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Consumer Protection Regulation: Microfinance Needs and Initiatives in India

- Kenny Kline* and Santadarshan Sadhu**

Abstract

Lack of consumer protection regulation for the Indian microfinance sector led to a repayment crisis in Andhra Pradesh in late 2010. The paper examines the salient consumer protection that led to the crisis, and also as how the 2011 RBI regulation addresses these issues. The paper also highlights a survey of microfinance institutions, gauging their response to the 2011 RBI regulation. The paper also includes an analysis of consumer protection components of the Micro Finance Institutions (Development and Regulation) Bill 2011, industry associations, regulation used around the world to achieve successful consumer protection policies in the microfinance sector.

Microfinance institutions (MFIs) in India expanded rapidly over the last decade, fueled by capital injection and widespread support that institutions were making a positive impact on the lives of the poor.

Introduction

Microfinance institutions (MFIs) in India expanded rapidly over the last decade, fueled by capital injection and widespread support that institutions were making a positive impact on the lives of the poor. Though MFIs increased in both size and number, the regulation and oversight of these institutions did not keep pace with the industry. During this phenomenal growth phase, Institutions were subject to minimal regulation, particularly with respect to consumer protection.

Larger for-profit MFIs classified as NBFCs were subject to a few prudential regulations, such as capital adequacy ratio standards and minimum capital requirements. Other non-

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profit institutions, such as NGO-MFIs, Cooperatives, and Section 25 faced almost no regulation other than local or state registration. The Reserve Bank of India (RBI) was responsible for the oversight of NBFCs; however there was no clear authority for institutions of other legal forms.

The for-profit NBFC model for delivering financial services account for over 80% of all lending by portfolio size, and were rapidly expanding. Institutions had proved that they could offer financial services, primarily credit, to poor customers and be profitable. The model thus attracted many investors, attracted by profit and social intentions. Private equity funds, international investment groups, development agencies, private donors, and banks flooded the market with capital. Though microfinance institutions operated as NBFCs still held serving the poor and addressing poverty issues as their primary mission, the shareholder structure now held these institutions to achieving profits and sustainable growth as well. As institutions expanded rapidly, many self-admittedly did not address issues like hiring, loan officer training, and customer feedback and interaction adequately.

As a result, clients in Andhra Pradesh stopped repaying microfinance loans to protest the policies and procedures of microfinance institutions. Media focused a few cases of suicides by individuals who were apparently MFI clients, and quickly, customers and politicians claimed that coercive collection practice had lead to the suicide of a number of clients over the last year. Customers also cited high interest rates and predatory lending leading to customer over indebtedness as source for their discontent.

The government of Andhra Pradesh passed the Microfinance Ordinance 2010 in October to respond to these issues. The ordinance restricts microfinance institutions by prohibiting collecting on existing loans and originating new loans until the institution registers with the district authorities where they operate. The ordinance also mandates an interest rate cap, restricts collection practices, and entrusts a great deal of discretionary power to district authorities. The repayment crisis and the state-level ordinance brought a great deal of uncertainty to the national microfinance sector, thus banks and investor quickly stopped the flow of funds to microfinance institutions, putting the solvency of these institutions at risk.

The repayment crisis and the response of the government of Andhra Pradesh brought to light the fact that current regulation did not adequately address consumer protection issues. Many customers felt that they were being abused, and there was no recourse for the customer to complain or hold microfinance institutions accountable to fair practices. In January 2011 the Malegam Committee, a committee appointed by RBI, released a comprehensive set of recommendations for the sector to address all of the regulatory shortcomings. In May 2011 RBI "broadly accepted" their recommendations, and enacted specific regulation relating to priority sector lending. Later in the summer of 2011, a draft of the Micro Financial Institutions (Development and Regulation) Bill 2011 was released that further addressed regulation issues facing the microfinance sector.

In this paper, we will identify and discuss major consumer protection issues in India prior to the crisis. We look at the existing client protection guidelines and code of conducts that are voluntary in nature and efficacy of such voluntary guidelines. We will then detail how RBI has addressed these issues so far, and gauge the effectiveness of these solutions through a survey of microfinance institutions across India. Our analysis will also cover the consumer protection issues addressed in the Micro Financial Institutions (Development and Regulation Bill 2011. We will then examine global best practices which address similar issues in microfinance sectors in other countries and will conclude with recommendation for addressing the client protection issues.

Consumer Protection Issues

Consumer protection issues in microfinance are being discussed around the world, driven by public concern over high interest rates, coercive collection practices, and irresponsible lending leading to customer over-indebtedness. These debates discuss how intrusive regulation should be when protecting a consumer. One side of the debate suggests that poor borrowers are often financially illiterate and unfamiliar with formal lending practices, and thus need additional protection compared to the formal financial sector. Others think that poor customers should have the right to manage their finances as they see fit, and should not be subject to restrictions such as indebtedness limits.

In this section, we will discuss the major consumer protection issues that lead to the crisis in Andhra Pradesh, including collection practices, over-indebtedness, and high interest rates.

Collection Practices

Collection practices refer to the method by which a microfinance institution collects loan payments from customers. In microfinance, collections predominantly take place in decentralised locations where the loan officers commonly go to a client's workplace or home for collection of periodic installment dues. This method of collection can be more convenient for a customer, since the door-step collection process reduces his opportunity cost for the loan. However, collection at these places can be abused, since the loan officer has significant access to the client's personal life and work environment.

Loan officers all over the world have utilised collection tactics that bring great shame to a client, both in his home and community. Loan officers have also engaged in bullying and physical violence in order to pay loans. Institutions may send individuals to intimidate customers into paying loans through physical threats on the customer or his family in many instances when clients fail to pay their dues. These collection tactics are inappropriate coming from a formal financial institution, and could have

consequences that leave the customer in a worse place than before he took the loan and could have severe personal and social consequences.

In the recent past, many news articles and media reports pointed out at instances of abusive collection practices adopted by the loan officers of certain MFIs in India, especially, in the state of Andhra Pradesh which has the highest microfinance penetration in India. These media coverage had a great deal of impact among the state policy makers and clients in Andhra Pradesh across the country, and resulted in serious round of discussion regarding prevention of abusive collection and recovery practices followed by some officials of the MFIs.

Regulation can include measures to protect customers from inappropriate collection tactics. This regulation can identify specific appropriate or inappropriate collection methods, dictate specifics of collection such as location or timing, or set a system in place that allows customers to identify incidents of inappropriate behavior by loan officers in order to curb these incidences.

Over-Indebtedness

Like any other individuals accepting credit, microfinance clients may elect to be responsible for more credit than they can repay. However, since microfinance is often considered a service aiming to benefit the poor, many policy makers think that institutions and regulation has additional responsibility to ensure that these poor customers do not become over-indebted as a result of easily attainable financing. Arguments also cite that microfinance customers often have less experience dealing with financial institutions and lower levels of financial literacy, and thus require additional protection from over-indebtedness.

Over the past couple of years, the MFIs in India grown rapidly and some of the large commercial MFIs often achieved a very fast growth over a short time period. As a consequence, due to competition and high growth targets, some of the MFIs did not act as responsible lenders and that resulted in over-lending by the MFIs where proper due diligence was not followed while extending the loans to the clients. Frequently, repayment capacity of the borrowers was not taken into account by the loan officers and as a result, multiple MFI loans became widely known phenomena in the highly penetrated areas. This process of irresponsible lending strategies might have fueled client over-indebtedness, and as a consequence, many clients fell into a debt trap as claimed by many stakeholders.

The regulators in India did not put a limit on total indebtedness until recently, when the new RBI regulation in India imposed a total indebtedness limit for microfinance clients.

Opposing arguments suggest that the poor should be able to manage their financial state just like customers in the mainstream financial sector, and thus regulation should not directly impose indebtedness restrictions since it could severely limit their choice.

One option for regulation is to address indebtedness levels directly, as has been done in India. However, this may be difficult to enforce for microfinance clients, where independent indebtedness information is often not available. Regulation may also address regulation over-indebtedness through the creation of credit bureaus or mandating the credit bureau information submission requirements for institutions. Other initiatives to prevent customer over-indebtedness, like financial literacy training, often fall outside of the scope of regulation.

High Interest Rates

Interest rates charged by MFIs are typically much higher than those charged by mainstream commercial lenders, due to the method of credit delivery and the size of loans. The Indian MFIs, in general, charge around 27% interest rate which is much lower as compared to the rates charged by the moneylenders- typically the alternative source of finance for a large majority of the poor population. Regulation can address high interest rates by restricting the interest rate that institutions can charge microfinance clients. This is effective for reducing charges for microfinance clients, but may have unintended negative effects, which will be discussed in the global best practice section.

Enforcement

The greatest challenge with consumer protection issues is enforcement. Though agreement around principles of consumer protection can be agreed upon, such as avoiding consumer over-indebtedness, enforcing related regulation can be a much more difficult issue. Enforcing consumer protection regulation in the Indian microfinance sector, which spans a large number of clients and geographic area, is especially difficult. The two general methods of enforcement are industry self- regulation and government agency enforcement.

Industry self-regulation is implemented through associations where members agree to adhere to a code of conduct, which details lending best practices, training programs, and review procedures. There are a number of self- regulation associations, such as the Microfinance Institution Network (MFIN) or Sa-dhan. Self-regulation often better reflects the views of microfinance institutions, thus supporting growth and expansion of microfinance services. However, the consequences of not adhering to an association's code of conduct are not that severe, and institutions are barely monitored. In India, expulsion from an industry association occurs on extremely rare occasions, if ever. Additionally, if an institution is expelled from an association, then that association no longer has any authority over the institution.

Government agency enforcement is enacted through state and central legislation. This legislation is often rigid, and has trended towards conservative practices in India in the most recent regulation. Regulation of this kind often applies to all institutions,

and can be very costly and difficult to enforce. Regulators may need to form groups to monitor institutions through financial review and regular site visits.

Each approach has advantages and disadvantages, though regulation to address consumer protection issues seems as though it will be enforced primarily through the government lead regulation. Industry associations will continue to exist, both to improve the operations of institutions, and to bind institutions together for expressing their views on government agency enforcement.

In the next section, we will detail how RBI has addressed some of these issues in its most recent regulation, released in May 2011.

RBI Norms for Priority Sector Lending

Priority sector lending is a government led initiative which requires Indian banks to lend approximately 40% of their total portfolio to priority sectors. Microfinance is designated as a priority sector, and thus banks are incented to lend to institutions offering microfinance services. Historically, although microfinance has attracted approximately only 0.5% of all priority sector funds, commercial banks are the largest sources of finance for MFIs.

Given the importance of the priority sector funds for the survival of the MFIs India, the RBI has strategically chosen to utilize their control over the priority sector funds as a measure to address some consumer protection issues through its most recent priority sector lending qualification circular. This regulation outlines the portfolio requirements a microfinance institution must meet in order to qualify for priority sector lending. This circular was sent to the banks, which offer priority sector funds. Thus, the banks are responsible for enforcing the regulation by ensuring that the microfinance institutions that they lend to meet these requirements in order to be able claim the loans given to the MFIs as priority sector lending. The regulation first creates a new legal category, NBFC-MFI, which is eligible for priority sector funds by meeting requirements. Thus, institutions have the option of not receiving priority sector funds, and not adhering to the regulation.

The requirements state that 75% of a microfinance institution's portfolio must meet a set of requirements. The requirements which relate to consumer protection issues are as follows:

- Maximum loan size of Rs.35,000 (first cycle) and Rs.50,000 (subsequent cycles)
- Maximum borrower total indebtedness of Rs. 50,000
- Minimum tenure of 24 months when loan exceeds Rs.15,000
- No prepayment penalties
- No collateral

An NBFC-MFI must also adhere to the following pricing requirements:

- Margin cap of 12%

- Interest rate cap of 26%
- Only three pricing components
  - o Interest rate
  - o Processing fee (maximum 1%)
  - o Insurance premium
- No penalty for delayed payment
- No security deposit or margin can be taken
- 75% of loan must be for income generating purposes

The RBI regulation addresses over-indebtedness and pricing issues. Over-indebtedness is addressed by restricting loan size, tenure limits, and by restricting customer indebtedness directly. The regulation also addresses customer indebtedness restricting penalties and collateral, so that a customer will not be required to pay more than the initial agreement, or be forced to turn over property. All of these requirements are enforceable by monitoring institutions, with the exception of the direct customer indebtedness limit. MFIs can currently only attain customer indebtedness information by self-reporting from the customer. Credit bureau licenses for microfinance in India have been issued over the last several years, and these bureaus are working to scale their coverage and functionality.

The current regulation restricts a customer from becoming over-indebted from a single institution; however, a customer can easily become over-indebted by borrowing from other microfinance institutions or sources. The regulation might incent the customer to misrepresent his indebtedness level to qualify for credit.

The 75% of loans for income generating purposes also indirectly address over-indebtedness. The regulation presumes that a borrower taking out a loan to invest in a business venture or small enterprise will having greater opportunity to earn income and be able to repay the loan. This regulation aims to deter borrowing for consumption purposes, where an individual borrows money for non-income generating activities, such as household purchases, healthcare, or dowry. Again, it will be difficult, if not impossible, for institutions to ensure the use of the loan, since the loan use will be self-reported by the borrower.

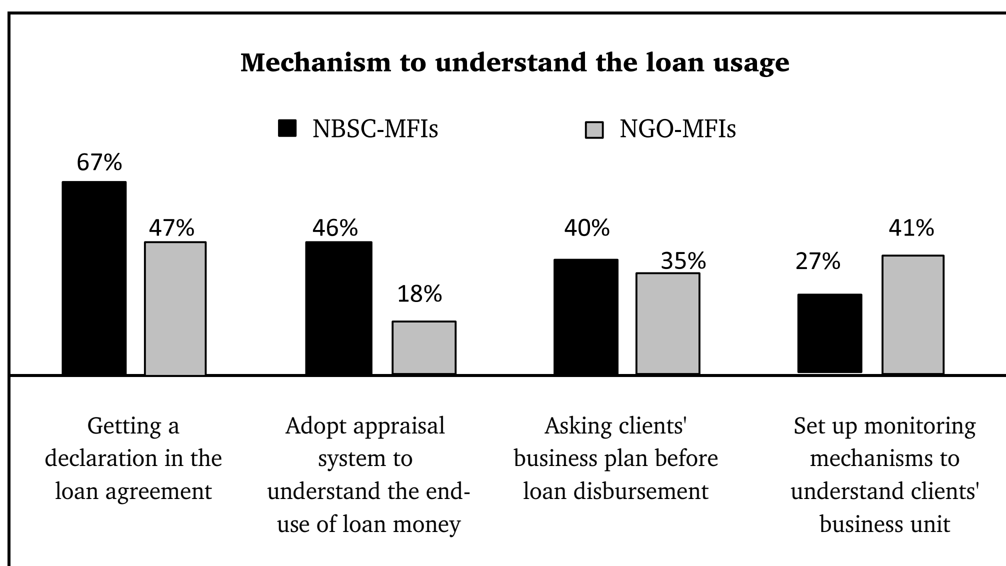
Pricing restrictions are directly applied through a margin and interest rate cap. These caps will be manageable to enforce since enforcement occurs at the institution level. With the interest rate restriction, the RBI has limited other types of charges, and prohibited other forms of charges through penalties or security deposits. This ensures that an institution does not circumvent the margin and interest caps by adding on extra charges in other forms.

Though most of the consumer protection regulation may be enforced, the restrictions may not be the most effective way to ensure consumer protection, particularly if expanding outreach is a priority. In the next section, we will analyse microfinance response to the regulation in regards to consumer protection issues.

Microfinance Institution's Response to RBI Regulation

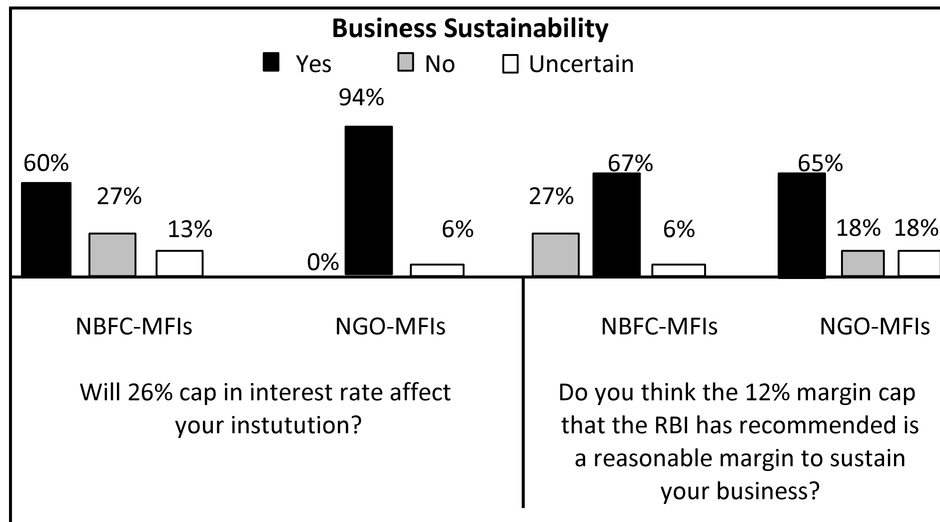
In the summer of 2011, the Centre for Microfinance performed a study in conjunction with Microfinance Researchers Alliance Program (MRAP) professors to interview microfinance institutions to gauge their response to the new RBI regulation relating to priority sector lending. The study included interviews with 32 microfinance institutions across India, representing NBFCs, Societies, Cooperatives, Trusts, and Section 25s. In this section, we will analyse the microfinance institution responses which relate to customer protection issues.

One section asked how microfinance institutions would ensure that a customer is using a loan for income-generating purposes. The institution could choose from getting a declaration in the loan agreement, adopt appraisal system to understand the end-use of loan money, asking clients' business plan before loan disbursement, or setting up monitoring mechanisms to understand clients' business unit. The graph below shows the results:



The most common answer for both NBFC-MFIs and NGO-MFIs was that they would get a declaration in the loan agreement, which obviously is purely self reported by the customer.

The survey also asked the institutions about how their business would be affected by the margin and interest rate caps. Many of the institutions expressed concern over sustainability of services, particularly for smaller institutions which do not benefit from economies of scale and alternative funding opportunities. The graph below details all the institution responses:



Since the RBI regulation currently only applies to NBFC-MFIs, it makes sense that 60% of NBFC-MFIs think the interest rate cap will affect the institution, while no NGO-MFIs think they will be affected. NBFC-MFIs may need to stop serving rural or harder to reach areas, and may need to target slightly more affluent customers, rather than serving the poorest of the poor. The second question indicates that a large number of NGO-MFIs would be affected if the margin cap was extended to cover all legal forms.

Though institutions were doubtful about the consumer protection aspects of the regulation, in general they thought that the RBI regulation was good for the sector, and a necessary step towards attaining bank funding.

Micro Financial Institutions (Development and Regulation) Bill 2011

A draft of the Micro Financial Institutions (Development and Regulation) Bill 2011 was released in June 2011, which outlines several new policies that could be put into action. The bill primarily aims to create a comprehensive regulatory framework which would encompass all institutions that provide microfinance services. RBI is designated as the overall regulator for the sector, and RBI's scope and entrusted power is designated in the document. The bill addresses consumer protection in two important ways that are new to regulation of the sector; the power for RBI to force submission of customer information to a credit information service, and a consumer redressal procedure.

The bill briefly mentions the mandatory submission of customer information to credit information service providers by microfinance institutions. The bill does not directly require the submission of information to credit bureaus, but rather gives RBI the power to require microfinance institutions to submit information.

Chapter VII of the bill discusses the consumer redressal procedure. The bill states that RBI, in conjunction with the Micro Finance Development Council and the State Councils, may appoint ombudsmen to facilitate the redressal of grievances between clients of microfinance institutions and microfinance institutions. The chapter further states that RBI will have complete power over the redressal proceedings, including the nature of grievances that can be addressed, and how ombudsmen will conduct themselves and deal with the complaints.

The fact that these two points are included in the bill is positive for the regulatory environment of the sector. However, simply providing RBI the power to address these two points does not ensure that RBI will utilise this power, or if they will execute policies that result in meaningful change for the sector.

Industry Association Codes of Conduct

Consumer protection is also addressed through industry association codes of conduct. Industry associations are a collection of microfinance institutions and microfinance related companies which outline best practices and policies for the sector. The two primary industry associations in India are Sa-dhan and the Microfinance Institutions Network (MFIN). Each of these associations has a code of conduct which every institution belonging to the association agrees to follow. Joining an industry association is voluntary for microfinance institutions, and the enforcement of the code of conduct is primarily through institutions self-regulation.

These codes of conduct outline the spirit of consumer protection for microfinance institutions, however procedures and appropriate practices are not addressed in detail. The MFIN code of conduct is only five pages long, covering the broad areas of fair practices with borrowers, multiple lending and lending limits, data and incident sharing, recruitment, whistle blowing, enforcement mechanism, ombudsmen person mechanism, and amendments to the code of conduct. The Sa-Dhan code of conduct is eight pages long, covering even broader categories such as integrity, transparency, and fair practices.

Industry associations are extremely helpful for sharing best practices with other industry players, addressing policy makers, and discussing pressing issues in the microfinance sector. However, since the associations are self-regulation, if an institution conducts inappropriate practices, the only measure the association can take is to expel the institution from the association. Thus, these associations are not adequate for enforcing consumer protection principles in the microfinance sector.

In the next section, we will examine how microfinance regulation and legislation has addressed the issues faced in the Indian microfinance sector.

Global Best Practice

Successful consumer protection regulation bridges the information gap between

institutions and consumers. Regulation must protect consumers and allow for expansion of microfinance services, while not imposing excessive costs. In our review of global best practices, we will emphasize redressal procedures and consumer education.

Redressal Procedure

The most impactful and comprehensive consumer protection measure is to give consumers a method for complaint and redressal. When consumers are given a voice, no matter what the problem or issue, regulators and institutions will become aware and have an opportunity to address the issue before it escalates to a crisis. For a redressal procedure to work, regulators and institutions must adequately address the complaints of consumers. If complaints are made, but not addressed, then consumers will quickly lose faith in the redressal system.

Peru is an example of a country that has implemented a successful consumer protection policy. In Peru, the financial regulatory authority puts policies and procedures in place regarding how institutions receive, manage, and resolve consumer complaints. In 2008, approximately 99% of 400,000 consumer complaints were handled by this financial regulatory authority. Consumers may also take their complaints to the courts, the banking association's financial ombudsman, or a consumer protection agency. Peru combines these opportunities with adequate supervision and financial literacy campaigns and projects. Off-site supervision of institutions assures that relevant and adequate information is disclosed. As a result of these policies, consumer complaints dropped by 32% since 2004.

Malaysia also focuses heavily on consumer education and response to consumer complaints. Financial information is disseminated to schools, community groups, and through various media sources to develop financial literacy. Financial institutions are required to have a complaints unit, with services targeting youth, involvement of the financial industry, credit counseling, and debt resolution. The central bank also receives complaints and offers advice.

Currently in India, the CPA has specified a redressal mechanism where quasi-judicial bodies can hear and resolve disputes at the national level, state level, and even district level. One option is to expand this redressal mechanism to cover microfinance services, so that microfinance customers will have the option to settle formal disputes with institutions.

Over-Indebtedness

Global best practice demonstrates that the best way to prevent client over-indebtedness is through the implementation of a credit bureau. The great majority of countries believe that credit reference services would improve conditions for both customers and institutions. However, regulation will determine what is required for

these bureaus. Some countries require financial institutions to submit customer information. Peru initially required submission of information on borrowers with loan amounts greater than US $5000, which excluded microloans. However, regulation was later amended so that customer information is required to be submitted for all loans. Thus, institutions can check for credit history when extending a microloan. Giving institutions access to a customer's current indebtedness will allow microfinance institutions to make better decisions as to whether to extend credit and in this way, mandating information sharing could strengthen the responsible finance initiatives.

Interest Rate Restrictions

Interest rate caps, though intended to protect the poor, often results in a reduction of financial services to the poorest of the poor and to those in rural areas. The costs of making very small loans and servicing rural areas is greater than making larger loans and servicing more urban areas, thus when an interest rate cap is implemented, microfinance institutions in many countries have reduced these services to maintain profitability. Interest rate caps can also result in less product transparency, since institutions may try to add charges or penalties that make it more difficult to understand product risk.

When an interest rate cap of 27% was implemented in South Africa, institutions immediately withdrew from rural areas and focused on less expensive areas to serve. Nicaragua's microfinance institutions' portfolio growth fell to 2% from 30% annual growth when an interest rate cap was introduced in 2001. Table 1 shows the interest rate changes, and the implications for microfinance loans as well as loans in developed countries.

Table 1: Interest Rate Caps

Jurisdiction	Date	Nature of Change	Reason for Change and Implication
Columbia	2006 (effective 2007)	Ceiling (34%) for microloans higher than the general ceiling	Higher ceiling to encourage microcredit. Implementation of the new ceiling has not occurred, microfinance portfolios and institutions still expanding
West Africa	1990s	27% Ceiling	MFIs immediately pulled out of rural areas and increased average loan size. Eventually found ways to circumvent with fees.
Nicaragua		The Central Bank publishes interest rate every month	Growth decreased to 2% annually to 30% annually. Several MFIs pulled out of rural areas.

Recommendations and Conclusion

Our recommendations are split into short-term and long term recommendations. Short term should are regulations to be implemented immediately, that will draw both immediate and long term benefits for consumer protection issues. Long-term recommendations should be implemented after certain aspects of consumer protection have improved.

Short-Term Recommendations

1) Require microfinance institutions to submit information to a credit bureau. A comprehensive database of microfinance credit information may never be complete if institutions submit information voluntarily.
2) Create standard legislation or regulation which details inappropriate collection and lending practices. This should set well-defined standards for the sector so that institutions can understand their limitations, and industry associations can help with enforcement.
3) Remove the interest rate and margin restrictions. This restrictions will not allow institutions to expand outreach to many unserved regions and the poorest of the poor.

Long-Term Recommendations

1) Require institutions to check a client's credit information with the credit bureau before offering credit or other financial services which result in client liability.
2) Implement a comprehensive redressal procedure for microfinance clients to enforce inappropriate collection and lending practices. Allow clients to air grievances at block or district courts to settle disputes with MFIs regarding lending practices, operations, and fraud. Require institutions of appropriate size to have a staff member or team dedicated to dealing with customer grievances.

Conclusion

Ultimately all policy makers and regulators want to adequately protect the customer, while providing them the benefits of access to credit and other financial services. However much debate surrounds how to achieve this goal and what tradeoffs should be made between expansion of services, customer protection, and institutional requirements.

Collection practices, high interest rates, and over-indebtedness have proven to

be the most salient customer protection issues in India for microfinance clients. A recent draft of the Micro Finance Institutions (Development and Regulation) Bill 2011 addresses some of these issues, notably giving the regulator the power to require institutions to submit their information to credit reference services providers and the power to create a grievance redressal procedure for microfinance clients. However, this legislation will be passed at the end of 2011 at the earliest, and RBI may not elect to use the power granted to them by this bill.

RBI has addressed consumer protection issues in their most recent regulation, however some aspect of their approach will be difficult to implement, and do not always represent global best practice. After the crisis in Andhra Pradesh, many are relieved to see any regulation that addresses consumer protection issues. As time progresses, regulation can be refined and amended to best allow for customer protection and expansion of microfinance services in India.

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Microfinance Regulation and Supervision: Overview of International Experience and Best Practice - Suggestions for India[1]

- Ramakrishna Regulagedda*

Abstract

The microfinance sector in India consists of approximately 800 Microfinance Organizations (MFOs) of different nature and size but there is a lack of comprehensive information. The regulation of financial entities has a triple motive which is to ensure efficient functioning of markets, to protect financial stability of the financial system and last but not the least to protect customers or clients. The generally agreed objectives of prudential regulation include Protection of depositors who are not well positioned to monitor the institution's financial soundness themselves. Prudential supervision is expensive. Furthermore, supervisory authorities have limited resources. Unsupervised deposit-taking institutions are risky. Once the limits are exceeded, the institution must comply with prudential regulation and be supervised. Around the world, microfinance is on the agenda of policy makers, regulators and supervisors. Over 50 countries have implemented or are considering specific arrangements for regulation and supervision of microfinance, either as a separate new law or as amendments to the existing legal and regulatory framework. In summary, most countries base their microfinance regulation on the CAMEL approach.

The microfinance Bill in India proposes RBI as the regulator and supervisor of the microfinance sector. The proposed Bill

Regulation of microfinance in India should be based on the existing patterns of regulation of banking entities but with appropriate adjustments based on the risk perception of the regulated entity.

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is a second-best compromise and it legitimises and legalises the existing practices of thrift. Regulation of microfinance in India should be based on the existing patterns of regulation of banking entities but with appropriate adjustments based on the risk perception of the regulated entity. The cost of supervising a large number of small financial institutions can be considerable. Cost efficiency is of paramount importance on both sides, i.e., the supervisor as well as the supervised MFO.

The current focus of microfinance is also the excluded sections from mainstream financial services. This would mean that the literacy levels of microfinance consumers are generally very low and therefore the topic of financial literacy and financial capabilities of the clients has an added significance. Financial literacy is therefore an integral component of client protection. GIZ through its initiatives supports client protection by building knowledge databases of client advisors in safeguarding the the rights of clients and redressing and filing of complaints.

Origin of Microfinance

The origin of microfinance can be traced to the efforts and initiatives of Raifeisen in Germany in setting up cooperatives of farmers for ensuring the credit and financial services needs are fulfilled. In India the Government of India in as early as 1904 set up credit cooperatives for a similar purpose. And these efforts have continued which could be seen in the nationalising of banks in 1969, the setting up of RRBs in 1975, the pioneering efforts of NABARD in piloting and mainstreaming the SHG-bank linkage programme and the search for alternate models of microfinance by the non government sector and the private sector.

1 Overview and Main Characteristics of MFOs in India

In order to understand the need for regulation and supervision of the microfinance sector in India, it is important to have an overview of the microfinance landscape. The microfinance sector in India consists of approximately 800 Microfinance Organisations (MFOs) of different nature and size but there is a lack of comprehensive information. Hence, the NABARD GTZ Rural Financial Institutions Programme conducted an inventorisation of MFOs and carried out a baseline survey of 786 MFOs in 13 states. The largest 2-3 MFOs did not participate in the survey. The objectives of the inventorisation were to get a clearer picture of the microfinance landscape, to compile the profiles of MFOs and the nature of their activities, and to understand the capacity building needs of the MFOs.

The results were presented in a comprehensive report[2]. The report provides important information on the MFO sector which is relevant for potential regulation and supervision. Hence, the main characteristics of the MFO sector are summarised in the following.

Table 1: Overview of MFOs in India					
MFO Type	Legal status	Number of MFOs		Loan outstanding	
Companies		No	Share	Crore	Share
	NBFC Section 25 company	24 9	3% 1%	2,701 102	65% 2%
	sub-total	33	4%	2,803	67%
NGO-MFIs	Trust Society	106 199	13% 25%	503 534	12% 13%
	sub-total	305	39%	1,037	25%
Mutual Benefit MFIs	MACS Cooperative	445 3	57% 0%	258 44	6% 1%
	sub-total	448	57%	302	8%
Total MFOs		786	100%	4,142	100%

There is a high geographic concentration with 75% of MFOs in two states only: Andhra Pradesh 61% and Tamil Nadu 13%, while the remaining 25% are scattered over 11 states.

The MFO sector is highly atomised and decentralised: 95% of MFOs operate in only one state and 68% operate in only one district. The majority of MFOs (58%) are rather young and have been established in the past five years. The remaining 42% of MFOs are quite mature: 29% being between 6 and 10 years and 11% over 10 years old.

MFOs can be categorized into three main types: companies, NGO-MFIs and mutual benefit MFOs. These three types are distinctly different in many aspects. Each type is found in again two distinct legal forms, as shown in Table 2 below. The microfinance sector has grown considerably in recent years, and the total loans outstanding amount to Rs 4,142 crore.

Table 2: Size and Leverage of MFOs					
MFO type	Number of MFOs		Loans outstanding		Leverage (D/E ratio)
	No	Share	Share	Avg. Rs crore	
Companies	33	4%	67%	84.9	9
NGO-MFIs	305	39%	25%	3.3	9
Mutual Benefit MFIs	448	57%	8%	0.7	2
Total	786	100%	100%	5.2	

The MFO sector is extremely polarised in terms of numbers and loan volume: only 4% of MFOs (companies) account for 67% of the total loans outstanding, while 57% (mutual benefit MFIs) account for only 8% of the loans. NGO-MFIs take a middle rung with 39% in numbers and 25% of the loan amount.

The MFO sector can be divided into three segments by MFO type and size (measured in average loans outstanding):

- Large MFO segment comprising only 33 companies with an average loan portfolio of Rs 85 crore and a high leverage (D/E ratio of 9).
- Medium segment comprising 300 NGOs with average loans of Rs 3 crore and a high leverage (D/E ratio of 9).
- Small segment comprising about 450 mutual benefit MFOs with an average loan portfolio of Rs 70 lakh and a very low leverage of 2.

60% of MFOs offer savings services to their clients or members - an aspect most relevant for prudential regulation and supervision. In total, an amount of Rs 634 crore in savings has been mobilised. Table 3 provides a breakdown of savings mobilised by MFO type.

Table 3: Savings in MFOs

MFO Type	Legal Form	Total Savings (crore)	Average Savings per MFO (lakh)	Savings to Loans Ratio
Companies				
	NBFC Section 25 company	0.0 0.6	0.0 7	0% 1%
	Sub-total	0.6	7	1%
NGO-MFIs				
	Trust Society	194.6 212.1	184 107	39% 40%
	Sub-total	406.7	133	39%
Mutual Benefit MFIs				
	MACS Cooperative	226.7 1.1	51 36	84% 0%
	Sub-total	227.8	51	72%
Total MFOs		635.1	81	15%

Member savings are most important in MACS, especially in relation to loans (84%). Surprisingly, NGOs are significantly involved in savings mobilisation in nominal amounts (Rs. 406 crore) and relative to their loans outstanding (39%).

However, one should be very careful in analysing the savings data thrown up by the survey. For one, no MFO is allowed to mobilise savings except for MACS and

NBFCs-(Deposit Taking). None of the NBFC-MFOs that responded to the questionnaire are deposit taking. All the savings indicated by the MFOs are necessarily savings of the SHGs which are not always parked with the MFOs. In some cases, the savings are compulsory balances against the loans on which interest is not paid by the MFOs. The segregation of what constitutes impounded savings (by MFO) and what is not impounded would not be possible from the survey. It is not very clear from the survey returns; if MFOs actually mobilise savings on own account or they are compulsory collateral deposits for loans.

Finally, a brief review of financial strength of MFOs:

Minimum capital: The large MFOs on average have a capital basis of 16 crore. However, this includes the big 4 MFOs and relates mainly to NBFC. Section 25 companies have an average equity of Rs 13 million. The medium and small MFOs are in the range of Rs 4 to 6 million (40 to 60 lakh) on average.

Table 4: Capital Base and Capital Adequacy of MFOs

MFO Type	Legal Form	Avg. Capital per MFO (lakh)	Capital to Loans Ratio
Companies			
	NBFC	2,100	19%
	Section 25 company	130	11%
	Sub-total	1,600	16%
NGO-MFIs			
	Trust	30	7%
	Society	60	22%
	Sub-total	50	14%
Mutual Benefit MFIs			
	MACS	40	63%
	Cooperative	180	12%
	Sub-total	40	56%

Capital adequacy: Capital adequacy, simply measured as capital over loans outstanding, is satisfactory in the range of 14% to 16%, with the exception of Trusts which are highly over leveraged and, hence, undercapitalised at 7%. MACS are more than comfortably capitalised with a ratio of 63% and have significant potential for leveraging.

Asset quality: Data on Non-Performing Assets (NPA) and over dues has not been collected. Loan loss provisioning is less than 1%. To some extent, this may indicate that the quality of assets of MFOs is good, or there could be under-provisioning given the lack of transparency or standards of good reporting.

Profitability: MFOs increasingly rely on interest income from lending as their major

source of revenue. Grants and donations are no longer important sources of income, except for small MFOs.

2 Guiding Principles on Regulation and Supervision of Microfinance

The regulation of financial entities has a triple motive which is to ensure efficient functioning of markets, to protect financial stability of the financial system and last but not the least to protect customers or clients. The major objectives of prudential regulation is to ensure the stability of the financial system, while regulation to ensure efficient functioning of markets is in the forms of rules to correct market imperfections such as for example monopolistic behavior. Regulation which is targeted at protecting client protection generally seeks to prevent abuse of client rights and exploitation of clients and includes standards for transparency such as right of the client to know the effective cost of borrowing, etc., and good governance practices.

During the 1990s, many countries started to regulate and supervise the nascent microfinance sector. The type and form of regulation varied considerably across countries and in about 2003 a consensus has emerged internationally on when, what and how to regulate microfinance. A good reflection of this consensus is contained in the Guiding Principles on Regulation and Supervision of Microfinance issued in 2003 by the Consultative Group to Assist the Poor (CGAP).

The principles define "regulation" referring to the set of government rules that apply to microfinance institutions while "supervision" is the process of enforcing compliance with those rules.

A clear distinction is made between "prudential" and "non-prudential" regulation.

Microfinance institutions that take deposits need "prudential" regulation. This type of regulation protects their financial soundness to prevent them from losing small depositors' money and damaging confidence in the financial system.

Prudential regulation-which mandates, for example, capital adequacy requirements and rules for provisioning loan losses-is relatively complex and costly because it involves understanding and protecting the core health of an institution.

"Non-prudential" rules - e.g., requiring transparent reporting and disclosure - tend to be easier to administer because government authorities do not have to take responsibility for the financial soundness of the organisation.

Prudential regulation

The generally agreed objectives of prudential regulation include

Protecting the country's financial system by preventing failure of one institution from leading to failure of others, and

Protection of depositors who are not well positioned to monitor the institution's financial soundness themselves.

When to apply prudential regulation in microfinance?

1. Deposit-taking MFIs only

Prudential regulation is needed only when there are depositors to protect, so it is not appropriate for credit-only MFIs that fund themselves from donors or commercial loans. Such MFIs may require relatively light non-prudential regulation.

2. Critical mass of qualified MFIs

Developing a new regulatory regime for microfinance takes a great deal of analysis, consultation, and negotiation; the costs of the process can exceed the benefits unless a critical mass of qualifying institutions can be expected.

3. Cost-benefit considerations: minimum size and capital of MFIs

Prudential supervision is expensive. When measured as a percentage of assets supervised, these expenses are higher for small institutions than for large ones. Furthermore, supervisory authorities have limited resources. As a practical matter, there is a need to ration the number of financial licenses that will require supervision. The most common tool for this rationing is the minimum capital requirement for obtaining a license. The lower the minimum capital, the more entities will have to be supervised, and vice versa. Those who see regulation of microfinance primarily as promotion will want low minimum capital requirements, making it easier to obtain new licenses. On the other hand, supervisors who will have to take responsibility for the financial soundness of the new institutions tend to favor higher capital requirements, because they know there are limits on the number of institutions they can supervise effectively.

4. Balancing of safety and access - the case of small community-based intermediaries

Some community-based or member-owned deposit-taking organisations are so small or remote that effective prudential supervision would be too expensive. Unsupervised deposit-taking institutions are risky. Most regulators facing the question have decided to let these small intermediaries operate without prudential regulation and supervision, as long as their assets and number of clients remain below defined size limits. Once the limits are exceeded, the institution must comply with prudential regulation and be supervised.

In large parts of the world the majority of microfinance service is provided by financial cooperatives that typically fund their lending from members' share deposits and savings. It is argued that because these institutions take deposits only from members and not from 'the public,' they need not be prudentially supervised. This argument is problematic. When a financial cooperative becomes large, its members may be in no better a position to supervise management than are the depositors in a commercial bank. Financial cooperatives are usually licensed under a special law, and their supervision is lodged in the government agency that supervises all cooperatives, including those focused on production, marketing, and other non-financial activities. While these agencies may be legally responsible for prudential supervision of the safety of depositors, they almost never have the resources, expertise, and independence to do that job effectively. Hence, financial cooperatives beyond a certain size should come

under prudential supervision by a specialised financial authority.

Recent work[3] by a group of microfinance experts on member-owned institutions (MOI) points in a similar direction and recommends an international task force of experts, promoters and practitioners to build consensus on good practice for MOIs operating in rural areas and to identify norms, standards, and related risks as a step towards appropriate regulation and supervision. Others (Cuevas and Fischer 2006) have proposed a Basel Accord-like process to develop international guidelines for MOI regulation.

3 Overview of International Experience with Microfinance Regulation and Best Practice

Around the world, microfinance is on the agenda of policy makers, regulators and supervisors. Over 50 countries have implemented or are considering specific arrangements for regulation and supervision of microfinance, either as a separate new law or as amendments to the existing legal and regulatory framework.

A study conducted by GTZ in 2003 provides a comparison of the legal frameworks in eleven countries and compiles the regulatory requirements for microfinance. Most countries use a combination of quantitative and qualitative indicators to assess the soundness of MFIs. The study did not provide a comprehensive overview of all regulatory requirements in the eleven countries, but rather focused on those regulatory provisions that are at the core of risk control in an MFI.

Table 5: Minimum Capital Requirements (2003)

Country	Type of Institution	Absolute amount in USD
Bolivia	Private Financial Funds (FFP) Open Savings and Loan Cooperative (CAC) Category 1 to 4	870,000 207,000 to 7,600,000
Ethiopia	Micro Financing Institution	24,000
Ghana	Rural Bank Deposit-taking NBFI	62,000 1,900,000
Honduras	First Tier Financial Private Development Organisation (FPDO) Second Tier FPDO	60,000 600,000
Indonesia	BPR in rural areas BPR in provincial capitals BPR in Greater Jakarta	56,000 112,000 224,000
Nepal	Cooperative Society with a Limited Banking License	13,000 to 130,000
Pakistan	MFI operating district-wide MFI operating province-wide MFI operating country-wide	1,700,000 4,300,000 8,600,000
Uganda	Micro Deposit-Taking Institution	270,000

Source: GTZ 2003

Minimum Capital Requirement: By and large, the minimum capital requirement for licensed MFIs ranges between US $50,000 and US $500,000, with Ethiopia at the bottom end and Pakistan clearly an exceptional case at the very high end. One reason for this is that microfinance banks in Pakistan are allowed to offer almost all the financial services of banks, including current accounts. Another reason is that the central bank does not want a mushrooming of MFIs, but rather the controlled and sustainable growth of this sector.

Capital Adequacy Requirements (CAR): Most countries impose stricter capital adequacy requirements than for traditional banks. The ratio of capital to risk-weighted assets is broadly in a range of 10% to 20% as compared to 8% for banks as the minimum standard under the Basel I Accord.

Loan Loss Provisions: For MFIs, the most important asset is their loan portfolio. Thus the classification of loans and the specification of provisioning requirements serve as important regulatory instruments. In general, provisioning requirements should be more conservative than for traditional banks, as microloans have more frequent repayment installments than traditional loans. In many countries, a general provision on the whole outstanding loan portfolio has to be made. Special provisions are made depending on the number of days payments are overdue. The provisioning schedules vary considerably, Uganda being the strictest and Ethiopia the least so.

Risk Concentration: Restricting the loan exposure to single borrowers is a typical regulatory requirement for both traditional financial institutions and MFIs. Whereas a number of traditional banks in developing countries suffer from a high dependence on a small number of big borrowers, this is usually not the case for MFIs with a portfolio of many small loans. Lending limits to any single enterprise are in a range of 5% and 25% of capital.

Insider Lending: Insider lending, i.e., loans to related or connected parties, has been a serious problem among many financial institutions in developing countries. One way of dealing with insider loans is the outright ban on insider loans, which is the case for certain types of MFIs in Bolivia, Nepal and Honduras. This is certainly the most effective way to prevent conflicts of interest, and is also quite easy to control. A second way is to restrict the volume of insider loans to a certain percentage of capital; this approach has been taken in Ghana, the Kyrgyz Republic, Uganda and Indonesia.

Reserve and Liquidity Requirements: Liquidity management becomes much more demanding when an MFI takes on savings business. A standard way of dealing with the liquidity risk of banks or MFIs is to prescribe a reserve or liquidity ratio. Most countries require between 10% and 20% of deposits to be held in liquid assets. In addition to the reserve requirement as a percentage of deposits, some countries require their financial institutions to build an accumulating reserve fund from their profits.

Ownership Concentration: Another standard regulatory provision for all types of financial institutions is the stipulation of a maximum percentage of capital that can be held by a single owner. The rationale for such a requirement is to prevent a

concentration of ownership, which could enable a single owner to take major policy decisions in his/her own interest without having to consult anyone else. In many cases, a single owner can hold a maximum of 20% or less of voting shares.

In summary, most countries base their microfinance regulation on the CAMEL approach.

4 Brief Comments on the Microfinance Bill in India

The Bill proposes RBI as the regulator and supervisor of the microfinance sector. The proposed Bill is a second-best compromise and it legitimises and legalises the existing practices of thrift. The major features of the bill are as follows:

- The focus of the bill is basically client protection and has sufficient provisions to ensure that MFIs behave in a client sensitive manner.
- Much of the provisions of the bill lay an emphasis on installing lenders discipline in the MFIs that leverage finances from the banking sector;
- Setting up of a Microfinance Development Council at the Centre and State Advisory councils at the state level;
- Regulations to provide for a Client Protection Code to be adopted by all MFIs;
- Provisions for grievance redressal procedures and establishment of ombudsmen;
- All MFIs must observe a specified Code of Corporate Governance to be managed by a self regulatory mechanism;
- Depositor protection is tototally missing in the bill;
- Very low entry requirement of Rupees 5 lakh: (could lead to proliferation of many small and weak MFOs);
- Legal conflict: Thrift from members only, but: Trusts and Societies legally have no members, only MACS have members;
- Lack of ownership and weak governance of NGO-MFIs: Bill should foster transformation not manifestation (Providing a legal framework such as the proposed bill manifests the role of NGOs and, with the absence of ownership and weak governance, creates a rather fragile foundation for the future of microfinance in India);
- One size fits all solution;
- No long-term vision of an inclusive financial sector where microfinance will be fully integrated.

The proposed bill proposes a one-size-fits-all legal framework. However, the MFO sector is very diverse, as the inventorisation[4] has also shown. The MFOs are divided into three segments by MFO type and size (measured in average loans outstanding):

- Large MFO segment comprising only 24 companies with an average loan portfolio of Rs 85 crore (this average excludes the big 4 MFOs)
- Medium segment comprising 300 NGOs with average loans of Rs 8 crore

- Small segment comprising 450 mutual benefit MFOs with an average loan portfolio of Rs 2 crore

Differential treatment in regulation based on risk perception and volume of business are central. The current structure of the MFO sector would rather suggest a tiered legal and regulatory framework. This would allow smaller institutions to graduate into the next higher tier.

5 Client Protection in the Context of Regulation of Microfinance

The current context of the discussion is in the background of the state of financial inclusion in our country which is as follows:

Only 40% of Indians have bank accounts, 10% have insurance and 2% have credit cards. As per the financial inclusion report of the Government of India

- 115 million households have no access to formal financial sources
- 17 million households are in a debt trap with money lenders
- 73% of the 89 million farmers households have no access to formal credit

As per the Arjun Sengupta Report on unorganised sector 95.86% of the enterprises in the unorganised sector have no access to formal sources of credit.

The current focus of microfinance is also the excluded sections from mainstream financial services. This would mean that the literacy levels of microfinance consumers are generally very low and therefore the topic of financial literacy and financial capabilities of the clients has an added significance. Now let us explore what this topic means for us in the current context.

Organisation for Economic Co-operation and Development (OECD) has defined financial education as 'the process by which financial consumers/ investors improve their understanding of financial products, concepts and risks, and through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being'. RBI in India has defined financial literacy or financial education as 'providing familiarity with and understanding of financial market products, especially rewards and risks, in order to make informed choices.

Thus, financial literacy is the ability to know, monitor, and effectively use financial resources to enhance the well-being and economic security of oneself, one's family, and one's business.

In the context of the advertisement and the marketing blitz, it is common that people tend to make the wrong choices while choosing financial products. The customer buys in haste and repents at leisure. The focus of any discussion on financial education is thus primarily on the individual, who usually has limited resources and skills to appreciate the complexities of financial dealings with financial intermediaries on matters relating to personal finances on a day-today basis. Financial literacy has assumed

greater importance in the recent years, as financial markets have become increasingly complex and as there is information asymmetry between markets and the common person, leading to the latter finding it increasingly difficult to make informed choices.

Financial literacy is therefore an integral component of client protection. Given the current levels of transparency, customers even the educated ones often miss out on the fine print leading to an information asymmetry between the financial intermediary and the customer. For example, customers are often penalised for minor violations in repayments, although they have limited redressal mechanisms to rectify deficiencies in service by banks. In this context, financial literacy can greatly help the consumers.

The GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit) in its Project - Consumer Protection and Sustainable Consumption is providing technical cooperation to the Department of Consumer Affairs (DoCA), Ministry of Consumer Affairs, GoI. Currently, pilot programmes were started in five states, viz., Gujarat, Madhya Pradesh, Orissa, Tamil Nadu and West Bengal, where consumer advice centers (CAC) were established and enabled with an IT platform providing sector specific knowledge in the form of a database of Frequently Occurring Problems (FOPs) that is developed and manned by qualified consumer advisors. The central knowledge data base and complaint database is accessible by the state consumer help lines and the advice centres while handling consumer issues. The complaint database provides useful information to the Central and State Governments on specific sectors with respect to the companies resolving/handling consumers' grievances. At the same time, the knowledge database provides advisories to the team with various possibilities in a given scenario. A section on micro-insurance and microfinance is being added on to this existing database to include comprehensive management and redress of consumer related issues by identifying and enumerating solutions and preparing advice for consumers. This initiative would safeguard and support the clients in getting transparent information on products and terms in order to find the product most suitable to them, as a safeguard against usurious interest rates, hazardous collection practices and consumers' knowledge of their rights of redress and filing of complaints.

6 Regulatory Parameters for MFOs in India - Suggestions

Regulations based on Microfinance Bill

The proposed Microfinance Bill represents the primary legislation on the basis of which the secondary legislation, namely the prudential regulations, is to be developed. Primary legislation is or should be broad, provide a general framework, and leave room for details and specifics to laid down in the regulations. The draft bill in its current form intends to provide a general framework but also contains some specifics and details which significantly narrow down the regulatory scope.

As a general guideline, good regulation should be:

Simple yet strict on core principles, tiered and progressive to provide suitable paths for graduation of smaller MFIs and affordable by both supervisor and the MFO.

Prudential norms for MFOs

For any MFO mobilising thrift or savings the existing regulatory and supervisory framework of RBI and NABARD should serve as reference and benchmark. The challenge is to adapt the norms to the specific conditions of microfinance, however, without lowering prudential levels and standards.

This balancing act can be mastered by introducing lighter norms in certain areas and at the same time stricter norms in other areas. Examples in this regard have been provided in Section 2 above, drawing from international experience and lessons from other countries.

The following areas require lighter norms than normal banks:

a. Minimum capital requirement

MFIs should require a lower minimum capital amount than normal banks. This will be compensated to some extent by higher capital adequacy (see below).

Rationale: MFIs serve a large number of customers but due to the small size of transactions they have much smaller loan portfolios and assets. Furthermore, MFIs are often based in local communities with highly decentralized operations, and this again limits their size. As shown above, 95% of MFOs in India operate in only one state and 68% operate in only one district. However, as the minimum capital requirement serves as an "entry ticket" to the market, it should also not be too low because this would lead to a proliferation of many small institutions.

Application to Indian context: The proposed Bill foresees a minimum capital of Rs 500,000 which is extremely low by international and even by Indian standards. As argued above, there is a danger of proliferation.

The medium MFOs currently have an average capital base of Rs 3 million (Trusts) to Rs 6 million (Societies), while the small mutual benefit MFIs (MACS) have an average capital of Rs 4 million. Section 25 companies have an average equity of Rs 18 million, ranging between the minimum capital of a RRB (Rs 10 million) and an NBFC (Rs 20 million).

Recommendation: The current structure would suggest a minimum capital of around Rs 5 million for the small and medium MFOs - or ten times the level foreseen in the Microfinance Bill - and a range of Rs 10 to 20 million for the large MFOs (Section 25 companies). Approximately 20% of all MFOs today would fulfill these minimum capital requirements.

b. Loan documentation

Loan documentation requirements must be significantly reduced and collateral requirements relaxed for microfinance loans.

Rationale: Given the nature of microfinance loan sizes, it would be excessive or impossible to require them to generate the same loan documentation as commercial

banks. Loan procedures and documentation must be well tuned to the small size of transactions with final clients in order to keep transaction costs and interest rates at acceptable levels. Cost efficiency is a key parameter for the sustainability of microfinance services.

Recommendation: Existing regulations on loan documentation should be thoroughly reviewed and simplified. Formal requirements such collateral registration, financial statements of borrowers' businesses, or evidence that those businesses are formally registered, must be waived for micro-sized loans.

c. Unsecured lending limits

The limits for unsecured lending must be lower than for normal banks.

Rationale: In order to minimise risk, regulations for commercial banks frequently limit unsecured lending to a certain percentage of a bank's capital. Applied to microfinance, such a rule would make it impossible for an MFI to leverage its capital with borrowed money. Microfinance lending is primarily character-based and the primary security of a loan is the cash flow of the borrower and her repayment capacity while physical collateral serves as a secondary security and fallback position.

In India, the RBI has withdrawn the limit on banks' unsecured exposures in 2004 and has since allowed banks' boards to fix their own policy on unsecured exposures. Especially for smaller loans up to Rs 50,000 there is an unwritten rule among commercial banks that these loans do not require conventional collateral.

Recommendation: The microfinance regulation should follow the norm of RBI and fix no limit on unsecured lending.

d. Branching and physical security requirements

Branching and physical security requirements merit re-examination - but not necessarily elimination - in the microfinance context. Clients' need for access to financial services has to be balanced against the security risks inherent in holding cash. For example, MACS are prescribed to have a fireproof safe as a minimum security requirement. The current requirements under the banking law will need to be screened and analysed in detail.

However, there are a number of areas where more stringent and stricter norms should be applied as compared to normal banks. These include the following:

a. Asset classification and loan loss provisions

The classification of microloans as non-performing assets (NPA) should be stricter, and loan loss provisioning should be more aggressive.

Rationale: The fact that microloans are unsecured justifies requiring them to be provisioned more aggressively than conventionally collateralized portfolio, especially where loans are short-term and frequent repayment schedules.

Recommendation: Loans should be classified as non-performing if they are overdue by more than 30 days (as compared to 90 days for normal banks). Loan loss provisions should start to be made from 30 days onwards. Provisions by MFOs should be more aggressive, similar to the rules presented in Table 4 above, e.g., providing 100% on

loans overdue for more than 180 days.

b. Capital adequacy

Capital adequacy in MFOs should be higher than in normal banks.

Rationale: Prudent conservatism would suggest that MFIs be subject to a higher capital adequacy ratio than is applied to normal banks, at least until some years of historical performance have demonstrated that risks can be managed well enough.

Recommendation: Capital adequacy of MFOs should be in the range of 15% to 20%. The risk weight of microloans could be determined under the Basel II framework where such loans are treated as a component of the "regulatory retail" portfolio and attract a risk weight of 75%.

c. Limits on thrift

In the interest of depositor protection, limits on thrift should be introduced. Two options may be considered: i) a single limit per individual thrift account, and ii) an aggregate limit per MFO.

i) Single limit per individual thrift account: For limiting the amount of an individual thrift amount, benchmarks are the post office savings accounts of max 1 lakh or the "no frill accounts" recently introduced at Rs 50,000. It is estimated that very few microfinance clients would have thrift amounts of more than Rs 10,000 which may be a realistic and inclusive ceiling, yet to be surveyed and verified.

ii) Aggregate limit per MFO: The aggregate limit should be linked to the capital base (net worth) and special reserve fund, the financial strength or the rating from A to E.

With regard to the thrift to capital ratio, a benchmark is the NBFC regulation which allows savings mobilisation of 1.5 to 4 times capital. Due to their weaknesses in ownership and governance, limits on NGOs (trusts and societies) should be stricter than for NBFC. Any breach of limits would need to be solved by an increase in capital; this may prove difficult in NGOs due to absence of owners. Hence, a tentative recommendation would be the following:

Maximum 2 times capital for A-rated MFOs

Maximum 1 time capital for B-rated MFOs

MFOs rated C-E should not be allowed to accept thrift due to their financial weakness. However, these ratios need to be verified and pilot-tested before being fixed.

d. Credit exposure limits

Legal lending limits should form part of microfinance regulation to avoid risk concentration. Limits should be devised for single exposures as well as for group exposure. Furthermore, lending to related parties should be strictly regulated, given the weak governance structure in most MFOs.

e. Fit and proper criteria for MFO Board and Management

The inventorisation of MFOs clearly illustrated weaknesses in the Board and the management of MFOs. Less than 40% of the Board members have experience with microfinance and only half of the CEOs have undergone some training and

qualification.

Hence, fit and proper criteria should be developed for MFOs. This well lead to a better qualified Board and management in the medium term. Better qualification will to some extent compensate the weaknesses in the governance structure. However, the criteria should differentiate between small community-based organizations and larger NGO-MFIs.

Cost of supervision

As repeatedly mentioned, the effort and cost of supervising a large number of small financial institutions can be considerable.

Hence, cost efficiency is of paramount importance on both sides, i.e. the supervisor as well as the supervised MFO. This principle should be applied to both off-site and on-site supervision. For off-site supervision, the frequency and content of reporting needs to adapted to microfinance. Reporting requirements should usually be less frequent, especially in remote rural areas, and simpler for microfinance institutions or programs than for normal commercial bank operations.

Moreover, as MFOs benefit from supervision in the form that they are permitted to offer thrift services they should also bear some of the cost of supervision. In the consultations with the MFOs and the sector it would be worthwhile to discuss and possibly (voluntarily) agree on some cost-sharing arrangement. This would send an important signal even to the conventional banks and to RBI.

Supervisory capacity

Effective supervision is a scarce resource; hence, there is a need to focus on supervisory capacity before, not after, regulation. When the government licenses financial institutions to take deposits, it implicitly promises depositors that it will keep their money safe. Licenses should be issued to MFIs only if there is reasonable assurance that this promise can be fulfilled. Experience so far supports several lessons:

Setting minimum capital requirements too low risks the proliferation of small institutions, stretching thin supervisory capacity past its ability. Minimum capital requirements should be high enough to limit licenses to the number of institutions that can be supervised effectively.

Occasionally central banks have successfully delegated some supervision to third parties, while retaining authority and oversight. "Self-supervision" by bodies controlled by the supervised institutions, however, has virtually never been effective in developing countries.

Prudential supervision of savings and loan cooperatives should be done by a specialised financial authority, not by the government agency responsible for all cooperatives.

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Ensuring Implementation of Client Protection in Microfinance: A Study of Select Microfinance Institutions in West Bengal

- Ashish Kumar Sana* and Bappaditya Biswas**

Microfinance programme is playing an important role in poverty eradication, women empowerment and improving the socio-economic condition of the poor in India . MFIs have made an outstanding growth in this sector in terms of client outreach and loan portfolio.

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Abstract

The over-indebtedness of microfinance borrowers, high interest rate and coercive method of collection by some mFIs are the vital problems in the microfinance sector of India. The situation became more critical as there is no such regulation and single regulatory body for the sector. So, there is a dire necessity of proper regulation for ensuring the clients protection and responsible financing. Sa-Dhan has developed few client protection principles for its members in India. Internationally, CGAP and Smart Campaign also came out with six client protection principles. There are some provisions also included in the Andhra Pradesh Ordinance 2010, Malegam Committee Report to RBI and Microfinance Institutions (Development and Regulation) Bill 2011 for ensuring client protection.

