



# micro

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## Decision on MFI regulation by March-end: RBI

BS Reporter, January 28, 2011, Mumbai:

**R**eserve Bank of India (RBI) Governor D Subbarao today said a decision regarding the implementation of the Malegam committee recommendations on microfinance would be taken by March-end. "We will interact with banks, state governments, the government of India and microfinance institutions (MFIs) and also invite feedback from the public before taking a decision," Subbarao said while talking to analysts and researchers at the customary post-policy meet.



The committee had recommended, among other things, the creation of a **sub-category for MFIs under non-banking financial companies (NBFCs)** for the purpose of regulation. It had also prescribed a 24 per cent cap on interest rates charged by MFIs. As part of a review of the report, RBI is planning to conduct a half-day workshop under **Deputy Governor K C Chakrabarty** in which the issue will be discussed with stakeholders. "We will try to understand their issues," Subbarao said.

On Tuesday, he had said more clarity was needed for regulation of MFIs. Released last week, the Malegam report suggested a **four-pillar approach to MFI regulation**. This included sharing of responsibility by **MFIs, industry associations, banks and RBI**. "Regulations should be neat, should not overlap and should be clear not only to us, the regulators, but also to the general public as to what has to be done by whom," said Subbarao. This will become clear as we implement the recommendations, he added. He further said that like Andhra Pradesh, other state governments might also bring some regulations.



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

**Sa-Dhan:** The Association of Community Development Finance Institutions (CDFIs) represents countrywide a total of 251 members across 20 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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## RBI gives breather to MFIs

 BS Reporter, January 20, 2011,  
Mumbai:

**A**sking banks to recast unsecured loans without NPA classification. The Reserve Bank of India (RBI) has asked banks to go easy on microfinance institutions (MFIs) by relaxing certain norms regarding loan restructuring. Banks can now restructure loans extended to MFIs even if they are not fully secured. As a special case, banks need not classify such loans as non-performing assets (NPAs)..

“This relaxation was given considering the fact the problems afflicting MFIs were not necessarily on account of any credit weakness per se but mainly due to environmental factors,” RBI said in a note. A top official of the Indian Banks' Association said total lending by banks and financial institutions to MFIs was over Rs 20,000 crore. Over 85 per cent of the exposure was to six-seven large players. “Banks will subject larger MFIs to greater scrutiny for books, pricing and recovery practices,” said the official.

The ad hoc measures required the various banks financing an MFI to come together to restructure the package. The common approach would improve information sharing and discipline in MFIs as borrowers, the official added. The restructuring will involve giving more time for repayment, a cut in interest rates, making some sacrifice on the amount due, asking MFI promoters to bring additional capital and commitment to restructure clients' loans.

These measures are applicable only to standard accounts. When banks restructure unsecured credit, the account is treated as an NPA for one year and requires higher provisioning. As a special case, when restructured, the unsecured loans to MFIs would be treated as standard assets. This would save banks from making provisioning for NPAs.

RBI has advised banks to recycle the collections of MFIs. This translates into MFIs using the repayment amount for further lending and operational purposes. These temporary measures are applicable to MFI loans restructured till March 31, 2011. RBI said this would help ease the liquidity crunch until action was taken on the recommendations submitted by the Malegam committee.

The committee was set up under **Y H Malegam** to study the issues specific to the MFI sector. The sector was hit hard, especially in Andhra Pradesh, after new norms regarding lending rates and collection practices were implemented. This led to shortage of funds with MFIs, in turn, affecting their borrowings from banks.

# Microfinance Recognition Awards Asia 2011

## SIDBI bags Runners Up Award under “Commitment to Social and Financial Transparency”

The International Microfinance Asia Conference 2011 was organized by Hanson Wade in Singapore during January 24-27, 2011. The theme of the conference focused on responsible investment and regulatory reform by tackling over-indebtedness and embracing innovative financial products to guarantee a sustainable industry. The conference had Microfinance Recognition Awards as a part of its agenda to highlight the newest trends and technologies from around the world. The Microfinance Recognition Awards in the following six categories were an effort to recognize individuals and



organizations who have demonstrated vision while delivering financial services to the less privileged, even as staying committed to innovative development:

1. Commitment to social and financial transparency
2. Commitment to improved implementation of good governance
3. Successful product innovation
4. Commitment to MFI professionalization
5. Innovative use of technology
6. Innovative social impact investing

SIDBI had sent its nomination for the category “Commitment to Social and Financial Transparency”. The entry broadly dealt with the major responsible finance initiatives of SIDBI which envision social performance and transparency as one of the vital constituents for MFIs. **The Bank's entry was selected for the Runner's Up Award from among 60 nominations across the 6 categories.** The judges were the representatives from IFC, Grameen Foundation and ACCION.

# Limit on annual income can be changed

TAMAL B ANDYOPADHYAY & D INESH U NNIKRI SHNAN  
Mint INTERVIEW - YH MALEGAM/CHAIRMAN, MFI PANEL –

Livemint.com, 28 January 2011  
MUMBAI:

**H**e Malegam panel's recommendation that only those households which have up to ₹50,000 in annual income should be eligible for borrowing money from micro-finance institutions (MFIs) have drawn flak from all quarters. Critics say by suggesting a cap on loan rate, the panel is also denying market forces in shaping the cost of loans.

But noted chartered accountant Y.H. Malegam, 77, who has been serving as director on Indian central bank's board for 17 years, said one should look at the philosophy of the report and not the figures. The objective is to define what micro-finance is and regulate them and the numbers can be revised. He said in an interview that there could be a distinction between borrowers in rural, semi-urban and urban India. While ₹50,000 annual income criterion can be kept for rural India, it can be raised for semi-urban and urban pockets.

He, however, strongly defended the idea of capping the exposure limit for an individual borrower at ₹25,000 and the loan rate at 24%. He described MFIs as "greedy" and said the mandate of the panel was to protect borrowers and not lenders. MFIs have enough profits and they can use part of it to reduce interest rate, he said. If indeed the Reserve Bank of India accepts the recommendations, there will be no need for the Andhra Pradesh law for regulating MFIs in the southern state, he said. Edited excerpts: You seem to have focused on micro microfinance, allowing households having only up to ₹50,000 annual income to access microcredit.

I think we should not place too much of emphasis on these numbers. It makes much more sense if you look at the philosophy of the whole report. Whether it is ₹50,000 or ₹100,000, the number can easily be changed. In fact, ₹50,000 is the number which was often mentioned to the committee by some of the MFIs and banks. It's not something which we picked up out of thin air.

Also, it was basically in the context of rural areas. Obviously, that ₹50,000 may not be appropriate for an urban area or a semi-urban area. When the regulations are made, this can be easily revised. So, I think the concept that there should be a limit is more important, rather than the number.

So you are flexible.

Yes. As I said, this is only a recommendation. When the regulations are framed, depending on the response, this limit can be changed. I have a feeling that the logical thing will be to create a distinction between rural, urban and semi-urban areas. It can be higher for urban. But the final decision should come from RBI (Reserve Bank of India).



## What about the limit of ₹25,000 on individual loans?

I don't think that should be changed. If you look at the statistics today, 92% of MFI loans are below ₹15,000. Only 8% is outside of ₹15,000, which we are increasing to ₹25,000. The second thing is that 90% of the loans (of each MFI) should be qualifying loans, or loans that satisfy the criteria. The balance 10% need not satisfy this criterion. This can go beyond ₹25,000.

So your view is that ₹50,000 cap on annual income can be changed, but ₹25,000 will stay.

Yes. Let's put it this way. ₹50,000 is a limit, which we know cannot be enforced. How do you find out what is the household income? It can only be based on the declaration given by individuals. But the concept that there should be a limit is more important. Because, if you do not have a limit, MFIs can give loan to anyone. Someone with a household income of ₹10 lakh can take a ₹15,000 loan. **Does that make sense?**

MFIs tend to give loans (to) people with higher income for safety. The objective of micro-finance is to give finance to people who cannot otherwise get finance. Therefore, by putting a limit, you indicate your intension and give a signal that you would expect MFIs to give loans to poor people.

## Are you also flexible on the loan rate cap at 24%?

If you look at the interest rate charged by MFIs, it has a component of the funds which they borrow. The cost of funds may be beyond their control if interest rates go up. But the other components--the staff cost, bank office cost, loan losses and the return on their capital--can be controlled. If the size of loans increases, the cost per loan will come down. Your loan losses are also within your control. If you improve your system, you should be able to bring down your cost.

