Microfinance Institutions of the Subcontinent: A Comparative Analysis

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Abstract

This research has been undertaken to learn from the successful practices of microfinance institutions operating in South Asia such as Grameen Bank and SEWA bank. The purpose is to make comparison and analysis of Pakistani microfinance institutions with them keeping in mind the international standards recommended for the microfinance institutions in "Institutional Performance Standards and Plans". Based on the comparative analysis it is concluded that regarding institutional strengths, accurate management information systems which facilitate effective planning, control and timely monitoring of loan repayment, staff policies that stress training, accountability and reward through monetary incentives and promotion, innovative low-cost distribution systems and mobile banking are the factors which contribute towards the success of microfinance institutions.

Keywords: Micro-Finance, Subcontinent, Comparative Analysis

About one-fourth of the global population lives in South Asia. However, it accounts for 44 percent of the poverty stricken segment of the world, slightly better than the Sub-Saharan Africa which has 46 percent of the world poor.[1] Table 1 given below shows the comparison of income/poverty in developing countries. A major obstacle faced by these poor people who want to improve their livelihood is lack of capital. Without capital, people cannot invest in productive activities, improve

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existing businesses, and/or fulfill consumption needs when needed, thus significantly limiting their chances of escaping poverty.[2] The poor have been historically considered as not creditworthy and not bankable. However, in the last few decades, microfinance has emerged as an extremely popular approach for providing financial services to those who do not have access to or are neglected by the financial institutions and commercial banks.[3]

Table 1: Regional Comparison of Income/Poverty in Developing Countries

	People living on less than US$1 a day (million)		*Share of population living on less than US$1 a day (percent)*	
Region	**1990**	**2000**	**1990**	**2000**
East Asia and Pacific	470	261	29.4	14.5
South Asia	466	432	41.5	31.9
Europe and Central Asia	6	20	1.4	4.2
Latin America and Caribbean	48	56	11.0	10.8
Middle East and North Africa	5	8	2.1	2.8
Sub-Saharan Africa	241	323	47.4	49.0
Total	**1237**	**1100**	**28.3**	**24.5**

Source: World Bank 2004. Global Economic Prospects 2004

Robinson defines microfinance as the

> *"small-scale financial services – primarily credit and savings – provided to people who farm or fish or herd; who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban"*[4]

Microfinance came with a promise to alleviate poverty.[5] It plays an important role in combating poverty. Microfinance has been successfully used to generate economic activity at gross root level in many countries including Bangladesh, Indonesia, Ghana, India, Bolivia and Philippine. [6] It has been found that the level of absolute poverty is 75% lower in the villages where Grameen Bank is operating than in the villages where it does not operate. [7]

The importance of microfinance as a tool for poverty alleviation has been realized by the South Asian countries too and many of them, particularly the Grameen Bank, are considered as pioneers in the field. The Grameen Model has been replicated throughout the world.

The importance of Microfinance for poverty alleviation and economic development has been recently realized in Pakistan. Institutions in private and pubic sector have started their operations with the involvement of NGOs. The creation of Pakistan Poverty Alleviation fund (PPAF) and Khushhali Bank is a clear manifestation of the government's interest in microfinance and its importance as a tool for poverty alleviation. Similarly in Private Sector, the creation of five specialized microfinance banks in the last few years shows the rapid development in the field of microfinance in Pakistan. At this stage it is very useful to study the successful practices of Microfinance in other third world countries to learn from their operations and experiences.

This research study has been undertaken to identify those plans and standards which improve practices of newly established Pakistani Microfinance institutions. The study of successful MFIs such as Grameen Bank and Self-Employed Women's Association has been useful for comparing their practices with their Pakistani counterparts. Giving recommendations on the basis of this comparison would help the Pakistani MFIs to achieve their financial, managerial and operational objectives effectively. The microfinance institutions, therefore, chosen for comparison and analysis are the Grameen Bank of Bangladesh, the

Self-Employed Women's Association (SEWA) of India and Khushhali Bank of Pakistan.

