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A Summary of Proceedings: Conference on Microfinance

**Jointly organized by the CAB and the CMF
at CAB Pune on January 16 & 17, 2009**

Critical gaps remain in our understanding of how micro finance can be best used to fight poverty and promote development of small and cottage industries. Does micro-credit help small businesses grow, or does it have an impact primarily on areas such as women empowerment? Which financial products have the most impact on the lives of those who take them up? Can the impact of micro finance be enhanced by the addition of non-financial programmes such as business training? How can we ensure that the poorest are not left out of the micro finance revolution?

Forward-thinking practitioners experiment with their programmes and models to address some of these gaps and improve their services. Academic researchers, working closely with practitioners, have attempted to document some of these innovations in order to provide the sector with information on best practices. Such research can help practitioners improve and develop their programmes further. In order to foster an environment where practice and policy is informed by rigorous research, and research questions are guided by insights from practitioners, it is essential to bring together academics, micro finance practitioners, bankers and policy makers on a common platform and to encourage interaction among these players.

To this end, the College of Agricultural Banking, Reserve Bank of India, Pune together with the Centre for Micro Finance at the Institute for Financial Management and Research, held a National Conference on Micro Finance in January 2009 in Pune. The objective was to provide insights from on-the-ground research and highlight their policy implications, and to draw lessons from the innovations of leading practitioners. The conference also aimed at identifying challenges and emerging issues in the sector and areas for future research and experimentation that would be relevant to both practitioners and policy makers. The conference facilitated interaction between prominent micro finance practitioners, bankers and policy makers, and researchers who are conducting field experiments in micro finance.

While the presentations and discussions raised as many questions as they answered, the conference showed that rigorous research can provide important insights for policy and practice. The conference encouraged to further facilitate such dialogues and interaction between academics, micro finance practitioners, bankers, regulators and policy makers.

The Conference was organised in five technical sessions, viz. (i) Enhancing the impact of micro credit (ii) Financial Inclusion, (iii) Financial Literacy (iv) Optimizing micro finance distribution channels and (v) Emerging issues in the micro finance sector. Following is a summary of the major issues/recommendations that emerged from the discussions and presentations.

Inaugural Session

Welcome Address : **Mr. Sandip Ghose**, *Principal, College of Agricultural Banking, Reserve Bank of India, Pune*
Special Address : **Mr. Justin Oliver**, *Executive Director, Centre for Micro Finance, Chennai*

In his welcome address, Mr. Ghose expressed his hope that this second annual conference would succeed in encouraging more interaction between academics, micro finance practitioners, bankers and policy makers. He then expressed his desire for more micro finance research in areas not currently focused on, including, corporate governance, staffing, and training. Such research would be useful for practitioners and also help inform regulatory decisions and support. Mr. Ghose stressed the importance of strong corporate governance for the continued growth and success of the micro finance industry.

Mr. Oliver, in his special address, focused on the importance of research for the micro finance sector. He briefly mentioned a few facts about micro finance that we already know, including that the poor are credit constrained and have low access to financial services, but find many creative ways to make up for the lack of formal financial services, and that providing financial services to the poor can be a profitable business venture. He discussed some key areas within micro finance that we still know little about, and where research could be useful. These key questions included:

- Do we know how well micro finance works as a poverty alleviation tool? What are the impacts of micro finance, in which situations do they occur, and for which populations? Are loans used for consumption necessarily worse as a poverty-alleviation tool than loans for productive purposes?
- How effective are our efforts to financially include the poor, and what are the tangible benefits of such inclusion?
- How well does formal micro finance perform at delivering other types of services (health, advisory services), relative to other possible service providers?
- What is the role of competition? Will increased competition lower interest rates or have other effects?
- Is multiple borrowing a normal consequence to be expected from keeping the poor credit constrained, or does it indicate extreme over-indebtedness?
- How do the poor understand interest rates? What alternatives for credit, savings, and insurance are available to the poor?
- Are financial literacy and business trainings worth the investment required?
- How can the business correspondent model be made to work to increase access?
- How should staff incentives be structured at MFIs? What are successful retention strategies?

