

Microfinance Delivery – Challenges and Remedies

Prathap B N,

Associate Professor & Head,
Department of MBA & Research Center,
East West Institute of Technology, Bengaluru, India.

Subrahmanya K C,

Assistant Professor,
Department of Management Studies,
Global Academy of Technology,
Bengaluru, India.

Harisha B S,

Assistant Professor,
Department of Management Studies,
Sir M Visvesvaraya Institute of Technology,
Bengaluru, India.

ABSTRACT

Today the financial inclusion of the economically weaker sections of the society is regarded as most challenging. Microfinance refers to providing of small loans to the poor for self employment and sustenance. Microfinance includes a wide range of services like credit, savings, payment and remittance services, transfer services, and other financial services. However, its growth is slowed down by various regulatory and operational hurdles they are obstructing the smooth functioning of Microfinance Institutions (MFIs). The main drawback faced by MFIs in financing the rural poor people was the low profitability and high transaction cost while trying to maximize the reaching to the needy in terms of small credit at regular intervals. This paper looks into remedies that take on the challenges that exist and the effective implementation of new modes to deliver microfinance to the poor. An attempt is made to understand the operational difficulties faced by MFIs in providing microfinance services to the rural poor. The paper also highlights the means of extending required credit funds to maximum number of poor people in rural areas.

Keywords: Microfinance; Structure; Delivery; Challenges; Remedies.

INTRODUCTION:

Microfinance in the financial world today has emerged as a very significant discipline. It has gained the importance as a major focus area by the Government of India as well as other nations. Microfinance has changed the idea of lending as it focuses on helping the poorest of the poor, who were outside the periphery of financing of any kind. Its conception came from Asia in the face of acute poverty spread over rural regions of India and Bangladesh. Today India is considered to be the largest growing markets for microfinance in the world wide. In the last few decades it has been growing at a steady pace. With Financial Inclusion gaining the central focus for the Government of India, and Microfinance as the most effective means of achieving the goal, this vibrant industry is exhibiting various business models. With the population exceeding over a billion; Today India has roughly around 400 million people within the precincts of the poverty line. This translates into 75 million households that would need micro financing and out of which around 60 million are rural households and the other 15 million are urban poor slum inhabitants. It is worth noting that the current credit usage by the same poor households is projected to be around Rs 495,000 million or US\$ 12 billion annually.

All said and done, the MFI channel is not without issues and problems. Various ways are sought to reinvent themselves as they face problems of continuity. The MFI channel is on the double to get back on the road to credibility as it works on its recovery in the face of the severe shock it hit during the crisis of Andhra Pradesh. Even the Indian Government's grand initiative of financial inclusion does not make it any better for the MFI

channel. The inclusion process poses a great deal of challenge in terms of getting large number of unreachable households for formal finance within the channels. This has not created any interest with the policy makers.

What is Microfinance?:

According to the Reserve Bank of India (RBI), microfinance is considered to be a crucial means of financial inclusion. So, what is financial inclusion? The RBI has defined it as the “provision of affordable financial services” to those poor people who have been avoided or neglected by financial agencies in India. Financial services refer to “payments and remittance facilities, savings, loan and insurance services” as defined by the RBI. The Asian Development Bank (2000) has defined microfinance as “the provision of broad range of services such as savings, deposits, loans, payment services, money transfers and insurance to poor and low income households and their micro-enterprises.” This definition by ADB includes both the BPL people and low income households. The Micro Financial Sector (Development and Regulation) Bill, (2007) has defined microfinance as “the provision of financial assistance and insurance services to an individual or an eligible client either directly or through a group mechanism for an amount, not exceeding rupees fifty thousand in aggregate per individual for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual); or an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing or other prescribed purposes.” Those who were eligible for the credit could be migrant and/or landless labourers, artisans, ‘microentrepreneurs’, ‘disadvantaged cultivators’ and farmers possessing up to 2 hectares of land.

OBJECTIVE:

This article aims to study the macro and micro challenges involved in delivery of microfinance services in rural India. It aims to suggest simple workable remedies to counter these delivery challenges

METHODOLOGY:

The methodology uses secondary data for the study of macro and micro challenges faced by the various microfinance institutions in delivering microfinance. The data has been extracted from reports published by Reserve Bank of India (RBI), National Bank for Agriculture and Rural Development (NABARD), Microfinance State of the Sector Report(2013) and research carried out by various authors as quoted throughout the article. The strategies for countering the delivery challenges are based on secondary data as mentioned above and interviews conducted with SEWA Bank and its diverse micro credit trusts, and micro credit associations, which are carrying out extensive micro credit activities, and ICICI Bank, Rural Operations – ‘Rural Operations Group’, Central Operations, Mumbai. (Personnel who gave the interviews requested anonymity).

