

A Promise to Pay the Bearer

An Exploration of the Potential for Urban Microfinance in India



A joint initiative of



Michael & Susan
Dell Foundation



Acknowledgements

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Executive Summary

The rise of microfinance in South Asia over the last 30 years has always been understood as a primarily rural phenomenon. The majority of microfinance clients in India today access financial services through Self Help Groups (SHGs), many of which have been created through an initiative specifically targeted at the rural poor and promoted by the rural development bank, NABARD. The Indian microfinance sector, outside the SHG movement, has similarly been characterized by a focus on rural markets, with many microfinance institutions (MFIs) following the Grameen approach, incorporating variants of the word "Grameen" (meaning rural) in their very names and mission statements.

The historic focus on the provision of microfinance to the rural poor is entirely understandable given the scale of rural poverty in India. Even today, close to 30% of Indians in rural areas live below the poverty line. Though economic hardship in rural areas continues to be an enormous challenge, important changes are underway in the landscape of Indian poverty.

While 70% of India may still be "found in its villages", India, like the rest of the world, is increasingly urbanizing. Depending on measurement criteria, two to three of the ten largest cities in the world can be found in India, and it is estimated that the country will be more than 40% urban by the year 2030. While the number of rural poor decreased from 25.7 crores (257 million) to 19.3 crores (193 million) between 1991 and 2001, the number of urban poor actually increased from 5.2 crores (52 million) to 6.7 crores (67 million). Despite the large numbers of urban poor, most of who have little or no access to formal financial services, there is relatively little outreach of microfinance in major urban areas today.

Interestingly, the rural focus of microfinance in India, and much of Asia, is in stark contrast with the predominantly urban orientation of microfinance in the rest of the world. While Indian microfinance practitioners have expressed reluctance in the past to target urban markets due to perceived high levels of client mobility and weaker social ties, many practitioners in other regions of the world are often reluctant to penetrate rural areas due to perceived high costs of outreach. Despite persistent efforts on the part of the global microfinance sector in knowledge capture and dissemination, there remain some matters on which regional markets still have much to learn from each other.

Though much of the energy of the Indian microfinance sector to date has been directed towards the rural poor, some of the pioneers of the sector have always had a strong focus on urban poverty. SEWA Bank, for example, was founded in 1974 and has over 1.5 lakhs (150,000) clients, most of them in urban Ahmedabad. Similarly, Working Women's Forum has been providing

microfinance and other livelihood services to poor women in Chennai since 1978. Interestingly, both these institutions have been guided by a holistic approach to combating poverty, steeped in a deep understanding of the myriad of challenges faced by the urban poor.

Recently, some of the largest rural-focused microfinance institutions have made moves towards urban markets. BASIX, SHARE Microfin, SKS Microfinance, and Spandana have launched strategies to penetrate urban markets, some of which are now quite advanced in their execution. In addition, a number of new start-up institutions have recently been launched with a specific focus on urban markets, including Swadhaar FinAccess in Mumbai and Ujjivan Financial Services in Bangalore. There has also been an increasing interest on the part of consumer lenders to explore serving the urban microfinance market directly. This is evident in the entry of mainstream non-bank finance companies (NBFCs) such as MAS Financials. In addition, down-streaming of banks to provide microfinance services is an emerging area of interest, with possible business models being explored by international technical assistance providers such as Accion.

Furthermore, there is also an increasing interest in the urban market at the wholesale and investor levels. Microfinance funds, such as Bellwether and Lok Capital, have expressed an interest in investing in urban institutions, and the Michael & Susan Dell Foundation has an exclusive focus on providing risk capital to start-up urban MFIs, with plans to support as many as 20 institutions in the next five years.

Despite a growing interest in the urban market, the true nature of the needs of urban clients is still somewhat unknown. To shed some light on the specific needs of this segment, the research team conducted an almost 600 respondent survey in randomly sampled slum areas of Delhi and Hyderabad. The research revealed a number of surprises about the financial needs of the urban poor:

- Despite the far greater coverage of bank branches in urban as opposed to rural areas, few slum dwellers have access to formal financial services. While a little over 40% of the respondents have access to formal savings accounts, only 4% have accessed a loan from a bank or non-bank finance company (NBFC).
- Access to formal financial institutions for the poor is constrained by the same barriers found in rural areas, such as the lack of a permanent address or an "introducer" who can facilitate the opening of an account.
- Though there is relatively little access to formal sources of finance, the rate of borrowing within urban slums is still surprising high. The average current indebtedness of the respondents was Rs. 22,543 (approximately US \$ 500) - much of which is drawn from informal sources such as money lenders.
- There is a strong demand for both enterprise loans to finance small businesses and consumption loans to cover family needs such as festivals, illnesses and school fees. Consumption loans in the sample are three times the number of enterprise loans. Enterprise loans, with an average outstanding of Rs. 36,000 (US \$ 800), are on average, twice as large as consumption loans which have an average outstanding of Rs. 18,000 (US \$ 400).
- Though it is difficult to accurately uncover savings rates via quantitative surveys, this

research revealed that 69% of slum dwellers save an average of Rs. 1,415 (US \$ 32) per month across the year, primarily at home.

- While data gathered on remittance flows was limited, it did reveal that both large and small remittances are sent through formal as well as informal channels, ranging in amount from as little as Rs. 100 (US \$ 2) to Rs. 1,600 (US \$ 35).

The potential market for urban microfinance is immense and growing. Based on the findings of the primary study and the figures on urban population and growth, the estimated demand for urban microcredit in 2006 is likely to be in the range of Rs. 22,245 crores (US \$ 4.9 billion), from 99 lakhs to 114 lakhs (9.9 million to 11.4 million) households. The market is likely to increase to between 101 lakhs to 120 lakhs (10.1 to 12 million) households over the next five years. In order to cater to this growing demand, the amount of long term growth capital required for the sector might be as much as Rs. 3,000 crore (US \$ 666 million).

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AP	Andhra Pradesh
BPL	Below Poverty Level (or Line)
CARE	Cooperative for Assistance and Relief Everywhere
CMFR	Centre for Microfinance Research
DWCUA	Development of Women and Children in Urban Areas
EWS	Economically weaker sections
FGD	Focus Group Discussion
GDP	Gross Domestic Product
GoI	Government of India
HUDCO	Housing and Urban Development Corporation
IHSDP	Integrated Housing & Slum Development Programme
IRDA	Insurance Regulatory and Development Authority
JLG	Joint Liability Group
JNNURM	Jawaharlal Nehru National Urban Renewal Mission
KYC	Know your Customer
LAB	Local Area Bank
MFI	Microfinance Institution
MSDF	Michael and Susan Dell Foundation
NGO	Non-Government Organization
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Bank Finance Company
NRY	Nehru Rojgar Yojana
NSDP	National Slum Development Programme
OXFAM	Oxford Committee for Famine Relief
PAR	Portfolio at Risk
PMIUPEP	Prime Minister's Integrated Urban Poverty Eradication Programme
RBI	Reserve Bank of India
SC	Scheduled Caste
SEEP	Small Enterprise Education Promotion Network
SHG	Self-Help Group
SIDBI	Small Industries Development Bank of India
ST	Scheduled Tribe
SJSRY	Swarna Jayanti Shahari Rojgar Yojana
TG	Target Group
UT	Union Territory
UBSP	Urban Basic Services for the Poor
USP	Urban Services Programme

Introduction

The importance of expanding microfinance access in India's cities is best understood in the broader context of the dramatic population shifts currently underway, not just in India, but across the globe. Since the earliest days of civilization, global populations have been gradually urbanizing. In recent years, the rate of urbanization has accelerated to previously unprecedented levels. While the growth of global rural populations has averaged 1.2% annually over the last 50 years, no net increase in the rural population is anticipated in the next 25 years. In contrast, urban populations worldwide are expected to continue to show dramatic growth of 1.83% per year.¹

Splitting this growth rate between developed and less developed countries reveals an even more dramatic trend. While developed countries can expect 0.5% annual growth in their urban centres in the next 25 years, developing countries anticipate 2.3% annual growth.² Driven by such growth rates, by the year 2030, almost all of the most urbanized countries will be found in the developing world, with Asia and Africa each having more urban dwellers than any other continent. Asia alone will account for over half of the urban population of the world.

It appears that much of the initial growth of urban centres is driven by the in-migration of the rural poor. Ravallion³ notes that the poor urbanize faster than the population of a country as a whole:

"...even though poverty is falling nationally with urbanization, the outcome could look quite different in urban areas, since the migrating workers are (at least initially) poorer than the urban population on average."

While urbanisation is generally seen as an outcome of economic development, there are indications that the urbanisation of the developing world is often occurring in advance of sufficient economic growth. Urbanisation, in advance of the build out of appropriate infrastructure and social services, can result in increasing concentrations of deprivation. These centres of poverty can produce social and economic development challenges that are increasingly complex and multi-faceted. Though urban poverty may initially stem from migration from rural areas, it is clear that it takes on a shape and scope of its own, once in place. The challenges of managing urban poverty in the developing world are evident in the fact that almost three quarters of developing countries having enacted policies to reduce migration to metropolitan areas, most to little effect.

The complexity of poverty in large cities calls for a wide variety of various social and economic interventions. Microfinance, in conjunction with other interventions, may prove to be a powerful tool in alleviating urban poverty.

This study is a concerted effort by the Michael and Susan Dell Foundation, Care-India and Intellectap, to understand the complex issues afflicting urban poverty and how access to financial services may act as a key enabler to address these challenges. The findings may assist practitioners, policy makers, investors, as well as entrepreneurs to make informed decisions about urban microfinance markets.

Drawing lessons from around the world and rural India on access to financial services and their impact on poverty, the study attempts to understand the potential of microfinance as a socio-commercial instrument for addressing urban poverty challenges in India. The study takes into account achievements of past urban initiatives, considers current trends in urban microfinance and the perceptions of practitioners, assesses the needs of the urban poor for financial services, estimates the potential demand of the urban microfinance market, and suggests potential investments that might be made to help build the sector.

The second chapter of this study, "Urbanization, Poverty, and Microfinance in India", provides an overview of global and local urbanization trends, and explores the interrelationship between poverty, urbanization and rural migration. This chapter also reviews the role of access to financial services in addressing these challenges. The chapter concludes with the thought that urbanization is likely to play a key role in development discourse in the current century.

Strong leadership and sharing of knowledge is crucial for the emerging Indian urban microfinance sector and to facilitate its movement from rural to urban areas. Chapter three, "The Supply Side", outlines the experiences and views of practitioners in urban microfinance. It presents the vision they hold for the sector, the myths about the urban poor they have challenged through their work, and the future tests and trials that most concern them.

To gain a deeper understanding of the demand for microfinance in urban India, this study collected primary data from two cities - Delhi and Hyderabad. Chapter four presents the "Findings of the Primary Study". This chapter covers indebtedness in urban areas, loan demand and its various facets, demand for other financial services, and effective communication methods to provide an inside view on the urban market's behaviour.

Understanding the market demand and the related financial and human capital requirement is critical to address the demand for microfinance in urban areas. Chapter five, "Projected Demand for Microfinance in India", makes an attempt to look at various projections to arrive at some consensus on market size for urban microfinance. It concludes with insights on the need of financial and human resources to meet the projected demand in a medium term horizon.

The need for financial service access for the urban poor is increasingly unmistakable. Key microfinance stakeholders can play important roles in shaping the future of the sector and in accelerating its development. The final chapter, "Urban Microfinance:

Building the Sector Prudently", identifies these actors, and based on the learnings of the study, provides an overview of the roles and responsibilities each might take up in order to assist the sector in achieving its market potential and contributing towards poverty alleviation by reaching out to the un-served and un-banked urban poor.

The annexure contains details of interviews with the entrepreneurs and investors, the methodology adopted for data analysis, and other elements that complement the findings of the report.

Urbanisation, Poverty, and Microfinance in India

While microfinance in urban areas has developed in many parts of the world, Indian microfinance has been largely rural, due primarily to a traditional focus on rural poverty. However, while 70% of the country's population may still be "found in its villages," India, like the rest of the world, is increasingly urbanising, and addressing urban poverty is fast becoming a significant concern for all stakeholders. The Government has taken steps to tackle poverty in urban areas, and has recognized the provision of financial services as an important strategy for poverty alleviation and enterprise development.

The world is heading towards a major demographic transition and is becoming increasingly urban, with urban areas gaining approximately 6.7 crores (67 million) people every year.⁴ This trend is particularly present in less developed countries, where the growing urban population is set to dominate the coming decades of development⁵ discourse.

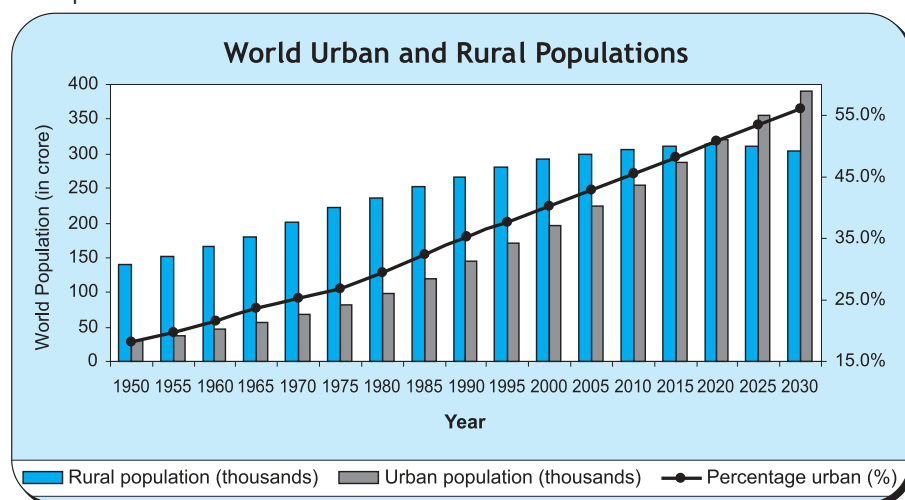


Figure 1:⁶ The World Moving Towards an Urban Future

Rapid urbanisation in the absence of economic growth creates stress in the urban ecosystem, resulting in a cycle of poverty compounded by poor infrastructure, higher living costs, and formation of slums that lack sanitation, potable water and access to health care. According to the United Nation's human settlements agency, UN-Habitat, a large number of less developed nations are experiencing the phenomenon of 'premature urbanization', where the size of cities bears no relation to the state of economic growth.⁷

2.1 The Indian Poverty Equation

"India lives in its villages", the famous quote from Mahatma Gandhi, has defined the vision of Indian policy makers for decades. The idea of "Gram Swaraj", which essentially meant locally governed and self sufficient villages, has consciously or unconsciously informed much of the Indian development policy since independence. Urbanization or migration to cities has been seen as an "evil" that drove the rural population with the promise of employment opportunities and better wages, forcing them to live in slums in unhygienic and deplorable conditions. Urbanization was, thus, an undesirable occurrence, and most initial planning and interventions were designed to prevent rural residents from migrating through attempts to provide the necessary opportunities and amenities within the rural setting itself.

Though causality is difficult to ascertain, it would seem that these policies saw some degree of success. At 27.7% urban population, compared to the global average of 47% and an Asian average of 36% (as per UN estimates for 2000), India has urbanized at a relatively slower rate.

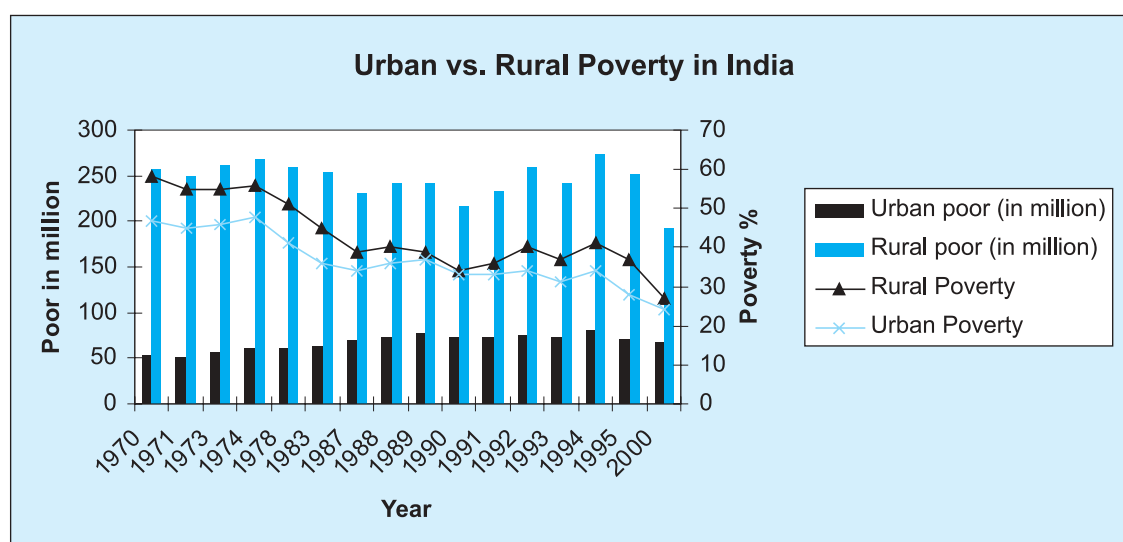


Figure 2: Urban Poverty Percentages Catching up with Rural Poverty in India⁸

Despite these measures and their presumed success, the Indian urban population has shown a sharp upward swing in growth during the period between 1991 and 2001, and is almost twice the rural growth rate (32.1% for urban India compared to 17.9% for rural India). As is clear from the graph, rural poverty is declining both as a percentage of population and in absolute terms, whilst the urban poverty has increased in absolute terms. An analysis of the census data presents some startling findings:

During the years 1970 to 2000:⁹

- The number of rural poor decreased from 25.7 crores (257 millions) to 19.3 crores (193 millions), the urban poor increased from 5.2 crores (52 millions) to 6.7 crores (67 millions).
- From a peak of 1% in the mid seventies, the annual growth rate of the rural poor was -1% in 2000, with a decreasing trend. In comparison, the annual growth rate of the urban poor, though on a downward trend from its peak of around 4% in

the mid-seventies, stood between 1% and 2% in 2000. Thus, in absolute numbers, the poor in the urban areas are increasing.

Acknowledging the challenges associated with rapid urbanization, the National Commission on Urbanisation¹⁰ adds:

"If job opportunities are productive and lead to gainful employment, urbanization becomes a catalyst for economic development. If, however, urbanization is merely a process of transfer of rural poverty to an urban environment, it results in [the] concentration of misery".

With the trend towards increasing urbanization, India's major metros are gaining in size and scope, and are currently amongst the largest in the world. These large cities contain some of the most congested slums and under-resourced squatter colonies in the world, with abysmal living conditions.

At the same time, it is certainly the case that urbanization in the Indian context has been driven by economic growth and the attraction of year-round income earning opportunities, in contrast with the more variable, seasonal cash flows typical of agricultural areas.

However, lack of physical space and infrastructure in the cities means that job creation is often not supplemented by provision of the necessary basic amenities. Hence, the migrants face a trade off: that of earning more hard cash, against the risk of losing the basic dignity of life that the rural areas provided them.

Patterns of urban poverty have some unexpected, and at times counterintuitive, dimensions. For example, incidence of urban poverty does not appear to be closely tied to overall state poverty levels. The urban poverty levels in economically more active states, such as Andhra Pradesh and Maharashtra, are much higher compared to less developed states, such as Uttar Pradesh.¹¹

It is, therefore, apt to sum up the Indian urban saga as a complex interplay between economic growth, rural migration, and insufficiently managed infrastructure development. While economic growth may have created real opportunities for migrants to urban areas, the impact of the pursuit of these opportunities on the quality of life of the urban poor is unclear.

