Seminar Paper

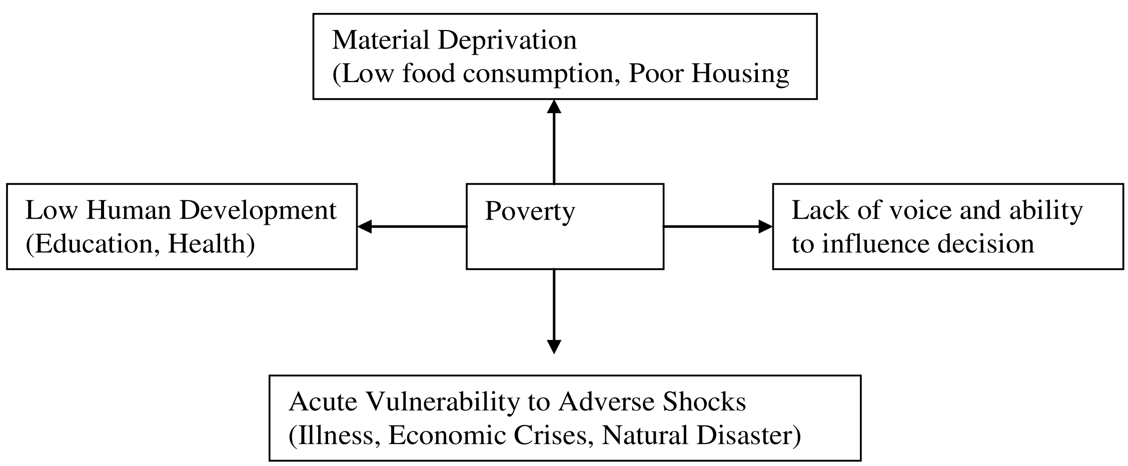
Reaching poorest of the poor: Building Inclusive Microfinance

Man Bahadur Bk

Defining Poverty and Poverty Status

Traditionally, poverty has been conceptualized in terms of income, with the poor defined as those living below a given income level. But poverty has been increasingly recognized as a multidimensional phenomenon that encompasses not simply low income but also lack of assets, skills, resources, opportunities, services, and the power to influence decisions that affect an individual's daily life (Seep Network, 2006). Poverty also frequently overlaps and reinforces other types of social exclusion, such as those based on race, gender, or ethnicity. This more comprehensive understanding of poverty better captures how the poor themselves define their situation (World Bank, 2004).

