



Discussion Paper BRIEFS

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Discussion Paper 178

Community-Driven Development and Scaling Up of Microfinance Services: Case Studies from Nepal and India

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Community action in the credit market is usually prompted by the need to improve the flow of information between borrowers and lenders. Left to itself, the credit market rations borrowers—whose creditworthiness is costly to assess because of lack of information. More often than not, poor households lack collateral, are thus considered risky borrowers, and are denied credit. Hence, a case arises for community action that acts on behalf of the poor.

But such community action is by no means automatic, at least when it comes to rescuing those in poverty. A key requirement of community-driven action is some critical level of convergence of interests within the community. Credit being a private good, convergence of interest is harder to achieve than a public good, such as a community road project, where it is much easier to build consensus. Also, because the excluded are usually the poorest in a community, convergence of interest within this deprived group is often insufficient to trigger the needed level of community action, given that the poor are general powerless and have a weak voice in society. Poverty-oriented, group-based microfinance institutions primarily aim to address the above shortcoming: they strive to align their services to the needs and preferences of the poor.

Purpose of This Study

This case study examines the scaling-up experiences of two microfinance institutions: the Nirdhan Utthan Bank Limited (NUBL) in Nepal and the Self-Help Group (SHG)-Bank linkage program of the National Agricultural Bank for Agriculture and Rural Development (NABARD) in India. Both NUBL and NABARD groups use self-regulation (peer selection, peer monitoring, and peer enforcement of contracts) as key to gaining access to services not otherwise available to them.

NUBL is what is known as a “Grameen replicator,” an institution that consciously replicates the main organizational features and practices of the

Grameen Bank of Bangladesh. Initiated as a non-governmental organization (NGO) and later incorporated as a not-for-profit development bank, NUBL operates in seven districts in southern Nepal. NUBL staff members actively identify destitute households in their operational area and motivate women from such households to form small groups. All group members agree to abide by a standard code of conduct. After some basic training, the women take turns borrowing small amounts of money from NUBL. Credit is provided without collateral and under group liability. All borrowers follow a standard repayment plan.

The NABARD program also makes group-based transactions a core principle. There are, however, two important differences. Unlike NUBL, however, NABARD is not in the business of providing financial services directly to the SHGs. Also unlike NUBL, NABARD is not directly involved in the process of group formation and operation. Instead, it provides financial and technical support to existing NGOs and other organizations that undertake the task of promoting groups in their locality and “linking” them with preexisting banks that provide the financial services. NABARD provides a combination of financial incentives and technical support to the banks so that the banks find it worthwhile to transact with the groups formed.

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Findings Related to Scaling Up

Both NUBL and NABARD’s programs have groups at the core of their operations, but for both, the principal lever facilitating group formation

and group action is located outside the immediate community of those who make up the groups themselves. NUBL provides well-defined banking services and oversees the process of group formation and conduct. NABARD, on the other hand, only indirectly facilitates group formation and their subsequent ties with banks—from cooperatives to private commercial banks. In the case of NABARD, the

dynamics of group formation and the quality of the group's interaction with the financial institution is greatly conditional on the type of NGO and bank selected to service the group. However, in both cases, standardization of the rules of conduct and of the basic service delivery mechanism (in NUBL's case, also financial products) was key to swift replication.

The Grameen experience in Bangladesh was instrumental in paving the way for the expansion of both programs. In Nepal, where the density of banking services provided by other financial institutions was low, NUBL chose to be a financial service provider and decided to replicate methodology of the Grameen Bank of Bangladesh. In India, where the density of banking services was already very high, NABARD recognized the core advantages of group-based finance as exemplified in the Grameen experience but decided to facilitate linkage banking instead. Simply put, the models responded to the different conditions in the two countries.

The NABARD experience was also different in that it was government-led. NABARD itself is a quasi-governmental body and receives critical support from both India's central bank and also from national-level policymakers. This has been a key factor in triggering the massive scaling-up witnessed in recent years. NUBL, on the other hand, was established as an alternative to government action. However, in both cases, government policy in the form of mandatory "priority-sector" credit played and continues to play a critical role in facilitating expansion.

The subsidy content of both NUBL and the NABARD program is quite high; further, continued expansion of both programs is highly conditional on

whether the policy regime of directed credit continues on in the future. Any change in this policy will deal a severe blow to both these institutions.

Provisioning group-based credit is costly, as it is facilitator-intensive. In the case of NUBL, staffing requirements are so high that it has so far not been possible to scale up services in more remote and sparsely populated mountainous areas. NUBL is currently searching for alternative models to expand services in these areas. In India, expansion of services in the more remote northeastern states has been hindered by the high cost of setting up and operating SHG-promoting institutions. One option in both countries is to induce the development of group federations that eventually become self-financing and self-regulating. Instances of well-functioning group federations are emerging in parts of India, and federations may well be the key to consolidating the gains made so far, ensuring that the programs are primarily driven by the interests of clients, and an eventual ending of subsidies.

Conclusions

These case studies show the importance of the broader national environment in facilitating the growth of institutions. NUBL's growth leveled off just as the expansion of SHGs accelerated in India. This was not a coincidence: the Maoist insurgency in Nepal severely restricted the development of the microfinance sector, while an enabling environment in India facilitated its unparalleled expansion.

Keywords: microfinance, scaling-up, community development, NUBL, NABARD, Nepal, India

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