

The Challenges of Scale in Microfinance Operation

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IDENTIFY THE NEED FOR MICROFINANCE

The history of micro-credit is not a new phenomenon. It existed in human history from the dawn of human civilization in different forms. Human civilization and people were not equal. From time immemorial there were fortunates/haves and unfortunates/have nots. Those who belonged to unfortunates/have not needed to borrow either for production/trading or for consumption.

As of now world population is around 6.5 billion. Among this around 61%, i.e., 3.96 billion people live in Asia. Generally 50% of the population in the Asia continent are living below poverty line, i.e., around 1.98 billion people and around 440 million families (family size 4.5) are living under poverty line. We can easily understand that a large number of the poor families are living in the world.

Though the process of poverty in the world, is the outcome of a complex and interacting set of factors rooted in the broad structure of the society, poverty involves wider aspect of deprivations which are not limited to purchasing power alone. Yet for a working solution NGO/MFIs should consider the factor which is directly linked and most critical in relation to poverty. Increased income can enable to take care of other needs gradually. As increase of income of an individual is directly related to poverty reduction hence increase of income should be given priority to all poverty reduction attempts. Income can be increased in two ways (i) Employment creation and (ii) Self employment creation.

Employment creation is done by Private and Public sector for various sectors of economy. Employment creation needs huge amount of capital. Overall economy

of a given country should justify profitable enterprises for production, consumption and service industries.

Government can create job for providing services from the revenues generated and or by borrowing from bilateral/multilateral bodies.

As job creation in a developing country is very difficult and needs gradual process, hence creating self employment is another way to solve this burning problem. Self employment creation needs meager amount of capital as the entrepreneur himself/herself has the initial capacity to start small economic activities that has demand in the local market.

Self employment facilities can be created either by own capital or by borrowing from financial institutions. A group of people is involvement in self employment creation with their accumulated capital. Another section of people is involved by borrowing from the financial institutions. Others have no means to try for that. Vast people have no such scope of participation without institutional credit facilities.

The banking sector needs collateral for lending. Small amounts of lending are not profitable for the bank. Banks operate in a different manner, which is not friendly to the poor and illiterate. Banks are of two categories, one is Government-owned and other is privately owned.

Government Banks are managed by the government officials under certain guidelines. They also create some guidelines of their own in the developing countries. Where resources are scarce, many people are in queue to take advantage. With this advantage, rent seeking and bribing are associated with the

transaction. Government Bank Staffs are permanent in services. They get their salary and promotion whether they work profitably or not.

Private Banks are providing most benefits to the owners and offering services to well off clients. They are not interested in micro-credit still now in a substantial manner.

Under this scenario in Asia, poor people are not getting expected loan facilities from the formal financial sector.

As there is lack of institutional credit facilities, most poor people either borrow from moneylenders, co-operatives and from NGOs/MFIs. Moneylenders instead of providing benefit to the poor lend money with an exorbitant rate of interest. Co-operatives have an inherent weakness for efficient delivery of financial services in many developing countries. NGOs/MFIs are also facing constraints either of capacity or of sufficient resources.

A section of people are willing to involve in self employment creation but they suffer from lack of capital as well as lack of collateral for borrowing from formal financial institutions. For them collateral free micro credit is the essential weapon to fight against poverty. NGOs/MFIs emerged for solving the credit need without collateral and service delivery at the doorstep of the poor, but not without constraints. According to microcredit summit, millennium development goal was targeted to cover 200 million poorest families under microcredit operation by 2015. Magnitude of the problem is quite big. Roughly 66.6 million poor households already covered by micro-credit within 2004 (according to Micro-credit Summit Campaign report 2005).

The major challenges in Microfinance are (a) Rapid growth (covering vast number) (b) Cost-effectiveness (financial sustainability) - Serving the Poor in sustainable manner (c) Covering the hardcore poor.

To meet these challenges microfinance sector needs broadly four factors which are as follows:

1. Firm determination of the leadership
2. Innovative Methodology
3. Friendly, hassle free Sources of Fund
4. Enabling environment

1. FIRM DETERMINATION OF THE LEADERSHIP:

As microfinance operation started to serve the poor we find few leaders founded their institutions with commitment, dedication and non-conventional manner. Few of them came from formal sector and started to establish organizations from grassroots and starting from zero they ensured step by step growth. Leaders have been successfully demonstrated providing financial services to the poor.

