MicroSave India Focus Note 9

Reaching Remote Areas – A Case For North East India

Abhijit Sharma[1]

Background

It is now generally accepted that, without access to financial services for the vast majority of population, they are left outside the growth process. Hence, one of the goals for national growth is "financial inclusion", and countries across the world, including developed ones like UK and USA, have now incorporated this as one of their national goals. It is in this light that financial inclusion and reaching remote areas assumes special significance in a developing country like India.

Financial inclusion is the delivery of financial services at an affordable cost to disadvantaged and low-income groups. Unlike earlier approaches that emphasised impact without focussing on outreach or sustainability, this approach places emphasis on financial sustainability as the key. For without sustainability, capital constraints mean that reaching larger numbers will be impossible ... grant-based approaches will be, by definition, rationed.

The Context

For all the efforts of past and present Governments, the North East region remains a classic case of financial exclusion. Despite the professed aim of providing universal access to finance, supply-driven approaches have failed to increase outreach. Key indicators remain clearly are much lower than the national average.

States	Savings A/Cs per 100 adult population (2005)	Credit A/Cs per 100 adult population (2005)	Households covered by banking services (2001)
India	59.3	13.3	35.5
NE India	39.3	6.7	21.1
Manipur	19.5	4.0	8.7

Sources: Report on Financial sector reforms for NEI (2006) and Census of India, (2001)

With the exception of just two districts of the North East, the credit per capita is lower than the national average: some districts have a credit per capita of Rs.200 compared to the national average of Rs.12,500. Worse, several key indicators are moving in the wrong direction, for example, in contrast to the rest of the country, there has been rapid withdrawal of banks from offering/ maintaining "small accounts" (<Rs.25,000) in the region. This has been primarily because most of the banks, in the face of declining profitability in the region, concentrate only on larger and "safe" customers. Thus for all the rhetoric and good intentions, the North East is back from where it began. Most of areas have not been touched, or are being increasingly left out, because it is "not profitable".

The location of the region, with almost 70% hilly/poor infrastructure and 98% bounded by foreign countries, makes markets in the rest of India difficult to access. It is thus almost inevitable that most economic activities remain at small scale. The immense diversity of the region in terms of its physical, social and economic characteristics also creates another disincentive to "scale up" operations. Despite the best intentions, the spread of bank branches has also been much below the national average; and in some states like Manipur bank branches serve 2.5 times as many people as the average benchmark for the country as a whole.

Despite (or because of) these conditions, micro- and small enterprise thrives in the North East. The Government of Assam statistics of 1998-99 shows that micro-enterprises contribute more than Rs.30 billion to the state GDP each year[2]. Most of these enterprises are serviced by the informal financial sector. The informal financial market is characterised by its variety (both in terms of sources and products) reflecting the diversity of the region. Studies[3] estimate the microfinance market to be around Rs.26 billion or more. While informal finance is ubiquitous, it is more vibrant in the valley regions, which have higher density of people and activities. Thus, contrary to the banks' assertions, financial markets do exist and can be characterised as follows:

1. Most of the financial requirements are small and frequent.
2. Markets are specialised or 'niche' particularly for the hilly regions.
3. Banks have hardly been able to penetrate this market given their thinly spread of branches and inappropriate products.
4. The region is rich in traditional institutions, some of which are involved in financing.
5. Women are more actively involved in the economic activity than in other areas.

[1] Abhijit Sharma is an Assistant Professor at the Indian Institute of Bank Management, Guwahati
[2] District potential survey for Rural Non Farm Sector for Jorhat District, IIBM, page 17.
[3] Expanding outreach to underserved regions: Kick-starting microfinance in North East Region of India, An Evaluation of the Microfinance Sector of the North East India: Scoping Task for SEDF

Microfinance in the Region

The North East therefore has the appropriate conditions for the growth and development of microfinance. The microfinance movement started late in this region and, to date, has been primarily focussed on Self Help Groups (SHGs). However, given the reliance of the SHGs on the availability of bank branches, it is obvious that the movement would be restricted to places that have a higher concentration of branches - the valleys and in the urban areas of the hilly areas. Even within Assam, it is concentrated in economically vibrant areas of Lower Assam. The cost of promotion of SHGs in most parts of the hills is prohibitive, and the grants available to promote the SHGs are usually much lower than the cost. This reduces the incentives/ability to promote effective SHGs - hence the slow growth in the region.

