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Poverty and Sustainability Issues of Microfinance in China: A Case Study in Fu'an, Fujian Province

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Abstract

Microfinance has a unique position in China. Currently striving for recognition as a tool for poverty alleviation, microfinance programmes in China, and especially the NGO types, are competing with local rural credit cooperatives and other existing financial infrastructures to provide similar services. NGO microfinance programmes are currently at a crossroads as to where and how their existing organizations will lead to with issues on sustainability and on the dynamism of poverty in the landscape of an economy with double-digit growths. This thesis focuses on NGO type microfinance programmes and the challenges they face to survive and continue providing services for poverty alleviation.

The notion of sustainability for microfinance programmes has been an indispensable discussion amongst international donors, academics and practitioners. The concern for China is that mainstream concepts of sustainability, especially in the achievement of financial sustainability, can misguide and discourage microfinance programmes from achieving its main objective of poverty alleviation. This thesis attempts to redefine the concept of sustainability so that microfinance programmes in China can continue to serve the financially marginalized.

By empathizing the concept of poverty and bringing insights into various aspects of financial services in response to villagers' needs based on a case-study in Fu'an, Fujian Province, this thesis also illustrates the conditions unique in China for the design of products and improvements in the programmes which can contribute to the long term sustainability of microfinance programmes.

Keywords: *Microfinance, Microinsurance, Poverty, Sustainability, China*

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- Pernille Gooch, my tutor for providing me advice and support throughout my fieldwork and thesis writing

Abbreviations

ADB – Asian Development Bank
CASS – Chinese Academy of Social Sciences
CFPA – China Foundation for Poverty Alleviation
CPSRB - The China Postal Savings and Remittance Bureau
FPC – Funding the Poor Cooperative
MFI – Microfinance Institution
NGO – Non Governmental Organisation
RCC – Rural Credit Cooperatives
ROSCSA – Rotation savings and credit associations
UNCDF – United Nations Capital Development Fund
UN – United Nations
WDR – World Development Report
WTO – World Trade Organisation

1. Introduction

Microfinance is not a new phenomenon in China. It was introduced in October 1993 as part of a government scheme in poverty alleviation.[1] The first experiment with Microfinance in China was based on the successful Grameen Bank model of loan delivery[2], targeting poor rural women in Xiling Township, Hebei Province. (Saich 2001, p.266) Since then, many similar programmes supported by the Chinese government and international NGOs have sprouted in the rural areas, with reports of varying degrees of success. Parallel to these microfinance programmes, the government has been providing loans for rural development through the Agricultural Bank of China, but non-performing loans and bad debts have plagued this institution since it was officially restored in 1979.[3] Subsidized credits and low interest rates have resulted in rent-seeking behaviour[4], while leakages have resulted in the failures of the bank's programmes to target the poor.

According to Weiss, subsidized loan programmes, which were available to poor counties, went principally to economic entities rather than poor households. (Weiss 2005, p.24) CASS suggests that the lack of manpower and network support from sub-branches at the grassroots level prevented the banks from allocating poverty relief loans to individual households. (CASS 2006)

NGO type microfinance programmes in China possess the advantage of good relationship with the borrowers at grassroots level over the larger banks and therefore are able to fill the gap where the larger banks failed. Like microfinance programmes in other countries, those in China, which are run by government supported financial institutions, started by providing subsidized credit to the poor. With a few reputable microfinance institutions such as Grameen Bank and Bank Rakyat Indonesia attaining financial and institutional sustainability after being in the business for more than 20 years, and rhetorical pressure from international donors to achieve full sustainability, microfinance programmes especially those run by NGOs in China, are now at a crossroad as to where and how their existing organizations will lead.

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[1] Concerned with the effect of the rise in prices on poor farmers due to the market reforms in 1981, a special agency, The Leading Group for Poverty Alleviation was set up by the State Council in 1984. This agency had offices down to township level (Saich 2001).

[2] The group lending methodology of loan delivery was pioneered by Grameen Bank in Bangladesh.

[3] The Agricultural Bank of China was originally set up as the Agricultural Cooperative Bank in 1951. Since then it has faced many ups and downs resulting in its abolishment twice and a merger with the People's Bank (CASS 2006).

[4] Evidence of rent-seeking behaviour in subsidized loans can be found in the research papers of Adams and Von Pischke, 1992 and Robinsons 2001 (Druschel, 2002).

In this paper I would first like to discuss 'sustainability' in the context of the general discourse on microfinance, the myths, facts and rhetoric surrounding it. Therefore I will illustrate, based on a case study in Fu'an, Fujian Province, the conditions unique to microfinance in China that can lead to a sustainable model different from the model that the general discourse on microfinance supports, the model of a Grameen Bank MFI which is deemed to have successfully achieved both financial and operational self-sufficiency.[5] I would also like to further illustrate the concept of poverty, especially against the rural backdrop of China and, by way of empathizing this concept, show how microfinance programmes in China can sustain their operations. In addition to the concept of poverty, an overview of the borrowers' basic understanding of finance, for example in the aspects of saving, loan usage and insurance knowledge, is also important as this will help microfinance programmes update and design products suitable for their clients, in order to be sustainable. As more data has been collected on the aspects of insurance, a large section will be dedicated to the discussion of microinsurance, a product which is not established within the microfinance field in China yet, but appears to be in great demand by both microfinance operators and their clients according to this case study. I would like to stress the importance of local conditions, which can vary between communities, between villages, between townships, etc. The results of this case study may not be representative for all of China's microfinance programmes but may verify unique conditions that need to be embraced by local microfinance programmes in order to be sustainable. Prior to discussion on the issues mentioned above, based on the analysis of my fieldwork findings, a section on research methodology will be given.

2. Methodology and Selection

This paper seeks to understand both the existing supply and demand conditions of microfinance which are unique to China in order to promote the long-term sustainability of these services to low-income groups. The supply conditions are concerned with the government's committed position in

[5] Grameen Bank has been lauded by academics and practitioners for achieving, or coming close to achieving, both operational and financial sustainability. One of the features of this bank is to achieve sustainability as soon as possible so that it can expand its outreach without fund constraints. The Grameen Bank website however, still welcomes donation from the public. Other features of the Grameen Bank can be found on http://www.grameen-info.org/mcredit/

poverty alleviation and rural development, and their interaction with local and international NGOs and GONGOs (Governmental Non- Governmental Organisations)[6], which are involved in microfinance. Contributions from the private sector, especially large corporates[7], in the form of corporate social responsibility and business opportunities, are also considered. The demand conditions involve not only understanding the financial needs of MFI clients but also understanding their life perspectives. By bridging the gap between supply and demand conditions it is hoped that this thesis can help contribute to appropriate proposals for the seamless engagement of microfinance programmes in China with other organizations and agencies with similar interests, and for the design of innovative financial products for their clients in the aim of sustainability for these institutions.

Data for this paper was obtained during a two months stay in China, including a three week fieldwork organized by the China Foundation for Poverty Alleviation (CFPA). I contacted a few microfinance organizations in China, but only received a positive response from the CFPA which generously offered me three sites where microfinance programmes are ran to choose from, Fu'an and Xiapu county in Fujian Province and Liuzhi in Guizhou province.[8] The coordinator suggested Fu'an and Xiapu as they are an hour apart by bus from one another and both offices have been running the programme extremely well. She mentioned that Liuzhi was facing some management problem[9] but that it would still be fine if I chose to go to Liuzhi. I decided to go to Fu'an since it was closer in distance from where I was based then. During the arrangement of my trip, I helped to edit the CFPA's English proposal to establish a professional and commercial microfinance institution. From the proposal I learned a lot about its present and past work, and its ambitions for the future. The CFPA and its works can be found on its website, www.cfpa.org.cn.

