Innovations in Financial Inclusion of The Urban Poor: A Model of Rahat Credit Cooperative Society, India

Anjali Kulkarni

Abstract:

Most of the Asian countries face challenge of poverty which is linked with unemployment. Lack of assets and income make poor unable to invest for self-employment or for knowledge / skill development leading to employment. Access to financial services may help people to co. Me out of poverty through variety of ways like availing credit, insurance and saving facilities. In India, in spite of several initiatives for financial inclusion, field level data shows that by merely opening bank account the access to credit may not be there and financial inclusion in true sense may not happen. The microfinance movement had regional success in India. There are almost 35% urban poor in India indicating the need of innovations in financial se, vices for them.

"Rahat Urban Credit Cooperative Society" was an initiative in 2008 of few persons belonging to Islam religion and believing on the teachings of Quran that the interest should not be taken. Though inspired by a particular religion the services are extended to all community groups. In today's context when different religions are discussed for using the religious values/ teachings negatively, Rahat will be a unique example how religious teachings can be utilized positively for society's benefits. Since 2011, besides usual financial products, it gives interest free and collateral free loans for urban poor for self-employment and for consumption purposes.

The case study focuses on understanding the community based business model and its impact on urban poor in terms of their financial needs by analyzing the financial performance. The study explores how 92% recovery rate for loans is there and how depositors are attracted for interest free product. It also tries to understand the use of social capital in provision of financial services for urban poor having inability to give collateral.

"Rahat" means relief. The present paper I brings out a Rahat model of financial services and inclusion of urban poor and try to understand how it has brought the relief in urban poor lives.

Keywords: Urban poor; innovations in financial inclusion; community based model; interest free model; social capital.

Introduction

The majority of Asian countries are currently facing the multiple challenges of poverty, among which unemployment often plays a key role. More than 680 million people in Asia and the Pacific region are considered poor (i.e., living on less than US$1.25 per day). More than 70% of these people live in South Asia, which contains the largest rural population in the world. India has the largest concentration of poor people in the world. The percentage of people living below the poverty line in India is 25.7% in rural areas, 13.7% in urban areas and the overall figure for those considered living in poverty in India is 21.9% (2011-12). Due to a lack of assets and income, poorer people are unable to invest in self- employment or in developing their knowledge or skills, which may lead to paid employment. Providing access to financial services, such as credit, insurance and saving facilities may assist people in escaping poverty. However, the majority of the Indian population is excluded from banking services as only 54.4% in rural areas and 67.8% in urban areas are able to access bank services (Census, 2011). Despite several initiatives for financial inclusion, field level data shov1s that merely opening a bank account may not equal access to credit. The movement of microfinance has not been successful across all Indian regions. The urban Indian poor can be considered particularly neglected in a variety of ways, for example, the provision of banking services. A number of researchers speculate there are almost 35% urban poor in India, indicating the chronic need of innovations in financial services, the increase in accessibility of these services and the promotion of the financial inclusion of the urban poor. Financial exclusion refers to the lack of access of certain consumers to appropriate, low cost, fair and safe financial products and services by the mainstream providers of financial services. Research conducted on the issue of financial exclusion suggests that services may not be considered relevant to the needs of consumers or the utilization of these services can involve a considerable amount of processing and documentation. A further reason suggested for exclusion of the poor is their inability to provide collateral when applying for loans. Thus the poor who are asset-less are likely to be excluded farther. This paper presents a case study of innovation in the financial inclusion of the urban poor, through an interest free model of microfinance.

Literature Review

One of the key factors in decreasing poverty, is finance. It is therefore imperative that people have access to financial services, which will enable them to participate more fully in society. According to Cull Ehrback and Hole (2014) it is shown that financial inclusion is positively correlated with growth and employment, at the macroeconomic level. Kempson and Whyley (1999) and Leyshon and Thrift (1995) have shown that financial exclusion is a phenomenon which often affects a minority of predominantly vulnerable and otherwise disadvantaged people, for example, single parents, social tenants, the long-term unemployed, members of some minority groups, ethnic communities and people with persistent low incomes. The conventional financial services do not consider it profitable to provide small and frequent lines of credit to poor people. This was the norm until Mohamad Younus, in the 1980s in Bangladesh, provided the innovative approach of a micro-credit facility for the poor who were excluded from formal financial services. This micro-finance approach has become popular in different parts of the world, especially in poor and developing countries. Other variations of micro-finance also gained prominence. Banerjee and Duflo (2011) concluded that microfinance has achieved foe objective of being a key instrument in, fighting against poverty through the supply of micro-credit to poorer members of society.

Criticism of Micro-finance

Although micro-finance has become more wide-spread, it has been criticized for offering higher interest rates and also its inability to reach the poorest in society. Wright (2000) stated that micro-finance projects actually fail to reach the poorest people and generally micro-finance has been shown to have a limited effect on income. A further criticism of microfinance is its lack of religious and cultural sensitivities (Muhammad, 2012). In some Muslim countries particularly, conventional microfinance has always been rejected, due to its non-compliance of Islamic principles, particularly interest or “rib a” (Muhammad, 2012).