During the journey NGOs/MFIs growth was not exponential. Some of them could not cover the cost from the income. Hence dependency remain with very cheap source of fund along with grant component. This step is also a milestone for microfinance from where attempts are being made to attract borrowed fund, tried to reduce costs and increase revenue through improving efficiency as well as changing relationship with funding mechanism. Leadership determination and demonstration of reasonable sources can take off from dependency on grant to borrowing from Apex bodies along with Commercial bank borrowing. These

initiatives demanded new types of relationships with new types of funding mechanism, which have been properly managed by NGO/MFI leaders.

2 INNOVATIVE METHODOLOGY:

Tiny amount of loan to large number of borrowers at their doorstep is a costly operation compared to revenue income. Cost reduction is also an essential element in microfinance operation. Reducing cost can be possible either offering larger loan size or by innovating non-conventional management which is less costly. ASA, Bangladesh took the lead for innovating management in microfinance operation. Thus reduces cost of money lent from 15% to 3% within 3 years time. The essences of innovative management are as follows:

1. Specialized operation.
2. Documentation of essential information only.
3. Simple product, simple loan application and verification process.
4. Absence of grant guarantee.
5. Staff recruitment in non-conventional manner.
6. On the job training (each one teaches one).
7. Simple standard loan register along with ledger and cash book abandoning the bookkeeper/cashier.
8. Standard furniture, fixture and collective use of facilities in the office.
9. Decentralized branch structure.
10. Branch level financial planning.
11. Strong monitoring from mid and head office.
12. Written Manual.

3. FRIENDLY HASSLE FREE SOURCE OF FUNDING:

Friendly hassle free source of funding is essential for microfinance institutions to function and grow. Sources of funds are as follows:

1. Donor agencies grant (charitable)
2. Multilateral Bodies like WB, ADB, IFAD concessional loan fund through Govt. to Apex for channeling to NGOs/MFIs
3. Savings from the members
4. Commercial Bank linkage with NGOs/MFIs
5. Transformation of NGO/MFI from not for profit to regulated financial institution under profit section
6. Equity/debt from International Investment Fund

All such sources are not without constraints and limitation.

To take advantage of the above mentioned sources, prevailing regulatory environment of individual country play the decisive role.

Grant from donor agencies is not a suitable funding mechanism for the growing entity. This can help startup organization at initial stage.

Multilateral Bodies channeling funds depends on the Bodies as well to Government of that country. When both agree along with presence of a vibrant microfinance sector it works. Bangladesh, Philippines and Pakistan are under such arrangement. There are some sorts of apex fundings available in India, Nepal and Sri Lanka also

Commercial Bank linkages with NGOs/MFIs are visible recently in India. Most prominent is ICIC Bank. There are other commercial Banks that also lend to MFIs. Commercial Bank linkage with NGOs/MFIs is also playing a role in Bangladesh and in the Philippines.

Transformed NGOs/MFIs are attracting fund in India from banks and investors and in the Philippines from Apex, Banks and mobilizing savings from public. In India NBFC are not allowed public deposit collection and in the Philippines foreign investment in Rural Banks are not allowed. Indonesia's Rural Bank can mobilize savings but cannot receive foreign loan or equity investment in Rural Bank.

Spreading microfinance activities through Branch structure of Rural Bank is different in the Philippine and Indonesia. Central Bank's approval as well as equity amount for each branch creates hindrance for the growth.

In Bangladesh deposit mobilization from public is not allowed as MFIs are not regulated hence microfinance sector depends on Apex funding and Bank linkage. In Pakistan both Apex funding and Bank linkage are functioning along with regulated MFIs. Regulated MFIs are allowed to mobilize savings from the public.

Equity/debt providers to MFIs by international investment fund are very recent in microfinance sector. Both equity and Debt from international investment fund has been associated with several constraints in several countries. In India both equity/debt has been open from International investment fund but in other countries either debt is allowed or both are not permitted.