A meeting with my tutor at Fudan University turned out to be a great source of information about the current status of MFIs in China, as he works closely with the Chinese Academy of Social Sciences and is very familiar with the latest developments about microfinance. I also managed to speak to the

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[6] GONGOs are social organizations established by government agencies, also known as SONGOs (State Owned Non Governmental Organisations) (Young, Nick in Yang, Guobin 2005).

[7] A few large corporates have involved themselves one way or another in Microfinance worldwide eg Citigroup donate USD3.9mio to Financial Education for the Poor in China early this year (Citigroup press release 22 March 2006).

[8] CFPA operates an open-policy with researchers and volunteers. They welcome them in the hope of gaining more knowledge from researchers and promoting their programs through volunteering.

[9] A staff ran away with money at this site and the management was taking steps to avoid this situation again.

Microfinance director of CFPA, Mr Liu Dongwen after my fieldwork. Both interviews were in the form of discussions, philosophical dialogues[10] unlike the semi-structured interviews I conducted with the microfinance clients and staff at Fu'an.

The semi-structured interviews with the microfinance clients were mostly done with translators as the clients spoke their local dialects. A framework of the questions asked is provided in the Appendix section (Appendix 1). The framework acted as a guide for my interviews. Some questions which were not appropriate to the respondent were not asked, while follow up questions had to be constructed ad hoc for those whose had experiences beyond my expectations.[11] Although some respondents understood Putonghua, they were unable to speak it. The younger respondents, or those with education, were able to converse with me in Putonghua. The translators were staff at the office and sometimes two of them would help translate at one time, reducing any reliance on one translator. Some respondents would nod or add something when they heard me repeat their answers in Putonghua. Sometimes during the interviews, other clients would chip in to give their viewpoints. I tried to minimize bias in the translations by sometimes validating the interpretation with other staff.

I interviewed about 12 clients and also chatted with some non-clients in the villages visited. The 12 clients were randomly chosen by staff members while they were distributing loans. Most of them obliged, but some were shy and were replaced by others who seemed more interested in talking. Apart from the semi-structured interviews, I also made lots of observations as a research method to complement the interviews. Data was also collected from literature reviews and the internet, prior to and during the fieldwork.

Six corporates were contacted but data was mostly collected from two large corporates involved in insurance through an email questionnaire.[12]

Limitations

Although I managed to collect plenty of important data during the fieldwork, there were a few limitations to the design and implementation of my research.

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[10] A philosophical dialogue is defined in Kvale as a conversation where partners are on an equal level, with reciprocal questioning with the intention by the conversing partners on the 'law of the subject matter'. A philosophical conversation seeks truth through an argumentative discourse (Kvale, 1996).

[11] For example, I spoke to one fish farmer who was diligently paying RMB2000 (about USD250) a year for a life insurance plan; this was beyond my expectations. I asked follow up questions as to how much he would be compensated if was disabled, etc.

[12] See Appendix 3: Email questionnaire to Insurance Company and Appendix 4 for Email questionnaire to Insurance Broking Company based in Hong Kong.

First, the respondents were randomly selected, females and males alike and of all ages, which sometimes resulted in diverse results during the interviews. However, these diverse results need not portray a weakness of the design method as they do represent the views and opinions of a group of people bound by at least one factor, the loan contract. In analyzing the data, specific cases among the diverse results were referred to in detail according to the themes of the thesis to give a three-dimensional window in terms of the clients' perspectives. Hence the random selection of respondents here can be an appropriate method for studies like this, in view of the varying local conditions. My tutor at Fudan University emphasized during our discussion that it is important to understand the local culture of one community, as one methodology of lending may not apply to another community.

Second, some loss in information during the translation to the transcription of text must certainly have occurred. However, loss of information during the translation was minimized by constant re-confirmation of answers and validating with other staff members. As for the transcription from speech to text, I was guided by asking "What is a useful transcription for my research purposes?" as suggested by Kvale (Kvale 1996, p.166).

My fieldwork experience was guided by multiple back and forth processes of interviews, observations and literature reviews. Where there was a lack of validity in the interview research method, observational research method compensated and where there was a lack of reliability and generalizability in the observational method, the interview research method compensated.[13]

Analysis

Analysis of literature and data was conducted using several approaches. A critical approach was used as a thread from the forming of the research question to the analysis and conclusion of the thesis. Thoughts and ideas were formed by questioning the applicability of the mainstream ideas of sustainability in the Chinese context.

Interpretation of fieldwork data was based on three levels; on Kvale's suggestion of self-understanding, critical common sense understanding and theoretical understanding. Self-understanding refers to my interpretations within the context of my respondents' understanding. Critical common sense understanding refers to interpretation made within the understanding of the

[13] Validity of a research method refers to how true the method is, while reliability refers to the extent methods can be replicated. Generalizability refers to extent that the study's findings would be true for others (Observational Research Methods
http://www.socialresearchmethods.net/tutorial/Brown/lauratp.htm)

general public. Finally, theoretical understanding refers to where my interpretations fall within the community of researchers (Kvale 1996).

In analyzing the data to study, the concept of poverty, I attempted to interpret the data through a Post-Modernist approach. Other themes were mainly analyzed through critical and interpretivist approaches.

Ethical Considerations

All respondents participated voluntarily in my interviews. Due to time constraints, I have not managed to obtain formal consent from the respondents or their companies for the disclosure of their names, and hence names and companies will remain confidential throughout this thesis.

3. Microfinance in China: Institution or Organisation?

Short History of Rural Finance in China

Before the market reforms in 1981, little finance was available in the rural areas as finance was dominated by the People's Bank of China, which was 'simply a fund distribution institution under the planned economy'. (CASS 2005, p.94) The Agricultural Bank of China was set up in August 1951 and was dismantled and re-established twice over the course of almost three decades before being officially restored again in 1979. The People's Bank of China always operated side by side with the Agricultural Bank of China and therefore there was no clear-cut division of labour between them. When the Agricultural Bank of China was restored in 1979 by the State

Council, rural credit cooperatives were placed under their jurisdiction and institutions were established at all levels. Its scope of business includes savings, providing loans for agriculture and handling loans for industry, purchasing agricultural products, and loans for agricultural development. The Agricultural Bank of China was also responsible for poverty relief funds. (CASS 2005, p.96)

The Agricultural Bank of China was under strong pressure as it was the sole financial institution managing the financial services for the agricultural sector of China, which was the backbone of the Chinese economy during the initial stages of market reform.[14] During the mid-80s, the bank faced bad

[14] 'Agricultural gross out put value (GVAO) grew by no less than 9% per year between 1978 and 1984.' (Riskin 1997, p. 290).

management problems and was heavily affected by bad debts, especially from heavy losses incurred by state-owned grain purchasing enterprises. (CASS 2005, p.97) Poverty relief was the least important item on the agenda, although it had always been high in the list of policy making priorities by the central government.

The Rural Credit Cooperatives (RCCs) were detached from the Agricultural Bank of China in 1996 and converted into a 'cooperative financial organization' with rural labourers as share-holding members with the intention of having them democratically manage their interests. Among many tasks are to provide rural households with small loans and to 'build up a credit rating system and establish a credit file system'. (CASS 2005, p.110) The recent years saw the RCCs promoting small loans to rural household in the form of 'jointly guaranteed loans' similar to the Grameen bank lending methodology. Although the RCCs are seeing profit for the first time in 2003[15], they are still inflicted by deep internal management problems, especially in equity ownerships. They are also dealing with a severe lack of technical expertise, auditing and bureaucratic problems.