### What kind of return should an MFI look for?

If you have a capital adequacy of 15%, out of ₹100, ₹15 is your own funds and ₹85 is what you have borrowed. You should get a 15%, post tax return on that. This is reasonable, works out to as much as 22% pretax return. Since interest cost is beyond your control, we give you a margin in excess of the actual cost of interest. Within that margin, 10% for larger MFIs and 12% for smaller MFIs. If you want to pay higher salaries, your cost will be higher and your profits will be lower. Today, the average cost for borrowing for MFI is less than 12%. Let's take it as 12%. If you add 10% margin, then you can charge 22%. If you add 12%, then you charge 24%. The government has already announced that public sector banks should ensure that MFIs should not charge more than 24%.

### Why are they charging so high?

When you are growing at a very fast pace, there is a lot of development cost which is incurred and that development cost is reflected in today's cost. You are asking the current borrower to pay for that development. If you look at any other industry, no one can do that. There should be some ways through which you bear that cost and recover it when you reach a certain size. The whole concept of micro-finance is getting debased because of greed. If you say I am small and my costs are high and the customer should pay higher interest, then I will tell you to grow larger.

### Why should a borrower subsidize you?

While the borrowing cost is fixed across India, other costs vary in different regions. If you look at any other industry, there is always a cross subsidization. Take the banking industry--it lends to exports at a lower interest, but makes it up somewhere else. You do not want MFIs to offer other services, but that's the way they can make money and bring down loan cost. There is a distinction between the financial services and other services. If you render services like remittance, that is a financial service. Now, if you sell mobile sets or supply products to kirana shops, those are not financial services. You are dealing with a vulnerable borrower whose banking power is limited. So there is big risk if an MFI goes to a borrower and says, if you want a loan, you buy a handset or insurance policy. We want to avoid this risk.

### Smaller MFIs may not be able to survive. Do you see consolidation in the sector?

The concept of microfinance itself started as NGOs (non-governmental organizations) and they were all non-profit NGOs. The intention was to provide some facilities to (the) poor to work themselves out of poverty. Then they said if we remain non-profit companies, we are not able to get enough money and grow. If I want to protect the borrower, I must encourage you to grow large. That will help you bring down the cost and pass it on to the borrower.

### How should MFIs raise money?

There are people who want to establish a social mutual fund for providing money to MFIs. They don't want exorbitant profits and are happy with 10-12% return.

These mutual funds will invest in only those MFIs which are willing to do social work. Grameen Foundation has made such an offer. They would like to allow us to have a social mutual fund which offers muted returns. The Central government is preparing a Bill which envisages National Bank for Agriculture and Rural Development (Nabard) as the regulator for MFIs. But you want RBI to be the regulator.

There are three types of MFIs--the self-help group model where banks lend money to the groups; the MFI model where banks give money to MFIs to be given to individuals; and others. The first two constitute 92% of the industry, which is regulated by RBI. The remaining 8% consists of cooperative societies, trusts, etc. The Bill says that Nabard should be the regulator. But it is also a participant in the business as it lends money. There is a conflict of interest when a lender becomes a regulator. Nabard should either give up its role as a lender and remain a regulator or give up its role as a regulator and remain a lender.

### Which one do you prefer?

I would prefer Nabard to give up its role as a lender. Ultimately, we are concerned with this risk that someone takes advantage of regulatory arbitrage. You have said that if the recommendations are accepted, the Andhra Pradesh law on MFIs will become redundant.

### How can a panel take on a sovereign Act?

We are saying that the Andhra Pradesh Act will not survive as far as NBFCs (non-banking financial companies) are concerned because RBI is going to regulate them. There are some provisions in the Act that create problems. For instance, it says that MFIs have to register themselves with the gram panchayat office. Now if you have to register with RBI also, then there can be a lot of duplication.

There are issues on repayments how it can be done and the frequency. We are in favour of making a distinction between the recovery of loan and its disbursement. As far as disbursement is concerned, it can be made at some central point because that happens only once. That central point can be anywhere even under a tree. The important thing is that a borrower repays the amount in the presence of others who have jointly guaranteed his repayment, then there will be peer pressure on that person. Whether the repayment should be weekly, monthly or fortnightly, must depend on the nature of the loan and the cash flows it generate.

If RBI accepts your recommendations, will Andhra Pradesh repeal the law? There is no harm in a state having its own law. But the difficulty is that if an MFI operates in five different states and each state has its own law, and in addition there is a regulation by RBI, then how will it manage its operations?

### Have you spoken to Andhra Pradesh on this?

Their secretary made a re-presentation to us. We told him that if you are satisfied that we are bringing in regulations that substantially cover the areas which you have identified, and if you accept that there is difficulty in having multiple regulations by different states, then why would you insist on having your own Act?

### What was their response?

They said the state government would consider. But obviously, they don't seem to agree to that. There is nothing we can do in that matter.

## What about coercive recovery?

We have said quite candidly that a regulator cannot punish for coercive recovery. It's a matter for the law and there are enough provisions in the law to take action against coercive recovery. In order to ensure coercive recovery is reduced; first you put the responsibility on the management not just on the individual himself. Banks earlier had this problem, but they solved it.

Then we have dealt with the question of compliance. It must be a responsibility taken up by more than one pillar. Let the MFI itself enforce compliance; then the banks, the industry associations and RBI. So even if compliance is weak in one area, it can be compensated by other. You have given only a month to implement the recommendations.

We have not given any time frame. Only on one aspect -- the rate of interest -- we said it must be implemented by April.

But we are not going to control interest rates for individual loans, but will look at the average rate for the whole year. While it will be easier for large MFIs to bring down rates, smaller MFIs will find it very difficult.

I am not protecting MFIs.

I'm protecting the borrower. I believe that a borrower should not be charged interest rate in excess of 24%. In the last several years, MFIs have made larger profits.

**What is the harm in using a part of that profit to bring down the interest rate now?**

**In the long term, do you expect this to come down further?**

It can come down. Their cost of funds should come down. If government feels that lending rates should come down from 22% to 20%, it must find some ways to make bank finance available for MFIs at cheaper rate.

## Sa-Dhan Interventions

While the microfinance sector in India continues to face the challenges arising from the crisis in Andhra Pradesh, Sa-Dhan progressed on addressing some of these by meeting members and conducting series of workshops across regions.

### Workshop on Community Based Organizations as Model of Delivering Livelihood Financial Services

The present crisis in the microfinance sector has brought focus back on the Community Based Organizations as models that have inbuilt design to build social and human capital. Sa-Dhan had been making efforts to strengthen these organizations towards expanding microfinance services for the poor, specially in the Eastern region. As a result, the sector has witness a new surge in growth of microfinance services in the East.

In continuation to the above, Sa-Dhan organized a workshop on "Community Based Organizations as



Model of Delivering Livelihood Financial Services" in order to look at and understand the status of various existing community based models, identifying the best practices in various models i.e. SHGs/Federations/ Cooperatives/ MACS/ Producer Companies/ Business Correspondent and Facilitator model, and to look closely into the intrigues of various ongoing government schemes/ policies to support the expansion of movement. Within this background the objective of the workshop was to provide a common platform to Sa-Dhan members, non-members, other NGOs and MFIs working with these models to build understanding of the concepts of various models, various policies or microfinance at national and state level vis-à-vis the emerging trends, issues and concerns associated in taking the movement forward. The workshop was positioned to help in mapping the possible collaborative efforts of participating agencies for various issues and challenges faced by the Community Based Organizations.

Participants discussed at length critical issues such as role and effectiveness of CBOs in extending financial services, SHG/ federations and issues, structure and governance of CBOs, issues of producer companies, implementation of BC model by MFIs, principles and practices of self reliant cooperatives etc. The Workshop also shared experience some of the success stories on livelihoods, cooperative model, MACS, MFIs working with BC model etc. A separate session was dedicated to issues and challenges within promotion and capacity building of CBOs.

Attended by sixty three participants, the workshop attracted representation from Sa-Dhan members, non members, NGOs, Cooperatives, MACS, MFIs, National and State level officials dealing with these models and entrepreneurs.

