

## FOCUS

## Linking Informal and Institutional Sources in the Rural Financial Market

THE widespread prevalence and popularity of the informal financial lenders in the rural areas establishes their ability to serve quickly and efficiently. The informal sector lenders like traders, shopkeepers, big farmers, and professional money-lenders are particularly popular not only to the groups who have no access to institutional sources of finance but also to a section of people who are rather more comfortable in dealings with the informal lenders. Money-lenders and other informal sector lenders are evidenced to be particularly popular in the villages of the country for their quick delivery procedures, simple formalities and minimum paper work. The inefficiency in handling aforementioned advantages of the informal sector lenders by the formal sources has added another positive point to the informal sector lenders. Another advantageous thing on the part of the informal lenders is that they have enough knowledge about their clients in their particular sub-market that reduces information costs and minimizes default risks. Informal lenders easily adjust with the changing circumstances without any government regulation on them and enjoy a lot of flexibility in regard to the procedure of loan processing, fixation of lending rates, repayment installment, repayment period, etc. Moreover, there are some areas where it is not possible for the institutional sources to offer services efficiently and economically. Thus, in a number of cases, the borrowers' choices is not between borrowing from institutional or informal sources, but between borrowing from informal sources or not at all.

In Bangladesh, most informal lenders lend out of their own funds and do not mobilize deposits. Mobilization of savings through informal channels is observed in the case of various samities, under which a fund is created through the monthly/weekly contributions of the members. However, these samities are also generally do not

collect deposit from the non-members. Thus, informal lenders of rural Bangladesh mainly depend upon their own funds for lending purposes. The reasons for the absence of deposit banking by the informal lenders may be as follows: Both depositors and borrowers are mainly engaged in agricultural work, and when borrowers need to borrow deposits at that time to start the production season. On the other side when depositors want to make deposits borrowers want to make repayments at the same time after completion of the season. After a bad harvest a depositor wants to withdraw deposits to cushion a shortfall, but borrowers are not in a position to repay at that time. Another obstruction may be the absence of information gap between depositors and borrowers who are generally known to each other and are engaged in the same occupation. However, it has been reported that the volume of deposit banking in some rural areas by informal institutions has been found in areas with diversified agriculture, and a well-developed non-agricultural sector. For example, the volume of intermediation is reported to be high in Kerala in India (CL Dhadhik, 1999). But, other than a few exceptional examples, such atmosphere for financial intermediation by the informal lenders has not developed in our agrarian rural economy. Thus, informal lenders are always in need of fund for lending operations.

The combination of the advantages of the informal system with those of the formal may give good result in the rural areas of Bangladesh. A linkage of formal and informal funding may also help in eliminating the disadvantages of their independent operations. Rotating banks or institutional loans through an informal agent or intermediary such as money-lender or samities at the village level may prove to be effective in raising the outreach of the formal fund in the rural areas. Such linkage operation, on the one side, may reduce the prevailing

very high interest rate of the informal sector, and, on the other side, formal sector would be able to disburse credit at a very low transaction cost. These may also reduce the default risk of loans through minimization of the information gap between borrower and lender.

In a number of developing countries, a popular form of linkage of the institutional sources with the informal sector is on lending through Self Help Groups (SHGs). The SHG is a group of people who usually belong to the same or similar profession or of income group generally organized by NGOs to work as intermediary. On the one side, SHGs are supposed to enjoy the rights to evaluate the project, select the borrower, disburse the credit and monitor, and, on the other they are expected to bear the liabilities and responsibilities of monitoring and repayment of loans. Various studies (Dash, 1999 for example) have shown that the self-help groups have the potential to bring together the formal banking structure and rural people for mutual benefit. In Bangladesh, MSFSCIP (The Marginal and Small Farms System Crop Intensification Project) is a linkage scheme with the informal sector initiated by IFAD and GTZ in 1989 in the district of Kurigram for providing financial services to the marginal and small farmers. The project aimed at testing a model of linkage between banks and SHGs with active participation of NGOs. The project ended in 1996, and the banks have accepted the outcome as a viable model replicable in other areas. Along with some other micro credit programmes RAKUB has already started replicating this model in rural areas of Rajshahi division. But, in a num-

ber of instances SHGs formed for such linkages are mere joint liability groups. Such system of credit delivery through SHG in Bangladesh is rather a form of group lending approach followed by a number of NGOs in the developing countries including Bangladesh.

