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Financial Inclusion in India: Do Microfinance Institutions Address Access Barriers?

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Abstract. *Financial inclusion, implying expanding access to financial services to those currently not accessing them, is an important objective in many developing countries. This article analyses if microfinance institutions (MFIs) adequately break down barriers to financial service access in India. Two lines of enquiry were followed: the spread of microfinance penetration in the country was analyzed and field interviews of 103 MFI field officers were conducted. It is found that while MFIs do break down many barriers to financial inclusion, there are limitations in the extent of their outreach to those excluded. First, MFI penetration in the country is skewed and excludes some areas neglected by the banking sector, suggesting a need for policy incentives to encourage expansion to those areas. Second, even in areas in which MFIs operate they are unable to provide services to some financially excluded individuals on account of their methods of operation. To provide greater and more long lasting access to more individuals there is a need for MFIs to consider adopting more flexible operating models and to offer portability of accounts. There is also a case for skill based training to enable greater access to MFI membership.*

Keywords*: Micro finance, Financial inclusion, India, Micro credit, Banking, Financial Access, Micro finance institution.*

Introduction

There is recognition that in countries at all income levels, there are population groups that are not adequately serviced by the formal financial system. Financial inclusion involves expanding their access to the financial system at an affordable cost.

Early definitions of financial exclusion viewed it in the larger context of social exclusion. Leyshon and Thrift (1995) defined financial exclusion processes as those which serve to prevent certain social groups and individuals from gaining access to the formal financial system. A 2006 UN report on building inclusive financial sectors for development defined an inclusive financial system as one which provides credit to all “bankable” individuals and firms; insurance to all insurable individuals and firms; and savings and payment services for everyone. Financial inclusion does not imply that everyone will use all available financial services rather everyone has the option to use them. A continuum of financial services needs to be made accessible to individuals as they improve their standard of living. More recently, financial inclusion has been defined by the World Bank (2008), as the absence of price and non-price barriers in the use of financial services.

Low and irregular income is often the primary reason that contributes to financial exclusion on both supply and demand sides. The reasoning is that it leads to lack of availability of suitable financial products, as well as lack of motivation to open accounts due to inability of the individuals to save. Studies in the UK context have also found that the lowest income group is twice as likely to not be accessing financial services (Kempson, 2006).

In developing countries, the growth of microfinance institutions (MFIs) which specifically target low income individuals are viewed as potentially useful for promotion of financial inclusion. Even though MFIs at present, mainly offer only credit products; as they grow, they are likely to expand their product range to include other financial services. By partnering with MFIs, mainstream financial service providers could expand their outreach.

This paper addresses the question of how adequately MFIs break down barriers to financial inclusion. Two lines of enquiry were followed to address this. First, secondary data on microfinance penetration in India was analyzed to examine if MFIs address geographic barriers to access by penetrating areas neglected by the banking sector. Second, interviews of 103 MFI field officers were conducted to ascertain whether in areas of MFI operation, they address barriers to access by serving financially excluded individuals desirous of availing financial services.

The next section is about the importance of financial inclusion and the common barriers in this regard. This will be followed by a section on the lending models adopted by MFIs in India. The fourth section analyses MFI penetration and the spread of banking services. The fifth section presents the findings of field interviews with MFI field officers. The final section draws conclusions.

Financial Inclusion: Importance and Common Barriers

The importance of financial inclusion stems from various factors. First, an inability to access financial services could lead financially excluded entities to deal mostly in cash, with its attendant problems of safe-keeping. Second, the lack of access to safe and formal saving avenues could reduce their incentives to save. When saving occurs, safety and interest rate benefits may not be to the extent available in the formal system. Inadequate savings could lead households to depend on external sources of funds, in times of need. Often these sources are unregulated and carry high interest rates. High interest rates increase the risk of default by borrowers. Third, the lack of credit products means inability to make investments and significantly improve their livelihoods. As a result, small entrepreneurs often lack an enabling financial environment to grow. Fourth, the lack of remittance products leads to money transfers being cumbersome and high risk. Fifth, the lack of insurance products means lack of opportunities for risk management and wealth smoothening.