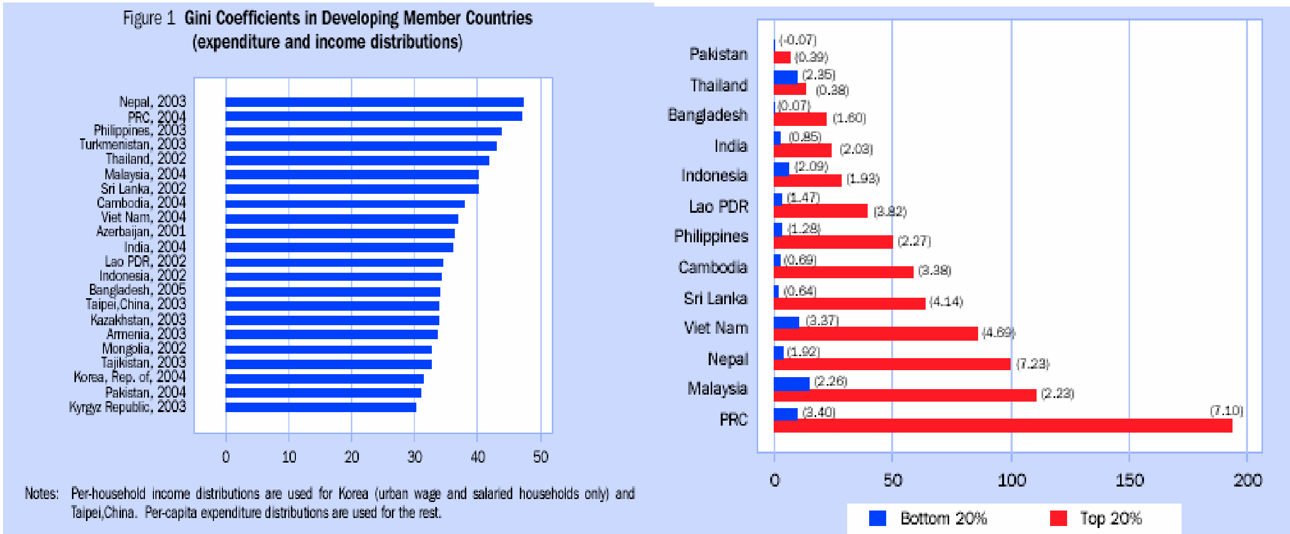
Dimensions of Poverty



Source: Dhakal, 2004 cited in SAP-Nepal (2005)

The complex and multidimensional nature of poverty makes it a challenge to measure. For the sake of simplicity, an income based measure of poverty is widely used as it permits comparisons between regions and countries. The World Bank defines extreme poverty as an income of less than US $1 per day, which is seen as the minimum amount necessary for survival.

Impact of the rapidly growing population of the country at the rate of 2.4 percent per annum has adversely affected especially the well being of the rural poor. Since the country is multiethnic, multi-cultural and multi-linguistic, there has not been balanced inclusion of the communities in the development process and governance as well. Following figure shows that Nepal is the most unequal country in the Asia. Even the disparity of have and have-nots is comparatively higher for Nepal as shown in figure 2.



Note: Second part shows Changes in Per Capita Expenditure; 1990s-2000s; Bottom 20 and top 20 (In 1993 PPP dollars)

Source: Inequality in Asia; ADB (2007)

In addition to geographical remoteness, the ethno-caste hierarchy is one of the various influential factors for socio economic deprivation of the people of Nepal. The long lasting caste-based practices have made many people deprived of socio-economic opportunities in the society. The representation of ethnic community and so-called lower caste people in every sector is non-influential whether it is the government sector or development sector or economic sector as well. It is also obvious that until and unless these groups are socio-economically empowered, economic development of the country is not possible. Ninth plan apprehend that the exclusionary development has further widened the gap between have and have-nots. Tenth plan through Poverty Reduction Strategy Paper (PRSP) has established social inclusion and targeted program aiming to bring such disadvantaged community in the mainstream of governance and development initiation (Bk, 2005).

Role of Microfinance in Reaching Poorest of the Poor

Microfinance since its beginning in 1970 in Asia and in some Latin American countries has been working to alleviate poverty. By providing small loans and saving facilities to people who are excluded from commercial financial services, microfinance has become a strategy for reducing poverty. Access to credit and deposit services is a way to provide poor women and men with opportunities to take an active role in their perspective economies through entrepreneurship and building income, bargaining power and social empowerment (Seep Network, 2006). Despite most Microfinance Institutions (MFIs) aiming to reach poor people, it has become increasingly apparent that they rarely serve very poor people. Most MFIs reach the "upper poor" in much greater number than the "very poor". So, the extent of which microfinance programs are able to reach the poorest of the poor remains an open debate (*Ibid*).

Since poverty and ethno-caste hierarchy is interlinked in our country, it has not been successful to alleviate poverty. In Nepal, many policies and programs were implemented by the government under different development plans to curb the poverty situation of the country. Poverty alleviation through subsidized credit flow to small farmers was the major goal of Ninth Plan. Many subsidized micro-credit projects have been implemented under the initiatives of commercial bank. But the experiences have shown that directly or indirectly subsidized micro-credit programs have not been so effective in reaching to the actual poor. Mainly because they depend on cheap government funds neglecting internal capital generation and mobilization of savings. It is presumed that these programs have also been proved costly for the government because of high administrative costs, high default rate and failure to reach the target people (Bashyal, 2001). Moreover, they are supply-driven rather than demand-driven in nature.

