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Microfinance Matters

Contents

Opening Notes

Diversity and Variety mark the microfinance interventions of INAFI-INDIA network members. Contexts, approaches, methodologies are diverse and products and services offered are varied.

We feature in this issue member initiatives in offering MF products to its clients. DHAN Foundation initiatives in developing a variety of insurance products for the Kalanjiam institutions are detailed.

Mr.V.Vivekanandan describes SIFFS initiatives of using PAR as a touchstone to find the horses for the credit courses.

China is another mega market for microfinance and their experience in addressing mountain poverty through microfinance is captured by Mr.Park and Mr.Changqing Ren.

Well, microfinance practitioners have a common concern of managing the growth with quality and self-regulation is being used as the instrument. The steps taken by DHAN Foundation for taking self-regulation to SHGs and its federations have been outlined.

- M. Kalyanasundaram*, Chief Executive, INAFI-INDIA*

International Network of Alternative Financial Institutions - India

Developing Insurance Products for Kalanjiam Institutions: Experience of DHAN Foundation

B Raghini, *Programme Leader, DHAN Foundation, Madurai*

1. Introduction :

The Community Banking Programme of DHAN Foundation has over a decade's experience in micro finance. The approach is promotion of financial institutions owned and managed by the poor women at various levels. The savings and credit transactions at the member level take place only at the level of Kalanjiams the primary unit. The Kalanjiams (Groups) promote clusters and federations at the next levels (secondary units) which are involved in activities related to strengthening the Kalanjiams and enlarging the range of benefits available to the members by interfacing with the mainstream institutions. The Kalanjiams comprise of 15-20 members, the clusters 200-250 members and the federations 2500-4000 members.

2. Need for Insurance Services :

The poor are vulnerable to sudden illness, death of a family member (especially that of an earning member) loss of assets and other natural calamities. This more so due to the seasonally and uncertainty of their income flows, nil or low value of assets owned by them, weak coping mechanisms and absence of any cushion to absorb the shocks due to the above reasons. The few governmental welfare and social security programmes barely reach those who are in need of them the most. The banking services provided by the mainstream do not reach the poor due to various reasons such as low value of transactions with a correspondingly high transaction cost to both the bank and the poor. Similar is the case with the mainstream insurance services. So much so that many poor are not even aware that something called insurance is there to take care of unforeseen calamities.

The federations in the Community Banking Programme offer the insurance services to their members. It is based on the concept of mutuality – a way of risk sharing and supporting each other in times of crisis and protection against vulnerability. The insurance service is restricted to the members and their families only.

The basic purpose is to provide support and some amount of security to the bereaved family especially the children. It also helps to repay the loan outstanding in the members' name thereby reducing the burden of debt on a family already dealing with the loss of a family member. To help the members overcome the loss of income and additional debt burden due the loss of assets (e.g. cow, goat, sheep etc.).

Microfinance is not just access to credit alone. To sustain the credit activities, they need to offer a package of services including initially savings and later on insurance. these three services complement and supplement each other in meeting the needs of the members and are crucial for the long-term sustainability of the microfinance programme. Savings provide the needed liquidity and funds for revolving as credit to members and for leveraging external funds. The insurance services safeguard the loan portfolio by ensuring repayment in the event of death and also as a source of support to the family. Thus the insurance service strengthens the savings and credit activity and is the logical graduation once the savings and credit activities have been stabilized. Besides it creates a feeling of solidarity among the members and or source of emotional and financial support at the time of crisis in the life of the members. The insurance service in the context of women focused programme helps in providing support to the family.

3. Genesis, Growth and Development of Insurance Products in Community Banking Programme :

Even before the initiation of the insurance products, the members had found their own way of responding to crisis in the lives of the members. In several locations, the members in each group in addition to the regular savings and loan repayments contributed Re.1 in each monthly meeting to a separate fund maintained at the cluster or federation level. In the event of death in any of the member's homes, immediately Rs.500/- from this fund would be given to family on the same day. This would help meet the immediate expenditure. This Rs.500/- would be provided in times of other crisis such as burning down of houses damage due to foods etc.

Details of insurance products offered by the Kalanjiam federations

Sl. No.	Type of Insurance	Years of Starting	Members / Units covered (Current Status)
1	Life (Accidental & Natural death)	1992	51,000
2	Livestock Insurance	1994	970
3	Health Insurance	1994	7,220
4	Housing Insurance	2000	80

During the last several years the older federations have experimented with and implemented various insurance services for their members. Each federation has designed similar products with suitable variations based on member's needs and demands. The insurance products offered by the federations fall under the following categories.

- **Life Insurance :** It provides insurance coverage for natural and accidental deaths. A fixed annual premium of Rs.100 is collected from each member to provide an insured amount of Rs.10,000/- in case of natural death and Rs.25,000/- in case of accidental death. Federations with viable numbers manage the product themselves and offer the benefit out of the premium collected. These federations invest these funds either in long term deposits or use as loan funds to ensure higher returns. A portion of the premium is also used to reinsure the accidental benefits with mainstream insurance companies. In case where the numbers are small, the federations opt for reinsurance with external insurance companies.