Access to an organized financial system implies availability of standardized financial products from regulated institutions. Savings products, small value remittances, insurance products and purchases on credit make financial planning easier. Savings products enable consumption smoothing over time. Remittance products are safer than cash payments, not only to prevent theft, but also to document proof of payment. More importantly, credit histories are built, which enable borrowing at more favorable terms in the future. With increasing automation, financial service providers rely on existing databases rather than personal interaction in order to make offers to customers. This puts financially excluded individuals at a distinct disadvantage as they are unlikely to feature in such databases. (Leyshon et.al., 1998).

It is commonly argued that the economy as a whole benefits through financial inclusion (Mohan, 2006). First, it could be an important tool to reduce income inequality in the economy. Low income individuals are often those not accessing financial services. Once access is provided, these individuals have greater potential to improve their income levels. Second, more financial resources become available for efficient intermediation and allocation. Third, greater financial stability may be expected if financial activity moves from unregulated to regulated institutions. Fourth, access to finance promotes more start-up enterprises, who often contribute to risk taking, employment and processes of creative destruction[i](Schumpeter, 1942).

As financial inclusion by definition implies increasing the coverage of the formal financial system, it may be expected to contribute to the development of a financial system. The relationship between financial development and growth has been studied by a number of economists. There is an agreement that the two are related, but there is a lack of consensus on the direction of causality (Fitzgerald, 2006). A number of empirical studies however suggest that development of the financial system spurs growth in an economy (King and Levine, 1993; Aghion, Howitt and Mayer-Foulkes, 2003 and Rajan and Zingales, 2003).

A study using data on 109 developing and developed countries by Calderon and Liu (2003) showed that the direction of causality was generally from financial development to economic growth. Moreover, economic growth is likely to be beneficial to the poorest segment of the population, as indicated by the results of a study by Beck, Demirguc-Kunt and Levine (2007). They used data from a sample of 72 developed and developing countries for the period 1960-2005 and found a positive relationship between financial depth [as measured by the ratio of private sector credit to gross domestic product (GDP)] and the change in the share of the lowest quintile in total national personal income. Similar results have been obtained by Burgess and Pande (2005) who studied the effect of the rural bank branch expansion which took place in India during the period 1977 to 1990, as a result of a specific rule. The rule was that a bank could open a branch in an area with other existing bank branches, only if it also opens branches in four other areas with no bank branches. It was found that there was a significant fall in rural poverty and increase in non-agricultural output.

Measuring financial inclusion is a challenge due to the difficulties in differentiating between voluntary and non-voluntary financial exclusion[ii]. The former refers to the population that has the ability to access financial services, but does not voluntarily do so. This segment of the population needs to be excluded from estimations of financial exclusion, posing measurement challenges. A census or household survey may be the only way to obtain such data but very few such surveys on use of financial services are available[iii].

Researchers therefore focus on measures of use of financial services. A basic measure used is the number of credit and deposit accounts (per thousand adult persons). This measure however has limitations, as there may be individuals or firms with multiple accounts. There also may be accounts which exist on paper but are inactive for long periods. Beck, Demirguc-Kunt and Martinez Peria (2007) compiled bank loan and deposit data for a cross section of 57 countries through surveys of bank regulators. Both loan and deposit data show wide variations among countries[iv]. While the ratio of deposit and loan accounts relative to the population increases with increase in per capita income, the average deposit or loan account balance relative to income per capita decreases with income, indicating that poor people and small enterprises are better able to make use of these accounts in high income countries.

Another proxy measure is the number of bank branches either per million people or as a proportion to the total area. This measure provides an approximate indicator of the average distance from a household to a bank branch, representing the physical barrier to access. Each of the indicators mentioned above provides partial information on the inclusiveness of the banking system.

Honohan (2008) has developed a composite data set to measure financial services access for 160 countries, which is a “synthetic headline indicator” of access, measuring the percentage of adult population with access to an account with a financial intermediary. The data set is based on a regression model using available data from regulators and household surveys. The results show wide variation in financial access across countries, ranging from

100 percent in Netherlands to five percent in Tanzania and Nigeria. The measure for India is 48 percent indicating the need for measures to promote financial inclusion in the country.

