MICROFINANCE – REACHING THE UN-REACH THROUGH PARTNERSHIP MODEL

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Abstract- The increased focus of central banks on financial inclusion has prompted banks to explore innovative means of reaching out the financially excluded section. In that process, various banks propose to adopt several models to reach the unreached. One of the most successful model is partnership approach by collaborating with credible and efficient financial intermediaries (interchangeably referred to as BC/Partner) to deliver the much needed micro-credit services to the said segment. The current document on "Partnership model", attempts to give an understanding of the partnership model, the products that can be offered, various risks associated and mitigation techniques, the technology and monitoring system adopted by various countries.

Index Terms- *United States, India, Financial inclusion, Inclusive banking, Micro Finance, Banking for the poor, Elimination of poverty*

<u>The term Microfinance:</u>

Timely delivery of financial services , which include savings, credit, Insurance, remittances etc at an affordable cost to the vast sections of disadvantaged and low income groups is the goal of Financial Inclusion Plan.

Financial Services includes

- Savings
- Credit
- Insurance
- Remittance facilities etc.

Who are excluded?

- Marginal Farmers
- Landless Farmers
- Oral Lessees
- Self Employed
- Urban slum developers
- Migrants
- Minorities
- Social excluded groups
- Senior citizens
- Women

<u>Research Elaborations</u>

<u>The Vision Applied – United States</u>

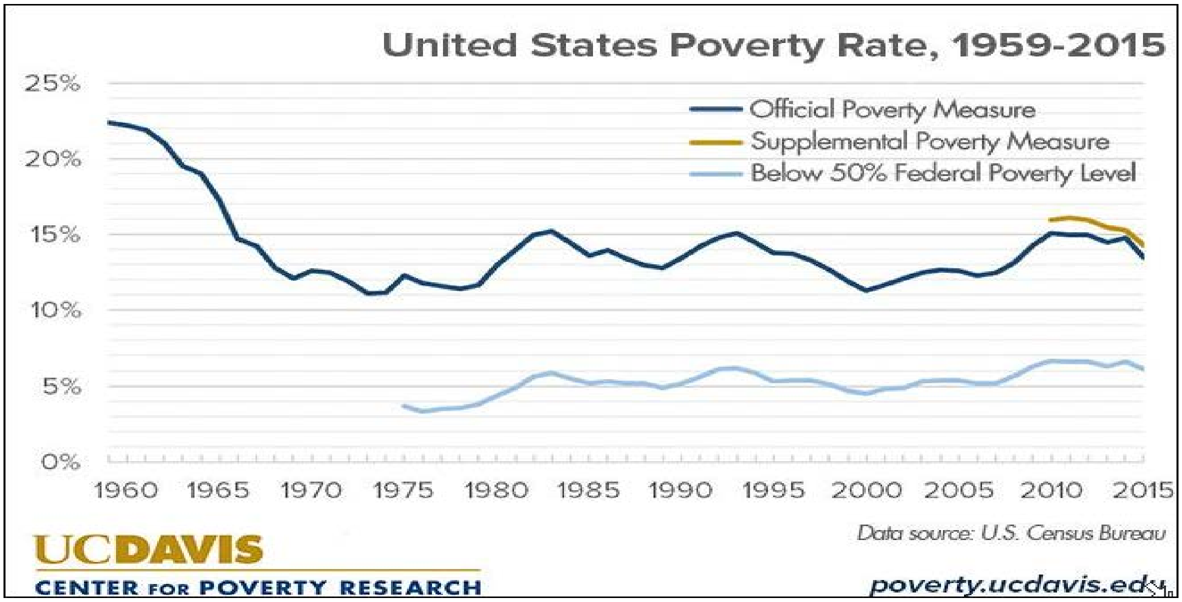
Financial Inclusion is one of the key challenges the Central Banks are trying to mull it over the past several decades.

With the dramatic increase of microfinance programs across various countries, like Bangladesh, Bolivia, India, Indonesia, and other developing countries, United States started to address the key issues with the weaker section or unreached section of the nation by welcoming few microfinance organizations. It is also evident that the difficulties for the microfinance institutes to expand the business in the United States than the rest of the developing countries.

