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Financing Livelihoods of the Economically Marginalized

Summary

The past few decades have witnessed poverty alleviation in India. Much effort went into the formation and nurturing of SHGs and federations which was followed by promotion of microfinance. However, over time it has been realized that providing credit alone is not the answer to creating sustainable incomes for the poor. Having come face to face with this reality, today, most of the formal financial institutions including microfinance and funding agencies are directing their focus to livelihood financing. As intervening in livelihood promotion is far more challenging than developing the efficient delivery of financial services, many microfinance organisations have, in fact, moved away from livelihoods promotion.

Need for financing livelihoods of the economically marginalized

In the realm of financial inclusion of poor, even though efforts like promotion of SHGs among others have fallen in place, there are still large gaps. In terms of micro credit, India has nearly 400 million people living below or just on austerely defined poverty line.

Approximately, 75 million households need microfinance and livelihoods support. NABARD alone had a target of bank loans for nearly one million SHGs by 2008 with absorption of at least Rs. 50,000 million worth of funds. With time, it was observed that providing micro credit does not necessarily enhance the income of the household sustainably.

Rather, the debate making the rounds today is between the minimalist credit provisions vs. integrated services for enhancing their income.

Therefore, ideally, the approach has to be in promoting livelihoods as an end result which will enhance incomes sustainably. Enhancing sustainable income involves a host of arrangements including creating assets, sustainable cash flow, reducing risk, providing control and ownership on created assets and democratic decision making.

However, intervening in livelihood promotion is far more challenging than developing the efficient delivery of financial services. Owing to this fact, many micro finance organizations have, in fact, moved away from livelihoods promotion.

Importantly, the financial agencies are unable to see the markets and opportunities beyond agriculture.

Ideally, the focus should also be on off-farm and small micro enterprise development, for which financing should be on fixed assets requirement, working capital, skill upgradation and expansion or diversification of livelihoods options.

Key challenges

It is clear that livelihood promotion depends on a range of resources like natural, human, social and physical. Financial resource is an important resource among the range of resources. But in truth, in their aspiration to fund these enterprises, the funding agencies and Micro Finance Organizations (MFOs) are up against a number of constraints. Some of the key challenges they face in promoting livelihoods are explained in the following paragraphs.

"Even after the efforts like promotion of SHGs, there are still large gaps in financing poor. India still has nearly 400 million people living below or just on austerely defined poverty line."

1 - Constraints related to groups, products and services

The challenges become most evident when there is a need to serve a wider range of groups (wage labourers, small and marginal farmers, artisans, fisherfolk, households, weaving labourers, livestock rearers, small and medium entrepreneurs and vulnerable groups) in varied geographical settings with range of livelihoods options and appropriate products.

There are many new financial avenues in the market like equity, debt, venture and grant funds. It becomes vital for the financial institutions to understand the needs of a variety of institutional forms like the SHGs, cooperatives and producers companies and provide services accordingly.

Institutional Forms	Source of Financing	Type/ Mode of Financing
SHGs	Bank	Venture
Federation	Local Agencies	Equity
Co-operative, Trade Union	MFOs	Grant
Producer's Company	Funding Agencies	Debt

As the aggregate scale of demand for financing household livelihoods needs is too large (approximately Rs. 60,000 * 5 to 6 Crore households), ensuring availability and management of such an enormous sum becomes a big huge challenge. Hence, there is a need to develop products and process technologies that are cost effective (like reducing the transaction costs) in order to reach the large and dispersed settlements of poor.

2 - Individual household vs. project financing

The present trend of integrating micro finance and livelihoods services at the household level requires efforts from the financing institutions to know about the financial absorption capacity of a household for different livelihoods options. Experience shows that the idea of financing a person rather than a project is difficult for the formal institutions, since this makes it difficult to ascertain the credibility or legal status of a loaner. Besides, it also requires a thorough assessment of the capacities of the concerned person/households as well as their aspirations and strengths. There are also other issues related to repayment, interest rate and security need for such loans.

3 - Collateral/Security

There has always been the issue of collaterals against lending loans. Livelihood financing usually goes for financing bigger loans (size, duration) than microfinance lending. There is a need to develop a new collateral mechanism that goes beyond the group mechanism to take care of the risks involved in long term and large scale loans. There is also a dire need to develop a risk pooling mechanism to protect the poor from failure and the potential debt trap. Overall, there should be more focus on saving-linked lending and insuring the productive assets so that the poor can absorb potential shocks and stress.

"The issue today is not access of money by formal institutions, rather how to manage the available fund."

