

*Full Length Research Paper*

# **Sustainability of NGO-type microfinance service provider in Shaanxi, China: Peer with Grameen Bank, Bangladesh**

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**This paper examined the sustainability of nongovernmental organisation (NGO)-type microfinance service providers (MSPs) in Shaanxi province, China in comparison with Grameen Bank (GB), Bangladesh. Despite geographical restrictions, the selected MSPs successfully expanded their services to isolated mountainous regions where formal financial institutions were not in existence earlier. Overall business performance of the sample institutions were found well. They built a strong financial and informational network with Plan China (country office of Plan International), China Association of Microfinance and women federation (Shaanxi province). However, the lack of funds, limited service provisions and restrictive policy environment shackles the industry from further expansion; necessitating urgent remedial steps for resolving existing barriers and allowing these institutions to participate in China's growth. The undertaking of similar research in other provinces was suggested for a better understanding of the Chinese microfinance sector.**

**Key words:** Microfinance service providers, China, China Association of Microfinance, Grameen Bank, Bangladesh, sustainability.

## **INTRODUCTION**

Microfinance sector is growing fast in terms of outreach, coverage, loan amounts and micro-savings, with services reaching over 150 million clients across the globe, and growing at around 25 to 30% annually (Pacheco et al., 2010), defying all conventional wisdom of financing the poor, while maintaining financial viability (Morduch, 1999; CGAP, 2006). The sector has developed and improved several unique and creative methodologies for their financial inclusion goals, and is considered to be one of the key instruments for poverty alleviation and economic growth in developing countries.

Like many developing Asian countries, both Bangladesh and China have adopted microfinance to reach out and integrate their poor into the economic mainstream. Bangladesh adopted microfinance early on and has made tremendous progress in developing

innovative micro-credit models, diversifying services, expanding outreach and achieving sustainability (MRA, 2009; Rahman and Luo, 2011b; Ahmed, 2010); with the Grameen Bank's (GB) group lending methodology proving to be one of the most successful models, serving over 8 million clients in Bangladesh.

China adopted the GB micro-credit model on an experimental basis in 1993. And consequently a number of different types of microfinance service providers (MSPs) were established within the Chinese financial market - including NGO-type institutions, formal financial institutes (state owned commercial banks), international donor agencies in collaboration with the Government and Government agencies (focused on poverty alleviation). These MSPs developed and adopted diverse credit models and innovative approaches (taking into consideration the country's policy environment) for their objectives.

In fact, there is great prospect, and a huge demand for microcredit service in China - large rural population with

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high levels of unemployed workers, numerous small and medium enterprises (SMEs) and limited outreach in rural areas (He, 2008) - the Chinese MSPs, particularly the NGO-type microfinance institutions (MFIs), have been unable to make much progress over the years. This has been attributed to a lack of supportive policy environment and the absence of a dedicated regulatory authority for the sector.

Previous research findings (Park and Changqing, 2001; Cheng and Abdullahi, 2010) establishes the effectiveness of GB model in China with respect to reaching poor clients; and the superior performance of NGO-MFIs, compared to the formal financial institutions. However, they also emphasise the need for further methodological innovations. Sun (2002) draw attention to other globally practiced micro-credit models alongside the GB model, while Lau (2008) focuses on NGO-type MSP sustainability with emphasis on poverty alleviation targets, especially in a liberalised China. There are two distinct arguments have emerged from these studies on the issue of MSP sustainability and regulation, one view holding that regulation might hinder the microfinance development process from attaining of sustainability, supported by Christen et al. (2000), Mersland et al. (2009a) and Dichter (1997); while the others agree on a limited, soft regulatory regime towards sustainability<sup>1</sup>.

Keeping previous reviews in mind, the present study focuses on the sustainability of NGO-type MSPs in China, taking GB as the peer model - something never carried out before. This study critically evaluates the overall performance of three NGO-type MSPs in China (Shaanxi province) and compares them with GB. More specifically, the paper is focused on outreach, credit performance, financial sustainability and regulatory situation of the selected MSPs.

## METHODOLOGY

The study employs both primary and secondary source of information. Primary data was collected by adopting qualitative and quantitative approach. Shaanxi province was selected for the field investigation based on three criteria: a) China's most successful province in microfinance services; b) Higher concentration of NGO-type MSPs, and; c) Sample counties are state designated poor counties.

