

Conceptualizing Microfinance Initiatives In India Using SAP-LAP Model: A New Paradigm In Marketing Engineering

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INTRODUCTION

Globally as well as locally, several forces are transforming the nature, scope, and fabric of the marketing profession. Marketers are seeing increasingly faster changes in the marketplace, flexibility in marketing mix decisions and are empowered with enhanced marketing intelligence. While many view traditional marketing as art and some view it as science, the new marketing increasingly looks like engineering. This article, combined with a classical SAP – LAP model analyzes better marketing plans, better resource allocations, and better decisions.

Financial market is one of the most exciting and sobering parts of economics. Market can also be visualized as a tool where country's resources are allocated. By proper utilization of resources, a nation can command its economy decisively. Modeling with SAP – LAP increases our appreciation of macro- analysis of financial market. This explores the exciting world where principles of marketing and finance work on the theories of system sciences. The SAP – LAP Model is found, to simulate adequately, the relationship of the complex process of Indian Micro Finance Market as a function of several interacting forces.

Micro-finance refers to small savings, credit and insurance services extended to socially and economically disadvantaged segments of society. In the Indian context, "small and marginal farmers," "rural artisans" and "economically weaker sections" have been used to broadly define micro-finance customers. The recent Task Force on Micro Finance has defined it as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi urban or urban areas, for enabling them to raise their income levels and improve living standards." (Source: rbi docs.rbi.org.in)

MICRO FINANCE IN INDIAN PERSPECTIVE

In India, the contribution of the formal sector to making credit available has been less than satisfactory. According to the All India Debt and Investment Survey (AIDIS) of 1992, only 64 per cent of the borrowal accounts were serviced by the formal sector. During the early plan periods, there was significant micro credit available through government and government-sponsored institutions. Although cooperatives have been functioning from the early 20th century, they have been unable to meet expectations and have suffered from a number of ailments. There was, therefore, a need to look at commercial banks as an additional source. When banks could not deliver, they were nationalized. In doing so, the primary objective was to ensure that the neglected sectors get credit. Then, there was some disillusionment in the mid-seventies with the functioning of the commercial banks in so far as rural poor were concerned. The state promoted new Regional Rural Banks (RRBs). We are now at a stage when there is an acute realization that RRBs have not quite succeeded in achieving the objectives for which they were set up.

Micro Financial Institutes are of vital importance in India as they act as a financial gateway to the poor. The poor need these services to save small amount in a secure manner, to invest in their business or home, to cover large expenditures and to ensure against risk. Poor households around the world have demonstrated their ability to use and pay for financial services through longstanding informal agreements such as savings clubs, rotating savings and credit associations, and mutual insurance societies. In India, there are numerous ways in which the poor can access credit through informal and semi-formal institutions. The poor, in absence of formal institutions, often must resort to informal sector, which is characterized by monopolistic practices and exorbitant interest rates – at times in the form of human capital.

Yet formal financial intermediaries, such as commercial banks, typically do not serve poor households. The reasons include high cost of small transactions (as high as 10% of the amount), the lack of traditional collateral, geographic isolation and simple social prejudice.

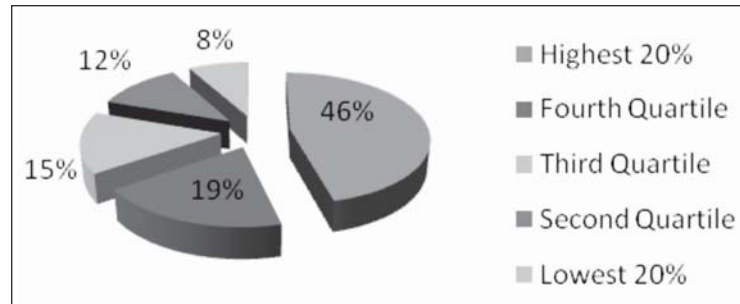
Rural penetration of banks in India is very low around 18%. Of the 428 million deposit accounts in the country, 30% are in the rural areas. 36 % of the poor still utilize informal sources of credit.¹ Most of the banks have largely ignored the BOP because of its low income and perceived less creditworthiness and low profitability. A vast unmet demand for credit at the bottom represents a fantastic opportunity. The breakdown of banking access by income category is shown in Figure 1:

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Figure 1: Share of Consumption by Income Stratification



(Source: The University of Michigan's Report Case Study on ICICI bank, 2003)

But much more attention is being given to Rural Finance now- a- days. Today, more than 2100 Micro Finance Institutions are working in India.² They exist in various legal forms. The vastly followed model is the NGO model. These MFIs have provided information on loans to more than 54 million clients. Their success has shown that poor people can be valuable clients of specially designed services. The experience with Self Help Groups (SHGs) in India has shown that lending can be profitable without massive scale and without donor dependency as long as it is coupled with saving requirements.³

MICRO-FINANCE INSTITUTIONAL STRUCTURE

The different organizations in this field can be classified as “Mainstream” and “Alternative” Micro Finance Institutions (MFI).

1. Mainstream Micro Finance Institutions

National Agricultural Bank for Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), Housing Development Finance Corporation (HDFC), Commercial Banks, Regional Rural Banks (RRBs), the credit co-operative societies etc. are some of the mainstream financial institutions involved in extending micro finance.

2. Alternative Micro Finance Institutions

These are the institutions, which have come up to fill the gap between the demand and supply for microfinance. MFIs were recently defined by the Task Force as “those which provide thrift, credit and other financial services and products of very small amounts, mainly to the poor, in rural, semi-urban or urban areas for enabling them to raise their income level and improve living standards.” The MFIs can broadly be classified as:

- NGOs, which are mainly engaged in promoting self-help groups (SHGs) and their federations at a cluster level, and linking SHGs with banks, under the NABARD scheme.
- NGOs directly lending to borrowers, who are either organized into SHGs or into Grameen Bank style groups and centers. These NGOs borrow bulk funds from RMK, SIDBI, FWWB and various donors.
- MFIs which are specifically organized as cooperatives, such as the SEWA Bank and various Mutually Aided Cooperative Thrift and Credit Societies (MACTS) in AP (Andhra Pradesh).
- MFIs, which are organized as non-banking finance companies, such as BASIX, CFTS, Mirzapur and SHARE Microfin Ltd. The microfinance sector comprises of two distinct mechanisms:
- The self-help group (SHG) movement that has emerged from the mid-1980s and is actively promoted by the state and the banking system.
- The microfinance institutions (MFIs) that have emerged in the 1990s and are largely coming up at the initiative of the non-governmental organizations and supported by international donors.

Both these mechanisms have achieved what the mainstream banks were not able to achieve. They have been successful in a culture that bore a legacy of write-offs and political intervention. They have worked under a paradigm of social collaterals, trust, and local systems thereby reducing significant amount of transaction costs. They have looked at activities other than agriculture helping people to diversify their livelihoods.

DEMAND OF MICRO FINANCE SERVICES

Due to its large size and population of around 1000 million, India's GDP ranks among the top 15 economies of the world. However, around 300 million people or about 60 million households, are living below the poverty line. It is further estimated that of these households, only about 20 percent have access to credit from the formal sector.⁴ Additionally, the segment of the rural population above the poverty line but not rich enough to be of interest to the formal financial institutions also does not have good access to the formal financial intermediary services, including savings services.

A group of micro-finance practitioners estimated the annualized credit usage of all poor families (rural and urban) at over Rs 45,000 crores, of which some 80 percent is met by informal sources.⁵ This figure has been extrapolated using the numbers of rural and urban poor households and their average annual credit usage (Rs 6000 and Rs 9000 pa respectively) assessed through various micro studies.

Credit on reasonable terms to the poor can bring about a significant reduction in poverty. It is with this hypothesis; micro credit assumes significance in the Indian context. With about 60 million households below or just above the poverty line and with more than 80 percent unable to access credit at reasonable rates, it is obvious that there are certain issues and problems, which have prevented the reach of micro finance to the needy.