Microfinance and Existing Financial Conditions

Three categories of microfinance programmes define the present microfinance landscape in China:

1. Project-based microfinance funded by international NGOs such as UNDP, World Bank, AusAID, etc and local governments. CFPA operates their microfinance programmes with both international and local funding.
2. Programmes run by government dominated funds via the Agricultural Banks.
3. Programmes run by the Rural Credit Cooperatives using their own deposits and the People's Bank of China refinancing facility (Du, 2005).

The existing financial infrastructures which seek to meet the Chinese government's aim to reduce poverty in rural areas and its recent proclamation on developing 'a new socialist countryside' may have a crowding-out effect on existing and potential services provided by the NGO type of microfinance programmes. These programmes are usually under international rhetorical pressure to move away from subsidies and donor funds to achieve self-sustainability. Savings and remittances, services that are advocated by many

[15] 'Total profit during the first 11 months of 2003 was 148mio yuan.' (CASS 2005, p.111).

for the sustainability of Microfinance Institutions, are provided by the China Postal Savings and Remittance Bureau (CPSRB) which will have its own legitimate bank, known as the China Postal Savings Bank by the end of 2006. A staff member at CFPA said that it is quite easy for villagers to remit money and receive money from relatives and friends through the enormous network of the China Postal Savings Bank, which usually has branches at least down to township level. The villagers hop on their neighbour's vehicle, or sometimes take public transport, to town to deposit savings or for remittance services. The minimum amount to open a savings account at the local RCC is only RMB 10. For those who save, rotation saving is also popular among village communities, especially in Fujian Province. At least one respondent engaged in this form of saving, while another saves regularly at the local CPSRB.

The CPSRB already has 36,000 offices around China, with 70% of the offices based in rural areas.[16] There is probably very little economy of scale for microfinance programmes in China to work on savings and remittance services given the enormous existing networks that the RCCs and CPSRB already have. With deposits reaching 1.22 trillion yuan (US$150.4 billion)[17], the China Postal Savings Bank is looking into ways to mobilize their enormous deposits and expand its business to lending activities in the future. This will result in direct competition with the Rural Credit Cooperative where rural clients will certainly benefit by getting better services, but this may pose an untimely threat to the survival of NGO microfinance programmes in China, which are currently solely dependent on lending activities.

In terms of regulation, NGO microfinance programmes are, in theory, illegal. However they have compromised informally with local governments on their activities; have permitted them to continue their operations and sometimes even to charge higher loan interest rates. The ambiguity and lack of a clear and legal financial role for the NGO microfinance programmes, and the inefficiency of microfinance programmes run by commercial banks, can undermine the sustainability of the microfinance movement in China. Given the differences in the legal and regulatory framework, and existing poverty alleviation policies in China, the path that the NGO microfinance programmes are taking in China could lead to a different course than that of the Grameen Bank. Other studies such as Beslev 2001[18] and Park, et al

[16] 'China to establish postal savings bank in December' http://www.zeenews.com/znnew/articles.asp?aid=334357&sid=BUS&ssid=51

[17] 'State okays new postal savings bank' http://www.chinadaily.com.cn/english/doc/2005-07/29/content_464463.htm

[18] "…differences (in local policy conditions) might mean that the direct replication of Grameen Bank model is not suitable in China,…" (Beslev 2001).

2003[19], have also suggested that the Grameen Bank model may not be suitable in the Chinese context, and that multiple micro-finance models can co-exist in China according to the local conditions.

Formal regulations for the operation of NGO microfinance programmes need to be developed for them to be recognized within the organization status quo, otherwise these programmes will continue to remain 'illegal' in their operations. NGO microfinance programmes in China are therefore neither organizational nor institutional in status. Some microfinance programmes have taken the lack of regulations as an opportunity to innovate and improve their programmes. The CFPA has recently launched a new loan product at the Xiapu site and the Funding the Poor Cooperative (FPC), run by the Rural Development Institute of the Chinese Academy of Social Sciences, is working on a trial commercial microfinance concept where loaned funds are owned by a community, consisting of not more than five members.

The CFPA has also used this lax but compromising regulatory environment to obtain institutional recognition and is currently preparing a proposal for the establishment of an independent commercial institution from its current project situation. With the regulatory framework lagging behind in China, it is already difficult to accord any organizational status to these NGO programmes, and scarcely an institutional status. However, in order to push the authorities to pay more attention to the development of a sound microfinance regulatory framework in China, strong initiatives at the bottom level, as seen in the CFPA, are being taken to influence higher level policy making.

NGO type microfinance programmes have a long and difficult path to tread to achieve commercial status in China, given that the focus on large-scale commercial microfinance is on re-hauling the RRCs. NGO microfinancers must therefore find their own way to achieve some form of non-commercial sustainability in their programmes as they possess many unique characteristics and concepts, such as grassroots relationships with their clients, community building, and the ultimate goal of poverty alleviation, that the management of RCCs is still struggling to include in its corporate management.

Sustainability Redefined

China, compared to countries in Latin America, South Asia and Africa, is considered a late-comer in the microfinance field and in its current position it

[19] "Given the space to operate and expand, there is no reason that multiple micro-finance models cannot coexist in China." (Park 2005).

can gain and learn from plenty of past experiences from other programmes. However, every country is different in the nature of its poverty, in the nature of its economic livelihood, in its culture and in its existing infrastructure. The Grameen bank model, advocated by many and which has achieved successfully both operational and financial sustainability, may not be applicable in China.

Operational/Institutional self-sufficiency and financial self-sufficiency are the catch phrases for many involved in microfinance. The Asian Development Bank (ADB) emphasizes that microfinance institutions need to achieve both self-sufficiencies to maintain their sustainability (ADB 2000, p.10) while the UN 'Vision of Inclusive Finance' for development recently reiterated the importance of financial and institutional sustainability for a financial institution 'as a means to providing financial access over time'. (UN 2006, p.2) Operational self-sufficiency refers to the ability of the institution to generate enough revenue to cover operating costs, while financial self-sufficiency refers to whether the institution is dependent on subsidies to operate. (Murdoch Dec 1999, p. 1588)

When talking about sustainability for microfinance, we need to be much clearer. Sustainability for microfinance programmes within NGOs has to be differentiated from the independent commercial microfinance institutions. Academicians, practitioners and international donors sometimes tend to merge the two and overstress the importance of institutional and financial sustainability, without referring to either specifically. It is undeniable that microfinance institutions need to achieve both institutional and financial self-sufficiency for sustainability, otherwise they may end up like the Rural Credit Cooperatives, which were in the red for many years when they lost money on subsidized loans and low repayment rates. Grameen Bank and Bank Rakyat Indonesia are constantly lauded for achieving financial sustainability. However preaching financial sustainability to NGO type microfinance programmes can discourage their current efforts and drive them in an idealistic direction away from what they were created for, microfinance programmes for poverty alleviation. The success of NGO type microfinance programmes are often artificially measured by 'financial sustainability', but sustainability should refer to keeping the microfinance programmes locked onto their aims and, in the NGO context, achieving operational sustainability is probably an adequate measurement for the success of such NGO programmes.