The way forward from the workshop was in terms of need for government to work with CBOs, focus on quality of SHGs, need of Code of conduct, clear vision and governance for CBOs, increased routing of services to poor through CBOs under the BC model, and sensitization of banks on CBOs. Sa-Dhan was asked to work towards building a self regulatory framework for CBOs.

### Workshops on Governance and Systems against Reputation Risk

The present microfinance crisis has exposed the vulnerability of the microfinance sector in India to reputational risk. In order to address the issue of reputational risk, Sa-Dhan organized two workshops on “Governance and Systems against Reputation Risk” in Ahmedabad and Kolkata on 17-18<sup>th</sup> January 2011 and 31<sup>st</sup> January – 1<sup>st</sup> February 2011 respectively.



Smt. Ela R. Bhatt, Chair Emeritus, Sa-Dhan inaugurating the Workshop in Ahmedabad

These workshops not only provided platform for banks and apex financial institutions to communicate their expectations from MFIs on governance and risk mitigation systems, but also facilitating learning among MFIs in terms of sessions dedicated for sharing of experience on these from some of the MFIs. Within the discussion on critical issue of “overcoming the present liquidity crisis” in the sector, the workshop also focused on the need of adhering to Code of Conduct and social performance. Special sessions were dedicated to the “Implications of Malegam Committee report” and “governance in Community Based Organizations”. The workshop facilitated the expectations of banks and apex financial institutions from the MFIs in terms of governance and risk mitigation systems.

The highlight of the Ahmedabad workshop was Smt. Ela R. Bhatt, Chair Emeritus, Sa-Dhan recommending creation of a “India Equity Fund” of Rs. 5000 crore to serve 500 MFIs need in India. This fund would be client-



Mr. P K Saha, CGM, SIDBI delivering the inaugural speech at the workshop in Kolkata

centric with a long term vision vis a vis the poor, with MFIs' deepened engagement with clients, to produce multiple –diverse products.

Supported by SIDBI and KFW, these workshops attracted large participation from MFIs as well as banks, apex financial institutions and technical service providers. These workshops in Ahmedabad and Kolkata were attended by 40 and 62 participants respectively. The Kolkata workshop was organized with the help of Sa-Dhan State Chapter in West Bengal.

### Workshop on ICAI Accounting and Reporting Standards for MFIs

In continuation to Sa-Dhan's contribution to the development of “Accounting and Disclosure Guidelines for MFIs” by Institute of Chartered Accountants of India (ICAI), a workshop on “ICAI Accounting and Reporting Standards for MFIs” was organized by Sa-Dhan in Pune from 20<sup>th</sup> to 21<sup>st</sup> January 2011. Sa-Dhan's objective was to bring awareness related to accounting and reporting among MFIs, build understanding on the present accounting systems in MFIs and to implement the ICAI accounting system among these.

The workshop was timely amidst the debate in the microfinance sector on transparency and governance. It was recommended that through standardized financial statements in MFIs the common information needs of various stakeholders would be met. The workshops helped to understanding the participants on the details of the accounting guidelines within their context of legal form. A special session was dedicated to discuss legal and taxation issues in MFIs.

The workshop was attended by thirty five participants representing CEO of MFIs, senior managers, MIS managers, Accounting managers from all over India. The distinguished panel of speakers included representatives from SIDBI, ICAI, Chartered Accounts from MFIs and senior bankers.

### Meeting with Members in Andhra Pradesh: Assessing Sectoral Scenario in Andhra Pradesh

To assess the sectoral scenario in Andhra Pradesh arising from the crisis and the Malegam Committee recommendations, Sa-Dhan had series of meeting with members and few banks on 27<sup>th</sup> and 28<sup>th</sup> January 2011 in Hyderabad.

During the meeting with members it was suggested that Lenders may consolidate portfolio as per geographical distribution, and then 2-3 local MFIs may collect loans of MFIs and share in the proportion of loan amount to avoid multiple collections from different MFIs. The effort on consolidation will lead to liquidity increase,

enhanced contact with the community to regain confidence, fresh lending etc. Member informed about heavy losses they are incurring each passing day.

In a meeting with Indian Overseas Bank it was informed that resource flow to MFIs in Andhra Pradesh has been frozen. It was informed that several meeting of Lenders' Forum, SLBC, SIDBI and NIRD have taken place on issues of the sector in Andhra Pradesh.

Members, specially NGO-MFIs expressed their concerns on the recommendations of the Malegam Committee Report. It was suggested that recommendations on capital base Rs. 15 crore is high, and would open doors for Corporates/MNCs to the social sector.

## Andhra law to curb microfinance firms comes into force

BS Reporter, January 2, 2011,  
Hyderabad:

**T**he Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Act, 2011, which aims at curtailing coercive practices by microfinance institutions, has come into effect from on Saturday. **Governor E S L Narasimhan** gave his assent to the Bill yesterday. The Bill was passed by the Legislative Assembly on December 14 and the Legislative Council the next day.

The state government had brought in an ordinance on October 15 following a spate of suicides by borrowers of MFIs. The ordinance was later replaced by a Bill, which was passed last month. **Minister for Women Welfare V Sunita Laxma Reddy** had told the

Assembly that 75 women committed suicide, unable to bear the coercive practices adopted by MFIs to recover loans.

The government also contended that the MFIs charged extremely high rate of interest. By their own admission, some MFIs, while registering with the District Rural Development Agency said they charged 50 to 60 per cent interest. The Act makes registration of all MFIs mandatory. The state government, in consultation with the Andhra Pradesh high court, may establish a fast-track court in each district for settlement of disputes of civil nature between borrowers and MFIs.

The government, in the representation to the Malegam Committee, said some MFIs adopted strong arm tactics for recovery. It also proposed an eight per cent cap on the interest rate spread on the interest rates being charged by the MFIs. It said the roles of MFIs should be limited to areas or households that are facing financial exclusion. It said the MFIs should not be allowed to go for IPOs as it would shift the focus of MFIs on profit generation only. It also said private equity players invested in the MFI sector due to the high returns while there was a need to promote social investor and rope in corporates as part of their corporate social responsibility.

# Small microfinance institutions fear for survival

M Rajshekhar & John Samuel Raja D,  
The Economic times, 21 Jan, 2011, .  
NEW DELHI:

**A** day after a central bank appointed committee submitted its report, small microfinance institutions (MFIs) say the recommendations if accepted would wipe away their presence in the sector because of stringent capital requirements. The committee, headed by **Y H Malegam**, proposes to create a new category of **non-banking finance company (NBFC)** to be termed as **NBFC-MFI**, and companies wanting to register in the new category will need to have a minimum net worth of Rs 15 crore. This is a steep increase from the current requirement where for-profit MFI can be formed via the NBFC route with Rs 2 crore.

“The smaller (MFIs) cannot survive,” says **MS Sriram**, an adjunct professor at IIM-A, who has written extensively on the sector. “It is very clear that this move is towards consolidation, having smaller players so that the supervisory function becomes simpler.” A back-of-the-envelope calculation reveals that under current capital requirements, **MFIs as nonbanking finance companies can have a loan portfolio of more than Rs 100 crore for Rs 15 crore of net worth**. At present, the capital adequacy requirement is Rs 12 for every Rs 100 lent. So, a medium-size MFI with a loan portfolio of Rs 50 crore needs only Rs 6 crore of capital under old regulations, as compared to Rs 15 crore needed if Malegam committee recommendations are accepted in total.

**The Reserve Bank of India would be comfortable with this recommendation as only 26 MFIs** have net worth of more than Rs 15 crore, as per data provided by **Micro-Credit Ratings International Ltd.** Together these 26 firms have a market share of 85% of the total loan portfolio. The question now is what will happen to the rest of the for-profit MFIs, which have net worth of less than Rs 15 crore.

## UNCERTAIN FUTURE

To be sure, the Malegam committee recommendations are yet to be accepted by the RBI. Even if it is accepted, it will take a long time to bring it into reality. “RBI has to amend the RBI Act if it wants to increase the minimum capital requirement to Rs 15 crore,” says a chartered accountant, who has been associated with the micro finance sector for close to 20 years. “Parliament has to amend the Act and it will take at least another two years.”

Further the latest committee report is not the first report on this fast-growing sector. Seven years back, the RBI appointed the Tomar committee to look into the microfinance industry. “Tomar committee submitted a 200-page report and only one recommendation was accepted, and it was inconsequential to the sector,” adds the same accountant.