The article has been organized in the following manner. The literature review looks in to the theoretical aspect the study by way of a discussion on microfinance in India, their role in financial inclusion, the diversity of methodologies through which microfinance is delivered in the country, the various delivery challenges faced by them and also some possible solutions to the microfinance delivery challenges. Delivery Challenges introduces the Macro and Micro challenges faced by various microfinance institutions in delivering microfinance. Remedies for Macro Challenges, discuss the simple workable remedies that may be adopted by various institutions participating in microfinance to counter the macro and micro delivery challenges faced by them.

LITERATURE:

Microfinance Institutions of India have a variety of legal forms and methods. In India, MFIs have registered as Non-Government Organizations. The Non-Banking Financial Companies (NBFCs). Commercial banks, Regional Rural Banks (RRBs), and cooperative societies have a significant role in refinancing MFIs. Banks, on the hand, have also leveraged the Self-Help Group (SHGs) by providing direct credit to such borrowers.

As highlighted by the research study conducted by Kothari & Gupta (2008), MFIs are organized under three models: SHGs, Grameen model/Joint liability groups and Individual banking groups as in cooperatives. ‘Group lending’ refers to where loans are provided to a group who in turn lend to its members. The group takes the responsibility of repayment as and when there is default of payment by its sub-borrowers. In the ‘Group guaranteed individual lending’ the credit is provided to individual borrowers as each of them would guarantee the repayment by the other. Default by any member would cease further loans to all other members. In this type of lending there would be with or without collateral security. There would be no group guarantee either. It is to be noted that ‘group lending’ is also known as Self-Help Groups (SHGs). Groups would constitute 15 to 20 women from similar socioeconomic background. They act as financial intermediary as they have routine

interactions with each other. During their periodical meetings they would agree to contribute a certain amount for the common pool. The contribution is made during every meeting. The SHGs constitute a President, a Secretary and a Treasurer as they are internally elected within the group. These elected members maintain the books of account and even the minutes. After some months the contributions become a reasonable amount, and from there on lending are carried out to a/some needy member (s). Of course, before lending, collective decision is taken by the members as to the availability of funds and repaying capacity of the member borrower. There are times when fund crunch may be experienced in the group. This happens when required funds exceed the amount accumulated. In this case they scout external sources of funding that may be specializing in microfinance funding like NABARD, SIDBI, Social Welfare Department of the government, DRDA, commercial banks, or NBFCs.

Ghosh (2005) in his study states that Microfinance comprises of various financial services, which mostly include savings and credit. It also includes other financial services like insurance, aimed at to ultimately benefit the poor and underprivileged section of the rural population, especially those who are economically poor. This services are often reinforced with a range of support services such as motivating and organizing the poor households and helping them build forward and backward linkages with other support institutions. The ultimate aim is to provide resources to help the poor so that they the stage of self sufficiency. They lack both resources and opportunities for employment to be independent financially.

Nandita Mishra and Munesh Chandra (2010) in their study "Microfinance in Indian Banking Industry and its future" attempts to understand the status of microfinance in India and to make a comparative analysis between private and public sector banks with reference to micro financing. The study concludes a couple of challenges related to microfinance and its programmes that keep on evolving. The first challenge is the look out for a cost-effective organizational structure to incorporate microfinance where it is "inherently ill-suited to adapt to the cultural world" of regular microfinance customers. The second challenge is more appropriate organizational structure as "former financial service NGOs" transform into banks. As far as commercial banks are concerned hybrid forms of organization are evolving inculcating microfinance systems. Maturing microfinance NGOs are evolving rapidly and are "experimenting with several forms of donor sponsored capital share ownership" in order to become an acceptable substitute for privately owned organizations. These governance and ownership structures are made to target "micro-enterprise clients." In the commercial banking world, whatever the ways the two challenges is met, they will carve the future of microfinance.

Sharma M (2011) in his study has stated that one of the major challenges for banks is to establish network of agents that can provide profitable as well as reliable services to lower income people and such segments who do not have access to other banking facilities. Banks are expanding a wide range of services and are now looking to drive lending facilities through agents. But this will depend on the MFIs who actually understand this segment of people.