Subsidized loans in the name of poverty alleviation operated by the RCCs and the past losses associated with them gave microfinance programmes a bad

reputation. Apart from direct problems such as rent-seeking behaviour, associated with subsidized loans, the RCCs seriously lacked expertise and grassroots client relationships in managing the subsidized loans. This is unlike the Bank Rakyat Indonesia where its success and profitability depended on a large network of branches with loan officers making decisions at the local level. (Morduch 1999, p.1578) Most NGO microfinance programmes (See Appendix 2 for list) in China continue to be funded by donors and cheap loans from local banks. For example, the microfinance programme by the CFPA in Fu'an has been running successfully for more than five years mainly with cheap government loan funds[20], starting with 3,420 borrowers and an average loan size of RMB 1,100. Now the programme has 4,300 borrowers with an average loan size of RMB 2,000. Most borrowers are repeat borrowers and the increase in loan size may reflect better livelihood. In fact, repeated borrowers interviewed said that generally their lives have improved and they are more relieved after receiving those loans. Can this microfinance programme in Fu'an be considered successful after being in operation for five years, even though it has not reached 'financial sustainability'?

According to Morduch's studies, 'programs that are breaking even financially are (also) not those celebrated for those serving the poorest clients'. (Morduch 199, p.1571) In another extensive study conducted by Morduch and Haley, experiences drawn from other academics on the effects of microfinance on poverty reduction have shown that excellent financial performance does not imply excellence in outreach to poor households and that many MFIs have tended to focus foremost on their own financial survival rather than on poverty reduction. (Morduch and Haley 2002, p.1) On the contrary, experiences from the same study have also shown that there is no clear trade-off between reaching the very poor and attaining financial self-sufficiency and suggest that MFI's potential for full sustainability relies on 'the degree which its financial services programme is well-designed and managed'. (Morduch and Haley 2002, p.41) The study covers microfinance programmes in Latin America, South Asia and Africa, with only one experience in China.

As most NGO microfinance programmes are run internationally, with pockets of presence in various countries, it is unrealistic to convert these programmes into commercial institutions. The legal and financial framework varies from country to country and with relatively small client bases, it would be too costly for the NGOs to advocate commercialization of their programmes. The target for NGO microfinance programmes should be to

[20] Society donation contribute to less than 20% of the loan funds.

reach operational sustainability since the notion of 'financial sustainability' does not fully apply to NGO microfinance programmes. Likewise in China, as long as microfinance programmes are under the patronage of an organization and not yet a commercial institution, there is less reason for them to achieve financial sustainability when they have met their operation costs and at the same time achieve their aims of poverty alleviation.

On the international front, better guidelines based on international standards should be adopted to encourage NGO microfinance type programmes to continue their work, as these programmes are the ones reaching the low-income groups. In China, NGO type microfinance programmes should engage and make use of the existing financial infrastructure to meet their aims. According to Park et al., 'In the right institutional environment, micro-finance principles will have much greater influence if they can help existing rural financial institutions (RCCs) to profitably provide flexible saving and borrowing instruments to a broad range of rural residents, especially private (micro) entrepreneurs.' (Park et al, 2003, p.13) Hence, the large presence of RCCs and CPSRBs in China's rural areas should not discourage the on-going work of the NGO microfinance programmes, as these programmes uniquely possess an understanding and experience in dealing with the poor. NGO microfinance programmes should find ways to cooperate with them as the programmes have dedicated staff who can reach out to clients in the villages. For example, the Fu'an programme covers more than 100 villages and it requires a heavy and labour intensive routine to visit them. Associated costs such as transaction costs and transport costs are reflected in the higher interest rates charged by the NGO microfinance programmes, while the RCCs can only charge fixed ceiling rates that are unable to cover the operation costs of reaching out to the poor. It may be asked if it were not better to 'outsource' the cheap loans to the NGO microfinance programmes and leave them to run efficiently this part of the RCCs' operations.

The notion of 'sustainability' needs to be re-defined for NGO microfinance programmes, not just in China, but elsewhere where local conditions and policies differ, affecting the existence of various programme models. Sustainability of NGO microfinance programmes should perhaps refer to the ability of the programmes to run for x number of years and be evaluated on their impact on poverty alleviation. In order to be categorized as 'sustainable',

NGO microfinance programmes should acquire qualities among others such as:

1. Maintaining good accounting practices
2. Good relationship with their clients and strong understanding of the livelihood of the poor to design appropriate and suitable financial products for them
3. Innovative and flexible when designing financial products
4. Sound management with strong leadership
5. Constant evaluation of the programmes

These qualities can ensure the sustainability of the programmes. With trust in the effectiveness of the programmes, support from donors and loan funding will continue.

4. Help the Needy, not the Poor[21]

Microfinance by default targets the 'entrepreneurial poor' and cannot help those who are unable to meet basic needs, such as shelter, food etc. Microfinance hence should not be the one and only tool used by a government in the effort of alleviating poverty. The major difference in microfinance compared to other poverty alleviation tools is that it 'empowers' the clients in making decisions to improve their livelihoods. China has been experiencing high GDP growth over the last 20 years, allowing an economic environment for microfinance to thrive both in the rural and urban areas. Reaching out and targeting the 'needy' (those in need of financial services) is one of the major tasks of these programmes.

With 'sustainability' re-defined in the NGO context, I hope to demonstrate the value of understanding clients and their lives and that this can bring about improvements and changes in client targeting and product design for microfinance programmes. In the case of Fu'an, to understand the clients, I observed and investigated the livelihoods of some borrowers and sought to explore factors, some abstruse, which can influence the design of microfinance programmes.

[21] Chinese Proverb.

Concepts of Poverty

Defining poverty is complicated, since by attempting to define poverty, there is a tendency to consider poverty as a static phenomenon whereas poverty is actually dynamic. The concept of poverty has been made tangible by defining poverty lines, such as an income of less than USD 1 per day. What makes the 'entrepreneurial poor' different from the 'core poor' is not revealed in this figure, which suggests the need for more insights in qualitative studies of the poor. Although the poverty line has been internationally accepted and issued as a guide for poverty alleviation strategies, other aspects of the concept of poverty such as life experiences and vulnerability factors are not reflected in the figure. As poverty is dynamic, with people constantly moving in and out of it, vulnerability is therefore an important concept to consider when defining poverty. Vulnerability can be minimized by insurance, as will be described later in this thesis. Hence, it is not a matter of applause by the poverty alleviation community when incomes are raised to USD 1.10 per day since the question of how the income increase of 10% can be sustained without falling back below the poverty line again becomes more appropriate. Another concept of poverty such as 'relative poverty' is also used constantly to guide poverty alleviation policy makers. The World Development Report (WDR) in 2006 stresses 'equity' by promoting a level playing field for all to combat poverty. Equity, according to the report means that 'individuals should have equal opportunities to pursue a life of their choice and be spared from extreme deprivation in outcomes'. (WDR 2005, p. 2)

Absolute poverty, relative poverty and 'equity' all represent numeric windows for academics and governments to develop poverty alleviation strategies on the macro level. A Chinese proverb says that 'The poor can only guess at what wealth is; the rich don't know what poverty means' shows that there is more to poverty than the three terms mentioned above. Graham Pyatt (Poverty vs. the Poor) in Booth and Mosley suggests two initial points of departure when attempting to define poverty. The first is that 'being poor is essentially a personal matter'; hence the starting point of definition must come from the individual, before considering the household. Second, there must be a distinction between poverty and destitution. Pyatt is referring to whether an 'individual has the capacity and sufficient resources to function in a sustainable way, albeit at a low level'. (Booth and Mosley 2003, p.93)

A rather deep level of the meaning of poverty has been touched here and I will refrain from going any deeper. Rather than debating about who the poor are and what poverty is, as the terms become more abstract the more we try to define it, I would suggest the use of the term, 'the financially marginalized'

which draws upon Pyatt's second definition above. For the sake of the identification of target clients for the sustainability of microfinance programmes in China, the 'financially marginalized' are economically active individuals who lack access to mainstream financial support rendering them unprogressive in improvements in their livelihoods. If microfinance programmes are able to work within this definition, the programmes can easily target those outside of mainstream financial services in both the rural and urban areas. As mainstream financial services vary in different countries, maintaining this definition for the target group also allows microfinance programmes to adjust to local conditions with specific financial products.