A total of three NGO-type MSPs were selected out of five [only five NGO-type MSPs have membership status with China Association of Microfinance (CAM) in Shaanxi province] by applying random and purposive sampling technique. The Xixiang Women's Development Association was chosen as the organisation received the first national welfare award in 2009. Pucheng Women's Sustainable Development Association and Chunhua Women Development Association were selected randomly from the remaining four CAM members. A detailed field survey was carried

out with the selected MSPs during July-August, 2010. In addition, telephone interview/conversation was carried out with MSP staff whenever information discrepancy appeared.

Meanwhile, focused group discussion (FGD), financial resource mapping (FRM) and problem tree (PT) tools were adopted to gather information from clients. A total of six FGDs were conducted - three with credit beneficiaries and three involving non-credit beneficiaries in the three selected villages, of the three counties. After gathering information, applying bottom-up approach, in-depth institutional survey data were analysed and presented in a meaningful way. Finally, collaborative relationship approach was applied to determine the relationships among stockholders.

## RESULTS AND DISCUSSION

### Performance of the selected MSPs

The overall performance of the selected MSPs was measured in relation to outreach, operational mechanism, financial sustainability and regulatory status.

### Outreach

Microcredit outreach refers to the ability of MSPs to provide financial access to a large numbers of borrowers who had previously been denied such access. It is notable that micro-credit outreach has expanded tremendously in most Asian countries, including China, over the last few years. Quoting example from the study area, Dongbu village of Chunhua County and BaYi village of Xixiang County are remote communities encircled by mountains, and underdeveloped in terms of transport, communication and market infrastructure, with the area lacking livelihoods opportunities. They had no access to any financial services and largely depend on informal sources for their financial needs. Formal financial institutes were reluctant to extend their services to these remote areas, and were sceptical of their ability to repay, preferring instead to lend only to larger small and medium enterprises (SMEs). Furthermore, the complex application procedures and collateral requirements made it difficult for such communities to access their services. Encouragingly, the selected MSPs Xixiang Women Development Association (XWDA), Pucheng Women's Sustainable Development Association (PWSDA) and Chunhua Women Development Association (CWDA) successfully extended their services, bringing micro-credit to these remote communities for the first time. The three MSPs expanded their micro-credit services to 5633, 6555 and 2620 clients, and increased their services from 3, 4 and 3 townships to 8, 6 and 4 townships respectively (cumulative no. end of July, 2010; Figures 1 and 2), despite the geographic limitations (remote and isolated communities) and policy restrictions (permit to operate within the county). It should be noted that GB, which has no such geographical or policy restrictions, cover 83,458 villages, with 2562 branch offices spread across the whole country, serving 8.28 million borrowers

<sup>1</sup> Including Bagyenda (2010) and Okumu (2007) from Uganda; Vada (2010) from Cambodia; Diaz (2010) from Mexico; Vento (2010) from England; Kereta (2007) Ethiopia; Chiymya (2006, 2010) from Zambia; Mohanty (2010) from India; He et al. (2009), Du (2005) and Sun (2008) from China; Rashid et al. (2010) and Haq et al. (2008) from Bangladesh

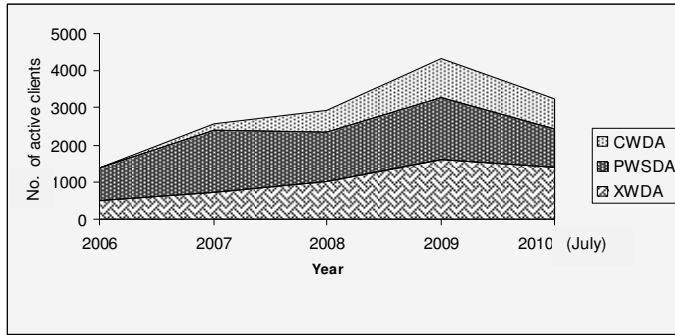


Figure 1. Outreach of each MSP during 2006 to 2010.

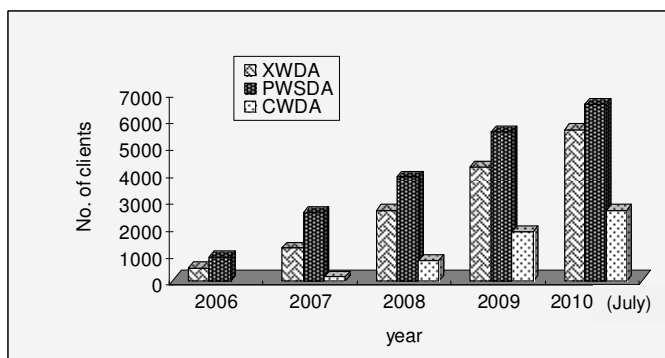


Figure 2. Cumulative outreach by each MSP during 2006 to 2010.

