New microfinance institutions have demonstrated slow pace in coming to India. They’ve felt constraints from low levels of grants, an unfavorable policy environment, substantial traditional banking infrastructure, and a lack of context-specific solutions. Even existing microfinance service providers are quite limited in total outreach because of late entry and little field work.

Indian banks are becoming increasingly more conscious of the potential of microcredit, however, and they have started to compete with MFIs. For instance, they’ve started lending to self-help groups (SHGs). NGOs initiated lending to SHGs in the mid 1980s. In 1992, the National Bank for Agriculture and Rural Development (NABARD) and the Reserve Bank of India recognized the benefits of SHGs and launched a pilot project to link five hundred SHGs with banks.

Now, the microfinance market in India covers approximately 75 million potential poor households and is the largest in the world. The average household demand varies from Rs2000 to Rs6000 (US$50 to US$150) in rural areas and Rs9000 (US$224) in urban settings. Eighty percent of the clients are from rural areas, and the total credit demand varies between Rs225 billion to Rs500 billion (US$5.6 billion to US$12 billion).

Many MFIs fill the gap between the supply and the demand for microfinance in India. These MFIs are classified as:

- NGOs engaged in promoting SHGs and linking them with banks.
- NGOs directly lending to borrowers who are either organized into SHGs or into groups and centers. These NGOs borrow bulk funds from various donors.
- MFIs specifically organized as cooperatives.
- MFIs organized as nonbanking finance companies.
The effective product penetration into remote areas and distribution to a large number of clients was due to two important innovations: (1) the individual counseling of clients by MFI/NGO staff and (2) the designing of an income generation activity or business plan by the client with MFI/NGO support. An example of MFI innovations in microfinance comes from Adhikar, operating in Orrisa and working with local tribes. Adhikar helped bring non-timber forest products into SHGs and linked the SHGs to microfinance without physical collateral. It also set up an organization of migrants and provided credit and saving services through cooperatives, using remittances along with savings as an entry-point activity.

**INNOVATIONS BY MFIs**
The 1990s witnessed the SHG revolution. SHGs were seen as a tool for initiating a developmental and livelihood project. NGO-based MFIs rapidly introduced a range of savings and credit products to expand their microcredit clientele. NGOs were governed by grants, and parts of those grants percolated as a grant for SHGs. The major focus at the time was to initiate internal savings rather than have a provision of external credit. The external credit was generally covered by a grant from an NGO or a loan from a commercial, nationalized bank with the support of more than six months of internal saving. In this system, the provision of the grant or loan targeted the group rather than individual clients.

The scenario was changed by the invasion of new generation MFIs in the early 2000s. Credit became the main theme, and individual clientele became the main focus. Rural financial products like credit and insurance dominated as the conventional saving style. The main difference between the two systems was the way people’s savings were viewed. Although the new financial services were more flexible and tailored closely to the preferences of the clients, many people felt that a loan from an MFI should come without interest, as in the former system.

Product innovations are different and specific to MFIs, but all focus on one feature: they are all geared toward providing a wider range of financial products and intermediation options. These innovations are the launching pad and competitive advantage for MFIs, but most people are confused about these innovations.

**Self Help Groups**
During 2004, mainstream MFIs expanded from female SHGs to include male SHGs in order to scale up the business; these male SHGs had a higher credit disbursal and a regular repayment rate. One reason for the continued success is that the loan was used to support an existing business. One problem in this model is that the male SHG benefits the business group while the responsibility is individual, the loan is individual, and the repayment is individual.

**Structuring Repayment Schedule**
The change from a pre-active to an active SHG movement is certainly a result of product innovation and product customization in the microfinance sector. MFIs now design the repayment schedules according to the income realization pattern of the clients. Different repayment schedules are structured for different clients, and the portfolio at risk is minimized at higher scale. The mainstream MFIs used to commission independent impact studies to discover the missing links and loopholes, thereby increasing product customization and innovation.

**Partnership and Intercollaboration of MFIs**
In 2002, BASIX and Aviva jointly designed a group life insurance product to provide life insurance to all BASIX credit customers, where the sum insured was up to 150 percent of the loan amount. BASIX entered into agency relationships in December 2003 with nonclients too. Thus, the local area bank, KBS, which was a part of the BASIX group, could offer life insurance to all deposit holders of the bank. For livestock and health insurance, BASIX worked with Royal Sundaram. It started the distribution of livestock insurance in 2002, worked with the insurance company toward product and process simplification, and began to offer health insurance to all its credit customers. BASIX, in collaboration with ICICI Lombard and with technical assistance from the Commodity Risk Management of the World Bank, piloted the sale of rainfall-indexed weather insurance to 230 farmers during the monsoon season of 2003. Within a span of three years, this pilot program has become a full-scale weather insurance program.

