



Round Table

Microfinance in India: Discussion

R Srinivasan and M S Sriram



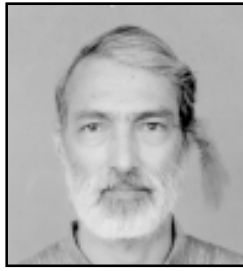
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Microfinance as a developmental and economic tool has caught the imagination of banks and other financial institutions, and NGOs in India. What makes microfinance such an attractive business proposition? Given their ideological leanings and their competencies, should NGOs be encouraged to morph into microfinance institutions (MFIs) or remain as social intermediaries between Self-help Groups (SHGs) and banks? How effective are the alternate delivery models such as the Grameen Bank, Self-help Groups and individual banking models, and schemes such as the linkage between banks and SHGs? How do these models fare on the essential counts of growth and sustainability? Have they made the leap from 'economics' to 'empowerment'? And what of the target segment, the poor themselves? While they are now admitted to be 'bankable', how do we define 'the poor' and how successfully have these models incorporated their actual needs? While government policy and the regulatory framework have been responsive to changing needs, has the system been successful in providing an integrated set of microfinance services, including savings, credit and insurance products, to the poor?

A panel of financial experts, academics, activists, bankers and policy makers who have long been working in the field, debated these questions among others, with R Srinivasan and M S Sriram.



Deep Joshi is Executive Director, PRADAN.

The participants in the discussion included Vijayalaxmi Das, Chief Executive, Friends of Women's World Banking; Aloysius Fernandez, Executive Director, MYRADA; David Gibbons, Executive Chairman, Cashpor Financial Technical Services; Malcolm Harper, Professor Emeritus, Cranfield University; Deep Joshi, Executive Director, PRADAN; M Udaia Kumar, Managing Director, Share Microfin; Vijay Mahajan, Managing Director, BASIX; Ramesh Ramanathan, Vice Chairman, Sanghamithra Rural Financial Services and Jayashree Vyas, Managing Director, Shree Mahila Sewa Sahakari Bank.

Microfinance: Attractive Business Proposition

MSS/RS: What makes microfinance economically attractive as a business? Let us start with non-governmental organisations (NGOs), why have they taken to microfinance?

Deep Joshi

The image of the NGO is led by the exceptional few that are mission focussed and strategic. The majority, however, tend to take on current ideas, and funding for current ideas often spawns new NGOs. For example, when the Janata Party Government (1977-79) launched the adult education programme and encouraged NGO participation, many NGOs, previously uninvolved in education, took up the programme. The story was repeated during 1985-90 with wastelands development and social forestry and later, with biogas. Microfinance in that sense is the current flavour. The field of development itself expands and shifts emphasis with the pull of ideas, and NGOs perhaps more readily adopt new ideas, especially if the re-

sources required are small, entry and exit are easy, tasks are (perceived to be) simple and people's acceptance is high – all characteristics (real or presumed) of microfinance.

Canvassing by various actors, including the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), Friends of Women's World Banking (FWWB), Rashtriya Mahila Kosh (RMK), Council for Advancement of People's Action and Rural Technologies (CAPART), Rashtriya Gramin Vikas Nidhi (RGVN), various donor funded programmes [especially by the International Fund for Agricultural Development (IFAD), United Nations Development Programme (UNDP), World Bank and Department for International Development, UK (DFID)], and lately commercial banks, has greatly added to the idea pull. Induced by the worldwide focus on microfinance, donor NGOs too have been funding microfinance projects. One might call it the supply push.

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A third factor, as a Sarvodaya leader of long standing pointed out to me, is that the idea seems to work! He said he had tried all kinds of things for 25 years, from khadi spinning to Nadep compost to balwadis, but nothing produces such concrete results and sustained interest among beneficiaries as microfinance. He has lately been promoting women's self-help groups (SHGs) and finds great enthusiasm among women, who are flocking to his NGO for inclusion. Most NGO-led microfinance is with poor women, for whom access to small loans to meet dire emergencies is a valued outcome. Thus, quick and high 'customer satisfaction' is the USP that has attracted NGOs to this trade.

The idea appears simple to implement. The most common route followed by NGOs is promotion of SHGs. A majority of SHG promoters do not conceive of SHGs as entities that would function independently of the promoters. It is thus implicitly assumed that no 'technical skill' is involved. Though the term 'social infrastructure' is often used, implying creation of an 'institution', most promoters and supporters are innocent of the conceptual underpinnings of these terms. NABARD and banks have further reinforced this notion. Besides, external resources are not needed as SHGs begin with their own savings. Those NGOs



Vijay Mahajan is Managing Director, BASIX.

that have access to revolving funds from donors do not have to worry about financial performance any way. Others are able to link groups to banks for small sums where repayment history is yet to catch up and therefore not of any consequence (the promoters in any case continue to pursue repayment, free of cost). The chickens will eventually come home to roost but in the first flush, it seems all so easy. Social forestry, for example, is far more difficult – one has at least to know how to raise saplings and survival rates become known within a few months of planting! Here, ‘all you have to do’ is ask women to form a samuha (group), start tiny savings and the rest takes care of itself. This is a bit of a caricature but not all that far from reality. For many NGOs the idea of ‘organising’ – forming a samuha – has inherent appeal. Groups connote empowerment and organising women is a double bonus.

Finally, to many NGOs, microfinance is a way to financial sustainability. Especially for the medium-to-large NGOs that are able to access bulk funds for on-lending, for example from SIDBI, the interest rate spread could be an attractive source of revenue, superior to uncertain, highly competitive and increasingly difficult-to-raise donor funding. Only a few NGOs might ever become full-fledged MFIs that combine savings and credit (if not insurance), but in the interim, credit retailing itself can yield attractive dividends without much regulatory burden.

Vijay Mahajan

The reasons given by Deep as to why a large number of NGOs have entered microfinance resonate with my own observations. As Deep has said, after

a long time NGOs found in microfinance, an idea that works. I see nothing wrong with many of them taking to the idea. Funding agencies too are constantly searching for developmental ideas that work, scanning the world of practice as well as academics, and also in response to the prevailing global and national political-economy. Thus funding becomes available only for a very small sub-set of developmental ideas, which have been subjected to a lot of a priori analysis. (The fact that many still do not work has a lot to do with factors beyond the control of development agencies). Widespread support and funding for microfinance took almost two decades to build up. There is thus nothing wrong if a number of smaller NGOs (which are not mission-focused and strategic) adopt a programme which is widely accepted as ‘working’ and for which funding is available.

The critical mistake that has been made, however, is that in the process, a large number of NGOs decided to become financial intermediaries, borrowing from wholesale institutions such as the RMK

There is nothing wrong if NGOs adopt a programme which is accepted as ‘working’ and for which funding is available. However, in the process, a large number of NGOs decided to become financial intermediaries. What was earlier a facilitator role, changed to a lender role.

and SIDBI and lending in retail to their constituents. Thus what was earlier a facilitator, enabler or welfare/service provider role, changed to a lender role. Most NGOs did not see that this role, if it had to be played seriously, needed changes in their attitudes, competencies and systems. They did not bring about these changes and in the early years at least, suffered delinquency and default. Through inputs from a number of capacity building agencies and also in response to funder pressure, NGOs have improved their performance on this front steadily.

Having said this, I do not see much scope for NGOs in financial intermediation roles to be able to make a surplus large enough to run their other activities. Nor is the possibility of ‘time-sharing’ of staff involved in microfinance so easy, since the work flow is intense and time-bound and any loading of staff with other work shows up in the form of delinquency or default.

Thus many NGOs have figured that they should not be financial intermediaries and so have taken to the role of forming SHGs and linking those with banks. NABARD’s encouragement of this model has also had a lot to do with the change in the role of NGOs

to social intermediation – that is forming groups and hand-holding them on an ongoing basis. However, NABARD has not been paying NGOs for this work, at all initially and inadequately lately. More recently, other sources of funds have come up including Swaran Jayanti Swarojgar Yojana (SJSY), SIDBI Foundation for Micro Credit (SFMC) and the ICICI bank, all of whom are now paying NGOs for the valuable role of social intermediation.