In the United States; the official poverty rate is 13.5 percent, based on the U.S. Census Bureau's 2015 estimates. That year, an estimated 43.1 million Americans lived in poverty according to the official measure. According to supplemental poverty measure, the poverty rate was 14.3 percent. In the year 1959, the poverty rate in the United States had ranged from a high of 22.4% to a low of 11.1% in 1973.

(Source: https://poverty.ucdavis.edu/faq/what-current-poverty-rate-united-states)

The country realized the impact of financially excluded sections of the economy and rapidly introduced several poverty elimination programs during and after 1964 and evidenced a fluctuation of 11 to 15% in the poverty rate.



(Source : https://poverty.ucdavis.edu/faq/what-current-poverty-rate-united-states)

There is lots of Microfinance organizations across the globe are working constantly to reach out to the unreached by various models under the umbrella of Microfinance.

Differences in the Microfinance organizations:

In the United States the microfinance organizations operate in a different manner compared to the other developing countries; Bangladesh, India. It is not easy for "Self-employment in the United States as compared to the other countries in the study". The below table exhibits the various types of microfinance organizations in the United States and in the developing countries.

Table 1. *Examples of types of microenterprises in the United States and the developing world*

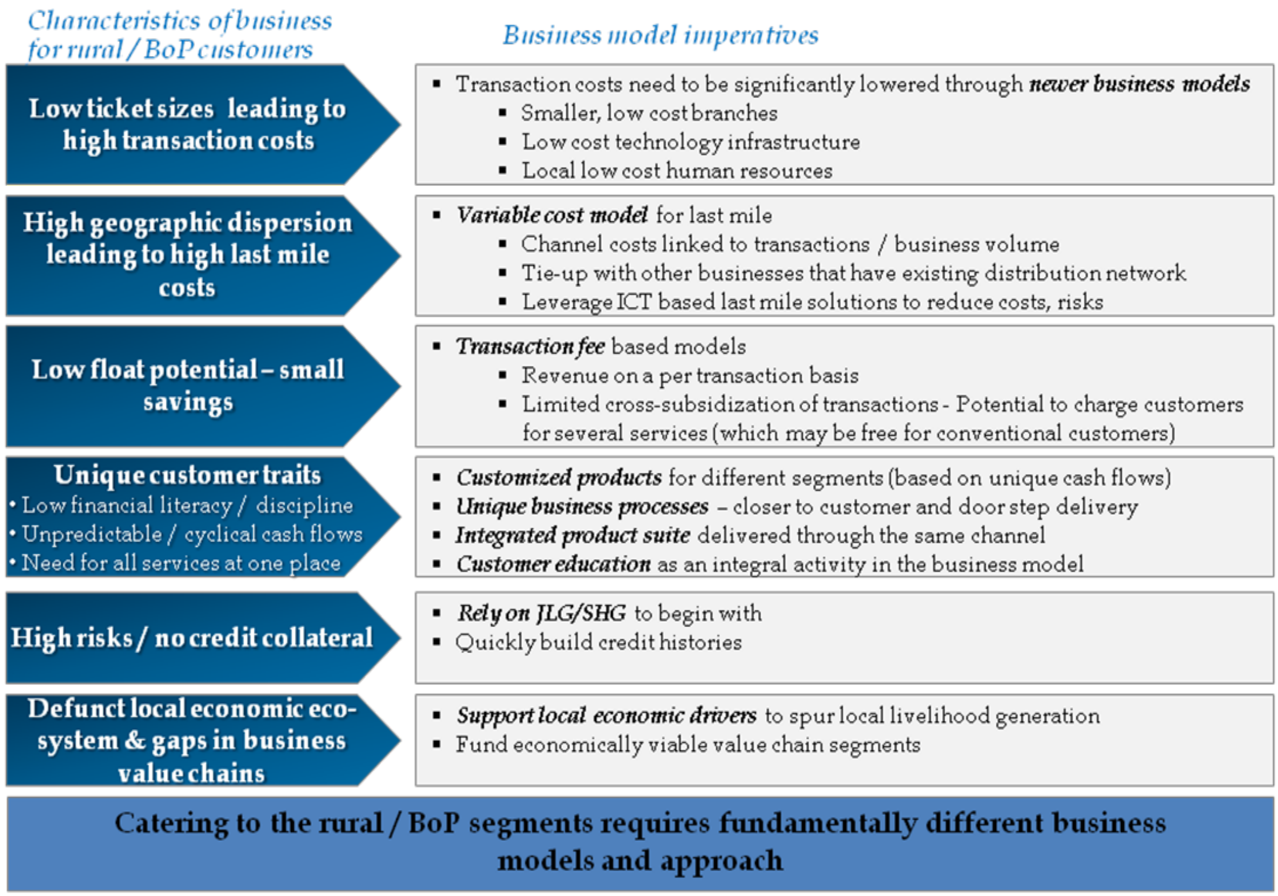
United States	Developing world
—Care for children or pets	—Plant crops and fatten livestock
—Cut hair or polish nails	—Do odd jobs, especially on farms
—Cook food and sell drinks at festivals	—Cook food and sell drinks on the street
—Sell Avon, Amway, or Mary Kay	—Petty trade in food, clothes, or toiletries
—Clean homes, cars, or offices	—Take in laundry
—Trade and/or repair clothes or cars	—Make and/or repair clothes or cars
—Paint or repair houses	—Build or repair houses
—Cut grass or trim branches	—Collect and sell wood, charcoal, or water
—Kill pests	—Carry loads or messages
—Repossess cars	—Drive a bus or truck
—Work with wood	—Work with wood or metal
—Rent video tapes	—Show movies from video tapes
—Deejay parties	—Play in a band
—Drive cabs	—Run a rickshaw
—Quilt or knit blankets	—Husk rice or shell peanuts
—Sling newspapers or brochures	—Sell newspapers or lottery tickets
—Make and sell arts and crafts	—Scavenge for things to recycle
—Make and sell fake jewelry	—Make and sell baskets or rope
—Buy and sell drugs	—Shine or repair shoes