The origin of Grameen Bank can be traced back to 1976 when Professor Muhammad Yunus, Head of the Rural Economics Program at the University of Chittagong, launched an action research project to examine the possibility of designing a credit delivery system to provide banking services targeted at the rural poor. The success of the project led to its extension in other parts of the country and in 1983, the Grameen Bank Project was transformed into an independent bank by government legislation. Today Grameen Bank is owned by the rural poor whom it serves. Borrowers of the Bank own 90% of its shares, while the remaining 10% is owned by the government. [8]

The Self Employed Women's Association (SEWA) was established as a trade union in Gujrat, India by a group of self employed women in 1972 with the main objective of "strengthening its members' bargaining power to improve income, employment and access to social security. In order to free themselves from the vicious cycle of eternal debt, the members of SEWA came forward with their own idea, in a meeting in December 1973 of "a bank of their own", where they would be accepted in their own right and not to be made feel inferior. 4,000 women contributed share capital of Rs.10/- each to establish the Mahila Sewa Co-Operative Bank. In May 1974, the SEWA Bank was registered as a co-operative bank under the dual control of The Reserve Bank of India and The State Government. Since then it has been providing banking services to poor, illiterate self-employed women and has become a viable financial venture.[9]

Khushhali Bank was established in 2000, as a part of the Government of Islamic Republic of Pakistan's Poverty Reduction

Strategy and its Microfinance Sector Development Program (MSDP) that was developed with the assistance of Asian Development Bank. It operates under the central bank's supervision (State Bank of Pakistan) with commercial banks as its shareholders. Its mandate is to retail microfinance services and act as a catalyst in stabilizing the country's newly formed microfinance sector. Fourteen commercial banks, including three multinational banks are the bank's shareholders. The Government of Pakistan has obtained a loan of US$ 150 million from the Asian Development Bank to support the operations of Khushhali Bank and to promote microfinance sector in Pakistan.[10]

Problem Statement

In Pakistan, the microfinance institutions do not appear to operate under the norms of theoretical framework such as institutional strengths, quality of services and outreach and sound financial performance. It is possible that non-satisfactory performance of these microfinance institutions might have resulted from various social, financial and service constraints. As a result, these institutions are unable to achieve the broader objectives of poverty alleviation and economic development of a developing country like Pakistan.

This study, therefore, analyzes the performance and evaluates the practices of MFIs in Pakistan within the theoretical and practical frameworks. The analysis will help in comparing “Practices of Pakistani MFIs with successful Practices of MFIs in other third world countries”.

Research Questions

The analysis has been directed towards finding answers to a number of research questions, which include:

- What institutional strengths do the microfinance institutions of the subcontinent have?
- What is the performance level of these institutions in terms of outreach and sustainability?
- Are the institutional strengths and performance levels similar across all the institutions?
- What strategies, tools and policies, should MFIs adopt to overcome their social, financial and service constraints?

Objective of the Study

The main objective of the study is to identify the best practices for microfinance institutions by doing a comparative analysis of the three south Asian institutions, i.e. Grameen bank (Bangladesh), SEWA (India) and Khushhali bank (Pakistan).

Hypotheses Development

The research questions were therefore translated into well-conjectured descriptive statements forming hypotheses of the study. Thus the following hypotheses have been evaluated descriptively.

H0: There is no difference in the performance of microfinance institutions in Pakistan as compared to similar institutions in Bangladesh and India in terms of institutional strengths, quality of services and financial performance.

H1: There appears to be significant difference in the performance of microfinance institutions in Pakistan as compared to similar institutions in Bangladesh and India in terms of institutional strengths, quality of services and financial performance.

Methods

Type of Study

This piece of research has mainly employed descriptive approach in general and the hypotheses have also been evaluated in the same manner. In this research the practices of the successful microfinance institutions in third world countries such as Grameen Bank, and SEWA have been described. This study enabled the researcher to compare their practices with Pakistani microfinance institutions such as Khushhali bank. This comparison also helped the researchers for identifying the relationships between various variables and testing of hypotheses.

Research Instruments

Research instruments for this study include the available secondary data and unstructured interviews with the senior management of Khushalli bank. The sources of information on the Micro credit are various libraries such as Institute of Banking library, State Bank of Pakistan library, different universities libraries such as Quaid-e-Azam University, International Islamic University etc. Online journals on Micro credit are helpful in getting familiar with the previous research work on Micro credit. The websites of Micro credit institutions are the source of getting familiar with their practices.

