



DEVELOPMENT PAPERS NO. 27

Microfinance for Poverty Reduction: Building Inclusive Financial Sectors in Asia and the Pacific

*Microfinance for Poverty
Reduction: Building
Inclusive Financial Sectors
in Asia and the Pacific*



United Nations
ESCAP

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PREFACE

The present volume of the *Development Papers* series addresses the subject of the microfinance for poverty reduction: building inclusive financial sectors in Asia and the Pacific.

The General Assembly designated 2005 as the International Year of Microcredit to highlight and promote the recognition to the role of microfinance in the eradication of poverty, its contribution to social development. In particular, "building inclusive financial sectors" is a major theme of the Year.

The region holds two thirds of the world's poor. Varieties of microcredit schemes have been experimented within the past few decades with specific focus on poverty reduction. The region has also seen the development of microfinance institutions (MFIs) which offer a wide variety of financial services for the poor. While the contribution of microfinance to the improvement of the life of the poor has been widely reported, the overwhelming portion of the poor is still in need of access to microfinance. Funds available for subsidized microfinance schemes are also limited. Expansion of access to microfinance to a larger population of the poor relies to a large extent on further development and up-scaling of these microfinance programmes. Thus, the question arises as to how the microfinance institutions should develop to enhance their outreach and positive impact on the poor. One option is to link the microfinance sector with the formal financial sector.

In the spirit of commemorating the International Year of Microcredit, this volume attempts to discuss the issues associated with integrating microfinance programmes for poverty reduction into formal financial sector.

The present volume has been based on a paper prepared by Mr. C. Upendranadh, who has a long experience in microcredit programmes. He is currently working with Aide et Action in India.

Ravi Ratnayake
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CONTENTS

Page

Preface	iii
Contents	iv
Abbreviations	v
 I. INTRODUCTION	 1
A. Microfinance and its potential for poverty reduction	2
B. Microfinance into the mainstream financial sector - the need for integration	4
 II. DEVELOPMENT OF THE INCLUSIVE FINANCIAL SECTOR	
APPROACH	7
A. Shift of approach in microfinance	7
B. Comparison of different approaches	10
C. Issues confronting the microfinance sector in Asia and the Pacific. . .	15
 III. BUILDING INCLUSIVE FINANCIAL SECTORS FOR POVERTY	
REDUCTION	18
A. Defining the contours of microfinance schemes in the inclusive financial sector approach	18
B. Advantages and disadvantages of building inclusive financial sectors	22
C. Impacts in the Asia-Pacific context	28
 IV. APPROPRIATE MICROFINANCE APPROACH FOR POVERTY	
REDUCTION	31
 V. CONCLUSIONS: THE WAY FORWARD	 38
 References	 44

Tables

Table 1: Growth of microfinance in some Asian and Pacific Countries - some estimates (2002-2003)	4
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ABBREVIATIONS

ASA	Association for Social Action
BASIX	New generation microfinance institution in India
BRI	Bank Rakayat Indonesia
BRAC	Bangladesh Rural Advancement committee (local NGO)
FDI	Foreign direct investment
ICICI Bank	Industrial Credit and Investment Corporation of India Bank
IFC	International Finance Corporation
IMEC	Impact monitoring
INGO	International Non-government Organization
MDG	Millennium Development Goals
MFB	Microfinance Bank
MFI	Microfinance Institution
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Financial Company
NGO	Non-governmental Organization
PKSF	Palli Karma Sahayak Foundation
PROSHIKA	A National NGO in Bangladesh, the name ' <i>PROSHIKA</i> ' is an acronym of three Bangla words, which stand for training, education, and action
RBI	Reserve Bank of India
RRB	Regional Rural Bank
SFMC	SIDBI Foundation for Microcredit
SHG	Self-help group
SHPI	Self-help Promoting Institution
SIDBI	Small Industries Development Bank of India
UNCDF	United Nations Capital Development Fund

MICROFINANCE FOR POVERTY REDUCTION: BUILDING INCLUSIVE FINANCIAL SECTORS IN ASIA AND THE PACIFIC*

I. INTRODUCTION

Microfinance¹ is the fastest growing segment of rural financial intermediation in the Asia-Pacific region. Spearheaded by non-governmental organizations (NGOs), microfinance is gaining a significant place in the national development plans of the region in the form of innovative field projects and programmes aimed at poverty reduction. For several decades, countries in Asia, which peopled approximately a third of the world's poor, were witness to targeted and subsidy-linked credit schemes as part of anti-poverty interventions. Such interventions have had a mixed impact on poverty. While some analysts argue that the government's anti-poverty schemes/projects have created conditions for poor people to participate in the local economy, others argue that these have adversely affected the credit discipline and created a dependency culture. A growing emphasis of microfinance practice is placed on the sustainability of its approach and the potential to integrate with the mainstream financial sector. In the discussion on microfinance development, 'inclusive financial sector development,' implies the identification of ways and means of enabling universal access to a complete range of financial services and the integration of the poorer segments of populations into the financial systems and markets. This aspect has been identified as one of the key challenges of accelerating poverty reduction. This sectoral approach is intrinsically linked to the possible future trajectories of the

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