Is Micro Finance leading to a Macro Mess
The AP Ordinance
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Micro finance started in 1966-67 with the Integrated Agricultural development Program and was adopted in several Govt. sponsored programs during the 80s and 90s culminating in the SGSY which amalgamated several of them. If several of these programs did not deliver as expected, the reasons were related to inadequate support services –especially in animal husbandry and agriculture , inadequate investment to support scaling up through aggregation, grading, adding value and marketing –AMUL being a major exception, corruption and poor targeting. Yet micro finance continued. The title of this article really refers to micro finance driven by pressures resulting from venture capitalists and other private investors which is characterized by quick growth, high profits, high cost (interest and remunerations especially for senior staff), IPOs and quick exits. This model is promoted aggressively by International Financial Organisations and is now rooted in India with the tacit support- so far - of financial authorities. I shall refer to this group as the Neo NBFCs involved in micro finance since they share a great deal with the neo liberals and International Organisations which promote their strategy. These Neo-NBFCs have become the dominant micro finance model between 2000 and 2010

The justification for this Neo-NBFC model are primarily these: a) it is sustainable; b) it encourages self help; it is based on the neo liberal principle that the poor should lift themselves up by their bootstraps and by inference Govt. should keep at a distance; c) it has reached the hitherto excluded sector where the official financial institutions have not penetrated and do not show any signs of doing so due to increasing corporate pressures arising from amalgamations, core banking, shortage of staff at the Branch level and a focus on a single bottom line namely profit (there are no champions of the SHG-Bank Linkage model at high levels); this reason is the main one behind the hands off approach with regard to Neo NBFCs of some sections in Government at the National level; the flip side of this is that official financial institutions have quietly shifted their social responsibilities to the Neo-NBFCs; this is the prevailing sentiment especially at the lower levels; d) it attracts private capital- private capital directly or indirectly amounting to Rs 2000 crore has flowed into the Neo-liberal sector ;this may be only 15%-20% of the total investment a large part coming from Commercial Banks but the influence of private investors on the Boards of these Neo NBFCs is far greater than that of the banks; and of late e) the share market supports the one Neo - NBFC that is listed and as long as this support continues, the investors also will do so.

High interest costs are justified because micro loans have high transaction costs and high risks. The best talent is required, hence high remunerations need to be paid which makes the Neo-liberal model a high cost one which the borrower finally has to bear. We are told that high interest costs can be reduced through technology and scale. All this sounds good - the right mix- especially since these Institutions were projected at least in the initial years as the real strategy for poverty alleviation. But suddenly the picture is becoming clouded due to several reasons which the media has highlighted.

The AP Ordinance, which is the Government's reaction to the changing scenario, refers only to the SHGs. In fact the Neo-NBFCs do not lend to SHGs; forming and training SHGs is too slow and requires up front investment in the form of grants or long term loans. They have instead formed Joint Liability Groups (JLGs) which experience has shown are neither joint or mutually liable or groups. Several policy makers in Government have supported the JLGs in preference to the SHGs since, the evidence shows, the JLGs are by far the quickest and cheapest way of disbursing credit. The SHGs require investment in institutional capacity building - which NABARD has supported since 1992; but it takes time - at least 6-10 months during which savings are promoted and internal lending starts before the Banks advance a loan. But today the name SHGs is a veil used by the neo NBFCs that covers (and justifies) many animals. In the long run however, the SHG model together with the SHG Bank Linkage is more sustainable especially for the borrowers.

To explain this a little further, we need to briefly trace the history and the concept of what a real SHG is. This history has been buried under media coverage promoting the fast growing Neo-NBFC model. Between 1984-1986 Myrada (an NGO) worked with the primary Cooperative Societies as the base institution. It realized that far from fostering the interest of all, the benefits went to a few powerful families including the President, Secretary and a few others. They borrowed at the official rates (6%-8%) and on lent to others at rates ranging from 30% to 40%. The poor were dependent on the powerful for jobs, immediate loans etc. Myrada encouraged them to challenge this situation., They broke away and formed small groups - the members were self selected; we later realized that the groups were based on affinity among the members. Affinity in turn was based on relations of trust and mutual support which existed before we entered. This was later called social capital and was the strength of people on which Myrada built. After several rounds of discussions they decided to return the loans they had taken from the Cooperative to their respective group. Myrada encouraged them to meet weekly; each member contributed to the agenda which comprised issues related to health, domestic problems, need for credit etc. They were encouraged to save and Myrada staff kept records of meetings and accounts. When they wanted money, they were encouraged to take loans from their savings which meanwhile had been deposited in a local Bank. These groups were the real cooperatives. Myrada approached NABARD in 1986 with a request to support this complimentary/alternate model.

NABARD provided Myrada with a grant of Rs 1 million in 1987 to train the groups how to meet, to participate, to analyse the society around them, to arrive at a consensus – it was called institutional capacity building (ICB). After several studies NABARD and Myrada came up with three recommendations for policy change to support the groups. The first policy decision was to allow Banks to lend to unregistered groups – this was based on the survey conducted by Myrada of its groups. They assured Myrada that they would function like registered groups but did not want to be registered – the reason? They feared harassment by petty government officials. Policy change in this area was difficult since the legal departments strongly supported lending only to registered groups.

It was Dr Rangarajan, as Governor of the RBI, who in 1992 decided to accept this. He said: "let Banks lend to unregistered groups". By this one stroke he liberated the SHGs.