Though, linkage through SHGs have earned popularity in a number of developing countries (like India, Nepal, Indonesia, etc), one important thing is to be noted that the success of such linkage mostly depends

upon organization of capable SHGs who are responsible for a number of aspects of loans. Success of linkages through true SHGs in Bangladesh would really be difficult in our present social and economic set up of the rural areas of the country. An SHG must look after some important lending issues like selection of borrowers, monitoring, repayment and book-keeping of loan. A group of literate and conscious people who need credit for productive purposes is expected to perform such intermediary task fruitfully. In rural Bangladesh, it is not easy to have such people together to make a group, and if so they may not always be interested to get involved with such activities to meet their own credit needs. Rather, existing group of individuals, money-lenders or samities may be more productive in this regard. A number of reasons can be identified: One, such groups or money-lenders have experiences of lending operation in their respective areas. Two, groups or samities are already formed and no additional effort would be required to form a group. Three, as the money-lenders and samities generally lend their own fund and face crises of fund, they are expected to be

interested to come forward to accept such a source of fund for their credit operations. Four, generally, money-lenders and most of the samities are economically sound and would be able to give collateral security to get fund from banks.

There are instances that the banks and NGOs in a number of developing countries lend through locally owned autonomous financial institutions or village samities, etc. As Matin et al. (1999) observed, by mid 1990s many sponsoring NGOs have given up the idea of promoting village SHGs, and, instead they have become permanent providers of financial services to the member-clients of village banks or organizations. Today, some international non-government organizations like World Neighbours (WN) have been working for strengthening local organizations. WN recognized fully the importance of strengthening local organizations and has been working to strengthen user groups, committees, samities, etc. In Bangladesh initiative should be taken to train and strengthen local samities or bodies and money-lenders to set up fruitful linkages with the formal sector lenders of the country. Three steps may be followed in the process of establishing linkages: Selection of intermediary, strengthening of intermediary and establishment of linkages.

In forming such a linkage, the intermediaries should be appointed by the respective banks or institutions. A particular lending rate and maximum allowable spread would be determined before starting operation, and for determining such rates flexibility should be there considering different target groups and

process. It is very important to allow flexibility in regard to a number of aspects of the intermediaries' loan operations. Intermediaries should have complete freedom of fixing loan processing time, repayment installment, repayment period, etc. The intervention objective by the sponsoring bank or institutions would just be elimination of exploitative nature of the money-lenders or samities. A reporting system by the intermediaries would be developed. However, the pain of getting report or information should be born by the banks or sponsoring institution only. Bank can develop a monitoring procedure or can develop a process of obtaining information by employing field officers for a particular region.

Strengthening of intermediary would be a very important step for the success of such linkages. Training would be essential to familiarize them with the procedure of selecting borrowers, documentation and disbursement of credit, security aspects and book-keeping of the loans. While imparting training, it would be essential to remember that the intermediaries should not be burdened with the longer and time consuming procedures of loan processing. Otherwise, the main objective of establishing such linkages would be lost. NGOs may also come forward to provide the strengthening services.

