



# micro

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## Sa-Dhan conducted regional meetings of microfinance institutions in AP

*Microfinance Focus, November 30, 2010*

The five-member committee set up by microfinance association **Sa-Dhan** has conducted three regional meetings in Andhra Pradesh to analyse the situation on ground post microfinance ordinance and adopt Sa-Dhan's code of conduct. "The committee is in the process of consolidating the findings of the meetings and will soon be sharing the report with the government officials", said **Mr. Ernest Paul of Saadhana** who is one of the members of the committee.

**A regional meeting was held in Kurnool on 22<sup>nd</sup> November, in Hyderabad on 23<sup>rd</sup> and on 25<sup>th</sup> to cover the microfinance institutions of Andhra region.** "We are organizing workshops and meetings to bring awareness to the community. We are explaining the salient features of the ordinance to the institutions. We are not going for collections as we are noticing that people are revolting where institutions are going for repayment collections", he added.

Sa-Dhan set up a five member committee comprising of **Mr. Ernest Paul from Saadhana, Rahul from SCCI, Satya Prasad from Star, Ms. Rama from BASIS and Uma Maheshwar Rao** to look into customer relationship issues and practices that microfinance institutions are adopting. The decision was taken up in an emergency meeting which Sa-Dhan called post microfinance ordinance issued by the government of Andhra Pradesh.



**Sa-Dhan**  
The Association of  
Community Development  
Finance Institutions

**Sa-Dhan:** The Association of Community Development Finance Institutions (CDFIs) represents countrywide a total of 252 members across 19 states with loan outstanding of Rs. 18,344 crore (4 billion USD) and client outreach of 2.67 crore (26.7 million).


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# Panel report to decide fate of MFIs

 The Telegraph, 3 November 2010  
Mumbai

**M**icro-finance institutions (MFIs) — which have come under a cloud after recent complaints against their usurious lending practices and weak corporate governance standards — face the prospect of regulatory scrutiny. **The Reserve Bank of India** today said a sub-committee appointed by the central bank would “make recommendations ... relate to regulation of micro-finance activities of **non-banking financial companies (NBFCs)**, especially with regard to issues impinging on borrowers' interests.”

Last month, the Andhra Pradesh government had passed an ordinance seeking to restrain MFIs from adopting coercive loan recovery processes that had reportedly sparked a spate of

suicides by a number of poor people in rural areas. The sub-committee, which is headed by noted chartered accountant **Y.H. Malegam**, is expected to submit its report by the end of January.

**RBI governor Duvvuri Subbarao** said there were a couple of concerns pertaining to MFIs. These included high rates of interest charged and coercive practices adopted by these institutions. Responding to a query, the RBI governor said the MFIs posed no threat to the stability of the financial system as loans to the sector were small. “At the individual level, there may be some strains,” he added. In October 2009, the central bank had established a working group under V.K. Sharma to examine the pros and cons of issuing priority sector lending certificates.

# Despite resistance, AP set to introduce microfinance Bill

K V Ramana

DNA, Nov 6, 2010

The Andhra Pradesh government has decided to go ahead with the introduction of a Bill to regulate microfinance institutions (MFIs) in the state despite all resistance. The legislation will focus on curbing extortion from the borrowers under the guise of interest and the coercive recovery practices of the MFIs.

Official sources said the ordinance on MFIs, promulgated on October 15, would be introduced as a Bill in the state assembly, which is to reconvene later this month. "The government is clear on what it has done and what should be done in handling the MFIs. Though they are all registered with the RBI as non-banking finance companies, they are engaged in money lending and they come under the state government's jurisdiction," an official source said. Though there were objections from the industry to a specific Act for regulating the sector, the state government has decided to go ahead with the Bill and iron out the issues, which are said to be creating major road blocks for the MFIs in carrying out business.

"The government is not against the MFI activity. But, there is a need to regulate the activity and ensure there is no unnecessary pressure on the borrowers," the source said. Though the Bill is still being given the final touches, sources said the key elements of the ordinance will definitely be carried forward in the Bill. Registration will be mandatory for the MFIs keen to operate in the state will be mandatory and any MFI operating without such registration will face punitive action including

punishment up to three years and Rs1 lakh fine.

There is also a proposal for naming all the directors and the top management in case of violation of this rule, though the government is said to be seeking legal opinion on such a move. With the preliminary information on the MFI activity in the state suggesting the borrowers are being pushed into a debt trap due to multiple lending by the companies, the government has decided to cap such lending. The MFIs will be asked to apply to the registering authority before lending to a borrower or a self help group already covered by a bank. The authorities will then verify the repaying capacity of the borrowers. Only after ascertaining the repayment capacity will the MFIs be allowed to extend loans. Lending to SHGs with a bank linkage without seeking the prior approval of the authorities is also a punishable offence.

While coercion will be a crime of sorts, leading to a punishment of up to three years, the MFIs will also have to disclose the interest collected to the authorities on a monthly basis. The government will also set up fast track courts to try the violations of the MFIs. "The information available with the authorities so far indicates that the interest rates are higher than what is being claimed by the MFIs. The average rate is upwards of 30%. There is also proposal to make the MFIs start collecting the repayments on a monthly basis instead of weekly. There is no final decision on this yet," the source said. Industry officials fear the conditions being laid out by the government would have a significant negative impact on the MFI activity in the state initially, though the institutions will have to find ways to keep themselves afloat.

## MFI body Sa-Dhan adopts code of conduct

BS Reporter, November 04, 2010  
Chennai/ Hyderabad

**Sa-Dhan, the largest association of microfinance practitioners,** adopted a code of conduct for self regulation. The code focuses on protection of borrowers in rural and urban areas and strengthening of transparency and governance of MFIs in the state.

The implementation of the code will help MFIs in Andhra Pradesh to comply with the provisions of the ordinance. Sa-Dhan on Wednesday formed an ethics and grievance redressal committee. It organised a meeting to bring the government, bankers and its members to a platform to deliberate on the issues relating to MFIs. Sa-Dhan members including **Spandana, Share, Basix, Asmita, Saadhana, Pragathi Seva Samithi and Indur MACS, and 25 banks attended the meeting.**

## Interface with Members on Code of Conduct

As the situation of reduced repayment and freezing of resource flow in Andhra Pradesh had the potential to spread to neighbouring states, Sa-Dhan undertook measures to communicate its implications through meeting with members in the states of West Bengal and Orissa. Members in these states are working towards increased emphasis on field level training of staff focusing on enhanced client sensitiveness. In these meeting Sa-Dhan has emphasized the need for adherence to the Code of Conduct within the membership.

### *Stakeholders' Meet on Code of Conduct in Andhra Pradesh*

To position the code of conduct and the efforts that the sector is making to amend practices on the ground, Sa-Dhan organized a Stakeholders' Meet on 2nd November 2010 in Hyderabad to inform about the details of Sa-Dhan code and seek support on the same. Seventy participants including 24 banks, the Principal Secretary, Rural Development and Sa-Dhan members attended the meeting. While the banks declared support for the code, the Principal Secretary responded to clarifications sought by Sa-Dhan members, as well listened to the complaints that they had about the issues in the registration process on the Ordinance. Members reiterated their commitment on the Code, where as the banks committed support on the same. This was an important initiative as far as showcasing efforts from the sector to take corrective steps is concerned.

