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The Market for 33 Percent Interest Loans.

Financial Inclusion and Microfinance in India

Markus Pauli*

Abstract

Financial inclusion is the process of building viable institutions that provide financial services to those hitherto excluded. These may include savings, insurances, remittances, and credit. Microfinance became the most dominant method for achieving financial inclusion. However, different microfinance schools of thought recommend opposite ways for attaining financial integration. India is a particularly insightful case study due to the sheer number of people excluded from formal financial services, as well as the spectrum of actors and approaches. The aim of this article is threefold. First, defining financial inclusion, depicting its status quo in India and comparing it to its South Asian and BRICS peers using recently released data from the Global Findex database. Second, focusing on microfinance as the dominant vehicle for achieving financial inclusion by scrutinizing its definitions, contrasting its two leading "schools of thought" and analyzing the central role of its dominant group-based approach. Third, the article will examine why people opt to take micro-credit at 33 percent interest rates.

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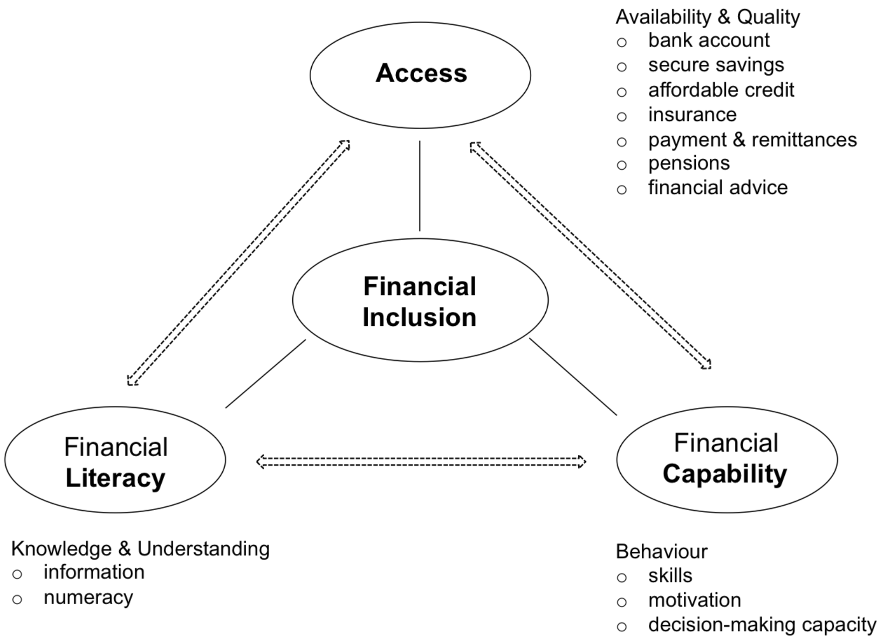
Introduction: Financial Inclusion

A bank account is – in many countries – still a privilege. However, account ownership improved substantially in the last years. Today 63 percent of people in developing countries have an account at a bank, a microfinance institution, or another type of regulated financial institution – compared to 42 percent in 2011.[1] South Asia is the region with the largest gain regarding account ownership with 70 percent in 2017 compared to 32 percent in 2011. This contrasts to Sub-Saharan Africa (43 percent, up from 23 in 2011), Middle East & North Africa (43, up from 33) and Latin America & Caribbean (54, up from 39).[2] People without access to formal accounts and other financial services use informal alternatives, which are costly, unreliable or insecure. For loans, they depend on family, friends, shopkeepers or money lenders. Financial inclusion is the aim of changing this: the process of ensuring access to timely, adequate and affordable financial services.[3] Definitions of financial inclusion usually focus on availability and access.[4] I argue that one has to look beyond the numbers and include an assessment of the quality of financial inclusion. Even more so, after several severe financial and microfinance crises it is not enough to focus on the outreach of financial inclusion. The numbers of loans disbursed, loan size and repayment rates are essential. Equally important are issues of appropriateness, affordability, grievance mechanisms, and procedures for repayment difficulties.

Access to financial services is, however, merely one element of financial inclusion. Aynsley emphasizes the significance of financial *literacy* and *capability*.[5] *Financial literacy* can be defined as the capability of understanding how to manage financial resources. That means how to earn, save, invest, borrow and spend money. It requires basic numeracy but even more so, the knowledge and understanding of opportunities, risks, and alternatives. The necessary foundation for achieving financial literacy is financial education.[6] (See Figure 1.) *Financial capability* can be defined as the capability of converting financial literacy into action. It requires practical abilities, motivation as well as decision-making capacity. Building financial capabilities requires commitment and endurance, which are scarce resources. Even more so, in times of a "quest for numbers," as Ghate described the Indian microfinance boom.[7]

Figure 1. Financial Inclusion Trinity.



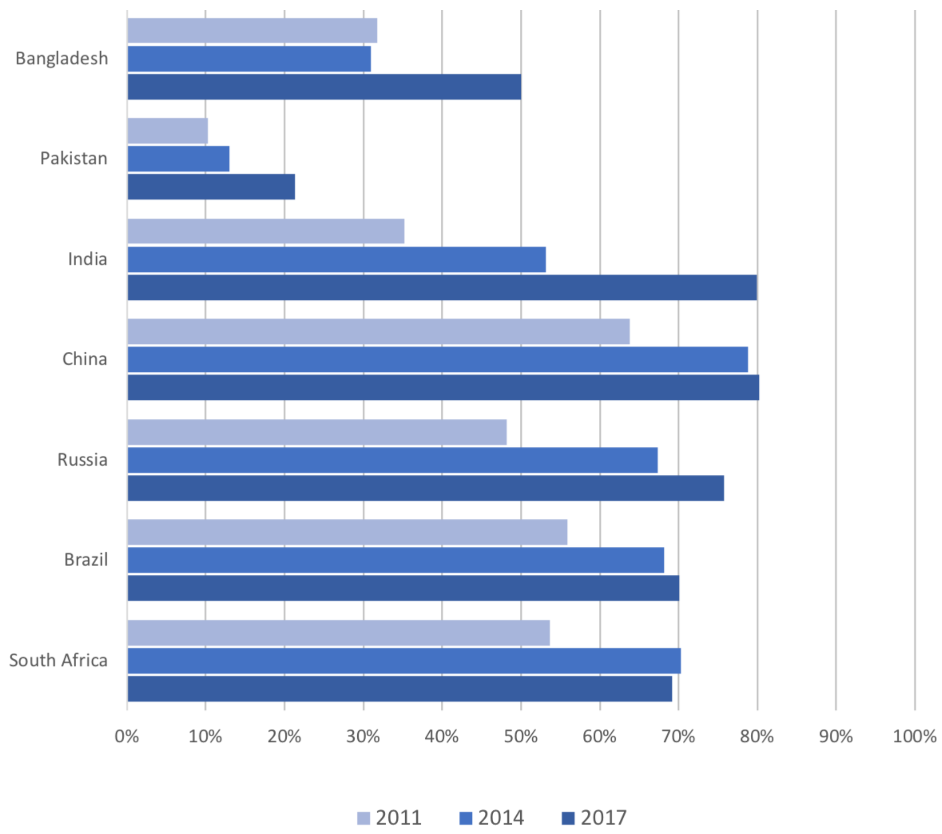
Compiled by Author. Source: Based on Aynsley (2010).

Financial inclusion features prominently on the agenda of international institutions. The *Group of Twenty* (G-20) initiated the *Global Partnership for Financial Inclusion* in Seoul in 2010.[8] The G-20 *Financial Inclusion Action Plan* focuses on loans for small and medium-sized enterprises (SMEs), consumer protection and literacy regarding financial products, as well as markets and payment systems.[9]

Status Quo of Financial Inclusion in a Comparative Perspective

What is the status quo of financial inclusion? How does India compare with its South Asian and BRICS peers? The World Bank´s *Global Findex* Database provides a quantification of financial inclusion.[10] The percentage of people with an account – either at a financial institution (including banks and microfinance institutions) or through a mobile money provider[11] – is the most basic quantitative measure for financial inclusion. India achieved the most substantial increase, compared to its South Asian and BRICS peers, from 35 percent in 2011 to 80 percent in 2017. (See Figure 2.) This success was achieved by the *Prime Minister's People Money Scheme* (*Pradhan Mantri Jan-Dhan Yojana*, PMJDY), which Prime Minister Narendra Modi launched in August 2014. This *National Mission for Financial Inclusion* aims to provide savings & deposit accounts at banks as well as financial services such as remittances, insurance, credit and pensions in an inexpensive manner. These accounts can then be used by the government for direct transfers of subsidies and welfare provisions, to prevent leakages.[12] The President of the World Bank, Jim Yong Kim, praised it as an "extraordinary effort."[13] The *Guinness World Records* features it as the fastest dissemination of most new accounts at banks.[14] India outperforms Bangladesh, the home to some of the largest and best-known Microfinance Institutions such as Grameen, BRAC, and ASA.[15] The number of accounts in Bangladesh stagnated between 2011 and 2014 around 30 percent – and then increased to 50 percent. In Pakistan merely, nine percent of the population over 15 years old was in possession of an account in 2011, that rose to 21 percent in 2017.

