FINANCE AND DEVELOPMENT RESEARCH PROGRAMME

WORKING PAPER SERIES

Paper No 56

MICROFINANCE AND THE POVERTY OF FINANCIAL SERVICES: How the Poor in India Could be Better Served

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August 2002

ISBN:	**1 904143 34 2**
Series Editor:	Colin Kirkpatrick
Further details:	Maggie Baldwin, Marketing and Publicity Administrator
Published by:	Institute for Development Policy and Management, University of Manchester, Crawford House, Precinct Centre, Oxford Road, MANCHESTER M13 9GH Tel: +44-161 275 2804/2800 Fax: +44-161 273 8829 Email: idpm@man.ac.uk Web: http://www.man.ac.uk/idpm/

Microfinance and the Poverty of Financial Services:
How the poor in India could be better served…

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Abstract

There is a vast network of banking and cooperative finance institutions in India and, therefore, formal financial services are, in theory, available and accessible to low income families in virtually every part of the country. However, their availability is a mirage. Stung by the deficiencies of the directed credit programmes, particularly in the 1980s, the banking institutions in India have virtually withdrawn from lending to the poor while the cooperative credit system is bankrupt and all but defunct in large parts of the country.

It is in this situation that the non-government microfinance sector has attempted to provide an alternative to the often high-cost informal financial service providers on whom most low income clients must rely. Despite the supporting efforts of apex funding organisations such as NABARD and SIDBI, however, the outreach of the microfinance sector remains minuscule in relation to the need. Barely 3 million of the estimated 60 million poor families in India have been covered by the microfinance sector. While many MFIs, and the NABARD programme, have done well in terms of promoting a semi-formal credit culture, however, this success has been achieved at the cost of flexibility.

The extent to which such financial service provision is appropriate is discussed in this paper using information from the financial histories of 20 low income families in the slums of Delhi and 28 families in two villages of Allahabad district of UP – one of the more economically backward areas of India.[2] The analysis of the financial flows of respondent families shows that the needs of low income families would be best served by highly flexible financial services that enable the conduct of frequent transactions both for saving small sums and for borrowing for a variety of purposes *at irregular intervals*.

In relation to this, the paper examines the suitability of five possible financial services available from formal financial institutions. These are the farmers' line of credit facility offered by the banks, savings in the form of insurance with the Life Insurance Corporation of India, savings services of a large private non-bank finance company, the deposit facilities of the post office and financial services provided by a large MFI operating in the study area. The findings suggest that such services do not fully meet the needs of low income families. As a result, outreach to the vast majority of such families is still relatively limited and they have to fall back upon the high cost services of informal service providers to fulfil their requirements.

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1 With inputs from Sushil Kumar and Orlanda Ruthven. We are grateful to David Hulme and the Institute for Development Policy and Management for supporting the research as well as to David, Orlanda, and Frances Sinha for their comments on an earlier draft of this paper.

2 As part of the Financial Services Research Project of the Institute for Development Policy and Management of the University of Manchester, UK. Undertaken by Orlanda Ruthven and EDA Rural Systems with assistance from two researchers, Sushil Kumar and Nilesh Arya.

The final section of the paper proposes alternative measures that could be undertaken by the banks, the Life Insurance Corporation and by MFIs to meet the needs of the poor. Specifically, it suggests a flexible microfinance product for banks (an adaptation of their farmers' line of credit specifically to the needs of low income clients), marketing of small insurance policies through the medium of MFIs and the introduction of a flexible savings-cum-credit facility by MFIs to serve the needs of the poor in a more appropriate way. These suggestions are aimed at providing practical ideas to financial institutions in the design of appropriate financial products for low income clients.

1 Financial services for the poor do exist…[3]

While informal financial services have always been an integral part of the traditional economy of India,[4] even semi-formal and formal financial services through agricultural cooperatives and banks are within physical reach (less than 5 km) of perhaps 99% of the population of the country. A vast network of commercial banks, cooperative banks and regional rural banks as well as other financial institutions provide such services. The other financial institutions include non-bank finance companies, insurance companies, provident funds and mutual funds. There are more than 160,000 retail credit outlets in the cooperative and banking sectors, augmented by another 37,000 or so NBFCs. In addition, there are some 94,000 cooperative societies or branches of cooperative banks, around 60,000 branches of 27 public sector commercial banks and 196 regional rural banks (RRBs) and another 4,700 branches of 55 smaller private banks providing financial services in India. There is also a growing number of foreign banks operating but their reach, through some 200 branches, is limited to the main cities.[5]

Formal financial services are, in theory, available to low income families mainly through 33,000 so so rural and 14,000 sub-urban branches of the major banks and RRBs and by 94,000 cooperative outlets – either bank branches or village level societies. Financial services to the poor are also available from the village or (town) neighbourhood-level agents of NBFCs. The RRBs, in particular, were established specifically in order to meet the credit requirements of the poor – small and marginal farmers, landless workers, artisans and small entrepreneurs and should, therefore, have emerged as a major source of microfinance. A total of 140,000 institutional outlets serving the rural sector and the poor implies the availability of one outlet for every 5,600 persons – in theory, a very favourable ratio for catering to the financial needs of the poor.

2 But their availability is a mirage

For many years, bankers and senior government officers were fond of describing the Government of India's main poverty alleviation programme, the Integrated Rural Development Programme (IRDP), as "the world's largest microfinance programme". And so it was. It involved the commercial banks in giving loans of less than Rs 15,000 to poor people and, in nearly 20 years, resulted in financial assistance of around Rs 250 billion to

3 Much of the discussion in the first three sections is based on Sinha, 2000. *India Country Study* in Asian Development Bank, 2000. *The Role of Central Banks in Microfinance in Asia and the Pacific.* ADB: Manila.

4 See Ghate, P., 1992. *Informal Finance*. Oxford: Oxford University Press as well as Rutherford, S and Arora, SS, *City Savers*, New Delhi: DFID, 1997 amongst other sources of information on ROSCAs, Chit Funds and other informal means of obtaining finance.

5 Reserve Bank of India, *Report on Currency and Finance*, 1997-98.

roughly 55 million families.[6] The problem with IRDP was that its design incorporated a substantial element of subsidy (25-50% of each family's project cost) and this resulted in extensive malpractices and misutilisation of funds. This situation led bankers too to see the IRDP loan as a politically motivated hand-out and they largely failed to follow up with borrowers. The net result was that estimates of the repayment rates in the IRDP ranged from 25-33%. Not surprisingly, the two decades of IRDP experience – in the 1980s and 1990s – affected the credibility of micro-borrowers in the view of bankers and, ultimately, hindered access of the, usually less literate, poor to banking services.

Similarly, the entire network of primary cooperatives in the country and the Regional Rural Banks – both sets of institutions established to meet the needs of the rural sector in general and the poor, in particular – has proved a colossal failure. Saddled with the burden of directed credit and a restrictive interest rate regime the financial position of the RRBs deteriorated quickly while the cooperatives suffered from the malaise of mismanagement, privileged leadership and corruption born of excessive state patronage and protection.[7]

3 So the semi-formal NGO sector has stepped in

Over the past 20-25 years, the resultant vacuum in the financial system has started to be filled, initially with the pioneering efforts of organisations such as the SEWA Bank (Ahmedabad) and Working Women's Forum (Madras) but, more vigorously during the 1990s, by the entrance of significant numbers of non-government organizations (NGOs) into microfinance. Current estimates of the number of NGOs engaged in mobilising savings and providing micro-loan services to the poor lie in the range of 800-1,000 organisations.[8]

Initially, many NGO microfinance institutions (MFIs) were funded by donor support in the form of revolving funds and operating grants. In recent years,[9] development finance institutions such as NABARD, SIDBI and micro-finance promotion organisations such as the Rashtriya Mahila Kosh (RMK - the National Women's Fund) have also started to provide bulk loans to MFIs. This has resulted in the MFIs becoming intermediaries between the largely public sector development finance institutions and retail borrowers consisting of groups of poor people or individual borrowers living in rural areas or urban slums. In another model, NABARD refinances commercial bank loans to self help groups (SHGs) in order to facilitate relationships between the banks and poor borrowers.