The primary objective of the study is to examine the present scenario of the client protection mechanism in Indian mFIs. The study tries to show the role of regulation for ensuring the client protection of the MFIs members. We have selected eight parameters of client protection and have matched it with the performance of two selected mFIs in West Bengal named Arohan and Bandhan for evaluating their client protection mechanism.

The current focus of microfinance is also the excluded sections from mainstream financial services. This would mean

Key Words: Client protection principle, self regulation, Microfinance Institutions

JEL Classification: G-21, G-28

that the literacy levels of microfinance consumers are generally very low and therefore the topic of financial literacy and financial capabilities of the clients has an added significance. Financial literacy is therefore an integral component of client protection. GIZ through its initiatives supports client protection by building knowledge databases of client advisors in safeguarding the the rights of clients and redressing and filing of complaints.

Introduction

Microfinance programme is playing an important role in poverty eradication, women empowerment and improving the socio-economic condition of the poor in India since the last two decades. In the last few years, Microfinance Institutions (mFIs) have made an outstanding growth in this sector in terms of client outreach and loan portfolio. At the same time, the issue of social responsibilities of the mFIs has put a question mark on the future of Rs. 22,000 crore market of this sector. There is a growing perception that the mFIs are making money by exploiting and overcharging the poor.

Microfinance has come under more critical scrutiny in the press and recent publications. The over-indebtedness of microfinance borrowers is the vital problem in some countries where microfinance has grown very rapidly. These markets, including Bosnia- Herzegovina, Morocco, Nicaragua, and Pakistan, have experienced intense competition, multiple borrowing by clients and erosion of credit discipline which has led to repayment crises and the rapid deterioration of portfolio quality.

Internationally, most countries are opting for specific regulations for mFIs, arguing that it is a 'special' sector, which needs specific regulation to enhance its quality, development, growth and to broaden the funding base. In Bolivia, the Banks and Financial Entities Law is applicable for the mFIs, so there are no separate legislation and regulation for mFIs. In Ethiopia, the National Bank for Ethiopia is supervising the mFIs sector from 1996. Bank Rakyat Indonesia is authorised by Bank Indonesia (central bank) to supervise the mFIs sector in Indonesia. Pakistan has also formulated special mFIs law where central bank plays a vital role. So, it is been found that the Central Bank of every country plays a vital role in supervising the mFIs sector.

After the death of two microfinance clients in Andhra Pradesh (AP), the mFIs operating in the state faced a tremendous pressure from opposition party of the Government, press and other stakeholders. The mFIs are blamed to be responsible for this death due to their coercive method of collection, high rate of interest and inspiring multiple borrowing. As a result, the Andhra Pradesh Government passed an ordinance in 2010 to control over the mFIs and to protect the clients. After passing this ordinance, the mFIs operating in AP faced a crucial funding and liquidity crisis as maximum of the mFIs borrowers stopped repaying and financial institutions disagreed to provide fund in this sector. The situation became more critical as there

is no such regulation and single regulatory body for this microfinance sector. So there is a dire necessity of proper regulation for ensuring the clients protection and responsible financing of the sector.

The present study is divided into nine sections. These are:

1. Introduction
2. Prior Literatures
3. Objectives of the Study
4. Methodology of the Study
5. Regulation for Client Protection in Indian mFIs Sector - Present Scenario
6. Client Protection Principles - An Overview
7. Analysis of Client Protection in select mFIs in West Bengal
8. Findings of the Field Survey
9. Conclusions and Policy Implications

2. Literature Review

A number of studies have been done nationally and internationally for verifying the client protection mechanism in the mFIs. A few of them has been pointed out below:

In 2004, The SEEP Network for its members adopted the pro-client principles, recognizing that a proactive approach to consumer protection will encourage mFIs to improve their practices before donors and regulators. Sa-Dhan[1] (2010) has made a voluntary code of conduct consisting of seven codes/principles for its member mFIs for ensuring client protection in India. Consultative Group to Assist the Poor (CGAP) (2010) has made six client protection principles which are internationally accepted for evaluating the client protection in an MFI. CGAP has also described the way of regulation for supervising the mFIs.

Arun and Murinde (2010) stated that the performance of mFIs depends largely on regulation for mFIs which eventually affect social protection in several ways mainly through its effectiveness and outreach. Muganga (2010) in his thesis paper described the international scenario of regulation for the development of mFIs with special evidence from Kenya.

MF Transparency[2] (2011) in their study show different ways of calculating the interest rate or price of the microfinance product. They also hoped that the launch of the India pricing database is the beginning of the process for changes for increased transparency and client protection.

3. Objective of the Study

The primary objective of the study is to examine the present scenario of the client protection mechanism in Indian mFIs. The study tries to show the role of regulation

for ensuring the client protection of the mFIs members. The study also analyses the current client protection system prevails in two selected mFIs in West Bengal.

4. Methodology of the Study

The study is mainly exploratory in nature based on the existing literatures on the subject including books, journal articles, newspaper reports of concerned committees and institutions, RBI guidelines etc. We have also conducted primary survey of 30 groups with the clients of the two selected mFIs, Bandhan and Arohan in three blocks named Shibdaspur, Icchapur and Hara of North 24 Parganas district of West Bengal.

Finally, we have selected eight parameters of client protection and have matched it with the performance of Bandhan and Arohan for evaluating their client protection mechanism.

5. Regulation for Client Protection in Indian mFIs Sector - Present Scenario

There is no single regulation for supervising the mFIs in India. Presently, the Non Banking Financial Companies (NBFC) mFIs are governed by RBI guidelines, the Section 25 Companies are governed by the Company Law and other mFIs registered as Societies, Trusts etc. are governed by the respective State Laws. Different types of laws in this sector cause discrepancies and confusion among the stakeholders of the mFIs.

There are some proposals came from the RBI and NABARD as well as government to regulate this sector. As a result, RBI formed Malegam Committee to study this sector and the committee has already submitted their proposals to the RBI. The Government of India has made a draft regulation named Microfinance Institutions (Development and Regulation) Bill 2011 for submitting before the Parliament. So there are some ongoing proposals for regulating this mFIs sector. In this section we have briefly described the proposals of these regulations.

5.1. Self Regulation in mFIs

The mFIs operating in India has some of their own system of operations and has own principles to provide better services and to satisfy their clients. These system and provisions varies from mFIs to mFIs. These own norms, principles, i.e., self regulation plays an important role to safeguard the interest of the clients. Self-regulation means prudential regulation (or supervision) by a body that is effectively controlled (whether in law or in fact) by the regulated entities, not by the government supervisor.

Internationally, the Swiss Banks Association and the Advertisement Industry of Brazil are the good examples of successful self regulation. BancoSol, the leading MFI of Bolivia maintained very healthy relationship with their clients, even in the situation of default of the clients. In India, organisation likes Microfinance Transparency working on increasing transparency and accountability in mFIs sector. Sa-Dhan, has made some core values and voluntary mutual code of conduct for its member mFIs in India to ensure better transparency and better clients' protection. All the 236 mFIs member of Sa-Dhan in India unanimously and whole-heartedly agree to abide by these guidelines. It has made Voluntary Mutually Code of Conduct for its members to provide all the necessary information to their clients regarding (a) terms and conditions of financial services (b) interest rate (c) premium of insurance (d) periodical statement, etc. It also made guidelines to provide microfinance services to the low income clients irrespective of gender, race, caste, religion or language. It also suggested to maintain high standard of governance, fairness and transparency in the operations of the mFIs. All the members of Sa-Dhan have to follow up this Code of Conduct and in case of failure to abide by these guidelines the membership of the mFIs is liable to be cancelled.

5.2. Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Ordinance, 2010

The Andhra Pradesh Ordinance, 2010 made it mandatory for all the mFIs operating in the State of Andhra Pradesh to apply for registration before the Registering Authority of the district specifying therein the villages or towns in which they have been operating or propose to operate, the rate of interest being charged or proposed to be charged, system of conducting due diligence and system of effecting recovery. The Ordinance also tried to ensure that the member of an SHG shall not be a member of more than one SHG and no MFI shall seek any security from a borrower by way of pawn, pledge or other security for the loan.

The main features of this ordinance are as follows:

- All mFIs shall display the rates of interest charged by them in a conspicuous place in their premises in bold letters visible to the members of the public.
- No MFI shall charge any other amount from the borrower except any charge prescribed in the Rules for submission of an application for grant of a loan.
- No MFI shall extend a further loan to a SHG or its members, where the SHG has an outstanding loan from a Bank unless the MFI obtains the prior approval in writing in such manner as may be prescribed from the Registering Authority after making an application seeking such approval.
- Any SHG or its members or any member of the public can file a complaint regarding violation of the provision of this Ordinance by a MFI before the Registering Authority.

5.3. The Microfinance Institutions (Development and Regulation) Bill, 2011

The Ministry of Finance of India released the much awaited draft microfinance bill which is to be introduced in the Parliament shortly. The consultative process adopted, the work done by the Malegam Committee, and the regulations issued by the RBI and the participation of the lenders, practitioners and others have made the draft comprehensive and well-rounded. The Andhra Pradesh statute, despite its debilitating impact on the sector, seems to have triggered this comprehensive response from the Government of India. The need to regulate the microfinance sector in customers' interest and also the need to avoid a multitude of microfinance legislation in different states has led to this bill which keeps registered microfinance institutions (mFIs) out of the ambit of money lending laws.

The main features of the bill are that every institution in microfinance should register with the regulator, transform into a company when they attain a significant size, be subject to a variety of prudential and operational guidelines that are introduced by the regulator, provide periodic information to the regulator and face penal action for violation of law or any rules framed. The bill provides flexibility of RBI to apply different measures, vary the same and delegate the powers to regulate to NABARD.

The grievance redressal procedures, mandatory enrolment to credit bureaus and code of conduct enforcement through industry associations will improve customer protection. The creation of national and state councils should provide wider sector participation in policy making. The proposed microfinance fund that would not only provide grants but also bulk finance to mFIs is a very welcome proposition.

Sections 23 and 24 of the proposed bill contain the substance of RBI's regulatory powers. The powers of RBI is to issue directions under section 24 are comprehensive and cover almost all aspects of functioning of the mFIs. While there seems to be a provision for recognition of Self-Regulatory Organization of mFIs, the process of recognition has not been spelt out. The industry associations have a critical role to play in assisting the regulators. In section 25, the bill has chosen to implement margin caps rather than interest rate caps. Absolute interest rate caps are anti-market and introduce rigidities. The bill proposes penalties for mFIs to a maximum of Rs 5 lakhs (almost $11,000) which seem paltry in comparison with the size of mFIs and the damage potential of ill-advised actions.

5.4. Malegam Committee Report on mFIs

The Board of Directors of the Reserve Bank of India, at its meeting held on October 15, 2010 formed a Sub-Committee under the chairmanship of Shri Y.H. Malegam to study the issues and concerns in the microfinance sector. The committee has mainly focussed on seven areas. These are (i) unjustified high rates of interest (ii) lack of transparency in interest rates and other charges (iii) multiple lending (iv) upfront

collections of security deposits (v) over-borrowing, (vi) ghost borrowers (vii) coercive methods of recovery.

The committee has offered the following suggestions regarding the client protection.

- There is universal agreement that the pricing of interest charges and other terms and conditions should be affordable to clients and at the same time sustainable for mFIs.
- It is important in the interest of transparency that all stake-holders in the industry including borrowers, lenders, regulators, etc. should have a better understanding of comparative pricing by different mFIs. This requires the use of a common format.
- It has been suggested that with the development of active competition between mFIs there has been a deluge of loan funds available to borrowers which has fuelled excessive borrowing and the emergence of undesirable practices.

6. Client Protection Principles - An Overview

Client protection is all about protecting the clients from over indebtedness, high interest rates and providing them more transparent, friendly and professional services. Client protection is a customer service issue, a public relations issue, and a regulatory issue and in a competitive setting an issue that will ultimately affect the mFIs' long term market share. Organisations like CGAP, Sa-Dhan, Smart Campaign, The Seep Network (along with its members ACCION International, CARE, Microfinance Network, Freedom From Hunger, etc.) are working on developing client protection principles and guidelines. The Seep Network has formed SEEP Consumer Protection Working Group (CPWG) in 2002 to increase the transparency of mFI policies regarding consumer protection.

The Client Protection Principles describe the minimum protection of microfinance clients should expect from providers. While the principles are universal, meaningful and effective implementation will require careful attention to the diversity within the provider community and conditions in different markets and country contexts. In this section, we have summarised the Client Protection Principles developed by different research organisations nationally and internationally.

6.1. CGAP-Client Protection Principle

The CGAP conducted various research works for ensuring social performance and client protection in mFIs worldwide. According to CGAP the mFIs that provide financial services to low-income clients should adhere to the following six core principles:

a) *Avoidance of Over-Indebtedness:* Providers will take reasonable steps to ensure that credit will be extended only if borrowers have demonstrated an adequate

ability to repay loans will not put borrowers at significant risk of over-indebtedness. Similarly, providers will take adequate care that non-credit, financial products (such as insurance) extended to low-income clients.

b) *Transparent Pricing:* The pricing, terms, and conditions of financial products (including interest charges, insurance premiums, all fees, etc.) will be transparent and will be adequately disclosed in a form understandable to clients.
c) *Appropriate Collections Practices:* Debt collection practices of providers will not be abusive or coercive.
d) *Ethical Staff Behaviour:* Staff of financial service providers will comply with high ethical standards in their interaction with microfinance clients and such providers will ensure that adequate safeguards are in place to detect and correct corruption or mistreatment of clients.
e) *Mechanisms for Redress of Grievances:* Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients.
f) *Privacy of Client Data:* The privacy of individual client data will be respected and such data cannot be used for other purposes without the express permission of the client.

6.2. SA-DHAN Client Protection Principle

The basic tenet of client protection is to understand the client's needs and situation while delivering micro financial services. This section analyses the level of code compliance towards client protection under different sub-sections of the Code of Conduct developed by Sa-Dhan.

a) *Fair practise:* Fair practise requires:
   - mFI should not discriminate on the basis of caste and religion.
   - mFI should share the benefits of cost reduction/profits with the clients.
   - The mFI should not collect any collateral from the clients for small loan size (Rs 50,000 and below) loans.
   - Where collateral is collected it should be returned to the clients within one week of closure of the loan.
b) *Avoiding over indebtedness:* This principle requires that the mFI should carefully analyse the repayment capacity of the clients before extending loans to them. Analysis of repayment capacity includes analysis of income and expense patterns as well as indebtedness.
c) *Appropriate Interaction and collection practices:* Sa-Dhan proposed the following guidelines to control specific aspects of behaviour:
   - Staff would not confront the clients or their family members under any situation.
   - The staff would not enter the house of the client for recovery of loans.

- Staff would visit clients only with the group leaders. More than two staff would not visit the client together for recovery.
- Staff would not insist on recoveries in case there is severe illness in the family of the clients.

d) *Privacy of client's data:* This dimension of the code requires that documents and information obtained from the clients are kept secure and are not disclosed without prior permission from the clients. Most of the mFIs have a policy of keeping the documents obtained from the clients under the custody of the senior staff in the branches (usually the branch managers). The documents are barred from unauthorised access by outsiders.

e) *Governance:* Sa-Dhan's Code of Conduct on Governance requires the following:
- The mFI should have independent members in its Board of Directors. This is to ensure that the affairs of the organisation are subject to scrutiny by independent persons.
- The Board is involved in policy formulation and effective decision-making. A well functioning Board should be able to provide oversight to the important functions.
- The annual compensation of the CEO should be approved by the Board. This is to ensure check on the CEOs taking unreasonably high level of salaries for themselves.

f) *Client education and financial literacy:* The Code of Conduct requires the mFIs to provide regular training to their clients on issues pertaining to financial literacy so that they are able to take an informed decision about their financial affairs. It is also imperative that mFIs should conduct basic financial literacy programmes to make the clients responsible borrowers avoiding over indebtedness. This will also help manage the default risk better.

g) *Competition:* On the one hand, healthy competition plays a positive role in bringing down the cost of credit and improving the quality of service for the clients, on the other, unethical competition would have adverse consequences.

h) *Feedback and Grievance Mechanism:* A sound feedback and grievance redressal mechanism is essential for the mFIs to maintain healthy relationship with their clients. This mechanism can also serve as an effective control system against staff fraud or other malpractices. Sa-Dhan's Code of Conduct requires the mFIs to have the following in place:
- mFIs should have a formal system of grievance redressal of clients
- They should inform clients and staff about their grievance redressal mechanism
- Clients should be informed of existence of the Sa-Dhan's Ethics and Grievance Redressal Committee
- mFI should also present summary of such grievances to the board and

the senior management

- mFI should conducts Client Satisfaction Surveys periodically (at least annually)

6.3. Smart Campaign

The Smart Campaign is a global campaign consisting of microfinance lenders, institutions and associations from around the world who believe that protecting clients is not only the right thing to do, but the smart thing to do. Launched in March 2009, the goal of Smart Campaign is to make sure financial service providers treat customers fairly, and avoid offering financial products that could harm or expose clients to unnecessary risks. The Campaign is working to establish standards for the appropriate treatment of low-income clients based on six Client Protection Principles: Avoidance of over-indebtedness; transparent pricing; appropriate collections practices; Ethical staff behaviour; mechanisms for redress of grievances and Privacy of client data.

According to the Smart Campaign the Six Client Protection Principles assert that all financial service providers to low income people must ensure that they implement responsible practice in the following areas:

a) Appropriate product design
b) Transparent and responsible pricing
c) Responsible treatment of clients
d) Effective problem solution
e) Privacy of clients data

After considering the above principles we have considered eight parameters for evaluating the client protection practices in the mFIs in West Bengal. These are:

I. Fair Practices
II. Avoiding over indebtedness
III. Transparent and responsible pricing
IV. Appropriate collection procedure
V. Ethical staff behaviour
VI. Mechanisms for Redress of Grievances
VII. Privacy of clients data
VIII. Governance

7. Analysis of Client Protection in select mFIs in West Bengal

West Bengal is now one of the important players in microfinance sector in India. Based on the above discussion, we have tried to match these eight indicators with the existing client protection mechanism prevail in the mFIs operating in West Bengal. For this purpose, we have selected two mFIs named Arohan and Bandhan.

7.1. Arohan

Arohan was established in 2005 and started operations in January 2006 in Kolkata, with the aim of catering to the credit needs of the under-served urban population of Eastern India. Arohan's early operations were restricted to Kolkata and its surrounding semi-urban areas. It has since expanded to other towns in West Bengal and also in Bihar. Arohan has a fair outreach to the financially (credit) excluded and moderate outreach to the poor.

Arohan is focused on ensuring ongoing alignment with the Reserve Bank of India's new guidelines governing the country's microfinance sector. As of June 1, 2011 Arohan's operations are compliant with the guidelines, however it remain committed to working with all staff and clients to ensure continued adoption of the operational changes. Clients remain at the core of Arohan's operations. Performance of Arohan is shown in Exhibit 1.

Exhibit 1: Arohan Performance as on 31st May 2011

Loan Outstanding (Rs. mn)	696
Number of Clients	184,408
Average Loan Size (Rs.)	9,767
Number of Clients Insured	168,750
Portfolio at Risk (90 days)	4.27%
Number of Staff	962

Source: www.arohan.in

7.1.1. Fair practices

Arohan provides financial services to the socio-economically disadvantaged sections of the society irrespective of caste, religion or language to enable them attain a better quality of life. It does not collect any collateral for sanctioning loan.

7.1.2. Avoidance of over-indebtedness

Arohan tries to ensure that its clients are not over indebted by choosing to work in areas where there are not more than two mFIs already operating. However, in older locations, competitors have started their operations, increasing the chances for multiple lending. Arohan captures indebtedness status of the client and cross verifies the information with three neighbours. Arohan doesn't accept clients with over two existing loans from other mFIs/ informal sources. Clients with debt over Rs.50,000 are also not extended loans. Cash-flow analysis of the client's household is done and loans are not granted if total monthly loan repayment exceed 40% of monthly income. Arohan does not offer top up loans as they believe that the clients may use it to make repayments on existing loans, potentially hiding a repayment problem. Similarly, clients cannot avail Saral and Bazaar products at the same time. A cap on over-achievement for the field staff for incentive calculation also keeps a check on aggressive client addition. Arohan has joined MFIN (Microfinance Institutions Network) which is in process of developing a client information data base (Alpha).

7.1.3. Transparent and responsible pricing

During physical verification, awareness of family members about client's loan application to Arohan is to be ensured. Processing charge is not deducted from loans, but is paid prior to disbursement so that the clients get the total loan amount in hand. Clients are provided a passbook (Loan Repayment Book-LRB) which contains all the terms and conditions of Arohan's membership as well as the loan product and the two types of insurance offered, in the local language. The declining rate of interest is printed in the LRB as well as in the strategic/ publicity documents of Arohan. All records are maintained at client level so that every client has an individual record of their repayments.

The annual Effective Interest Rate (EIR) for Saral loans is 27.9% in West Bengal and 31.8% in other states, while for Bazaar it is 36.9% across states. The EIR includes declining interest and an upfront processing fee of 2% of the loan amount in West Bengal for Saral and 4% in other states for Saral, and in all operational areas for Bazaar. Charges in comparison with other providers are significantly lower, and Arohan has sought to keep operational costs low by maximizing outreach in densely populated areas and by having low cost branches with manageable area - usually 5 km radius - as field staff travel by bicycle.

7.1.4. Appropriate collection practices

Arohan focuses on minimal time wastage at its repayment meetings so that clients do not lose their productive hours. The LRB contains the attendance record and repayment schedule. Arohan is in the process of recovering past overdue, which it had incurred during early stages of operations, through persuasion and repeated visits. Field staff use persuasion to convince the group/ batch members to pay the outstanding amount. If this fails, the Area Head (AH)/ Branch Head (BH) approach the groups and collect the dues. Any use of force and coercion would be easily detected. Arohan does not reschedule loans and there have been minimal write offs (0.2%).

7.1.5. Ethical staff behaviour

Arohan expects all its staff members to be polite and respectful while dealing with clients & even defaulters. Unacceptable behaviour during client dealings is clearly explained during the induction. Field Officers (FOs) are expected to have only a professional relationship with clients. Staff behaviour towards clients is also monitored by the internal audit and monitoring team. Such reports are directly linked to the pay at supervisory levels (BHs and AMs). In case of default, the FOs follow up with the concerned clients and if needed asks their group members to make them pay up

through pressurising. In some situations, the BH also follows up the cases. In no situation is the FO supposed to misbehave with defaulting client. A contact number is printed on loan pass-book for clients to lodge complaints against any staff for dishonesty or misbehaviour. The loan pass-book also mentions service and behavioural standards from field staff with clients (timeliness, addressing queries, honesty, integrity and respectful behaviour).

7.1.6. Mechanisms for redress of grievances

Arohan has recently introduced a toll free phone numbers for addressing the complaints and queries of the clients. The number is printed on passbooks and displayed in its branches, to encourage clients to call up the HO in case of any concern. Clients are informed about this number during disbursements. Further, the head office address is mentioned on passbooks and other documents, and most of the BHs share their contact details with clients during group disbursement. Clients are instructed to call the toll free number in case any staff has collected payments but not given them a receipt.

7.1.7. Privacy of client data

Arohan has recently introduced a formal privacy statement, printed in local language, on the clients' passbooks. Arohan does not share client information with any third party. However, being member of Alpha (Credit Information database Agency), once the credit bureau becomes operational, it will have to submit client loan and repayment information.

7.1.8. Governance

Arohan has a five member board which meets at least once a quarter. The discussions are mainly on operational and financial performance of the organisation. Board and management demonstrate commitment to the mission and core values, especially with respect to transparency and customer centricity. The Board meetings are well attended and minutes are recorded. The operational processes are reviewed to be customer centric, and focus is given on transparency to clients.

7.2. Bandhan Financial Services Private Ltd. (BFSPL)

Bandhan, the Non Banking Financial Institution (NBFC) mFI based on Kolkata has ranked second in the Forbes ranking among the top 500 mFIs in the world and has been conferred the Micro Finance India Award, 2009 under the category of Institution of the Year' by ACCESS Development Services and HSBC. The Mission of

BFSPL is to reduce the economic and social poverty significantly through providing client focused, quality, cost effective and sustainable financial services. Exhibit 2 is shown the performance of Bandhan.

Exhibit 2: Performance of BFSPL at a glance as on July, 2011	
No. of States Covered	18
No. of Districts	174
No. of Branches	1553
No. of Staffs	8,940
No. of Groups	1,78,016
No. of Members	36,34,504
No. of Borrowers	33,35,095
Cumulative Loan Disbursement (Rs. in crore)	11,258
Loan Outstanding (Rs. in crore)	2,484

Source: http//www.bandhanmf.com

7.2.1. Fair practices

Bandhan is fully unbiased in sanctioning loan to the clients in terms of community, language, religion or race. There is ideal balance in membership from SC, ST, Minority and General categories. Loan application forms are printed in different local languages and they include all necessary information which is utmost importance so that borrowers can make informed choices. Loan is without collateral and security deposit is not taken at the time of disbursement of the loan.

7.2.2. Avoiding over indebtedness

Bandhan practices responsible lending by conducting visits to the prospective borrowers to assess their financial needs and repaying capacity, based on the viability of the project undertaken by her. A preliminary visit to the house of prospective borrower is conducted by the credit officer to fill up loan form and to examine her income generating activities. Final decision is taken by the Branch Manager, based on his/her visit to prospective borrower and other operational guidelines.

7.2.3. Transparent and responsible pricing

All the borrowers are properly communicated about the amount of loan sanctioned along with other terms and conditions including effective rate of interest, instalment calculation methodology, lending methodology, number and amount of instalment etc. in the group meeting, which is simultaneously noted down in the group resolution register (which remain with the group). All of these terms and conditions of the loan are clearly communicated to the borrowers in a medium which is understandable by them.

At the time of loan disbursement, a passbook is issued to each borrower which contains photograph of the borrower and all details of financial transaction, viz., loan amount, interest amount, instalment amount number of instalment fees charged etc. hence transparency at every stage of financial transaction is ensured by Bandhan. Exhibit 3 shows the terms and conditions of products offered by Bandhan.

Exhibit 3: Terms and conditions of products offered by Bandhan				
No	Loan Product	Loan Amount	Tenure	Effective Rate of Interest (p.a.)
1	Suchana *(Micro Loan)*	Rs.1,000-Rs.15,000	12 months	22.90%
2	Srishti *(Micro Enterprise Loan)*	Rs.16,000-Rs.30,000 (Loan does not exceed Rs. 35,000 in the first cycle)	24 months	22.90%
3	Samriddhi *(Micro Small and Medium Enterprise Loan)*	Rs.51,000-Rs.3,00,000	12/18/24 months	22.90%
4	Suraksha *(Micro Health Loan)*	Rs.1,000-Rs.5,000	12 months	20%
5	Susikhsha *(Micro Education Loan)*	Rs.1,000-Rs.10,000	12 months	20%

7.2.4. Appropriate collection practices

Bandhan do not resort to unfair means like of muscle power, abusive language, persistently bothering borrowers at odd hours etc. for recovery of loans. Processing fees are charged at the time of disbursement. Penalty is not charged in case of default. Loan is repayable by weekly, fortnightly or monthly instalments at the choice of borrowers.

7.2.5. Ethical staff behaviour

Bandhan's staffs comply with highest ethical standards in their dealings with borrowers. Every borrower is treated with utmost respect and dignity. It keeps a close monitoring on the income generating activities pursued by borrowers in an amicable manner without causing any unreasonable interference in the affairs of the borrowers. Request for borrower transfer from one group to another or from on branch to another is accommodated as per its operational norms and the decision is timely communicated to borrowers.

7.2.6. Mechanisms for redress of grievances

Bandhan, being a systematically important company and compliance to the requirements of RBI has already put in place a Grievance Collection and Redressal Mechanism (GCRM). It has a dedicated helpline number to address any complaints/

grievance/queries of the borrowers. A person located at the head office is designated to receive and register quarries/grievance from borrowers and such are dispensed/ resolved by appropriate authority as priority basis. The helpline number is also printed on the passbook of all borrowers/clients of Bandhan. A complaint/suggestion box is maintained at each branch office of Company, ca easily be accessed by borrowers. An Ombudsman Committee comprises of three Senior Executives (not associated with field operation of the company) are there to resolve the complaints. Serious case arising either from helpline or through complaint box is dealt with by them.

7.2.7. Privacy of client's data

Bandhan use to maintain high privacy about the information about its clients. No outsiders can get any data without the prior permission/approval from the head quarter.

7.2.8. Governance

Bandhan is governed by seven member board. Byelaws of the organisation are clearly established including the process and procedures for selection of board member. All of the board members have more than ten years of experience in their respective area of specializations. The management committee meets on a monthly basis to monitor the activities of the organisation. Financial and operational performance is discussed in the meeting and necessary guidance is given by the board members. It formed different sub-committees including risk management committee, audit committee and ombudsman committee for effective monitoring and to increase transparency in their operations.

8. Findings of the Field Study

From the field survey we have found that around 30% of the SHGs members' clients of both Bandhan and Arohan have the multi-borrowing practices which ultimately lead to a debt trap situation. Maximum of the clients have taken microfinance loan from Swarnajayanti Gram Swarojgar Yojana (SGSY) programme or from other mFIs operating in that area. So, Bandhan and Arohan should examine the borrower's capacity before lending to them. However, the clients are satisfied with the behaviour of the employees of these two mFIs as officials of the mFIs visited and supervised SHGs periodically. Bandhan's collection officer used to collect the loan instalments from the group meeting at the village, so the clients are very happy with the system. Arohan also follow the same procedure. None of the clients surveyed from the two mFIs have complained regarding the coercive method of collection. They are also little bit satisfied with the interest rate charged by these two mFIs as it is comparatively

lesser than the interest charged by the other mFIs operating in the district. But the clients of both mFIs are not aware or informed about the privacy of their data. So, both the mFIs may consider introducing written policies to institutionalise the client protection practices.

9. Conclusion and Policy Implications

From this study we have found that several client protection principles have been developed by the different organisations nationally as well as internationally. There are some common principles existing among the organisations. The Andhra Pradesh Ordinance 2010 has made some negative effect on the mFIs sector as the ordinance treated the mFIs with the moneylenders. So, the ordinance should be more practical rather than a political issue. Some changes are required in the norms of the ordinance for the long term sustainability of the mFIs.

The mFIs Arohan and Bandhan that we have selected almost fulfilled all the eight parameters of client's protection. Arohan scores high on fair pricing, transparency to clients and complaint redressal. Due the presence of large number of mFIs and high competition the clients of Arohan are facing over indebtedness. The interest rate charged by Arohan is much higher than Bandhan, so it should make way out for reduction of interest rate. It doesn't have a specific policy to implement or evaluate these principles; however, several aspects are covered in the process design and are partially evaluated through regular monitoring and the internal audit.

There should be uniform law for all the mFIs operating in India, as mentioned in the Microfinance Institutions (Development and Regulation) Bill, 2011. This will bring more transparency in the microfinance sector and will be helpful in safeguarding the future of the mFIs and ensuring client protection. The bill requires implementation and enforcement in some cases. The regulatory capacity has to be ramped up and the small and medium mFIs capacity to comply with regulation would also need to be beefed up. The bill is an important first step; several more steps in translating the bill to action are required before we reach a stage that restores the vitality of the sector.

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Micro Finance Institution Regulation: Case for Hybrid DNA Institutions

- C.P. Mohan*

Abstract

This paper is positioned to discuss a 'right-fit' institutional arrangement for the microfinance sector in India. The discussion focuses on the underlying concepts and the importance of Hybrid-DNA microfinance institutions. It also examines the significance of the people-centric and calibrated response of NABARD, in creating such an institution. This paper does not analyze the merits or otherwise of the Microfinance Regulation and Development Bill. The more erudite in the realm of financial sector regulation will certainly ensure that a robust regulation will eventually replace the present vacuum. State may also come up with stringent enforcement and legislations to rope in rogue elements in the sector. The paper proposes to highlight that robust regulation, supporting legislations and stringent enforcement will not be the end of major threats to the sector. Several challenges that remain are a product of a non-sync between some of the more technical aspects of regulation and the demand side conditions in terms of the level of satisfaction possible from the regulated entities.

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Need for Regulation

Typically, the regulatory framework for the microfinance sector or for that matter any financial sector is designed primarily taking the following interests of the larger financial sector into consideration.

1. Institutional stability and sustainability
2. Good governance

Key Words: Microfinance Institutions, Hybrid DNA Institutions, Microfinance Regulations

JEL Classification: G-21, G-28

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3. Client protection
4. Protection of lenders' interests
5. Investor confidence
6. Comparability of institutions through establishing and enforcing benchmarks and norms

The usual ingredients of robust regulation are:

1. A strong, trusted and experienced regulator
2. Efficient oversight with feedback mechanisms
3. Regular offsite and onsite supervision mechanism
4. Timely and sufficient compliance
5. Enforcing transparency and pro-active disclosures

The institutional ingredients required to meet the rigors of robust regulation are:

1. Strong and ethical governance system including appropriate board room presence
2. Good internal controls
3. Clear understanding of regulatory and compliance requirements
4. Processes and procedures to ensure regulatory compliance as a habit and not in reaction to regulatory raps
5. Capacity to expand business within regulatory framework

Demand Side Analysis

It is of greater imperative that the demand side dynamics and situation is well understood at the design stage of the regulatory pillars. In the case of microfinance, the predominant client protection requirement is of the borrowers and not savers as is usual in banking sector.

The target client base of the MF sector is largely poor, defined broadly rather than minimally. It may include a variety of poor - located in remote geographies, suffering from deficits such as limited market access or information asymmetry. Apart from these there are several characteristics of the potential clients which need to be taken into account such as:

- Irregular incomes
- Low levels of social capital deterring access to formal financial institutions
- Inability to provide acceptable collateral security
- High cost of dealing with formal institutions either due to distance or irregular visits by the clients
- Difficulties in complying with Know Your Customer (KYC) norms and

documentation needs

- Small ticket requirements disliked by most formal institutions
- Highly time sensitive credit needs and the propensity to borrow from any source under stress
- Difficulties in credit appraisal as decisions may depend often on community credibility
- High credit requirement led by aspirational demand, inflationary trends, easy access to goods and services etc
- Low level of financial, legal and market literacy
- Near zero access to financial services other than credit
- Prevalence and continued dependence on local money lenders
- In adequate / improper product range of formal financial institutions
- Prevalence of rent seeking middle men.
- Likely loss of trust due to earning losses and inability to access funds when most needed despite multiple visits
- Perceived loss of dignity due to repeated unsuccessful visits or improper treatment received
- Inadequate quantum of credit

Supply Side Response

The characteristics of the demand side as explained above sets the foundation for the supply side response. The evolution of the present day microfinance sector have its genesis in responding to the above demand side diagnostics resulting in two highly differentiated approaches within the sector: one taking lower risk based on Self-Help Group (SHG) model and other involving institutions have high risk appetite with flexible approach and simple procedures.

The more entrenched and sustainable is the Self-Help Group led movement which holistically looked at the demand side perspectives and sought to influence policy, products, processes, procedures and institutional response from such a holistic assessment. The movement involved a variety of stakeholders and galvanised the policy makers, the third sector, the delivery institutions and development agencies into responsive paradigm thereby encouraging the development of the largest microfinance movement in the world. It also facilitated the inclusion of massive numbers of the demand segment described above into formal, well regulated financial service providers constituting of banks in general.

The demand situation also provided enough space for the entry and growth of a class of institutions with high risk appetite willing to resort to coercion and even outright harassment in case of defaults. These institutions systematically innovated to leverage the concept of collateral substitute established though the SHG movement, enforce repayments and attract clients. The modern day Microfinance Institutions

(mFIs) took advantage of the inherent rigidities of the formal financial sector and flourished in an environment nearly free of regulation. They capitalised on the high credit demand. Recognizing the inelastic nature of the demand, they took calculated risk to scale up at exponential rates often eating into each others client base. The clients, too, took advantage of the easy credit availability from competing sources, often arbitraging between the sources.

Most mFI's identify door step delivery, timely delivery, small ticket products, extremely simplified processes, flexi-timing, etc., as their selling propositions. While on the one hand, the designs of the delivery mechanism responding to the above result is high transaction costs, the clients are fairly insensitive to the cost of credit as they do not have many options to choose from. The main alternative is the local money lenders who are even more usurious and provide lower quantum of credit. The potential for growth is high. Pricing freedom that allows easy cost recovery combined with high margins and large volumes drive up the profits.

Thus, the supply side response is primarily the result of a demand side pull. Regulation becomes exceptionally difficult in such cases as add it is amply evident from the prevalence and unbridled activities of the money lenders. The findings of the All-India Debt and Investment Survey (AIDIS) 2002 which concluded that the share of informal sources increased when compared to 1991 bears this out.

The brief analysis of both the demand end and supply side responses sets the context for the regulatory mechanism that is needed for the microfinance sector. The argument, therefore, is that there are several aspects relating to the clients, delivery arrangements and products which need to be focused upon to get the 'Right Fit' institutional and regulatory framework into place. The main components to be considered are the context, characteristics and needs of the client, a holistic definition of microfinance, institutions and delivery mechanisms. The overall regulatory framework also includes ensuring compliance, providing proper oversight and avenues for disputes redressal.

The Context Characteristics and Needs

The necessity to invest significantly to increase the capabilities of the clients cannot be gainsaid in the context of the high degree of illiteracy, poverty, and several other difficult circumstances being suffered by the potential clients of microfinance. There is also growing community which has ever increasing aspirational demands. Empowerment typically leads to increase in consumption when large numbers of rural women, poor, etc., emboldened to increase domestic consumption for education, health, better food. There is also an increase in spend on cable TV, mobile phones, entertainment and non-essential travel. There is also increased spending on account of higher quality of life. Higher empowerment leads to greater aspirations. The greater empowerment needs to be matched by public policy response to raise purchasing power.

The SHG movement stands out prominently in this context. It empowers the masses, public policy response made it possible to mobilise resources both encouraging savings and leveraging credit. It helped to reduced costs and created much needed space for unheard voices to be heard. It helped to increase bargaining power and neither last nor least, produced a large number of village and panchayat level leadership, prominently from among poor women. On the whole, underprivileged sections are in a transformational phase demanding more of both financial and other services.

A Holistic Definition of Microfinance

The bulk of the micro finance clients are marginal or small producers/ service providers with weak market access lacking economies of scale. The need for creating aggregation effect organizing value chains and interlinking communities with welfare services need to be factored. The approach to better the lot of he potential clients cannot be limited to mere delivery of credit. In fact, if seen as an acronym, MICRO, expanded as Management of Individual Capacities, Resources and Outputs will give a better understanding of a holistic definition of Microfinance. The institutional arrangements of microfinance need to look beyond the delivery of merely financial services; it must aim to bring convergence of a large number of players who enable the poor and build their capacities at different levels. This brings into sharp focus the relevance of Hybrid-DNA institutions which are necessary to bring in such convergence.

Institutions and Arrangements to Deliver Microfinance

The service DNA can be defined as the value system with a degree of altruism. It looks at poverty and disadvantages as unacceptable and engages in activities that may directly or indirectly alleviate poverty, improve livelihoods, reduce the risks at the demand side and help in bringing socio economic sustainability. The service oriented microfinance organisations identified exclusion of the poor from the financial capital as an important reason for their poverty and involved in providing low interest credit to encourage entrepreneurship and development. It has to be recognised that the poor has to be supported substantially through programmatic approaches and otherwise for capacity building before they can graduate to the effective use of such capital. Thus service oriented microfinance institutions shall have the business model enabling them to provide credit and financial services at low cost seen from a broader perspective than mere low interest rate. It shall also have to work in tandem with entities that engage in various programmatic initiatives of Government, civil society, donors and development agencies that seek to reduce multiple deficits of the poor and the disadvantaged. These characteristics can be termed as the service DNA institutional framework.

At the same time, large scale Commercialisation, profit maximisation and targets for exponential growth can be termed as the enterprise philosophy of a commercial financial institution. The commercial entrepreneurial institutions tends to focus on funding sources like commercial lenders, capital markets, venture capital etc to enable the exponential growth. High degree of competition is seen among these institutions as several of them operate in the same market formed of vulnerable clients. It has been seen that Commercialisation focused on the goal of earning profits. These characteristics are deemed as the Enterprise DNA institutions in the context of this paper.

The hybrid DNA institutions are those which imbibe a balanced value system that includes both the service DNA and the enterprise DNA as explained above. This theme is discussed in the following paragraphs.

The service DNA is an essential ingredient for a microfinance institution. If this be the case, governance, products, processes and client base of that institution must reflect this. Once this percept is accepted, then all pillars of regulation will have to subsume the need for institutional appropriate compliance for this. History shows that the evolution of the Hybrid-DNA institutions is rare. Historical data confirms that hybrid DNA institutions started by entrepreneurs quickly transformed into Enterprise DNA institutions motivated by supernormal profits, unfair practices and poor governance.

How, then, can hybrids be created and sustained? It is important to look at diagnostic studies to understand why the mission-drift takes place. A blue print to create such institutions must be based on an understanding of this. Much work has already been done in area of diagnostics and some of the well documented reasons are:

- Unsustainable nature of small operations
- High equity requirement for fast growth
- Need for vast geographical spread as well as penetration into un-banked client base that drastically increases transaction costs
- High cost of borrowing
- In-elasticity of demand for credit even under significant rate changes
- Non-availability of institutional credit due to physical, procedural and man power constraints
- Small ticket size provides for an easy market to high cost credit
- Lack of incentives for formal sector to widen the client base giving a ready market to mFI's
- Inadequate / improper product range
- Un-certainties about the clients' cash flow
- Client's inability to source / lack of perceived need for non-credit product lines limit the scope for other income sources from the client base.

While the above are reasons for mFIs to spawn, grow and exploit an easily accessible market with a high cost credit product, several reasons exist for the segments of the population to a very large access such financial products as already explained.

From supply side constraints and demand side requirements as well as perceptions, there is a clear opportunity for sporadic growth of lending institutions that can service a large segment of the population.

The evolution of the concept of Non Governmental Organisations (NGO's) is an example of how hybrid DNA institutions which combines the Enterprise DNA with the service DNA. The acceptance of Social Entrepreneurship is another indication of the recognition of the need for the hybrid DNA institutions. It is relevant to point out that most of the profit maximizing microfinance institutions also recognised the inherent need to converge service DNA with enterprise DNA as is evident from their mission and vision statements. However, over the time, these microfinance institutions came to be constantly commented upon for Mission Drift. This contention is based on the reality that several players who got into high growth trajectory easily mutated into Enterprise DNA.

Hybrid DNA Institutions

Indian banking sector is perhaps the most shining example of engineering the Service DNA into financial institutions through mandates. Well structured oversight mechanism (LBS) and multilayered monitoring includes all stakeholders. We can vividly see several vertical structures involved in the monitoring.

The mission for doubling of agricultural credit, the policy for rural branch network, subsidized rates for farm sector loans etc., are examples of convergence of regulatory mandates, effective monitoring and the manifest will of the State. Presently the financial inclusion targets have been brought under the ambit of the multi layer monitoring structure. Through mandated target and well structured monitoring, the Indian banking system has been able to establish the hybrid DNA institutional genotype as distinct from Enterprise DNA seen elsewhere in the world.

The banking sector experience demonstrates that it is, indeed, possible to engineer the service DNA into robust financial institutions. Microfinance institutions must have Enterprise DNA to respond the demand side pulls while conforming to regulatory mandates that ensures tight integration of Service DNA. Going by the analogy of the banking sector, such institutions are probably better created with the help of large financial sector players. Similar role can be played by NABARD to enhance the spirit of Service DNA while providing capital resources and transferring Hybrid DNA into subsidiaries.

The hybrid DNA institution shall serve the overall regulatory concerns by ensuring sufficient compliance to all the statutory requirements. It shall ensure that there is no arbitrage threatening the financial system, provide good governance, and also support several mother initiatives that are required to effectively support the poor and the disadvantaged. The benefits deriving from such institutions are discussed below.

Systemic Importance of mFI's

Systemic relevance of financial institutions can be broadly bifurcated into the impact on the Financial System / Macro economy and the impact on the clients. All mFI's existing in the country are not big enough to impact the financial system / macro economy by its total top line size. Individually they form only a very small percentage of the total financial market. However, the total number of clients of these mFI's is purportedly large, as well as vulnerable.

Another key parameter for assessing systemic importance is the concern for the safety of public deposits. This primacy of regulatory concern is globally well accepted. In the case of mFI's, most of the savings are in the nature of compulsory savings linked for lending and not voluntary savings collected from general public. Typically, the loan in the clients hand is more than her savings in the mFI's hand.

Yet another parameter is protection of borrower client from usurious rates and unfair practices. Traditionally it will be seen that these two infringements are sought to be controlled thorough state level legislations and the laws relating to crimes.

It will be seen that institutions that are linked to already well regulated entities shall tend to remain within the acceptable limits of regulations and will tend to be low on regulatory arbitrage.

Governance and Regulation

A new governance paradigm was started in the 1980's. It was actively promoted by agencies like World Bank, UNDP, DFID and USAID. The World Bank identified four major areas of concern to be addressed in achieving good governance. They are:

a. Improving the public sector management.
b. Ensuring the accountability of public and private sectors.
c. Creating appropriate legal frameworks of development, and
d. Promoting transparency and information.

The underlying ethos of good governance which evolved is steeped in features like legitimate exercise of power and the adoption of transparency, equity participation and accountability. Multiple institutions or agencies such as the state, market and civil society play important roles in this, making it necessary to have significant levels of convergence and harmonious relationship among them. In other words multiple tiers of the state, civil society and private agencies have to work in concert. The overall governance strategy has to embed in itself the characteristics of predictability, stability and efficiency.

In India, the new governance paradigm was applied to the financial sector. The realization that the financial sector plays a key role in achieving socio-economic development, helps to complement the economic reforms, and at the same time suffered from instability and in efficiency led the adoption of the new governance paradigms.

This was broadly characterised by:

a. Reduced state control
b. Encouragement to multiple actors in rural finance systems
c. Large scale functional freedom to financial institutions under a liberalized regime of deregulation

The design of the regulatory mechanisms must keep in mind the evolution of the good governance paradigm within the sector. Therefore, the development of delivery institutions needs to integrate the historical factors. Much success has already been achieved in the last two decades in implementing essence of good governance paradigm among the players in the Indian Financial System. The argument is to leverage these achievements into serving the most needy of our people by promoting Hybrid DNA Microfinance Institutions with the participation of the major players in the financial system that shall automatically carry good governance in their system.

Fragmented Approach to Micro-Credit

There is highly fragmented approach to deliver credit to the clients of the MF Sector. On the one hand the Micro Finance institutions provide credit at very high rates of interest, with minimum hassles to the vulnerable sections. On the other hand several State Governments offer highly subsidised credit at as low as 4% in certain cases to this segment. This poses systematic risks.

Another major collateral damage of the product and delivery innovations is that these institutions found a ready market for their products by breaking up SHGs into smaller mutual guarantee groups. Thus willingly or unwillingly they cut at the very roots of the SHG structure. The classical SHG also flourished with the support provided by the Reserve Bank of India that favored the affinity group approach, which helped in the convergence of empowerment processes and access to financial services. During last two decades, the movement brought much needed aggregation effect. With proactive policy initiatives, a well regulated banking sector reposed great confidence in the SHG's and helped in the inclusion of women as both depositors and borrowers.

A systematic approach to co-create microfinance institutions within the overall management and equity control of well regulated entities shall go a long way in improving and augmenting the availability of financial services to the needy. The flexibility of an mFI coupled with the benefits of subsidiarisation of a well regulated entity serve the demand end requirements through appropriate innovations, products, processes and service levels on the one hand and subject itself to continuous managerial oversight by the holding entity, thus mitigating regulatory concerns. It can also bring convergence in even State assistance by way of subventions as in the case of the interest subvention for agriculture administered by central government, if found necessary.

Other Financial Services

There is little attention paid to meeting the demands of the other financial services of the client constituency. In the absence of institutionalized and well regulated arrangements, these services shall play to high degree of arbitrage and exploitation as we saw in the case of micro-credit. We have to recognise that growing aspirations and new opportunities have pushed up the demand for a variety of financial services.

The development of large numbers of microfinance institutions under a co-creation framework involving the well regulated entities like banks and the state shall give raise to possibilities for strategic alliances between such mFIs, banks, insurance companies etc. Such institutions shall also have both the goodwill, competency and above all the managerial will to bring convergence of various development projects and services to the benefit of their clients. The hybrid DNA subsidiaries shall also operate as a synergic continuum of the inclusive policy.

Market Development Efforts

The overall situation in the micro-credit market today continues to be ripe for unscrupulous elements to reap super normal profits. It is, therefore imperative to invest in market development of the microfinance sector. The initiative shall comprise of building appropriate institutions, developing products, simplifying processes and procedures of formal institutions, client centric delivery models, awareness creation among the people, increasing capacities of people to enable economic inclusion, developing and enabling critical accesses to rural population in general and the poor in particular such as information access, physical access, market access and access to services, etc., establishment of information bureau on microfinance clients. Such initiatives can be better rolled out through holding entities with deep pockets, commitment to national goals and are well integrated within public policy implementation. This will ensure that these institutions grow with hybrid DNA.

Compliance with Prudential norms

At certain levels, the capital adequacy and prudential norms put considerable pressures on institutions to push for high levels of profitability. This phenomenon is evident in the case of rural banking in India as a whole wherein the typical institutional response has been gradual increase in average ticket size and reduction in transaction costs. The first decade of financial sector reforms probably can be defined as one dominated by these negative trends. The AIDIS 2001 confirmed the increasing dependency on informal credit. Interestingly, the second decade of reforms saw many largely successful proactive State policies and regulatory action to contain these tendencies. Constant and effective structured monitoring played a vital role

in their success. The monitoring and compliance by the financial institutions was possible since they were well regulated entities subject to sufficient oversight including government level reviews. The hybrid DNA institutions have greater access to both equity and debt through appropriate arrangements. Such arrangements favour effective monitoring and compliance as compared to Enterprise-DNA institutions.

Hybrid DNA mFI's: Two Examples

1. S**anghamitra Rural Financial Services (SRFS)** is perhaps the first Hybrid DNA Microfinance Institution in India. It represents a unique experiment in the microfinance sector. MYRADA which pioneered the SHG movement along with NABARD realised that banks were reluctant to meet the needs of the SHGs even after the Reserve Bank of India (RBI) permissions. MYRADA's original strategy was to marry the mainstream banking system with SHGs. MYRADA found that it is necessary to have a working model that will demonstrate that banking with the SHGs which are essentially peoples' institution is a viable proposition. By 1994, several years after the SHG model was established, MYRADA became even more aware that under the economic liberalization era, banks were consolidating operations and rationalising rural branches. MYRADA felt that while it pioneered and created a well founded, replicable model of building bankable peoples' institution, the expected linkage with banks were not going to happen easily. The alternative was to set up an independent entity to provide credit to the SHGs. The SRFS was established as a non profit Company under section 25 of the Companies Act 1956 and after much travail obtained the necessary permissions to carry out microfinance activities. It clearly articulated its objectives as working with the poor to reinforce their efforts to rise and remain above poverty line.

   The objectives were not confined to financial intermediation. Over time Sanghamithra proved over time that the poor are bankable, helped to create confidence among banks that credit to SHGs is recoverable, and that there is space for an intermediary organisation that would pay for itself. It also ran into several roadblocks when it tried to respond to client needs. For example when it sought regulatory and legal clearance to provide larger loans to needy individuals, the request was rejected with the explanation that it will constitute commercial activities as that of an Non Banking Finance Company) NBFC. The overall impact and success of Sanghamithra is a matter for more detailed study and analysis. The experience is invoked here to focus on the relevance of a more interventionist model of financial intermediation while dealing with the poor and deprived; the poverty and deprivation here are seen from far wider sense than minimalistic definitions of absolute poverty or deprivation bordering on destituteness (Sriram, MS: Building Bridges between the Poor and the Banking System).

2. **NABARD Financial Services Limited (NABFINS):** The Board of NABARD while establishing NABARD Financial Service Ltd (NABFINS) which was registered with RBI in 2008, envisaged the following benchmark principles for the company: i) set standards of governance among the mFIs; ii) operate with exemplary levels of transparency; iii) operate at reasonable / moderate rates of interest and iv) provide a "bundle" of "retail" financial services at door step/ near doorstep. It has been constituted as a for profit company under the Companies Act 1956 non-deposit taking Non Banking Financial Company (NBFC-ND) with all India Jurisdiction. The for profit nature enables it to raise equity and net-worth without restrictions as opposed to the not for profit section 25 companies.

   The first three benchmark principles focus on the company's governance, ethics and culture which are critical to keep the organisation on track. With remarkable foresight, the NABARD Board sought to warn NABFINS against practices that we now know were mainly responsible for the crisis in the micro finance sector. NABFINS has endeavored to respect these benchmark principles and to design its organizational structure and supporting systems to promote them. The Board of NABARD also realized that for NABFINS to achieve its objective to support sustainable livelihood strategies of the poor and marginalised and to promote peoples institutions both at the base and at the second level (which can aggregate, add value to participants) provision of credit is critical but not enough. It therefore stated that the NABFINS business model requires "substantial amount of strategic alliances"; therefore it must "build synergies with other institutions involved in development in the area of operation". This strategic direction, based on the understanding that credit alone would not suffice to include the target group into the growth process requires an organisational culture which promotes healthy partnerships rather than either cut-throat competition or cartelisation. Partnership is defined as "sharing risks". NABFINS decided that its client risks also should be shared as part of its core operational strategy.

   NABFINS will try to balance Business with Inclusion of the marginalised in the growth process, not just in the financial system. It follows that its business model would have to ensure that it adheres to all the requirements of a business - mainly to break even as soon as possible and that it customizes its loan products and mobilises support services, in a partnership mode, to meet the diverse needs of its clients and to remove the hurdles to their inclusion. Given the diversity of loan purposes and sizes required and the need to respond quickly to unexpected changes, the decision how to customise must be made by peoples institutions at the base which are able to assess each loan, provide support to members to cope with pressure from a male dominated society to divert the money for their purposes, exert pressure to repay and adjust the repayment schedule if required. These functions promote inclusive development. This is why NABFINS partners peoples' institutions at the base like SHGs and JLGs as well as at the second level like companies

and cooperatives in which people have an ownership stake and set the agenda.

Learning from the impact of the micro finance sector in general, that inclusion of the marginalized in the growth process involves considerable risks to the them, NABFINS decided to i) incorporate and address the risks of its clients in its business model and ii) work with partners to provide all round support to the client in its business model.

Reducing the risks of clients will be a structural part of its core strategy and not an add on through corporate social responsibility. This requires that the core of its business model does not adopt any strategies, systems and practices which increase the risk of the client in order to reduce the risk to NABFINS and maximize profits. Examples of these features which increase the risk of the clients which emerged from NABFINS analysis of the micro finance scenario are the following: Standardisation, a multiple lending growth model, exclusive focus on maximisation of profits, high remunerations and incentives related to outstanding and recoveries.

NABFINS selects BCs as partners who are involved in reducing the risk arising from the nature of investments and creating value for its clients. For example, it partners BCs involved in watershed management (which reduces the risk of investment in dryland agriculture), those promoting productivity increase, agricultural diversification, health care for the client as well as for livestock/poultry, off farm technical and marketable livelihood skills and insurance. Resources for these programs will be raised by the partner as well as by NABFINS. The risk to NABFINS and the clients is higher in second level institutions like Companies and Cooperatives which aggregate, add value and market. Hence it propose to cover part of this risk through support from financial institutions. To lower risk for all partners and clients, NABFINS invests in improving the quality of the institutions it partners.

To summarise - NABFINS' business plan which is taking shape endeavors to cover all costs of maintenance and growth without raking in excessive profits. It will invest in under banked areas even if it means higher transaction costs. It will provide competition to reduce the interest rates of moneylenders and financial institutions, which are not affordable by the poor. To reduce the clients' risk, it will respect the diversity of several livelihood activities, which comprise a poor family's livelihood strategy and not reduce this strategy to a single large so-called viable activity (which the family finds it cannot manage) or to a standardised product to fit into pre-designed software. It will endeavor to develop low cost delivery systems and organisational structure. (Fernandez, AP, 2011)

The two examples above are poignant. In the first, MYRADA, a well established, highly reputed Development NGO took to the "subsidiarisation" route to create an interventionist and developmental Financial Intermediary at a time of need. NABARD, the largest Development Bank in the country and the catalyst for nurturing the largest microfinance movement in the world, sought to do the same at a time of crisis in the microfinance sector by establishing a value based commercial subsidiary

that will not only deliver financial services, particularly to agricultural and microfinance sectors, but also set standards in governance, ensure regulatory compliance, and adhere to transparent and fair practices. The equity of NABFINS is contributed by NABARD who is the majority share holder, the Government of Karnataka, and financial institutions such as Union Bank, Canara Bank, Federal Bank and Dhanalakshmi Bank reflecting a shareholding pattern for the proposed model.

Sanghamithra was able to break even and make fair amount of profit in its first three years of existence. It demonstrated that with appropriate procedures it was able to slash transaction costs and deal with the poor. Sanghamithra had a repayment rate of 98.9% and PAR at 60 days was 6.1% (2003). Sanghamithra achieved thereby proper customer identification keeping the procedures simple and also keeping both products and repayments simple. However, being a not for profit company under section 25, it has limited access to equity and thus have serious restrictions on the amount of money it can borrow for onlending.

NABFINS was able to scale up its operations both geographically and financially in a short period of two years since it started its operations in November 2009. It is able to reach a portfolio size of Rs.100 Crore with a small staff compliment of the 70. The model adopted by NABFINS involved the engagement of Community entrenched NGOs as Business Correspondents. This methodology enables to reduce transaction costs and ensure door step delivery of services thus reducing costs to clients. NABFINS too has simple processes, and client friendly repayment schedules etc. The organic link of NABFINS with NABARD enables it to bring convergence with provision of credit and several grant assisted developments of NABARD.

Both are Hybrid DNA Institutions. Both need to succeed. At the same time the NABFINS model is replicable through the subsidiarisation route by public sector banks, development financial institutions, and RRBs. Such institutions shall have access to both debt and equity funds by the very status of being a subsidiary of entities mandated to serve the defined client group of the microfinance sector. Over time, it can build strategic alliances with both the holding entity as well other major players to bring a bundle of financial services and other developmental services to the community. The Sanghamithra model may need highly motivated leadership backed by a developmental interventionist NGO or a strong corporate CSR initiative to replicate.

Conclusions

The Hybrid-DNA financial intermediaries with greater interventionist and developmental role is a relevant and workable alternative in the context of the evolving microfinance sector. They are better equipped to understand and respond to demand end realities. These institutions have a greater understanding about major characteristics of the potential microfinance universe such as the need to continue efforts

for socio economic inclusion, the non-scalar, marginal nature of production of goods and services, the need for organizing the client segment into producers/services providers for aggregation and integrating them into a tubular supply chain etc. It recognizes the urgent attention necessary for multi agency convergence for strengthening institutional arrangements to perpetuate the Service-DNA and commitment to poverty alleviation. The proposed institutions shall also ensure effective regulatory environment in all crucial areas. In-house access to managerial talent, continuous oversight by the holding entity, easier supervision as a related entity of well regulated entities also finds argument in favour of such institutions.