With globalization and liberalization of the economy, opportunities for the unskilled and the illiterate are not increasing fast enough, as compared to the rest of the economy. This is leading to a lopsided growth in the economy thus increasing the gap between the haves and have-nots. It is in this context, the institutions involved in micro finance have a significant role to play to reduce this disparity and lead to more equitable growth.

SUPPLY OF MICRO FINANCIAL SERVICES

Lately, investments in microfinance have been on the rise due to the involvement of the capital market and private sector investors. And we have the big daddies of banking such as Deutsche Bank, ICICI Bank and Citibank entering this segment as well. Not surprisingly, microfinance is fast emerging as a hot opportunity for global players with an estimated \$20 billion to be invested globally and around \$3 billion in India, by 2010. The volume of total microfinance loans globally rose from \$4 billion in 2001 to around \$25 billion in 2006, according to a research recently conducted by Deutsche Bank.⁶

India has seen many MFIs entering the market and those present are growing at a fast clip though none of them have yet reached the level of the better known MFIs in Bangladesh such as Grameen Bank and ASA. Nevertheless, Indian MFIs have penetrated rural areas and successfully helped poor women. In 2002, the market share of MFIs in small credit was 28%. That has grown to 47% in 2007. Opportunities ahead are promising. The industry is growing at the rate of 50% and so the future is very bright. If the growth continues, India can reach the \$2 billion mark within two years.⁷ The word micro is re-defined with the average size of loans increasing from \$161 to \$201. And in India, MFIs are now moving from the south towards north and north east.

Leading MFIs in India presently have an estimated 9.76 million clients, up from 0.76 million clients in 2003. This figure is estimated to touch the 50 million mark by 2012. While loan portfolio was pegged at about \$769 million, assets were pegged at \$915 million dollars in 2007. For top 10 MFIs in India, the return on equity is over 60% a year. So by 2012, around \$6 billion would be required for capital in MFIs in India.⁸

MFIs however have been criticized for charging high interest rates of anything between 25% and 40%.⁹ But MFIs maintain that the rates are still low compared to the ones charged by private money lenders. But despite the high interest rates, borrowers still prefer the MFIs to money lenders especially in rural areas where MFIs have been able to penetrate successfully.

THE LIMITATIONS OF MICROFINANCE

There are problems which need to be tackled for the very success of the movement. While the RBI has been taking some steps such as 1:3 rule (banks get a license to open one branch in a location that already has a branch of another bank only if they open branches in three other unbanked locations) to increase the rural penetration of banks, it is only in recent years rural finance is witnessing rapid growth.¹⁰

One major problem they are facing is they typically lack the resources to build permanent support structures of micro lending and due to small loans, the key to sustainability becomes scarce. In addition, they face constraints of the scalability of their operation, and thus individual transactions become too costly. If an MFI could achieve a large volume of loans, then the aggregate interest payments would suffice to cover operating costs. Achieving such scale is very labor intensive and takes many years.

The achievements of microfinance programme in the country have been impressive. But sometimes, the progress of the microfinance sector is termed as 'small, short, and unsecured' because the loans are really small amounts given for a short duration without any security. This in itself could be the limitation of microfinance and, therefore, it was unlikely that microfinance would compete with the Indian banking system. Instead, it can be safely assumed that these two segments are playing complementary roles.

There are some fundamental differences in which these two segments operate. One, Banks have specialized knowledge and monitor the borrowers' project. Two, what keeps banks going is that they have depositors who can demand their money back. In Microfinance, the loan repayment is monitored, not the borrower's project. In this structure, they have not introduced demandable deposits. Therefore, there is no scope for monitoring by depositors.

Also one point that needs to be taken into account is that the formal sector has problems in servicing this segment because of high transaction costs, small scattered accounts, and high transaction intensity. The formal institutions have inappropriate systems, procedures, products, rigidities, incapacity to innovate, and lack of initiative to service this segment. Microfinance by virtue of its slightly informal nature and its reliance on the principle of "Poor will make every effort to pay back the loan" has inherent advantage in overcoming of these problems. As they say, "Microfinance works on faith."