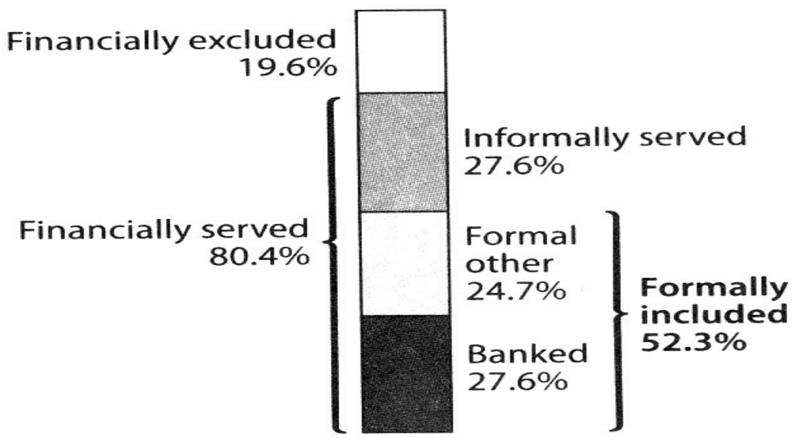
Therefore, some methods have been developed as a challenge to traditional financing system e.g. target group identification, group lending, collateral free loan on group liability basis etc. This method has led the micro-finance institutions towards the long-lasting sustainability. Evaluation of the effectiveness of micro-finance institutions is not a simple and easy task as one may raise a number of issues regarding quality and techniques of measurement. There are some critical issues related with micro-finance institutions in Nepal. Some of them are: organizational, managerial, structural, policy related, financial, human resources and membership criteria. However, in practice, it may be possible to identify certain impacts of micro-finance in national economy that shows the effectiveness in reaching poorest of the poor segment of the population.

The outreach of microfinance services is still low and the market for micro and rural financial services appears to be huge. Using the analytical methodologies, about 41.6 percent HHs out of 1,339,642 HHs below poverty line have access to microfinance services in Nepal. This statistic implies that an additional 782,642 HHs are yet to be served by the microfinance sector in Nepal (Ibid). Hence, the breadth and depth of outreach is yet to be expanded to ensure access to microfinance services to people below the poverty line which mostly includes the excluded groups. An analysis of the concentration of microfinance services reveals that MFIs are concentrated in the Terai and accessible hills. There is virtually no formal MFI with only limited presence of the SHGs and credit union model in the inaccessible hills and mountains. MFI services are more concentrated in urban and semi-urban areas and such services are very limited for the poorest of the poor. Following figure shows the access of financial services from various kinds of financial service providers. Just 28 percent of Nepalese households have an account with or loan from a bank. Another 25 percent have an account with or loan from a formal financial institution other than a bank. Some 28 percent rely solely on informal financial services, and 20 percent are financially excluded (World Bank, 2006). .

FIGURE 2.1

About half of Nepal's households have access to formal financial services, 2006

Percentage of households



Note: A household with an account in a bank and a loan from the informal sector belongs to the "banked" group.
Source: Access to Financial Services Survey 2006.

An analysis of the concentration of microfinance services reveals that MFIs are concentrated in the Terai and accessible hills. There is virtually no formal MFI with only limited presence of the SHGs and credit union model in the inaccessible hills and mountains. MFI services are more concentrated in urban and semi-urban areas and such services are very limited for the poorest of the poor.

The largest provider of the microfinance is the saving and credit cooperatives in number of institutions and the clients which counts 24.4 percent of the total clients of microfinance. The following table shows the scale of microfinance program in Nepal. Saving and credit cooperatives being socio-business unit of the village has the largest outreach.

Scale of Microfinance program

Financial Institutions	**Number**	**No. of members**	**Percentage**
Regional Rural Development Banks (RRDBs)	5	146,000	22.3
Microfinance Development Banks (MDBs)	4	90,000	13.7
Saving and Credit Cooperatives (SCCs)	2,650	160,000	24.4
Small Farmers Cooperative Ltd (SFCLs)	161	88,000	13.4
Government supported Microfinance Programs[1]	1	76,000	11.6
ADB/N (Small Farmer Development Program)	1	66,000	10.1
Microfinance NGOs[2]	44	29,000	4.4
Total	**2,868**	**655,000**	**100**

Source: Sharma S.R., 2004 cited in SAP-Nepal, 2005

1 Government supported microfinance programs include MCPW, PCRW etc.

2 Microfinance NGOs include SAPPROS, DEPROSC and other private saving and credit organizations.

The World Bank's research on access of financial services found that nearly38 percent had one from the informal sector only and 15 percent from the formal sector only. The rest had loans from both formal financial institutions and formal sector. When considering all the sources for both formal and informal loans, financial NGOs and cooperatives are by far the largest providers (28 percent) followed by banks (24 percent) and family and friends (20 percent). Informal borrowing is more prevalent only in rural areas and especially among the poorest households (World Bank, 2006).