Islamic Microfinance

Recently, a number of traditional financial companies have started offering services which are aligned with Islamic principles. Evans (2014) reviewed financial institutions in the UK and the US and found that Islamic-specific ranges, such as interest free and profit loss sharing products were launched to attract Muslim customers. The International 1vfonetary and the World Bank also recognized Islamic financial products as alternative means of financial intermediation (Sundararajan and Errico, 2002; World Bank, 2013). Further the World Bank also has recognized that the customization of program is one of necessary conditions for poverty reduction (Haq & Shafiq, 2015). There are a growing number of microfinance institutions which have emerged who follow these Islamic principles, particularly interest free loans and savings. However, many issues have been raised regarding the sustainability of this interest-free model. Pejman et al. (2015) conducted a review of studies of the performance of conventional and Islamic banks and concluded that the Islamic banks were at least as efficient as the traditional institutions. Indeed. smaller Islamic banks had particularly low default/insolvency risks compared with their more conventional counter parts. This may be because Islamic banks typically focus more on higher margin small business borrowers who are less likely to default. Pappas et al. (2014) studied the survival rates of Islamic and conventional banks from l 995 to 2010 using duration analysis and found that Islamic banks had significantly lower failure rates compared to similar conventional banks. Baele et al. (20 i 4) used hazard functions to model the loan default rates of small business loan borrowers in Pakistan. Using a unique data sample of 150,00G small business loans from 2006 to 2008, their research showed that the default rate on small business Islamic loans was less than half of that of conventional loans. The study also showed that small business borrowers that take loans from both conventional and Islamic banks are more likely to default on the former. This could be due to the moral pressures linked to religious beliefs. Soylu and Durmaz (2012) studied the profitability of interest free versus interest based banks in Turkey from 2002 to 2008 on a yearly basis. Their study showed that interest-free banks did have positive and reasonably strong rates of profitability, though their level of profitability was somewhat less than that of traditional banks. The data suggested that interest-free banks, based on Islamic principles, can be a viable option to traditional capitalist banks that derive a large portion of their profits from interest charges. Iqbal et al. (2015) undertook a comparison of interest free and interest charging micro-finance institutes in Bhawalnagar in Pakistan. It was observed that customers of interest free micro-finance institutes succeeded in reducing their poverty levels by improving their basic needs and living standards as compared to the customers of conventional micro-finance banks. However, product line, overall management and loaning procedures of conventional microfinance banks were perceived to be more successful.

Cases of Interest Free Models

There are a number of institutions worldwide offering interest free loans, which use a variety of models. The following are brief examples of case studies from different parts of world.

Interest Free Model: JAK Bank, Denmark, Sweden and Italy

The interest free model has been in practice not only in Muslim dominated countries, but also in other countries. The JAK bank was registered in Denmark as a cooperative society in 1934 and offered an interest free saving and loan system. These interest free loans helped the members/farmers to pay off their expensive bank loans. The JAK bank model emerged as an alternative to conventional high cost loans. The bank was only successful for a number of years before closing. However, the earlier members imitated JAK savings and loan systems and a number of them are still in operation today. In 1965 the Swedish JAK was formed and in 1997 it gained the status of a bank in Sweden. The JAK. model has also been adopted in other countries like the UK, Finland, Belgium, Germany, Canada, the Netherlands, Spain and Italy.

JAK believes in a fair and sustainable economy to increase long-term prosperity for everyone. JAK does not pay any interest on savings and does not charge any interest on loans. Every member has to pay an annual membership fee. If a family member then joins, other members pay a little less membership and children do not pay any fee. Members gain an equity share in the bank and this gives the right of one vote to one member in board elections. The member can start saving immediately and begin accumulating saving points, without necessarily needing to take a loan. The saving can be undertaken in the repayment period and saving points are then accumulated. The loans are giver, on the basis of the total liquidity or savings and a member's capacity to save and repay loans. Therefore loans are supported by r.1.embers' savings and liquid assets. Thus deposits become a major source of funds available to the bank. A loan fee is charged which subsidizes operating costs related to loan services. The loan fees are in proportion to the amount of loan provided. There is no interest paid on deposits but saving points help the member to gain a loan. The JAK model is promoted by a network of m0re than 700 volunteers through regional and local offices and also with the help of existing members. They support other members in creating their savings and loan plans. The JAK bank organizes various capacity building programs for its members and volunteers. The JAK Italia was founded in Italy in 2011 and follows the JAK Sweden model with some variations. Both these banks focus on small and medium size businesses and households. The JAK bank model is considered a sustainable one and the individuals, businesses and communities are committed to sustainability and improving life quality for all. The bank does face challenges. such as new banking regulations at the European Union level and client demand for new financial services, according to Lelisa and Vichi 2013