Udaia Kumar

NGOs may have taken up microfinance for their own reasons, but today most institutions are actively thinking of regulating/regularising their micro-credit activities. Much learning has been taking place in the sector. Workshops are being organised all round the year to educate NGOs and MFIs on regulation and sustainability. Micro-credit is not as simple a task as it is perceived to be.

The microfinance sector is not only restricted to the SHG mode. There are a number of Grameen replications and other programmes that retail microcredit. These programmes have accessed commercial sources and proved that microfinance can be sustainable while reaching the poorest. It is one of the best means to reduce poverty. The SHG model is far more visible because of government support and funding. But SHGs will not be sustainable in the long run as they are primarily grant-driven and the supervision on loans is minimal. Although forming groups may be an easy task for SHGs because of the high demand for microfinance services, repayment rates are not very commendable. Whereas in the case of regulated MFIs, repayment rates are very high, with fewer chances of default. Most SHGs are promoter based because they are not formalised organisations. They work as a project based team rather than a formal organisation.

Jayashree Vyas

The attractiveness of microfinance is more developmental than economic, and this is the key to answering our questions. Of course economic attractiveness follows – but the root of the MFI approach has been developmental in orientation.

While there is a lot of truth in what Deep Joshi says



Jayashree Vyas is Managing Director, Shree Mahila Sewa Sahakari Bank.

Organising a group is not all that simple. It is extremely difficult to build instantaneous rapport with issues like better work place, hygienic living conditions, legal aid and other support systems that the poor sorely need. Microfinance is a good entry point to get people together.

– that microfinance (unlike other developmental efforts) gives quick, tangible and satisfying results, I do not think that organising a group is all that simple. It is as difficult as any other developmental intervention. It appears simple only because the results are quick to see. For instance, when MFIs start forming groups or any other microfinance activity, they are servicing almost the same clients who were either served or deprived of loans by all the governmental schemes like the Integrated Rural Development Programme (IRDP), and have seen loan melas. Organising them and ensuring financial discipline from these people is a lot of hard work. MFIs do take a lot of risk by lending to people who are otherwise classified as ‘non-bankable’. Considerable work goes into teaching them how to keep accounts, process transactions and design systems to make the intervention last. The very fact that there are a large number of experts working in this area indicates the amount of intellectual input that this activity demands.

I do agree that the idea of ‘organising’ people, especially women, is very attractive. But organising women for what? In our experience, we have found that it is extremely difficult to build instantaneous rapport with issues like better work place, hygienic living conditions, legal aid and other support systems that the poor sorely need. Microfinance is a good entry point to get people together. They then start talking a common language, a link is established, it gives a reason to meet regularly and establish a relationship – and the fall out is that other developmental issues gradually start coming out.

I am not sure if the entire edifice of microfinance has been ‘supply driven’ as Deep Joshi points out

– whether the supply is from the funding institutions of the banks such as SIDBI or NABARD. It may have been supply driven soon after 1969 when the banks were nationalised and a policy push was given. But we know that the policy push did not work, and there was a negative backlash. It was only when the push failed that people started getting organised, and it has been the demonstrated success of the microfinance sector that has given a second renewed push to both the funding and the governmental agencies. Therefore we have to recognise that the success was driven by a demand pull than a supply push.

Microfinance has been attractive to the lending agencies because of demonstrated sustainability and of low costs of operation. Institutions like SIDBI and NABARD are hard nosed bankers and would not work with the idea if they did not see a long term engagement – which only comes out of sustainability (that is economic attractiveness). However in dealing with these bankers over the years, I have found that they are bankers with a heart and will back projects that are development oriented as long as they are adding a marginal amount to the bottom line.

On the supply side, it is also true that it has all the trappings of a business enterprise, its output is tangible and it is easily understood by the mainstream. This also seems to sound nice to the government, which in the post liberalisation era is trying to explain the logic of every rupee spent. That is the reason why microfinance has attracted mainstream institutions like no other developmental project.

MSS/RS: Why is the commercial world (banks and other financial institutions — FIs) interested in microfinance?

Deep Joshi

I am not sure that the commercial world (even as narrowly defined as banks and other FIs) is truly interested yet. Admittedly, the performance of NABARD's SHG-bank linkage programme (loans worth over Rs 10 billion, mostly during 1999-2002 to nearly half a million SHGs) is impressive and a few banks – in the public as well as private sector – have shown a higher level of interest in the past six months. The State Bank of India (SBI) and Andhra

Bank have announced interest rates ranging from 9.5 to 10.5% for SHGs, a large private bank is working with several NGOs and another private bank has commissioned an elaborate study of SHGs. However, an overwhelming majority of the SHG-bank linkages are in the four south Indian States, the average loan per household works out to about Rs 1,200 and the few banks that have shown some aggression in the past few months are all looking for deals with well established NGOs, of whom there are only a handful in the country. Similar is the story with

other FIs that are involved in microfinance. I do not think banks have quite figured out yet how to do microfinance on a large scale and I do not see signs of widespread interest. Even so, it is true that a proposal to link an SHG to a bank has a far higher probability of success today than three years ago; and five years ago the probability was close to zero. Let me hazard a few guesses to explain why.

Perhaps the most important factor that got banks involved (in spite of the horrendous IRDP experience) is what one might call the policy push. Given that most of our banks are in the public sector, public policy (including frowns and nods from the Finance Minister), does have some influence on what they will or will not do. In this case, policy was fol-

lowed by diligent, if meandering, promotional work by NABARD. (It would be worthwhile to look at how this particular policy was implemented compared to the other policy and programme interventions by the state). The policy change about a decade ago by RBI to allow banks to lend to SHGs was initially followed by a seven-page memo by NABARD to all bank chairmen, and later by sensitisation and training programmes for bank staff across the country. Several hundred such programmes were conducted by NGOs alone, each involving 15 to 20 bank staff, all paid for by NABARD. The policy push was sweetened by the NABARD refinance scheme that offers much more favourable terms (100% refinance, wider spread) than for other rural lending by banks. NABARD also did some system setting work and banks lately have been given targets. The canvassing, training, refinance and close follow up by NABARD has resulted in widespread bank involvement.

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Perhaps the most important factor that got banks involved is what one might call the policy push. This was followed by diligent promotional work by NABARD. The policy push was to some extent accompanied by (and also generated) demand pull.

by (and also generated) demand pull. The SHG bug spread among NGOs rather quickly and they began going to banks to get SHGs linked. But the favourable policy environment made it possible for NGOs and others to draw the banks out.

The most recent interest among banks, particularly regional rural banks, is perhaps because they are looking for alternative markets given their present high liquidity. Their SHG portfolio, though small volumetrically, is performing well (comparable to their prime clients). The average SHG loan, insignificant though developmentally, is larger than an average crop loan.

Finally, for banks the operating cost of microfinance is perhaps much less than for pure MFIs. The banks already have a vast network of branches. To the extent that an NGO has already promoted SHGs and the SHG portfolio is performing better than the rest of the rural (if not the entire) portfolio, microfinance via SHGs in the worst case would represent marginal addition to cost and would often reduce marginal cost through better capacity utilisation. In the process the bank also earns brownie points with policy makers and meets its priority sector targets!

Vijay Mahajan

Once again, Deep's observations significantly capture the motivation of banks and FIs to be in this business. It is true that banks will do what their masters tell them (which till recently, and even now substantially, was the government). But as the market is taking over from the master, at least the more foresighted of the banks, such as SBI in the public sector and the ICICI Bank in the private sector, are looking out for emerging markets.

It does not take much analysis to figure out that the market for financial services for the 50-60 million poor households of India, coupled with about the same number who are technically above the poverty line but are severely under-served by the financial sector, is a very large one. Moreover, as in any emerging market, though the perceived risks are higher, the spreads are much greater. The traditional commercial markets of corporates, business, trade, and now even housing and consumer finance

are being sought by all the banks, leading to price competition and wafer thin spreads.

Further, bank-groups are motivated by a number of cross-selling opportunities in the market, for deposits, insurance, remittances and eventually mutual funds. Since the larger banks are offering all these services now through their group companies, it becomes imperative for them to expand their distribution channels as far and deep as possible, in the hope of capturing the entire financial services business of a household. Banks and insurance companies have realised that NGOs offer a gateway to the large market of the lower-income households and that accounts for why a number of them, the ICICI Group leading, are establishing business alliances with NGOs. As long as this enables the spread of financial services to the under-served at competitive rates, I think it is a good thing that is happening.