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Evolution of Mobile Banking in Microfinance: Issues and Challenges

- K. Martina Rani*

By bringing informal transactions into formal economy, thus m-banking becomes transformational m-banking. M-banking services can bring financial services to previously unbanked people and socio-economic development will follow in its track

Abstract

The last two decades have witnessed a vast change in the mode of financial services offered by not only banks but also the financial sector, all of which have had a positive impact on the customers of these organisations and the general public at large.[1]

Mobile phones are the new channel, explored by India to spread financial services. As an initial effort, the RBI in 2006 announced that it would develop a regulatory and oversight framework for mobile banking, and made clear its concern over the safety of transactions through mobile phones. Beginning from 2006, RBI has been issuing various guidelines for viable growth of mobile banking service as a tool of financial inclusion.

Generally the first concern of the regulator is to maintain, and if necessary restore, public confidence in financial services and markets. In addition to financial stability, the regulator is also concerned with financial inclusion. Hence, the restrictions imposed on the industry must be proportionate to the benefits that are expected to result from the restrictions. While making judgements for this, they take into account the costs to firms and consumers, by applying cost benefit analysis of proposed regulatory requirement.[2] Proportionate, hence, is said to be the application of regulations which should not be burdesome and overly restrictive, recognising and resolving any inconsistancies in the light of country's overall priorities and achieve an appropriate balance for encourgaging innovations among the players through various types of partnerhip models.

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This potential bank-mobile telephony integration has been the long awaited issue which has started appearing with the possibility of delivering new financial services by leveraging secure, low-cost mobile networks and extending access to financial services and perhaps stimulating convergence of two services-banks and telcos. Hence, the ability of mobile money is facilitation of financial inclusion that gives enormous potential for development impact.

However, the challenges to the growth of mobile banking services depend upon the issues like Business Correspondent (BC) appointments, KYC norms, Technology and Risk connected with mobile banking services. Hence, the paper attempts to bring out the regulatory issues relating to the challenges created by the mobile money market based on the experiences of few successful mobile banking services of developing countries like Bangladesh, Kenya, Philippines and South Africa.

Introduction

In developing countries, formal banking reaches about 37% of the population, compared with a 50% penetration rate for mobile phones. For every 10,000 people, these countries have one bank branch and one ATM, but 5,000 mobile phones. There was a study conducted by McKinsey with Global System for Mobile Communication Association(GSMA) on 147 countries, which says that about 1 billion people in emerging markets have mobile phones but no access to banking services; by 2012 this population will reach 1.7 billion. Today, only about 45 million people without traditional bank accounts use mobile money, but it is expected that this number could rise to 360 million by 2012, if mobile operators were to achieve the adoption rates of some early movers (Beshouri 2010).

It is expected that mobile banking could bring down the cost of delivering financial services to unbanked people.[3] It is hoped that technology will help to increase the outreach as well as reducing operating costs, which is made possible through mobile banking (m-banking) (Bhavani et.al.2008). By bringing informal transactions into formal economy, thus m-banking becomes transformational m-banking. M-banking services are believed to have real development impact, as it can bring financial services to previously unbanked people and socio-economic development will follow in its track (Bangens and Soderberg 2008). Transformational m-banking markets in South Africa, Kenya, the Philippines have been growing very fast, transforming the informal economy by bringing the rural poor into the inclusive finance. Among the various countries, South Asia is one of the fastest growing regions in terms of mobile phone subscribers. The mobile phones are already transforming lives of people here for the better by enabling people to 'leapfrog'.[4] Domestic and international remittances have become indicative of the potential of mobile banking as the case of the Philippines' G-Cash from Globe Telecom and Kenya's M-PESA from Safaricom demonstrate. International remittances have significant contribution to South Asian countries' national economies.

The remittance flows to developing countries reached US $305 billion out of which South Asia got US $66 billion (22%) in 2008.[5] The Juniper research on Mobile financial services forecasts that by 2011, there will be US $587 billion worth of financial transactions to be handled by mobile financial service around the world.[6]

This potential bank-mobile telephony integration has been the long awaited issue which has started appearing with the possibility of delivering new financial services by leveraging secure, low-cost mobile networks and extending access to financial services and perhaps stimulating convergence of two services-banks and telcos (Schutts 2007). Hence, the ability of mobile money is facilitation of financial inclusion that gives enormous potential for development impact.

Due to these developments which are the real challenges to India, the paper attempts to study such challenges which become the main issues to practitioners and policymakers. The main areas of concern are using Business Correspondent (BC) services in the channel of m-banking, KYC norms, Technology issues and Risks connected with mobile banking services.

Literature Review

According to Miller H. (2008), the major drive for the successful financial innovations have come from regulations and taxes. A Financial Innovation (FI) is defined as running a new process that reduces costs, reduces risks, or provides an improved product/service/instrument that better satisfies financial system participants' demands. This process includes several periods of volatility or stability. A mobile banking can be regarded as financial innovation, as it reduces cost of reaching out the poor.[7] The conditions in which innovations emerge can be the nature of technology, the structure and competitiveness of the industry, the economic environment of the industry and the regulatory environment of the industry. The diffusion of m-banking is likely to be dictated by a multitude of factors; general and country specific. To develop and adapt technologies in mobile banking, the successful marriage of two fundamentally different technological platforms; banking and mobile telephony is inevitable. The work of Sridhar and Sridhar (2000) points out that as the ICT infrastructure improves, transaction costs reduce, and output increases for firms influencing various sector of the economy.[8] Thus investment in ICT infrastructure and derived services provide significant benefits to the economy. Bangens and Soderberg (2008) say that so far policy makers and regulators have taken on a "wait and see" approach and their attitude favours the payment service but not deposit taking service. The regulators will eventually know the gap in the service and clarify the rules of the game and it is not an easy task for regulators to fix the rules of the game on one hand and m-banking evolutionary pace and curve are difficult to predict on the other hand. Morawczynski, Olgo & Miscione, G. (2008) conducted ethnographic research on M-Pesa, the m-banking service, studying how poor people belonging to

two places Kiber and Bukura support the m-banking services. The research offers insight into how poor people use M-Pesa, its impact on their lives, and some unexpected consequences. Rapid adoption and frequent use of M-Pesa engendered a variety of positive outcomes. Pickens et. al (2009) say that by partnering with financial service providers, mobile operators can play a significant a role in mobilising savings. Branch-less banking channels-mobile phones or card-based solutions, often with merchants acting as cash-handling agents will likely play a prominent role. These approaches will deliver cheaper financial services to the poor recipients than using traditional payment arrangement. Mas, Ignacio (2008) highlight that even where there is agency network with third parties to serve as their retail channels, banking regulations require bank to retain legal and financial responsibility for the action of all its retailers. Banks can outsource its operations, but cannot delegate responsibilities. Banks may achieve lower costs, but these retail arrangements do not transform the nature of the problem. It remains difficult and involves cost for bank to go after business where the volume of deposits is relatively low, either because of low population density or low income levels. Beshouris and Gravrak (2010) argue that m-Banking will have the effect of increase in direct revenue primarily from financial services fees and increase in indirect revenue, along with others benefits of reduced churn[9] and higher average revenues per user for traditional voice and short message service (SMS). In a Vodafone report, "Africa: The impact of Mobile Phones (2005)"[10], it is said that higher levels of mobile penetration led to higher rates of GDP growth, particularly among low-income developing countries.

Hence, the economic sector, financial sector, telecom sector, and the public sector need to continue to partner so as to harness the full potential of mobile technology to achieve sustainable economic growth to eliminate poverty from this world.

Issues and Challenges

The microfinance sector has been growing at 30% per annum over the last few decades and has become a possible source of hope to drive out poverty, combined with intermediary services of BCs and NGO. However, the sector has touched less than 200 million people, (at best 1 billion people considering a family size of five). There are probably 4 billion unbanked[11] people in the world and over the last four decades, 41% of the adult population in our country is unbanked, who are still waiting for microfinance to arrive to their doors (Shankar 2007; Ashta 2009). One such technology is mobile banking.

In India, banks have been exploring the feasibility of using mobile phones as an alternative channel of delivery of banking services since 2006. Before that in the Mid Term Review of Policy (2005-06), the RBI exhorted banks to make basic no-frills savings accounts, either with nil or low balances, widely available to a vast section of the population in a transparent manner and permitted banks to utilise the services

of non-governmental organisations (NGOs), micro-finance instituions (other than Non-Banking Financial Companies) and other civil society organizations as agents either Business Correspondants(BCs) or Business Facilitators (BFs).[12]

The report of the IIMS surveys reveal that more than 60% of the household expenditure is from non-institutional resource that made RBI give priority for inclusive growth.[13] The major challenges to banks in extending services to the excluded are large costs of covering the huge number, small ticket size for each transaction, need for communication modes suited to the illiterate and in local language, affordability of the product or service, need for local acceptance and involvement locally acceptable. This objective was clearly spelt out in Vision 2020 to bring in 600 million new customers with the help of a variety of channels leveraging on IT. The Mobile Banking Services Report released by World Economic Forum 2011 reports that India is strengthened with readiness of market environment and whereas the country has competitive disadvantage in the agency network.

M-banking in India, viewed by the government as a potent tool for financial inclusion, is yet to clear many hurdles before it can fulfill its objective of reaching the unbanked masses. As an initial effort, the RBI in 2006 announced that it would develop a regulatory and oversight framework for mobile banking, and made clear its concern over the safety of transactions through mobile phones. Beginning from 2006, RBI has been issuing various guidelines for viable growth of mobile banking service as a tool of financial inclusion. Operative guidelines for Mobile Banking Transactions in India were notified on October 8, 2008[14] (Appendix I). On 24th December 2009, RBI released operative Guidelines for Banks on mobile banking.[15] Banks are now permitted to offer the service subject to a daily cap of Rs. 50,000 per customer for both funds transfer and transactions involving purchase of goods/ services with certain conditions (Appendix II).

The challenges to the growth of mobile banking services depend upon the various issues such as working of agency model -BCs and BFs, Know Your Customer (KYC) norms, mobile technology and risk connected with mobile banking services. Hence it is imperative to discuss the following issues which are the major challenges to be addressed by the policymakers and regulators.

i. Agency model: With the objective of meeting the financial needs, RBI, has been issuing circulars since January 2006 permitting few categories of institutions and individual to act as BFs or BC. The greatest benefit of agency model is that RBI has allowed BCs appointed in compliance with RBI guidelines, for extending mobile banking services to their customers.[16]

The agency model can be regarded as an innovation that would permit us to transform the economics of financial delivery at the customer end, be it wholesale arrangements or retail arrangements for the supply of financial services, and it can result in the use of

1. Existing retail outlets in the form of BC

2. Existing technology of banks and Telcos
3. Existing mobile phones owned by BCs.

The first two steps above are the essence of the banking agent model that had considerable success in Brazil. Extension of the model using mobile phones is finding market success in Philippines, Kenya and South Africa. (Mas, Ignacio 2008) And India can also be added to the list of these developing countries, by relaxing regulations on BCs for same use.

Hence while using agency model, the banks look into the following aspects[17]:

- Selection of BCs and their appointment with strict norms.
- Complete oversight of processess and performance of BCs.
- Regular audit of BCs activities.
- Responsibility of training the BC and its Members on KYC and Anti Money Laundering (AML) practices.
- All customer transactions have to be electronically stored and are to be available on request to the Customer in the form of an e-passbook.
- Ensuring that BCs render valuable service to their customers interms of opening of accounts, cash deposits and withdrawals, KYC norms, protecting customers' interests, etc.,

However, in the spirit of the BC model, only banks willing to assume ultimate responsibility for the service and have the ability to enforce the agreed terms and conditions with the BC should use this model to create financial inclusion. The guidelines permit the BCs for the appointment of employees, contract workers, members, agents, etc., for rendering services defined herein on behalf of the BC, and it is upto BC that their employees/workers/members/agents work as per the laid out procedure. (Sengupta, Santanu 2009). At present, BCs are used as a tool for raising deposits through no-frills accounts and they are used for the various governments like NREGA, pension and other social security payments are routed. If BCs are used for this purpose, the income generated by the BCs will not be sustainbale over a period.[18] For a BC to be viablly used, the range of services to be delivered through the BC should be ramped up to include suitable small savings, micro credit, micro insurance, small value remittances, etc.

Many banks have utilized the scheme for expanding their operations. Many bank have started functioning with BCs, like SBI, ICICI, HDFC etc.. September 2010, banks used the services of NGOs and MFIs, but after the announcement of revised guidelines, all registered companies, except non-banking financial companies (NBFCs), as business correspondents (BCs) in addition to the individuals/entities permitted earlier. The new guidelines have opened up avenues for even technology companies to engage with banks as business correspondents. TCS is engaged on the business correspondent level with certain banks and is taking active part in field management platform. The new guidelines would address common issues such as physical constraint of spacing and location.[19]

However, a white paper on "The Series on Financial Inclusion", which studied the mix of possible structure evaluating the BCs based on two crucial factors: the profit structure and size, suggests that large non-profit can be an optimal structure due to the factors like lack of risk of higher returns to the stakeholders, attraction of foundation funds, and lower cost of service due to large customer base (figure 1).

Figure 1: Optional Structure for BCs

	For Profit	Not For Profit
Large Entities	• Large scale, lower cost for customers • Good employees with talent • Shareholders demand profits • For profit structures could be viewed with suspicion and getting funding from foundations could be harder	• Large scale, lower cost for customers • Ability to attract and retain talented employees with performance bonuses • Can attract foundation money
Small Entities	• Small scale, high cost • Low reach, unable to serve most • The drive to keep cutting cost and not seeking outsize returns will not be easy in a for profit	• Cannot attract employees, no innovation • Low reach, unable to serve most • Will service poor • Small scale, hgh cost

Source: Series on Financial Inclusion, Bhargava, Sanjay

ii. Know Your Customer (KYC) Norms: The concept of KYC is to know the five basics among others, of a customer -nature, source, location, ownership and purpose. As a measure of Anti-money launderring and combating financial terrorism, the KYC norms are being laid from time to time and it started with a circular[20] issued by RBI in 2002 emphasising formulation of KYC policies and Risk Management and Monitoring procedures. Also another Circular[21] was issued on customer due diligence (CDD) prescribing key elements of KYC policies, like customer acceptance policy, customer identification procedures, monitoring of transactions and risk management. Thus KYC norms are applicable to not only the customers who have accounts, but also to the individual who get connected to the banks for financial transactions. As a measure of faster creation of Financial Inclusion, simplified KYC, one time settlement (OTS) for loans upto Rs. 25,000, offering a GCC/simplified overdrafts, etc., were implemented. 100% financial inclusion was aimed through enrolment and identification. In August 2006, through the circular[22] KYC norms were relaxed for those who did not have proper location identification[23] (Thorat, Usha 2008). Though there are number of issues to be focused on KYC norms for the traditional banking like, proper identification and location requirements, there are additional challenges which are something extra to the mobile applications. When mobile technology is operated by the BCs, the following precautionary measures are considered:[24]

- To appoint BCs as intermediary to offer banking services to customers as per RBI circular DBOD.No.BL.BC.58/22/01/001/2005-06
- The control of customer ownership is with the bank.
- KYC should prescribe separate identification to banks and telecom companies.
- The KYC documents should be thorough and only a bank official should be the ultimate authorizing person to allow opening of the account.
- Banks may adopt stringent selection criteria for its members, with airtight process for monitoring of all member of BCs, and regular audit of member activities and location.
- The bank will be responsible for training the BC and its members on KYC and AML/CFT practices.
- Banks should ensure that customers access their account through their mobile phones over available mobile networks to ensure a complete mobile experience.
- All customer transactions can be electronically stored and be made available on request to the customer in the form of e-passbook.

The KYC norms provide protection against money laundering and financing of terrorism. The goals of AML/CFT may create financial exclusion if the procedures are too costly and if the prospective customers do not have proper identity. The KYC norms are followed by Suspicious reports (SAR) and Usage limits (UL). The role of SAR and UL is much more greater than KYC, provided KYC procedure is not very tough. Hence, tightening the SAR and UL procedure would be apt than having the stringent KYC policies.

iii. Technology: Developing a solid management information system still remains one of the most important tasks facing Banks and mFIs, particularly those scaling up, because of the high cost and limited availability of existing technological solutions, lack of widely available local technical support to support MIS software, consumer adoption rates of technology, lack of basic communications infrastructure (Gopinath, Shyamal 2009). In 2008, the RBI issued guidelines[25] and circular[26] on Regulatory and supervisory issues like risks and controlling computers and telecommunication risks applying to mobile banking. Rapid expansion in the use of mobile phones as a mode of communication has created new opportunities for banks to use this mode for banking transactions. Many countries have adopted this delivery channel as a means of financial inclusion as this facilitates small value payments at a very low cost.[27]

Lyman et. Al. (2006) makes two distinctions of m-banking: 1. Bank led and 2. Non-bank led actors. In the bank-based model, customers have a direct contractual relationship with a prudentially licensed and supervised bank or a financial institution. In the non-bank model,[28] customers have no direct contractual relationship with a fully prudentially licensed and supervised financial institution. This virtual account is stored on the server of a non-bank. Whatever be the models, there is presence of all the players and even in non bank led model where banks hold excess cash deposit to effect the m-transactions. After taking into account various issues involved, India

has adopted the bank-led model.

The RBI emphazizes telcos to follow widely accepted open standards to allow interoperability among the different systems adopted by different banks, being encouraged by financial Inclusion Technology fund. One of the very important issues in the technology is the interoperability, because of the lack of common technology standards for mobile banking. Many protocols are being used for mobile banking HTML,WAP, SOAP, XML, etc., The disadvantage of these protocols are inability to connect to multiple banks. There are a large number of different mobile phone devices and it is a big challenge for banks. Some of the device support J2ME and others support WAP browser or only SMS. Overcoming interoperability issues, have localised, with countries like India using portals like R-World to enable the limitations of low end java based phones, whereas, South Africa have defaulted to the USSD as a basis of communication achievable with any phone. Some transactions are difficult to be operated by internet banking with SMA, whereas Java based applications are of better security and easy to use (Agarwal, Gaurav 2007). The physical security of the hand-held device, thick-client application running on the device to protect the clients' ID/ Password to access the application, authentication of the device with service provider to avoid connection to the unauthorised devices, User ID/password authentication of bank's account, Encryption of the data being transmitted over the air and Encryption of the data that will be stored in device for later/off-line analysis by the customer are the major technology concerns.

The RBI's guidelines call for a two-factor authentication for validation of a customer. The industry has reacted to this by interpreting that two-factor authentication can be supported only by GPRS and not through SMS. The two factor authentication does not facilitate financial inclusion since basic mobile phones owned by majority of people in rural India do not support GPRS. In April 2010, the RBI issued a new circular mandating the use of two factor authentication for all IVR and mobile based online payments with effect from January 2011. To comply with the RBI's new guidelines, India's banks have made it mandatory for a customer to generate a "One Time Password" (OTP) for every single mobile transaction.

iv. Risks : When business activities around the world increasingly attract outsourcing, as a means of both reducing cost and accessing specialist expertise, which are not available internally to achieve strategic aims. The appointment of BCs for mobile banking services is an outsourcing activity, hence to address issues on risks involved in BC models, the banks are advised to refer guidelines on 'Outsourcing of Financial Services' issued by the RBI on November 3 2006. Outsourcing brings in its wake, several risks. The Strategic risk arises when the service provider conducts business inconsistent with the goals of banks. Poor service by the service provider may result in Reputation risk to the bank, when the service provider hinders the compliance with prudential norms applicable to banking services, it leads to compliance risk. Operational risk arises due to technology failure, fraud, error, inadequate financial capacity to fulfil

obligation or provide remedies. The over reliance on the outsider may result in loss of relevant skills in the bank itself preventing itself from bringing the activity back in-house and the improper credit assessments may give rise to counterparty risk, the social, political and legal factors to Country risk, Contractual risk results if the banker is unable to pursue, lack of control of individual banks over a service provider may result in concentration and systematic risk. The failure to manage these risks can lead to financial losses/reputational risk for the bank and could lead to systematic risks within entire banking system of the country.[29] Apart from these risks, there are other types of risk which are directly involved in the dealing and handling the cash are theft of cash, identity theft, frauds relating to receipts, failure of transactions, success of wrong transactions, theft of mobile phones, wrong communication between banks and BCs and between BCs and customers etc., Hence it is important that banks, BCs and their members create, implement and evolve their systems at every level in a way that facilitates early detection and hence prevention of fraudulent activities. Such fraudulent activities may be carried out by both BC member and customer alike. Banks and their BC should be cognizant of these and try to minimize the same at as early stage as possible.

Hence, the RBI may keep a watchful eye for competitive dynamics in the payments network which includes diagnosis of many issues and challenges mentioned to the mobile banking, which can be understood from the following discussion on the mobile banking system based on the various experiences of countries like Kenya, Philippines, South Africa, Bangladesh including India.

Kenya: In Kenya, the Financial Institutions Supervision Department is responsible for the prudential regulation of banks and deposit taking MFIs. The country's National Payment system (NPS) views M-Pesa (Third party provider-Non bank led model) as a payment service provider dealing with e-money,[30] however it does not have specific regulations to supervise the payment system. With respect to bank led models, Central Bank of Kenya (CBK) is approving agents on an ad hoc basis. It exercises its approval right in its sole discretion. The telecommunications regulator, Central Communications of Kenya (CCK) and the National Communications Secretariat agree that the central bank should oversee financial services offered by MNOs. CBK is primarily responsible for regulating and supervising the payments system. There are no licensed credit reference bureaus yet in Kenya, but there are firms providing some of the same services.(Liu and Mithika.2009) The regulation of M-Pesa's services is not yet formalised by the Central Bank, which has agreed to allow the transactions under the assumption that "remittance is not banking"[31] and should be viewed as a payment service. The country has AML/CFT law in the form of AML Bill 2007. The agents are not covered by any law.

South Africa: South Africa has made it a priority to extend reliable financial service in spite of the e-money to be issued by only banks. The South African Reserve Bank (SARB-Central bank of South Africa) issued a Position paper on E-money[32]

enabling e-money issue only by banks. The payment of bills are considered payment services, but transfer payments between people (remittances) are considered deposits. Under the National Payment System Act, SARB is permitted to delegate its responsibilities with respect to control of the national payment system to Payment Association of South Africa (PASA) which is the self regulatory body for payment system. Bank Circular 6[33] and Exemption 17 allows banks to open mobile phone operated banks accounts without face-to-face KYC procedures[34], beyond a limit, it is necessary. These data must then be verified against a third-party source, such as credit bureaus or databases containing information from the Department of Home Affairs. To transfer money Wizzit uses the well developed South African inter-bank clearing house system as an as an autonomous division of the South African Bank of Athens Ltd. The financial Intelligence Center Act (FICA) and its regulations govern anti-money laundering. The country permits a range of player subject to appropriate regulation

Philippines: The Bangko Sentral ng Pilipinas (BSP), the central bank of Philippines, in 2000, issued two circulars[35] requiring banks wishing to offer services via electronic channels to seek prior approval from Payment system unit of BSP before offering them to the public. Pursuant to the circulars, five commercial banks (each having applied individually) have entered into partnerships with Smart, the largest MNO, to use the Smart Money mobile payments platform for account opening, marketing, data processing and other functions. In Philippines, e-money[36] is not considered as deposits. In 2006, the BSP passed a circular[37] for consumer protection, and it requires face to face check by remittance agents. Smart money and G-Cash render international remittances services through mobile. A draft of the Payments and Settlements system act is pending for implementation. And G-Cash was chosen by Rural Bankers Association of Philippines and Microenterprise Access to Baking service (MABS) to provide microfinance products to the rural poor. The country follows FATF's AML?CFT recommendation. The BSP circular 471, covers all registered agents under it as remittance agents.

India: RBI has been issuing various guidelines since 2006 for viable growth of mobile banking service as a tool of financial inclusion. In year 2008, the RBI issued mobile banking guidelines[38] that permit only licensed banks with a physical bank presence in India to launch mobile banking. This disqualifies mobile network operators from offering their own service. Services shall be restricted only to customers of banks and holders of debit/credit cards issued as per Reserve Bank of India guidelines. After the modification of guidelines in 2009[39], banks are now permitted to offer this service to their customers subject to a daily cap of Rs. 50,000 per customer for both funds transfer and transactions involving purchase of goods/ services. The guidelines mandate interoperability among service providers to ensure prevention of monopoly by one or a few mobile operators. The guidelines 2008 and 2009 reflect a fact that RBI plans to provide additional guidance for mobile banking to take off. And RBI indicated that it sees high potential for electronic banking to increase efficiency

and have concern for mobile security, particularly authenticating users accessing bank accounts remotely.[40] The mobile payment is being guided by the Payment and Settlements Systems Bill 2008 and the country has an agency model called BC model[41] and the Prevention of Money Laundering Act 2002 govern the AML/CFT.[42] There are few pilot projects going on in few States of India, however all the projects are under bank led model, of which, FINO (a financial services technology provider) emerged just three years ago, reached 10 million[43] poor clients with various financial services on behalf of banks. FINO has launched FINO-MITRA (Mobile Based Information and Transactions) a comprehensive set of end-to-end offerings for enabling microfinance initiatives leveraging mobile as a platform. SKS finance, from India, is testing m-banking model in the State of Andhra Pradesh in collaboration with Andhra Bank. However the model being used is bank led model.

Bangladesh: Bangladesh Bank (BB-the Central Bank) has published the draft 'Bangladesh Payment and Settlement System Regulation 2009' with the aim of modernising the payment and settlement systems functioning in Bangladesh. BB will have the authority to grant licenses for payment systems under bank based model. E-money can be issue by any entity authorised by BB. The regulation leaves room open for the Bank to issue rules, procedures, guidelines and directives under the Regulations in order to govern paper-based payment items and other instruments that are eligible for transaction and electronic check image presentment. Under this regulation, banks are to recognise the new payment instrument as a Designated Payment Instrument for protecting the interest of the public by ensuring integrity, security and reliability of the payment system. In September 2009, BB has given approval to three commercial banks to introduce e-money service named 'Digital money electronic prepaid system' (Sultana 2008). The central bank permitted Trust Bank Ltd. to act as a settlement bank for digital money transfer. Grameen Phone (GP), Bangladesh's top mobile service provider, partnered with Dutch Bangla Bank to provide its users with a mobile banking service. The service allows customers to use text messages on their mobile phones to pay their phones bill by debiting against their accounts directly, check their balance (Kramer and Paul 2006). AML/CBT transactions are regulated by under Money Laundering prevention Act 2002.

Conclusion

Mobile Banking is the most spoken about factor in the area of development in the banking sector as a whole and mobile Banking system can be faster if the issues discussed such as agency model, KYC, Technology and risks are addressed. And India can also be added to the list of the developing countries, by relaxing regulations on BCs and inclusion of the same in mobile banking regulations. The mobile banking regulations need to be researched piece-meal and put together since they come from many different laws, decrees and circulars which essentially modify the existing banking

and telecom laws to permit the additional activity of mobile banking. The study focused on agents' alliance with the regulations, KYC legislation, technology requirements, risks connected with mobile banking transaction which are notable and there is a needto be addressed based on various others countries experiences in relation to their ability to achieve objectives of their respective financial inclusion polices. Hence proportionate regulation can be welcomed in India.

Further Research Direction

- Interoperability of Service Providers in Mobile Banking
- Customer adoption and Scalability in Mobile Banking
- Technology in Mobile Banking -Trust and Security
- Collective Security Concerns of the Providers
- Development of Proportionate Regulation

Appendix I
Operative Guidelines on Mobile Banking - October 8, 2008

The major features of the guidelines are: (i) Only banks who have received one time approval from Reserve Bank are permitted to provide this facility to customers; (ii) Banks can extend this facility only to their customers and their holders of debit/ credit cards issued as per the extant Reserve Bank guidelines; (iii) banks can extend only Indian Rupee based domestic services as per the guidelines; (iv) banks can extend this facility through their business correspondents also in order to promote financial inclusion; (v) Minimum "Technology and Security Standards" have been prescribed in the guidelines; (vi) limit of Rs. 5,000 per transactions for funds transfer and m-commerce transaction limit of Rs. 10,000 has been prescribed to ensure the safety of transactions through this channel; and (vii) the guidelines mandate interoperability among service providers to ensure prevention of monopoly by one or a few mobile operators.

Appendix II
Operative Guidelines - 24th December 2009

Transactions up to Rs. 1,000 can be facilitated by banks without end-to-end encryption.

Banks can facilitate transfer of funds upto a maximum of Rs. 5,000 from the accounts of their customers for delivery in cash to the recipients, and the disbursal of funds at the agent/ATM shall be permitted only after identification of the recipient covered under Prevention of Money Laundering Act 2002 as amended from time to time.

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7. www.eefs.eu/conf/Athens/Papers/635.pdf
8. http://www.nipfp.org.in/working_paper/wp04_nipfp_014.pdf
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11. The un-banked are people without formal bank accounts who operate in a cash economy; they are limited in their ability to take out loans, maintain savings, or make remote payments, and these constraints can inhibit their economic opportunities.

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13. Household expenditure includes purchase of residential plot, construction, addition/alternation of building for residence, purchase of durable household assets, clothes, medical expenses, education, marriages, and ceremonies- Source : Report on Currency and finance 2007-08
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Technology Intervention in Microfinance: ASOMI's Experience

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Technology can reduce transaction costs and improve transparency in delivering financial services, both of which can translate into increased access and lower costs for many lower-income clients.

Abstract

In the changed perspective of post-Malegam operation of microfinance, the need of the hour happens to be technology intervention vis-à-vis cutting down the cost. The RBI guidelines also urge to take the financial literacy as well as microfinance to the door-step of the financially poor. In ASOMI, state-of-the-art technology is developed using the open source tools for managing the financial transactions, data-base, and preparing the reports. The growth in the portfolio and the expansion of the service area with the same size of the work-force clearly indicates at efficiency achieved through innovative technology intervention, though requiring development of the tools available. Experimentation with Business Correspondent model for the last few years and the experience of project implementation as a Technology Provider for six months suggest robust R&D activity in both software and hardware fronts to make it cost effective.

Introduction

Like any other sectors, in financial sector too, technology plays a major role. Technology can reduce transaction costs and improve transparency in delivering financial services, both of which can translate into increased access and lower costs for many lower-income clients. Streamlined and automated processes allow financial institutions to extend services to hard-to-reach and more costly clientele by replacing people and

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** Looks after the HR and Training of Asomi Finance Pvt. Ltd.

Key Words: Microfinance, Rural, Sustainable Development, Women Empowerment, Technology Intervention, Financial Inclusion, Management Information System, POS.

JEL Classification: G-21, O-32, O-31

branches with point-of-sale (POS) devices and branchless banking strategies. Technology enhances the management information and reporting systems that are essential for efficient financial service delivery.

Despite the appeal of advanced delivery technologies, relatively few financial institutions have successfully deployed them to reach poor and low-income clients. Developing a solid management information system still remains as one of the most challenging tasks for microfinance institutions. Increased demand for technology needs quick adaption and at the same time we also need to upgrade the knowledge of our staff as well as our beneficiaries. It is obvious that, Technology when used effectively can have a transformational effect in unlocking greater efficiencies, more direct outreach to the poor, the innovation of new services, greater insight into social performance, and broader financial transparency across the sector. On the other hand, investment in technology without proper utilisation of the same will have an adverse effect. The present analysis is an attempt to highlight the journey of ASOMI and Asomi Finance Private Limited in the field of technology vis-à-vis Rural Development through Financial Inclusion.

CGAP (Consultative Group to Assist the Poorest) defines branchless banking as the delivery of financial services outside conventional bank branches using information and communications technologies and nonbank retail agents, for example, over card-based networks or with mobile phones. Branchless banking entails these elements:

- Use of technology, such as payment cards or mobile phones, to identify customers and record transactions electronically and, in some cases, to allow customers to initiate transactions remotely.
- Use of (exclusive or nonexclusive) third-party outlets, such as post offices and small retailers, that act as agents for financial services providers and that enable customers to perform functions that require their physical presence, such as cash handling and customer due diligence for account opening.
- Offer of at least basic cash deposit and withdrawal in addition to transactional or payment services.
- Backing of a government-recognised, deposit-taking institution, such as a formally licensed bank.
- Structuring of the above so that customers can use these banking services on a regular basis (available during normal business hours) and without needing to go to bank branches at all, if that's what they choose.

The continuous developments in the microfinance industry necessitate the implementation of computerised management information system (MIS). Technology certainly plays a big role here. But of equal, if not greater importance are the processes used to manage information as it flows in, out, and within an mFI. A good information system equips managers to make informed decisions and produce reliable reports that follow recognised international and national standards. This transparency can also

attract funding agencies and provide clients with immediate information about their accounts, thereby attracting more customers. Technology remains one of the major barriers inhibiting the expansion of microfinance globally.

Process Implementation

We use the term Information Systems to encompass all of the processes involved in gathering, storing, analyzing, and sharing information related to the operations of a microfinance institution (mFI). When complimented by a set of well documented and efficient operating procedures, technology can greatly improve an mFI's ability to effectively manage information. However, selecting the right technology and a well managed implementation mechanism are the keys to success. Of course, for an IT solution to be successful, it is not enough to select the right system. The system also has to be implemented in a way that enables users to use it as it was intended. The only way a person will be able to use the system is if he or she understands it, and thus, training becomes another important area to look into.

Few available IT solutions in Microfinance can broadly be categorised as:

a. Portfolio Management Software
b. POS Enabled Device

For implementing any new information system, we need to follow the six-step process which includes the following:

i. Preparation: This means preparing the project as well as preparing the organisation. The main points that need to be focused on under this are:

who's going to be leading this?
Who needs to be involved in the Project?
How to ensure that various members from various departments of the organisation are working together and jointly, defining the system's requirements?

ii. Need Analysis: The institution must figure out what its needs are today and what they will be tomorrow. What kind of technology context is it operating in? How long will it operate? Will there be any scope for further customisation as per the change of need in future? What environmental considerations does it need to take into consideration? Whom does it need to report to? What kind of reports do its managers need? This step requires detailed documentation of information needs and work flows.

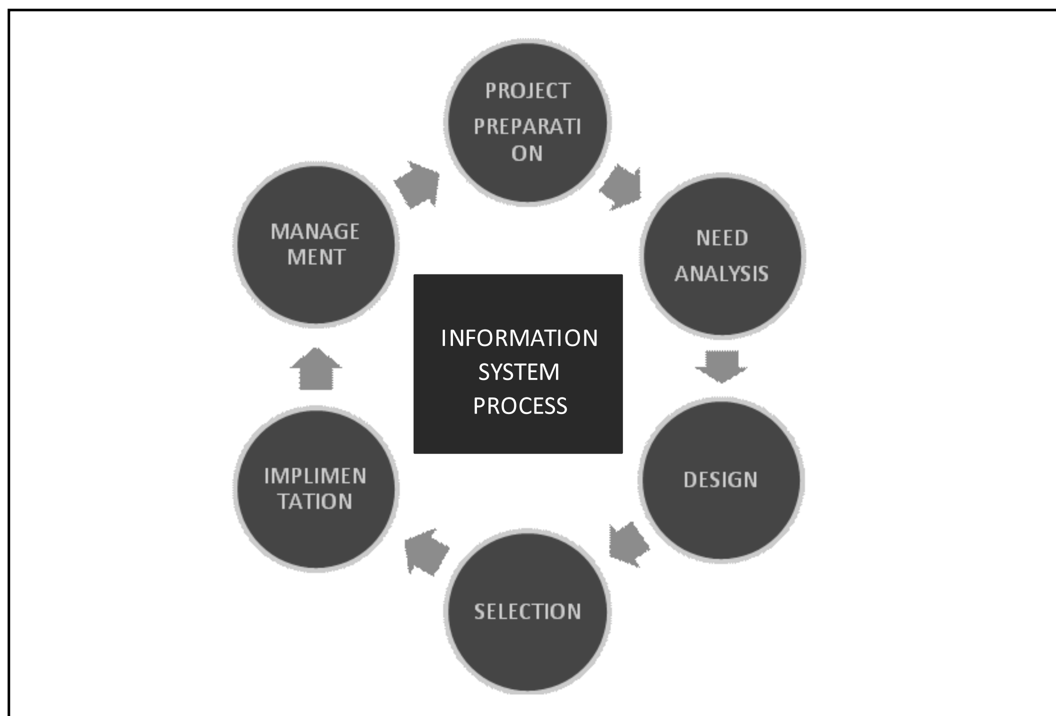
iii. Design: This is the most important step if the institution is designing its own system, but it is also relevant otherwise also, if it is planning to buy someone else's system. The institution needs to define and document, in detail, its solution-requirements. The results of all its previous analysis should be brought together in this phase, reviewed in light of the impact on the entire organization, and integrated as deemed

appropriate to create the new design for the information system. By the end of this stage, the institution should have a clear idea of what its system should be able to do and what it will enable the staff to do.

iv. Selection: During this phase, members of the information systems team research options for addressing the requirements defined in the needs analysis phase. This involves researching companies, distributing a request for proposals, and evaluating the responses received. The institution should select the technology option that it thinks will work best for the institution and its clients and will fit within its budget.

v. Implementation: The implementation phase transforms the information system from a plan to a functioning system. It encompasses the hardware installation, software installation, data conversion and transfer, acceptance testing, staff training and general process alignment.

vi. Management: The management of an information system involves not only caring for the hardware and software that are the main conduit for the collection and dissemination of data, but also attending to the people, procedures, processes, and policies that comprise the complete system.



Technology Tested and Adopted

As the microfinance industry continues to grow and reach more clients in more remote areas, technology becomes an essential tool in making information management and communications. At present, AFPL is operating in 19 districts and with it fast growth, technology has become an indispensible part of it. In ASOMI and AFPL, one can witness three different broad areas of technology intervention as well as development, which can be categorised as under:

(i) Implementation of MIFOS
(ii) Mobile Phone Technology for Proliferation of Microfinance
(iii) BC concept- A Model under Experimentation in ASOMI as well as AFPL.

(i) Implementation of MIFOS: Mifos is a management information system developed to meet the requirements of the microfinance industry. Its architecture is based on Software as a Service (SaaS) framework and delivered through the Internet. The Mifos Initiative was launched in 2006 by the Grameen Foundation's Grameen Technology Center under the leadership of Mr. George Conard. The flexibility and scalability of the product means that one will be able to simultaneously standardise common processes, accommodate regional variations, and scale for new innovations in the future.

Asomi Finance Pvt. Ltd., an mFI working in the state of Assam, is a growing mFI. Prior to implementing Mifos, the organization used spreadsheets and a software package developed in-house in order to manage its data. As the client-base increased and the types of services offered to its clientele increased, it was felt that a more robust information management system was the need of the hour. Out of the several options available, Mifos was chosen for implementation for loan portfolio management.

From operational point of view, Mifos is a portfolio tracking and reporting system. Although, other organisational activities, like finance and human resources, are being integrated, Mifos still has a long way to go to become enterprise level software. Mifos being a community effort, new features are being added every day and many developers from different parts of the world are contributing their efforts to add new features.

- Greater Transparency — anytime, anywhere access for mFI staff and outside stakeholders ensures greater control.
- Deeper Social Alignment — tracking poverty levels of clients through Progress out Poverty Index (PPI), a leading social performance measurement tool.
- Better Decision making — data analysis from multiple dimensions providing deep intelligence about an mFI's business and clients.
- Greater Operational Efficiencies — flexible work management streamlines processes, from client surveying and bulk loan approval to new product roll outs.
- Rapid Response to Market Conditions — flexible product definition and connection to outside services enables proactive response to clients and

competition.

- Cost-effective — a cloud-hosted option requiring no up-front capital expenditure, and minimal IT overhead.

Results of Implementation of MIFOS:

(1) Reduced Paper Work: unnecessary paper work got reduced as a result of this intervention of MIFOS and thus cutting down the transaction, reporting, and documentation cost considerably

(2) Reduced Duplication of Work: Technology support of MIFOS has helped us in reducing data redundancy and duplication of work. Earlier, the same work is done in three different levels-- Branch Office, Area Office and Head Office; but after implementation of MIFOS, the entry is done through MIS Executive at Branch Level and the reports are available at all the levels supported by MIFOS. Thus, manpower engaged to generate one report has also got reduced

(3) Reduced System Error: MIFOS is supported with automatic arithmetic and statistical calculations/operations that can easily detect human error, resulting in a reduced risk of fraud and theft.

(ii) Mobile Phone Technology Perspectives for Microfinance: Financial services have typically been provided under a conventional brick and mortar setup, where clients physically visit service-centers. This approach however has a high transaction cost, and has therefore resulted in financial exclusion of a majority who cannot afford them. For developing countries, where the cost of doing business is relatively high due to the lack of physical infrastructure and institutions, and where income levels are low, this issue becomes even more acute.

For providing financial services to this low-income population, microfinance sector (which primarily caters to this segment) needs to leverage high levels of innovation in technology and process adoption. From ATMs, to POS and smart cards (multiple mFIs in India), to Internet microfinance has effectively lived up to this challenge. Moreover, mobile phones are now envisaged to further revolutionize the way in which micro-finance is delivered. It promises to be transformational primarily because it enables reaching out to people who would normally not be reachable due to their remoteness and the associated high costs of delivery.

There is no universal form of mobile banking. Rather, purposes and structures vary from country to country. Most interventions however offer a bouquet of financial functions (micro-payments to merchants, bill-payments to utilities, money transfers between individuals, long-distance remittances). Currently however, different institutional and business models deliver these systems. Some are offered entirely by banks, while others are done by telecommunications providers, and still others may involve partnership between these. Regulatory factors, which can vary dramatically from country to country, also play a pivotal role in determining which services can be delivered

via what institutional arrangements. (For example, some national laws stipulate that the stored value accounts be managed by a registered bank, which necessarily requires a bank partner). For all the reasons elaborated above, each model has therefore ended up having different set of actors and services.

In ASOMI as well as AFPL, Mobile phone technology was launched in the year 2010. This technology can be referred as smaller version of MIFOS, which is very handy and through it, technology can be carried up to even the lowest level of functioning. As a common practice, few criteria to establish MIFOS in cell phone may be listed as follows:

- Handset with Opera Mini Browser is preferable
- Activation of GPRS is must.

Results of Mobile Phone Intervention:

(1) The main advantage of mobile technology is that it enabled MIFOS to reach each and every branch office, whereas earlier it was limited up to Area Office only

(2) the entry in MIFOS became easier and ensures accuracy as through mobile phone, it is posted instantly in the field itself and can assess one's account anytime, anywhere

(3) moreover, it has also increased the customer satisfaction and loyalty.

(iii) BC Model - An Instrument to take Mainstream Infrastructure to the Poor: ASOMI and AFPL have been serving the poor and rural people through its various development activities. Financial exclusion is one of the major barriers in the economic development of the country. There are certain under-banked states such as Bihar, Orissa, Rajasthan, Uttar Pradesh, Chattisgarh, Jharkhand, West Bengal and a large number of North-Eastern states such as Assam, Manipur and Nagaland, where the average population per branch office continues to be quite high compared to the national average of 16,000 people per bank branch. There are many people who are excluded from all financial services though in recent years, there has been a considerable widening and deepening of the Indian Financial System, of which banking is a significant component.

In the present scenario, financial inclusion is the buzz word which means delivery of banking services at an affordable cost to the vast sections of underprivileged and low income groups. By financial inclusion we mean the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded. It is important to recognize that in the policy framework for development of the formal financial system in India, the need for financial inclusion and covering more and more of the excluded population by the formal financial system has always been consciously emphasized. In India the focus of the financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account without frills, to all, and even this is still a challenge to India. The financially excluded sections as we know, largely comprises

marginal farmers, landless labourers, oral lessees, self-employed unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens women. The reasons for their exclusions from financial demands are basically lack of awareness, low-incomes, illiteracy in addition to inaccessibility to delivery points due to remoteness and poor infrastructure.

The scenario in the state of Assam is not so encouraging and it is categorized as under-served area of the country. The state of Assam has a network of 1509 branches of 28 Commercial Banks, 2 RRBs and Cooperative Banks. The present average population per branch in the state is 17,664 as against the national average of 16,000 with a credit deposit ratio of 42.05 as on 31st March 2010.

Thus to improve the situation, Reserve Bank of India has chalked out a plan for financially including 2327 villages of Assam having a population of 2000 and above. The target for achieving this aim has been set for March 2012. Being the largest Regional Rural Bank in the state of Assam with a branch network of 335 Branches, the State level Bankers entrusted Assam Gramin Vikash Bank to play a major role in the Financial Inclusion Programme.

In the mean time, having seen the need for financial services by the rural people, ASOMI proposed to build up a partnership with Assam Gramin Vikash Bank as a Business Correspondent to provide various financial services to the people of Assam to improve their reach, speed of processing, as well as to cut down the operating costs. It is worth mentioning here that ASOMI has made certain experimentation already, devising and implementing different versions of Business Correspondent through its "Service Providers" in those areas where local mFIs/NGOs were having greater access to the people. The positive output received prompted us to open our own branches in such areas later, and most of the branches are providing good service so far.

In turn, Assam Gramin Vikash Bank has engaged ASOMI as Technology Provider cum Business Correspondent under this programme to provide basic financial services at 409 villages.

The basic objective of the programme includes:

1. Issuing Smart Card to 2,50,000 rural clients in 409 villages.
2. Provide deposit and withdrawal facility at village level through POS machines.
3. Provide financial literacy by organising camps, street play, etc.
4. If allowed by Banks, other banking services would be provided.

ASOMI started its experimenting phase, with three pilot projects executed at

a. Baitamari, Bongaigaon District
b. Nagabat, Jorhat District, and
c. Nayaralga, Dhubri District.

Results of ASOMI'S Implementation of the BC model:

ASOMI has been providing the financial services as well as technology to the clients of AGVB in 3 districts of Assam. In terms of achieving the set mission, ASOMI is satisfied

to be able to touch the lives of more than 2000 households in these three districts during last six months, providing financial services. Though the experience so far has proved to be negative, financially, it is expected that all the stake-holders will reach a win-win situation soon when modifications proposed in the existing model gets approved and implemented. In order to have a better idea of the business carried out under this model, here we have attempted to document monthly transactions ASOMI has had:

Salient Features and Throughput of the BC model implemented so far:

(1) Technology compatible to the software used by the Bank is developed to implement:
    a. POS terminal (with/without Biometric) Smart Card
    b. Mobile based solution with PIN Code
(2) Cost of the technology, especially the recurring cost:
    o Cost per Bank Transaction = Rs. 50
    o Cost per ATM Transaction = Rs. 15
    o Cost of Technology per BC Transaction = Rs. 6
(3) NABARD is providing fund to acquire the POS while funding is required for acquiring / developing the software.
(4) Feed-back and statistics say that the woman is benefitted by getting banking services at field.

Discussions

While providing the services as Business Correspondent for the AGVB, ASOMI has carried out transactions of around Rs. 19.6 lakh in the three districts, a total of 1272 new accounts are opened. Interestingly, the net income generated during this period has been a meager Rs. 36,000 (approximately), resulting in a deficit of around Rs. 55,000 which is far more than the tolerance level for any project to remain alive. Even a school level analysis would point out the reason for non-sustainability of the Project to be that of non-viable means of implementation, may be because of unfamiliarity with the existing ground realities.

To achieve the objectives of financial inclusion it is important to ensure that all stakeholders in the ecosystem are given equal opportunity to survive and sustain themselves. Business correspondents (agents) and their managing support organisations, BCs, play a very important role in promoting Financial Inclusion in India, yet they often face the biggest challenge of sustainability. Further it is also found that over a period of time, the transaction amount keeps on increasing depending on the services allowed to be operated by the BC. Hence for a viable, the revenue structure may be designed in a system of fixed monthly fee plus commission per transaction. Moreover, ASOMI has also proposed to the AGVB for earmarking a Gap Fund of Rs. 15 lakh in order to compensate for the deficits incurred by ASOMI caused during the implementation

so far, and make model viable and sustainable. Few of the issues requiring innovative solutions are further highlighted below.

Challenges

- *High cost:* The cost involved is high. Institutions should invest in advanced delivery technologies only if their foundation, the information system, is already sound. Yet, in many markets, these systems are not available or they are costly to develop. mFIs continue to struggle with integrating baseline technology into their operations for a number of reasons: many mFIs lack the technological know-how to make informed investment decisions when it comes to technology; commercially available software products can be expensive and vendors often do not provide sufficient local support to ensure efficient implementation of the system; mFIs perceive their operations as unique and therefore prefer to build custom applications which are difficult and costly to develop.
- *Limited availability of local technical support to support MIS software*
- *Remuneration to BC is always an issue*
- *Fear factor of technology among common people*
- *Difficulty in using mobile phones:* It has been observed through field experiences that only number literacy is required for transacting on mobile phones (which is a lesser problem than functional and language literacy). Therefore, if one is familiar with the use of mobile phone through its conventional use, all one has to do is to memorise a few strings of numerical code to carry out the transactions. Biometric technology is also being used, especially at initial customer sign up to address the poor literacy levels of the target market. Finger prints or eye scanners are is use or being experimented with to capture identification data.
- *Security Concerns:* Mobile phone technology is a secure channel, and conventional belief is a misconception. Multi-level security authentication can be further enabled, with a minimum of two layers - sim and handset. Security of particular system can be augmented through choice of data formats and whether it can be encrypted or not. Technology choice should however bear in mind that not all options can work on all handsets. It may also be noted that considering low value transactions in microfinance, it is not necessary to have an elaborate, expensive security system as the risk factor is low. For instance, GPRS/WAP may not be suitable for a mobile banking platform targeting microfinance as they usually have the low-end handsets. However, it may be important to note that if mobile banking is perceived to be an unsecured channel, credibility risk and potential fall-out is high, regardless of the amount involved.
- *Infrastructure:* Financial institutions in countries that lack strong communications

and electric infrastructure may have a hard time implementing technology solutions that rely on internet connectivity-or even electricity.

- *Consumer and staff literacy:* Illiterate and uneducated clients do not always trust technology. Staff members may also be reluctant or ill equipped to adopt new technologies. Efforts to educate them may be necessary. Majority of the mFIs do not have the technical capacity and required resources to understand, adopt and implement MIS solutions. There is a shortage of skilled professionals who can understand technology as well as the microfinance industry, and be able to suggest the right solution. Such professionals can act as a bridge in filling the gap between use of Technology and microfinance operations.
- "*Change is the only thing that remains permanent*"*:* Microfinance is a rapidly changing industry. Due to the ongoing evolution of the industry, mFIs face difficulty in defining business objectives, needs, priorities and limitations for acquisition of an MIS solution. There is lack of standardization within the microfinance sector, and business practices of mFIs differ from each other. Consequently, software developers face problems in coming-up with an MIS that can be used by most of the mFIs. Common failures are due to ill defined business process and procedures.

Recommendations

- mFIs should invest in relevant technologies after thorough and careful assessment of their requirements. The requirement should be in the perspective of current needs and future plans.
- The software industry needs to do more in developing quality software for microfinance sector.
- Capacity within institutions to manage technology is key to successful implementation and operation of its MIS. mFIs should employ skilled IT professionals on their staff.
- mFIs must adopt MIS solutions that not only meet their needs but are also manageable by the mFI from all aspects. In some cases small and medium size mFIs go beyond their needs in adopting an MIS that ultimately becomes a drain on their resources. Such systems reduce the organizations overall efficiency and ultimately their sustainability.
- mFIs can get maximum benefit by investing in technology, and putting in a better MIS solution that works for them. MIS is a strategic investment for mFIs.
- Progressive policies that make technology accessible and affordable to the majority of the population are important for encouraging the use of technology within microfinance and for the development of the microfinance sector.
- lastly but not the least, support and some kind of gap funding should be there so that microfinance institutions are not reluctant to come up with new

technology and sustainability flourish along with it.

Conclusion

Assam is a state where 48% of the population remains unbanked and underserved. Being a micro finance institute our aim is to serve those people too and include them in our financial inclusion mission. As such we feel technology will play a vital role in reaching this population by providing the service at their door step. Technology always paves a new path in every sphere. Though in the initial stage, implementation seems challenging and costly but in the long run it will surely become cost effective and will also be of great use in making cent percent financial literary rate in the state.

Microfinance is a high touch, high cost business. As a business model, its greatest challenge is to lower operating costs in order to reduce the cost of service borne by borrowers. Hence it must marshal its resources to identify areas of greatest potential for lowering operating costs, and execute relentlessly to achieve these cost savings using technology where appropriate. mFIs must continue to take prudent risks to grow and scale their operations and to lower their operating costs through the use of technology.

Acknowledgement

Though the state-of-the-art software as well as hardware solutions are conceived, developed, and implemented by ASOMI and AFPL without outsourcing any of the components involved, the mission has seen the success visible so far due to the support extended by NABARD and Assam Gramin Vikas Bank. There has been an important role played by the Government of Assam also, in the form of its mandate given to ASOMI for implementing the Employment Generation Mission. INCOFIN, one of the partners of AFPL, has also assisted in conceiving the Projects, and as such we express our gratitude for all the cooperation.

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Enhancing Outreach of Microfinance: Role of Technology

- Tarun Agarwal*

Abstract

World over research has been ongoing to reach the unreached. Challenges which have emerged are the foot proof identity, low level of awareness, lack of access to banking facilities in remote areas, information gap, illiterate populace, immature networks for deep penetration, infrastructure (roads, power, etc.) issues, etc. To mitigate the above issues, it is pertinent to study in depth the challenges and innovations to reach the deprived.

As we know, technology in the urban areas has been an important part of people's lives. On the other hand, in rural areas the use of technology is still an alien idea. Innovations like biometric smart cards will help in aligning the rural population towards the use of technology and will bridge the digital divide between rural and urban India. The strategy for universal access to comprehensive financial services will have to address two key challenges - (I) ubiquity and (II) comprehensiveness of range of financial services.

Each of the innovations brought out in this paper offers potential to be replicated for the greater good of the poor and the unreached. As competition among microfinance institutions intensifies, we should see a broadening and deepening of the technology innovation process. They will also successfully find ways and enhance means to outreach the millions of micro poor who have not been reached so far at all.

Innovations like biometric smart cards will help in aligning the rural population towards the use of technology and will bridge the digital divide between rural and urban India.

Reaching the unreached

World over research has been ongoing to reach the un-

Key Words: Microfinance, Technology
JEL Classification: G-21, O-31

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reached. Challenges which have emerged are the foot proof identity, information gap, illiterate populace, immature network for deep penetration, infrastructure (roads, power, etc.) issues, etc. To mitigate these issues, it is pertinent to study in depth the challenges and innovations to reach the deprived.

In this context, the economic landscape of India has undergone tremendous change with visible signs of growth momentum in all the sectors. However, still the benefits have not equitably percolated to different parts of our society. Even after establishment of co-operative banks, nationalisation of major commercial banks, emergence of many microfinance organisations, both in the organised and the unorganised sector and creation of Regional Rural Banks, only 59% of adult population in India has bank accounts. Only 39% of rural adults have access to accounts while in the urban areas the percentage rises to 60. Only 14 out of 100 adults have loan accounts on an all India basis. In rural areas it is just 9.5%.

Despite innovations within the sector, the reasons for such low banking penetration can be attributed mainly to low income, unemployment and under employment, low level of awareness, low level of financial literacy and lack of access to banking facilities in remote areas.

It is observed that in rural areas, people hesitate to have bank accounts because of the perception that they are too small economically. In order to remove this apprehension, the initiatives to reach the unreached were modeled on the following lines:

- Open No frills/ zero balance savings bank accounts on the spot.
- Deliver the passbook at their doorsteps.
- Adopt simplified procedure for fulfilling KYC norms.
- The financial services would be provided to the people at their Doorstep.

The initial process structured to reach the unreached appeared as follows:

- Collection of basic data such as population pattern and household details.
- Collection of basic details such as name, age, voter ID no. / ration card no., occupation, income level and their association with financial institution.
- Making arrangements to take photographs on the spot and open "no frills" SB accounts.
- Coverage with low cost life and health care insurance.
- Issue of financial Inclusion Identity cards to the members of SHGs.

The early challenges faced for making the dream of reaching the unreached realisable:

- The household survey process revealed that the business hours of the banks are often inconvenient for the poor. Visiting a branch during day time would mean loss of wages for the day.
- The rural masses that are left with surplus money divert it for their consumption needs.
- Lower strata of the society mostly depend on non-institutional sources for

their financial needs as it is considered more operationally convenient.

- Lack of information on financial services restricts the people from accessing the banks voluntarily.
- Non-availability of low cost insurance products is a major barrier for access to such 'must have' products.
- Conducting household survey and opening bank account is a mammoth exercise, requiring adequate manpower, support of rural volunteers, SHGs, students and local leaders.

Time to Think out of the Box: Need for Innovations

"Liberalisation without regulation is like kids playing football before you have the referee and the playing lines." - Anonymous

A strong need was felt for an exploratory innovation which can address the broad issues like:

- Providing banking services right at the door steps.
- In a secured manner.
- At an affordable price.
- To the right/benevolent beneficiary.
- With desired standardization of quality and delivery of service.
- Providing emerging market returns.
- Expanding the outreach/scalable.
- Reducing poverty.

What is Innovation?

The term innovation generally means a new way of doing something. It can be an idea, practice or object that is perceived as new by a unit of adoption. This definition covers the diffusion of innovations as well as their initial creation and application. Innovation is usually understood to be distinct from invention. While invention is the first occurrence of an idea for a new product or process, innovation is the first attempt to carry it through into practice.

Hamel (Harvard Business Review) states, "Innovation has become a mantra: Innovate or Die. A company can't outgrow its competitors unless it can out-innovate them. Surely everyone knows that corporate growth - true growth, not just agglomeration - springs from innovation."

Innovations: Technology & Non Technology Outreach

Innovations can be broadly divided into product innovation and process innovation. Product innovation is the result of bringing to life a new way to solve the customer's

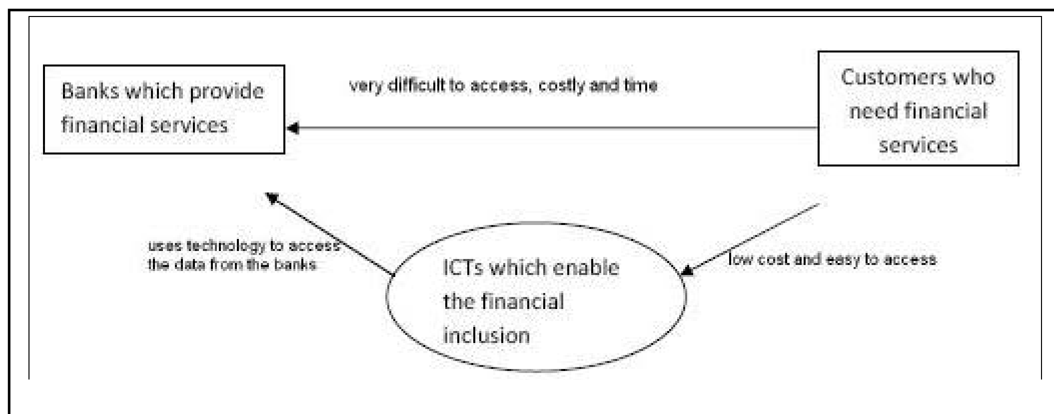
problem - through a new product or service development - that benefits both the customer and the sponsoring company. They refer to the financial services offered to individuals and groups. Examples are product mixes combining savings and credit services; farm and non-farm credit. Process innovation can be defined as a new and significantly improved way of producing a product or a service. But it may be argued that these two categories of innovation are insufficient. For example, it may happen that a particular innovation can be considered both as a process as well as a service product innovation.