Even though growth of SHGs has been high in Assam, it has been erratic. One of the major reasons for this has been because the bank branches with 2 or 3 employees are not equipped to handle large number of SHG accounts, and so they stop accepting new ones after a critical mass has been attained. The second major reason is that despite the hype associated with high repayment of SHGs, the PAR of some sample branches is around 43.1% and 69.1% (for RRBs and commercial banks respectively). This, however, drops to 19.5% and 19.6% for RRBs and commercial banks after 90 days (i.e. the time when the trigger mechanism for banks' normal loans is activated). Furthermore, the SHGs (primarily in Assam) have also adopted a habit where only the interest is paid monthly and the principal is paid in a bullet payment at the end of the loan. All these factors increase the inherent risks of SHGs and make them a less attractive proposition for rapid scale-up and expansion.

In addition, the diversity of the region means that a one-size-fits-all SHG product would not be able to meet all the requirements. This was clearly illustrated in Mizoram, where a small change in the delivery system, from SHG-based to a joint liability group-based (Grameen Bank) approach, led to a growth of 3,378.6% of groups accessing credit and 2,158.5% growth in advances to the groups in a single year (2005-06).

As a result of the growing understanding of a range of effective microfinance products and delivery systems, there are now more than 365 NGOs/institutions offering microfinance services in the region … and more than 50% of these started operations after 2000. These organisations are market driven in their approach, but have limited knowledge and skills to upscale their operations – capacity development and technical assistance will be essential to assist them reach scale. Furthermore, these inputs cannot be delivered on a "cookie-cutter" basis, but will require careful analysis of local operating conditions and realities in a way that has rarely been seen in India to date.

The Way Forward

If the objective is to reach the maximum numbers in a sustainable manner, the key will be to use different strategies for areas with a cash-based economy, and those areas with limited cash. Current best practice models (such as joint liability, group-based systems) can indeed be replicated in the areas, (typically the plains and valleys) with a cash-based economy. However, in order to make microfinance institutions (MFIs) sustainable, and also to meet the wide variety of unmet needs in these areas, a wider market segment than the traditional poor microfinance clientele must be served[4]. Thus MFIs need to focus on vertical growth as well as horizontal expansion, and to develop a broader product suite for different clients.

In low cash economy areas like the hills, initial focus will have to be on the urban areas where the cash economy is more active. However, in order to make institutions viable, it will be essential to cater to an even wider segment of clients with a product suite to meet their diversified needs – an option that is made feasible by the withdrawal of the banks. For many areas with a limited cash economy, traditional organisations and financial products need to be harnessed and promoted for financial intermediation, since these offer low cost alternatives to more formalised, centralised systems. This will require more research to understand these organisations. Also, with the spread of mobile networks, e-banking may offer another attractive proposition[5].

However, a few conditions need to be put into place for the interventions to be effective. They are:

1. Developing a tool designed to identify and assess institutions that are carrying out low level financial intermediation, but have potential for greater scale based on their unique position and products.
2. Start-up funds for institutions that want to scale up their operations quickly.
3. Capacity-building funds for building MFIs so that they can scale up effectively.
4. Funds for allowing experimentation on delivery of services and products.
5. Local (North East-based) technical assistance and capacity development providers.
6. Building institutional mechanisms to take this forward.

[4] See *MicroSave*'s Briefing Note # 7 "Are You Poor Enough?: Client Selection By MFIs" for a detailed discussion of these issues.
[5] See *MicroSave*'s India Focus Note # 4 "E-banking: The Next Revolution?" for a discussion of the opportunities and impediments to this.