### *Expediting the Code of Conduct Implementation Process: Workshops with Members in Andhra Pradesh, West Bengal & Orissa*

During November the Code of Conduct (CoC) Team within Sa-Dhan

has conducted five workshops with members in Kolkata (55 participants), Bhubaneswar (53 participants), Hyderabad (45 participants), Kurnool (20 participants) and Rajahmundry (59 participants), explaining the elements of Code of conduct and its importance in the present context of the sector. These workshops witnessed the participation of NABARD, DRDA, SIDBI, private and public sector banks apart from members and non-members. Through participation in these workshops banks and government officials are also being communicated the preventive steps the microfinance sector is taking to avoid unpleasant situation in the field. There has been an overwhelming response in terms of participation of members as well as banks in these workshops. This will also pave way for greater coordination between MFIs, banks and government at the state level.

### *Seeking Compliance report from members on CoC and Social Performance Indicators*

While the workshops on code of conduct is bringing greater clarity on the details and significance of the Sa-Dhan Code, the CoC team has also developed a questionnaire to measure compliance of the membership on the Code. Compliance on parameters such as integrity and ethical behavior, transparency, client protection in terms of fair practice, overindebtedness, collection practices, privacy of clients' data, governance, financial literacy of clients, competition and feedback mechanism with clients are being measured through the same. Till date we have already received eighty reports on the compliance questionnaire. Validation of a sample of compliance reports on the CoC has started already started in Andhra Pradesh. This process will be followed in Orissa and West Bengal.

During December, it is planned to conduct validation exercise with members in Tamil Nadu and Karnataka. The aggregate data will be published in the Sector Report next year along with the analysis on financial performance of MFIs. The team also has plans to conduct peer review on the compliance on the CoC as well as putting the compliance data in the public domain through the website.

There has been greater emphasis on "Social performance" among MFIs. Sa-Dhan along with the compliance report on CoC from members, is also seeking report on social performance indicators designed in the form of a questionnaire. The questionnaire is designed to seek information from the members on the kind of area of operation, social background of the clients, income/ poverty levels, outreach to difficult areas and districts, range of products, credit plus services offered to clients, livelihood support, women empowerment, education, health, client retention, incentive structure of field staff, methods of measuring the poverty level of the clients etc. Till now, we have received thirty filled questionnaire on social performance parameters.

Social performance is an integral part of our implementation process on code of conduct. We plan to organize more workshops, and seek greater numbers in reporting. This will be important information to share with the policy makers and the government on the sector's efforts in correcting the practices.

# At the micro finance frontier

Ashok Jha

The Financial express, Nov 16, 2010

**M**icrofinance has shot into the limelight of late, for entirely wrong reasons. In a country where only about 40% of the population has access to banks, micro finance institutions (MFIs), over the last decade and a half, have provided a lifeline to about 30 million households that are otherwise outside the banking system. Commercial banks, as they are structured today, are unable to service the requirements of micro credit to those who have no collateral.

MFIs have brought banking to the doorstep of the borrower, whereas commercial banks typically expect the borrower to come to their doorstep. Because of the activities of some MFIs, there is an attempt to strangle the entire sector. Onerous conditions are sought to be placed on their functioning. An impression is being created that rates of interest at which they lend should be capped as MFIs are earning profits of a high magnitude.

A letter from the government to the public sector banks to discourage those MFIs that lend at beyond say 22-24%, threatened to choke funding. While many banks understood the numbers to be interest rate caps, the government clarified that the numbers were illustrative and not mandatory. The government's example did not take into account the intrinsic differences amongst MFIs in terms of their age, their size and their area of operation. A new MFI, even if professionally and competently managed, will be unable to lend at 24%. This is so as they borrow from banks and other financing institutions at 15-16%. Operational costs of such MFIs are about 10%. Allowing 2% for non-performing loans, around 2% for return on assets, means that the minimum that they need to charge to stay alive is 29-30%. The government's concern is obviously motivated by the perception that MFIs are making money hand over fist at the cost of poor loanees. While some may be, the majority are not.

The fact of the matter is that according to the State Sector Report 2009, out of

about 230 MFIs that reported information, about one-third are making losses. Only about half of the smaller MFIs are profitable. If at all, the government is agitated about MFIs making supernormal profits, the right approach would be to control the spread (margin over cost of funds) rather than the rate at which an MFI lends. Incidentally, some companies in the financial sector (stock exchanges) have gross margins of 75% because of a lack of competition. But we haven't heard anyone from government complaining!

A global comparison shows that on average, return on assets of Indian MFIs was 0.7%-considerably less than Brazil's 6.4%, Mexico's 3% and Indonesia's 3.1%. So while some larger, older MFIs in India are perhaps enjoying substantial profits, most of the others are not. Formulating public policies on the basis of a few outliers is fraught with a number of unintended consequences. The most extreme consequence will be that MFIs will vacate the credit space that will gratefully be reoccupied by the local moneylenders with all their associated ills. Another possibility is that MFIs will perform have to borrow at a higher rate of interest from unconventional sources and therefore their lending rates would go up rather than come down. A third consequence will be that only the very large MFIs will survive.

Such attempts revive the age-old conundrum: Is the price of credit more important than its availability? Should competition not be allowed to take care of pricing?

Take the case of a constable in Hyderabad who lends Rs 100 every morning to a push cart vegetable seller and is paid Rs 110 every evening by the vegetable seller. The annual simple rate of interest in this case works out to a whopping 3,650%. On the face of it, such an interest can raise the hackles of everybody. However, if the vegetable seller is able to earn Rs 250 with the amount borrowed, then parting with Rs 10 by way of interest does not bother him at all. On the contrary, in the absence of the loan from the constable, he would not

have been able to earn anything at all. Should the government step in and stop this practice without finding an alternative source from which the vegetable seller can raise funds?

The Ordinance governing the activities of MFIs in Andhra Pradesh should be viewed in this context. While the Ordinance has no doubt been promulgated for the public good, whether it will do more harm than good is debatable. Amongst other requirements, MFIs are prohibited by the Ordinance from disbursing or recovering loans at the doorstep of the borrowers. They cannot collect loan repayments on a weekly basis. The loan recovery can only be at the local gram panchayat office, not more frequently than once a month.

These conditions strike at the basic model of MFIs. Unlike banks who wait for the customers, MFIs go to the customers and provide banking services in the vicinity. By forcing them to move away, much of the *raison d'être* for the existence of MFIs will be defeated. While no one would recommend strong-arm methods of recovery, forcing recoveries to be made only after a minimum of a month attacks the very revenue model of these institutions—a model that has contributed to a less than 2% non-performing loans.

Andhra Pradesh has been at the forefront of micro finance. Out of the approximately Rs 30,000 cr of bank outstandings to MFIs in the country, nearly one-third are in Andhra. Reports indicate that the average borrowings per household from MFIs in the state was eight times the national average. Clearly, multiple lending and ever-greening of loans was rampant. So, some checks and controls were obviously necessary. But whether the Ordinance will help to control the activities of MFIs or eliminate them altogether should be a matter of public concern. Let's hope the Ordinance is not a case of throwing out the baby with the bathwater along with the bathtub.

## Microfinance rules after RBI report, Mukherjee says

Sanjiv Shankaran,  
Livemint.com, 20 November 2010  
New Delhi

Finance minister Pranab Mukherjee on Friday said the Union government will finalize a regulatory architecture for microfinance institutions after a central bank-appointed committee submits its report in January. Despite the crisis the microfinance industry is facing in Andhra Pradesh in the wake of an ordinance aimed at prescribing stricter norms for the sector, it would be prudent to wait for the **Reserve Bank of India (RBI) report, Mukherjee** said at the Hindustan Times Leadership Summit on Friday.

