Foundation Day Dialogue
on
"The Anxiety of Growth in Microfinance"

By

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Indian Institute of Management, Ahmedabad

Fourteenth Foundation Day of
DHAN Foundation - 2010

2nd October 2010

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178-B, Kamarajar Salai, Madurai

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person a sudden buffet in a five star hotel. This in the short run will harm the interests of inclusion. Hopefully all these will stabilize in the long run.

It is indeed a pleasure to be with you on this day and speak with you on the superior approach taken by the DHAN family that treats its people with dignity and honour. How I wish that the market models had the sagacity and vision to look at the poor as their long term partners and grow with them at a natural pace and get anxious about a handful of investors. I am sure with the models shown by DHAN, with the initiatives taken by the government and the RBI we have some interesting action and good news to hope for in the years to come.

Thanks for a patient hearing and I hope to continue to learn more from the experiments and successes of the DHAN family.

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going to build into a bubble sooner than later. We are possibly seeing such a formation in the market based microfinance sector now.

The hope that the demonstration of one market based experiment will attract more players has proved to be true. Now more and more organisations have entered this arena and are competing to lend to the poor. In the process they have put the "understanding" of the needs of the poor aside and have started chasing targets and numbers. For these institutions poor are not seen as human beings that have their individual identity, characteristic and need. Instead they are seen as data points that add up to their profit statements.

This anxiety for growth is partly dictated by the fact that this is a market based model and investors in the market based models are impatient and look for returns. The more the investors put pressure on returns, the more the pressure is on fast growth and this in turn makes the organisations cut corners to achieve growth.

The growth story of microfinance thus is giving enough cause for anxiety. In the process what happens is that we are creating an unnecessary storm in the lives of the poor by offering them something that is difficult for them to digest in such a quick time. It is almost like offering a malnourished standardized, we tend to lose sight of what the client actually wants or can afford. All that we are doing is effectively disbursing credit, in as efficient a manner as selling soaps and shampoos. This has its own merits. For instance in a largely agrarian society where large cash inflows happen only during harvest season and the local economy operates on general spikes of flows and peaking financial activity at the harvest season, forcing a weekly repayment is by definition defying the logic of the agrarian cash flows. However, by forcing this weekly discipline, these institutions have possibly expanded the market for credit, by forcing people to think about activities that give a weekly cash flow that can service the loan, and thereby could have made more cash move through their hands and reduced their vulnerability.

However, the downside of a standardized model is that unless you understand the cultural nuances of each location, there could be some locations where this model would provide a backlash. Doing business in Tamil Nadu and dealing with the poor is not the same as dealing with poor women in Bihar or Rajasthan. Therefore a standardized model for some reason closes innovation, responsiveness and customization. The other downside of a standardized model is that once the model has reached stability it expects to grow at a scorching pace. When something – particularly in the financial services – grows at an unnatural pace, it is

The Anxiety of Growth in Microfinance

M S Sriram[1]

At the outset I would like to thank the DHAN family for inviting me to deliver this keynote address. I am indeed privileged to have been invited to such an august gathering here in Madurai to an institution that has conducted itself in an exemplary manner that has been compassionate, inclusive and responsive to the needs to the poor. Being invited to be amongst you is in itself a great honour and I am indeed happy to be here.

I am an academic who travels a lot and learns from what people do. It is said that those who can, actually do things and those who cannot teach! I am not sure if I can teach, but possibly I could learn from most of what I see. I have been watching the growth of financial access to the poor as an interested academic for more than a decade now. We are in the most interesting phase of institutional interventions in the arena of financial inclusion now. This intervention along with some impacts has also brought forward some anxieties and I hope to discuss these anxieties in the next few minutes.

[1] Independent researcher and Adjunct Professor, Indian Institute of Management, Ahmedabad.

We all possibly know that there are three significant interventions that are happening in the field of providing universal access to financial services.

1. The people's movement which existed irrespective of government schemes, banks and other interventions by outside entrepreneurs. This movement has various names and has been promoted by various institutions that work in the area of civic intervention and empowerment. I put this as the first intervention, not only because it is one of the oldest interventions, but also because I am speaking under the aegis of DHAN collective, which has steadfastly worked in trying to put resources and decision making in the peoples' hands. We call this Kalanjiam here, and it goes by the name of self-help affinity groups when promoted by Myrada Bangalore and by the generic name of SHG movement across the country. This movement came from a groundswell of organizing people to sort out their financial mismatches mutually without an intervention of the outside world, and if there was an intervention of the outside world, it was a conscious choice exercised by the people collectively.
2. The intervention by the government which possibly pre-existed the people's movement in the form of SHGs. This intervention of the government has usually been supply driven, addressing the institutional and physical

will yield us instant statistical returns, but they would be qualitatively compromised.