Economies of scale and imaginative uses of technology and effective innovations have brought costs and interest rates down for MFIs. Analyzing and understanding the vast opportunity, many MFIs plan to offer more microfinancial products to both rural and urban households. These include additional loan products, such as housing, auto, and education; new insurance schemes for health, life, and assets; and unique services like remittances.
Reduction of the cost of bad debt is achieved by intercollaboration of MFIs. For example, BASIX has collaborated with local, grass-root level NGOs, agribusiness firms, and commercial financial institutions. These partners have better informal information about the potential borrowers and a clearer understanding of the borrower’s repayment history.

ICICI Bank, the second-largest private commercial bank in India, has aggressively doubled its rural microfinance and agribusiness loan portfolio over a period of nine months. The outstanding portfolio in the group’s total rural microfinance and agribusiness portfolio nearly doubled between 2005 and 2006. This success comes from an outreach of 3.2 million low-income clients. Simultaneously, the bank has also increased its partner strength of MFIs from 49 in 2005 to 102 in 2006. The bank ultimately plans to partner with 200 to 250 MFIs, each serving three districts in the country.

ICICI’s microfinance portfolio has increased from ten thousand microfinance clients in 2001 to 1.2 million clients in 2006 through its partner MFIs, and its outstanding portfolio has increased from Rs0.20 billion to Rs9.98 billion (US$4.9 million to US$248 million). The rapid growth of ICICI was due to its partnership model of action where: (1) the MFI acts as a collection agency instead of financial intermediary. Microloans are contracted directly between the bank and the clients so the risk for the MFI is separated from the risk inherent in the portfolio; and (2) the bank secures microfinance portfolios before entering into a partnership.

Securitization
A microfinance portfolio became a priority sector for banks due to high risk-adjusted returns, and many banks—private and government—partnered with MFIs under diverse innovative models. One of these innovations is assessing and buying out microfinance debt through the process of securitization. Microloan securitization benefits MFIs in several ways. It decreases financial products to interested investors, like other banks that can register such a security as a priority-sector investment. In a securitization deal, the MFI is still responsible for collecting the microloans from its clients but the risk of repayment default is not backed by any of the MFI’s assets. As collateral, the bank uses a first-loss, default guarantee financed by either the excess spread on the MFI portfolio or by a third party.

In 2004, the largest securitization deal in microfinance was signed between ICICI Bank and SHARE Microfin Ltd, a large MFI operating in rural areas of India. Under this agreement, ICICI purchased SHARE Microfin Ltd’s portfolio and resold it as a package in the SHARE deal. ICICI had purchased a part of SHARE’s microfinance portfolio against a consideration calculated by computing the net present value of receivables amounting to Rs215 million (US$5.3 million) at an agreed discount rate. The interest paid by SHARE is almost 4 percent less than the rate paid in commercial loans. Partial credit provision was provided by SHARE in the form of a guarantee amounting to 8 percent of the receivables under the portfolio, by way of a lien on fixed deposit. This deal frees up equity capital, allowing SHARE to scale up its lending. On the other hand, it allows ICICI Bank to reach new markets, and by trading assets of high quality in capital markets, the bank can hedge its own risks.

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CONCLUSION
The innovations in the microfinance sector have made a dramatic change in the supply of credit to the neediest, neglected sector by formal financial institutions. Now, the microfinance market in India covers approximately 75 million potential poor households and is the largest in the world.
change in the supply of credit to the neediest, neglected sector by formal financial institutions. The most important innovation that has come up is that societal upliftment and social development are no longer grant based. People have realized that the formal credit is more flexible and yielding than grants. The most important impact of this innovation is the development of confidence among the poor and their realization to grow according to their own plan rather than the grant provider.

According to the 2005 impact assessment study of NABARD and GTZ, the average loan per SHG member nearly doubled between 1998 and 2005. In the same period, the average portion of borrowed funds used for production purposes increased from 72 percent to 85 percent, and the portion of the loan used for consumption purposes came down from 28 percent to 15 percent. The portion of loans borrowed from moneylenders with high interest rates significantly decreased from 42 percent of the total loan amount to 3 percent. Also, the overall loan repayment by members of the SHG improved from 84 percent to 94 percent.

These achievements of microfinance programs in India, and probably similarly around the world, are largely due to the continued innovation and customization of financial products.