There were three other committee reports on microfinance industry before the Tomar committee. These facts are not a consolation for **Manab Chakraborty**, the founder and MD of **Mimo Finance**, who has portfolio of 55

crore. “On the whole, the report will help large microfinance companies and the likes of Mahindras and Reliance, and can result in an oligopoly in this sector. For the smaller players, there will be a consolidation,” he explains.

For smaller MFIs, say industry executives, it would be tough to meet the net worth requirement of 15 crore, as investors are skeptical to bring in equity investment at this time. So, what options does a small player like Mimo Finance have? “**The small MFIs will have to merge or sell their portfolios to larger ones,**” says a banker working with MFIs in Lucknow.

One way to lessen the impact on small MFIs is to lower the capital requirement and give more time to comply, says **Manmath Dalai**, managing director of **Krishna Bhima Samruddhi Local Area Bank**, a **BASIX** group company. He is not affected by the recommendations by the Malegam Committee as he is operating via the banking licence. Consolidation is likely to happen just in numbers but also in terms of areas covered by the MFIs because of caps proposed by the committee.

## CONSOLIDATION AND COMPETITION

One of the key recommendations of the report was to cap interest rate on individual loans at 24%. Further a margin cap of 10% was placed on the interest rate charged. For example, if an MFI borrows at 12% interest rate from banks. The report says the maximum interest rate chargeable would be 22%, which is 10% on top of cost of funds. Further individual cannot borrow more

than. 25,000, that too from a maximum of two MFIs.

“The recommendation that only two organisations can lend to a borrower will make for intense competition,” says Chakraborty of Mimo Finance. Higher competition will mean competitive interest rate for borrowers but this benefit is unlikely to be obtained by people living in far flung areas or the areas where MFIs have not yet established their presence. “Bigger MFIs would still be

profitable, but even they would think twice before expanding their operations in remote areas where the need for financial inclusion is most required,” says the banker.

“One of the reasons for multiple borrowing was because of small loans given by MFIs. Often the clients needed more capital to buy things. As a result, they end up taking loans from multiple lenders,” **Sanjay Sinha, managing director of M-Cril, a rating agency focused on MFIs.**

## NOT IN TUNE WITH REALITY

MFIs also says certain provisions relating to determining the income level of the borrower and monitoring the end use of the loan is not possible. “The report also says that the women we give loans to should have an income below **Rs 50,000**. But how do we know for sure that the woman's income is below. 50,000? I am not even sure if we can so accurately pinpoint incomes. Rural incomes are seasonal and vary.” asks **PN Vasudevan, managing director of Equitas.**

## Association of Karnataka Microfinance Institutions (AKMI) Seminar on “Microfinance in Financial Inclusion: Opportunities and Challenges

**A**midst the crisis in the microfinance sector, AKMI in collaboration with FICCI and Rotatory International Dist 3190 to in organized a seminar on “Microfinance in Financial Inclusion: Opportunities and Challenges” on 18th January 2011 in Bangalore. This initiative of AKMI was supported by Sa-Dhan. The seminar was very timely in an environment where MFIs are facing criticism on charging high interest rates, coercive collection practice, over extension of credit, high profiteering etc. The objective of the seminar was to bring all the relevant stakeholder such as the MFI's, State government, banks, regulators, associations, Media etc., together to discuss the current issues, achievement, relevance of MFIs in the micro finance & Financial Inclusion.

While AKMI is part of the State level bankers' committee, it's district level efforts are being led by one of the members in terms of sharing the progress of MFIs', handling issues from banks and customer grievances in a amicable manner with cooperation from other MFIs and community.

Ms. Vijaylakshmi Das, CEO, Ananya Finance Ltd. emphasized on bringing back the focus of the microfinance sector on the needs of the poor. She also asked the members to analyze on what went wrong? She also urged the members to focus on training of staff on client centric approach. She said that mistakes of few MFIs should not lead in impacting the whole



**Mr. Vivekanand N. Salimath, Vice Chairman, AKMI presenting the recommendations from the seminar**

microfinance sector. Referring to Andhra Pradesh, she informed that Community Based organizations also have been severely affected by the crisis. It was emphasized that MFIs need to work in those areas where bank's facilities are not reaching the poor.

Separate session on financial inclusion scenario in Karnataka, regulatory framework for MFIs and role of members in self regulation provided participants' opportunity to have a detailed discussion on the way forward. The seminar concluded by making recommendations on MFIs credit limit to borrower as Rs. 1 lakh, government support to microfinance initiatives, a single national regulation for microfinance, uniform standards on interest rate apart from need to reduce interest rate and a credit bureau integrating district and state level data on clients.

# Microfinance: misunderstood, Malegamed

M.S. Sriram

Livemint.com, 21 January 2011

**T**he Malegam panel's report disappoints not only in its inability to meet expectations, but also on fundamentals

A generally beleaguered microfinance industry was eagerly waiting for Yezdi Malegam for deliverance. Any conversation about the microfinance business would end with the expectation that the Malegam committee would deliver a healthy dose of oxygen to the choking microfinance industry. The report was expected to be the panacea for all that ails microfinance in India.

*Little reason to smile? A file photo of borrowers availing microfinance services in Tiruchirapalli, Tamil Nadu. According to the Malegam committee recommendations, the*

*borrower should be eligible for a microfinance loan only if his or her household income is less than Rs. 50,000 per annum. Ganesh Muthu/Mint*

The report, which came out on Monday, disappoints not only in its inability to meet these expectations, but also on fundamentals. While each one of the recommendations may have merit when seen in isolation, together they are a lethal combination. It is difficult to accept that **the collective wisdom of Malegam, Shashi Rajagopalan, an expert in cooperatives; Aditya Birla Group head Kumar Mangalam Birla; Reserve Bank of India (RBI) deputy governor K.C. Chakrabarty and former chief of India's space research organization U.R. Rao** could have delivered this blow to the

microfinance sector in the country.

First, the good things in the recommendations: The committee suggests retaining priority sector status for the microcredit business; keeping microfinance institutions (MFIs) out of the **Moneylenders Act**; keeping the regulatory role with RBI instead of state governments; enhancing the role of RBI in supervision; and engaging with industry associations on an ongoing basis.

However, there are several problems with the report. Chakrabarty, during his brief tenure as the central banker in charge of rural credit, provided progressive measures for financial inclusion in the banking sector by suggesting two radical steps in the rather conservative atmosphere of RBI—the first was to remove



licensing requirements for opening branches in towns with a population less than 50,000 people; the second was to remove the interest rate cap on all loans as the base rate regime kicked in. The only area where there were some controls on interest rates was in the case of politically sensitive agricultural loans. As a member of the Malegam committee, he has signed off on a report that puts a cap on microfinance interest rates at 24%, without dissent. The question is not whether 24% is an appropriate cap; it is more about the principle.

RBI has taken bold steps in the banking sector; no other **non-banking financial company (NBFC)** has an interest rate cap; but the Malegam committee has moved one step backward in even thinking of such a measure. **Even the dreaded Andhra Pradesh ordinance, which has no interest rate cap, looks better on this count.** According to the committee, the borrower should be eligible for a microfinance loan only if his or her household income is less than Rs. 50,000 (translating into an average household income of less than Rs. 140 per day). So, if a household crosses the threshold of full employment at a minimum wage for one person, none of its members can qualify for a microfinance loan. It does not take a supercomputer to arrive at the per capita income of an average household that is eligible for a microfinance loan.

For a moment, let us agree that the interest rate should be capped at 24% (this was the number that the finance ministry had advised the banks to put as end-use conditionality). Having put an upper limit on the interest rate, the

committee has also decided to be careful to ensure that some MFIs do not make excessive profits and put a 10% cap on the difference between average borrowing cost and lending rate, thereby providing no incentive to companies in the business to push efficiency if the average cost of funds is less than 14%. (There is also a mention of 12% spread for small MFIs with a book size of less than Rs. 100 crore, but that is rendered almost irrelevant by the clause below.)

Then, the committee comes to the issue of who can lend to the poor. Using some strange calculations, the panel has indicated that only those who have a net worth of more than Rs. 15 crore should be dealing with the poor. This figure is higher than what was required of a local area bank, which was Rs. 5 crore, specified at the time when the net-owned funds requirements for NBFCs was hiked to Rs. 2 crore (circa 1997, when it was increased from a silent nil amount to Rs. 25 lakh for existing institutions and Rs. 2 crore for new NBFCs).