Figure 2. Account (% age 15+), BRICS and South Asia, 2011-2014-2017.

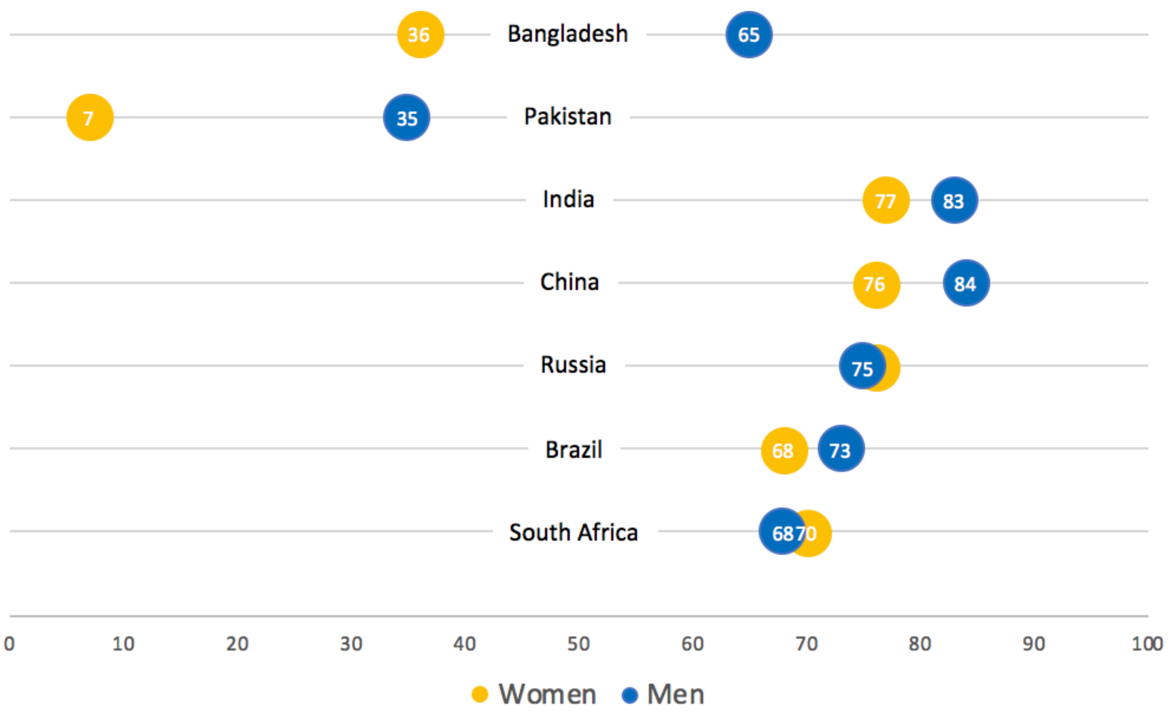


Compiled by Author. Data Source: World Bank, "The Global Findex Database 2017," 2018, https://globalfindex.worldbank.org (accessed May 16, 2018).

India was also successful in closing the gender gap regarding account ownership. While in 2014, the gender gap was unusually large in India, both in comparison to Bangladesh and the BRICS –

with 62 percent of Indian men versus 43 percent of Indian women owning an account. Merely three years later, 83 percent of men and 77 percent of women have an account (see Figure 3). In Pakistan, the percent of women owning an account is astonishing low: a mere 3 percent in 2014, up to 7 percent in 2017 – compared to 35 percent of men in the same year. Given that the vast majority (90 percent) of clients at microfinance Institutions in Bangladesh are women,[16] the country faces a surprisingly large gender gap regarding account ownership: 36 percent of women versus 65 percent of men.[17] In Russia and South Africa, slightly more women than men have an account.

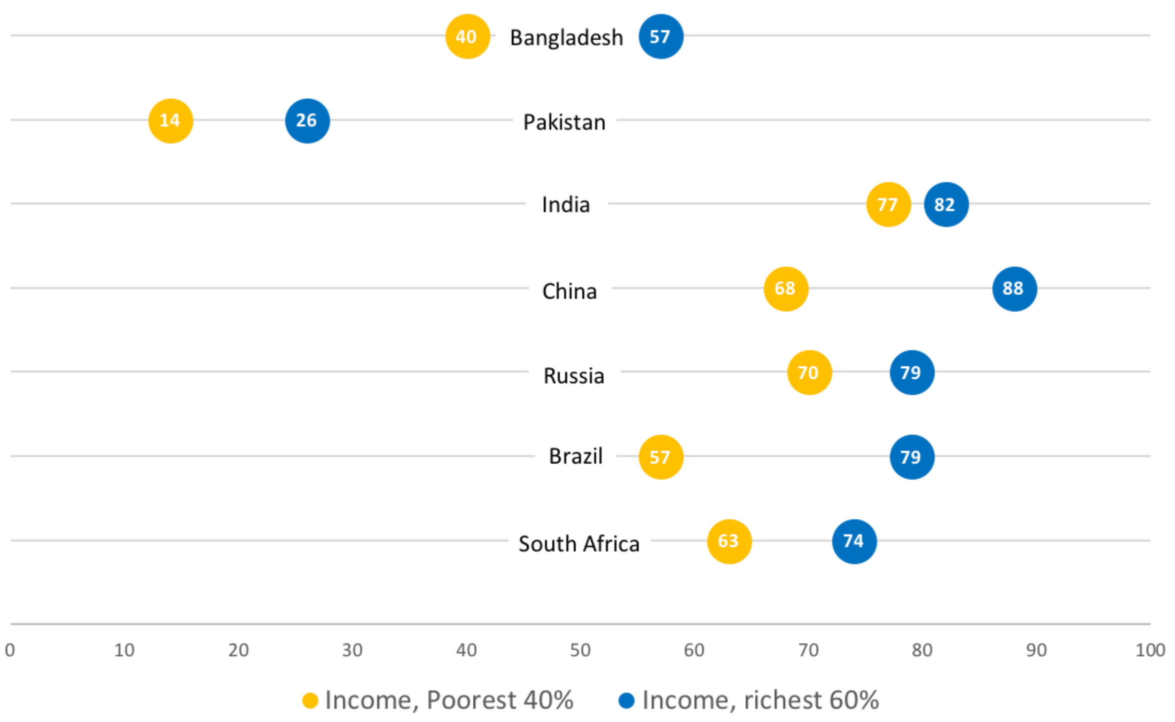
Figure 3. Gender Gap for Account (% age 15+), BRICS and South Asia, 2017



Compiled by Author. Data Source: Global Findex Database 2018.

In addition to the access of women to formal accounts, one can assess the inclusiveness of a financial sector by looking at accounts by income group. India is leading ahead of its BRICS and South Asian peers with a gap between the poorest 40 percent and the richest 60 percent of five percent. (See Figure 4.) Huge is this income gap regarding account ownership in Brazil (22 percentage points), China (20 points), Bangladesh (17) and Pakistan (12). Particularly impressive is the achievement in India, which reduce its income gap regarding accounts from 14 percentage points (in 2011) to five points (in 2017).