The essence of microfinance is its voluntary character. It should not be over-regulated and be at the disbursing end of directed credit with excessive government involvement. Another aspect that needs attention is capacity building. It is

estimated that there is a need to train about 1,200 top management professionals, 4,000 middle management professionals, and 12,000 field management personnel for microfinance to realize its potential effectively.

The state and the central banks could play a positive role in the area of microfinance and SHGs. Most SHGs now borrow for consumption requirements and this will grow for commercial requirements which would take borrowers face to face with the market. The role of the state in infrastructure creation cannot be undermined. There is an urgent need to have the entire gamut of financial legislation including new legislations on insurance and pension funds.

AN ASSESSMENT OF THE MICROFINANCE POTENTIAL IN INDIA

The rural market is fascinating and challenging at the same time. It offers scope on account of the sheer size of the country and is growing steadily. The term 'rural' is no longer synonymous with agriculture. The rural non-farm sector covers a wide spectrum of activities including handlooms, handicrafts, cottage and village industries, agro- processing units, and service and transport activities. The products manufactured by women belonging to SHGs include embroidered sarees, paintings, wooden handicrafts, jute products, sculptures, metal idols, leather bags, sea shells, cushion covers, etc.

The capital structure of most of the small units is fragile. There is a need to strengthen their capital base. Venture capital will have to come in a big way to take care of such units. There is a need to track the financial requirements on an ongoing basis. There is an urgent need for shifting from a minimalist approach of offering only financial intermediation to an integrated approach of providing enterprise development services like marketing support with direct linkage between borrowers and buyers.

There is an urgent need to identify and nurture new institutions in underserved regions to ensure that the financial services reach a very large number of poor left out by the voluntary grassroots initiative. Making the primary cooperatives available to the banking system can greatly transform the rural scenario. Banks can leverage their reach to the rural poor by providing them credit and management inputs. Mainstream banks and microfinance institutions will meet the challenging demand for financial services from rural India over the next decade. This will not be an easy task but is achievable especially if we provide an enabling policy framework.

On the supply side, we need to make corrections on how we can offer composite financial services. Lower income households want a single place that provides access to all the financial services. They should be able to save small amounts, make withdrawals, take loans, remit, buy a mutual fund, buy insurance, pay premiums, lodge claims, and get compensation. All these transactions should be possible from one physical outlet.

Microfinance has had relative success with small loans of short maturity if success is to be measured by high repayment rates. It certainly has met the needs of small investments and of consumption credit. The challenge now is to meet the needs of significantly larger sums for the non-farm sector. Unless microfinance is tuned with livelihoods in production, manufacturing, and service sectors, it would not be able to deliver anything. It is important that the money is used productively. It has to produce something — goods or services — that could be marketed at a remunerative price.

The delinking of credit from livelihood is a very vulnerable trend and credit — micro or any other — will not lead us anywhere. In the case of micro livelihoods, backward and forward linkages have to be based on group activity. Our producers are so small that to expect them to do something individually and succeed is unfair. They have to work as a group and know a lot about group activity and dynamics. They have to know how to run a cooperative enterprise. It takes time and effort. People with knowledge of commodities and marketing have to come together to assist the small producers with meager means.

APPLICATION OF SAP-LAP MODEL TO ANALYZE MICROFINANCE INITIATIVES BY ICICI BANK

Following is an illustrative case of ICICI Bank which has done considerable progress in providing Micro Finance services to poor citizens of rural India. The case is analyzed using the SAP-LAP model. The SAP-LAP model (**Situation Actor Process–Learning Action Performance**) is an innovative and holistic framework for case analysis¹¹. In this model, the case is analyzed with respect to the mentioned heads and their interdependence is studied to gather learning from the case.