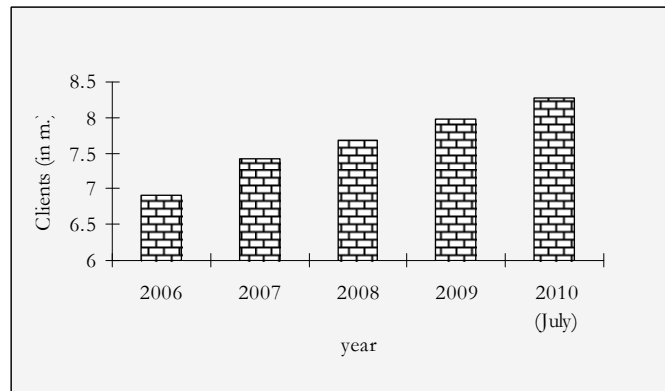


Figure 3. Cumulative outreach of MSP during 2006 to 2010.

(cumulative no. end of July 2010; Figure 3).

They also have like most other Chinese MSPs adopted the group guaranty system over traditional form of collaterals. Figure 4 shows the percentage of active women borrowers for the three institutes, XWDA, PWSDA and CWDA, were 97, 97 and 95 respectively, which was similar to GB Figures (97% women clients).

The FGDs yielded some interesting information, clients

gratefully acknowledged their ability to access financial services, but claimed an insufficiency of funds. They informed that the service charge on MSP loans were lower than informal sources, but higher than formal institutions (state owned banks). Generally, rural credit cooperatives (RCCs), as a formal financial institution, offer loans at around 8% service charge, whereas the selected MSPs offer is at around 11%. Clients revealed that though they mostly do not pay interest when borrowing from friends and relatives (informal sources), but there were instances where they had to pay a higher interest (15 to 20%) on such borrowings. However, their dependency on friends and relatives were decreased after the micro-credit services reached their village through the initiative of these MSPs. They also advised that the application and approval procedure for MSP loans were reasonably simple.

### Operational mechanism

The selected MSPs follow a modified GB model for their micro-credit services (Plan China, 2009). Generally, they adopt the following lending procedure - selecting village, motivating villagers, group formation, household investigation, group training and awareness building, and electing group leaders. This was followed by application for loans, loan disbursement and, finally, repayment through quarterly instalments. But, like all other Chinese MSPs, they too were restricted from deposit collection.

As per regulations, the manager or loan officer required to make weekly visits to the villages for monitoring credit function, and developing a friendly relationship with the clients. But the researcher's field investigation found no such monitoring or rapport building exercise. In fact, the borrower was responsible for paying back loans at the MSPs' offices, rather than the loan officers collecting instalment from the villages. This causes lower interaction between borrowers and loan officers, and can lead to alienation. Furthermore, group training for these MSPs did not involve training for entrepreneurship or enterprise management rather it was limited to creation of group awareness and group responsibility only.

Though GB too lack supervised or productive credit services in Bangladesh, the differences were apparent weekly versus quarterly instalments, loan officers collecting instalment from clients against clients visiting MSP offices, non-requirement of formal application for lending versus formal application requirement, which were completely different from the GB model. Further, GB can offer supplementary services including deposits, micro-insurance, remittance, pension, training, education, health and social awareness programs, which is known as credit plus-plus approach.

It is widely accepted that only micro-credit cannot change the livelihood of the poor particularly the womenfolk. Hence, the concept of 'credit plus' approach

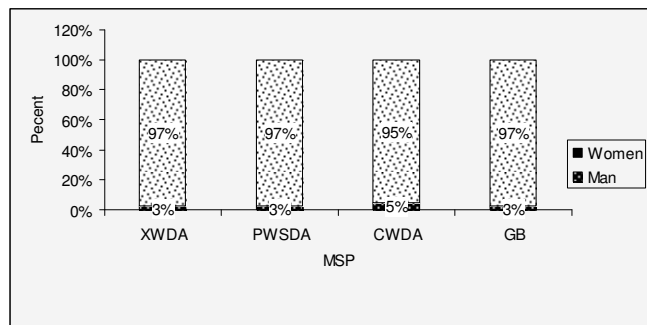


Figure 4. Percentages of clients for women and men in 2010.