2.2 Alleviating Urban Poverty and the Access to Finance

The Planning Commission, the apex body for social and economic growth planning, is mandated to plan for the overall development of the country. The commission recognizes poverty as an impediment towards a developed India, and hence is focused on tackling it. While poverty alleviation initially had a rural focus, over time, urban development too has figured on the agenda.

The Government of India's urban poverty alleviation initiatives are categorized by Supriti, Barnhardt and Ramanathan¹² into three waves: Housing, Welfare and Credit & Employment. The first wave of housing programmes began in the 1950s and has continued to be a priority. The second wave of programmes was welfare-oriented, starting in the late 1950's and growing in the 1960s and 1970s. The third wave, that

of credit and employment programmes, started in 1977 with the extension of the Differential Rate of Interest scheme to the urban poor.

The erstwhile Urban Poverty Alleviation Programmes included Nehru Rojgar Yojana (NRY), Prime Minister's Integrated Urban Poverty Eradication Programme (PMIUPEP) and Urban Basic Services for the Poor (UBSP).¹³ These programmes, however, left much to be desired both in terms of outreach and impact, mainly because they were designed as coping measures rather than interventions that provided lasting solutions to urban poverty, as urban poverty was still thought to be a by-product of rural poverty.

Over the years, however, urban poverty reduction has gained increased importance. The Planning Commission undertook a paradigm shift in its approach towards urban poverty in its Ninth Plan (1998-2002), stating that urban poverty is a manifestation of marginal and low income employment in the informal sector. It thereby proposed enhancing the capacity of the informal sector by supporting self-employment, group based employment, improving access to credit and technology, and improving the overall legal and physical environment for the poor.

This was followed by the Tenth Plan (2002-2007), which further acknowledged urban poverty, noting that it is often more complex than rural poverty and that microfinance might be an important poverty alleviation mechanism in urban settings. The plan suggested the provision of alternate finance channels for increasing outreach to address poverty.

An important step in the right direction is that the three waves of urban interventions are presently not mutually exclusive, and have also become more holistic with time. Interventions, such as Valmiki Ambedkar Awas Yojana (VAMBAY), focus on providing housing to all urban slum dwellers that are below the poverty line, and other interventions, such as The Swarna Jayanti Shahari Rojgar Yojana (SJSRY), cater to the employment and credit needs of the poor in urban areas. The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) and the State Urban Services Programme in West Bengal and Andhra Pradesh are others that provide relief to infrastructure and service provision to the underserved in urban areas.

In short, while the early focus of the Indian Government development programmes was somewhat tightly focused on the rural poor, in recent years there has been increased recognition of the need to address urban poverty in a holistic fashion, not merely as an outgrowth of rural poverty. Within this increased recognition has been some early acknowledgement that microfinance may have an important role to play in urban poverty alleviation.

2.3 Microfinance in India: Historic Focus on Rural Markets

In light of the widespread poverty in rural India detailed in the previous section, the genesis of Indian microfinance in outside urban settings is not a surprise - it is clear that there is no shortage of demand in these geographies. In addition to underlying demand however, there are several other important factors that have shaped the early development of the Indian microfinance sector.

Microfinance

This report goes by the Reserve Bank of India's definition of microfinance:

"The provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their living standards".

The most important factor in the development of microfinance with a rural focus in India has been government policy. First, the Reserve Bank of India¹⁴ priority sector lending intervention, encouraging banks to lend to the priority sectors, including agricultural areas, has created a real demand at the wholesale level for channels such as microfinance that are able to serve the rural poor. The relative attractiveness of many microfinance programmes, when compared with some of the other priority sector segments, has meant that wholesale financing has been more readily available to grassroots microfinance organizations in India than is in most other countries.

A second government initiative, the creation of the National Bank for Agricultural and Rural Development (NABARD), has proved to be the most important driver in the creation of the Indian microfinance sector. Through its wide scale promotion of the Self Help Group¹⁵ (SHG) model of microfinance, and provision of refinancing capacity building funds, NABARD played an unparalleled role in catalyzing the rural microfinance market.

Parallel to NABARD's efforts with Self Help Groups, the Small Industries Development Bank of India (SIDBI) has played an essential role in catalyzing the microfinance institution (MFI) or Grameen approach to microlending¹⁶ in India. It is interesting to note that the Grameen vision of the role of microfinance has historically been rural in nature. The word "Grameen" itself means village, and the genesis of Bangladeshi microfinance has been in the country's villages. It is clear that this rural focus was carried over in many of the early adaptations of this methodology to the Indian market.

NABARD

National Bank for Agriculture and Rural Development (NABARD) is an apex institution, in charge of policy, planning, and operations in the field of agricultural credit and other economic activities in rural India. NABARD's functions include:

- (i) To serve as an apex financing agency for institutions in rural areas;
- (ii) To provide for institution building for providers of rural credit;
- (iii) To co-ordinate rural finance providers and their interface with national and state level government institutions; and
- (iv) To undertake monitoring and evaluation of projects refinanced by it.

Source: <http://www.nabard.org/org/org.htm>

SIDBI and the SIDBI Foundation for Microcredit (SFMC)

The Small Industries Development Bank (SIDBI) is the principal development financial institution for promotion, financing and development of small scale industries.

Initiated in January 1999, the SIDBI Foundation for Microcredit (SFMC) is an apex wholesaler for microfinance in India, providing a comprehensive range of financial and non-financial services including loan funds, grant support, equity and institution building support to the retailing Micro Finance Institutions (MFIs) to facilitate their development into financially sustainable entities. SFMC also plays a significant role in advocating appropriate policies and regulations and in acting as a platform for exchange of information across the sector.

Source: www.sidbi.in

While the NABARD SHG programme has been the dominant microfinance delivery channel in India since its inception, there is evidence that microfinance institutions are slowly catching up and currently account for 30% of the total microfinance outreach. Recent projections estimate that this trend is likely to continue.

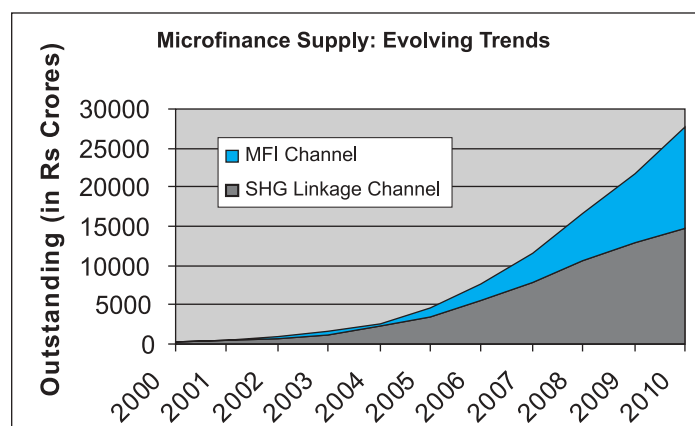


Figure 3: Outreach and Growth of Supply: MFI and SHG Channels¹⁷

One of the key inferences that can be drawn from the above graph is the incline setting up in the MFI channel from 2004. The CAGR in 2004-2005 was 83.8% for the SHG channel and 93.0% for the MFI channel. Opening up the private banking sector and the emergence of equity investors, capacity building institutions, and positive policy movement have all contributed to this steep incline.

The Indian microfinance picture is evolving as the SHG channel is increasingly being augmented by the MFI channel. Microfinance initiatives in urban areas are relatively new and growing quickly, and are using the MFI channel as a model that can accommodate rapid increases in scale and scope of services.

2.4 The Potential for Urban Microfinance

Microfinance today is a global movement; however, it has developed in different ways across the globe. Latin America, Africa, and Eastern Europe have embraced urban microfinance, while Asian microfinance has been predominantly rural. The worldwide

microfinance experience suggests that urban and suburban areas offer equally attractive, if not more attractive, markets for microfinance products and services.¹⁸ Mark Schreiner and Hector Horacio Colombet point to the economic logic of the varying experience between rural South Asian microfinance and urban Latin American experience:

"Much of the success of rural microfinance in Asia depends on low wages and dense populations. For example, it costs much less to get college graduates in Bangladesh or Java to walk or cycle between villages than to get anyone in South Africa or Argentina to drive between rural homesteads."¹⁹

In countries where urban microfinance predominates, it has been driven primarily by the belief that urban markets are a lower cost to serve. Given the extreme density of India's major cities, it seems likely that greater efficiencies, than what are seen in rural areas, can be achieved by MFIs serving urban customers.

Rural microfinance has been the story of the first generation in India. Drawing inspiration and reason from history, the pioneers and mainstream support, the microfinance sector has embarked upon the second generation of change. These changes include a new policy framework, migration from providing only microcredit to a diversified product set within microfinance, and a new interest in urban markets.

The Supply Side Story

Microfinance in India is rapidly evolving to the next generation. The changes are evident in the motivations for microfinance, leadership, nature and availability of institutional finance and on-lending funds, policy framework and methodologies supporting client-friendly outreach.

From a rural poverty focus, the Indian microfinance sector is now moving towards addressing poverty in urban areas as well, with due attention to service provision in the urban space. While the opportunities in urban areas are immense, with potentially faster breakeven times, risk factors are yet to be clearly understood in the urban context.

3.1 Championing Urban Microfinance

Both the policy and practice of microfinance in India have been predominantly rural, as the nomenclature of the stakeholders reveals. For example, the keystone of the rural microfinance movement based on Self-help has been the National bank for Agricultural and Rural Development. Similarly, a quick glance at the names of most of the top Indian MFIs, such as SHARE Microfin, (Society for Helping, Awakening Rural poor through Education), SKS (Swayam *Krish*²⁰ Sangham) Microfinance, Village Welfare Society, and ASA-GV (Activists for Social Alternatives- *Grama*²¹ Vidiyal), *Grameen*²² Koota, reveal their rural roots and biases. Thus, the success of rural microfinance is credited to exceptional microfinance leaders, support from the powerful apex banking institution, policy makers, donors, and active private banking support.

However, as far back as the 1970s, successful initiatives in urban microfinance, such as SEWA Bank (established in 1974 in Ahmedabad) and Working Women's Forum (established in 1978 in Chennai, formerly Madras) have served the needs of the urban poor in their areas of operation. The intervention framework employed by these institutions is very close to what the development planners discovered during the tenth five year plan of 2002-2007 (i.e. development occurs when conditions enhance the capacity of marginal workers to become self employed by providing access to credit and other linkages).

Today, a large numbers of microfinance entrepreneurs are looking to focus on urban areas, attempting to cater to the markets of metropolises such as Mumbai and Delhi. These urban startups are a part of the generational change in microfinance, with

formerly rural-focused players also beginning to set their sights on urban areas.

The evolving nature of the sector reflects on the nature of challenges that the leaders of microfinance institutions face today. The pioneers, both rural and urban, grappled with survival issues; on-lending funds and the next tranche of grants being the key concerns. The new generation microfinance institutions have to face the challenge of growth, including raising equity, ensuring quicker outreach, and improving efficiency and governance.

These differences are captured in the table below that provides an interesting overview of the generational change that microfinance has undergone. The classification and explanation in the table is largely empirical, and it is likely that the differences as depicted are due to the evolution of microfinance rather than any key difference between rural and urban focus.

First generation Microfinance (Predominantly rural)	Second generation Microfinance (Predominantly Urban)
Leadership	
<ul style="list-style-type: none"> • NGO Leaders, mostly with a social motive • NABARD, as part of its focus on rural areas 	<ul style="list-style-type: none"> • Successful Mainstream Finance, including Commercial banks • Successful Rural Entrepreneurs, wanting to address poverty holistically • Ex-employees of Rural MFI, wanting to become entrepreneurs
Motivations	
<ul style="list-style-type: none"> • Developmental Strategy with a historic focus on rural areas • Poverty Alleviation in the rural areas 	<ul style="list-style-type: none"> • Quicker Sustainability, making business sense • Market Driven, focusing on the delivery of Financial Services • Growing inequality between the rich and the poor
Institutional Finance	
<ul style="list-style-type: none"> • National and International Donors, with social and development motives • Government, with development motives 	<ul style="list-style-type: none"> • Social Venture Funds, with double bottom line returns in mind • Private Foundations, with double bottom line returns in mind
On-lending Finance	
<ul style="list-style-type: none"> • Public Sector Banks, as stipulated by policy • Private Banks, as stipulated by policy 	<ul style="list-style-type: none"> • Overwhelmingly Private Banks, making more business sense
Methodology	
<ul style="list-style-type: none"> • Self Help Groups • Grameen Groups • Joint Liability Groups 	<ul style="list-style-type: none"> • Diverse methodologies, including Joint Liability Groups, Self Help Groups, and Individual Lending

Figure 4: An Empirical Comparison of the Factors Affecting the Development of Microfinance

The groundwork for rural microfinance has created the right platform for urban initiatives to jumpstart entrepreneurship. The emergence of urban socially responsible entrepreneurs, interested social venture funds and private foundations with the motivations to make double bottom line returns (both financial and social), coupled with the increasing interest from rural microfinance institutions to expand into urban areas, have added to the increased activity in urban microfinance markets. The supply side story is being written by the vision and dedication of the leadership of microfinance institutions and their support systems, such as investors and donors, and it is important to gain insights into their mindset in order to construct the supply side visage for urban microfinance.

This chapter contains the views of practitioners, investors, and social entrepreneurs of microfinance. These individuals were interviewed based on their current or proposed involvement in urban microfinance and their thoughts on the shape of urban microfinance in the foreseeable future. The interaction was conducted either in person, over phone or over email, and the summaries of the interviews are available as Annexure I. The table below introduces these individuals and their organisations to the reader.

Name of the Institution	Interviewee	Designation	Founded	Urban Focus Since
Microfinance Institutions				
SEWA Bank, Ahmedabad, Gujarat	Ms. Jayshree Vyas	Managing Director	1974	1974
Working Women's Forum, Chennai, Tamilnadu	Dr. Jaya Arunachalam	Founder / President	1978	1978
Swadhaar Fin Access, Mumbai, Maharashtra	Ms. Veena Mankar	Founder / Director	2005	2005
BASIX, Hyderabad, Andhra Pradesh	Mr. Hemanth Valvekar	AVP	1997	2005
Ujjivan Microfinance, Bangalore, Karnataka	Mr. Samit Ghosh	Founder / CEO	2005	2005
Grameen Koota, Bangalore, Karnataka	Ms. Vinatha Reddy	Founder/CEO	1999	2006
Commercial Banks				
ICICI Bank, Mumbai, Maharashtra	-	-	-	-
ABN - AMRO Bank, Mumbai, Maharashtra	-	-	-	-
Others				
Michael and Susan Dell Foundation	-	Investor	-	-
Aavishkaar Goodwell - Investment Fund	Mr. Wim van der Beek	Partner	2006	-
Lok Capital - Investment Fund	Mr. Vishal Mehta	Fund Manager	2004	-
Accion International	Mr. Siddhartha Chowdri	Advisor for India		2006
Unitus - Funder/ Tech. Advisory	Mr. Sandeep Farias	Country Director	2001	2005
SIDBI - Funder	Mr. A. Vikraman	Chief General Manager		
	Mr. Vijay Mahajan	Co-founder, BASIX		

Figure 5: Microfinance Stakeholders Featuring in the Study

3.2 Leadership and Motivation: Who Leads the Urban Microfinance Sector?

For the purpose of this study, urban microfinance practitioners in India may be classified into four categories: Pioneers, Rural Converts, New Social Entrepreneurs, and MFI Managers-turned-Entrepreneurs. It is acknowledged that this classification is based largely on observation and is overlapping. It is, by no means, the only way to categorize the stakeholders, and is open to debate and interpretation.

The Pioneers had an understanding of urban poverty issues, had the ability to venture into unknown territory and were driven by a long-term vision. Shri Mahila Sewa Sahakari Bank (SEWA Bank) was established by 4,000 self-employed women in 1974. Today it has over 1,50,000 depositors and a working capital of Rs. 10 crores (US \$2.2 million).²³ The Working Women's Forum (WWF) was initiated in 1978 as a social organisation to bolster the rights of poor working women. Access to credit was the forum's first initiative, but today WWF has expanded its focus to include education, health care, and all other basic services.²⁴

The Rural Converts are the first generation rural microfinance sector leaders, who decided to confront the multi-faceted dimensions of poverty when evidence suggested that urban poverty was severe and that poverty in India had increased in absolute terms. Vijay Mahajan, co-founder of BASIX and a thought leader in the microfinance sector, quoting from the National Sample Survey (NSS) data, described BASIX's intervention in urban areas as part of its mission strategy to address increasing poverty. Share Microfin, Spandana, and SKS²⁵ Microfinance are other rural institutions leading the assault on urban poverty by rolling out an urban microfinance model.

Liberalization of the Indian economy in 1991 paved the way for unprecedented economic growth, creating opportunities and wealth for young Indians. The GDP of the country grew at a rate exceeding 6% per year during 1992-93 to 2000-01.²⁶ This economic growth also brought the widening inequality between the rich and the poor into sharp focus, considering that the GINI Index of the country rose from 0.27 in 1993-94 to 0.3 in 1999-2000.²⁷

The New Social Entrepreneurs are professionals who achieved success in commercial life, were affected by the growing inequalities, and saw microfinance as an opportunity to address the divide. The success of rural microfinance as a sustainable and entrepreneurial option attracted these social entrepreneurs to microfinance. The starkness of urban poverty and its presence in their immediate surroundings were motivations for some of them to look at interventions in the urban setting as possible avenues for tackling poverty. The promoters of Ujjivan in Bangalore, Swadhaar FinAccess in Mumbai, and Ajeevika in Delhi are such entrepreneurs.

The fourth category of urban microfinance practitioners are former managers of rural microfinance institutions who decided to strike out on their own. These leaders are able young men and women, looking for leadership opportunities and setting up new institutions strengthened by the enabling environment from investment funds and the evolving market oriented approach of microfinance. The promoters of Aarohan Microfinance and Sonata Microfinance are examples of Managers-turned-Entrepreneurs starting up microfinance in urban areas.

While it is known that the first generation rural microfinance entrepreneurs adopted microfinance to tackle poverty, a pioneer in the urban microfinance space, Dr. Jaya Arunachalam of Working Women's Forum, identified the same social drivers while defining her key motivations:

"Urban poverty is quite complex and is not just [a] lack of access to financial services. It is very challenging and the plight of women is exacerbated by these additional webs of urban poverty."

Eclipsing the welfare-based approaches of early microfinance, current rural and urban entrepreneurs are looking to instil a culture of sustainability in their institutions. With the increased scale of operations and well defined business models, sustainability and efficiency are the benchmarks in microfinance. The urban microfinance entrepreneur's attitude toward commercial viability may be attributed to this generational learning; however, it is not far fetched to conclude that demographic features such as higher population density, higher client service efficiency and potentially larger loan sizes are equally inspirational business logic. Samit Ghosh of Ujjivan believes:

"Urban microfinance should achieve quicker breakeven, it is too early to say if my experience is the same, but I hold the belief based on experience in other parts of the world."

Increasingly, one finds that leaders and entrepreneurs with professional backgrounds would like to integrate their professional understanding into interventions for achieving social goals and creating a visible impact. As Veena Mankar of Swadhaar says,

"The fact that urban poverty is so stark and in the face and not much was being done about it motivated me to take up the challenge."

Leadership holds the key to success of the urban microfinance sector in India. The positives of having an urban perspective, prior financial experience, new thought processes, and the corporate insights of a new generation of entrepreneurs, are an encouraging sign for the future of this sector.