Case of Akhuwat, Pakistan

One important characteristic of Islamic finance is the prohibition of interest in lending activity. "Qard-Al-Hassan" or a benevolent loan is a loan given to community members who are experiencing financial distress. It is a non-rewarding loan but the borrower is under a moral obligation to repay the principal amount as per their financial capacity. "Akhuwat", which means solidarity, is another model of social and sustainable finance, and Was launched in Pakistan in 2001. The mission of Akhuwat is the alleviation of poverty by empowering socially and economically marginalized families through interest free microfinance by promoting entrepreneurial potential, capacity building and social guidance. Akhuwat funct10ns under the guidance of a board of directors and there is an executive committee who is responsible for administrative and operational issues and both volunteers and paid staff. The loans are provided for a variety of reasons, for example, open businesses, pay off car1:cr loans with high interest, pay for children's education, cover health procedures, pay off emergency loans, facilitate marriages of daughters/sisters and enable business expansion. In addition, liberation loans, which are used to clear earlier loans with higher interest rates, are also provided. The lending methodology used is very simple. It includes the assessment of an individual's income and the feasibility of the prospective business. AS well as meeting the previously mentioned criteria, two guarantors from the same community also have to be provided by the family. Besides the provision of the financial services, Akhuwat also provides Plus Services. These services focus on offering technical advice to the borrowers which may assist in the long term sustainability of the entrepreneurial activities. After the loan has been administered, a Loan Officer monitors the repayment schedule through work place visits or, in the case of delay, reminders are sent through the guarantors. If default occurs due to external circumstances, due consideration is given to repayment options. In the case of the death or disability of the borrower, then the loan is waived off and additional support is offered to the borrower or their dependents. This support is also extended through the Akhuwat Mutual Support fund where borrowers voluntarily contribute 1% of their loan amount if the loan amount is above Rs. 4000 (US$40). In addition to the capacity building of the borrowers, Akhuwat also works on social issues like girls' education, observance of local laws and traffic rules, etc. In order to reduce operating costs, Akhuwat works in religious places such as mosques and churches. Disbursement of loans from these places may also increase transparency and accountability. Using such premises can help to minimize potential moral issues also act as a selection tool, which could then decrease the risk of default. The Member Donor Program is one major source of funds where borrowers donate voluntarily to the organization and another source is a fund recently provided by the government. Although Akhuwat enjoys a high recovery rate and a very low percentage of written off loans due to Akhuwat' s focus on the client's sustainability, continuous access to a flow of funds is crucial for sustainability. So, Akhuwat is developing partnerships with local organizations who want to follow the same model. Akhuwat's aim is to be an apex organization for such local level partnering organizations. Though Akhuwat is successful in reaching out to the poor, it faces criticism for its limited reach to women, perhaps due to its use of religious places where women's entry may be restricted.

Interest Free Model, Kenya

Beck and Chull's (2013) research, entitled "Banking in Africa", reports the advantages of combining financial products specifically designed for poor clients with mobile delivery methods. A Kenyan venture combines elements of credit extension and mobile delivery methods with a commitment to encouraging savings. This program is named "Jipange KuSwave", which means to organize oneself to save in Swahili. In this model the client is given an interest free loan. A portion of the loan must stay in a savings account and the remainder is deposited directly into a client's M-Pesa mobile wallet, from which loan repayments are made. There is no fixed schedule for repayment of loan, although the client only becomes eligible for the next loan after the earlier one is fully paid. In addition, clients also set personal targets for saving and a penalty is imposed if funds are withdrawn before the target is met. According to Rutherford (2012), the assessment of this model showed that the clients were able to save and continued to do so until they reached their target. As it is a low-cost product, Rotman, Ferand and Rasmussen (2012) observe it helped to promote financial inclusion of the poor in Africa. This example clearly shows that clients can establish saving and credit history and can also gain access to larger loans. An individual's credit history with Jipange KuSwave is essential when applying for loans without collateral.

Al Khair Credit Cooperative Society Limited, India

The Al Khair Credit Cooperative Society Limited is a successful example of an organisation offering interest-free loans. It currently operates in Uttar Pradesh, Bihar, Delhi and the Jharkhand states of India. The organization's premise is that focusing on saving ensures the continuous flow of money and therefore increases the number of loans available. It has also implemented a profit sharing product for loans. In addition to the Al Khair society, there are a number of other organisations providing interest-free loans to poorer people in India.

Financial Exclusion in India

In India, policy makers are extremely aware of the effects of financial exclusion and therefore, long-term attempts to create a more financially inclusive landscape are made at the national policy level. The nationalization of some banks was one such endeavour to promote financial inclusion, particularly of the rural poor. Priority Sector Lending was another initiative taken by the Reserve Bank of India (the regulatory body for the financial sector in India) in 1972. The aim of this initiative was to ensure that credit would be provided by banks to those sectors of the economy which required it. A key element of this policy was the prioritization of lending to weaker sections of society to fulfil their financial needs and prevent their financial exclusion.

The Financial Inclusion in Asia Country Survey report 2014 concludes that despite India's efforts, only 36% of the population possesses a bank account. Micro, Small and Medium Enterprises (MSMEs) are drivers of growth; however, they mostly relied on informal financial arrangements. It has been suggested that financial products and services should be designed around the needs of households and businesses, for example, financial education, rather than the needs or banking institutions. in spite of concerted efforts for more financial inclusion in India, available data suggests that financial exclusion is still widespread. Recent ventures such as "Jandhan Yojana" may create improved access to banks, but they do not necessarily ensure increased access to credit facilities. A lack of access to financial services is also a major issue for specific groups, for example, certain tribes, women, etc. due to cultural and other reasons. Therefore particular attention needs to be focused on the financial exclusion of minority communities in India. The Muslim population as reported in the 2011 Census is 14,23%. The influential "Sachar Committee" report in 2006 provided an insight into the financial exclusion of the Muslim community in its chapter "Access to Bank Credit".

The report explains that under Priority Sector Lending, Muslims hold only 12% of accounts in 27 public sector both and 11 % of accounts in 29 private sector banks. Further data shows that in 44 minority dominated districts in the country, where Muslims constitute 33% of the population, they hold only 21 % of all public-sector bank accounts. Using a range of data on loans and savings, the committee concluded that the shares of Muslim's accounts, total amount outstanding and amount outstanding per account of Muslims remains disappointing. The committee suggests this limited share is due to the negative mindsets of the banking sector and also because of faith reasons. Indeed, the Raghuram Rajan Report on Financial Sector Reforms, 2006 has clarified that certain faiths prohibit the use of financial instruments that pay interest. The lack of availability of interest-free banking products results in some Indians, particularly those from economically disadvantaged areas of society, not being able to access banking products and services due to reasons of faith. Therefore, it has been suggested that there is a need to introduce "interest-free" banking to promoting financial inclusion within India. As India has the third largest Muslim population country in the world after Indonesia and Pakistan and it is estimated that it will contain the largest Muslim population in the world by 2050 (Indian Express, 2015), it is imperative that the banking sector meets the needs of this growing population.