Context:

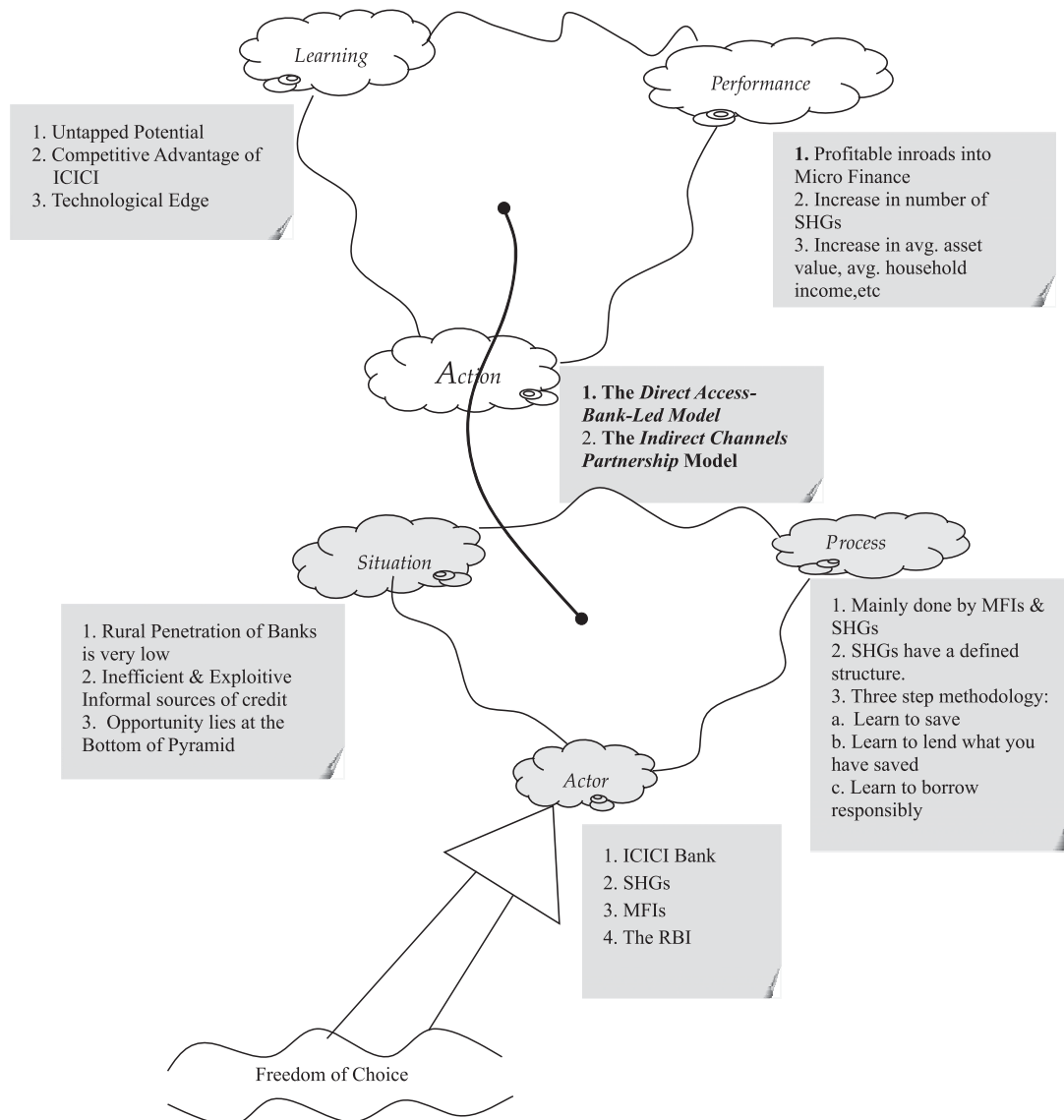
Nearly 400 million people of India do not have access to formal sources of credit such as banks. ICICI bank identifies it as a huge market with real economic potential and commercial viability. The bank sees the poor as a lucrative customer class critical to the future of the company. In line with the mission statement of the Social Initiatives Group within the Bank, ICICI has focused their resources and creative thinking towards innovatively serving the Bottom of the Economic Pyramid.

