

Editorial

The Centre for Micro Finance recently celebrated its first anniversary. Today, we are happy to release our first newsletter. Through Eye on Micro Finance, we will update our readers regularly on our activities, pilots, research projects and findings, as well as give a voice to our microfinance partners.

Who is the CMF? Through its research, consulting services and training, CMF responds to some of the most critical issues in the sector to support MFIs in their growth: understanding the sector better (why are recovery rates so high? how do people behave with respect to financial services?), improving and diversifying services (can repayment schedules be more flexible? what designs work for health insurance?), improving organizations (how to make organizations more efficient? how to improve information management?) and promoting a growth-friendly environment (what regulations are required for microfinance? how to share information?).

The goal of the CMF is to maximize the impact of microfinance in India: reach deeper, better. With the microfinance sector progressing fast, witnessing rapid changes and receiving a great deal of attention, it is imperative now, more than ever, to take a step back and analyze the impact that micro finance has had so far in improving the lives of the poor and think of ways in which this can be maximized in the future. The challenge today is making micro finance more accessible, customized, comprehensive and effective, while ensuring sustainable growth. In order for microfinance to be a useful mechanism for poverty alleviation, and to reach the 500 million under-banked households, several questions need to be answered and challenges to be addressed.

The Research Unit of CMF, with its 18 research associates, supports various initiatives aiming at better understanding which programmes work and which do not in order to help design

more effective interventions. In partnership with several microfinance institutions in India and leading academic institutions in India and abroad (including MIT, Yale, Harvard, NYU, and ISB), we undertake impact evaluations of various microfinancial products, experimentation on product design (with a focus on customer segmentation), analysis of microenterprise and constraints to productivity, as well as research on financial and organizational aspects of MFIs.

More recently, the MFI Strategy Unit has been set up within CMF and now has 6 members. Its objectives are to help MFIs define and execute their growth strategy. The MSU aims to do this by addressing some of the main constraints that MFIs face in terms of capital structure (equity/debt) and access to financial markets (venture capital, securitisation), HR (training, recruitment, incentives), organizational design (MIS, processes of operations, governance), marketing strategy (customer segments to target, products to develop to serve these segments, portfolio management) and overall strategy (SWOT analysis). Moreover, the MSU assists in identifying missing market linkages at the customers' level in co-ordination with MFIs and in selecting relevant partners to create these linkages (private companies, NGOs, government entities). This effort is being undertaken through close collaboration with MFIs and organization of thematic consultations. Some of the value chains the MSU is currently focusing on are dairy, handicrafts, fisheries, pulp wood and mint.

To reflect the fact that our research is action oriented, we have chosen to change our name and to call ourselves the "Center for Micro Finance", which we hope will soon become a full-fledged resource for the microfinance sector in India.

Is microfinance the solution? Yes, if growth is properly managed and questions are correctly answered. CMF will help this effort.

~ Annie Duflo & Sarah Djari | April 2006

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Introduction to the MFI Strategy Unit (MSU)

The MFI Strategy Unit (MSU) at CMF was created to address the issue of “missing markets” by building collaborations with sectoral experts to work closely with the MFI client base. The MSU engages in identifying these livelihood opportunities and building backward and forward linkages to increase overall productivity of the client households and give a boost to the local economy. In addition, as MFIs grow and professionally deliver a comprehensive range of services to a variety of credit-constrained segments, practitioners will need to be systematically equipped with a set of strong skills in banking and finance. The MSU also offers MFIs with training and consultation in terms of expansion strategies.

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Using Microfinance to Improve Dairy Market Linkages

It is well known that access to credit for the poor allows them to manage risks and engage in income generating activities. However, microcredit alone might not be sufficient to alleviate poverty. Apart from offering additional financial products such as insurance, remittance services and savings, Micro Finance Institutions (MFIs) could also address the issue of missing markets which prevent their customers from participating more actively in the larger economy, an issue which not only traps the poor in a never ending cycle of poverty (even with access to microcredit) but also prevents MFIs from scaling up. Examples of such constraints are poor/non-existent infrastructure, poor knowledge of best practices in the occupations MFI clients are engaged in, constrained linkage with markets, information asymmetry, health hazards and poor education.