"I can't press the panic button," he said. "To find remedy, (one) shouldn't bring harm to the system." According to Mukherjee, microfinance institutions are an instrument of financial inclusion as they serve a segment of the population without access to banks. RBI appointed a sub-committee in October under one of its board members Y.H. Malegam to

study the industry and recommend ways to better its practices. Microfinance companies organized as non-banking financial companies, which have made 80% of the industry's outstanding loans, are regulated by RBI.

The microfinance industry is facing a repayment crisis in Andhra Pradesh after the state government issued an ordinance on 15 October, which imposed tough restrictions on the industry's functioning. The ordinance, which is yet to be cleared as legislation by the state assembly, was promulgated on the heels of allegations about exorbitant interest rates and coercive recovery methods by the microfinance industry.

Mukherjee said he had read the Andhra ordinance and suggested changes in it to the state government. "I do hope they will get reflected," he said. The finance ministry is currently working on legislation to regulate the microfinance industry. Though the

ministry has asked banks to push microfinance companies that are their clients to bring down interest rates, the proposed Bill will not cap interest rates. "My idea is not to strangle it (the microfinance industry)," Mukherjee said.

On 13 October, financial services secretary R. Gopalan said that the government had no plans to cap interest rates charged by microfinance institutions. "It is not feasible to control interest rates. As far as we are concerned, the microfinance regulation Bill is in the offing...and in that Bill, we will never have a provision for control of interest rate," Gopalan said on the sidelines of a function organized by Oriental Bank of Commerce in the Capital. Mukherjee said the government's aim was to establish a framework for the microfinance industry where the interest rate on loans would not be exorbitant and coercion would not be part of the recovery process.

## Kaushik Basu warns against over-regulation of MFIs

Virendra Singh Rawat,  
Business Standard, November 30, 2010  
Lucknow

In the backdrop of questions on functioning of microfinance institutions (MFIs), **Chief Economic Advisor to the government of India, Kaushik Basu**, has called for regulating MFIs for more transparency in their loan contracts with the beneficiaries. However, he also warned that over-regulation of MFIs could imperil their survival. "The regulation of MFIs is a must, but it should not be done to the point that they go out of existence," Basu said in an interaction with journalists on the sidelines of the Lucknow University convocation.

He said regulation should ensure transparent contractual terms for loan seekers rather than capping interest rates, as microfinance was a costly service due to

the small ticket size of the loans. Microfinance had provided succour to almost 30 million people in India, he said, adding we (India) had the tendency to overregulated. MFIs have hogged the limelight over alleged high interest rates and recovery practices. They face possible regulatory clampdown, which could erode their profits and future growth. The interest rate can be as high as 30 per cent.

"If microfinance is not there, the gullible people will turn towards money lenders, who charge over 200 per cent interest rate annually," Basu added. Meanwhile, he said inflation had come down over the past weeks, but was still high. He forecast there would be a 'fairly sharp decline' in food prices and they would come down to single digit. To a Business

Standard query, Basu said he disapproved investing of foreign exchange reserves for economic and social development projects. "Forex reserves are not owned by the Reserve Bank of India or the government. They are only its custodians. Forex reserves are subject to high volatility of the global money market," he said, referring to the crisis faced by the South East Asian economies in the late 1990s.

Earlier, delivering a lecture, he said the real driver of India's growth in recent times had been high saving and investment rates. "Going forward, we need to do more in terms of fiscal and monetary policies, ramping up infrastructure, cutting on wasteful subsidies and stemming bureaucratic slowness."

# A cut above the rest, MFIs in East ease borrowers' pain

Atmadip Ray

The Economic times, 15 Nov, 2010

KOLKATA

Amid the heat and dust over high interest rates charged by microfinance institutions and reports of coercive recovery methods by some lenders in Andhra Pradesh, **MFIs in eastern India are trying to strike a more cordial note with borrowers by lowering interest rates.** At least three MFIs based out of Kolkata are on the verge of slashing lending rates by nearly 500 basis points to 19.1% per annum, on reducing balance from a little less than 24% now. This move will allow them to be at par with **Bandhan Financial Services**, the leader in the eastern pack. At present, Bandhan offers the cheapest loan among MFIs in the country.

**The Reserve Bank of India** also seems to be quite pleased with the **MFIs in West Bengal.** "MFIs here offer loans at comparatively cheaper rates," a senior RBI official in Kolkata said. Kolkata-based Sahara Utsarga Welfare Society and its associate Destiny Finco have already decided to reduce interest rates to 19.1% from December 1. These two entities collectively have an exposure of around Rs 90 crore. Village Financial Services, the state's second-largest MFI by assets, is contemplating reducing rates too. Its managing director & CEO Kuldip Maity told ET that the company would take a final view at its next board meeting on November 19. "We are most likely to lower the rate as our average cost reduced following expansion of business," he said. **Village Financial Services'** outstanding loan portfolio runs to Rs 150 crore.

The rate cuts are happening at the time of tight liquidity and when other borrowers, including retail ones, are seeing their borrowing cost go up. The central bank in its recent monetary policy had

increased key interest rates by 25 basis points. **Sahara Uttarayan, another local MFI** with Rs 51-crore exposure, plans to withdraw its 1.5% loan processing charge in three phases from January next year. It will, however, keep its interest rate unchanged at around 24% a year on reducing balance. Incidentally, none of these entities has so far raised capital from private equity players. "MFIs which did not raise capital from private equity players are better placed to reduce lending rates as there is no pressure on them to increase profit margin,"

**Bandhan CMD Chandra Shekhar Ghosh said. Sudipta Banerjee, managing director of both Sahara Utsarga and Destiny Finco,** said: "Our operation is guided by principles of an NGO or a socially-motivated entity. As we are nearing a Rs 100-crore portfolio, we have decided to pass on the benefit of scale to our customers by lowering rates." Earlier, the RBI had told banks to ensure that MFIs they lend to do not charge usurious rates from their borrowers. Around the same time, the Andhra Pradesh government sought to increase its regulation of MFIs by asking entities operating in the state to obtain a registration from the state government.

MFIs in Bengal are reducing rates so that the all-inclusive cost to their borrowers reduce to 24% a year. Besides charging interest, MFIs also levy a one-time 1% fee on account of processing charge or other charges and 10% security deposit. RBI has recently said the all-inclusive cost to borrowers should be within 24%, although it has not issued any operative guideline to this extent. **SKS Microfinance** has slashed interest rates in quick succession over a month to reduce the effective lending rate to 24% from 31.08% (inclusive of insurance and registration charges), following an ordinance passed by the Andhra government to lower interest rates.

# Responsible lending, regulations vital to mend fault lines in microfinance

*Priority sector status to banks lending to MFIs needs to be linked to efficiency, margins and social fulfilment parameters rather than the present universal application. Banks may also have a share of surplus beyond a threshold and may even lower interest rates.*

B. Sambamurthy  
Business line, 15 November 2010

**Y**ou love them or hate them. Money spinner for some and resource drag for others. A story in contrast. The recent fracas is a rude awakening. But given the sense of urgency let me begin with the conclusion. Microfinance as a transformative tool shall not be allowed to be aborted. Microcredit in many forms and shapes has touched not even 5 per cent of the inclusive imperative. India cannot move forward leaving behind 500 million people.