Finally, both agri-input and processing companies such as EID Parry, fast-moving consumer goods (FMCG) companies such as

Hindustan Levers, and consumer durable companies such as Philips have realised the potential of this big market and are actively using SHGs as entry points. Some amount of free-riding is taking place here by companies, for they are using channels which were built at a significant cost to NGOs, funding agencies and/or the government. In response to this, BASIX has launched an initiative in retail mutual marketing called 'Our Way', where it has encouraged, trained and financed SHG federations to act as wholesalers for not one but any number of companies and capture the margins as well as bargain for higher discounts on the strength of their 'ownership of demand'. Once again, if this initiative works, it would not be such a bad thing, for low-income households will get things 5-10% cheaper.

On the whole, the economic attractiveness of microfinance as a business is getting established and this is a sure step towards mainstreaming. We know that mainstreaming is a mixed blessing, and one tends to exchange scale at the cost of objectives. So it needs to be watched carefully.



Udaia Kumar is Managing Director, Share Microfin.

Udaia Kumar

It is true that there is a huge gap between demand and supply. The outreach of MFIs/NGOs is negligible. But things have started to move slightly in favour of microfinance. While commercial banks today are interested in microfinance they do not have the expertise to enter the business directly. But they are keen to invest in loan funds. The SHG programme supported by NABARD may have attracted a lot of nationalised banks to support SHGs but otherwise, regulated MFIs have been able to access loan funds from commercial banks. Regulated MFIs which are not grant driven have been thriving on commercial funds and are sustainable. The commercial world is interested in lending directly to retail MFIs that have had a good track record. Today commercial banks are thinking of allocating a good chunk of their portfolio to regulate MFIs. So, MFIs should be thinking in terms of regulating their businesses rather than depending on the grant component and NABARD refinancing.

Alternative Delivery Models

MSS/RS: What about the alternative delivery models used: group models such as Grameen and SHG and individual banking?

Vijay Mahajan

In India there are three major models of delivery of microfinance. We at BASIX have distilled the principles of some of the best practices across the world and improvised upon them. However each model has its own merits and seems to work under differing conditions.

The Grameen Model

The Grameen Model which was pioneered by Prof Muhammed Yunus of Grameen Bank is perhaps the most well known, admired and practised model in the world. The model involves the following elements.

- Homogeneous affinity group of five
- Eight groups form a Centre
- Centre meets every week
- Regular savings by all members
- Loan proposals approved at Centre meeting
- Loan disbursed directly to individuals
- All loans repaid in 50 instalments

The Grameen model follows a fairly regimented routine. It is very cost intensive as it involves building capacity of the groups and the customers passing a test before the lending could start. The group members tend to be selected or at least strongly vetted by the bank. One of the reasons for the high

The Grameen model follows a fairly regimented routine. It is cost intensive rather than meeting intensive. The greatness of the model is in the simplicity of design of products and delivery. The focus on the poorest has also made the model a favourite among the donor community.

cost is that staff members can conduct only two meetings a day and thus are occupied for only a few hours, usually early morning or late in the evening. They were used additionally for accounting work, but that can now be done more cost-effectively using computers. The model is also rather meeting intensive which is fine as long as the members have no alternative use for their time but can be a problem as members go up the income ladder.

The greatness of the Grameen model is in the simplicity of design of products and delivery. The process of delivery is scalable and the model could be replicated widely. The focus on the poorest, which is a value attribute of Grameen, has also made the model a favourite among the donor community.

However, the Grameen model works only under certain assumptions. As all the loans are only for enterprise promotion, it assumes that all the poor want to be self-employed. The repayment of loans starts the week after the loan is disbursed – the inherent assumption being that the borrowers can service their loan from the ex-ante income. Both these assumptions could be questioned.

There is enough literature to question whether it is the best model for the poorest – particularly when their ability to take risks with new enterprise might



Malcolm Harper is Professor Emeritus, Cranfield University.

not be up to the mark. There are also questions raised on the fact that the Grameen model excludes many.

One of the necessary conditions for this model to work is discipline and growth of the number of clients. By design this model might not be appropriate for sparsely populated areas like Kutch in Gujarat, or areas where there is a widespread migration of the labour class such as in parts of Rajasthan, Mahaboobnagar District of Andhra Pradesh and Bharuch District of Gujarat.

Malcolm Harper

To add to what Vijay has been saying about the Grameen Model — in its operations, Grameen Bank and some of its ‘replicators’ outside and within India have introduced more flexible products for farming, housing (a long standing Grameen product) and other purposes.

While the Grameen method is time consuming for members, it is also quite easy for them; the only decisions they have to make as a group are whether or not to accept their fellow members’ loan proposals, which is usually somewhat of a formality, since loans are at least initially disbursed on a strict rota basis. It is indeed quite simple for the bank but also, perhaps more important, for the members. Hence it may be the best method for seriously ‘disempowered’ people who lack confidence. An SHG is a bank, albeit on a micro-scale, and it takes skill and persuasive powers to run it.

People do not borrow for ‘enterprise purposes only’ as Vijay said. They do borrow ‘officially’ for non-enterprise purposes, particularly for their husbands’

businesses, and unofficially a great deal more, for marriage, food, sickness and all that.

As to whether it is the best model for the poorest, there is quite a lot of evidence from Bangladesh in particular that the Grameen model benefits the poorest least, and that it actually harms many people. Its very simplicity leads staff to focus exclusively on recoveries, and hence to mobilise fierce group pressure which has led to seizure of roofing material as security, hence houses being torn down, and even suicides.

Vijay Mahajan

The Self-help Group Model

The SHG model is a model that is homegrown. Unlike other models of micro-credit, the SHG model starts off with savings as a base. The model is like the Grameen model, but not as regimented. Mainstream banking has accepted this model for a nationwide bank linkage programme and it is quite popular with bankers who see potential in microfinance. The essential design elements of the SHG model are as follows:

- Homogenous affinity group of 15-20 members
- Regular meetings
- Regular savings
- Lending decisions are of the group
- Group selects their leaders
- Group accesses external funds

The SHG model is homegrown. Unlike other models of micro-credit, it starts off with savings as a base. The model is like the Grameen model, but not as regimented. Mainstream banking has accepted this model for a nationwide bank linkage programme.

Groups federate at Cluster/Block level. Most of the groups in India have been promoted by NGOs. The groups tend to be dependent on the intervening agency for a long time to help them not only maintain accounts and conduct meetings, but also to manage the external interface with the bankers and others. The rate of growth of SHGs is not as fast as the Grameen groups, because of the heterogeneity of group formation. Since the design allows for flexibility and focusses on internal capability development, it may take a long time for penetration. Moreover not all promoters of SHGs have the same focus towards the poorest of the poor.

Since there is no single external agency channelling credit, there is every danger that the groups might wither away after a while. However, some of

the agencies of the state have seen these as effective channels for delivering the programme funds of various line departments. Since there is no single apex body, and most of the groups are independent, there is every danger that they would get misused as the co-operatives got misused in the past.

SHGs tend to work better in areas where the credit culture is not severely damaged – particularly in the southern part of India. The Grameen model – which is more disciplined – seems to work in areas where the credit culture is severely impaired – particularly in the north and eastern parts.

One of the benefits of the SHG model is that it begins with, and continues to promote member savings. Though SHGs rarely act as the main mode of saving for their members, they at least promote this fundamental financial habit. Further, the SHG model builds on the fact that India already has a large number of bank branches and this channel builds the ‘last mile’ linkage with the lower-income customers.

Malcolm Harper

SHGs do not always access external funds; there are many SHGs which find that their members’ savings plus the high earnings from internal lending are sufficient for their needs. As for Vijay’s statement about groups federating at Cluster/Block level, it is not always the case. Less than 50% of SHGs ever federate or will federate, I suspect.

Banks are promoting an increasing share of new SHGs, as are government agencies, and members themselves are more and more forming their own groups as they learn about the concept from their neighbours.

Regarding the SHG and bank linkage, in theory, and increasingly in fact, any bank branch can do business with an SHG. This institutional advantage may be the strongest feature of SHGs.