Though the (mainly) NGO micro-finance sector has made a start in providing "user friendly" formal financial services to the poor its outreach is still miniscule in comparison with the need. A compilation of support provided by major institutions to microfinance in India shows that the cumulative disbursement of bulk loans to MFIs by domestic financial institutions did not exceed Rs3.5 billion (US$72 million) by March 2001 with an outreach to less than 2 million families - at best less than 5% of the poor in India. Even allowing for a significant volume of donor grants, the total coverage is likely to be under 3 million families.

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6 This suggests that virtually all the 60 million or so poor families were covered by the IRDP. Alas, this was not the case as the numbers include many cases of repeat assistance (deliberate) and perhaps even more cases of unjustified selection of 'beneficiaries'.

7 For a more detailed discussion, see Sinha, 2000, *op cit.*

8 This number includes all registered societies, trusts, a few NBFCs and "new generation" cooperatives acting as financial intermediaries. It specifically excludes unregistered self help groups that are usually established and facilitated by the NGOs; and it also excludes conventional cooperatives.

9 Roughly since 1994

This includes the NABARD scheme for linking self help groups (SHGs) directly with banks. Progress and outreach in the scheme amounts to Rs 4.8 billion (US$99 million) disbursed and covering, at most, 1.5 million families.[10]

At the same time, the involvement of commercial banks in microfinance is negligible both in relation to the current volume of microfinance and (even more so) to their broader engagement in rural areas. The total credit from the scheduled commercial banks to the "weaker sections"[11] is estimated at Rs 290 billion (US$ 6.7 billion) at the end of March compared to the total rural deposits of Rs 1,330 billion (US$ 31 billion).[12]

Direct finance to MFIs is limited by continuing widespread scepticism about the credibility of micro-borrowers and, by extension, of MFIs. The problem is compounded by the lack of exposure of most bankers to NGOs and MFIs and their consequent difficulties in assessing adequately the latter's implementation capabilities.

4 Yet the MFIs adhere largely to rigid models

Amongst MFIs in India, there are three broad sets of approaches employed for providing financial services to the poor, all of which focus on women[13]

(i) SHG programmes The operations of self-help groups (SHGs) are based on the principle of revolving the members' own savings. External financial assistance augment's the resources available to the group-operated revolving fund. Savings thus precede borrowing by the members. In many SHG programmes, the volume of individual borrowing is determined either by the volume of member savings or the savings of the group as a whole. The vast majority of MFIs in India have SHG-based programmes. Some NGOs operate microfinance programmes by organizing federations of SHGs to act as the MFI which obtains external loan funds in bulk to be channelled to the members via the SHGs. The NABARD programme is essentially a variation of the SHG model but involves the re-finance of loans made by commercial banks direct to SHGs rather than via bulk loans to MFIs.

(ii) Cooperatives All borrowers are members of the organisation either directly, or indirectly by being members of primary cooperatives or associations which are members of the apex society. Creditworthiness and loan security are a function of cooperative membership within which member savings and peer pressure are assumed to be a key factor. Though the magnitude and timing of savings and loans are largely unrelated, a special effort is made to mobilize savings from members. There is now a large number of "new generation" cooperative credit societies in India devoted specifically to providing financial services to the poor. Most of these are in the southern state of Andhra Pradesh which was the first to enact a law permitting

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[10] Authors' estimate for the number of families. The information available on this programme does not cover amounts outstanding or the number of SHGs with outstanding loans.

[11] "Weaker sections", official parlance in India for the poor and under-privileged sections of society. Includes all families officially classified as poor but also some non-poor who belong to the lower caste categories of Hindu society or to specified groups of other religious minorities.

[12] Bankers' attitudes which limit commercial bank exposure to microfinance are extensively discussed in Goodwin-Groen, Ruth, *The Role of Commercial Banks in Microfinance: Asia Pacific Region*. Brisbane, Australia: Foundation for Development Cooperation, 1998.

[13] Discussion derived from EDA Rural Systems, *India: Microfinance for the Poor,1996*. Study prepared for the APDC, Kuala Lumpur.

mutually-aided – as opposed to traditional government-assisted – cooperative societies. Elsewhere, a number of well known programmes such as the SEWA Bank in Ahmedabad, the Indian Cooperative Network for Women, Tamil Nadu and the Annapurna Mahila Cooperative Credit Society in Mumbai have still survived under the traditional cooperative laws.

(iii) Grameen replicators Those following the model developed by the Grameen Bank of Bangladesh. These undertake individual lending but all borrowers are members of joint liability groups within which peer pressure is the key factor in ensuring repayment. Each borrowers' creditworthiness is determined by the overall credit-worthiness of the group. Savings are a compulsory component of the loan repayment schedule but does not determine the magnitude or timing of the loan. There are some two dozen MFIs in India known to be following this model.

The common characteristics across these current approaches to the provision of microfinance services can be summarised as follows:

Financial service	Characteristic	Description
Credit	Loan amount	Determined by the longevity of the client's association with the MFI. Not often directly related to the credit needs of the borrower.
	Loan term	Usually 12 months, occasionally less, sometimes greater
	Repayment instalments	Monthly or weekly – usually fixed, equal amounts
	Interest charges	Range: 24-36%, usually levied as a flat charge, partly to simplify calculations for both the MFI and the client. Some MFIs in India charge lower rates but unfortunately suffer from poor sustainability as a result
	Collateral	No physical collateral but often linked to some compulsory savings component which acts as financial collateral. Reinforced by joint liability (Grameen) with other clients or peer pressure arising from membership of a community group revolving its own as well as borrowed funds (SHGs, cooperatives) Some MFIs also create reserve funds to cover the risk of default
Savings	Amount deposited	Grameen: Compulsory – usually, a fixed proportion of the repayment instalment SHG: Compulsory – fixed amounts per (weekly or monthly) meeting to be deposited as part of the group fund; occasionally also voluntary Some MFIs now offer long term fixed deposits

	Withdrawals	Compulsory savings cannot be withdrawn except when the client leaves the group Voluntary savings often require some notice of withdrawal
	Interest paid	Most programmes pay 4-6% interest (but this is not consistent)
Insurance	Life	Some MFIs are starting to offer life insurance covering client loan repayments plus a small payment to the family in case of the death of the client. This is done either through the creation of a reserve fund for the purpose or by buying insurance from the organised sector on behalf of the client/member
	Animal	Usually linked with a formal insurance company which obtains bulk business from the MFI while the latter provides the service of premium collection and assists in the verification of claims

In practice, the average microfinance client's relationship with an MFI can be defined by a fairly **rigid set of obligations**

- Attendance of regular weekly (fortnightly or monthly) meetings of her group
- Sometimes, training in "loan utilisation" or participation in discussions of developmentally relevant issues such as social discrimination, gender awareness, health, sanitation, education
- Contribution of fixed amounts, termed "savings", to a fund managed either by her group or by the MFI with direct access of the member limited or even barred
- Repayment of fixed amounts as instalments on any loan she obtains from the MFI or from her group.

What she actually **receives** in return for fulfilling these obligations are

- Fixed amounts of loan apparently "for productive activities" – with the size of the loan usually determined by the longevity of her relationship with the MFI rather than by her financial needs
- Emergency loans for "consumption" – in the case of some MFIs – but relatively small amounts and subject to the approval of her group
- Insurance – provided by a risk fund or insurance fund created by a very few MFIs, or by an insurance company in collaboration with the MFI
- Other development services, in the case of multi-service NGO/MFIs.