Barriers to Financial Inclusion

Collins et al. (2009) studied more than 250 financial diaries of low income individuals in Bangladesh, India and South Africa. Their findings show that each household uses at least four types of informal financial instruments (such as interest free loans and informal savings clubs) in a year, with the average being just under ten. The cash turnover through these instruments (i.e. the gross amounts routed through them) was large (77 percent to 300 percent), relative to the net income of the households. This suggests that low income individuals do need access to financial services and that there are barriers that prevent their use of formal sector services.

There are many complex factors that prevent rapid progress towards the goal of financial inclusion. In the UK, the Financial Inclusion task force (which monitors access to basic banking services) has differentiated between supply and demand side factors of financial exclusion, in its action plan for 2008-2011. The supply side factors include non-availability of suitable products, physical barriers and non-eligibility on account of documentation issues. On the demand side, financial literacy and financial capability are regarded as important factors by the task force. While financial literacy refers to the basic understanding of financial concepts, financial capability refers to the ability and motivation to plan financials, seek out information and advice and apply these to personal circumstances.

Supply Side Factors

On the supply side, lack of appropriate financial products is an important barrier. Often, the terms and conditions of banks are not suitable to low income groups. Minimum balances required to open accounts are at times found to be too high, and accounts are closed by some banks due to infrequent use. In the UK context, where substantial research on financial inclusion has been carried out, the fact that overdrawing on conventional current accounts, resulting in account closure, has been identified as a reason for persisting financial exclusion (Kempson, 2006). Safeguards to prevent cases of over-drawing can be useful in ensuring that financial inclusion, when it is achieved, is not temporary.

Another common supply side barrier to financial inclusion is the physical barrier stemming from distance to bank branch or automated teller machine (ATM). Inability to provide documentation such as identity proof required by formal financial institutions is another frequently faced barrier. Banks are required by regulators to conduct sufficient identity checks before opening accounts. These regulations sometimes result in lack of access to genuine customers.

Demand Side Factors

One of the demand side factors is financial literacy, which is a prerequisite for first time users of financial services. Another demand side factor is financial capability which is important in view of increasing complexity of financial products. The need for financial capability development is important throughout people's lives, as financial markets and personal circumstances change (Mitton, 2008). Finally, there are the demand side factors of psychological and cultural barriers which stem from mistrust of banks, either due to negative experiences or negative perceptions. These factors lead to self exclusion from formal financial services.

Indicators of Access Barriers

Based on a survey of up to five large banks in 99 countries, Beck, Demirguc-Kunt and Martinez Peria (2007a) developed indicators of access barriers to loans, savings, and payments services of banks. It includes indicators of physical barriers such as geographic branch penetration and ATM penetration per population[v]. In addition, documents required for account opening, minimum account balances required to be maintained on accounts and annual fees charged are also included. Beck et al. present the last two indicators relative to the respective country's per capita GDP in order to provide a sense of the affordability of the products.

As may be expected, the results relating to geographic and demographic penetration show wide variations in access barriers across countries[vi]. The number of documents required to open a savings account varied from one in the case of 13 countries, to more than four in the case of Bangladesh and Zimbabwe. In India, it was more than two but less than four. However an important point to be noted is that the survey by Beck et al. was conducted during the period 2004-2005. In November 2005, RBI introduced the concept of no-frills accounts in India. Hence subsequent to the survey, the number of documents required may be expected to have reduced in India[vii]. Minimum account balances in the case of savings account was zero in 18 countries, though it was as high as 74 percent of per capita GDP in the case of Nepal. In India, it was five percent of per capita GDP. This too is expected to have become close to zero subsequent to the survey, as a result of introduction of no-frills accounts.

Indicators of access barriers show a negative correlation with actual use of financial services confirming that they can exclude individuals from using bank services (Beck et al., 2007a). **Figure 1** below summarizes the barriers to financial inclusion.