With these findings we can conclude that inclusive Microfinance program can be pertinent instruments for economic empowerment which can also be instrumental for enhancing democratization process in grassroots level. Moreover, it is also relevant for the achievement of Millennium Development Goals by reaching more poorest of the poor people.

Global Perspective for Building Inclusive Microfinance

Microfinance provides financial services to millions of the world's poor. Poor people, just like anybody, may use financial services for many purposes and in different ways throughout their lives, but they are particularly vulnerable since their income is small and unstable. Thus it is difficult for them to anticipate when they might need small but critical amount of money. These amounts help them to overcome the problem of unstable income, for example by allowing them to pay school fees, pay for events such as wedding and funerals, or cope with crises as a result of illness or natural disaster. These amounts mostly are invested in income generating activities which help to reduce poverty.

Thirty years ago, a group of development revolutionaries created a new strategy for tackling global poverty by providing small, uncollateralised loans to some of the poorest people in the world. Families were able to start or expand tiny businesses and, as a result, many found a dignified route out of poverty. Microfinance became one of the most powerful tools to address global poverty, and it has been doing so in a way that builds self-esteem in the individual and self-sufficiency in the institution providing the financial services. It works in a synergy with other development interventions such as those that promote health, nutrition, democracy, and education. When executed effectively, it can 1) relieve suffering, 2) bring dignity, 3) become sustainable and 4) inspire supporters (Harris, 2006). Microfinance is a key strategy in reaching the Millennium Development Goals (MDGs) and building global financial systems that meet needs of most poor people (Hashemi, 2004).

In February 1997 the first Global Microcredit Summit was organized to streamline the microfinance activities practiced globally as a tool for poverty reduction. At that summit, delegates launched a bold campaign to reach 100 million of the world's poorest families, especially the women of those families, with credit for self-employment and other financial and business services by the end of 2005 (Harris, 2006). The summit focused on catalyzing the international development community to recognize that scaling up microfinance was essential to reaching the MDGs and creating a just world. One of the main themes of the Microcredit Summit Campaign was reaching the poorest of the poor. In 1998, UN General Assembly proclaimed the year 2005 as the 'International Year of Microcredit' to recognise the contribution of Microcredit to poverty alleviation. 'Building inclusive financial sectors to achieve Millennium Development Goals' was the official slogan for the year (UNCDF, 2006). To achieve these objectives, various activities have been undertaken at national, regional and international level. Despite the broad consensus regarding the importance of microfinance as a poverty alleviation tool, it is estimated that over two billion people are currently excluded from access to financial services. The situation is particularly dire in Least Developed Countries (LDCs) where often more than 90% of the population is excluded from access to the formal financial system (UNCDF website). Following the International Year of Microcredit the UN Advisors Group on Inclusive Financial Sectors consisting of 25 individuals representing governments, central banks, regulatory agencies, microfinance institutions, civil society, development agencies and donors, and academia from all over the world was established. The main role of the Advisors Group is to inform the United Nations system and members states on global issues relating to inclusive finance (*Ibid).*

The next important event related to this issue was the Global Microcredit Summit 2006. The Campaign was re-launched with two new goals for Phase II (Harris, 2006):

1. Working to ensure that 175 million of the world's poorest families, especially the women of those families, receive credit for self-employment and other financial and business services by the end of 2015.
2. Working to ensure that 100 million of the world's poorest families move from below US$1 a day adjusted for purchasing power parity (PPP) to above US $1 a day adjusted for PPP, by the end of 2015.

With these global efforts, now a days, the microfinance practiceners worldwide agree that the reaching very poor people should be a priority because access to finance is considered a human rights to combat against economic exclusion. However, the global challenge is how to build the inclusive microfinance accessible to the most deprived and excluded people.