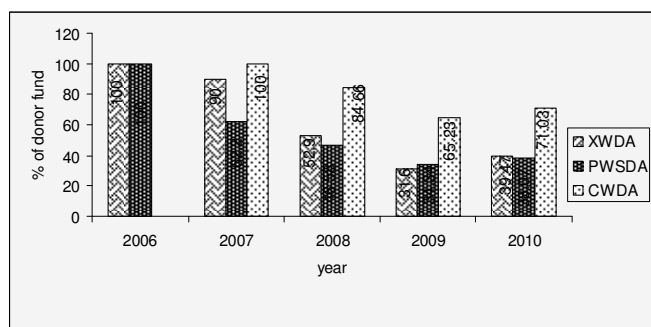


Figure 5. Donor dependency of the selected MSP.

emerged in the microfinance sector. In this approach, loans are disbursed to the poor women in combination with health care services, various forms of skill-training, compulsory and voluntary savings, micro-insurance, remittance transfer, non-formal primary education for children, legal aid and the creation of grassroots organizations for the poor (Rahman et al., 2011). For instance, provision of deposits has number of advantages-poor can save their small amount of money, MSPs can overcome their financial deficit through collecting deposits from general public, and the access to deposit services may outstrip access to credit in the long run (Haq et al., 2010). Accordingly, the credit plus-plus approach has benefited more and has considered more applicable towards poverty alleviation. It is unfortunate to note that the studied MSPs were restricted to offer such supplementary services. However, XWDA, PWSDA and CWDA followed similar approach of GB in respect to increased lending amount considering previous lending successes. Figure 5 shows.

### Financial sustainability

Sustainability may be defined as earnings (from micro-credit services) that cover operational and funding costs and can take care of bad loans, while allowing for further expansion of services. It may be further delineated as

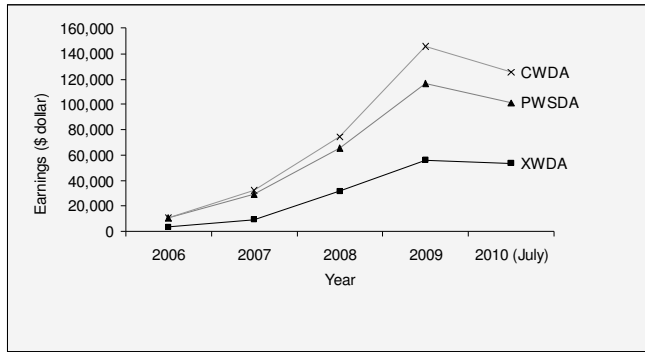
operational self-sufficiency (OSS) and financial self-sufficiency (FSS), where OSS refer to the ability of the institution to generate enough revenue to cover its operating costs and FSS refer to the institution's dependence (or lack of it) on subsidies for successful operation (Morduch, 1999).

However, financial sustainability of the Chinese MFIs is slightly different due to the restrictive fund sources, funding options and limited service provisions. In fact, financial sustainability is considered as one of the major constraints of China's microfinance service providers. NGO-type MSPs were not allowed to collect deposit from members, or funds from commercial banks and other sources. Financial assistance by Plan China was the only source of funds for these MSPs and the only means towards achieving financial sustainability. Plan China provided seed grants to the three selected MSPs - XWDA (24.12 thousand USD), PWSDA (22.06 thousand USD) and CWDA (22.35 thousand USD) for working in underprivileged villages, particularly with women, and may be considered as a milestone in allowing them to gradually accomplish success in respect to loan quality, profitability, management efficiency and independent operation.