For many MFIs, dairying is the most common micro enterprise adopted by their clients and in most cases cattle loans account for the largest share of an MFI's portfolio (for example Cashpor attributes 40% of its portfolio to cattle finance). With this in mind, the Microfinance Institutions Strategy Unit (MSU) at the Centre for Micro Finance (CMF) organised a consultation on the dairy value chain in early January where private companies, research institutions, NGOs and MFIs came to a common forum to identify missing market links in the dairy value chain and decide how new innovative business models could be created. As a result of this effort the MSU has created a strong network of potential partners and is following up to explore opportunities for each.

Feeding Innovation: Distributing Cattle Feed through MFIs

Spandana simultaneously started its operations in both rural and urban areas and has since expanded in both regions. The organisation recognized that there exists a significant variance between these two regions in increases in the credit absorption capacity of its clients and therefore in the improvement of their socio-economic status. The impact of micro-credit is much more evident in urban areas as opposed to rural ones.

Analysis revealed that livelihood options of the urban poor are significantly different from that of the rural poor. While the majority of the urban micro finance clients used their loans for activities related to trading and manufacturing, about 70% of the rural poor invested the loan amount into dairying activities. Clients in urban areas expanded their business in proportion to the availability of capital and some of them took up more than one income generating activity. Over time their businesses stabilized and they chose to acquire assets. In contrast, there was saturation in the credit absorption capacity of rural clients, as they did not find reasons (opportunities) to go for higher loans which would have augmented their income. Further, it became clear that rural clients who are engaged in dairying do not want to expand this activity beyond three buffaloes, despite there being a large market for milk and milk products. When asked why, the rural clients explained that beyond three buffaloes they would need to hire labor, and if they hire labor, dairying becomes unviable. From this discussion, it was evident that most of them, while calculating the profitability of dairying, do not take their own labor into account, leading them to believe that it is profitable. Once they factor in the cost of labor dairying becomes an unviable activity.

Spandana was surprised to find out that the main income-generating activity of 70% of its rural clients is unviable. Efforts were made to further understand this activity by interacting with the women engaged in dairy-

ing.

Some of the reasons identified were: increase in the cost of buffalo - the demand for buffalo has gone up since a large number of rural households have taken up dairying as an income generation activity. This has led to an hike in prices; dependence on middlemen/brokers for selection of buffaloes due to poor knowledge on aspects of breed and quality amongst women; dependence on neighboring villages for procuring buffaloes due to absence of linkages with the larger market and also the lack of institutional efforts to increase the quality and quantum of the cattle population; increase in the cost of fodder and nutritional supplements, accompanied by a decrease in the quality of nutritional supplements – including adulteration; and low milk yields.

Spandana realized that since women invest the entire loan amount in buffalo, they do not have enough money to purchase fodder and nutritional supplements, resulting in low productivity. Moreover, dairies pay prices that are far below what the end customer pays. The clients also felt that the demand for milk had increased. It was decided to tackle these issues one at a time, the first being the quality of supplementary nutritional cattle feed.

With the help of ICICI Bank, Spandana negotiated with different cattle feed manufacturing companies. A partnership with Godrej Agrovet, which expressed interest in and shared the mission of improving the yield of buffaloes and therefore the income of poor households, was established. In the initial discussions Spandana had with Godrej, they were assured that the buffalo's milk yield would be increased by at least 1 liter. As this feed replaced the traditional feed/brawn it did not result in additional cost to the client.





cial and governance variables within these institutions. The literature has tended to focus on the financial sustainability of microfinance rather than on its developmental impact. While tracking performance at this level is important, we should also be evaluating programs at a more fundamental level to find out whether, for example, providing financial services to the poor increases household's investment capacity and consumption, whether it reduces its vulnerability and whether it increases women's bargaining power within the households. The question of the impact of microfinance, and what are the channels of this impact has remained largely unanswered. While some celebrate micro-credit as

Prior to informing clients about this product, Spandana decided to pilot-test the feed to verify the claims. The pilot-test was done with two different breeds of buffaloes and an increase in yield of 1 – 1 ½ liters/day was observed within 10-15 days of using the feed.