## Safe Credit

Their record speed of outreach notwithstanding, there is many a practice that has come under intense scrutiny. Two immediate issues cry for attention - over-indebtedness and sky-high interest rates. Out-size loans resemble the munificence of supply side schemes of the Government and high interest rates resemble those of money lenders whom they are supposed to replace. Someone said that credit, particularly microcredit, is like good food. Eat too much and you regret later. This is more than demonstrated in the subprime crisis. There is admission from all the sides of the problem of over-indebtedness. But it does not lend itself for easy measurement. In conventional banking, a size beyond a defined percentage of income (typically 40 per cent) is regarded as over-indebtedness.

This is easy when the borrowers' income is stable like those of salaried class. But in the case of rural poor and

self employed, the incomes are highly volatile, while over-indebtedness is difficult to measure. But that does not negate the principle. The purpose makes qualitative difference. The ultimate, if not litmus test, is inability (not unwillingness) to repay as the (out-size) loan made the borrower worse off. You may let an organisation fail but not individuals are another lesson of the recent global crisis. There is also the issue of drift from livelihood to inflating lifestyles.

High interest rates mixed with over-indebtedness is a deadly cocktail. The advantage of access cannot outweigh the disadvantages of high interest rates. This is the root of the problem. Multiple borrowings and coercive recovery practices are only symptoms of the deeper malaise. At 11 per cent operating costs, MFI is anything but low-cost delivery model. This is not withstanding the externalization of costs in other delivery models. Cover of group guarantee, loan insurance cover and high recovery performance do not justify huge risk premium. Over-indebtedness and high interest rates are inherent in the business models of MFIs. There are other fault lines fuelling over-indebtedness. There is concentrated competition in the markets. Andhra Pradesh (over 450 applied for registration) alone accounts for over 30-35 per cent of the country's MFI business. Four States account for over 70 per cent of business.

Some of the Indian MFIs are growing at double/treble of the national average. It is typical of animal spirits that economist Robert Shiller talks of than the skills. Capacity gaps are evident. It takes at least three/five

years for an officer to be given credit sanction powers in conventional banking. With head count doubling every year this is a difficult proposition. Having sound head offices and applying standards may help at strategic level but not equally so at tactic level. Cross-country experience bears this out. Management incentive structures are abetting.

## Scaling up models: Fault lines

Raghuram Rajan in his book Fault Lines reminds that the new miracle of microcredit holds promise on a small scale but when scaled up it is likely to create significant problems. Easy credit as a tool to redistribute income proved costly to the poor. Is it scaling up or proliferation?

Many of the MFIs have proliferated but not scaled up in true business sense. This is evident from sticky and high operating costs. The proliferation is skewed towards market cap. They proliferated through rapid customer acquisitions, pushing product suites and bloating the loan book. Their models of scaling up have benefited the shareholders and management and not the borrowers.

There is an argument in the case of MFIs in countries like China, low interest rates impede their growth and are slow to scale up. In the context of countries like India, high interest rates are buttressed for scaling up faster and reaching large number of people in short period. Scaling up should serve the borrowers and not the other way round. In the concentrated market they are trapped in, it led to supply side solution rather much needed demand side solution leading to the present

crisis. This fault line needs to be mended. Processes offer huge value proposition and increasing electronication of front office drives holistic scale benefits.

### Winner takes it all

The reduction in interest rates should come as much from reduction in costs as from reduction in profits. Some of the MFIs operate on over 20 per cent NIM and over 5-6 per cent ROA as against 3.5 per cent and 1.2 per cent respectively for mainstream banks. Of course they are broad averages. There are reports of over and mis-selling of insurance products. Then there is this issue of zero tolerance for delinquency. This is not a moralistic principle but long-term business fundamental. The share of SHG in micro credit has come down from 64.7 per cent to 33.2 per cent during 2004-2008 with

corresponding gain by MFIs. Has the mission drift helped MFIs gain market share?

### Way forward

Priority sector status to banks lending to MFIs needs to be linked to efficiency, margins and social fulfilment parameters rather than the present universal application. Banks may also have a share of surplus beyond a threshold and may even lower interest rates. Banks need to design a new operating model to facilitate outreach. The present organisational structure is a drag. Their exposure of Rs 30,000 crore is enough money to sit up and take notice.

Development of market infrastructure by way of reporting, accounting, auditing, disclosure and

lending standards need to be addressed by way of self regulation to start with. Consumer protection should start with financial literacy and include transparency (starting with APR) product options, over indebtedness, value right price/product options, competition, etc. There should be an ecosystem where in interests of the poor and players converge. It is not a bad idea even to think of a quasi-regulatory framework for the sector comprising over 500 million people. The need of the hour is to promote ethical finance and healthy micro finance industry. Fat profits are no indicator of long-term health as is evident from the global financial crisis. Public opinion, regulation and competition have a role to play in addressing the issues.

## Ela Bhatt doing path-breaking work for women: Hillary

Narayan Lakshman  
The Hindu, 17 November 2010

***Ms. Bhatt has helped poor women attain dignity and independence "Investing in women is one of the most powerful ways to fight poverty"***

Washington

**Ela Bhatt, founder of the Self-Employed Women's Association**, was presented with the first Global Fairness Initiative Award by **United States Secretary of State Hillary Clinton**, "for her contribution to India and particularly the women of India, and to the global community."

Speaking at the awards ceremony held at the Kennedy Center here, Ms. Clinton said Ms. Bhatt had spent nearly every day of the past four decades helping move more than a million poor women in India to a position of dignity and independence. On her path-breaking work through **SEWA**, Ms. Clinton said Ms. Bhatt had helped provide women with access to opportunities they did not have before, including a chance to start a business, send their children to school, open their own bank accounts, or simply be treated with respect by their husbands, families and authorities.

### Ahmedabad visit

Although she had known Ms. Bhatt for 15 years she had heard about Ms. Bhatt even before they met in 1995 when, as First

Lady, she travelled to SEWA's Ahmedabad headquarters, Ms. Clinton recalled. During that visit, she did not know what to expect but was overwhelmed when she was greeted by a "huge group of women, wearing saris that were all the colours of the rainbow," many of whom were ragpickers who had walked 12-18 hours to get to the meeting.

"We sat together under a sweltering tent and I listened as, one by one, they told me about how SEWA had changed their lives and how they now had a belief in themselves that was absolutely unthinkable before they became involved," Ms. Clinton said. Further outlining some of Ms. Bhatt's key contributions to women's rights in India, Ms. Clinton commented on her ideas of investing in women as "one of the most powerful ways to fight poverty," and the innovative programmes that Ms. Bhatt pioneered, providing the poor with access to services such as credit, banking, sick leave and child care.

SEWA, with a membership of over 1.2 million, works towards "strengthening women's leadership, their confidence, their bargaining power within and outside their homes and their representation on policy-making and decision-making fora," according to Reema Nanavaty, a director, who was in Washington a few months ago.

# MFI crisis in perspective

K. Kanagasabapathy

The Hindu Business line, 26 November 2010

*Several issues of MFI regulation and governance need to be addressed. But the potential of MFIs to emerge as a safety net for the poor should not be overlooked.*

Andhra Pradesh is in the limelight, with the State government issuing an ordinance to regulate microfinance institutions (MFIs), effective from October 15, 2010. The merits of such a law in the absence of any regulatory framework for microfinance cannot be denied. Yet this has given rise to extreme uncertainty for thousands of agencies engaged in microfinance. Moreover, following the reactions of the banking industry and silence of the regulators, the liquidity of MFIs has come under severe strain. This is likely to affect flow of funds to more than 100 million families, benefiting from various forms of microfinance assistance.