PREVAILING SITUATION

Rural penetration of banks in India is very low around 18%. Of the 428 million deposit accounts in the country, 30% are in the rural areas. 36 % of the poor still utilize informal sources of credit. These informal systems are mostly inefficient and exploitive. Also they charge exorbitant interest rates (in the range of 3-10 % per month) as compared to formal sources of credit. More than 2100 MFIs are working in India mainly following the NGO model. They typically lack the resources to

build permanent support structures of micro lending and due to small loans, the key to sustainability becomes scarce. Major chunk of Micro Financing is done through Self Help Groups (SHG) and the experience, so far, is quite encouraging.

SAP – LAP MODEL FOR ANALYSIS OF MICRO FINANCING BY ICICI BANK



MAJOR ACTORS AND THEIR ROLES

ICICI Bank:

ICICI Bank is the second largest Banking Institution in India. The bank wants to increase its rural presence and has one group named Social Initiative Group dedicated for the same purpose.

The mission statement of the Social Initiative Group is “to identify and support initiatives designed to improve the capacities of the poorest of the poor to participate in the larger economy.”

In line with this, ICICI wants to focus on Bottom of the Pyramid of Indian economy and wants to lend in a sustainable manner to rural India. ICICI’s main role is that of social mobilization as well as financial intermediation which it has been performing by leveraging its own capital, expertise, scale and reach.

SHGs:

Self Help Groups are the groups comprising of around 20 women from the same village having income below the poverty line. Their role is to collect savings of group members and distribute the loans received from bank to group members.

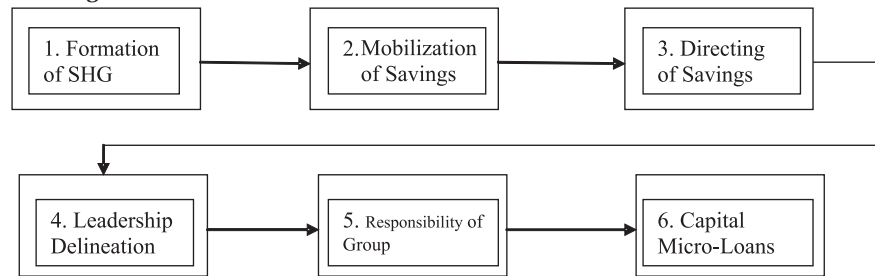
MFIs:

Micro Financial Institutions are the organizations, mostly NGOs, which are working with SHGs and providing them loan facilities. They are primarily funded by donors and supported by institutions.

The RBI:

The RBI is the Central Bank and the regulatory body for banking in India. It has taken many initiatives to encourage the banks to increase their network in rural areas.

Process of Micro financing



- Micro Financing in India is mainly done by MFIs through the SHGs.
- The SHGs have one woman from the group elected as a leader. She coordinates with MFIs.
- The group initially has to collect savings for some period of time. Depending on the savings, MFIs then decide the amount of loan to be sanctioned to the SHG.
- This loan is then distributed among the members to start something which will earn them their livelihood.
- A predefined amount is then collected from the members each month towards the payment of the Loan. It is the group's collective responsibility to repay the bill. If somebody defaults on the monthly payment, then that person is charged some penalty.
- Once the loan is repaid fully, the same cycle repeats but with an increased amount of loan.
- Collective responsibility and group pressure act as social collateral. The entire process of Micro Financing can be summarized in 3 essential steps:
 - Learn to save.
 - Learn to lend what you have saved.
 - Learn to borrow responsibly.

KEY LEARNING ISSUES

Untapped Potential

Most of the banks have largely ignored the BOP because of its low income and perceived less creditworthiness and low profitability. As a result, there is heightened competition at the top which is a value loss. A vast unmet demand for credit at the bottom represented a fantastic value opportunity and ICICI oriented its banking operations to capture the same.

Competitive Advantage of ICICI

MFIs were facing problems because of their NGO model of operation which relied on help from donors and institutions. Because of the small loans, the only way in which they would sustain was to have the large number of customers. ICICI's huge capital resources, expertise, scale and wide reach offered the competitive advantage to overcome these problems.