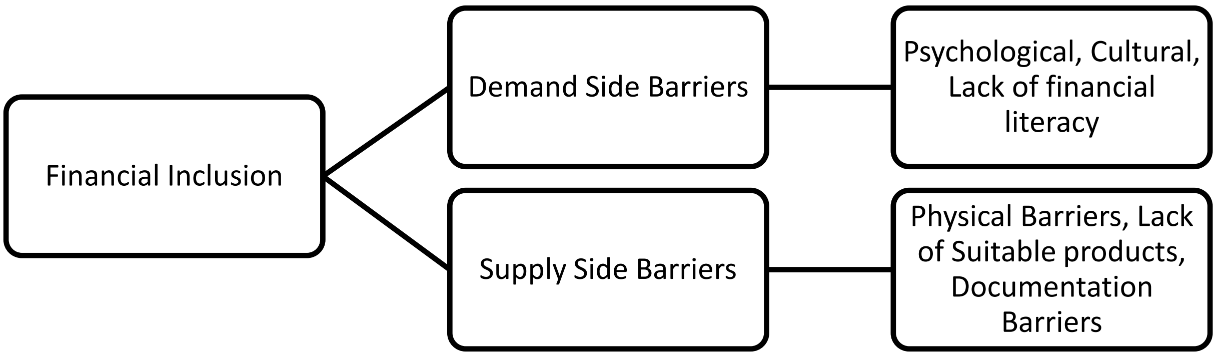

Figure 1: Barriers to Financial Inclusion (Source: Author)

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MFIs in India and Access Barriers addressed by them

A majority of MFIs in India use group based models of lending. While there are variations in methodology, the most common model among large, rapidly growing MFIs in India is the joint liability group model, based on the model originally used by Grameen Bank[viii].

In this model, the MFI raises funds from various sources (donors, equity investors and lenders) and then on-lends them directly to low income women who form themselves into groups usually with those in the same neighborhood. While loans are given to individuals, the group as a whole is jointly responsible for repayment of the members' loans. A group usually has five members, with six to eight groups forming a centre.

The MFI has a team of field officers who help in the formation of groups and later provide them training. Each group has a leader who helps in coordination among group members. After training of groups, there is an assessment of the group by the MFI branch manager which involves visits to the residences of members. This process is called as "group recognition test (GRT)". Thereafter, the groups meet regularly on a weekly basis in the neighborhood where the members reside. Loans are disbursed soon after the GRT. Most MFIs (other than those registered as banks or cooperatives) in India are not permitted to collect savings of members so the primary financial service offered is credit. Often credit life insurance is provided which means that in case of death of the member, the loan is written off. This usually requires payment of a small premium at the time of loan disbursement.

All members in a group usually get the same amount of loan, the tenure of which is around 50 weeks. All disbursements and repayments are made in the weekly centre meetings which typically take place in the early hours of the morning. The meetings are conducted by the MFI field officers who insist on strict discipline to ensure that the meetings take place punctually and are concluded within a particular time frame. All records of transactions of the group are maintained by the field officer. Progressively higher loan amounts are considered by the MFI on successful repayment of loans. This prospect acts as a significant incentive for loan repayment.

Access Barriers addressed by MFIs

MFIs have a number of features which make them in some ways appropriate channels for addressing some common barriers to financial inclusion.

Supply side barriers

First, MFIs provide financial products more or less tailored to the requirements of low income groups. For instance, in the case of MFI loans, collateral is not usually insisted upon and loan repayment amounts are small and frequent. Second, they usually provide convenient forms of delivery of financial services, often by regular visits to the neighborhoods of customers, making physical access particularly easy and attractive. Third, they do not usually have elaborate documentation requirements. Loan officers in MFIs usually rely on address checks and neighbor references rather than documents.

Demand Side Barriers

Microfinance can also address demand side barriers to financial inclusion such as cultural and psychological barriers and lack of financial literacy and financial competence. MFIs motivate potential members by explaining the benefits of usage of the financial products. The loan officers of MFIs are drawn from local populations, who usually communicate effectively with potential customers and give them opportunities to obtain clarifications on any concerns they may have. They also provide basic training to first time customers on financial concepts. The group model provides companionship to first time users of financial services. The fact that all transactions are conducted in group meetings ensures a degree of transparency and sense of security to members. All these design features suggest that microfinance may be a suitable means to promote financial inclusion. The next two sections draw on empirical data to ascertain the extent to which MFIs actually break down barriers to financial inclusion.