Satisfied with the results, Spandana organized awareness campaigns in villages with the help of Godrej Agrovet. Information on the benefits of the feed, with an emphasis on cost, was given. Spandana also offered credit (to be repaid in weekly installments) to its clients for buying the feed and agreed to supply the feed at the client's door-step every month. So far, 625 women have procured the feed and most of them have had excellent results. So far Spandana has supplied 400 quintals of feed to its borrowers. Spandana sees this as a developmental intervention that helps its clients; as such, Spandana has not profited from the cattle feed program and is in fact subsidizing the program's operating costs.

Impact on borrowers:

Kalavathi of Sangam Jagarlamudi said "I have been using the Godrej feed since last month. It's great to see that my buffalo started giving 5 liters while it was only 4 liters earlier. My income went up by Rs. 400 per month. Earlier I was giving rice brawn to my buffalo. This feed (Godrej Agrovet feed) is not more expensive. Without any change in the expenditure, net income went up by Rs. 400 per month. I did not see any change in the fat percentage. I am extremely happy that the feed is delivered at my door-step. This should be continued forever. My buffalo looks healthier than before."

Kamakshi of Yadlapalli who has been using Godrej feed since the last five months is extremely happy and shared that the milk production increased by 1.5 liters per day per buffalo. Initially, she used half brawn and half feed, but now has completely replaced brawn with feed. She also said that the fat percentage increased from 7% to 8%. Her income went up by Rs. 1200 per month on two buffaloes.

Rajani of Chebrole said that her buffalo's yield increased by one liter in the morning and 0.5 liter in the evening and fat percentage went up from 9% to 10%. She said that if she stops using this feed, she will immediately observe a decline in the milk yield.

Evaluating Microfinance: Randomize!

The UN has declared 2005 as the Year of micro-credit, on the ground that "micro-credit has been changing people's lives and revitalizing communities". However, there have been very few good assessments of the extent to which microfinance has improved the lives of the poor, nor of the best and most beneficial ways to provide financial services to the under-banked.

What is the best way to provide financial services to the poor? What is the impact of microfinance on the socio-economic conditions of these households? Despite plethora of anecdotal evidence, we know very little about these questions. Substantial funds are spent on evaluating microfinance programs. However these evaluations often just evaluate organizational, finan-

cial and governance variables within these institutions. The literature has tended to focus on the financial sustainability of microfinance rather than on its developmental impact. While tracking performance at this level is important, we should also be evaluating programs at a more fundamental level to find out whether, for example, providing financial services to the poor increases household's investment capacity and consumption, whether it reduces its vulnerability and whether it increases women's bargaining power within the households. The question of the impact of microfinance, and what are the channels of this impact has remained largely unanswered. While some celebrate micro-credit as the unique solution to poverty alleviation, some argue that it does not have any ground breaking impact on its own.

As a matter of fact, it is very difficult to answer these questions. Imagine, for example, that a person received a micro-loan. Before the program, this person's income was 500 Rs per month, and after the program, it is 1000 Rs. At a first glance, it is tempting to attribute this to the micro-credit program. However, imagine further that in the same time, an income generating program was introduced in the village. The effect we see may be due to this rather than to the microfinance program. To solve this problem, some propose to compare borrowers and non borrowers within the same village. Imagine that a microfinance program is introduced in a village. It is likely that the most entrepreneurial people will be the ones taking up credit. One year after the program, imagine you observe that the person who took up credit is better off than the person who did not. Should one conclude that this difference between both persons is due to the credit program? Well, it is likely that the entrepreneurial person would have been better off in any case. It is therefore usually not appropriate to compare beneficiaries to non beneficiaries to infer the impact of the program. Now imagine that to avoid this caveat we decide to compare those villages that have a microfinance program to villages that do not. However, it is likely that the NGO would have targeted the poorest villages. Therefore, one might observe that the village that did

One of the main problems identified in the consultation was that dairying is perceived as a subsidiary activity by farmers. This means that people will invest the minimum input at the minimum cost in order to own cattle. However, farmers will continue to invest in cattle since they provide an additional source of income and can easily be liquidated in times of need, therefore serving the purposes of risk management mentioned earlier. A number of issues were raised with regards to availability of inputs such as breeds and feed, artificial insemination centres and veterinary health services. One of the main problems that farmers face is that while the prices of inputs has been increasing (with increasing sophistication and technological innovation) the farm gate price of milk has remained stable over the years. This is decreasing the margins for the farmer and will dissuade any large scale investment in dairying. However the dairy market is not over saturated and demand for milk and milk products is expected to grow at a steady pace of 4-5% per annum over the next decade. Improving the forward market linkages for farmers could have considerable impact on their incomes and might in turn encourage them to invest more time, effort and money into dairying to strengthen this process.