Establishment of linkages is the final stage of the three-step

process. It is very important to allow flexibility in regard to a number of aspects of the intermediaries' loan operations. Intermediaries should have complete freedom of fixing loan processing time, repayment installment, repayment period, etc. The intervention objective by the sponsoring bank or institutions would just be elimination of exploitative nature of the money-lenders or samities. A reporting system by the intermediaries would be developed. However, the pain of getting report or information should be born by the banks or sponsoring institution only. Bank can develop a monitoring procedure or can develop a process of obtaining information by employing field officers for a particular

region. The following eligibility conditions may be considered to select a money-lender or samity as an intermediary. One, money-lenders/samities are permanent residents of a particular area or village with good reputation and a minimum level of education. Two, money-lenders/samities have good track record and are not defaulters of any bank or NGOs. Three, money-lenders/samities have experiences of lending among the target groups of the banks. Four, money-lenders/samities have the acceptable securities and/or collateral to provide to the banks.

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Yes, initially it may be difficult in a number of cases to attract the existing lenders. But if supply of credit can be raised through such linkages with a few, then afterwards the rest would come up to stay in the market. Requirement

The author is Assistant Professor, BIBM.

## 'Bombay' Moneylenders Take the Credit

Belated recognition is now being given to the Indian moneylenders of the Philippines for their role in offering unsecured loans to small-scale entrepreneurs, reports Gemini News Service.

Michael A Bengwayan writes from Baguio City, Philippines

## Money matters

Fewer than 2% of poor people have access to financial services (credit or savings) from sources other than money-lenders.

Under 10 million of the 500 million people who run small businesses have access to financial support.

But microcredit programmes are on the increase, proving that the poor are bankable.

"We just come back again and again until the loan is paid, of course adding up the interest as the days go by," Ramnani says.

No Indian lender has asked the police to act against a client who failed to pay. Baguio City police chief Roland Rafin says: "I have been chief of police for 20 years and I have never known of any [such] case. These Indian lenders can't file a case anyway as there are no contracts signed between the parties involved."

Ramnani says: "We trust our clients, so there is no need for police involvement. If a client really cannot pay, we strike him or her off the list and life goes on."

The blacklisted client will never get a loan from any Indian lender again, as they all know each other.

The impact of the Bombays on Philippine villages has sent many financial institutions back to the drawing board. More and more Filipinos no longer go to banks to want it."

Don't they find it hard to repay the money? Alex Flores, a butcher who started his business from a \$50 loan from the Bombays, says: "Not at all."

Ramnani says: "We collect every day so that our clients never feel the burden of paying the huge amount of their loan. For instance, a \$50 loan for three months can be paid daily at 55 cents."

Flores says: "The banks never do that. They collect when your time is up and more often than not, it is difficult to raise the whole loan all of a sudden. The Bombays, on the other hand, come to collect from your shop daily and you are never disturbed in your work."

Julian Santos, a Baguio City baker, says: "I used to borrow from the bank, but it killed me. They asked for 34 per cent interest and I got hauled in front of the judge for failing to pay. I couldn't raise my loan when the time came for it to be paid. With the Bombays, I got my business back. It was easier to pay daily."

What happens if a client does not meet a repayment scheme?

A study by the University of the Philippines Department of Economics shows that in 12 of the most populated cities in the country, street-hawkers depend mostly on these Indian lenders for credit, particularly in urban areas.

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They are helping pump back life to the economy and doing it

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They are helping pump back life to the economy and doing it



By Hanna-Barbera



James Bond  
BY JAMES BOND  
DRAWING BY HORAK

with little fanfare. Where there were once no sources of credit, the Indians arrived to provide it.

Mayor of Baguio City, Mauricio Domoguen, says: "Twenty years ago, Indians used to provide credit only in this city. Now you see them everywhere."

The Bombays' way of lending can be said to be a "school of learning" by micro-credit finance institutions in the Philippines. The micro-credit scheme is new to the country, having been popularised first in 1987 by non-governmental institutions until the government picked up the idea seven years later.

The Bombays taught what banking officials from the World Bank (WB), Asian Development Bank (ADB) and International Fund for Agricultural Development (IFAD) never thought was possible that the poor are bankable.

Bombays never lend to the rich. Banks usually lend to the rich thinking they are the only ones with capacity to pay.

Not so, a 1998 ADB report says. "Formal finance institutions have shown their inability to serve potential small entrepreneurs in urban and rural Asia. Micro-credit supplied by informal sources has shown how it can be done."