Fu'an

Fu'an County is located in the north of Fujian Province, two hours bus ride from Fuzhou, the capital of Fujian Province. It is exposed to typhoons and floods, being situated on the coast and was recently hit by Typhoon Saomai in August 2006. Some lives were lost and crops and property were seriously damaged. The population of Fu'an County is estimated to be around 600, 000. The majority of the population is based in the city, with the remainder scattered in villages across an area of about 1 200 km^2. The villages are connected by roads, both unpaved and paved. The main economic activities include tea planting, fisheries and small and medium sized industries. Fu'an has been 'infamous' for two events according to the locals. Government officials have busted a number of financial pyramid scams derived from the rotations saving schemes that the Fujian Province is known for. The other event that put Fu'an in the headlines was the arrest of a drug developer. The 'entrepreneur' apparently earned the admiration of many locals for having evaded the police for over 10 years and having chemically developed narcotics from garlic bulbs.

Fu'an City is small and bustling with motorbikes beeping their horns endlessly. Luxury cars can easily be spotted among the motorbikes. Construction and renovation works are seen everywhere, with new shops opening every other day in every little corner. The city appears to have been left behind in China's double-digit economic growth over the last 20 years and is first now suddenly catching up. It seemed to be happening right before my eyes.

The targeted villages for microfinance have been selected by the local government based on the annual income of the inhabitants. It is unknown what this annual income is, but it could be based on the official poverty line

of RMB 680 per year.[22] The loans disbursed by CFPA in Fu'an attract a variety of borrowers. First time borrowers are allowed RMB 1,500 and following that the maximum loan amount of RMB 3,000. There is no restriction on the loan usage. The borrowers form groups of five to apply for the loans, with each of the borrowers affected if one of them defaults. So far, the group lending methodology has worked successfully with high repayment rates recorded.

Deconstructing the borrowers

Disparities in lives – Targeting microfinance clients

The lives of the borrowers in the villages, although classified as poor by the local government, appear to be rather interesting. While the villages are considered to be poor by the local government, the villagers in one location who usually share similar livelihoods such as fishing or tea planting are varied individuals, sometimes with large income gaps between them. It is challenging to academics and policy makers to determine the reasons for the occurrence of marginalization of a lower income group even in a small community like a village. Generally, inheritance is an important factor, while other factors such as level of education, health, age and gender are also factors behind the disparity.

A young married lady, aged 27, who graduated from high school, is a first time borrower and is planning to use the loan of RMB 1,500 for some small business activities, probably a trading business in the city of Fu'an. She has also borrowed from relatives for this business activity and is rather confident that she can start returning money in instalments within 60 days of the loan. Although she does not work, she saves regularly, most probably from her husband's income, and says she has no problems accessing the banks for saving. She is also using part of her savings for her business and thinks that saving is important. She feels that she leads quite a comfortable live.

Another first time borrower, an illiterate lady who is 58 years old and has kidney problems, is struggling to make ends meet. Her husband has passed away and she supports a daughter who needs tuition fees at university; she thus feels compelled to borrow and to make some extra money from pig raising in addition to her income from tea farming for three more years till her daughter who she pins high hopes on graduates. Unlike the young lady, she feels that she leads a difficult and hard live.

[22] "Official: China's poverty line too low" http://www.chinadaily.com.cn/china/2006-08/23/content_672510.htm"

The differences in the above two individuals are clear. The first lady is rather savvy financially and scarcely approximates to the picture of the 'poor' depicted in the media. The fact that the first lady is young, of good health and has relatively good education gives her an edge over the other borrower in terms of her capacity to function in a sustainable way. On the other hand, any shocks such as bad health or bad weather can result in the second lady becoming incapable of making any income on her own.

In a fishing village, two female borrowers, both in their late 30s appear to have very different lifestyles. The first is trendy with painted nails, tinted hair and a good complexion while the second has dark weathered skin and looks a decade older than the first woman; she was also more reluctant to talk, compared to the first. One male villager in his 40s complained that the loan amount was too small for him, as there was nothing much he could do for his business with RMB 3,000. He has been part of a group to help others to form a group and has plans to pass his business on to his children in the future.

With such diversity in the villagers' lives, classifying villages as poor may be an easier job than classifying individuals as poor. We have less understanding and even less right to question and quantify these differences, and to judge their lives. They are conscious borrowers of loans; and how they live and organize their lives is sometimes beyond our understanding. Most important is whether financial services are available for them to progress into better lives, defined on their own terms, from their existing livelihoods. NGO microfinance programmes should continue targeting communities rather than individuals in the aim of providing financial services for the financially marginalized.

Life Improvements – Service Improvements

Repeated borrowers of the Fu'an programme reported improvements in their lives after taking out the loans. Some have used the loans to pay for school fees and healthcare but the majority of the loans have been used for economic activities such as buying seed, rearing pigs, petty trading, etc. In most cases, taking out loans helped relieve the borrowers of cash flow problems.

A 50 year old lady who owns a small provision shop took the loans to buy sundry goods to sell in her shop. She says she is too weak to do any manual work. The loans have helped her run the shop rather than work with grape vines. A young man in his early 30s also felt that his live has improved due to the loans, after being a borrower for three years. He used the loans to buy agri-products to sell in his shop.

This shows that getting access to financial services, albeit at a low-level, has a positive impact on the borrowers' lives. One study shows that half of the

borrowers in pilot microfinance programmes in China also borrow from other sources[23]; therefore there is certainly room for expansion for microfinance programmes. The positive impact on borrowers' lives can be viewed as a symbol of the success of the programmes but the programmes should not stagnate as the borrowers progress from their existing livelihoods and require better and more advanced financial services, which are still inaccessible to them. For example, there were demands from borrowers for larger loans, above the maximum of RMB 3,000, but due perhaps to lack of capital and a proportionately larger risk of loan default, the microfinance programme was unable to meet this demand. Larger risks can be mitigated by credit insurance, which is currently unavailable for NGO type microfinance programmes in China. The programme officers usually recommend their clients to enquire at the local Rural Credit Cooperatives, but it is unknown if they were eligible to apply for larger loans as the RCCs usually require some form of physical collateral. There are also demands for earlier repayment to qualify for another loan application.

NGO microfinance programme can be quite rigid in order to minimize transaction costs. Stagnant microfinance programmes can prohibit growth and may return borrowers back to their previous circumstances. If microfinance programmes are about improving lives, then they should follow this dynamism by constantly improving their services and financial products up to the point where their clients graduate to become accessible to mainstream financial services. By engaging the local RCCs, NGO microfinance programmes can identify gaps between their programmes and the financial products provided by the RCCs. Partnerships can be formed between them to bridge this gap so that the borrowers can progress from small loans to medium size loans from the RCCs.

Savings next?