In several researches it is found that access to credit is a major constraint for the US entrepreneurs. Racism, Good Credit History check for immigrants etc are the main limitations for the microfinance organizations to tumble in the United States. It is still understood that access to credit is a major challenge due to the fact that the lenders always require some sort of security as collateral, which needs savings. Several housing finance corporations need an initial payment, corporate financing companies / banks need the entrepreneurs to bring initial capital of their own, besides the loan capital, at risk.

In the United States, microfinance organizations generally have a reach to the loans. It is well known that 25 percent of the clients of microenterprises in the United States are either bankrupt or used the monies to pay off the previous debts. In the United States with a good credit history and salaried person can get a credit card without any hurdles. Almost all microfinance entrepreneurs and/ or the spouses have a salaried job and thus meet most demand loans through the usage of credit cards.

Even though the pricing of credit card financing is high, the transactions costs and low in total costs attract the financing through Credit cards in the United States. Similarly, loans from pawn brokers, check cashing outlets, Payday Lenders and rent to own stores charge a huge interest rate but the overall costs associated will be low. Eventually banks started focusing on financial exclusion areas to extend financial support through various means of microfinance models. It is evident from the developing countries that the best microfinance programs can make profit out of lending and sustain the business for long term than working as a non-profit organization with a limited resources and limitations in financing to the weaker sections of the society. The objective of the paper is to differentiate between the United States strategies on micro lending programs with other developing countries. The methodology adopted by developing countries to make a sustainable growth in micro lending and making the reachability to the poor and creating employment through the means of micro finance through partnership model. It is observed that in the United States, microfinance organizations cannot compete with regular commercial banks. In order to make a success in micro lending to the poor, Central govt should come up with a strategy and bring up new policies and regulations, like the central banks in the other developing countries made it mandatory for the banks to lend a part or certain percentage of their loan portfolio to micro lending through different models of micro finance. It is also observed that the banks alone cannot reach to the weaker sections of the society and hence there are several micro-lending models available and adopted by developing countries to reach the ultimate weaker section are remarkable. United States need to acknowledge and adopt these proven and successful models to reach the unreached, educate and create sustainability in the lives of poor.