Technological Edge

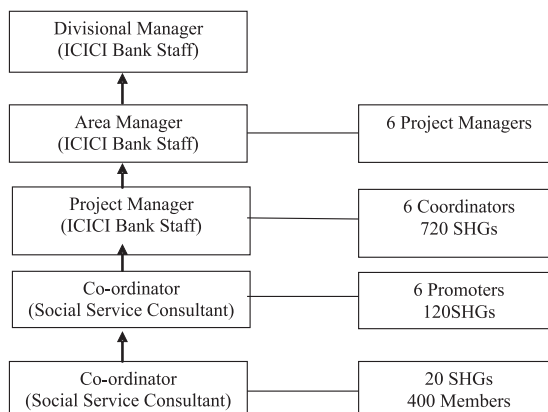
ICICI had the technology which it leveraged successfully to gain sustainable competitive edge and improved its ability to serve the BOP profitably.

Actions undertaken

ICICI identified two innovative models towards serving the BOP:

1. The *Direct Access-Bank-Led Model*, which was catalyzed by the merger with the rural banking institution- Bank of Madura, utilizes the power of ICICI to promote and grow SHGs and to dramatically increase the scope and scale of rural savings and lending.

The structure



2. The *Indirect Channels-Partnership* Model which leverages the relationships, knowledge and rural network of organizations in the fields to avoid the costly brick-and-mortar expansion process thus helps to efficiently cultivate ICICI's banking presence.

PERFORMANCE

ICICI has made profitable inroads into serving the Bottom of the Economic Pyramid. ICICI's efforts at virally growing the micro financial model and of partnering with MFIs and NGOs in the field have been successful.

ICICI has grown the number of SHGs from around 1500 to more than 8000 within two years since their purchase of the Bank of Madura. Financial effects of the effort can be seen in the increase in measures such as average asset value, average household income and average share of loan amount.

Also the non- financial factors such as Self confidence & self worth, Decision Making, Communication Skills and Behavioral Changes have shown significant improvements.

The impact of the ICICI micro finance program has been to fundamentally change the lives of the SHG members with long-lasting economic solutions while achieving breakeven costs in the operation at its present scale.

CONCLUSION

Over the last few years, the Government of India has been encouraging micro-finance because of the sustainability of micro-finance activities. In the last two Budget Speeches, the Finance Ministers have talked about the need to enhance the reach of the MFIs. The RBI also made a special mention of micro-finance in its credit policy announced in April 1999. The RBI has established a micro-credit cell; NABARD has set up a Micro-credit Innovations Department, while HUDCO is also formulating a similar plan. The issue of inappropriate legal form for MFIs is being addressed by a Task Force setup by the Reserve Bank of India, which among other things is looking into the regulatory and legal issues concerning microfinance in India.

An increasing number of MFIs have begun to address the issue of financial sustainability of their programs and have started taking effective steps towards achieving sustainability. Many of them have increased their interest rates, at least to cover their costs. Some of them have taken steps to convert themselves into for-profit corporations and have sought commercial investors to invest in them. These will not only make microfinance more commercially oriented but will also increase the quality of governance.

Indian micro-finance sector in recent years has been the establishment of networks of micro finance practitioners. These networks not only help in creating awareness but also help in formation, experience sharing etc. These could also develop into a Self Regulatory Organization of microfinance institutions.

Microfinance by itself is no solution to the problems faced by rural India. The answer lies in production and successful marketing of goods and services that will fetch the small producer a reasonable return. We need strategies to have a much wider coverage if we want that microfinance be accepted as a national answer to some of our major problems such as the problems of universal financial service and poverty alleviation. The next limitation is that of low level of professionalism. On the supply side, there is a dearth of trained manpower and good outside consultants. There is an urgent need to identify and nurture new institutions in underserved regions to ensure that the financial services reach a very large number of poor left out by the voluntary grassroots initiative.

It is evident from the SAP-LAP model description of the Micro Finance Market that all new information is quickly understood by the market state variables and the information itself becomes immediately incorporated in the model. The operating principles of an efficient market hold that marketing system contains all available information. Thus it can be safely concluded that Indian Micro Finance Market can be efficiently monitored using the SAP-LAP Model.

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