The Reserve Bank of India published a Report of the Committee on Medium Term Path of Financial Inclusion in 2015 and made some key recommendations. It suggests that commercial banks in India may be enabled to open specialized interest-free windows with simple products like demand deposits, agency and participation securities on their lability side and also to offer products based on cost-plus financing and deferred payment and deferred delivery contracts on the asset side. This would create more choice in the financial services for potential Muslim customers. Tiwari (2012) that as the Muslim population in India is considerably high, compared to other countries, and the demand for Islamic products is increasing, there is also a need for specialized Islamic financial institutions. In agreement, Rahman (2014) also acknowledges that there is the potential in India for such banking services, but cautions that favourable regulatory conditions and awareness will be required. The last few decades have witnessed microfinance emerge as an alternative to the usual financial services. However, the traditional microfinance institutions are criticized for offering higher rates of-interest, their inability to reach the poorest sections of society and their lack of presence in certain areas. The literature clearly shows that interest-free loan models are offered in different parts of the world and that the financial inclusion of the very poor is In India, there are numerous successful examples of institutions offering interest free loans. However, the number of these loans in relation to the population size is very small Tbc Reserve Bank of India's research concludes that the banking needs of the poor should be met by, for example, interest free loans.

Rahat Urban Credit Co-operative Society Limited (Rahat)

Osmanabad district is located in the drought-prone region of Marathwada in the Maharashtra state of India. Due to the consequences of its climate, the region experiences a flow of migration to urban areas for employment. More entrepreneurial activities and diversification of jobs from agriculture could increase employment options and standards of living. Osmanabad is the most populous city in the district and 25.85% of its population is Muslim. This paper presents a case study of the Rahat model of financial inclusion used to benefit the urban poor.

Objective of the Study

The objective of this research is to better understand the Rahat model, in which interest-free loans and deposit facilities are provided to the urban poor, particularly the Muslim population and to decipher its impact.

Methodology for Case Study

A qualitative approach was exclusively employed as the focus of this research was to better understand the functioning of the society. Sec Table 1.

Table 1. Respondents and data collection tools used

Tool	Type of participants	Number
Focus group discussions	Board of Directors of the society Staff	2 2
Focus group discussions	3. Borrowers	2
In-depth interviews Exit Interviews	4. Chairperson of the society 5. Members of Board of Directors 6. Pigrny (Uaily) Saving Collectors 7. Customers as borrowers & depositors 8. Customers as borrowers & depositor	1 4 2 15 15

The customers as borrowers and depositors were randomly selected from the data base of the society. The secondary sources, for example. annual reports, audit reports, individual files of borrowers, different forms and application formats, etc. were requested and provided by Rahat staff.

Establishment of Rahat

Rahat Urban Credit Cooperative Society was founded in 2009 by a group of concerned Islamic people from Osmanabad city. They bad observed that to survive on low incomes, poor people borrowed money from informal sources, especially private money lenders. These lenders often offered high interest rates and the recovery methods used could be coercive. Once a loan was taken out, people were often caught in a debit trap. This exasperated the cycle of debt and poverty and no asset creation occurred even though people were engaged in entrepreneurial activities. They also observed that the Muslim population did not use formal financial institutions due to their lack of assets, their inability to offer collateral and the interest that the institutions charge which does not adhere to Islamic principles.

Based on these barriers to accessing the mainstream banking sector, the group decided to establish a financial services organisation which would serve the urban poor based on the Islamic principle that loans given as well as deposits received have to be interest-free. Initially the organization was set up with 1,000 shareholders. With USD 7794.84/Rs. 5 Lac as the share capital, the society was registered. It was open to all community groups and the minimum share value was USD 1.56/Rs. 100 which allowed entry for all income groups. After initial registrations were completed, members were sceptical of who would repay the interest-free loans and weather there would be a dropout of the members. Nearly 30% of the shareholders are women and there are shareholders from other religious denominations, however their percentage is very low.

Table 2: Current membership and share capital 2016

Year	No. of members	Share capital in USD
2014-15	646	25973
2015-16	760	34161.67

Source: Society's Annual Reports 2014-15, 2015-16.

Table 2 shows that there is an increase in share capital of the society.

Table 3. Details of the products and costs involved in using the products

Type of Product	Share holding	Costs involved
Membership of society and share holding No dividend is offered	Can start with shares of USD 7.79 / Rs.500 Shares can be increased in phased manner up to USD 109.13 / Rs. 7000	Fees for form etc. USD 1.71 / Rs.110
Loan Rs. 10,000 Interest free	Share requirement USD 15.59 / Rs. l000	Service charges 6.24 / Rs.400 Account opening charges USD 1.56 Rs. 100 (in the case of first loan)
Loan Rs. above 10,000 to 20,000 Interest free	Share requirement USD 77.95 /Rs. 5000	Service charges USD 9.35 / Rs.600
Saving through Daily collection. Interest free		Service charge USD 0.78 / Rs.50 Out of which USD 0.12 / Rs7.50 consists of stationery charges and remaining is for the daily/ pigmy collector
Loan on profit sharing basis Interest free	Share holding	20% of profit to be shared with Society
Fixed Deposits interest free	....	....

Table 3: displays the costs recovered by the society in the case of the loan. Besides this, the applicant has to spend DSD 7-8 for other initial expenses, such as providing photographs, stamp-paper for agreement, etc. as per the legal requirements.