Now let me come to the last part of my talk and the last type of player in the inclusion market. This is the player who is a product of the market forces. In the last decade there have been several people who for years worked in the developmental sector with communities getting impatient for growth and embraced a market based model of inclusive finance. The idea was that if we are able to make this activity of inclusive finance inherently profitable, then more and more people [who work for profits] will see merit in operating in this market and with a good number of players, the market will not only expand, but because of competition the poor customers would eventually get a good deal.

If we look at the developments of the market based models, most of whom follow an efficient credit delivery model, there is enough cause for us to be concerned. During the initial phases of the intervention of the market model, most of us looked at the growth of these organisations with a sense of awe. That was because these organisations brought in a great deal of efficiency in their operations. But we have to remember that the gains in efficiency are usually a function of standardization. Therefore when we examine most of these market-based models, they are also highly standardized. When we offer products that are highly financial services will be fundamentally redesigned in the coming years.

7. The RBI has removed caps on interest rates on all forms of loans [except agricultural loans] so that the banks can operate in the markets freely by fixing a fair interest rate that gives them a decent risk adjusted return. If this channel is opened up then the bankers should ideally see an opportunity in expanding their footprint and customer base of the poor, even if they charge high interest rates. We have to realize that whatever interest rates that the banks might charge, they would be very competitive compared to the alternative sources available to the poor. Hopefully this initiative will also help the banks to innovate on relevant products for the poor.

Given that these initiatives are not a part of the scheme but these initiatives are independent and aimed at building a larger institutional and technological architecture for inclusive finance, this would hopefully work better than the schematic approach that the state has implementing all these years. The impatience on the part of the RBI and the government to achieve the inclusion target and the anxiety should be seen in a positive light, because we are chasing the architecture and technology rather than targets of individuals and numbers. We all know that chasing numbers

infrastructure and also offered standardized supply side solutions that could be called schemes. I will discuss the current and changed role of the State in a short while.

3. The intervention by the market forces, which looks at the poor as a market and has found an interesting mechanism to deliver financial services – particularly credit – to the poor through an interesting and efficient delivery model. This approach is slightly more than a decade old, has made rapid growth and has lately been in the news for crossing certain milestones. The rapid growth of this segment has indeed encouraged us to look at the business from a different lens and we have a lot to learn from what could be happening in the field.

Each one of the above interventions touches the lives of the poor in some way or the other. Each one of the interventions has their own merit, grow at their own pace and have an internal logic that takes them towards certain achievable goals. However, the difference in each of these approaches is that they use different methodologies to reach out to the poor. These methodologies do have an important bearing on what it does to the process and also how it packages the financial services.

Let us take the first model first. The SHG model that was promoted as an alternative to the available sources of financial institutions was a model that was rooted in the community at one level and was integrated with the larger banking system at another level. This movement proved to be a bridge through which the poor were able to touch, feel and visit the large banks which for a long time were thought to be out of reach. This access happened by bringing people together, on the basis of mutuality on a common platform and providing the power of a collective. The approach therefore is by definition a slow approach because we need to get individuals together, bring them on a common platform, get a good understanding on how a collective based on the principles of mutuality works and also builds in patience, tolerance and appreciation of the constraints that our fellow SHG members face. This model makes the members of the mutual think about the financial services needs of not only themselves and their households, but also those of their neighbours who are members of the collective. This helps the members to think responsibly because they are dealing with their own money or the money of the members of the collective, which is almost like family. Very much the way a new bride takes time to settle down in her in-law's place, takes time to understand the customs of her new home and learns to live in a new environment, getting the collective to work and work efficiently takes time. However this methodology also ensures that people are together to narrate a growth story, narrate a story of their

hands of the poor, and hopefully this will help the poor to manage those resources responsibly.

3. The Reserve Bank of India has been talking about financial inclusion and has been pushing the banks to deal with the poor. Importantly it has liberalized its licencing policy in favour of unbanked areas by allowing the banks to open branches in locations that have less than 50,000 population without the need for a licence.

4. The RBI has also asked the banks to submit a financial inclusion plan and how they would provide banking services to villages that have less than 2,000 population in a clear timeframe.