Almost all borrowers interviewed say that they do not save. The young lady mentioned earlier saves in a bank and the man in his 30s saves through ROSCAs. Borrowers complain that they never have enough money to save, especially those whose crops and feedstock were damaged by typhoons the previous year. One male borrower, who surprisingly has enough money to pay for an annual RMB 2,000 insurance plan, also remarked that he does not save. The action of saving and 'savings' need to be distinguished between here. It is possible that the villagers consider the action of saving to refer to saving

[23] Park et al (2003, p.8).

regularly. Since their income can be irregular, something which does not allow them to save regularly, they may not admit to 'saving' when asked, 'Do you save?' It follows that they do not have any 'savings'. When some reported that they have had had any income for one year due to the typhoons, they must have been drawing on savings from somewhere. None of the borrowers interviewed intended to use the loans for consumption purposes due to the typhoons; therefore they must have used some allocated saving funds for consumption when they had no income.

The question for NGO microfinance programmes in China is whether creating savings products is worth their while since they would face intense competition from savings services offered by the growing network of the China Postal Savings Bank in the rural areas and the already large network of RCCs. The apparent lack of demand from borrowers interviewed here is also not very encouraging. Half the NGO microfinance programmes surveyed by Druschel (2002) provide savings services although none of them are sufficient to be mobilized as on-lending capital due to the small sum of deposits collected. (Druschel 2002, p.90) The small sum of deposits collected is not adequate to propel the programme towards financial sustainability as defined by mainstream academics and practitioners. However, with sustainability of NGO type microfinance programmes as redefined in Chapter 3 and the targeting of the 'financially marginalized' to provide them with the financial services they lack, savings services should be provided by the NGO microfinance programmes. They should not be deterred by the superficial lack of demand for savings services shown in the borrowers interviewed here. If allocated funds have been used to smooth consumption during no-income periods, the villagers must have stored funds somewhere, which means they have been saving. They may not consider 'informal savings', such as keeping cash under the pillow, community rotational savings, etc, as officially saving money. Also if the loans provided by this programme are improving lives, their wealth accumulation may increase too, allowing the borrowers surpluses to save.

The saving behaviour of the low-income is poorly understood, but it has also been recognized that the demand for savings service exists even among the most impoverished households. (Armendariz de Aghion and Morduch 2005, p.165) The availability of saving services from NGO microfinance programmes will encourage good saving habits and provide the 'financially marginalized' with another means to save. Similarly to those who obtain access to financial services, they would also like to diversify their savings.

There are however concerns about creating flexible savings products and whether these products can be extended to non-borrowers in a village designated as 'poor' by the local government. The design of the product has to be commensurate with its transaction costs, which would be reflected in lower deposit interest rates. The NGO microfinance programmes can possibly set up a fixed-term savings fund with the local financial institutions and charge a slightly lower interest rate to the depositors to cover their costs. This may not be, however, sufficiently competitive for depositors but designing flexible savings products can camouflage low and uncompetitive interest rates. As NGO microfinance programmes are running on a project basis, there are also concerns as to whether depositors can trust their sustainability; thus it is important first to recognize the organizational status of the programmes. This would allow the potential organization to open saving accounts officially in the local financial institutions, engaging the services of the existing financial infrastructure in rural China.

5. The Demand for Insurance Services

If there is an apparent lack of demand for savings, there is on the other hand a vibrant and unexpected demand for insurance by both borrowers and programme in Fu'an. Insurance, being a more sophisticated financial product, has been the least introduced service in the microfinance community but is gradually gaining importance and reaching the financially marginalized. Providing insurance to low-income people can reduce their vulnerability and could be a long term measure for poverty alleviation, since according to Morduch, the condition of poverty can be linked to vulnerability. (Morduch Aug 1999, p.187)

The FINCA-AIG partnership in Uganda is at present the most successful by far and the most talked about microinsurance programme for penetrating into the poor market. The partnership with AIG, a world-leading insurance provider was initiated by FINCA Uganda in 1996 and started on very uncertain grounds. The risk that AIG has undertaken has now proven to be a first. The partnership currently serves more than 1.6 million clients through 26 MFIs in three countries and generated USD 750,000 in premiums in 2003 (McCord et al, 2005).

Credit life insurance is the most popular and basic form of insurance available to MFIs, and is sometimes arranged and provided by the MFIs themselves without the help of insurance companies. It covers the outstanding

loan amount if the borrower (the insured) dies and is sometimes packaged with a small sum of compensation to the family of the insured. Health insurance is currently being attempted[24] but remains a huge challenge due to the influence of various government policies on healthcare. Property and crop insurance are also being attempted.[25] Innovation plays an important role in developing microinsurance products for the low-income and such innovation is rooted in a strong understanding of the local culture, community and livelihood. Despite the fact there could be a large potential market in China, there is still little interest in microinsurance, which could perhaps be due to the information asymmetry between supply and demand conditions in the rural market.

Supply Conditions

The insurance business in urban China has been expanding in line with the country's vigorous economic growth, but the rural insurance industry is still underdeveloped. Total premiums for agricultural insurance for the government-run China People's Insurance Company amounted to RMB 817 billion in 1992 but dropped to RMB 418 billion in 1999, and has recently fallen even further (CASS 2006) reflecting the lack of competence by the government in monopolizing and handling the insurance market. According to a large insurance broking firm based in Hong Kong[26], the government has been making considerable efforts to provide insurance to farmers affected by natural catastrophes, but low premium levels and high loss ratios[27], running at several hundred percent[28], have discouraged international insurers and reinsurers to participate in government insurance programmes. A government-run insurance company has very recently started a pilot programme, providing house, property, crop and liability (against bodily injury) insurance following natural catastrophes to farmers and fishermen in the Fujian province. Currently only a few counties are covered but house insurance is available throughout the entire Fujian province except for Xiamen city. The premium for house insurance is fully paid by the local government,

[24] For example, clients pay an annual premium of USD1.50 for coverage against loss of property in the event of a catastrophe at SEWA and receive a compensation of USD10 for each collapsed wall in their house and USD60 if the house is beyond repair (Armendariz de Aghion and Morduch, 2005).

[25] For example, clients pay an annual premium of USD1.50 for coverage against loss of property in the event of a catastrophe at SEWA and receive a compensation of USD10 for each collapsed wall in their house and USD60 if the house is beyond repair (Armendariz de Aghion and Morduch, 2005).

[26] See Appendix 3 for email questionnaire.

[27] Loss ratio is defined as total losses/total premiums x 100%.

[28] There could be a lack of transparency in insurance data and loss ratios. The loss ratios may have been jacked up by local insurance companies so that the government can support the premiums.

while the premium for crop insurance is shared 50-50 with the farmer. Private insurers and reinsurers have participated in this programme with more confidence since the government guarantees the premium collection from the farmers. However, studies need to be conducted on whether the farmers actually receive the correct compensation for the premiums paid, as there have been cases where farmers were not paid the claims amounts due to them.[29] The programme officers at Fu'an are unaware of this programme but one officer said that the government has compensated the lives of fishermen lost during Typhoon Saomai, which occurred in August 2006. He is unsure whether this was part of an insurance programme or purely an initiative by the government to compensate for lives lost.

In another village in Fu'an county, the government paid compensation of RMB 500 to the farmers of grape vines damaged by typhoons in 2005. The money was split between the affected farmers, but was hardly enough to buy seeds to replant the grape vines.

