

## **Trust – an essential element & pillar of Micro Finance**

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*"To be trusted is a greater compliment than to be loved." – George MacDonald*

*"If you don't trust people, people will not trust you." – Lao Tzu*



### **Micro Entrepreneurs and Finance:**

Finance is lifeblood of any enterprise irrespective of its size. Micro enterprise faces more problems in raising finance, as the provider of finance may not find the return on investment interesting as compared to large enterprise, and also investor is more skeptical about repayment. Micro entrepreneurs are also not generally able to document their financial strength, as they are weak in accounting system and cannot seek expert advise on accounting as well. The formal banking requires documents to appraise the credit application and security if normal course of business activity fails to repay the loan amount. Micro entrepreneurs are lacking capacity to offer marketable securities, as a compliment to their credit needs. Due to low literacy level and poverty, micro entrepreneurs are doing business activities in unplanned manner and they do not have business plan like small, medium and other formal businesses. Micro entrepreneurs therefore are compelled to run business on their own as no formal banking system normally willing to extend credit facilities.

### **Financing Options:**

If we look at how financing is fulfilled by small entrepreneurs, it is observed that either they borrow money at very high rate from informal financiers, who knowingly

exploits the vulnerabilities for their own benefits. Very few entrepreneurs enjoy credit-worthiness among suppliers of goods and such suppliers extend credit for goods to be sold. So they do not require cash in purchasing required goods. Many a time, in a community or a village, peer members have kind of dissymmetry of income & expenses. The situation is some time met with compromising pricing of the products, by creating pledge when products are not ready, lender advances money with condition that when produce is ready, will be transferred to lender at predetermined prices. These predetermined prices are generally very low compared to fair market prices. Farmers generally borrow money to purchase seeds, fertilizers and meet daily expenses when crop is in growing stage.

There are several individuals who have time differences, either in terms of income or in terms of expenses. Few have surplus income at particular point of time and need money at different point of time. Few may have exact opposite needs at the same point of time or near about. These differences across persons are not uniform. Therefore, there is a case where some persons are savers and have no current needs for money and borrowers, who have a current need for money to be met from future savings, or to be taken away from past savings. Thus there is a demand and supply situation where one could get/pay a price for the difference in timing. This creates opportunities for transaction between people. (M S Sriram, Information Asymmetry and Trust: A framework for studying micro-finance in India).

If demand and supply dissymmetry is recognized among peer members, they themselves can manage and compliment each other. This is possible within small group. If the group is large there requires a third intermediary who takes care as coordinator and trustee to manage demand and supply of fund. Since full information about who is willing to supply money and who is willing to borrow is not easily available, there is asymmetry. A person might have greater amount of information about the needs and reliability of a small circle of people with whom s/he might have regular dealings.

So, intermediation bridges the timing gap within the person's own cash flows, it bridges the gap between the differing need for money at the same time and bridges the gap on reliability and trust to enable exchanges with unknown people. It helps individuals to plan their differing needs of finance at differing points in time by an intervention that helps to balance. In essence the intermediation offers a mechanism of meeting the demand for finances of a person by the person's own supply. How it is done? Putting away some money to be used at a future point in time and using the money in the current point with a promise to replace it in future do this. In either case - the service of intermediation is usually used to manage the time differences.

### **Financiers:**

Financing is done either from own saving or group members' saving and helping each other. Self Help Group (SHG) in India is kind of an example. In SHG, helping each other is due to 'expecting cooperation and hence cooperating' principle. It is relying on future promise of each other to return money with interest and reciprocal help to the lender. The group itself manages the whole affair and few or all members represent the group. The success of SHG depends upon cohesiveness of the group members and trust on each other. It means higher the trust, longer the bond works amongst members and hence through financing their small business runs. This bond become weak as the group is heterogeneous (in terms of culture, caste, distance, business activities and so on) and require reliable intermediary. Cooperative Banks either on their own or through schemes of National Bank for Agriculture and Rural Development (NABARD) extends credit to SHG and or their members and SHG becomes surety of the loan. Many commercial banks are also extending credit to SHG and their members.

Small entrepreneurs thus meet financing with formal or informal means. In either case trust is the base on which business relations stands. Where in formal and government supported financing, the assistance in form non-finance also form part of business and social deal. Banks help entrepreneurs to develop business plan, identifying supply, market places and other resources. In SHG and cooperative enterprise too, trust is an important element that leads to sustainable development. Where there is high level of trust, low cost & certainty exists in planning for all those who are concerned. Due to high level of trust, consultation and advise brings better results in business output of the micro entrepreneurs.