Method of Analysis

The analysis was based on the comparison of microfinance institutions of Pakistan with the successful microfinance practices in third world countries. The practices of Grameen Bank, Bangladesh, and SEWA, India were studied for this purpose. The analysis has been done keeping in mind the international standards recommended for microfinance institutions such as of Institutional Performance Standards and Plans" published by the Global Development Research Centre (GDRC) in year

2002. The objective of the analysis was to understand the relationship between variables and consequently the testing of hypotheses.

Results

The comparative analysis of the three selected institutions is presented in the following sections.

i). Institutional Strength

a) *Structure and operating system*

KB and GB (SEWA lend individually) form homogenous groups. It is supposed that homogeneity leads to lower rates of default of both group members individually and group as a whole. KB is totally depending on NGOs for delivering of credit. Although their representatives also go with them on the day when credit is delivered but this is not sufficient as they do not know about people and just monitoring on the last day. If for example any dispute arises between KB and NGOs, KB is totally helpless in that situation because they are dependent on NGOs. While GB and SEWA are not relying on NGOs and they are working independently.

All international microfinance practices stress on the need of training. Both Grameen Bank and SEWA have well established training programs for their employees. So KB should provide its staff training so that the staff itself can work in rural areas easily and know about the strategies of how to work in rural areas and as the result KB do not need to depend on any other institution for the delivery of credit.

b) *Importance of Management Information System*

GB recovery rate has been maintained stable since 1992 and is almost 100% in year 2003. The reason might be of good information management system. KB is currently working on its information management system. While information on SEWA information management system is not available.

c) *Operations*

KB, GB and SEWA all work for the social mobilization of the community. But they should not increase their expenses too much for the purpose of providing social services to their clients. Successful programs generally hire people with a business or banking background to be village bank workers and the program is perceived to be a banking program, pure and simple, in which the borrowers are clients, not beneficiaries. This practice is the same as KB, which also considers its borrowers as clients and is hiring efficient workers from banking background.

d) *Clients Repaying in Time*

In GB there is a strategy of giving clients who repay in time a gold card. This card is for the purpose to distinguish them from other members and is a sign of pride for the borrower. These cards encourage the borrower to continuously repay in time and also other borrowers to do so. KB should also implement such a strategy of either charging less interest rate or giving gifts or gold cards or stars to its loyal customers.

ii). Quality of Services and Outreach

a) *Focus on the Poor*

Khushali Bank (KB) criteria for poor is that it must have income less than minimum taxable limit i.e. Rs.80,000 per annum, which is not specific. In case of Grameen Bank (GB), criteria for poor is that he or she must have a piece of land less than half an acre or total assets of the same value. So what is realized is that the criteria must be clearly and specifically defined so that it becomes easy to select the target client and screen out easily those who do not meet this criterion.

KB policies as given in table 2 show that 40% of its clients and workers should be women. The women only COs is 40% to total COs but it is much less than international practices.

b) *Client-appropriate lending*

KB follows community-based group lending process similar to some extent to GB and SEWA on individual basis. One point that is identified after study of SEWA is that they also provide loan to those women who give jewelry as collateral and provide them loan on the same day. KB hasn't any such scheme for those who cannot form a group. Group size in case of KB is at least

Table 2: Showing % of Women clients in the three institutions

Institution	Percentage of Women Clients
Grameen	96%
SEWA	100%
Khushali Bank	40%

ten while in case of GB it is at least five. The group size should be at least 5 and can be up to 15 depending on the demography of that area. As in Pakistan their is a vast difference in the concentration of human beings in different provinces e.g. Balochistan is less populated province but in case of Punjab it is much more populated province. So the group size must be based on the population of area.

Table 3: Average loan size of three MFIs.

Organization	Average Loan Size
Khushali Bank	$160 (RS 3000 – 30000)
Grameen Bank	$100

SEWA	$ 75 (Rs. 4000 approx.)