Vijay Mahajan

One way to look at the Grameen vs SHGs question is the way time is spent in the group meetings. In case of Grameen, perhaps 70-80% of the time is spent in carrying out transactions whereas in SHGs, 70-80% of the time is spent on member interactions.

In both cases, a lot of time is spent on counting and recounting currency notes and making accounting entries in passbooks. Some attempts have been made to automate the latter, including smart cards and hand-held terminals, but the time-savings are not good enough to enable the staff to hold more meetings per day than at present. SHG meetings tend to be less frequent, monthly not weekly. And a bank worker need not attend every time, or even ever, as the group develops.

Individual Banking

Under the individual banking model, there are two sub models: one where joint liability groups are formed – thereby providing social collateral to the

lending institution, the other being direct lending to individual clients. BASIX offers both the products, in addition to offering loans to intermediaries for on-lending. Both the models seem to be appropriate for larger clients – who either carry out enterprise on their own, or carry out enterprises that hire the other poor who want to be self employed. The reason why this works with larger clients is because the transaction size is large enough to justify the transaction costs.

The SHG and the Grameen models offer economies of transaction costs to the MFI, but at the cost of the members’ time, because the unit of dealing is the ‘group’ rather than the individual. In contrast, MFIs offering individual loans incur higher transaction costs for servicing their borrowers.

Malcolm Harper

In Tanzania, Mongolia, and some other places there have been quite successful attempts to ‘force down’ the minimum level for individual loans, and thus to spare quite poor people from the burden of working

with a group. And we should not forget the village unit system of Bank Rakyat Indonesia, arguably the world’s biggest and most profitable microfinance institution. They do not reach all the poor, and maybe only a few of the very poorest, but they do not use and never have used any form of group at all.

Vijay Mahajan

The SHG and the Grameen models offer economies of transaction costs to the MFI, but at the cost of the members’ time, because the unit of dealing is the ‘group’ rather than the individual. In contrast, MFIs offering individual loans incur higher transaction costs for servicing their borrowers, particularly where they are engaged in farming, since it is difficult to locate a farmer, as compared to a weaver

or a shop-keeper in a village.

In summary, Exhibit 1 captures the appropriateness of each of the models described and discussed above:

Malcolm Harper

I like to see it as a time line. Start with the poorest, most disempowered in Grameen groups, then go to SHGs (this has happened a lot in Kenya) and then such members as wish can 'graduate' to individual loans, at first with and later without group guarantees. But maybe I am too optimistic about the possibility of many of India's (or Africa's) poor ever becoming significantly less poor.

Vijayalaxmi Das

Vijay Mahajan's introduction gives a good perspective on the models that are being tried out in the Indian context. However, we need some basic analysis on the strengths and appropriateness of the models in different contexts.

The Indian sub-continent is diverse and we need to understand why some things work in some areas and not in others. This has to be seen in the context of the overall fabric of the state, the alternate institutions and their growth. We also need to very closely examine why alternative models of reaching out to the poor are not working in certain parts of the country. Is it the absence of a sufficient number of appropriate social intermediaries? Is the cost of promoting appropriate delivery mechanisms too high?

The typology of the microfinance delivery mechanism is but only a route taken to address the basic issue of poverty. Therefore, it does not matter what the typology or the ideology behind the typology is, as long as the channel is appropriate for the social milieu and can deliver the services to the deserving people.

I also do not believe that growth has something to do with the typology. If the objective is outreach, then growth should naturally happen. There are fast growing Grameen models and equally fast growing individual banking models. But these are working in a certain given environment. If we are able to

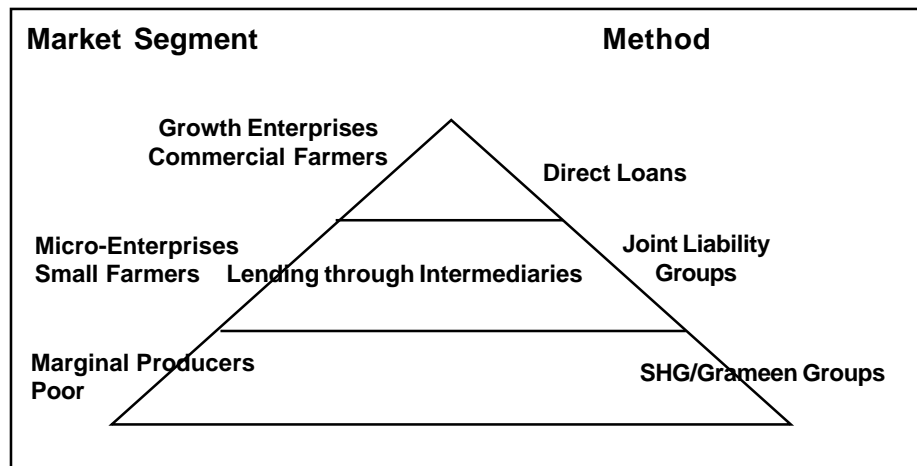


Exhibit 1

crack the issue of what it is in the environment that makes one model more effective than the other, we would have multiple models working in the country – more than the three listed by Vijay, each appropriate to its context. However, classifying the models will help understand their attributes better.

MSS/RS: MYRADA is the pioneer in SHGs. AI, can you talk about how the alternate model (the SHG) emerged?

Aloysius Fernandez

The first SHGs emerged in MYRADA in 1984-85 when the co-operative societies we had organised broke down. Small groups of members of the co-operatives emerged; the members decided to return the money they owed to the co-operative society to their group. By 1986-87 about 300 such Credit Management Groups emerged in MYRADA's projects. In 1986 MYRADA approached NABARD with a proposal to support the formation of an alternate model of credit provision for the poor. In 1987, after several field studies, NABARD gave MYRADA a sum of Rs 1 million. The groups were now called Self Help Groups at NABARD's request. This amount from NABARD was used to train the groups and to match their savings. Between 1988 and 1990 NABARD conducted studies to assess the progress of this pilot; a study of the comparative transaction costs of three models was also carried out. The Self-help Affinity group (SAG) model emerged as the most cost effective. NABARD organised several meetings with MYRADA and the bankers to convince them that this was a viable model. In 1990-1991 the Reserve Bank of India (RBI) allowed banks to lend directly to groups and in 1991 NABARD came out with guidelines which have been reviewed and updated regularly. When the SHG strategy was adopted by the government in 1999,



Aloysius Fernandez is Executive Director, MYRADA

MYRADA decided to change the name to SAGs to stress the basis on which the group was formed, namely affinity (a network of relations based on trust and mutual support) and to distinguish these groups from those that were being formed to meet targets of beneficiaries and whose profile was decided by a particular scheme. In 1992, NABARD launched the SHG-Bank Linkage strategy which has spread all over the country.

Growth in Microfinance

MSS/RS: There is significant debate on the growth of the microfinance sector, with enormous sums of money bandied about. Can you comment on growth in microfinance?

Aloysius Fernandez

If you read the literature on MFIs, one of the assumptions made is that about Rs.15–20 thousand crores (150–200 bn) is required to meet the demand in the microfinance sector, and that the MFI sector should grow to meet this demand.

First, I question the assumption that the microfinance sector has to meet the total demand. The goal is to promote an environment (policies, systems, culture and practices) in which the poor can access credit and other financial services quickly, easily and at minimum cost. In some of our projects where the SAGs have met around 20–25% of the demand, the entire interest structure in the private or the informal sector, has come down. The informal sector was always easy to access, it was the interest rate that was exploitative. If this is reduced, not through legislation (which anyway is ineffective) but through competition, the informal/private sector will always have a role as credit demand can-

not be met fully by the formal sector and the MFIs. If the MFIs can provide 20–25% of demand, the interest rates in the area will come down. This is a debatable point, but worth putting on the floor.

Secondly, there is also the emerging view that the NGO-MFI animal has to grow and to professionalise in order to cope with demand. But the literature seems to take the position that for an NGO to professionalise it should do so by adopting the functions of an MFI. I think this is a dangerous one-track path. There is a whole sector of NGOs which will continue to function without entering into microfinance, and such NGOs too need to professionalise, which they are not doing.