In ADB study: A micro success story

A study by Nimal A Fernando concludes, "Empirical evidence shows that most transformed MFIs have achieved encouraging results". The same study mentioned, "Transformation of NGOs into Regulated Financial Institutions (RFIs) should not be viewed as the only approach to sustainable microfinance." BRAC and ASA Bangladesh performances have been highlighted though both of them are not regulated financial institutions.

I have observed during intensive Technical Assistance of UNDP, in the Philippines to MFIs that few "Rural Banks" of them prominent are CARD and Life Bank operating in both regulated and NGO manner by forming separate Foundations. The growth of NGOs/Foundations accelerated microfinance lagging behind Rural Bank operation due to regulatory restrictions.

4. ENABLING ENVIRONMENT:

Favorable environment for microfinance in different manners are prevailing in most developing countries. Favourable environment is not only among Government but also among general public, civil society, media and various institutions within the country needed for favorable growth of microfinance for poverty reduction. Though Government is

favourable in general to microfinance in many countries but specific modalities of NGOs/MFIs determine the nature of favourable.

ELEMENTS OF FAST SCALING UP WITH REFERENCE TO ASA

1. Fast scaling up is best understood as meeting unique challenges of effective organizational management that characterizes fast expanding programs. It relates to:
 - i. Ensuring effective decision making by an ever expanding work force. The following features of ASA policies ensure effective decision making in the face of its fast expansion:
 - ii. Minimize decision errors through minimal decision making load on new and less experienced employees by the reliance on simplified and standardized procedures through written manual;
 - iii. Simplified administrative and accounting approval and decision making process;
 - iv. Unambiguous indicator-based performance review;
 - v. Quick and close-to-field problem solving;
 - vi. Responsive decision making.

2. Managing organizational and staff learning. ASA employs the following four policies to bring this about.
 - i. Minimize information carrying and analysis load;
 - ii. Limited needs of complex group/institutional development skills;
 - iii. Guided decision making based on a manual;
 - iv. Officer presence in the field.

3. Management of resource acquisition. Two of ASA policies are crucial in this regard, namely:

- i. Strategic viability and positioning on the basis of cost-efficiency and not on novelty;
- ii. Tapping existing non-political institutional resources

4. Management of organizational development. Developing organizational capability in the form of technology, systems and culture, constitute a great challenge in a fast expanding organization. ASA adopted a multi-pronged approach to organizational development that reduced demands of complex organizational development process. The followings are the outline in this regard.

- i. Absence of complex group development;
- ii. Start simple and grow elaborate;
- iii. Market competitive staff incentive policy;
- iv. Insulating staff from social pressures.

ASA at a glance (Upto January 2006)

1	Total number of Branch Office (ASA - 2,250, HP - 41)	2,291
2	Total number of Village	63,226
3	Total number of Upazila / Thana	511
4	Total number of District	64
5	Total number of active group (Function as a collection center)	176,179
6	Total number of active member (end of the month)	5.97 million
7	Total Active Families	4.10 million
8	Savings balance (end of the month)	Tk.3,021.52 million
9	Total numbers of Security Fund policy holders	5.83 million
10	Security Fund (end balance)	Tk.3,000.83 million
11	Total number of active loanees (end of the month)	4.17million
12	Loan Outstanding (with service charge) Disbursed (cumulative)	Tk.19,313.32 million
13	Rate of Recovery	99.88%
14	Total Number of Staff : (Male - 13,137 & Female - 1,732)	14,869

SOCIAL IMPACT:

Social impact of microfinance is not questioned nowadays. Globally it has been again and again proved that access to financial services helps the poor to increase their income. As microfinance clients are overwhelmingly women hence micro finance improves the empowerment process in the family and society at large. Political empowerment at the grass-root level has been visible. Due to the increase income poor are sending their children to school, housing condition has also been changing, visiting doctor, food intake increasing. Pure drinking water, sanitation situation has also been improving.

Still question remains that process is slow and vast numbers are still under poverty line along with a section in bottom line is yet to cover where microfinance flourished for a decade.

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