

DEVELOPMENT PAPERS NO. 27

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



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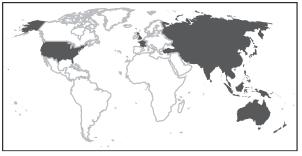
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PREFACE

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
Director
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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 'PROSHIKA' 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 FINANCIALSECTORS 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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