The Vision Applied – India



Source: BCG India Banking 2020

Over 430 million people, or 37% (as per Tendulkar report) of the population in India, live below the poverty line (BPL). The vast majority of Indian households with an annual income less than INR 150,000 (USD 3,260), a total of 700 million people, though not necessarily of BPL status, still lack access to essential financial services like credit, insurance, and savings facilities, and therefore constitute the potential target client base for microfinance services. The annual micro-credit demand for the above population is given as under.

	No. of Target HH	Total Credit Demand (in Rs Millions)	Average Credit Demand per HH (in Rs)
Urban	24,712,703	718,320	29,067
Rural	117,508,000	2,582,170	21,974
Total	**142,220,703**	**3,300,490**	**23,207**

What makes this segment different to be served?

Despite many efforts, Banks have not been able to serve this segment because of peculiar Characteristics of this segment calling for newer business models as explained below:

What would it require to succeed in Banking with the poor?

The key for succeeding in the partnership initiative is given below:

Key Success Factors	Description
Strong channel/ distribution model	▪ Strong distribution network to reach, acquire and service a large customer base ▪ Large and mature distribution/ channel management team structure ▪ Effective channel training to help them deal with financial services
Robust product strategy	▪ Products suited to the unique needs of the customer segment; customization as per unique regional / segment needs vital to ensure relevance ▪ Offer the complete suite of multiple products required by the customers ▪ Services to be delivered in an easy to use manner at convenient outlet environment / other convenient delivery channels yielding a good overall customer experience
Effective marketing and branding	▪ High on the ground BTL activities near the outlets designed to attract consumers to enroll & transact ▪ Focused efforts to establish a brand identity connoting "trust" and "good customer service" ▪ Use of innovative marketing media to control costs while attracting a wide customer base
Robust technology platform	▪ Good overall customer experience in technology usage – simple, easy to use and reliable front-end technology platform ▪ Ability to offer real-time transactions through strong backend integration with existing CBS ▪ Low capex requirements and cost per transaction
Financial Literacy	▪ Focused efforts on customer education and train them on financial planning methodologies ▪ Active wealth management services / guidance to the customers to help them choose the appropriate products and services
Risk management & compliance framework	▪ Robust processes & systems to ensure adequate supervision and compliance at field level ▪ Strong cash planning and management ▪ Risk management policies and framework
Financing	▪ Funding for setting up the wide distribution network and for financial literacy programs ▪ Financing to meet capex and setup requirements

Bank can rapidly build these relevant competencies with the assistance of appropriate partners

Who could be the potential partners?