In an article that I wrote some time ago entitled ‘Is Micro Finance Heading Towards a Macro Mess?’ I concluded that it is a mistake to expect (and urge) the NGO into becoming an MFI. My recent experience in Bangladesh seems to confirm my position.

I’ve been involved with Bangladesh since 1971 and till about 10 years ago the Bangladesh Rural Advancement Committee (BRAC) groups spent 80% of their time discussing issues related to education, health and religion. Over the last 10–12 years, BRAC has promoted a major microfinance programme (which was not on the agenda in the earlier years) and the groups today spend 80% of their time discussing loans, recoveries and savings. Hardly 10% of the time is spent on the broader issues for which the groups were first formed. Within a few years of its creation the finance sector has over ridden the development one, for the simple reason that at the end of the day, you really must report on loans, recoveries and payments, but you do not need to report on how empowerment has progressed.

I question the assumption that the microfinance sector has to meet the total demand of 15-20 thousand crores. The goal is to promote an environment in which the poor can access credit and other financial services quickly, easily and at minimum cost.

It would be self-defeating to make an NGO into an MFI. MYRADA is an NGO, it does not work like an MFI, nor is it equipped to run an MFI. We have excellent systems, financial/compliance audits, etc, but at the end of the month we are not interested in a break-even analysis. Disbursement and recovery pressures, break-even analysis, a lender-borrower relationship (which does not promote the building of institutions) are all features of a sound financial institution, not of an NGO. We are not interested in

disbursing funds like an MFI, which has to reach disbursement (and repayment) targets and so on. On the contrary, we hesitate to push funds which people's capacity cannot absorb, so we are very careful to see that our pushing funds into groups does not disturb their learning and empowerment process. We use credit as an empowering instrument – even in our microfinance strategy, we do not give priority to the provision of funds but to their management. The entire model concerns the management of funds. That is why in MYRADA, the SAGs decide on the loans, the interest the repayments and the sanctions. There are no decisions taken outside the group which in itself is an empowering process. It is not just in the financial systems that we differ from an MFI but the whole culture. Further, most NGOs have traditional people who like us subscribe to Gandhian ideology or an ideology with leftist leanings. Turning an NGO into an MFI is like asking a banana tree to produce coconuts. This is my second point, which I know will be debated hotly.

NGO-MFIs complain that in the present environment they feel insecure as they are not supported by a legal framework and are not allowed to take deposits from the public and therefore, have no low cost capital and stable resource mobilisation opportunities. NGOs need to live with a sense of insecurity in order to be effective. They need to have a strategy for withdrawal (from sectors and from areas) after their objective is achieved; this sense of insecurity is not a negative one which fosters a sense of exclusion but one that promotes a renewed vision, increased commitment and new strategies which allow other institutions to grow. So it is insecurity in a positive sense.

What then do I propose? Instead of trying to morph into an MFI, the NGO should promote a separate financial institution. Possible models are companies (for profit or not-for-profit), co-operatives (various types) and others. MYRADA promoted Sanghamithra (a not-for-profit company), which lends only to SAGs. The Sanghamithra Board believes that an MFI should be comparatively small – around Rs 20-25 crores (200-250 mn). The growth strategy adopted is to promote several Sanghamithras and an asset (or fund) management institution which will monitor/supervise, mobilise/

manage funds, influence policy and represent the several Sanghamithras. The basic financial institution will continue to be the SAG, the second tier institution will be the Sanghamithras (all not-for-profit companies) mobilising grants, subsidised loans and graduating to loans at market rates of interest. The Asset (Fund) Management Institution will be a for profit institution.

Finally, included in the growth scenario is the trajectory of individual members of SAGs. The MYRADA experience indicates that in the first year or so the number of loans for consumption is large (though the amounts are comparatively small), in

the second and third years the number of consumption loans fall and the number of loans for trading and small assets increase – the average size of the loan is around Rs 3000. After the third year the average increases to Rs 5000, with several loans ranging from Rs 10,000 to Rs 15,000. During this period, the SAGs link up with banks or with Sanghamithra. After the fourth year, several members approach the banks directly for larger loans. The banks assess their credibility on the basis of their performance in the SAGs.

The other issue is the question of mainstreaming. The basic reason why credit from the formal sector did not reach the poor is not only because of extra paper work, but because we have always tried to

mainstream the poor. The formal system has insisted that they fall in line with the official system. The poor have never been allowed to develop a sound alternate system that the mainstream financial institutions would recognise in its own right. For example, we have SAGs which function according to all the norms of registered institutions but do not want to be formally registered for fear of petty official harassment. But the banks would not give them loans unless they were registered. Further, our SAGs wanted to be assessed as institutions and they want group loans and not individual loans so that the purpose of each loan is not questioned (as the banks do now). The formal institutions also insist on lending only for assets or productive purposes when the SAGs want to be free to lend for any purpose including health, food, repayment to money lenders, purchase of land, trading and so on. MYRADA studies indicated that over 60% of repayments on

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David Gibbons is Executive Chairman, Cashpor Financial Technical Services.

asset loans do not come from the income derived from the asset at the time of repayment.

The SAG-Bank Linkage programme has succeeded because we have allowed the groups to develop their own alternate systems without trying to mainstream them. We have managed to get the mainstream (thanks to NABARD and the RBI) to accept the SAGs policies and practices, their interest rates and schedule of payments, restricting the role of the banks to focussing on assessing the SAGs as institutions, on repayments and on reducing transaction costs. Thus, mainstreaming can be disempowering.

David Gibbons

My concern is, growth for whom by whom? The problems facing all of us are the huge number of below the poverty-line (BPL) households in the country, and how to give access to sustainable microfinance services to them.

The alternative system (SHG Linkage to Banks), is not nation-wide. It is concentrated mainly in the southern states which are relatively less poor, both in percentage and in absolute numbers of households below the poverty-line. SHGs have not caught on in the north and east, particularly in the BIMARU states (Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh), Orissa and West Bengal, in which much more than half of the country's BPL households live. So definitely other approaches, both alternative and mainstream, are needed to grow the outreach of microfinance services to a significant proportion of the poor, all over the country.

Its skewed growth aside, there are other limitations

of the SHG-Bank Linkage programme. What proportion of the MYRADA SAG members and those who get loans from the Linkage programme are genuine BPL households, that is households whose normal annual income is less than the official poverty line income for the state and region? How do you know? What about SHGs in general? In theory, the SHG-Bank Linkage programme is open to considerable leakage of funds and subsidies meant for the poor, to the non-poor. This is because normally being a BPL household is not a condition for entry into SHGs, and SHG-promoting NGOs do not normally take the trouble (and cost) of identifying on the ground in the villages, who is BPL and who is not. Given that BPL households are less than half of all rural households in the country, probably they are less than half of SHG members, as well. If so, a huge amount of effort and funds, made and allocated in the name of the poor, are not reaching them. Is this the same old story of so-called 'poverty-focussed' programmes being hijacked by the non-poor?

BPL households must be cost-effectively identified on the ground in their villages, and SHGs should be formed among them alone, if we are to ensure that the SHG-Bank Linkage programme provides access to microfinance services to significant numbers of the poor.

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Further to Al Fernandez's reasons why NGOs should not be expected to meet most of the huge demand for microfinance services or become formal financial institutions, I would like to add their chronic capital shortage and dependence upon donors. Realistically most NGOs cannot hope to build up sufficient corpus to leverage from banks the large amount of funds that would be required for on-lending to a significant number, say even 500,000, of BPL households; and the RBI is not going to let them raise these funds as public deposits.

MFIs, including those established by NGOs, cannot have a significant impact on their own because of the capital/fund constraint that they inevitably face. Establishment of equity funds for MFIs is not the answer either, because before long they themselves would be crippled by capital constraint.

A New Linkage Programme: Banks and MFI Agents

If NGOs can promote Sanghamithras, why cannot the Sanghamithras get around their inevitable capital constraint by linking with banks, with MFIs acting as agents for the banks' financial intermediation with BPL households? MFIs could receive bulk funds from the banks, and deliver the microfinance services to poor women in their villages (the only way that the latter could participate). The MFI could charge its clients an administrative fee to cover the additional costs of delivering the financial services, so that the service becomes sustainable, and the banks could charge their prime lending rate for the loans. Provided large numbers of BPL households could be reached, the programme would be profitable for banks. If it were profitable, it would spread to even larger numbers of BPL households, and make a significant impact on rural poverty in India. That would be growth worth aiming for!