Mr. Oliver concluded by stressing that research can help answer these questions that are critical to policymakers and practitioners for decision-making. Researchers need to answer these critical questions, policy makers should use such research to help enable practitioners to successfully reach and serve the poor, and practitioners must reach the poor with well-structured services.

Technical Session I : Theme : The Impact of Micro Credit
Chairman: Mr. Stephen Rasmussen, Micro Finance Lead Specialist, CGAP

The Impacts of Micro Finance :

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| A Randomized Evaluation of Spandana's Program | : | Mr. Justin Oliver , <i>Executive Director, CMF</i> |
| Integrating Social Impact into Strategy, Operations and Reporting | : | Mrs. Frances Sinha , <i>Director, EDA Rural Systems</i> |
| Need to Understand Poor's Borrowing and Consumption Needs | : | Mr. Samit Ghosh , <i>CEO, Ujjivan Financial Services</i> |

Mr. Justin Oliver drew upon early results from a CMF research project in Hyderabad slums that focuses on evaluating the impact of micro-credit on households, which is the first rigorous field experiment examining the impacts of credit in the world. Spandana began operations in 52 slums around Hyderabad, selected randomly from 104 slums they would consider entering. This allowed an excellent comparison between the slums where Spandana entered and those they did

not enter. The additional presence of Spandana in a slum resulted in large overall differences relative to the slums where they did not operate. This borrowing and the availability of credit resulted in new business creation. In addition, Mr. Oliver also reported that the availability of credit also resulted in increased household spending on durable goods for businesses or for the home, and a corresponding decrease in investment in alcohol, cigarettes, tea, paan, and festivals. Mr. Oliver suggested that the mere presence of an additional source of credit has a major impact in the decisions households make, resulting in what might be considered “smarter” investment in durables rather than quickly-consumed “temptation goods.”

Ms. Frances Sinha spoke about the impressive financial numbers that Indian MFIs have been making lately, and that the numbers provided do not get to impact of borrowing on clients’ livelihoods. She mentioned that the Spandana study presented by Mr. Oliver was rigorous and useful, and raised a few questions. First of all, it seemed as though micro finance was already in the areas that Spandana entered, and wondered if there could be negative effects of competition. She also considered how long it can take to create sustainable change. The study looks at changes in consumption and livelihood indicators over three years; practitioners usually say it takes five years to see impact. Ms. Sinha suggested that creating and measuring impact should also become the responsibility of MFIs, and that creating social impact should be an integral of managerial strategy. Ms. Sinha mentioned several new tools that are available to help MFIs measure performance that derive from the social performance task force (SPTF).

Mr. Samit Ghosh, explained that Ujjivan, over time, has learned more about its customers and has begun offering types of products to different client segments (e.g., a business loan for income generation to a housemaid). Mr. Ghosh argued that it is very important to know what people are borrowing for. Often, the urban poor in Bangalore borrow for (1) children’s education, (2) housing, and (3) healthcare. That said, the first Ujjivan loan is typically used to repay existing debt, as clients typically borrow heavily from informal sources. Moreover, Mr. Ghosh agreed with Ms. Sinha that MFIs typically do not measure impact, especially in the first few years.

Mr. Rasmussen stressed that the impact of micro finance needs to be measured over longer periods of time. He spoke about how practitioners, including Mohammed Yunus, have now begun to advocate measuring the impact of micro finance institutions in generations rather than in years, as has been the norm so far.

Technical Session 2 : Theme : *Financial Inclusion*

Chairman: Mr. Shyamal Acharya, Chief General Manager, State Bank of India

Financial inclusion: Taking a Closer Look at No-frills Accounts in Gulbarga District	: Ms. Minakshi Ramji, Research Associate, CMF
Cost-Benefit and Usage Behaviour of No Frills Accounts in Cuddalore District	: Mr. Jayaram Venkatesan, Research Consultant, CMF
Financial Inclusion Efforts by State Bank of India	: Mr. V. Ramkumar, Deputy General Manager, State Bank of India
Need to Leverage Technology to Create Universal Financial Access	: Mr. Vipin Sharma, CEO, ACCESS Development and Mr. Sanjay Bhargava, Chairman, Eko Financial Services