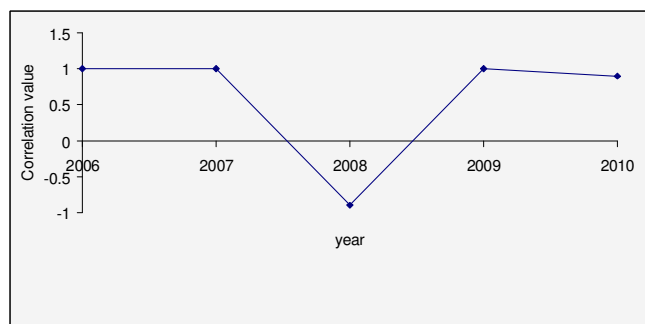
The Bangladeshi MSPs (the most self-sufficient in Asia, particularly the larger ones), on the other hand, are financially more sustainable since they can collect fund from various sources, including commercial banks, Polli Kormo Shyakak Foundation (PKSF)-apex organization with the mandate to alleviate poverty through generating employment, international donor grants, savings/deposit of members, interest and service charges (Bedson, 2009; Ahmed, 2010). GB has been enjoying financial self-sufficiency without receiving donor and government grants since 1998 and has disbursed 100% credits from bank deposits. In fact, PKSF has been playing a greater role in making MSPs financially self-sufficient, particularly the small and medium MSPs. As an apex institution, PKSF has played the role of both financial intermediary and market developer and continues to be an institution central to the Bangladeshi microfinance landscape (Bedson, 2009). Unfortunately, China has not established any such apex institution, though CAM has great potential in playing such a leading role.

### Trends of annual earnings

The study found that within a short period of time XWDA, PWSDA and CWDA had accomplished a positive trend of annual earnings (Figure 6). CWDA's earning increased to US \$29421 from US \$2941 (2007 - 2009), XWDA's increased to US \$7290 from US \$ 2967 (2006 - 2009), and PWSDA's earnings increased to US \$ 60887 from US \$ 55397 (2006 to 2009). The increase in the annual rate of earning was 4.66, 2 and 3.33% for XWDA, PWSDA and CWDA, respectively. Undoubtedly, such performance acts as an incentive and enhances the



**Figure 6.** Annual earnings of the selected MSPs.



**Figure 7.** Correlation between active clients and profit performance of the selected MSPs overtime.

confidence of the MSPs toward reaching their financial sustainability target.

Similarly, GB too made profit each year, except 1983, 1991 and 1992. GB earned the highest amount of profit in 2006 (US\$20 million), while profits had declined in the following years US\$1.56 million (2007), US\$18.99 million (2008) and US\$ 5.38 million (2009). This profit reduction may be attributed to greater social responsibility undertaken by GB during natural calamities, investment on innovative and non-profitable schemes (beggar loans, student loans), and dividend sharing.

### Correlation between borrowers and profit performance

Figure 7 shows the correlation between the number of active clients and profit performance. It was measured using data from three MSPs (with the exception of 2006, for which year CWDA data was not available). There was concern in certain areas that it may not be feasible for the MSPs to reach out to poor clients for lower loan amounts, but the selected MSPs had actually made profit by servicing such small loans for the poor clients. The number of active clients and earning were strongly linked as observed, and implies that the MSPs had done well.

### Financial resource relationships network

At the institutional level, interviews were carried out with MSP staff, their clients and partners (that is, Plan China and CAM) in order to determine the degree of interaction and the level of financial flow. Figure 8 depicts the complete set of association and highlights the more intense relationships. Plan China was at the centre of this network and interacts with the three key partners - XWDA, PWSDA and CWDA, who had their own association with women federations and CAM. All three MSPs had membership status with CAM, and were registered with the local government offices at county level. They got approvals from the women federations of Shaanxi province and had also received grants from Plan China's sustainable livelihood program.

Figure 9 represents the core network, showing the intensity of relationship that exists among MSPs, village and township beneficiaries, Plan China and CAM. Plan China can be considered as the backbone of this financial network, from where financial aid flows to the MSPs, and then, on to the target clients. Plan China not only provided financial resources but also provided other services, that was, training (MFI staff and micro-credit clients) and information. Meanwhile, the selected MSPs also raised funds from commercial sources, though it was not 'legal'. Women's Federation of Shaanxi province and CAM provided technical and capacity building support for a smooth and healthy business environment. However, the donor dependency were reduced overtime (Figure 4). With regard to the GB model, at the initial stage, GB's financial network was built with charity funds (mostly from International Fund for Agricultural Development, soft loans from the central bank of Bangladesh, commercial banks and borrower savings). The donor agencies provided the bulk of capital money at a cheap rate of interest - with the government banks availing funds at a mere 2% annual interest rate, which GB then lent to their clients at 10 to 15% flat rate, helping GB to become financially self-sustained within a short period of time. However, the structure of the financial networks have shifted over time and at present borrowers of GB own 95% (GB share) of the total equity of the bank; the remaining 5% being owned by the government (GB, 2010). Today, GB's growing amount of deposits is more than enough to run and expand its credit program, and repay all its existing loans. Certainly, client's deposits are a major contributor to the GB success story, playing a vital role in the financial resource network. For instance, GB finances 100% of its outstanding loan from its deposits and over 54% of its deposits come from the bank's own borrowers.