### **Trust:**

Trust can be explained rather than defined. Trust is complete confidence in a person or plan. 'Trust' indicates a depth and a sense of assurance that is based on strong but not logically & conclusive evidence, or based on the character, ability, or truth that someone or something has shown over time or across situations. Trust makes for a sense of being safe or of being free of fear, enough so that one's focus can be on other matters because that matter is taken care of. It becomes easier to simply enjoy life. (Robert Longman Jr.). Cohesive group for SHG and cooperatives are based on mutual trust among members, and more particularly higher trust enjoyed by executives leads to success. These organizations are formed of members who are generally having similar wavelength in terms of their economic & social conditions.

We could say that a person or organization trusts another when both sides have reason to expect that neither will take advantage of the other, and, whenever possible, will even do things that advance the other's interests. Since trust is calibrated to the potential risk if the other party does not act as expected. Thus trust is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the trustee will perform an action important to him, regardless of his ability to monitor or control the trustee. Trust from perspective of good reputation is belief about a person; several things contribute to the overall reputation of an individual, profession or organization and on the basis of perception the trust is placed on them. Mutual trust is a shared belief that you can

depend on each other to achieve a common purpose. Trust-based working relationships are an important source of sustainable competitive advantage in general and specific in micro finance, because trust is valuable, rare, imperfectly imitable, and often non-substitutable. It can build relationship of a weak (micro entrepreneur) and strong partner (bank or MFI) that if lasts will not only extend credit but also enhance employment capabilities of micro entrepreneurs.

How to build trust amongst stakeholders? Contrary to corporate organizational culture it can't be designed, it has to be built -- little by little. In a dynamic, non-routine work environment trust is essential. People must feel they can take risks and that their vulnerability will not be taken advantage of. (Notes on Trust and why it matters in corporations, Brigitte Jordan). A little exploitation of poor may result into chaos, being very sensitive & vulnerable; frustration of micro entrepreneur will lead to withdrawal from formal credit system rather than consolidate relation with lender in future. Small amount even matters too much, as if they even lose small amount of the earning, it is big fraction and their livelihood suffers.

### **The Role of Trust in Micro Finance:**

Micro Finance as we have seen lacks visible and credible evidence compared to other normal business credit and hence require different set of trust compared to normal commercial finance. However, trust has a significant role to play in the various forms of financial exchanges that happen in the financial markets. There have been some attempts in the past to look at various levels and the scope of trust and its effects on defining relationships in terms of economic exchange (Humphrey and Schmitz, 1996). It is argued that the lesser the trust, the greater would be the transaction costs. Fukuyama (1995) discusses the matter in great detail in his seminal work on Trust. He says that “..The communities do not require extensive contract and legal regulation of their relations because prior moral consensus gives members of the group a basis for mutual trust.” He further argues that “..Legal apparatus, serving as a substitute for trust entails what economists call ‘transaction costs’. To build trust, cost incurred should be less than benefits expected. And therefore expenses incurred by large corporate to build reputation can't be an instrument in micro financing.

Widespread distrust in society in other words imposes a kind of tax on all forms of economic activity...” Another disadvantage in micro financing may be withdrawal of availing credit by micro entrepreneurs as they are not accustomed to provide documents due to illiteracy and customs, rather they will choose to borrow from informal source, even though credit may be with highly exploitative terms. Government of India and Reserve Bank of India has therefore taken liberal stands and advised bankers to act accordingly. Fortunately, recovery of the banks in micro finance is quite higher than normal credit extended to other sector of economy.

Evidence of using trust to reduce transaction costs is reflected in the level and extent of documentation that is done. In case of several self-help group and co-operative group

movements, it is possible that the transaction costs which are kept low initially because of informality and access to information is no longer feasible when the movement grows. The necessary element of growth and formalizing the systems is increase in transaction costs and developing mechanisms of institutional memory. In a counter example we see how over a period of maturity the nature and role of intermediation itself could change when the type of information availability changes.

### **Stakeholders of Micro Finance:**

Micro entrepreneurs who are the borrowers are center of micro finance. The typical client base of any micro finance is poor people who do not have access to formal financial institutions. They are typically self-employed, micro entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as cattle & poultry farming, food processing and petty trade. In urban areas, micro finance activities are more diverse and include shopkeepers, service providers, artisans, street vendors and hawkers. Micro finance clients are poor and vulnerable non-poor who have a relatively stable source of income. The group of peer members, if create an entity either informal (SHG) or formal (cooperative) are important stakeholder as a unit. Here the interest of the entity becomes substance rather than the individual interest. The executives and employees of such entity and banks and refiners (NABARD in case of India) will be crucial stakeholders, who do not lend only money, but assist business to develop. Micro Finance is not money only. It is more than that. The government and their agencies, donors, MFIs and NGOs are stakeholders who plays vital role as supplier of fund with a social motive. Government plays tutelage role and hence critical in the whole system.

The mesh of stakeholders creates a typical matrix for relations that exist among them. The level and nature of trust expected from each other is different to an extent when point of matrix change. And therefore how to build trust among each other also requires special attention. Following points are indicative in building trust. It may be noted that building trust is slow and ongoing process, it takes time to build but betray of trust requires a moment to destroy trust. And once betrayed will generally never built a trust, at least for long period of time. It implies that maintenance of trust is very vital in micro finance.