The literature on "Status of Microfinance in India" (NABARD 2012) highlights that Microfinance is the tool for financial inclusion. As seen from the table, the self help group Bank linkage programme has made significant progress in terms of financial services by reaching 103 million families in the year 2012. Out of the total no of 79.6 lakh SHGs linked to bank for the year 2012, 62.99 are exclusively women SHGs and out of the total credit disbursed (16534.77), 14132.02 was disbursed to exclusive women SHGs. With almost 8 million savings linked SHGs it has more than 103 million poor households. Over 70% of the savings are internally loaned within the group and at same time the balance in savings account is maintained by the financing banks. The most stand-out feature of microfinance in the country is that above 79 % of SHGs linked/connected to banks are select women groups. In this light, all the 8 million SHGs have a working balance of over Rs. 6550 crore in the Savings Bank account. It is estimated that banks have already utilized savings of over 22,000 crore and out of that over Rs. 15,000 crore went to internal lending. Disbursements of credit from banks have been happening regularly to over 4.4 million SHGs. On the flip side, the Microfinance State of the Sector Report (2013) mentions that the SHG programme has started to lose pace and optimism. The programme initiated twenty years ago by NABARD worked well with steady growth. But in the last three years it has slowed down. And now, with the NRLM in the picture, things got worse without a clear agreement between NABARD and NRLM on how the SHG programme will evolve in the future. According to the Microfinance State of the Sector Report (2013), the microfinance is no more alien to country's financial system as it has acquire a unique method of delivering limited finances. Thus, the Indian microfinance system is a combination of diverse organizations that are reliant on the financial institutions their sustenance.

Nair T and Tankha A (2013) in their study state that in past couple of years 'Client' has emerged as the main character that revolves around microfinance. "All the self-regulatory initiatives have been mainly woven around

strengthening the mechanisms of gathering client level information. Multiple instruments - code of conduct, client protection principles and fair practices code - are being used to reinforce the idea of responsible microfinance.” There are lending institutions that want the MFIs’ to take up membership in “credit bureaus” so that multiple lending does not take place.

CHALLENGES IN DELIVERY:

It is clear from the review of literature that Microfinance is a very effective means for India in achieving its aim of financial inclusion and alleviating poverty from the country. It has made significant strides in up scaling the Microfinance industry but it still deals with some major, macro and micro challenges limiting its access to the client. Some of the challenges which need the attention of the stakeholders and the policy makers are:

Macro Challenges:

Assumptions in conduct and delivery of Microfinance:

The major challenges to delivery and conduct of Microfinance is the set of assumptions related to this activity. These assumptions are as follows:

Self-employment is what the poorest wish for: Those who support the strategy of eradicating poverty through micro-credit assume that the poor would prefer self-employed. They would take up “micro-scale farming” or even processing or trading activities only to support their earnings from employment that pays wages. Most of the poor, especially landless laborers would prefer a steady wage wherever they may work. The main financial service needed by the poor is credit: Most Microfinance institutions assume that all that the poor need is credit, but this is not entirely true. As an example, SEWA Bank’s experience explains that women prefer to park their savings in a safe place. Savings not only cushion sudden want of cash, but also create ‘equity’ for getting loans. It is inappropriate to target people just above the poverty line for micro credit: This is from the “Grameen Bank experience” as they have succeeded in helping the poorest by providing micro credit. Programmes have helped the poor above the poverty line and yet access to micro credit “by those who are not among the poorest is not necessarily better than the poorest.” Moreover those above the poverty line when helped through microfinance, generate the much needed wage employment opportunities for the poorest. Therefore it is certain that those above the poverty line need micro-credit. All micro-credit institutions can become financially self-sustaining: There is support for overall self-sustainability, but assuming that it is possible for all microfinance institutions is not a good idea and thus needs to be studied.

Conversion of microfinance as a savings and credit movement:

This is best understood by taking the case of Andhra Pradesh. The organizational energy that grew with the total literacy campaign led to the anti-arrack movement of the women. Arrack is a locally made alcoholic beverage. Later on this movement was channeled to create the savings and credit movement where several organization, the government and NGOs participated. A great number of women formed and organized regarding “thrift and credit” thus creating many groups. Such activities in other states have not taken the shape of a movement but do extend financial assistance to alleviate poverty.

Challenge for Access and Sustainability:

The mainstream Financial Institutions also find it tough to expand into micro financing. Microfinance has traditionally not been seen as a potential business opportunity but it is looked as a social obligation. There are even legislative blocks to refinancing. For example, the NABARD Act curtails refinance to financial institutions of the private sector. Post tragic incidence of the Microfinance crises of Andhra Pradesh, and the resultant introduction of the Microfinance bill 2012, the organizations have to register themselves and follow all the requirements laid down by bill and the RBI while conducting the business has posed another challenge for them.