a.) Micro Finance Institutions-Largely NBFCs
b.) Business Correspondents

Enabling regulatory changes

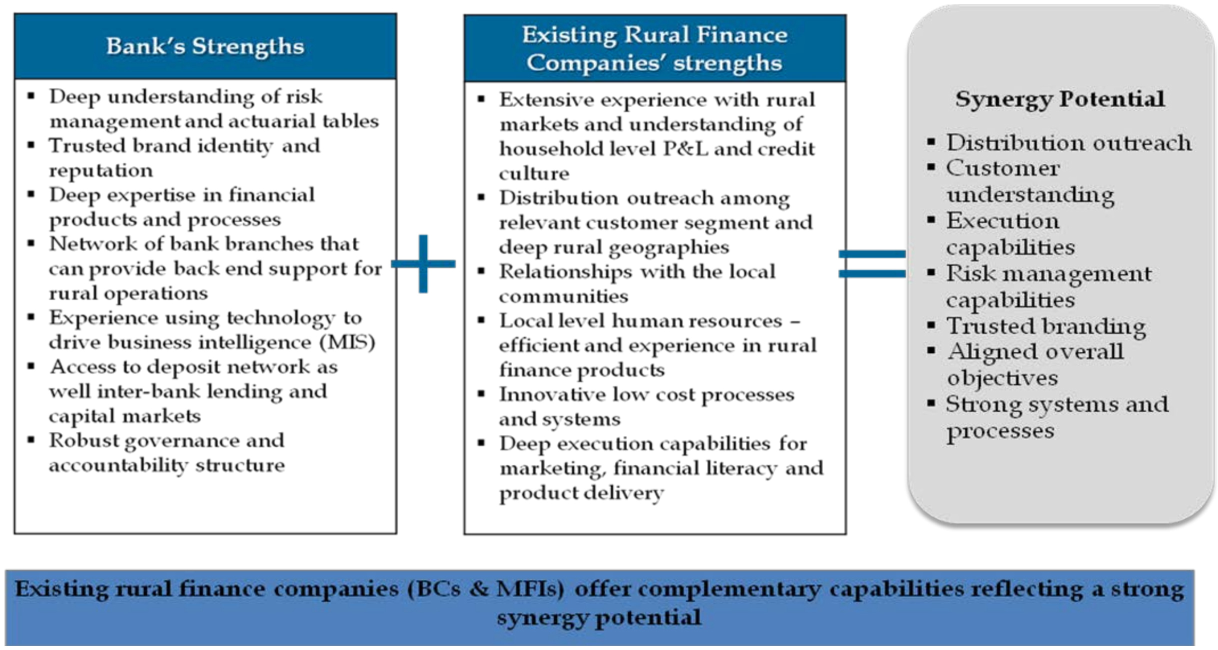
Up on recommendations of Mr.H.R.Khan Committee (Deputy Governor of the Reserve Bank of India) and also drawing from the advancement in technology (resulting in significant reduction in transaction costs) with proven delivery models, RBI has come up with circular (Jan'06) on appointing Business Correspondents/Business Facilitators (BC/BF) on carrying out the basic banking services on behalf of the bank. RBI also made lending to such excluded sections mandatory under Priority Sector Lending obligations of the banks.

As per the guidelines BC/BF can originate both liability and asset business for the bank. But, among the list of eligible entities to be a BC/BF (given in text box), NBFCs were excluded.

However, NBFCs are permitted to conduct the asset business for the bank and hence can become a potential business **partner** in delivering micro-credit services which is one of the key components of financial inclusion.