5 While the needs of the poor would be best served by flexible financial services

The extent to which this form of financial service provision is appropriate can be gauged from the findings of a study of financial needs undertaken during 2000 and 2001 in three slums of Delhi and two villages of Allahabad district of Uttar Pradesh – the latter, one of the less developed areas of India. The financial histories of 20 respondents in the Delhi slums and of 28 respondents in rural Allahabad district were traced over a period of one year for the purpose of this study.[14]

An indication of the magnitude and pattern of financial transactions undertaken by residents of these low income localities can be obtained from the financial diaries emerging from the research and depicted in the figures in **Annexes 1-6**. The first three of these relate to the financial transactions of the respondents in Delhi slums and the second three relate to rural Allahabad. One clear pattern emerging from the financial diaries[15] is that the low income families resident of the study areas conduct a series of financial transactions within any given month. These are

- Outflows = savings deposited, loans advanced, loans repaid – shown as negative bars in the figures, and
- Inflows = loans taken, savings withdrawn, loan repayments obtained – depicted as positive bars in the figures

As discussed in Ruthven, 2001 these transactions are undertaken through a series of financial devices and service providers such as banks, non-bank financial institutions, post offices, insurance companies, ROSCAs, moneylenders, moneyguards, neighbours, landlords, employers, friends and relatives. These transactions entail a series of loan taking, loan making, savings withdrawals and savings deposits – often *all taking place in the same period.* This pattern of transactions represents the coping mechanism of the poor when faced with

1 An array of financial service providers, users and opportunities, in the context of

2 Incomes as well as expenditure patterns that a highly variable.

Table 1 (following page) provides an analysis of the financial flows of the low income respondent families in the Delhi slums covered by the study. The poorest category of respondents (classified as "very poor" for the purpose of this study) had average incomes as low as $33 per month or $400 per family per year while the better off category (classified "non-poor") had incomes of the order of $1,330 per year. In rural Allahabad, the very poor category earned just $18 per month or $222 per family per year while the non-poor category at $1,180 per family earned somewhat less than Delhi's slumdwellers. Given India's per capita income of $420 per year[16] and an average family size of six persons, this translates to one-sixth to a half of the national average income level in the Delhi slums and less than one-tenth to less than a half for rural Allahabad.

As the table shows, the "non-poor" category amongst the respondents in slum Delhi reported net *outflows* – a build up of assets (or decline in liabilities) over the year – while, as might be expected, the less well off categories reported net *inflows* – a decline in assets (increase in liabilities). In rural Allahabad, however, all categories reported net inflows that were higher than net outflows emphasizing the findings of the overall study programme that in rural areas it is possible to leverage higher volumes of loans on the strength of publicly known asset

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[14] Study sponsored by the Institute of Development Policy and Management, University of Manchester, UK and undertaken by Orlanda Ruthven and EDA Rural Systems along with two short term researchers.

[15] See also other papers emerging from the IDPM-sponsored research study, Patole and Ruthven, 2001. *Metro Moneylenders;* Ruthven, 2001, *Money Mosaics* and O Ruthven & Sushil Kumar, 2002 (forthcoming), *Saving against the Grain*.

[16] World Bank, 2001. *World Development Report.*

holdings as well as traditional, historical relationships. In urban slums, the transitory nature of a significant proportion of the population limits both the relationships as well as knowledge of asset holding and results in smaller loans.[17]

For all categories, aggregate flows are a relatively high proportion (115%-165%) of the incomes of the respondents. This underlines the expectation that families existing on relatively small incomes have a substantial need for financial services and use them virtually on a weekly basis. Overall, the respondent families in the Delhi slums undertake an average of 45 financial transactions every year while residents of rural Allahabad undertake 40 transactions.

Table 1

Analysis of the financial flows of respondent families

Parameters	Very poor		Borderline poor		Non-poor	
	Rs & US$/family/month					
Delhi slums						
Income	1,620	33	2,480	51	5,370	111
Outflows	1,002	21	1,569	32	3,695	76
Inflows	1,406	29	1,788	37	2,692	56
Net flow	402	8	219	4	-1,003	-20
Aggregate	2,408	50	3,357	69	6,387	132
Aggregate flow/income	149%		135%		119%	
Range of monthly financial transactions undertaken, upto…						
Outflows	2,000	41	3,000	62	5,000	103
Inflows	2,000	41	3,000	62	5,000	103
Outstanding loans and accumulated savings, upto…						
Loans	8,000	165	8,000	165	6,000	124
Savings	2,000	41	4,000	82	20,000	412
Rural Allahabad						
Income	906	18	2,485	51	4,818	98
Outflows	379	8	2,039	42	3,294	67
Inflows	646	13	2,100	43	3,769	77
Net flow	267	5	61	1	475	10
Aggregate	1,025	21	4,139	84	7,063	144
Aggregate flow/income	113%		167%		147%	
Range of monthly financial transactions undertaken, upto…						
Outflows	600	12	3,200	65	8,000	163

17 In the village, families' holdings of agricultural land and likely inheritance patterns are well known. It would be difficult for a town-based creditor either to verify asset holdings or, more importantly, to foreclose on any formal or informal mortgages.

Inflows	800	16	6,000	122	12,000	245
Outstanding loans and accumulated savings, upto…						
Loans	7,300	149	11,500	235	26,000	530
Savings	1,000	20	3,500	71	12,000	245

Equally importantly, this compilation of the financial histories enables the determination of the range of financial flows to and from the respondent families. The analysis shows that, for the poorest families in the Delhi slums, 95% of the inflows and outflows tend to be less than Rs2,000 (US$41) per month, for medium level families they are less than Rs3,000 (US$62) per month and for the better off amongst our respondents the range is up to Rs5,000 (US$103) per month. In rural Allahabad, the range is much wider with the poorest families reporting flows of less than Rs1,000 ($21) per month while the better off report higher flows even than in the slums of Delhi. It is apparent both that the non-poor in the villages have greater credit needs (mainly) for agriculture and also (see above) that they are able to leverage larger loans than urban slum dwellers on the strength of their landholdings.

So, for slum dwellers, as might be expected, loans outstanding are higher for the poorer categories (upto Rs8,000) whereas the average for the better off is Rs6,000. The real difference here is in the accumulated savings that are only up to Rs2,000 for the poorest and can be as much as ten times more for the better off. However, in rural Allahabad, being better off means higher debt on account of the higher credit needs for realizing an adequate income from agricultural assets. Nevertheless, the very poor have outstanding loans that are over 5.5 times their monthly income whereas for the other two categories the debt to monthly income ratio is between 3.0 and 3.6.

It is apparent from this discussion that the financial needs of the low income respondents of this study entail frequent transactions – both inflows (borrowing and savings withdrawals) and outflows (repayments and savings accumulations or deposits) – within a fairly narrow range (in terms of amounts of money) which is closely related to the family's income level. An examination of the disaggregated financial diary information shows that some of the transactions take place because people, invariably, try to minimize their costs and maximize their security (and returns) by shifting money from one sort of financial device to another. This nimble, if economically rational, financial behaviour of the diary respondents – and the reasons for it – have been well covered in the other papers emerging from this research.[18] Essentially, when faced with an array of financial devices with different characteristics in terms of costs, returns, security, accessibility and flexibility, people opt for a range that suits their needs at a given point of time. Their tendency to shift between these devices over time is dependent on their (often variable) income flows and expenditure needs as well as on the accessibility and suitability of a particular device.

In this context, it is not surprising that informal sources of finance are popular with low income and low asset owning households. The main actors in this sector are traders/money lenders, friends/relatives, neighbourhood self-help groups, revolving savings and credit associations of various forms. For the poor – in both urban and rural areas – such sources are of overwhelming importance on account of their

[18] Ruthven, 2001, op cit; Patole and Ruthven, 2001 and Ruthven, 2002, op cit.

(i) far greater accessibility both in physical and procedural terms as they are available within the village or neighbourhood and require virtually no paperwork, and

(ii) high degree of flexibility with loan terms as well as loan sizes being negotiable and the purpose of borrowing unrestricted except in the case of loans from traders who usually lend only to those with whom they have trade/production relations.