Deposits and Loans :

Table 4. Details of deposits mobilized and loans given [amounts in USD]

Year	Savings through daily deposits & savings accounts	Amounts distributed as interest-free Loan
2011-12	7373.92	3554.45
2012-13	25255.28	31101.41
2013-14	51212.10	61735.13
2014-15	214794.61	70574.48
2015-16	2416.40	97747.29

Source: Society’s Annual Report, 1014-2015, 2015-16.

Data in Table 4 shows that there is growth in deposits and a continuous increase in the amounts distributed as interest-free loans.

Process of Giving Loans

The process followed in loans is very simple. The borrowers have to submit an application explaining the reason for the request and the amount. The application is processed during the monthly meeting of the Board of an approval decision is then via phone and the borrower can collect the amount from the office. While completing the formality, two guarantors need to be provided. There is no need to give collateral in terms of any assets. Minimum documents such as ID proof and photograph are required. If the proposed borrower is not a shareholder, then he/ she has to become a shareholder first. The borrowers shared that their experiences of the process were easy to understand and straightforward to complete. The borrowers also explained that it was possible to obtain the loan if necessary in les3 time than the typical period of 15-20 days. Some of the borrowers who were interviewed were examples of individuals who had begun saving first through daily collection, and then become shareholders, before borrowing a loan.

Costs Involved in Obtaining a Loan

The cost of taking out a loan is also less when compared to other financial institutions. Table 3 shows the cost involved in getting a loan which is considerably less than other traditional financial services. These are the actual costs which the customers have to bear and no interest charged.

Reasons for Providing Loans

Rahat provides interest-free loans for both consumption, used for living expenses and productive purposes, on developing businesses. It was observed that initially loans from Rahat arc used for debt swapping and are used to repay earlier taken out loans from other sources. Out of 30 borrowers who were interviewed, nearly five had arranged their loans from Rahat to repay earlier leans they had obtained from informal sources. The borrowers shared that loans from Rahat save huge amounts of interest they would have otherwise paid to other sources. Later on, the subsequent loans are used for consumption purposes related to family issues, especially for illness, etc. The loans for consumption purposes are used for improving living conditions, for example, building additional rooms or creating basic facilities like toilets and bathrooms. The borrowers then slowly start investing in some small business activities. It was observed that generally after the third or fourth loan, the amounts are invested in more productive purposes. Out of 30 clients who were interviewed, nearly 24 have invested their first loan or subsequent loans into business activities. Through productive purpose loans, the borrowers have invested in creating assets for business activities like buying small machinery, furniture, using the amounts for working capital or investments for upscaling the business activities.

Selecting the Correct Borrower and Recovery of Loans

In lending activity, the recovery rates depend on the effective selection of the correct borrower. Furthermore with interest-free lending, identification of appropriate borrowers is crucial in this process. The members of the directing board of Rahat come from different areas of Osmanabad city and as the Muslim community is relatively homogeneous, crosschecking the credibility of loan applicant is easily possible. This means that individuals who may be considered high-risk applicants, such as people who arc alcoholics or gamblers, can be avoided. In many instances, cases are referred by other community members, who assist in the vetting of individuals. Now that Rahat has built a strong network of community volunteers to identify appropriate borrowers, this network can be used to recover loans too. The loan recovery rate is 98% which shows that the present recovery mechanism of peer pressure and the use of social capital of trust are working effectively. The borrowers also revealed that recovery mechanism is borrower friendly and Rahat is sympathetic to potential repayment difficulties. The borrowers also expressed that they are highly motivated to make timely repayments for the following reasons.

Reasons for High Recovery

1. Saving - Interest-free

As no interest has to be paid, the borrowers find that it is a method of direct saving for them.

2. Regular loans leading to increase in faith and effective permanent relationship

The urban poor need frequent loans for their entrepreneurial or self-employment activities. Therefo1e for them. the creation of a permanent source of support is necessary. The frequent access to loans can provide stability in business activity and also leads to asset creation at the business and family levels. Out of 30 borrowers, nearly 25 had taken loans for business activities. They felt that regular repayment creates a positive relationship for them with the society. Building faith and creating permanent support is important.

3. Linking with daily collection deposits

For urban poor households and small entrepreneurs, it is possible to save small amounts on a daily basis and they require a product which will create a safe saving mechanism. For them, going to branches every day to save small amounts is not possible and hence a daily collection deposit, through pigmy collectors, is preferred. These deposit accounts are linked 10 the deduction of monthly payments on the loans taken. Thus, for borrowers it is possible to save amounts on daily basis for loan repayment and to ensure recovery. Some new depositor:' have als0 started saving which will help them to borrow in future.

4. Creating a chain of identification of borrowers

It is acknowledged that satisfied customers act as a source of positive publicity. Based on their experience, the initial borrowers are referring other reliable borrowers and also becoming guarantors for others. Thus identification of needy borrowers become easier and the earlier borrowers are also assisting in the recovery process of new borrowers. This cycle proves the hypothesis that the social capital generated from believing in the poor, which was initially created by Rahat, helps to build further social capital and facilitate financial inclusion of other urban poor.

Making More Money Available for Lending

Along with the high recovery of loans, it is necessary to engage depositors who will make money available for lending. Some of the borrowers who have broken-even in their business activities, have offered the necessary funds to allow the continuation of interest-free fixed deposits. This behaviour supports the Islamic principle that the needy should be helped. Thus interest-free depositors are contributing to making more money available for lending and to positively impacting poorer people's lives.

Impacts of Rahat's Efforts for the Financial Illusion of the Urban Poor

1) Rahat has created financial services for the urban poor which are easier and more accessible than more traditional offerings. All the borrowers who were questioned shared that the financial services which are provided by Rahat are simple and consume less time. It was observed that most of the borrowers had earlier obtained loans from informal sources where the interest rate was very high. Very few had taken loans from formal institutions like banks; however, respondents who had found that it was costly in terms of interest and they had to undertake many visits to branches which was time consuming and led to other costs.