3.3 Commercial Finance: Grants to Equity

The sources of funds for early microfinance were linked intricately to social objectives. Being one of the key policy instruments for the government to bridge the opportunity divide between urban and rural India, institutional finance came from government subsidies or from donor agencies, most notably NABARD, SIDBI, the Swiss agency for Development Corporation (SDC) and the Department for International Development (DFID). This finance was crucial as it helped establish institutional infrastructure that allowed rapid growth without jeopardizing the microfinance institutions' survival.

The profile of the institutional investor providing funds to MFIs has changed over a period of time as microfinance has gained scale, size and sustainability. The emergence of private social venture funds and private foundations, with a more professional approach and focus on commercial microfinance, has assisted the urban microfinance sector more than emerging institutions in the rural area. Vishwananth Prasad, Bellwether's Fund manager, aptly summarized the focus on the urban institution,

"The fact that our urban MFI investments are outpacing the rural ones confirms our hypothesis that urban operations would be more efficient. They [the urban MFIs] are exceeding their own projections made at the beginning of the year."

Philanthropic foundations, such as the Michael and Susan Dell Foundation (MSDF), are looking to invest a substantial amount of money over the next 5 to 10 years in specifically urban areas in the six largest cities of India - Mumbai, Delhi, Kolkata, Chennai, Bangalore, and Hyderabad. The foundation has an exclusive focus on providing risk capital to start-up urban MFIs, with plans to support as many as 20 institutions in the next five years. According to the foundation:

"MSDF's initiative is designed to catalyze microfinance in India's cities by systematically attracting talented entrepreneurs and providing start-up capital and targeted capacity building to spur their development."

Mr. Wim van der Beek, partner at Aavishkaar Goodwill India Microfinance Development Fund, whose fund's objective is to increase poor people's access to affordable financial services by developing entrepreneurial MFIs with patient risk capital says:

"Urban Microfinance is clearly benefiting from second generation development in microfinance. This, coupled with the fact that urban institutions are catering to an underserved poor population, makes them an interesting social-commercial investment choice. Urban microfinance is a strategic investment area for Aavishkaar Goodwill."

With an immensely underserved or un-served population in close proximity, limited competition and strong infrastructure backed by sophisticated management teams and technology, start-up Urban MFIs have the pull to sway investors towards them. Vishal Mehta of Lok Capital says:

"We are encouraged by the profile of people starting urban MFIs, their experience from the corporate sector is crucial in managing these institutions on commercial principles' gives us more confidence."

3.4 Methodology: Retaining Social Collateral with a Market Focus

The two traditional methodologies to deliver microfinance are the Self Help Group and the Grameen model. Innovations have taken place around these, and Joint Liability Groups, Individual Lending and Hybrid methods have evolved as new methodologies of lending to the poor. Hybrid models incorporate larger group sizes, similar to the SHG model, but follow the rigor of the Grameen model. Individual lending is the common model of retail lending, based on individual credit requirement and with individual liability.

Rural microfinance has seen methodological evolution, but some practitioners believe that urban microfinance is more amenable toward innovations in lending methods. The driving force behind innovations appears to be the desire to retain social collateral without hurting the growth of the on-lending business. This has led to modifications in all aspects of delivery, from the number of members in the groups and the frequency of meetings, to the modes of disbursal. Traditional rural models are being tried out in urban areas by institutions such as Sanghamithra, hybrid Grameen models are being rolled out by SPANDANA, while BASIX is using the Joint Liability Group model. Some

institutions are also experimenting with individual lending methods in their urban microfinance programmes. Individual lending, which does not utilise social collateral to the same extent as group lending, is being practiced by several microfinance institutions as a solution to the time-management issues expressed by group borrowers who do not have time for weekly meetings; instead, frequent door-to-door visits are carried out to ensure loan repayment.

The debate on methodology is a vibrant one. While opining that women's groups could be more stable than men's groups, Mr. A. Vikraman, Chief General Manager of SIDBI, Lucknow, thinks that both can be tried in urban slums. He further states that:

"Individual lending seems to work better in urban situations but group lending can be tried in more settled older slums."

Veena Mankar of Swadhaar, conducted focus group discussions in Mumbai slums. The discussions indicated that it would be difficult to work with SHGs in an urban setting, because of lack of time, different opportunities on hand, and the fact that natural groups were not necessarily available. However, she believes that people prefer individual loans, but are often willing to form only very small groups (two three members).

Agreeing with the finding, Samit Ghosh of Ujjivan states that,

"Loan size beyond Rs. 15,000 (US \$ 330) cannot sustain the social collateral, we would need to innovate as the loan size increases".

That methodological adaptations are needed is also echoed by Vinatha Reddy, founder of Grameen Koota in her statement:

"We use the Grameen model, but overwhelmingly as the members mature over loan cycles, they want individual large loans."

She adds though that Grameen Koota continues to follow group lending methodology, the response has been good.

However, the founder of Working Women's Forum, Dr. Jaya Arunachalam believes that it is not the group versus the individual argument. She states:

"Groups are just an efficiency inducing and solidarity enhancing mechanism. We use groups in ways that are convenient to poor people, especially women. Good group methodology would not enhance transactions costs for the poor like in SHG sittings - tell me, would you sit in an SHG for hours every week to get a loan and maintain records. I would not, as it would affect my livelihood."

Samit Ghosh of Ujjivan understands the limitations of group liability, and says:

"Group liability works for temporary cash flow dislocation in urban settings, but not for permanent liability arising out of loss of a performing asset. Groups may play the role of ensuring repayment. But in such circumstances where the asset is lost, it would not be easy to make the group pay for the entire asset."

Putting forth a case for client preference for individual dealing in other financial products, especially savings, Jayshree Vyas of SEWA Bank says:

"Many of our clients value secrecy with information on their savings! This is not possible in group savings, and hence individual accounts are preferred."

Despite the wide variety of delivery channels, almost all methodologies are represented in Indian urban microfinance across the country. Along with experiments with the tried and tested models, practitioners are on the watch for creative approaches to make urban microfinance grow and scale up in the most viable manner.

3.5 The Myth and Reality of Urban Microfinance

Urban poverty and urban microfinance continue to carry many more myths that need to be unravelled and discussed. The study tried to peek into the minds of the practitioners to understand some of the myths that they discovered were unfounded during their journey, and at the same time, trying to find those beliefs that still hold true.

Migration appears to be the single biggest myth about urban microfinance. Calling it the most unfounded belief, Samit Ghosh of Ujjivan says:

"That the Urban poor are mobile is a hyperbole; my belief is that 80% of urban poor are rooted to their surrounding."

Veena Mankar agrees that while they did assume that urban people are mobile, their final conclusion is that most people have been living in slums for a generation or more. Her finding is that mobility is temporary, and in spite of seasonal migration between the village and the cities, people often come back to the same slum that they were living in earlier, and that the risk from mobility is more from relocation and slum rehabilitation programmes.

Lack of social cohesion in urban India appears to be another myth that most practitioners found to be untrue. Dismissing it Samit Ghosh states:

"My belief is that the urban clientele is as cohesive, and at times more cohesive compared to the rural clients. Most of the urban slum clients have not only lived together, but have faced similar threats (such as disasters, fire, and evacuations), and lived together through all this."

However cautioning words came from Vijay Mahajan:

"Social cohesion is linked to the age of slums; older slums are more amenable to group lending than new slums, provided, the older slums have a stable population."

There are diverse facets regarding the loan sizes in urban areas. Vikraman of SIDBI observes that:

"Loan sizes in rural the portfolio of SIDBI is Rs. 4500 (US \$ 100) while it is Rs. 20,000 - 25,000 (US \$ 444- 555) for the urban areas."

Veena Mankar mentions that significant numbers of borrowers in the slum population may actually be the wage labour or working people, and may require small emergency loans to even out cash flow, rather than loans only for building productive assets. Samit Ghosh concurs with the statement and adds that it seems like consumption finance might form a large part of Ujjivan's portfolio.

Views among practitioners differ, and Dr Jaya Arunachalam adds her opinion on the loan size issue:

"As we operate in Urban, Peri-Urban and Rural Areas across three states, I can say that it is a myth that urban micro-finance requires larger loan sizes. Our experience shows that the loan size depends on the specific enterprise/service context."

The report would elaborate further on the debate of loan size in the findings of the primary data analysis, in Chapter 4.

Lack of knowledge about financial instruments with the urban population, and financial viability of urban microfinance, are the two beliefs that most practitioners agree are true.

One of the keys to successful policies and practices is identifying and disproving the myths of urban microfinance. As leading microfinance practitioners continue to share their knowledge and experience, urban microfinance can increase its outreach and better serve the urban Indian poor.

3.6 Scaling up Urban Microfinance: Challenges of Growth

The practitioners of urban microfinance are facing some unique challenges. Urban areas, especially the large cities, pose property and human resources cost challenges and the fear of unscrupulous competition. The strategic focus of urban microfinance, at times, needs to be decided based on the area of operations and the contextual challenge.

Veena Mankar of Swadhaar believes determining the right methodology is a key challenge, and will continue to be so as they scale up. Her belief is that formal financial systems that helped banks to retail well, such as the system of credit scores, may be the key to meeting the scale-up challenges in urban microfinance. She believes that technology may have a major role to play in keeping costs down while scaling up the retail microfinance model. The key is to find the right balance between technology, cost, and methodology to deliver microfinance. Vinatha Reddy of Grameen Koota agrees to the challenge and states:

"Since we were unsure of the differences in an urban setting when compared to the rural, we started off first in the semi-urban areas for a better transition of our methodology."

Human resource management seems to be a key challenge for the sector in general. The higher opportunities that the urban set-up offers make it difficult for the institution to retain staff. Keeping staff attrition low and retaining staff are the key challenges for urban MFIs according to him. Veena Mankar holds a similar view:

"Finding, recruiting, training and retaining staff is a huge challenge. Attrition at the loan officer level may be very high as we could face competition from FMCG companies for our sales staff, once they acquire computer, language and other skills of working in a formal organisation."

Interestingly, institutions such as BASIX and Grameen Koota did not see attrition as a major challenge. The supply of trained staff from their rural microfinance settings may be a mitigating factor they have in place compared to start ups such as Ujjivan and Swadhaar.

Real estate costs are another major challenge. While a spacious branch office in a small town or village costs an MFI in the range of Rs. 3000 per month as rent, the costs for a medium sized office in an urban area could be twice or even three times that, depending upon the city and location of the branch. Veena Mankar observes:

"Our strategy to be based outside the slums means our branch costs are very high, making our scaling up effort challenging. It is just not the cost, the ability to find right space is another challenge."

Challenges of slum destruction, evacuation and rehabilitation may cause much distress to the MFI operations. Geographical expansion to other cities is a strategy that Vishwanath Prasad of Bellwether advocates for MFIs.

"There are risks such as the threat of slum destruction, road widening etc. Some urban investments of ours are in a single city. A higher concentration of risk in a certain city can be offset to some extent by expanding to other geographies."

New and uncharted territories and an emerging market, combined with the fact that many of these institutions are startups, increases the risk profile of the urban MFI. According to Sandeep Fairas of Unitus:

"Urban MFIs, may be viewed as more risky than the established rural MFIs, as they are mostly start ups and are operating in untested territories. However with the passage of time once these institutions have established a track record, these risks would not be as significant."

Vikraman of SIDBI shares the apprehension, stating higher risk as one of the important reasons for urban operations being a higher cost model:

"Interest rates are higher in urban portfolios since risk is higher (18- 24%) as opposed to 15-16% in the rural portfolio".

Mitigating these challenges calls for a well coordinated effort on the part of urban microfinance institutions in the area of capacity building, knowledge sharing, and technology.

Experiences in the urban microfinance domain are limited, and hence it is not possible to make definitive conclusions. However, the practitioners believe that urban microfinance has the potential to scale up and impact poverty. Although the knowledge gap is visible, cross learning is already taking place and would continue with increased number of institutions becoming serious players.

Client Voices for Product Choices

The potential poor urban clientele are still an unknown quantity as a likely market. The primary research, through a survey of 596 respondents in randomly sampled slum areas of Delhi and Hyderabad, was conducted to gain insights into their minds. The findings ranged from ones that discarded widely held beliefs, to ones that confirmed long standing views. The information is presented in a manner so as to assist microfinance practitioners to design customer-oriented, need-based and sustainable urban microfinance services/products, and to understand the implications of other product attributes. The importance of gender dynamics to decision making in urban households is also presented.

4.1 The Microfinance Needs of the Urban Poor

Perspectives on the urban microfinance space have been diverse, with each opinion putting forth its own supporting facts. However, the urban microfinance client is still largely an unknown quantity.

As an emerging sector, primary research in the field of urban microfinance is limited, and there is a dearth of knowledge at all levels - be it at the level of the client, or at that of the investor. However, the success of financial initiatives is intricately linked with the understanding that the financial institution has of its customers. Given the current state of the microfinance sector in India, with its emerging focus on the urban space, it seems that information in terms of client behaviour and the magnitude of the potential market are critical to facilitating an in-depth understanding of the sector.

A review of existing literature revealed that primary researches with quantitative data and statistically relevant samples appear to be the key to bridging the knowledge gap in the sector. It is obvious that the sector needs research studies and quantitative analysis of data at this early stage of its evolution.

The objectives of a quantitative study would be to understand the magnitude of the use of financial services by the urban clientele, and thence develop an estimate of the market size for the whole of India. As an effort to avoid biases on the basis of gender and estimate the financial service needs of both the men and the women, the household was taken as the unit of the study. A primary study with a statistically relevant sample was designed with the intention to collect and analyze information from the urban slums to assist institutions in developing robust urban market entry strategies.

What's in a name?

The layman's concept of slums and their colloquial definition varies considerably across India. There are regional differences in the names by which these slums are known. For example, in Delhi, slums are commonly called 'Jhuggi-Jhopri', whereas in Mumbai they are known as 'Jhopadpatti' or 'Chawls'. Slums in Kolkata are known as 'Bustees', 'Cheris' in Chennai, and 'Keris' in Bangalore. However, it should be noted that the physical characteristics such as lack of infrastructure and cramped living conditions in most of these slums are the same.

The study team debated the appropriateness of various indicators such as the below poverty line population, unbanked population and the slum population as representative sample for the study, and finally chose slums as the most representative. The reasons for choosing slum²⁸ as a proxy for urban poverty included their being a major subset of the unbanked or below the poverty line population, in addition to the presence of clearly defined geographies associated with them. Their coverage by the census made them an attractive indicator for the purposes of extrapolation, as well and our belief that that slums hold large concentration of informal sector workers, who are likely to be the most underserved subset in the urban areas.

The study collected primary data from two cities in India - Delhi and Hyderabad. The survey sample size, at 95% confidence level and 6% margin of error, came to 267 households' data points for each city, and was rounded off to 300 data points. Household was chosen as the unit of the survey to cover beyond individual needs. A list of the slums and their populations was created for both cities (Hyderabad-Secunderabad are considered to be a single city for sampling) using data from their respective Municipal Corporations. The slums were selected randomly from this list, and 5% of the respondents were chosen from each slum to arrive at the 300 data points for each city. 15 slums in Hyderabad and 17 in Delhi formed part of the study, and Annexure Two provides the list of slums visited during the primary study. For the purposes of the primary research, the number of valid data points came to 596.

The study also conducted three focus group discussions in order to complement the household data gathered in the quantitative survey wherein the head of the household were predominantly male.

The study faced several limitations, and although the team took adequate safeguards, it is important to mention these limitations.

Delhi presented a unique challenge to the study, as data collection coincided with the slum eviction drive. As a result, the study team was viewed with suspicion, and this negatively affected the data quality. Study did not manage to cover informal service providers in its survey. The team's attempt to seek inputs from them regarding products, service charges and other details, were stonewalled.

Lack of awareness amongst respondents on products such as insurance or remittance was a serious limitation while exploring the scope of these services. There are areas for further research that would add value to the sector, including insurance services and remittances.

4.2 Profile of the Respondent Households

The National Sample Survey (NSS),²⁹ with the survey spread over 4755 villages and 2669 urban blocks, covering 59159 randomly selected households, indicates the following for the urban respondents:

Overview ³⁰	Urban	
Average household size	4.4	
	Male	Female
Literacy Rate	81.09%	64.05%
Population: Employed per 1000 persons	54	54
Population: Unemployed per 1000 persons	117	95
Average wage-rate for casual labourers (In Rs.)	75.51	44.28

Figure 6: NSS data for Employment Survey: Data for Urban Areas

The national average family size per urban household is five people.³¹ We would expect the family size of our sample to be above the National Sample Survey figure (as the latter would include non-slum residents) and closer to the national average, as the underprivileged classes have larger family sizes. The education and literacy levels of the study sample is expected to be way below the National Sample figure of 4.4 people, as shown in the table above.

The study survey indicated that in an average household, a male primary earner is the household head (95% respondents were male earners) with a miniscule number of women as primary earners (5% of respondents). 65% percent of the households had more than two earners and 18% of the households had a female secondary earner.

As expected, the average family size per household in the study sample is 5.14 people, while 93% of the respondents had education up to, or below, the matriculation level.

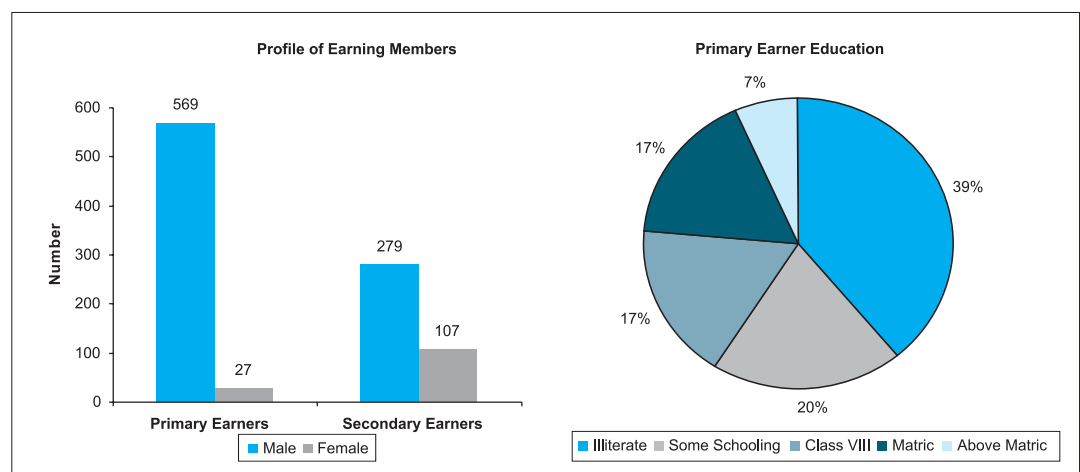


Figure 7: Respondent Profile: Earning Members and Education

4.3 The Opportunity: Significant Demand for Urban Microfinance

The experience of many MFIs would indicate that there is little investment required for creating a demand for microcredit. In many cases, it is a market that requires no advertisement for demand creation.

In this study, this is brought out by the fact that in spite of the paucity of service providers and variety of services, credit offtake in the slums is a sizable amount. While it was believed that urban loan sizes were large, the researchers themselves were surprised at the magnitude, despite using a methodology that was expected to underestimate loan sizes.

4.3.1 Credit: The primary need

The study queried the respondents the average indebtedness instead of demand for loans during the survey; the reason being that understanding the current debt load is a more conservative approach to estimating market size. However, the researchers recognize that not only does this underestimate the size of loans that were originally taken by clients (as it just addresses current balance outstanding), but it also does not indicate how much borrowings poor clients might access if they had the option. This means that the estimates in this study are likely to underestimate demand on both these counts.