The amount should be flexible and according to the requirements of clients e.g. a woman in a village wants to open a small school or an embroidery center and she wants some more amounts than the actual first loan. Then it should be provided to her because her work is beneficial in two ways. First it provides employment to others and second and most important is that it provides education too. So for special cases loan size may vary as compared to maximum limits. Repayment time is one year for both KB and GB, which is the same for most of the international practices

c) *Savings services*

KB support compulsory saving while SEWA and GB support voluntary saving (see table 4). This saving in case of GB and SEWA is in the form of investment in shares of the bank but in case of KB to get a loan the client must have to save 10% of it with KB. For developing the habit of saving in the clients, it is good to support compulsory saving.

Table 4: Saving scheme of three MFIs

Institution	Type of Saving
Grameen Bank	Voluntary saving
SEWA	Voluntary saving
Khushalli Bank	Compulsory saving

d) *Loan Processing*

KB takes one week after the formation of COs to disburse credit and COs formation takes about a month. GB takes one week for the disbursement of loan after the submission of application form. SEWA disburse loan at the same time when the application is given if there is a collateral in form of jewelry etc with the loan otherwise it takes one week for the processing of application form. As suggested in international best practices, loan applicants become discouraged if they have to wait months before receiving services. They are accustomed to moneylenders who dispense money on the spot. Well-managed projects extend credit in less than a month and often within a week. They disburse subsequent loans even more quickly. So KB should decrease this time taken to disburse loan.

e) *Number of people to whom loan is provided within a group at a time*

In case of KB all the group members are provided loan at the same time. In case of SEWA there is individual lending. GB provides loan to 2 persons of a group of 5 members at a time. The practice of GB bank looks more favorable because of its more social security because provision of loan to other group members depends upon the repayment by the members provided loan firstly.

iii). Financial Performance

a) *Appropriate pricing policies*

Successful programmes charge an appropriate level of interest, usually higher than what a bank might charge, but much less than what a money lender would charge. This is generally between 2-3 percent per month, just enough to pay salaries of the bank workers supervising the programme in their area. For KB interest rate is 18%, which accumulates 1.5 % per month. Whereas Grameen bank interest rate on all loans is 16% per annum. On the other hand moneylenders charge above 50% and certain NGOs above 40% and are working easily and providing credit to individuals successfully. So interest rate should be such as to cover a reasonable part of operating expenses especially salaries of workers providing these services.

b) *Portfolio quality*

In GB, there is participation of the branches in formulating their own annual work plan and cost-estimations in relation to their income. The branches are free to spend, as long as they are commensurate with their earnings. The workers are told that if they earn more, they can take more salary and they can also spend more. This makes the branches very competitive. Each branch tries to perform better than the others, while keeping their expenditures low. In fact, they have raised the salary of branch staff twice in the last four years, because of the high performance rate and increased income earnings. The operating costs for KB are increasing rapidly and most of them are not necessary costs. Such kind of costs should be avoided.

KB and SEWA both have monthly installments for loan repayment and the GB has weekly installment (see table 5). According to the GB this helps to increase discipline, as people have to pay a very small amount every week, which is not difficult for them to pay. And if anybody cannot pay it, others can help him/her to pay this amount. SEWA also provides a flexi repayment schedule for those who cannot pay monthly. So what is observed is that there should be a weekly and half-monthly schedule to increase discipline and develop the habit of saving.

Table 5: Mode of Repayment

Institution	Mode of Repayment
Grameen Bank	Weekly installments
SEWA	Monthly installments
Khushalli Bank	Monthly installments

c) *Default rate*

Grameen has given out nearly 16 million tiny loans, and enjoys an unparalleled customer loyalty. The on-time loan repayments exceed 98%. Defaults (bad debts) are less than one-half of one per cent. Whereas KB has given out nearly 36 thousands loans and its on-time loan repayments exceeds 95%. Thus, defaults are less than 4%.There is a common fund in GB for the purpose of covering defaults within groups. There is no such fund in KB but it is good to have such a fund.

Discussion

The information from research finding provides the sufficient ground to reject the null hypothesis Ho and accept alternate hypothesis H1. There appears to be significant difference in the performance of microfinance institutions in Pakistan as compared to similar institutions in Bangladesh and India in terms of institutional strengths, quality of services and financial performance.

