

SYNTHESIS

Welcome to *Synthesis*

We are delighted to bring to you the first issue of *Synthesis* — IFMR Foundation's quarterly thought piece. IFMR Foundation is a not-for-profit entity promoted by IFMR Trust that shares the mission of ensuring that every individual and every enterprise in India has complete access to financial services. We seek to uncover the systemic reasons that access to financial services is constrained and then address these by influencing policy and practice. In doing so, we rely on advocacy, applied research and diffusion of innovations as key tools.

Our vision of an inclusive financial system entails continuous, reliable, flexible and convenient delivery of financial services at the 'front-end,' and at the 'back-end,' the aggregation of risk by a range of diversified, well-managed and well-capitalised institutions. This vision of a financial system would necessitate appropriate transfer of risk between the front-end and the back-end and sufficient financial markets infrastructure (credit bureau, payment systems). To pursue our mission, we will work on different elements of the financial system, while focusing our energy on levers of systemic change.

Since its inception about a year ago, the IFMR Foundation team has applied its focus and resources to initiate action research projects, provide incubation support to new institutions, and to document and disseminate knowledge.

Our central intent has been to become a creative and strategic group that can deploy its ideas, energies and funding to create leveraged impact on the state of access and use of high-quality basic financial services for the financially excluded in India.

Motivated by a common interest in delivering financial services to rural migrants, we have developed an action research and advocacy initiative in partnership with Aajeevika Bureau in Rajasthan. The effort is to understand the rural

migrants' need for financial services and build operational models for delivering these services, while advocating to create a more favourable regulatory environment for providing access to financial services for migrants.

IFMR Foundation also provided incubation finance to Centre for Innovative Financial Design (CIFD), a new research and resource centre being set up at IFMR, Chennai. CIFD has been set up with a view to creating usable conceptual advances in financial design for emerging markets like India, and to actively disseminate them to financial designers and policy makers.

The Centre's work revolves around the innovation, testing, diffusion of financial design principles to improve and create more effective access to finance for the poor and middle-class within emerging markets.

The IFMR Foundation team has also written a paper that brings together

empirical learnings and policy imperatives on the possibility of enhancing financial inclusion by linking it with social security programmes like National Rural Employment Guarantee Scheme in India. We continue to work closely with other entities promoted by IFMR Trust — particularly in the design and evaluation of the Kshetriya Gramin Financial Services (KGFS) model of financial services origination for remote rural India.

Given our mission and strategy, it is critical for us to actively learn from and communicate to various organisations and people working in the domain of financial inclusion. We sincerely hope *Synthesis* will emerge as a vehicle to do that.

IFMR Foundation works through a number of partners, each of whom is doing fascinating and important work in bridging knowledge and practice gaps with respect to financial services. Through *Synthesis*, we will put this work under the spotlight.

We eagerly anticipate your active participation in this endeavour.

IFMR Foundation is working on an initiative for ensuring financial services to migrants.



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Ideas for increasing financial inclusion

The October 6, 2008 issue of *India Today*, a special issue on ideas for 'Transforming India', featured an article co-authored by Suyash Rai and Joy Miller of the IFMR Foundation, together with Dr Nachiket Mor, President of ICICI Foundation for Inclusive Growth. The article presented some key ideas that can change the landscape of financial inclusion in India:

- Allowing automatic branch licensing in rural India and priority states for local and international players – banks and non-banks – as well as automatic licensing for non-banking financial companies (NBFCs) and, at Rs 250 million of capital, automatic licensing for rural banks after a strong financial fitness test
- Removal of geographical and other restrictions and allowing more institutions (including NBFCs) to act as business correspondents
- Developing innovative ways to ensure that people's access to the financial system is not unnecessarily hindered due to the 'Know Your Customer' (KYC) restrictions
- Deregulation of interest rate ceilings on savings accounts and allowing a direct link between bank accounts and money market mutual funds
- Aggressively promoting the PAN card as the universal identity card
- Building a biometric identification system that can be used by a variety of service providers and allow even illiterate people to benefit from secure transactions
- Establishment of a credit bureau, which combined with a proper identity system, will allow individuals to build credit histories over time, permitting registered lenders to access an individual's credit score and enabling reliable payers to get credit on better terms and lower interest rates.

The solutions are well-tried and tested, and the problem is urgent. The choice is between taking a few measured steps to increase inclusion



Each citizen has to be given the **RIGHT TO SAVE** and the opportunity to invest. It's not rocket science. It's democracy.