The average indebtedness of an urban household is Rs. 22,534

- A high average indebtedness indicates an even higher loan size demand
- There seems to be demand for both large loans (>RS 20,000) and small loans (<RS 5,000), with relatively less demand for mid-sized borrowings.

Out of the sample of 596 respondents, only 204 (34%) responded to having taken loans. The remaining 66% of the respondents either responded to having no loans or miniscule loans (to the tune of Rs. 50 or US \$ 1!).

The high average indebtedness of Rs. 22,534 (US \$ 500) indicated a high appetite for credit among the urban poor, which is corroborated by A. Vikraman of SIDBI who says that the average loan sizes in urban areas in SIDBI's portfolio are between Rs. 20,000 and 25,000 (US \$ 450 and US \$ 550).

The average indebtedness of an urban household is Rs. 22,534

- *A high average indebtedness indicates an even higher loan size demand*
- *There seems to be demand for both large loans (>RS 20,000) and small loans (<RS 5,000), with relatively less demand for mid-sized borrowings.*

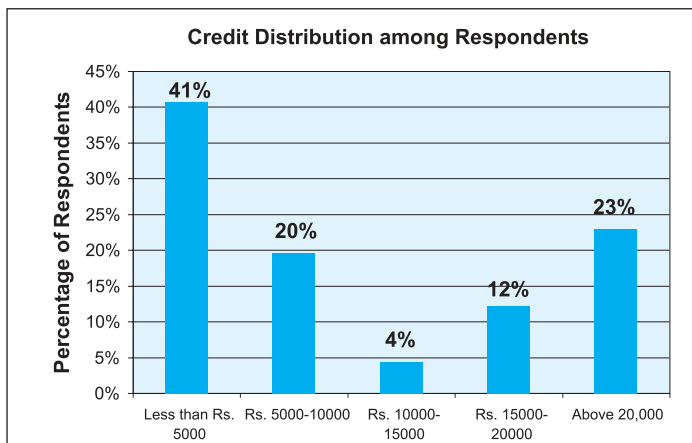


Figure 8: Loan amount versus number follows a "U" curve

However, a closer scrutiny of the data suggests that average indebtedness may not be a true representative of the very heterogeneous credit obligation behaviour of the urban poor.

The graph shows that loan demand is not uniform and both small and large loan sizes are currently taken.

Almost 40% of the sample population has a loan obligation of more than Rs. 15,000 (US \$ 330), while 60% of the respondents had loan obligations below Rs. 5,000 (US \$ 110). Only 23% of the clients took loans above Rs. 20,000 (US \$ 440).

However, the current shape of the distribution may be a function of supply rather than demand, and multiple small loans may be a strategy to cater to larger requirements in the absence of access to larger amounts from single sources. This has been corroborated by practitioners such as Mrs. Veena Mankar of Swadhaar, who says:

"While the demand for loans is in the range of Rs. 10,000-30,000, many clients nevertheless avail of smaller loans in the absence of a choice."

Practitioners are also wary of extrapolating the demand for larger loan sizes across the urban areas. According to Dr. Jaya Arunachalam of Working Women's Forum, loan sizes depend on the specific enterprise or service context, and urban areas do not necessarily mean larger loan sizes. This was brought out on comparing the purpose and size of the loan in the sample data.

4.3.2 What is the credit used for?

- Most large size loans are for entrepreneurial activities and small size loans for consumption and emergency purposes
- A substantial number of urban earners are wage-employed and need consumption and emergency loans
- A relatively lower number of households seek enterprise loans
- Most large size loans are for entrepreneurial activities and small size loans for consumption and emergency purposes
- A substantial number of urban earners are wage-employed and need consumption and emergency loans
- A relatively lower number of households seek enterprise loans

On comparing the purpose and size of loan, it is clear that larger loan amounts (> Rs. 20,000) are being used for productive assets, such as work equipment, livestock, and housing and infrastructure. The average loan outstanding depends on the purpose for which the loan is taken as shown below.

Loan Type	Average Outstanding amount (in Rs.)
<i>Enterprises:</i>	
Work Equipment	36,000
Livestock	33,000
<i>Consumption:</i>	
Infrastructure/Housing	27,000
Social Expenses	25,200
Education	14,500
Medical	9,600
Others	3,000

Figure 9: Enterprise Loans Are Much Larger Than Consumption Loans

Loans taken for self-employment or enterprises are larger than loans taken for consumption (education, medical and social expenses), as shown in Fig 3. In a similar point, Vishwanath Prasad observes:

"Enterprise loans need higher loan sizes as the business activity and volumes are high. If a vegetable vendor in a village does Rs. 200/- worth of business daily, for his urban counterpart, it's Rs. 2000/-."

Out of the 204 respondents who had taken loans, the total recorded consumption loans were 75%, and the total amount of loans taken was about Rs. 28 lakhs (\$ 60,000). For the 25% entrepreneurial loans, the amount was Rs. 18 lakhs (\$ 41,000). That is, close to two fifths of the total recorded loan portfolio of the sample was with around one quarter of the clients.

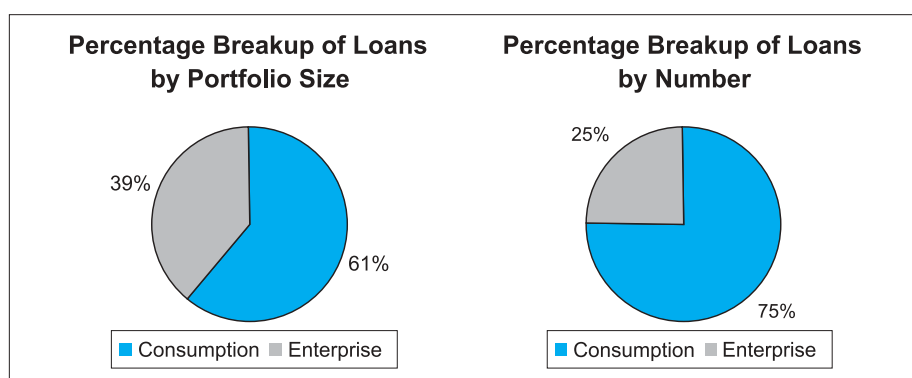


Figure 10: More People Took Consumption Loans than Entrepreneurship Loans

The number of loans taken for self-employment and productive assets is much lower than those taken for consumption purposes. This may be due to the fact that many of the poor are not self-employed, but are wage labourers. Of the total respondents of the study, 45% were wage employed. Building on the observations offered by Ujjivan founder Samit Ghosh on his organisation's urban clients, it may be that most of the loans taken by these individuals would likely be used for consumption purposes and not to finance a business.

The higher average loan outstanding amounts for enterprise loans could suggest an alternate reason for their lower demand. These loans require a substantial amount of collateral that the prospective borrower would scarcely be able to afford. However, consumption loans of relatively small amounts are taken to fund immediate requirements (primarily social and medical). A further break-up between enterprise and consumption loans is given in the figure.

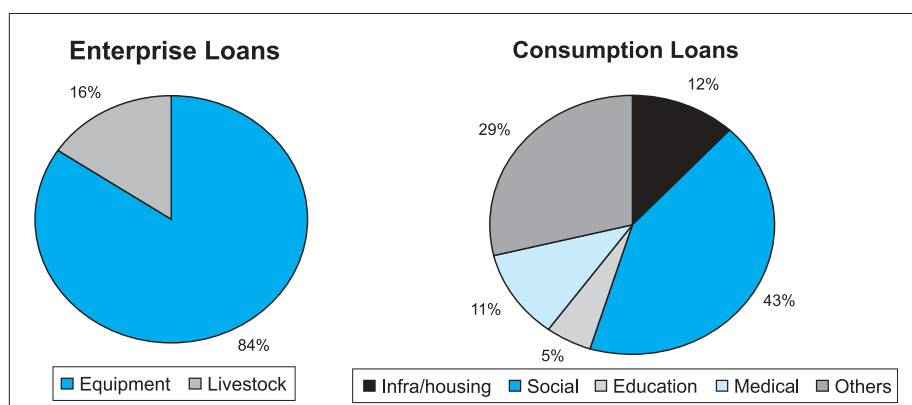


Figure 11: Loans By Type: Equipment and Social Loans Predominate

4.3.3 Who are the potential borrowers?

- The entire slum population is a potential client for urban microfinance services

The study uncovered a broad array of potential clients for microfinance. Of the 31% of the sample that have had access to formal financial sources at any point in time, there appears to be no substantial difference from the rest of the sample on the basis of demographics, gender, occupation or income.³² At least among this dataset, there does not appear to be readily observable characteristics that lead a poor person to have access to formal financial services. The implication of this for potential new entrants to the market is that virtually the entire slum population may be potential target clientele. Further research in this area might reveal differentiating characteristics of those who have access to formal financial institutions not revealed by this analysis.

4.3.4 Savings: The other half of microfinance

There is a large potential market for savings services

- 69% of the households in the overall sample save
- 60% of the active savers save less than Rs. 1000 a month
- Only 55% of all monthly savings is parked in an institutional setup

Global experience indicates that gathering entirely accurate data on savings rates of the poor is difficult with any research instrument, but particularly challenging within the quantitative survey format. Most individuals are reluctant to reveal their true savings rates in the context of a brief questionnaire.

There is a large potential market for savings services

- *69% of the households in the overall sample save*
- *60% of the active savers save less than Rs. 1000 a month*
- *Only 55% of all monthly savings is parked in an institutional setup*

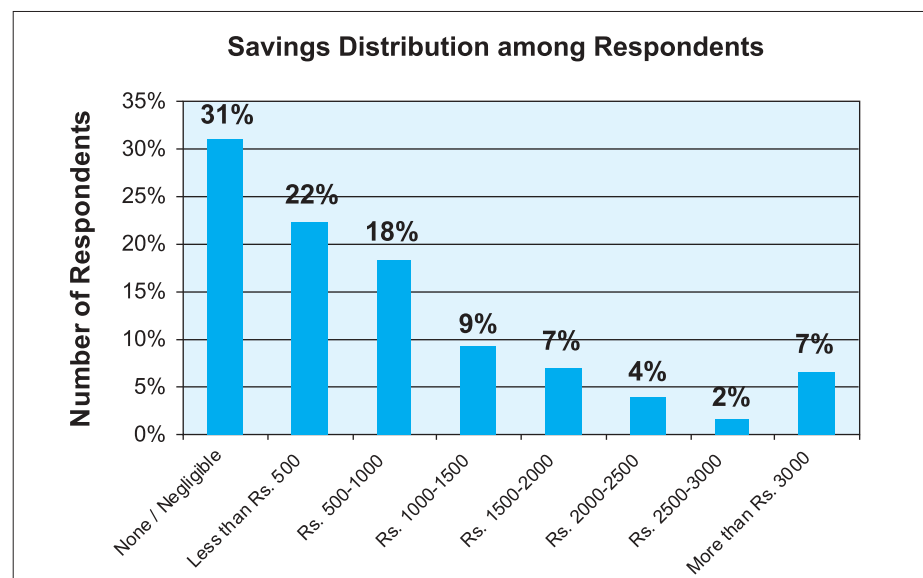


Figure 12: Savings Distribution amongst Respondents: More People Save Smaller Amounts

Another reason could be that much of the "savings" of the poor is held in relatively illiquid assets (cows, building materials, land, etc.) due to the difficulty of safely saving in cash.³³ As such, we can assume the numbers in this section are likely to underestimate the actual demand for savings, as the amount of savings may be influenced by a lack of a safe place to save. The graph outlines the distribution of monthly savings among respondents to this survey, out of a total of 411.

60% of urban clients save less than Rs. 1000 a month. Only 55% of all monthly savings by urban clients are parked in an institutional setup, formal or informal. Of this, 65% use formal sources (commercial banks, post offices, and NBFCs) while 35% save in informal institutions (chit funds, kitties, and employers).

Lack of savings services

Salma (40), mother of six children, lives in a small hutment in a Delhi slum. Her husband, a disabled man, is a vegetable vendor. They have a hand cart, which is their only source of income.

Salma says that there are days when she manages to save Rs. 10-20. She usually puts it away in her rice box. But her husband and children know of this 'hiding place', and take the money as and when they want.

As a result, she is never able to save more than Rs. 50 in a month, which is eventually spent on medicines for one of the children, as one kid or the other keeps falling sick, and she prefers to take precautions.

Earlier, she tried saving with a 'company', whose agents took Rs. 10 from her everyday for two years. Then one day, they stopped coming. On enquiring, Salma found out that such a company did not exist. Her savings were lost. And she is not alone.

Source: Field Study

The rest prefer to keep their savings with themselves or do not save, for want of a savings institution or in order to be prepared for any exigency. Ruthven³⁴ has also found a striking need for savings services for the urban dwellers. This reveals a wide gap in the mobilisation of savings, given the lack of a suitable institutional type that appeals to the slum population, suggesting an untapped market.

The relative lack of access to formal financial services is striking when one considers the relatively extensive coverage of urban areas by banks and post offices:

- Public Sector Banks have a presence of 15,940 branches in urban areas.
- 376 Regional Rural Banks were placed in urban areas.
- Private bank branches in urban areas number 2,477 and 200 branches of foreign banks are located in urban areas.
- Urban co-operative banks have grown in number from 1,307 in 1991 to 2,105 in 2004.³⁵
- According to the Annual Report 2005-06 of the Department of Posts,³⁶ there are 1,55,516 Post offices in India of which about 20% are in urban areas.

4.3.5 Remittances: A vital need in urban microfinance markets

- **Those with lower annual income remit small amounts, but those with higher annual income remit varying amounts**

The number of valid data points for remittances were just 39, due to the challenge of gathering data during a time when slum relocations were occurring. In spite of this,

the researchers consider this data to be valuable as an early indicator of demand. However, there is a need to study the demand and volumes of remittances with a larger data set of migrants.

In our dataset, those who visited their native places once a year during harvest have a greater tendency to use formal financial institutions for making remittances. This may be because they may own land in their villages, and landowners typically lease out their agricultural land to tenant farmers, making a visit once in a year to clear accounts.

On the other hand, those who need to make more frequent visits related to harvests seem to be using informal sources of remittances. The more frequent visits may be due to the need to be present in the village for contributing to labour requirements during harvest.

A larger percentage of those who deal with formal institutions make large volume remittances, while a larger percentage of those who deal with informal institutions alone make smaller volume remittances. Further, those with an annual reported income of less than Rs. 10,000 remit small amounts, while those with greater than Rs. 50,000 annual income remit a range of different amounts, not necessarily only large amounts. In other words, the respondent data seems to indicate that while a low income may lead a migrant to remit small amounts, a relatively larger income does not necessarily indicate that the migrant will remit proportionally more money. This would indicate that other factors, possibly the strength of family ties and the specific nature of financial obligations and opportunities, are also important drivers of remittance patterns. Additional study would be required to draw any clear conclusions in this area. Finally, it is interesting to note that large and small remittances appear to be sent through both formal and informal channels. While this may indicate a large unmet demand for formal remittance channels, it may also point to a fair degree of comfort with the existing, informal channels. Future experience of providers on the ground will help develop our understanding in this area.

4.3.6 Life insurance, the most preferred insurance service

Our queries regarding insurance were to find the preference for types of insurance. The survey respondents showed a lack of awareness regarding financial services in general, and an even lower awareness regarding complex financial services such as insurance. The team had to resort to explaining the concept of insurance itself in order to glean the required data.

In spite of these constraints, it was reasonably clear that life insurance (or the explained concept of it) is clearly the most preferred kind of insurance service. In Delhi, respondents ranked life and health insurance as the top two preferred types of insurance they would be interested in, while Hyderabad respondents preferred life and vehicle insurance.

4.4 Exploring the Opportunity: The Key Design Elements?

Urban microfinance practitioners express a belief that clients are more demanding in terms of options and service quality. Many factors play a role in the choice of service providers, and the critical design elements for products may include non-financial factors, as can be seen in below.

4.4.1 The urban client values trust, easy access, familiarity and esteem and pride over financial considerations

- Esteem and pride, and trust sway the decision to use formal institutions
- Familiarity and easy access decide the usage of informal institutions
- Lack of awareness of service offerings, feeling of having insignificant needs, past refusal by formal sources and the fear of exorbitant charges by informal sources deter those who do not access formal financial services today

The study provides insights into the key drivers underlying the differential behaviour in terms of accessing financial service providers. The usage of informal institutions prevails in the sample, and around 80% of clients availed loans from informal sources such as moneylenders, friends, and colleagues. Households prefer to borrow from informal sources and save with formal sources. A significant finding here is that holding savings accounts with formal institutions does not necessarily translate into usage of formal credit products.

Analysis reveals that the banking status of the poor with a formal financial institution is likely to be driven first and foremost by constraints on or channels for access, such as the requirement of a permanent address, convenient location of service providers, access to an introducer for an account, etc. For those that can access a formal institution, it is clear that there is a real sense of esteem and pride associated with having an account with a formal institution. At the same time, some potential clients are reluctant to access formal institutions because of some degree of mistrust (the survey did not call on respondents to specify which type of provider they mistrusted - banks, chit funds, etc.). A further factor analysis shows that respondents to the survey emphasised the esteem and pride associated with having access to formal financial institutions over any specific product or service attributes, such as price and convenience.

For respondents who currently access informal savings services, the primary reason for their doing so was a lack of access to formal institutions. In some cases however, clients did express a preference for the availability of door step services and flexibility of access that characterize informal service providers. The package of services provided by the informal financial institutions and community caste affinities may also drive the use of informal services in some cases. In a sense, this is another case of familiarity and access taking precedence over specific financial considerations such as interest rates.

Of the respondents who did not access formal financial service providers, it was observed that most expressed an unsurprising relative lack of awareness of different financial products. They had the perception that their needs were too small to be of interest to the formal provider and believed that the official, rigid nature of formal financial services would preclude them from access. As in the above instance, we need to note that this data may reflect not so much an actual preference for informal services as a simple lack of alternatives.

- *Esteem and pride, and trust sway the decision to use formal institutions*
- *Familiarity and easy access decide the usage of informal institutions*
- *Lack of awareness of service offerings, feeling of having insignificant needs, past refusal by formal sources and the fear of exorbitant charges by informal sources deter those who do not access formal financial services today*

4.4.2 Low interest rates, low collateral and faster loan processing are preferred attributes

- *Low interest rates are the most important consideration in choosing a provider for larger loans, such as those to finance enterprises, housing construction and other infrastructure investments*
- *Fast loan processing and low processing fees are also important attributes for entrepreneurship loans*
- *Low collateral requirements is the most important attribute for smaller consumption loans*

Like borrowers everywhere, urban households seek low interest rates across all loan products, and this was reflected in the product attribute preferences recorded by our survey. For large volume loans for entrepreneurship, housing and infrastructure, a low interest rate ranked as the most preferred attribute. Faster loan processing and low processing fees also emerged as significant attributes. It could indicate that urban households might choose low recurring costs in the form of lower interest rates over a larger one-time charge such as a processing fee. In support of this possibility, the need for integrated livelihood and financial services at low transaction costs, even at the expense of higher interest rates, has been found by Ruthven's³⁷ study.

The relationship between collateral and consumption loans is a chicken and egg story. While the need for lower collateral takes precedence over the preference for a low interest rate for these loans, a lack of collateral often leads to small consumption loan sizes. It could be worthwhile to explore if given a low or no requirement for collateral, would there be a demand for volumes larger than the current loan sizes of consumption loans?

It is interesting to note that for loans taken for medical purposes, a repayment holiday emerged as key attribute, next only to a low interest rate. For a social purpose loan, a low penalty on default and a fast processing also appear to be prominent preferences. This seems to be intuitive, as social and health related events may or may not coincide with cash flows.