Capital Adequacy:

It is an irony that although the NGOs created microfinance they are not the best type of agencies in the long run. That’s due to funds of the NGOs which are generally grants that are quite restricted/inadequate. Moreover, NGOs are not allowed to lend as they could violate Section 11(4) of the Income Tax Act. This could make them lose their “charitable status” under Section 12 of the Act. As such microfinancing, to whomsoever it may concern, cannot be an activity of charity according to Section 2(15) of the Income Tax rules. The other thing is that NGOs as such do not have the appropriate financial structure to undertake microfinance activities. Concept of capital adequacy does not apply to them as they are registered as societies/trusts with no equity capital.

Bringing Millions of People under Micro Finance is not easy:

According to a survey by the NCAER (National Council of Applied Economic Research) in 1994-95, the “bottom three income categories with per capita income up to Rs 250 per month and accounting for 31.7 percent of all rural households, reported incomes below expenditures.” Such people could be considered hardly as savers. This means that such people do not have adequate livelihood opportunities, which is the major problem. The survey, in fact showed the poor comprising 32 percent of rural household are all agricultural labourers and non agricultural wage labourers. This makes it all the more difficult to bring them under the fold of microcredit making it a major challenge to overcome.

Demand and Supply Gap:

Numerous initiatives taken by government and financial institutions have not aided the rural poor in improving their standard of living. Analysing the patterns of providing credit to the rural sectors, there seems to be a large gap between the needs of rural households related to savings and credit options, and the receiving of the same from a range of financing institutions. According to the Banking Statistics (RBI, 2003), and the Rural Population Census India, 2001, the availability of banking services to the rural population is just 18.4 percent through saving accounts. The availability of rural loans is still lower at 17.2 percent coverage of the rural population. It is obvious now that there is a huge gap in the supply of both savings and credit facilities to the rural population. This really needs to be covered by the Microfinance institutions.

Lack of Women Orientation in promotion, assessment and Delivery of Micro-Finance:

It has been observed for a long time that generally the main consumers of microcredit and the micro savings are the rural women. One of the reasons for this is the social system and culture of rural India. Men of rural India usually don't approach SHGs or NGOs for small amount of credit or savings. And the other thing is that the men being busy with agricultural operations are unable to find the time to spend with an SHG/MFI. Therefore, MFIs need to address women in their schemes for savings and lending. Their evaluation process for giving credit has to be based on the status of women in the rural areas. To have women oriented approach in marketing would be worthwhile in micro funding. Microfinance is the only strategy that can reach out to women who can be involved in the development process. There has been a realization under this by international donors, scholars, governments and other related experts who have been focusing on microfinance. The microfinance sector has gone through leaps and bounds finding barriers affecting women's access to financial services.

Micro Challenges:

Operational Factors That Impede Extension of Rural Credit

High Transaction Costs:

When it comes to amount being saved or required in rural areas, it is often miniscule. The provision of it through the conventional banking system or other financial institutions has not proved to be cost effective.

Document/Collateral based lending:

The mainstream financing is based on documentary evidence of identity and income streams. But generally both of these are not available with the poor in rural areas. Under conventional banking, some assets have to be pledged with the lender as a security. This ensures that the loan would be repaid. If there is a default, the lender has the right to amortise the asset to recover the losses. Rural folk hardly own any assets (land, jewellery) and as such are left out by the conventional banking system.

Issues Related to Repayment:

As such micro-credit is not based on documentary evidence, so repayment tracking becomes a huge operational task. Further, in times of emergencies like natural disasters where the entire rural economy is affected, the FIs are faced with a situation of write-off of the entire portfolio as there is no other alternative for risk mitigation. Another major challenge faced by the microfinance organizations is cash management especially with respect to payment of the EMI of microcredit. As the organizations especially the MFI and the NBFC, depend highly on the field officer for the collection of the payment, any cash theft by them makes the things worse for the organisation.

REMEDIAL MEASURES FOR MACRO CHALLENGES:

There is a great need to increase the accessibility and reach of the MFI activities to a large number of rural poor, especially the poorest. Therefore, the challenge of creating this activity into a savings and credit movement can be fulfilled by involving the State machinery. The polity not only supports the movement, but also gets the bureaucracy involved in the effort, besides giving it the necessary freedom. As both financial and non-financial resources are at the command of the State, it could boost the movement and also giving it legitimacy.