Figure 4. Rich-Poor Gap for Account (% age 15+), BRICS and South Asia, 2017



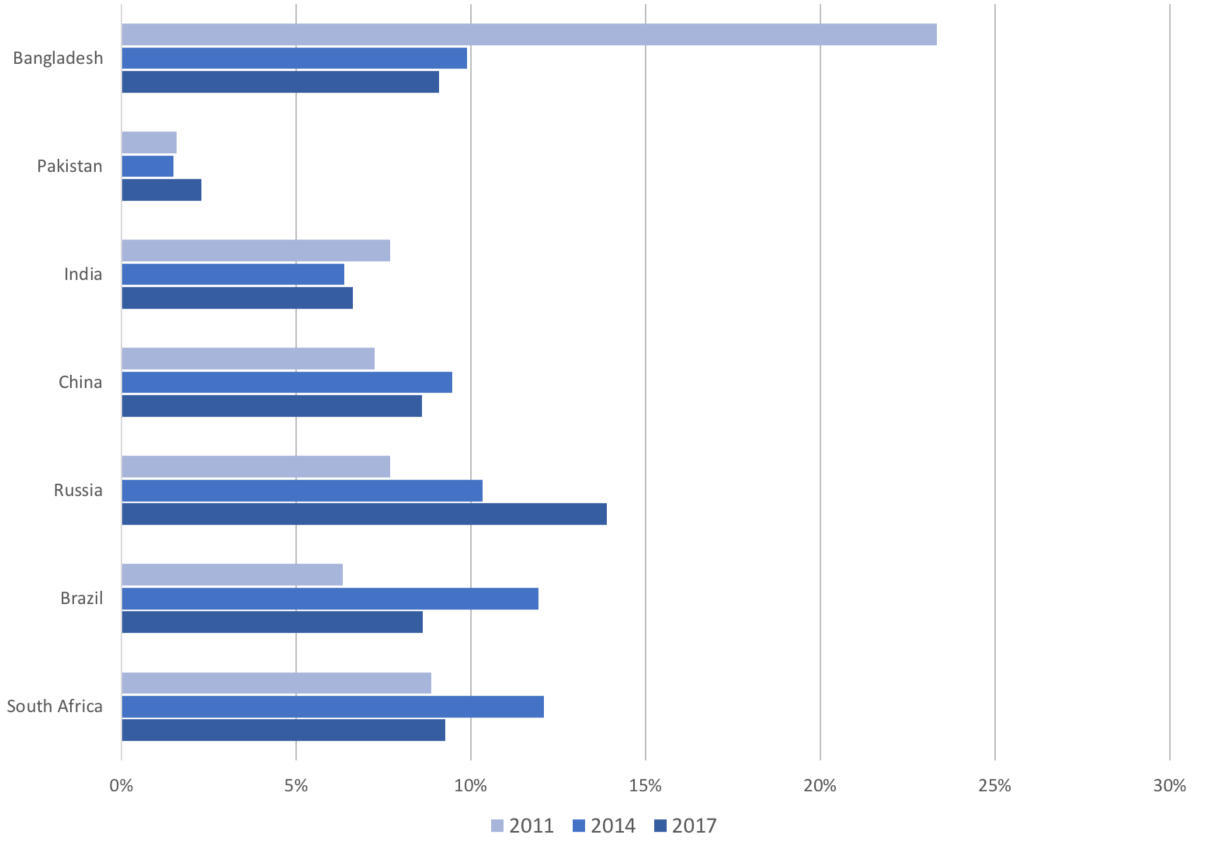
Compiled by Author. Data Source: Global Findex Database 2018.

The number of accounts at formal institutions, however, is only one aspect of financial inclusion. Bank accounts might be *inactive* (which in doubt, might be due to long-term savings) or *dormant*. When surveying individuals with a financial institution account whether they *used* the same in the last year to withdraw money, the results for 2017 are: India (43 percent), Bangladesh (52 percent), Pakistan and South Africa (both 66 percent), Brazil (77 percent), China (78 percent), Russia (82 percent) – in contrast to USA (94 percent) (Global Findex Database 2018).[18] Hence, many accounts at formal financial institutions in South Asia, particularly in India – with more than half (!) – and Bangladesh are inactive.

Mobile banking is regarded by many as the next big thing in financial inclusion. The usage of mobile phones for financial services, however, differs substantially between countries. Generally, the low-income countries take the lead. The results in 2017 for "sent or received domestic remittances through a mobile phone (percent senders and recipients)" are low-income-countries (51 percent, before 28 percent in 2014), lower-middle-income (17 percent, before 11) and upper-middle-income (40 percent, before 7) (Global Findex Database 2018). The variance among different lower-middle-income countries is astonishing: Kenia (95 percent, before 90), Bangladesh (64 percent, before 24), Pakistan (25 percent, before five) and India (five percent, *unchanged*). Among the other BRICS (all classified as upper middle income), China (54 percent, before nine) takes the lead, followed by Russia (38 percent, before eight) and South Africa (38 percent, before 18) and Brazil (six percent, before zero).[19] Generally, Africa takes the lead in mobile banking. Not unsurprisingly, given that the pioneering mobile payment provider *M-Pesa* launched in 2007 in Kenya. There is a considerable potential to utilize mobile phone technologies to reach the unbanked. In India, more than 50 percent of the unbanked population (190 million or 11 percent of the adult population are unbanked) have a mobile phone.[20] In China, 82 percent of the unbanked population (225 million or 13 percent of the adult population are unbanked) have a mobile phone.[21]

Bangladesh is seen as a global leader in financial inclusion regarding loans. One out of four Bangladeshis reported a loan from a microfinance institution (MFI) or bank in the last year when asked in 2011, topping loan provisions in the United States and with a distance those in BRICS countries. (See Figure 5.) However, this self-reported loan provision in Bangladesh decreased sharply to circa 10 percent in 2014 and 2017. This survey finding calls for further qualitative investigation into the reasons for this decline. Generally, Bangladesh experienced, according to the *global findex* data, a decline in borrowing any money (including all sources) from 48 percent in 2014 to 37 percent in 2017. As of 2017, Russia leads the BRICS states regarding the percentage of people who borrowed from a financial institution. India and Pakistan come in last in this comparison.

Figure 5. Borrowed from a Financial Institution (including Microfinance Institution) (% age 15+), BRICS and South Asia, 2011-2014-2017



Compiled by Author. Data Source: Global Findex Database 2018.

In summary, financial inclusion consists of several complementary aspects. These include access to financial services such as savings accounts, remittances, insurances, loans or pension schemes. It has been argued that beyond access, financial literacy and financial capability are crucial elements of financial inclusion. As the Indian case shows, both private (non-for profit and for-profit) institutions and the state play a crucial role in financial inclusion. The Indian state functions not only as legislator and regulator (Priority Sector Lending scheme, see below) but also as a core actor in the provision of accounts at financial institutions (*Pradhan Mantri Jan-Dhan Yojana* scheme) as well as the largest provider of microfinance (through its *Self-Help-Group Bank Linkage Program*). Essential for the sustainability of private financial institutions (especially those dealing with the most vulnerable sections of society like microfinance institutions) are the social license to operate (trust by society), linked to that a favorable political climate (political risk) and some degree of legal protection.[22]

Microfinance as the Dominant Model for Financial Inclusion

> *"[Microfinance is] one of the most important policy tools aimed at the poor."*[23]
>
> *"Ultimately, it's Indian microfinance] something like subprime lending [...] The same incentives are operating here... it was securitisation and derivatives that operated in the US. Here it is the priority sector lending by banks."*[24]
>
> *Y V Reddy 2010, former Reserve Bank of India Governor*

Misperceptions and incorrect descriptions obscure the understanding of microfinance. Due to the range of actors, services, objectives, and assertions, this does not come as a surprise. It is essential to clarify the basics, such as how to define microfinance, contrast its competing schools of thought, understand the centrality of its common group approach and why people take microcredit and other financial services in the first place. The answers provide insights into what microfinance is – and what it is not. Microfinance is no panacea for poverty alleviation as claimed by advocates. Research shows that it can enhance clients´ capabilities if done reasonably and responsibly, and it can contribute to building a sustainable, inclusive financial sector. However, microfinance can also reduce clients´ capabilities. Not least by dis-empowering them through a patronizing approach, by causing or aggravating over-indebtedness and social tensions through the use of peer-pressure for loan recovery. Karim provides an anthropological account of adverse impacts of microfinance in Bangladesh focusing on NGO governmentality.[25] The author asserts that "indebtedness has created heightened forms of strife and subordination in the lives of the female borrowers. (...) (and) how kin obligations have become enmeshed with indebtedness, creating toxic effects that lead to strife and competition among women borrowers."[26]

Defining Microfinance

Scrutinizing the plethora of microfinance definitions, like those found in academic dictionaries is insightful:

> „A term for financial services aimed at very low-income individuals and communities who would be otherwise excluded from banking, savings, and credit arrangements. A common form is micro-credit, based on poor people pooling their savings and taking it in turn to access them (see *Grameen Bank*). Microfinance institutions are often caught between being co-opted into mainstream finance on the

> one hand, for example by stock flotation, and dependence on state largesse and private donors on the other.“[27]

This definition highlights that microfinance targets very low-income individuals and communities, who in several countries are predominantly female, who else lack access to *formal* “banking, savings, and credit arrangements.” Informal financial services are often available. Poor households use them – especially credit – on a regular basis, as we will see. The definition furthermore refers to one element of micro-finance: micro-credit, as distinguished from other aspects like savings, insurance or remittances. Its description is wrong. The author instead is describing *Rotating Savings and Credit Associations* (ROSCAs). They provide micro-credit, “based on poor people pooling their savings and taking it in turn to access them.” ROSCAs are, however, a particular version of informal, group-based, peer-to-peer lending. Microcredit does *not,* at its core, entail lending amongst members of informal groups.