Citing a preference similar to a middle or higher income class client, the urban poor household values a repayment holiday and a long maturity period for an education loan over a high interest rate or processing fees. The key attributes as per each loan type is given below:

Loan Type	Most Preferred Attributes
a. Enterprise	
Equipment loans	Low interest rates, Fast processing, low processing fees
Livestock loans	Low interest rates, low penalty charges, fast processing
b. Consumption/allied	
Infrastructure/Housing	Low interest rate, long maturity period
Consumption	Low collateral
Education	Repayment holiday, long maturity period
Medical	Low interest rate, repayment holiday
Social	Low interest rate, low penalty, fast processing

Figure 15: Different Loan Types Have Different Preferred Attributes

4.4.3 Urban savers need high returns, easy withdrawals and simple documentation

- Key determinants of household savings include level of household income and whether or not they send remittances. Their desire for consumer durables may also influence savings behaviour.
- Key preferred attributes for savings services include high interest rates, easy withdrawal facilities and easy-to-read passbooks

The key determinants of a household's monthly savings, whether rural or urban, rich or poor, include the income, the number of job changes of the secondary earner, remittances made, and the want for consumer durables. This was also the case among our survey respondents.

Interestingly, at least in our dataset, banking status and the number of job changes of the primary earner did not affect the amount saved by the household. This may be an indication of the importance of multiple revenue streams in the urban poor household. The banking status (savings with a formal versus an informal service provider) also does not seem to have a differential impact on the amounts saved.

Financial Acumen

Yadamma (53) is a domestic worker from a slum in Hyderabad. All her family members are employed.

She is a member of a SHG that was started by her children's school ten years back. She still saves Rs. 150 per month with that group, and can take a loan of up to Rs. 30,000 at the time of need.

She also saves Rs. 2000 per month with a chit fund, a saving that she will use to repay her employer from whom she has taken a loan of Rs. 80,000. She intends to pay her employer back in the next 3 years.

She says that since her employer wanted the entire money back in one go, she decided to start saving with the chit fund so that she could also earn some interest on the same.

Source: Field Survey

The most preferred attributes for savings service included high interest rates, easy withdrawal facilities and easy-to-read passbooks. Interestingly, a low minimum amount to open an account did not rank high as an attribute, even amongst low income savers, though this may depend on the respondent's definition of "low amount". Also, the option of using savings as collateral for loans was not a highly ranked attribute. This may be due to the fact that few survey respondents have encountered this option in the past, and therefore, are unfamiliar with how it might work. An additional reason might be that, if most of the loans are distress loans and a large percentage of respondents' savings is kept at home, they might not be willing to "give up these funds" just when they need them most.

- *Key determinants of household savings include level of household income and whether or not they send remittances. Their desire for consumer durables may also influence savings behaviour.*
- *Key preferred attributes for savings services include high interest rates, easy withdrawal facilities and easy-to-read passbooks*

4.4.4 Urban households need fast and secure remittance facilities

As mentioned, the study of remittances was constrained by the small sample size, and hence, the findings below may be considered indicative rather than conclusive.

It is clear that security and speed of transfer are the key attributes of this service. Processing fees and user-friendly passbooks and receipts are less important but figure as relevant attributes.

An interesting dynamic that links savings to remittance emerged during this analysis. Among active remitters, a greater percentage of those dealing with formal institutions alone and those outside the ambit of financial institutions tend to save smaller monthly amounts, while a greater percentage of those dealing with informal and formal institutions tend to save larger amounts monthly! The researchers do not consider this finding as being conclusive, and earmark remittance behaviour of prospective clients as an area for further study.

4.5 Exploring the Opportunity: Reaching Out to the Demand

4.5.1 Client mobility may not be a challenge for microfinance

- *Most clients, though migrants from rural areas, are likely to be long standing residents of the slums*
- *Their visits to their rural origins may not be very frequent*
- Most clients, though migrants from rural areas, are likely to be long standing residents of the slums
- Their visits to their rural origins may not be very frequent

Based on the belief that most urban slum dwellers have relatively recently migrated from rural areas, many rural microfinance practitioners in India have expressed the concern that the urban poor are potentially too high risk to serve, on account of their perceived high degree mobility between major cities and native villages. In contrast, however, the survey found that client mobility in major urban areas was not very high. Most respondents had been living in the same areas for relatively long periods of time.

Our questionnaire asked the respondents whether they hailed from the same state, neighbouring states or states further away. Going by responses to this, the primary earner in our Delhi sample has a migrant status. This means that the respondent is from outside the state.

Delhi is a state-metropolis easily accessible to some of the poorest states in India³⁸ and thus attracts a sizable number of migrants. However, based on the findings of this study, these migrants seem to have settled more or less permanently, with their close and extended family, in the Delhi slums. Hyderabad tells the same story with the primary earner staying in the city for prolonged periods.

While this finding is in contrast with some perceptions, it is in line with the experience of MFIs currently operating in major Indian cities. Samit Ghosh, the founder of Ujjivan in Bangalore, says: "In my experience, the migration myth appears to be hyperbole."

It is possible, however, that client mobility might have been high in the past, and that the evolution of livelihood options may have resulted in the current state of relative stability. A finding by Rao, Deshingkar and Farrington³⁹ reiterates this:

"Until the early 1990s, migration to Hyderabad and other urban locations was essentially seasonal or "cyclical" in nature as most migrants used to move out during the lean farm seasons...and come back to the village after the monsoon showers... Over the years, urban migration has become more permanent as most migrants no longer come back to the village ..."

4.5.2 Clients may prefer individual loans as an ideal scenario, but in the absence of a choice, would avail group loans

- Most households prefer to form groups of family, friends and neighbours
- Practitioners predict the success of group model up to loan sizes of Rs. 15000- Rs. 20000
- A middle path - smaller amounts for group loans and larger individual loans could be a possible methodology

- *Most households prefer to form groups of family, friends and neighbours*
- *Practitioners predict the success of group model up to loan sizes of Rs. 15000- Rs. 20000*
- *A middle path - smaller amounts for group loans and larger individual loans could be a possible methodology*

While the data reveals an overwhelming preference for individual loans over group loans for all types of loans and across cities (See table below), we recognize that preferences may be the same in rural areas as well. Veena Mankar of Swadhaar, and other practitioners, note that urban clients do accept group loans in absence of an option for individual loans.

Type of Loans	Group Loan Preference (%)	Individual Loan Preference (%)
Consumption	21%	79%
Equipment	14%	86%
Education	14%	86%
Medical	17%	83%
Infra/housing	18%	82%
Social	16%	84%
Livestock	19%	81%

Figure 13: Individual Loans Are Most Preferred for all types of loans

If forming a group to borrow a loan, given a choice, the respondents prefer groups comprising family, friends and neighbours, same religion/caste and workplace colleagues. Practitioner's views corroborate this by acknowledging the cohesion and affinity that exists in urban slums due to continued association. This is contrary to the popular belief of a lack of cohesion and the concomitant inapplicability of the group model in an urban setting. Vishwanath Prasad of Bellwether Fund states:

"I have visited slums where people have been living in 20 years and all know each other. You'll see that even amongst migrated groups, you'll find an underlying cohesion."

Many other urban microfinance practitioners believe that the group lending model will be feasible in urban areas too, as Samit observes:

"Most of the urban slum clients have not only lived together, but have faced similar threats (such as disasters, fire, and evacuations), and have stayed together through all this"

For respondents to prefer individual loans as an ideal scenario is natural. However, it is important to note that numerous providers are currently finding significant demand for group loans in urban areas. It seems likely that there will be room for a variety of different lending methodologies in urban areas for some time.

The middle path may ultimately be separate products, with smaller amounts for group loans and larger for individual loans. The reason for this is an increase in repayment risk with increasing loan size. Groups may balk at taking higher risks once the loan size crosses a certain amount. Ujjivan's estimate of this amount is Rs. 15,000, while Grameen Koota has been successful for loans up to Rs. 20,000 per member.

With regard to methodology, it is for the service provider to carefully choose areas of operation and preferably minimise risk by operating in old, recognized slums. Also, the current scenario is such that demand does not change, irrespective of the methodology. As the market matures and multiple products are offered by various service providers, this aspect may undergo a change, and clients may become more discerning. The same is likely to happen as they move up along the hierarchy of needs.

4.5.3 Word of mouth is the most prevalent source of information for financial services

Similar to their rural counterparts, the main medium of information and advertisement of financial services in the urban areas is the word of mouth.

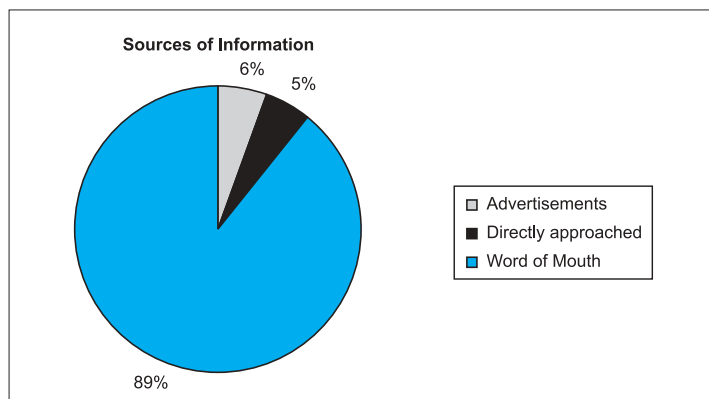


Figure 14: Outreach: Word of Mouth is most effective

The low rate of literacy and the correspondingly low awareness of advertisements suggest the relative inefficiency of the written medium.

A very small number of the respondents mentioned having been approached directly by providers in the past, though this would likely be an effective means of marketing financial services, if it were employed. Practitioners believe that there is a necessity to undertake more awareness generation in order to develop the market.

Veena Mankar observes a clear lack of knowledge of financial products, other than loans, among potential clients of her institution in Mumbai's slums. Similarly, our findings from the focus groups as well as observations during the field visits too stand testimony to the general lack of awareness regarding financial services.

Even in the rural areas, there has been very little marketing to popularise microfinance and grow the business. This is likely to be the case in the cities, as can be seen from the data findings, and formal mainstream advertising may not be likely to merit the cost. MFIs may like to develop offbeat outreach strategies and marketing material. For example, one common strategy is to use spokespersons to carry out marketing. Requesting any satisfied and articulate client of the MFI to convey his or her experiences in the new target area is usually very effective.

4.6 Some Gender Concerns

- The women who earned/worked were empowered to make limited financial decisions.
- These women were more likely to take up informal wage and home based work as opposed to enterprises.
- It is likely that the modalities of most enterprise loans, such as the decision to take a loan, the choice of service provider and other details, were decided by the menfolk, with limited participation from the women.
- The younger women might prefer to allocate expenditure to the betterment of the family.
- The older women of the house were decision makers regarding social expenditure.
- Most of the women said they took up work as a compulsion in order to meet a pressing financial requirement in the family.
- A demand for "safe" savings spaces was evident.

In the course of conducting the quantitative study it became apparent that while the choice to survey financial head of households would best enable us to understand the financial needs of the household as a whole, it would also mean that the research would gather very little direct data from women. As the vast majority of the existing Indian microfinance clients is women in urban as well as rural areas, the research team felt this report would be incomplete without at least some research into the financial needs and challenges of poor urban women. It was outside the scope of the analysis to conduct deep research in this area, and clearly much additional research is required, but the team was able to conduct a limited number of focus group discussions with female slum dwellers in Delhi and Hyderabad.

The discussions were carried out in randomly selected slums in Delhi and Hyderabad. Support was sought from PRATHAM in both the cities to build better rapport in the slums. While the discussion in Delhi fell in one of slums sampled for the primary survey, the discussion in Hyderabad was conducted in a slum that was convenient to the local NGO. The sampling methodology for the discussions was through self-selection, as only those women who could take the time off and were inclined to talk participated. The percentage of workers and non-workers in the groups may thus not be a reflection of the overall sample. The participant profile in Hyderabad included women from the minority communities, while Delhi had participants from the religious majority.

The characteristics of our focus group participants varied a fair amount from one group to the other. In Delhi, only four of the ten women participating professed to being employed or working. Three of them were employed as domestic workers, while one worked as a performance artist for street plays. In Hyderabad, none of the women in the first group claimed to be working or being employed. In the second group,

- *The women who earned/worked were empowered to make limited financial decisions.*
- *These women were more likely to take up informal wage and home based work as opposed to enterprises.*
- *It is likely that the modalities of most enterprise loans, such as the decision to take a loan, the choice of service provider and other details, were decided by the menfolk, with limited participation from the women.*
- *The younger women might prefer to allocate expenditure to the betterment of the family.*
- *The older women of the house were decision makers regarding social expenditure.*
- *Most of the women said they took up work as a compulsion in order to meet a pressing financial requirement in the family.*
- *A demand for "safe" savings spaces was evident.*

however, almost 70% of the participants were involved in multiple income generating activities, including tailoring, garland making, as domestic help, and so on. The reason for this variation might be because of the self-selecting nature of the sample.

The women's activity profile gravitated towards wage labour, home based work and other sources of regular income, as opposed to enterprises. As Siddhartha Chowdri, Accion's Country Advisor for India, reiterates:

"India's urban microenterprises are significantly more likely to be operated by men, as compared to other countries where urban microfinance is present."

In Delhi, the non-earning participants reported that the decision making power regarding most issues rested with the elder male member within the household. This was especially true for decisions related to financial issues in general, extending to accessing loans, choice of financial service provider and others. The women were rarely consulted for these issues.

On the other hand, the participants who contributed to the income of the household reported to have more control over financial decisions such as the purpose and the amount of loans, and the choice of the service provider. This group of earning members gave preference to expenditure on the welfare of the children in the family. School fees, other education and health related concerns were the top priority.

The elder female members in the family, on the other hand, had the decision making power regarding the monthly household consumption expenditure, as well as that for social occasions such as weddings, death or birth rites. In Delhi, if the female member was also an earner, she was most likely to hand over her income to the husband/mother-in-law. The participants in Hyderabad, however, reported that the husbands usually handed over their monthly incomes to the wives to meet monthly consumption expenses, although, at the end of the month, the wives had to account for the expenses.

All the participants across the cities reported a lack of 'safe' space for savings. The common places for keeping away small amounts of savings included the coal/rice storage box, under the mattress, in the place of worship, etc.

The National Sample Survey statistics state that women were more frequently engaged in subsidiary economic activities⁴⁰ in urban areas than in rural areas.⁴¹ Lending to women alone in urban areas may mean a higher incidence of lending for consumption. However, further research and ground experience would be required to corroborate this.

Similar to rural areas, gender dynamics determines, to a significant extent, the distribution and management of financial resources in the household in the urban areas as well. Existing knowledge of the impact of Microfinance on gender relations is, however, limited.

While the focus of most microfinance programmes has been on credit alone, economic empowerment, increased well-being, and social and political empowerment of women are also touted as being the positive effects of microfinance programmes in both

rural and urban areas. However, given the credit and, to some extent, savings focus of the current literature, the empowerment impacts are still under debate.⁴²

SEWA's approach to microfinance and empowerment is through the creation of a platform for mobilizing the women through a union, providing financial services as well as other member services. Other stakeholders too perceive that the urban poor need support services apart from credit. Hence, while providing credit in isolation might make limited contribution to the empowerment of women, viewed in conjunction with other interventions, microfinance could turn into an intervention that is "more empowering for more women".⁴³

Sizing the Market in Urban Microfinance: What is the Opportunity?

Considering the magnitude of the urban population in India and the large percentage of urban dwellers living below the poverty line, it seems that the potential of microfinance in urban areas is immense. The projections below are an attempt to size the demand for microcredit in India's major urban centres. So, how big is the opportunity? Drawing from the primary study and official population data, educated assumptions on growth rates and household size say that the unmet demand may reach higher than Rs. 20,000 crore (US \$ 5 billion). Given this figure, what would it take the sector to reach out to the demand? Estimates based on our current understanding of microcredit methodology and branch configuration, the amount of capital needed to fund the above growth is to the tune of Rs. 3,000 crore (US \$ 6.7 billion) for on-lending.

In order to consider the likely demand for microfinance services in India's cities it is useful to begin with a general understanding of the national landscape of credit services. Financial liberalisation and the overall growth of the Indian economy in recent years has dramatically increased credit off take in the formal financial sector and, in absolute terms, the total amount of credit has doubled over the last three years. Credit penetration data over the last twenty years demonstrates the dramatic expansion in the availability of credit services in recent years.

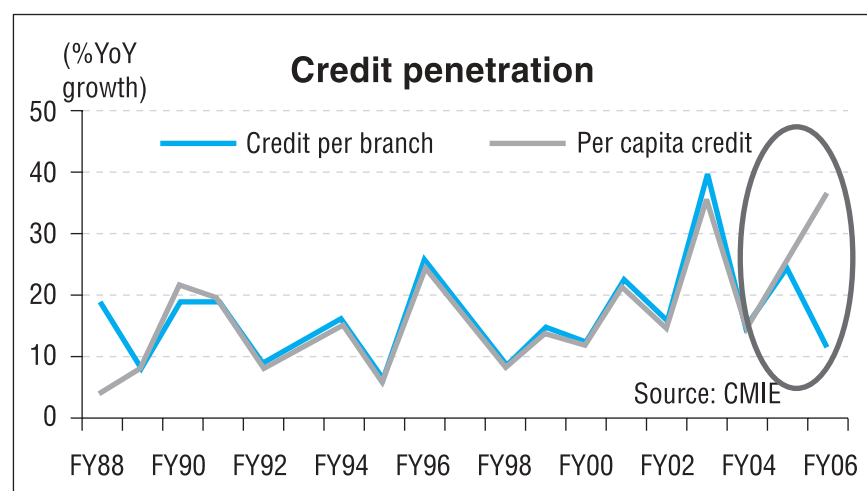


Figure 15: Credit Penetration Showing Growing per capita Credit, but Falling Credit per Branch⁴⁴

While per capita credit has gone up during 2004-06, it is worth noting that credit per branch has decreased. This may be as much an indication of rapid expansion of branch networks to capitalize on future growth as anything else.

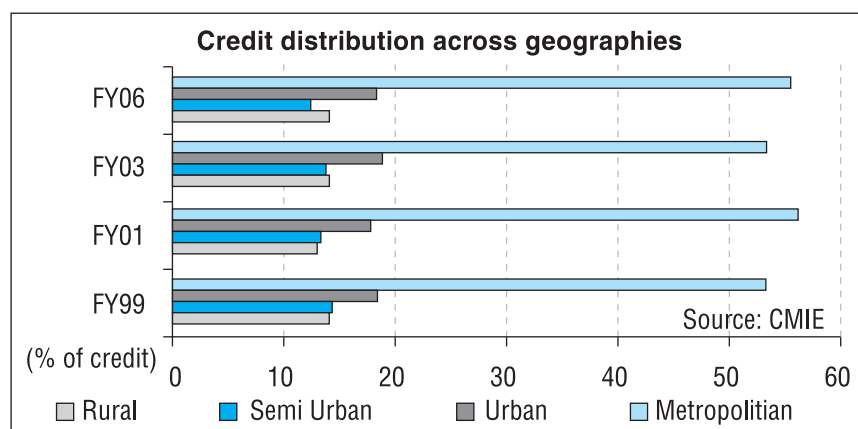


Figure 16: Credit Penetration across India: Maximum in the Urban Centres and the Metros⁴⁵

From the graph below, it is clear that the bulk of the credit off take is in the metros, and they continue to account for more than 50% of the formal credit market, followed by smaller urban centres.