Details of Life Insurance covered by the federations on

Year	No. of Federations having Life Insurance Schemes	No. of members covered	Contribution per person covered	Amount of Insurance cover (Rs.)
97–1998	5	6995	25-50	2,500–25,000
98–1999	5	10419	25-50	2,500–25,000
99–2000	5	8515	25-100	2,500–25,000
00–2001	9	21232	50-100	5,000–25,000
01–2002	14	28299	50-100	10,000–25,000
Present status	32	51,000	50-100	10,000–25,000

- **Health Insurance :** This product facilitates members to avail reimbursement of medical expenses during illness. Medi-claim insurance products help members meet expenditure on unforeseen illness due to hospitalization. For a poor family, illness especially of the earning members results in (I) loss of income during the days they are incapacitated and that of caretaker if they also happen to contribute, (ii) debt incurred for treatment which is usually at high interest rates as they are sought at the time of emergency, (iii) cost of travel to hospital, food etc, (iv) children and old people in the family get neglected. This is also an annual product and reinsured with other insurance companies. But it was found that the norms and procedures followed by the insurance companies were restrictive and not able to meet all needs. One federation has developed it's own product and is able to manage independently. This provided lot of flexibility and timely support to members. The premium was fixed based on the market rates offered by the format system.

Details of Health insurance scheme in federations

Year	No. of Federations	Number Covered	Amount Insured	Premium Amount
99–2000	1	994	Rs. 5000	50
00–2001	3	3124	Rs. 5000 – Rs. 10000	50 – 150
01–2002	5	5036	Rs. 5000 – Rs. 10000	50 – 150
Present status	5	7220	Rs. 5000 – Rs. 10000	50 – 150

- **Livestock Insurance :** All the livestock assets provided to members created out of the loan from Kalanjiam are insured through this product. In case of livestock insurance the Federation arranges for a linkage with the insurance company and borrower. The insurance company issues an individual policy for each member and the claim amount is settled through the federation to the member. This product was instrumental to reduce the risk of groups and ensured 100% repayment in spite of the loss due to death of their livestock. Federation collects a service charge from the member's to recover it's cost of management.

- **Housing Insurance :** The federation have begun taking up the housing programme in a big way to meet the needs of the members. The loans for housing and considerably larger in size and spread over a longer period. Hence this product helps to protect the family against any damage to the property and or death of the member or her husband. This product is also managed similar to livestock product, where federation plays a facilitating role only.

Each federation has created operational mechanisms and systems for evolving norms, fixing and collection of premium, settling of claims. In case of reinsurance federation acts as a intermediary and all the claim settlement is done through the federation. Federation deals both with the individual member and the insurance company. As many companies are not able to reach individual borrowers due to higher transaction costs, they find this intermediation convenient, In view of this Federations are able to negotiate with insurance companies for a competitive price and concessions. Federation uses the existing institutional mechanisms to offer the insurance services to members and able to recover all it's costs. DHAN Foundation provides needed technical and managerial support and guidance to design and implement products profitably.

Salient Features:

Acceptance of the Insurance Product : The poor not having much exposure or knowledge about insurance products were reluctant to adopt it, especially life insurance. Some members felt the federation was inviting a crisis like death to come in member's family by initiating the life insurance products. Initially not all members joined the scheme. Only after seeing the benefits in a few cases they were convinced of going for life insurance. They wanted to get back the premium amount after a period of certain years if they made no claims. It look some convincing to get the idea of pooling risk and resources to cope with the crisis and that it is not possible to return the premium amount.

- **People owned :** Another unique feature is that the insurance products are offered by the federations with active involvement of members and evolved over a period. Each federation has constituted a committee comprising of leaders and staff at different levels for smooth and disbursal of claims.

- **Flexibility :** The federation has the flexibility to offer new products, modify products based on their own experience or that of the other federations. More importantly they have developed simple and flexible systems to settle the claims of their members in a shorter time, which is normally not available with the regular insurance providers.

- **Collaboration with the Mainstream :** The federations have in addition to managing certain products on their own followed reinsurance for maximising the benefit to their members and minimising the risk to the federation. Most of the federations are able to negotiate with the companies and get sizable premium rebates for the members.

- **Timeliness:** The federations have been successful in accepting, processing and disbursing the claims within a week where they are offering the products. Similarly in case of reinsurance they have negotiated and actively followed up with the companies to reduce the time normally taken by them.

Learnings

Insurance requires viable scale for success : If the federation or an MFI has to offer insurance on it's own, it needs an optimum size to achieve viability. If the members are small reinsurance could be a viable alternative. Reinsurance can be done through collaboration with insurance companies. This scale is also essential for getting better bargaining and negotiating advantage with the companies. The federation need to work out their own strategies for maximising the benefiting to their members by opting for a mix of products – own products, directly with insurance companies and reinsurance with insurance companies.

- **Package of services and Graduation :** Insurance services will be successful if offered as part of Micro finance package of services. Logically insurance will follow savings and credit services. The insurance products need to be offered for graduated members so that credit risk can be minimised. This process also builds involvement of clients and helps in sustainability. Similarly with insurance services there needs to be a graduation of products from livestock to life, health etc. for it to be successful.

- **Risk Asessment :** It is important to have a study of the historical data about death rates in the area to make a proper assessment of the risk to help fix premium amount claim amount and develop features of the product. Involving of technical persons is advisable.

- **Asset creation and insurance :** With the growth of the savings and credit activities, the size of the loans and repayment periods go up. The members create assets and the need for insurance is critical both for the member Micro Finance Institution to insulate against loss of assets and subsequent default.

- **Systems for Management :** Operationalising the insurance product needs clear-cut policies and mechanisms. The system should ensure timely renewal and settlement of claim and administration of the products. This would ensure that none of members lose out due delay at any stage.

- **Ensuring reach and end use of the money :** Since the insurance programme is operated by or through the MFI, the system can ensure the end use. First the claim should be used to adjust the out standing due and the rest should benefit the children especially when the client is poor women primarily to meet future needs of children such as education, marriage, etc.