Innovations can be further categorised into various other types: technological innovations, strategic innovations and institutional arrangement innovations.

Technological Innovations: They refer to improved technologies used to deliver financial services to un-served and deserved people lying at the bottom of the pyramid. Examples are solidarity group lending, village banking, repayment incentive schemes such as peer group monitoring, incentives for the borrower to repay through rebates and progressive lending. IT is such a revolutionary technological innovation, offering new ways of processing information - an activity inherent in all economic processes.

There has been a different type of technical innovation like smart card solution, remote transaction system, POS, Kiosks, Portable Micro Deposit Devices, Mobiles, etc. A smart card, chip card, or integrated circuit card (ICC), is any pocket-sized card with embedded integrated circuits which can process data. This implies that it can receive input which is processed - by way of the ICC applications - and delivered as an output. The remote transaction system (RTS) allows microfinance institutions to extend financial services to low-income customers living in rural areas by increasing access to convenient locations for secure and affordable financial transactions. The RTS solution also increases transparency and data integrity for institutions using a group lending methodology. It also provides these institutions a cost effective way to scale up services in the rural areas.

The technological innovation also includes the creation of an e-account wherein the customer can deposit cash into the e-account or withdraw it, using the agents spread across the country. They may pay bills, repay loans or purchase goods by using the same account. In addition to this, to reach out to millions of unbanked rural customers, for illustration, a Mumbai based technology solutions provider Financial Information Network and Operations Ltd. (FINO) has been working jointly with Access Development Services (ADS) to promote management information system (MIS) in the sector. As a solution provider, FINO will implement MIS solution along with its various delivery channels, including mobiles, smart cards, micro-deposit machines (MDM's) and credit bureau services to aid Access Microfinance Alliance (AmFA) partners to scale up their operations.



Case: PRADAN Computer Munshi

A Computer Munshi is just - a person who provides accounting services by using a computer. This by itself may not sound a great achievement, because we see offices all over, using computers for maintaining their accounts. But, when we say that thousands of Self-Help Groups of illiterate, poor women, in remote rural, often very inaccessible villages, where the basic infrastructure such as power or roads scarcely exist, use of omputers on a routine basis to conduct business becomes difficult. About 95% of PRADAN's 6,000 SHGs are today covered under the computerised accounts system run and operated by local youth-entrepreneurs named Computer Munshis. These are young men or women selected from among the local villages. They are trained and equipped by PRADAN to set up the Computer Munshi business. They do need close hand-holding and incubation in the initial couple of years before they become independent. This is because the business is new and untested, both for the buyers, sellers and the facilitators.

Currently, there are 50 Computer Munshis in PRADAN serving the 6,000 Self-Help Groups in the 25 Blocks. The setting up of these CMs has been supported by CARE-INDIA, SIDBI-SFMC and NABARD.

The CM system has been very successful in addressing some key problems in SHG microfinance promotion and sustainability, including (1) having higher quality, up-to-date, standardised and aggregated electronic financial records of SHGs, (2) having weekly and annual accurate accounting of SHG records performed by a professional, relieving the SHG members of this arduous task, and (3) Pradan staff being able to focus on their "real" work of rural livelihood promotion. At the same time, a number of problem areas remain in the present CM set-up that are keeping the system from running as intended in some locations, including (1) the high costs associated with irreconcilable errors resulting from the double data-entry process, for which SHG members need to personally visit the CM to make the necessary clarification,

Case: PRADAN's Computer Munshi experiment

(90,000 rural clients, EAST/CENTRAL India)

Problem area

- Poor quality of financial data
- No aggregate record

Issues

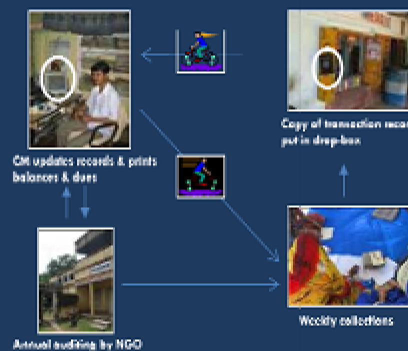
- Costs associated with:
  - Time spent on accounting each week
  - Mistakes discovered at annual audit

Experiment

- Goals
  - Improve SHG data quality & aggregate data
  - Outsource weekly accounting function – create sustainable business model
- Methods
  - Have an Accountant with a PC serve a Federation of SHGs
  - Charge nominal fee for data processing service
  - Use manual transport to ferry data back and forth
- Results
  - Weekly meeting time cut by half
  - Instant evaluation of financial performance of large group of SHGs possible

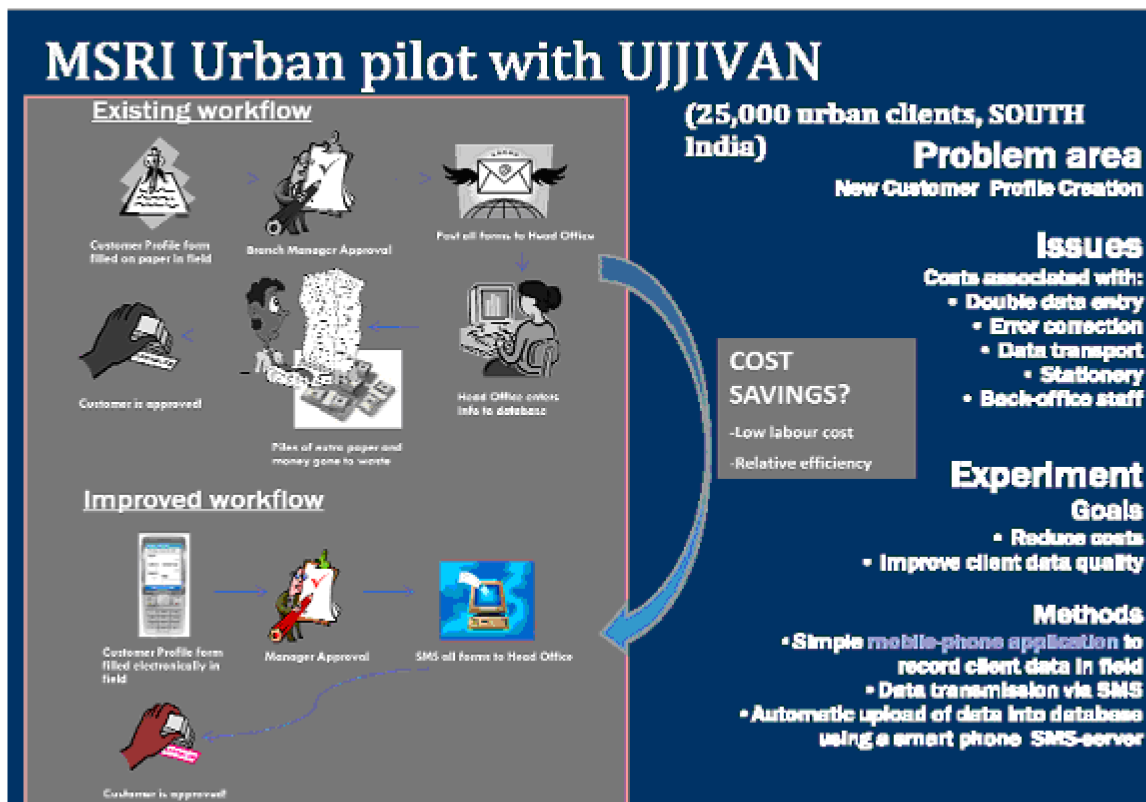
Original workflow

Improved workflow



(2) the problem of attracting and retaining appropriate talent as CMs in these remote areas, (3) the paltry gains received by most Peons in carrying out the manual transport activity integral to the functioning of the system, particularly in areas with low population densities, (4) sensitivity of SHG demand to the CM's fees, (5) the implicit subsidisation (hidden costs) of many CMs' enterprises causing new dependencies on Pradan, and (6) unclear mechanisms for protecting the privacy and security of the SHG members' financial records. Resolving these operational difficulties through even more cost-effective communication channels between rural SHGs and the urban/ semi-urban CM (e.g., through mobile telephony/ cellular phone network-based data transfer), even greater scales of operation per CM, and clear data protection/ security features will make for a more efficient and sustainable system. (3)

Case: MSRI Urban Pilot with Ujjivan



Aartoo is a startup with a vision of a "Paperless Microfinance" world with reduced delays and dramatically reduced expenses via its flagship Android application for the mFI field agents.

Artoo ran its first pilot with Ujjivan Financial Services (co-funded by Ujjivan and Lok Capital Foundation) in December 2010 which yielded some impressive results. The end-to-end data collection process was reduced from 3+ days to less than one hour. The collections processing time at Ujjivan's branches previously used to take an hour - the Artoo pilot reduced it to less than 5 minutes. Overall, the Artoo workflow enabled a 35% increase in productivity, reduced the turnaround time for loans to two days and a projected 2.4% reduction in the Operating Expense Ratio (OER). The other important learning was that field agent adoption rates and performance were independent of seniority and technological savvy. (4)

Technology Enabled Outreach of Microfinance

The strategy for universal access to comprehensive financial services will have to address two key challenges - (I) ubiquity and (II) comprehensiveness of range of financial services.

Ubiquitous of financial services: By ubiquity, it is meant that the financial service is easily accessible to the individual in terms of geographical proximity and the ease with which it can be dealt with. For instance, ubiquity as an idea has been pursued in India, but through the route of commercial banks opening branches in rural areas and Regional Rural Banks. There are today over 60,000 commercial bank branches, over 100,000 primary agricultural credit societies (PACS), around 12,000 state and central co-operative bank offices and about 15,000 RRB branches. (5) However, this infrastructure has not been able to address the demand for financial services in a comprehensive and satisfactory manner. The experience of extending financial services through the infrastructure outlined above suggests the following - costs of delivery have been high under traditional models, local information was not sufficiently leveraged (reflected in poor repayment rates and poorly designed products), there was an almost exclusive focus on credit, neglect to align staff incentives to maximize outreach. Therefore, in order to achieve ubiquity that is meaningful, innovations in technological models of outreach must have the ability to leverage local information while being cost-effective. The two broad strategies that seem to be effective in this regard appear to be:

1. Delivering these services through high quality, private sector (both for-profit and not for- profit) local financial institutions, broadly referred to as Micro Finance Institutions (mFIs).
2. Building technology (ICT) enabled low cost direct service channels.

1a Micro Finance Institutions (mFIs): Given that mFIs are an important means to achieve ubiquity, it becomes important to articulate a vision for mFIs in India as follows:

- Existence / creation of more than 200 mature mFIs serving all parts of the country.

- Each mFI to operate in 3 districts of the country with an average population per district of 2 million, giving it a total population coverage of 6 million for choosing its customers. This gives it a large base for an adequate level of diversification, but, is sufficiently concentrated so that the benefit of local knowledge and understanding is not lost.
- Each mFI to have on average 0.5 million customers.
- Average credit outstanding per customer being Rs. 3,000 (USD 60).
- Each mFI to provide a comprehensive range of financial services to the customer including insurance, savings, credit and remittance to begin with. If these numbers are achieved, and if each mFI borrower represents a single household, then financial services would be available to 100 million households. Against a requirement of at least 200 mFIs, there are very few mFIs which have achieved a measure of scale-up and most, despite a very good track record of performance, have not been able to increase the size of their operations. The reasons have principally been the absence of several key ingredients: (a) adequate quantities of risk capital to provide the degree of coverage required to absorb the risks inherent in this business and adequate debt funds and (b) technology. A discussion on technology is very critical for mFIs because it gives opportunities for reducing costs of delivery and process management, besides bringing about transparency in operations. It assumes significance because of the manpower-intensive nature of business (which gives rise to control issues), underlying financial risks and regulatory sensitiveness. In order for mFIs to grow rapidly, operations must be supported by robust and scalable systems. Such initiatives taken today in this area: like the creation of rural connectivity in partnership with telecom companies and internet service providers, assistance to emerging mFIs to adopt scalable MIS solutions (Core Banking), support to research and development on technological devices that can reduce costs of intermediation (low-cost Hand Held Devices, low-cost computing devices, smart card, mobile and internet-based transaction platforms). In addition, training initiatives will include a focus on the use of technology.

2b. Low Cost Direct Service Channels: Although mFIs have been recognized as the key purveyors of micro finance in India, one cannot rule out the potential of new service delivery configurations that combine a 'local agent' and various technological aids for ease of transaction. In a growing number of countries, banks and other commercial financial service providers are finding new ways of delivering financial services to unbanked people. Rather than using bank branches and their own field officers, they offer banking and payment services through retail outlets, including grocery stores, pharmacies, seed and fertilizer retailers and gas stations/petrol pumps, among others. For poor people, "branchless banking" through retail agents or Banking Correspondent may be far more convenient and efficient than going to a bank branch.

For many poor customers, it will be the first time they have access to any formal financial services-and formal services are usually significantly safer and cheaper than informal alternatives/channels.

Two models of branchless banking through retail agents are emerging: one led by banks, the other by non-bank commercial actors. Both use information and communication technologies, to transmit transaction details from the retail agent or banking correspondent to the bank.

Branchless banking through retail agents appeals to policymakers and regulators because it has the potential to extend financial services to unbanked and marginalized communities. But it also challenges them to ask: What are the risks of these new approaches, and are they different from those of conventional branch-based banking? How should we respond to these risks, so as to permit branchless banking with retail agents to operate safely and expand access to finance?

Some models that have made use of the local agent idea in the past include the Life Insurance Corporation of India's use of agents to sell insurance policies and commercial banks' pygmy deposit scheme which used agents for the function of savings collection. The key challenge in developing scaled agent-based models lies in the ability to control agent fraud and create incentives for the agents that are aligned to the objectives of the provider. The emergence of (effective and speedy) connectivity and transaction devices (hand held devices like POS, PDA, mobile, etc.) increases the scope for agent-based models. For example, internet connectivity enables third-party agents to offer 'transaction fulfillment' at a non-bank/provider location. For instance, a person desirous of purchasing an insurance policy can avail it from an authorised agent of the insurance company in a village. The process now looks as follows: client chooses the relevant policy and makes payment to agent; agent accepts cash and remits the money through the payment gateway from his/her account. The agent also updates the database of the provider (in this case the insurance company) on a real-time basis. The provider issues the policy online; the agent prints it out and hands it over to the customer. In this manner, the entire transaction loop is closed at the agent location itself without a time lag and without the client having to ever travel or interact with the provider directly. The distinction between the process outlined above and a traditional agent model is the fact that internet connectivity is leveraged to reduce potential for fraud (agent has to update provider databases online and make payments immediately. Lags in this process increase agent risk) as well as reduce transaction costs (agent is responsible for entire transaction, not parts of it). Similarly devices such as POSs enable the provider to disburse and collect cash at a non-provider location while minimising the risk of fraud. The POS has the ability to authenticate the customer (say biometrically today) and update the transaction on a real time basis. The role of an agent in these models lies in assisting the customer through the various steps of the transaction. The benefit of agent models vis-à-vis other dedicated channels, e.g., the rural branch of a commercial bank is also the fact that the agent represents

a multiple service channel. S/he can distribute fixed costs of operation over several services. This has implications for channel viability. The connectivity scenario in India, that is essential to the emergence of new models, is encouraging. Several participants have been engaged in this task.

- Bharatiya Sanchar Nigam Limited (BSNL) already has around 0.5 million Village Public Telephones in rural India. Based on this, one estimate says that if wireless system with 10 km range is installed at the existing fiber connected rural exchanges, 80-85% of the villages could be connected. About 70% of the Indian land-mass is covered by optic fiber with cellular networks gradually coming up along national highways. (6)
- Linked to these technologies, companies such as Vortex and Neurosynaptic have built a variety of devices designed to work within Internet kiosks such as ECG monitors, digital stethoscopes and biometric / low cost ATMs.
- Financial Inclusion Network & Operations (FINO) has created both offline & online contact/contactless biometric enabled Hand Held Devices, PC Based Point of Transaction, Micro Deposit Machines and Mobile based technological solutions to address issues of lower cost of transactions, extensive reach, transactions on an offline & online mode in a secured manner right at the door steps of the micro customer (both rural and urban). (7)

Two models that combine agents with internet connectivity and other devices that are currently working are:

1. Internet kiosks: An infrastructure of village-level kiosks is being promoted across the country by Internet service providers, public-private partnerships and agribusiness corporates. Several participants have been engaged in this task. ITC, n-Logue, Drishtee and Development Alternatives (Tara Haat) have built more than 6,000 internet kiosks using technologies such as Wireless in Local Loop (WILL) and VSAT Terminals.

2. Credit Franchisee: Another agent model that is working on at a block level (kiosk is a transaction platform for an agent at a village/cluster level) is the Credit Franchisee Model. The credit franchisee is envisaged to provide asset-backed loans (auto, gold, fixed deposit) and other financial services. The credit franchisee will be located in places that are likely to be under-served from a financial services perspective, but would not be able to support a branch-based model of outreach in a viable manner. The credit franchisee is an entrepreneur who contributes equity, has a good understanding of the local market conditions, credit needs and credit history of individuals and who is willing to enter into risk-sharing arrangements with a bank. However, even here several significant gaps remain.

Comprehensive Range of Financial Services

Success of an effective ICT Rural Financial Rural Delivery also depends upon Development of well-designed products that cater to various needs (both risk management

as well as growth) of the poor is an important aspect of universalisation of access. Much of the work that has happened in India has been geared towards increasing access to small loan amounts that may be used either for consumption or for enterprise purposes (typically livestock). While this is a critical need, there are gaps in access/ availability of other financial services including insurance (life and non-life), investment, remittance and derivatives. Microfinance and Information and Communication Technologies (ICTs) are both new age paradigms on the development and the corporate canvas. Hence, it was only a matter of time before the two were thought to form a double-edged samurai sword which would greatly enhance the effectiveness of the efforts being made towards the empowerment of the poor and contribute to broad-based sustainable economic development. Due to their nascent state and tremendous potential, both Microfinance and ICT continue to evolve at mind-boggling speeds.

Enhancing Outreach of Microfinance: Role of Technology

As we know, technology in the urban areas has been an important part of peoples' lives. On the other hand, in rural areas the use of technology is still an alien idea. Innovations like biometric smart cards will help in aligning the rural population towards the use of technology and will bridge the digital divide between rural and urban India. More importantly, there shall then exist compatibility of all the stored information of the people of the country irrespective of where they are residing. Some of the specific advantages that technology provides are as follows:

- *Fraud Prevention:* Use of technology has helped in reducing the frauds due to improper customer identification, delivery to fake/false customer as well as in the case of duplicate or multiple identities. Use of Biometric smart cards has helped in exact customer identification without any requirement for remembering a numeric password or PIN number as in most of the other conventional methods. Biometric identification almost makes it impossible to create more than one card for the same individual.
- *Process record:* In the traditional system of money transfer and disbursement, people are less/not aware of how much they owed and how much they are receiving. In the biometric based system, they are getting a receipt of the amount they would be getting. This shall make siphoning of the money more difficult and the probability of people becoming aware of the malpractices is higher.
- *Real-time Transaction:* Smart card based systems can provide a highly secure offline and online transaction platform. All the transactions whether in online or offline mode can be recorded immediately and hence the time consumed for the data transfer can be minimised to a great extent. Because of this feature, the time lag between the work done and wage disbursement can be reduced to one week , which in case of the manual system takes between 15 days

to even one month.

- *Data Corruptibility:* In the smart card based biometric system, there are less chances of corruptibility of the data at different levels (entry level, disbursement level or during data transfer), since the information at all the levels travels in digitised form and almost all are real time transactions, so once a transaction happens it automatically gets recorded and the information is transferred to the account of the beneficiary.
- *Demographic Database:* Technology based processes ensure that there is one time collection of demographic data for a particular customer. Once there is aggregation and digitisation of all the data pertaining to people in the rural and urban areas, then it would be easy, efficient and cost effective for both government and private players to extend other services to these people.
- *Outreach:* The technology helps in reaching out to the people in the rural areas and in difficult terrain where so far there is a very poor reach of the formal financial systems.
- *Future Possibilities:* Once there exists digitisation of records of the poor in the country and biometric smart cards have been issued to them then it becomes a technology driven channel and can be leveraged easily by both the government and private players for reaching out to the poor. By the use of the technology we are also making an effort to include the poor in the mainstream of the economy which so far has excluded them. The model once established can later be scaled up for delivering a variety of services to the people. More the services offered lesser will also be the cost to the system. Some of the future possibilities include:
    - Government using the same biometric cards for delivering different social security schemes (like targeted Public Distribution System, Aam Aadmi Yojna, Old age pensions, BPL schemes, schemes for SC and STs, Anganwadi schemes, ICDS, etc.) and input subsidies for the poor.
    - Microfinance institutions/banks and insurance companies using the same channel for delivering financial services to the poor people.
    - In advanced stages, these cards can be used as debit cards.
    - Digitisation of records helps in the formation of a credit bureau in the future.

In Conclusion

The technology innovations that are taking place in the rural hinterland are many. Each of these innovations offers potential to be replicated for the greater good of the poor and the unreached. However, what the author has mentioned is merely the tip of the iceberg. True success shall lie in keeping a note of the below mentioned points:

- Have a balanced appreciation of microfinance as one of many 'killer apps' to target poverty and/ or promote growth.
- The value-addition of ICTs in enabling microfinance greatly depends on delivery model, operational efficiency and labour/technology costs.
- Hybrid, cost-aware approaches and accurate matching of device with target functionality are key.

A great deal of experimentation is going on-quietly and silently. There is no doubt that change is happening. Personally, the author find the pace, depth and variety of these changes extremely exciting. As competition among microfinance institutions intensifies we should see a broadening and deepening of the technology innovation process. Given crises, given a challenge technology has always and unfailingly risen to the occasion. I have no doubt whatsoever that it will also successfully find ways and enhance means to outreach the millions of micro poor who have not been reached so far at all. I say this not as a pious hope, I say this as affirmation of my faith in the creative genius of our microfinance institutions & innovators in the space of technology.

A word of caution: This piece of research paper is neither prescriptive nor prophetic. It seeks not to radicalise but offer solutions in context of "what it is today and what can be done", factoring the wide disparity in perception and practice among the various stakeholders, soothsayers and the policy pundits of the financial world.

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Enhancing Outreach of Microfinance by Use of ICT in BC Model - Field Level Problems and Their Probable Solutions

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Abstract

Microfinance is about providing financial services to poor people. The extent of financial exclusion in India has been a matter of concern since long. RBI has allowed BC model for increasing outreach since 2006. The cost effectiveness of BC model largely depends on the use of Information and Communication Technology (ICT) in Banking. However, there are practical difficulties in accessing financial services through BC model. Some of these problems at customer, BC and Branch level and their remedial measures are discussed in this paper. The problems and probable solutions stated in the paper have largely emerged out of the field based experiences of the authors through their involvement in the training of rural Bankers engaged in delivery of financial services to the rural people.

The paper highlights the need for increasing the outreach of microfinance. Further, the relevance of BC model is highlighted for increasing the outreach. BC model uses ICT extensively for its operations. The paper presents the field level problems involved in financial intermediation faced by villagers and FBCs who are field level functionaries of BCs and Bank staff at the Branch level. The main problems relate to mistrust, inadequate technology support, financial non-viability and technology obsolescence of ICT. Some probable workable solutions to overcome these problems are given in the paper. Banks and BCs have to work more closely in terms of sharing MIS, databases, trust building, capacity building and updating

Microfinance is about providing financial services to poor people. Main financial services are - deposit, credit, insurance and money transfer and facilitating participation in capital market. The outreach of microfinance remains limited in rural as well as urban areas.

Key Words: BF/BC Model, Microfinance, Rural Banking, Financial Inclusion, Branch Banking

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of technology on regular interval to make BC model successful in enhancing outreach of microfinance services.

Microfinance and Outreach

Microfinance is about providing financial services to poor people. Main financial services are - deposit, credit, insurance and money transfer. Facilitating participation in capital market is also a financial service. It is observed that outreach of microfinance remains limited in rural as well as urban areas. There are statistics to support that the extent of exclusion in rural areas ranges from 4 to 32 % in Kerala and Odisha, respectively. This magnitude of exclusion is in terms of savings Bank accounts in Banks, post offices, SHG-Bank Linkage Programme (SBLP) and MFIs at house hold level. However, if credit accounts and insurance accounts are also considered, the extent of exclusion is in the range of 63 to 83 % (CMR Study 2011, under preparation).

1.1 Challenges in increasing outreach

The extent of financial exclusion in India has been a matter of concern since long. To tackle the problem of financial exclusion, one major intervention in Indian Banking Industry was the nationalization of 14 major Banks in the year 1969 and subsequent nationalisation of 6 more Banks in 1980. After that the outreach of financial services increased tremendously, including outreach of microfinance, particularly through intervention of Integrated Rural Development Programme. The situation changed after financial sector reforms were introduced in the country in the year 1991. The trend started reversing after the introduction of financial sector reforms. Though the introduction of SHG-Bank linkage and other models of microfinance have increased the outreach of financial service to poor people, there still remains a large section of society that is outside the formal financial institutions. The main challenge in reaching more microfinance clients by these institutions has been shortage of staff and lack of positive orientation towards the quality of service to microfinance clients. Also it may be argued that their Human Resource Incentive System is not geared to encourage provisioning of financial services to the poor people, particularly in rural areas.

1.2 Current methods of increasing outreach

The most popular method of increasing outreach in the country is Branch expansion by nationalized commercial Banks. This method has limitations in the sense that a Branch can be opened in an area if there is enough business to make it a business proposition. As of now, it appears that this method does not fit into the profitability assessment of Banks. Therefore, it is relevant to look for alternatives and more economic modes of increasing outreach. Some Banks have adopted the method of Banking with

mobile van or Bank on ferry. These models have helped in increasing access of banking services by rural people. The challenge of reaching out to most people in rural areas remains unanswered, however. It is in this context the Business Facilitator/Business Correspondent (BF/BC) models permitted by Reserve Bank of India (RBI) show immense potential for increasing outreach in a cost effective manner.

1.3 BF/BC Models

RBI has allowed BF / BC models for increasing outreach since 2006 (RBI, 2006). BF/ BC models are about hiring Business Facilitators and Business Correspondents by Banks to increase their business mainly in the rural area. Business Facilitators are agencies or individuals who would help the Bank in getting the business and facilitate the Banks in their respective area of operation. BFs will not be involved in financial transactions directly. However, Business Correspondents are agencies, agents or individuals who will be dealing with financial transactions as well. Both, BFs and BCs would be working on commission basis or mutually agreed terms and conditions with the Bank.

In other words, BFs and BCs are extended arms of Bank Branch. As BCs are actually doing financial transaction, this paper henceforth focuses on BC Model. BCs could be agencies/organisations such as Microfinance Institutions/ Non-Government Organisations (MFIs/NGOs), Information and Communication Technology (ICT) service providers, Post Offices, Ex-servicemen Associations etc. In practice, however, BCs usually work with ICT service providers such as FINO, Integra, a Little World, etc. BCs in turn engage Field Business Correspondents (FBCs) to provide the financial services in the villages. The FBCs are also known as Customer Service Providers (CSPs) or Business Agents (BAs). The agencies who are acting as BCs use the technology (ICT) to minimise the cost of transaction at the village level.

The cost effectiveness of BC model largely depends on the use of Information and Communication Technology (ICT) in Banking. The information and communication technology as of now functions in three broad ways:

1) Financial Inclusion (FI) server operated and managed by BC (ICT Service Provider) without providing connectivity to CBS (Core Banking Solution) Server of the Bank.
2) The CBS Server of the Bank is connected with FI Server of the BC. However, data are exchanged in batch mode (at the time of day-and-process).
3) Both the servers (FI server of ICT service provider and CBS server of the Bank) are connected and operated in real time mode.

This paper explores the practical aspects of ICT being used by FBCs in the field. As is well known that the technology back-up and support in the country, be it electricity or connectivity or transportation are not easily available at field level, i.e., - customer, BC and Branch levels, there are practical difficulties in accessing financial services

through BC mode. Some of these problems at customer, BC and Branch level and their probable remedial measures are discussed in this paper.

2 Sources of Information

This paper is based on the information gathered by the authors as Programme Co-ordinators through the training programmes on Financial Inclusion conducted at the Bankers Institute of Rural Development (BIRD), Lucknow and elsewhere. The interaction and experience sharing the authors had with the participants of these programmes and the field visits involved provided rich insights into the issues and challenges faced at the field level. The sources of information for this paper, therefore, are:

a) 17 Training programme on Financial Inclusion conducted during February 2010 to June 2011. These programmes were conducted on-campus at BIRD, Lucknow and on-location at different places such as Etawah (UP), Dehradun (Uttarakhand), Sikar (Rajasthan), Mangalore (Karnataka) and Bolpur (West Bengal) under titles such as "Capacity Building Programme on Financial Inclusion", "Total Financial Inclusion", "Skill Development of Trainees in the Area of Promotion and Financing of SHGs and JLGs for Financial Inclusion", "ICT Solution for Financial Inclusion - Training Programme for RRBs in UP" and "On location Programme on Financial Inclusion". The duration of these programmes varied from 2 to 4 days.

   More than 400 participants across the country representing officials from Commercial Banks, Regional Rural Banks, State Cooperative Banks, District Central Cooperative Banks, NGOs and MFIs attended these 17 programmes.

b) The participants of these programmes were taken on field visits to different villages and Bank Branches to expose them to the actual environment and provide them with the opportunity to interact with all stake holders such as the customers, BAs and the Branch functionaries in the field. Interactions were held with about 85 customers, 20 FBCs and 15 Bank Branches during these field visits. The issues and challenges faced by them were also discussed during the class room interaction after the field visits.

The problems and probable solutions stated below have largely emerged out of the field based experiences of the authors through their involvement in the training of rural Bankers engaged in delivery of financial services to the rural people. The problems and probable solutions are described at customer, BC and Bank/Branch level in the following sections.

3 Problems and probable Solutions at Customer level

The following are the problems and their probable solutions at customer level.

3.1 Mistrust of customers on Field Business Correspondents (FBCs)

Though Field Business Correspondent (FBCs) or the Customer Service Providers (CSPs) or the Business Agents (BAs) belong to the same area of operation, but they are little known to the customers of those villages where they do not belong to. If a FBC visits those villages, the villagers do not trust him for depositing money with him. If FBC tries to convince the villagers that he is providing services on behalf of the Bank, does not receive adequate recognition amongst the villagers as Branch staff seldom visits along with him in the village. Moreover, by merely getting the receipts of the transaction from thermal printer of the Point-of-Sale (POS) device, the customer is in a dilemma as to whether amount has been credited to his account or not, as in most of the cases, the passbook has not been issued to the customers. On account of providing the Banking services in rural area at the affordable cost, most Banks are not issuing passbook to the villagers.

To develop the trust between FBCs and the customers, the following could be the probable solution:

a) It is desirable that the FBC should belong to the same area of operation
b) At the initial level and thereafter on regular interval the Branch staff should accompany the FBC and should convince the villagers that whatever the services FBC is providing, are on behalf of the Bank. Basically Branch staff has to convince the villagers that their money is safe and secure in the hands of FBC.
c) The passbook and its regular updating will develop trust in the villagers that their money is properly accounted for and is safe. Hence, the Bank should issue passbooks to the villagers and FBC should have a facility to update the passbook then and there. Since, at present the facility of printing the passbook is not available at field level, the updating of passbook may be allowed at Branch level.
d) Money transfer: The relatives of the villagers who have moved out of the village and working in different cities of the country must be encouraged to deposit the money in the account of the villager and the villager should be allowed to withdraw the money through FBC. It will develop the trust on FBC.

3.2 Lack of access to Branch Banking

In most cases, the Branch database has not been merged/synchronized with the FI-database, due to which villager is not in a position to avail any Banking services at the Branch level. Even the villager is unable to get his account re-checked from the Branches, in case, he has deposited money with the FBC. In that case, the villager does not have any option except to rely on the reliability of the FI System. The villager

must be provided with the Banking services at the Branch level also, for that the following probable solution may be opted by the Bank:

a) The FI-database should be merged/synchronised with the Branch-database so that the villager may avail the Banking services from the Branch even if he has opened his account in the village through FI System.
b) If the FI-database can not be merged/synchronised with the Branch-database (as most RRBs are in the preliminary stage of implementing CBS), a FBC with ICT-devices may be deputed at Branch level so that the villagers may get the services and verify their account position in the Branch also.

3.3 Card Related

ICT companies with the help of the Bank are issuing Plastic Cards/Smart Cards with personal details and transaction details embodied on them to the villagers. At present, the villagers are given different type of cards by so many different government/ semi-government agencies such as health cards, insurance cards KCC, GCC, etc. The FBC also advises the villagers that for availing Banking services, the villagers must come along with the Bank issued cards only. But the villager having 4-5 cards get confused as to which card is meant for Banking transactions by FBC. Generally, he comes along with all such cards. It is further noticed that the micro-chip visibly embedded on the plastic sheet of Smart Card, becomes defunct and sluggish quite often due to dust, scratches and moisture due to sweating. These problems can be addressed if following actions are taken by the Bank:

a) The villagers should be sensitised on the need and ways to preserve and maintain the plastic/Smart Card. It should be protected from dust, moisture and bending and scratching.
b) The Plastic/Smart Card should have Bank's logo and now RBI has instructed to put 'Swabhiman' logo on cards meant for banking operations.
c) The Banks may prefer to have smart card in which the chip is embedded between the plastic layers of the smart card to prevent dust, scratches and moisture on the chip.

3.4 Truancy of FBC

It is found during the field visits that the FBCs are not punctual and remain absent for as many as four to five days at a stretch from the Customer Service Points (CSPs) without informing the Bank / customer or other stake holders. To check truancy at the FBC level, following solutions are suggested:

- The Bank should identify a suitable place in the villages to function as Customer Service Point (CSP) for providing the Banking services. The Bank should publicize the place details and the timing of availability of FBC at

Customer Service Point for providing Banking services.
- BCs (ICT companies) should devise a system to check the truancy of the FBC with the help of field supervisors appointed by them.
- The Bank should also have a system to properly monitor the functioning/ non-functioning of FBCs at the CSPs.
- A system needs to be devised which compels the FBC to visit the CSP at the pre-determined time.

3.5 Non-availability of 24 x 7 Banking

Though the villagers may avail the Banking services at the CSPs but that is only during the fixed timing in a day. In some cases, the CSPs are not opened on daily basis also. If a villager requires the Banking services in the evening or at night, no facility is available in the remote places except he is bound to visit the residence of FBC to fulfill his immediate financial needs.

If a villager has to do Banking in emergency during odd hours, the following points are suggested:

a) The address and mobile number of FBC should be written on the Bank's banner at CSP. The FBC should be allowed to provide Banking services from his residence during emergency/exigency of the villagers. It is preferred that the FBC should belong to the nearby place.

b) According to the guidelines of RBI, the Bank may appoint Kirana stores, medical stores, PCOs and other shops in the villages as the FBC. Such shops in the same village may provide Banking services on 24 X 7 basis.

4 Problems and Probable Solutions at FBC level

The FBCs are employed persons of the institutions/organisations working as Business Correspondents. The FBCs travel in rural areas for providing financial services related to savings, loans, insurance scheme etc. on the ICT devices. The FBC faces various problems at the field level. Some of these problems and their probable solutions are described as follows:

4.1 Non Co-operation from the Branch functionaries

At the initial level, the FBC requires the co-operation and support from the Branch functionaries so that he could develop the trust amongst the villagers for carrying out banking functions in his area of operation. But the Branch functionaries feel that FI-work has been out-sourced and it is the sole responsibility of the FBC to arrange and provide the Banking services to the villagers. In some Branches it was noticed that the Branch functionaries think that FBCs are their competitors and will eat away their

business if the job of FBC is not curtailed/stopped in the region.

The following measures may be taken to overcome such problems:-

(a) The Branch functionaries should be sensitised that whatever the work a FBC is doing is to only supplement the Branch work. And the business generated by the FBC in the field will be added to the business of the Branch.

(b) The Branch functionaries should rather motivate and encourage the FBC for increasing the business in the area of operation and reduce the pressure on the branch.

4.2 Inadequate Maintenance Support for Technology

All the operations of FBC are technology driven. A FBC can function only if technology functions. In the remote area of operation if any ICT- device which he is using, becomes faulty, he is bound to send that faulty device to the ICT- provider or to the nearby service centre for repairing or replacement. ICT-provider or the service centre takes their own time to rectify the problem. Some-time the maintenance support for ICT devices is so poor that the rectification of the problem takes as many as 15 to 20 days. Due to delay in maintenance support the FBC does not visit the villages and as a result the work of the Bank suffers.

The following measures may be taken to reduce the maintenance time:

(a) The Bank may keep some backup-ICT devices and replace the faulty device immediately.

(b) The service centre for ICT devices should be near to the Branch / Bank's Regional Office/ Head Office.

(c) The ICT provider should provide the FBC the basic knowledge to trouble shoot the minor problems in the ICT devices in the field.

(d) The technology provider may design the "diagnostic software" in such a way that at the time of Begin of day (BOD) operations on the ICT devices, it should diagnose and rectify the software problems in the ICT devices automatically.

4.3 Inadequate Compensation

The FBCs are paid meager amount in different mode of payments adopted and agreed upon by the Bank and the BC (ICT service provider). Since at the initial level the business does not grow as fast, their performance-linked payments remain as low as 'zero' some times. In addition to this, sometimes the FBCs do not get their salary regularly. It is natural that a FBC can function properly only if his/her salary and other emoluments are paid regularly.

The following measures the Bank may take in this regard:

(a) The Bank may ensure and monitor the BC (ICT provider) from time to time that whatever financial commitments have been made by the ICT provider to the FBC are honored.

(b) The Bank may ensure that the minimum wage to the FBC is paid by BC (ICT provider) irrespective of the level of business in the area of operation.

4.4 Resistance from the customers

As the entire scenario of ICT enabled FI is too new to the village community, they do not accept this new concept of banking services so easily. Sometimes, due to technology failure or limitations of FBCs for operating the ICT devices, the customers feel that the entire system is not reliable. Due to these reasons, the FBC faces the problem of not being accepted by the customers for performing the Banking operations in the field. Further, though the FBC provides signed receipt of the transaction but the verification and cross check of transactions at the field level is a problem. The following measures, the Bank may take in this regard:

- The Bank should make it mandatory that a reliable signed receipt is issued for the transaction as evidence and verified in the Branch whenever the customers visit the Branch.
- The passbook may be issued to customers at the time of opening of account.

4.5 Ambiguity in Career Progression of FBCs

There is ambiguity in the mind of FBCs about their present status and the further career progression. In some places, even appointment letters have not been issued to FBCs. FBCs are not sure for how long the project will go on and what will happen to their job once the project is over. To deal with this problem, the following steps may be taken by the Bank:

(a) The Bank must define in the agreement letter and compel the BC (ICT service provider) for clearly stating the job conditions and pay structure for FBC.

(b) The Bank may obtain a copy of the acceptance letter from FBC for accepting the job, terms and conditions and pay structure as being offered by the BC (ICT service provider).

5 Problems and Probable Solutions at Branch/Bank level

There are problems at Branch level which impede the functioning of BC model for enhancing financial inclusion. These may range from complete ignorance of Branch staff about the model itself to variety of other matters. These problems are described below along with their probable solutions.

5.1 Branch Managers not aware of BC Concept

In some Branches, the Branch Managers are not clear about the role and responsibility of the FBCs working in their area of operation. They are not aware of the Banking services which the FBCs are providing to the customers and are not clear about other operations such as, how the reconciliation of database is taking place, how their accounts are maintained etc in FI System. Even about the cash limit with the FBC, is not known to the Branches.

Incidentally, in one Branch, it was noticed that FBC's account was opened as VC's account and the Branch Manager was not aware of what FBC stands for. To resolve such problems, following step may be taken by the Bank:

- It is highly required that the Branch functionaries should be fully aware of entire system of ICT enabled FI with the clarity of Bank's role along with the role and responsibility of FBCs in the area of operation. Therefore, the Bank is required to develop the capacity building of Branch functionaries in this regard.

5.2 Questionable Financial Viability

Providing Banking services to the villagers at the door-step (in the village where they live) is costly because they have small amount of money to transact. The ICT driven solution needs to be economically sustainable, given the constraints in rural areas. The BC/BF model must provide the BCs (ICT providers) and Banks with a business model which enables them to not just make money but also grow the business in the villages. The Banks may attain to financial viability in FI System by considering following points:

(a) The costing of the project needs to be analyzed by the bank and based on the analysis, the banks should select most suitable model for implementing the project. The project could be based on CAPEX (Capital Expenditure) or OPEX (Operational Expenditure) or mix of both CAPEX and OPEX models. Broadly, under CAPEX model, the technology and management of the project are provided by the bank as bank incurs the capital expenditure involved in the project. However, under OPEX model, the bank does not provide technology as it is deployed by the technology provider. The bank pays the technology provider and BCs engaged in the project and incurs the operational expenditure.

(b) The Banks may identify and promote ICT based delivery channels which are inexpensive to setup, and has the ability to handle large number of small transaction at low cost.

(c) A wider range of financial services such as insurance, remittances etc may be provided to the villagers.

5.3 Inadequate MIS at Branch Level

In the entire system of ICT enabled FI, the MIS should enable the Branch Manager to obtain reports and monitor the various activities such as cash movement, cash balances, cash payments, reconciliation, exceptional transactions, etc regularly. As the formats of the reports keep on changing, the system does not provide with the customised MIS reports. The basic problem at the Branch level is that the reporting of FI System is not regular and timely. In some Branches, the reports are not coming in the format as demanded by the branches. To deal with this problem the Bank may adopt following probable solutions:

(a) The system should be flexible enough to generate customised reports as and when required by the Branch.

(b) The reports should be produced to the Branch timely by using e-mail or other electronic media by FBCs.

5.4 Threat of Data Security

As the FBCs are working at field level, collecting the personal data of the customers on papers, feeding and maintaining the data-files in the field-computers, the security of data is one of the major concerns for the Bank. Furthermore, in most cases, the data are maintained and regularly updated on FI Server, which is maintained by the BCs (ICT service providers). If the BC (ICT service provider) becomes hostile to the Bank or destroys the data, there could be a great problem for the Bank. To deal with this problem, the Bank may take following probable precautions:

(a) The Bank may have one "Shadow Database Server" in the Head Office and keep it under own possession. The "Shadow Database Server" will be managed by the Bank staff only. On this "Shadow Database Server", a shadow of entire database is prepared on daily basis.

(b) A commitment can be taken from the BC (ICT service provider) to maintain the confidentiality of the database.

5.5 Technology Obsolescence

The technology used in financial intermediation such as - the POS, POT, ICT-terminal, ATMs, Laptop Computers, Mobile etc keep on changing. The technology involved in Plastic Cards and Smart Cards is changing. Even the technology used in maintaining FI server, shadow database server is also changing at a very fast rate.

The obsolescence rate of technology involved in whole system of Financial Inclusion is quite high. When technology changes the systems and procedures of a Bank also get affected.

For Banks, it is a puzzle whether they should go for CAPEX (Capital Expenditure)

mode or OPEX (Operational Expenditure) mode for implementing the ICT enabled Financial Inclusion in their area of operation to deal with the menace of obsolescence.

Irrespective of the mode, the Bank must ensure that whatever the technology involved should sustain for about 5 years and should be compatible and inter-operable to the new technology thereafter.

5.6 Increase in Work Load at Nodal Branch Level

The work load at nodal branch level has increased tremendously on account of:

a) Reconciliation of FI database
b) Adding business of FI project in the business of the nodal branch
c) Monitoring and management of FI project
d) MIS and report generation

The solution of all such problems listed above could be to automate activities pertaining to these problems as much as possible so that the involvement of branch functionaries can be reduced.

6 Concluding Remarks

The Paper has highlighted the need for increasing the outreach of microfinance in remote areas. Further, the relevance of BC model is highlighted for increasing the outreach. BC model uses ICT extensively for its operations. The paper presents the field level problems involved in financial intermediation faced by villagers and FBCs who are field level functionaries of BCs and Bank staff at the Branch level. The main problems relate to mistrust, inadequate technology support, financial non-viability and technology obsolescence of ICT. Some probable workable solutions to overcome these problems are provided in the paper.

Performance Analysis of Microfinance Through Individual Liability Credit Contract System Operated By Primary Agricultural Credit Society

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Microfinance is the provision of financial services for low-income people and covers the lower ends of both rural and agricultural finance. Agricultural finance is defined as a subset of rural finance dedicated to financing agriculture-related activities.

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Abstract

The basic objective of this paper is to investigate the effectiveness of micro-credit in the form of agricultural credit in improving the economic conditions of individuals under individual liability loan contract system operating through Primary Agricultural Credit Society in two blocks of Hooghly district of West Bengal. With the help of two period longitudinal data, the first-differenced method has been applied to minimise the possibility of selection bias as well as the presence of unobserved heterogeneity of data in this impact evaluation. It is observed that majority of the sample households belonging to treatment group are marginal farmers both in t^{th} as well as in the $(t+1)^{th}$ period. Results reveal that micro-credit through individual liability loan contract system operated by PACS is ineffective in improving the living conditions of the participating farmers even though rate of interest charged by PACS for crop loan has reduced and the repayment rate is high because they repay the loan at the cost of consumption. The inability of the sample respondents to increase their land size during the concerned time period and high cost of cultivation is responsible for such a result. The positive aspect is that the individuals under individual liability credit contract system do not have to face peer pressure and group dynamics.

Key Words: Primary Agricultural Credit Society, individual liability loan contract system, micro-credit, marginal farmers,

JEL Classification: G14, G21

Introduction

Majority of the farmers in West Bengal are small and marginal. For this, group of farmers facing land and liquidity constraints in the risky and fluctuating production conditions of agriculture, credit transaction remain a crucial aspect because the banks are unable to meet the stipulated norms of financing the agriculture sector. Microfinance emerged as an alternative credit delivery mechanism to formal banking in rural India. Microfinance is the provision of financial services for poor and low-income people and covers the lower ends of both rural and agricultural finance. Agricultural finance is defined as a subset of rural finance dedicated to financing agriculture-related activities. There is no specific estimate of the size of micro-credit. But we can consider that if the size of credit is not more than Rs. 20,000 then, that credit can be treated as micro-credit (Kundu, 2011). Agricultural credit for the small and marginal farmers can be treated as one form of micro-credit because the size of credit through Primary Agricultural Credit Societies is a function of size of land owned by the borrower which in any case is low for small and marginal farmers. This type of micro-credit can be availed under two different types of credit contracts: (i) individual liability credit contract and (ii) joint liability credit contract. The basic objective of this paper is to investigate the effectiveness of micro-credit in the form of agricultural credit under individual liability loan contract system operating through Primary Agricultural Credit Society in improving the economic conditions of participating farmer households.

Overview of Literature

The main argument raised against the individual contract is that, the collateral requirement makes it impossible to reach the target group of poor people since it is in particular them who have nothing to pledge as collateral (Khandker 1998). Todd (1996) found that many borrowers were using loans to purchase land, rather than to complete their proposed projects. Hulme and Mosley (1996) concluded that growth in incomes of borrowers always exceeds that of control group. They also found that positive impacts on income are larger for better-off borrowers. Morduch (1998) argued that no evidence was found to support claims that the microfinance programmes increase consumption levels. Khandker (2001) confirm that programmes make a difference to poor participants by raising per capita income and consumption as well as household net worth, thereby increasing the probability that the programme participants lift themselves out of poverty. Coleman (1999) found no significant impact of access to micro-credit on improving household wealth. Coleman (2006) found that the insignificance was limited to general beneficiaries. Meyer (2002) concluded that while access to micro-credit seems to have an overall positive effect on income and education, results differ substantially across countries and programmes both in magnitude and statistical significance and robustness. Estimates in Montogomery (2005) using

data from Pakistan found a mild significant impact on per capita food expenditure in the months after the beneficiary first borrowed. Menon (2005) demonstrate that although membership has beneficial impacts on a household's consumption smoothing ability, members may become less dependent on programmes after a few years of participation. Bebezuk and Haimovich (2007) found that credit increased labour income in a statistically and economically significant manner. Asian Development Bank (2007) concluded that there was no significant difference between those who received micro-credit loans and those who did not.

Operating Procedure of Individual Liability Micro-credit Contract through PACS

Credit given directly to individuals also form a part of the microfinance technology. In India, Cooperative banks, via the Primary Agricultural Credit Societies (PACS) play a very important role in priority sector lending. The basic eligibility criterion for agricultural loan from PACS is that the individual will have to be a member of PACS. Therefore a person will first have to apply for membership stating the reason and pay a nominal entry fee or admission fee which varies from one PACS to the other. The applications are usually submitted during the crop seasons, i.e., Kharif (April to August) or Rabi (October to January) season which has to be passed by the Board of Directors in the meeting. During each season, the Board of Directors meets at least thrice to discuss the membership issue. There is an agreement between the loanee and the PACS stating the amount of loan, the interest rate to be paid and the repayment period which has to be accepted by the loanee known as "tomsuk". When the application is passed by the Board of Directors of the respective PACS, the applicant is to pay the membership fee which varies from one PACS to the other and is decided in the Annual General Meeting of PACS. The membership fee, different from entry fee is paid through purchase of share issued by the respective PACS. The value of each share is decided in the Annual General Meeting of PACS. But a minimum of one share is to be bought for membership. No dividend is declared by PACS on shares. The loanee then submits the photocopy of 'land deed' or 'porcha' and the original copies of the same are to be produced to validate the ownership right. In case of a 'bargadar' or 'patta holder' the land record is considered as the document provided by the owner of the land. Maximum amount granted as crop loan to these cultivators by PACS is Rs. 3,000 which is much less compared to the amount granted to the owners. The credit limit in this case does not depend on scale of finance but depends on PACS. Since land is the only asset owned by a farmer it acts as the collateral for PACS. If the amount of loan is greater than Rs. 5,000 then the land is registered in the name of the respective PACS known as 'mortgage carbonnama'. After this the person becomes eligible for loan. The person opens a savings deposit a/c with the respective PACS if the person does not hold one and deposits a minimum of Rs. 50 in the account.

This system of opening an account with the PACS has been effective only since the introduction of 'Kisan Credit Card' (KCC) scheme in 2002 in Hooghly. At this point the KCC is issued in the name of the loanee. The loanee then fills in a 'voucher' with the details of his/her name, address, the KCC number and amount of the loan applied for. The voucher is signed by the loanee and two witnesses. The loan amount sanctioned is then transferred to the account as per the 'scale of finance'. The loanee becomes eligible to withdraw the entire amount of loan sanctioned or in installment according to the needs at different stages of cultivation.

The amount of loan sanctioned depends on the credit limit known as '3 Year Composite Credit Limit' scheme which is calculated with the help of the following simple formula:

*Credit Limit = Scale of Finance * Amount of Land for Cultivation.*

Scale of finance is different for different crops. It is calculated on the basis of average total cost of cultivation and average gross yield per acre and the scale of finance has been fixed on whichever is higher. Cost of cultivation includes cost of seeds, manures, fertilizers, plant protection chemicals, labour and irrigation.

Credit limit which is dependent on scale of finance is fixed for a period of three years. Disbursement of loan is on an annual basis. But if the cost of components increases during these three years then there is a provision of introducing supplementary credit limit even before the completion of three years. Crop-wise scale of finance is worked out and fixed by District Level Technical Committee under the Chairmanship of Principal Agricultural Officer (PAO) on the basis of one acre of land.

Rural West Bengal is now dominated by small and marginal farmers whose size of land is less than 3 acres. So their requirement for agricultural credit is also small. PACS can fulfill their requirement of small credit which can be termed as micro-credit. Here every micro-credit has to be repaid with a fixed rate of interest within a stipulated time period. Similarly, PACS also charge interest on agricultural loan fixed by the Government of India through NABARD. The rate of interest charged by PACS for agricultural loan from borrowers was 11%, in 2004 and that has dropped to 7% since 2006. This loan is now refinanced by the branch of the District Central Cooperative Bank Ltd., at the rate of 5% per annum. The loan is to be repaid within a year from the date of disbursement. If the cultivator is unable to repay the loan within the stipulated time period then an overdue of 2% is charged along with the existing rate of interest. Even though the repayment period is one financial year yet the rate of interest charged during this period is not the same for all crops. Crop-wise repayment period prevailed before the introduction of KCC.

Since the introduction of 'Kisan Credit Card' scheme the cultivator does not have to wait for the loan. The scheme aims at providing adequate and timely credit for the comprehensive credit requirements of farmers for taking up agriculture and allied activities. The maximum credit limit sanctioned so far in Hooghly is Rs. 80 thousand. Even though agricultural credit is provided by commercial banks as well and at the

same rate of interest as that of PACS yet it has been experienced that people prefer to borrow from PACS because of the known environment. In addition to land, gold is also accepted as collateral by commercial banks. The employees of the respective PACS belong to the same village and thus the borrowers are at ease and more comfortable in borrowing from PACS. Ignorance and illiteracy also prevent the borrowers from approaching the commercial banks for agricultural credit where they find the process to be cumbersome and complicated. Sometimes, distance of the commercial bank from the village also hinders the borrower's eagerness to borrow from the commercial bank. Thus the importance and operation of PACS in the rural areas in case of individual liability micro-credit contract is enormous.

Methodology

The sample is drawn from Hooghly district of West Bengal. Hooghly District Central Cooperative Bank Ltd. (HDCCB) registered on 29.4.1966 is the premier cooperative institution in Hooghly District catering to the agricultural credit needs of the farmers. This Bank is the highest lending financial institution among all the banks including any nationalised bank in Hooghly. The credit plan for agriculture and allied activities were targeted at Rs. 8,343.71lakh in 2005-06 and 95.85% was achieved. The cumulative issue of KCC loan till 2005-06 was Rs. 7,036.17 lakh and the cumulative number of KCC cards issued till 2005-06 was 89,356 (Annual Report of Hooghly District Central Cooperative Bank Ltd.). The role of the Hooghly District Central Cooperative Bank Ltd. (HDCCB) in microfinance is also significant compared to the Cooperative Banks of other districts and has been considered as the role model for many districts and states. Out of the eighteen blocks in Hooghly, only two blocks have been selected for the survey randomly and these two sample blocks are (i) Chinsurah-Mogra and (ii) Tarakeshwar. Both the blocks have tribal based communities with a considerable percentage of people lying below the poverty line. Chinsurah-Mogra has two PACS affiliated to Hooghly DCCB Ltd. - Digsui Union Large Sized Primary Cooperative Agricultural Credit Society Ltd., and Talandu Sech 'O' Samabyay Unnayan Samiti Ltd. The former is the oldest. This is also another reason for choosing Chinsurah-Mogra. This society was formed on 5th March 1957 at Digsui. Till 1975, this society provided only agricultural credit but since 1976 provisions were also made for other loans. The society also has formed four Farmer's Clubs since 1996. Talandu Sech 'O' Samabyay Unnayan Samiti Ltd was formed on 26.12.73. The main objective of this society was to provide agricultural loan and make provisions for irrigational facilities like all other Primary Agricultural Credit Societies till 1995. Since 1996 this society started accepting deposits from public and granting other loans. Before the introduction of 'Kisan Credit Card' scheme crop loans were usually short-term loans. But with the introduction of KCC, medium-term crop loans are also provided by this society. Land acts as the collateral for short-term loans and medium-term crop loans. This society had formed

one farmer's club on 20.03.03 named "Udayan" which is not effective. In Tarakeshwar there are eighteen PACS out of which, one is chosen randomly and it is known as Vivekananda Samabyay Krishi Unnayan Samiti Ltd. Incidentally Vivekananda Samabyay Krishi Unnayan Samiti Ltd was awarded for having the best 'Farmer's Club' of West Bengal by NABARD during 2004-05. This society was formed on 17th September 1977. Till 1985, the society had the power to disburse agricultural credit only. The society also has formed two farmer's club since 2002. Both the farmer's clubs are registered under this society. The rate of recovery varied between 80% and 90% for all the three PACS in the financial year ended in 2004.

As the basic objective is to do impact study, during the time of drawing samples we divided them into two groups, i.e., treatment group (the group consists of the households who have become members of PACS in the 'base line' period, i.e., between September to December 2004 and control group or reference group who did not or could not take membership of PACS in the 'base line' period). Out of 160 members, 115 were selected as sample respondents belong to treatment group on the basis of availability and easy communication. We were very careful during the time of selecting the control group. Here the sample households belonging to control group are chosen from the same locality from where the sample households belonging to treatment group is chosen. But we made sure that the sample respondents belonging to control group are not getting any indirect benefit from the sample respondents belonging to treatment group. Besides that the rural households where one member on one hand is a direct member of PACS and another member mainly the female counterpart is a member of SHG are left out during the time of drawing samples. To minimise the problem of sample selection bias we here depend on longitudinal data. So the survey was carried out twice in order to determine the impact of microfinance programme on the treatment group and to evaluate whether there has been any economic improvement among the members PACS as compared to the control group within the concerned time period. The first survey period was from August to November in 2005-06 to get the socio-economic information of the sample respondents during September to December 2004, and the second survey period was from September to December in 2008.[1] The periods were chosen to minimise the recall period of each respondent and to get direct observation as much as possible. After the sample households were selected the socio economic conditions were studied with the help of a well framed detailed questionnaire in order to determine the impact of micro-credit in the form of agricultural credit in improving economic conditions among the participants. In our sample, the rural households of the same villages had the option of either becoming a member of PACS or stay away from them. Thus the sample has two categories:

1. Individuals who have taken membership of PACS in the tth period and plans to take credit in future when required from PACS under individual liability loan contract. These individuals in our paper belong to Treatment Group.
2. Individuals, from almost identical socio-economic background who are not

members of individual liability loan contract system in the tth period but have the eligibility to join PACS. These sample respondents belong to control group.

The total sample size is 215 out of which the treatment group has 115 individuals and the control group has 100 individuals. As the participants are directly attached with PACS, initially we have to identify the size of land holdings of the sample households belonging to treatment as well as control group which is shown in Table-1.

According to Land Ceiling Legislation, marginal farmers are those whose own-

Table 1: Distribution of the Sample Respondents in terms of Size of Land Holdings

Size of Land (Acres)	Treatment Group		Control Group	
	2004: (t^{th} period)	2008: $(t+1)^{th}$ period	2004	2008
No Land	0	0	45	45
Less than 1 acre	36	36	19	19
1 acre to 2.5 acres	66	66	36	36
More than 2.5 acres	13	13	0	0
Total	115	115	100	100

Source: Field Survey

ership of land holdings is not more than 2.5 acres. It is observed that 102 sample households belonging to treatment group are marginal farmers both in t^{th} and in $(t+1)^{th}$ period who have become members of PACS to avail of the agricultural loan facilities in spite of their small size of land holdings. The amount of loan sanctioned by PACS to these farmers is less because it depends on the size of land owned and hence can be termed as micro-credit. They prefer individual liability loan contract system to avoid peer pressure and group dynamics.

Impact Assessment among the Sample Respondents on the Basis of Natural Experiment

Pooled cross section can be very useful for evaluating the impact of a certain event or policy. In our survey the data arises from a natural experiment. A natural experiment occurs when some exogenous event like any change in government policy can possibly change the socio-economic environment of the individuals or households. This natural experiment always has a control group which is not affected by the policy changes and a treatment group which is thought to be affected by the policy changes. In order to control for systematic differences between the control and treatment group we need two years data, one just before the implementation of the policy and one after the change. To collect the longitudinal data we attempt to follow the same households or individuals across time. Let the two time periods be denoted by t^{th}

period and $(t+1)^{th}$ time period. These years are not adjacent, i.e., t^{th} period corresponds to 2004 and $(t+1)^{th}$ to 2008 year in which the actual impact have been measured. Thus our sample is usefully broken down into four groups, (i) the control group at the base line period, (ii) the control group at the 'end line' period, (iii) the treatment group at the base line period and (iv) the treatment group at the end line period. In this 'before versus after' comparison the time gap here taken is four years. We can call 'C' as control group and 'T' as the treatment group. DT is here treated as dummy variable and equal to 1 for those in the treatment group 'T' and 'zero' for control group. We here also consider D2 as the dummy variable for the second time period.