The overall distribution of credit from formal financial sources in India, and the dramatic growth in the availability of credit are two important contextual factors to consider in sizing the demand for microfinance in urban areas.

The above information, coupled with the fact that Indian banking penetration is around 35.5%,⁴⁶ (as per the census data of 2001) means that much more needs to be done to reach those who need banking services. The high credit off take in metros may signify better infrastructure and more opportunities, making urban areas the key target markets for financial services in India.

The market seems to be a game of numbers, depending greatly on the populations and to a lesser extent on the degree of use of financial services. This section attempts to estimate the market size for credit based on the slum population data provided in census data of 2001.⁴⁷ Demand has been estimate for India's 27 urban centres with total populations of 10 lakhs (1 million) or more in 2001.⁴⁸

The 2001 census data mentions 426 lakhs (42.6 million) people as slum inhabitants in India. The study considers the household as the unit, and assumes the average family size to be five people. In the absence of any information on slum growth, we have used the growth of the urban population as a proxy for slum population growth. The urban population growth rate has hovered between 3% and 3.5%. Applying these growth rates to the 2001 census data, we expect that the total number of households in urban slums would range between 99 lakhs to 114 lakhs (9.9 million to 11.4 million) in 2006 and if the slums continue to grow at the same rates around 101 lakhs to 120 lakhs (10.1 to 12 million) in 2011.

These estimates are conservative, keeping in mind that the slum population is a subset of the population that represent the poor and does not include the unbanked who reside outside the slums.

5.1 Microcredit: Projected Market Size

The primary survey conducted in Hyderabad and Delhi revealed that the average indebtedness of the sample is Rs. 22, 534 (US \$ 500). Using this indebtedness figure as a proxy for slum households' loan demand, the latent demand for urban microfinance in 2006 is estimated to be Rs. 22,245 crores (US \$ 4.9 billion). As discussed in chapter four, average indebtedness may be an underestimation of credit demand;⁴⁹ we believe that the markets may be larger in size. The contradiction to the above is the wide distribution of indebtedness curve with over 60% of the urban clients in the range of Rs. 5,000 (US \$ 110). This leads us to believe that the real demand could vary over a large range. It is also important to recognize that this estimate relies solely on current credit consumption figures, much of which is accessed through informal sources that generally offer higher rates and sometimes less attractive terms than microfinance institutions. These estimates do not include any sizing of the additional off take in the market that one would expect to see upon the introduction of more attractively priced credit services.

It is important to note that the above estimates are about two to three times the total market size projected in other recent studies of the urban market. A study done by Indian Grameen Services on the demand for microfinance services in Delhi puts the loan size expected between Rs. 5,000 to 9,000 (US \$111 to 200). Similarly, a study conducted by Mahajan and Nagasri estimated the demand for urban credit to be around Rs. 9,000 (US \$ 200) per annum per household.⁵⁰ These estimations for loan demand were made on the basis of personal interviews with target people. The study was carried by BASIX in July 2004. A survey conducted by the Paradigm Group prior to the BASIX survey predicts average credit availed at Rs. 10,071 (US \$ 224).⁵¹ Assuming the loan demand is in that range, the total market size could be in the range of Rs. 9,000 crores (US \$ 2 billion) to Rs. 10,000 crores (US \$ 2.2 billion).

Ramanathan⁵² et al. used the minimum credit necessary to sustain the urban poor as an alternative method to arrive at microcredit demand in urban India. The methodology divided population below the poverty line into spending classes and the gap between the average spending for a given class and the state-specific poverty line is taken as an estimate of the amount of the funds needed by that population to reach the poverty line. The amount is assumed to be met by microcredit. For example, in 1993-1994 the poverty line in Andhra Pradesh was Rs. 278 (US \$ 7) per person per month. Over ten lakhs (one million) urban poor in Andhra spent less than Rs. 160 per month on necessities and non-essentials. Assuming that this difference between required income and actual spending could be made up by microcredit, the report claims that on an all India basis the urban demand for microcredit is Rs. 6,000 crores (US \$ 1.3 billion).

The primary research conducted as a part of this study indicates a greater demand for urban microcredit than has previously been identified in other analyses. Only time will tell which estimates are closer to the truth, though it should be noted that most urban microfinance practitioners have called out the demand for significantly larger loan sizes in urban areas as opposed to rural markets, in ranges that are consistent

with those identified in the primary research of this analysis. Larger loan sizes in urban areas alone could account for the discrepancy in the above market projections. Regardless of which estimate one employs however, it is clear that these numbers are large and call for a dramatic up-scaling of retail capacity in order to meet demand.

5.2 Building the sector: Estimating the Capital and Human Resource Demand to Meet the Growth Challenges

Estimating the capital and human resources needed to support the rapid scale up of urban microfinance markets is challenging to do as the ultimate nature of the urban delivery channel has not yet crystallized. The following estimates are based on the assumption that urban microfinance will look more or less similar to rural microfinance on the ground in terms of branch configuration and staffing needs. Innovations in credit delivery at the retail level or successful partnerships with existing retail channels might indicate a significantly lower level of capital investment than what is estimated here. In the absence of a clear vision of what kinds of innovations can be expected, it is prudent to estimate future investment needs based on current capabilities.

While the on-lending funds are no longer a real challenge to the growth of Indian MFIs, equity and long term funds continue to be something of a constraint challenge. Similarly, while the management manpower can be found, finding and retaining the loan officer and client service representatives for MFIs in urban area might be a challenge.

Working from the estimated total market size of Rs. 22,500 (approximately US \$5 billion), we can extrapolate a need for a rapid scale up of loan officer ranks in urban areas. While rural MFIs are achieving a productivity ratio of 500 clients per loan officer at optimal efficiency levels, industry experts believe that favourable demographic features such as greater population density, increased use of technology and better infrastructure, in an urban setting, may allow the average optimal client to loan officer ratio to reach 600.⁵³ However, this factor would be constrained by the type and number of clients and the exposure per loan officer. Interviews with several leading urban MFIs revealed that they are comfortable with an exposure level of up to Rs. 50 lakhs (US \$110,000) per loan officer. Urban MFIs operating at this efficiency level and with the upper cap on maximum exposure per loan officer would need to recruit 44,491 loan officers to reach the estimated client base of 99 lakhs (9.9 million) households.

5.3 Estimation of Capital Needs

In absence of past trends, it is difficult to make predictions on capital needs, but keeping in mind that this study looks to create a benchmark for further studies to refine, it makes some broad projections on capital needs. The researchers acknowledge that these assumptions are broad and the estimations are indicative in nature at best.

The microfinance institutions need money for capital expense, to meet the negative spread during the early and growth stage and for on-lending funds. The capital investments are mostly for setting up branches. To be able to employ 44,491 loan officers, urban microfinance institution would need to open 7,415 branches assuming six loan officers per operating branch is the norm. In urban markets, it may well prove to be the case that it is more efficient to have branches with a larger number of loan

officers (due to the greater client density than that which is found in rural areas). While these might suggest greater efficiencies than that which are found in rural markets, the increased real estate costs of urban settings may ultimately offset those efficiencies. Branch start-up costs can differ significantly from one MFI to another, but for the purposes of more generalized projections, researchers have approximated Rs. 1.50 lakhs (US \$ 3,300) as the setup cost for an urban branch.⁵⁴ Based on the above estimates, a total capital expenditure of Rs. 110 crores (US \$ 25 million) would be required to build the needed branch infrastructure to serve this market.

This is admittedly a simplified approach as the number of branches and loan officer required per branch would be a function of external factors such as infrastructure, accessibility, geography and the population density within the area of operation

The next major estimation is the need for meeting the negative spread arising out of operating costs at the branches. These costs need to be supported till the branches are sustainable. We have assumed that the annual operating expenses of an urban branch are approximately Rs. 8 lakhs (US \$ 17,000). Assuming the MFI wants to raise all the investment needed to secure every branch, the total start up investment is Rs. 595 crores (US \$ 132 million) to support 7,415 branches to break even.

The financial provision of Rs. 700 to 900 crores (US \$ 155 to 200 million) estimated above for capital and break even funding does not take into account the regulatory capital needed by the microfinance institution to do on-lending business. To maintain a 1:10 equity to debt ratio while achieving Rs. 22,500 crores (US \$ 5 billion) outstanding, Rs. 2,200 crores (US \$ 490 million) of equity funds would be required. All these number put together suggest that the risk capital needed for urban microfinance may be as great as Rs. 3,000 crores (US \$ 660 million), with a corresponding demand for on-lending funds of Rs. 22,245 crores (US \$ 5 billion).

The snapshot of funds needed is provided below:

1. On-lending funds of Rs. 22,245 crores (US \$ 5 billion) to be accessed from banks as term loans, lines of credit or via the "partnership model."
2. Long term growth capital of nearly Rs. 3,000 crores (US \$ 666 million). To be mobilized as:
 - a. Paid-in equity: Approximate Rs. 1,000 crores (US \$ 220 million) as start-up equity to be mobilized by the promoters and social and commercial investors.
 - b. Internal accruals and reserves: Most likely to meet Rs. 1,000 crores (US \$ 220 million) representing revenues earned in the first year by all branches.
 - c. The remaining amount might be raised through long term debt instruments such as bonds or convertible preference shares.

Although no official figures are available on the existing outreach numbers for urban microfinance, we have made an assumption that 5% of the outstanding of Rs. 2,000 crores (US \$ 445 million) on 31st March 2006⁵⁵ or Rs. 100 crores (US \$ 22 million) represents the urban microfinance outreach. This portfolio needs to grow at 195% CGAR if the estimated urban microfinance demand is to be met in next five years.

Indian MFIs in rural areas have had average annual growth rates of 76% during the last five years. If we saw a similar pattern of growth in urban markets it would take ten years to meet the outreach goals (CGAR 72%),⁵⁶ but it is reasonable to expect that the benefits of second generation institutions and the client density of the urban market would drive faster growth in these areas.

Urban Microfinance: Building the Foundation to Grow the Sector

Growing the urban microfinance market to scale is a challenge that will require the support of multiple stakeholders in order to be met. This study finds that much of the basic environmental elements necessary to rapidly scale the sector already exist: the basic legal framework for microfinance is in place, and access to funds for on-lending has expanded dramatically in recent years. Given the scale of the investment required, it appears that there will be demand for more risk capital in the market than is currently available. The recent entrance of numerous microfinance equity players should help meet this need. The greatest challenge in serving this market will be at the retail level. The ability to build scalable organizations to serve a diverse array of demanding urban clients will ultimately decide the fate of the sector.

Based on the findings of this report, it seems clear that the demand for urban microfinance in India is substantial. Growing the sector to meet this demand is a significant challenge. The best means to achieve rapid scale up in the new market would be through the concerted and complementary efforts of a range of different actors.

It is a positive sign for the future development of the urban microfinance markets that key elements of the supportive environment for microfinance are already in place. Though there appears to be a need for far more equity capital than is currently available in the market, many new players are entering this space. On the regulatory front, while the possibility of new microfinance law casts some uncertainty over the section, it seems that the most important elements for productive regulation of the microfinance sector are in place. Despite the early stages of the development of the rural market featuring relatively modest growth due to limiting regulatory and funding environments, urban markets can be expected to develop more rapidly as more of the enabling variables are in place.

The real challenge in building the urban microfinance sector in India will be at the retail level. As is so often the case in the development of microfinance markets, retail capacity is currently the most pressing constraint in the market. While the learnings from the Indian rural microfinance will certainly help jumpstart the development of this sector, it is clear that there is still much to learn about what it will take to succeed in the urban market. The ultimate success of the urban sector will depend upon the efforts of retail microfinance institutions and supporting services.

6.1 Investors, Lenders and Donors: Complementary Roles

The relatively high liquidity in the banking sector, along with the increased comfort that banks have with the microfinance business model, means that on-lending funds are no more a critical constraint to the growth of urban microfinance in India. Early experiences of MFIs operating in urban areas suggest that banks are relatively at ease in providing funds for on-lending outside of the rural arena. Further experience on the ground should only increase their comfort level.

In contrast, equity capital or risk finance is likely to be something more of a challenge for start-up MFIs. As is estimated in chapter five, the need for risk capital is substantial. The recent entrance of several new players with an appetite for funding start-up institutions and urban MFIs into the microfinance investing space, including Bellwether, Unitus and the Michael & Susan Dell Foundation, means that there are now many more sources of risk capital available to urban MFIs than there were just a short time ago. At the same time, the availability of capital will have to expand significantly to meet the estimated Rs. 1,000 crore (US \$220 million) needed to build institutions to serve the current demand.

Investors must recognise that urban microfinance may be a higher cost model compared to the business model of rural areas in the short term. It is possible though that higher density of population and better infrastructure may create efficiencies of scale and nullify the high cost factors by building revenue faster.

While a lack of proven exits is a constraint on microfinance equity investing in all markets, there are at least two options available in the Indian market that may ease this constraint:

- Introduction of innovative instruments such as royalty on revenue: This may generate returns in a shorter time period and create incentives for larger players to evaluate and consider becoming involved in the urban microfinance sector. The flip side is the implications on growth that such instrument may pose for the MFI.
- The take out finance model of ICICI Bank: This is another option that is available to investors. The weakness of the model is very low return to the investor, yet it works as the last solution.

The need for more research to improve understanding of risks, patterns, and dynamics of growth and associated challenges may assist the investors to make informed judgments and prepare social venture funds for raising larger amounts once the current round of funds is invested.

Long term finance has not really been discussed in the discourse about raising capital. Isolated attempts to raise capital through instruments such as bonds among the rural microfinance institutions have not been very successful. Urban microfinance is still in infancy, and at this stage long term capital may not have much role to play in its current growth. That being said, the sector should prepare itself to attract long term capital to fund late stage growth, and to judiciously utilize the risk capital being made available to support the early stage growth.

A further area of interest for the Indian microfinance sector as a whole to explore, is the option of Initial Public Offerings (IPOs). Though the option of going public still seems remote for most Indian microfinance institutions, further development of this option would certainly help fund future growth and attract further venture capital funding to the sector.

Much like those for the development of the Indian microfinance sector as a whole, there are also a number of enabling environment initiatives that could play a central role in the stimulation of the industry. Donors can play an important role in helping develop the urban and rural markets by funding the development of a credit bureau, training centres and other support services.

6.2 Researchers and Academics: Knowledge and Innovation for Growth

Chapter three of the report gives clear indication that the tried and tested delivery methodology of rural microfinance also works in the urban arena. There is an opportunity to serve clients better and meet a broader array of client needs through innovation not only in products, but also in delivery methodology. Since the urban sector is only just now developing, it has the potential as the "second generation" of Indian microfinance to build in capabilities to deliver a range of services from inception, rather than having to work through the difficult process of retrofitting a monolithic single product operation. In order to know how and where the sector should best meet these more diverse needs, however, deeper research and analysis will be required across a variety of fronts.

While this study has provided some early insights into the financial needs of the urban poor, it is clear that myriad additional studies will be required to understand fully the diverse financial needs of the urban poor across credit, savings, insurance and remittance services, and to identify the variations in needs across different customer segments and geographies.

In addition, there will be a real opportunity to study in detail the social impact of the provision of microfinance services in India's cities, and to look at this alongside the impact of rural microfinance. It would be a valuable contribution from the community of researchers and academics to the development of the sector if they are able to shed light on exactly how access to financial services affects the lives of the urban poor.

6.3 Policy: Macro Interventions for the Sector

In broad terms, it is clear that the regulatory framework which has allowed for the dramatic growth of microfinance in rural India will support a similar expansion in urban markets. While additional supports might enable the sector to develop faster or better, the provisions that are already available are sufficient to provide for the expansion of at least microcredit services. Two recent developments may provide for an enhanced regulatory environment for microfinance.

First, the recently announced business correspondent model⁵⁷ has opened up avenues for banks to provide savings through not for profit MFIs to the poor. It is early to say

if the banking correspondent model has strong business foundation, but it surely is an option for offering saving services to the poor. The RBI introduced interventions such as the no-frills account, and the mandatory preparation of promotional material in vernacular languages to encourage the less privileged to gain access to banking services, may have positive implication for both urban and rural poor.

In addition, the Finance Minister's announcement in the budgetary session on the proposed microfinance regulatory bill should prove to be a major development. The designation of a "Microfinance Regulatory and Development Authority" suggests a desire on part of the government to play a more supportive role in the development of the sector. The urban microfinance sector must benefit from the development agenda of the proposed regulator.

While the above may prove to be positive developments for both the urban and the rural microfinance sectors, the position of policy makers on the sticky issues of interest rates remains less than clear. The counterintuitive impact of interest rate regulations on the poor, in particular, has been established world wide; however, it remains the favourite intervention of the executives in power. Ramanathan et al state that for the development of the urban sector "...policy makers should not only allow, but indeed encourage removal of ceilings on interest rates on small loans."⁵⁸ The industry will have to wait to see the positions that the new authority would take on such contentious issues.

Finally, the demand for large equity investments in urban microfinance means that start up capital is still in paucity. While the investment restrictions that apply to investors may not change, the policy framework could stimulate interest by creating right incentives attracting equity investments in urban microfinance. Also, drawing a parallel from the software sector, tax breaks or concessions for microfinance institutions might help microfinance institutions build reserve and make them more attractive to investors. The government might also consider providing capital gains tax exemptions on exits in order to attract investors interested in building the urban microfinance sector and create right incentives for these early stage and patient investors.

6.4 Meeting the Demand: Options and Challenges for the Retail Channel

The most significant constraint in the ability to serve the urban microfinance market in India is the same constraint faced by microfinance sectors across much of the globe, namely the retail capacity. In order to serve the estimated minimum of 100 lakhs (10 million) households in need of microfinance services in India's major cities, a massive up-scaling in retail capacity will be required. As detailed earlier in this document, this additional retail capacity will need to come from the creation of start-up microfinance institutions, the expansion of existing MFIs, and the downscaling of consumer lenders and banks. At the current nascent stage of the development of the urban market, it is clear that all institutional forms can play an important role in meeting the financial needs of the urban poor and we are far from the point of selecting one institutional form over another.

Both current players in the urban microfinance market and future entrants can be expected to confront at least some challenges in their efforts to meet the needs of this massive, relatively unexplored market. While early efforts of rural-focused MFIs that have entered major cities, as well as those of start-up MFIs targeting urban centres, have confirmed that existing approaches to microcredit can be rolled out in urban areas with little adaptation, the sector as a whole is still in its early stages. It is likely that there are certain risk factors particular to urban clients that have not yet been uncovered. It is also likely that there will be some urban areas, be they particular types of slum pockets or particular cities, in which existing microfinance methodologies will prove to be inadequate. How microfinance providers respond to these challenges will be a key determinant in the future development of the sector.

In addition, there is a clear opportunity in the development of the urban microfinance sector to build institutions that are equipped to serve a broader range of financial needs than Indian microfinance has historically addressed. Both on the ground practitioners and this study's data suggest that there is demand in the urban market for both relatively small loans, primarily for consumption, and much larger loans for going concern microenterprises. While it is likely that an urban MFI can be quite successful simply by focusing on one core lending product, there is a real opportunity for retail institutions to do more.

Finally, the greatest test to the retail channel in rising to meet the financial needs of the urban poor is likely to come from the challenge of managing massive growth. Given the scale of the build-up that is required, it is clear that institutional growth on a monumental scale is necessary. In addition, some believe that client uptake in urban areas will outpace that in rural areas, similarly leading to rapid expansion of the retail channel. In order to successfully manage this growth, institutions will need to leverage both technological innovations and human resources.