It is okay if you have a net worth (actually net-owned funds) of just Rs. 2 crore to be a truck financing firm or a leasing company or a lending firm. But being in the business of microfinance needs much more capital, based on a calculation of what a decent sized MFI is and does. The committee's calculation seems based on its sense that an MFI with a book size of Rs. 100 crore would need a capital of Rs. 15 crore and, ergo, this needs to be the minimum capital requirement. There would appear to be no other argument for this number, which makes a random appearance in the report.

In addition, the report has some other interesting recommendations. It says the microfinance industry association would need to have at least one-third of the registered entities in the business as members to be recognized and to engage in dialogue with the regulator. It says that 90% of the loans should not be of a ticket size of more than Rs. 25,000 (assuming the borrower is solely borrowing from the MFI) for those entities that wish to be classified as an NBFC-MFI. And it adds that for other MFIs, not more than 10% of the portfolio should be "microfinance". So, if you are anywhere between these numbers, nobody knows what will happen to you, but you are probably illegal!

The cap of Rs. 25,000 is further qualified by how the committee suggests the loan be sliced. It says not more than 25% should be given for non-income generating loans. This would mean a loan cap of Rs. 6,250 from all sources at all times on microloans for consumption, education, social expenses all bundled together. Indeed, the cap of Rs. 25,000 itself contradicts an old RBI notification that exempted not-for-profit companies registered under section 25 of the Companies Act and issuing loans of less than Rs. 50,000 from the requirements of registration as an NBFC.

So, how many steps backward is the current recommendation?

The panel also has some suggestions on protecting the customer's interests. One of these is an interesting formulation on how the instalments would be structured. Any loan of more than Rs. 15,000 (and of course less than

Rs. 25,000, which is the ceiling) will have to be necessarily structured for at least 24 months. Any lending of more than Rs. 25,000 will not be eligible for repayment till the overall liability is reduced to Rs. 25,000. And, there is a clause that a customer can borrow from no more than two microfinance sources.

It is indeed surprising that this report is coming from a sub-committee of the RBI board. From 1991 onwards, we have seen progress in the regime and here is a committee trying to control all that can be controlled. The loan size, the income of the borrower, the amount they can borrow for income generation and consumption, the overall indebtedness, the tenor of the loan, the period of moratorium, the minimum membership for an association to be considered a representative of the industry...what else is there left that can be regulated? Does the committee take the role of RBI as

a “regulator” literally, in that it regulates everything?

One of the concerns that led to the formation of the committee was that microfinance companies were profiteering from the poor and not treating them with dignity. As a central banker, a more non-invasive way of addressing the issue would have been in controlling the capital flow to these institutions both through the nature of equity investments and through the banking system, thereby giving the market an opportunity to experiment and provide diversity of services, improving transparency and enforcing a customer responsibility code.

If the banking sector, the auto finance sector and the housing finance sector have plurality of institutions (and no loan size and interest rate caps and definitions of moratoriums) with the central bank stepping in whenever it seems to think a larger customer interest is involved (as it did in the case of

teaser rates offered by housing finance companies), we see no reason why the same principles should not be applied to the poor. Dealing with poverty does not mean restricting choices and giving people what we think is good. Dealing with poverty means trying to give the poor as much dignity and diversity of choices that the non-poor enjoy. The report defies the plurality of institutions and choices. The Andhra Pradesh ordinance (as recommended by the sub-committee) can lapse because the panel has effectively completed the task that was started by the state government. For not having abdicated the responsibility to supervise and inspect MFIs that have shown poor governance and indifferent behaviour towards customers, this antidote by the RBI committee appears populist and misplaced in what should be controlled and what should not be. *M.S. Sriram is an independent researcher based in Bangalore. This is the first in a series of critiques on the Malegam committee report.*

## 189 members of ESAF Microfinance get elected to Local Government Bodies in Kerala

India microfinance business news, January 18, 2011

ESAF Microfinance last month held a program called 'Janekayadaram 2010' which was organized to honor 189 ESAF Sangam members who were elected to various local bodies in the State. During his presidential address, Ollur MLA, **Rajaji Mathew Thomas** said that for women empowerment what was required was a sustainable approach to uplift the living standards of the poor through skill training. He added that finding a market to sell their products was equally important like training.

**Kodakara MLA, Prof. Raveendranath** delivered the key note address. He opined that Housing, Water and Education were the primary requirements for the development of a society and so development organizations like ESAF played a key role in a country, where more than 40 crore people were living under the poverty line.

During his welcome speech, **K. Paul Thomas, Executive Director, ESAF** opined that the efforts of ESAF in the last 18 years, sans any religious or political favoritism were now bearing



*(P Paul, Thrissur Mayor, inaugurating Janakeeyadaram 2010, flanked by Prof Raveendranath (Ollur MLA), K Paul Thomas and George Thomas.*

fruits. He then briefed the audience on the social oriented projects undertaken by ESAF in association with the Governments of **Maharashtra and Jharkhand** like Slum Rehabilitation and Water Sanitation.

## Saath – DBS collaboration for affordable housing

### Conceptualizing the company

DBS Affordable Home Strategy Ltd was established in July, 2009 with a clear focus on creating a viable business model for providing affordable housing to those customers who, as of now do not have access to mainstream legal housing. The flagship brand of the company was named 'DBS Communities', indicating that this enterprise was not just about building houses. The company's vision is to grow and expand into a large social enterprise where people who join as customers transform their lives and become partners in the movement, mentoring newcomers. Its mission is to establish an efficient, viable and transparent system for the large-scale mass-production of houses that are affordable and financed through savings and credit systems that are accessible to the bottom half of the socio-economic pyramid."

### A Unique Enterprise model

DBS Communities targets the informal segment of the market mostly the lower middle income group having average household incomes ranging from Rs. 8,000-20,000. The present formal real estate market does not offer housing affordable for this clientele. Public housing is their only resort which has limited supply and can never fulfill the huge demand. The mainstream housing finance companies also find it difficult to serve this market because of the risk perception associated with people who have informal sources of income and very little banking behavior. DBS Communities recognizes that it requires a specialized set of business process and skill sets to make the enterprise successful. The key components of the unique enterprise model developed by the company are briefly described below:

- 1. Design and production of community housing:** Housing products that are not just sized right and priced right, but go beyond the stereotype that exist in the market today and incorporate features to serve the specific market segment – a range of small, efficient, livable houses and supportive infrastructure such as workspaces, social services for health, education and livelihood.
- 2. Community Housing Finance:** Housing finance systems that are customized to the needs and realities of low income households by innovating further on micro finance models with features such as flexibility in repayment periodicity and person-to-person loans.
- 3. Community Development Initiatives:**

Community development as a core activity of the enterprise, with a commitment to enable customers to make social and economic progress in their lives through interventions in the areas of livelihood, health and education.

To support this three pronged strategy, it was decided to create a Research and Development Centre that would generate practical knowledge on all three areas and also advocate changes in policy.

On the basis of the three pronged strategy, DBS Communities entered into collaboration with Saath Charitable Trust and its affiliated institutions. From that point, DBS and Saath have been partnering actively in developing the business model and the first project.



### DESIGN CHALETTE (9<sup>th</sup> - 10<sup>th</sup> January 2010)

The Design Charette was an intensive, hands-on workshop to bring people from different disciplines and backgrounds (finance, housing, community development, urban planning, architecture and engineering). The event was conducted to refine the business strategy, to identify resources to make the business operational and explore opportunities for collaborating with various players in the industry. During the Charette, the first project, Umang Lambha, which was being conceptualized at the time, was discussed in detail. The deliberations during the Charette informed the finalization of the project.

### Launch of Umang Lambha (2<sup>nd</sup> May 2010)

Umang Lambha, the pilot project is being built on a 6 acre plot in an industrial area on the southern side of Ahmedabad. The project will accommodate 1400 dwelling units ranging in size from 350 Sq.ft to 600 Sq.ft and in price from Rs. 3.5 lakhs to 8.5 lakhs.

A formal launching event was organized at the project site. At the launch pavilion, there were two booking sections – one for the reserved category which comprised of people coming through the NGO partners Saath and another

which was open for all. Housing finance companies like Mahindra Housing Finance, Micro Housing Finance Corporation, GRUH Finance and Dewan Housing Finance Limited had their stalls at the launch.