Impact Study through First Differenced Method

The impact study can be analysed on the basis of simplest kind of panel data of two periods using first differenced method. The assumptions for the first-differencing estimator are:

Assumption 1: For each i, the model is:
$Y_{it} = \hat{a}_1 x_{it1} + \ldots\ldots + \hat{a}_k x_{itk} + a_i + u_{it}$, t= 1, …….. T, where the âj are the parameters to estimate and a_i is the unobserved effect, Y_{it} is the outcome variable and x_{itj} (j = 1…k) are the explanatory variables.

Assumption 2: We have a random sample from the cross section.

Assumption 3: Each explanatory variable changes over time (for at least some i), and no perfect linear relationships exist among the explanatory variables. For the next assumption, it is useful to let X_i denote the explanatory variables for all time periods for cross sectional observation i: thus X_i contains x_{itj}, t= 1,…., T, j= 1, … , k.

Assumption 4: For each t, the expected value of the idiosyncratic error given the explanatory variables in all time periods and the unobserved effect is zero: E (u_{it} I Xi, ai)=0.

We have taken the cross section data of a group of households both belonging to control group and treatment group for two separate periods. Here t = 1 is for base line period and t = 2 for end line period. We can write a model with a single observed explanatory variable as

$$Y_{it} = \beta_0 + \delta_0 d2t + \beta_1 X_{it} + a_i + u_{it} \text{ when } t = 1 \text{ and } 2 \ldots\ldots\ldots\ldots\ldots\ldots (1)$$

In this model d2t is the dummy variable which equals to zero when t = 1 and one when t=2. Therefore the intercept at t=1 is β_0 and at t=2 is $\beta_0 + \delta_0$. The explanatory variable a_i is generally called unobserved effect. It captures all unobserved,

time-constant factors that affect Y_{it}. In this application the main reason for collecting panel data is to allow for the unobserved effect a_i to be correlated with the explanatory variables. To remove the unobserved effect we can difference the data across the two years. If we subtract the second equation, i.e., the situation when t =2 from the first equation when t = 1 we have the following equation:

$$(Y_{i2} - Y_{i1}) = \delta_0 + \beta_1(X_{i2} - X_{i1}) + (u_{i2} - u_{i1})$$

Or $$\Delta Y_i = \delta_0 + \beta_1 \Delta X_i + \Delta u_i \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (2)$$

Here 'Ä' denotes the changes of the values from t = 1 to t = 2. The above equation (Eq.2) is called the first differenced equation. It is just a single cross-sectional equation but each variable is differenced over time. The most important is that Äui is un-correlated with ÄXi. When we obtain the OLS estimator of â1, we call the resulting estimator, the first-differenced estimator.

To do the impact study we modify the above equation (2) in the following form:

$$\Delta y_i = \delta_0 + \beta_1 DT + \beta_2 \Delta DRatio_i + \beta_3 CRINGACT_i + \Delta u_i \dots\dots (3)$$

and

$$\Delta MPCE_i = \delta_0 + \beta_1 DT + \beta_2 \Delta DRatio_i + \beta_3 CRINGACT_i + \beta_4 OUTMCR + \Delta u_i \quad \dots (4)$$

Here two outcome variables of interest are $Ä_{yi}$ which denotes the change in average monthly income of the ith sample household during the concerned time period and $ÄMPCE_i$ is change of monthly adult equivalent[2] per-capita consumption expenditure of the ith sample household during the concerned time period. During the time of calculating y_{it} we have to consider net income from land and income from other sources like income as agricultural labourers as well as a non-agricultural labourers (reference period is one year), earnings from selling milk products, small business like grocery shop, wage income as labourers after being engaged in different activities as carpenters, primary school teachers and working in firms (reference period is one month). It also includes women folks working as maids and income earned from National Rural Employment Guarantee Scheme under NREGA Act which promises to provide 100 days of employment during a financial year to adult members of any rural household willing to do unskilled manual work at the statutory minimum wage. This income has been considered only for the $(t+1)^{th}$ period.[3] After calculating the annual income where necessary we have converted that in to average monthly income. If in a sample household we observe more than one earning member then initially we have converted the earning of each member in terms of monthly income and then added the average monthly income of each earning member (giving them equal importance) to get y_{it} the average monthly income of the ith sample household either belonging to treatment group or to control group in the tth period. Similarly we can get the value of average monthly income of the sample household's income in the $(t+1)^{th}$ period at the current

price. But we have to convert that average monthly income in constant term considering 2004-05 as the base year on the basis of consumer's price index of the agricultural labourers of West Bengal. During the time of calculating monthly per-capita consumption expenditure of the sample household, i.e., MPCE we initially have to subtract average monthly savings and average amount spent for loan repayment per month if required from calculated average monthly income to get total monthly consumption expenditure of that sample household. Dividing that by adult equivalent family members we can get MPCE of the ith household.

Among the explanatory variables in both the equations, $DRatio_{it}$ is the Adult equivalent dependency ratio of the ith household in the tth period. It is the ratio between total number of adult equivalent family members and total number of adult equivalent earning member(s). $CRINGACT_i$ is total size of credit taken by the sample members for income generating activity between the concerned time periods. Here loans are taken only for cultivation by members of PACS. PACS also grant loans for health, business, education and marriage purposes. Loans granted for these purposes by PACS are rare. Credit taken for health reasons is considered as income generating activity because health is an asset for an individual. In India out of pocket individual medical expenditure is very high. Better the health better will be the working capability of the individual and hence more will be scope of earning. As we here consider only two time periods, total size of credit taken by the member households between the concerned time period for income generating activity are accommodated in the second time period as we have considered only previous year's loan. As none of the sample respondents both in treatment and control group in our case have borrowed for non-income generating purpose we are not considering this item in our Natural Experiment. In the second equation we incorporate a dummy variable OUTMCR, i.e., whether the participant has any outstanding micro-credit in the second time period. It is '1' if the participant has any outstanding micro-credit in the second time period and '0' otherwise. Actually if the participant has any outstanding micro-credit in the second time period, then he has to pay a good amount for loan repayment and that can be done only through sacrificing present consumption which ultimately may affect $MPCE_{i2}$.

We have already mentioned that 'T' denotes the sample households belonging to treatment group and 'C' denotes the sample households belonging to control group. Table 2 gives the summary statistics of the explanatory variables both in t^{th} and in $(t+1)^{th}$ period.

It has been checked that there is significant difference between $\overline{y_{1T}}$ and $\overline{y_{1C}}$ or $\overline{MPCE_{1T}}$ and $\overline{MPCE_{1C}}$. This is because 45% of the sample respondents belonging to the control group possess no land.

As two surveys had been done for more than two years apart, the problem of selection bias during the time of choosing samples can be minimised. $DRatio_i$ will be non-zero if either (i) the family size changes, and (or) (ii) the number of earning

Table 2: Summary Statistics of Outcome Variables and Few Explanatory Variables						
Table 2A: Sample Households belong to Treatment Group						
Variables	2004 Mean (Rs.)	2008 Median	SD	Mean (Rs.)	Median	SD
Y	4184.05	3100	3284.09	3895.98	2940	3073.17
MPCE	945.08	700	549.93	817.02	697.05	490.75
CRINGACT	0	0	0	13629.31	10000	8596.29
N	115			115		
Table 2B: Sample Households belong to Control Group						
Variables	2004 Mean (Rs.)	2008 Median	SD	Mean (Rs.)	Median	SD
Y	2842.07	1987.5	2362.06	2948.38	2142	2416.39
MPCE	757.9	650	428.8	782.5	689	409.5
CRINGACT	0	0	0	0	0	0
N	100			100		
Source: Calculated on the basis of Primary data						

members of the sample household changes. The explanatory variable CRINGACT is zero at t=1. Total size of micro-credit taken for income generating activity (CRINGACT) by the members of PACS between the concerned time period are accommodated in t =2. Now to know the impact of micro-credit on the two outcome variables we mainly have to test the significance of â1, â2, and â3, respectively. The results of the two regressions of the equations of first differences are shown in Table 3.

From the above table it can be definitely said that there has been no economic improvement among the participants operating through individual liability loan contract system under Primary Agricultural Credit Society in terms of average monthly income

Table 3: Results of First Differenced Method where outcome variables are Äy_i and Ä$MPCE_i$		
Different Parameters Estimates	Model-1 Äy_i	Model-2 Ä$MPCE_i$
äï	137.806*	24.702
â$_1$	-189.076	-60.612
â$_2$	-98.345	-35.789
â$_3$	.017**	-.005**
â$_4$	-	-19.163
$\bar{R}^2$	.204	.304

*=> Significant at 5% level.
**=> Significant at 1% level

and monthly per-capita consumption expenditure. The $\bar{R}^2$ is low for both the equations.[4] The in-efficiency of micro-credit programme under individual liability operated by Primary Agricultural Credit Society for economic improvement among the participants is reflected in Table 4 where it is observed that between the concerned time periods there has been an increase in the number of participants below the poverty line though it was marginal. The rural poverty line in West Bengal was Rs. 445.38 in 2004-05 which is measured on the basis of monthly per capita consumption expenditure.[5] So we need not make any adjustment of MPCE of the sample respondents in the tth time period but some adjustments of both average monthly income and monthly per-capita consumption expenditure of the entire sample respondents both belonging to treatment group and control group in 2008 was required. To do the comparative analysis of the outcome variables we have to convert the calculated nominal values of the outcome variables of the $(t+1)^{th}$ period into real terms for the tth period (here 2004) with the help of consumer price index of the agricultural labourers of West Bengal published by the Labour Bureau Government of India. Table 4 shows how MPCE for both treatment group as well as control group changes from 'base line period' to 'end line period' in our experiment.

Table 4: Distribution of the sample respondents in terms of MPCE both in the tth period and $(t+1)^{th}$ period

Range of MPCE	Treatment Group		Control Group	
	t^{th} period	$(t+1)^{th}$ period	t^{th} period	$(t+1)^{th}$ period
Below Rs. 350	2	3	11	10
Between Rs. 351 and Rs. 445	2	11	24	24
Rs. 446 and above	111	101	65	66
Total	115	115	100	100

Source: Calculated by authors.

Table 4 shows that a majority of the members of PACS belonging to the sample (96.5%) were above the poverty line in the tth period. But in $(t+1)^{th}$ period there was a marginal (8%) decrease in the number of participants lying above the poverty line.

Actually micro-credit through individual liability loan contract system operated by PACS did not play a significant role in improving average monthly income as well as Adult Equivalent Monthly Per-capita consumption expenditure of the member households between the experimental time periods. Now we will have to identify the possible reasons for such a result in spite of the high repayment rate as stated by the respective reports of PACS and a fall in the rate of interest charged by PACS from borrowers as already mentioned. No specific increment of monthly income of the

farming households belonging to treatment group is observed if we compare that with rural households belonging to control group. The possible reasons are:

1. The size of land holdings owned by the sample respondents remained the same at t=2. Data collected from field survey show that there was no purchase of land since 2004 which is considered here as the base year.
2. The level of productivity did not change because of unchanged size of land holding. There was no improvement in irrigation facilities in the regions from where the samples have been drawn. There was no improvement in other farming inputs as well.
3. These regions are predominated by double cropping pattern i.e. either Aman (paddy) and potato or Aman and Boro (paddy) which showed no marked improvement in terms of multiple cropping.

Micro-credit through individual liability loan contract system operated by PACS also did not also play any significant role in improving MPCE of the sample respondents. There was no change in average monthly income of the sample respondents. Rather there were few marginal drops in MPCE of the sample respondents between the concerned time periods. The possible reasons are as follows:

1. The cost of cultivation increased during the concerned time period. Even though scale of finance increased it did not benefit the small and marginal farmers because the amount for repayment also increased.
2. In order to repay the loan the participant had to curtail present consumption of essential items to manage the household budget.
3. Though some participants earned more due to NREGA which was accommodated at t=2 but the increase in the amount for repayment negated the increase in income leading to insignificant change in MPCE.

Recommendations and Prospects

The micro-credit through individual liability loan contract system operated by PACS is ineffective in improving the living conditions of the small and marginal farmers. Even though rate of interest charged by PACS for crop loan has been reduced and the repayment rate is high yet marginal farmers are not better-off. They repay the loan at the cost of consumption because if they are unable to repay the loan within the stipulated time period then additional rate of interest will be charged by PACS depending upon the type of crop grown. Size of land owned by the sample respondents is the major constraint because the amount of credit largely depends upon the size of land holding. The inability of the sample respondents to increase their land size during the concerned time period is also responsible for such a result. The individuals operating through individual liability loan contract system under PACS will be economically beneficial if the following steps can be undertaken by NABARD through PACS.

1. The small and marginal farmers should be provided with support services like transfer and adoption of technology, harnessing advantages in purchase of inputs, obtaining market information and market of produce along with credit facilities by PACS to increase agricultural productivity and their income levels. This will benefit the farmers directly as the role of intermediaries will reduce because the farmers will then have complete information about the market.
2. There should be direct provision for better irrigation facilities by PACS either through additional credit facilities or in kind so that multiple cropping is possible on a large basis.
3. The members of PACS should be involved in decision-making to reduce politicisation of the institution which affects the governance functions of these organisations.
4. PACS should involve Farmer's Club more effectively in dissemination of information and technology through different training programmes to small and marginal farmers thereby creating awareness among them to improve agricultural productivity.
5. The rate of interest charged on crop loan for small and marginal farmers should not be the same as that of large farmers. It should be less so that repayment does not become a problem; so that they can repay without curtailing household budget, thereby improving their MPCE.

The positive aspect is that the individuals under individual liability loan contract system do not have to face peer pressure and group dynamics nor do they have to wait for credit for a longer period of time as in the case of joint liability micro-credit contract.

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Notes

1. So to do the impact study, we consider the time gap of four years.
2. Following Townsend (1994), to get adult equivalent family members, we have considered 1 for any adult member (both male and female), 0.25 for any member of that household up to six years of age, 0.5 for any member of the household between 6 and 14 years of age and 0.75 between 14 and 18 years of age. We have calculated dependency ratio in terms of adult equivalence.
3. During the time of incorporating earnings of a rural household from NREGA, we have to consider the total earnings of that sample household under NREGA between September-December 2007 and September-December 2008, which indicates that the reference period here is the last one year.
4. Low value of R2 is not important in this type of econometric study for natural experiment. The required parameter estimate is insignificant and most of the remaining explanatory variables are also insignificant.
5. The estimation is given according to the report (November 2009) of the expert group by Planning Commission, Government of India to review the methodology for estimation of poverty under the Chairmanship of Prof. Suresh Tendulkar.

Fast Tracking Financial Inclusion through Innovative Cooperative Models - Existing Scenario and Future Prospects

- Navin Anand*

In the context of financial inclusion, Cooperatives are functioning as an important vehicle for addressing social inclusion through sub sectoral and service cooperatives and also for social protection by providing health insurance besides other social protection activities.

Abstract

Finding microfinance, an important component for inclusion, Dr. C Rangarajan's Committee report on financial inclusion has focused on strategies, technologies and a delivery mechanism for reaching the poor and providing them timely, adequate and affordable financial services. This certainly requires shifting from the 'Supply led approach' to a 'Demand let approach' by the mFIs and other players of microfinance sector. The paper recognises the existence of a wide network of cooperatives at various levels/ environments - Micro (internal), Meso (intermediary) and Macro (external). All the three levels are elaborated in the paper to provide a clear understanding of the structures and organisational setup of cooperatives in context of microfinance and financial inclusion.

While examples of international experiments of undertaking microfinance through cooperatives like Raiffeisen Model developed in Germany, is taken as a base to discuss the issue at international level, Indian models of micro financing through cooperatives have also been elaborated.

The paper discusses the examples of microfinance initiatives in rural areas such as Cooperative Development Foundation Model, Hyderabad; SHG - PACS linkage Model - (Examples - Bidar DCCB/ DCCBs of West Bengal and other states); Cooperative Banks - SHG-linkage model and SHG - Federation Models at one end. It also elaborates the key features of urban cooperative models like SEWA BANK, Gujarat; Cuttack Urban

Key Words: Financial Inclusion, Microfinance, SHG Microfinance Product, Cooperative Models.
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Cooperative Bank, Orissa; Bhagini Nivedita Sahakari Bank Limited, Pune, and other examples of Thrift and Credit Cooperatives.

In India, a variety of SHG-federations have also emerged at various levels with a legal entity of cooperatives. Some of the federations registered under cooperative Acts are engaged in non-financial intermediation whereas others have also undertaken financial intermediation services. The paper covers the existing models at one side and also provides ideas and potential models of Self-Help Promotion Systems in the cooperative domain. The paper incorporates a brief analysis of co-operative legal scenario existing in different states and at the national level, in order to exhibit the issues associated with various cooperative Acts and rules. It is a fact that the Cooperative Societies Acts of various states differ from each other in context of various provisions relevant for the development of microfinance and financial inclusion.

The paper identifies various subsets within the cooperative framework in context of financial inclusion. These subsets include - SHG federations registered or registering under cooperative Act, Primary Agriculture Cooperative Societies (PACS) / Mini Banks of PACS, Sub-Sectoral cooperatives like handloom cooperatives/Handicraft Cooperatives/ Agro Processing Cooperatives, Urban Cooperative banks / Thrift and Credit cooperatives and Salary Earners Cooperative Societies.

Finally, the paper provide a holistic strategy to take forward the agenda of financial inclusion through variety of cooperatives through adoption of innovative methods/ product and services, changes in legal framework and cooperative Acts as well as proposing new replicable models.

Introduction

In the U.N. Millennium Summit held in 2000, the goal of reducing extreme poverty in half by 2015 was declared and, therefore, the adoption of the Millennium Declaration became a defining moment for global cooperation as it brought poverty eradication on to the global map.

A comprehensive publication of UN on inclusive finance states that "Creation and expansion of financial services targeted to poor and low-income populations can play a vital role in enhancing financial access. Inclusive financial sectors - those in which no segment of the population is excluded from accessing financial services - can contribute to attaining the goals contained in the United Nations Millennium Declaration, such as halving the proportion of people in the world who live in extreme poverty by 2015"[1]. The emphasis placed on "faster, more broad-based and inclusive growth" in the 11th Five Year Plan of Government of India[2] is an acknowledgment that a considerable population of the country has been ex-cluded from the benefits ear marked for poverty reduction and human development programmes.

The importance of financial cooperatives in the world cannot be undermined. The International Raiffeisen Union which estimates that 900,000 cooperatives with around 500 million members in over 100 countries are working on the cooperative principles worked out in Germany by Friedrich Raiffeisen. In Europe alone there are 4200 local cooperative banks, around 60,000 branches. Hence, the market share of cooperative banks is 20%. Some of the largest banks in the world are cooperatives: Rabo bank, for instance, has 50% Dutch citizens in membership. It is rated world third safest bank. A comprehensive report of ILO also informs that during financial crisis, financial cooperatives remain financially sound.[3]

In the context of financial inclusion, Cooperatives are functioning as an important vehicle for addressing social inclusion through sub sectoral and service cooperatives. Inclusive finance related issues are being covered through savings and credit cooperatives. Besides social and financial inclusion, cooperatives also function for social protection by providing health insurance besides other social protection activities. In the recent past, a large number of Health Mutuals have been formed and started functioning in India, on the principle of self-help and mutual help. For these mutuals and their federations, Cooperatives could be one of the appropriate legal entities.

A report on "Cooperatives in Social Development" by the Secretary - General, United Nations[4] endorses the need for promotion of financial cooperatives to meet the goal of inclusive finance by providing access to financial services to all. Based on the recommendations of this report, United Nations declared 2012 as an 'International Year of Cooperatives'.

2 Need of Financial Inclusion - Rural and Urban

The estimates (59th Round) of National Sample Survey Organisation (NSSO) revealed that out of 89.3 million farmer households in India, nearly 45.9 million households do not have access to any credit. This is over 50% of such households. If we look at the institutional financing, we will find that only 27% people receive institutional finance which means that 73% of farmer households have no access to formal sources of credit. Among non-cultivator households nearly 80% does not have access to credit from any source.

A report by United Nations Population Fund on one hand reveals interesting fact that by year 2030, 40.7% of India's population will be urban. On the other hand, the report of National Commission for Enterprises in the Unorganised Sector states that "informal workers in the Indian economy are estimated to be more than 91% of the workforce. They consist of informal workers in the informal sector (85% of the total workforce) and informal workers in the formal sector (6% of total workforce). These workers have limited social security cover and access to formal financial services which increases their vulnerability during times of illness, old age and in the situation of unemployment.

Hence, a fast track approach to financial inclusion is required both in urban as well as rural areas.

2.1 *Understanding of Financial Inclusion (FI)*

Finding microfinance, an important component for inclusion, Government of India had set up a committee on financial inclusion. The committee[5] chaired by Dr. C Rangarajan had focused on strategies, technologies and delivery mechanisms for reaching the poor and given number of recommendations for providing them timely, adequate and affordable financial services. As per the report, financial inclusion may be defined 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".

The key concepts in the definition given in the report are - Access to Financial Services, timely credit, adequate credit and affordable credit. In the present scenario, financial services will include - Savings: (Mandatory Savings and Voluntary Savings); Credit; Micro Leasing; Insurance services (Life insurance, Health insurance, Livestock insurance and general insurance); Micro pensions; and Transfer of money - Remittances as well as payment services. The report gives a clear message of the need for shifting from the 'Supply led approach' to a 'Demand led approach' by the mFIs and other players of microfinance sector.

Client Oriented Inclusion: The approach of the financial inclusion is different if it is 'supply led' as it is oriented towards the suppliers of MF services and their sustainability. This approach has some basic problems as the focus is on profitability and also enhancing outreach as per the available business opportunities and not necessarily on the needs of the poor. Since the committee on financial inclusion stressed on providing MF services to vulnerable and weaker section, therefore 'client oriented financial inclusion' approach has to be promoted with the focus on financial deepening. There are six aspects of client oriented inclusion[6]: Depth - refers to the poverty level of mFI's clients); Breadth - refer to number of clients covered; Length - refers to sustainability of the mFIs to provide MF services for a long period of time; Worth to Clients - worth reflects client's willingness to pay for the services; Costs to Clients - refers to interest rates, fee and the transaction costs, etc., and Scope - reflects the variety of microfinance services an mFI offers.

The committee on financial inclusion envisaged the following as an overall strategy for Inclusion:

- Effecting improvements within the existing formal credit delivery mechanism;
- Suggesting measures for improving credit absorption capacity especially amongst marginal and sub marginal farmers and poor non-cultivator households;
- Evolving new models for effective outreach, and
- Leveraging on technology based solutions.

2.2 Important Initiatives for Financial Inclusion

The Reserve Bank of India (RBI) introduced "Business Facilitator" and "Business Correspondent[7]" models to enable banks to improve outreach through innovative delivery mechanisms. Under these models, Panchayats, Post offices, NGOs and even Cooperatives are now allowed to function as Business facilitators. Additionally, RBI advised banks for opening of 'No frill Accounts' with low or 'nil' minimum balance and simplified know your customer (KYC) procedures; Government Created two funds - Financial Inclusion Fund and Financial Inclusion Technology Development Fund with NABARD for speeding up financial inclusion by promoting technological and process innovations.

There have been introduction of innovative delivery channels/methods adopted by banks, including new age cooperative banks such as Internet Banking, Mobile Banking, Mobile Automated Teller Machines (ATMs), multi-functional ATMs and smart card as part of initiatives aimed at financial inclusion. Recognising these technologies, RBI suggested banks to adopt technology-based solutions[8] for managing risks, and increasing the outreach in a cost effective manner.

3 Initiatives in Cooperative Sector

"Innovation is the hallmark for credit unions and credit Cooperatives spanning its birth at the first wave of the Industrial Revolution to today's fifth wave dominated by Information and Communication Technology, back dropped in a new liberalisation and the advent of globalisation[9]. Another understanding of Innovation is that it is the key for the sustainability of cooperative banks and financial cooperatives in the competitive environment. Financial cooperatives need to invest in "continuous innovation" by simply modifying prevailing products or services to the more intense ones that involve a new marketing concept meeting the needs of service users as well as service providers.[10]

In today's market oriented, liberalised and competitive markets, rapid changes are taking place with all new technology. The challenge is of doing things better, cheaper, faster than before which can be achieved through innovation. Financial cooperatives have to innovate for the following reasons:

- Providing variety of MF services timely, at affordable prices and on sustainable basis
- Having good market share in the competitive environment
- Reducing cost of delivery by effective management of value chains

The Khusro Committee (1989) stressed on considering savings as a product and also advocated for preparing business development plans which is still relevant for financial inclusion.

Based on the report of Financial Inclusion committee (Dr. C. Rangarajan Committee), Dr. Vaidyanathan Committee [11] Report on Cooperative Structures (2005) recommending

for more autonomy to PACS and recapitalisation of credit organisations; Hazari Committee Report recommending for the integration of short term and long-term credit structure; Chaudhary Brahm Prakash(1991), Jagdish Cappor, (2000) Vike Patil,(2001) V.S.Vyas (2001) Committees and High Power Committee on Cooperatives (2009) to suggest cooperative sector reforms, following developments have taken place:

- Emergence of Model Cooperatives Societies Act
- Enactment of MACS/ Self Reliant Cooperative Societies Acts in different states
- Emergence of mutually aided, self-reliant, autonomous and fully democratic cooperatives
- Re-engineering of old Cooperative Societies Acts through Amendments in provisions
- Reduction in the Government's equity and their controls
- Application of Revival package for Rural Cooperative Credit Institutions
- Legal reforms/amendments in cooperative credit structure/societies as a result of acceptance of revival package of Short-term Cooperative Credit Structure.
- 106th Constitutional Amendment Bill (2006) placed in the Parliament suggesting states to promote "voluntary formation, autonomous functioning, democratic control and professional management "of the co-operatives societies.

3.1 Cooperatives in Microfinancing and Financial Inclusion

In India, microfinancing through cooperatives was started in an organised manner after the state passed legislation to govern cooperative in 1904. Since financial cooperatives have been heterogeneous in nature in term of membership therefore the financing done by PACS, thrift and credit cooperatives and cooperatives banks has not been segregated as the loans for poor and others. Hence, financing by financial cooperatives especially PACS has not been recognised and considered under microfinance. Technically, majority of the financial services provided by a variety of financial cooperatives should come under micro financing as majority of the loans are less than Rs. 50,000.

Share of Cooperatives in Microfinancing through SHGs:

NABARD's report[12] reveals that as on 31 March 2009, total 61,21,147 SHGs were having saving bank accounts with outstanding savings of Rs. 5,545.62 crore. Out of these SHGs, more than 42 lakh SHGs are linked with banks for credit and about 8.6 crore poor households are covered under SHG-bank linkage programme.

Under SHG-bank linkage programme, Commercial banks, Regional Rural Banks and Cooperatives are financing SHGs under the SBLP guidelines of NABARD. The

programme was initially opened for Commercial banks in 1992 and later cooperatives were also allowed by NABARD to undertake financing of SHGs. In the year 2008-09 commercial Banks had the maximum share of SHGs' savings of 35,49,509 SHGs (58%) with savings amount of Rs. 2772.99 crore (50%). Cooperative Banks were having savings bank accounts of 9,43,050 SHGs (15.4%) with savings amount of Rs. 782.88 crore (14.1%).

In the year 2008-09, the share of cooperatives in loan disbursements to SHGs was 8.2% of the total whereas it was 65.7 and 26.1% respectively for commercial banks and Regional Rural banks. Keeping in view the network of cooperatives, there is a potential to enhance savings linkages as well as the share of lending to SHGs by cooperatives.

An analysis of the members of PACS (as on 31 March 2008) revealed the fact that out of the total members of 13.15 crore, 22.6% were SC, 8.5% ST, 37.3% small farmers and 3.6% rural artisans. Similarly, out of total number of borrowers, SC constitutes 9.7%; ST - 6.3%; small farmers - 32.8% and rural artisans - 2.6%. This shows that there is a scope for financial cooperatives to include more members from SC/ST category and weaker section of society. Cooperatives will have to broaden up the portfolio of products and services to cater to the needs of variety of clients/ members.

Micro Insurance:

UNDP study report on Micro insurance[13] reveals that a conservatively estimate of the potential market size for micro insurance (life and non life) in India ranges between INR 62,304.70 to 84,267.55 million (US $ 1,384.55 to 1,872.61 million). In the case of life, the potential is estimated to be between INR 15,393 to 20,141 million (US$ 342.07 to 447.58 million); in the case of non-life, between INR 46,911.70 to 64,126.55 million (US $1,042.48 to 1,425.03 million). The non-life estimation is limited to four types of coverage - milch animals, livestock, health and crop insurance. The population used for this estimation was 40-50% of those earning less than US$1 a day and 50-70% of those earning between US$1 - 2 a day. The report informs that the potential of micro insurance is expected to increase as demand grows and a wider range of risks are recognised as insurable.

3.2 Lessons from Successful Experiments - International Scenario

It is a fact that financial cooperatives including Credit Unions are the first and original microfinance institutions in the world. The present financial cooperatives existing in the form of credit unions, thrift and credit cooperatives, Primary Agriculture Credit Cooperatives (PACS), rural and urban cooperative banks, etc., are in one way or the other based on the lessons drawn from the well known models

promoted by Raiffeisen, Shultze - Delitzsch, Dr. Wollemborg, Desjardins and Rochdale pioneers.

In the developing countries, there have been many successful examples[14] of financial cooperatives being instrumental in enhancing financial inclusion. Few examples of financial cooperatives networks are SICREDI (Sistema de Cooperativa de Credito) in Brasil, SANSA in Sri Lanka, RCPB in Burkino Faso and KERUSSU (Kenya Rural Savings and Credit Cooperative Society Union) in Kenya. Each example provides different lessons related to Microfinance and financial inclusion.

SICREDI with 130 affiliated cooperatives has financial cooperatives, central cooperatives, the confederation and the cooperative Bank in the structure of financial cooperatives. Besides having a variety of savings, loan, insurance and investment services, it offers innovative financial services like international exchange services, a credit card and interbank transfers. Insurance services are provided in conjunction with two major insurers.

SANSA is the largest member owned financial cooperative Network. In the structure it has a variety of organisations (based on products and services offered) at the apex level. SANSA Federation, District Unions and Primary societies completes the whole structure. Besides savings, loans and insurance, SANASA also offers micro leasing products and payment services which is a specialty and learning.

RCPB, Burkino Faso has the federation model to provide financial services to the poor. Customisation of products as per the needs of different client segments such as salaried workers, traders, livestock herders is innovative in terms of linking innovations with different segments of members. It has 'Community credit' as one service of loaning to groups and village banks. Besides other financial products, providing salary advances is another innovative service of RCPB.

KERUSSU, Kenya is a loosely integrated network with large number of Savings and credit cooperative organisations as members. The products and services offered by KERUSSU are very innovative which include sale of school fee checks, access to ATMS, mobile banking services for remote areas which are not covered by branches. 'Pay Points' at which members can receive their salaries and pensions and farmers can receive their crop payments is an innovative idea to be replicated. Some other innovative services include children's account, Christmas accounts and market day loans.

Besides innovative experiments in developing countries, example of cooperative rural finance restructuring initiated in Hungary is a good case which depicts step by step process adopted by the Hungarian state to restructure savings cooperatives existing in rural areas and to build up an operational and viable system of rural finance. Another example could be Cooperative Union Model in Canada's poorest and least economically diversified province - Saskatchewan. Here, Saskatchewan Mutual Aid Board has promoted a cooperative credit society and also worked to streamline cooperative union Act.

3.3 *Financial Inclusion - Indian Cooperative Structure and Initiative*

Financial Cooperatives Structure - Traditional and New Age Cooperatives

The Cooperative credit structure in our country is area specific, i.e., urban or rural and credit need specific i.e. short, medium & long term credit. The rural cooperative credit structure is three tier with the PACS at the primary/village level, federating into DCBs at the District level, which are further federated into SCBs at the state level. National Federation of State Cooperative Bank (NAFSCOB) functions at national level, however it does only promotional role and do not undertake any type of financing. If RBI and Government of India permit functioning of a National Cooperative Bank of India, it will be useful for the sector especially in terms of transfer of money from one state to other state. Urban Cooperative banks operate at the primary level in the urban areas with NAFCUB as their National Federation. Some banks are registered under Multi State Cooperative Societies Acts. At the National level, Cooperative organisations like NCUI, NCDC, NCCT play very important role in Cooperative education, research, training and strengthening of Cooperatives providing financial and non-financial support. The National Federations have Indian membership to International Cooperative Alliance. The rural cooperative credit structure is not uniform across the states and reflects the state specificity and plurality of Indian society. Scanning of cooperative legal environment reveals that cooperative milieu of different states differs in terms of:

- Various provisions relating to financial inclusion and microfinance
- Adoption and implementation of Self-Reliant Cooperative Societies Act/ MACS Act
- Implementation of Single Act/Double Acts (MACS as well as Old Act)
- Utilisation of Multi State Cooperative Societies Act
- Acceptance and implementation of Prof. Vaidyanathan Committee's recommendations

In terms of adoption and implementation of cooperative Acts, the existing legal scenario in different states can be classified into four categories:

- States having Self Reliant as well as the old Cooperative Societies Act
- States having only Self-Reliant Act
- States having re-engineered Single Cooperative Societies Act
- States having more or less the same old Act

In context of financial inclusion, especially after enactment of MACS/Self-Reliant Cooperative Societies Acts in different states, the structure of cooperative financing institutions is changing and there is a mixed structure of traditional and new age financial cooperative structure.

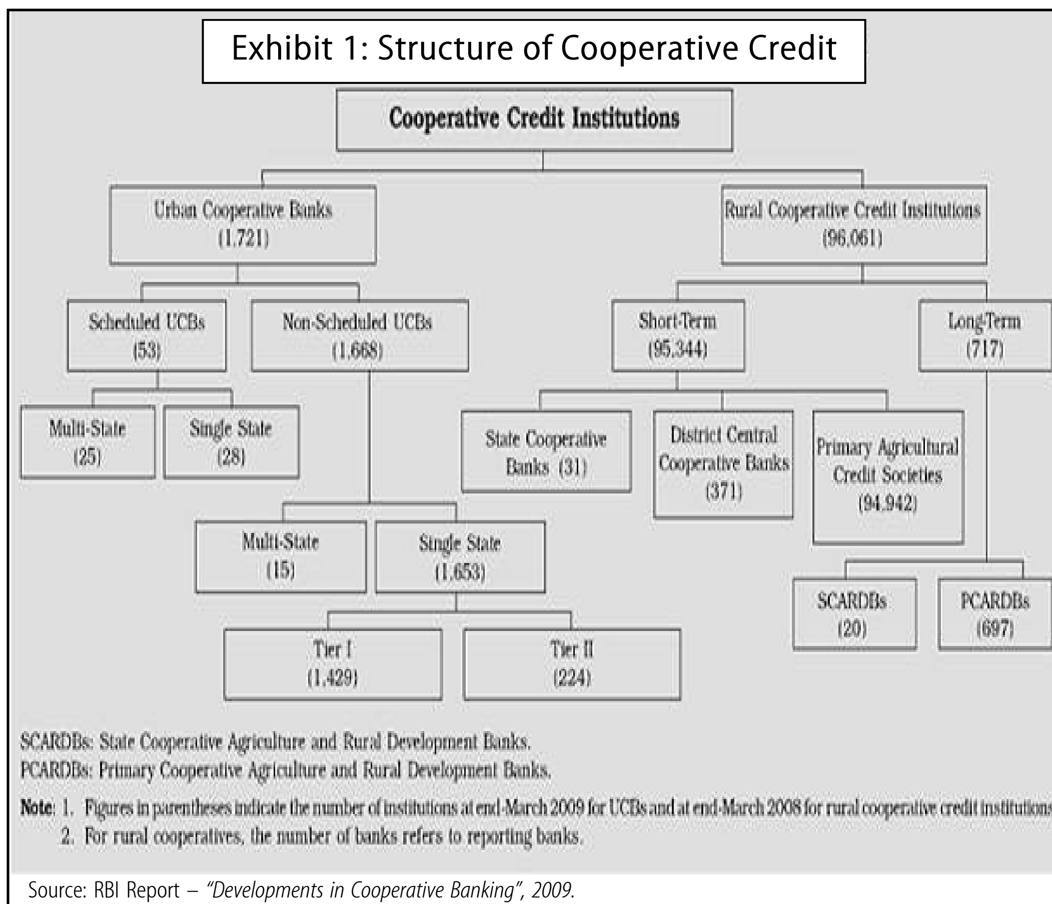


Exhibit 1: Structure of Cooperative Credit

Source: RBI Report – *"Developments in Cooperative Banking", 2009.*

The new structure of financial cooperatives will include the following at different levels:

Financial Cooperatives catering mainly to Rural Areas - Short-Term structure

- Primary Agricultural Credit Societies (PACS)
- District Central Cooperative Banks (DCCBs)
- State Cooperative Banks (SCBs)
- Multipurpose women thrift and credit cooperatives - (established by Women SHGs)
- Thrift and Credit Cooperatives/ Multi Purpose cooperatives (Reg. under State Cooperative Soc. Act/ Multi state Cooperative Societies Act)
- New Age Cooperatives/Mutually Aided Cooperative Societies (MACS)

Financial Cooperatives catering mainly to Rural Areas - Long-Term

- State Cooperative Agriculture and Rural Development Bank (SCARDB) through its branches
- Primary Cooperative Agriculture and Rural Development Bank (PCARDBs)

Financial Cooperatives catering to Urban as well as Semi-Urban/ Rural Areas

- Women Urban Cooperative Banks (WUCBs)
- Urban Thrift and Credit Cooperatives
- UCBs registered under Multi-state Cooperative Societies Act
- Salary Earners Cooperative Societies

Insurance Cooperatives: Insurance Cooperative Societies (i.e., VIMO SEWA-Reg. under Multi-state Cooperative Societies Act)

The abovementioned classification clarifies that old and new structures of financial cooperatives are required to be merged to see the holistic picture of financial cooperatives in India. The classification provides a broad framework of financial cooperatives.

3.4 Glimpses of some Innovative Indian experiments of Financial Cooperatives

The innovative models[15] of India can be simply classified in terms of rural and urban. Some important models include:

Financial Cooperative Models in Rural Areas: Cooperative Development Foundation, Model Hyderabad (A Cooperative Thrift and Credit System (CTCS) is promoted by the Cooperative Development Foundation (CDF) as a community-owned self-help model); SHG - PACS linkage Model - (Examples - Bidar DCCB/ DCCBs of West Bengal and other states); Cooperative Banks - SHG-linkage model (based on NABARD's SHG-Bank Linkage Programme); SHG - Federation Models (Federation registered under MACS/ Self-Reliant Acts)

Financial Cooperative Models in Urban Areas: SEWA BANK, Gujarat (started Mobile Banking in India for serving rural clients); Cuttack Urban Cooperative Bank, Orissa (Agent Model for daily collection of savings and to some extent for collecting loan installments); Bhagini Nivedita Sahakari Bank Limited, Pune and Mann Deshi Mahila Sahakari Bank, Mhaswad (Examples of microfinancing to urban poor, especially women); and Thrift and Credit Cooperatives - (Example SHG-urban financial cooperatives linkages in Maharashtra), Annapurna Mahila Cooperative Credit Society, Mumbai (A successful women thrift and credit coop.).

Indian Cooperative Network for Women (promoted by Working Women's Forum), Chennai is a unique multipurpose women cooperative registered under Multi-State Cooperative Societies Act. It works with women groups providing financial and non-financial services so as to give complete solution to livelihood promotion of poor women.

Some Examples of financial cooperatives of Minorities: Al-Khair Cooperative Credit Society, Patna (A cooperative model of 'Interest-free' Microfinancing) and Marwar Sharia Co-operative Credit and Savings Society, Jodhpur (A thrift and credit cooperative of minorities established by the Marwar Muslim Educational and Welfare Society)

There are examples of financial cooperatives focusing totally on weaker sections such as Scheduled Caste/ Schedule tribes population. Ankuram Sangamam Poram, Hyderabad (An AP Dalit-Bahujan Cooperative Societies' Federation Limited (Ankuram) is an example of a federation of MACS which are comprised of the members from Dalit-Bhujan communities. Another innovative type of financial cooperative society is - Usha Multipurpose Cooperative Society (UMCS), Kolkata. This society is promoted by Durbar Mahila Samiti, Kolkata. It is a unique example of a society providing microfinance services to the sex workers and their families in an innovative way.

In mountain regions, there are innovative experiments going on in terms of providing MF services. Rawain Women's Multipurpose Autonomous Cooperative Society Ltd. (RWMACS), Uttarkashi (promoted by Himalayan Action Research Centre, Uttarakhand) and Swaraj Bahu Udeshiya Swayatta Sahkari Samiti, Guptkashi, Uttarakhand are examples of microfinance through federations of SHGs registered under Self-Reliant Cooperative Societies Act. These societies are providing financial and non-financial intermediary services to their members. Since microinsurance is an important activity under the microfinance domain, National Insurance Vimosewa Cooperative Ltd., a society registered under Multi-State Cooperative Societies Act and promoted by SEWA Ahmedabad, is a good example of providing micro insurance services to the women. Being registered in Central Act, it functions in few states like Gujarat, Rajasthan, Madhya Pradesh, Delhi and Bihar.

Many UN and international agencies through their MF and livelihood promotion projects, promote cooperatives at various levels. Under ILO's INDISCO Programme on promoting Self-Reliance of Indigenous and Tribal Peoples, thrift and savings activities were promoted through a Women's Savings and Credit Cooperative Society, in Gujarat. In Jharkhand, an RLF committee was initially instituted and after three years, the RLF Swavalambi Sehkari Samiti Limited was registered under the Bihar Self-Supporting Cooperative Societies Act 1996 to undertake microfinance activities. Similarly, in IFAD funded project - 'Aajeevika' / ULIPH (Uttarakhand Livelihoods Improvement Project for Himalayas) federations of SHGs at various levels are promoted and they are getting registered under Self- Reliant cooperative Societies Act of the state.

It is important to mention that in the competition with private mFIs, financial cooperative of India are also included in 'India Top 50 Microfinance Institutions', by CRISIL Rating 2009. It includes the following four successful cooperatives of Andhra Pradesh engaged in MF activities:

- Payakaraopeta Mutually Aided Cooperative Thrift and Credit Society (PWMACTS);
- Indur Intideepam MACS Federation Limited;
- Pragathi Mutually Aided Cooperative Credit and Marketing Federation Limited; and
- SEWA Mutually Aided Cooperative Thrift Societies Federation Ltd.

Keeping in view various experiments of financial cooperatives, a variety of models and financial cooperatives are coming into picture. Some models are emerging after adoption of MACS/Self-Reliant Cooperative Societies Acts (SHG Federation Models) whereas some are existing models of financial cooperatives (PACS - SHG linkage Model). Another set of Models relates to Urban Cooperative Banks. In order to fast track financial inclusion, the issues at various levels related to regulations, policy, operations, microfinance practices are identified and discussed in the following section of this paper.

4 Key Issues related to Fast Tracking Financial Inclusion through Cooperatives

SHG Federations: SHG-Federations have emerged at various levels in different states. A number of these federations are undertaking financial as well as non-financial intermediation activities. For financial intermediation services, the SHGs and members depend on mFIs and Banks. Cooperatives could be good options provided provisions are made conducive for MF. In majority of the MACS/Self-Reliant Cooperative Societies Acts, provision of nominal and associate membership is not included therefore the SHG federations depend largely on ordinary members' share capital and deposits. A GTZ and NABARD supported study of SHG federations in Rajasthan, Uttar Pradesh and West Bengal reveal that majority of the federations are registered as not-for-profit type of institutions and therefore not able to provide savings services to the members. Due to the fear of undue intervention of the state, they have not opted for registering under cooperative Acts. This shows that financial cooperatives are good options as federation of SHGs to cater to the savings related services.

There are many positive aspects of the Mutual Aided Cooperative Societies Act, these cooperatives can mobilise funds from its members and can also raise financial support from banks and other financial institutions. This situation will be more positive in the case wherein the provisions of nominal and associate membership will be included through changes in the respective Acts. In such situation the societies will be able to generate resources from these members as well. However, it is important to have a clear regulatory framework to watch that the autonomy given to these societies are not misutilised by few members. Hence, the challenge will be to get members involved in governance and oversight of their institutions.

PACS as SHPIs and Mini Banks: An analysis of the short term credit structure available for micro financing in rural areas, shows that nearly one lakh PACs, 371 DCCBs, 31 SCBs already exist to cater to the needs of farm and non-farm entrepreneurs, especially marginal and small farmers. Based on the success of SHG-PACS linkage models and positive factors of PACS (wide national network, intimate knowledge and capacity to cater to the needs of rural poor, affordable interest rates on the loans, and good rates of interest on deposits), it is envisaged that PACS could be one of

the appropriate agencies for fast tracking financial inclusion. PACS have low risks in providing MF services through SHGs.

PACS having mini banks are more appropriate financial intermediary for undertaking multiple financial services. Some good mini banks in Kerala and Western districts of Uttar Pradesh and few district of Uttarakhand are having deposits of Rs. 10 million or more, However these PACS, having good mini bank deposits are not allowed to use the savings/deposits for lending to the poor. It is envisaged that after implementation of Vaidyanathan Committee's recommendations, these PACS will be having more autonomy to function as a microfinance institutions and could also act as good Business Correspondents.

SHG Membership in Cooperatives: Some states still have laws that do not permit SHGs becoming members and holding equity in PACS/Thrift and Credit Cooperatives. (Examples of the provisions of SHGs becoming ordinary and nominal members of the PACS under Section 69 (1) (d) and Sec 69 (3) of West Bengal Cooperative Societies Act, 1983; and Modification in section 22 of Gujarat cooperative Societies Act are good cases wherein the Acts permit SHGs to become members of PACS/ Primary Thrift and Credit Cooperatives. This provision is supportive in speeding up financial inclusion.

MF through Sub-sectoral Cooperatives: Sub-sectoral cooperatives like handloom cooperatives/Handicraft Cooperatives/Agro Processing Cooperatives are not able provide microfinance services to their members and therefore even for small credit needs these members depend on other cooperatives, banks or money lenders. Additional provisions to permit linkage and membership of SHGs in the sub sectoral societies and societies functioning as financial intermediary will help members to get financial services from a single door.

Financial Support from Government: The MACS/ Self-Reliant Cooperative Societies Acts do not permit government shares in the societies so as to maintain the autonomy of the societies however this does not deny these cooperatives to avail other benefits and grants provided to the cooperative sector. At present, no grant/financial support is being provided by the government even to the well functioning cooperatives registered under MACS Act. There needs to be more clarity at both ends - government as well as Self-Reliant Cooperatives/MACS.

Enhancing Urban Microfinancing: Selected Urban Cooperative Banks are successfully functioning as microfinance institutions in different states. The Cuttack UCB, Orissa has used agents for daily collection of deposits and recovery in last few years. They can immediately adopt BC/BF model to upscale their business. The SEWA Bank, Ahmedabad is also an example of an UCB working for financial inclusion. They were the first to start Mobile Banking in India for serving rural clients. In order to widen the scope, UCB registered under Multi State Cooperative Societies Act have still to take up lead role in micro financing. Many Thrift and Credit Coop. are catering to microfinance needs of urban areas with SHGs as primary units. However, these are some stand alone cases and not yet replicated.

Participation of Members: A very important issue is low participation of members in the affairs of Coop. This can be attributed to lack of effort to enhance member equity in Coop. and near absence of member communication and awareness building efforts. There is a need for Provision in Indian cooperative law to ensure that members are users and for removal of inactive members expeditiously and on a regular basis.

Differentiation between Banking and Cooperative Activities: There is less clarity about - what constitutes banking activity to be regulated by RBI (Triangular Regulation) and what constitutes cooperative activity to be regulated by Registrar Cooperative Societies.

Value Delivery Chains: The value delivery chains of microfinance products and services are different for different organisations and therefore the models and methodology for undertaking each activity also differ case by case. Good governance, effective management, innovative processes and systems, member centered financial services, adequate and result oriented Human resource will be prerequisites for the successful management of value chains.

Using Salary Earners cooperative Societies in Financial Inclusion: There are number of Salary Earners Thrift and Credit Cooperatives which are in profits and having surplus money to lend. The SHGs of ultra poor and excluded people can be linked with these cooperatives for financial inclusion under 'concern for community'. In this arrangement the provision of nominal membership can also be explored. Alternatively, minor changes in the cooperative societies Acts and bye-laws of these cooperatives can help to undertake these cooperatives for financial inclusion.

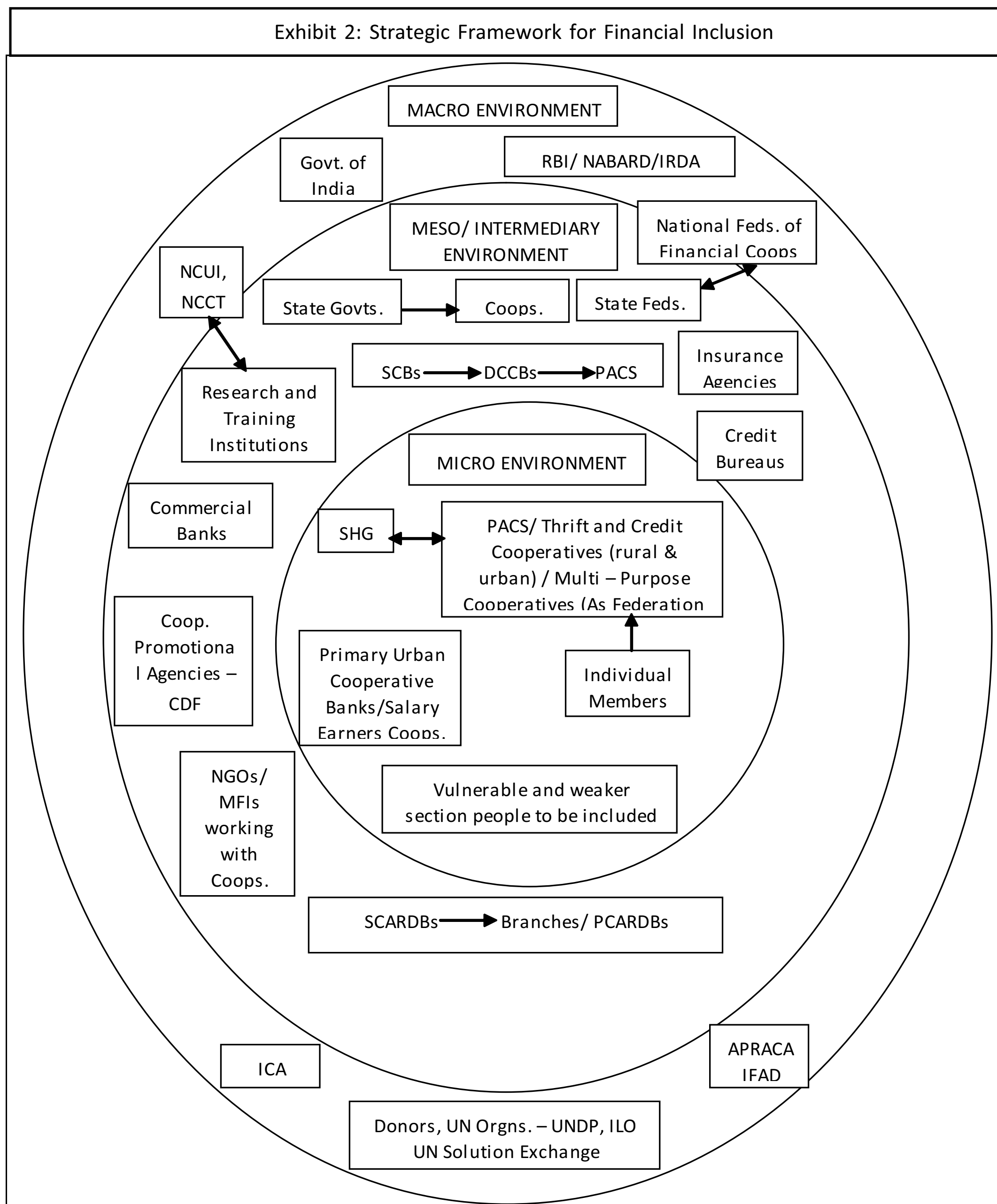
Financial Literacy and Counseling Initiatives: The RBI has initiated to introduce a model scheme of Financial Literacy and Credit Counseling Centres (FLCCs) (RBI Circular- RPCD.CO.MFFI.BC.No.86/12.01.18/2008-09 dated 4 February 2009) through NABARD. Here, special type of service cooperatives can be established to undertake the work of FLCC. Besides promoting awareness and giving counseling for credit and savings it would be good to link FLCCs with insurance companies so that the poor can get information and counseling services from a single door.

4.1 Need of addressing the issues at three levels

In order to address issues related to fast tracking financial inclusion, it is pertinent to see the scenario of financial inclusion through cooperatives by classifying different players and their relationships in context of three different environments - Macro, Meso and Micro. The strategic framework provides a holistic picture of cooperatives in context of financial inclusion facilitating in developing strategies for outreach, collaborations and delivery mechanisms.

Macro Level Environment: As seen in the Exhibit (2) given below, Macro Environment is important in terms of addressing Policy and Regulatory changes required for making the environment conducive for financial inclusion. Regulatory bodies like IRDA, RBI,

Exhibit 2: Strategic Framework for Financial Inclusion



Government of India and State Governments can independently and also collectively pursue the agenda of changing policies, Acts and regulations.

Meso Level Environment: The organisations and their relationship in this environment reveals interface potential with Macro and Micro environment. A variety of promotional agencies, financing institutions, support and capacity building institutions form the Meso level environment. In context of financial inclusion and MF the organisations and network existing in this environment supports the micro level environment.

Micro Level Environment: The organisations and set up at micro level is most important for implementation of the financial inclusion initiatives through cooperatives. The issues relate to strengthening these institutions and making them more autonomous and self-Governed. Segmenting the excluded people will help to develop strategies for coverage of these people and also in developing innovative products and services.

5 Road Map for Future and Possible Models

Based on the analysis made in the earlier part of the paper, it is important to take forward the agenda of financial inclusion in a holistic way by making changes in legal framework and cooperative Acts; adopting new replicable models; strengthening existing financial cooperatives and creating new age cooperatives; emphasis on Marketing, developing and adopting innovative delivery mechanism as well as product and services.

To start with, it is important for the cooperative sector to do a segmentation of the people who are excluded socially and financially. Majority of the socially excluded people are also financially excluded. The classification of the target group could be in following different ways:

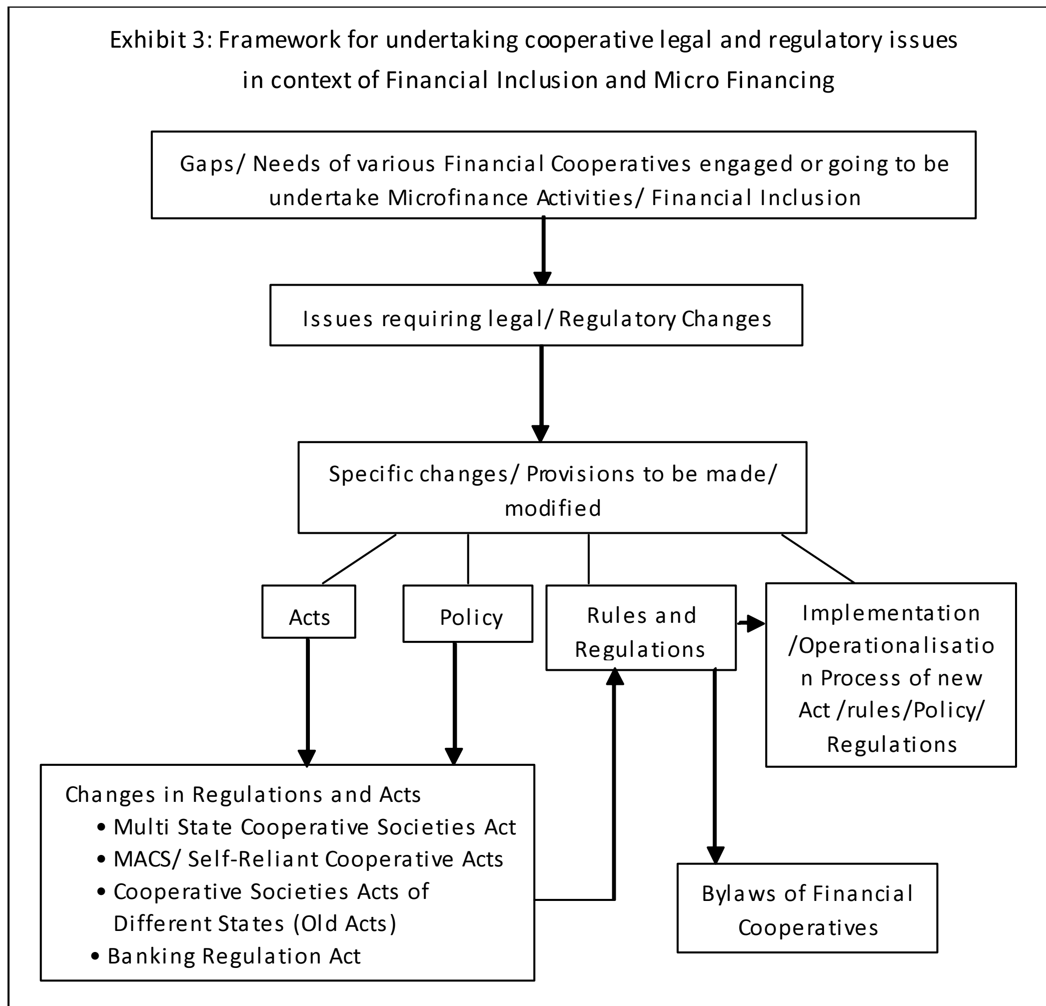
- Rural, Semi-urban and Urban poor.
- Scheduled Caste, Scheduled Tribes, Backward people, physically and mentally challenged people including visually impaired, poor widows, transient laborers and poor people from minority class.
- People living in mountain and remote areas (including those living in border areas where microfinance institutions and bank branch network is low).
- Poor senior citizens, daily/monthly wage earners in urban areas migrated from different states who do not have any identity proof required by the banks and formal financing agencies.

The segmentation of different categories of people will help in formulating a different strategy and plan for inclusion through cooperatives.

Cooperative Policy and Regulatory Issues

In order to make changes in the policy and regulations there is a need to analyse:

- The relevance and appropriateness of existing provisions in different



Cooperative Societies Acts of various States and Multi-State Cooperative Societies Act, 2002 in terms of microfinance and financial inclusion.

- Innovative provisions in the cooperative societies Acts of different countries that have facilitated in the development of microfinance sector.
- Changes required in the existing cooperative societies Acts and also for strengthening the regulatory system of the cooperatives engaged in microfinancing.

Other initiatives required

- A field based study of cooperative legal setup and also on operational implications of the provisions in the liberal Acts.

- Synergising cooperative law with the National Rural Livelihood Mission and the proposed MF bill in relation to policy and operational aspects.
- Besides changes in Acts and Laws, preparing the cooperatives to work on the operational part of various Acts, rules and regulations.
- Analysing of the provisions under different Acts related to disposal/utilisation of surplus especially dividends, bonus and incentives to the members and staff.
- Coming out with innovative financial solutions by shifting from traditional products to need based innovative products, services and processes; introducing marketing of financial products and services, linking the cooperatives with the global economy and sharpening technical and professional skills of staff.