Poor women, in particular, tend to borrow small sums, frequently, for domestic needs and, in a male dominated society, are less able to cope with formal mechanisms outside their local environments. For them, informal sources of finance represent an essential component of their daily lives and the formal financial structure is still a mysterious element of the inaccessible world beyond. In this situation, the availability of flexible finance, virtually at the doorstep, rather than its cost is the critical factor.

6 Existing financial institutions do not adequately recognise this

In relation to the need for flexible finance for low income clients, emphasised by the findings of this study, the services actually provided by formal financial institutions bear examination. Some important formal financial devices potentially available to low income clients in rural Allahabad district are

1 The **Kisan Credit Card** – as the most flexible financial service available from the public sector commercial banks

2 Insurance with the **Life Insurance Corporation of India** as a savings device

3 Savings with **Rashtriya Sahara** – a non-bank finance company

4 **Post office savings** facilities

5 Financial services with **CASHPOR Financial and Technical Services**, the largest MFI operating in the region.

The discussion in this section examines the characteristics of these services to determine their suitability to the needs of the poor.

6.1 Kisan Credit Card

The Kisan (or farmer's) Credit Card (KCC) is essentially a line of credit facility for farmers that has been on offer from the public sector banking system in India since mid-1998. By November 2001 – more than three years after its inception – some 6 million KCC accounts had been opened all over the country with total sanctioned credit limits of Rs173 billion (US$3.5 billion).[19] The distribution of KCC accounts across the country was fairly even and all the major banks were participating in the programme. In discussion with bankers during the study it emerged that there was a general sense of satisfaction amongst them that the KCC was a useful financial device for their rural clients and that good progress had been made in its distribution.

[19] Information obtained from Government of India, **Economic Survey 2001-02.**

According to the scheme for its distribution, the KCC is available to any farmer who is able to provide security mainly in the form of a mortgage – either formal or informal – on agricultural land. The local development office[20] is supposed to play a key role in the identification of farmers for this purpose. For obtaining the card, farmers may or may not be included in the "block" list but they must fulfil the following conditions

- Complete an application form and attach photographs
- Provide extracts from land records showing ownership of agricultural land (*khatauni*) and actual cultivation of the land during the current cropping season (*khasra*)
- Submit a residence certificate obtained from the *gram pradhan* (chairperson of the village council)
- Obtain a non-encumbrance certificate from the local land registry office indicating that the land has not been mortgaged for any other purpose. This is not an official condition for marginal farmers requesting credit limits of Rs30,000 or less but most bank managers continue to require it.[21]

In practice these conditions can entail expenditure of Rs500-1,000 ($10-20, sometimes more) for the KCC applicant.

In theory, a tenant farmer is also eligible for the KCC, but it is virtually impossible for such a person to obtain a KCC in the absence of written tenancy agreements.

Each bank has established it own norms for determining the credit limits under the KCC. Thus, for instance, in late-2001 one of the major Indian banks – with a number of branches in rural Allahabad – was using the following norms

- Only land income is calculated
- 80% of this income is included in the credit limit where it exceeds Rs40,000 to a maximum of Rs100,000
- 85% of land income is included when it is less than Rs40,000
- An additional 25% of this is added to the credit limit (as a standard substitute for the likely non-farm income of the farmer)
- 100% of land income is included when the estimated amount is less than Rs10,000.

Thus, a farmer earning Rs50,000 a year from his farm is granted a credit limit of Rs42,500 + (25% of Rs42,500 = Rs10,625) = (~)Rs53,000.

Significantly, since May 2001, non-irrigated land can now be included in the calculation of income.[22]

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20 Termed Block Development Office in north India.

21 One bank manager described it as "psychological security".

22 Again, the manager did not provide details of the income calculation but using government norms used by

The bank scrutinizes the documents submitted by the applicant and, if these are acceptable, a set of detailed forms is completed. These forms include a Sanction Letter, Limit Promissory Note and Agreement for Hypothecation.

In relation to a traditional banking system driven more by the decisions of the government (and the convenience of the institutions) than by the needs of the clients, the KCC is quite a revolutionary product in meeting the short-term credit needs of farmers. Those farmers who are able to access it regard the KCC as a very useful product partly on account of its flexibility since

- There is no limit on the number of withdrawals that can be made by the client within the overall monetary limit sanctioned by the bank.

- In theory, KCC accounts even provide the flexibility of doubling as savings accounts since clients can maintain positive balances and earn interest at 4% per annum.

- The debit balance in the account (within the KCC limit) must only be reduced to zero once, by the end of each one year period after the sanction of the CC limit.

- Interest charged is just 12% per annum on declining balances, the lowest interest rate available from the banking sector in India and far lower than the 24-36% customary in the MFI sector and 60%+ charged by moneylenders in the region.

- As a measure of security for the KCC holder – but mainly as an additional comfort for the bank – some banks have linked up with insurance companies to provide accident insurance of Rs50,000 to KCC holders.

If a client does not pay the requisite amount by the stipulated date, the KCC account is termed as "irregular". The bank waits for another 6 months (by when the next crop is ready) and in case the client fails yet again to repay, the account is included in the Non Performing Assets (NPA) of the bank and interest accumulation in the account is stopped.

While it is apparent that the KCC is a product specifically intended to meet the credit needs of farmers rather than the poor, since it is the most flexible product for mass distribution ever introduced by the banking sector in India, the issues related to its outreach to the bank's relatively low income clients bear examination. Information obtained from four rural branches of three public sector banks operating in rural Allahabad district is summarised in **Table 2** (next page). This table suggests that as many as 36% of all KCCs issued by the four branches had credit limits of less than Rs30,000 and these accounted for 18% of the total credit limits sanctioned and 23% of the amounts outstanding in the KCC accounts. As the table shows, however, the average credit limit even in the bronze (smallest) category is over Rs20,000 – well beyond the means and, indeed, needs even of all but the non-poor respondents in rural Allahabad. Unfortunately, information on the number of bronze card holders with credit limits in the range Rs5,000-8,000 – as discussed in **Section 5** (above) the most relevant category for the poor families covered by the study – was not available.

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the BDO as a guideline, the minimum annual amount would be Rs.600 per acre for non-irrigated land.

Feedback on the issues affecting access to the KCC for its lower income clients, is illustrated by the case studies presented in **Boxes 1 & 2** below.

Box 1: Bronze KCC holder, Laxmi Narayan Shivamber

Laxmi Narayan Shivamber holds a Kisan Credit Card with virtually the lowest possible KCC limit of Rs 5,500. He owns 2 *bigha* (1.24 acres) of inherited agricultural land. He has also taken on lease another 5 *bigha* (3.1 acres) of agricultural land.

Narayan acquired the KCC 2 years ago. He came to know about the card first from a couple of others from the same village who had obtained the KCC. He met the Bank Manager and collected all the information about the card. With the help of a cousin based in Allahabad city he was able to obtain an NEC in the relatively short period of 10-12 days. Narayan paid Rs 700 as fees for obtaining the Credit Card. His KCC limit was sanctioned in July 2000 and he immediately withdrew the entire Rs 5,500.

Narayan used the first withdrawal for paying part of the cost of purchasing additional land. The rest of the cost of the land was paid through savings he had made over the past 8 years and deposited in a bank savings account in the next village. The first repayment on the KCC was deposited in his account in April 2001 on the advice of the bank Branch Manager that this would reduce his interest burden. The total amount including interest deposited was Rs6,040. He made this payment by taking an advance in the village against the prospective sale of his crop.

Narayan made another withdrawal of Rs 5,500 in July 2001. He used Rs 3,000 for paddy transplanting and the rest for household expenses.

The immediate motivation for Narayan to acquire the KCC was the need for money to help with the purchase of new land. He approached the *mahajan* (village moneylender) in the village. However, the *mahajan* could not provide him with credit as he was short of funds since the prevailing price of agricultural produce was low. The *mahajan* wanted to hold on to his crop in order to obtain a better price later. At this point Narayan thought of applying for the KCC. He seems quite content with the product. He likes the flexibility to withdraw within the limit at any time and considers this the major advantage of the KCC.