India adds more than six million mobile phone users every month, but fewer than 30 per cent of farmers take loans from formal sources, under \$1 per cent of all households have insurance and a mere 1.6 per cent of wage earners invest in mutual funds. It has been difficult for several decades that access to basic financial services continues to lag and that it is an essential service for subsistence and growth among low-income households. The unambiguous link between access to financial services and reduction of poverty in rural India has also been suggested by academic research. Why then has the goal of financial inclusion proved so elusive? Could it be the case that while there is a great deal of talk and hand-wringing all around, we are not really serious about this? That we know what needs to be done but for some reason we are not keen to do it? Here is a set of ideas that can make a difference in this landscape. They are neither new nor bold, they have been well-liked elsewhere in the world and they are well within our capability to carry out here and now. So, why have they not been implemented in India? #1 Let there be more banks and bank branches. We continue to require licensing for all new bank branches and cities. We have rolled back on Local Area Banks, stopped awarding new bank licenses and lightened licensing of Urban Cooperative Institutions and Non-Banking Financial Companies (NBFCs), giving our biggest efforts to revive cooperative banks and the government-owned commercial banks. While these efforts could add some value, we already know that they are not going to provide

and allowing existing informal mechanisms to rule the financial lives of India's un-served majority.

The article can be accessed on *India Today's* website.

EVENT

'Indian micro insurance: What works?'

A conference on technology, regulation & trends

On September 19, 2008, IFMR Foundation, together with Centre for Insurance and Risk Management (CIRM) and *Microfinance Insights* hosted 'Indian micro insurance: What works?', a day-long conference at the Oberoi Hotel in Mumbai. NABARD was the lead sponsor of the conference. Additional sponsorship was

provided by FINO and Life Insurance Corporation of India (LIC).

The conference provided policymakers, micro insurance providers, technology enablers and others the opportunity to discuss ways of maximising efficiencies, improving sectoral management and controls, and scaling-up outreach in the micro

insurance sector. Panellists included Manish Khera, chief executive of FINO; A Ramanathan, NABARD chief general manager; Rupalee Ruchismita, executive director of CIRM; S V Sunder Krishnan, chief risk officer, Reliance Life Insurance Company Ltd, and Dr Nishant Jain, a leading researcher in the field of health insurance in India.

Participants discussed ways that technology can overcome challenges faced by the micro insurance sector, for example, by reducing transaction costs, increasing transparency and enhancing efficient claim settlement. Panellists were optimistic that mobile phone and other technology could facilitate delivery of micro insurance products, but stressed that for all technology, issues of security, viability and connectivity must be resolved.

While discussing regulatory issues, participants suggested that bold changes in the administrative and regulatory system were needed to enable micro finance penetration in rural areas. Finally, participants highlighted trends in product design and models of delivering risk hedging products.



CENTRE FOR MICRO FINANCE

Health insurance Opportunities and challenges

Micro finance institutions (MFIs) may be able to help mitigate catastrophic health shocks faced by poor households by providing health or accident insurance. Being uniquely placed to offer insurance to a large number of people with minimal marginal costs, several MFIs have introduced catastrophic health insurance as a mandatory 'rider' service with new loans.

To evaluate the impact of this 'rider' service, Centre for Micro Finance (CMF), Abdul Latif Jameel Poverty Action Lab (J-PAL) and SKS Microfinance Pvt Ltd (SKS) in February 2007 initiated a randomised experiment to evaluate the impact of offering health insurance to micro lending clients.

When it concludes in June 2009, the project is expected to provide data covering 7,000 households and some 28,000 adults in northern Karnataka, where SKS has introduced its Swayam Shakti catastrophic health insurance cover. Among the questions to be addressed by the project are: What is the quantified need for health insurance among the rural poor in India? How does the additional cost of a health insurance premium affect client drop-out rate? Does the availability of health insurance help clients overcome health crises?

At this preliminary stage, the data suggest that micro finance institutions are indeed effective channels for the delivery of health insurance. The insurance 'rider' has not led to clients dropping out, nor has it affected the composition of SKS clients. Future research will assess the benefits to the clients.

At this stage, the baseline data also reveal a considerable unmet demand for insurance. While fewer than 1% of households have accident or health insurance, 93% of households experienced a serious health event in the past year, at an average cost of Rs 1,900. Almost half the households resorted to a loan to pay this expense. Though they are already members of a micro credit organisation, the data suggests that SKS households continue to face considerable financial risk due to health events. Bundling health insurance with micro finance loans may be a particularly promising mechanism for mitigating the high cost of health shocks among SKS clients and other rural poor in India.