Ms. Ramji presented findings from a recent CMF study which looked at one specific district, Gulbarga (Karnataka), to learn more about poor households’ awareness of the drive and take-up/use of bank accounts. 12 percent of households possessed bank accounts before the drive and 17 percent of households opened a bank account during the drive. Of the new accounts opened between July 2006 and July 2007, 78 percent were National Rural Employment Guarantee Programme (NREGP) beneficiaries. Given the involvement of panchayat officials (compared to bank officials) and the increase in NREGP accounts, it seems as though the majority of people opened accounts to receive government payments/assistance. Ms. Ramji concluded that while access to accounts more than doubled, significant numbers of households (36 per cent) remain excluded without access to savings. Moreover, access does not always lead to usage of bank accounts, as over half of the opened accounts never had deposits (i.e., accounts not used for savings). Coupling government schemes assistance with the formal banking system may increase financial inclusion compared to other initiatives that offer people to open bank accounts.



Mr. Venkatesan explained that the purpose of the study in Cuddalore district was to determine results of the financial inclusion drive in the district by evaluating the gap between the schemes objective and what occurred on the ground. The study focused on three main areas: (1) coverage of the drive by geography and other categories; (2) usage by clients of no-frills accounts, and (3) cost involved for the banks in opening and maintaining accounts. 28.3 percent of households (about 145,000) opened new no-frills accounts, while about 25 percent were unwilling to open accounts. With regards to usage, Mr. Venkatesan detailed that 85 to 90 percent of the accounts were inoperative. Only 7 percent of accounts had a balance greater than Rs. 500. The surveys during the study showed that many households did not know that the no-frills passbooks could be used to save money and that villagers opened the accounts because they thought it would help them receive a loan or benefit from a government scheme. That said, the 10-15 percent of account holders that actively used their account more than doubled their savings in the 12 months after opening the account. When concluding, Mr. Venkatesan stressed that 25 percent of households still fall outside the banking system and that only 15 percent of those that opened accounts used them. To address these problems, financial literacy training, particularly around savings, could be very useful as lack of financial literacy seems to be one of the main reasons for low usage. He explained that among the operative accounts, there is an overall positive trend with respect to balance per account. Therefore, educating poor households on how to use no-frills accounts, and the benefits, could be beneficial.

Mr. V. Ramkumar enumerated State Bank of India's (SBI) financial inclusion efforts, particularly focusing on the bank's efforts within the RBI's no-frills account drive. Mr. Ramkumar also discussed the expansion of SBI's use of the business correspondent model, in which the bank uses agents to help deliver SBI financial services in rural areas, to reach poorer rural households.

Mr. Sanjay Bhargava outlined the ambitious goal of creating universal financial access with negative use of public money by 2013 for which practitioners and researchers must seek and support innovation. He exemplified the case of rapid growth of mobile phone usage in India despite wide-spread skepticism about the ability of the people to use technology. Mr. Bhargava concluded by encouraging researchers and practitioners to use technology innovatively and to address the difficult obstacles within financial services that contribute to the entrenchment of poverty in India.

Mr. Vipin Sharma commented on the study Mr. Venkatesan presented on financial inclusion in Cuddalore district. He cautioned that with no-frills accounts, bank officers open accounts and provide services but that it may not be cost efficient because as accounts get used more, transaction costs at the branch level will only increase. Therefore, banks should seek technologies that are available to deliver specialised financial products and services because these technologies have minimal transaction costs.

Technical Session 3 : Theme : *Optimizing Micro Finance Distribution Channels*

Chairman: Mr. Bazil Shaikh, Chief General Manager, RBI

Results from Rainfall Insurance Studies in Gujarat and Andhra Pradesh	: Professor Raghendra Chattopadhyay, <i>IIM-Calcutta</i>
Fighting Malaria with Micro finance: Results from Treated Bed Nets Study	: Mr. Dan Kopf, <i>Research Associate, CMF</i>
Research Needs to Facilitate Practitioner Implementation	: Mr. Paul Breloff, <i>Vice President, Business Development, SKS</i>
Basic Micro Finance Principles for Using Distribution Channel	: Dr. Sankar Datta, <i>Managing Director, Livelihoods School, Hyderabad</i>