6.5 Technology Service Providers: Leapfrogging Outreach

Technology may be able to significantly reduce cost and outreach challenges in both urban and rural microfinance institutions. However, strong infrastructure, such as the availability of electricity and good connectivity, may mean that new technologies will be adopted at an earlier rate in cities rather than in more remote areas.

That being said, the ability of technology to improve the bottom line is, as yet, not proven in the rural Indian context. Evidence to date would suggest that the past growth and profitability of rural microfinance institutions has not been significantly driven by the amount of technology integrating into their operations. Some of the largest rural MFIs in India have very basic level of technology interface and yet have high efficiencies.

Urban microfinance institutions have a unique positioning for technology usage. Some of the high cost elements associated with urban microfinance such as manpower and real estate may be reasonably offset through more intensive use of technology.

However, technological interventions go beyond improving efficiency of the microfinance systems. Some of the more advanced interventions, such as the proposed Financial Information Network and Operation (FINO),⁵⁹ would not only improve the

efficiency of the system but may also contribute to the creation of new applications such as credit bureau that would provide positive social benefits and enable far more rapid expansion of the microfinance sector than has been seen to date.⁶⁰

Product innovations in microfinance and delivery methods may also benefit from technological interventions. Data mining and consumer research tools may be even more relevant in an urban setting rather than a rural one due to assumed greater diversity of client needs in a more complex economy.

Samit Ghosh of Ujjivan in Bangalore believes,

"Urban microfinance would be driven by consumer behaviour and client demand. Single product companies may not be able to scale up as easily in the urban environment, and would need the support of market research experts and consumer behaviour experts to understand client behaviour... Technology has an increasingly important role to play as we scale up".

Veena Mankar of Swadhaar in Mumbai believes that appraisal, combined with credit scoring, may have more relevance in the urban context, and technology integration may help in making the use of such methods cost effective. Credit scoring and tracking client performance may assist in migrating group clients to individual clients more efficiently in urban settings to serve the demand for larger loans.

Time will tell what role precisely technology will play in the expansion of urban microfinance in India, but it is clear that there is real potential for institutions just now building out in urban markets to "leapfrog" established rural MFIs through the strategic deployment of new technologies.

6.6 Human Resource, Training & Manpower Development: Creating a Talent and Resource Pool

Finally, as with all human endeavours, human resource will play an essential role in the development of urban microfinance providers. While unemployment and lack of opportunities may have allowed rural microfinance institutions to recruit relatively easily committed and hard working local talent, the urban scenario is very different. Numerous urban microfinance institutions have suggested that recruiting and retaining the entry level employees, particularly at the loan officer level, is or will be a key challenge for their organizations. MFI leaders believe they will need to manage against the reality that urban settings often provide a far greater array of employment options to potential employees than are found in more rural settings.

In contrast to perceived challenges in recruiting at the more junior levels of the organisation, urban MFIs may have an easier time than their rural counterparts in recruiting for top managerial positions simply because there are more professionals of all kinds available in urban centres.

An additional human resources challenge somewhat unique to urban areas is the lack of physical space in which to conduct training programs for the tens and hundreds of new loan officers each institution will need. A constraint as simple as this might

create a real opportunity for independent training institutions that may consider partnering with MFIs in order to customize the training needs.

Institutions such as the Indian School of Microfinance for Women, the Centre for Microfinance (CMF) in Jaipur, and the Centre for Microfinance in Chennai (formerly Centre for Microfinance Research), EDA Rural Systems and Intellectap are contributing to the development of content and training human resources for the management function in the industry. Specialized management education institutions such as Institute of Rural Management, Anand, and Indian Institute of Forest Management have also been serving the management need of the sector. Accion, CGAP, Unitus, MicroSave-India and Grameen Foundation-USA are also involved in interventions on the capacity building front. The services of all categories of training and technical assistance providers will likely be needed in the development of the urban microfinance sector.

Annexures

Annexure One: Personal Interviews with Supply Side Actors in Urban Microfinance

The following key respondent interviews were conducted towards the primary research on the supply side and to gain further insights on the demand side. The respondents include practitioners, lenders and investors. The interviews are sorted by alphabetical order of Institution.

The objective of these interviews were to understand the motivations driving the entrepreneurs entry into the urban space, the beliefs that they held, the motivations driving the entrepreneurs' entry into the urban space, beliefs that they held, experience so far with regard to validation of disproving of such beliefs, key distinguishing factors with respect to the rural space, key challenges and enablers for outreach and success in the urban space.

Providing Technical Services in the Urban Microfinance Space Interview with Mr. Siddhartha Chowdri, Advisor for India, Accion

Q: What prompted Accion to start work in India?

ACCION International started working in India for several reasons:

- The demand for microfinance consulting services
- ACCION wants to be a global leader in microfinance and it could not be that without operating in India
- There were several senior management people who were compelled to do work for India because of an affinity for the country and its people
- There are many lessons to be learned from India that can be applied elsewhere in the world particularly in terms of rural finance, scale and micro-insurance
- We had a great opportunity to work with Unitus

Q: How does the current state of urban microfinance compare across India, Latin America and the rest of the world?

In India, the urban microfinance markets are much less mature than in Latin America. India's development sector has historically focused on the needs of the rural poor and neglected the needs of an ever increasing urban population that has no formal access to finance. Therefore, urban microfinance markets in other countries are much more mature, competitive and efficient. The cost of labour in

these other parts of the world are much higher, therefore technology and other non-labour intensive ways of improving loan officer efficiency are more important.

Another major difference is that, at least as far as I have seen, in general, in other countries India's urban microenterprises are significantly more likely to be operated by men. I am sure there are statistics on this.

In India, at least in the south, urban areas are much safer than in most urban areas of Latin America and Africa.

The idea of daily repayment collections is much more pervasive in India than in other parts of the world.

Savings are much more important part of microfinance. Also most non-regulated MFIs in other parts of the world transform to regulated institutions so that they can mobilise deposits as a cheaper source of funds. In India if you transform to an NBFC you still do not have that ability.

Q: What were some of the key myths that were discovered and exploded while attempting to downscale banks to provide microfinance to the underserved in India?

We have not down-scaled anybody yet. Ask me this in a year.

Q: Can you share with us some of the hypotheses with which Accion started the initiative in India?

Microfinance can work in urban areas. Microfinance to urban micro enterprise operators on an individual basis is microfinance. Men can be served by microfinance. It is extremely important to understand the local context (culture, language, legal framework, economic conditions, etc.) in order to adapt the microfinance methodologies from other parts of the world. There is a lot to understand about India before applying our methodologies that we have learned elsewhere.

Q: What is perceived to be the relevance of individual lending in urban areas?

Individual lending will likely be the dominant methodology used in urban areas in India.

Q: What is Accion's stand on the debate of group vs. individual methodologies, if any?

There is no debate. There are certain economic segments, cultures and businesses that group lending is more appropriate and others where individual lending is more appropriate. Ultimately this is a debate that should be answered by the clients. In more cases than not clients have chosen individual loan products over group products when given the choice.

Q: What are the key challenges to down streaming banks?

- Over regulation
- Interest rate caps
- Political interference

- Changing the culture and human resource requirements of the institution
- Expectations of scale and efficiency
- Finding, training and retaining the appropriately qualified human resources.

Q: What are the key challenges to serving the underserved in urban areas?

- Local money lenders and their political collections
- Designing products that are more efficient and appealing to the clients than what is being offered in urban areas by the informal sector.

Q: Would you agree that urban microfinance is more sustainable and easy to break even than rural microfinance? Would the sustainability issue be linked to greater efficiencies in the urban areas?

No, it really depends on how complicated and large you want your microfinance business to be. Urban microfinance can be more efficient because there are less transaction costs, but labour costs are traditionally higher in urban markets so it could negate this. Our projects tend to break even in about 2 years. I am not sure what the real non-subsidised breakeven of rural Indian MFIs is.

Q: What would be the key factors that would differentiate urban microfinance and rural microfinance in India in future?

I think the key factor is that rural lending is so connected to the agricultural economy which is significantly more risky and cyclical. Urban microfinance is in general less volatile than the rural economy. I think that as markets have expanded and opened this volatility has only increased. The rural micro borrower requires significantly more non-financial inputs to ensure the long-term profitability of their livelihood.

Creating Livelihoods and Tackling Urban Poverty

Interview with Mr. Hemanth Valvekar, BASIX

Q: What were the reasons for moving on from rural to urban operations, what services is BASIX currently providing and what are its future plans in urban areas?

According to available data, urban poverty appears to be growing at a faster pace when compared to rural poverty. We had already mastered rural microfinance, and now it was time to move to the urban areas. We also felt the need to initiate the urban operations in order to inculcate the savings habit amongst slum dwellers. Most of the urban poor residing in slums do not have bank or post office accounts, and hence do not save.

BASIX is providing comprehensive financial services to the urban dwellers, including savings, credit, and insurance.

BASIX has also begun a skill development programme, initially in tailoring and embroidery, in slums in Hyderabad. This would be developed further.

The plan on the anvil is to foray into the provision of water and sanitation services in urban areas from 2007 onwards. BASIX has initiated a survey for the same, and action would be taken very soon.

Q: What were the assumptions and apprehensions about urban microfinance and what has been your experience till date on each of them?

1. *There exists a high demand for microfinance in city slums*

This demand is especially high for credit services, because the urban poor take loans from money lenders at high interest, and would avail services offered at better terms. In the past 1 ½ years of operations, this assumption has been proved to be valid.

2. *Migration and client mobility*

The question of mobility and high migration has not been a bottleneck for urban operations for us. This may be true in the context of Hyderabad, where the rate of migration appears to be less when compared to other cities.

3. *Limited understanding of the clients*

We were apprehensive about the complexities of the urban context. So we began operations with getting their group members to open bank/post-office accounts and save a minimal amount for 9 weeks. Once a group completed this mandate, they became eligible for loans. This system has worked well in terms of knowing/understanding the clients' behaviour.

Contrary to the popular belief of limited social cohesiveness in the urban slums, the JLG model has worked well for us. The neighbourhood, when selected carefully, is willing to carry the liability of fellow members. Till date, the repayment rate has been 100%.

Q: What are the key challenges that BASIX has faced till date?

In the urban microfinance market there is severe competition from the new entrants. These new players are not practicing systematic lending processes. The lending is aggressive and there is no attempt to understand the client profile.

Our clients are required to maintain a savings account with a local bank or post-office for a period of 9 weeks. However, while the higher officials have welcomed our approach, the officials of most branches have not been supportive, stalling the processes.

High-growth Rural MFI Ventures into the Urban Space Interview with Ms. Vinatha Reddy, Grameen Koota, Bangalore

Q: What prompted you to enter into urban microfinance?

Grameen Koota's vision is to impact poverty through a sustainable microfinance intervention. We aim to reach out to 10% of Karnataka's total poor households by 2010. Statistics said that urban poverty was growing at a fast pace, and that there is a clear need for microfinance. At Grameen Koota, we made a New Year Resolution to start operations in Bangalore and took the plunge.

Q: What were your assumptions and apprehensions about urban microfinance and what has been your experience till date on each of them?

We had major apprehensions about running into trouble with the mafia. Even in our rural operations, we met with resistance from the local money lenders. We believed that in an urban slum setting, the problem would be aggravated. However, our experience so far has been otherwise.

Since we were unsure of the differences in an urban setting when compared to the rural, we started off first in the semi-urban areas for a better transition. In our experience till date, there is a demand for a higher loan size. Amongst rural clients while the average loan size demanded is Rs. 6000, for urban clients, it goes up to Rs. 10,000.

We have a hundred percent repayment history till date in the urban operations. This could also be because of our operating model. The loan goes through the Kendra⁶¹ and it is the Kendra which is responsible for the repayment to Grameen Koota. Till date, the Kendra has ensured hundred percent repayments to Grameen Koota. This is the same model that we follow in our rural operations, except for the fact that the collection is made at the client's door step. The disbursement continues to be made at the branches.

The group methodology seems to work even at a loan size of Rs. 20,000 to the Kendra. However, there is a strong demand from some of our star borrowers for individual loans of higher amounts. Since we have always been following the same operating methodology, we continued with it. But there is a strong potential for borrower graduation into individual loans.

Q: It is often said that a large part of the urban client base is mobile and are hence social cohesion and 'peer pressure' might not work. What has been your experience on this front?

Our experience so far does not totally agree with the statement. We found that most of our borrowers have been living in their urban dwellings for ages.

Urban Microfinance Needs a Dynamic and Responsive Approach Interview with Mr. Vishal Mehta, Lok Capital, Delhi

Q: What is your take on the trend of established rural MFIs shifting their focus towards Urban Microfinance and several new MFIs coming up in an urban setting? Where would you prefer to invest and what are the perceived risks in the urban context?

The shift towards urban microfinance is an encouraging trend. From available data it appears that there is a huge unmet demand, and this augurs well for the scalability of institutions that are operating in the urban space. What is also very encouraging is the profile of people who are starting out these urban MFIs. Experienced professionals from the corporate sector running these institutions on commercial principles give us the confidence to invest in these institutions. Mid to long term, as a fund, we will most certainly focus on both - rural as well as urban. At present, it is too early for us to start narrowing down prospective MFIs solely based on their urban rural mix. Having said that, we would definitely look to have at least one of our initial 3-4 investments in an urban MFI.

Q: What are the key constraints and challenges for the Urban MFIs and how would you facilitate your investee companies to overcome these challenges?

The tried and tested rural methodology may not be applicable in the urban setting. The challenge before the urban MFIs is to constantly innovate and come

up with new models of delivery, new products and effective means of leveraging on technology. While in the rural setting MFIs were experimenting with technology, in the urban context the use of technology would become an imperative. The urban customer is going to be a lot more demanding than his rural counterpart. The MFIs would constantly need to innovate on the product design and work on the economics such that it is viable both for the borrower and the lender. Recruiting and retaining professionals both at the top as well as the middle management level would remain a critical constraint.

Q: What has been your experience so far with Urban MFIs? Are there any stark revelations or myths exploded?

Based on our interactions with potential investee companies so far, all I can say is that the urban microfinance market is a lot more complex than its rural counterpart, and requires a more dynamic and responsive approach. This is mainly because, the delivery model, organizational model and the economic model, in the India urban context is yet to be fully tested.

Providing Financial Services to Mumbai's slum dwellers Interview with Veena Mankar, Swadhaar Fin Access, Mumbai

Q: What are the reasons that prompted you to look at urban microfinance after a successful career in banking? Did you think about rural microfinance as an option?

My experience as part of the NBFC I was managing had given me both professional and commercial satisfaction. I decided to slow down in life and give up mainstream finance. While looking at alternative options that would be non-commercial in nature, I heard someone from SIDBI discuss microfinance at a conference. It looked like a good area to explore.

After the initial study regarding microfinance, I thought that supporting small NGOs involved in microfinance could be a good way for a banker to initiate involvement. Thus, my initial focus was capacity building. However, it was a challenge to find NGOs that were looking for similar external assistance. I was also advised not to participate in microfinance as a hobby. The experience with small NGOs and the understanding that I need to be more intense in approach lead me to set up Swadhaar.

As I looked around, I realised very few grassroots institutions exist, and still fewer urban microfinance institutions. While comparing rural poverty with urban poverty during my visits to slums and villages, I found the latter to be stark, striking, and at times even more extreme.

These experiences helped me to decide that urban microfinance institution is my calling.

Q: What were the assumptions and apprehensions about urban microfinance and what has been your experience till date on each of them?

I had some thoughts on issues and challenges. The lack of knowledge about financial products was very obvious to me during my visits. This has been proven time and again in my experience in lending as well.

I thought self help groups may work in Mumbai slums. But it did not. Unlike in rural India, the urban work force and entrepreneurs have different financial needs and have different issues on timings. They are reluctant to form large groups due to lack of information regarding the fellow group member's background. A large group also does not make sense in a space-starved Mumbai slums. Women were willing to form small groups with 2-4 members, but not beyond.

We also realised that one cannot go into slums without building credibility for oneself through partnerships. We did the same through our partnership with the Rotary club.

We also believed that most of our loans should be for income generating activities. However, we found out that 60% of our target clients are salaried workers, and are not interested in income generation. They need consumption loans for purposes such as building safeguards at home (to prevent flood water), for education of children and other needs. Our experience is that 30% of our current loans have been accessed by salaried people for consumption purposes. Though 70% of our current clients are women engaged in business, 30% of these women take mostly consumption loans or for repaying the money lender.

I went into microfinance believing that educating the mass about financial products is a must. The view is still closely held. We also went in knowing that demand for savings services is high and insurance does not appeal to people. This too holds true.

We believe that one cannot confuse the client by both educating them on services and lending at the same time. Hence we intend to set up an NBFC for lending business and let the Section 25 company do charitable activities.

We did assume that urban people are mobile. Our conclusion is that most people have been living in slums for generations. Mobility is temporary, and even if people move between their village and Mumbai, they come back and look for space in the same slum they were living earlier.

Q: What are some of the key challenges that you think Urban Microfinance is facing?

Determining the right methodology is a key challenge, and would continue to be a challenge as we move forward. We believe that formal financial system tools that helped banks to retail well, such as the system of credit scores may be the key to meet the scale-up challenges. Technology may have a major role to play in keeping the costs down and in scaling up the retail microfinance model.

Another key challenge in urban microfinance is the cost of space. Swadhaar is looking to place its branches outside the slums. This raises the cost of infrastructure. Finding, recruiting and training staff is also a huge challenge. Attrition at the loan officer level may be very high as the FMCG companies may be looking to poach into our staff.

The demand for loans is very large with most people seeking loans in the range of Rs 25,000- 30,000. Repayment capability assessment has not been easy. We have seen that though people do not want small loans, faced with no choice, they take the loan irrespective.

Q: What is the difference between urban and rural microfinance markets?

The benefits of retail finance in an environment that support opportunities can be seen all around us. My personal experience of finding living space in Mumbai as a young MBA in absence of retail loan was horrifying. I can see that such challenges do not exist any more. Urban microfinance offers the same opportunity to people in slums who are witnessing emergence of options, but are suffering due to lack of financial support.

Urban microfinance would create new opportunities, would expand faster, and would create new tools and products such as joint liability for micro enterprises. This may initiate involvement of both husband and wife, instead of the current surrogate women borrowing.

Urban poor possibly would not mind reaching out to urban microfinance deliverer compared to rural poor who need door step delivery of services. Technology may have a major role to play. Urban microfinance also may focus more on institutional partnerships due to proximity and better infrastructure issues.

Experiences of a first generation urban microfinance promoter
An interview with Mr. Samit Ghosh, Ujjivan Financial Services, Bangalore

Q: When you started you looked at all good institution around you and most of them happen to be rural microfinance initiatives. What prompted you to set up an Urban Microfinance Initiative?

Having seen the rural microfinance initiatives, I was convinced that microfinance was a viable and sustainable model for poverty alleviation. I found that the urban poor formed a very significant portion of our country's population and growing rapidly. Yet they are largely overlooked in the poverty alleviation programs by the MFIs, Financial Institutions, NGOs and the Government. Secondly, being from urban India, I found it much easier to relate to the urban population. The urban microfinance prima facie has advantages largely due to geographical concentration of population that makes it potentially more viable. Driven by these three basic considerations, we thought the more logical approach was to first build a viable urban initiative and use the base to also reach the rural population.

Q: What were some of the key myths that you discovered during your journey of setting up the Urban Microfinance Initiatives?

The two biggest myths I encountered were related to client perception.

1. The urban clientele living in slums is not cohesive

My belief is that the urban clientele is as cohesive, and at times more cohesive compared to rural clients. Most of the urban slum clients have lived through traumas and threats, both natural and man made. They have stayed together as a community providing mutual support.