2) It has not only provided interest-free loans to the urban poor but has also created a small deposit saving product which suits the saving needs of the poor. All borrowers said that linking the loan account to their daily saving account is really helpful as they obtain small amounts of money on a daily basis which can be saved from their entrepreneurial activities. For the consumption loan, it was observed that daily saving is helpful.

3) The entrepreneurs, when gaining increased amounts, prefer to save as fixed deposits. Some of the depositors reported that as they were planning to take loans in the future, they have opened up a daily savings account. Contrary to other financial programmes, the Rahat model shows that it does not make restrictions at the savings account level out it further allows its customers to take up credit facility which is truly required by the poor to deal with their economic situation. Due +o certain values of Islam, some of the Urban -poor Muslims were not using the usual financial services as they charged interest.Rahat has continuously progressed in reaching out to the.

4) Rahat has helped the urban poor to come out of the debt trap of private money lenders and according to the chairperson of Rahat, it is one of the greatest achievements of Rahat. As these poorer have come out of the debt trap by using Rahat's interest-free loans, in a better situation in terms of their living standards and have their business sustainability. Without Rahat there was no possibility for them to save as the amount potentially save. we have been lost in interest to traditional money lenders.

5) The clients of interest-free loan products show that they are repeatedly visiting Rahat for loans. The process usually begins with consumption loans but as more loans are accumulated,

6) they are used to help create better facilities for the urban poor like housing, toilet, water and electricity facilities at home, etc. Almost everyone who had taken loans for business activities and who were covered under the present study reported taking repeated loans, especially for working capital and also gradually adding the assets required for their business activities. Some borrowers had taken five or six loans and the majority of them had attempted to r:1ake earlier repayments as per the repayment schedule.

7) Small, self-employment roles arc essential in this region, considering the drought-prone nature of the area. The data shows that small loan amounts help to initiate these businesses, for example, small shops, hotels, laundry services, tailoring units, idol making, etc. and other services like saloons, painting, construction related activities, etc. For these roles, the initial investments are not huge but do require frequent loans to sustain them. These borrowers have shown that the uninterrupted supply of loans has helped to sustain their activities. The detailed analysis of such borrowers was undertaken and it showed that most of them have taken out five plus loans, nearly USD 150-200 at a time and on average USD 780 over a four- year period. Some of the activities which are seasonal also get supported when the need for working capital become more. Thus, one important criterion of financial inclusion is that provision of need based, easily-accessible financial services, especially credit is fulfilled by Rahat for thus urban poor. The following case study will help to strengthen Rahat's position further.

8) Some of Rahat's customers have used the loan services and have reached a break-even point in their business activities. They have begun generating profits, saving money and they have then become the depositors who do not require loans.

9) Although Rahat is providing financial services based on Islamic banking principles, it has helped the urban poor from other religions as well and does not differentiate based on religion. The percentage of non-Muslims is small. However, in due course this number will increase as

volunteers from other religious communities are also added to support Rahat's activities for identification and selection of borrowers and recovery. Five borrowers from other religious group were interviewed and they shared that they were treated with respect and offered all available services.

10) The discussions with borrowers and depositors and the board of directors and staff revealed that Rahat has established a community based model. Members of the Rahat community are actively involved in identification of borrowers and the recovery mechanism. ln this whole process the social capital of borrowers as well as the social capital created by Rahat is found to be useful. The clients are selected based on their social capital in the community and additionally, the social capital and faith created by Rahat connects new clients to the financial services.

Case of a Young Person in the Hotel Business: Improving Business

Mr. A, aged 28, 10th passed youth has had a small hotel in the city for the last five years. He has taken a le.an four times amounting to USD 780 for business activities over the last three years and has repaid each loan before the deadline. With these loans, he has improved his business adding some assets. He paid deposits to install a cold-drink sales point with refrigerator facility. Since this improvement, his profit levels have increased. He believes no other bank would have invested in him and provided the opportunity Rahat has.

Survival and Sustenance of This Model Without Profit Making?

The issue of survival arid sustainability of this model is key as the major source of income, i.e., interest is not involved. However, the board of directors pointed out that profit making is not the objective of this model and so far, the society has been able to successfully manage the costs through the following sources. Indeed, the annual reports show the society made a profit generating. In 2014-15, the society gained USD 139.58 and in 2015-16, the society made a profit of USD 118.27 after deducting all expenses.

Service and Other Charges

When there is no profit earned, there is 110 need to create a source for managing expenses, such as staff salaries, rent, electricity, communications, etc. These expenses are minimal and Rahat is able to manage them through service charges, stationery charges and fines, in delayed payments of loan instalments, etc. There are only three staff members who are paid a minimum salary. The management is conducted by board members who work voluntarily. The daily saving collectors gain commission on the amounts they collect The recovery work is mostly followed by volunteers and daily saving collectors. Furthermore, the society has electronic records, which helps to reduce costs and requires less staff as well.

Profit Sharing from Other Units

Rahat has started offering loans to profit sharing units and such units are increasing. This is an additional source of income.

Center for Electricity Bill Collection

Rahat has undertaken the role of collecting electricity bills and obtains commission for each bill, thus providing revenue for Rahat.

Sustainability of Rahat Model of Financial Inclusion of Urban Poor

Rahat is making good progress in terms of increasing loan distribution and broadening the customer base. However, the issue of sustainability does need to be considered. Due to legal constraints, it will not be possible to expand beyond certain geographical areas and this will limit the sustainability of the Rahat model.