While Narayan felt there were advantages in having the Card, his brothers were not able to obtain it. It seems that his brothers also approached the *mahajan* for Rs700 for financing the transaction costs of the Card. The *mahajan* replied "Why don't you just pay me Rs 700 and I will give you a loan of Rs 5,000".

Table 2

Information available on Kisan Credit Cards issued by four bank branches in rural Allahabad

Landholding, acres	Card type	Credit limit, range in Rs		Number issued	Total CC limit	Withdrawals outstanding	Average		
							limit	outstanding	OS/Lt, %
		minimum	maximum		Rs'000		Rs '000		
greater than/=10	Diamond	60,000	100,000	10	951	5.58	95,100	55,800	59%
7.5-10	Gold	40,000	60,000	28	1,705	11.40	60,893	40,724	67%
2.5-7.5	Silver	25-30,000	40-50,000	459	23,483	143.92	51,161	31,354	61%
less than 2.5	Bronze		25-30,000	276	5,547	48.76	20,098	17,668	88%
				773	31,686	209.66	40,991	27,123	66%
Microfinance (bronze category)				36%	18%	23%	49%	65%	

Box 2: Bronze KCC holder, Ganga Prasad Gupta

Ganga Prasad owns 6 *bigha* (3.7 acres) of agricultural land and is also a *teli* (oil extractor) by profession and caste. In April 2001, Ganga Prasad took a loan of Rs10,000 from a moneylender in the village for the marriage of his daughter. This was at a flat interest rate of 10% per month. In June 2001, he contacted another well-off person in the village, Ram Naik, and asked him for a loan to repay the moneylender. Ram Naik told Ganga Prasad about the KCC. Until then, Ganga Prasad had never visited a bank or obtained any bank loan so Ram Naik took Ganga Prasad to the local bank. However, the Bank Manager told Ganga Prasad to come back 10 days later, alone.

Ganga Prasad met the Bank Manager in July 2001 who told him that the KCC scheme had closed. Ganga Prasad then happened to meet Shankar Shukla, owner of the building in which the bank is located. He knew Shankar Shukla because the latter's relatives live in his village. Shankar Shukla told him that KCCs are issued only after the 15th of every month. Shankar took Ganga Prasad to the bank manager and the process of obtaining the KCC began.

Ganga Prasad felt that since he had no experience of dealing with the bank, the Manager did not trust him. The key in obtaining the KCC was his acquaintance with Shankar Shukla who, as the landlord of the building in which the bank office is located, had obvious credibility.

The Bank Manager told Ganga Prasad that on a landholding of ~6 bigha he could obtain a limit of Rs30,000. Ganga Prasad, however, only needed Rs15,000 to repay his loan from the moneylender so that was the limit sanctioned.

Ganga Prasad paid a total fee of Rs 500 for the KCC. The bank manager told Ganga Prasad that he would have to visit the Bank's advocate in Allahabad to obtain the NEC. Since Ganga Prasad felt he would not be able to manage the ways of the big city, however, the Manager agreed to get it done, himself. The NEC was ready within a week.

Ganga Prasad used the bank loan to repay the moneylender. He planned to repay the KCC credit by February 2002 and then, if necessary, withdraw some more money from this account. It was because of his lack of knowledge that he had never gone to a bank before or tried to join the local Primary Agricultural Credit Society.

The **key factors** emerging from the interaction with low-income KCC clients and with local bank branch managers responsible for KCC operations are

1 For people at the lower rungs of the economic (and social) scale, knowledge of the existence and design of the products of formal financial institutions is, itself, a constraint

2 Knowledge alone is not enough; in a situation where rural bank branches are limited to four members of staff, it is the bank manager's time rather than the availability of credit that is at a premium. Without appropriate contacts or influence a low-income client cannot hope to be selected for the low cost, high flexibility credit provided by the KCC.

Apart from the two cases narrated in the above boxes, other typical low-income KCC holders were a bank's *paanwala* (betel leaf supplier) and an influential local priest.

3 As is well known with institutional credit, there is both a direct transaction cost (Rs500-1,000) and an opportunity cost (several days of the applicant's time plus a waiting time ranging from 10 days to 3 months) entailed in obtaining a KCC. For a low-income client either could be a binding constraint.

4 The flexibility of use and operation afforded by the KCC are highly appreciated by all clients. Apart from land purchase and repaying a moneylender's loan, KCCs in rural Allahabad have been used for a daughter's marriage, as working capital for business and for house repairs.

5 In theory, such a product is open to "abuse". One client had borrowed from a neighbour to make his annual repayment to the KCC account, then withdrawn from the KCC account to repay his neighbour! Given that it is a loan secured by immovable property, however, this need not be a matter of concern for the bank so long as the "repayment" is made regularly and the bank receives the interest due. Given such cases, it is not surprising that bank managers – stung also by the IRDP experience of the past – are reluctant to enrol without collateral even low-limit bronze card holders.

6 In discussion, some bank managers express willingness to lend without collateral to selected bronze card holders whose credentials they are able to assess personally at the village level. However, in practice they are reluctant to do this. Branch managers are regularly transferred to other branches after a period of about three years and they point out that there is no guarantee that their replacement as branch manager would either be able to or have the motivation to establish the same rapport with the same client. Since responsibility for lending to a 'bad client' falls on the manager who sanctions the loan, there is a 'moral hazard' built into the system. Managers uniformly proclaim that lending without collateral (to low-income clients) would be possible only if "immunity from irregular clients"[23] were to be provided to them.

6.2 Insurance with the Life Insurance Corporation of India

The Life Insurance Corporation of India (LIC) is a government-owned institution, one of the largest financial corporations in the country. Until early 2001, the LIC had a monopoly on life insurance business in India. A series of income tax concessions and rebates provided by the government has, over the years, greatly popularised life insurance as a savings (and risk coverage) instrument amongst the middle classes. Largely as a result, the organisation has grown, to encompass dramatic numbers – 92 million policies in force, with total individual risk coverage in excess of $108 billion and annual premium collection of the order of $4.2 billion by 1998-99. The LIC has 2,000+ branches distributed all over the country and as many as 650,000 agents.

Unfortunately, in spite of a concerted effort in rural areas in recent years, life insurance has remained mainly a middle class product. It is indicative that amongst the 28 respondents of this study in rural Allahabad, only 7 held LIC policies and none of these belonged to a family that could be classified as poor. Amongst the urban respondents in slum Delhi just one non-

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[23] In public sector parlance this means absolution from responsibility for lending to them

poor respondent held an LIC policy. In attempting to understand the reasons for this, an assessment of the LIC's most popular insurance products – the Money Back Policy, the Endowment Policy and the Marriage Endowment/Education Annuity Policy – is instructive.

Money Back Policy

Customers interested both in long term savings and obtaining some bulk inflows of funds at five year intervals during the saving period can take this policy for a 20 or 25 year term. The pay-back on the policy – assuming the survival of the policy holder to the end of the term– is summarised in **Table 3**.

Table 3

Pattern of Pay-back on the LIC's Money Back Policy

Time elapsed – years	**Period – 20 years** – proportion of sum assured	**Period – 25 years**
Five	20%	15%
Ten	20%	15%
Fifteen	20%	15%
Twenty	40% + "bonus" @~7.5% p.a.	15%
Twentyfive		40% + "bonus" @~7.5%p.a.

Endowment Policy

A simple life insurance product entailing a pay back in terms of a lump sum at the end of the 5 to 25 year term of the policy or payment of sum assured plus bonus in case of the earlier death of the policy holder.

Marriage Endowment/Education Annuity Policy

This is a policy designed to provide parents either with a lump sum for the marriage of a daughter or with 10 six monthly instalments for the education of a child after the completion of the term of the policy. In the event of the death of the policyholder before the completion of the term, no further premia are payable but the sum assured and accumulated bonus is paid only on completion of the term of the policy. The term of the policy can range from 5-25 years.