## GROWTH OF MFIs

India has a large number of MFIs, varying significantly in nature, size, outreach and delivery mechanisms. The sector has been going through rapid transformation in the past few years, experimenting with different models. MFIs operate under various legal structures, as 'for profit' and 'not for profit' organisations. The entry of commercial ventures in the form of NBFCs is of recent origin, but in a short time the sector has grown rapidly, because of new entrants, and old entities such as NGOs transiting into companies. The attraction seems to have come from regulatory arbitrage, besides the fact that the bank loans to such institutions are given priority sector status.

The problem has erupted with reference to the largest 'for profit' NBFC, which from humble beginnings has grown into a listed company. There are several such MFIs availing bulk loans from banks for on-lending to

groups and other small borrowers. In its annual publication on **Status of Micro Finance in India for 2009-2010**, Nabard has indicated that the total exposure of banks and financial institutions to MFIs as on March 31, 2010, was Rs. 13,956 crore, representing a growth of more than 100 per cent during the year.

## INTEREST RATE ISSUE

There are four major issues surrounding the episode. The first is whether MFIs need to be brought under the regulatory ambit of an apex institution such as Nabard or RBI or be left to be self-regulated. The consensus now seems to be in favour of a comprehensive regulatory framework. The Bill in this regard is already before Parliament, but awaits revisions to incorporate additional features emanating from the Andhra Pradesh episode and the recommendations expected from the RBI-appointed Malegam group.

The second issue is the interest rate charged by MFIs, which are considered to be usurious, though perhaps not as usurious as the rates charged by the traditional money lenders. Several committees in the past desisted from imposing any ceiling on the interest rate. The Andhra Pradesh ordinance has not introduced any ceiling, except for saying that the interest should not exceed the principal. The Finance Ministry has said that the new Bill will not impose any ceiling on interest rates. Given that the current average interest rate is in the 30 plus range, even a ceiling of 24 per cent would seem to have a large repercussions on the sector, as per a recent study posted by a global agency monitoring MFIs.

Based on India's MFI financial data from 2003 to 2009, the agency has estimated a loss of over 10 million loans, and forced shutdown of at least

half of the institutions by 2010. This is indeed a very dismal picture. The third issue pertains to coercive methods, forcing poor to commit suicide. In this respect, traditional money lenders have proved to be angels. This issue needs to be addressed without creating the moral hazard of loan repudiation.

Last, but not the least, is the application of priority sector status to MFI loans. There is a valid criticism of dilution of priority sector lending since the first **Narasimham Committee of 1991**. As Dr. Y.V. Reddy observed, since the recent episode is rooted in priority sector benefit, RBI should seriously consider redefining the status of priority sector for bank loans to MFIs.

## ROLE OF MFIs

There are no doubt several legitimate issues with respect to governance of MFIs, particularly the profit-making NBFC MFIs. But, given the hope of this sector emerging as a viable social safety net model for the poor, both government and the **Reserve Bank in coordination with Nabard and SIDBI**, should urgently contain the current crisis of faith so that it does not inflict long-term damage on the entire sector.

The recent utterances of the Finance Minister are heartening. He said that no harm should be done to the system. The government's aim was to establish a framework for the microfinance industry where the interest rate on loans would not be exorbitant and coercion would not be part of the recovery process.

The Andhra Pradesh episode provides an opportunity to clean up unhealthy practices in the microfinance sector. This can protect genuine lenders as also prevent vulnerable people from falling into a debt trap. It would be wiser for the AP government to withdraw its ordinance, once the central legislation comes into force.

## Sectoral Bias between the Rural/Semi-urban/Urban poor and the Agriculturists in the Context of Financing the Poor through Microfinance

N.T.Paramasivaiah

Microfinance is not new to the world only its versions are changing their colour & shape. That means the age old practices of money lending by zamindars, professional money lenders in rural areas and multanis, pawn brokers in semi-urban and urban areas have been the non-institutional for profit enterprises going on uninterrupted. State Governments enacted the Money Lenders Act to prevent exploitation of borrowers by these agencies which has not made any significant difference to anybody. Government of India brought about a few measures like Nationalization of major Banks, creation of Rural Regional Banks, mandate for financial inclusion, etc, which have all been either less effective or ineffective in solving the issue of meeting capital requirement of poor and vulnerable section of the huge population. The people of this category, who have remained away from the mainstream, are estimated to be to the tune of 60% of the total population. This is not peculiar to our country but to many other countries spread all over the world. After 1990, there have been a few individual and small organizational efforts, including that of Prof. Muhammad Yunus, of Bangladesh, who has been recognized by awarding the renowned Nobel Prize for peace for the year 2006. In India also there were quite a few NGO movements especially in southern region like MYRADA, DHAN, etc, trying to help these unreached to reach the institutional finance. Of late, there have been new sprouts of large number of NGOs (Non-Governmental Organizations) which

have sprung in to action in forming SHGs/JLGs (Self Help Groups/Joint Liability Groups) and linking them with some institutional finance or themselves lending as the intermediaries. Several NGOs after a lapse of short exposure have changed over from 'Not for Profit' mode to 'For Profit' mode by converting themselves into NBFCs (Non-Banking Finance Company). Following are some of the reasons adduced for such change-over:

1. NGO/Sec.25 company format are not suitable for large scale operation
2. The lenders are more comfortable with the NBFC format
3. Better Net worth can be accomplished by inviting private investments
4. Provides better structure, control, visibility, etc.
5. Helps in attracting human resources of high quality and better commitment
6. Affordability to introduce high-end technology and management

Most of these NBFC –MFIs adopted the JLG(Grameen) methodology to extend the micro-credit as it allows faster expansion and credit dispensation compared to the traditional SHG route. Many of these MFIs have grown so fast and thereby they have become the all India operators. There has been severe completion amongst them more particularly in the states of Andhra Pradesh, Karnataka and Tamil Nadu which has resulted in

multiple lending/borrowing leading to over-indebtedness in several packets. Due to this several cases of defaults in repayment of dues are reported. Most of these MFIs are providing loans for a period of one year repayable in weekly installments. The loans are disbursed and recovered at the doorsteps of the borrowers. The rate of interest charged by and large varies from 24 to 36 percent per annum.

Following are the justification for the rate of interest:

1. Cost of funds varies from 12% to 15% per annum and the cost of operation varies from 10% to 15% depending on the size of the MFI portfolio; Loan loss provision varies from 1% to 2% depending on the quality of portfolio.
2. Average of 15 to 20% equity has to be maintained to meet the stipulation of RBI and Lending Institutions.
3. Average of 10% cash collateral has to be maintained with the banks which carry low rates of interest.
4. Loan Processing Fee varying from 1% to 1.5% has to be incurred
5. To mobilize private equity the investors have to be rewarded at least about 12% to 15% per annum.