I argue that microfinance refers to *formalized* institutions, including banks, NBFCs (*Non-Banking Financial Companies*, and (*semi-)formal* organizations such as NGOs.[28] The definition furthermore denotes the linkage of informal groups to formal financial institutions. In India, the most comprehensive scheme is the *Self-Help-Group Bank Linkage Program* (SHG-BLP), which helps self-help groups (SHGs) to obtain collective loans from formal financial institutions. Also, in the *Grameen* model, the clients do not access the money they pooled together, instead *Grameen Bank* initiates the group formation. After that, the MFI provides loans to two of the women in the group. Further loans – to them and the other group members – depend on their repayment performance.

Finally, many microfinance institutions (MFIs) achieve financial sustainability beyond "stock flotation" or "dependence on state largesse and private donors." Though, scholars pointed out that MFIs struggle to meet the double bottom line – achieving financial sustainability as well as a positive socio-economic impact.

Let us scrutinize a different dictionary definition:

> "A method of enhancing quality of life and improving health for people living in extreme poverty, by providing very small interest-free or very low-interest loans to enable them to start a small, local enterprise. (…) Indian subcontinent and Africa, where the program has perceptibly raised living standards and improved population health."[29]

This definition makes the major and unsupported assertion of microfinance having “perceptibly raised living standards and improved population health.” Contrariwise, people “living in extreme poverty” in South Asia and Africa do mostly *not* obtain microcredit. Furthermore, microfinance does *not* provide “very small interest-free or very low interest loans.“ Critics regularly point to usury interest rates. Interest rates will be discussed in detail later in this article.

One last definition of micro-*credit* from an academic dictionary to consider:

> “Lending small amounts of money to very poor households at commercial rates, rather than at the ‘usurious rates of loan sharks’ (S. Buckingham-Hatfield2000). The classic model is the Grameen Bank, initiated in Bangladesh by Mohammed Yunus. Similar micro-credit schemes have been set up throughout the developing world, and have been enormously effective, not only in alleviating poverty and improving child nutrition but also in increasing the voluntary use of contraception. N. Burra et al., eds. (2005) assess the impact of micro-credit. Poverty trends would probably not be reversed, ‘but booming micro-credit would at least speak for a world where justice would have a greater place’ (Santiso (2005) Int. J. Soc. Sci. 57, 185).“[30]

It is controversial how effective microfinance is. Is it "enormously effective, not only in alleviating poverty and improving child nutrition"? Does it increase "the voluntary use of contraception“? This definition is useful in one way. It shows, how also in academic literature microfinance attracts high hopes and assertions, such as, “a world where justice would have a greater place."

To conclude, consider this *Asian Development Bank* (ADB) definition:

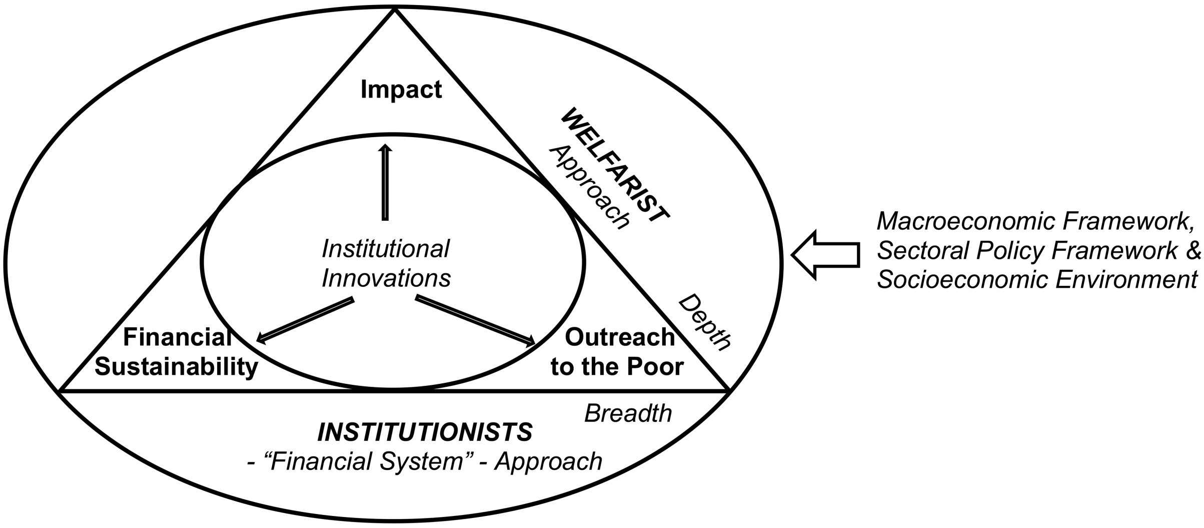
> “Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their microenterprises. Microfinance services are provided by three types of sources:
>
> - formal institutions, such as rural banks and cooperatives;
> - semiformal institutions, such as nongovernment organizations; and
> - informal sources such as money lenders and shopkeepers.
>
> Institutional microfinance is defined to include microfinance services provided by both formal and semiformal institutions. Microfinance institutions are defined as institutions whose major business is the provision of microfinance services.“[31]

ADB’s “institutional microfinance“ is, as I argue, *microfinance* as understood in common usage. In journalistic, academic and all-day language, moneylenders do not provide *microfinance*. Nor do we use *microfinance* when describing pawnbroker's shops or payday loan providers. Microfinance providers assert on their homepages and in their reports that they are fostering positive social impact, whether they stem from the public, private or civil society sector and whether they are non-profit or for-profit. This is also true for the listed Mexican microfinance institution (MFI), Compartamos which is notorious for its interest rates of 100 percent. Compartamos states on its homepage that it is "committed to eradicating financial exclusion." They claim to aspire to create economic, social, as well as human values. Referencing these proclamations is not merely a polemic. These MFIs might well pursue or even somewhat accomplish these goals. Instead, it is meant to highlight and illustrate the self-perception of microfinance providers. Hence, the ADB definition needs, as I argue, two modifications to mirror its common usage. First, one has to exclude "informal sources such as money lenders and shopkeepers." Second, one has to include that microfinance pursues a so-called "double-bottom line," i.e., financial sustainability and a beneficial socio-economic impact.

Microfinance Schools of Thought – Welfarist versus Financial System Approach

The "double-bottom line" in microfinance refers to, first, financial sustainability – regarding the microfinance institution themselves. Contrasting the unsustainability of subsidized credit their financial objective is profitability. Second, microfinance strives for positive social impact, in the form of financial inclusion, fostering entrepreneurship, poverty alleviation or (women´s) empowerment.[32] There is a third defining element of microfinance: the quantitative aspect of outreach to the poor. Together, this forms the "triangle of microfinance" which is useful in analyzing "existing trade-offs and synergies" between these three "overarching policy objectives in microfinance."[33] (See figure 10.) The new paradigm of non-subsidized, for-profit credit to poor clients emerged in the mid-1980s thanks to two factors. First, it was due to the failure of state- and development bank-driven loan programs designed for smallholder farmers in the 1960s and 1970s. Secondly, it was thanks to the success of microfinance pioneers like Bangladesh´s *Grameen Bank*, Bolivia´s *Prodem* (*BancoSol*) and *Bank Rakyat Indonesia* (RBI).[34]

Figure 6. Microfinance Triangle



Compiled by Author. Source: Adapted from Zeller (2003: 6) and Woller, Dunford & Woodworth (1999: 2).