2. The urban client is mobile

I believe that the migration myth is a hyperbole. In Bangalore we did not face this challenge. I believe most urban populations would be similar to what we have encountered. Our estimate is that 80-90% of the population

in urban India is rooted to its surroundings. A substantial section maintain contact with their place of origin, be it village or town, but are permanently rooted to the city. Among the exceptions are those employed in the construction industry, who tend to move with the location of the construction sites and are largely sourced from the rural areas. They are from across the country and also a sprinkling from across the border. Each brings their own specialization and skills. The urban and rural poor are no more mobile than the other. At times it is like looking at the same coin from two sides.

Q: Can you share with us some of the hypothesis with which you started the business and whether they still hold true?

The belief that urban microfinance is more sustainable (in terms of quicker breakeven) appears to be holding true, though it is still in its early days.

Q: With your experience of Urban Microfinance, what are the key challenges you have identified that would keep you company in your pursuit to address poverty issues?

The three key challenges that we have faced so far include:

1. *Human resource management*

The greater opportunities that the urban economic environment offers make it difficult for the institution to source and retain field staff. Thus, keeping the attrition low and retaining staff at the lower, as well as management level, is one of the key challenges for urban MFIs.

2. *Costs*

The cost of human resource recruitment, retention, salary and training is much higher. So is the cost of infrastructure (branch, office location).

3. *Microfinance as perceived vis-à-vis as desired, by the clients*

Microfinance has always advocated income-generation loan as the key offering in rural settings. In my experience, the customer profile within the poor segment in urban slum is such that most of them are already employed full time. In such a situation, most of the loans would be for legitimate family needs and not necessarily entrepreneurial. This perception issue is a key challenge for us as most microfinance investors, lenders and consultants do not understand the shift in client demand. Secondly, income growth of the employed need to come from programs leading to skills enhancement.

Q: Do you use the group lending model or the individual lending model? Do you believe that group lending is as effective in an urban setting as it has been found to be in the rural setting?

As stated earlier, social cohesion exists in urban slums. Hence we have been using the group lending model. However, this model does not work in certain industry-driven clusters such as the garment factory workers, where the employee turnover is very high. It is also clear to us that increasing loan size is a threat to the idea of social collateral, and it could be breached if the loan sizes average or increase beyond Rs. 15,000 per customer.

Group liability works for temporary cash flow dislocation in urban settings, but not for permanent liability arising out of loss of a major performing asset or loss of the primary earning member of the family.

Groups play a role in enforcing financial discipline. But in circumstances where the asset is lost or a key family member loses earning power, it is unrealistic to expect the group to repay the entire loan.

Q: How do you compare the loan sizes in urban microfinance to the rural experience?

The loan sizes are a function of the segment of population that you are targeting and the type of loans. With increasing focus on the lower strata that is entrepreneurial, the loan sizes can go up to Rs. 20,000-30,000, or even higher for college/university education and housing loans.

Q: Is the sustainability issue linked with superior efficiency in urban microfinance? If so, what do you expect in terms of loan officer to client ratio in urban settings?

The efficiency in the urban setting is going to be high. A larger proportion of customers are on monthly repayment cycles based on their cash flows. 600 clients per loan officer is the efficiency we are aiming at. With some improvements in the system & technology, this could go up as high as 800 clients per loan officer. Easier access to technology also has an increasingly important role to play as we scale up.

Q: What would differentiate rural and urban microfinance in future?

Urban microfinance would be driven by consumer behaviour and demand. Single product MFIs may not be able to service the customer needs in the urban environment, and would need the support of market research, experts to understand consumer behaviour and pragmatic skills enhancement programmes.

Funding urban microfinance: An investor's perspective Interview with Mr. Sandeep Farias, Unitus, Bangalore

Q: What is your take on the trend of established rural MFIs shifting their focus towards Urban Microfinance and several new MFIs coming up in an urban setting? Where would you prefer to invest and what are the perceived risks in the urban context?

Unitus is agnostic when it comes to choosing between rural and urban MFIs for partnerships and investment opportunities. We look at the following issues:

1. Operating in a under served geography;
2. Have huge economic potential due to their ability to scale up;
3. Profile of entrepreneurs who are associated with these institutions.

From the risk perspective, the urban MFIs may be viewed as more risky than the established rural MFIs as they are mostly start ups and are operating in untested territories. However with the passage of time once these institutions have established a track record, these risks would not be as significant.

Q: What are the key constraints and challenges for the Urban MFIs and how would you facilitate your investee MFIs to overcome these challenges?

One of the distinguishing features for urban MFIs could be their vulnerability to local disruptions and dealing with them could be a key challenge. They need a much better understanding of the needs of the customer compared to the rural setting as the urban customer is likely to be more vocal and resist traditional microfinance structures like group lending. The institutions would need quicker diversification of products. Technology would have a critical role to play in designing delivery mechanisms.

Q: What has been your experience so far with Urban MFIs? Are there any stark revelations or myths exploded?

The MFIs need to streamline their products offerings and ensure consistency in their operations. The urban client is more demanding, and individual loans are going to be the way forward.

A Multitude of Services for Poor Women Interview with Dr. Jaya Arunachalam of Working Women's Forum

Q: What prompted you to set up an Urban Microfinance Initiative?

Way back in the mid-1970s, by when, I had completed almost 15 years of public work, I felt that the plight of the poor had not changed much since independence. And the woes of women, among the poor especially, simply, was compounding. So, it was during one such situation, the devastating cyclone of 1977, which hit Madras first before battering Krishna district in AP, where I was involved in running food and shelter camps during the cyclone, I felt the strongest urge to intervene in an Urban setting. Urban poverty is quite complex and not just lack of access to financial services and it is very challenging and the plight of women is exacerbated by these additional multi pronged web of urban poverty.

Q: What were some of the key myths that you discovered during your journey of setting up the Urban Microfinance Initiatives?

The biggest myth is that poor women can never repay. Our poor women have consistently shown that they can be disciplined borrowers, they can take and repay loans (over 98% repayment rate over 27 years for over 4 lakhs members is a very good demonstration), they can save, they mitigate risks with insurance (life, health, asset etc), they can invest in their institution (shares) and do much more including improving their health care, nutrition, financial literacy etc.

Another myth is that the poor women cannot manage their affairs and scale up operations. Today, we talk of SHG bank linkage etc but let me tell you that we did it way back in 1978 with Bank of Maharashtra and Bank of India, both of whom wanted personal guarantees from me. We moved on, vertically integrated backwards and set up our own institutions - women owned, women run and women used - because these bankers could not respond to needs of poor women. I said it at the

meeting of the RBI last year - if banks had responded, then MFIs would not have come up. So, where is the question of trying to stifle us with regulation now.

The third myth is that the poor and women among them hardly count in the national economy. Whether in urban or peri-urban or rural areas, our women have decisively and conclusively shown that they indeed contribute significantly to the national economy through their enterprises and services. If they were in a position to boycott the rest of us in the economy, we would all be in trouble - farmers not selling their goods, urban microenterprises not providing services. Thus, they provide invaluable services, which we must now recognise and add value to in terms of better prices.

Q: Can you share with us some of the hypothesis with which you started the business and whether they still hold true?

1. If poor women are given options, choices and services on honorable and affordable terms, they will use them and use them, very well
2. Poor women are extremely innovative and adaptive and any institution that desires to serve them must of course have a similar character
3. Mere financial services are insufficient, the poor need access to a range of services, which they will also pay for, if it is relevant to their needs and also affordable

Q: With your experience of Urban Microfinance, what are the challenges you have identified that would be the key obstacles in your pursuit to address poverty issues?

Poverty is much more than lack of access to financial services. It is a state which is characterized by lack of access to financial services, health, education, rights and several other aspects. Poverty also has a great gender dimension. Hence, any serious attempt to tackle poverty must be holistic and address these different aspects. Mere provision of credit cannot tackle poverty in the absence of ensuring that women really hold custody of income that they earn. There are too many instances of women have earned the money and men use the same for alcohol etc.

Q: Do you use the group lending model or the individual lending model? Do you believe that group lending is as effective in an urban setting as it has been found to be in the rural setting?

Groups are an efficiency inducing and solidarity enhancing mechanism. We use groups in ways that are convenient to poor people, especially women. Good group methodology would not enhance transactions costs for the poor like in SHG settings - tell me, would you sit in an SHG for hours every week to get a loan and maintain records. I would not as it would affect my livelihood.

All of this is the work of the institution and this is where technology helps. We have an extremely efficient automated MIS that works like a teller model in a bank and the groups are local mechanisms that provide support, ensure

conformance to organizational norms and strengthen collective action at the grass-roots, besides several other functions.

Ours are neighborhood groups that are most convenient for the poor women and also low cost in terms of transactions cost as well as initial establishment. The group leaders play a pivotal role in the whole process and leadership is multiplied at the grass-roots, with more ordinary group members becoming leaders and forming their own groups, thereby enhancing outreach as well. That is why we have grown at the good pace that we have grown.

Q: How do you compare the loan sizes in urban microfinance to the rural experience?

Loan sizes are a function of the loan product, which in turn should be based on the needs of the poor women and the enterprises they run/services they provide. As we operate in Urban, Peri-Urban and Rural Areas across 3 states, I can say that it is a myth that urban micro-finance requires larger loan sizes. Our experience shows that the loan size depends on the specific enterprise/service context. A loan is a product and it must have the enabling effect to catapult the borrower to a better quality of life. That is, it must facilitate the poor women to do many things in their life and so, is a means rather than an end.

Q: Do you agree that urban microfinance is more sustainable and easy to break even than rural microfinance. Is the sustainability issue linked with superior efficiency in urban microfinance? If so, what do you expect in terms of loan officer to client ratio in urban settings?

Sustainability is linked to the model and philosophy of the institution and we operate in Urban, peri-urban and Rural areas. Using a methodology that is cost effective, having efficient processes and strategies, automating systems are all factors that enhance sustainability at a lower cost. Our effective interest rates have rarely exceed 18% and yet we have been sustainable because we use a low cost community model where the community people are used as agents of change and as loan officers etc. Using local people helps in overcoming information asymmetry, enhancing social acceptability and also reduces cost. It also ensures that products, services, processes etc are relevant and tailored to the needs of the poor women.

Q: What would differentiate rural and urban microfinance in future?

Urban poverty is much more complex and requires a greater range of services besides finance. I am not saying that MFIs should do all of this - linking their members/clients to such services is going to be critical.

Annexure Two: List of Slum Locations Sampled in Primary Research

HYDERABAD		
Name of Slum	Name of Locality	Number of Families
Bhagvandass Bada	Abids	57
Divine Life Society	New Boiguda	1186
Fathima Nagar	Phool Bagh	90
Jiyaguda (mch qr.)	Imampura	400
Mahajan Wadi	Tappachaputra	60
Misrigunj, Gulshan Nagar	Misrigunj	457
Amlapoor	Tappachaputra	226
Sham Nagar	Asif Nagar (South)	110
Indira Nagar (New Bakaram)	Gandhi Nagar	200
Akash Nagar	Amberpet	800
Chisti Chaman	Mangalhat	300
Ganga Putra Sangam	Subju Mandi	800
Moulana Azad Nagar	Gandhi Nagar	500
Kattelamandi	Abids (South)	200
Sanjeevapuram	Parsigutta	680

HYDERABAD		
Name of Slum	Name of Locality	Number of Families
JJ Camp, near Nabikarim	Ramnagar, Paharganj	700
Jhuggie No. 4, MCD store, Pant Nagar	Jungpura	135
Tri Nagar	Tri Nagar	350
Indira Colony bg-1	Shalimarbagh	370
Indira Camp No.1, Thokar No.7, Rainy Well	Lakshmi Nagar	1500
JJ Camp, Nai Basti, Nangal Dairy	Mahipal Pur	300
JJ Sangharsh Morcha, Ravi Dass Camp	Pandav Nagar Mother Dairy	200
JJ Cluster Dhobi Ghat No. 4	Talkatora, Gole Market	280
Subzi Mundi Rly. Station, Bagichi Peerji	Sadar Bazar	135
JJ TCM Camp, (Kali Basti), Shamshan Bhoomi	Hastal, Uttam Nagar	476
Indira Camp Okhla Industrial Area, Phase I	Okhla	135
Opposite Gagan Cinema, Block F, Sunder Nagari	Seemapuri	390
JJ Camp near OH Tank, F block	Vishnu Garden, Khyala	100
JJ Camp, Peer Bagh Bapu Park	Kotla Mubarakpur	270
JJ Camp, Prasad Nagar, Mithapur	Badarpur	390
Purvanchal WH-58-59, JJ Camp, Mayapuri Phase I	Delhi Cant	100
Karpoori Thakur jag Jiwan Camp	Sriniwas Puri	140

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¹ *World Urbanization Prospects: The 2003 Revision, United Nations Department of Economic and Social Affairs/Population Division*

² *Ibid.*

³ Ravallion, M. 2001. *On the Urbanization of Poverty, World Bank Policy Research Working Paper 2586.*

⁴Source: http://www.nhb.org.in/Publications/hNews_jun2003_Articles.htm

⁵ *The objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives.* quote from Mahbub ul Haq, in UNDP powerpoint presentation on: *Human Development: Concept and Reporting. RBI Training Course on Financing of Human Development, Prof. K. Seeta Prabhu, Head Human Development Resource Centre UNDP India*

⁶ Source: *Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: The 2004 Revision and World Urbanization Prospects: The 2005 Revision, <http://esa.un.org/unup>, 13 August 2006*

⁷ Source: *State of the World's Cities 2005-06, UN Habitat*

⁸ *National Sample Survey Data, 2001*

⁹ *Ibid.*

¹⁰ Source: <http://www.cseindia.org/programme/pov-env/master-plan.htm>

¹¹ *10th Five year plan document, Chapter 6.1, Urban Development*

¹² Supriti, Barnhardt S.M, and Ramanathan, R. 2002. "Urban Poverty Alleviation in India : A General Assessment and a Particular Perspective". *Ramanathan Foundation*

¹³ Source: <http://muda.nic.in/SJSRY.htm>

¹⁴ *The Reserve Bank of India (RBI) is the central bank of India, and was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. RBI acts as the monetary authority that formulates, implements, and regulates national monetary policy in order to maintain price stability and ensure adequate flows of credit to productive and priority sectors.*

¹⁵ *An SHG is a group of about 20 people from a homogeneous class, who come together for addressing their common problems. They are encouraged to make voluntary thrift on a regular basis. They use this pooled resource to make small interest bearing loans to their members. The process helps them imbibe the essentials of financial intermediation including prioritization of*

needs, setting terms and conditions and accounts keeping. This gradually builds financial discipline & credit history for themselves, as the money involved in the lending operations is their own hard earned money saved over time with great difficulty. They also learn to handle resources of a size that is much beyond their individual capacities.

¹⁶ Grameen lending is a well known form of group lending, initiated by Prof. Muhammad Yunus.

¹⁷ "Future Directions of the Growth of the Microfinance Sector in India", Sa-Dhan. 2006.

¹⁸ Schreiner, Mark and Hector Horacio Colombet "From Urban to Rural: Lessons for Microfinance from Argentina." *Development Policy Review*, 2001 (p. 339)

¹⁹ Ibid.

²⁰ Krishi means "agriculture"

²¹ Grama means "village"

²² Grameen means "of the village/rural"

²³ Source: <http://www.sewa.bank.org/faq.htm>

²⁴ Source: www.workingwomensforum.org/

²⁵ While SKS began with a rural focus, as its name suggests, the MFI began urban operations in 2006.

²⁶ UN Country Health Profile: India

²⁷ Quoted in, "India: Higher growth in the 1990s, But how much impact on Poverty?", Ravallion, M., The World Bank.

²⁸ Under Section-3 of the Slum Area Improvement and Clearance Act, 1956, slums are defined as "Mainly those residential areas where dwellings are in any respect unfit for human habitation by reasons of dilapidation, overcrowding, faulty arrangements and designs, narrowness or faulty arrangement of streets, lack of ventilation, light or sanitation facilities, or any combination of these factors which are detrimental to safety, health and morals."

²⁹ Report No. 506: Employment and Unemployment Situation in India: January-June, 2004

³⁰ Employment and Unemployment Situation in India January - June, 2004 NSS 60th Round (January 2004- June 2004), and Census India Report 2001, available at: <http://www.censusindia.net/literates1.html>

³¹ Source: National Sample Survey, 2002.

³² The Multiple Discriminant Analysis was carried out on four groups of clients, such as groups of slum dwellers using only formal financial institutions, those using only informal financial institutions, those who use both formal as well as informal, and those who don't use any financial services at all.

³³ CGAP, Donor Brief No. 4, June 2002.

Available at: http://cgap.org/docs/donorbrief_04.html

³⁴ Ruthven, O. 2002, Money Mosaics: Financial Choice and Strategy in a West Delhi Squatter Settlement, *Journal of International Development*

³⁵ Devarajan, P. "Welcome initiative on urban co-ops". *The Hindu Business Line Internet Edition*. 1 July 2005.

³⁶ <http://www.indiapost.gov.in/>

³⁷ Ruthven, O. 2002, *Money Mosaics: Financial Choice and Strategy in a West Delhi Squatter Settlement*, *Journal of International Development*

³⁸ Such as Madhya Pradesh, Rajasthan and Uttar Pradesh.

³⁹ Rao, L, Deshingkar, P, and Farrington, J. 2006, *From Survival to Strategy: Population Growth and Migration in Semi-Arid Andhra Pradesh, India*, Overseas Development Institute.

⁴⁰ Case Summary: *India's SEWA: Empowerment through Mobilization of Poor Women on a Large Scale*

⁴¹ Report No. 506: *Employment and Unemployment Situation in India: January-June, 2004*

⁴² Mayoux, L. *Microfinance and the empowerment of women*, ILO.

⁴³ *Ibid.*

⁴⁴ www.equitymaster.com

⁴⁵ www.equitymaster.com

⁴⁶ <http://www.banknetindia.com/banking/6613.htm>

⁴⁷ It is important to note that the census data, both because of the infrequency with which it is conducted and the natural constraints of gathering accurate data from low income and slum areas, likely admits some errors of omission or commission.

⁴⁸ www.censusindia.net

⁴⁹ In order to develop a more accurate estimate of current demand we would need to know the original principle borrowed and the average tenure of loans.

⁵⁰ Source: Supriti, Sharon M Barnhardt and Ramesh Ramanathan. Publishers: Ramanathan Foundation (*Access to money for the urban poor*)

⁵¹ *Ibid.*

⁵² *Ibid.*

⁵³ As per staff productivity estimates of Ujjivan, an urban MFI operating in Bangalore

⁵⁴ This is only an indicative figure which is the norm for most Urban MFIs with wide fluctuations observed between different Urban MFIs. Some MFIs such as BASIX, which requires Rs. 5,00,000 startup funding per urban branch, have more capital intensive branch setup

⁵⁵ *Future Directions for the growth of Microfinance Sector in India, 2006*, Sa-dhan Publication.

⁵⁶ *Ibid.*

⁵⁷ See RBI circular - RBI/2005-06/288 DBOD.No.BL.BC. 58/22.01.001/2005-2006 at www.rbi.in

⁵⁸ Adapted from "Urban Poverty Alleviation in India: A General Assessment and a Particular Perspective" (2002), Authors: Supriti, Sharon M Barnhardt and Ramesh Ramanathan. Publishers: Ramanathan Foundation

⁵⁹ FINO is an aggregator of technology solutions for institutions catering to un-banked customers. For more details www.fino.co.in

⁶⁰ The event of the same client availing loans from multiple sources

⁶¹ A Kendra acts as the second tier for the 5 member borrower groups



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