Professor Raghendra Chattopadhyay presented results from two randomized experiments – one conducted with BASIX and another with SEWA – that attempt to understand factors that drive household insurance demand. 80 percent of respondent households in the study cite weather shocks as the major risk faced by the household and access to rainfall insurance might help households mitigate the risk of a major income shock. At the same time, such policies might encourage them to explore costlier but more efficient agricultural practices (for e.g. investment in high-yield varieties of seed and fertilizer). While the key benefits of rainfall insurance stem from divisibility (unit sale) and faster claim settlement,

Professor Chattopadhyay explained how the complexity of the product, cost and expected frequency of payouts may act as deterrent factors. The results from Gujarat marketing experiments revealed that households are significantly price sensitive and the Andhra Pradesh study revealed that cash-in-hand was the single most important determinant of take-up. Professor Chattopadhyay discussed something that continues to puzzle the researchers is the unit demand for the product – 90 percent of the households purchased only one policy – and in the near future, the Gujarat study will continue to look at these take-up issues and attempt to offer crop-specific and/or taluka-level (block) policies.

Mr. Dan Kopf spoke about preliminary results and on-going implementation challenges from the study 'Fighting Malaria with Micro finance: Impact on Health, Productivity and Willingness to Pay' being conducted in the state of Orissa in partnership with BISWA, an MFI. Insecticide Treated Nets (ITNs) have proven effective in significantly reducing the risk of malaria, particularly for children and pregnant women. However, adoption rates remain low in many countries. The study seeks to understand whether alternate mechanisms – distributing nets for free or bundling with a microcredit loan and spreading costs over time – increases take-up and improves health outcomes. Another issue is the effect these ITNs can have on repayments and debt absorbing capacity of clients. Mr. Kopf spoke about how the non-integration of the loan for nets with existing processes for loan collection proved to be one of the biggest challenges faced by BISWA and the researchers. While loan officers may have a role to play in promoting the product, it is important to determine whether they have sufficient time, skill sets and incentives to do so. Otherwise, a parallel structure may have to be established or additional training and incentives system be put in place.

Speaking about the role of research, Mr. Paul Breloff said that MFIs often consider the robustness and profitability of the business model but not just the impact of the intervention, and that researchers have to address this factor. Also, institutions are constantly looking for guidance on how to better understand client needs and how the design of contract structures (mandatory down payments, tenure etc.) impacts take-up. While provision of services can increase customer retention and loyalty and help diversify revenue streams, there a number of challenges to overcome. First, having expertise in cash handling and customer interaction does not translate into expertise in planning the logistics or inventory management. Second, loan officers are frequently untrained in marketing strategies to sell products and customers may have limited ability to understand additional new products. Finally, MFIs with foreign direct investment (FDI) are not permitted to retail products under the current regulations. Institutions need to look at ways to separate the distribution channel and financial operations.

Mr. Sankar Datta explained that BASIX's experience suggests that while self-help and joint liability groups can act as a demand aggregator and can benefit from distribution mark-ups while acting as the wholesaler, a separation of such services from micro finance, and communication to explain the same, is essential. Speaking about feasibility, Mr. Datta described how the cost of setting-up a distribution channel, the risk of failure and its potential effect on micro finance portfolio, and, the design of the incentive system for players involved will ultimately determine whether an MFI is interested in being a channel for any particular product or service. Mr. Datta pointed out that technology does involve high upfront investment costs and the risk of obsolescence.