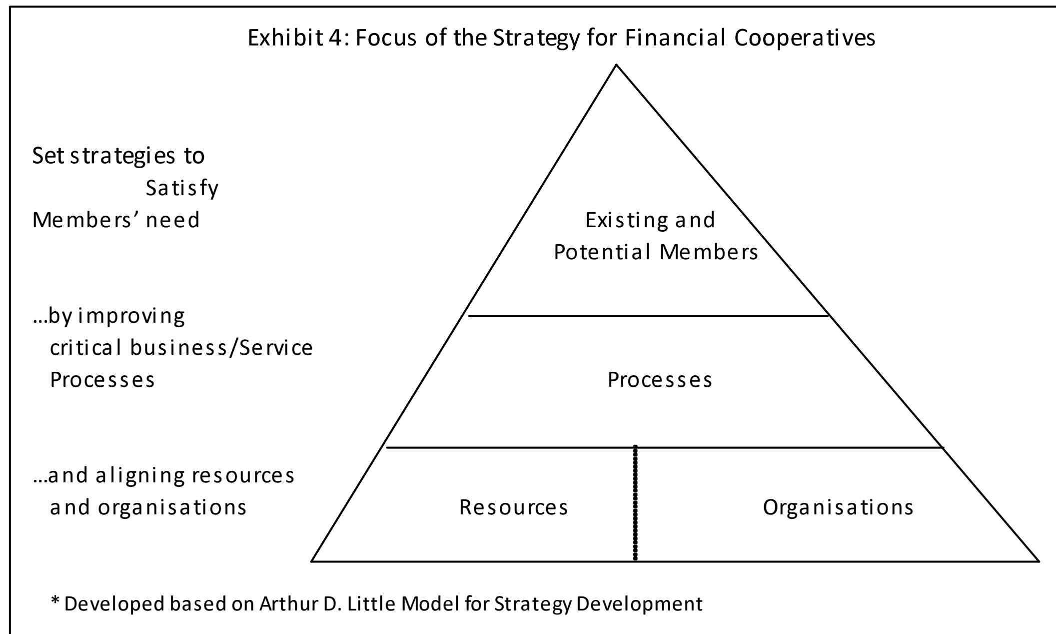
5.1 Approach and Suggestive Models

Keeping in view the share of cooperatives in providing microfinance to SHGs for on-lending, it is pertinent for sector to have proactive approach to make changes in Macro, Meso and Micro level environments related to microfinance.

At macro level, policy and regulatory issues are to be streamlined and can be made conducive for the microfinance. Changes in the some of the provisions in the Acts related to membership, functional and management autonomy, utilisation of surplus and Governance etc. can change the whole scenario at the national and state levels thereby facilitating faster growth of cooperatives at grassroots level. At meso level, vertical and horizontal collaboration between different types and levels of cooperatives and other service providers would be required. At the micro level 'Cafeteria Approach' will be required so that cooperative can provide solutions to a wide range of clients through multiple financial products and services. Cooperatives need to become 'ONE STOP SOLUTION' for poor.

For fast tracking financial inclusion a broad strategy is shown in the diagram (Exhibit - 4) which is self-explanatory. Further two broad models are suggested (Exhibit - 5 and Exhibit -6). In Exhibit - 5, based on the experiences of Asia and Pacific as well as India and also the reasons of exclusion, it is depicted that how through a range of possible products and services financial inclusion of excluded people can be done (Horizontal expansion). Additionally, the model also envisaged for the vertical expansion by envisioning the products and services that could be provided to the existing members. Exhibit -6 is an extension of the broad model (Exhibit 5) and it shows the linkage of various products and services with appropriate type of financial cooperative.

Keeping in view the present context of SHGs and their emerging federations, two options are proposed in Exhibit - 7 and Exhibit - 8. These two Exhibits provides clear options for the Financial cooperatives - one purely based on SHGs and other which focuses on SHGs as well as individuals.



The proposed SHG based federation models are having following positive features, however there will be requirement of changes in the MACS Act/ Self-Reliant Cooperative Acts in terms of membership:

Positive Features of the proposed models

- Generation of Resources at the local level therefore less dependency on external source of funds
- Funds availability at a low cost so there are possibilities to keep the interest rates affordable
- Taking Advantage of Heterogeneity of membership in terms of generating resources
- Involving non-poor people in the society by making them nominal members and getting their savings and deposits from them
- Promoting savings habits among the members by providing multiple options
- Keeping the ownership, governance and management of the society in the hands of poor
- Involving service providers in the form of Associate members and getting deposits from them to use it for on-lending
- Providing different benefits to different kind of members

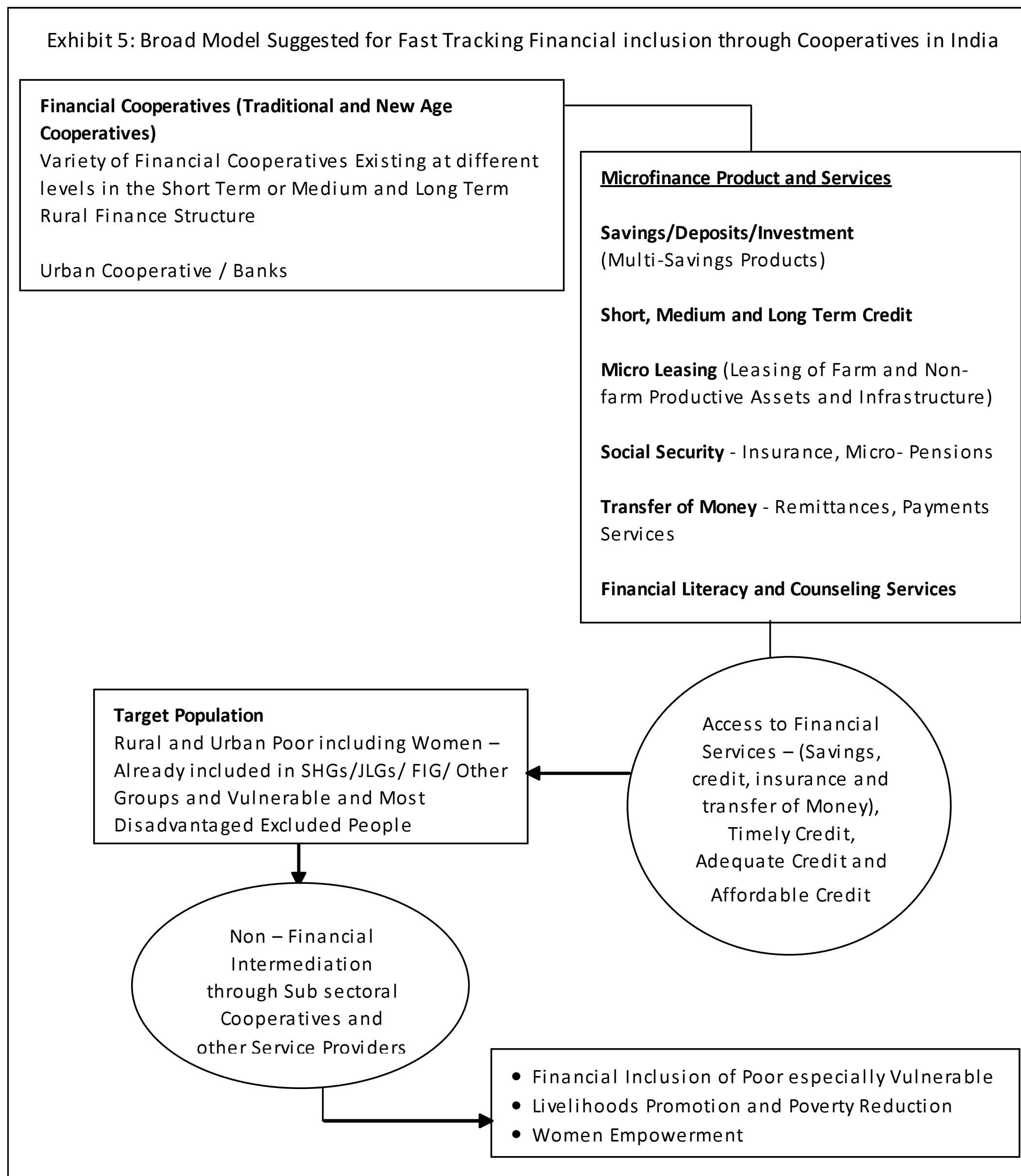


Exhibit 5: Broad Model Suggested for Fast Tracking Financial inclusion through Cooperatives in India
Financial Cooperatives (Traditional and New Age Cooperatives)
Variety of Financial Cooperatives Existing at different levels in the Short Term or Medium and Long Term Rural Finance Structure
Urban Cooperative / Banks
Microfinance Product and Services
Savings/Deposits/Investment (Multi-Savings Products)
Short, Medium and Long Term Credit
Micro Leasing (Leasing of Farm and Non-farm Productive Assets and Infrastructure)
Social Security - Insurance, Micro- Pensions
Transfer of Money - Remittances, Payments Services
Financial Literacy and Counseling Services
Access to Financial Services – (Savings, credit, insurance and transfer of Money), Timely Credit, Adequate Credit and Affordable Credit
Target Population
Rural and Urban Poor including Women – Already included in SHGs/JLGs/ FIG/ Other Groups and Vulnerable and Most Disadvantaged Excluded People
Non – Financial Intermediation through Sub sectoral Cooperatives and other Service Providers
Financial Inclusion of Poor especially Vulnerable
Livelihoods Promotion and Poverty Reduction
Women Empowerment

Exhibit 6: Model Showing Types of Cooperatives and Microfinance Products and Services

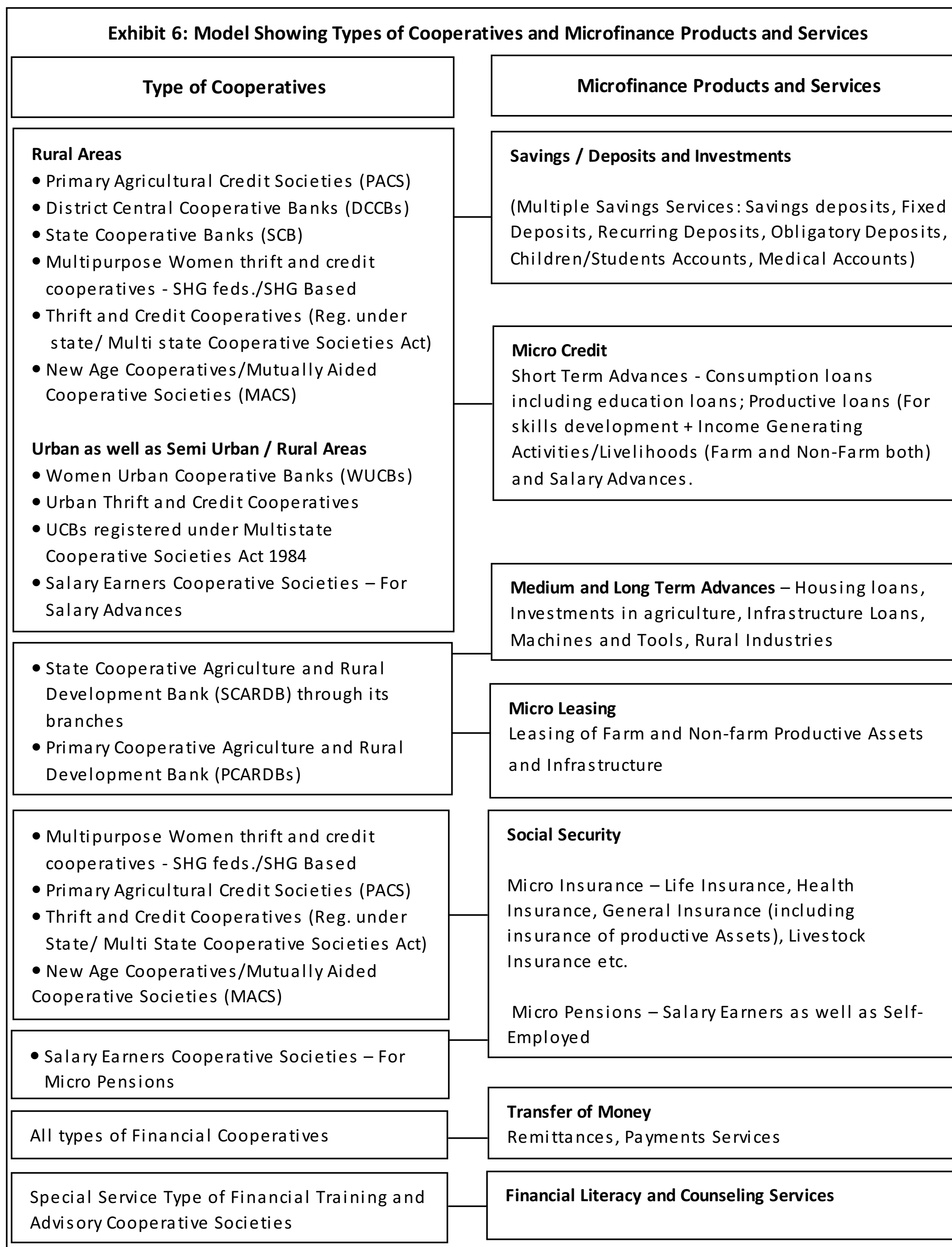
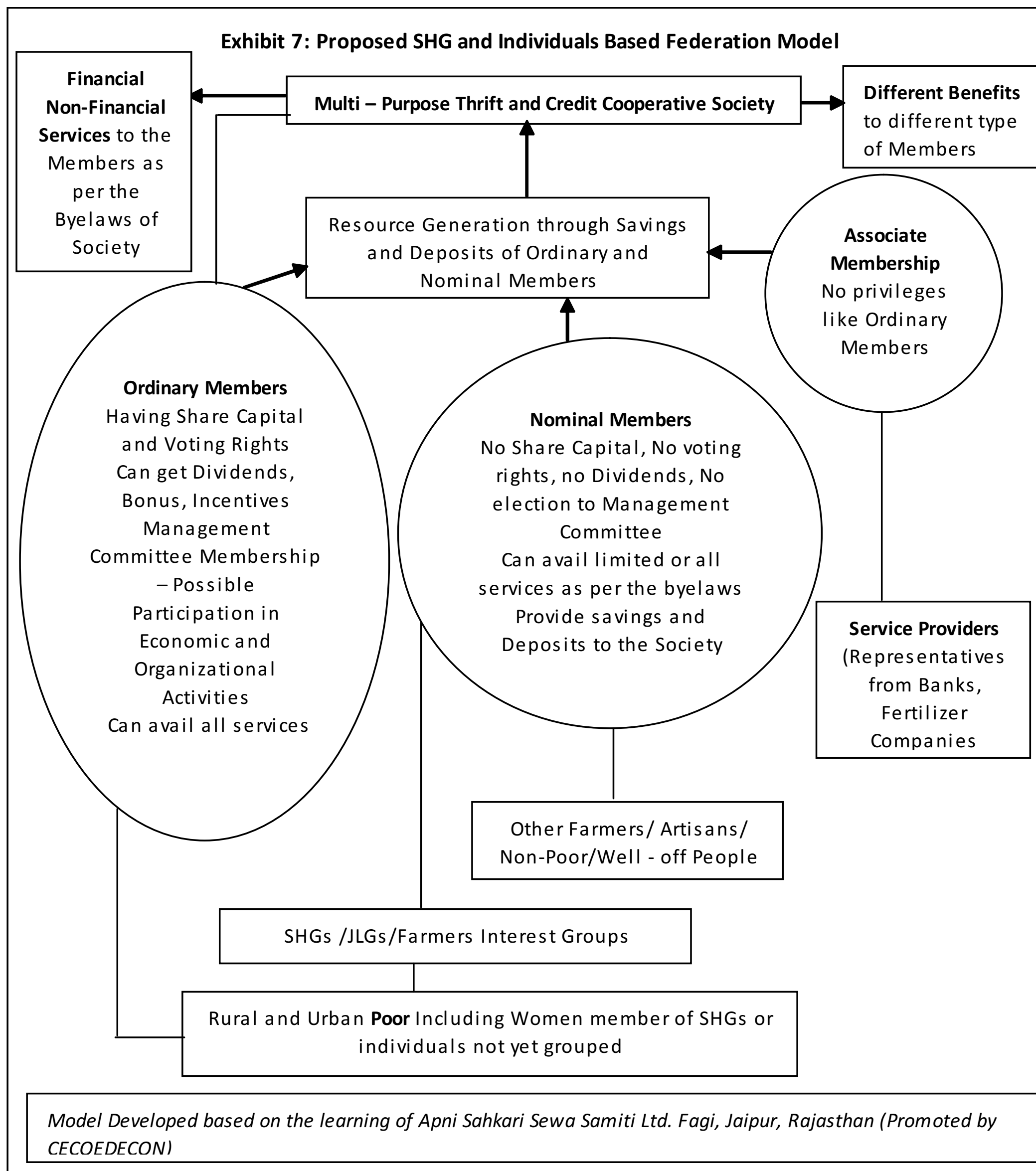
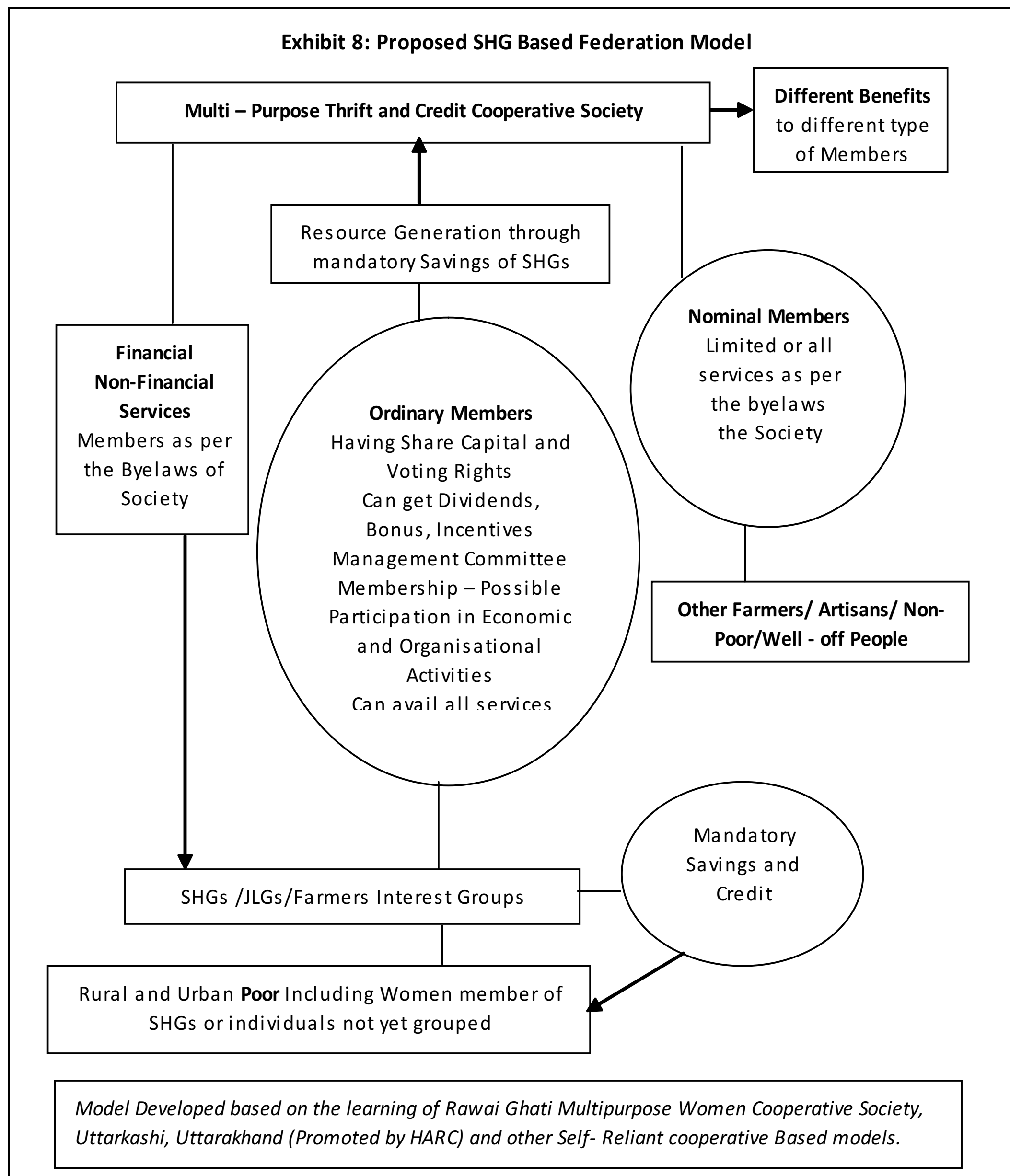


Exhibit 7: Proposed SHG and Individuals Based Federation Model



Model Developed based on the learning of Apni Sahkari Sewa Samiti Ltd. Fagi, Jaipur, Rajasthan (Promoted by CECOEDECON)

Exhibit 8: Proposed SHG Based Federation Model



Model Developed based on the learning of Rawai Ghati Multipurpose Women Cooperative Society, Uttarkashi, Uttarakhand (Promoted by HARC) and other Self- Reliant cooperative Based models.

5.2 Summing up

The future agenda of financial cooperatives in India can be depicted through 'Nine R'.

- REEXAMINE the existing and new Acts, cooperative structures, Financial Products and Services in the new liberalised environment
- REORIENT cooperative policy towards changing environment
- RECAPITALISE cooperatives as per the recommendations of the Vaidyanathan committee.
- REVIEW strategies of financial cooperatives in context of clients and capacities of the organisations.
- RESTRUCTURE the cooperatives' - ST, MT and LT financing structure based on emerging SHG based cooperative movement.
- REDEFINE Cooperative philosophies by balancing between the 'Service to the Members' and 'Profitability and sustainability'.
- REORGANISE activities based on new strategies for the financial inclusion.
- REENGINEER the cooperative systems - MIS, M & E and delivery mechanisms by studying value chains.
- REVAMP financial cooperatives by medicating the exiting ones through upgrading or modifying operations, services, functions or organisational structures and creating systems for the new age cooperatives.

Declaration: The views given in the paper are personal and do not reflect the views of the respective organizations of the writers.

ACRONYMS

APRACA	:	Asia-Pacific Rural and Agricultural Credit Association Cooperative
DCCB	:	District Central Cooperative Bank
FI	:	Financial Inclusion
FLCCs	:	Financial Literacy and Credit Counseling Centres
ICA	:	International Cooperative Alliance
IFAD	:	International Fund for Agricultural Development
JLGs	:	Joint Liability Group
KERUSSU	:	Kenya Rural Savings and Credit Cooperative Society Union
MACS	:	Mutually Aided Cooperative Societies
MF	:	Microfinance
MFI	:	Microfinance Institutions
NABARD	:	National Bank for Agriculture and Rural Development

NAFCUB	:	National Federation of Urban Cooperative Banks and Credit Societies Limited
NAFSCOB	:	National Federation of State Cooperative Bank
NCCT	:	National Council of Cooperative Training
NCDC	:	National Cooperative Development Corporation
NCUI	:	National Cooperative Union of India
PACS	:	Primary Agriculture Cooperative Society
RBI	:	Reserve Bank of India
SCB	:	State Cooperative Bank
SEWA	:	Self-Help Women Association
SHG	:	Self-Help Group
SICREDI	:	Sistema de Cooperativa de Credito
UCB	:	Urban Cooperative Banks
UN	:	United Nations
UNDP	:	United Nation Development Programme

Microfinance Through Cooperatives: Performance and Prospects

- Ashok Bandyopadhyay*

Abstract

Co-operative is a socio-politico-economic institution evolving from the Primitive Communist Society to the Capitalist society transforming itself from one form to other. The paper has tried to ascertain the role of Co-Operatives, i.e., short term Co-operative Credit Structure for development of microfinance and it strengthening including its prospects. This paper also attempted to discuss empowerment of women and poverty alleviation which are very much related to microfinance with specific reference to the state of West Bengal.

The study concludes that the poor including poor women are also bankable and they have good potential to manage the economic and social affairs of microfinance scheme. This paper also highlighted that the Fourth model, i.e., Co-operative model (a co-operative within a Co-operative) is the strongest model with more or less 100% coverage of villages and with world wide horizontal and vertical network played an important role in developing microfinance and still have the relevance in strengthening microfinance.

Co-operative model is the strongest model with more or less 100% coverage of villages and with world wide horizontal and vertical network played an important role in developing microfinance and still have the relevance in strengthening microfinance.

Introduction

Co-operative is a socio-politico-economic institution evolving from the Primitive Communist Society to the Capitalist society transforming itself from one form to other. "A Co-operative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural

Key Words: Microfinance, Co-operatives, Micro-credit, Financial Inclusion.
JEL Classification: G-21 and G-28

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needs and aspirations through a jointly owned and a democratically controlled enterprise" as defined by the International Co-operative Alliance, in its 1995 Manchester Congress. The century old cooperative movement in the country with its vast horizontal and vertical network, principles and values, played a crucial role for purveying credit to the poor farmers, agricultural labourers, artisans and weaker sections of the people to generate their incomes and to improve their livelihood. But co-operative movements with its tremendous strength and age old weakness, are at the cross roads in the era of market economy and struggling hard to turn themselves around encountering the challenges of the market economy based on the principles and values of the cooperative movement.

2. Economic Scenario

A disastrous picture was revealed from the N.S.S.O. Report, 2003, that out of the total 89.3 million farmer households in the country, 75.0 million, i.e., 84% households were small and marginal farmers. More than half of the total households i.e. 51.4% have no access to credit. Out of total 43.4 million indebted farmer households, 46.8%, i.e., 20.3 million has availed credit from non-institutional sources including moneylenders. In West Bengal, 42.1% households availed credit from non-institutional sources including 13% from moneylenders and 10.7% from traders.

Andhra Pradesh is highest (68.6%) in taking money from non-institutional sources including moneylenders (53.4%). "The share of small, marginal and other farmers in the total number of accounts, which were 42.8%, 31.3% and 25.9% respectively in 1991-92, reduced to 39.85, 31.5% and 28.7% for the respective category of farmers in 2003-04. Thus, overtime, while credit deepening has taken place, credit widening has not yet been effectively addressed".

Despite high growth, economies growth process and liberalization era, have impacted very badly on the lives of more than three-fourths (76.8%) of Indians, the common people [extremely poor (6.4%), poor (15.4%), marginal (19%) and vulnerable (36%) consuming an average less than Rs. 20 a day and would be below the international definition of poverty line.

When Globalisation Process started, the United States, the father of the Globalisation with its frontal organisations World Bank, International Monetary Fund (IMF) and World Trade Organisation (WTO) raised their voice that due to huge development, trickle down effect will help in developing the poor. It is a fact that huge development occurred but trickle down effect did not work. Nobel Laureate Professor Joseph Stiglitz, the ex-chairman of the Economic Advisory Committee of the President Bill Clinton and Ex-Chief Economic Advisor of World Bank who resigned from this post, opined, "Trickle down economics which holds that so long as the economy as a whole grows everyone benefits, has been reportedly shown to be wrong".

3. Relevance of Cooperatives

Yet the "Task Force on Revival of Rural Cooperative Credit Institutions" popularly known as Vaidyanathan Committee, in its report unequivocally opined, "Cooperatives of the mutual thrift and credit type, are the only form of organisations by which economically disadvantaged individuals and groups could through voluntary collective action, overcome their disadvantageous position in an equal market and promote their well being (Para 3.53). The Task Force has also clearly spelt out, advocating the case of cooperatives for revitalisation support that in functional terms, co-operatives already had a wider and deeper reach in the countryside than other financial institutions and experience had shown that the latter serve mostly the better-off segments of borrowers, that had a sufficiently large asset base and they were reluctant to cater to the small and marginal farmers and other underprivileged sections, on grounds that lending to them is far too costly and risky to be profitable (para 3.52). These opinions prove that with age-old strength and weakness, the cooperatives till have a relevance in deploying credit and other financial services including microfinance, micro-remittance, micro insurance, etc., to the vulnerable sections of the rural poor.

4. Objectives of the Paper

The objectives of this paper is to ascertain the role of Co-Operatives, i.e., short term Co-operative Credit Structure for development of microfinance and its strengthening including its prospects. This paper also attempted to discuss empowerment of women and poverty alleviation which are very much related to microfinance.

4.1. Genesis of Micro credit in West Bengal

In land reform, the West Bengal tops the list as the beneficiaries of land reforms in West Bengal is 53.2%, highest in the country. As per NSSO Report, in India, the percentage of cultivable land in the hands of small and marginal farmers are 43%, whereas in West Bengal it is 84%.

It has been observed that the outreach of traditional institutions for providing credit to the lowest strata of people have certain limitations on various grounds. There lies the need for a completely new type of credit institutions which will be owned by beneficiaries themselves.

Considering the importance of SHG as new generation credit institutions, the West Bengal State Cooperative Bank along with seventeen Central Cooperative Banks and six thousand PACS started organising Self-Help Groups initially experimentally in one society, i.e., Khanri Large Sized Cooperative Credit Society at Mandirbazar Block in the district of South 24-Parganas in the year 1992 as a new model in the country, 'a cooperative within a cooperative' purely under Cooperative Credit Structure

as detailed below:

PACS as SHPIs
Central Coop. Banks as Facilitator
State Coop. Bank as Coordinator

The West Bengal State Cooperative Bank (WBSCB) with a purpose to increase the purchasing capacity of toiling masses of rural West Bengal by enhancing flow of resources to under privileged sector of the economy of the state, the State Cooperative Bank along with Central Cooperative Banks (CCBs) and Primary Agricultural Credit Societies (PACS) have organised more than 1,70,000 Savings Linked SHGs in the State only through Cooperative Model. Savings linked SHGs increased from 1,05,493 in March, 2006 to 1,70,497 in March, 2010, i.e., an increase of 61.6% whereas total number of members increased by 62.6% during the relevant period. While deposits, mobilised from these groups, increased by 215.4% during the period, loans issued increased to the order of 259.6%. As on 31st March, 2011, credit linked members of 8, 82,036 covering 63.95% of total number of members, i.e., 13,079,050 with 91.58% coverage of female members.

4.2 Study of the functioning of the Microfinance

With a view to strengthen the SHG movement, WBSCB decided to make a study of the functioning of the SHGs in the state organised under Cooperative Model, by the Academy for Cooperative Management Research and Training Institute (ACMART), an Institution of the State Cooperative Bank.

4.3 Objectives of the Study

The specific objectives of the study are as under:

[1] To examine the performance of PACS in regard to SHG Development;
[2] To bring out the extent of fulfillment of aspirations of women beneficiaries within the ambit of SHG;
[3] To identify and analyze the hindrance of SHG movement;
[4] To suggest measures for smooth functioning of SHG.

4.4 Sample Selection

Out of 19 districts covering 17 CCBs and three regions of State Cooperative Bank (i.e., erstwhile CCBs amalgamated to SCB) and around 6594 PACS with a membership strength of 36,88,724 and credit linked membership strength through Kissan Credit Card of 21,12,330(57.26%) as on 31st March, 2011, only 9(nine) societies of 6(six) blocks under one district, i.e., South 24-Parganas are selected as sample units of the study.

4.5 Limitations

The work suffers from number of parameters on which data on the working of the societies for a reasonable period is available. Based on which outline of objectives are drawn. However, the parameters selected are to find out the performance of PACS in SHG development and any performance analysis without these parameters tends to remain incomplete. The selected indicators are easily comprehensible and are basic to judge the role of PACS in SHG development. The field level investigations based on individual respondents' opinion which may not be exclusively un-biased might be reflected in the results as well as findings.

The study is area specific as it relates to 9 PACS distributed over Six Blocks of South 24-Parganas District. The selection of PACS is made considering the most of the related factors and is expected to deliver results which is also representative in character and devoid of systematic lines though the samples are small in nature. Along with 9 PACS, 135 SHG beneficiaries served by the Societies are also part of the evaluation study. The PACS and SHG beneficiaries together form the primary data for the study.

4.6 Sample Design and Methodology

The study has been conducted based on both primary as well as secondary data. Purposive sampling technique is used to collect data on PACS working from 10% of 90 PACS as well as interviewing randomly selected SHG beneficiaries using structured questionnaire. PACS are selected based on criteria with a view to give a fair representation of the societies with different grades allotted in audit reports. Three societies each from different grades of audit rating are selected. The targeted sample size of SHG beneficiaries is 135. Equal numbers of sampling units of 15 from each of the 9 societies have been interviewed from each society and their responses were recorded as well as their aspirations are noted.

Secondary data for a consecutive period on membership and deposit accretion of the individual societies have been collected from the concerned societies. Similarly PACS officials are interviewed to obtain data basically related to SHG development.

After scrutiny, the collected data had been processed to fulfil the various objectives as laid down for this study. A multi-dimensional measure of performance of membership increment and Deposit accrual in terms of year wise absolute and percentage increase is studied. Compound growth rates of selected parameters, i.e., membership enrolment and deposit accrual have been estimated. Functional analysis has been made by way of estimating correlation co-efficient to examine the inter-relationships among the variables.

5. Role of PACS

5.1 Driving Force to form Groups

From the analysis of data, revealing features in regard to Role of PACS in developing SHGs was unearthed. Driving Force for forming of the societies by PACS is to increase the profit. Social agendum, i.e., empowerment of women is the residual outcome.

5.2 Motivating reason to join Self-Help Group

The study reveals some weaknesses in motivating the people to form groups. 64% of the entire sample joined SHG with only purpose to save money. 36% of sampled members expressed the reason of joining group is to obtain loan. This reveals that the perspective of joining SHG was not clear to them and as a result in some cases this might be the cause of incipient weakness developed within the group.

5.3. Purpose of obtaining Loan and its utilisation

83% of sample size members took loan primarily for generation of income, i.e., for production purposes. A very small size of four percent of the members utilised loan for their immediate personal need and 13% have not availed loan so far.

However, from another study, conducted by Prof. Gopa Samanta in the district of Bardhaman expressed " in reality, credit hardly used by women for productive activities. In a number of cases, credit is used for regular consumption needs such as food, clothes, education of children and medical treatment." Mohindra(2003) also noted that loans are often used by the SHG members for consumption, such as health care and marriages.

Small loans may turnout to be big curse if the loan is issued to the person who has no capacity to repay, the loan is utilised for the purpose which is not productive and the aggressive multiple loans are issued to the same borrowers, may lead to committing suicide by the borrower as happened in Andhra Pradesh where more than 80 people have taken their own lives in the last few months after defaulting on micro loans, according to the Government.

5.4 Livelihood Generating Activities

In the area under survey, two major livelihood generative activities are Agricultural(22%) and Animal Husbandry (22%) constituting 44% of such activities. Another major income generating activities is Industrial Activities (34%). Service and Business activities constitute 22% only.

The study made by Professor Gopa Samanta indicates only 4% of women from small farmer families take credit for agriculture. Her study also indicated that women take credit for non-productive assets such as homestead land (2%) and construction of houses (4%). However, she also indicated that in her study about 25% of women are using the credit for pretty business and another 36% purchasing livestock sources constituting 61% of women using credit for production purposes. However, in our study 78% are using credit for productive purposes.

5.5 Average Monthly Income of SHG Members

From Income Generating Activities

The study opens the eyes of activists, organizers and stake holders of Micro-Credit that after elapsing of 19 years from inception of micro-credit in West Bengal that average monthly income of a SHG member after joining SHG Group is only Rs. 500.00 as opined by 56% of the sample. SHG beneficiaries in 22% of the remaining PACS are earning Rs. 1,000 a month after taking up economic activities. The rest 22% PACS are of the opinion that on an average a SHG member earns Rs. 1,500.00 in a month.

"Over 60% of our surveyed SHGs have crossed that threshold limit of three years. However, none of the groups have achieved that target of Rs. 2000.00 income per member per month. There are number of groups who were formed eight to ten years ago and yet most of them could not ever earn Rs. 1000 ………… These categories of income are again only found in SGSY Groups" as per the study conducted by Prof. Gopa Samanta. She also indicates that SHG Groups' women have not yet attained the income categories above Rs. 700 per month. On an average 29% of Women have no income from SHGs as their livelihood activities are yet to start. About 49% of women has monthly income varying Rs. 500.00. Another 10% earn Rs. 500.00 to Rs. 700.00 per month from their group activities which are more or less the same to that of the study made by us.

36% of SHG members under Cooperative Sector did not obtain any loan from the Groups for generating livelihood activities which is more than 29% of such women as revealed in the study conducted by Prof. Samanta.

5.6 Group Functioning

5.6.1 Group Meetings

From different studies it is focused that social capital is the lifeline of SHG movement. The group meetings build relationship between the group members. Relationship creates trust among themselves. Trust develops trustworthiness which

forms the social capital fostering unity and oneness among its members.

But none of the SHGs are holding group meetings with weekly frequency which is a major weakness and one of the causes of disintegration of groups which is evident from different empirical studies. 89% of sampled SHGs is holding group meetings at monthly intervals and one SHG, i.e., only 11% of sampled SHGs is holding group meetings every fortnight. All SHGs should hold weekly meetings.

5.6.2 Place of holding group meetings

SHG should hold group meetings in rotation to different member's house to create awareness amongst other family members of the group member and keep transparency of holding meetings. SHG meetings are not conducted in public places. 67% of the PACS reported that group meetings are held in rotation to different members' house and 33% of the reporting PACS hold that group meetings at a member's place by rotation.

5.6.3 Members' awareness of SHG Rules

To ascertain the group members' awareness of SHG functioning, 89% of the sample PACS prefer to interact with the SHG members but 11% depend on account, books and records to ascertain group members' awareness of SHG Rules.

5.6.4 Charging of Interest Rate

100% of sampled PACS are charging uniform interest rate to their SHG members and not varying interest rate depending on repayment period. In West Bengal the rate of interest to ultimate borrowers is 11%. The Government of West Bengal is also providing subsidy to the default free SHGs to the tune of 7% which is unique in nature in the country.

5.6.5 Mode of Group Functioning

It is noteworthy that 89% of the sampled SHG reported that decisions are taken in group meetings and 11% opined that groups functioned as per direction of the PACS which is against any democratic functioning.

5.6.6 Group wise lending

67% of the sampled PACS' level of lending per group is above Rs. 30,000. The level of lending of 22% of the sampled PACS are Rs. 20,000 to Rs. 30,000. 11% of such PACS lend to the tune upto Rs. 20,000.

6. Recovery

The study exposes the comprehensive position of the recovery, extent of decrease in recovery and causes of default. 56% of the sampled PACS are having defaulters in the groups. However, in the remaining 44% of the sample PACS there is no defaulter.

In regard to recoveries of outstanding dues 78% of sampled PACS do not experience decrease in recovery; but 22% of the sampled PACS experienced decreased in recovery.

It is a great concern that recovery percentage of outstanding loan is decreasing in the cooperative sector in the country which will be revealed from the following Tables:

Banks	Amount of outstanding Bank Loans to SHGs (Rs. Lakh)		Amount of NPAs (Rs. Lakh)		% of NPAs to total Outstanding Bank Loan	
	31/03/08	31/03/10	31/03/08	31/03/10	31/03/08	31/03/10
Commercial Banks Including Private Bank	1019214	2016471	21371	53753	2.1	4.02
RRBs	387048	614458	17327	21853	4.48	3.56
Cooperatives	74686	172899	3595	6704	4.8	3.88
Total		2803828		82304	2.9	2.94

Source : A. Microfinance in India 2007-08 - NABARD
B. Microfinance in India 2009-10 - NABARD

Analysing the above mentioned data it is revealed that the NPA in Commercial sector increased considerably but it decreased in the case of RRBs and Co-operative sectors.

From the table it is clear that within three years, for bad performance of recovery in some CCBs/Regions, e.g., Balageria, Coochbehar, Burdwan, Tamluk-Ghatal, Bankura, etc., the recovery has come down to 82.5%

6.1 Cause of Default

Analysing the probable cause of default and decreasing recovery, 22% of sampled PACS observe 'less income generation' as the cause of default and decrease in recovery. Curious enough that none of the sampled PACS has reported either 'absence of marketing facilities' or apprehension in generating income has any adverse effect on the recovery performance. Yet 11% of sampled PACS feel that 'absence of proper trading facility' is the cause of default and decrease in recovery.

The study reflects that diversion of fund is the root cause of default in stray cases affecting individual recoveries. Diversion of funds, less income generation and absence of proper trading facility are the causes of default and decreasing recovery.

Comparative Study of Recovery & NPA status of SHGs in West Bengal [CCB wise]			
Percentage of Recovery to demands			
Sl.	Central Coop. Banks	2007-08	2010-11
1.	Balageria	93.8	45.88
2.	Bankura	91.0	76.25
3.	Birbhum	92.6	88.51
4.	Burdwan	95.3	63.85
5.	DK. Dinajpur	182.4	79.21
6.	Darjeeling	138.5	93.80
7.	Hooghly	98.0	81.82
8.	Howrah	98.7	93.82
9.	Jalpaiguri	44.6	72.49
10.	Malda	99.0	98.74
11.	Mugberia	92.0	95.96
12.	Murshidabad	97.0	88.42
13.	Nadia	92.4	95.38
14.	Purulia	87.6	95.20
15.	Raigunj	82.0	78.07
16.	Tamluk-Ghatal	93.3	77.75
17.	Vidyasagar	85.0	78.20
	SCB Regions		
18.	Coochbear	-	66.46
19.	North 24-Parganas	-	95.38
20.	South 24-Parganas	-	84.81
	Total		82.5

Source : 1. 2007-08 Microfinance in India 2007-08
2. 2010-11 Central Coop. Banks' Conference held on 27.06.2011 Agenda Note

7. Disintegration of the SHGs and its Causes

It is an eye-opening fact that SHGs are disintegrating in huge number in West Bengal and India. The study also focuses in this matter. 56% of the sampled PACS indicates that 'feud' amongst the members is the main cause of disintegration of the Self-Help Groups. However, 22% of them attributed difficulty in arranging monthly deposit to be the reason of disintegration of groups. There are still 22% who discloses that the cause of disintegration is some other classified reason except the reasons mentioned above.

It is also revealed from the data received from the West Bengal State Cooperative Bank that the groups and SHG members in West Bengal are disintegrating. No such data is available in case of all India SHG movement. The table below as on 31.3.2011 indicates a clear picture:

No. of Savings Linked SHGs disintegrated	No. of Savings Linked members disintegrated	No. of Credit Linked groups disintegrated	No. of Credit Linked members disintegrated
4797(2.81%)	17347(1.24%)	8701(0.71%)	59455(6.31%)
Out of total groups and members			
170459	1396397	1221838	941801
Source : CCB Conference in West Bengal held on 27.6.2011 – Agenda Note.			

Analysing aforementioned data it exposes that though the percentage of disintegration is very low, yet the trend is dangerous because it is a beginning of erosion which should be seriously looked into by the organisers, stake holders, all CCBs and SCB and correcting steps to be undertaken seriously otherwise it will cause a disastrous effect in SHG movement.

8. SHG of West Bengal vis-à-vis Andhra Pradesh and India

The following table will provide a comparative status of SHG movement of West Bengal against Andhra Pradesh and India.

Sl.	No. of SHGs	West Bengal	Andhra Pradesh	All India Total
1.	No. of SHGs	609439	1280900	6121147
	On Savings			
2.	Savings Amount (Rs. in lakh)	123328	119193	554562
3.	Average Savings per SHG(Rs)	20236	9305	9060
	On Credit disbursed during the year			
4.	No. of SHGs secured Bank Loan	114543	636816	1609586
5.	Total Bank Loan disbursed (Rs in lakh)	43613	550860	1225351
6.	Average Bank Loan disbursed per SHG(Rs)	38076	86502	76128
	On Credit Outstanding			
7.	No. of SHGs having outstanding Bank Loan	472556	1219311	4224338
8.	Total Bank Loan outstanding (Rs in Lakh)	105044	890217	2267984
9.	Average Bank Loan outstanding per SHG(Rs)	22229	73010	53689
	On NPA			
10.	Amount of Gross NPAs (Rs in Lakh)	1878	3773	62587
11.	Average Gross NPA per SHG (RS)	308	295	1022
12.	% NPA	2	0.5	2.9

Analysing the data mentioned above, it appears that West Bengal surpassed in Savings per SHG but the per SHG Credit disbursement and credit outstanding is much less than national data more particularly than Andhra Pradesh. Further, NPA percentage is higher in West Bengal than Andhra Pradesh.

9. Role of Short Term Co-operative Credit Structure

CO-OPERATIVE MODEL: FOURTH MODEL

Under the SHG linkage programme in the country, broadly four models have emerged:

9.1 Model I: SHG-Bank Linkage: NGOs as SHPIs

a) NGOs: NGOs are working as self-help promotional institutions (SHPIs): Promotion, training and helping linkage with banks are their main jobs.

b) Banks: Banks are working as financial institutions. They are providing finances to SHGs as per recommendations of the NGOs.

9.2 Model II: SHG-Bank Linkage: NGOs as Financial Intermediaries

a) NGOs: NGOs are working as financial intermediaries. Promotion, training and providing credit support to SHGs are their main jobs.

b) Banks: Banks are providing credit to NGOs for on lending to SHGs.

9.3 Model III : SHG-Bank Linkage: Banks as SHPIs.

Banks: Promotion, training and providing credit support to SHGs are their main functions.

9.4 Model IV: SHG-Bank Linkage: "Co-operatives within Co-operatives" under three-tier / two-tier co-operative credit dispensing system.

a) 1st Tier - Primary Agricultural Credit Society (PACS): PACS functions as SHPI.

It promotes the SHGs, nurses and nurtures them and provides credit to the SHGs either from its own fund or by obtaining refinance from District Central Co-operative Banks. It also arranges quarterly general meetings/ workshops of the self help group members under its jurisdiction.

b) 2nd Tier - District Central Co-operative Bank (DCCB): DCCB functions as facilator.

As a facilitator, DCCB provides refinance to PACS by obtaining refinance from State Co-operative Bank. It helps PACS in organising SHGs,

attend general meeting/ workshops of the SHG members. It also arranges training/workshop programmes. DCCB has separate Department and Nodal Officers for nurturing the SHGs. DCCB also provides information (in printed booklets) to the PACs and SHG members.

c) *3rd Tier - State Co-operative Bank (SCB): SCB functions as a coordinator.* SCB coordinates with Central Co-operative Banks (CCBs), PACS, NABARD, Cooperative Directorate and Department of Cooperation of the State Government. It formulates the policy for organising self-help groups, prepares forms and ledgers and supplies leaflets, booklets etc. it also provides refinance to DCCBs after obtaining from NABARD. It has employed one Women Development Officer and constituted Women Development Cell for looking after the functions of DCCBs, PACS and self-help groups.

In North Eastern states and some other states, the cooperative credit dispensing system has two tiers as follows:

i) 1st Tier - PACS : It will work as a SHPI.
ii) 2nd Tier - SCB : It will work both as a facilitator and a coordinator.

9.5 The advantages and limitations of the above four models:

Shri S. M. Sheokand, ex-Chief, General Manager NABARD under his article "Reorienting banking with the Poor" explicitly presented the advantages and limitations of model I, II and III. I am reproducing it hereunder in Table I and adding the advantages and limitations of fourth model there to in the said table which will help in understanding critically the advantages and limitations of the four models stated hereinbefore.

10 Formation of Self-Help Co-Operatives

Formation of Self-Help Co-operatives are in the offing. The different states are constituting Self-Help Co-operatives through legislation with a purpose to form a legal umbrella organization with a view to form a micro business enterprise for the purpose to mobilise resources, deploy credit, carry out different productive activities, arrange marketing, training facilities.

The Orissa Self-help Co-operative Act, 2001 provides for the formation of co-operatives and Conversion of Co-operative societies as self-help, self-reliant, mutual aid, autonomous, Voluntary and democratic business enterprise, which are to be owned, managed and Controlled by members for their economic and social betterment through the financial and gainful provision of core services which fulfill a common need felt by them and matters connected therewith or incidental thereto (Government of Orissa - 2002). The above act provided an opportunity to the people of Orissa and particularly

Table 1

MODELS	ADVANTAGES	LIMITATIONS
Model I	# Each partner institution plays a role best suited to it. Banks lend, NGOs organize poor into SHGs and SHGs manage small group finance in their own interest. # The whole system is localised. # SHGs and local NGO learn to deal with an accessible bank branch and vice-versa.	# In spite of wider acceptability of the model, majority of field level bankers are yet to be sensitized and do not view it as banking mandate. # In many places, it is still difficult to open a savings account. # Absence of NGOs in many areas.
Model II	# It further reduces the transaction cost and risk cost of the bank as the banks lend a larger sum to an NGO, which guarantees repayment. # Easier for the poor to deal with an institution which they know and trust. # Easy to be adopted by stakeholders.	# NGOs are not traditionally equipped to work as financial intermediaries. # Calls for substantial investment in capacity building of NGO. # Adds one more intermediary structure. # Wide scale adoption not possible.
Model III	# Exposes bankers to social realities first hand. # Possible solution where NGOs are not present.	# Wide scale application may not be feasible because of other priorities of bankers.
Model IV	# Wide coverages—covering most of the villages # Closest relation with the people. # Easier for the poor to deal with the institution which they know and trust. # Easier for the SHGs to get finance. # Better and closer relation and linkage with the SHG members and Board of the PACS. # Easier for the PACS to organise, nurse, to nurture the SHGs as the organisers and the poor are of the same areas which guarantees repayment. # The whole system is localised. # It divides the transactions and risk cost in three tiers. # Better coordination.	# Due to wide scale application there may be some difficulties in coordinating the three tier system.

the poor to organise themselves and form self-help Co-operatives to protect their own interests and to carry out productive activities.

11. West Bengal Experience

Government of West Bengal promulgated The West Bengal Co-operative Societies, Act, 2006, The West Bengal Co-operative Societies Amendment Act, 2010 & West Bengal Co-operative Societies Rules, 2011 on 18th January, 2011 ensuring members involvement in making decisions, making the Co-operative societies self-reliant and vibrant by changing the vision and mission of the institutions, promoting thrift, self help and mutual aid amongst the people with needs and interest in common, bringing about economic and social regeneration including better and happier conditions of living for the weaker and poorer sections of the community including women folk and to bring them within the fold of Co-operative movement.

For this purpose the Act under section 2(2) provided that state should not interfere in the management and operation of the Co-operative Societies.

The Act also under section 4(07) made provision for Block Level Mahila Self-Help Group Co-operative Societies to be formed by the self-help groups consisting of women members only within the administrative jurisdiction of a community development Block. Clause 8(3) of West Bengal Co-operative Societies Rules, 2011 also provided that not more than three number of Block level Self-Help Group Co-operative Societies shall be registered. Further this legislation by providing one representation from women SHGs in the Board of Primary Co-operative Societies and primary Co-operative Banks dispensing Credit, including Women's credit Co-operative societies and Women's Co-operative Banks which have formed self-help groups composed of Women members created land mark in the history of Co-operative movement. The provisions have made a sea change in developing and strengthening of microfinance in the state.

12. Poverty Alleviation and the Microfinance

"Poverty eradication in not only a developmental goal- it is a central challenge for human rights in the 21st century"

We should consider the following at the time of formulating the programmes for poverty alleviation:

Money supply to the Poor :

- Increases income of the poor
- Reduces their vulnerability
- Strikes at the roots of their deprivation
- Increases their self-confidence
- Arouses in them a sense of social solidarity

The issues of defining poverty, determining the incidence of poverty, identifying the poor, etc. are extremely debatable. Even without going deep into such issues, it may be safely concluded that poverty, vulnerability and deprivation are quite synonymous. Poverty lowers income, reduced consumption, snatches rights, creates an environment of dread, renders life unbearable. The poor increase their income by taking up self-employment ventures once they have money at hand. This leads to increase in their self-confidence and alleviation of their vulnerability. Rise in income frees them from social degradation, powerlessness and alienation thereby dawning on them the sense of oneness with the Society.

While evolving the programmes of poverty alleviation, we must consider how sincerely we want to eradicate poverty and to what extent. How much unbearable to us is the sight of a man living the life of beast. In fact, any programme of poverty

alleviation demands firm determination to implement it much more than resources in the shape of money. The second most important thing is institutional arrangement for achieving this goal. However, we must not harbour the illusion that poverty can be fully eradicated in a class divided society, where production is universal but distribution is private and personal. Our experience in West Bengal shows that provision of microfinance alone, without implementing the land reforms policies distributing land to the tillers, strengthening the permanent resource base of land-less labourers, rural poor, rural artisans, making them centre-stage actors in the rural balancing power situation and without withholding pressure on the land by providing industrial activities and employment, may not be adequate to solve the problem of rural poverty. It may be an intermediate activity and a palliative. It can strengthen the bargaining power of the poor people, help them acquire more assets, increase their (including women) social status.

It may alleviate the miseries of poverty to some extent provided there is enough zeal, sincerity and dedication of the organiser, provider and implementer of the microfinance programme.

13. Microfinance and Empowerment

Microfinance plays an important supplementary role in creation of assets of the poor. There are two dimensions of the impact of Microfinance. Firstly, it facilitates the SHG members in generating and enhancing there income which helps in strengthening their livelihood, increasing their self confidence in managing their micro finance programme and improving their leadership quality. Secondly, the microfinance has a tremendous impact on the life of the poor and the society which actually creates empowerment of the poor, particularly women. Empowerment is multidimensional. It is very difficult to measure empowerment. However microfinance and self-help groups enhanced the power of women to come out of the family and talk to Government officials, Bank officials, elderly people of the village, to organize the programme resulting in improvement in their present status in regard to education, health, human rights and other social services.

Empowerment: Experience from the life

To judge empowerment of women we can also draw inference from the life of the women who are engaged in micro finance. In a remote village of Balurghat district near Hili Border of West Bengal, when a women was asked in a meeting of about 900 women, assembled in the village, whether she had experienced any resistance when she tried to join the SHG movement, she replied, "the mother-in-law told that if you go outside the house, you would become a spoiled woman and the husband told that you need not had to look into it, you maintain the family and look after the child". I did not pay any heed to it and I joined the group in disguise and paid

weekly deposit to the women leader regularly at the bank of the pond outside the house with a plea to wash the utensils. One day one bullock died and my husband was in trouble. He had no money. I give him Rs. 3,000/- taking loan from the group for purchasing one bullock. His first question was what nuisance you had committed so that had got the money. I told him that I committed the nuisance of joining SHG though I was prohibited. He and my mother-in-law told that from today you were free to join the groups and allowed me to go outside the house. Now no decision was taken in the family without consulting me, but previously I was only a maid servant.

Conclusion

It clearly emerges from the foregoing paragraphs that the SHG-linkage programme is strong supplementary credit delivery system in the country. It proves that the poor including poor women are also bankable and they have good potential to manage the economic and social affairs of microfinance scheme. It helps mobilising deposits which strengthens the resource base of the banks and increases very sustainable credit flow. Holding regular weekly meeting in the house of the members by rotation, monthly income generation of the group, per group lending, recovery and disintegration of the groups are the grey areas where deep attention of all stake holders is required to be drawn.

This paper also highlighted that the Fourth model, i.e., Co-operative model (a co-operative within a Co-operative) is the strongest model with more or less 100% coverage of villages and with world wide horizontal and vertical network played an important role in developing microfinance and still have the relevance in strengthening microfinance.

At the macro level also the microfinance or provision of microfinance alone can not solve the problems of poverty and inequality.

It may not be called a poverty alleviation programme. It is actually an income generation programme. Which helps generating income of the poor and by this process it helps empowering the poor to fight against poverty. With out providing a perennial nature of income generation activities, a decent standard of living, adequate nutrition, health care, education, decent work and protection against calamities which are also human rights, poverty can not be eradicated as envisaged in Human Development Report, 2000. Microfinance can reduce the poverty to some extent if the organizer, provider and implementer of the microfinance programme have enough zeal, sincerity and dedication to the jobs as also hatred for the poverty. Particularly higher participation of the women folk in the SHG-linkage programme increases earnings of the women borrowers leading to higher share in house-hold decision making and higher status in the society and helps their empowerment. Co-operative Model with 100% village coverage in the country having required infrastructure facilities with popular functioning may act as the best Model in the country.

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Financing Micro Enterprise Clusters - Challenges, Opportunities and Way Ahead

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Financing micro, small and medium enterprises is a continuous challenge, emanating both from the demand as well as from the supply side. Micro enterprises are looking for various finance plus models in order to link the micro enterprises to go for formal sources of financing

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Abstract

At the macro level it is being increasingly recognised that most of the Indian micro, small and medium enterprises are available in clusters, with micro enterprises being the majority among them and simultaneously, finance related challenges are paramount among micro enterprises. This paper estimates that two-third of Indian manufacturing MSMEs are present in cluster, with 95% of them being micro and 72% of them being micro-micro enterprises. We suggest that while finance is a critical issue in many of these clusters, many a times, the entry point of promoting these clusters are other competitiveness related issues and finance follows as a logical conclusion, very soon. Based on statistical analysis of primary information collected through structured questionnaire from six micro enterprise clusters, we find that (a) micro enterprises are looking for various finance plus models in order to link the micro and the micro-micro enterprises to go for formal sources of financing and (b) the level of institutionalisation of a cluster, i.e., the presence of intermediary institutions and their pro-activeness is directly linked to institutional sourcing of such finances in clusters. Accordingly we suggest (a) various financing tools like order discounting, financial vouchers through technology and raw material providers, (b) working with cluster based intermediaries (associations/other NGOs) for improved financial practices and (c) providing services through empanelled finance experts for better banking practices, etc.

Key Words: Micro Enterprises, MSME
JEL Classification: G21 and G-28

Introduction

Financing micro, small and medium enterprises is a continuous challenge, emanating both from the demand as well as from the supply side. Purpose of this paper is to identify the challenges faced and possible ways out in financing micro manufacturing enterprises (MMEs) in India. In what follows, section 2 identifies the presence of MSMEs in clusters and suggests cluster based approach as a possible route to address this issue. Section 3 suggests that MSMEs are not homogeneous and their financing needs are different. Section 4 makes a detailed analysis of the varied financing needs of the heterogeneously distributed MSMEs. Section 5 suggests that while financing is an important need, in many cases it is a derived issue, that follows only with other needs like marketing, technology, raw material, quality, etc. have been addressed which are often more critical. In some cases, financing follows these other non-finance needs. Section 6 analyses a sample survey done in few clusters to identify the needs, challenges and possible ways out while effectively addressing the demand and supply side issues in cluster based financing. Section 7 provides the broad conclusions and possible way outs.

2. Are MSMEs situated in clusters?

MSMEs, consisting of both manufacturing and service providing MSMEs; have grown steadily during the period 2001-02 to 2006-07 from 10.5 to 26 million. This growth has taken place substantially in the services sector, where the number of enterprises grew from 4.5 million to 18 million. However, the number of manufacturing enterprises also nearly doubled from 4.1 million to 7.5 million.

A number of these enterprises are situated in clusters. A cluster is a conglomeration of large as well as MSMEs producing same or a similar range of products and is geographically concentrated in a city, town or few blocks and their surrounding areas. The firms producing the cluster product are called the principal firms and those in the value chain producing backward and forward linkages are called support firms. Besides there exist various other support stakeholders including banks, associations, technical institutions and business development service providers (BDSPs) in the cluster.