In case the rate of interest on these loans to poor borrowers has to be

brought down, someone like State Government or Central Government have to step in to help the MFIs to reduce the effective rate of interest. If we can draw parallel to the Government help between agriculturist borrowers and MFI borrowers, it is obvious that the MFI borrowers belong to much lower strata of the economy in terms of their net worth, annual income, social status, and credit absorbing capacity and on many more parameters. Most of us are aware that the Central Government has allowed a subvention of 2% on all crop loans/short term loans (up to one year) to all agriculturists all over the country. This apart many state governments are allowing some interest subsidy which ultimately resulting an effective rate of interest of as low as 3% to 4% per annum. Apart from these populist policies Government of India waived repayment of agricultural debts to the tune of Rs.70,000 crores in the recent past. Considering such measures by the

Government, from the equity of justice point of view the following suggestions are made to render the MFIs to lend at reduced rates of interest and the poor borrowers reap the benefits of such fair cost loans.

### Suggestions:

- a) Government can consider bringing down the stipulation of Equity requirement for these MFIs so that there is not much pressure to earn more to satisfy private investors. Lending banks may also be made to accept such norms.
- b) Government can waive Income Tax at least for an initial period of 5 to 10 years so that the MFIs will not have the pressure of making well the out goings and that such policy will also help improve the sustainability of MFIs through better internal accruals.
- c) Government can consider

fixing the low interest rates on lending by the banks to MFIs both as the priority sector/weaker section and special interest subvention so that the MFIs can balance their high cost of operation and lend to the poor clients at reasonable rate of interest.

- d) Special recovery process and customer grievance redressal measures may be introduced so as minimize the hardships faced by the poor.

Government should take a positive look at the microfinance sector as a whole and institute necessary regulations for their healthy growth and fruitful contribution.

*(The author is CEO of Navachetana Microfin Services Private Limited and the views expressed here are his personal views)*

## We want to reintroduce savings in the financial-inclusion agenda: Christen

The Economic times, 17 November 2010

**O**n Tuesday, at the Global Savings Forum in Seattle, the Bill and Melinda Gates Foundation pledged \$500 million over the next five years to increase savings opportunities across the world. The Foundation has already deployed \$40 million through six grants, some of which will come into pilot projects in India on better savings options. Bob Christen, director of the Financial Services for the Poor initiative at The Bill & Melinda Gates Foundation, told Ahona Ghosh over telephone from Seattle why and how the Foundation wants to focus on household savings. Excerpts:

**What's your view on financial inclusion and microfinance in India? Especially with regard to what's happening in Andhra Pradesh — the crisis and the cap on interest rates?**

We, in Seattle, are not in a position to get into the goings-on in Andhra Pradesh. We are excited about the steady move of the

RBI (Reserve Bank of India) towards correspondent banking. This will allow more banks to set up agent networks in small towns, villages and slums, where most of these people we're interested in live and work. What's particularly encouraging is the latest development of allowing banks to establish relationships with networks with different reaches, instead of forcing banks to empanel individual agents.

We are particularly interested in trying to reintroduce the concept of savings in the financial-inclusion agenda. Microcredit was gaining momentum and moving in a more commercial direction, which is fine. Savings is important to India, as indicated by the savings pattern. In most parts of the world, including India, there is a lack of quality bank-based deposit services for people earning less than \$2 a day. That, really, is our agenda. The key barrier, globally, is the cost of going to a bank. People have to pay for



transport. And it costs a bank \$1 for somebody to stand in the teller line. In relative terms, it's expensive. Which is why we are excited about agent banking opportunities that allow cash management in savings accounts at a far lower average transaction cost than physically going to a bank.

**Branchless banking has been in India for some time now, but the impact has been unsatisfactory. How will your projects make a difference?**

Correspondent banking is tough. You have to make sure the agents, banks and telecom companies involved sort out the fee and revenue model. From what we understand, one of the main issues in India is the cost incurred by agents to open accounts. We're trying to figure out what these complex relationships need to work well.

**Funds from foundations like yours come with conditions. What is the difference between commercial money flowing into microfinance institutions (MFIs) and grant money? Do you see grants becoming more commercial?**

Our approach is really about seeding a market. If we're interested in a particular country, we will work with their post office and savings institutions that try mobile money solutions. We would grant them money for a pilot. This lowers the risk for those involved. If that fails, the money is gone; and if it succeeds, we're gone anyway. In all cases, even in a pilot, the parties involved put in a lot more money than we do. Our grants help prime the pump. We are neither long-term investors nor primary funders.

**How much of the \$40 million grant will come to India?**

We are not sure. We work by giving larger grants to organisations like World Savings Bank Institute. They open up a competitive

process for their industry organisations. In the first round, we looked at 37 funding proposals from savings banks across the world, and funded 10. Round two will look at another set of proposals. We know Indian savings institutions are interested, but because of that process, it is hard for us to say how much money will come to India and who its recipients will be.

**Are there specific projects in India that have received grants?**

Some very small activities. For instance, we are supporting MicroSave (India Foundation) with technical assistance. We have some small research grants looking at different policies around correspondent banking and remittances. Through our beneficiaries in India, we have done some work in micro-insurance. I'm sure we have half a dozen sub-grants operating in India.

**Who are some of the industry players you have approached in India to partner with for this initiative?**

We are working with the State Bank of India, Eko and the MicroSave India Foundation.

**How will you measure the savings impact of this initiative?**

We have already commissioned, or are in the process of commissioning, 30 impact studies. Results of the first 4-5 are coming in. Through them, we are looking at the effect of savings on lives of households on income levels and other measures of family welfare. We got a study last week, which looks at farmers in Malawi. They agreed to set aside a proportion of their harvest proceeds till the next planting season. The result was they invested those savings in their farms, and saw their farm revenues increase by 54% and total expenditure by 31% a year later.

## Nabard is equipped to take responsibility for MFIs

Dinesh Unnikrishnan,  
Livemint.com, 25 November 2010

**U.C. Sarangi** will step down as chairman of the National Bank for Agriculture and Rural Development (Nabard) on 3 December after a three-year stint. In an interview, he spoke about the ongoing crisis in the microfinance sector and Nabard's readiness to take up the role of sector regulator. In the last three years, Nabard's annual disbursements have risen to Rs.57,000 crore from Rs.29,000 crore while the total balance sheet size increased to Rs.1.36 trillion from Rs.81,000 crore. Edited excerpts:

How do you assess Nabard's performance as a development organization during your tenure?

I am satisfied. When I joined Nabard, I tried to ask myself what Nabard was

established for. I found that though we had sufficient funds available, the level of utilization was low. Hence, scaling up disbursements was a major challenge. One of the most important initiatives Nabard spearheaded immediately after I took over was the implementation of the Rs.60, 000 crore debt waiver scheme. In just one month, we could list out all the beneficiaries of the scheme to facilitate implementation.

Nabard has been closely associated with **the microfinance and self-help group (SHG)** movement in India. The microfinance sector is currently facing a crisis following the Andhra Pradesh government ordinance. What is your take on the entire issue? My reaction is what was happening (in the microfinance industry) was of concern. What is happening now is a greater concern.

Could you elaborate?

The microfinance programme was expanding very fast over the past (few) years, at a year-to-year growth of 70-80%. It benefited a large number of people in rural areas who did not have access to capital owing to the inaccessibility of bank branches. The overall costs of microfinance institutions (MFIs), when started, were very high compared with the returns, and their portfolio at risk was very high. To stay afloat, higher interest rates became the only possible solution. But as their business expanded, their return on assets increased and portfolio at risk went down significantly; the cost also declined. Then, it was possible for them to reduce rates, (but) this did not happen.

Has the ordinance helped address the issues?