### **Various approaches to deal with trust:**

There is no readymade plan or a single plan that can build trust always in all situations. It means one size does not fit all. The ability to gain and keep trust is a vital factor in being able to influence others. Research has shown, time and time again, that trust is always a contributing factor in the ability to influence others. When a person trusts you, that trust alone can motivate them to accept your message. Inversely, if people don't trust you, all the evidence, reasoning, facts or figures in the world won't get them to budge in their resistance. Building relationships requires the building of trust. Trust is the expectancy of people that they can rely on your word. It is built through integrity and consistency in relationships. Following are few hints that provide clues in building trust in general and may be modified to build trust in micro finance activities, whether you are member of a

group, donor, bank, executive of government or any other entity. Those involved in this social cause should be sensitized to the issues discussed here.

1. Enactment of laws or regulations, particularly conflicts of interest be taken care of, it provide long term conducive environment, and is job of legislation to provide framework that interest of provider of money, user of money and micro entrepreneurs are served best
2. Enforcement of existing laws or regulation, is job of government executives that ensure that law is not for sake of law, but taking care of all concerned
3. An increased transparency or visibility of transgressions is job of officers of entities involved that money they are handling is used with utmost prudence & propriety
4. The ethical behavior of individuals, particularly those who manages finance should reflect that there is no personal interest
5. Character – Integrity and Honesty of those who deals in business transaction and take long term decisions
6. Competence – Knowledge and Ability of those who deals in business transaction and take long term decisions
7. Confidence – Conviction and Belief of all stakeholders that objective will not be forgotten
8. Credibility – History and Experience of leaders builds credibility and hence conscious efforts of leaders to build credible history
9. Congruence – Consistency and Harmony in commitment & procedure, explanation when there is a deviation
10. Speak their language, when dealing with micro entrepreneurs understand them and speak in their language, that will bring oneness
11. Bring disparity narrow amongst members while giving any treatment or protection
12. Communicate. Say accurately what you are doing, and don't assume others know
13. Take suggestions of concerned parties, if some way they can help out in bringing better decision, this will also avoid future conflict
14. Do what you've communicated. Nothing is more important to building trust than actions that match the words, non-verbal cues, and stated reasons (scorekeeping & control), give reasons if you could not perform as per plan
15. No scorekeeping (in behavior!). Tit-for-tat is a game that does not help create a sense of trust (but scorekeeping in financial matters & performance!)
16. Look in the mirror. Are you giving others reason to distrust you? Were you acting the same way in a past instance that you were shown untrustworthy?
17. Repetition of building trust gives synergic effect, the geometrical expansion of trust. Each time you act in a trustworthy manner, you earn more trust. After a while, the trust starts adding up. Build trust in every matter, big or small.
18. Show trust. People who are trusted are more likely to trust. Most people actually are trustworthy in most matters most of the time. Trust them, and the trust may spread. (That doesn't mean blind trust, which is a way to become an untrustworthy person's enabler.)

19. Building Trust: Behavioral Attributes are most and explicit, it is continuous process, always build trust, once betrayed or lost trust will difficult to recover
20. Sharing important information, especially about your decisions, take suggestions of those who are affected
21. Willingness to be influenced, others must be confident that you will be convinced if what they say is fair, you are not rigid or adamant
22. Avoiding the abuse of team-members' vulnerability (because of their inadequate access to information or lack of positional power)
23. Being fair, just and one should feel that you are fair & just
24. Fulfilling promises, keep your own score. What was promised is done?
25. Trust your self first. Charity begins at home!
26. Use appropriate technology, people trust technology first
27. Use appropriate procedure to foster & strengthen trust
28. Use appropriate control & check, every body under supervision are more honest, honest foster the trust

### **Trust and Conflicts of Interest:**

The level of trust changes dimension, when you hold fiduciary position. There is high expectation from holding fiduciary position. The governance procedures and the actions of the board members (by what ever name they are called in SHG, cooperatives, Association of Persons etc.) should be such that they create accountability and enable the stakeholders to trust one another. Governance gives stakeholders confidence that managers are being supervised. Person is more honest when he knows he is under constant supervision. It creates checks to prevent management from serving its own interests. Governance engenders trusts that allow a MFI to attract depositors and investors. Governance provides assurance to government officials and, in the case of financial institutions, to bank superintendents. One way to create trust in the governance process is to eliminate conflicts of interest. For any reason if absolute elimination is not possible, the fact should be kept before those who are decision makers. Responsibility of fostering trust is higher if you enjoy higher position in a hierarchy. However it does not undermine responsibility of the other people. If the micro entrepreneurs community is robust in capacities, cohesive in honest behavior and sensitive enough to their own responsibility, vigilant about their rights & obligation, success of micro finance movement will be quite high.