- **Cost of the Insurance Programme :** The insurance programme incurs a cost for designing, monitoring and delivering of the product. Usage of the existing system of MFI for the savings and credit services will help in reducing the costs of administering the product. Introducing insurance would only result in incremental costs, which need to be recovered from the product.

Immediate plans

Based on the last few years experience the following areas will be given attention in the immediate future.

1. **Increasing outreach :** Providing insurance cover to all members of groups which are more than 6 months either through their own federations or through nearby federations.

2. **Experiment with new products :** Presently only few federations have the experience of offering the health insurance. The focus will be on developing appropriate products for the poor and fine turning them each year based on their experience as well as other federations.

3. **Expanding collaboration with other Institutions :** The collaboration with insurance companies and government sponsored schemes can be explored further in greater depth. This will help maximise the beneifts to members, reduction in costs, reduction in cumbersome procedures, recognition of federations as legitimate intermediaries for insurance services etc.

Future Challenges

1. **Technical competence :** In the current situation the present knowledge is adequate to run the programme. But to run it more effectively and in view of the future expansion of these services, there is a definite need to build the technical competence. This can be done by developing the competence within the organisation or source it from outside.

2. **Collaboration :** In spite of good results in collaboration with insurance companies, there is a need to further strengthen it to reduce the cumbersome procedures and procedural requirements, delays in setting claims, getting more favourable terms and conditions for the federations

3. **Enlarging the coverage pool :** Since the number of members in a federation would tend to be a constant in the future, the risk increases as the number of years increases. For this various alternatives need to be explored and worked out such as extending insurance cover to husband and children, increasing premium amount, group common fund allocations for meeting costs, reinsurance options, etc.

Building Congenial Credit Culture SIFFS Way

Mr. V. Vivekanandan, *Chief Executive, South Indian Federation of Fishermen Societies, Trivandrum*

Introduction:

We often hear people talking about above par or below par while referring to the standard / quality of particular thing or performance. The PAR in the world of Microcredit has the potential to make or mar the programme. The Portfolio at risk (Problem loans as % of loan outstanding) should be either par (i.e. <2%) or above so that the Microcredit programmes sustain itself on long haul.

SIFFS has put the concept of PAR to effective use for maintaining the quality of the Microcredit Portfolio and to bring about credit discipline among the programme participants i. e. Village societies / members. Its seeks to build a good credit culture through the instrument of PAR.

SIFFS' Model:

The micro credit model followed by the South Indian Federation of Fishermen Societies (SIFFS) is somewhat different from that of other MFIs. The difference basically arises out of the fact that the SIFFS intervention is a sectoral intervention using a "commodity cooperative" model where the main target group is the sea going fishermen who are normally exploited by middlemen and moneylenders by controlling the beach level fish sales. To counter this exploitation, the village level society model developed in the early 1970s was based on the concept of fishermen having their own marketing arrangements and linking it with a savings and credit system. Though not unique, the SIFFS society model is a relatively rare one where marketing, credit and savings are integrated into one single system at village level. The most successful commodity cooperative model in the country is the Anand Pattern Cooperative Society (APCOS) in the dairy sector, which deliberately keeps credit out of the cooperative and sees this as one of the reasons for its success. However, the specific situation prevailing in the fisheries sector made a marketing intervention *sans* credit, a non-starter.

The second tier, the district federation, was mainly involved in providing support services like audit of society accounts, helping with bank linkages and trouble-shooting. The district federations also provide marketing support and linkages when needed and also help society members access cheaper inputs like nets and other fishing requisites. Certain welfare and educational activities have also developed over time in each district federation. The federations have also been compelled to get involved in providing credit due to the decline in credit availability from the banking sector due to a number of factors in the late 80s and early 90s. They have revolving funds based on grants received from donor organisations.

SIFFS as the overall apex organisation, was mainly intended in the mid 1980s to take up technology development and promotion, a role that became essential due to the declining fortunes of the traditional fishermen who faced unfair competition from mechanised trawlers. However, over time, SIFFS has diversified its portfolio in response to changing needs and opportunities. Today SIFFS runs a network of boatyards manufacturing marine plywood boats as alternatives to the country craft. It imports and supplies out board motors (OBMs) and spares and also runs a network of OBM service centres. It has a large R&D programme involving development of new boats, improvements in propulsion, artificial reefs, safety at sea, improvements in fish handling, etc.

The SIFFS was able to see the emergence of Micro credit programme near about mid 90's due to shyness of mainstream banks to finance fishing sector and also the growing demand for credit owing to technology development.

SIFFS has, since 1999, been putting a lot of effort into its Microcredit programme and has emerged as a leading MFI in the fisheries sector. Today it has a total loan outstanding of 2.2 crores and the portfolio is growing substantially each year.

Thus SIFFS has an exclusive Micro credit programme as compared to general MFI's with the following distinct features.

Parameter	Most MFIs	SIFFS
Clients	Mostly Women	Mostly Men
Local organisation	SHGs or Joint Liability Groups	Fish marketing society (commodity coop)
Loan amounts	Small: few hundreds to few thousands	Larger: Rs.5000 to 50,000
Loan repayment	Fixed installments, often weekly	Fixed percentage of income with high uncertainties and fluctuations in income
Loan period	Short term: 6 months to 18 months	Medium term: 3 years
Loan purpose	Significant percentage for consumption	Almost entirely for fishing equipment (productive purpose)
Interest rates	18-40% p.a; comparison with informal sector rates of 60% and above	16%; comparison with bank agri loans (12%) and Government coops (15%)
Interest spread	High	low
Operating costs for credit	High due to sole focus on credit and associated activities	Low due to multiple activities and revenue generation from marketing and input distribution
Risk	Lower due to small loan size and effectiveness of peer pressure	High due to larger loan size and repayments dependant entirely on fortunes of fishing enterprise.