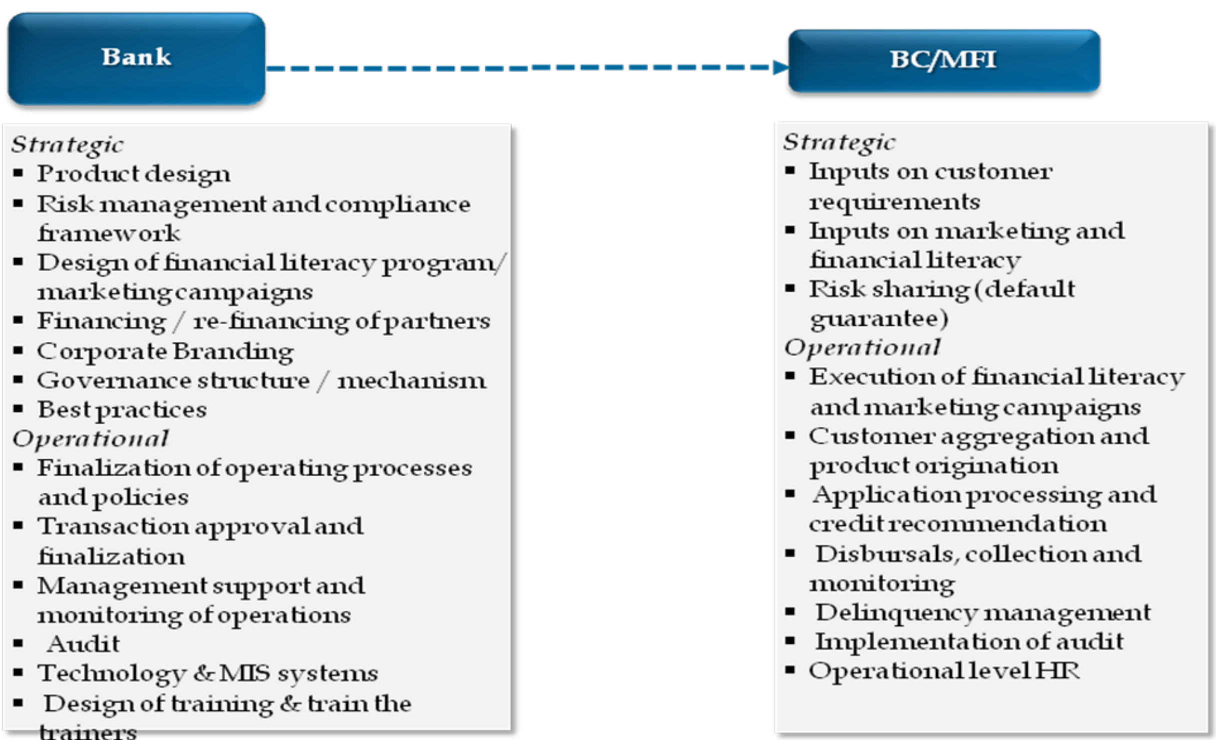
The approach of collaborating with the NBFC (partner)/BC (interchangeably used in this document) for delivering the **micro-credit** services is termed as **partnership model**. The scope of activities under this model are **loan origination, follow up, monitoring, recovery etc.** and also to **facilitate basic banking services** to the un/under banked segments on bank's behalf.

What can a partner bring to table?



The BC/Partner provides the services to end customers/borrowers on behalf of the bank on a commission basis/revenue sharing basis (details of engagement covered under separate section on 'Management of the BC/Partner). While the intermediation is carried out by BC/partner, the ownership of the portfolio lies with the Bank. Hence to safeguard the portfolio from various risks, credit enhancements (in the form of first loss default guarantee) & tight monitoring & control mechanisms are put in place.

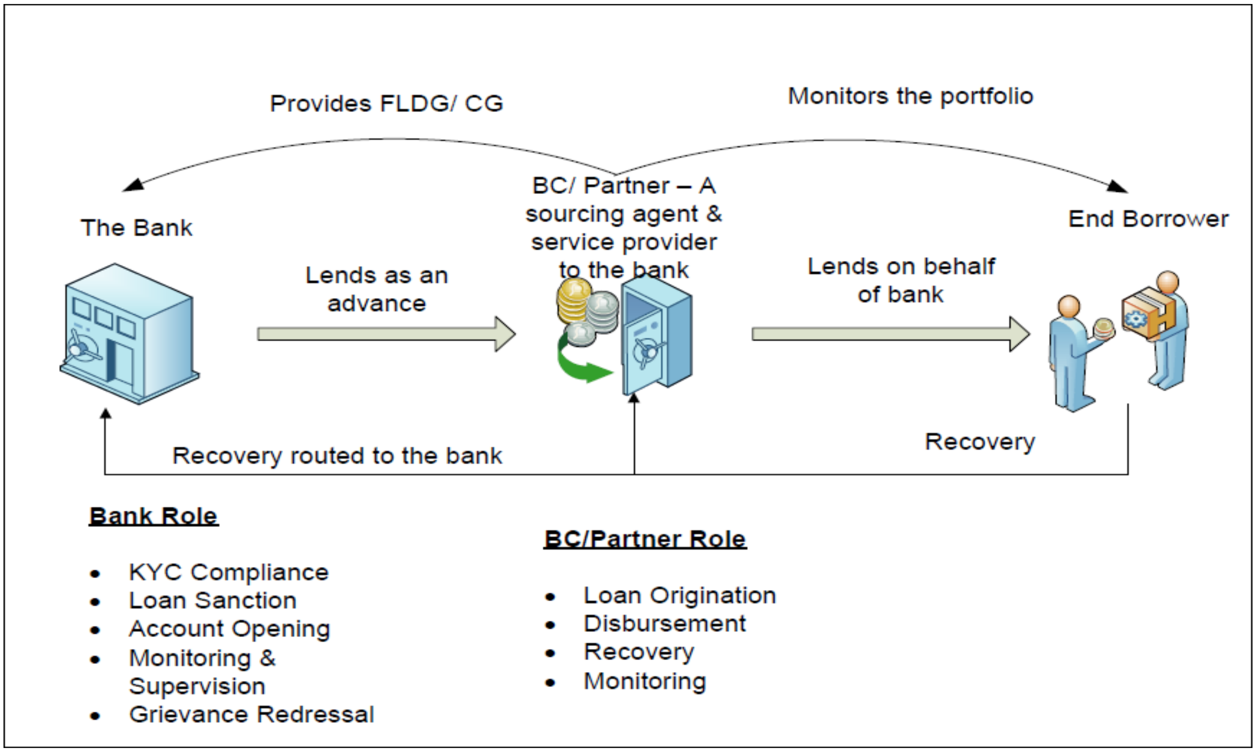
What could be the operating model of the partner/BC