The successful microfinance institutions of subcontinent as Grameen Bank and SEWA have accurate management information systems that are actively used to make decisions, motivate performance and provide accountability for funds. Khushalli bank is currently working on establishing their management information systems. Khushalli bank is totally depending upon NGO's for delivering of credit and do not train their employees to visit and monitor the whole process.

Whereas, Grameen Bank and SEWA have well trained employees and they are working independently. Similarly KB focus on women is less as compared to other two selected institutions. Khushhali bank's standard group size for loan disbursement is 10, whereas Grameen bank has flexible strategy for group size if situation demands. Time of delivering the credit is high in Khushhali bank as compared to other two selected institutions.

The study identifies the successful practices for microfinance institutions. Hence in order to be successful Khushhali bank should learn from their successful counterparts operating in South Asia.

Recommendations

i). Khushhali Bank (KB) should properly advertise its programmes so that people living in rural areas become aware of its importance. The most effective medium for this purpose in our opinion is radio advertisement. This works in three ways:

   a) It will save time of the mobilizer to first educate people of an area about KB.

   b) People will trust on them, as they know that they are from a government organization and are working for their benefit.

   c) They may also allow their women to interact with women service mobilizers.

ii). The percentage of women in Community Organizations should be increased from 40% to 60-70%. Reasons for doing this are:

   a) Women are about 52% of our population and Women represent the most marginalized group among the poorest of the poor.

b) In villages most of the women work with their husbands in fields etc. And try to contribute to increasing their household income.

c) From the experience of GRAMEEN and SEWA BANK it is seen that the women are far more effective agents of change.

d) It was found that when an extra income comes into the household through the woman, children's diet, family's health and nutrition and the state of repair of the house receive the highest priority.

e) It was also found that women are much better credit-risk than men and more responsible managers of meager resources.

iii). There is no strategy made for the borrowers who regularly pay in time. The suggestion is that KB should give them certain incentives to motivate them to continuously repay in time by offering them the following incentives:

a) They should be given gold card or stars so that they can be easily recognized among other creditors.

b) When they go to the bank they should be served first as compared to other borrower.

c) Interest rate after a certain timely repayments should be lowered.

iv). Criteria for poor must be clearly defined: Loans should be provided only to the very poorest of the poor. As these people have no other alternatives, so they are much more committed to repaying their loans.

v). Management information system should be improved. The study of successful microfinance institutions indicated that they have effective and efficient information management system. There should be an online contact between branches and hubs.

vi). Work directly in the community: KB is depending on NGOs for delivering of credit. Although there representative also go with them on the day when credit is delivered but this is not sufficient as they do not know about people and is just monitoring on the last day. If for example any dispute arises between KB and NGOs, KB is totally helpless in that situation. So

a) Staff should visit villages and poor neighborhoods almost daily. They should hold meetings in the communities. If the project is operating in a rural area, staff should visit towns and villages, perhaps on a weekly basis.
b) KB should train its staff to directly communicate with clients about microfinance services and procedures
c) Influence of NGOs should be decreased gradually if KB wants to become an independent institution.

vii). Working directly in community helps the KB workers to better monitor and evaluate the credit programmes and solving their client's problems at proper time. This would also help in maintaining good relationships with clients. By having knowledge of where the client is starting from and by building credit bit by bit as the client improves his or her economic situation and income, put the client in a non risky situation and consequently do not put the institution at risk.

viii). KB follows community-based group lending process. But there is possibility that someone having good entrepreneur skills and have any source of collateral is willing to work individually. For example a person wanted to open a vocational school. Granting loan to such person is good in two ways. First its social service to the community and other is encouragement of an entrepreneur. Hence KB should grant loans individually if the borrower has collateral and have good entrepreneur skills.

ix). The group size is at least ten for granting loan in KB. But it is recommended that it should be at least 5 and can be up to 15 depending on the demography of that area. As in Pakistan there is a vast difference in the concentration of human beings in different provinces so the group size must be based on the population of area.

x). KB should reduce the time of delivering the credit. In KB, the formation of COs and granting of loan takes more than a month which is not according to the international standards. It should be reduced to weeks.

End Notes

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