Of the 5000 people who visited the pavilion, about 70% were from the real target group. Of the 220 families who made bookings, about half were through Saath. About 50 families who came through Saath didn't come prepared with money, so they came the next day to complete the booking payment. There were people waiting outside with money before the pavilion opened on the next day.

**At the time of writing this, of the 1000 units for which booking was opened, there are bookings for about 750 units.**

### Credit Camp (5<sup>th</sup> - 6<sup>th</sup> June, 2010)

The credit camp was a joint initiative from DBS, Saath and one of the interested housing finance companies to understand the financial positions of the clients better by interacting with them and by gathering the required documents for loan processing. There was a good participation on both the days with about 75 clients approaching and exchanging information with the organizers. Almost all the families that came turned out to be eligible for loans, but many needed to be counseled to go for a smaller apartment than they had set their minds on.

### DBS ASHRAM (Academy for Sustainable Habitat Research and Management)

The ASHRAM campus is coming up near Ambapur on a 1.5 acre plot. The campus will house the corporate office of DBS as well as work spaces for researchers with facilities for documentation, conference and training. It will research approaches that are cost effective, sustainable and have the potential to involve home buyers in the housing process. ASHRAM will also research micro finance models for housing, research and advocacy in the area of housing policy and other policies that impact housing and provide training to support the community development initiatives.

### Griha Pravesh – A Housing Facilitation Center

The idea of the housing facilitation center evolved with the realization that the customers need to get all answers pertaining to the project, housing finance and community development under one roof. The idea is to create a one stop shop for a person seeking an affordable home. At the time of writing this, the operational manual for Griha Pravesh is under preparation.

*(Contributed by: The Saath Savings and Credit Cooperative Society Ltd)*

# MFIs must go beyond lending

Swaminathan S Anklesaria Aiyar,  
The Economic times, 19 Jan, 2011,

**F**oxconn, the world's biggest manufacturer of electronic components, runs an entire city of 4, 50,000 workers in China, Foxconn city. This summer, 14 workers committed suicide. The media blamed this on low wages and bad working conditions. One Chinese professor wrote that Foxconn's working conditions were actually high by Chinese standards. Another said 14 suicides in a population of 4, 50,000 meant a suicide rate of just 3.5 per lakh of population, far lower than China's overall suicide rate of 14 per lakh.

But these cold facts could not counter the terrible publicity of the suicides. Foxconn decided to cut its workforce in the city by one-third, raise wages and relocate in several other interior cities. It plans a total workforce of 1.3 million split into several locations, in none of which it has a dominant population share. That way, even if total suicides do not fall, suicides per location will be few, and cease to attract media or political attention.

**The main lesson for Indian microfinance institutions (MFIs)** is that allegations of suicide cannot be rebutted by technocratic analysis. They can be met only through politically sensitive solutions, including dispersion among several locations. SKS chief Vikram Akula investigated allegations of 17 suicides among his borrowers, and found that none was a defaulter. But as in Foxconn's case, this did not change SKS's image. Any group with more than a lakh members is going to have some suicides, and SKS has 5.7 million borrowers. If the media look for suicides in any large group, it will find many instances. The company in question cannot escape blame.

Many people think suicide is a rare phenomenon caused only by great financial distress. Alas, suicide is not uncommon at all, and has little to do with financial distress. The accompanying tables list suicide rates. The highest rates in India come from Puducherry (47.2) and Kerala (31.0) which are by no means the poorest states. But poor Bihar (1.1) and Uttar Pradesh (2.1) have the lowest rates. Low rates occur in poor states Jharkhand (3.6), Rajasthan (7.7) and Orissa (10.8).

States with the best welfare systems (Kerala, Tamil Nadu, Goa) have high suicide rates.

Examine WHO data on suicides in 2003 (See table). India (10.7) is on par with much richer USA (10.8). China is much worse (14 per lakh). The highest rates come from Belarus (36.6) Sri Lanka (30.7) and Japan (25.3). The highest suicide rates in the West come from prosperous Finland (18.8) and Switzerland (17.5), which have strong welfare systems. By contrast, low suicide rates come from poor Zimbabwe (7.9) and Nicaragua (3.5).

Suicide and living standards have little correlation. Suicide is caused substantially by psychological and cultural factors. It is strongly associated with depression and mental disorders. Antidepressants have brought down suicide rates in the West. Cultural factors explain exceptionally high suicide rates in Japan and Finland. What does this imply for the accusation that (MFIs) have driven borrowers to suicide in Andhra Pradesh? The state has just under 15,000 suicides per year, or almost 40 suicides per day! MFIs have been accused of using coercive tactics, but this relates to very few cases in millions of loans.

Have MFIs worsened the suicide rate? Very careful statistical work is needed to throw light on this, but nobody is even attempting this, since the issue is political, not technocratic. The state has enacted a draconian law enabling it to arrest MFI staff even on flimsy grounds like causing annoyance. Unofficially, borrowers have been told to stop repaying. Hence repayment rates have plummeted from 98% to 20%. This threatens all MFIs with bankruptcy. MFIs in other states think they can survive by having a closer linkage with state government anti-poverty schemes. Not so — the problem in AP arose because opposition parties (Telugu Desam and the two communist parties) decided that MFI suicides could be a good tool to whip the state government with. The government sought to protect its flanks by cracking down on MFIs itself.

This can happen elsewhere. MFIs are growing in UP, and there will doubtless be some suicides among borrowers. If Mulayam seeks to make this an election

issue, Mayawati will crack down on MFIs before this can become Mulayam's platform. India has an ingrained political culture of loan waivers. Agricultural credit co-ops went bust because politicians urged default. For the same reason the IRDP programme of small loans from government banks became a fiasco. The central government itself decreed bank loan waivers in 1990 and 2008.

Across developing countries, MFIs have been hailed as heroes aiding the poor. Only in India are they castigated. Why? First, only in India is there competition between government-sponsored and private MFIs, with the government wanting a monopoly. Second, India alone has a tradition of politically-induced default. Third, India alone has rival MFIs giving multiple loans to borrowers, leading to overborrowing and unsustainable debt. Indian MFIs hope that the Malegam Committee of the RBI will come out with regulatory guidelines that defuse political opposition and ensure MFI viability. This is too optimistic. The main threat is political, not technocratic.

First, a la Foxconn, MFIs must spread activities among several states, and not become dominant in any one state. Second and more important, MFIs must start organising women borrowers to stage demonstrations on their behalf when needed. Politically, that alone will take the sting out of allegations that they are driving people to suicide. To achieve this, MFIs will have to do more than pure lending. They need to get involved in livelihoods development, in providing veterinary services and insurance, and in lowering prices of basic goods for clients by clubbing their orders together, passing on wholesale discounts to clients.

Only such activities will convince borrowers that they truly need MFIs, and should demonstrate against state action to hobble these. If MFIs cannot persuade women to demonstrate on their behalf, it will prove that they have lost their social mission and are seen by clients just as commercial lenders. If so, they cannot expect to be exceptions in a political system that revels in loan cancellations.

## A woman of substance!

It is said that fate is written on the forehead! Precisely so in case of Krishna Ghosh. Every morning before going to work she unfailingly smears her forehead with dusts of vermilion, sindoor as we call it here! For millions of married Indian women, it's rather a custom which signifies the well-being of their husbands....and for this unassuming lady from the fringes of Kolkata, sindoor embraces boundless freedom pregnant with infinite possibilities. The hallowed mark of Indian marriage manifested as Krishna's liberator rescuing her from the daily quotidian humdrum of being a dutiful wife, a doting mother and most shockingly...a self-effacing woman with no knowledge of the wider world. She started her business of selling sindoor and *alta* (a red liquid that an Indian married woman applies on her feet) with the precious Rs 7000 that she received from Bandhan! It's been five years now since she received her first loan, scripting steady success stories with consecutive loans of Rs 10,000, 15,000 and 20,000. Her business, in the meantime, has diversified to accommodate perfumes and miscellaneous cosmetics. The increased needs and changing circumstances have necessitated a larger cash infusion in the business. Seeing her unputdownable zeal Bandhan handed her a fresh bouquet of loans—Shristi..and this time the amount was even greater..a whopping Rs 40,000. In her entire stint with Bandhan there has hardly been any anomaly in repayment. Armed with business acumen she never allows her income (almost Rs 25,000 now) to trickle down her fingers..She is pragmatic in her savings—what with her son and two daughters depending entirely on her..Not just that..Krishna is the custodian for 20 more families of her employees now. When asked about Bandhan, Krishna reveals her gregarious self, "I was just another woman blithely settled in a constant (dis)comfort zone with 4 walls around me until Bandhan came and showed me how to lead a complete life. Now I have a bigger family, with my children and employees—all united through a common bandhan of togetherness"

*(Contributed by Bandhan Financial Services Pvt. Ltd)*

## PROTECTION VERSUS SERVICE - The RBI should rethink its entire model of regulation

Ashok V. Desai

The Telegraph, 25 January 2011

The Reserve Bank of India is an exceptionally clean and efficient organization. It discourages contact between its staff and outsiders in the belief that personal contacts are an essential component of corruption. That could make it unfriendly to outsiders. But it promises quick response to letters, and almost invariably gives it. It minimizes discretion by making clear rules. Its rulebook runs into thousands of pages; but the result is that everyone knows or can find out rules, and everyone gets equal treatment. In brief, the RBI is an admirable institution; if the Central and state governments ran half as well as it, Indian lives would be much improved.