Impact, outreach and financial sustainability are the defining aims of microfinance, depicted in the triangle of microfinance. (See Figure 6.) They are shaped by the macroeconomic framework, sectoral policies and the socio-economic context (outer circle) as well as institutional innovations (inner circle). In the words of the authors:

> "The inner circle represents the many types of institutional innovations that contribute to improving financial sustainability (such as employment of cost-reducing information systems), impact (such as designing demand-oriented services for the poor and more effective training of clients), or outreach to the poor (such as more effective targeting mechanisms or introducing lending technologies that attract a particular group of clients). The outer circle represents the external socioeconomic environment as well as the macroeconomic and sectoral policies that directly or indirectly affect the performance of financial institutions. Innovations at the institutional level (the inner circle) and improvements in the policy environment (the outer circle) contribute to improving the overall performance of financial institutions."[35]

There are two schools of thought in microfinance. The poverty lending or *welfarist* approach contrasts the *financial system* approach[36]alternatively, *institutions* approach[37]. (See figure 6.) The welfarist approach focuses on socio-economic welfare impact as the central aim. Supporters stress the depth more than the breadth of outreach. They prefer to provide loans to more impoverished clients but attempt to ensure a sustainable positive socio-economic impact. The aim of achieving financial sustainability must take a backseat. The prime goal is "self-employment of the poorer of the economically active poor."[38] The welfarist approach advocates a focus on credits for women, on the basis that increasing women´s control is most beneficial to children´s welfare. Grameen Bank in Bangladesh and FINCA in Bolivia follow the welfarist approach, as do their international offshoots and replicates.[39]

Institutionists (as referred to by Woller et al.) advocate the *financial system* approach and emphasize that microfinance must be financially sustainable. Not only is this necessary to deliver financial services reliably in the long run but also, to benefit from economies of scale as well as access to finance provided by mainstream financial markets by achieving profitability. They insist that a focus on outreach and profitability will benefit their clients as they disburse more loans in a shorter period, through increased efficiency as well as accelerated institutional innovations. Most importantly *institutionists* argue that the enormous demand can only be met by the financial markets, not by government and donor funding. In this view, the future of microfinance would be "dominated by numerous large-scale, profit-seeking financial institutions that provide high-quality financial services to large numbers of poor clients. Because of their insistence on financial self-sufficiency, *institutionists* eschew subsidies of any kind."[40] *Bank Rakyat Indonesia* (BRI) and *BancoSol* in Bolivia are major MFIs that follow the *financial system* approach. The *financial system* approach is also the most widespread in the academic literature – not least promoted by the World Bank, the *Consultative Group to Assist the Poor* (CGAP) and USAID.[41]

Group-based Microfinance to Reduce Risks and Costs

High risks and high costs are the main reasons why private banks have not been very keen on lending to the poor. Information asymmetry leads to higher risks and costs – both for banks and customers.[42] Credit providers have to deal with the threat of *adverse selection* (attracting customers who have a higher likelihood of defaulting on their loans) and *moral hazard* (risky behavior of customers in the knowledge that others will face the consequences). Due to information asymmetry clients, on the other hand, bear the risk that the financial institution is not trustworthy, that the "institution" (often in the form of the person claiming to represent it) disappears with the clients' money or goes bankrupt. This risk arises more regarding savings, insurances as well as remittances. In case of a bankruptcy of a loan supplier, the customer loses a potentially very valued credit source. The bankruptcy of an institution that collected savings can lead to the forfeiture of a substantial part of one´s savings. Hence the stricter regulations for saving providing institutions in most countries.

Group-lending involves three essential elements: First, it encourages group´s *self-formation*. Secondly, it leads to the group member's *joint liability* for the repayment of credits. Third, it entails a *conditionality* of further loans to group members based on the loan repayment performance of their group peers. This group approach is the most common method for aiming at profitability when lending small amounts to low-income people, often in rural areas – in the absence of collaterals. Moneylenders are, in a sense, in a better position than formal institutions. First, they have the local knowledge or contacts to judge the creditworthiness of applicants – to prevent *adverse selection*. Second, they can observe the financial conduct of their clients – to avoid *moral hazard*. Third, they can and do pressure clients and their relatives in case of repayment delays – to ensure *enforcement of repayment*. For private and public actors, it is more problematic and expensive to obtain such knowledge and to secure repayment.

Coleman observed that in "tightly knit communities that exist in many villages in *less industrialized countries* (LICs), members are well placed to judge the creditworthiness and to observe the actions of their peers, thus mitigating the problems of adverse selection and moral hazard."[43] Stiglitz names it *peer monitoring* and models “gains from improved monitoring” and compares it to the “costs of increased interdependence” regarding *Grameen* clients. He concludes: “the gains from peer monitoring more than offset the loss in expected utility from the increased risk-bearing.”[44] Stiglitz identifies three elements as essential for peer monitoring: First, adequate *incentives*, i.e., the conditionality of future loans. Second, *small groups* to avoid problems of bigger groups such as free riding and the reduced incentive to monitor given lower costs in case of defaults. Third, *homogeneity* in the group, i.e., regarding risk characteristics such as default proneness, is usually accomplished through group self-formation.[45]

Joint liability can reduce *adverse selection* through self-selection, as well as *moral hazard* through peer monitoring. It also “gives group members incentives to enforce the repayment of loans and reduces the lender’s audit costs for cases where some group members claim not to be able to repay.”[46] The peer *pressure* created by joint liability, however, also carries the risk of high *social* costs. When credit groups fail, and credit becomes unavailable from this source for all group members, the relations between the clients can be jeopardized and have “far-reaching consequences for village life."[47] Such acknowledgement of the possible negative social costs of peer pressure is, by and large, lacking in the econometric literature. Contrariwise, raising fear of "wrath of other group members" is indicated as a valuable tool, denoting it "social collateral" to be "harnessed" by financial institutions.[48] Without irony, the authors refer to the "wider significance in contract design in situations where market and non-market institutions interact" and of "drawing on the punishment capability of some agents to improve upon outcomes."[49] They summarize that if "the group is formed from communities with a high degree of social connectedness, then this may constitute a powerful incentive device and hence may serve to mitigate any negative effects from group lending."[50] The question remains: should one focus on "any negative effects" for the institutions or the clients?

In summary, the double-edged group mechanism is a central element of microfinance. There is, on the other hand, a tendency towards *individual* loans in microcredit, which builds on contracts and collateral. Nonetheless, for most of the (rural) poor, the group mechanism is the available model.

Microfinance – Grameen Style

One of the microfinance forerunners is *Grameen Bank* in Bangladesh. It provides an often-replicated model for new microfinance institutions (MFIs). Also, most of the large Indian MFIs deploy the *Grameen* approach, which describes the *method of delivering* financial services by establishing and sustaining small joint-liability groups – *not* the structure of an MFI´s *ownership* and *management*. The clients of *Grameen Bank* own the majority of its shares. The nearly nine million, mainly female *Grameen Bank* clients own the vast majority of its shares. In its Board, nine out of thirteen members are borrower-elected members.[51] How does the *Grameen* approach work in practice? MFI loan officers advertise and explain their financial services to potential clients and encourage low-income women to start a five-person credit group. The New York Times reports:

> "Although loans are made to individual entrepreneurs, each individual is in a group of four or five others who are in line for similar credits. Together they act as co-guarantors. If one individual is unable to make timely payments, credit for the entire group is jeopardized, which results in heavy peer-group pressure on the delinquent. (…) At first, only two members of the group are allowed to apply for a loan. Depending on their repayments, the next two borrowers can apply, and then the fifth."[52]

The group meets weekly in its village with members from around eight other credit groups. The *Grameen* center manager leads these meetings, during which all clients pay their weekly dues in front of the group. Often clients do not differentiate between the various parts of their "weekly bill" such as interest rate, mandatory saving, and loan instalment.[53] If a client fails to attend a meeting or is unable or unwilling to pay, the center manager tries to convince the group members. This takes the form of "exerting moral pressure (reminding them of their promises to pay regularly, or appealing to their good nature by telling them that if they didn't pay he might have to pay out of his own pocket), by delaying the processing of requests for new loans, by hinting that he would reduce loan values, or simply by using his authority to keep the members sitting there for hours on end until full repayment collection had been made."[54] Pressure on those on the verge of default also stems from members of the joint liability group.

The Market for 33 Percent Interest Loans

Over the last decades, India witnessed, like many of its peers, several attempts to urge or even force banks to provide adequate services to low-income clients – also by nationalizing banks and establishing new Regional Rural Banks. However, banks hardly feature as a loan source for low-income and poor people. (See figure 7.) This backdrop makes the success of microfinance institutions in the last two decades stand out. The data from the most extensive household survey in India shows clear segregation of household borrowing sources between the income groups.[55] Rich and high middle-income individuals use banks as their primary loan source. Lower income groups rely on family members and friends as their top loan source given their inadequate access to formal sources. Moneylenders are the second most crucial credit source for people with lower incomes. However, microfinance institutions and bank-linked self-help groups (SHGs) become an increasingly more popular loan source among the poor and those with low-middle-incomes.