The important change made when SIFFS started its lending was to develop eligibility criteria for loans even though the loans were routed through the district federations and village societies. The societies and federations generally operated on the principle that any fishermen who sold his fish through the society and followed the other rules should be given a loan. However, given the wide variations in the income of individuals and their abilities, the loan repayment performance was not up to the mark. SIFFS introduced strict income criteria and tied loan amounts to repayment capacity rather than just need. This would ensure that the loans will be repaid within the stipulated 3-year period even when the repayment was only a percentage of the income rather than a fixed monthly installment. Another change was to make modifications to the principle of fixed percentage of income as repayment system. Societies with repayment problems were encouraged to either increase the percentage deducted for loan repayment or to make up shortfall in repayments by deducting additional amounts. For the record, SIFFS computed an EMI and used it as a surrogate for monthly demand even though the fisherman was not expected to remit an EMI. Using the EMI as bench mark, the performance of individual loans were tracked and action taken when it became clear that a member was not likely to repay within the prescribed term.

Defining Delinquency and PAR

The biggest problem faced by SIFFS was to define delinquency given its system of repayments linked to income. Fishing income is highly seasonal and variable. While there are distinct fishing seasons, they vary across regions. Moreover, the actual income variation depends on fishing technique used by the fishermen. In the same village, a fisherman using hook and line will have a different seasonality when compared to a fisherman depending on nets for fishing. Further, the actual fish availability during the different seasons varies from year to year making it difficult to work out a realistic demand schedule. It is normal even for good fishermen to have three to four months at a stretch when their repayments are below the EMI. However, there is also considerable amount of pre-payments in other months. Till recently SIFFS used its own judgement of individuals and societies to decide whether there was a repayment problem. No common objective criterion was used.

It is only at the time of credit rating by M-Cril in 1999 that the use of PAR to assess our portfolio quality was done. M-Cril used PAR at 60 days and found that it was around 40%. This was clearly a shocking figure and was at odds with what appeared to be otherwise a well managed credit programme. We were not convinced that the PAR measure reflected the actual situation and felt that delinquency had to be measured differently in our case. However, as we started to look deeper into the matter we realised that we do have a problem and it stemmed from our inability to define delinquency. Sometime towards the end of 2001, we started a detailed exercise of studying the behaviour of the PAR of our member societies as well as look into reasons why many members are lagging behind in repayment. The results were not easy to interpret. However, one thing became clear. PAR at 60 and 90 days was very much affected by seasonality and fluctuated wildly from month to month. It is only at PAR-180 that stability is achieved. We decided to use 6 months overdue as the most realistic definition of individual delinquency and use PAR-180 as the standard to assess the society and federation performance. Though PAR-180 may appear to be a liberal index by Microcredit industry standards, we have decided to go by our own internal judgement on the matter (let us not forget that SIFFS loans are for 36 months rather than 12 months or 18 months). Possibly as the system improves and we have more refined understanding of the factors that need to be manipulated to bring down PAR at 60 or 90 days, we can go for a more stringent standard.

The society rating system

As we started understanding the importance of PAR and found that it is the measure that financing institutions and rating institutions give importance to, we decided to make it the single measure to assess our portfolio quality. Being a three tier cooperative organisation of fishermen we realised that the whole idea needs to be internalised at all levels. To achieve this we decided to get the federations and societies to be aware of their PAR-180 figure and to work on reducing it. We also decided to link the lending policy to a society's PAR-180.

What emerged in the process was a society rating system based on PAR. Based on an analysis of the PAR figures the prevailed in December 2001, we worked out the following system.

It is however obvious that though we started with PAR as the measure, we have developed another measures to assess the societies. This is the percentage of members who have arrears of more than 6 months. This is perhaps an important measure for a people's organisation. The percentage of delinquent members is a measure of the effectiveness of peer pressure and control the society has over its members. A danger with depending on PAR is that it can be distorted by just one or two

Rating	Criteria	Credit policy
A+	PAR90 = 0	No restrictions on credit flow. Cash award if consistent over a year
A	PAR180 = 0	No restrictions on credit flow
B	PAR180 < 10% Or <15% of borrowers have more than 6 months arrears	Credit flow initially normal subject to credible plan for reducing arrears; subsequently will depend on improvements shown
C	Number of borrowers with 6 months arrears >15%<50%	Only repeat loans. No loans to first time borrowers
D	> 50% of borrowers having 6 months arrears	No loans. Has to improve to C to get loans

members who have had a fishing failure and this can be a discouragement for a society which has otherwise a good hold on its members.

People's response

The PAR based rating system is in place now for a little less than a year and it has been found useful. The concept has quickly taken root even if the members only have a superficial understanding on how PAR is calculated or what it really means. However, for the staff at all levels, a systematic training programme with the help of EDA Rural has helped to generate good awareness. The federations, which have their own revolving funds, have started applying the PAR concept as well as the rating system to their own portfolio.

The most encouraging response has been from societies that are already better than others. Those who have received a rating of B have worked on improving it to A and those who have got A have tried to move to A+. For the better societies and their leaders, it has become a prestige issue to do better than the other societies. To generate this competitive feeling, each month the society ratings are circulated to all societies.

However, the rating system has had only a limited impact on those with C and D rating. Except for one society that managed to jump from D to A in six months, most societies with C and D rating grumble about the rating system. *For these societies, PAR has become a dreaded term. It is not just a harmless three-letter word but the equivalent of a four-letter insult!* Obviously it takes more that a mere rating system to solve their delinquency problems. We are working on a package of measures that will help these laggards to also improve.