Al Fernandez

In reply to Prof David Gibbons' statement that the SHG-Bank Linkage has not caught on in Orissa and West Bengal, my figures show that the difference in these states and the south Indian states is not much; while in Andhra Pradesh the figures are lopsided as it has become a political issue. The performance in the south Indian states has been better as the movement started in the south first. Moreover, studies reveal that the whole financial system is reasonably good in the south and in the west, with the graph declining significantly as you go east.

The need for alternate models is accepted. What we are saying is that the potential of the poor to organise into groups and the pervasive presence of banks make the SHG model currently the one with the most potential for upscaling in a reasonably sustainable manner. As to why some states remain stubbornly poor and whether an alternative model of credit outreach would serve any better in these states, there are other issues, basically of governance which come into play here. This is not true only of the microfinance sector but of overall finance and governance as well. So alternatives are not just welcome, they are necessary. But I would

like to know what concrete options Prof Gibbons has, that build in some of the essential pillars of sustainability that the SHG model builds in, such as linking up with banks and so on.

His statement that the SHG movement does not reach the poor, is loaded with ideology; conceptions of the poorest of the poor and so on. (My studies on the subject have been documented in my book, *Putting Institutions First.*) The issue is, how do we define the poorest of the poor? Should

When we asked the people themselves to identify who they considered to be the poorest, they did not include the landless who have regular jobs. Large families with irrigated land but with a number of sick people were identified as the poorest because they did not have labour.

it be according to the official definition of BPL criteria? When we asked the people themselves to identify who they considered to be the poorest, their list and their criteria were in variance with the official BPL list. They did not include the landless who have regular jobs among the poorest whereas large families with irrigated land but with a number of sick people were identified as the poorest because they did not have labour. There are many other issues and our survey lists how people identify the poorest. It is on that basis that we identify the poorest. Our survey shows around 85% of our SHG members are genuinely poor people. They're not necessarily on the BPL list, which is precisely the point, as the list does not reflect reality.

Once the people identify the poor amongst themselves, we invite them to form their own affinity groups. I think Prof Gibbons' assumption that with 50% of the community being non-poor, 50% of the SHG members must also be non-poor is invalid. If the organising strategy is what I suggested earlier and if the NGO is sensitively pro-poor, obviously there may be a queue, and we find that the non-poor usually drop out very fast. We also need to remember that loans from banks to SHGs are drawn from priority sector funds and not from poverty programme funds.

Further, the poor do not need microfinance alone. A large number of our people do not want credit. They are part of SHGs because they have other social needs – some are ill, others aged, and they need other kinds of help. Our SHGs are engaged in getting pensions for the old, and medical care for the sick, as responsibilities that they themselves have adopted. And there are some people that the SHGs will not accept, like the perpetual drunkards, or those who have a reputation of being unreliable in



Vijayalaxmi Das is Chief Executive, Friends of Women's World Banking.

the village, though officially they may be poor. Since we have some criteria to classify people as poor, why not give them the same privilege?

As for Prof Gibbons' question, if NGOs can promote Sanghamitras (I presume he's interpolating from MYRADA) why can't Sanghamitras link with banks is a question we ourselves asked five years ago. Sanghamitra has taken a loan from NABARD and is also now negotiating one with the Canara Bank. This is one way of raising capital until we can mobilise capital through savings and deposits. Further, I would like to clarify that Sanghamitra is not there to expand and push out financial institutions. Banks are the major lending institutions. Sanghamitra is there as an option, for people to approach if they are not happy with the bank, to keep the bank on its toes.

Vijayalaxmi Das

Al Fernandez's views on the role of NGOs in the microfinance sector is based on the assumption that once the NGOs play the social intermediary role and build SHG/SAGs the poor will have access to affordable credit facilities. Most of the NGOs would love to do this instead of borrowing from financial institutions and on-lend to groups they had promoted. What makes them take this risk?

- The linkage between the SHGs and the banks is not as smooth as the NGOs had expected. There are geographic variations in the bankers' response and the NGOs' ability to link the groups.
- Not all the NGOs have sufficient grant fund to play the role of 'social intermediary'. They are able to cross-subsidise the costs of 'social intermediation' through the income from 'financial interme-

diation'.

- Many NGOs are concerned, like Al Fernandez, about the way the SHGs are made the 'beneficiaries' of all development programmes of the government, leading to distortions in the original concept of mutual help and affinity. (Even the focus on the poor has been compromised while forming these 'target-led SHGs'). This concern had led many NGOs, reluctantly, to play the role of financial intermediary, and they have looked for opportunities to discontinue this role. (Eg: Federations of SHGs was one such option many opted for but this did not work as expected.)

- The few NGOs that were focussing only on financial services created non-banking finance companies (NBFCs)/ mutually-aided co-operative societies (MACs) etc. once their member base had in-

creased and they were confident of reaching out to larger numbers of people.

Further, the NGO-promoted alternate financial service delivery models emerged in the early 1970s, when bank nationalisation did not assure the poor the expected access to banking services. Till the banks fully recognise that the poor are bankable and not just 'programme targets', NGOs concerned about poverty issues will continue to look for alternative mechanisms to deliver financial services to the poor.

Ramesh Ramanathan

Al has made three or four key points. While Al's point that if MFIs can meet 20–25% of the demand, you create a comparative environment for the pricing of credit, is

based on a very reasonable premise, I would like to see some data supporting the validity of this 20–25%. Secondly, how sustainable is it? And who are the actors in the issue of sustainable growth?

Today the actors are the formal financial institutions, the informal lenders as well as the new breed of either MFIs or NGO-MFIs, or NGOs and so on. What is the role of these actors as we move into the growth phase? If MFIs have come together to create the 20–25% threshold in a particular district (and if this data is valid) what is the economic capacity of that MFI to remain in business, say ten years from now, in that same district, to continue to ensure that the 20–25% threshold is held? We could

Many NGOs are concerned about the way the SHGs are made the 'beneficiaries' of all development programmes of the government, leading to distortions in the original concept of mutual help and affinity. Many NGOs, have looked for opportunities to discontinue this role.



Ramesh Ramanathan is Vice Chairman, Sanghamitra Rural Financial Services.

break down a virtual monopoly or an oligopoly for a short period of time, but entrenched players can simply outlast this temporary scenario. If five years from now the MFI in question does not exist then you'll go back to a different pricing structure altogether.

I completely agree with AI that the NGO has to professionalise independently and the core competencies required to be an MFI simply do not exist.

One of the key questions in financial viability is the rate of interest. If you talk about growth and its sustainability, the key question is how you price your service and your financial product. In Sangamithra itself we have had this interesting tension over the pricing. Sangamithra has two different pricing structures. In the rural areas we price at 12%, in our urban areas we price at 24%. There are two reasons why this emerged. One reason for this I think is that since MYRADA with its pro-poor, NGO thinking is present in the rural areas, we had to cost ourselves at a price acceptable to the poor. In the urban areas, given the absence of MYRADA, we didn't have the pressure to price ourselves at a lower point. But there is a larger, more fundamental economic issue here. You are a price-taker in the rural areas because you are dealing with an entrenched banking system which is already doing a fair amount of microlending. Now the problem arises when the incumbent is pricing without understanding that there are hidden subsidies under which they are operating. If the microfinance transactions are separated, they would understand that 12% is impossible. But such a separation is unlikely as it will just get embedded with their various products. The only other way in which I can see this happening

If you talk about growth and its sustainability, the key question is how you price your service and your financial product. The problem arises when the incumbent is pricing without understanding that there are hidden subsidies under which he is operating.

is, as microcredit becomes a larger and larger portion of their portfolio, organisations are going to realise that this pricing is not sustainable. We need to track this with NABARD and ask, are there districts where SHG lending as a proportion of a particular bank's portfolio has gone beyond 20-30%? And there we should ask the bank managers, what do you feel about lending at 12%? I am sure we will get data to say that we should increase the prices. If we want sustainable growth we really need to talk about price points. This is an eight hundred pound gorilla for the development sector to deal with because it's combined with ideological issues as well.