The basic thing is that we do not want microfinance, which provides the poor

access to credit, to stop altogether. We want that to remain, but with some arrangement for disciplined behaviour from the part of MFIs. Now what has happened is the Bill has impacted both new disbursements and recovery. That will not be to the advantage of anyone. Also, banks have thousands of crores of exposure to MFIs, which is deposit money.

Who is responsible for the issues that the microfinance sector is currently facing?

The prevailing situation is an outcome of the profit motive of some of the MFIs who did not guide the sector in a manner that ensured sustained continuity, on the one hand, and justice to the poor, on the other. If you look at certain developments in the past one year, people started not-for-profit agencies, primarily (using) donations, to cater to the poor, which later became non-banking financial companies and for-profit organizations. When a **Micro-Credit Rating International Ltd study** said nine of them have more than 5% return on assets, there one has scope to say that yes, extra profiteering in terms of business became an objective for some of the MFIs.

Do we need large profit-oriented MFIs, or should they be retained as small entities to cater to the poor?

There is an advantage for large MFIs, if regulated. The advantage is the scale of business operations enables them (to) do business at a much lower cost. Cost of funds goes down when the size of operations increases. If that helps you charge low interest rate and sustain business, then it is good. But microfinance has to be a localized operation. Small MFIs, who work in a district or two, will be more successful because of their intimate contact with the borrower. It requires personal, one-to-one contact with the provider and receiver, and that is where I totally agree with **former Reserve Bank governor Y.V. Reddy** that it (MFI operations) has to be informal.

Ever since the ordinance was introduced, there has been a slump in loan recovery.

What is the way out?

See, there are two solutions—a localized solution, and a national-level solution. The local solution is that Andhra Pradesh needs to look into its Act immediately...and not put excess control. Excess control is as counter-productive as no control. Do not stifle the system. Getting an Act in place is not objected to, but it should ensure and serve the purpose the government of Andhra has been striving for in the last 15 years. Andhra was the first where state support for self-help group-bank linkage programmes came into full scale with the creation of more than 10 lakh SHGs.

Which aspects of the ordinance need to be changed?

Each of them needs to be looked into. Many of these provisions (in the ordinance) can be counter productive. For example, interest cannot be more than principal. Now this does not help solve the problem. Most of the loans do not have a tenure more than one year. If you take a one-year loan, can the interest be more than principal, even if you charge 40% or 50%? So, they did not put a quantitative cap. What is the use of this provision?

Then, you have to register with multiple authorities. MFIs operating in Andhra Pradesh's 22 districts have to register with 22 different authorities. The amount of workload for an organization with respect to the paperwork and queries rises, and that will increase the cost and will ultimately lead to an increase in interest rates. Will it help? Also, by doing so, you are permitting too many people into the system as so-called regulators. Everyone will use the power available to him in his own way. I am saying it has to be one authority.

Another change that has visibly impacted MFIs in Andhra is the change from weekly collection to monthly. Does this need to be changed?

There are two arguments. One is, weekly collection helps frequent borrower contacts and, in a sense, induces discipline in the borrower since the

repayments are regular. Now, monthly contacts mean less frequent customer contact. But the point against this is, if you give me Rs.5,000 to start a business and ask for repayment at the end of the first week, how does one generate the surplus to pay back. If you take that view, a monthly schedule is reasonable. As far as multiple lending is concerned, it should be avoided as it pulls the individual into over-indebtedness.

Do you believe that Andhra Pradesh did the right thing by issuing such an ordinance?

A lot more thinking could have gone into it before this ordinance came so that it will become useful in serving the purpose for which AP had taken a large number of steps over the last 10-15 years. The regulation in place today is not adequate and, in the Andhra ordinance, the regulation intended is excessive. We have to find some midway. We should decide whether each state be allowed to have their own ordinances, or there should be national-level legislation, empowering a single agency. If you create a national regulation and at the same time states have their own systems, then dual control will lead to more conflicts. In my opinion, national-level legislation should come.

So should state governments refrain from similar legislations?

I think so, and there should be national-level legislation.

Nabard has been proposed as the regulator of MFIs in the proposed microfinance lending and regulation Bill. Is Nabard equipped to take up the role?

Yes, Nabard is happy to become the regulator and is equipped to take the responsibility for MFIs. Nabard has sufficient experience and expertise in the way these programmes work and should be able to devise means for putting appropriate regulation in place.

# RBI, Banks Warming up to financial fitness

*RBI's going great guns with its financial inclusion plan. Banks have roped in business correspondents to give the project a big push, but structural problems may play spoil sport, says Gayatri Nayak*

*The Economic times, 17 November 2010*

**N**AMO Narain Meena, the Union minister of state for finance, would not have frowned upon bankers last week in Mumbai for not doing much on 'financial inclusion', if only he had read the **Reserve Bank of India's (RBI) report on 'Trend and Progress of Banking in India 2009-10'**, released a week earlier. All that the report said was, the number of people, who are out of the financial system is more because they did not have the necessary input to be a part of it, rather than being left out by design.

The biggest fad in the financial sector now is 'financial inclusion' with almost everyone worth his salt talking about it — be it in seminars, press conferences, contributory articles to newspapers, television debates, parliament, and whenever they find time beyond scam debates. If four decades of banks' nationalisation, hundreds of co-operative banks, thousands of regional and rural bank branches, non-banking finance companies, chit funds, lead area banks, foreign banks, private banks and, of course, the crisis-hit micro finance institutions, could not take banking to more than half the population, then there is something vital that is lacking with those people. Money. Why would anyone with no money operate a bank account?



“While no-frills accounts have grown phenomenally, an important challenge before the banking system is to keep these accounts operational, as many such accounts are found to be dormant since the poor often find it difficult to save and deposit money into these accounts,” said the RBI report released on November 8. The financial inclusion in 2005 was defined as the provision of affordable financial services — access to payments and remittance facilities, savings, loans and insurance services by the formal financial system with no pre-condition or low minimum balance maintenance.

Just a month before the release of this report, the central bank made yet another attempt to take banking within the reach of the majority of the population, by permitting profit-making companies to be business correspondents (BCs). This is an expansion of a list released previously that did not achieve its objectives. The RBI last year allowed many nonbank entities and individuals, like retired bank and

government employees, including exservice men, to act as BCs.

It also allowed not-for-profit organisations, popularly known as Section 25 companies and self help groups. It expanded the list by adding owners of kirana/medical/FairPrice shops, PCO operators, agents of small savings schemes of the government and insurance companies. But only the Section 25 companies are active. Though it may be difficult to estimate the active, they typically operate through technology-enabled devices, such as point of sales machines or through mobile banking. Some business facilitators also operate through laptops, through what is popularly known as kiosk banking.

Popular BCs, who have tied up with major banks, include Fino, Seed Enterprises and A Little World among others. Another technology provider Oxigen has tied up with State Bank of India for kiosk banking. “We conduct transactions worth 5,000-10,000 every day,” says Anriban Roy, cofounder and managing director of Seed

Enterprises, whose firm has opened about 1.5 million accounts. While the ultimate onus on the safety of the funds is with the bank, the BC is responsible till he deposits the cash at the nearest local bank branch. About 130 business correspondents were appointed till last year who opened 90 lakh accounts, according to latest available data. Most of them were by state-run banks. ICICI Bank, Federal Bank and Axis Bank were active among the private sector.