Microfinance with Chinese Characteristics

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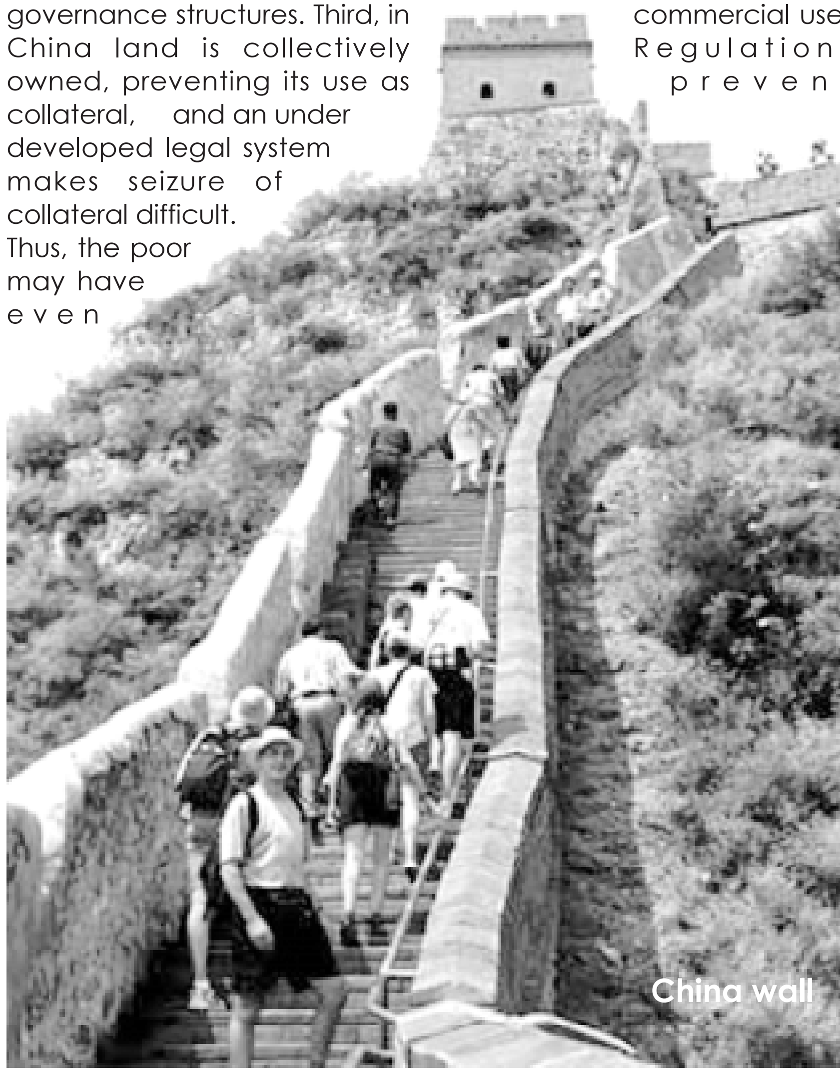
1. INTRODUCTION

With the world's largest rural population, 124 million of which were poor in 1997 based on the World Bank's dollar-per-day poverty standard, China represents an important testing ground and opportunity for the microfinance movement.

The rapid expansion and growing diversity of microfinance programs in China mirrors worldwide trends.

Following initial experiments by researchers at the Chinese Academy of Social Sciences (CASS) begun in 1994, a host of international and domestic organizations (often in partnership) have introduced a variety of microfinance models to rural China.

Distinguishing features of that environment include the following. First, the poor are increasingly concentrated in remote, mountainous regions where income-generating activities are more agricultural and less diversified than in more densely populated areas (e.g., Bangladesh, Indonesia). Second, because of the strong administrative authority of local governments, village and township leaders playa prominent role in almost all development initiatives. This is true even for non-governmental microfinance programs. China is the first country where the government itself has initiated a large-scale microfinance program. Bank-supervised programs in Indonesia (e.g., Bank Credit Desa) have also utilized village governance structures. Third, in China land is collectively owned, preventing its use as collateral, and an under developed legal system makes seizure of collateral difficult. Thus, the poor may have even greater difficulty gaining access to formal credit. Fourth, broader aspects of rural financial system reform constrain the prospects for microfinance. The state banking system steers resources to state-owned enterprises, leaving fewer funds for commercial use. Regulations prevent



China wall

microfinance programs from registering as financial institutions (and taking deposits), and interest rates have been tightly controlled at below market-clearing levels.

Through this paper, we attempted to the following:

1. Discussing the rural financial landscape of China
2. The history and the State of Government programmes for poverty alleviation and microfinance
3. Presenting the oral assessment from the survey of the microfinance programmes in China – three types of programmes, purely Government programme, mixed programme of Government and NGO purely NGO programmes. While the NGO programme is located on flood plains. The other two from in mountainous regions.

2. RURAL FINANCIAL INSTITUTIONS

In considering the appropriate role of microfinance in China, one must begin by describing the rural financial and scope. The main Chinese rural financial institutions providing loans to rural households are the Agricultural Bank of China (ABC, or nongyey in hang) and the Rural Credit Cooperatives (RCCs, or xinyongshe). 4 The ABC is one of China's four specialized banks, with the largest branch network among specialized banks, extending to most but not all townships. In1996, the ABC accounted for 14% of lending volume in China. 5 Most lending was working capital loans for state commercial enterprises,14% went to township and village enterprises(TVEs), and 16% to agriculture (including some households). The ABC currently administers China's subsidized poverty loan program. The RCCs are cooperatives in name only (not in governance). They are under the administrative supervision of the Peoples Bank of China and are the only financial institutions with branch outlets extending to most villages. In 1996,RCCs accounted for 10% of national lending, with 52% of RCC lending going to TVEs and 24% to agriculture (including households). RCCs are by far the most important source of formal credit in rural areas. Formal intermediation in rural areas has not increased substantially during the reform period, however, and most rural loans continue to come from informal sources.