Analysis of MFI penetration and spread of banking services in India

India has a strong network of public sector banks but availability of banking services in different parts of the country is non-uniform. In places where there is inadequate availability of banking services, the supply side barriers to financial inclusion are particularly high, making availability of MFI services particularly useful. Even though banks often themselves do not provide service tailor made for low income groups, they often partner with Non Government organization (NGOs) through the self help group bank linkage program promoted by the National Bank for Agriculture and Rural Development (NABARD). Hence low income groups in areas with bank branches are often able to access financial services through this route. In this section, we seek to assess if MFIs fill in spatial gaps in banking services by showing high levels of penetration in areas neglected by the banking sector.

To assess the availability of microfinance in a state, the state-wise Microfinance Penetration Indices (MPI) computed by Srinivasan (2009), which indicate a state's share in microfinance relative to its share in the country's population were used[ix]. States with MPI greater than 0.5 have microfinance shares which are at least half their population share. Such states are classified as having "high microfinance coverage". Regions with MPI equal to or lower than 0.5 are considered as having "low microfinance coverage". As the MPI by definition should be around 1.0 for the state to be represented in the proportion of its population, a ratio of 0.5 indicates that 50 percent progress has been made.

For banking penetration, the average population served per bank branch in each state is used. This is a frequently used measure of financial inclusion with regard to banking services. The national average for the population per bank branch is 15,000 and hence regions having higher than 15,000 are considered as having "low banking coverage" while those having lower than 15,000 are considered as having "high banking coverage".

The results from the analysis of MPIs and data on bank branches are summarized and displayed in the form of a matrix (**Table 1**) which is obtained by cross-tabulating microfinance coverage with banking coverage.

Table 1: Matrix on Availability of Microfinance and Banking Services

	Low Availability of Microfinance	*High Availability of Microfinance*
Low Availability of Banking Services	Central Region	North Eastern Region Eastern Region
High Availability of Banking Services	Northern Region	Southern Region Western Region

(Source: Author)

The matrix in **Table 1** leads to the following observations:

1. In the North Eastern and Eastern regions of the country where the number of bank branches relative to the population is low, microfinance has made considerable progress in increasing access to financial services.
2. In the Northern region, where bank branches relative to the population is high, microfinance penetration is low.
3. The Southern and Western regions of the country have higher than average number of bank branches relative to their population but also have high microfinance penetration.
4. The Central region seems to have lower access to both bank branches and microfinance.

Findings from interviews with MFI field officers

As explained above, field officers of an MFI are the contact points between the MFI and its members. They perform the critical roles of group formation, training and monitoring, and as such are likely to be well aware of the ground-level realities. In order to tap into this valuable resource, field officers were interviewed on the reasons why MFI membership is inaccessible or temporary in the case of some financially excluded individuals.

Interviews with field workers were conducted in the state of Tamil Nadu[x] at Grama Vidiyal Microfinance Limited (GVMFL), the 9th largest MFI in India[xi] during the period June to August 2009. Headquartered in Tiruchirapalli district in Tamil Nadu, GVMFL has been working exclusively with women since it started operations in 1996. As on March 31, 2009[xii], GVMFL had 408,685 members and 154 branches in 27 out of the 30 districts in Tamil Nadu and in the neighboring union territory of Pondicherry. The loans outstanding stood at Rs. 2 billion. By April 2010, GVMFL had 862,482 members and loans outstanding of Rs. 5.9 billion. GVMFL had also expanded geographically and had 230 branches.

Field officers were interviewed in 12 branches of the MFI around Tiruchirapalli. These included four urban branches, four semi-urban branches and four rural branches. At each branch, all field officers attached to the branch who were available at the time of the study were interviewed resulting in 103 interviews. As the study was conducted after obtaining approval of senior MFI personnel, all field officers approached participated in the study.

The interviews for field officers followed a standardized format which as defined by Berg (2001) as a formally structured schedule of questions. A pilot of the questionnaire was administered to GVMFL field officers in December 2007. The interviews were conducted in the local language, Tamil. The interviews were conducted at the MFI branch as all field officers report at the branch after finishing their group meetings in the morning. The detailed comments of each field officer were transcribed on individual copies of the question format. As these were 103 in number, numeric codes were assigned to expected responses for each question at the time of framing the questionnaire. When new categories of responses emerged, additional numeric codes were assigned by the researcher. Each questionnaire with the associated codes for each question, was then entered into a Microsoft excel sheet. Using the pivot table function the frequency of each code was counted for each question and the responses were organized into tables. The pivot tables were then summarized for presentation. This was the manner in which the processes of data reduction and data display were carried out in this case.