“Though the statistics are disturbing, it may not be fair to totally write off efforts by banks,” says Jayanta Sinha, chief general manager in charge of rural business at State Bank of India. But whether the admission of more entities into the BC list will lead to more people coming under the financial fold is doubtful, given that they may continue to face the same hurdles that the existing ones faced. “As almost all BC transactions are cash based, the flow of cash with BCs has been highlighted as the biggest issue,” says a report prepared for RBI in August 2009 to enhance the BC coverage. “Besides the logistics of handling large volumes of cash, it leads to increased costs and added operational risks,” the report says. “Beneficiaries of BC services are mostly illiterate and susceptible to

misguidance. Further, at times, clients tend to perceive the BCs themselves as banks,” the report adds. “The viability of the BC model has remained the most critical issue that has led to the model not taking off as envisaged,” says the report. With this experience, it may be too early to assess the corporate interest in the central bank's offer as banks are still awaiting worthwhile intents. Doubts arise given the fact that post offices, with the biggest reach anyone could dream of, has not succeeded in it so far.

Some believe that post offices did not succeed since they lacked technology and others said it was due to their own products competing with banks'. That makes little sense as it does not matter if one is financially included under the post office or a bank. Will this time be different?

A good portion of the banking system is now under the core banking solution. As a result, technology is playing a bigger role in the efforts to increase financial inclusion.

RBI has enlarged the list of BCs, but the same old problems remain. Those who have the money don't

trust many of these intermediaries and those who trust them do not have the money. When both these things happen, there are a different set of problems. “The reason we are apprehensive about appointing individuals as BCs is that we fear they may seek permanent employment with the bank,” said a senior official with **Punjab National Bank (PNB)**, requesting anonymity. Moreover, in case of retired bankers, incentives may not be attractive enough.

With this chicken-and-egg situation, there is little hope that the lives of millions would transform with the slogan getting louder, than action. “In 2009, deposits mobilised in rural bank branches was a mere 9% of the total deposit mobilised by banks and the share of rural credit in total credit of banks was even lower at 7%,” said Mr Meena. “The percentage of people having any kind of insurance cover is just 10%, while the percentage of non-life insurance is a measly 0.6%.” he added. Mr Meena may be aware that this statistics have remained more or less the same for decades, like the Gharibi Hatao slogan of Indira Gandhi. **Will financial inclusion be Manmohan Singh's legacy?**

## Rural non-farm sector still in incubation mode

*NILABJA GHOSH & ARUP MITRA*  
*The Economic times, 11 November 2010*

**W**HAT role the rural non-farm sector plays in the process of development of a country has been a serious question. Its pattern of expansion has been so diverse across regions that it is difficult to be explained in terms of a single uncontested framework. Apparently, each region has a different story to tell. Three important stages of the rural non-farm sector transformation have been identified in literature. Africa and south Asia are possibly in the first stage that have a



production or expenditure linkage with agriculture, and not much of a rural-urban link. A tendency towards a greater mix of situations is seen in Latin America where non-farm sector includes activities based on linkages with agriculture

as well as separate ones, such as tourism, mining and service sector activities. Also, East Asia is in the third stage where urban-rural links are stronger as manifested in terms of more advanced forms of business linkages, such as sub-contracting arrangements and labour commuting.

Unfortunately, the rural non-farm sector in several parts of India is characterised by low productivity and it does not seem to provide a sustainable livelihood. On the other hand, the components that have grown in response to demand, do not tend to derive the growth stimulus from the rural sector itself. In an attempt to reduce the diseconomies of scale and to take advantage of the positive externalities available within the large cities, the urban activities are spilling over rapidly to the rural hinterland of the big cities. There is, thus, a tremendous change that is taking place in the land-use pattern, away from agriculture and towards commercial activity. Besides, these urban activities relocated in the rural areas are less likely to provide job opportunities to the rural job seekers, as the skill mismatches are phenomenal.

From the policy point of view, productivity growth in the rural nonfarm sector deserves a special mention. The poor income potential of agriculture has become a serious concern in a country where a large number of citizens are farmers and, more often, small farmers. Nearly 40% of the farmers would be willing to quit farming, according to an NSSO survey. Several studies have noticed relatively lower incidence of out-migration from the rural areas that showed improved performance of the non-farm sector. This, in turn, reduces the excessive pressure on urban infrastructure. Hence, if the urban areas, rather select cities, that draw much of the migrants from the rural areas have to become world class, development disparity across the space has to be reduced. It is not just about providing urban services in the rural areas — more importantly, productive employment opportunities have to be created in a big way. A viable non-farm sector would be an important answer. Usually, big farmers used to access productive avenues in the nonfarm sector. However, education

for rural households — as has been the case in the Philippines — has a major impact on non-farm employment.

Besides, rural infrastructure is important. Usually those who have access to capital in the rural areas experience a steady flow of income from non-farm activities. In this context, microfinance can be critically important: while affordable interest rates are an essential, the lender's risk in the rural setting needs to be recognised as well. A balance between the two requires the regulators' attention while not derailing the process, as is feared in the recent Andhra Pradesh incidents. The implications of the nexus between traditional agriculture and its supplement in the form of non-farm sector and particularly the concern for food security loom large in the process.

Indeed, to an extent, there is a backward linkage and activities can be located on the supply chains of agro-goods the non-farm sector is likely to benefit agriculture and improve agricultural prices through the demand side. However, there is a possibility of labour shortages arising at critical stages of farm activities, leading to wage increases. The net outcome is not totally clear. While farm mechanisation and a search for efficient methods may be a response so that crop production is not hurt, adverse effects on production are possible when extension and research do not receive adequate attention. In this context, the impact of NREGA on farm wages, food prices and production can deserve investigation as a starting point. On the contrary, to the extent that the withdrawn labour is truly surplus in the Lewisian sense or non-farm activities are scheduled in line with farm timetables, the apprehension may be misplaced.

Probably of greater significance is the demand for land that is known as a scarce resource in rural India. While not as demanding as agriculture, non-farm activities also require space. This calls for rational planning of land use based on fertility, water endowment and logistical requirements. Land distribution schemes for the poor and landless and ways to improve efficiency in resource use in agriculture are also considered effective in this direction.



# Important Upcoming Events

- Programme on "Product Development Strategies in MF Sector", 10 - 14th January 2011, Lucknow, Conducted by Bankers Institute of Rural Development (BIRD)
- Conference on "Microfinance: Translating Research into Practice", 12 - 13th January 2011, Pune, Conducted by College of Agricultural Banking (CAB), Centre for Micro Finance (CMF) at IFMR Research
- Programme on "Financial Management of MFIs", 17 - 21st January 2011, Lucknow, Conducted by Bankers Institute of Rural Development (BIRD)
- Fourth International Conference on "Financial Literacy and Financial Inclusion", 27 - 29th January 2011, Pondicherry, Conducted by Pondicherry University
- Programme on "Rating of Microfinance Institutions", 31st January - 2nd February 2011, Lucknow, Conducted by Bankers Institute of Rural Development (BIRD)
- Programme on "Development of Microfinance Facilitators in Banks acting as SHPIs", 7 - 11th February 2011, Lucknow, Conducted by Bankers Institute of Rural Development (BIRD)
- Programme on "MFI Valuations and Investments", 10 - 12th February 2011, Gurgaon, Conducted by M2i
- Programme on "Community Based Enterprises for Livelihood Enhancements", 7 - 11th March 2011, Conducted by IRMA
- Sa-Dhan - FICCI National Microfinance Conference, 15 - 16th March 2011, New Delhi



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