Client Identification and Loan Recovery

The Rahat model uses social contacts to identify clients for loans and recover loans through the closely linked network of volunteers. Whether this model is sustainable is debatable. Rahat is making efforts to create a network not only within the Muslim community but with other communities as well. It is also helping to create a secondary leadership who can be involved in due course. As Rahat is inspired by a religious value system, it is likely to be more sustainable. The increasing response of clients and efforts to bring new clients by the pre-existing ones suggests that the community members are taking the responsibility. Ninety percent of borrowers covered under the study were referred by volunteers, earlier borrowers, board members, etc. and very few came through staff. The recovery rate is 98%. As shown in Table 3, the amounts given as interest free loans are increasing every year. It is not possible to make new loans available unless there is a steady and regular recovery of earlier loans. According to members of the director board, clients who were defaulters had genuine reasons which were beyond their control, such as the occurrence of medical emergencies or chronic illness in the family. The community based model using social capital helps to control adverse selection, information asymmetry. The higher rate of recovery also suggests that this model also plays a significant role in the moral hazard of collecting loan repayments.

Upscaling or Replication

The Rahat model of borrower identification and loan recovery suggests that it will not sustain if it has a wider geographical capture. The close proximity to the clients is the key to success in this model. Thus, expanding the present unit to cover a larger area may not be a very effective strategy. Rahm has motivated some individuals who follow Islam in nearby districts to form such organizations and two such units in neighbouring districts have been established. Rahat is also providing support and guidance. This development of a network of such organizations shows it is possible to reach out to the urban poor in wider geographical areas.

Suggestions Need of Profit Sharing Product Expansion

To make more money available to lend to customers, it would be helpful if Rahat focused on financing profit sharing units.

Provision of Other Services to Urban Poor

Besides credit and saving facilities, the urban poor also need insurance services to protect themselves, especially in their entrepreneurial and self-employment activities. Health emergencies are one major cause of pushing the urban low-income groups into further poverty. Health insurance is equally needed for the urban poor as it is for the well-off. Rahat should explore the provision of insurance facilities to its customers. Thus, it could be an umbrella of all financial services required for the urban poor.

Provision of Business Plus or Credit Plus Services

Small entrepreneurs generally lack the appropriate management skills required

for entrepreneurial activity and hence need capacity building or guidance. Thus provision of business or credit plus services would be very useful for the sustainability of the business units and it would strengthen these activities. This will impact in terms of more demand for loans and maintaining a high recovery rate.

More Focus on women

There is a significant amount of literature indicating the plight of Muslim women. Due to certain systems like “pardha”, low levels of literacy, lack of property, etc., these women are often excluded from traditional financial services. Rahat’s own records show that women prove to be better customers for loan and saving products. Other studies also suggest women to be better customers of financial services. Rahat should ensure it focuses on female

clients as they require these services urgently.

Training and Capacity Building of New Leadership

The skills developed by current stakeholders at various levels in this model, like the governing board members and volunteers at the community level, need to be documented. Simultaneously, the next generation of leaders and volunteers at the community level needs to have systematic training to establish and sustain this model of financial inclusion of the urban poor. The leaders and the volunteers appear to be the backbone of this model. Thus, their capacity building will be very necessary.

Learnings

The urban poor need financial services to fulfil their consumption needs as well as to support creating employment opportunities for themselves. As the urban poor do not have assets and the scale of their business activities is very small, the traditional financial services are not interested in providing the need based services for them. However, the urban poor market is significant and there is considerable business potential for service providers. The Muslim population in India is excluded from accessing financial services because of the Islamic system of not giving and receiving interest. The poverty level among this minority group is also high.

At present, the Indian banking sector is facing problems in loan recovery and the rate of NPA is increasing. Rahat is a totally community based model and uses social capital as the base in dealing with the financial needs of customers.

Their continued high recovery rate of loans suggests that this model is effective. Involvement of community members help avoid adverse selection and cantoris the potential moral hazards of repayment. In-depth analysis of some borrowers has shown that after starting with consumption loans, they then took loans for entrepreneurial activities. A sustained supply of credit has helped to stabilize their income generation activities and they have eventually left the poverty trap and can enjoy a decent standard of living. As community is involved in this model, it is proving to be more successful. Currently there is significant discussion on people's participation in the development process. Through the Rahat model, it can be said that people can be involved in creating and effectively using financial services which arc crucial in dealing with poverty. As discussed previously in the literature review section, suchcommunity based models in other parts of the world are also showing significant success in providing financial services to the poorer members of society. As India contains such a diversepopulation, local or regional based interventions will be the most appropriate and useful. Rahathas assessed the landscape and has accurately understand that rather than further expansion, it is most valuable to the urban poor by sharing its knowledge and guiding other financial services organizations.

Rahat presents a model of providing financial services, which are aligned to the Islamic faith system, to a Muslim population. The model is also showing sustainability and replicability. Rahat has also demonstrated that a religious value system can also be used very positively to create supportive systems for poor people. Additionally, as Rahat has avoided religious places, it has been successful in connecting to the urban poor from other religious groups.

The Rahat model is also showing potential scope for further research, such debt swapping for poor people and poverty reduction, the continuous supply of small amounts of loans to the urban poor leading m poverty reduction and increasing standard of living, etc.