Of the 103 field officers in twelve branches of GVMFL who were interviewed, 22 were women. There was no significant difference observed in responses of male and female field officers and hence these are not separately reported. The average number of years of "microfinance" experience of the field officers was a little over 2 years. As the microfinance sector in India is relatively young, GVMFL as it expanded recruited field officers with various backgrounds. Some had been studying prior to joining the MFI while others had accounting or marketing experience in other businesses prior to doing so. The typical educational qualification of the field officers was a Bachelor's degree or a diploma.

The questions asked of field officers with regard to access barriers were as follows:

"Q1: Have you come across a situation where a financially excluded member could not access group microcredit?

Q2: If yes, approximately how frequently do you come across such cases?

Q3: What are the main reasons? Please rank them

Q7: What are the main reasons why members drop out of groups?"

101 out of 103[xiii] field officers interviewed mentioned that they do regularly come across individuals who want to join the group, but are not able to for various reasons. While the second question asked the field officers also attempted to obtain a quantification of the average number of individuals excluded during each group formation exercise, it was found that most field officers were unable to estimate these numbers. This is because during the group formation stage, the focus of field officers is solely on forming groups. The officers have not been encouraged to collect information regarding those who do not successfully join the group. This could possibly be because as the market for microfinance so far has been largely untapped, branches are able to achieve the required targets without being forced to give much thought to these aspects.

The field officers were then asked to list out the main reasons why they are usually unable to do so. The first three reasons mentioned by each field officer were tabulated and the frequency with which each reason featured in the responses was calculated. Responses obtained in urban, semi-urban and rural areas were grouped and analyzed as the location of the member may have an impact on these factors. **Table 2** summarizes the results relating to this question.

Table 2: Field officers' Responses: Main reasons for Individuals not being able to join microfinance groups

REGION	Reasons for not being able to join Microfinance groups	Percentage of Field officer responses that referred to the reason.
URBAN	Inability to attend weekly group meetings	35%
	Lack of address proof	28%
	No economic activity to engage in	16%
SEMI-URBAN	Inability to attend weekly group meetings	38%
	Lack of address proof	28%
	No economic activity to engage in	20%
RURAL	Lack of address proof	31%
	Inability to attend weekly group meetings	25%
	No economic activity to engage in	16%

(Source: Author)

Table 2 indicates that the same three reasons were cited in urban, semi-urban and rural areas as the main reasons for lack of access to microfinance. These were inability to attend weekly group meetings, lack of address proof and not having an economic activity to engage in. In rural areas, "lack of address proof" ranked highest while in urban and semi-urban areas "inability to attend weekly meetings" emerged as the most important reason.

With regard to the first reason, it was mentioned by field officers that some low income women worked as day laborers at distant locations (such as factories or construction sites) and so had to leave for work early in the morning much before group meetings are usually held[xiv]. This meant that these women had to lose their daily income if they wanted to join a group.

On the second reason regarding lack of address proof, it was mentioned that at times women did not have an address proof when they move into a village after marriage. They also hesitate to go through the processes required to obtain it, as they are often afraid to go by themselves to Government offices. This issue appears to be particularly important in rural areas.

For the third reason, on lack of economic activity, field officers gave examples of low income women who are rag-pickers who sometimes approach MFIs for loans. As they do not have a particular income generating activity into which they can invest the loan funds, MFI field officers as well as other group members are hesitant to include them in groups.

The researcher found while discussing with branch managers that there were also many instances of members dropping out of groups. Most MFIs including GVMFL do not specifically track this figure, as usually a member who drops out is replaced with a new member.

As these drop-out members are unable to access microfinance in an ongoing manner, information regarding the main reasons for members dropping out was gathered and a question on this was added to the questionnaire for field officers. **Table 3** summarizes the findings in this regard.

TABLE 3: Field officers' Responses: Main reasons causing members to drop out.

