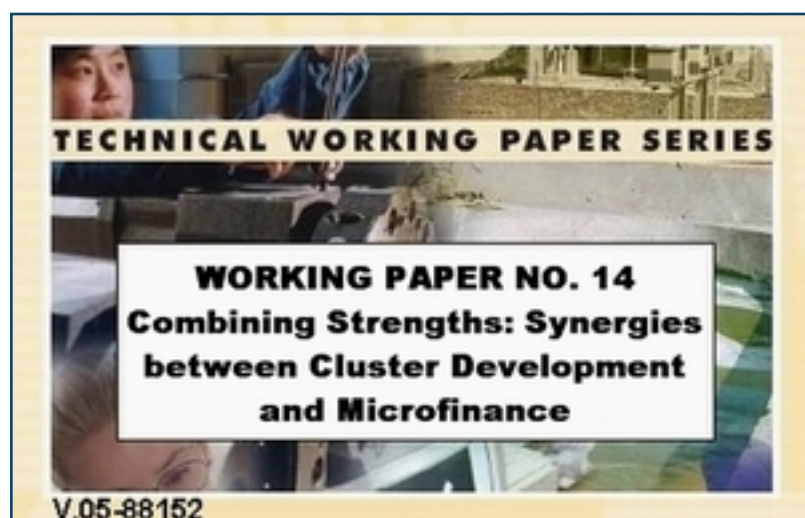




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## Synergies between cluster development and microfinance



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For a variety of reasons, poor people lack access to formal credit and must therefore shoulder the high interest costs and dependence associated with informal credit markets. The negative implications on the development process have long been emphasised and microfinance, which includes microcredit but also other financial services such as savings facilities, insurance and payment services, has been identified as a viable solution to meeting the financial needs of the economically active poor.

The UN has declared 2005 as the [International Year of Microcredit](#) to

increase awareness of the fact that, when effectively delivered, microfinance can contribute to the [Millennium Development Goals](#) of economic and human development. Microfinance has the potential to stimulate the establishment of new businesses owned by the poor and to help existing microenterprises grow or diversify their activities. In addition, it can increase the standard of living of the economically active poor, improve their access to health care and education, reduce vulnerability and promote the empowerment of women and marginalized groups.

As a contribution to the objectives of the International Year of Microcredit, UNIDO has prepared a paper entitled [Combining Strengths: Synergies between cluster development and microfinance](#), drawing attention to the importance of microfinance for human and private sector development and exploring innovative uses of microfinance. The first section of the paper is an overview of the very large and still growing literature on the rationale, benefits and limitations of microfinance. In section two, the Indian microfinance experience is described in greater detail. The third part, which is the core of the paper, analyses the synergies between UNIDO's Cluster Development Programme and microfinance. The concluding section discusses the transferability of UNIDO's experience in India and it emphasises the importance of business development services in addition to financial services.

It is now well over a decade that UNIDO has been implementing an innovative approach to assist micro-, small- and medium-scale enterprises (MSMEs) in the areas of network development. Its [Cluster Development Programme](#) assists MSME clusters, i.e. geographical concentrations of enterprises operating in the same or highly correlated activities, become more competitive by fostering inter-firm linkages and

collaboration with local support institutions. The Programme helps MSMEs combine their strengths to jointly take advantage of market opportunities and to solve common problems.

In India, where the UNIDO Cluster Development Programme is well established ([see India Cluster Development pages for more](#)), the provision of microfinance is different from that in most countries due to an extensive bank branch network. The most widely spread model of microfinance in India links so-called self-help groups with existing formal financial intermediaries rather than relying on the establishment of specialised microfinance institutions. This minimises set-up costs and ensures outreach. The main steps involved in the self-help group model include formation of self-help groups, accumulation of group savings, internal lending and on-lending of bank loans. In addition to improving access to financial services, the self-help group model also has significant social benefits. Nevertheless, like other types of microfinance programmes, it has its limitations.

In its activities in India, ([see UNIDOScope 2 - 8 Nov 2003](#)) particularly those focusing on promoting clusters of microenterprises in the handicraft and agro-processing sectors, UNIDO's Programme repeatedly aimed at improving cooperation between cluster actors by creating and strengthening existing, but non-operational, self-help groups. The fact that such revival of cooperation often calls for, or at least also involves, addressing deep-rooted financial problems suggests the existence of synergies between the Cluster Programme and credit institutions willing to provide microfinance to self-help group members.

In Sindhudurg, 16 self-help groups have formed a network for food processing. The self-help groups (SHG) pooled their savings as a common fund for the network and each self-help group contributed an additional Rs 300 (USD 6.60) as an annual fee. The network applied for a common loan and received Rs 50,000 (USD 1100), which was used to purchase the equipment necessary to process kokum and enabled the groups to attend a trade fair. It is particularly remarkable that a bank sanctioned a loan to attend a fair, i.e. for promotional purposes. The loan was repaid and since it was in the form of cash credit, it became available to the network again. One member SHG has now obtained a loan from the network for goat farming and another for the production of traditional products. In Chanderi, one of the main strategies to improve the income of weavers is to link them directly with buyers, thereby reducing their dependency on intermediaries. To achieve this, seven self-help groups have been formed into an apex organization, registered as an NGO. The need for such an organization arose from the recognition that a group of 10 weavers could not attain the critical mass and variety of products required by buyers. Furthermore, quality control and marketing efforts were believed to be more effective within a larger group. ( p26 *Combining Strengths: Synergies between Cluster Development and Microfinance* )

Closer cooperation between UNIDO and microfinance providers can thus allow each organisation to focus on its own strengths and jointly offer a comprehensive package to promote enterprise and cluster development with a pro-poor bias. A variety of steps can be taken to create linkages between the SHGs and local financial institutions. These include exploring the financial needs of the cluster stakeholders, identifying suitable partner institutions, sensitizing bankers to the needs and reality of the cluster, providing training for the economically active poor, and monitoring and evaluating the outcomes. With time, the Programme's efforts to link cluster actors with financial institutions can trigger positive externalities to enhance the contribution of cluster development to poverty reduction. The quality and accessibility of financial services may improve for all those living in the cluster, even those who are initially not involved in cluster-related activities.

Due to the specifics of the Indian financial context, it may be difficult to transfer the SHG model of microfinance provision to UNIDO projects in other countries. Nevertheless, many features of the model remain relevant for countries beyond India and can be adapted to local circumstances.

Although the provision of financial services is a necessary condition for cluster development in any country, it is not a sufficient condition for pro-poor cluster development. Other constraints faced by the economically active poor must also be addressed.

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