A number of factors impede the ability of China's rural financial system to meet the financial service demands of rural households, especially the poor. First, rural financial institutions are part of a national banking system in which a large share of lending is driven by government policy objectives (one estimate is 42% of loans), mainly to support state-owned enterprises but also for grain procurement. This leaves fewer funds for commercial loans. Second, because China's official loan interest rates are often set below market-clearing rates, excess credit demand leads to credit rationing. Local government officials, whose views often carry weight with banks, prefer to see rationed loans go to productive investments that will generate tax revenues. rather than to rural households. Third, even without rationed credit or local political pressure to lend to TVEs, financial institutions often exclude poor households because of high transaction costs, lack of collateral, and high risks. The lack of private land makes collateral-based lending especially China. Finally, banks and RCCs are restricted in the financial instruments (both savings and credit) that they can offer to households, preventing innovations that might profitably better meet the credit and savings needs of the poor.

Despite these problems, it would be a mistake to assume automatically that lack of credit access is a critical constraint facing the poor. Barriers to inter bank lending in China, especially by RCCs, may have reduced capital outflows from poor areas. This, combined with the lack of enterprise activity in poor areas, weak managerial incentives, and political rhetoric to support local agriculture, may lead RCCs to lend more to households in poor areas. A separate 1997survey of households in six poor counties in different provinces (hereafter, poverty survey) found that nearly two-thirds of households either had an outstanding formal loan (mainly from RCCs) or felt they could get one if they wanted (the amount, however, is constrained). On the one hand, the fact that RCCs lend to poor households suggests that a promising approach to microfinance may be to reform the policy environment for existing financial institutions in China, but on the other hand, the lending itself reflects a highly regulated environment that makes innovative reform difficult and has led to mounting financial losses. As China's rural financial institutions become more commercialized, funds are increasingly likely to flow out of poor areas and into richer areas.

3. GOVERNMENT POVERTY LOANS AND MICROFINANCE

The Chinese government has tried to expand credit access of the rural poor through a targeted subsidized-loan program begun in 1986 that is the centerpiece of China's poverty alleviation program. In September 1996, the conference on poverty in Beijing, attended by China'' top central and provincial government leaders (including Jiang Zemin, Li Peng, and Zhu Rongji) to emphasise the importance of meeting the goals of the haqi (8-7) plan established in 1993 to eliminate the remaining 80 million rural poor by the year 2000 (within seven years). The government increased significantly national funding for the subsidized loan program, from 5.5 billion yuan in 1996 to 8.5 billion yuan in 1997. By 1998, the official poverty count had fallen to 42 million.

Unfortunately, China's subsidized loan program, like a litany of similar programs in other developing countries, has been heavily criticized for failing to reach the poor and for achieving low rates of repayment. Subsidised rates of 2.88% (compared to official interest rates of 8-10%) have made the loans an attractive target for rich households, enterprises, and local leaders eager to support revenue generating industrial projects. The loans are considered to have a welfare dimension that encourages delinquency. Average timely repayment rates have been only about 50%.

After initial skepticism toward microfinance models, the Chinese government has become an active proponent. Much of the initiative has come from local government has become an active proponent. Much of the initiative has come from local governments eager to meet poverty reduction goals of the baqi plan (perhaps leading to a short-term outlook) and dissatisfied with the performance of earlier programs. Mainly since 1996, government financed programmes, mainly based on the Grameen model, have begun in Fujian, Guangxi, Hebei, Henan, Liaoning, Sichuan, Shanxi, Shaanxi and Yunnan. Most programmes use funds previously allocated to the subsidized loan programme. The largest programmes are in southern Shaanxi Province, which in its first year 1996 already reached over 50,000 households. According to the office of the leading group for Economic Development in poor areas, by August 1998, 605 countries in 22 provinces were involved in government microfinance programmes with total funding of 600 million yuan. While microfinance still reaches only a small share of China's rural population, it is relatively large in absolute terms in comparison to programmes in other countries. The rapid expansion of government microfinance has no precedent internationally, and probably should be cause for as much concern as excitement. Local officials may have interest that compromise their ability to effectively implement-lending programs. Officials have narrowly focused on the ability of microfinance to increase repayment rates without grasping basic principles. Interest rates remain highly subsidized.

4. MICROFINANCE WITH CHINESECHARACTERISTICS

Microfinance is a movement founded on the promise of institutional innovation. Most but not all programs (including the earliest ones) in China are based on the Grameen Bank model. Allegiance to this model has probably constrained the innovative potential of the microfinance movement in China. Internationally, there are many alternative models which include features such as individual lending(BRI), flexible loan duration and repayment frequency (Banco Sol), and larger groups and no training component (Association for Social Advancement (ASA) in Bangladesh, village banking by the Foundation for International Community Assistance, or FINCA). It remains an open empirical question which design features matter most for program success. In a large and heterogeneous country such as China, it is likely that loyalty to any one model will be counter productive.