But, as can happen with rule-bound institutions, it is extremely compartmentalized; it does not see the interconnections between the various areas it oversees. And it has strong preconceptions. In particular, it dogmatically protects the interests of banks and of government banks in particular, and is consequently biased against change and



innovation. How much damage this blinkered approach can do is illustrated by the report prepared for its directors by a **sub-committee to study issues and concerns in the micro financial institutions sector**.

To begin with, the committee's terms of reference were so narrowly defined that it considered only **MFIs** and defined them as only lending institutions; it consequently ignores

the larger purpose, which is to extend financial services to the villages and the poor. Contrast this with the **Raghuram Rajan Committee of the Planning Commission**, which is never mentioned by the RBI. It said that the poor have three kinds of financial needs: credit, security, and earning from savings. It would save costs if the needs were fulfilled by the same institutions; for that, financial institutions need to be diversified. The RBI's model of the institutions as extensions of banks is ill-suited to the needs. There is plenty of evidence of its weakness, for example cooperative credit societies and rural banks.

The Rajan Committee pointed out that microfinance organizations needed to raise money from somewhere. The answer was obvious to the MFI committee: the money would come from the banks. But there is an even more obvious answer that it strenuously avoided: the money can come from their clients. In other words, the MFIs would be much more viable if they could take deposits — if they were banks themselves. And the need is not for a dozen or two; to reach 700 million people in half a million villages, thousands of banks would be needed. The RBI hates this idea, and relates how experiments with small and rural banks have failed. If banks are to be made failure-proof, they must start with huge capital; the RBI would not think of anything less than Rs 300 crore. They would have to have promoters with deep pockets; and since there are not so many of them around, only a handful of new bank licences can be given.

But if the Rajan Committee is right, the fault did not lie with their smallness. Cooperatives failed because they were used only to channel credit from state governments; they came under the control of local politicians who gave

themselves loans and forgot to repay. This was, for example, the story of the Maharashtra sugar cooperatives, but it will never be mentioned in any official document because the politicians who ruined the cooperatives were the pillars of the Congress. The record of state-sponsored credit institutions is at least as bad as that of private ones.

The MFI committee wants the MFIs to confine themselves to lending to the deserving poor, and wants to place a ceiling on the interest rates they charge. Both proposals are designed to make MFIs less profitable and therefore more susceptible to failure. Interest rates charged by moneylenders go to very high levels. That is what creates a business opportunity for MFIs. They can charge high rates and still lend more cheaply than moneylenders. But the rates are not high just because moneylenders are crooks and exploit their borrowers. Costs of giving small loans to a large number of borrowers in villages are high; so are the risks. They will affect MFIs as much as **they do moneylenders**, and MFIs will have to charge high rates if they are to survive and to put something by for expansion. Hence it is a thoroughly bad idea to control their interest rates, or their margins — and it is impossible to control both together, as the committee's chairman, **Yezdi Malegam**, a chartered accountant, should know.

More generally, the MFI committee wants to confine MFIs to lending to the deserving poor, and for that purpose, to collect considerable information about their income, their borrowings and so on. One wonders which world the committee is living in. A villager may do some agricultural labour while it is available. She may go and work on some public works if any are going on. She may go to the next town and do some domestic work. The poor find work wherever they can, and travel for it. The MFI committee

wants MFIs to pursue the poor and compile a record of how much they are earning, how much they have borrowed and from whom, and so on. It expects the itinerant poor to cooperate with the MFIs and give them all the information from day to day. This is unrealistic; if MFIs keep collecting such detailed information, they will be able to lend to very few.

But then, the MFI committee does not expect them to lend to the poor. It wants every poor person to join a “self-help group”, borrow through it, and repay through it. It wants the MFI to sit in the courtyard of the village council and wait for SHGs to come and transact business; it would prohibit anyone from an MFI to ever go near an individual's home. It has a closely defined, structured model in view: banks would finance a very small number of MFIs, MFIs would deal only with SHGs, and all SHGs would be attached to and sponsored by the establishment of the village. This would be very convenient for the RBI; it would simply reproduce its current model of bank regulation and extend it to villages.

It seems to me that the Malegam report has been designed to enable the RBI to keep close control of rural credit and to keep its hands clean. It is simply not concerned with creating competition, bringing down the costs of financial services, or taking to villages the variety of financial services that townsmen are used to or with encouraging innovation. As I have said, I have a high opinion of the RBI's competence. I also think that the government has created too many financial regulators, chiefly to create jobs for its favourite bureaucrats, and that we could do with fewer. But it could not make a bigger mistake than allow the RBI to regulate MFIs; that would be the way to deal rural financial development a death blow. In fact, the RBI's recent attitudes make me wonder if it has lost the plot. Maybe it should rethink its entire model of regulation.

## SHGs' challenges need unique solutions: Subir Gokarn

Dinesh Thite  
DNA, Jan 11, 2011,

**R**eserve Bank of India (RBI) deputy governor Subir Gokarn on Sunday said financial inclusion initiatives such as self-help groups (SHGs) require unique solutions for unique challenges. Merely an access to money is not enough in such initiatives. He was speaking after inaugurating the first specialised SHG branch of Bank of Maharashtra (BoM) in Hadapsar to provide financial services to SHGs in the district.

BoM chairman and managing director AS Bhattacharya, National School of Banking Management (NIBM) director Ashish Saha and BoM executive director MG Sanghavi, among others were present. Gokarn said BoM has shown commitment to financial inclusion by starting a dedicated branch for the SHGs and his presence at the function recognised the fact.

He said in case of financial inclusion, one does not deal with banking issues like others. These are unique challenges and they require unique solutions. Capacity to use funds, which are made available to

the beneficiaries, has to be developed for which training is required, said the RBI governor. He said the marketing of products or services of SHGs need to be ensured. The efforts of financial inclusion are successful if the three dimensions of credit, capability and marketing are taken care of.

BoM with its special branch for SHGs has recognised the need of taking care of all three dimensions. The bank should be congratulated for taking the initiative, said Gokarn. Saha said women's empowerment and social empowerment are at the core of SHG movement. BoM is a dominant stake holder in the SHG sector in Maharashtra.

Bhattacharya said the special branch of the bank for SHGs has a target of covering 1,500 SHGs in the district and lending Rs150 crore to them. Bank manager Ratna Ganapthy said the loan proposal of all SHGs in the district would be henceforth handled by the special branch. The SHGs would be provided services of documentation and consultation in the branch. By the end of this financial year, there would be a lending of Rs10 crore.

## Bhu: Sattva to source products made by rural women

BS Reporter, January 31, 2011,  
Mumbai/Ahmedabad;

**A**s 'Bhu:sattva', the organic textile division of Ahmedabad-based organic foods manufacturing company Rising Tradelink Ltd (RTL), plans to come up with its new range of organic home furnishings and spa products in a year's time, the company has decided to source the entire product range from more than **10,000 women** from across Gujarat.