Figure 7. Sources of Household Borrowing by Income Group (2009-10)

Category	*HH Count (%)*	*Annual Income (Rs '000)*	*Source of Borrowing*				
			Friends & Family	*Money-lender*	*SHG/MFI*	*Bank*	*Any*
Rich - I	0.3	1,367	0.4	0.2	0.1	18.0	20.1
Rich - II	0.6	834	3.3	2.8	0.6	16.8	20.1
High middle income - I	5.6	479	9.9	8.6	2.1	22.8	30.9
High middle income - II	8.8	292	10.4	8.2	1.9	20.0	32.7
High middle income - III	9.5	209	11.8	7.8	2.3	14.2	32.2
Middle income - I	16.3	148	16.5	10.2	4.1	12.9	36.5
Middle income - II	10.2	108	20.9	13.1	6.0	10.4	40.4
Low middle income - I	22.4	77	21.5	14.6	7.0	7.3	42.1
Low middle income - II	19.3	49	24.7	14.3	7.7	5.2	42.6
Poor - I	5.2	31	29.5	14.1	7.0	4.6	46.1
Poor - II	1.8	19	30.0	13.3	6.7	3.1	44.9
Overall	100.0		20.6	12.6	5.8	9.3	39.9

Source: Sane and Thomas (2013: 61).[56]

Usury interest rates for informal credit are widespread in developing countries. Studies show average interest rates for informal credit to poor people (below the one dollar per day poverty line) in rural India of 57 percent per year.[57] Slightly less poor people (with one to two dollars income per day) pay a bit less on average as they have more access to other sources. The authors determine that the "(y)early interest rates in the 40 to 200 percent range (or even higher) are the norm, and the poor pay more than the rich."[58]

Microcredit interest rates also appear to be usurious. Why should an interest rate of 33 percent per year be anything else than exploitative?[59] The average *Annual Percentage Rate* (APR) for microcredit in India is 33 percent – while it differs substantially by the type of microfinance institution (MFI).[60] (See Figure 8.) It is noteworthy that NGOs have on average a similar APR like for-profit MFIs (both privately-owned and publicly traded). However, the minimum and maximum APR of NGOs is lower than that of their for-profit competitors. Co-operatives are the positive exception with an average APR of 25 percent. The highest APR observed at co-ops (30 percent) is lower than the average APR for all other types of microfinance institutions.

Figure 8. Indian Microfinance *Annual Percentage Rate of Charge* (APR)[61] including Interest, Fees and Insurance, by Institution Type

Type of Institution	*Minimum of APR (Interest + Fees + Insurance)*	*Maximum of APR (Interest + Fees + Insurance)*	*Average of APR (Interest + Fees + Insurance)*
Co-op	10%	30%	25%
NGO	17%	45%	34%
Other	28%	45%	35%
Privately-owned For-Profit	20%	58%	33%
Publicly traded For-Profit	25%	43%	33%
Aggregate	10%	58%	33%

Source: MFTransparency (2011: 28). Figures are rounded.

33 percent is the *lowest* average microfinance interest rate for the World´s regions.[62] These rates reflect, to an extent, the high expenses of providing microfinance. However, they are in stark contrast to the extreme costs of informal alternatives such as local moneylenders (36 to 120 percent), moneylenders from outside the local community (160 to 225 percent) or middlemen selling agricultural inputs (48 to 75 percent). (See Figure 9.) They are also in contrast to the highly subsidized costs of government schemes like *"Pavalavaddi"* by the Government of Andhra Pradesh, which reimburses interest amounts above 3 percent, paid by all SHG members as an incentive for on-time repayment of bank loans.[63]

Figure 9. Interest Rates of Different Loan Sources in Andhra Pradesh

Service Provider	*Effective Interest Rate (Per Annum)*[64]	*Terms and Conditions*
Group-Based, Semi-formal		
Self-Help Groups (SHGs) (The group needs to save for the first six months to access loans from banks.)	**3%** (*"Pavalavaddi"* scheme of the Government of Andhra Pradesh reimburses interest amount above 3% to incentivise on-time-repayment.) **12% - 24%** (For loans from group-internal savings.) **12%** (For loans taken from the federation.)	**Amount:** Rs. 5,000 to 50,000 [65] **Loan Term:** 2 to 5 years **Instalment:** Monthly **Collateral:** No
Microfinance Institutions (MFIs)	**27% - 45%** [66] (Including processing fee, mandatory insurance.)	**Amount:** Rs. 5,000 to 30,000 **Loan Term:** 50 weeks **Instalment:** Weekly **Collateral:** Group Liability. No physical collateral.
Individual, Informal, Unsecured		
Moneylenders (Weekly) (from outside community) ("Kangali bank")	**160% - 225%**	**Amount:** Rs. 2,000 to 10,000 **Loan Term:** 10 weeks **Instalment:** Weekly **Collateral Requirements:** No
Daily Finance Corporations	**78% - 120%**	**Amount:** Rs. 2,000 to 10,000 **Loan Term:** 100 days **Instalment:** Daily **Collateral:** No
Individual, Informal, Secured		
Moneylenders (Local)	**36% - 120%** (Depends on urgency, collateral & credit history of borrower.)	**Amount:** Up to Rs. 200,000 **Loan Term:** Flexible **Instalment:** Monthly for interest; bullet repayment of principal. **Collateral:** Secured & unsecured.
Middlemen	**48% - 75%** (Depends on crop cycle.)	**Amount:** Rs. 5,000 - 30,000 (also in kind, i.e. agricultural inputs) **Loan Term:** 6 to 12 months **Instalment:** Monthly for interest; bullet repayment of principal. **Collateral:** Pledge agricultural produce.
Pawnbrokers	**30% - 36%**	**Amount:** Depends on value of gold. **Loan Term:** Flexible **Instalment:** Bulleted **Collateral Requirements:** Gold
Individual, Formal, Secured		
Banks (Crop Loans)	**7% - 13%**	**Amount:** Depends on crop & land. **Loan Term:** Up to 3 years **Instalment:** Bulleted (2 months after harvest) **Collateral:** Hypothecation of crops/ additional security / 3rd party guarantee

Source: MicroSave (2011); abbreviated and edited.

This APR includes fees, interest as well as compulsory insurance and deposits.[67] Comparing interest rates by World regions shows that South Asia has the lowest average interest rates in microfinance.[68] This achievement of comparable "lower" interest rates in South Asia is not least due to the scale – with 43 million active borrowers in India and 26 million in Bangladesh.[69] South Asia also has the smallest interest rates charged for the 5 percent most expensive MFI loans (95th percentile). Their average interest rate is 44 percent – that is "inflation adjusted" but without taking into account "hidden costs" such as compulsory savings and insurances. In Latin America & the Caribbean, the equivalent rates are the highest worldwide with 73 percent. In this regional context the Mexican MFI Compartamos, the first MFI with an initial public offering (IPO), charged its infamous 100 percent annual interest rate, which includes a 15 percent value added tax.[70] Muhammad Yunus, the founder of *Grameen,* attested Compartamos of being "absolutely on the wrong track": "Their priorities are screwed up. (…) When you discuss microcredit, don't bring Compartamos into it. (…) Microcredit was created to fight the money lender, not to become the money lender."[71]

Conclusion

Financial inclusion is a central element of the international development agenda and intents to establish sustainable financial institutions to provide services like loans, savings and insurances to formerly excluded people. It requires in addition to the availability and quality of such services, the fostering of financial literacy as well as financial capability. Financial capability can be seen as the capability to convert financial literacy into action. The recent progress towards financial inclusion in India was illustrated and contrasted with its South Asian and BRICS peers. Between 2011 and 2017 the Indian government managed to increase the number of formal bank accounts from 35 percent to 80. The current Indian government managed, through its *Prime Minister's People Money Scheme* (*Pradhan Mantri Jan-Dhan Yojana*), launched in 2014, to reduce its considerable gender gap of 19 percentage points in 2011 to six percentage points in 2017. Also, India has the lowest rich-poor gap (of five percentage points) regarding account ownership among its BRICS and South Asian peers. However, that more than half of the accounts in India (57 percent) and Bangladesh (48 percent) are inactive, puts these achievements into perspective.

Definitions of microfinance are, as demonstrated in this study, often misleading, make grand, unsubstantiated claims or are wrong (e.g., asserting that microcredits are interest-free respectively having "very low" rates). The *Asian Development Bank* definition of microfinance has been modified: Microfinance refers *to financial services* beyond mere micro-credit; targets *poor* a*nd low-income households* and their enterprises; includes *(semi-)formal* institutions and hence excludes moneylender; aims at a *double bottom line* – combining profitability *w*ith positive socio-economic impact. The microfinance trinity aims at achieving financial sustainability, outreach, and positive impact. There are two competing microfinance schools of thoughts: the *welfarist or poverty-lending approach* contrasts with the *institutionists* or *financial system* approach. Proponents of the *welfarist approach* emphasize the outreach´s depth to the poor as well as the socio-economic welfare impact. *Institutionists* prioritize the sustainability of the financial institutions as well as the breadth of outreach to the poor. Key indicators for *institutionists* are portfolio size, number of clients, repayment rates and profitability. This "quest for numbers" played an essential role in the Indian microfinance crisis in 2010 (in Andhra Pradesh) and drew on *economies of scale* to attract funds from financial markets. The argument is that the demand by the not-yet-banked is enormous and that only financial markets can provide the required financing. Going beyond these schools of thought, I argued to also consider the ownership and governance structure and its impact on the aims and processes of microfinance institutions (MFIs).