The government insurance programme in Fujian province is in its infancy and it is only tapping into a very small market, hence it appears that there are plenty of opportunities for private insurance companies in the rural areas. Recently, the government pledged to invest in the rural areas, raise farmers' income and to rebuild a socialist countryside.[30] With a figure of more than half the population of 1.3 billion people living in the rural areas, these factors should be extremely attractive features for insurance companies to expand their market, but there does not seem to be anything in the pipeline yet. There are hardly any representatives of foreign insurance companies in the rural areas, even though foreign insurance companies are allowed to conduct business without geographic restrictions five years after China's accession to the WTO.[31] Business preferences are obviously given to urban settings where insurance data such as loss history and premium estimation are more comparable to other developing countries. Also, rural areas have been hit badly by catastrophes such as earthquakes and typhoons. Previous losses and low premium levels from government insurance companies become a testimony to why foreign insurance companies are absent from the rural areas. Insurance companies also face another challenge, similar to the RCCs in the rural market, the challenge of distribution, delivery and reaching out to

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[29] See *Demand Conditions* for cases reported from this study.

[30] Full Text: China's economic and social development plan-III' 05 Mar 06, http://english.peopledaily.com.cn/200603/15/eng20060315_250831.html

[31] 'China Unveils WTO Details on Opening Insurance Market' 23 Nov 2001, http://english.peopledaily.com.cn/200111/23/eng20011123_85130.shtml

clients. Lack of transport and telecommunications are preventing insurance companies from using conventional urban methods to reach out to their clients. The lives of rural people and the financially marginalized are more heterogeneous than regular urban clients and hence costs will be involved in designing new, suitable and simple insurance products that are differentiated for various local communities. Suitable products are vital for the survival of the insurance business in rural areas.

What are the driving factors, then, for insurance companies to venture into the rural market in China? Insurance companies are driven by profits and demand from the public and policy makers. An insurance company with vast experience in the microinsurance sector remarked that they view this sector seriously as a business opportunity. They have a team solely dedicated to the business development of microinsurance as a sustainable line of business for their company.[32] Allianz also has the view that microinsurance is a good way to combine corporate responsibility with a business opportunity. Therefore, although the Corporate Affairs divisions in large corporates are committed to the philanthropic act of providing funding and grants to the microfinance community, business opportunities and profits are still the main driving forces.

In terms of demand from the public and policy makers, Allianz recently developed and offered microinsurance products to low-income households in Indonesia, based on a study which revealed that a huge gap exists between demand and supply. There is a lack of study and research on microinsurance in the microfinance community in China, as studies are still concentrated on the sustainability of microfinance and its basic products, such as loans and savings.

Cooperating with partners from the microinsurance industry such as microbanks and savings cooperatives, credit-life insurance products are offered by Allianz to the loan clients. The microbanks and savings cooperatives, like FINCA-AIG Uganda are responsible for the premium collection and claims settlement. Allianz is targeting a figure of 50,000 microinsurance clients by 2007.[33]

Insurance companies are uncertain about the status of microfinance in China as there is no such industry status yet, unlike the situation in Indonesia. Programmes are mostly operated by NGOs and are project based. The

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[32] From email questionnaire with insurance company.

[33] 'Allianz Offers Microsinsurance for Low-Income Households in Indonesia' 24 Aug 2006, http://www.allianz.co.id/AZLIFE/English/News/News+Archive/2006/Press+Conference+-+Microinsurance.htm

customer base can be as transient as the project based microfinance programmes and it is possible that insurance companies are unable to foresee the long-term sustainability of these projects with such a weak and transient client base.

With the lack of demand studies and rural experiences, foreign insurance companies are still hesitant in seeking partnerships with the microfinance community in China. A leading insurance company commented that the microfinance industry in China is 'very nascent and small, with little experience and few partners to work with'. They however see opportunities when both the microfinance industry and operations in China grow.[34]

Demand Conditions

The study conducted in Fu'an indicated that there is indeed a demand for insurance from borrowers and the programme. Discussion with programme officers show that credit life insurance is necessary to secure the long term sustainability of their microfinance programme. The situation where a few healthy borrowers die each year has affected their balance sheets and the programme is trying to create a reserve fund for such events by charging borrowers a small sum of money. If the programme charges RMB 5 per person, it can create a fund of RMB 22,500 among its approximately 4,500 borrowers. This fund can cover about 7.5 deaths a year based on a RMB 3,000 loan. The pooling effect can be extended to the rest of the almost 40,000 borrowers of other programme locations by CFPA, creating a total fund of about RMB 220,000. The programme in Fu'an has matured to a stage where its managers view insurance as a need and a financial product to complement their existing loan services.

Most borrowers interviewed have come across the word insurance or *bao xian* in Chinese. A village, which was partly affected by Typhoon Saomai, had borrowers who had bad experiences with local insurance companies, which were unable to pay the claims incurred by the damage to their crops and properties. The borrowers here were angry with unscrupulous insurance agents and said that they had lost their trust in local insurance companies, as they felt cheated after paying the premiums diligently and not receiving their due compensation. During an informal focus group discussion, when asked if the programme officers were to offer insurance services would the borrowers trust them, the borrowers enthusiastically replied in the affirmative. I tested

[34] From email questionnaire with insurance company.

their willingness to pay for premiums for general crop and property damage with a maximum compensation of RMB 3,000. The extent of damage was not fully described but borrowers were given the situation where a typhoon hits and their crops and property are badly damaged. The idea was to test how much they were willing to pay annually for a certain amount of compensation so that insurance product designers can have some numbers to work with for development and pricing of microinsurance products. The borrowers in this village and another fishing village were content with paying RMB 50 annually for a compensation of RMB 3,000. The programme director at Fu'an also agreed that this would be an acceptable compensation for an annual premium of RMB 50. He suggested that the premium could be paid in instalments over ten months to ease the burden on the borrowers and that it could be collected together with the loan instalments.

Life insurance seems to be a more popular product compared to property insurance according to one programme officer. Some fishermen have been paying RMB 1,000 annually for a RMB 60,000 cover. This product is provided by a local insurance company and fishermen have approached the company reluctantly to secure cover, aware of their poor track record of paying claims. Even with minimal trust, they are still approaching insurance companies, as they are acutely aware of the risks they face when going out into the sea.

It appears that insurance is not a new concept for the low-income households based on this study. Demand for insurance products exists but insurance providers have to first face the hurdle of recovering from the loss in trust for their services. The incompetence of the local insurance providers gives international providers an edge and the director of the programme in Fu'an, impressed by the integrity of large international insurance providers is extremely eager to work with them, if the opportunity arises.

The Potential for Microinsurance

Some practical literature[35] is already available on how to form partnerships, and the resulting benefits, between MFIs and insurance providers, but the unique situation in China calls for more prior understanding before partnerships can be formed. This case study does not represent the entire rural insurance market in China but is based on a few locations in Fujian province.

[35] For example, 'Technical Note 4: Insurance as a Microfinance Product prepared by Mary Miller and Zan Northrip of Development' Conference on 'Advancing Microfinance in Rural West Africa in Mali' Feb 2000.

Nevertheless, it reveals some unexpected factors in the impending challenges when forming such partnerships in China.

The benefits of microinsurance are numerous for the actors involved. Microfinance programmes are enhanced by this risk management service developed by insurance providers by providing them with a form of revenue for delivery and distribution of the microinsurance products. The risk management service for microfinance programmes does not only confine itself to credit life insurance products, as by providing their clients with other forms of insurance, such as property and health insurance, their vulnerability to shocks in life can be reduced. The client's livelihood can be rebuilt in a short matter of time, while interruption for the demand of loan and savings services from microfinance programmes are minimized ensuring and enhancing the sustainability of the programmes. Clients of microfinance programmes are also willing to take higher entrepreneurial risks after subscribing to insurance, raising their income, loan demand and savings prospects, which directly benefits the microfinance programmes.