Technical Session 4 : Theme : *Financial Literacy*

Chairman: Sanjay Sinha, Managing Director, Micro-Credit Ratings International Limited

How Do Micro finance Clients Understand their Loans?	:	Ms. Minakshi Ramji , <i>Research Associate, CMF</i>
Financial Literacy Initiatives of Punjab National Bank	:	S.P. Singh , <i>Chief Manager, Punjab National Bank</i>
Financial Literacy Initiatives of Union Bank of India	:	Dr. K. Ravindranath , <i>Chief Manager, Union Bank of India</i>
Need for Sustained Financial Literacy Efforts	:	Mrs. Vijaylakshmi Das , <i>CEO, Friends of Women's World Banking</i>

Ms. Minakshi Ramji discussed two recent CMF studies that relate to financial literacy. She started a study which aims to understand how MFI clients understand their loan contracts and exactly what it means for an MFI client to be informed. She explained that the study tries to go beyond assessing whether a client understands the terms of the loan to explore which aspects of loan terms are important to MFI clients. Such understanding could help inform the types of policies regulators create with regards to MFI disclosure of loan contract terms. She explained that a random survey of two



hundred first-time borrowers in Uttar Pradesh (Sonata Finance) and Karnataka (BSS Micro finance) revealed that borrowers typically understand weekly repayment amounts and the loan duration but not interest rates. Ms. Ramji argued that these results show that although interest rates may be relatively important to borrowers, when it comes to MFI disclosure of loan terms, weekly repayment amounts and loan duration may be more useful to micro finance clients.

Ms. Ramji then transitioned to discuss a study on the effects of business training on savings and credit behavior, which CMF conducted in conjunction with SEWABank in Ahmedabad. As Ms. Ramji described, the training course, which SEWA developed to supplement its financial literacy training, teaches business skills such as marketing, cost reduction, investment and customer service. She explained that for each session 12 women were invited from the random sample, among which half were invited with a friend and half were invited alone. Ms. Ramji stated that it is not known why training with a peer positively influences the savings behavior of clients. It may be positive peer pressure or a commitment device; the trainees learn about the importance of savings during their course, friends commit to saving a certain amount, and then friends remind one another of the lessons learned. Or the real reason may be different from the proposed options above. Regardless, Ms. Ramji argued that if training with a friend can help improve financial outcomes, finding out the underlying reasons is worth further exploration.

Mr. S.P. Singh explained Punjab National Bank's financial inclusion initiatives, which included expanded use of the business correspondent model, to open up banks accounts for poor rural households. Thereon, Mr. Singh detailed how bank branch employees aimed to help inform clients about the different financial products offered to them, and how the clients could best utilize these services.

Dr. K. Ravindranath spoke about Union Bank of India's financial literacy initiatives. Union Bank branch managers use discussions with clients as an opportunity to detail difficult-to-understand products, such as insurance or savings accounts. In conjunction with Union Bank of India's financial inclusion efforts, Dr. Ravindranath was hopeful that these educational efforts would benefit poorer customers.

Mrs. Vijaylakhshmi Das used the two CMF studies as a springboard to discuss the importance of well-structured financial literacy efforts. She argued that training in itself is not good enough. Training modules or programmes need to be customized for a given audience (e.g., language, comprehension levels etc.) for financial literacy efforts to have their intended positive impacts.

Mr. Sanjay Sinha discussed the large potential of public sector banks' financial literacy efforts, particularly because of their branches' reach into rural districts. To fulfill this potential, Mr. Sinha hoped that bank efforts would be more targeted to the needs and comprehensions of poor, less educated households

Technical Session 5: Theme : *Emerging Issues in Micro Finance*

Chairman: Mr. B P Vijayendra, Chief General Manager, RBI, Mumbai

Innovations in Product Offerings and Customization	: Mr. Justin Oliver , <i>Executive Director, CMF</i>
A New Banking Agency Model	: Mr. Doug Johnson , <i>Research Associate, CMF</i>
Micro finance in India: Small, Ostensibly Rigid and Safe	: Professor Rajalaxshmi Kamath , <i>IIM Bangalore</i>
Savings Products to Meet Client Needs	: Mrs. Chetna Sinha , <i>President, Mann Deshi Bank</i>
Future of SHG-Bank Linkage Programme	: Mr. Sukhbir Singh , <i>Chief General Manager, NABARD, Pune</i>

Mr. Justin Oliver discussed the huge increase in access across the past five years in Indian micro finance as the number of clients has more than doubled to over 40 million over the past few years. One possible problem could be the recycling of debt; micro finance institutions should not overburden borrowers with credit. Management information systems will need to improve, and a credit information system could help provide a fuller picture of where borrowers have taken out loans. Increased competition may also affect pricing but will likely have more impact on product customization and convenience. Mr. Oliver argued that there is space for micro finance institutions to help develop supply chains and focus more holistically on livelihoods, and predicted that some MFIs and SHGs would help fill this need.