### Regulatory status

Beside financial sustainability, policy regulation of microfinance is considered a crucial factor for the

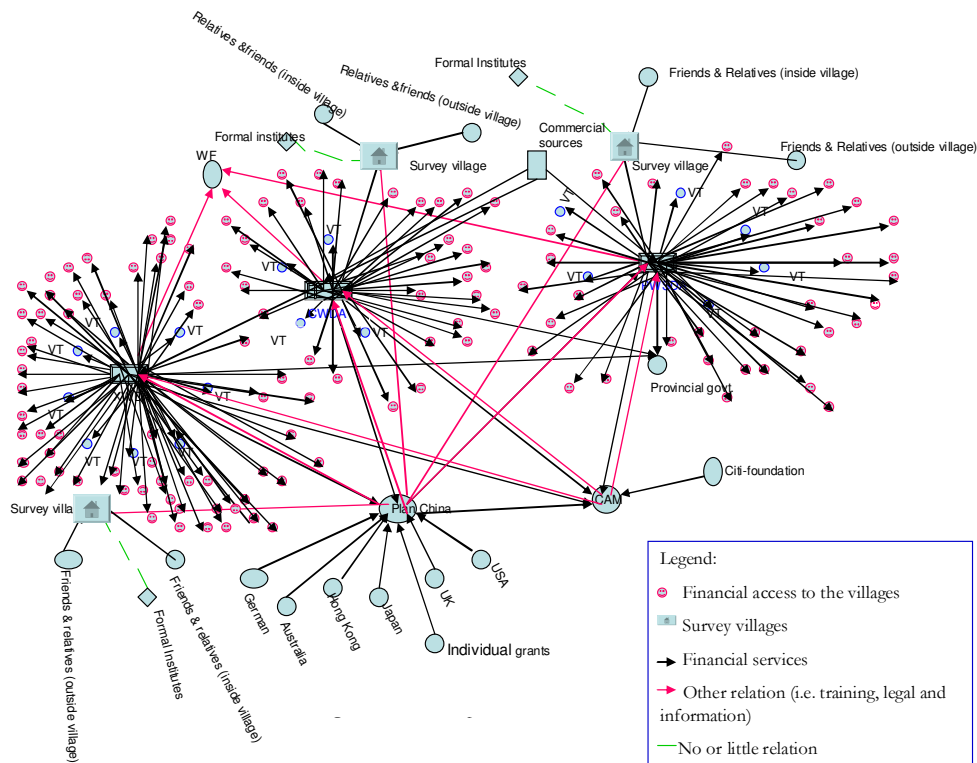


Figure 8. Financial network relationship of the selected MSPs.