Capital adequacy issues faced by NGOs can be solved by using the model of Banks-NGOSHG Linkage, where banks both the public and the private lend capital to the NGOs. These NGOs are actively involved in lending funds to SHGs and other institutions providing microcredit. Funds can also be raised from national and international development bodies, which lend credit for the same purpose. This has been successfully practiced by leading organizations like BASIX, which has borrowed from banks like HDFC, ICICI, SIDBI and developmental institutions like the Swiss Agency for Development Corporation and Shorebank Corporation of USA, etc. The same has lent to NGOs and SHGs in Andhra Pradesh for providing micro-credit. Today one has the opportunity to bring in private capital to fund outreach programmes. The private capital could be used as the equity component of Microfinance institutions.

Micro-credit programs can be re-engineered to target the poor and micro entrepreneurs who would not belong in the category of 'poor.' That's because micro entrepreneurs along with commercial farmers do businesses creating the much needed wage related employment opportunities for the underprivileged. The poorest need support initially through wage employment before they can be self-employed. The moment they get wage employment, they would automatically get into micro savings and then perhaps go for micro-credit. Besides, MFIs and banks working through the NGO-SHG linkage model can also fund NGOs for enhancing their activities related to providing opportunities for wage employment or for becoming micro entrepreneurs.

REMEDIAL MEASURES FOR MICRO CHALLENGES:

As far as recovering transaction costs are concerned, some strategies under micro challenges can be adopted. The post office can play an important role in the delivery of micro-finance as a physical contact point. Every post office can have a nodal agency which can assist the rural people to form an SHG towards securing micro-finance. Besides this, post offices' network and the post office staff can carry out the role of delivering banking services through 'Banko Postal'

Technological upgradation in operations of the micro and small scale sectors would enhance the efficiency empowering the participants and the administrators. Use of ATMs to accept payment, opening of a/cs, collection of small deposits, provision of microcredits, selling of saving bonds and insurance may contribute to recovering transaction costs. Besides this, automation in a phased manner will also assist in realizing faster and bigger growth at all levels of financial industry. The access to mobile banking for microfinance transactions have resulted in increase of its access to its clients. One reason for the popularity of mobile banking is its 24/7 access. Microfinance Institutions benefit from the mobile's low transaction costs and the foothold it gives them in the difficult to access rural markets.

Another major development in overcoming the challenges of microfinance delivery is the emergence of Business Correspondence Model. The Reserve Bank of India, in January 2006, put forward guidelines that allowed banks to designate "Business Correspondents" to raise their outreach. A Business Correspondent (BC) is one who acts as a "teller" for the bank and also conducts all transactions on bank's behalf. Banks pay commissions to the BCs for the services rendered. In the beginning NGOs, MFIs, NBFCs, and Post Offices functioned as BCs, but now the rules have changed to include individuals, local provisional stores, and companies.

Further tie ups with NGOs and SHGs situated in the rural area, could bring down transaction cost, by making them deliver the finance. These institutions with their database and history on the consumers of the area will be effective micro-credit deliverers. This will result in the increase of micro-credit and reach for the MFIs at the same time reducing the direct cost of lending. Lending needs to be coupled with insurance and other services such as training and marketing support, govt. subsidies etc.

CONCLUSION:

Microfinance is a necessity in India today to achieve the objective financial inclusion especially of the poor in both rural and urban areas. There is a great need to increase the accessibility and reach of the MFI activities to a large number of rural poor, especially the poorest. The MFIs do face macro challenges that include not getting access to micro finance services by the poor, have capital inadequacy, gap in the demand and supply of micro credit and

savings, and the women's lack of knowledge related to evaluation, marketing, and microfinance delivery. As far as micro challenges are concerned, MFIs are unable to reduce the soaring transaction costs related to microfinance delivery, then there is the problem of documentary evidence and collaterals with most of the poor, and of course the problem of tracking repayments where there is no documentary evidence of money lent.

The main road block in successful delivery of microfinance can only be overcome through innovation in operations, to handle all the macro and micro challenges discussed. As reflected in the study, innovative practices like tying up with local NGOs, and SHGs would help in effective delivery of microfinance. Also the option of involving the post office branches and the local panchayat as nodal agencies for microfinance delivery could be explored for mitigating the challenges relating to delivery. The success of Microfinance activity in the future would be a utility of the participatory approach of the MFIs, NGOs, SHGs, and banks. There is an enormous need for integration and linkage among all these institutions for all types of resources including information sharing and delivery.

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