Barriers of Reaching Poorest of the Poor

Save the Children USA had a rapid situation analysis on the information regarding inclusiveness of clients in the national MFIs. The assessment found that no MFIs have such specific information regarding the inclusiveness. However, they also agreed that they have not reached up to the level they should have. In this regard, there has been found many challenges of reaching poorest of the poor people in the country. The major barriers are categorized into three groups; i.e. Physical, Economic and Social barriers. They are discussed below in detail.

Physical Barriers

In many settings, very poor people live in remote rural areas that have no access to financial services. Reaching poor people in remote rural areas means higher transaction costs for MFIs. Such areas are often characterized by poor infrastructure, low population density, low levels of literacy and relatively less economic opportunities. Our rural economy is based on agriculture and it has low profitability and prone to high risk. Even if some microfinance programs are present in rural areas, they often lack well-trained professionals and have insufficient support from the other sectors. Mostly they are informal sector and lack institutionalization.

Economic Barriers

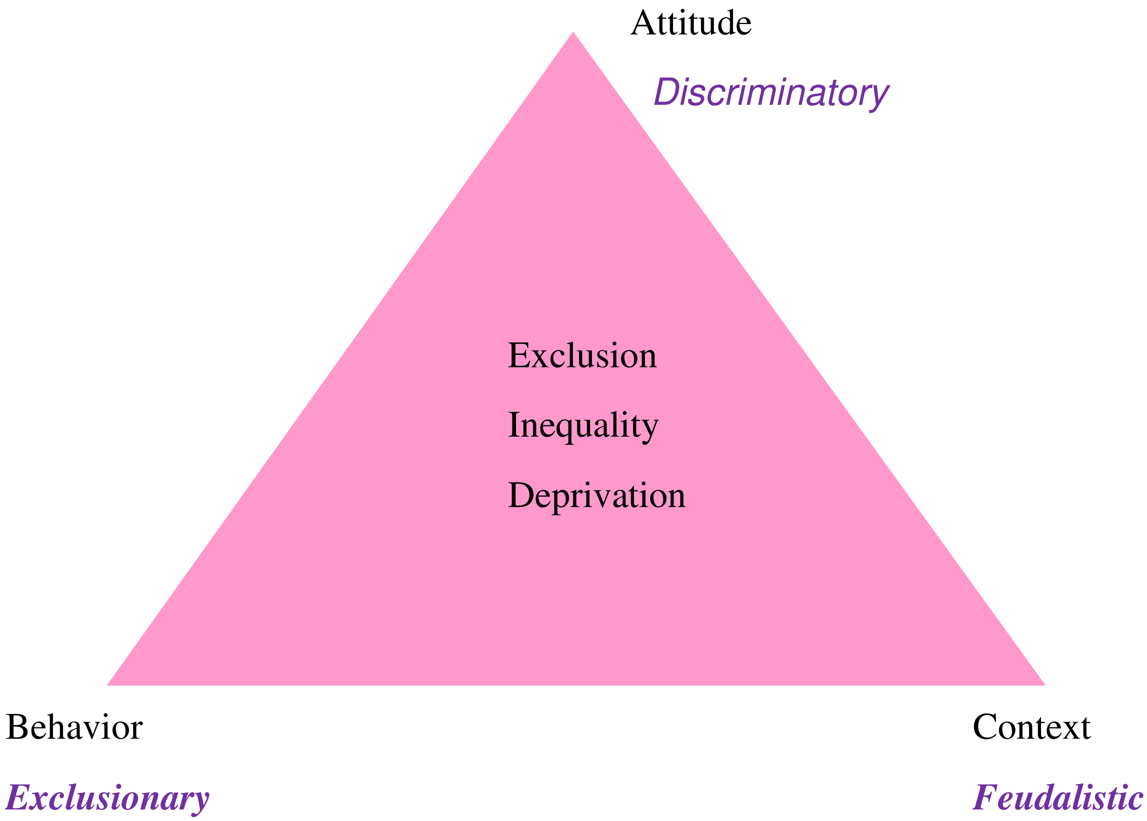
Most microfinance programs in rural area is informal way which use group-lending methodology where clients attend a weekly or monthly meetings to access credit. The cost of transportation to these meetings, together with the opportunity cost of attendance can be a barrier for poor people to participate in microfinance programs. Methodologically, most of the microfinance operations in Nepal require clients/members to save a certain amount before they can access loans. Even to enter as a member after some years of MFI formation, the clients need to deposit accumulated equivalent amount which counts significantly big for the rural poor. Such methodology of membership criteria and providing loan often prevents participation of poor people in the Microfinance program. It has been found that MFIs that focus on savings more than credit tend to reach a smaller proportion of the poorest, have a lower and slower impact on poverty reduction, and are therefore less conducive to reaching the Millennium Goals by the target dates.