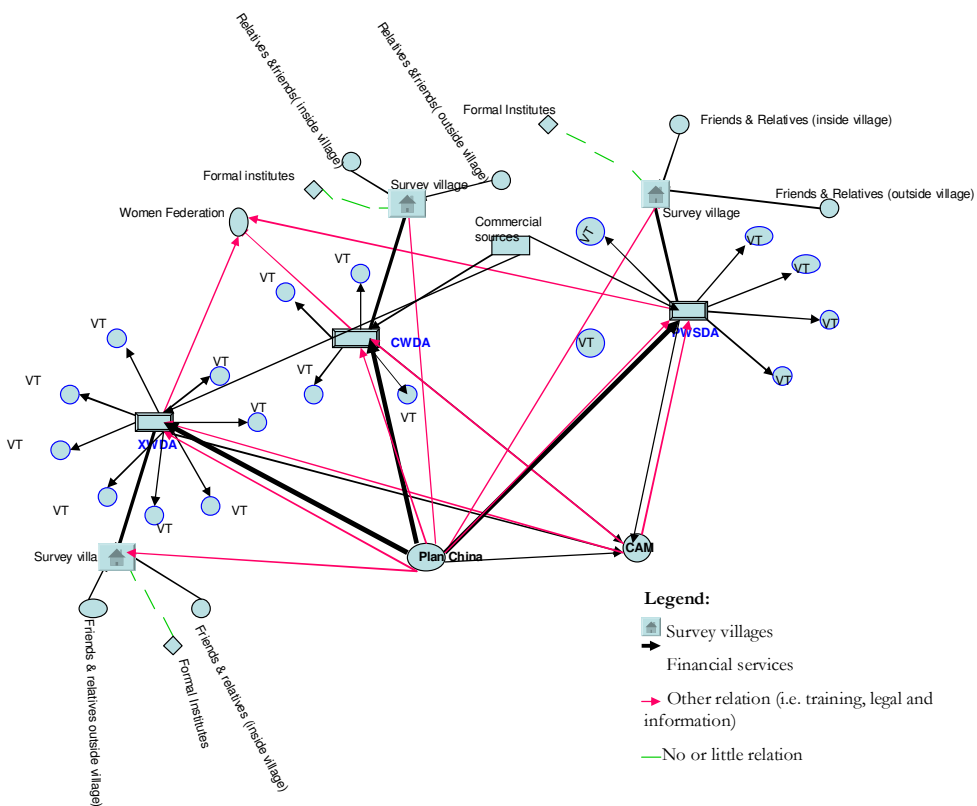


Figure 9. Core financial relationship of the selected MSPs.

overall development of the microfinance sector. Policy regulation for sustainable microfinance has been prioritised at the national and international level since 1990s (Haq et al., 2008; Villacorta et al., 2009; Mohanty, 2010). The importance of policy regulation is recognised by stakeholders (Government, NGO-MFIs and borrowers), but attaining consensus remains problematic. In a recent speech Prof. Muhammad Yunus, founder of Grameen Bank, states that, "...there should be a separate regulatory authority for MFIs as distinguished in character from that for the commercial banks. The regulatory authority for MFIs should evolve guidelines keeping in view the objectives of socio-economic development of the poor". Bangladesh (like many other countries) established micro-credit regulatory authority (MRA) in 2006 to ensure transparency and accountability of the microfinance sector. GB is regulated by the special Grameen Bank Act 1983. Meanwhile, GB followed self-regulatory mechanism and internal audit system for better financial and staff management. In addition, it is audited by two internationally reputed audit firms of the country. The financial report is published every year and is available on the GB website.

On the other hand, China Banking Regulatory Commission (CBRC) is the prime authorised institute for framing rules and regulations for, and maintaining the banking and microfinance sector in China. The policies governing microfinance remains vague and do not have a comprehensive framework that can promote smooth growth of the sector. Furthermore, NGO-MFIs are not adequately regulated under this national policy, and come under the aegis of local administrations and departments, resulting in inconsistency, and consequently, insecure legal structure that undermine investor confidence (Bedson, 2009). For instance, the selected MSPs were registered with provincial government (civil affairs of their respective counties), and since there was a lack of regulation, the MSPs adopted self-regulatory approach with the collaboration of Plan China, CAM and women's federation. MSPs produced financial report and it is certified by Plan China, after investigation. It must be noted that the MSPs did not have an internal audit system.

### Problems of MFIs and their clients

a. Shortage of Fund: Fund shortage was a major issue raised by both MSPs and the clients. MSPs claim that they could not expand their services due to limited funds. There was a lack of wholesale fund, while commercial funding is forbidden (MSPs accumulate fund from commercial sources illegally). Meanwhile, farmers/clients ask for larger loans as the current level of grants is insufficient for their enterprise. Interestingly, BaYi Village of Xixiang county's clients were satisfied with the present amount of loans as previously they were totally lacking

financial access.

b. Lack of supervised loan: From focused group discussion it was observed that there was a lack of supervised credit - farmers visit the MSP office to receive credit, and few cases were investigated by the MSPs' field officers.

c. Lack of motivation: MSPs along with Plan China have been motivating farmers/clients about group lending methods but have had limited success so far.

d. Geographic location: The investigated villages were surrounded by mountains and lack transport and communication facilities. Hence, MSP field officers, along with other development workers, only occasionally visit these villages, which tend to alienate clients from development benefits. In addition, clients complained about low price for their products.

f. Service provision: Selected MSPs mostly provide micro-credit, rather than supplementary services like savings, insurance, education, medical, remittance and social awareness. In fact, they are restricted from offering additional services, particularly saving and insurance, which was reported during the institutional survey.

g. Lack of training: Both MSP staff and clients had limited training. Plan China offers some basic training for MSP staffs and clients; however, Plan China's programs mostly cover awareness building rather than enterprise skill development.

h. Instalment duration: Selected MSPs have been practising quarterly instalments for credit repayment. This seems good when compared to GB's requirement of weekly repayments, particularly for farming enterprise. However, farmers suggested a half yearly instalment plan.

i. Regulatory environment: Like others, China's MSPs have also faced lack of regulatory structure for their services. They mostly seek legal status from provincial or local government as the central government does not have distinct microfinance regulation. Hence, they were deprived from government collaborative programs for regional development on a partnership basis.