The AP Ordinance completely overturns this historic decision. It requires all SHGs to be registered. However this is the result of the confusion cause by neo NBFCs between the JLGs and SHGs. I fully agree that the quality of the SHGs has declined due to Government's policy of achieving time bound targets to form and disburse funds to SHGs. The pressure to lend fast together with the total failure to provide ICB has caused this deterioration in SHG quality. The SGSY allotted Rs 10,000 for ICB but it was never used for training a group. The solution is to invest in ICB, not to register SHGs in order to control them and impose standardized norms; after all the Cooperatives are registered; this has not improved their governance. The AP Ordinance primarily intends to control alleged excesses that have emerged in some of the Neo NBFC management; but it will throw the baby out with the bath water and in this case the wrong baby.

The second policy decision was to allow Banks to give one loan to the group allowing the group to decide whether and how to lend to its members. This was easier to push through in official circles. It reduced transaction costs - this encouraged the Banks. NABARD and Myrada welcomed this because it promoted the SHGs members skills and confidence. This was accomplished because the group was free to discuss and decide on individual loans. The dialectic of this discussion together with the ICB training increased their confidence to talk and gradually their skills to lobby for their rights and entitlements without resulting in open conflict with the power structure. However it is necessary that the members of SHGs self select themselves on the basis of affinity. Unfortunately this policy of one loan to the group has been forgotten. Loans are given to individuals who happen to be in groups. The Neo NBFCs do not advance one loan to the group; they advance individual loans and claim that the members are jointly responsible even though they are not inked by affinity. In most cases they are selected by the NBFCs often from various existing SHGs; further no ICB has been given – because this is time consuming and costly. Government policy to give different subsidies to SCs, STs and Minorities has further divided several genuine SHGs which comprise all these communities and undermined social capital which still prevails in Bharat.

The third policy decision was to lend without physical collateral; the affinity and training was considered adequate. This did not meet with much opposition.

These three policy decisions have not been taken anywhere in the world. Due to them the SHG-Bank Linkage which was launched in 1992 by NABARD and nurtured by it thereafter progressed.

The need for supervision. Any financial institution especially the private ones using public funds from Banks need to be supervised. Concerned individuals have set up an apex organisation called MFIN - a self regulating initiative. But MFIN at most can black list those Neo NBFCs which do not fall in line with accepted norms relating to multiple lending resulting in large amounts which drive the client into deeper debt, to transparency in reports and acceptable behavior in ensuring repayments. As long as the share market supports the Neo NBFC, MFIN can do little to enforce norms though they may have all subscribed to them. The RBI is the next possible institution that can play a supervisory role. But do the Neo NBFCs want to morph into Banks? They originally lobbied for this on the grounds that credit would become cheaper but of late they are silent. Is this because they are hesitant to have officials on their Board or to be subject to RBI supervision? The RBIs position on this matter is ambivalent. The Govt. of AP has come in perhaps as the supervisor of last resort with the ordinance; but experience has shown that Government intervention especially in the Financial sector has had negative consequences all around- including a fillip to corruption - in spite of the good intentions of senior officials.

What can one suggest? All three perhaps have a role to play. MFIN can collect, aggregate and analyse data but it must also be free to meet the borrowers and verify reports. One sees no reason (apart from the costs in terms of time and personnel) why RBI cannot ensure that larger NBFCs in the micro finance sector conform to all requirements required of Banks. The State Government could intervene but not through the District Authority that the Ordinance proposes but through a fast track court (which the 0rdinance also proposes). The approach taken by NREGS to appoint Ombudsman at District levels could be an approach to adopt.

The AP Ordinance does not touch on interest rates. Flat - declining- effective interest rates are terms floating around. Each Neo NBFC interprets these differently. Yet flat rates of 26% are common among them. Official Financial Institutions hesitate to set a limit since they are apprehensive about being branded as supporters of non sustainable models or because it is difficult, they say, to monitor. But to be honest, if the clients are in the poor category can they really invest and manage businesses which earn a return of at least 80% to 100% if flat rates of 26% are to be paid. Are there any takers from the private organized sector for loans over 15%. Not for Profit MFIs with a low cost model have broken even and earned adequate surpluses at interest rates of 16% - 17% declining; why cannot the Neo NBFCs do the same?

A subsidised model not just for credit but also for creating wealth through upscaling, value addition etc, is required for inclusion in growth not just into the financial sector which is largely reduced to opening no frills accounts in Banks. Among the neo NBFCs and their institutional supporters, self help ideology has been interpreted to mean that the poor must pull themselves up by their bootstraps without any subsidized support. The burden is entirely on them. This model needs to be seriously questioned. Another emerging model in Vietnam which this author had the privilege of visiting is decried as non sustainable since it is heavily subsidized by the State. Vietnam based its approach on promoting financial institutions to cater to the credit needs at household level for better inputs, appropriate mechanization as well as at the secondary level directed at creating value through small scale processing, storage and packaging - these were small scale enterprises. These institutions were owned by the people or in partnership with government and they were low cost (no high salaries etc). Interest rates hovered around 13% declining. The impact has been a fall in poverty. It is not necessary to subsidise the cost of the assets but surely subsidised investment is required to provide the skills to manage then and for adequate support services for the asset to realise its potential for income generation. Subsidised credit is required to lower the risk to the borrower not to reduce the cost of asset.

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