REGION	REASONS FOR DROPPING OUT	Percentage of Field officer responses that referred to the reason.
URBAN	Migration	38%
	Inability to attend centre meetings	23%
	Default	16%
SEMI-URBAN	Migration	32%
	Marriage	18%
	Inability to attend centre meetings; Default	15%;15%
RURAL	Default	29%
	Migration	24%
	Marriage	21%

(Source: Author)

It seems that migration, marriage, default on the loan and inability to attend centre meetings are the main reasons why members are forced to drop out. When families migrate, there is no provision for members to transfer their account to the new location, even if the MFI has a presence there. This implies that members have no choice but to drop-out. On moving to the new location, they have to once more commence the process of forming a group, providing address proof and undergoing training before they are able to access microcredit. When women get married, as they typically move to the area where their husbands reside, they have to again drop-out of their existing MFI. If they want to access microcredit in the new location, they have to again go through the membership process. "Default on the loan" refers to a situation when a member either is unable to repay a part of the loan or repays it with considerable difficulty. Such members usually drop-out before the next loan cycle. "Inability to attend centre meetings" refers to situations when circumstances change and a member is no longer able to attend centre meetings. Usually this is due to change in job location such as, when members decide to take up jobs in nearby cities requiring them to leave house early in the morning. As they are no longer able to attend the centre meetings, they drop-out of the MFI.

These findings indicate that there are individuals who may want to access microfinance but are not able to do so due to a number of reasons. First is the requirement to regularly attend weekly group meetings in the mornings. Second, even though documentation requirements of microfinance institutions are minimal, there are some individuals who are not able to comply with them. Typically, they do not have a proof of address. While field officers state that such individuals can visit the local Government officials and obtain a letter of proof fairly easily if they are residents of the place; it appears that a number of them are hesitant or lack the resources to do the needful. Third, the lack of an economic activity is a significant barrier to accessing microcredit. There is perhaps need for such individuals to obtain some skill training prior to joining a microfinance group.

The findings also indicate that current access to microfinance services does not necessarily imply ongoing access to financial services as in a number of cases it is found that the access is purely temporary as members drop-out. There is a need for greater portability of microfinance accounts in order to address drop-outs due to migration and marriage. To address the drop-outs due to default on loans, access to savings services would be useful to enable such members to continue their use of financial services and prepare for contingencies. This is particularly important as they no longer have access to loans. Drop-outs on account of inability to attend centre meetings need to be addressed perhaps by offering these members the option to avail branch based services.

The findings of the field officer interviews were discussed with the senior management of GVMFL. It was found that the executives were aware that GVMFL did not reach all women who do not presently have access to financial services, even in the areas in which it operated. GVMFL branches, which were set up based on market studies by GVMFL managers, typically had a target to reach 4,000 families in a radius of five kilometers in rural areas and ten kilometers in urban areas. Usually only poor women who had an ability to engage in an income generating activity were selected. Data regarding the coverage of financially excluded population covered was not collected by them. But the MFI executives mentioned that almost all their customers did not have bank accounts and hence were financially excluded.

GVMFL's focus was on replicating their model in other areas and so was expanding geographically. GVMFL's growth strategy did not specifically involve trying to cover other individuals not having access to financial services in the areas they were already operating in.

The above suggests that microfinance providers tried to reach low income women in areas surrounding their branches who were able to engage in an income generating activity and comply with the requirements of the group lending model. All financially excluded individuals were not expected to be covered. The focus, rightly from their viewpoint was on quality of loan portfolio. Moreover, once branches reached the benchmark number of members, they focused on maintenance of portfolio by gradually increasing loan amounts and replacing members who dropped out. The growth strategy of the MFI was focused on expanding geographic outreach and not through continuously increasing penetration in areas already covered. This focus on increase in geographic coverage is observed in a number of MFIs. This strategy enables rapid increase in outreach within a short span perhaps enabling the MFP to attract the attention of potential investors and lenders.

Conclusions

While financial inclusion is an objective in many developed and developing countries, the most cost effective means for financial inclusion needs to be evolved depending on the culture as well as the institutional and legal infrastructure in the country. For instance, matched savings programs have been tried in Australia and USA. However such programs require high budgetary resources and may not be a feasible option in the case of many low income countries. MFIs represent a good vehicle for promotion of financial inclusion in developing countries such as India.