Providing loans to low-income people is associated with high costs and risks. Central challenges are *"adverse selection*" and *"moral hazard*" due to information asymmetry. Group-based loan provision seems to overcome these challenges, thanks to group self-formation, joint liability as well as the conditionality of further loans on repayment behavior. Peer-monitoring and peer-pressure are, however, a double-edged tool and bear high social costs in cases of default. The usurious costs of informal credit explain why low-income households take 33 percent interest loans from microfinance institutions. While MFIs delegate some aspects of group-formation, book-keeping, monitoring, and repayment enforcement to the members of the group, nonetheless high labor costs apply when offering microfinance to low-income people. However, clients value the additional loan source provided by microfinance institutions, which is less expensive than moneylenders and often more timely, convenient and reliable than government-schemes with lower costs.

[1] See *Global Findex* by the World Bank, https://globalfindex.worldbank.org, accessed May 16, 2018.
[2] Data for all regions exclude high-income countries. See *Global Findex* (2018).
[3] The Indian *"Rangarajan" Committee on Financial Inclusion* defines financial inclusion as "the *process* of *ensuring access* to financial services and *timely* and *adequate* credit where needed by vulnerable groups such as weaker sections and low-income groups at an *affordable* cost." Report of the Committee on Financial Inclusion (2008: 1) URL: www.sidbi.in/files/Rangarajan-Commitee-report-on-Financial-Inclusion.pdf, accessed May 16, 2018.
[4] An excellent overview of financial inclusion definitions is provided by Thingalaya, N. K., Moodithaya, M. S. & Shetty, N. S. (2011: 28) Financial Inclusion and Beyond: Issues and Challenges: Academic Foundation.
[5] Aynsley, H. (2010) Financial inclusion and financial capability: What's in a name? URL: http://www.toynbeehall.org.uk/data/files/Services/Financial_Inclusion/Financial_Inlcusion_and_Capability_-_Whats_In_A_Name.pdf; accessed May 16, 2018.
[6] A good literature review on the relationship between financial exclusion and inclusion, financial literacy and policy initiatives is provided by Atkinson, A. and F. Messy (2013) Promoting Financial Inclusion through Financial Education: OECD/INFE Evidence, Policies and Practice, OECD Working Papers on Finance, Insurance and Private Pensions, No. 34, OECD Publishing.
[7] Ghate, P. (2007: 93) *Indian Microfinance: The challenges of rapid growth*. Sage Publications India.
[8] The *Seoul Development Consensus* points to nine areas in which „action and reform" is required to achieve "inclusive and sustainable economic growth and resilience," ranging from infrastructure, private investment, job creation to knowledge sharing. See *Global Partnership for Financial Inclusion* (GPFI) (2016) Seoul Development Consensus for Shared Growth, URL: www.gpfi.org/about-gpfi, accessed May 16, 2018.
[9] „Markets and payment systems" refers to remittances and innovative technologies. Remittances costs rose in 2014 as accounts at money transfer operators vanished, due to new regulations on *Anti-Money Laundering and Combatting the Financing of Terrorism*. (Global Partnership for Financial Inclusion 2016).
[10] The *Global Findex* by the World Bank includes data on 148 countries, covering 97 percent of the World´s adult. The evidence stems from around 150.000 interviews in 2011 and follow-up rounds in 2014 and 2017. URL: https://globalfindex.worldbank.org; accessed May 16, 2018.
[11] Demirgüç-Kunt, A., Klapper, L. F., Singer, D., Ansar, S., Hess, J. (2018: 2). The global findex database 2017: Measuring Financial Inclusion and the Fintech Revolution. World Bank.
[12] "In India the leakage of funds for pension payments dropped by 47 percent (2.8 percentage points) when the payments were made through biometric smart cards rather than being handed out in cash." Demirgüç-Kunt et al. (2018: 2).
[13] For an assessment of PMJDY see Agarwal, A. et al. (2017) Banking the Unbanked: What do 255 Million New Bank Accounts Reveal about Financial Access? Working Paper, URL: http://w3.bm.ust.hk/fina/2017symposium/paper/Sumit_JDY%20draft%20%20%20v17_November_12_final.pdf, accessed May 16, 2018.
[14] The Economic Times, Jan Dhan Yojna makes it to Guinness World Records, 11.5 cr Jan Dhan accounts opened, 21-Jan-2015. URL: //economictimes.indiatimes.com/articleshow/45955376.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst; accessed May 16, 2018.
[15] *The Global Findex* definition of financial institutions includes microfinance institutions, cooperatives, and credit unions. Demirguc-Kunt, A., Klapper, L., Singer, D., Van Oudheusden, P. (2015: 4) The Global Findex Database 2014 Measuring Financial Inclusion around the World, Policy Research Working Paper 7255, World Bank.
[16] Chowdhury, S. S., and Chowdhury, S. A. (2011). Microfinance and women empowerment: A panel data analysis using evidence from rural Bangladesh. *International Journal of Economics and Finance*, 3(5), 86.
[17] The Consultative Group to Assist the Poor (CGAP) lamented about the gender gap in digital finance in Bangladesh in 2015. URL: http://www.cgap.org/blog/digital-finance-bangladesh-where-are-all-women, accessed May 16, 2018.
[18] A similar picture emerges when asking individuals about deposits in the last year: India (42 percent), Bangladesh (51 percent), Pakistan (56 percent), South Africa (both 66 percent), Brazil (68 percent), China (71 percent), Russia (79 percent) – in contrast to USA (95 percent).
[19] Ibid.

[20] Demirgüç-Kunt et al. (2018: 11, 35, 36).
[21] Demirgüç-Kunt et al. (2018: 11, 35, 36).
[22] The World Bank´s Legal Right Index rates the strength of countries´ justice system. The Legal Right Index has a spectrum from "weak" (0) to "strong" (12). India and the Russian Federation reach the highest valuation amongst the BRICS (both 8); followed by South Africa (5), China (4) and Brazil (2) and contrasting to Bangladesh (5), Pakistan (2) and the United States (11).
[23] Chowdhury, P. R (2012: 149) Microfinance: The SHG-Linkage Program, in Ghate, C. (ed.): The Oxford Handbook of the Indian Economy, p. 149–166, Oxford University Press.
[24] Quoted in *The Economic Times* (23-Nov-2010) Microfinance in India is like subprime lending: Y V Reddy. URL: https://economictimes.indiatimes.com/news/economy/indicators/microfinance-in-india-is-like-subprime-lending-y-v-reddy/articleshow/6972903.cms, accessed May 16, 2018.
[25] Karim, L. (2011) Microfinance and its discontents: Women in debt in Bangladesh. University of Minnesota Press.
[26] Ibid, xxxi.
[27] Castree, N., Kitchen, R. & Rogers, A. (2013) *A Dictionary of Human Geography*, Oxford University Press.
[28] NBFCs are the most popular legal form for Indian MFIs.
[29] Last, J. M. (2007) A Dictionary of Public Health, Oxford University Press.
[30] Mayhew, S. (2009) *A Dictionary of Geography.* 4th ed., Oxford University Press.
[31] Asian Development Bank (ADB) (2000: 2) Finance for the Poor: Microfinance Development Strategy, URL: www.adb.org/sites/default/files/institutional-document/32094/financepolicy.pdf, accessed May 16, 2018.
[32] Microfinance´s impact on women´s empowerment is tough to measure. Numerous qualitative studies suggest that women are perceived differently in their households and communities due to their participation in microfinance groups. A common operationalization is to focus on household and community decision-making capacity and control over resources. The *Women´s Empowerment in Agriculture Index* (WEAI) operationalizes empowerment using the dimensions production, resources, income, leadership and time allocation. See Alkire, S., Meinzen-Dick, R., Peterman, A., Quisumbing, A., Seymour, G., & Vaz, A. (2013). The women's empowerment in agriculture index. *World Development*, 52, 71-91.
Kabeer (2005: 4709) concludes that the evidence is highly contingent on "context, commitment and capacity." See Kabeer, N. (2005). Is microfinance a "magic bullet" for women's empowerment? Analysis of findings from South Asia. *Economic and Political weekly*, 4709-4718.
For further discussions and literature see Armendáriz, B., & Morduch, J. (2010). The economics of microfinance. MIT press.
[33] Zeller, M. and Meyer, R. L. (Eds.) (2002: 3) *The Triangle of Microfinance: Financial Sustainability, Outreach, and Impact,* International Food Policy Research Institute.
[34] Zeller and Meyer (2002: 3-4).
[35] Zeller and Meyer (2002: 7).
[36] See Rhyne, E. and Otero, M. (1994) The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor, Kumarian Press. & Robinson, M. (2001). The microfinance revolution: Sustainable finance for the poor. World Bank Publications.
[37] Woller, G., Dunford, C. and Woodworth, W. (1999) Where to Microfinance? *International Journal of Economic Development* 1(1).
[38] Woller, Dunford, and Woodworth (1999).
[39] FINCA provides microfinance through a "village banking" approach. At least 35 women form a group and collect initial savings in weekly meetings. FINCA contributes training regarding its methodology, group dynamics, and basics of entrepreneurship. The group members elect a *Village Bank Board of Director*s. FINCA trains Directors to manage credits, including application screening, approval, disbursement, supervision, recovery, and book-keeping. FINCA project promoters supervise the meetings, and commercial banks provide savings accounts. See Chirwa, E. W. (1999: 8) Management and Delivery of Financial Services for the Poor: FINCA´s Village Bank Approach in Malawi. Savings and Development 23(1), 5–28.
[40] Woller, Dunford, and Woodworth (1999: 3).
[41] Ibid.
[42] See Zeller and Meyer (2003: 4) & Stiglitz, Joseph E. & Weiss, Andrew (1981) Credit Rationing in Markets with Imperfect Information. The American Economic Review 71(3), 393–410.