Mr. Doug Johnson spoke about a new banking agency model in which non-banking financial companies (NBFCs) could provide government benefits. He started by introducing branchless banking and discussed its potential to reach poor households that currently do not have access to formal savings accounts. He then discussed the limitations of India's current branchless banking approach, the business correspondent model. These limitations included the fact that commissions for prospective business correspondents do not seem to be high enough to spark adequate participation by potential correspondents, that government benefits are not distributed through the scheme, and that NBFCs, which have done a good job of reaching the unbanked, are not allowed to be business correspondents. Mr. Johnson proposed that RBI take advantage of NBFCs' reach into unbanked populations, but reduces risks by only allowing NBFCs to provide government benefits, such as NREGA and pension payments. Mr. Johnson explained that NBFCs could play a similar role in dispensing government benefits.

Professor Rajalaxshmi Kamath presented findings from a financial diary study she conducted in a district outside of Bangalore. Through the study, Professor Kamath found that many of the 20 borrowers that participated received credit from multiple sources, both formal and informal. Some borrowers were members of more than three MFIs and there was evidence of debt recycling, in which a new loan was used to pay off an old loan. Professor Kamath concluded by stating that multiple borrowing will continue to happen if loan sizes are too small to meet client needs and if coordination between MFIs to limit multiple borrowing does not improve.

Mrs. Chetna Sinha explained the challenges in providing formal savings to poorer clients. The transaction costs related to saving at a bank are quite high for poorer women. Female customers like to keep how much they save private, and going to a bank makes the fact that they are able to save very public. Mann Deshi addresses these challenges by having bank employees go door-to-door to provide daily savings options to clients. This practice reduces the transaction costs for clients and also provides more privacy to individual customers. For the bank, Mrs. Sinha explained, this option is difficult to provide in a sustainable manner. Going door-to-door is expensive and saving deposits are often small. That said, the product is flexible and meets clients' needs, which is key to the success of a savings product for poorer rural households.

Mr. Sukhbir Singh started his presentation by describing the Indian self-help group (SHG) system and explaining how individual SHGs function. From there, Mr. Singh discussed the successes of the SHG-bank linkages in providing liquidity to self-help groups which help women improve their families' livelihoods. He then elaborated how the SHG and MFI systems currently coexist and serve needs of different women in India. He concluded by predicting that both micro finance systems would continue to thrive.

Valedictory Session

Learning from the Conference and Need for Future Research	: Mr. Justin Oliver, <i>Executive Director, CMF</i>
Special Address: Regulator's Perspective	: Mr. B.P. Vijeyendra, <i>Chief General Manager, Reserve Bank of India</i>
Concluding Remarks	: Mr. Sandip Ghose, <i>Principal, CAB</i>

In summarizing the discussions, Mr. Oliver spoke about how useful it was for researchers, practitioners and policy makers to come together in this type of forum. He spoke about how regulator and practitioner presentations and questions will influence future research. Mr. Oliver also spoke about the need for more understanding of the basic impact of micro finance on its clients, and beyond that, the impact of different micro finance products (e.g., different loan sizes). He concluded by encouraging practitioners to participate in the evaluation process.

In his concluding remarks, Mr. Ghose discussed areas of possible collaboration between practitioners, researchers and policy makers. Specifically, he spoke about regulators' receptivity to learning about how to improve the business correspondent model. Mr. Ghose also spoke about the need for MFIs to improve their human resources practices. Mr. Ghose thought that the improvement of HR policies for this group was of the utmost importance.

Mr. B.P. Vijayendra spoke about microfinance's exciting potential, but also from a regulator's perspective, concerns that have arisen with regard to the industry, for example interest rates. He also discussed the problem of ever greening, in which an MFI give an additional to help clients pay off an existing loan with this same MFI. Such a practice improves repayment rates, but masks clients' difficulty repaying loans.