Muzzammel Huq, director of the Grameen Bank that popularised micro-credit in Bangladesh, says commonly held views on the effects of informal financial activity for the poor are misguided.

Foremost among these negative perceptions is the notion of a crooked moneylender charging a monthly 10 per cent rate.

ADB says the interest rates are actually not so high considering the levels of risk. ADB also rejects the charge from formal lending institutions that informal credit is unproductive. An informal loan for subsistence consumption can give a household the opportunity to be productive, it said.

Such arguments are now encouraging formal banks to engage in micro-credit too. They are opening their doors to the poor for small loans payable up to a maximum six months with high interest.

The first cooperative bank in the region around Baguio City, the Cooperative Bank of Baguio, started a micro-credit scheme three years ago.

"We realised even small credit is a very, very powerful economic and social instrument. If we have to serve, then we have to serve the poor too," says Norman Berlo, the bank's micro-finance officer.

This is particularly welcome news at a time when people are looking for a response from the private formal financing sector now that all banks, expect one, have been privatised.

The author is a journalist specialising in environment and science.

## BPDB's Local Tender Notice

Sealed local tenders are hereby invited by the Bangladesh Power Development Board for the procurement of following materials:

SI No	Tender enquiry no & date	Description of materials	Qty	Cost of tender document	Date of opening & receiving of tender
1	2	3	4	5	6
01.	Pur-223/99-2000/Rev. dt: 31.10.2000.	Earthing Rod.	1,00,00 0 nos.	Tk. 2,000/-.	22.11.2000.

The expenditure will be booked under operation & maintenance budget-2000-2001.

A complete set of tender document may be purchased by interested bidders on submission of written application and upon payment of non-refundable fee of Taka 2,000/- (Taka two thousand only) in the shape of Bank Draft/Pay Order favouring Director, Purchase, Power Development Board, Dhaka.

A bid bond equivalent to 2.5% (two and half per cent) of the offered price shall be submitted with tender. Tender will be received up to 11:00 AM and will be opened at 11:30 AM on the same date as mentioned in col no. 6 above in presence of the intending bidder or their representative if any. Tender document will neither be sold on the day of opening nor it will be received through Telex/Fax/Post/Courier etc.

BPDB reserves the right to accept or reject any or all bids without assigning any reason thereof.

Biddit/Jana-844(5)/2000-2001  
GD-1002

Director, Purchase  
BPDB, Dhaka.

## গণপ্রজাতন্ত্রী বাংলাদেশ সরকার

নির্বাচী প্রক্রিয়ার কার্যালয়  
শেরে বাংলা নগর গণপূর্ণ বিভাগ-২

চাকা

স্মারক নং ডি-২/টি-৩/৭/উন্নয়ন/২০০০-২০০১/১০৭৯

তারিখ: ২৬-১০-২০০০ইং

## পুনঃ দরপত্র আহ্বানের বিজ্ঞপ্তি

১। এতদ্বারা নিষ্পত্তি করার জন্য গণপূর্ণ অর্দ্ধবিপ্লবী সিভিল টিকান্ডার/ফার্ম এর নিকট হিসেবে ২০১১ নং বাংলাদেশ ফরাম শীলমোহর কর্তৃত খামে দরপত্র আহ্বান করা যাইছে। দরপত্র বিভাগীয় কর্মশালা, ঢাকা বিভাগ, শেরে বাংলা নগর গণপূর্ণ বিভাগ-১/২/৩/৮ গণপূর্ণ পিটি ডিভিশন/মেডিক্যাল কলেজ/অ্যাজিমুর/মার্তিল/সার্কার/মিল্পুর/সম্প্রদ/রক্ষণাত্মক/এবং ঢাকা গণপূর্ণ জেল এবং নির্বাচী প্রক্রিয়ালী (স্ট্যাট অফিসার) কর্তৃ আগামী ১-১১-২০০০ইং