Premia on all LIC policies are based on the age of the policy holder and can be paid in annual, half yearly, quarterly or, for most policies, even monthly instalments. The minimum sum assured for all three types of policy is Rs25,000.

Discussion with the LIC's representative in the rural Allahabad study area, the Development Officer (DO) shows that there were, in early 2002, 63 LIC agents operating in the development block so there was no lack of suppliers of the LIC's services. However, despite this, in an area (Koraon Block) that is said to be the insurance leader in the region, there were just 13,000 policies in an area with some 30,500 families. Allowing for more than one policy per family with insurance, the coverage appears to be no more than 15%. The DO estimates that 75% of policy holders in the block are middle class farmers or professionals and only 20% belong to relatively low income families. He estimates that 90% of policies sold are money back policies – a long term savings instrument in a predominantly agricultural area – and the endowment policies are purchased mainly by those in government service or other salaried employment. Most policies (70%) are sold between December and March every year since that is when farmers have some money after the sale of the monsoon crop with, usually, another crop to come in April.

In terms of customer profile, it was reported that most of the older and more established LIC agents have the best customers – with the highest incomes and largest policies – whereas the more recent entrants into the field have to hustle for business from the poorer clients in the area. Information obtained from one of these newer agents (only 18 months) is instructive. Out of 80 policies sold by the agent, so far, only 16 (or 20%) were for relatively small sums assured (Rs25,000 or Rs40,000 following the pattern of the LIC). These were distributed as follows

Type of policy	**Sum assured, Rs25,000**	**Sum assured, Rs40,000**
• Money Back	1	3
• Endowment	4	
• Marriage endowment/ Education annuity	7	
• Children's Money Back		1
Total	**12**	**4**

Agents in the area report that virtually all their policies entail payments of premia on a half yearly basis though, for some clients, they do make an exception and agree to accept quarterly premium payments. Though all three types of policy have provisions for monthly payment of premium, the agents actively discourage this even to the extent of not accepting policies from people who cannot pay at least on a quarterly basis. The reason for this is simple: in a rural area where people are less accustomed to regular payment obligations – particularly to the government and large institutions such as the LIC – the burden of work in the collection of the premium inevitably falls on the agent. The collection of the premium on a monthly basis would entail very high travel costs and the investment of considerable time by the agent – an opportunity cost that would far exceed the 5% commission that is paid by the LIC.

Boxes 3 & 4 (below) contain profiles of two small policy holders in the study area. It is apparent from discussion with a selection of low income clients that while the LIC's policies are quite appropriate to their needs and outreach is facilitated by the large number of agents in the area, the competition amongst these agents is concentrated in the towns and (a very few) large market villages where they themselves live. The agents' lives revolve around these population clusters and they are not interested in making expensive, time consuming trips to villages more than 3-4 km away. This, in itself, limits the outreach of the LIC as a savings service provider to the rural poor. Secondly, since agents do not expect policy holders to volunteer the payment of their premia they neither make significant efforts to sell policies to the poor, nor do they provide information to clients – particularly of small policies – about the option of making frequent (monthly or even quarterly) payments. All of these factors limit the use of the LIC policy as a savings device for low income families.

Box 3: **Marriage Endowment Policy holder, Ms Prabha Devi**

The policy holder runs a small grocery store from her home using the capital obtained from a Rs5,000 loan provided by a local MFI. Her husband is a casual labourer on local construction projects and also farms their two *bigha* of agricultural land. She has one daughter and two sons. While the boys attend the village primary school, her daughter stays home to help with domestic chores and running the shop.

Ms Prabha Devi is particularly worried about the financial burden likely to be imposed by her daughter's wedding expected in 12 years' time. It is for this reason, that she was persuaded by the MFI field worker's husband, an LIC agent, to take the Marriage Endowment Policy. In return for regular six monthly premium payments of Rs871 she expects to get Rs25,000 plus "bonuses" in 15 years' time. She would have preferred to pay her premium on a monthly basis but the agent said there was no such provision in the LIC's rules and persuaded her to pay six monthly. She feels this is a substantial lump sum burden compared to the Rs120 per week she pays as repayment instalments on her MFI loan but accepts that she must make the sacrifice, even borrowing temporarily from friends and neighbours to pay the LIC premium, if necessary.

Privately, the agent reported that since the policyholder's village is located 7 km from Koraon, where he lives, it is not feasible for him to come to collect the premium more than once in six months.

Box 4: Marriage Endowment Policy holder, Pappu Rayin

Pappu Rayin, a 22 year old vegetable vendor, has 3 younger sisters. The youngest will reach marriageable age in 10 years time. By the time he and his mother have fulfilled the obligations of all three marriages they expect to have very little capital left. For a few years they will have to live off borrowed funds until the Rs25,000 LIC policy matures in another 14 years.

Pappu came into contact with the LIC agent through the goldsmith whose premises are opposite his vegetable shop in the centre of the market town. Having befriended the agent, he learned about the LIC's policies and together they worked out a six-monthly premium schedule – payments in September and March during the peak seasons for selling vegetables. He will, thereby, be in the best position to pay his premium.

Despite, the vegetable shop being located just around the corner from the agent's home, the latter had not informed the policyholder of the monthly premium option.

6.3 Sahara India Financial Corporation – better known as Rashtriya Sahara

Sahara India Financial Corporation is a large finance company operating in some of the more economically backward states of northern and eastern India. Sahara collects savings from 39 million depositors ("1 out of every 25 Indians") through 1,379 branch offices and has 600,000 staff and agents for the purpose. Sahara invests its asset base of Rs160 billion ($3.3 billion) on the Mumbai money market as well as in lucrative real estate projects. It has even invested in an airline – the third largest airline providing domestic air services in India.[24]

Sahara came to the study area in rural Allahabad some ten years ago but was forced to reduce its operations in 1997-98 when several deposit collectors fled from the area after the collapse of another non-bank finance company (NBFC). Sahara presently has two senior and five junior agents operating in the block.

Sahara offers three deposit (savings) schemes:

- <u>Daily deposit scheme</u>: Rs5, Rs10, Rs20 up to Rs60 can be deposited on a daily basis with Sahara agents for terms of 2-5 years at interest rates of 4-6%.

- <u>Monthly deposit scheme</u>: Rs100 or Rs200 and upwards per month for a period of 4 years.

- <u>Fixed deposit scheme</u>: Rs1,000 upwards for terms of 69 months (for double value) and 111 months (for three times principal value).

One senior agent in the block has around 200 clients for the daily deposit scheme, 150 for the monthly deposit and a few fixed deposit holders. Though the agent has no particular bent towards any one type of client, he does not believe it is feasible to operate outside the main town and a couple of the other large markets in the block. This is especially so in the case of the daily deposit scheme.

As a result of the problem of feasibility outside the large market areas, the effective physical outreach of the daily deposit scheme is very limited. Yet, to some extent, in terms of the needs of the poor it is this scheme that could be particularly useful along with the Rs100-200 monthly deposit scheme. [25]

The other issue that arises in the context of the Sahara schemes as a savings device for the poor is flexibility. Since each of the schemes entails regular deposits it is similar to the relatively rigid savings programmes of MFIs. Any savings instalment missed by a Sahara depositor has to be paid later along with 9% interest and the withdrawal of savings before the completion of the term of the deposit is virtually impossible. The only means depositors have

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24 The website, www.Saharaindiapariwar.com, proudly (but not entirely accurately) announces that Sahara is the only Residuary Non-Banking Finance Company in the country to have been granted a certificate of registration by the Reserve Bank of India for complying with all the guidelines applicable to NBFCs.