Rising Tradelink has entered into a **memorandum of understanding (MoU)** with **Gujarat Livelihood Promotion Company (GLPC)** to associate with around 10,000 women across Ahmedabad, Bhavnagar and Surrendranagar regions of the state over the next five years and involve them in the production process of organic fabric. GLPC which is an implementing agency of the State of Gujarat for Livelihood Mission, named as **Mission Mangalam, under the National Livelihood Mission of Ministry of Rural Development, government of India.**

Jainam Kumarpal, managing director, Bhu: Sattva said, "We have already started work in the Surrendranagar

district and plan to scale it up soon. We will provide the raw material and infrastructure required for making organic fabric and related products, and the net investment from our side would be to the tune of Rs 40-50 crore." The company would also train these women through artisans and fashion designers from across India.

The project would involve **self help groups (SHGs) and each SHG would comprise 10 beneficiaries.** "These women would be provided training in different processes of the production of organic garments such as herbal dyeing, block printing, cutting and stitching, embroidery, khadi art and revival of languishing art forms", Kumarpal added.

Rising Tradelink will buy back the entire products range from these women and market it. He added, "We plan to source the entire requirement for our upcoming organic home furnishings and spa products range from these rural women, and expect the revenues from these products to touch Rs 400-500 crore within the next five years." The company will pay Rs 100-150 per day to each woman craftswoker, taking their average monthly income to the range of Rs 3,000 to Rs 4,500.

# SBI to set up 600 financial inclusion centres

K. Ram Kumar  
The Hindu Business line, 7  
January 2011, Mumbai,

In a bid to give back-end support to business correspondents operating in rural areas and also exercise administrative control on them, State Bank of India has decided to set up 600 financial inclusion centres across the country. The move to set up FICs is aimed at powering the bank's drive to reach basic and affordable banking services to 12,421 out of the 72,315 unbanked villages (identified according to 2001 census) having a population of over 2,000 by March-end 2012.

According to the Government and the Reserve Bank of India's directive, banks, especially from the public sector, between them have to ensure that all identified villages have appropriate banking services by March-end 2012. These services have to be provided using the business correspondent (BC) and other models with appropriate technology back-up.

As the FICs have been envisaged by SBI, each centre will provide the BCs back-end support services for opening 'no frills account', processing applications for micro-credit (up to Rs 25,000) sourced by them, and cash management. Further, the centre will also keep tabs on the progress made by the BC in furthering the bank's financial inclusion plan. Each FIC will support and control 25 BCs.

India's biggest lender has marshalled the services of 14,000 odd BCs, including those working with third-party technology service providers, for fulfilling its financial inclusion mandate. By March-end 2011, SBI will have 300 FICs. Last month, the bank set up 22 FICs in Andhra Pradesh and four in the **National Capital Region**. Overall, it will establish 600 FICs by March-end 2012.

## Basic banking services

"Under the financial inclusion plan, our bank is currently providing basic banking services in 1,300 villages. This number will jump to 5,300 by March-end 2011. We will complete the target of providing banking outreach in 12,421 villages by March-end 2012," said Mr M.I. Dholakia, Deputy General Manager, SBI.

A BC undertakes activities such as identification of borrowers; collection and preliminary processing of loan applications including verification of primary information/ data; creating awareness about savings and other products and advice on managing money and debt counselling; submit loan applications to banks; disbursement of small value credit, recovery of principal/ collection of interest, collection of small value deposits, sale of micro insurance/ mutual fund products/ pension products/ other third party products and receipt and delivery of small value remittances/ other payment instruments.

**SBI's rural outreach**

- To open 300 Financial Inclusion Centres by March-end 2011
- To open another 300 FICs by March-end 2012
- FICs to provide back-end support to Business Correspondents as well as control them
- The bank has been assigned 12,421 unbanked villages for implementing financial inclusion

Among others, the entities that can function as BCs include NGOs/ MFIs set up under Societies/ Trust Acts, Post Offices, retired bank employees, ex-servicemen, retired teachers, retired government employees, individual kirana/ medical/ fair price shop owners, Public Call Office operators, agents of small savings schemes of Government of India/ Insurance Companies, individuals who own petrol pumps, and authorised functionaries of well run **Self Help Groups (SHGs)** linked to banks.

# Empowerment comes the pickle way

BMC project transforms lives of 800 disadvantaged women  
Telegraph, 4 January 2011  
Bhubaneswar

The Bhubaneswar Municipal Corporation is doing its bit to help women from disadvantaged groups to become self-sufficient. Under the Urban Women Self-Help Programme, the civic body is supporting 800 disadvantaged women organised under self-help groups (SHGs). The programme is part of the **Swarna Jayanti Sahari Rojgar Yojana (SJSRY)** sponsored by the central government.

The programme aims to make women **living below poverty line (BPL)** self-sufficient. The corporation, which provides seed money to SHGs engaged in economically productive activities, hopes to extend assistance to another 200 BPL women under the scheme by the end of March. So far, 100 SHGs, each comprising eight women, have received seed money that can go up to a maximum of Rs 25,000.

The activities of the SHGs include making papad, pickle and badi besides manufacturing incense sticks, candles and phenyl. “The seed money per person is Rs 2,000 but can go up to a maximum of Rs 25,000 in case of a bigger group. We have the target of helping 662 women SHG members by December end. We hope the number will be more than 1,000 by March,” said BMC slum improvement officer Dilip Kumar Routrai.

The programme is part of SJSRY that aims to empower BPL women by helping them achieve financial stability. “To become eligible for help under the scheme, an SHG must have work experience of at least a year. Our community officers also check their status, their ability to work as a team and help each other.



*A woman member of a self-help group prepares 'papad' in Bhubaneswar. Picture by Ashwinee Pati*

After meeting the parameters, the groups are given the seed money to start ventures of their choice,” Routrai added. Durgabati Singh, president of Subhalaxmi SHG near Ruchika Market, said: “The scheme has enabled us to achieve self-reliance and economic independence. We have also learned management and marketing skills with the support of the BMC officials.”

Padmavati Das, secretary of Maa Siddheswari SHG of IRC Village, Nayapalli, said that besides promoting leadership among the urban poor, the central scheme would help change the face of slums across the city. Last week, several self-help groups such as Maa Siddheswari, Matrushakti, Padmalaya, Jaineswari, Maa Tarini were formed in IRC Village. Laxmi SHG was formed in ward no. 3, Jai Sriram Sahayata Runa Samiti in Kalpana area and Gopaljew SHG in Behera Sahi. “We have spoken to many marketing organisations to help the women SHGs sell their products. Soon, there will be training programmes for the SHG members,” added the BMC official.

# Syndicate Bank, Tata AIG launch micro-insurance scheme

Anjana Chandramouly  
The Hindu Business line, 28 January 2011  
Bangalore

All that Gowamma from Mayasandra village near Bangalore had to do for buying an insurance cover of Rs 25,000 was to get herself a bank account and set aside Rs 33.09 — for a whole year — from her kitty. At a little over 10 paise for Rs 1,000 a day, the micro-insurance product is something that's well within her reach.

As part of its financial inclusion initiative, Syndicate Bank has tied up with private insurer Tata AIG Life Insurance to launch its micro-insurance scheme. "Along with our bank products such as savings bank account, deposits and loan products, we thought it better to have a micro-insurance product which would go a long way for residents of villages, those with lower income and cannot afford to pay higher premium for life insurance cover," said Mr Ravi Chatterjee, Executive Director, Syndicate Bank, while launching the product.

## Insurance cover

The insurance product will offer both life and accident cover. According to him, the bank has a large network of branches in Karnataka, Andhra Pradesh and the national capital region (NCR), and "we will focus on these three areas for this product," he said. The bank was also planning to

come out with new products and the same product with different amount of cover, depending on the demand for this micro-insurance product and those staying the commanding areas of these villages.

Mr M. Anand, Senior Vice-President and Head – Alternate Channels, Tata AIG Life Insurance, told Business Line that his company was in talks with other banks for financial inclusion. "It could be the same product too. Product development is going on now, and it will take a couple of months for us to come out with new products," he said.

Through this relationship with Syndicate Bank, the insurer plans to cover five lakh lives by 2012. Syndicate Bank has been allotted 750 villages in the first phase and "we would work with business correspondents and branches to reach out to these villages," said Mr Anand. The bank has been allotted a total of 1,493 villages with a population of over 2,000 to be covered before March 2012, and has so far opened 3.5 lakh no-frill accounts.

## Pricing

On the pricing, he said that it was "affordable since it is a group product." He added, "We see this as a starting point to go bottom up and reach out to a larger mass, and this is the first-of-its-kind product that we are getting into in this space."

# **Important Upcoming Event**

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