CMF recently published a toolkit which details how SKS has rolled out its health insurance product in order to help other practitioners and players in micro finance understand product features and implementation challenges. To access the toolkit, please go to www.ifmr.ac.in/cmfi

CENTRE FOR INNOVATIVE FINANCIAL DESIGN

Pregnancy financing Financing for predictable expenses

Lack of financial access has clear implications for health. Medical expenses drive many to expensive debt, while others are unable to finance any care at all. Centre for Innovative Financial Design (CIFD) is collaborating with Hand in Hand, a public charitable trust based in Tamil Nadu, ideas42, an initiative based at Harvard University, and IFMR Trust, to develop a project to create and test a product to finance institutional delivery. If successful, it would allow women to give birth with the safety of resources provided by a health centre rather than a riskier home delivery. The product also tests an interesting financial design insight: can savings behaviour predict repayment behaviour?

To understand the scalability of this product and its underlying financial design principle, the following questions would be crucial:

Can financial access increase institutional delivery rates? While health is a primary concern for households in India, many do not have the ability to finance their healthcare. With a missing insurance market, households face significant financial constraints in

meeting their health needs, creating financial shocks that further impoverish them. Lack of financing also drives healthcare decisions that are suboptimal for a household's long-term health. For instance, even with the known benefits of prenatal care and institutional delivery on maternal and infant health, in India, only 51% of mothers had the recommended number of prenatal care visits and just 41% of births occurred in an institution.

Can savings behaviour predict repayment behaviour? CIFD has designed a financial product that requires women to save during the course of their pregnancy. Near delivery they receive a loan that is a multiple of their savings. Tracking savings behaviour prior to disbursing the loan and repayment behaviour after delivery allows us to determine the effectiveness of savings as a screening mechanism.

A mini pilot is being implemented with a small number of SHG members to test the product's operational model. A large scale rollout is planned, which will allow evaluation of the effectiveness of the product design.

CENTRE FOR INSURANCE AND RISK MANAGEMENT

Scaling up low-cost weather insurance for small and marginal farmers

Centre for Insurance and Risk Management (CIRM), in collaboration with Government of Rajasthan (GOR) and Confederation of Indian Industry (CII), is developing innovative market-based weather risk management solutions for farmers in Dungarpur district of Rajasthan.

The project aims to address critical issues such as *low outreach, covering the weather event at the customer's location, high basis risk, high premium rates and poor weather monitoring infrastructure and data issues*, thereby creating a model that could facilitate affordable, scalable and sustainable weather risk management solutions.

A critical problem in designing index-based weather insurance contracts is that of basis risk, ie, the risk that the farmer may not receive payouts in the

event of a loss or that payouts may be made though there is no loss. CIRM has initiated the process of creating weather infrastructure to overcome this risk. In the first phase, weather sensors have been installed in two villages of the district, with Weather Risk Management Services Ltd as the implementing partner. In a demand assessment study, low level of understanding, high illiteracy and lack of trust in insurance due to bad past experiences with crop insurance were found to have a significant negative impact on the demand for weather insurance. Still, the farmers were more than willing to buy weather insurance if they were assured transparency. The first phase of the pilot launch is due for the rabi season of 2008. The lessons from each phase will contribute in customising the product further.

FOCUS ON A PARTNER



Centre for Innovative Financial Design (CIFD)

Despite the staggering growth of India's financial sector, many financing needs remain unmet. To spur the financial innovation that is required to meet these needs, a new financial framework is required — one that is attuned to the unique features of emerging markets, such as contractual difficulties, missing markets, customers with low and volatile incomes, and the

need for project financing at the individual level.

CIFD works to create usable conceptual advances in financial design for emerging markets and then to actively diffuse them to both financial designers and policy makers. The Centre's work revolves around the innovation, testing, and diffusion of financial design principles to improve and create more effective access to financing for the poor and urban middle-class within emerging markets.

Excerpts from the INDIA DEVELOPMENT BLOG...

Maintained by the research staff of Centre for Micro Finance (CMF), Centre for Development Finance (CDF), and Centre for Insurance and Risk Management (CIRM), www.indiadevelopmentblog.com is a lively forum for exchange and expression of ideas and opinions. Here are excerpts from some recent posts*:

PRINCIPALS, AGENTS AND BAILOUTS

For anyone paying any attention to any kind of press, there seems to be an unending stream of thoughts analysing the financial crisis in the US. This has made skipping the finance page and heading straight for the cricket news that much more difficult, and, as such, I find myself reading about the crisis and comparing the issues involved to analogous ones in development...