[43] Coleman, B. E. (1999: 107) The Impact of Group Lending in Northeast Thailand. *Journal of Development Economics* 60(1), 105–141.
[44] Stiglitz, J. E. (1990: 353, 362) Peer Monitoring and Credit Markets. *The World Bank Economic Review* 4(3), 351–366.
[45] Stiglitz (1990: 361, 362).
[46] Ghatak, M. & Guinnane, T. W. (1999: 225) The economics of lending with joint liability: theory and practice. *Journal of Development Economics* 60(1), 195–228.
[47] Ibid.
[48] Besley, T. and Coate, S. (1995: 16) Group lending, repayment incentives, and social collateral. *Journal of Development Economics* 46(1), 1–18.
[49] Besley and Coate (1995: 16).
[50] Ibid.
[51] Roodman (2013) points to the disapproval of this management structure: it "appears that the Board was ineffectual and that Muhammad Yunus ran the bank with a free hand. The highly touted female borrowers who constitute the board's majority could not be expected to understand the octopus-like complexity of the Grameen family of companies, assuming they were apprised of it. And they certainly could not be expected to perform appropriate oversight." See Roodman, D. (2013) Much Grameen Bank Investigation, Signifying What? URL: http://international.cgdev.org/blog/much-grameen-bank-investigation-signifying-what, accessed May 16, 2018.
[52] *The New York Times* (1988) Micro-loans to the World's Poorest, by Farnsworth, C. H., 21-Feb-1988, URL: www.nytimes.com/1988/02/21/business/micro-loans-to-the-world-s-poorest.html?src=pm&pagewanted=3&pagewanted=print, accessed May 16, 2018.
[53] Rutherford, S. (2006: 13) Grameen II: The first five years 2001-2005: A "grounded view" of Grameen's new initiative, URL: www.cgdev.org/doc/blog/Rutherford,%20Grameen%20II--The%20First%20Five%20Years,%202001-2005.pdf, accessed May 16, 2018.
[54] Rutherford (2006: 17).
[55] The data from the CMIE (Centre for Monitoring Indian Economy) refer to the year before the most severe microfinance crisis to date – in 2010 in Andhra Pradesh.
[56] Sane, R. & Thomas, S. (2013) Regulating Microfinance Institutions. *Economic and Political Weekly* (EPW) xlviii (5).
[57] Banerjee, A. and Duflo, E. (2011: 160) Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty, New York: Public Affairs.
[58] Ibid.
[59] An interest rate of 33 percent per year sounds absurdly high for many people from OECD countries. The average *annual percentage rate* (APR) for a credit card in the United States was 15 percent. See Dilworth, K. (2-Jan-2013) Rates begin 2013 at 14.96 percent. URL: www.creditcards.com/credit-card-news/interest-rate-report-010213-unchanged-2121.php, accessed May 16, 2018.
However, the 10 million low-income clients of payday loans in the USA were charged 25 percent for a two-week loan in 2009, amounting to a 650 percent APR. See Carter, S. P. (2012) Payday Loan, and Pawnshop Usage: The Impact of Allowing Payday Loan Rollovers.
URL: https://my.vanderbilt.edu/susancarter/files/2011/07/Carter_Susan_JMP_website2.pdf, accessed May 16, 2018.
[60] These most recent available data refer to the year 2010. See MFTransparency (2011) *Pricing Data Report. Transparent Pricing Initiative in India*, URL: www.mftransparency.org/wp-content/uploads/2012/05/MFT-RPT-201-EN-India-Pricing-Data-Report-2011-01.pdf, accessed May 16, 2018.
[61] The *Annual Percentage Rate* (APR) does *not* take into account the effect of *compounding*; it is the standard in some countries like the USA. The *Effective Interest Rate* (EIR) (per annum) is the annualized interest rate *including compounding*; it is the standard in the European Union; depending on countries' legislations it can include *fees.* "It is important to understand that both approaches agree on the figure for the price for a shorter period, such as a month. However, when annualizing that monthly figure, the compounding effect results in a larger annual figure than the nominal approach. Compounding results in a slightly larger figure for low-interest rates, but as the monthly rate grows, the difference between the annualized APR and the annualized EIR become much larger. For example, a monthly rate of 4% results in an APR of 48%, but an EIR of 60%." MFTransparency (2013) FAQs, URL: www.mftransparency.org/faqs; accessed May 16, 2018.

[62] Roodman (2012: 185) calculations of *inflation-adjusted* MFI interest rates *without* "hidden costs" (such as compulsory insurance and deposits) show the following median for 2009: South Asia (15 percent), Eastern Europe & Central Asia (23 percent), Sub-Saharan Africa (24 percent), Latin America & Caribbean (28 percent), East Asia & Pacific (29 percent), Middle East & North Africa (32 percent). The 95th percentile ranges from 44 percent in South Asia and the Middle East & North Africa to 67 percent in Sub-Saharan Africa and 73 percent in Latin America & Caribbean. See Roodman, D. M. (2012) Due diligence: An impertinent inquiry into microfinance. Washington, D.C: Center for Global Development.

[63] Ibid.

[64] See endnote 64.

[65] Average loan amount *per SHG* under bank-linkage: First Loan 50,000 rupees; Second Loan 100,000 rupees; Third Loan 150,000 to 200,000 rupees; Fourth Loan, 250,000 to 500,000 rupees.

[66] The so-called "flat" interest rate is 12.5 percent - 15 percent p.a. Such "flat" interest rates are common in Indian microfinance and calculate the interest for each period based "on the original amount of the loan, rather than the current balance." (MFTransparency 2011: 9)

[67] See MF-Transparency (2011: 28). *MF-Transparency* recommends including *all mandatory* aspects of microfinance costs such as forced savings and insurance.

[68] Eastern Europe & Central Asia and Sub-Saharan Africa follow, with a distance. The Middle East & North Africa have the highest microfinance interest rate; followed by East Asia & the Pacific as well as Latin America & the Caribbean. (Roodman 2012: 184-185)

[69] South Asia (74.8 million) is followed by Latin America & the Caribbean (24.9 million), East Asia & the Pacific (19.9 million), Eastern Europe and Central Asia (3.7 million), Africa (6.3 million), Middle East and North Africa (2.4 million). See *MixMarket,* www.mixmarket.org, accessed May 16, 2018.

[70] Rosenberg, R. (2007: 5) CGAP Reflections on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profits, www.cgap.org/sites/default/files/CGAP-Focus-Note-CGAP-Reflections-on-the-Compartamos-Initial-Public-Offering-A-Case-Study-on-Microfinance-Interest-Rates-and-Profits-Jun-2007.pdf, accessed May 16, 2018.

[71] Businessweek (13-Dec-2007) Yunus Blasts Compartamos, URL: www.businessweek.com/stories/2007-12-12/online-extra-yunus-blasts-compartamos, accessed May 16, 2018.