25 Indeed, only one of the 28 diary respondents in the block had used any of Sahara's services at all, while a different respondent had used the services of Peerless, another national level NBFC active in the area.

of leveraging their savings with Sahara is the possibility of taking a loan against the balance in the deposit account; Sahara lends back 75% of the depositors' savings at an interest rate of 15% per annum compounded monthly. However, the company is reluctant to make such loans and agents generally discourage clients from using this facility. Only 10% of the Sahara clients in the block have been able to utilise the service.[26]

6.4 The Post Office

In theory, the Post Office is also a supplier of savings services in rural India. Post offices exist in every cluster of villages in the country and, apart from acting as the only means of communication to the remotest villages have also, traditionally, provided the only accessible financial remittance service for poor migrant workers in the form of the "money order".

The post office in one of the study villages was established in 1979 and its service area covers 6 villages. It offers the following financial services – Term Deposit (TD), Recurring Deposit (RD) and Current Account (CA). In the past – 6 years ago – this post office could offer fixed deposit schemes such as the National Savings Certificate and Kisan Vikas Patra (Farmers' Development Certificates). These are currently available only to clients of larger post offices since, as a measure of rationalisation, the function was shifted to the main Post Office in the block town 12 km away.

The postmaster provided the following information about the deposits at his office

Particulars	**Term deposits**	**Recurring deposits**	**Current accounts**
No. of accounts	3	60-70	30-35
Deposit range (Rs)	45,000-50,000	20-500	Can go upto Rs 8,000
Client type	Large farmers	*Bidi* makers[27], business people, those in formal employment, others	Mostly business people

Money orders come from migrant workers in other parts of the country sending savings to their families in the post office's service area. The total volume of money orders handled by this post office ranges from an aggregate sum of Rs10,000 to Rs30,000 per month.

Other than the money orders, however, the physical outreach of the post office is very limited. Besides the fact that the number of clients using the savings schemes of the post office is very small and few of those would count amongst the poor, almost all of its current clients are from the village where the office is based.

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26 This may have a positive side to it in that the poor certainly need some discipline to save and not withdraw. Nevertheless, the discussion in **Section 5** shows that product flexibility is an essential component in enabling the poor to cater to their financial needs.

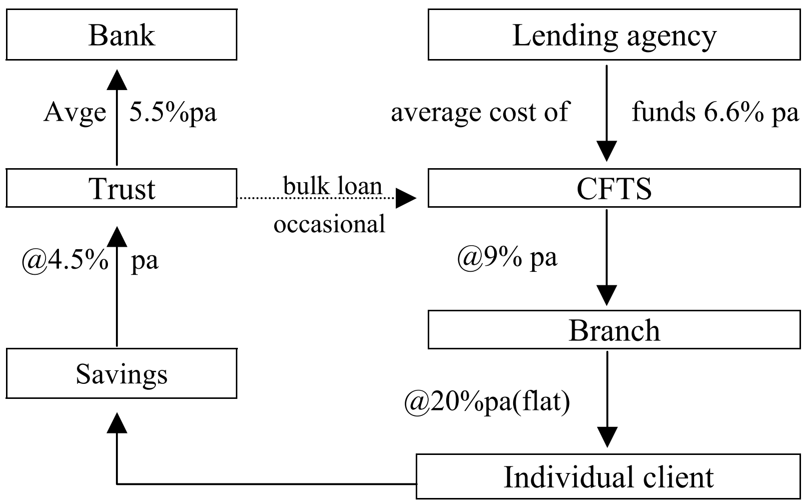
27 *Bidi*s are traditional cheroot cigarettes.

6.5 **Cashpor Financial and Technical Services Ltd** – a major microfinance institution

Cashpor Financial and Technical Services (Cashpor) is a for-profit company established in 1996, providing financial services to low income families – especially women – in selected blocks of Mirzapur and Allahabad districts, including the study area. Its 10 branches presently service around 16,000 clients. The financial services offered and the flow of funds in the provision of these services is illustrated in the figure (below).

A Cashpor client can take a maximum of 3 loans at one time. In addition to the main "income generation" loan, she can take an additional seasonal loan or a marriage loan. If she faces a special need at home (accident, health, birth), she may also apply for a Rs500 emergency loan (rising to Rs1,000 in special cases). All these loans are repayable over a 12-month period.

Flow of funds in the provision of Cashpor's services



In relation to Cashpor's main income generation loan, in the first year a client can borrow up to Rs8,000, in the second year up to Rs15,000 and in the third year up to Rs25,000. All the five members of a joint liability group receive the first loan within 2.5 months of group formation. The loan term for the main general loan product is fixed at 12 months. In a given year, a client can obtain the specified loan amount as many times as she wishes. For example, a client could repay the loan amount within 6 months and again take a fresh loan of the same amount. Cashpor charges interest at 20% per annum on a flat basis.

Another product is the marriage loan of Rs 8,000. This loan is disbursed only in those centres that are at least a year old and to those clients who have regular savings for the last 6 months. The loan is repayable in weekly instalments over 4 years and also carries interest at 20% per annum (compounded annually).

Operational information

Within the study area, Cashpor has seven centres, 56 groups and 280 clients. Two centres are in the block town (with 70 clients). On 30 September 2001 the total savings of the 280 clients in the block amounted to around Rs 200,000 and loans outstanding Rs 805,000 – 80 clients were in the first loan cycle (Rs 8,000) and 200 in the second (15,000). Only one client had obtained a marriage loan. Of the 28 diary respondents, 5 were Cashpor clients and only one of these to the very poor category.

At the start of its programme, the Cashpor management insisted that the focus of their microfinance programme should be the poor but, towards the end of 2001, the organisation's drive to sustainability led to pressure to expand membership and portfolio size, resulting in the focus changing to 'the poor <u>and</u> small business'. Most of the Cashpor clients in the study block are already involved in trade or business activities and own very little or no land.[28] With increasing emphasis on bringing in more business with larger disbursements, the MFI's field staff are being encouraged to start more groups in town areas. This is likely to result in a further shift in the socio-economic profile of clients away from the very poor.

Meetings with MFI clients

All Cashpor clients (mostly traders) are highly appreciative of the MFI's role in providing working capital regularly, at lower than moneylender rates, in increasing amounts and in a customer-friendly manner.[29] They are also happy to be dealing with an institution that is transparent unlike the moneylenders. The clients are aware of the interest rates charged by Cashpor, which they feel are better than the 10% per month flat rate charged by local *mahajans* (moneylenders) for short term loans. However, Cashpor's interest rates are also not perceived to be particularly low.

One respondent who values Cashpor's services, spoke to 5 tribal families in another village to wean them away from the local *mahajans* to whom they were attached for their livelihood and credit needs. It appears that these families became interested in joining Cashpor. When the *mahajans* found out about this, they persuaded the families not to join Cashpor on the grounds that the interest rate of the MFI is, in any case, high and the *mahajans* are much more flexible than the MFI in enabling access to credit.

Another issue that arose was that Cashpor's weekly repayment system is more suited to small businesses or the relatively few low income clients who own two milch cattle. Clients felt it did not work well for those with just one animal or those who are dependent on agriculture – where wages are often paid in consolidated amounts rather than daily – or for those who earn salary on a monthly basis. The clients would like the repayment schedule to change from weekly to fortnightly or monthly since making weekly payments is very difficult for them.

A typical case of the limitations of Cashpor's rules in providing financial services is that of 25 very poor *kol* (tribal) households in one of the study villages. They are not part of the Cashpor programme due to their inability to fulfil the compulsory savings requirement, on the one hand, and to meet the demands of a rigid repayment schedule, on the other. Further, given Cashpor's increasing focus on larger loan sizes the relatively small financial needs of these very poor families no longer fits the MFI's business model so staff are not encouraged to work with them. It is, on the other hand, starting to reach marginal leasehold farmers and this is a significant benefit since the KCC has no practical mechanism at present for catering to the needs of this group.

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28 See Ruthven and Sushil Kumar, 2002, forthcoming.