Conclusion

Rahat has shown successful progress in providing interest-free loans to the urban poor and also proved that the interest-free deposit mobilization is also possible. The community based borrower, identification and recovery process has also illustrated that default can be reduced considerably. It also proves that appropriate religious values can be used to create support for poor people. Rahat has created a community based financial support system for the urban poor. It also indicates that the faith of one religion can also be effectively used to support Rahat means relief. It is not only bringing “relief” w the urban poor irrespective of their religions. As one of the female borrowers explained, Rahat not only relief to her family’s life, it has brought “barkat” meaning prosperity. She says, “Earlier, all additional income used to go to pay the interest to money lenders. Rahat helps to save our money and now my family has a better condition as my hotel has new investments. Rahat has brought ‘barkat’ to my family’’.

She further pointed out, “Now I am introducing other needy persons to Rahat so they will also have a better situation as this is the best service to God”.

References

1) A Hundred Small Steps (2009). A Report of the Committee on Financial Sector Reforms. Sage Publications.
2) ADBI (2014). Financial Inclusion in Asia: Country Surveys. Asian Development Bank Institute.
3) Baele, L., Farooq, M., & Ongena, S. (2014). Of religion and redemption: Evidence from default on Islamic loans. Journal of Banking and Finance, 44(6), 141-159.
4) Banerjee, A.V., & Duflo, E. (2011). Poor Economics. New York: Perseus Books. Beck, T. & Chull, (2013). Banking in Africa, Working Paper, WPS2013-16, Center for the Study of African Economies, University of Oxford.
5) Census of India (2011).
6) Chowdhury, S. (2006). Creating an Islamic microfinance model: The missing dimension. Dinar Standard: Business Strategies for the Muslim World.
7) Hyder, A. (2013). Interest-free banking in Sweden: How much is it Islamic?
8) Ielasi, F., & Vichi, G. (2013). A particular model of interest free bank: The case of JAK bank in Italy, Universita Degli Studi fr:enze.
9) Iqbal, Z., & Shafiq, B. (2015). Islamic finance and the role ofQard-Al-Hassan (benevoleilt loans) in enhancin2: inclusion: A case studv of Akhuwat. ACRN Oxford Journal of Finance and Risk Perspectives, 4(4), 23-40.
10) Iqbal, Z., Shahzad, F., Ahmad, H., & Mustafa, G. (2015). Comparison of interest and interest free microfinance institutes: the study of district Bahawalnagar, Punpb.
11) Pakistan Management and Administrative Sciences Review, 4(6), 854-873.
12) Kamal, M. (2013). Interest-free Aficoifinance -A Potential Step for Inclusive Growlh and Empowerment. New Delhi: Sahulat Micor.finance Society.
13) Karmarkar, K.G. (1999). Rural Credit and SHGs Micro.finance Needs and Concepts in India, New Delhi: Sage Publication.
14) Kempson, E., Whyley, C., Caskey, J., & Collard, S. (2000). in or Out? Financiol Exclusion: A Literature and Research Review. London: Financial Services Authority. Kodan, A.S. & Chhikara. K (2013). A theoretical and quantitative analysis of financial inclusion and economic growth. Management and Labour Studies, 38(1&2) 103-133. Lazaaeyshon, A., & Thrift, N. (1995). Geographies of financial inclusion of British Geogrphers, 20(3), 312-341.
15) Maeeshat (2016). AL-Khair Co-operative Credit Society: An experiment of interest free microfinance in lndia.Accessed online from http://www.maeeshat.in/2015
16) al-khair-co-operative-credit-society-an-expcriment-of-interest-free-microfinance-inindia/on 6 May 2016.
17) Muhammad (2012). Challenges of micro finance and prospect of introducing and
18) developing IMIM in Nigeria Unpublished PhD Thesis, International Islamic University Malaysia (IIUM).
19) Pavnesh K. (2012). Interest free banking model: Is it possible in India? International Journal of Business Economics and Management Research, 2, 137-146.
20) Rahman, M.E. (2014). Interest free banking in India for rapid growth and economical uplift future and prospects. Asian Journal of Management Sciences, 2(Special
21) Issue), 180-183.

22) Rahman,R.A.,& Dean,F.(2013). Challenges and solutions in Islamic microfinance. Humanomics, 29(4), 293-30c.
23) Reserve Bank of India (2015). Report of the committee on medium term path on financial inclusion.
24) Rotman, S., Ferrand, D. & Rasmussen. S. (2012). The Jipange KuSave experiment in Kenya. CGAP Brief, October, Washington DC.
25) Rutherford, S. (2012). Product innovation that provides useful services for the poor: P9 and Jipange KuSave. CGAP Micro-finance. Accessed online from http:/microminance. cgap.org/2012/03/21/4340 on 21 March 2012.
26) Soylu, A., & Durmaz, N. (2012). Profitability of interest-free vs. interest-based banks in Turkey. Accessed online from http://mpra.ub.uni-muenchen.de/36376.
27) Sundararajan, V., & Errico, L. (2002). Islamic financial institutions and products in the global financial system: Key issues in risk management and challenges ahead. International Monetary Fund Working Paper WP/02/192, Washington DC, IMF. Tara, N., & Tankha, A (2015). Inclusive Finance Report 2014. Oxford University Press. The Times of India (2015). Address Financial Exclusion Based on Faith: RBI Panel.
28) 29 December 2015.
29) Tiwari, S. (2012). Future of interest free Islamic banking. IBRD's Journal of Management and Research, 1, 57-60.
30) Tripathi, P.S. (2009). Inclusive banking. Frontline, 26(21), 43-46.
31) Wright, G.A.N. (2000). Microfinance Systems: Designing Quality Financial Services for the Poor. London & New York: Zed Books Ltd. arid Dhaka: The University Press Limited.

Anjali Kulkarni

Tata Institute of Social Sciences, India anjali.kulkarni@tiss.edu