In the urban areas for example, Sangamithra is lending at 24% because we are the price makers. There is no formal sector, no other development NGO here, and as we improve our operating environment we think we can reduce our price.

MSS/RS: Don't the NGOs you deal with in the urban sector object to this 24%?

Ramesh Ramanathan

They do but they're not the size of MYRADA. When we work with an NGO as a partner, one of the first questions that comes up is pricing. We sit down and walk them through our entire economics so that there is an awareness building. Then we explain things to the poor as well. There, what works is the fact that we're a not-for-profit institution. We make it very clear that this 24% is not excess rent and it becomes palatable when they understand the transparencies. Sangamithra discloses its financials to all partners every month, so it makes it acceptable that we're charging 24%.

MSS/RS: You're saying 24% is a reasonable cost for any kind of institution. If you're a for-profit MFI,

then would you be looking at an even higher number?

Ramesh Ramanathan

Of the 24% we give 3% to the NGO partner, so we're actually getting only 21%. And in the 21% we're factoring in a cost of funds of about 10%, whereas for a banking institution their true cost of funds is only about 6-6.5%. So there's a three hundred basis point spread, which is more than sufficient for

them. We believe that a not-for-profit MFI will have a cost of fund which is about three hundred basis points more than a for-profit institution and that should be sufficient for their profitability.

Al's suggestion that NGOs promote MFIs is a valid one but we should probe that question a little deeper to ask under what circumstances should an NGO or a cluster of NGOs come together to form an MFI. An individual NGO may not have a critical mass. So how do you create a set of critical mass conditions for a cluster of NGOs to come in?

Further, what have we proven about the economic sustainability of the MFI itself? If you want to create competitive conditions, and if you believe that the MFI is one of the key players in creating those competitive conditions, then the MFI must be economically viable long term. But that question still has not been answered.

MSS/RS: Are you saying that based on the current experience you're not sure whether MFIs can be economically viable in the long-term?

Ramesh Ramanathan

Well, how many MFIs are there? We literally have five or six experiments in the country. Vijay's BASIX model, despite its value add to the idea of microfinance, I do not think is replicable throughout the country. Al has suggested a very interesting multiplier model, but in order to onset that multiplier model we need to show that the individual Sangamithra is capable of breaking even so that it can be the catalyst for the 20-25% credit needs, and that it is sustainable in the medium to long term.

Which brings me to Al's point about NGOs feeling insecure and it being a healthy insecurity. I completely agree with that. But for a financial institution or an MFI insecurity has a very different implication. An NGO can afford to say we came into this area because we wanted to ensure a certain minimum development. Now that it's been met we can extract ourselves and go away. There is a sunset clause built into every NGO's activity. But what's the sunset clause for an MFI? If Sangamithra says since the credit needs are met here, we can move away, it may not be viable, because there's a certain investment cycle, a certain return on that cycle and so on. These are legitimate questions and un-

less we find answers for them, we can't say this is a replicable model.

Finally to come to Al's last point that the growth scenario included the trajectory of individual members of SAGs. I think it's an extraordinarily important point, both in terms of the development cycle as well as the role that the stakeholder plays in the long term scenario, which is the larger point. These groups of poor are also actors in this scenario and they figure in what is almost like a university environment, where every year a new set of students comes in. If our model is good, then every year a new set of poor will come into this group system and the graduating class will be those who are no longer poor, whether the period is one year or six years. As they move up the ladder of going from the poorest, to the poor, to the less poor and to the middleclass, and as they move up the ladder of going from a group loan for consumption, to a group loan for income generation to an individual loan, then clearly, by the end of the period, on graduation day they are no longer the

poor. But there's another group coming in. So, what is the role of the graduating stakeholder in the sustainable growth environment? We don't know but we have to think about that, because they clearly play a role. As the poor become empowered and/or financially independent, do they influence the responses of other players?

MSS/RS: It's like saying the alumni need to work with educational institutions.

Ramesh Ramanathan

Exactly, it's too important to be left out. They play an important role in defining what that competitive environment is. My central comment in this growth paper is, who are the actors in a long term sustainable growth model, and what role do they play over time? You cannot have the MFI play a short term catalytic role and then vanish, because then that system will revert to its original state. My biggest fear is that we are not considering the economic implications for the long term sustainability of the MFI.

MSS/RS: In the urban context, how are NGOs coming to terms with microfinance in all of its various

aspects?

Ramesh Ramanathan

The single biggest issue, which is an ideological issue, is the question of pricing the service. We now have 20 NGO partners in the urban area and they have all recognised the complexity of the task, that this is banking where a whole set of competencies and backend processes are required. They have also recognised that there is a significant role for them here as well and that the process is complementary in many ways. Moreover, even building the capacity on the group side to access credit takes time, energy and effort. Connecting with AI's last point about what true empowerment is, so far, going by Sanghamitra's track record in the urban areas, we have helped to create credit management groups rather than true self help affinity groups. There is a definite discipline, they are talking about savings, rotation and loans, but whether it has graduated to the larger issues of empowerment, making their own decisions and so on, are outstanding questions. That's our challenge at the current moment. How do we get the NGOs to talk about the impact that the group has had on the larger issues rather than just the economic, credit and management issues.

Beyond Micro-credit

MSS/RS: What do we see happening beyond micro-credit?

David Gibbons

Regardless of the microfinance methodology utilised, an integrated set of microfinance services, including savings, credit and insurance products, should be provided for the poor, as quickly as possible.

The most important reason is that all these services are needed by the poor, especially by poor women who predominate among the clients of microfinance. They need savings facilities for safekeeping and to tide them over food deficits and other periodic emergencies, as well as to accumulate larger amounts of funds for the marriage of their daughters and the purchase of productive assets. Micro-credit is needed for investment in income-generating activi-

ties, so as to break out of the vicious cycle of poverty. Life and large livestock insurance are needed so as not to burden survivors with debt, and to be able to cope with the death of a large farm animal purchased with loan funds.

As far as savings facilities and micro-credit are concerned, the usually strong demand from poor women is sufficient evidence. In the case of insurance, however, demand is usually weak; but objectively the need is strong. The unexpected death of a wife and mother, leaving a debt to an NGO-MFI that may not be repayable if she was the income-earner, usually pushes an uninsured household deeper into poverty. The death of a large farm animal purchased with loan funds not only deprives an uninsured household of the expected means of repayment of the loan, but also can deprive it of access to credit in future, if it is unable to repay the loan. While the practical attitude of most poor women toward insurance (that they don't benefit from it even if they die) is understandable, given their chronic shortage of surplus income

to pay for it, continuing education by NGO-MFIs is necessary to open their minds.

A second important reason for NGO-MFIs to provide clients with an integrated set of microfinance services is that they promote the early attainment of institutional financial break-even and sustainability, without which NGO-MFIs will not be able to serve the poor for long. Not only do loan client savings provide an obvious 'cushion' for timely repayment; but even more important, client savings provide the basis for financial intermediation that makes possible the efficient supply of micro-credit to its clients. Normally, savings are an alternative and relatively cheap source of funds for NGO-MFIs, because the interest rates usually are less than those that have to be paid for debt. Therefore, by maximising its savings mobilisation, an NGO-MFI should be able to minimise its average cost of funds. This in turn should maximise its margin at any given interest rate to its clients, and thereby hasten the attainment of break-even and profitability.

Insurance products also promote the attainment of institutional financial break-even and sustainability; but indirectly through promoting

Regardless of the microfinance methodology utilised, an integrated set of microfinance services, including savings, credit and insurance products, should be provided for the poor. These services are needed by them, especially by poor women who predominate among the clients.

loan portfolio quality. Insurance on the life of borrowers and large farm animals makes loan recovery possible at times when it could be quite difficult or impossible otherwise. Other things being equal this would tend to maximise loan repayment rates and to reduce any gap between expected and actual yield on portfolio. This in turn should promote the attainment of institutional financial break-even and sustainability for the NGO-MFI.

From the points of view of both client and institutional benefit, therefore, NGO-MFIs should offer their clients savings facilities, micro-credit and life and large farm animal insurance. To maximise their benefits, these financial services should be integrated. That is, some savings should be required before access is given to micro-credit, so as to provide funds for financial intermediation and as a cushion for loan repayment. Similarly, insurance on the life of borrowers and large farm animals should be compulsory as soon as clients can bear the premia, say after successful repayment of their first loan on time and in full, so as to maximise the recovery of subsequent loans.