29 See Ruthven and Sushil Kumar, 2002, forthcoming

7 So, how could the poor be better served…?

Throughout the previous section, the rigidity of products, economies of scale in offering financial services to individual clients in population clusters, the issue of collateral in providing credit and links with conditions such as compulsory savings (in the case of the MFI) have emerged as limitations in the design of products relative to the needs of the average poor family. Yet, a considerable fund of knowledge and experience has been built up in recent years on these needs. The main objective of this paper is to use this knowledge and experience to suggest ways in which the major providers of financial services can better serve the needs of the poor in areas such as slum Delhi and rural Allahabad where low income families tend to be concentrated. It is the belief of the authors that the major service providers could not only learn from this research but also from each other's experience to improve the design of their services for meeting the needs of the poor.

7.1 The banks: Sukshma Vitth (micro-finance) Facility

In theory, the KCC provides precisely the flexibility, in terms of number and type of transactions that the poor need. Having a single account for both credit and savings would save the banks, as well as their (mostly) semi-literate and illiterate clients considerable aggravation in terms of transaction costs and paperwork. In the context of the IRDP, and other "priority credit" experience, however, the average branch managers' concern with collateral is understandable. Equally, it is virtually impossible for the now thinly staffed rural branches to establish "relationship banking" with large numbers of poor clients. Yet, if the banks are to serve the needs of the poor, a reasonable medium must be found. In this situation, it seems apparent that the banks need to learn some lessons

- <u>One</u>: It is not necessary to allow poor clients to borrow beyond their means. Having relatively high minimum limits, even Rs5,000 (in rural areas) would, therefore, only result in the virtual exclusion of low income clients from the ambit of the banking sector. For this reason, the minimum credit threshold ought to be reduced to Rs2,000.

- <u>Two</u>: Given the present low (12%) interest charged on the KCC, the banks may well feel that they cannot cater to large numbers of clients who will each bring them only a small amount of business. Yet the exclusion of the banks as an option means the poor have, perforce, to pay interest rates ranging (in rural Allahabad) from 36% upwards on the credit available to them from MFIs or from informal sources. Surely, such clients would welcome credit even at 18% interest. A higher expected revenue on a microfinance product should enable banks to experiment with placing additional staff at branches where this product is to be promoted. This would facilitate a substantial element of "relationship banking" in the provision of a micro-finance (or *Sukshma Vitth)* facility.

- <u>Three</u>: It is virtually received wisdom in the microfinance world that the poor are better repayers of credit than the more influential better-off clients – with or without collateral. The benefits of relationship banking could be further leveraged by employing the well-known device of MFIs: good clients get higher credit limits with each successive round of borrowing. In the case of Sukshma Vitth, this could entail successive credit limits of Rs2,000, Rs3,000, Rs4,000 and Rs5,000. Anyone, interested in a limit in excess of Rs5,000 could be expected to offer some collateral and become a KCC client.[30]

[30] Though with larger numbers of low income KCC clients the banks may no longer be able to lend at 12%

- Four: The possibility of using the *Sukshma Vitth* facility equally as a savings instrument, albeit for small amounts (equivalent to the credit limit) and for short periods should also be publicised. The banks should pay the same interest on a positive balance in a *Sukshma Vitth* account as for a normal passbook savings account (currently 4.5%) – and, unlike the present situation with the KCC, branch managers should be made aware of this characteristic of the product.

7.2 Life insurance: Collaborate with MFIs

The minimum size of a policy with the LIC, Rs25,000 entails the payment of a monthly premium of Rs147 for a 15 year term by a 30-year old policy holder.[31] This amount is even lower than the Rs48 a week that a micro-borrower would need to repay on a 50-week Cashpor loan of Rs2,000. In theory, it is an excellent facility for a micro-saver. In practice, as the discussion in **Section 6** has shown, it is not available since agents are not only unwilling to offer the monthly payment option they are even reluctant to offer policies with a sum assured that is less than Rs50,000.

The answer may well be in the LIC collaborating with MFIs (as do some of the general insurance companies for their animal insurance products) for the collection of premia and the administration of policies. Essentially, the LIC could designate selected MFIs as their agents and authorise them to "sell" policies (of sum assured less than Rs50,000) to their members; to collect premia from the policyholders on a monthly basis, and to assist in claims processing. In return, the MFIs could be paid the commissions normally paid by the LIC to its agents. The claims processing assistance would greatly facilitate matters for policyholders' families while greatly increasing the outreach of the LIC's service to low income clients – both in rural areas and urban slums. The benefits of experimenting with such a facility are apparent.

7.3 MFIs: Learn from the banks…!

Such rigidity as there is in MFI products has served them well in establishing operations in a credit scenario that, over the years, has become vitiated by the loan "melas" and loan waiver schemes that have characterised social banking in India. However, for established MFIs, amongst others, an attempt to increase focus on the real financial needs of the poor is now called for. For this to work, the better established MFIs need to start seeing themselves more as offering comprehensive financial services and not just as institutions providing yet another option in the wide spectrum of financial devices available to the poor. Based on the lessons of this study programme, the most appropriate financial device for this purpose, would have the virtue of flexibility which could be offered to clients who have an established relationship with the MFI. The product would have similar characteristics to the KCC and would, in fact, be virtually identical to the *Sukshma Vitth* facility proposed above for the banks.

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interest under the KCC either. So be it.

[31] Life Insurance Corporation of India, 2001. **Ready Reckoner** (for agents of the LIC).

Product name: Flexi-Finance

Product features:

- Begin with savings of Rs10 per week or more until the savings balance reaches Rs500.

- Once the Rs500 threshold has been reached, clients are free to withdraw money and run down their accounts upto a maximum debit balance equal to their credit limit – say Rs3,000 or maintain credit (savings) balances in the account in accordance with their needs.

- Both credit balances (savings) and debit balances (borrowing) can be maintained up to a maximum of Rs3,000. If either balance is to exceed Rs3,000 the clients should be encouraged to opt for other financial products of the MFI.

- Interest will be calculated on a monthly basis at 6%p.a. on the minimum credit balance or 24%p.a on the maximum debit balance in the account during the month.

- All debit balances should be reduced to zero at least once every twelve months.

- The continuation of a Flexible Finance account for an individual borrower would be at the discretion of the MFI Branch Manager advised by the field worker.

A typical ledger account for the Flexi-Finance product could be summarised as follows

all figures in rupees

Date	Deposits	Withdrawals	Net Balance Credit	Net Balance Debit
Balance on 5 Nov			490	
12 November	10		500	
19 November		300	200	
9 December	120		320	
15 January		500		180
25 February	100			80
16 March	200		120	
25 April	100		220	
7 May	50		270	
16 June		400		130
23 June		800		930
7 July		350		1,280
12 August	150			1,130
15 September	200			930
22 September	400			530
30 September	300			230
10 October	400		170	
20 October	250		420	
5 November – net interest added*				

* either as debit or credit depending on the calculation based on the principles above.

This product may cause some practical difficulties for the MFI in terms of accounting and control systems. Clearly some trial and error will be required to create the systems necessary to enable the organisation to offer this product effectively.[32] As with the other products, a period of piloting and experimentation would be appropriate.

8 Conclusion – pilot testing and experimentation are required

The research project on the financial services and devices used by the poor – in India and Bangladesh – has generated a wealth of information. In a sector that is increasingly researched and analysed, it is inevitable that a substantial proportion of the information generated confirms what is already known and does not necessarily generate startling insights. However, there can also be considerable value in incremental information provided it leads to practical recommendations which help to improve the lives of low income families living on the margins of subsistence. This is the rationale for this paper and the suggestions made in **Section 7**. If this effort leads to further work and, especially, to experimentation by financial institutions on the design of appropriate financial products for the poor, this paper will have made a significant contribution to the cause of poverty reduction in the region.

[**Third draft**: EDA, 24 June 2002]

(Please note: Annexes not available in electronic version)

[32] The authors could make suggestions for this, based on their organisation's experience of working with MFIs, but such details are outside the scope of this paper.

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