinance clients are expected to grow to between 1.5 and 2 million by 2009, with the total demand variously estimated between 10 and 16 million clients. Some 7 million of these clients would be from families classified as living below the poverty line. The key characteristics of microfinance outreach in Pakistan are as follows:

- Average loan size to gross national income (GNI) per capita ratio is between 11 and 25 percent, which could suggest a high poverty outreach but is partly due to limitations on loan size resulting from caps on loan size imposed by the main apex funding institution (PPAF) and other donor incentives to provide smaller loans.
- 84 percent of clients are concentrated with five MFIs (one registered as a microfinance bank and four NGOs).

<sup>31</sup> EDA 2004.

<sup>32</sup> M-CRIL database.

- More than half the clients are male, unlike other countries of the region where there is a predominance of female clients.
- Historically, microfinance began from rural areas, and coverage in urban areas is still low.
- Most of the outreach is attributed to multidimensional NGOs that focus on rural areas and provide credit as one of many inputs, although much of the recent growth has been from specialized MFIs.

The multidimensional RSPs that are predominant in Pakistan microfinance are relatively slow-growing programs. In percentage terms, the fastest growing NGOs over the past two years have been smaller organizations with more focused microfinance programs, although the bulk of the increase in numbers served by microfinance service

providers is attributable to two large organizations—Khushhali Bank and the NRSP. Again, the extent of poverty outreach in Pakistani microfinance is unlikely to exceed one-third of the total number of microfinance clients.

Overall, the information presented here is roughly compatible with the data from the Microcredit Summit campaign that shows penetration rates (clients as a percent of the population) in a number of South Asian countries (see table 2.3). Looking at cross-country data, the analysis suggests a threshold of 2 percent beyond which countries are able to scale up much more rapidly. In South Asia, only Bangladesh and Sri Lanka meet this criterion, although the recent rapid growth in India might challenge this proposition.

**Table 2.3. MFI Penetration Rates—Top Countries**

Country	Borrowing clients, % of population	Country	Borrowing clients, % of population
Bangladesh	13.1	Cambodia	3.0
Indonesia	6.7	Nepal	1.5
Thailand	6.5	Honduras	1.2
Sri Lanka	4.3	India	1.1
Vietnam	4.3	Bolivia	1.1

Source: Extracted from Honohan 2004.

Note: Using the same approach to calculate microcredit penetration, the Maldives had a penetration rate of 8.7 percent at the end of 2005, giving it one of the top outreach ratios in the world. In a population of 300,000, more than 26,000 active borrowers had microloans valued at less than half of the gross domestic product (GDP) per capita amount. These loans are for a maximum amount of \$1,200 and are provided without any collateral requirement, while GDP per capita is \$2,500, the highest in South Asia. In fact, if the number of microdeposit accounts (accounts with a value of less than \$1,000) is considered, the penetration rate is between 20 and 25 percent. Less than 15 percent of the population is considered to be poor, but it is estimated that the majority of these people are not yet covered by microcredit services.

Thus, even the theoretical coverage of some 35 million families in South Asia by microfinance services is no more than 17 percent of the total number of poor families. Apart from Pakistan, financial services are now largely provided by specialized institutions that focus on providing microfinance services. The overall concentration of microfinance in the region is on women clients based in rural areas, although in Bangladesh, and increasingly in India, the growing focus is on urban clients.

The era of benevolent, statist intervention in support of financially excluded sections of the

population has spurred recognition of the need to create structures that cater to the financial needs of the economically poorer segments of society. Except in Sri Lanka, where the cooperative system is already reasonably well served by the financial system, this process is resulting in the creation of structures—apex institutions and enabling legal frameworks—that eventually could integrate microfinance service providers with other parts of the broader financial system. Given the still relatively low overall coverage of poor clients, in particular, there is still a long way to go.