5. The RBI has also taken initiatives to extend banking to the last mile by allowing the appointment of business correspondents, by allowing technology enabled business correspondents to undertake cash transfers to a limited extent and by encouraging mobile companies to be a part of the financial inclusion initiatives.

6. The mobile technology is the technology of the future. RBI has recognized this. With technology growing at this pace and evolving fast to meet the poorest, and settlements of transactions happening without the exchange of cash, it is possible that the access to

financial services in future. These are a series of unconnected initiatives and hopefully all of these initiatives will add up to better access. Luckily they have not been offered as a scheme and therefore we need to see the potential changes as game changers. We also should follow each strand of the development carefully in order to ensure that they do not fall into the trap of the anxiety of quick growth, quick achievement of ambitious targets but evolve at a pace that make them strong and lasting. Let me deal with some of the developments briefly.

1. One of the developments that would help the poor in accessing financial services is by getting an identity that meets with all the requirements of the know your customer norms of the banking sector. The launch of the Unique Identity Development Authority of India which has embarked on an ambitious project of maintaining a biometric identity of the residents and providing a unique number will go a long way in ensuring that the initial barrier to access is eased a bit.

2. The government has mandated that all payments that come from government schemes, particularly the MGNREGA schemes will necessarily have to go through a formal account. With the roll out of the MGNREGA scheme, the government is putting more money into the

confidence and how they took charge of their own lives and are feeling more confident.

This movement is very time consuming. The collective has to go through phases of forming, storming, norming, performing and depending on how cohesive the groups are, how quickly they see reason, this process will take time. It is not like meeting once, forming a group and from the next day onwards we have something to show. No. We have to ensure that this group understands the members mutually, irons out any differences, lays down the performance norms and then grows. Like it takes some time for the roof of the building to be cured, like it takes time for a seedling that is planted to grow into a full-fledged tree, this process has its own justification and growth process. Any external engineering or genetic modification could at best accelerate the process. Very much the way rice cannot be 'manufactured' in a factory but could be only a result of an agricultural process of growing paddy and processing it, the groups cannot be manufactured. They have to be nurtured and grown. If there is an organization like DHAN working towards promoting and nurturing the groups, its achievements are bound to be slow but exemplary. Even if the process is slow, we have to realize that the edifice that is built is strong and lasting. We also have to realize that this edifice could continue to serve the poor and marginalized on an auto-pilot basis without further intervention from outside once they stabilize. We know that many of the Kalanjiam cluster federations are headed by "DHAN Sirs", but we also know that these DHAN Sirs are actually paid employees of the community members. The day poor and unlettered women start hiring MBAs to manage their finances, we know that true empowerment has happened. This is no less an achievement than dairy farmers of Gujarat hiring somebody like Dr. Kurien as their paid employee. This shows that the poor can not only take control of their resources, but also as these resources grow, can hire professional help to manage their resources in a manner that is most beneficial to the community. Clearly this transformation does not happen overnight, but through a long process of community intervention.

Unfortunately, we are an impatient society. If something succeeds somewhere we are impatient to implement it quickly in other parts of the country. We believe that if a DHAN collective took eight years of work to have a group that could do civic intermediation, with some magic wand we can replicate this model where we could achieve these results in 8 months. Unfortunately we all know that it does not work that way. Herein comes the role of the government. I recall in one of the seminars Dr. N S Sisodia, the then Secretary Financial Services had said that one of the most dangerous things in a government programme is the success of a pilot. That is because once it works in Madurai, the

government will believe that it can be converted into a "scheme" and replicated throughout the country. The government deals with large numbers and its anxiety to deliver development at a pace that can do justice to the incumbent combination is understandable. However some of these do not fit into such a short horizon and would need investments to be made over a longer period of time. The government for instance learnt quickly from the SHG movement and decided to adopt this as one of its schemes. The bank linkage programme has been going on for years, with each year the government increasing the targets to the banks for linkage and porting several other welfare schemes on to the groups. When freebies are given, we have to realize that it makes the groups and individuals complacent. When somebody consistently feeds you, the need for you to earn your food becomes secondary. There is a difference between helping to earn your food and feeding you. The government, usually does not see this finer difference, because the way it is organized. Therefore it would be good for the poor to keenly follow the government "schemes" and pick and choose the ones that benefit them in the long run.

However, while talking about the government, we now need to realize that we are in interesting times. The central government and the Reserve Bank of India have taken several measures in the recent past that might change the face of how the poor, particularly the rural poor will access