As for the insurance providers, the microfinance programmes provide access to a large network of clients with local expertise, especially in local culture and language across provinces that can fundamentally increase risk spread for insurance providers. The marginal returns on premium from low income earners can actually be better than from high income earners, based on the willingness to pay RMB 50 for a compensation of RMB 3,000 for property damage. The premium rate for property damage as a result of earthquake in Indonesia for a high-rise building varies from 0.20% to 0.30% of the total sums insured, while potential premiums from the villagers' amount to a rate of 1.6% (50/3,000 x 100%).[36] Of course, this is a very gross approximation as there are technical aspects of insurance, which have not been considered here, such as whether the rate is based on the total sum insured or on a first loss basis. Nevertheless, the very high premium rates should appeal to insurance providers considering entering the market, as it shows that the low income earners are willing pay a higher rate than their counterparts who normally obtain access to insurance services.

Partnerships are built on mutual understanding and a win-win situation for both parties. Microfinance organizations look for insurance providers with a good track record and international experience in microinsurance, while

[36] This figure is a gross approximate obtained from the years of personal experience in the insurance industry in South East Asia. Based on a recent presentation by an Indonesian insurance company, the rate, depending on zone, occupation of the building, construction etc ranges from 0.104% to 0.33% of sums insured. See www.tsrsb.org.tr/NR/rdonlyres/928EF283-422D-4514-B579 C0E83FDD7E77/1178/Bugl_EarthquakeInsuranceIndonesia.ppt

insurance providers look at the availability of a good and significant client base, and the sustainability, management and resources of the programme. In China, microfinance programmes have large client bases with the UNDP/CICETE programme leading with about 130,000 clients, followed by CFPA with approximately 45,000, clients and the FPC with 30,000 clients[37]. There is also a potential for insurance providers to reach out to non-clients in the designated 'poor' villages, taking note that the income gap between villagers in a designated 'poor' village can be quite high. Hence they have to consider delivering products based on different levels of income for the villagers. As mentioned earlier in this thesis, if microfinance programmes are about improving lives, then insurance providers should follow this dynamism by constantly improving their products up to the point where their clients graduate to become accessible to mainstream financial services.

All the three programmes mentioned above have been in existence for more than five years, a sign of operational sustainability, but are still project based with no legal organization status as yet. This could be a deterring factor for insurance providers to form partnerships.

Insurance providers may be fearful of the extent of losses due to the catastrophic events in the villages, especially in Fujian province, but even in one village not all the farmers have been affected. If priced properly, with a large outreach to spread the risk, the products can protect the villagers and can also make profits for the insurance providers. On the other hand, insurance companies need to be fair since there could be a tendency to charge higher premium rates based on the willingness to pay and the lack of competition. This is where insurance companies could face the difficulty of balancing between consciousness of corporate responsibility and business opportunity.

The main hurdle for partnerships between insurance providers and microfinance programmes is for the programme to first legal organization status. Following that, partnerships can be formed and steps can be taken towards regaining the trust of the villagers in insurance products. This can be done by delegating and training trustworthy microfinance programme officers to run the microinsurance programmes, where resources allow.

The staff at the Fu'an office was very enthusiastic about starting a pilot programme with a suitable partner and suggested various methods for running a microinsurance programme. For example, the group methodology can be extended to avoid fraudulent claims with peers in a group not receiving any compensation for a claim if one claimant in the group is found to be fraudulent.

[37] Drushcel, 2002 - Table 1, pg 57 & 58.

This may appear to be a simplistic portrayal of the operations of a partnership. If the FINCA-AIG partnership started on uncertain grounds with 8,500 clients in Uganda in 1997[38] growing to 1.6 million in 2003, there could also be similar potential in China. More studies are required, however, to support this potential and it is hoped that partnerships like FINCA-AIG Uganda can materialize, given the benefits to the actors involved.

CONCLUSION

Attempts to achieve financial the sustainability by NGO microfinance programmes as supported by some international donors in China may backfire due to intense competition. In China there are already many existing financial infrastructures for poverty alleviation promoted by the central government. This may render the survival of microfinance programmes problematic, and microfinance programs may end up either better or worse depending on how the programmes manage to adjust to existing and changing policies.

Therefore the notion of 'sustainability' has been redefined here for NGO microfinance programmes under the unique conditions for microfinance in China, referring to the adequacy of operational sustainability and the ability of the programmes to run for a certain number of years with constant evaluation on their impact on poverty alleviation. In order for programmes to survive, their objectives have to be clear; not necessarily towards them shaping into a formal financial or commercial institution, but towards the development of legal organizations and thereafter towards embracing the existing financial infrastructure to form sustainable partners.

This case study involved the understanding of the concept of poverty by examining the lives of borrowers in order to ensure the sustainability of NGO microfinance programmes. With disparities in life situations even among the poor, those to be targeted should be the 'financially marginalized' rather than the 'poor', who are economically active individuals lacking access to mainstream financial instruments. Hence, microfinance programmes should follow the dynamism of improving lives, and provide services and financial products up to a point where their clients graduate and become accessible to mainstream financial services.

[38] Kasi, p.6'Gender Targeting of Rural Financial Services: Is this Appropriate? Case Study of FINCA Uganda'.

Successful and sustainable microfinance programmes in China can improve lives and play a part in improving the rural economy and possibly reduce the inequality gap between the rural and urban areas.

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Appendix 1: Framework of Interview Questions for Microfinance Clients

Borrower's Profile

- Age
- Gender
- Occupation
- Kid(s) and age
- Education

1. How long have you been taking out loans? What is the loan for? Have the loans improved your lives?
2. Do you save? Why? Where?
3. Do you remit money?
4. What is your priority in life? Good health? Children's education, etc?
5. Do you lead a 'comfortable' life?
6. Do you know what insurance is? Would you be willing to pay for an amount of premium to get compensation for your damaged crops, property?

Appendix 2: List of active NGO microfinance programmes in China (Druschel, 2002 p.57)

FPC (Funding for the Poor Cooperative)
UNDP/CICETE (China International Center for Economic and Technical Exchanges)
UNICEF (United Nations Children's Fund)
UNFPA (United Nations Population Fund)
ARDPAS (Association for the Rural Development of Poor Areas in Sichuan
Heifer Project International)
World Vision
CC97 (Canada-China Women's Income Generating Project)
Malipo REDA (Rural Economic Development Association)
Oxfam Hong Kong
CFPA (China Foundation for Poverty Alleviation)

Appendix 3: Email questionnaire to Insurance Companies

1. A short description of the company's development and potential of microinsurance programmes worldwide and China?
2. What are the conditions required (regulatory, risk spread and pool etc) for MFIs to incorporate Microinsurance into their programmes or the basic conditions for insurance to seek partnership with MFIs worldwide and in China?
3. Please describe constraints in China, if any.
4. Company's objective in developing microinsurance business (corporate responsibility, profits, demand oriented etc)

Appendix 4: Email questionnaire to Insurance Broking Company based in Hong Kong

1. Please give description of the government insurance programme, the cover of the programme - damage to crops (and other property?) following natural catastrophes etc?
2. Who is covered? If farmers, farmers in which county? What is the outreach, and does this programme reach down to the low income villagers?
3. Premium and compensation, how much do the farmers pay? How much are they compensated? How is the insurance administered - premium collection and loss payment?
4. Is the local government cooperating with any local agents?
5. What were the obstacles in getting this programme to work?