On the downside, the very people who caused this crisis are getting bailed out by taxpayers and only have to endure some bad press and corporate restructuring; the proverbial slap on the wrist. While a perhaps radical juxtaposition, these arguments remind me of the debate on the Indian Government's recent loan waiver programme...

Posted by Nilesh Fernando, September 29, 2008

Read more here: <http://www.indiadevelopmentblog.com/2008/09/principals-agents-and-bailouts.html>

JUDGING FOR-PROFIT MICRO FINANCE

One of the most controversial discussions that emerged from the recent Microcredit Summit Campaign conference in Bali was Mohammed Yunus's scathing condemnation of for-profit micro finance company Banco Compartamos, which with much fanfare, recently held an IPO that raised almost \$500 million.

Compartamos started as a typical nonprofit MFI, but switched over to a for-profit model in 2000, and has now become one of the world's first publicly traded for-profit micro finance companies.... But how does one distinguish micro financiers from money-lenders? Making any such distinction is more of an art than a science, and therefore involves drawing a line in the sand. Interest rates alone are an insufficient gauge as they provide almost no information on actual outcomes of loan recipients. It is distinctly possible for high-interest microloans to ultimately benefit poor clients when initial returns to capital are high (research indicates that they often are), which suggests that attempting to distinguish "good" and "bad" microcredit on the basis of interest rates alone is rather misguided.

Posted by Selvan Kumar, August 18, 2008

Read more here: <http://www.indiadevelopmentblog.com/2008/08/judging-for-profitmicrofinance.html>

*Views expressed in the blog do not necessarily reflect views of IFMR, CMF, CDF, CIRM or IFMR Trust.

ANNOUNCEMENTS

IFMR FOUNDATION

Livelihoods India Conference and The State of the Sector – Livelihoods Report

IFMR Foundation supported the Livelihoods India Conference, which was held on November 13, 2008, and focus-ed on challenges and issues related to the livelihoods of the poor. The theme for this year's conference was 'Inclusive value chains', and focused on how the emerging and potential value chains can be made inclusive, such that the poor can effectively participate and thus, improve their livelihoods. For more details see: www.microfinanceindia.org

IFMR Foundation also supported *The State of the Sector – Livelihoods Report*, which has brought together experiences and challenges, case studies, progress on programmes and policy related issues. The report focuses on the poor, programmes and plans, policies, promoters and the private sector. A group of authors including Vijay Mahajan, Orlanda Ruthven, Ajay Tankha, Ramesh Arunachalam and Girija Srinivasan were associated with the process, and the initiative was steered by ACCESS and the Livelihoods School, Hyderabad.

CENTRE FOR MICRO FINANCE

Researchers Alliance Programme

CMF is commencing the Researchers Alliance Programme, a research capacity development programme targeting Indian researchers currently working on or interested in working on micro finance research. This programme aims to provide over three years of research-support services to approximately 20 highly motivated researchers in early-to mid-career. This programme is financially supported by the Ford Foundation.

For details of the programme, please see: www.ifmr.ac.in/cmfrap.html

AN IDEA WHOSE TIME HAS COME?

Cash management inefficiencies

In the absence of extensive use of electronic money and electronic payment system implementation, a significant component of the transaction cost of institutions serving in remote rural locations is the cost of cash/currency movement.

There are also serious delays in point to point movement of cash. That rural micro finance clients pay for these systemic inefficiencies is a perverse outcome of this systemic problem. These clients in remote locations obviously pay more than clients in urban locations, and those who are poorer may be paying more as a share of their income.

We believe that the first step in the process of advocating for change is precise documentation and quantification of these cash management costs and the micro drivers of the same. Subsequently, we need to identify the key bottlenecks and suggest changes that could have high returns. IFMR Foundation is putting together an initiative around this theme. This will involve:

- undertaking empirical investigation on practices and costs of cash management
- identifying key bottlenecks that prevent greater use of digital money in India
- undertaking desk reviews on relevant practices in other countries
- generating ideas for piloting some innovations that could radically reduce the costs and increase convenience for clients by exploring the role of technology
- recommending and advocating for policy changes

We welcome your suggestions on this idea. Since the initiative is in a formative stage, your inputs could greatly enrich it. Please write to: ifmrfoundation@ifmrtrust.co.in

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