Chinese characteristics

There are many reasons to be optimistic about China's microfinance movement. The surveyed NGO and mixed programs charge a modest interest rate that does not appear to deter poor borrowers. Yet, the pilot NGO programs are approaching financial sustainability thanks to unusually low operating costs and high rates of repayment. In the most successful surveyed program (the NGO program), repayment is nearly 100% and the programme has effectively established key microfinance principles of peer screening and monitoring, dynamic incentives, and regular repayments. Subjective and econometric estimates of program impact find evidence of positive effects on income. Thus, the early microfinance pilot programmes serve as useful models for what can be achieved by well-run microfinance programmes in China.

It will not necessarily be easy to replicate this success throughout China. Reasons for concern relate back to distinguishing Chinese "characteristics". First, China's poor are concentrated in remote, mountainous regions where agriculture (cropping and livestock) is more common. Agricultural projects take longer than trade and manufacturing projects to produce cash flow. For households lacking diversified incomes, weekly repayments can cause difficulty, even hardship, especially during certain times of the year. Remote locations also increase the travel time required for weekly meetings, increasing participation costs for both rich and poor. A large majority of surveyed participants prefer less frequent repayments. Relatively high dropout rates suggest that some households may be discouraged by the costs of participation even atmoderate interest rates. This evidence provides justification for more flexibility in loan contract terms, especially the repayment schedule. Some programs in other countries have even been successful eliminating group lending altogether. In China, too, a number programs have altered design features and experimented with loan contract terms or very different microfinance models (e.g., Caohai group revolving funds, CIDA village banking project).

Second, we are skeptical about the prospects for government-run microfinance programs. The surveyed government program does not target the poor effectively, does not effectively establish basic principles, and achieves low repayment rates. In these respects, the program differs little from the failed subsidized loan program it replaced. These problems are due both to overly rapid expansion without proper preparation and to inherent incentive conflicts when local government officials manage targeted programs. This pessimistic view contrasts with some positive accounts of the role of village governance structures in Indonesian microfinance programs for evidence of problems). Different outcomes may be attributable to differences in the accountability of local leaders to the populations they serve or the role of bank supervision. Concerns about agency problems in government programs should be openly recognized and if the government insists on administering programs , efforts should be made to provide strong managerial incentives and independence to program managers.

Third, China's microfinance movements could be part of an overall strategy to create a rural financial sector with a diversity of institutions that face competition and specialize in meeting the needs of groups with different demand characteristics (ranging from banks to cooperatives to microfinance institutions). Reform should push on all fronts. In particular, efforts to encourage existing financial institutions to profitably target previously excluded savers and borrowers with innovative contracts (e.g., Aus Aid collaboration with the ABC, Development International Desjardins project with the RCC) may have the greatest potential to expand financial services throughout rural China. Moreover, in order to expand outreach, it will be important eventually to allow successful microfinance institutions to take deposits as recognized financial institutions. Possible tradeoffs between targeting and sustainability should be acknowledged and discussed openly. There is considerable evidence that only some of the poor will benefit from greater credit access, so that there is a real danger that the recent surge in donor funding of microfinance programs may overlook more pressing needs facing many of the poor. The Chinese experience may be instructive for other countries that share "Chinese characteristics'' such as mountain poverty, a strong government regulatory and administrative role in development initiatives, and a relatively unreformed financial sector.

We find reasons for both optimism and caution in assessing China's microfinance movement. While many farmers in poor areas do have access to at-least some formal loans (including microfinance participants), expanded credit access can enable some of the poor to undertake projects not otherwise possible. The performance of the surveyed non-governmental program provides a model for the potential benefits of microfinance programs. It charges a moderate interest rate attractive to some of the poor, has enjoyed excellent financial performance, achieving near- perfect repayment rates, has adhered to basic principles of peer screening and monitoring as well as incomes. The NGO pilot programs have, however, received strong advisory support from researches at the Chinese Academy of Social Sciences, and it will be a challenge to replicate their exemplary performance on a large scale. In considering China's unique "characteristics", we find, first, that the remote location and focus on agricultural projects in poor areas, make meetings costly and frequent repayment difficult. We advocate greater flexibility in loan contract terms, especially repayment schedules.

Evolving Self-Regulation in INAFI-INDIA Network

Self-Regulation has been recognised and acknowledged as an effective instrument to guide the growth of microfinance interventions / programmes of the member organisations with order, quality and equity. It has been accepted and adopted as a INAFI method and the member organisations of the INAFI-INDIA network have pledged to enable the people organisations / SHGs promoted by them to evolve and practice self-regulation in the Asia international workshop organised at New Delhi on August 29-30, 2001.

Sequel to the workshop and with a view to introduce self-regulation in the INAFI-INDIA network, inception workshops were organised by the member organisations under the aegis of INAFI-INDIA network to sensitise, create awareness and to generate appreciation for the concept. These inception workshops were organised during 2001 and early part of 2002 and the professionals / field staff of the members of the network had participated. It has been agreed by member organisations that self-regulation would be taken up to promote the three performance standards – Institutional, Development and Financial.

Each of the member organisations have chosen a broad set of standards relevant to their context of working although there have been common grounds under institutional and financial standards. In other words developmental standards will have to be evolved by the members with specific relevance to the context.

Self-regulation now moves to the next phase, with member organisations, with better understanding / appreciation of the concept, will, now, sensitise peoples organisations, SHGs and its federations would adopt this method for focus on poverty reduction and development with discipline. During the month of July 2002, DHAN Foundation has taken the step forward and organised a workshop for the Kalanjiam (SHG) movement Leaders to sensitise and evolve parameters for the standards under Development Institutions, financial indicators. The Kalanjiams are nested institutions promoted by DHAN with SHGs (Kalanjiam) at the grass roots forming clusters (10 – 15 SHGs) at the revenue village level andfederations (150 – 200 SHGs) at the block level.