On analyzing the geographic spread of microfinance services, the study finds that microfinance penetration in the country was non-uniform, with state specific contextual factors playing a major role in driving microfinance growth. A comparison of the spread of microfinance services with that of banking services, found four distinct regional categories. While the Southern and Western regions were characterized by widespread availability of both kinds of services, the Central region had low availability of both kinds of services. The Eastern and North Eastern regions showed high availability of microfinance but not banking services, while the Northern region showed high availability of banking but not microfinance services. This suggests the need to develop the microfinance sector in inadequately served regions. Targeted incentive packages at the national level to encourage the spread of microfinance to these areas could be useful.

The interviews with field workers suggests that there are individuals who want to access microfinance, but are not able to do so due to various reasons. These include requirements such as attendance at weekly group meetings, documentation such as address proof, and a lack of a market-oriented economic activity. The findings also indicate that microfinance does not imply ongoing access to financial services, as it is found in a number of cases that access is temporary as members drop-out. There is a need for greater portability of microfinance accounts, in order to address drop-outs due to migration and marriage. Such portability could also reduce overall resource costs of providing microfinance services.

In summary, while MFIs do break down many barriers to financial inclusion, there are limitations in that MFI penetration in the country is skewed and excludes some areas neglected by the banking sector, suggesting a need for policy incentives. Further, to provide greater access for a longer duration of time, there is a need for MFIs to consider adopting more flexible operating models, providing skills training and offering services such as portability of accounts.

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i Creative destruction refers to the process of entry by new entrepreneurs by creating value through innovations, in the process eroding the value of older firms who may lose out as a consequence.

ii While there have been a number of studies regarding financial development and growth, they usually use aggregated indicators of financial depth rather than that of access. Typical indicators used are ratio of credit availed by the private sector to GDP, the turnover of shares relative to stock market capitalisation and the spread between lending and deposit interest rates (World Bank, 2008).

iii In fact, such data are available only in the case of around 44 countries, half of which are in the European Union (Honohan, 2008).

iv In Greece there are 776 loan accounts per 1000 persons while in Albania there are only 4 for every 1000 persons. In Austria, there are more than 3 deposit accounts per individual, while in Madagascar there are only 14 for every 1000 individuals. The data set does not include India.

v Number of bank branches and ATMs per 1,000 kilometers; and bank branches and ATMs per 100,000 people

vi Geographic branch penetration varies from 0.11 in Namibia to 636 in Singapore (India: 22.5) while geographic ATM penetration varies from 0.07 in Nepal to 2642 in Singapore (data not available for India). Demographic branch penetration varies from 0.41 in Ethiopia to 95 in Spain (India: 6.3) while demographic ATM penetration varies from 0.06 in Bangladesh to 135 in Canada (data not available for India).

vii However even to open no-frills accounts, both identity and residence proof are required, which is a challenge for many low income individuals, particularly migrant workers. Issue of unique identification number to Indian residents which is currently being implemented is expected to help in this matter.

viii Grameen Bank in 2002 introduced changes in its lending methodology and did away with the joint liability nature of its groups.

ix Another indicator reported, the Microfinance Poverty Penetration Index compares a state's
microfinance share with its share in the population of individuals below the poverty line. This is not used as many MFIs do not use the "below poverty line" benchmark preferring instead to do their own poverty assessment. Moreover, as pointed out by Robinson (2001), microfinance may be more useful for the better off among the poor who may be slightly above the poverty line. As at present there is no measure available which measures the microfinance penetration as a proportion of this segment within each state, the MPI which measures microfinance penetration as a proportion of the population of the state seems to be the best available option.

x The interviews of field officers were conducted in Tamil Nadu, which was not directly affected by the Andhra Pradesh crisis of 2010, which occurred due to instance of multiple borrowing and aggressive collection practices leading to alleged instances of suicides by microfinance borrowers and consequent restrictive legislation by the state Government. Moreover the data collection for the study took place June to August 2009 prior to the crisis.

xi CRISIL (2009), "India's top 50 MFIs".

xii As the study was conducted in the period June-August 2009, the figures as on March 31, 2009 have been provided.

xiii It is quite likely that the 2 who said they had not come across such situations were overcautious in trying to play safe and not say anything that could possibly show their employer in negative light.

xiv Group meetings typically start around 6.30 or 7.00 a.m. These workers leave their homes by 6 a.m.

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