4 - Institutional challenges

Looking at the situation of managing capacity of fund by existing SHGs and federation, low financial literacy among the SHGs seems an area of concern. Managing bigger loans or funds for livelihoods promotion by existing SHGs/federation also looks difficult. The issue today is not the access of money by these formal institutions, but rather managing the available funds. Even at the cooperative and federation levels, the capacity of hired employees to manage the funds is lower. Building capacities for fund management is required on a priority basis.

Financing livelihoods requires that most agencies support promotion and establishment phases of collective institutions. However, the costs incurred during these phases are very high, especially in community-owned entities like cooperatives and trade unions. However, these resources are not available any more.

With the growth of cooperatives and producers companies, there is a need to look at the investment needs, especially in the processing, marketing and infrastructure. Further, one needs to look for investments that are most suitable for financing. It has been felt that there is dearth of quality intermediary agencies who sufficiently understand the life cycle and growth needs of these institutions. Surprisingly, one does not even have standard rating tools to evaluate and value such institutions for financing. Besides, ensuring organizational autonomy of these institutions and providing value added services in the course of promoting livelihoods of poor are the other dire needs.

5 - Managing Risk

While promoting enterprise around the selected activities, one needs to enlarge the basket of solutions to manage their enterprise risks. Depending purely on insurance as a risk mitigation measure is not going to solve the requirements of poor. The requirement is to incorporate risk reduction/prevention and diversification strategies, both traditional as well as newer approaches. There is a challenge in identifying how to expand these options for the poor.

The way forward

In the past few decades, efforts were centralized in the formation and nurturing of SHGs/federation and promotion of microfinance. Yet, the future will surely focus on livelihood promotion with these groups. Although this approach of livelihood promotion was started way back in 1980, many agencies have concentrated on promotion of micro finance. Considering the challenges in promoting livelihoods, improving outreach and larger financial inclusion, there is a significant requirement for newer innovations at different levels. These innovations should focus clearly on reducing transaction costs to reach the poor and address the need for collateral.

Innovations are also required in sources, delivery mechanisms, and products to meet needs like savings, credit and risk management. Although these innovations are already happening across various sources like equity, debt, grant and venture funds, the pace and reach have to increase considerably.

Importance to the existing livelihoods options, especially for the emerging green initiatives, needs to be given. The support to such initiatives through government programmes is yet to emerge on a large scale. The need of the hour, however, is supporting such initiatives on priority basis as there are ample opportunities. The way CII has created a venture capital for such initiative could be a good example.

Recent Trends in Financing Poor

There are several models which have emerged recently in financing the poor. The significant ones in reaching the poor with livelihoods financing include:

1- Peer to peer lending and grant making

2- Venture funds and Angel Investors

3- Community enterprises

4-Nationalised banks

5- Loan funds of donor agencies

1-Peer to peer lending and grant making

Peer to peer lending and grant making is a process by which individuals across the world can directly choose the purpose/need, project/program and organization according to the cause they would like to support from a variety of possibilities. This is being made possible due to the emergence of information technology as an efficient intermediary medium. The evolution of online banking has also played its part in the success of this mechanism. Give India (www.giveindia.org), Good Gifts (www.goodgifts.com) and other such sites are mobilising grants for various development projects. There are a couple of websites for microfinance too: (www.capitalconnect.org), (www.indiadevelopmentgateway.org). These have been attempting to create more options for lending, using the peer to peer mechanisms.

2 - Venture funds and Angel Investors

Venture funds and angel investors are fast emerging as key players in promoting enterprises. Although focusing on the microfinance enterprises, they are looking to expand their base in enterprises which promote large volume of livelihoods. However, most of them are coming up with equity funds, and not debt funds windows, which deny the producer companies and cooperatives access to such funds. In addition, since they operate in the high risk and high return portfolio, they expect very high returns. However, if the objective is to support wealth creation for the poor, these funds should ideally come at a lower cost. Therefore, it will be interesting to see how these funds are able to tailor their terms to meet the livelihoods requirements of the poor.

3 - Community Enterprises

Under various government projects funded by bilateral agencies like the World Bank, Asian Development Bank and Japan Bank for International Cooperation - community enterprises are being formed. They are being supported with revolving funds from the agencies. The income on the revolving fund is helping these institutions to meet their operational costs. These enterprises are mostly being promoted by the State government departments which, in turn, pass on this money to community enterprises once they are promoted.

4 - Nationalised banks

The national banks have products like the collateral guarantee scheme for small and medium enterprises. The banking correspondent model being offered by SIDBI extends services to the poor. Both these innovations are aimed at extending the reach of formal agencies to the poor.

5 - Loan funds of donor agencies

HIVOS and Ford Foundation have special funds to give out loans at lower costs to promote productive investment. More donor agencies should have such multiple financing instruments which are available to finance the livelihoods of the poor.