Broadly there are three types of clusters. Firstly there are traditional manufacturing clusters. They produce industrial items like engineering goods, leather and products, pharmaceuticals, textiles, etc., Broadly a traditional manufacturing cluster is considered to have at least 100 units. These clusters have MSME as well as large firms too. Then there are micro enterprises clusters, consisting of at least 50 units including household units. These include artisanal (handicraft and handlooms) and other micro enterprises clusters. Here all units are micro and household enterprises. Also there are high-tech clusters.

There is no estimate of the presence of registered and unregistered manufacturing units in clusters in India[1]. India is estimated to have over 4439 manufacturing clusters, and the list is constantly rising starting with a figure of 138 clusters in 1997[2]. These include 1090 traditional manufacturing clusters - having presence of micro, large, small and medium units and around 3349 micro-enterprises clusters - having only micro enterprises and consisting of mostly handicrafts (2686), handlooms (491) and other micro enterprise (172) clusters.[3]

A mapping of the 1090 traditional clusters was done based on the 2-digit item basket of Index of Industrial Production[4]. Secondary data on the number of units present in these clusters are of different vintage, varying from 1997 to 2002 and are available for 644 of the 1090 clusters identified so far. For the rest, average of data available on similar clusters, barring extreme cases of low and high numbers, were extrapolated. The value was then normalised to 2006-07 level by multiplying with an average annual growth rate calculated for manufacturing MSMEs (number of large firms being negligible). Accordingly based on the number of enterprises in manufacturing, this

Table1: Sector wise distribution of Clusters and Units in Traditional Manufacturing

S. No.	Sector Name	Estimated No. of Clusters	Estimated No. of Units 2006-07	Percentage of traditional manufacturing MSME Units	Sample of 79 Clusters[5]	% of Total Clusters Overall
1	Basic Chemicals and Chemical Product (except products of petroleum and coal)	61	20949	1.7	6	6
2	Basic Metals and Alloy Industries	50	14544	1.2	3	5
3	Food Products	241	106460	8.6	8	22
4	Jute and other Vegetable Fibre Textiles except Cotton	8	2423	0.2	1	1
5	Leather and Leather and Fur Products	73	55408	4.5	8	7
6	Machinery and Equipment other than Transport	89	81497	6.6	5	8
7	Metal Products and Parts except Machinery and Equipment	138	335297	27	20	13
8	Non-Metallic Mineral Products	108	40281	3.2	3	10
9	Other Manufacturing Industries	20	15442	1.2	4	2
10	Paper and Paper Products and Printing and Publishing and Allied Industries	25	9486	0.8	1	2
11	Rubber, Plastic, Petroleum and Coal Products	55	24409	2	5	5
12	Textiles Products (including Wearing Apparel)	153	477999	38.5	10	14
13	Transport Equipment and Parts	23	26825	2.2	1	2
14	Wood and Wood Products	46	31769	2.6	4	4
	Traditional Manufacturing	1090	1242789		79	100

Source: www.clusterobservatory.in and estimates by authors

shows that traditional manufacturing clusters cover around 17% of manufacturing MSMEs in India.

However the Ministry of MSME data cover all manufacturing enterprises - registered and unregistered. Among the unregistered units are the various micro enterprises clusters, especially handicrafts and handlooms. In handlooms, a household unit having one or more looms is considered to be an enterprise. According to the handloom census of 2009-10 (adjusted for the negative growth in handloom enterprises, it is estimated that there are over 2.3 million such enterprises. Of the 2686 handicraft enterprises, data is available for 482 clusters. A handicraft cluster is often defined as those having around 50 household enterprises[6]. Hence assuming that there are on an average 50 such enterprises in each of the remaining clusters, it is estimated that there are around 0.86 million handicraft enterprises. Together with the available data of 172 micro enterprises, it is estimated that the 4439 clusters account for 4.7 million enterprises. Thus it is estimated that 63% or approximately two-third of MSMEs are situated in clusters.

Table 2: Clusters and Units Estimates

		No. of Clusters	No. of Units	Sample Clusters[7]
1	Traditional Manufacturing	1090	1242789	7984
2	Handicrafts	2686	863944	1614
3	Handloom	491	2323000	3
4	Micro Enterprises	172	293944	2
	Total No. of firms	4439	4723677	100

Source: www.clusterobservatory.in and estimates of this paper for number of units

3. Composition of MSMEs in Clusters

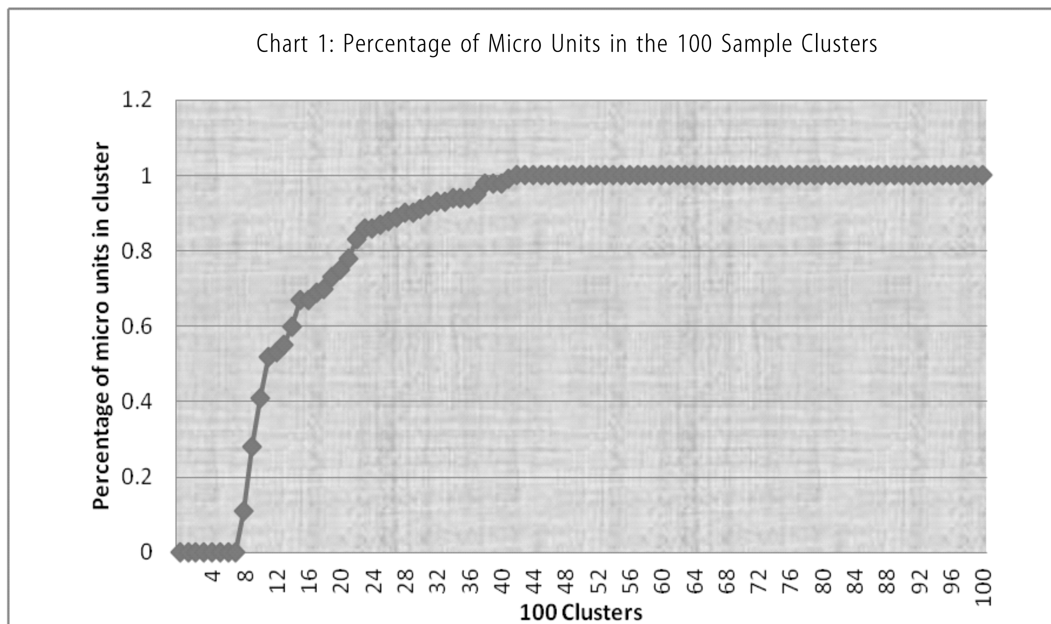
That MSMEs are present in clusters, is only half the story told. To understand the distribution of MSMEs, we did a secondary data analysis of clusters from the diagnostic studies[8] of these clusters. During the last eight years of cluster development programme (CDP) in India, it is estimated that detailed diagnostic study (DS) has been done for 288 micro enterprise clusters. Unfortunately not all studies are accessible or are reporting the distribution of firms as desired. Also, one needs to balance the representation of cluster types as per their distribution over the sector. Accordingly a group of 79 clusters were selected as per distribution given in Table 2 above.

Barring three cases of food, metal and non-metallic products, in the remaining 11 sectors, representation of clusters is proportional to their presence. So far as the purely microenterprise clusters is concerned, their numbers are disproportionately higher as compared to the traditional manufacturing clusters with 2900 handicrafts

and 491 handlooms clusters. Also the handloom clusters are highly homogeneous and so are the handicrafts clusters barring the different product groups in handicrafts. Accordingly we have included 3 clusters of handlooms, 12 clusters of handicrafts and 2 other micro enterprises clusters.

Analysis shows that of the 79 traditional manufacturing clusters, 48% have all micro units, 5% have more than 95 but less than 100% micro units, 11% have more than 90 but less than 95% micro units, 10% have more than 75 but less than 90% micro units, 11% have more than 50 but less than 75% micro units, and 4% have less than 50% micro units. A weighted average shows that in traditional manufacturing clusters, and 81% of the units are micro enterprises. s, where all units are micro enterprises only. Thus it is estimated that around 95% of manufacturing enterprises in cluster are micro enterprises.

Again even the micro enterprises are not a homogeneous category. Handloom clusters are known to have 3 categories of weavers - master weavers or those who do selective weaving and get work done through other job working weavers and then



there are weavers who work as weaver labourers. Similarly the handicrafts clusters also do have few entrepreneurs who are traders/exporters, with majority of the entrepreneurs as pure crafts persons, whose earning can be interpreted as either wage or profit. Data for such distribution of micro enterprises was available in 11 of the 79 selected clusters. Here the units were divided based on varied parameters including production capacity, turnover, technology (handmade or machine made), type of labour (family or hired), estimated investment, etc. This showed that around 5% of

the micro enterprises are relatively big among the micro enterprises, while 23% are relatively small. Around 72% are the smallest among the micro enterprises and are being termed as micro-micro enterprises. These findings are summarised in table 3 below.

Table 3: Distribution of MSMEs in India

	Type of Units	Number of Enterprises (million)	Per cent of Enterprises
1	MSMEs	26.10	NA
2	Manufacturing MSMEs	7.45	100
3	Manufacturing MSMEs in Clusters	4.72	63
4	Manufacturing micro enterprises in cluster	0.4.45	60
5	Manufacturing micro-micro enterprises in cluster	3.20	43

Note: Absolute number of enterprises is based on Fourth All India Census of Micro, Small & Medium Enterprises 2006-07

4. Financing needs of cluster

As per the Reserve Bank of India (RBI) guideline banks need to direct 60% of their advances to MSE Sector to the micro enterprises[9]. In contrast, evidence from NCEUS 2009 shows that ".....August 2007 and 2008, credit for credit cards increased by 86.3%, all services sector by 35.3%, construction by 48.3%, real estate by 46.3%....increase of credit ...for small scale industries (including micro enterprises by just 9.7%.....Overall availability of credit to small and micro enterprises as percentage of net bank credit of the scheduled commercial banks has declined from 15.5% in 1996-97 to 6.6% in 2007-08. The lower segment of micro enterprises (with investment upto Rs 5 lakh in plant and machinery) has experienced a decline from 2.2% to 1.6% in the same period[10]. These are adequately reflected in the diagnostic studies of 40 odd clusters, where detailed analysis was conducted during this current research.

Some clusters, where majority of the units are medium and small, financing is not a major issue. For example, in Tirupur, ".....75% of the interviewed firms are availing support from banks and financial institutions for their financial requirements...."[11]

Table 4: Extent of finance issues in 50 Diagnostic Studies

S.No	Sector	No Problem	Problem for Micro units	Is a Major Problem Area
1	Handloom		1	1
2	Handicrafts		4	1
3	Micro Enterprises		1	1
4	Traditional Manufacturing	8	25	9
	Total	8	32	12

Linkage with appropriate value chain partners, also lighten the finance requirement. For example, in Kolkata, "... Most existing tannery units operate mainly on own funds. Some units do use working capital loan but most other units stay away from institutional financing. The main reasons for this are the perceived high rates of interest and low operating margins. The raw materials suppliers provide credit. SME units have an adequate capital base while the fabricator units are supported by the SME units in terms of confirm orders...."[12]. However, even in a financially advanced cluster like Jamnagar, it was reported that "...entrepreneurs (operating in local market) hardly advance bank for term loan..."[13]

At times the problem is all pervading. In the HDPE Rope & Twine cluster of Chanditala, ".... Till date no financial assistance has been provided in this sector from their (bank) end. No SHG has been found in the cluster area...."[14] In the Rajarhat Silver Ornaments cluster, ".....Due to lack of finance they are unable to stock raw materials and finished product to meet the peak season demand. Therefore, it requires injecting finance from the financial institutions to make the artisans /firms independent from the traders for opening direct marketing channel/ alternative marketing channel...."[15]

In Barpalli Handloom weaving cluster lack of sufficient working capital is a major problem for which weavers incur huge losses during lean season. Weavers started defaulting when the repayment schedule set by the bank did not match their business cycle and no mechanism was put to take care of the seasonality issue in the cluster.

However, the problem is most pronounced among the smaller units of the clusters. In the Chennai leather cluster, "...There are serious gaps in terms of access of micro-sized job-working vendors to institutional credit. Many of them resort to informal markets and incur costs of upto 5% a month to repay this informal finance. In fact, even larger SMEs suffer from working capital constraints which affect their growth potential and capacity utilisation. Few (if any) firms have availed of assistance provided by the support FIs in terms of collateral-free credit. This is despite the fact that there are dedicated branches of institutions such as the SBI (leather and international branch) to cater to the needs of firms in the sector...."[16]

In Coimbatore, "....Micro enterprises find it difficult in getting loans from financial institutions/ banks and source loan from private sources at higher interest rate. ...there is need to develop cluster specific financial model.[17]" In Kanpur, "....Access to finance and market are major concerns of about 1000 household units making open footwear, i.e., sandal and chappals for the domestic market. ...95% of units surveyed are not having access to finance. .....". In similar lines, "...smaller tanneries that do not have access to formal finance to secure domestic supplies by paying advance amounts demanded...."[18] In the Jalpaiguri plastics goods cluster, while all the relatively bigger units working with high cost "....virgin materials ...are being mostly finance by equity or Nationalised Bank, no banking institute has yet recognised the potential of the Recycled unit of the cluster and hasn't come up with any type

of scheme for those enterprises. .... The banks very often do not finance the recycled units because of their improper paper works. 90% of the RUS is running short of working capital."[19]

In the Rourkela Engineering cluster, it is tiny machining and tool units who are not able to access institutional credit. They also needed finance for expansion. On the other hand bigger and better organized units do not have much problem in accessing institutional credit. In Rajahmundry Auto component cluster, lack of proper education on loan management coupled with lack of awareness on advanced technologies have adverse impact on repayment. In the Agra petha making cluster, while the bigger units are well organized in financial planning and control, "...the small units are financially less organized and most of them have not availed any term loan from banks...[20]" In Panipat carpet cluster while the exporters and some manufacturing firms do have good banking relations, the same is absent for majority of the composite manufacturers and the tufting units, the later being relatively much smaller units. Same is the situation in Bhadohi carpet cluster. The tiny entrepreneurs and the weavers are largely dependent on "...money lenders or own sources of funds for purchase of equipment and working capital including labour payment...."[21]

At times, lack of proper records creates problems in financing. For example, in Ganjam Cashew and Kewda cluster, although ... "a strong banking network is available in the cluster for financial assistance but they are not catering to the need of Cashew processing units. The issues with the banks are tedious and lengthy process of documentation, collateral security and time consuming process".[22] In Shantiniketan, "....Lack of proper book-keeping, no trade license and non-registration as SSI units etc. pose as major handicap for the entrepreneurs. The working capital requirement for the cluster units varies as per the seasonality of production and in most cases unit holders are unable to meet their working capital requirements...."[23] In the Darjeeling bee keeping cluster, it appeared that, "...financial institutions do not have any interest in extending term loan or working capital because of lack of credit discipline of the stakeholders ....."[24]

At times poor recovery also stifles the process. In the Zari cluster of South 24 Paraganas, "...due to poor recovery of loan, they (banks) are not so interested to further extend their credit support to the craftsmen...The master craftsmen have built their own capital base and the small craftsman inevitably turns to the former for his credit needs. ..."[25]. Similarly in the Silver Filigree Cluster of South 24-Parganas, "....Finance has never been a bigger problem for the entrepreneurs in the Cluster area. There is a problem of getting finance to new entrepreneurs without having much guarantee and security...."[26]. However, there had been number of cases of bad debt. In Chaltaberia earthen pottery cluster "...Due to poor repayment rate most of the Banks are not ready for financing. The number of loans received is extremely low. ...[27]"

Most regular banks and microfinance institutions avoid financing micro enterprises since this is perceived as risky and costly, with cash flow requirements that are irregular

and difficult to manage. Banks shy away from the high transaction costs and risks related to the business, including market fluctuations. Also the lack of physical collateral is a restriction, and the risk of political interference that can damage the repayment behaviour of the MSME clientele is high. Most financial institutions opt for big industries in high-density urban or peri-urban areas where they serve their clients in standardised systems, usually unfit for the needs of small units.

5. Major Issues in the Cluster

While finance is an important need in clusters, need for the same are not uniform and heterogeneously distributed among units. Clearly need for the small enterprises are less pronounced as compared to the micro enterprises (section 4). Also as the cluster units suffer from various types of inefficiencies, the operations becomes limited and the need for financing does not become that pronounced in the otherwise prospective micro units.

To understand the severity of needs of the clusters, an analysis of the diagnostic studies of 100 clusters were done. It was found that apart from financing the cluster issues include various other parameters including availability of raw material, quality, design, technology, market, skill, finance and issues related to environment, energy and safety. This shows that while finance is an important issue in 43% of the clusters, need for access to market is paramount (62%), followed by appropriate technology (59%). Other important issues are appropriate raw material (40%), quality (28%), environment, energy and safety issues (26%), skill (24%) and design (16%).

In many places the need analysis section explicitly ranked the severity of the problems based on value judgement provided by the interviewees done during the diagnostic studies, However at places, where such views were not explicit, the value judgement was taken based on the severity of the needs. Accordingly the issues were ranked for their severity of need in each of the 100 clusters. The ranking are as follows:

Table 5: Ranking of various pressure points for 100 Clusters

Pressure Points		Figures in Percentage		
		Rank 1	Rank 2	Rank 3
1	Raw Material	24	5	11
2	Technology	23	18	19
3	Market	21	21	21
4	Design	14	17	13
5	Skill	9	11	4
6	Finance	6	19	18
7	Social, Environment and Energy (SEE)	4	8	14

Thus while finance is not the most important issue in most of the clusters, cluster level initiation in any of the other activities including availability of raw material, installation of appropriate technology, access to appropriate market, etc. will naturally lead to strong finance needs. This becomes evident as finance turns out to be the second most important needs in the second rank and a very close third in third rank.

Cluster development literature suggests that intervention in a cluster should start off in pressure point areas. Thus while in some cases intervention in a cluster can start off with financing needs, in majority of the clusters, intervention need not necessarily start with financing related interventions and financing issues often follow.

MCGFS at the HBPT Cluster of Jaipur[28]

In 1997, UNIDO initiated a cluster development programme in the hand block printed textiles (HBPT) cluster of Jaipur. The major issues of the cluster were lack of access to market and marketing skill, lack of organisation skill, lack of adequate financing, lack of appropriate infrastructure, etc. However market access was identified as the most critical issue. Thus initial interventions were done in providing training in marketing skills and design creation, providing marketing exposure, etc. Once these gave them business, the printers wanted to expand their business and needed working capital. It was at this stage that a mutual credit guarantee fund scheme was introduced in the cluster. The groups created for marketing purposes gave inter group guarantee to banks and with a seed fund support of SIDBI, 3 banks - State Bank of India, Bank of Baroda and State Bank of Bikaner and Jaipur provided a loan worth Rs 1.5 million to 65 units. Apart from group guarantee provided the newly formed cohesive SHGs, the local association Calico Printers Cooperative Society Ltd. also provided guarantee to banks.

Thus the role of local intermediaries including banks, micro finance institutions, associations of micro enterprises, also become critical in such endeavours. Hence many a time it becomes important to create trust with such enterprises, which is often done through interventions in other pressure point areas. Thus while financing can be done by banks or micro finance institutions, such intermediary trust nodes, already existing in a cluster, may become important handholding partners while promoting financing.

6. Analysis of Sample Survey

To understand the loan behaviour pattern of the micro and the micro-micro enterprises, a sample survey was done in six clusters. Here we covered two traditional manufacturing (Vijaywada Gold Ornaments and Rajamundry Auto General Engineering) clusters, two handicraft (Chaltaberia Earthen Pottery and Bhubaneswar Stone Carving)

clusters, one handloom (Barpali) cluster and one micro enterprise (Deoghar Carpet) cluster. Primary data was collected through execution of a structured questionnaire in these clusters from a total of 149 micro entrepreneurs. Few value chain partners like buyers, raw material providers, machinery suppliers, etc., and financial institutions in the cluster were also interviewed. Needless to say the sample size is too small and the findings and conclusions thereof are at best indicative. Description of the cluster along with the number of respondents covered in the survey appears below.

Tabl 6: Profile of the Sample Clusters with Number of Respondents

	Name	Products	No of Micro Units	Turnover (Rs in Million)	Number of respondents for data collection
1	Vijayawada Gold Ornament Cluster, Andhra Pradesh	Chains, Rings, Bangles, Black Bit Chains, Bracelets, Long Chains, Necklaces, Nallapusalu, Studs, Matis, Earchains, Tikkas, lockets, Belts, bajubandis nosepins, etc.	6250	1800	26
2	Rajahmundry Auto General Engineering Cluster, Andhra Pradesh	Repairing Fuel injection pumps, turning works, tipper body repairs, engine re boring works, clutch plates repairing, Bus/ Tipper Body Building	200	600	24
3	Chaltaberia Earthen Pottery Cluster, West Bengal	Earthen pottery like Decorative Diyas, Idols of God & Goddess, Traditional Pottery Items like Pitcher, Jar, Dish, Glass, Trays, etc.	250	75	20
4	Barpali Handloom Cluster, Orissa	Handloom Sari, Dress materials, Yardages, Bed sheets, etc.	1894	80	25
5	Bhubaneswar Stone Carving, Orissa	Stone carved items - mainly Sacred Wares, Icons, Luxury goods, Household utensils and art ware.	66	2.7	29
6	Deoghar Carpet Weaving Cluster, Bihar	Carpets	427	10	25

Out of these 149 respondents, around 46% respondents have registered entities and around 81% have bank accounts. Almost half of the respondents operate in national market where as the remaining half caters to regional and local markets. Around 65% respondents belong to second/third generation of the business and the remaining are first generation entrepreneurs.

Summary of Findings

(1) The need and purpose of credit its present availability by type, source, volume, time, delivery and repayment mechanism, etc.

More than 90% of the enterprises in these 6 clusters mentioned that their enterprises are set up either with own investment or money taken from relatives/

money lenders and also from other value chain partners like traders, raw material suppliers, etc. Very few reported that they took finance from the bank to start business. However, after establishing the business some of them took formal credit for meeting working capital requirements, buying land, machines and setting up new units or to expand the capacity of existing units.

All units fall in the micro-micro enterprises category, are more labour than capital intensive and have high relative production costs (because raw materials are purchased in small quantities). They lack technical experience in production, accounting, administration and stock control (due to low levels of qualification). 46% respondents unregistered and are mostly family-based. Access to formal source of credit is limited mostly to registered/ partially registered units. Unregistered units and units which are family based suffer from lack of access to working capital. Some of them even do not have a bank account as they deal with hard cash for business transactions. Banks perceive family based units and units having seasonality problems as risky and hence un-bankable.

Most of the respondents of Micro of Micro Category revealed that banks are rigid to accommodate them as they do not have any collateral. They do not have much property to offer as collateral. Their houses are not concrete/semi-concrete/ wooden and thus banks would not give a high loan amount for such houses.

The turnaround time for disbursing the loan is too long. On an average, it takes about 4 to 6 months for the loan to be disbursed. Bureaucratic problems and too much documents requested by the banks dampens the spirit of the micro enterprises. The challenges faced by most of the respondents in the survey revealed that the high cost of borrowings, high bank charges and fees have made the micro entrepreneurs seeking other alternatives and soft credit with high interest rates such as money from the money lenders, traders, raw material suppliers, etc., as the last resort. These informal agents disburse the money the next day and do not require much documentation and collateral.

Respondents were asked to rate the problems related to finance in a scale of 4 based on its severity in reverse order, where 1 means big problem, 2 means medium problem, 3 means small problem and 4 means no problem. The summary of the rating can be seen in Chart 1.

"Lack of Capital", is rated as most severe problem (average rank - 1.68). Lack of access to working capital (average rank-1.83) and lack of loan for capital asset (Average rank-2.1) is also considered as medium problems. However, seeing at individual cluster wise responses, it is worthwhile to note that clusters which are value chain linked are suffering more from problems like "lack of loan for capital asset" where as clusters not linked with value chains find "lack of capital" and "lack of access to working capital" as most severe problems.

Respondents were also asked to rate the issues that they may like to tackle given access to credit. The result is presented in the in Chart 2. It is observed that "bargain

Chart 2: Rating of severity of financial problems

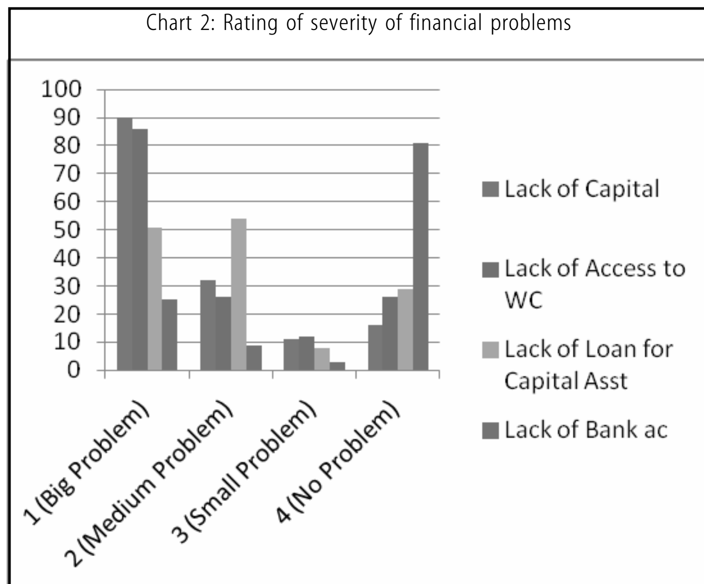
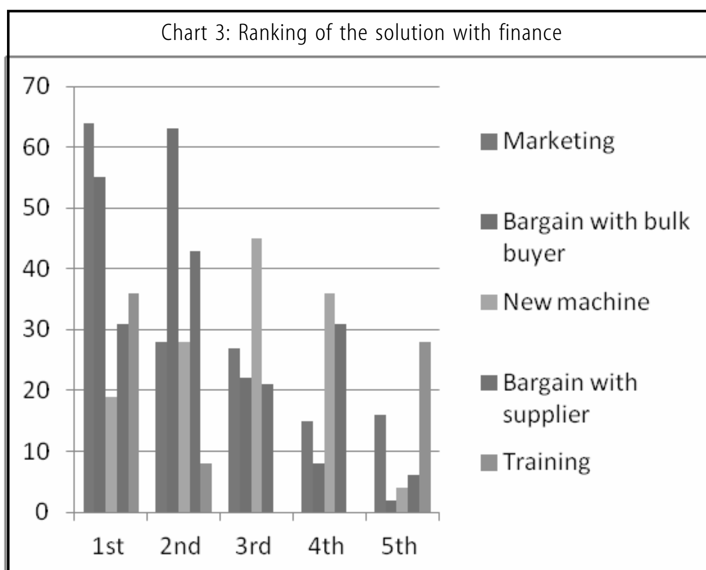


Chart 3: Ranking of the solution with finance



with the bulk buyer" (average rank 1.92) is felt as the most critical area to be tackled given access to finance. In other words, holding stocks and reaching out to the right markets and having greater clientele that give boost to better bargaining of the product comes out as a most important area for which entrepreneurs demand money.

Moreover, some of the responses of the micro-micro category suggested need for credit to (a) meet the cash outflow requirement at the beginning of next cycle

owing to causes like delays in realising the sale proceeds, work in process, etc. (b) meet future expected non-recurring needs (input/material not available readily) and (c)household emergency as the source of safety net (in the form of trader from whom they used to purchase the raw material earlier) dries up.

(2) Need for finance and Type of Cluster

Credit need/ purpose vary with the level of maturity of the cluster. Cluster units which are value chain linked in production, need credit for technology, expansion, creation of sheds and building, etc. Whereas, non-value chain linked units demand credit for basic purposes like meeting the working capital requirements, marketing, buying raw materials, tackling seasonality problems, etc.

For example, Barpali Handloom cluster suffers from seasonality problems which spread over 3 to 4 months in a year. "lack of capital" (average rank: 1.6) comes out to be the most severe problem followed by "lack of access to working capital" (average rank: 1.92) as per the ranking given by the respondents. These respondents ranked "bargain with bulk buyer" as the most important area to be solved given access to finance. This slack period offer scope for the weavers to take loan, produce and stock the products and thus use the idle productive capacity. These products could later be sold during the season to make profits. Where as in Rajamundri Auto Components cluster which is value chain linked and seasonality is not a constraint, the respondents ranked "Lack of Loan for Capital Assets" as the most severe problem (average rank-1.78). The credit is required for buying new machines, for business expansion and creating new market linkages.

(3) Incidence of and reasons for not using the credit - idle money/mis-utilisation, etc.

Cluster where seasonality is a problem, "Incidence of non-repayment" and "seasonality" in business are found to be related. It is also noticed that when the repayment schedules do not match with the business cycle/ cash flow, the incidence of defaults/ non-repayment becomes high.

In Barpali Handloom cluster, where seasonality is a big problem, more than 40% respondents revealed that they have defaulted in repayments as they used the loan amount partially to meet consumption need and the remaining for buying raw materials during the off season and thus the default is due to the non-productive use coupled irregular cash flow in business during lean time. In the case of the stone carving, few artisans mentioned that they gave the amount as advance to the traders for procuring the stone. But due to huge scarcity, many of them do not get stone in time. Therefore, they felt themselves overburdened in repaying the instalments even before they could benefit from the loan and thus defaulted. Poor health condition is also observed as another cause of defaults.

(4) Credit Assessment; Goodness of Fit of the Loan Product and Delivery Mechanism

Huge difference between the felt credit need and the credit accessed by the banks has been observed in more than 90% cases in the sample. However, in remaining 10% cases, the loan assessment was done as per the business plan prepared by the entrepreneurs to arrive at the loan requirement. Business cycle and cash flow were studied and need assessment was done by the bank officers and requirement was then rounded off to a commonly acceptable amount within the range to arrive at a certain amount by the bank. There is no mismatch between the demand and supply of loan and since the assessment was thorough, and therefore the credit utilisation was proper and repayment was regular.

Around 40% respondents suggested that apart from productive purposes, there is also a need to assess the household consumption requirement to enable the entrepreneurs/ artisans improve their holding capacity to reach out to better market. In addition, many a times entrepreneurs require multiple but simultaneous loans. For example, the units in Vijaywada Gold Ornament Cluster require term loans for buying machines and building and also to buy raw material.

High variability in the loan requirement by the entrepreneurs involved in Handloom, Carpet weaving, Stone carving, Auto Components manufacturing, Earthen Pottery and Ornament manufacturing has been observed. Even within the cluster, the need varies with the type and size of the units and therefore variability needs to be addressed effectively with proper assessment. This could help tailoring the loan product (purpose, amount and repayment period) to suit the requirement of the individual entrepreneurs.

(5) Financial Education and Loan Preparedness

As mentioned in the previous section, huge difference between the felt credit need and the credit accessed by the banks has been observed in more than 90% cases. Most of the financial institutions normally require the borrower to prepare detailed working paper together with the cash flow projections. Due to lack of knowledge, most micro entrepreneurs are ignorant of proper accounting principles and values to reflect their financial position and therefore they do not articulate the right requirements in a right procedure. Therefore, there is a need to develop the understanding of the MEs on business assessment/ credit requirements/ credit disciplines, etc. The entrepreneurs then use the understanding and the capacity to articulate and approach the formal financial institutions to diversify their credit sources.

(6) Institutionalisation of the financial system and growth of the cluster

An attempt has been made to group the clusters into two distinct groups based on its level of development with respect to the institutionalization of financial sources.

A cluster is considered to be institutionalised if there are presence of active network of stakeholders, e.g., SHGs/JLGs/Associations, who are already working for cluster development. In the case of complete absence of the same or their non-activeness, we have considered the cluster as not institutionalised. Discriminant Analysis (DA) technique was used to confirm whether the two groups are different with respect to 1) units availing credit including both term loan and working capital loan taken from bank and other formal sources (denoted as X_1) and 2) units availing credit taken from other than formal sources(denoted as X_2).

Thus the specified form is as follows:

$D= c + b X_1 + d X_2$

Where, D has been divided into two groups such as:

Group 1 = Clusters where financial system has been institutionalised

Group 2 = Clusters where financial system has not been institutionalised

and the two independent variables are X_1 and X_2 as mentioned above.

The purpose of the Discriminant Analysis is to assess the relative importance of the independent variables in classifying the dependent variables. Discriminant function and other statistics are reported as follows.

Table 7

Test of Function(s)	Wilks' Lambda	Chi-square	df	Sig.
1	0.964	5.125	2	0.077

Table 8: Canonical Discriminant Function Coefficients

	Function
	1
Formal Sources of Finance	-0.13
Other than Formal Sources of Finance	0.734
(Constant)	-0.147
Unstandardised coefficients	

Table 9: Functions at Group Centroids

Institutionalisation of Finance	Function
	1
0	0.278
1	-0.133
Unstandardised canonical discriminant functions evaluated at group means	

On the basis of the above output the estimated discriminant function is as follows.

D= -0.147 - 0.130 *(Formal Sources of Finance) + 0.734*(Other than Formal Sources of Finance)

It is observed from the output that the Wilk's Lambda is statistically significant at 0.07% which suggests that the two variables successfully discriminate the two groups. However, variable represented by units availing credit taken from other than formal sources (denoted as X_2) is relatively more important.

The Z critical value is used to classify a respondent as to whether it may belong to a group with the above variables. The said value is calculated by the following formula:

Z critical= (0.278*group 1 -0.133* group 2)/N

Where, Group 1= respondents of 4 Clusters (Institutionalised financial system) and Group 2 = respondents of 2 Clusters (Non-institutionalised financial system) and N=142

Therefore, Z critical=0.448

Whether a cluster is financially institutionalised or not can be found out with the Z critical value. The Z value coming lesser than 0.448 means it is a financially institutionalised cluster and value greater than 0.448 values means financially it is not institutionalised.

(7) Financial services needed by the MEs

In order to find out the factors which influence the decision about the loan products/loan source (or in other words the factors that are considered very important in loan product/services by the micro entrepreneurs), Factor Analysis technique was used. This technique is being applied as there is systematic dependence amongst the set of observed or manifest variables (see table-10) to find out something more fundamental (or latent) which creates this commonality. Accordingly, the present factor analysis was carried out by using Principal Component Analysis (PCA) method for extracting the important factors out of the 15 manifest variables where 152 respondents from 6 clusters were asked give their rating in a likert scale having rating value from "1 to 5" where "1" means lest important variable and "5" means most important variable while demanding/sourcing loan.

The variables considered are as follows.

The factors extracted using PCA are in the order of importance (see table-). We have extracted 8 factors. Variables have been grouped based on 1) its factor loadings values which explain how closely the variables are related to each one of the factor discovered, and 2) the commonality between these variables. After extracting the factors, we have estimated the reliability coefficients of the variables under a

Table 10: Variables	
1	Accessible near/ our place
2	Explaining the loan product
3	Speedy assessment
4	Quick processing
5	Low interest rate
6	Less paper work required
7	No collateral
8	Size of the loan
9	Loan repayment schedule (Depending on product cycle/cash flow in the business)
10	Availability of subsidies
11	Gives loans and also help market products/buys products
12	Provides raw material and loan at reasonable rate of interest
13	Provides technology and loan at reasonable rate of interest
14	Give insurance facility also
15	Gives loan on seeing order

Table 11: KMO and Bartlett's Test		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.730
Bartlett's Test of Sphericity	Approx. Chi-Square	557.932
	df	105
	Sig.	.000

particular factor by using the standard Cronbach's Alpha which has a range from 0 to 1 and found all as significant. Moreover, there is sampling adequacy in the exercise and no Sphericity in the data which can be seen in table.

Table 12: Output of Factor Analysis using Principal Component Method

Rotated Component Matrix[a]

	Component							
	1	2	3	4	5	6	7	8
Accessibility	0.231	0.142	0.509	0.031	0.594	-0.27	-0.001	-0.173
Explaining Loan Product	-0.134	0.534	0.471	0.258	0.031	0.174	0.055	-0.125
Speedy assessment	0.001	0.877	0.014	0.171	0.017	-0.087	0.074	-0.002
Quick processing	0.227	0.814	0.087	-0.047	-0.03	-0.103	0.187	0.097
Low Interest rate	0.08	0.066	0.835	0.05	-0.07	0.021	0.04	0.165
Less paper work	0.042	0.251	0.048	0.085	0.068	0.001	0.925	0.043
No collateral	0.121	0.036	0.103	0.041	0.062	-0.031	0.039	0.93
Loan size	0.008	0.202	-0.041	0.83	0.11	-0.007	-0.059	0.119
Repayment schedule	0.288	-0.02	0.238	0.692	-0.072	-0.034	0.238	-0.101
Subsidies	0	-0.051	-0.126	0.048	0.868	0.195	0.066	0.125
Help market/ buy products	0.787	0.044	-0.042	0.066	0.007	0.15	-0.053	0.117
Raw material and Loan at reasonable interest	0.856	0.061	-0.008	0.041	0.078	0.104	-0.064	0.079
Technology and Loan at reasonable interest	0.795	-0.127	0.055	0.081	0.032	0.03	0.229	0.038
Insurance facility	0.828	0.205	0.168	0.054	-0.005	-0.035	0.017	-0.07
Order based finance	0.228	-0.109	0.025	-0.03	0.111	0.913	-0.001	-0.037

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalisation.
a. Rotation converged in 8 iterations.

8 most important factors in order of importance have been mentioned below with the variables and its factor loading values.

Factor-1 ("Finance plus" services)
- Help market/ buy products (.787)
- Raw material and Loan at reasonable interest (.856)
- Technology and Loan at reasonable interest: (.795)
- Insurance facility (.828)

Factor-2 (Ease of Finance)
- Explaining Loan Product (.534)
- Speedy assessment: .877
- Quick processing (.814)

Factor 3 (Interest rate)
- Accessibility (.509) (Not considered for the factor)
- Low Interest rate (.835)

Factor 4 (Finance w.r.t business need)
- Loan size (.830)
- Repayment schedule (.692)

Factor 5 (Loan comforts)
- Accessibility (.594)
- Subsidies (.868)

Factor 6 (Order based finance)
- Order based finance (.913)

Factor 7 (Less paper work)
- Less paper work (.925)

Factor 8 (No collaterals)
- No collateral (.930)

Analysis of the findings of the FA is as follows:

- The most important factor, Factor 1 suggests "finance plus" models which means the micro enterprises demand finance along with other add on services like marketing of the finished products, linking with raw material sources, technology and also insurance facilities. This is understandable as business model of most micro manufacturing enterprises (MMEs) is vulnerable to market fluctuations with high operational risk and they are hesitant to source finance without a guaranteed outcome, e.g. orders received (marketing) or raw material received (input) or appropriate technology delivered (technology up-gradation) and also minimising unforeseen exigencies.
- Factor 2, Factor-5 and Factor-7 have almost the same meaning and therefore can be clubbed as one Factor and named as "ease of finance". The need of credit of most of the MMEs remained unanswered due to either lack of physical collaterals or in the absence of appropriate business intelligence, improper loan assessment done by a financial agency and also improper articulation of requirement by micro enterprises due to adequate loan and business education. It is also seen that the turnaround time for disbursing the loan is too long. Bureaucratic problems and too much documents requested by the banks dampens the spirit of the micro entrepreneurs. Most of the financial institutions normally require the borrower to prepare detailed working paper together with cash flow projections. Due to lack of knowledge, most micro entrepreneurs are ignorant of proper accounting principles and values to reflect their financial position and therefore they do not articulate the right requirements in a right procedure. High cost of borrowings, high bank charges and fees have made the MMEs seeking informal credit with high interest rates. Sometimes, MMEs need flexi-credits to meet consumption expenditures during off seasons or to improve holding capacity to try and innovate new products/ explore new markets, etc.
- Factor 3- "Interest rate" and Factor 4-"finance with respect to business needs" come out to be the next two important factors. Here the role of financial institutes to understand the need of business and estimate right product and right interest rate becomes crucial. There is also a well felt need to develop the understanding of the MEs on business assessment/credit requirements/ credit disciplines, etc. and for this they need support and service of financial experts and banks.
- Factor 6 "Order based finance" has come out as another important factor. As discussed earlier, MMEs have limited access to formal credit due to lack physical collaterals and improper loan documents. Order based finance can play a major role in such cases. Under this, the purchase order (the contract between the seller and buyer) can be used as collateral for the loan. The accounts receivable can be transferred to the lending institution and becomes

the source of loan repayment. The financial institution may then collect payment for the loan plus interest and fees from the buyer once the product has been delivered. This factor looks similar to Factor-1.

7. Suggestions and Recommendations

It is clearly observed in many clusters that there is a problem in availability and accessibility of financial services that suit the demands and circumstances of ME clients. Poor households increasingly have access to small loans from microfinance institutions, and small & medium enterprises can get credit through commercial banks. But many micro entrepreneurs remain under-served. Their financial needs are generally too large for microfinance, but too small for commercial banks. This gap hampers growth and limits the development of MEs. It is also a loss to the financial sector, which ignores millions of potential micro clients.

Several important lessons emerged out of the primary data of sample clusters and secondary data of the microenterprises clusters in general. The analyses have also drawn important factors which tell the preferred products/ services demanded by the micro entrepreneurs. However, the key concern is how to define these products, in other words, how to package the services and ensure a cost effective, risk free and sustainable delivery mechanism. In this regards, given below are few suggestions and recommendations which are thought to be appropriate to the deal with the concerns and help towards building more inclusive financial system for the micro enterprises either through banks or micro finance institutions or other financial institutions.

7.1 "Finance plus" *model* came out to be the most demanded/ preferred model (see section Factor 1 and Factor 6 of section 6). This model can be defined and delivered in the following ways.

a) Order based finance can be a solution for this under which the purchase order can be used as collateral for the loan. The accounts receivable can be transferred to the lending institution and becomes the source of loan repayment. The financial institution may then collect payment for the loan plus interest and fees from the buyer once the product has been delivered. Risks can be reduced for financial institutions to lend by creating an accounts-receivable mechanism based on buyer demand.

b) Where orders are not sure, and MMEs are doing own marketing, raw material needs can be fulfilled by giving voucher to bank approved raw material suppliers (RMS). RMS here would be just a facilitating agent/ agency and things can move with issues of regular transactions, old history of buying from that RMS, etc. Here the liability will not be on the RMS, but his relation can be used as collateral.

c) The above can be applied to technology needs also, which can be fulfilled

by giving approved voucher by the technology provider/machine supplier

d) Finance can be given with insurance product for possible losses for damages or theft

In the above cases (a, b and c), bank can create an approved panel of its large customers- like big buyers, raw material suppliers, technology providers, etc and then take their linkage/relation with the micro enterprise as collateral for finance. This will help reduce cost and risk of finance and benefit the micro entrepreneurs with collateral free loans.

7.2 The role of financial institutions (Factors 2, 5 and & 7 in Section 6) is important in both the subsequent important factors emerged out of the study which hints at the need of easy accessibility and proper financial education. For this, financial institutions can have an approved list of agents who can educate the MMFs and handhold them in preparing accounts. Financial institutions can give also this responsibility to local trust nodes like associations to educate the entrepreneurs. More over approval of the association can also be used for assessing the credibility of micro unit. The charge for such services can be linked to credit off-take.

Also both for 7.1 and 7.2, there needs to be a monitoring mechanism to upgrade or downgrade the rating of these intermediaries based on success and failures.

7.3 Financial product with respect to business need (Factor 4 in Section 6) is crucial. The products need to specially consider this issue for certain clusters with seasonality. In addition, the banking procedures need to be less rigid to accommodate the micro-micros. It should take into account the business operations including production cycle/ cash flow, seasonality issues and other factor that influence the business.

7.4 It is observed that finance in many clusters (analyzed in section 5) is not perceived as a major issue by the stakeholders. Hence taking finance as a product might not work. However, solutions to most of the problems need finance and therefore it is considered to be a derived demand. Thus, there is a need for grant element to look into pressure points of the clusters. Once those are attended, need for finance will come out naturally.

Notes

1 Ministry of MSME has done a great work of identifying 1100 clusters in the 3rd Census. On closer examination we found that a number of categories were in general services (e.g., barber shop) or doing very marginal value adding manufacturing (e.g. atta chakki,, dal chakki, carpentry, etc. or categories like product not elsewhere classified, etc. Also in the 4th census, the number of clusters for registered MSME (not necessarily manufacturing) units has been identified is2263.

But no details are available.

2 Report of the Expert Committee on Small Enterprises by Abid Hussain, 1997

3 Some estimates put that there are around 2000 micro enterprise cluster apart from handicrafts and handlooms. Although no exact name of such clusters are available

4 Base year -1993-94

5 Refer to section 3

6 Office of the DC(Handicrafts) defines a cluster as conglomeration of 100 artisans (50 for North-East). Assuming 2 artisans per family, we consider a unit as a family of 2 artisans and hence 50 units per cluster, for those cases where there is no value of number of units are available:" Policy and Status Paper on Cluster Development in India", Foundation for MSME Clusters, November 2007

7 Refer to section 3

8 A diagnostic study provides an overall picture of cluster covering the industrial scenario particularly with respect to the cluster product, History of the cluster along with its turning points, Understanding of the production process and value chain, Key stakeholders involved and their business relationships and Key challenges and opportunities that help to develop a possible direction for the cluster development.

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16 Chennai Leather and Leather Products Cluster Diagnostic Study Report by EDII

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22 Fruit & Vegetable Processing subsector in Ganjam & Gajapati Diagnostic Study Report by Access Development Services

23 Shantiniketan Leather Goods Cluster Diagnostic Study Report by EDII

24 Darjeeling Bee Keeping, Honey Extracting and Processing Cluster Diagnostic Study Report by District Industries Centre Darjeeling

25 Zari Embroidery Works Cluster Diagnostic Study Report by District Industries Centre, South 24 Parganas

26 Silver Filigree cluster of South 24-Parganas Diagnostic Study Report by District Industries Centre South 24 Parganas

27 Chaltaberia Earthen Pottery Cluster Diagnostic Study Report by District Industries Centre, North 24 Paraganas

28 End of Project Report, US/GLO/95/144, UNIDO CDP, New Delhi

Making Market Work for MSMEs - Cluster Centric Approach Suitable for Microfinance/Micro Enterprises

- R. K. Singh*

Access to Finance and Business Development Services is very crucial. Institutions supporting Micro Enterprise development have largely targeted their attention at access to financial services.

Abstract

Globally, Poverty alleviation and inclusive growth are crucial tenets in the strategy of most economies. Be it unorganised microfinance to Micro Enterprises (MEs) to Small and Medium Enterprises (SMEs) the inclusive growth agenda form integral part of their strategy. The unorganised and small size nature coupled with inability to leverage on inherent strength impacts the growth of enterprise. Even if an entrepreneur knows that these are necessary to improve their competitiveness and performance however it does not venture into it for the fear of unknown. As one grows and particularly in the present ever changing business atmosphere one needs to handle the complexities by sourcing the right services in right doses at right time. Access to Finance and Business Development Services is very crucial. Further clustering is one widespread acceptable solution for such Micro and Small Enterprises (MSEs).

Institutions supporting ME development have largely targeted their attention at access to financial services. Slowly they have realised that non-financial aspects particularly the access to strategic services also deserve attention. This is an answer for shift from comparative to competitive turf.

This paper presents the experience of SIDBI in attending to poverty alleviation through enterprise development. It adopted 19 clusters across the country for BDS market development through intensive intervention. During the process of implementation, it could realise that it equally benefits the enterprises at the bottom of pyramid. While the project called

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Key Words: Microfinance, Micro Enterprises, SIDBI, MSME
JEL Classification: G21 and G-29

MSME Financing and Development Project (MSMEFDP) was MSME centric however at many cluster level it was largely ME oriented. The story from field level involving examples on theme basis from Kanpur and Shantiniketan (Leather), Ganjam (cashew), Alapuzha (coir) etc. (targeted more at micro enterprises) are illustrative models . The learning's amply indicated their potential for being replicated at the bottom of pyramid, i.e., in MF/ ME domain.

MSMEFDP adopted a robust monitoring methodology which included baseline and impact evaluation of indicators aimed at tracking the achievements from the supply side i.e. BDS. This approach is a drift from traditional transaction or subsidy led support and lays thrust on participation & ownership and thus enabling market to function on its own. The bouquet of offerings which was customised as per the cluster profile included a wide range of offerings to include awareness, handholding/ mentoring, training. The thrust was on developing local expertise by strengthening the existing BDS or bringing in new ones, where ever felt essential by the stakeholders. The learning, evolution and consolidation phases involved several tests and filter mechanism thus evolving customised best practices.

SIDBI's experience in strategising and setting up an example of 'Making Market Work for MSMEs' has worked. It has won appreciation from many quarters including few international awards and recognitions.

The models depicts inherent resilience and sustainability traits which can be tried out for the entire MSME value chain - right from bottom of pyramid to the top.

Introduction

Globally, Poverty alleviation and inclusive growth are crucial tenets in the strategy of most economies particularly the development institutions that are committed to enterprise development. Be it unorganised Microfinance (MF) to Micro Enterprises (MEs) to Small and Medium Enterprises (SMEs) the inclusive growth agenda form an integral part of their strategy. As known, the performance of MSMEs more specifically the unorganised MEs, suffers due to their small size and insufficient capital. They are too small to afford investments towards improving human capital leave aside the strategic aspects of quality improvement, marketing, skill development etc. They know that these are necessary to improve their competitiveness and performance however they do not know how to go about doing this.

Institutions supporting ME development have targeted their attention at access to financial services. However as some of these MF beneficiaries enter the realm of MEs they grapple with challenges at both financial and non financial levels. Besides access to credit, issues of information asymmetry for setting up (type, sector, market, skilled people) or growth of their enterprises (requiring access to strategic services) affect them. Here they require right mentoring and handholding.

Some of the potential entrepreneurs also suffer from 'Missing Middle' syndrome

where Microfinance institutions who were hitherto serving them express inability and when they go to bankers they expect credit history (which they are unable to show). Further, the success starts getting measured not only at bottom line (profitability) level but also at top line (turnover) level. With squeezing margins (due to their vulnerability of being suppliers) they have to look within. This calls for traits of enhanced productivity, efficiency, vibrancy and resilience. These complexities can be suitably handled by sourcing affordable and appropriate services. Access to Business Development Services (BDS) or Business Services is very crucial. Also, clustering is one widespread acceptable solution for such MEs.

SIDBI and Clustering

SIDBI has been attending to clusters through its promotion, financing and Development mandate. Under Promotional ambit, through its Rural Industrialisation Programme and thematic / Performance linked EDPs it promotes sectoral niche. In its early years, cluster development support was largely on cluster level standalone interventions and was initiated as supplement / complement to other institutions such as UNIDO, Project UPTECH, SBI etc. Later, instilling competitiveness became its thrust agenda.

SIDBI's cluster centric financing covers 600 clusters catered through its 103 offices. Today it supports entire value chain (Microfinance, Missing Middle and SMEs). It has entered into MoU with banks covering 200 plus MSME clusters. It has setup Central loan processing Cells for sectoral expertise. It has also been financing in clusters through MoU with MSME Associations and structured channel financing. SIDBI entered into collaboration with the Asian Development Bank to develop MSEs access to finance and BDS. For attending to this Missing Middle segment (those unorganised microfinance beneficiaries looking up the value chain and intending to setup MEs), SIDBI has started a project titled 'Financing Micro Enterprises and Capacity Building in SIDBI - using Downscaling (doing small loans profitably) Techniques' by placing a consultant of repute. The project has since been pilot launched in the Microfinance Branches of SIDBI.

SIDBI has been implementing a multi partnership (international partners include World Bank, DFID UK, GIZ and KfW) MSME Financing and Development Project (MSMEFDP) where one of the key components has been targeted at clusters. The demand and supply side issues in the adopted clusters have been attended through market development of Business Development Services.

Making Market Work for MSMEs - BDS Market Development in Clusters

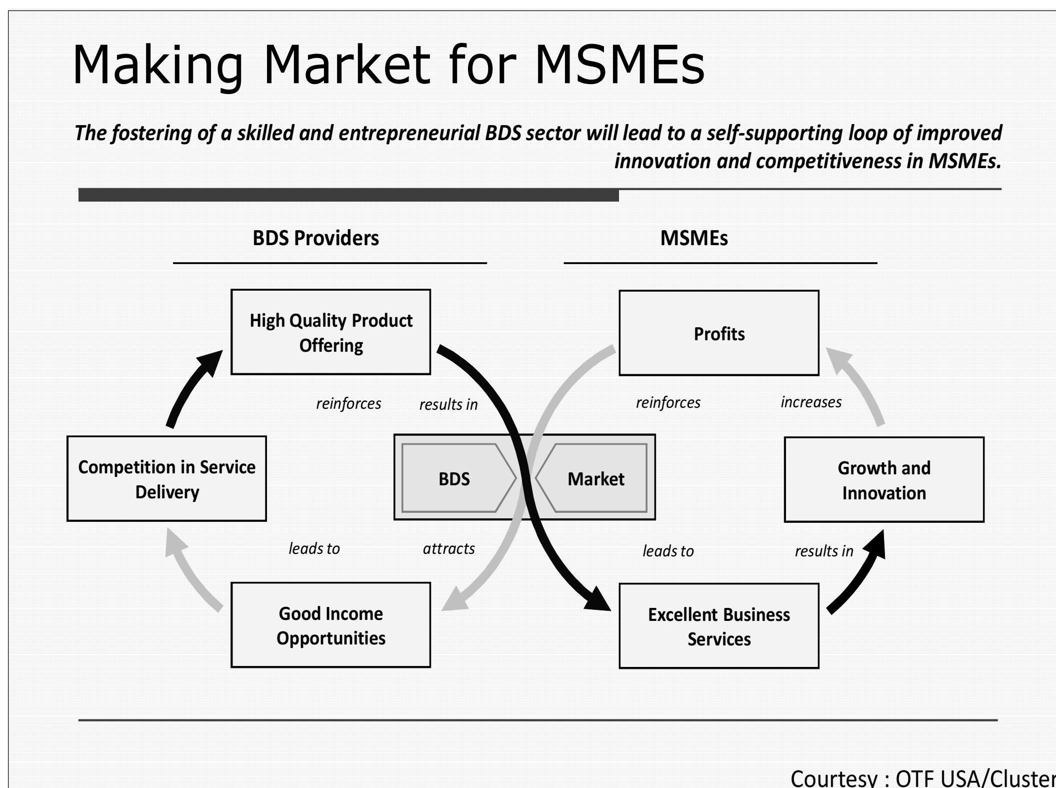
This paper presents the experience of SIDBI in attending to poverty alleviation through enterprise development. It adopted 19 clusters across the country for intensive

intervention. During the process of BDS market development it could realise that it equally benefits the enterprises at the bottom of pyramid.

Business Development services are wide range of services used by entrepreneurs to help them operate efficiently and grow their businesses. It includes training consultancy and advisory services, marketing assistance, information, technology development and transfer, and business link promotion as also financial services. The BDS field focuses on promoting access to and use of these services by MSMEs

Approach

It is known that MSMEs do not involve BDS Providers as (a) they are not sure about their credentials (trust factor) b) the BDS products are not tailor made to suit their need and (c) they are not sure about the returns to such investment. The BDS market development believes in the theory that once BDS are capacitated and are acceptable to market they will kindle appetite of MSMEs and once profitability of service provider and recipient goes up it imbibes functionality. The market attributes get imbibed in form of a self sustaining loop (exhibited below - courtesy OTF USA and Cluster Pulse) which brings in innovation, cooperation and competition.



The BDS project has worked for increasing MSMEs access to improved private and public benefit BDS. To promote market led BDS in the clusters project identified both demand & supply side issues in the select clusters, stimulation/ creation of demand for BDS, strengthening the capabilities of supply side (BDS providers) and facilitating a sustainable demand-supply nexus of BDS providers and MSMEs.

Project focused on demand side issues through awareness creation / sensitisation. On supply side, issues such as capacity building and handholding of BDS providers in the cluster were taken up. For demand - supply nexus or match making (i.e. making market work) innovative instruments such as voucher support (subsidising the initial payout by MSMEs on tapering basis) were supported.

Broadly the project adopted following approach:

- ➢ Sub sectoral approach - instead of standalone clusters, subsectors were chosen for developing niche of Indian enterprises, viz., when leather subsector was chosen it included Kanpur, Chennai and Kolkata.
- ➢ Emphasis on MEs and instilling competitiveness driven by Participative, market driven.
- ➢ Stakeholder ownership- A cluster coordination committee was set up in each cluster which vetted each critical step.
- ➢ Experimenting
  - ➢ Internal Expert and Facilitator Agency (FA),
  - ➢ Piloting (3 clusters) and Scaling up (16 clusters) - simultaneous implementation across clusters with subsectors
  - ➢ Different models and after success replications in other clusters
- ➢ Partnering key players - Foundation for MSME cluster (possessing rich UNIDO experience and expertise) were roped in as an Independent reviewer, M&E and for strategic Inputs
- ➢ Knowledge management- all clusters have websites attached to mother website (msmefdp.net), bringing out useful booklets and wide circulation
- ➢ Synergy with available government schemes for leveraging

The thrust has been on developing technically competent - locally relevant experts, enabling national/ international compliances by MSMEs etc. The themes being attended include new technologies, use of IT, skill development, energy efficiency, marketing, etc. in clusters.

Methodology

SIDBI engaged expert Facilitating Agencies (FAs) to roll-out the project at the select cluster locations.

Mapping of Select Clusters - The FAs carried out the mapping of the cluster/sub-sector and the major players/actors. The FAs then carried out the analysis of various Business Development Services (BDS) available in the cluster using tools such as 'Who does-Who pays matrix' etc. The FAs then prioritised the critical areas of intervention and accordingly developed an action framework (Action Plan which was kept dynamic), which identified the activities/programmes that were be pursued along with rationale for the proposed line of activities. This framework specified areas for intervention in alignment with timelines, the likely target group, the number of beneficiaries, the likely multiplier effect and the sustainability of the intervention over a period of time.

Development of a Prioritised Action Plan - The FAs developed detailed Action Plans for respective cluster(s) giving overall direction to the component. The FAs also defined long-term and short-term goals and provided operational and financial benchmarks.

Focus on International Best Practices - Designing the interventions was, from the beginning, focused on bringing in international best practices and approaches in development of BDS markets. Learning's from successful cluster/sub-sector level programmes in India and from other emerging economies was factored in the plans. Successful instruments tried out at other locations were tailored to fit local conditions and drawn up keeping in view the needs and aspirations of local industry.

Exit Strategy - The thrust of project has been to ensure that it walks with the stakeholders of the clusters (both BDS and MSMEs) so that they emerge as natural facilitators, after exit of the project. The identified exit vehicles were strengthened through various capacity building support tools.

Monitoring - It adopted a comprehensive methodology which included baseline and impact evaluation of indicators aimed at strengthening the supply side, i.e., BDS. Tracking the growth of BDS providers (in terms of widening of client base and product offerings thus indicating acceptability by MSEs) , their profitability (indicating sustainability) and their ability to take the same forward on their own (demonstrating that market works)

Implementation

The project adopted subsectors (and clusters therein) which included:

Sub Sectors	Cluster Locations
Pharmaceuticals	Indore, Dehradun, Hyderabad
Knitted Apparel	Tirupur, Ludhiana
Engineering	Coimbatore, Rourkela, Rajkot, Mohali-Panchkula-Chandigarh
Dyes and chemicals	Ahmedabad
Fruits and Vegetables processing	Pune , Ganjam - Gajapati (Orissa)
Leather	Kanpur, Kolkata - Shantineketan, Chennai
Floor Coverings	Alapuzha, Bhadohi, Panipat,

Besides strengthening internal value chain in adopted clusters, the Dyes and Chemical subsector was chosen to strengthen the external value chain (Chemicals and Dyes are consumed by leather, floor coverings, Knitted Apparel, etc.). In addition to the above clusters, the project also implemented short-term projects in Morbi, Ludhiana, Guwahati and Jamnagar.