Likewise, rural poor people are mostly dependent on subsistence farming or related occupation as their main source of livelihood. MFIs are usually reluctant to lend in this sector due to high risks and unique requirement of financing. In fact, the microfinance program intentionally rejects very poor people because they might be unable to repay their loans and could thus jeopardize the creditworthiness of the entire groups. Poor health condition of poor people and less market alternatives in the rural areas presents the major obstacle for conducting microenterprise, which is the fundamental of microfinance.

Social Barriers

Even when very poor people are not actively excluded by the community, they often opt out of community related projects because they are socially intimidated, believing that the services offered by such projects is not suited to their needs (Seep Network, 2006).
Living in absolute poverty far a period for a prolonged time strongly affects people's dignity and hope for the future, as well as their ability to take initiative and overcome stigma.

Ethno-caste based social structure is the main hindrances of inclusion of Dalits and marginalized ethnic groups due to the discrimination they face with the society. In many cases, the so-called upper caste people intentionally exclude these groups in the name of their capacity deprivation. In many cases, these groups exclude themselves not feeling easy to work together. In fact, they lack the voices heard and influence in decision making. The following triangle shows clearly how Nepalese society is structured and has the impact on the inclusiveness in microfinance.



Source: Author's research on Inclusiveness on Microfinance, 2006.

Recommendation and Conclusion

- **Linking Microfinance and the mainstream financial sector is considered to be an effective way to enhance outreach and sustainability of MF.**
- **Inclusive financial sector (Microfinance) be a part of the national development.**
- **Diversification such as remittances, hire-purchase and insurance should be introduced in microfinance operations.**
- **Shift in Approach: Project approach to Institutional development approach**
- **Microfinance can be the effective tool for rehabilitation and reintegration in post-conflict stage**
- **Increasing Foreign Direct Investment (FDI) in microfinance sector.**
- **Goals of Social Banking: Promoting microfinance as the investing in humanity.**
- **Enhance Microfinance practice (Cooperatives) as a school of democracy.**
- **Developing appropriate mechanism of regulation and policy direction: National MF Policy oriented with inclusiveness.**
- **Developing networking and advocacy so as to sharing knowledge and experience in a regular basis.**
- **Up-scaling of operations of MFIs and other microfinance promoters to accelerate outreach in term of breadth, length and depth.**

Microfinance has proven to be an effective and powerful tool for poverty reduction. Like many other development tools, however, it has insufficiently penetrated the poorer strata of society. The poorest form the vast majority of those without access to primary health care and basic education; similarly, they are the majority of those without access to microfinance. Even a well-designed microfinance programme is unlikely to have a positive impact on the poorest unless it specifically seeks to reach them through appropriate product design and targeting (Wright 2000). Experience shows that unless there is a targeting tool, the poorest will either be missed or they will tend to exclude themselves because they do not see the programs as being for them. It should be noted that emphasizing financial sustainability above all else can have the practical effect of excluding the poorest because of the widespread misperception that the poorest are a greater credit risk and the reality that the unit costs of small loans tend to exceed the unit costs of larger loans. Small income changes for the very poor have proportionately much greater impacts on livelihood, than those for the better off.

Both breadth and depth of services are very important for the microfinance industry. It is apparent that until and unless the programs are intentionally designed to reach them, reaching poorest of the poor is impossible. In order to design products and services for this target market, it is important to better understand the factors that contribute to the dire conditions of very poor people.