### Applicability of GB approach

GB approach has proven its applicability in many developed and developing countries in the world. These include - China, India, Pakistan, Sri Lanka, African countries, USA, Canada and Germany, has been applying the approach according to their country's suitability. It is worth to mention that China's most of the NGO-type microfinance service providers including studied one have been using GB plus something of their own kind of approach suiting to their own environment (Rahman et al., 2011). Thus, before adapting microfinance approach in a certain country the approach need to be well understood and some flexibility is adopted according to the particular socio-cultural and political background. There is no best solution that one

size fits all cannot be applied to others. Therefore development solutions can not really be imported or exported from one country to the other. It can only be adapted by learning lessons from each other.

## Conclusions

The research found that as China moves towards a more liberalised and commercialised economic environment, the Chinese microfinance sector finds itself at a crossroad. Meanwhile, the MSPs and Plan China have been motivating group lending method that can be considered as an instrument towards increased popularity of microfinance among masses. The market access of microfinance service providers have significantly increased, contributing to capital mobilisation in rural areas. The selected MSP services have reached poor clients, particularly women living in isolated and mountainous villages. The collateral free micro-credit program that has been adopted has further broadened the micro-credit base, and their adoption of small amount of loans with quarterly repayment is highly suitable for farming enterprises, especially when compared to GB's weekly repayment mode. The service charge was quite reasonable at around 11%, and lower than GB's usual interest rates (except education, housing and beggar loan). There was lower complexity in loan application and approval system (takes only a few days), and can serve as a lesson for formal financial institutions. Noticeably, the selected MSPs had accomplished about 100% repayment rate.

Regarding the financial status, the studied MSPs were in a better position as they had received seed grants from Plan China; it is an uncommon case with China's microfinance service providers. Hence, the selected MSPs were able to build a good service network (Plan China, CAM and Women's Federation) which definitely improved their business capacity. Consequently, they gradually achieved success with respect to loan quality, profitability, management efficiency, independent operation and sustainable growth. However, they were facing some challenges due to restrictions on geographic expansion, funding from commercial and donor sources, limited service provisions and lack of supportive policy environment. The following are further findings and suggestions of this study:

1. It is observed that selected MSPs performed well in all three areas. Given the remote location and focus on agricultural farming in China's poor areas, it is suggested that, they should have greater flexibility in loan contract terms, increase monitoring mechanism and ensure productive uses of credit.
2. It is clear that micro-credit alone cannot bring significant changes of poor livelihoods and a credit plus-plus approach is needed. Studied MSPs have had limited supplementary services which may not be sufficient for

an overall, comprehensive development. MSPs should be innovative and offer new products suited to regional environment, and the government authorities should legalise such innovative services.

3. Despite group lending motivation by Plan China, MSPs and other similar platforms, government should take more initiatives to increase awareness.
4. Financial sustainability has been a major issue of concern for the Chinese microfinance sector. It is regarded that the restriction on fund collection was a major constraint toward attaining financial sustainability, as proven by the sample MSPs, whose success was dependent on Plan China's seed grants. Thus, it is suggested that the authorities allow MSPs to raise fund from commercial sources or external donor.
5. It is proven globally that successful and sustainable microfinance programs can improve lives and play an important role in improving the rural economy and possibly reduce the inequality between rural and urban areas. The government should come forward and take the opportunities offered by the microfinance sector and extend market access and policy supports toward a balanced development of this industry.
6. Government-MSP partnerships tend to bring better results, as proven by international experience (Bangladesh government has several partnership programs with GB, BRAC, ASA etc.). In fact, the selected MSPs have good orientation within their service areas, and it is suggested that that potentiality should not be undermined by legal compulsions, and China too should include these MSPs in the local developmental process.
7. China's MSPs are still regulated by the CBRC. It is recommended that the authorities institute a separate regulatory body to better utilise the enormous potential that exists for microfinance sector in China.

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