Regulatory and Institutional Matters

In most countries, like in India, the provision of savings facilities, credit and insurance were regulated before microfinance for the poor became established. It is necessary now for these regulations to be reviewed in terms of whether they promote or hinder the impact of microfinance on poverty. Currently the RBI prohibits the collection of savings by any institution except banks and NBFCs, that have been licensed to do so. The minimum capital and other requirements for attaining such a license are stiff. Yet licensed banks and NBFCs do not normally provide savings facilities to poor women in their villages. Hence most of them do not have access to legal savings facilities.

This unacceptable situation could be changed easily by the RBI accepting that micro finance for the poor is different from conventional finance, in that nearly all microfinance clients are simultaneously savers and debtors with their NGO-MFIs. Normally they have much more of the NGO-MFI's money in their hands as loans outstanding, than it has of their money in the form of savings. Thus, if a micro fi-

nance client becomes concerned about the security of her savings with an NGO-MFI, she can protect them by deducting them from her repayment. RBI could provide adequate protection for the savings of the poor with NGO-MFIs, by limiting them to a safe proportion of loans outstanding to its savers, say 50%.

The ongoing de-regulation of the insurance sector in India provides adequate opportunities for NGO-MFIs to arrange the needed insurance cover for their clients, by becoming agents of established insurance companies.

On the institutional side it is of course necessary for NGO-MFIs to build the institutional capacity to provide quality savings and insurance products to their clients, including the necessary staff training and market research.

Deep Joshi

Considering that poor people spend a great deal of money on health (often 25 to 40% of micro-credit goes to meet medical costs), I would put a high premium on medical insurance. Of course, there are serious problems with medical insurance and often the problem lies with poor health consciousness and poor basic health services, but if we are concerned with improving the quality of life of the poor, we

have to deal with difficult problems. We need not stop only at life insurance and insurance of (purchased) assets but go further into crop insurance and livelihood insurance, but all of those are tough ones ...

On micro-credit itself, I think there is a great deal that can be done. Most micro-credit presently deals with fairly conventional loan products — take a loan that is either related to your savings or to some investment idea and repay it in so many instalments. But poor people actually need a 'credit card' or line of credit kind of facility — they need a tap rather than discrete bucketfuls of credit. On countless occasions I have met women who have mortgaged one-half or more of their crop to the moneylender at 50% interest per crop season (five to six months) to buy food during the lean season even as they had access to micro-credit. This leads to a vicious cycle — every time you mortgage your crop, the next time you have to mortgage even more as you will have

less left with you ... till you become a share-cropper on your own land by mortgaging it. Much micro-credit still remains focussed either on dire emergencies or micro-investments rather than full scale financial smoothening.

How about offering some sort of rating or valuation service to poor people? After all, poor people are producers or enterprises. They could offer their 'enterprises', including wage earning capacity, as a kind of standing equity? In a way the SHG is supposed to do that and members in any halfway-decent SHG assess each other in this fashion, but the external world does not quite deal with SHGs that way — in fact, the capacity to repay is rarely taken into account in rating SHGs by the umpteen tools now floating about.

Then there is the idea of 'stopping the leaks in the bucket' that BASIX has tried — the Apna Bazaar kind of idea of enabling poor people to procure and distribute among themselves various items of daily consumption. A village of 100 poor families would be buying between half to one million rupees worth of food and provisions a year. Finally, if one is concerned about livelihoods, micro-credit needs to become macro and for that you need to do something about increasing the absorption capacity.

Jayashree Vyas

I fully agree with David Gibbons, that regardless of the methodology used, we need to provide an inte-

grated set of microfinance services. I would add financial counselling to his list of services, as we think that is an integral part of our responsibility in working with the poor.

As the poor are very vulnerable, it is not sufficient for us just to provide micro-credit, but to have a series of support systems provided at the appropriate time; if not they tend to slip back into abject poverty. We have conceptualised this in SEWA as in Exhibit 2.

Initially a poor woman has negative equity, in other words debt (point 1). By accumulating savings she can move upwards out of negative equity (2). However, because of her vulnerability she is quite likely to fall back into debt (3), and needs insurance and emergency loans, as well as her accumulated savings, to guard against such a scenario. Further savings, and increasingly loans for business investment, can then enable the woman to build positive equity as she moves from point 2 towards point 5. On the way, the woman continues to be vulnerable to shocks and emergencies, which could push her back to point 4, requiring an on-going need for her accumulated savings, insurance and emergency loans. In this way, poor women can gradually move out of the vicious cycle of poverty.

Throughout this process, financial advice and guidance are available to the clients, both in the bank itself, as well as at women's doorsteps through the 'hand holders', to show them ways of increasing their assets and incomes as well as enhancing their

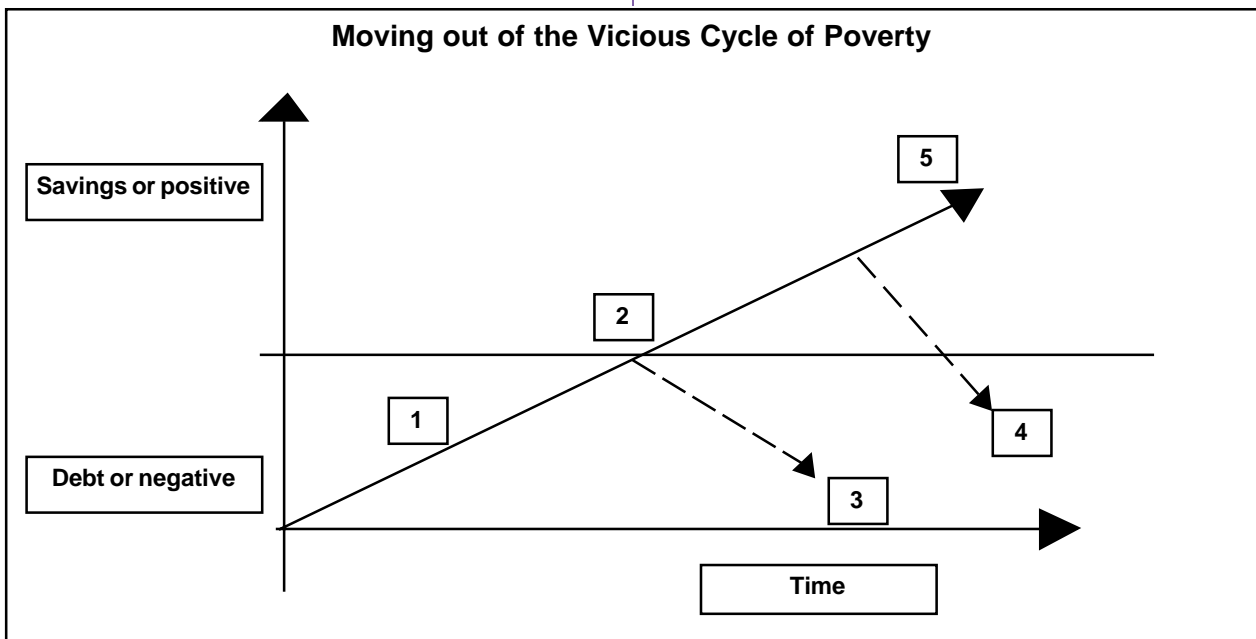


Exhibit 2

abilities to manage their limited resources effectively.

We believe that microfinance institutions could take such an integrated approach. This would help in looking at the overall financial flows of a poor family rather than at just the livelihood or the enterprise aspect. Ultimately the poor do need resources for consumption, health and education – and unless we look at this as a whole, we might lose sight of the ultimate goal.

We at Sewa Bank do not see regulation as a major constraint. We think that the cooperative form of

organisation is best suited to carry out these activities because of the following features:

- It is democratic, and by definition calls for the involvement of the people
- It believes in sharing of risks and benefits and therefore people's stakes are built in right from the first day
- It allows the offering of a range of services without too much of regulatory interference and we have been providing not only savings and credit, but also insurance and financial counselling into our offerings.

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