The Kalanjiam movement is a body of all Kalanjiam members numbering 1.50 lakhs and movement leadership (20 leaders) spearheads the activities and programmes of the Kalanjiam (SHG).

The Self-Regulation workshop has drawn the following broad standard frame work

DEVELOPMENT STANDARDS :

S. No.	Parameters	Starting Phase (1 year)	Young Phase (2-5 years)	Advanced/ Mature Phase (Above 5 years)
1.	Exclusivity of poor	100%	-	-
2.	List of all poors in the village	75%	90%	100%
3.	Outside borrowings at Usurious interest rate	40-50%	NIL	NIL
4.	Abolition of alcoholism	Building database	50%	100%
5.	Social gifts by availing loans - Eradication of the undesirable practice	5%	50%	100%
6.	Loans for assets build up	25% of the clients (2 times)	50% of the clients (3 times)	75 - 100% (4 times)
7.	Family avocation	25%	50-75%	75-100%
8.	Village Industries / Cottage industries	5 villages	20 villages	50 villages
9.	Civic amenities	5%	20%	50%

INSTITUTIONAL STANDARDS :

1. **Graduation of leadership:** The leaders of the Federation (Executive Committee Members) should have been either leaders of Kalanjiam (Group) or the Cluster Development Association before assuming the leadership of Federation.

2. **Leadership Qualities:** The aspirants for Federation Leadership should possess capacity for visioning and exhibit willingness for self-less services and sacrifices and also clear headedness.

3. Absence/non-participation in three consecutive Executive Committee Meetings shall render the leaders of Federation to step down.

4. **Leadership Rotation:** The leaders of Federation shall hold office for not more than 3 years to enable induction of fresh leadership and leadership development among large section of the members.

5. **Leading by example:** Leaders of the Federation shall set examples for others to emulate with high standards of integrity, hard work and sincerity. Kalanjiam

Federation of SHGs should become part of civil Society and emerge as role model for Government and other Institutions.

6. Budget planning, implementation of plans, annual auditing shall become part of the institutional process and practices. All Federation will hold the General Body Meeting every year involving leaders of the all Kalanjiams (Groups) which are members in the Federation without fail, so also the Annual Maha Sabha involving all individual members.

7. Institutional culture building process and the requisite meetings for this purpose shall be part of the institutional events of Federation.

FINANCIAL STANDARDS :

Equity in loan allocation and distribution.

- Making available timely credit
- Time limit of one week for appraisal of loans and sanction/disbursement
- The basis for sanctioning is not only need but also the repayment capacity of the members
- Ensuring 100% repayment for all the loans
- Cost coverage – operational self sufficiency
- Mechanism for expenditure control – ensuring quality expenditure
- Good accounting and auditing system
- Accountability and transparency in the Annual Maha Sabha Meetings by submission of the financial statements and plans for the future

REGULATION OF SELF-REGULATION – evolving SRO for Kalanjiam Institutions

The Self-regulation practice would be monitored by the SROs as indicated below for the Kalanjiam Institutions. The People institution would also be enabled to evolve the system of sanctions for non-compliance of the Self-Regulation.

THE SRO STRUCTURE FOR KALANJIAM INSTITUTIONS ARE AS UNDER :

Kalanjiam Movement
SRO
for Kalanjiam Federation

↓

Federation
SRO
for Kalanjiam Cluster Development Association

↓

Cluster Development Association
SRO
for Kalanjiam Group

WAY FORWARD:

A. Capacity Building: Capacity building of the People institutions and its members for evolving the standards in line with the indicative standards suggested above and practicing it.

The leaders of the Kalanjiam Movement will enable the Federations and Cluster Development Associations to set standards and practise it.

The Self Help Groups will be facilitated by the Federations and Cluster Development Associations to implement the self-regulation.

Monitoring through SRO: The Kalanjiam Institutions charged with SRO responsibility would monitor the implementation process smoothen the practice and enforce sanctions for non-compliance.

Events and Activities

Events	When and Where	Remarks
Self Regulation Workshop in the Member Organisations - DHAN Foundation	June 17 and 18, 2002 Madurai	This workshop has been organised for the benefit of people leaders of Kalanjiam nested institutions to sensitize them and create awareness. The leaders of Kalanjiam movement who will spearhead the self-regulation method in the Kalanjiam nested Institutions of SHGs, Clusters, federation have been exposed to the standard framework under three major indicators namely Development, Institution and Financial and also the processes and methodology involved in building the capacity of federations, cluster and SHGs for practicing self regulation.
INAFI-ASIA Executive Committee meeting	July 9 – 10, 2002 DHAKA, Bangladesh	With Mr.Abed of BRAC in the Chair, the meeting, largely, focussed on finalising and firming up the integrated proposal for INAFI i.e. (International, Regional and National) for the period 2003 – 2006. The important issue of positioning INAFI in the North and the need to play an active advocacy and lobbying was deliberated upon in good length and it has been decided to open a liaison office at Washington U.S.A. and also establish the International office at Hague Netherlands. INAFI - INDIA was represented by Mr. Girish G. Sohani of BAIF, Mr. M.P. Vasimalai of DHAN Foundation and Mr. M. Kalyanasundaram of INAFI – INDIA.
INAFI–INDIA Meeting	July 30,2002 Madurai	Seven member organisations (out of Nine) participated and deliberated on establishing INAFI – INDIA as a strong network of Microfinance practices in India. Membership expansion, INAFI – INDIA incorporation, Self regulation and Asset building are among the substantive issues discussed in detail and necessary action plan drawn up.

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