Achievements

Project has given new dimensions to cluster development by acting as market enabler. In three years of implementation MSMEFDP project has overall outreach of about 40000 stakeholders which included extending financial and non financial offerings. Under Business Development Services (BDS) interventions in 19 clusters it had outreach of around 25,000 plus stakeholders. It has, through seven FAs, developed sustainable and locally relevant experts (450 BDS - both individual/ Institutional), enabled national/international compliances by over 1950 MSMEs in clusters (achieved through 1100 activities-cumulatively from 2007), over 1,500 transactions (with/without voucher support), enabling Credit linkages, etc. While project hand holded the initial transactions between MSME and BDS through Voucher support, almost 700 plus transactions have happened on their own indicating market functionality.

BDS Project Snapshot	
SIDBI clusters	19
Facilitating Agencies involved	7
Awareness programme conducted	>1100
Participation	>25000
Women Participation	>2200
Firms benefited through voucher support	>700
BDS providers introduced	>450

The BDS providers brought in, were in areas like energy, technology, Finance, marketing etc. Among various types of Strategic BDS, the highest usage reported is for Quality related Technical Services (60% of the MSMEs). The other popular services offered by external BDS providers, used by MSMEs are for obtaining Market Information (32%) and for Marketing of their products (29%). Industry Associations (IAs) being integral part of the programme, are being handheld to emerge as natural facilitators after Project exit. The support has enabled 49 IAs to cater to members with revenue models such as accessing finance, move ahead to float Public Private Partnerships (PPPs - to pilot nearly 22 such initiatives), leverage common procurement / marketing etc. The project has through Learn-shops and regular interactions, strengthened the capacity of the 7 FAs (through cross learning forums nurturing over 100 experts) who are ready to take forward the initiative.

Best Practices

The Project has successfully tried and replicated various innovative tools / model

for BDS delivery, viz. Voucher support (subsidising by the project towards initial payout by MSMEs to BDS on tapering down basis through a tripartite arrangement between BDS, MSME and FA where FAs role has been to oversee successful transaction completion), BDS clinic (an one point solution and matchmaking platform bringing MSMEs/BDS together), BDS on Wheels (a vehicle carrying BDS to cater to MSMEs service requirements at the place of MSMEs), BDS Panel (created panel of > 350 empanelled BDS who have successfully rendered services to MSMEs thus giving the needed trust), Nineteen virtual BDS (each cluster has a website which have acted as knowledge repository), BDS consortia (pooling BDS of different specialisation under one umbrella to offer advantages of collaboration), etc.

On Policy side, project has, for the first time in India launched, the Advocacy Challenge Fund for Enterprise development under which support has been extended for MSME Solution Centre (a facilitation point for BDS and MSMEs which facilitated matchmaking for over 60 transactions in six months), Green Dhabha (enabling 60 plus road side eateries to go for green agenda), MSME Confidence Index (periodical perception assessment of MSMEs) and so on. Towards Institutionalisation of the initiatives, project has supported/established various models/institutions such as msmementor.in (A national level database of BDS provider providing a pool of over 12000 professionals enabling matchmaking at national level), Micro Enterprises Business Information Counselors (MEBIC) in underserved region (More than 1200 prospective micro entrepreneurs have been provided counseling services in North East), Modified Rural Industrialisation programme (piloted in Rajasthan and Orissa with thrust on local BDS for local enterprises).

Learning's from Thematic Approach

In order to present the gains and learning's from MF/ME perspective, we enlist few of the key thematic aspects which are discussed below:-

1. Local Economic Development

In India over 20% of total workforce engaged in the unorganised sector, comprises women (source: National Sample Survey Report 1999-2000), earning well under $1 a day and only 7% of MSMEs are owned by women (source-4th All India Census of MSMEs).

MSMEFDP while aiming at achieving economic development and employment generation, recognised the importance of addressing the issues of 'gender' and 'social inclusion'. In a Local Economic cluster at Kanpur, Uttar Pradesh, which comprises largely of women, about 900 hunter artisan families make leather whips, an accessory of Saddlery products. These women had faced exclusion in the value chain and earned miniscule amount as remuneration due to limited options available to them. The Project

therefore, focused on three cross cutting issues, i.e., 'diversification of the product', establishing 'market linkages' and 'developing the skills of these women'.

Thereafter, the women were imparted training on skills of beading, weaving, surface making and related techniques. A mini loom was designed specifically for the purpose of surface making for smooth operation by women. Those managing the production thereafter realised that the haphazard cutting techniques of the larger units were resulting in materials which were less suitable for the artisans. The project then, with help of IAs, induced their members to look within the cutting techniques and share usable materials on regular basis with the artisan groups.

The Project then started showcasing the diverse and improved quality products of these artisans at various local/national trade fairs/exhibitions. Through feedback at such fora, the Project realised that there was a need to further diversify the products and started the move from woven and stitched bags, cushions etc. to smaller products like office stationery sets, wallets, key purses, etc. From originally just 1, around 32 new products were developed including bags, mats, cushions, etc.

Some of the visible benefits so far have been:

- the Project has reached out to over 1000 women.
- their income levels have increased from around Rs 10 to 15 per day to Rs 100- 125 per day.
- orders of more than 1400 bags worth Rs 2.5 lakh of various designs have been generated in around 8 – 10 different exhibitions;
- 76 women have received Artisan Cards which provide them a gateway for accessing various State-funded benefits, including major discounts on health insurance schemes as well as access to credit at preferential rates.
- The state government has rolled out similar training program in its own training centers across the State.

Today, the unorganised women (or say families) have turned 'leather waste to market taste' and emerged as an important pillar of inclusive growth in the local economic development.

2. Skill Development

Skill development is the foremost challenge of MEs. The project realised the need to focus on bottom up approach thereby directly benefitting poor. An example is the Training with active involvement of local body. Ludhiana knitwear cluster is highly labour-intensive. The industry faces challenges of availability of labour. The Project strategised to mobilise women labour from the nearby villages, do their skill up-gradation and link them to the needy units. For addressing social aspects, a reliable intermediary was roped in. Accordingly, the female trainees were selected by the Sar-Panch (Head) of the village Panchayat (elected body) and the training arrangement was done in a reliable local NGO. The machinery was organised by the local association

- Knitwear Club. The first batch of 50 persons trained were absorbed by the SMEs. The confidence created in this process led to the emergence of two village level female trainee coordinators (BDS Providers - BDSPs), who mobilise trainees after taking the Sar-Panch into confidence, with trainings now being given in the factory premises of SMEs themselves. Over 270 women have been trained and placed in the firms with project support.

In Ganjam and Gajapati district housing Cashew (120 processing units exist with a turnover of Rs. 160 crore and giving direct employment to around 12,000 people) the cluster was found highly lacking behind in terms of skilled manpower. Also there were no strategic BDSPs present in the cluster. To address the issue, project in association with ITI Berhampur and local IA, started a unique course. The course Certificate course was first of its kind in the country. This course aims at skill development as well as employment generation. First the association persons trained the Trainers from ITI. The course got recognised later from state government. The project is now facilitating the emergence of barefoot BDSPs and skilled manpower who will serve the cluster.

Learnings - Skill development (whether instilling new skills or reskilling) is an important agenda which can be sustainably furthered through BDSPs.

3. Technological Change

Issues related to technological change surfaces regularly as challenge for MSEs. It impacts their success or failure. Led by the FAs (only to be picked up by the stakeholders later) few such interventions proved their economic sense. The various models of technological changes witnessed include exposure to improved technology in benchmark cluster (Ganjam) and introduction through private service provider (Kanpur and Alapuzha), etc.

As an example, we present below the before and after scene in Alapuzha Coir Cluster (which has predominance of unorganised coir MEs):

i. *Spinning sheds without electricity:* Sheds were required in spinning area as Kerala gets a lot of rains. While a Special Purpose Vehicle (SPV) under government support scheme had provided subsidised sheds and motorised spinning ratts to women SHGs but many of them did not have electric connection to run motorised spinning ratt. Due to this reason many of them were sitting idle.

   After survey of these SHGs project team brought in project empanelled BDSPs and provided hand holding/ training to them. These BDSPs were linked to the few women SHGs which resulted into electrification of spinning sheds. As a pilot project, BDSPs worked with Kerala State Electricity Board to get electricity to sheds. As a result, 7 SHGs (with 20 women in each SHG) totaling

to 140 women started earning Rs. 90-100 a day. Later all sheds then got electricity through the BDSPs .

Learning: It indicates how useful it can be to rope in BDSPs for strategic supports particularly in MEs.

ii. Lack of technology in coir spinning sector: Coir spinning was identified as an under developed component of the value chain (during diagnostic study) where a public sector BDSP was trying to develop appropriate technology from sometime. Spinning sector is one of the most important sector with 98% women workforce and lots of drudgery during work. Women workers had to walk to & fro 10-12 km a day to spin the coir yarn and income was also low - Rs. 80-90 per day. It required 2 women to make the rope with motorised spinning ratt which was actually a poor technology in coir spinning.

Project brought in two private BDSPs. 1st one had done R&D on basic technology and design of the spinning machine by which project got success to develop a Version 1 spinning machine. 2nd was introduced as an embedded BDSP (Manufacturer + Training + repair). The technology of Version 1 was transferred to the embedded BDSP, who made a commercial version of spinning machine which created income increment for women spinners by Rs.70-90/ day. The project also facilitated the introduction of private BDSPs in R & D.

Learning: Technological information/transfer are crucial and here Private sector BDSPs can play an important role.

iii. *Low productivity in handloom weaving sector:* Coir industry was using weaving handlooms with old technology. As a result, coir weavers were not getting sufficient wages and exporters were not getting good quality products. Coir weavers were moving to other sectors of economy like construction sector leading to a labour shortage in coir sector.

Project brought a Lean manufacturing practitioner for suggestions and training on handloom up-gradation of available carpenters who use to make/ repair looms for coir weavers. Project reformed them into BDSPs (out of carpenters) which brought increment of Rs. 80-100/day for weavers and income generation for Loom BDSPs as also improvement in quality.

Project provided technological intervention in MEs where it was needed most for instilling competitiveness. It created a breed of handloom BDSPs which will be available for long in cluster and created a service which is commercial and will motivate them to provide service. Also coir weavers can see an instant and direct change in quality, smoothness in working and increase in daily income which helped to generate and sustain demand. Learning: Small technology interventions can bring about good impact in income.

iv. *Lack of IT usage and management skills in coir co-op societies* - Coir co-op societies, a 500-600 micro spinners and weavers society, were supported by many financial schemes by state Government but need for "Skill Development" was felt. Average number of individual producers as a member in co-op society is 120 to 130 and total registered societies were 59. Under a govt. scheme/subsidy, majority of co-op societies were having computers but only 1 or 2 had a skill to operate it.

Project brought in a BDSP for conduction of practical Information Technology(IT) trainings "IT Gyaanam Yagnam" of 32 - coir co-op societies for 21 days each . By this effort project made them IT enabled and competitive. All members of these co op societies were MEs. After the successful "IT Gyaanam Yagnam" project, project initiated the "Management Gyaanam Mantra" - 7 days practical training on management subject in combined language (English + Malayalam) for coir co-op societies. Training module had Human Resources/ Organisation/ Marketing/ Business orientation/ Decision making as subjects. 26 coir co-op participated.

Impact - 20 societies have purchased new computer and internet connection after this training program. Other 10 societies have hired IT staff and started using their computers. Due to higher enquiries & orders, they increased their production capacity by 20%, Time / Manpower / Paper Saving led to income increase in the range of 7% to 10%, Basic understanding of the management led to organising of business activities in a better manner, Some of the societies reported increase in turnover worth Rs.80 lakh.

Learning: MEs can, after learning IT & management skills (if given for a longer time period & in local language with close handholding support), record faster growth parameters.

How Market Worked in Alapuzha Coir Cluster

The micro enterprise domain in the cluster comprised of 59 coir co-operative society (with average membership of 300 members) having 17700 coir handloom weavers and about 40,000 coir yarn spinners. 95% of the weavers are women. The project reached out to 55 coir co-operative societies (touched directly through – Seminar/ Training/ Awareness programmes/ BDS linkages/ Voucher support) and it touched more than 20,000 indirect beneficiaries. During the course of implementation the number of BDS involved/ strengthened (which benefitted MEs) were in themes such as Financial linkages (01), Design and quality improvement (03), Market promotion (04), Industry academia linkage (02), Technological change (09), Skill development (02), Industry Associations (3). These had significant impact on MEs in terms of change in their livelihood patterns - income, turnover, access to different services which is very crucial for harnessing their inherent potentials. The cluster level website of project www.alappuzhabds.com acted as virtual BDS and recorded hits of around 28700 In terms of Best Practices, in Alapuzha 12 BDS clinic, 2 BDS Bazaar, 12 visits through BDS on Wheels, promoting one BDS consortia were promoted. 56 BDS Linkages were facilitated through voucher support and thereafter 74 BDS Linkages without voucher support were tracked. This indicates that once MSMEs understand the strength and value of a particular service they go for it on their own.

4. *Market Promotion*

Market related challenges are crucial for MSEs. In Kanpur, it varied across value chain and for the unorganised units, the challenge was to create a new foothold with meaningful learning. Project support (as shown above) led to their permanent increase in earnings. The Kanpur artisans are now looking forward to create a common sourcing-cum-servicing point such that they can do their part of the job along with their household work.

Similarly in Kolkata, the challenge for the micro shoe making units was the need to have arrangement of appropriate raw material sourcing, technology and market promotion. In Shantiniketan leather goods cluster, majority are small artisan based entities with low turnover (Rs. 2 - 2.5 Lakh). Production was tuned to cater largely to the local market and no marketing initiatives (apart from participation in few trade fairs) were in practice. The Project, through BDS, supported for documentation for brand building. Through creation of common brochure and doing appropriate visual merchandising/ banner display, it attracted a large number of visitors in the India Pavilion. Now these units have achieved a sale figure of Rs. 6,57,696 with orders received worth Rs. 7,69,000. They are witnessing better price realisation because of better quality and design. The market perception reflects a movement away from "Token" to "Utility Goods". The cluster has received Geographical Indication (G.I), obtained logo for Trade Mark Registration, developed Certification Mark and so on.

To address the challenges of marketing in the Kewda sub sector, project facilitated submission of application for GI of Kewda flower and Kewda Rooh under Intellectual property right. As Kewda in unique in nature and 90% of the global production comes from the district of Ganjam, the rights of the growers and distillers need to be protected. This GI will help to protect their right and this will create opportunity in international market to market the Kewda products.

In Alapuzha, poor market access opportunities for micro enterprises was a difficult task. The following interventions helped generate Rs. 41 lakh sales in 1 year for MEs:

a. *Workshop on export for co-op societies:* During work shop presentation made on Art and science of export, complete workshop was in Malyalam and BDS provider was connected to ME for daily handholding.

b. *IITF - 2010 for societies :* Another challenge was EXPOSURE of MEs to real markets. The project led a delegation of coir co-op societies to IITF -2010 n Delhi and facilitated sale of goods worth Rs. 2.25 lakh. Though the sales amount was not much, but the entire process of marketing cycle was very well understood by these MEs and they started their own marketing initiatives locally in Kerala & South India.

c. B*DS VAN:* New concept to go into market with mobile van taking samples and BDSP for handholding & teaching sales talk & techniques. This boosted their confidence.

d. *Worlds Longest Coir Mat:* In order to accord visibility to coir project helped in facilitating the making of longest doormat in the world. The mat has been accepted into the World Record Academy run by Guinness Book of Records. It has raised the brand of value of handloom and natural coir products against machine-made, artificial fiber alternatives.

Learning: Multiple approaches required to take MEs to markets. It can be in form of linking of Local MEs to Local market, Local MEs to national and even global market. Close handholding required in the process from end to end.

5. Social Capital

In Shantiniketan Artisanal cluster of Leather products, lack of knowledge on areas like Organisational Management, Fund raising, financial management and other relevant areas to run the Industry association (IA) effectively was badly affecting their cooperative leveraging capacity. Project organised the IAs capacity building programme and provided computer support to enhance their functioning. They were sensitised on above referred areas so as to run the association effectively. Now Amarkutir- the IA has started functioning as a raw material bank on a pilot basis. A consortium has been formed within the cluster for raw material sourcing directly from Chennai. Samples has been already been procured on a trial basis by the consortia. The association is on its path to create difference.

In Ganjam-Gajapati (Cashew and Kewra cluster) steps towards instilling financial discipline such as encouraging employees to opt for Provident Fund policies, taking safety measures, maintaining books of accounts enabled micro MSMEs to be part of inclusive growth.

6. Access to Finance

Under GIZ portion of MSMEFDP an innovative financial product and delivery model for the upstream apparel supply chain has been worked out in association with Satin Creditcare Network Ltd. (SENL) - a Microfinance Institution(MFI). SIDBI had sanctioned a line of credit to Satin Creditcare Network Ltd. for onward lending to the MSEs in this apparel supply chain.

There are a large number of MSEs in the unorganised sector at various industrial centres who are engaged in activities relating to readymade garments such as fabrication, embroidery, etc. While they have necessary experience and expertise in their line of activity and many of them have been operating from this area for the last 10 to 20 years but they do not have necessary financial resources to manufacture and market their production. Hence they were not able to access credit. The owners/ promoters of these enterprises were not in a position to provide the comfort of collateral security to the banks. Their credit requirements range from Rs. 1.00 lakh to Rs. 5.00

lakh (small ticket), depending upon their volume of operations.

SENL operates in Delhi and nearby areas since 1990. The ticket size of the loans granted by SENL was very small - around Rs. 10,000 - to 15,000. After a series of discussions with key functionaries of SENL they were persuaded to take a limited risk on at least a small select group of MEs engaged in fabrication and embroidery of garments in Govindpuri, Tuglakabad Enclave and Sangam Vihar areas. They were helped:

(a) To design and develop a special credit scheme with the following features:
   1. Loan ticket size in the range of Rs. 50,000 to Rs. 200,000;
   2. Loan to be available for investment in machinery or for work capital needs;
   3. Repayment period up-to 2 years;
   4. Repayment in fortnightly/monthly installments instead of daily installments depending upon cash flow of the borrower;
   5. No collateral security;

(b) In human resources development for appraising and risk assessment of credit to MEs.

(c) Interactive sessions were held with apparel supply chain MEs to understand their needs followed by sensitisation workshops to motivate them to borrow from SENL. They were given an orientation course in accounting, finance, quality improvement and marketing in the evenings after their working hours.

Results: The results of pilot intervention (started in the latter half of 2008) are as under:

1. SENL granted loans to 60 MEs . Each ME, on an average, employed 40 workers and therefore this intervention impacted the lives of around 2,400 families and around 12,000 people (assuming that each family has 5 members) at pilot stage;
2. The enterprises financed under the scheme have shown much better financial discipline and have been repaying installments in time with no default.

Learning's - The concept/scheme has shown replication traits. Efforts to replicate these are being done under discussions with lead MFIs and their networks.

7. Design and Quality improvement

In Shantiniketan stereo type designs were in use for decades. There had been hardly any innovation in terms of design apart from the design intervention under Cluster Development Programme of MSME-DI and UNIDO. Several interventions had been undertaken in past but the process needed impetus towards its institutionalisation and for imbibing sustainability traits in the long run. By strengthening existing BDS and introducing new ones, 106 new designs (surface and patterns) and 12 mock ups

designs were introduced through design workshop with a high response from the buyers. Training of Trainers (ToT) on design was conducted with emphasis on grooming them on design to ensure sustainable design innovation.

Learning's- The MEs are feeling capacitated and their appetite to grow has been kindled.

Conclusion

SIDBI has been attending to clusters through its promotion, financing and Development mandate. The unique cluster programme implemented by it in 19 clusters aimed at soft infrastructure development . It has established that by fostering a pool of sustainable & technically competent - locally relevant experts functionality can be instilled in market. This leads to 'Making Markets for MSMEs' thus benefitting the domain as a whole. The thematic examples stated above indicate that strengthening the supply side, i.e. BDS market, brings in more cooperation, competitiveness (leading to market corrections) and offers value for money . It brings in enabling eco system which instills sustainability and offers Win Win situation for BDSPs and MSMEs. The model depicts replicability traits and should work for Microfinance and ME domain. By adopting cluster centric strategy and fostering market for BDS, new dimensions to micro enterprise development can be realised.

Summaries of Studies Conducted by the Centre for Microfinance Research (April 2011 - December 2011)

During the period April 2011 to December 2011 the Main Centre of CMR and its four Sub-Centres have brought out 6 study reports. The major findings of these studies are as follows :

1. Rural Indebtedness and Practices of mFIs in AP

(Tapas Kumar Sarangi, CMR Main Centre, Lucknow)

Andhra Pradesh has around 49,49,393 number of mFI clients with a loan outstanding of Rs. 3,56,528 lakhs which is highest as compared to other states in India. Andhra Pradesh is one of the leading states in terms of SHG and mFI growth, with the largest number mFIs based in the state. There have been concerns that this rapid growth has caused intense competition amongst mFIs competing for both clients and staff. Clients with multiple-borrowings from various sources are in some cases over-indebted. Many microfinance commercial organisations have entered the Rural Credit Market in search of profit and are competing to lend to the poor. In the process of giving loan to the poor the mFIs started chasing targets and numbers.

The objective of the study was to find out the share of different sources of finance in rural areas of Andhra Pradesh. Identifying the gaps, issues and challenges faced by the rural households to manage their indebtedness situation is another objective of the study. Further the study aims at understanding the critical issues of multiple borrowing and the collection practices followed by the mFIs in the state of Andhra Pradesh.

The study was conducted in the three tribal districts of Andhra Pradesh, i.e., Khammam, Mahabubnagar and Warangal. These districts have been selected due to the high penetration of microfinance there as well as the reported incidents of unhealthy competitive practices by mFIs in the districts.

The key findings from the survey and analysis are as follows:

- It is estimated from the survey data that on an average more than 80% of rural households in studied villages in Andhra Pradesh are indebted and all occupational categories are more or less equally indebted in percentage terms.

- Across the occupational categories in case of landless labourers and marginal farmers the indebtedness level is almost 90%.

- The amount of indebtedness was highest in Warangal district. The Large farm households are also heavily indebted to different sources.

- The share of moneylenders is maximum (44.1%) followed by friends & relatives to the total informal loan borrowed by the rural households.

- Out of the total loan outstanding around 44% of the loan outstanding is under the informal sources, followed by 23.1% from the SHGs, 21.6 percent from the formal sources and 11.4% from the mFIs.

- Multiple borrowing is very high in all the studied villages of Andhra Pradesh. It has been found from the survey that an average of four loans has been borrowed per household at overall level in Andhra Pradesh. Mahabubnagar has topped with 4.6, followed by Warangal (4.5) and Khammam (3.9).

2. Study on Joint Liability Group in Bihar - Problems and Prospects

(B L Mishra and Dr. Manesh Chowbey, Chandragupt Institute of Management, Patna)

NABARD had introduced the concept of Joint Liability Group in 2006-07 to help clients like tenant farmers, share cropper, oral lessees, etc., through formal banking channels/mFIs as they had no access to credit due to lack of acceptable collateral. In Bihar, the JLG scheme was operationalised through 4 RRBs. Except Canara Bank, no other Commercial bank participated in the implementation of the scheme. The entire co-operative credit structure remained aloof from implementation of the scheme due to their organizational and financial weaknesses. About 13,200 JLGs had been financed by the RRBs till 31 March 2010. Some of the mFIs also started participating in the implementation of the scheme and financed 1,11,692 JLGs as on 31 March 2010. Owing to overwhelming presence of tenant farmers, Bihar was one of the most fertile places for implementation of this scheme. Although the scheme was implemented in all the districts of Bihar the coverage was not proportional in qualitative as well as quantitative terms. Therefore, it was pertinent to launch a study on the subject "Joint Liability Group - Problems and Prospects".

Objectives of the Study

- The objectives of the study was to examine the extent of coverage of JLGs, important issues and problems in formation and financing JLGs, impact of JLG financing, agencies/intermediaries involved, reasons for success of JLGs

in other parts of country and in the study areas and thereafter offer suitable suggestions/recommendations.

JLGs financed by Samastipur and Madhya Bihar Gramin Bank in Samastipur, Gaya and Nalanda districts have been covered during the study.

Major Findings:

The study revealed that pro-active support of the State Government, lack of focused attention at Banks' level, lack of awareness about JLGs among stakeholders; lack of credible intermediaries, lack of group dynamics, absence of specific budget to branches by their controlling office acting as deterrent, lack of monitoring/review in BLBC/DLCC/SLBC/banks' meetings, were main hurdles in up scaling of the scheme.

Recommendations

The State Government may utilise the services of its Co-operative Department and specially the Short-Term Co-operative Credit Structure and together they can participate in the programme. The short term cooperative credit structure has 8,463 Primary Agricultural Credit Societies (PACs) through which the programme may be launched for massive up scaling. Besides Milk Producer Co-operative Society (6,200 in number in state) may form JLGs of their members and can obtain loan for dairy cattle from CBs/RRBs/Co-operative with marketing tie-up arrangement with milk federation. In order to upscale programme, massive capacity building programme was required to train the government staff.

The banks may take the help of intermediaries as suggested by NABARD for awareness creation, right selection of members, formation of groups, their nurturing, capacity building, recovery etc. Suitable intermediaries in Bihar may be Farmer Clubs, Business Correspondents, Basudha Kendra, PACs, Milk producer Co-operative Society, retired bank officials, retired teachers in addition to the list of agencies mentioned in NABARD circular. They may also appoint above agencies as their Business correspondent.

Awareness programme may be organised to inculcate the concept of joint liability, peer selection, peer screening, peer pressure and selection of leader by rotation, etc. Concept of regular meeting at least at monthly interval may be introduced in JLG financing. The bankers concerned should also occasionally meet the groups in such meetings to maintain close proximity and have regular feedback.

Loan amount should be determined according to the purpose and requirement of the individual member or group (if group activity). The RBI has fixed the loan amount limit per borrower at Rs. 50,000.

All banks may adopt the programme in their corporate plan and branch plan. Bank staff may be suitably trained so that they understand the business opportunity available under JLG programme. Banker's active role was required for awareness creation, capacity building, financing of JLGs, involvement of intermediaries, ensuring suitable allocation in Branch plan, regular review of implementation, making available guidelines and documents to branches. Banks may also activate their LDM for ensuring planning in DCP and regular review in BLBC/DLCC, SLBC, etc. Pro active review of the scheme at various forum by controlling office of banks would help in up scaling the programme.

As per RBI's instructions banks have opened 'no frill accounts' in large number in rural areas to give boost to financial inclusion but only opening of account is no remedy. In order to ensure effective financial inclusion mobilisation of such account holders under JLG fold may be explored by banks. Given staff constraints the banks may utilise the services of credible intermediaries as business correspondents for the purpose.

Banks should also ensure strong monitoring mechanism to avoid any slippage in the programmeme.

3. SHG Bank Linkages in North West India : Experiences and Challenges in Financial Access and Poverty Alleviation

(Dr. Surjit Singh, Institute of Development Studies, Jaipur)

The microfinance movement through SHG has been also considered as an effective development tool to enabling SHG members to graduate to microenterprises and in turn, to tackle poverty. Against this theoretical backup, the present study assesses the performance of SBLP and its impact on poverty.

The study reviews the performance of SHGs on various issues including theirs saving and credit mobilisation, linkage with banks, leadership issues, monitoring processes, book keepings and group training; and perspective of micro-enterprise development. In the process the study looks at who are the women who join SHGs, factors for joining the groups, economic background of these women, asset structure of the households they belong to, educational background of members, their occupational structure, income sources of their households, SHG participation in terms of meetings, attendance, saving and inter-loaning behaviour, sources, purpose and usage of loans, type of IGAs involvement, repeat loans, contribution of SHGs in households and impact on households especially on poverty. What could be the higher levels of undertaking of micro enterprises or livelihood activities? The study was conducted by drawing samples from four states including Gujarat, Rajasthan, Himachal Pradesh and Madhya Pradesh. It covers 1000 member households with 250 from each state and five members from each SHG.

Some of the findings that emerge from the study are given below:

A. *Composition and Functioning of the Group*

- The bulk of the SHGs, i.e., around 74.5% of the SHGs are at least 5 years old. On an average, the average size of the group was 14.5 and around 75% SHGs had more than 10 members.
- Distribution of SHGs by caste composition indicates that 59% of the group had members from the same community and the remaining 41% groups had members from different castes.
- A mixed caste structure in the SHG was prominent in Himachal Pradesh (60% groups) followed by Rajasthan, Madhya Pradesh and Gujarat. In other words, except Himachal Pradesh, relatively higher percent of SHGs in other states are having members from the same caste.
- It seems caste play an important role in defining group's homogeneity.
- Distribution of SHGs by economic status of members reveals that 18% of the sample SHGs had no members from PBL category. Apparently, about 31.5 percent of such SHGs have the bulk of their membership drawn from non-poor families. Of the total members in our sample SHGs across states, only 40 percent were BPL. This indicates that microfinance is concentrating more on APL families.
- There is no evidence of election for leaders in any these SHG in our sample states. In about 88% of SHGs, leaders were nominated by SHG members themselves. Only in 12 cases, either SHPI or NGO/Bank staffs nominated the group leaders.
- Of the total sample SHGs, 88% of them had written rules and regulation and only 57% of the groups had revealed updating their rules and regulation.
- It is observed that groups having written rules and regulation are more prone to update compared to groups having oral rules and regulations.
- The practice of monthly meeting (86.5% groups) was quite common across the SHGs in all the sample states and about 77% groups reported of conducting meeting regularly. However, only about in 60.5% SHGs, more than 75% of members were attending group meeting regularly.
- It is observed that in 52.5 % groups, the book of accounts and individual passbooks are maintained by insider, i.e., group representative (49.5%) and literate members (3%), whereas for the remaining group it was maintained by the outsiders consisting of representative of SHPI/NGO/Government agencies and/or person employed by the SHG.
- It was found that that 68% of SHGs had regular, accurate and update financial accounts (saving register, loan register, bank accounts, and individual passbook).
- The level of maintenance of book of accounts and individual passbook is noticed regular, accurate & updates to a significant extent when these records are being managed by the outsider (including representative of SHPI/NGO/Govt.

agency, any person employed by the SHG and Member/Leader's relative) compared to insider including group representative and a literate member.

- Based on the 13 indicators (as mentioned above), of the 200 SHGs, 27% of the groups are found to be strong and stable. A majority of the groups (62.5%) are found to be moderately stable. 10.5% groups are found to be poor.

B. Savings Behaviour

- It was observed that more than 75% of members contribute regularly savings in case of 77.5% SHGs and in most of the cases they deposit in the group meeting.
- Evidently, 56.5% SHGs had revised compulsory saving per member since their formation. The average number of times revised compulsory savings was 0.95 times.
- The distribution of internal funds reveals that overall 45.5% SHGs had more than Rs. 50,000 internal funds, for another 28% SHGs this was within the range of Rs. 25,000-50,000. Only 26.5% SHGs had the internal funds up to Rs. 25,000.
- In the case of Rajasthan, around 82% of SHGs had more than Rs.50000 internal funds. For other states, this figure was between 32 and 36%.
- The average amount of loanable funds (savings plus interest and other income) per SHG varies between Rs.44,659 and Rs. 128,012 across the states with an average figure of Rs. 66,570. Similarly, the average saving as percent to average loanable funds varies between 62.04% and 88.97% across the sample states. Other things remaining the same, the ratio between savings and interest and other income is highest in Rajasthan, while the same is lowest in Madhya Pradesh. It implies that SHGs from the former states, on an average generate more amounts of loanable funds through interest and other sources of income compared to other sample states.
- It was observed that whenever the amount of internal funds (i.e. total funds in the group) of the SHG has risen, the compulsory savings as% to internal funds of the group has declined. This implies that as the amount of internal funds increases, the frequency as well as amount of internal lending too increases.

C. Bank Linkages and Internal Lending

- It is observed that repeat loan to a SHG is hardly seen. Even, most of the well functioning groups have not obtained loan for more than once.
- The average number of times raised loan from Bank/mFI per SHG since starting the group stands at 2.11. SHGs from Himachal Pradesh have obtained relatively

higher number of times loan from Bank/mFI against SHGs from other states. This figure was lowest in case of Rajasthan.

- The average amount of loan obtained each time by a SHG stands at Rs. 69,976. This figure was the lowest in Madhya Pradesh (Rs. 22,229).
- The amount of loan obtained each time by a SHG move in an opposite direction with respect to its extent of stability. For instance, the average amount of loan obtained each time by A (strong and stable) category groups was the highest (Rs. 73,631) followed by B (Moderately stable) category groups (Rs. 73,153) and C (Week) category groups (Rs. 26,933).
- However, the average times of raised loan by A, B and C category groups stand at 1.91, 2.30 and 1.43 times respectively. It is likely more percent of A category groups may not be asking for loan to banks as they have enough funds (saving + interest income). Because of this, the average number of times loan raised is less in A category groups compared to B category groups. But, for C category group bankers may be rationing loan. Thus, for A category group we can say that there is demand constraint (less demand for loan) and for C category SHGs there is supply constraints (even if they ask for loan).
- Only in few cases, where either the group representative is having some connection with bankers or through the SHPI, the group have obtained loan more than one time. We are said that most of the groups tried for second loan but they are denied by bankers by saying no such scheme to extend credit to SHG at present except through SGSY scheme.
- Few well functioning SHGs from Rajasthan, Himachal Pradesh and Madhya Pradesh even reported that in spite of visiting banks for several times with detailed loan documents and other records, their cases are still pending. Because of this, almost all the SHGs have started generating greater amount of loanable funds through regular contribution. Out of 200 SHGs, around 20% of them are of the view that they can manage to meet their consumption and short-term credit (to purchase seeds, fertilizer and other farm requirements) needs through internal loan. Around 5% SHGs are even reported that they need no more external funds to meet their loan requirements.
- It is also observed that around 75% SHGs are in a position to provide a loan of amount Rs. 2,000 to its member at any point of time from internal funds.
- As most of the SHGs are not obtaining loan from the bank any more, and since the amount of loan from internal funds was small, it did not provide the opportunity to undertake an activity which would bring the household out of poverty.
- Three major patterns have been observed in inter loaning system. First, disbursing of loan as and when demand made by the member borrower. In such pattern, the group maintains the credit limit depending upon the availability funds and likely demand of loans by other members. Second, disbursing

of loan on circular basis. Here, the group normally fix the loan amount and disburse to member one after another still the circle is over and they decide the loanee by consensus. Third, disbursing equal amount of loan to all members. Here, the group first decide the loan amount depending on the availability of funds and distribute to its members equally. It is observed that because of internal loaning system, the SHG members as well as their household depending on informal credit market has reduced significantly.

D. Repayment pattern

- Most of the groups follow either 5 or 10 equal installments at reducing balance method for the repayment of the loan. Few SHGs have even fixed the repayment period. This kind of repayment pattern was mainly observed in the region where households primarily depending on agriculture or work as agricultural labour.

E. IGAs and Poverty alleviation

- The purpose-wise distribution of loan amounts indicates that the micro-finance programmes give emphasis on either consumption or income generation. However, a good balance between these two is often lacking.
- As the loans provided for income generation were often small, members were unable to undertake viable income generation activities and earn good income.
- These programmes concentrate almost entirely on women. The social conditions come in the way women undertaking non-farm activities in general and income generating activities in particular.
- Lack of skills obstructs women in undertaking non-farm activities. Lack of appropriate training facilities also adversely affects their entrepreneur capacity.
- Most of the villages are small and depend on large villages and towns for marketing their produce and purchase of essentials. The possibility of starting small business, trade and services in such villages are, therefore, limited. As there were few opportunities other than agriculture, members, especially women, found it difficult to formulate viable proposal on non-farm activities.
- There is paucity of funds for undertaking 'credit plus' activities such as training in skills, marketing, etc., as either the formal banks or the funding agencies do not often provide funds for these activities. The funding agencies only provide funds for on-lending to the target group, and their support does not often include capacity building component. As a result, the loan obtained through the SHG can meet mostly either the household consumption need or short-term production activities like financing crop production.

Nevertheless, the survey of members of SHGs reveals that most are happy with SHG movement. Immediate needs for funds are fulfilled though interest rates charged are high, but no one complained. Not all have set up micro-enterprises and milk based activity is more prominent as market channels are developed. Education level of most members is below primary or no education. Main occupations of members include animal husbandry, NREGA, housewife, agricultural wage labour. Income sources of the households are agriculture, dairy, salaried jobs and non-agricultural wage labour. The average annual income is relatively high across states; Rs. 97,398. This means households are not relatively poor.

It appears that poorest of poor are left out from micro-finance movement as is evident from sample households. It is revealed that 59.3% members presently put their households as non-poor.

90% members reported regular meetings of groups, though the lowest proportion is from Madhya Pradesh (81%). A higher percentage of members from Madhya Pradesh and Rajasthan reported meetings happening occasionally. The causes of poor attendance in group meetings include engagement in wage labour and opportunity cost is high of attending the meetings and most members are from Madhya Pradesh. Poor health is another reason.

Savings contribution to group varies from a low of Rs.10 to Rs. 200. 88% members characterise their savings as regular and this percentage varies between 67.2% in Madhya Pradesh and 98% in Gujarat. The main cause of poor savings habit is low income and majority from Madhya Pradesh cited it. Only 4% contribute more than scheduled compulsory savings and most are from Madhya Pradesh (38) and 2 from Rajasthan. Inter- loaning is high. There are cases who have borrowed 15 times. Thus repeat loan is common. Majority of members have obtained loan at 24% followed by 12% and 18%. The main purposes of borrowing are: consumption (26.72%) followed by farm activities (14.59%), medical exigencies (11.32%), house repair (10.74%) and income generating activity (IGA - 9.92%). Members have recurring deposits, fixed deposits and regular savings account. Some also have voluntary deposits with SHG too.

It is found that only 20.3% members have taken loan for income generating activities. This percentage varies between 13.6% in Madhya Pradesh and 26.8% in Himachal Pradesh. Dairy (buffalo rearing) tops the list of IGAs. This activity has daily cash flow which is suitable for poverty reduction if all other factors are provided for like fodder, marketing channels etc. It is found that familiarity with work is the most important reason cited in all states except Madhya Pradesh. It is followed by demand for product/ service exists. The other reasons cited are easy availability of raw material, limited capital required, can manage with household chores, caste based occupation, and loan was given for the particularly activity only. It is the husband who helps in marketing (78 cases) and it is more so in all states except Madhya Pradesh. In 57 cases member herself does the marketing. And son contributes in 25 cases. This reflects on

poor gender empowerment.

Finally, it may be stated that SHG movement financing has reduced dependency on moneylenders, enhanced financial inclusion. Many households have been able to buy durable assets in the past three to four year in terms of TV, washing machine, cows, buffaloes, farm equipment and so on. This means that poverty reduction took place. Besides, the present income is far greater than even the incomes reported in NSSO 59th round on farmers for farmers. The survey also shows that if little better off individuals are provided low interest finance then, greater chances are there for them to come out of poverty situation. However, these households also show that existing asset based is important as most households had land and other assets to rely up on. Repayment is a problem in a sense that money for repayment is taken from other sources and also new loans used to repay the existing loans.

Some SHPIs are forming SHGs only as a project, if they get outside funding and thus there is no symbiotic relation between the promoter and SHGs. Some have adopted federation system to pass on the responsibility to members. It appears that the common member is never consulted. All decided by the promoter as to what is good for poor. Entry points are different for forming SHGs and so is the origin point. For instance in some cases, drought led them to organise poor in groups and in others moneylenders role led them to form groups. It also appears that SHPIs have not built capacities of the poor even where federation system is in place. There are large over heads and thus high transaction costs. This leads to high interest rates. In this situation the processes followed by promoters does not really help in poor getting out of poverty situation. In some cases we have found that loan procedures are also not simple. It moves up and down the line. There is also difference in approaches of large and small promoters. This also means that promoters keep tight hold on groups and do not allow outsiders to interact with members of the groups. In some cases penalty system for default is heavy and does not solve the problem as to why the default occurs.

4. Microfinance and Gender: Social and Economic Empowerment

(Dr. Gagan Bihari Sahu, Institute of Development Studies, Jaipur)

The study attempts to explore the relationship between participation in microfinance programme and the improvement of women's empowerment status. 1000 sample women spread over the five states including Rajasthan, Himachal Pradesh, Orissa, Karnataka and Tamil Nadu. In all, 104 villages were covered to contact 1000 households in five states and 188 SHGs.

The study tries to understand that women's empowerment is about the process in which those who have been denied the ability to make strategic life choices acquire such an ability. Based on the above framework, some of the salient findings that emerge from the analysis are presented below:

A. Family income Vs. own income

Average annual income of the sample households was Rs. 94,260 and SHG member households have much higher income compared to control group, in general and Rajasthan, Himachal Pradesh and Tamil Nadu, in particular. The annual average income of the SHG members' households varies between of Rs. 161,806 (the highest, Himachal Pradesh) and Rs. 41,728 (the lowest, Orissa). Among the control groups women's family, the same varies from a maximum range of Rs.121,914 in Rajasthan to minimum range of Rs. 51,377 in Orissa.

It is observed that, 278 of the 500 member respondents (55.6%) reportedly had their own income while this proportion was lower at 38.2% in case of control group The average annual income of SHG member was higher at Rs. 13,706 compared to Rs. 9,646 for control group women respondents. Results also indicate that a SHG member contributes more towards her family income (7.5%) compared to a non-SHG member (4.3%). This holds true in all the sample states. This shows that not only the extent of contribution of SHG women towards their family income is more but also in terms of number of contributors compared to control group women. This could be possible as relatively higher percentage of SHG women were engaged in petty business/services compared to control group women.

B. Control Over Own Income and Household Resources

One of the important aspects of women's empowerment is whether or not they keep and control the income earned by them. Of the 278 member respondents who had self income, 78.1% of them reported that they keep income earned with them. Across states this proportion varies between a low of 42.5% in Karnataka and a high of 97.6% in Himachal Pradesh. Evidently, of the 191 controls group women who had own income, 67.5% of them reported that they keep the income earned with them. Across states however this figure varies between a low of 44.0% in Orissa and a high of 91.5% in Rajasthan. The next individual who keeps income earned by a woman is her husband.

It is observed that only about 42.4% of SHG women and 32.1% of control group women expressed of having self control over the income they earn. The data shows that self and husband jointly control the money earned by women for about 44% cases in each category of samples. This clearly shows that SHG linked women have relatively greater control over money they earn compared to control group women. On an average, a higher percentage of members expressed significant improvement on their spending on children's education; buying personal items like hair oil, soap, bangles, sarees and other cosmetics; social functions and household consumptions compared to non-members.

As far as control over household assets is concerned, 43.4% members and 29.6% non-members had reported of having full control over it. About 45% cases from each

category samples, we found women's marginal control over household assets. Overall, it is the member having better control over household assets rather than non-members.

C. Control over loan use

The data reveals that for house repairing or building a new house, the maximum proportion of loan is being used (18.9% of total loan raised). The next important purpose where loan was used is farm activities including purchasing of fodder. On an average, 10.2% of the total loan raised by women are used for men's productive activities, while another significant proportion are used for activities where gendered patterns of control are more ambiguous, such as consumption, repayment of old debts, marriages, education etc. Importantly, only 5% of total loan are used for income generating activities directly undertaken by the women themselves. This figure is just 0.1% in case of Rajasthan and Himachal Pradesh. Only in case of Orissa, women use 15.5% of loan raised by themselves on various traditional activities. This clearly indicates that women are being used as a means for accessing loan and a significant proportion of such loans are being used for "family" investment such as housing, repayment of old loans, education, marriages, etc., and for men's productive activities. Thus, it is possible to conclude that SHG members had hardly control over the loan raised by her, which corroborates with other studies.

D. Indebtedness

Overall, 34.6% of SHG members' households had outstanding loan of Rs. 46,466 from sources other than the SHG. The extent of indebtedness among member's household is quite high in case of Karnataka (Rs. 71,084), followed by Rajasthan (Rs. 51,326), Himachal Pradesh (Rs. 39,421), and Tamil Nadu (Rs. 36,691). This indicates that, SHG may be a necessary source of loan for the poor household but it does not meet their credit requirement fully.

E. Undertaking income generating activities (IGA)

Out of 500 SHG women, 94 of them reportedly had undertaken some income generating activities (IGA). However, in 38 out of 94 cases had undertaken IGA before joining the SHG. Nevertheless, 86 reportedly are continuing with the activity at the time of our fieldwork. It was found that only 16 control group women had undertaken some IGAs.

It is observed that income- generating activities really do not add much to the family income; engagement is more of use of spare time these respondents have. Where women have set up enterprises it has led to small increases in access to income at the cost of heavier work load and repayment pressures. Results and discussion showed

that in some cases women's increased autonomy has been temporary and led to withdrawal of male support because of higher opportunity costs. Though a significant difference is there between SHG and control group women in terms of undertaking IGAs, the achievement of microfinance program in converting its members as micro entrepreneur is poor.

F. Economic, social and political empowerment

The result of the study suggests that micro finance creates an enabling environment for empowerment. It is found that participation in the microfinance programs not only enhances women's economic security but also empowered socially, psychologically and politically as compared to non-participants. Overall, a significant difference was noticed between SHG and non-SHG member in terms of economic security, ability to make purchases, involvement in major financial and other household decisions, physical mobility, relative freedom from domination by the family, participation in public/civic protests, self-confidence, public interaction and their participation in political and other forum.

According to the composite empowerment indicator, about 38.2% of women associated with microfinance were empowered, whereas this figure was just 8.8% for non-SHG members. The significant differences between member and non-member women in terms of economic, social and political empowerment demonstrate a definite relationship between women's exposure to credit programs and their empowerment. It is observed that 'economic empowerment' appears to be playing an important role in achieving women's empowerment, be it member or non-member.Out of 191 SHG women who were empowered, 79% of them had economic security. Thus, if more and more number of women will be engaged in income earning activities, this may enhance their economic security and, in turn, the rate of women's empowerment.

The analysis suggests that with the increase in the duration of membership in microfinance program by one year, the probability that a woman will be empowered in terms of composite empowerment indicator increases by about 7%. While the same is measured by the indicators assessing women's economic and political empowerment, the probability increased by about 7% and 10% respectively. However, the duration of membership does not show a significant relationship with women's social empowerment. This confirms that the rapid expansion of microfinance programs with a growing emphasis on achieving high repayment rates has undermined its social dimensions.

Overall, women have greater access to resources especially income, but limited control over other assets obtained through collective action of SHG movement. The political participation is minimal and in cases where it exists has not led to any tangible achievements in terms of outcomes of raising issues and getting elected as members of local panchayats and so on. Local structures of gender inequality are typically experienced as 'natural' and therefore seem to unalterable to actors in particular social

setting. Tradition and culture are so taken for granted that they themselves as persons of lesser value, their sense of their own rights and entitlements are diminished. They have gained limited ability to exercise agency (in form of power over another person). It appears that she has become a vehicle of loans which the family mainly uses. In this sense the system is letting her exercise power, but only in way that is reinforced by the system.

5. Exploratory Study on Traditional Institutions of Lower Assam

(Prof. Abhijit Sharma, Indian Institute of Bank Management, Guwahati)

The North East region of India is home to traditional institutions which are part of the community and are involved in governing and providing community services including financial services to its constituents. The potentiality of engaging with them and expanding outreach to the rural and remote areas is immense. The study looks at these institutions closely so as to understand their processes and inform the formal sector either in developing linkages or modify products and processes in the latter. In order to capture the information more vividly, the study has restricted itself to looking at only six districts covering Lower Assam.

This area is the most economically backward region of Assam. It is also low in the Human Development indices. The branch network is sparser here than the other parts of the state. Consequently, it is also the most financially excluded area of the state.

The credit markets of the study area is characterised by requirements which are small and mostly for household expenditure. The data also reveals that the Life Cycle lumpsum needs of households were mostly used for Health, Education for Children, Marriages, Social functions and House building and Repair. Most of these set of requirements are fulfilled by the informal sector institutions and hence they dominate the rural financial landscapes in Lower Assam.

Among the various informal institutions Xonchois are the most used informal institution. Xonchois are ASCAs (Accumulated Savings and Credit Associations) which are concentrated in the districts of Nalbari, Kamrup, Barpeta. ASCAs are commonly found in other parts of the world. In some parts of Africa it is also being actively promoted as Village Savings and Lending Associations in areas where they are absent so as to provide an option to the people living in these areas. In Nalbari, they are ubiquitous and cover as much as 90% of the households as compared to only 39.2% by banks and only 43.2% by SHGs. In terms of usage, Xonchois are used extensively by households. In Nalbari, on an average, 100 households have 481 saving accounts with these institutions as compared to 55 savings bank account for every 100 households. Similarly, SHGs have only 53 savings bank accounts for every 100 households. In other words, there are only 53 households which have membership in SHGs. Assuming 10 members per SHGs, there are 5.3 SHGs per 100 households. Despite its near absence in districts

of Kokrajhar and Dhubri, the average saving accounts with these institutions were still at 162 for every 100 households as compared to only 68 bank accounts for every 100 households. Nearly, 70% of the all the savings accounts in Nalbari are in Xonchois. Only 8% of the savings accounts are in banks. Moreover, a large number of the savings account in banks are also dormant and very irregularly used (nearly 77%). In comparison, the Xonchois are used extensively (mostly on a monthly basis).

In terms of its depth, it is seen that it is used extensively by all the classes of households,i.e., the rich, not-so-poor and the poor. Despite the use of banking services by the rich, they still use Xonchois extensively. For instance, on an average the rich had 167 savings bank accounts for every 100 households compared to 332 savings accounts with Xonchois which is almost double. Similar is the case with credit accounts. In fact, it is so popular that in the districts of Nalbari and Kamrup that they have displaced the moneylender here. There is a strong correlation of the presence of Xonchois and the displacement of money lenders and it is significant at 99%.

Although the Xonchois break after a period and distribute the corpus as dividends and the SHGs do not do so, the average amount saved in the Xonchois, by the poor, are still much more than in the SHGs. Overall, the poor save much more in Xonchois than in the banks. Thus, the Xonchois are the most extensively used institutions for financial services by the rural households especially in the districts of Nalbari, Kamrup and Barpeta. They offer their services cutting across class, community and gender. In Nalbari, male groups are equally common as women groups. This makes them perhaps the most financially inclusive of the all the institutions including the SHGs.

Xonchois are popular amongst all segments primarily because of certain features which endear them to the people. They are looked upon as secured instruments as default rates has been low due to strong member control as all of them are either their neighbours, friends and relatives. Similarly, high returns on their savings, easy, flexible and simple and friendly process, physical and perceptual proximity and loan facility integrated with savings are attributes that Xonchois rank very high as compared to banks or other financial intermediaries. All of these make it a financial institution which is used extensively by all classes of people and by all the communities in the districts.

The range of membership in Xonchois usually varies from 8-60. However, in the districts where they are concentrated, the sizes are much larger ranging from 20-60. Although most of them consist of female members, in Nalbari, where it is concentrated, it is dominated by males suggesting that it also plays an important in economic activity.

Xonchois, by design, has fixed tenureship. This is their strength. However, Xonchois in the study area have extended their tenureship and thereby expanded the savings product range to seven different types of savings product - much more than a typical ASCA offers in other parts of the world. The households therefore have multiple memberships in them to avail the different benefits associated with them. In addition

to savings they also offer credit. The multiple memberships are also to ensure that they have an access to a larger sum as and when they require it. They use the Xonchois as their credit card, drawing from it when required and replenishing back when they are in surplus. Xonchois are extremely flexible in their operations with contribution amounts varying based on the seasonality of income and expenditure. All of the above makes Xonchois a preferred institution to save and borrow money from.

In comparison with SHGs, Xonchois score higher in the following points:

Firstly, there are no start-up costs in Xonchois, as the norms and process are known to all the members; they therefore do not need to be trained in its operations. They leverage on the knowledge which is available. This is very unlike an SHG where large investments are needed in capacity building and training of members. Knowledge has to be transmitted from outside. This can be costly and hence prohibitive. Xonchois on the other hand, because of its low costs can be started up by anyone with some members.

Secondly, Xonchois are easy to manage. The cash collected is disbursed every cycle, thus reducing the scope for fraud. The books are very simple (often just in a single sheet) and the accounting is kept within manageable limits as the group breaks after a fixed period and disburses the entire corpus. On the other hand, a large number of books have to be maintained in a SHG. This means that at least some members has to be trained in book keeping quite well for ensuring that the books are well maintained and updated. The absence of this has been a serious issue in the SHG management and consequently has lead to delinquency in them.

Thirdly, the benefits of Xonchois are clearly marked out. Members are aware of the date of termination of the Xonchois and the amounts that they are likely to get at the end of the term. This ensures members interest in the group and thus effective control. In an SHG however, since they do not have fixed tenureships, members cannot link the savings and the benefits from it. The fund generated is looked up as only a conduit to access loans from external agencies like banks. Once this is achieved, members gradually loose interest if the banks are not responsive enough in providing repeat loans. Consequently, the members drop out of the group and it defuncts.

Fourthly, Xonchois offer the households the flexibility to contribute more when there is surplus in the house and allows them to draw down from it when their cash position is tight. It also provides the access to the larger lumpsum when they need it. All of these ensure that Xonchois are viewed as essential coping mechanism and hence being part of it is very natural and also essential. The members in a SHG, however, save only small amounts and the inflexibility of its mechanism does not allow the households to use it effectively as an instrument of coping with their crisis and other needs. It therefore remains outside the 'financial ecosystem' of the household unlike the Xonchois.

There are however, two weaknesses in Xonchois. The over reliance on the manager could lead to problems especially in a group where most of the members are illiterate. And in most of the cases, Xonchois are able to meet only the basic requirements of the households. They have mostly failed to meet long term savings needs or larger loans for production related needs etc.

Besides, the Xonchois, there are other types of traditional institutions which provide financial services only partially. These are village level institutions which provide community services to the community. They differ in scale and scope in different areas and within the different communities. These are fairly powerful and hence can censure individuals/households if they violate the norms of the group. They also provide financial services but in a limited manner and also to the most needy. They, therefore provide some sort of a social net to the most underprivileged and needy in the villages.

Traditional institutions therefore play a major role in the rural areas of the study area. Some of them, like the Xonchois, provide crucial financial services to households. They have an enviable outreach, surpassing all the other intermediaries including money lenders in their area of concentration. It is truly one of the most inclusive of all the financial institutions in the area. Their excellent track record due to their good governance and transparency ensured by strong member control makes it a highly trustworthy institution where the household can park their savings.

Some suggestions for linkages of Xonchois with banks have been made. These suggestions however need to be taken up only after a detailed product development work including piloting is undertaken. The suggestions are as follows;

i) A recurring deposit scheme for a longer term upto 7 years or so. This would help the members to build up a larger lumpsum which most of the Xonchois are currently not offering.

ii) A term deposit (or fixed deposit) scheme for a period of 7 years or so. This product is also not being offered by most Xonchois.

iii) A credit linkage for a larger amount with the Xonchoi offering a guarantee for its members. A part of the corpus of the group could also be kept as security by the banks till the closure of the loan.

For the other traditional institutions involved only partially with offering financial services, the role could be that of providing assistance to the banks as Business Facilitators. This could start initially with the Dong Committees of Bodo areas and the Kuchis of Barpeta.

6. Loan default by SHGs in Rajasthan

(This is a collaborative research taken up CMR in collaboration with Centre for Microfinance, Jaipur)

The repayment rate of Self Help Groups to banks is usually perceived as good compared to other priority sector lending and it is more than 95%. But for the last

few years, the repayments of SHGs are slowly coming down. As per NABARD's status of Microfinance in India, 2008-09, 8.6% of the total loan outstanding under SHG was classified as NPA in Rajasthan as on March 31, 2009.

In the above mentioned backdrop, the study assesses the reasons for SHG default. The objectives of the study are to understand the reasons underlying the phenomenon and develop an early warning system so that timely action can be taken to avoid defaults. To study SHGs with 100% repayment is also one of the features of the study.

The study used a stratified sampling methodology, the strata being district, block, SHG and members. Five districts were selected to give geographical representation of the state; Alwar (in east), Jodhpur (in west), Churu (in north) Dungarpur (in south) and Ajmer (in central) regions of the state. One block per district (except Alwar, where two blocks were taken for study) was selected for the study. The study covers 213 default SHGs and 691 SHG members spread across five districts along with 20 best qualities SHGs with 100% repayment. The Self-Help Promoting Intuitions (SHPIs) featured in the study include Department of Women and Child Development (DWCD), Watershed department, NGOs, panchyat and banks. 69% of the sample groups were from DWCD department and on scheme basis almost same percentage, i.e., 69 percentages were from SGSY. 11 schedule commercial banks, 3 regional rural banks and 5 district central cooperative banks were part of this study.

The study highlights several reasons for default. Improper process of group formation is the foremost reason of default as accepted norms like area selection, proper selection of members, concept seeding, etc., has not been followed in any sample groups while the other set of samples of 18 groups with 100% repayment have gone through some localized established process. The SHG movement in the country started with savings lead model with objectives that community will come together, save and fulfill their immediate need. Saving first and credit later has been the success mantra of quality groups across the country. But the study revealed that prime objective of 66% of members were to get bank credit only and 13% said that subsidy was the main driving force. Data from sample was quite revealing in terms of capacity building input as only 16% leaders and 13% members have undergone any training on group concept.

The progressive erosion in quality is visible in records which have not been updated for years together. During the study, it was found that even though 74% groups maintain attendance register, only 28% out of that 74% update it regularly. The scenario with cash book and ledger is more worrisome as only 30% and 62% groups possessed these books out of which updated record was available with 34% and 32% respectively. Transparency in groups which is maintained through proper records existed nowhere due to lack of proper record keeping and hence members stopped repaying. Interestingly the crucial activity, i.e. Interloaning was found only in 46.5% of the SHGs surveyed. The proportion of members who have availed the services of interloaning was even low, i.e., 34.9% of all the members about whom information was collected through the survey. Only 18% of group fund is being used by members and rests were lying

idle in bank account.

It was also seen that small NGOs that work on a project mode find it difficult to carry on with group strengthening work as they are not financially supported beyond the initial phase. A large majority of SHGs promoted by one NGO in the northern district of the state (Churu) became defaulters after the organization withdrew from the villages at the end of one year 'project' of SHG promotion. The NGO said that it was forced to get out of the villages due to paucity of funds and personnel. At the same time, large NGOs with integrated activities were found to be doing well in terms of SHG activity as they use the groups to channelise multiple activities. Many groups suffered because of their dependence on what can be called "a single individual support system". The relocation and transfer of the key individual resulted in degeneration of many such groups.

It has been observed that financing targets are pushed through the banks by the DRDAs in case of BPL groups. The pressure on the banks to disburse subsidised loans seems to have disturbed the normal process of growth and maturation of SHGs in many cases. Many BPL SHGs were directly given second loans (activity based loan), i.e., without first loan (revolving fund). In the case of SGSY loans, it was reported that the amount of loan is generally decided after the SHG promoter or the Bank manager informs that a specific loan can be applied for rather than how much credit is actually required. In many SHGs, there is manipulative intermediation by the President or Secretary, who takes the lion's share of the loan and distributes the rest among the members. This is further aggravated by multiple group membership of leaders. Permanent leaders, often the ones with power and resources, form convenient groups and use it to source bank loans for themselves. Lack of knowledge on the part of the members about the rules and structure of leadership further deteriorates the situation. The leadership in many cases stayed with the same women since the formation of groups.

Findings of the study clearly shows that all the stakeholders, i.e., SHG, SHPI, Banks and improper implementation of concerned schemes with system of financing have stake in making a group defaulter.

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