How does the model work?

The Partnership model is depicted pictorially below.

ISSN 2250-3153



Benefits of Partnership model

Apart from the above benefits and operational ease offered by adopting BC / Partner model, it also provides the bank with some of the key strategic advantages:-

- Helps leverage the strong geographical/physical outreach of entities and scale up the direct portfolio of our banks in different parts of the country with limited resource allocation
- Will enable us to offer products which are customized to the local requirement with minimal effort in an economically viable and sustainable manner
- Helps better control on the operations compared to term loans given by us for on-lending.
- Gives better yield than both terms loans and pure buy outs.
- Helps meet the sub targets under the overall PSL i.e Direct Agri and Weaker. This would be very crucial keeping in view the growing uncertainty on the classification of the MFI lending/ portfolio buyouts for PSL reporting.
- Can extend to full-fledged Business Correspondent Services including for liability products going forward.

Considering into account the merits of appointing a Partner/BC, it is preferable for the banks to adopt a partnership approach to cater to the financially excluded segment rather than directly carry out the operations in the field.

CONCLUSION:

Complete Financial inclusion by the year 2020 could be within sight in most of the countries. It is in appropriate to conclude that Financial Inclusion is not a success factor in United States, rather the strategies adopted and discussed above should be looked upon and evaluation should be done before adopting the strategy in the United States. The Partnership Model of Microfinance is a key success in the developing countries India, Bangladesh and Indonesia. Traditional bankers in the United States need to be involved, so they are part of the microfinance chain reaction. The community reinvestment act was passed in 1977 by congress to encourage commercial banks to meet the credit needs of all sectors of their community, including low to moderate income neighborhoods. The opportunity that exists for banks today is that they were willing to invest in providing grants to microfinance institutions to help provide the capital that can be dispersed to budding entrepreneurs in the community; that is a room that could receive positive consideration for community reinvestment act credit on the banks behalf. In addition to that there is an opportunity to partner right so these microfinance institutions most of them are non-profit and a very few are for profit in the United States. In order for the country as a whole to achieve a goal of making good to the weaker sections of the community, local banks in the United States need to partner with the microfinance institutions and seek their support in reaching the un-reach, rather than waiting on customers to come to the bank and seek for financial help for their lively hood. The Govt should make financial inclusion as a goal and set aside some targets to the banks by fixing a year to achieve a certain amount of financial inclusion.

Abbreviations

BC	: Business Correspondent
FLDG	: First Loss Default Guarantee
SLDG	: Second Loss Default Guarantee
RBI	: Reserve Bank of India
MFI	: Micro Finance Institution
BPL	: Below Poverty Line
SHG	: Self Help Group
SHGBLP	: Self Help Group Bank Linkage Program
PSL	: Priority Sector Lending
NGO	: Non Govt Organisation
KYC	: Know Your Customer
CSP	: Customer Service Point

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