The MSU sees three ways that MFIs can play a role in increasing net revenues to the farmer:

1) Cattle finance. This is the core capability of an MFI and the one that can have the most impact. Most MFIs do not offer tailored cattle finance products that meet the needs of their customers. Loan size needs to increase in order to be able to purchase better quality breeds and repayment mechanisms need to adapt to the cyclical nature (lean and flush periods) of milk production as well as region specific constraints such as the payment schedule of the local coop/private company. The MSU has been researching the context specific constraints that the milk producing clients of each MFI face in order to develop innovative products that will ensure better investment with higher returns for both the MFI and their clients.

2) Making inputs and knowledge readily available to their clients. Since the core capability of MFIs is to offer credit the MSU agenda does not envision MFIs developing the capacity to offer credit plus services. However, we do try to promote win-win partnerships with other entities that can leverage the structure (weekly/monthly group meetings) and outreach (doorstep interaction with the most marginalized rural population) of MFIs to provide services and products. One example is that of Spandana, an MFI, which has partnered with Godrej Agrovet, cattle feed company, to offer doorstep delivery of quality cattle feed which can be purchased on credit at an affordable price. Basix, another MFI, supplies the services of para-veterinary health workers for a



not get micro credit is better off. This would not mean that micro-credit has a negative impact! Inversely, the NGO may have chosen to go to better off villages first, to avoid taking too much risk from the beginning, so that comparing those villages to others would result in an over-estimation of the program effect! The ideal comparison would be to compare Person A in one state of the world (with microfinance) to Person A in another state (without microfinance), at the same time. Of course, this is not possible, but researchers need to create equivalent situations. Dean Karlan has called such a valid control group the "holy grail of any micro-finance impact assessment".

Some studies have tried to go around the difficulties we just described, and create a control group, by comparing new entrants to old entrants. Studies using this methodology have become recently quite popular, as they are cheap and easy to implement. For example USAID, through its AIM project, encourages this methodology (Dean Karlan 2001). However, it is important to warn the donors and development community with several caveats. This method presents some advantages compared to the methodology mentioned above, as it considers only people who decided to take up credit, who should therefore be equally entrepreneurial. However, is the set of new clients the same as the set of old clients? No, because some have dropped out in the meantime, either because they were not successful or because they were very successful. Unless one compares all old clients (including the ones who dropped out) to the new clients, this methodology has therefore serious caveats. And following up with the old clients who dropped out is likely to be difficult, making this methodology less easy than it sounds at first. Even if one manages to do that, old clients joined earlier than new clients probably for a reason, and are therefore probably not the same as the new clients. Maybe the "best" clients joined first and the "bad"

clients last, convinced by the repeated coming of the loan officer or by mere imitation. In addition, the MFI may have witnessed institutional changes as a result of internal learning so that old and new clients may not have been subject to the same policies.

The cleanest and clearest way to establish the impact of microfinance is to run a randomized trial. Choose 100 villages, start a micro-credit program in half of

them (randomly chosen), phase in the program later in the other half, and in the meantime compare the outcomes in the two groups of villages. This approach requires that evaluation be built into the design of the original program and that data be collected on all 100 villages, which can be expensive. However, this is what we do if we want to know whether a drug or vaccine is effective, and new research is showing this technique can teach us a lot about development. Some would argue that such a randomization is unfair or hard to implement in practice. However, there is no organization that starts a program in the same time in all targeted areas: usually, it is possible to introduce randomization by randomly phasing in the order of villages to be brought into the program.

Having strong evidence about what works is important for many reasons. Non-governmental organizations (NGOs), MFIs and governments can use this evidence to focus their limited budgets on those programs that are most effective. Following such an evaluation, an MFI may be convinced to expand the same program since it proved to be very effective. The MFI may decide to add some changes into the design as it did not seem to achieve the desired effects. In addition, providing evidence to regulators that microfinance has a strong impact may convince them to mainstream in the regulated system; so far, it has not in India.

The evaluation of the micro-credit program of Spandana led by MIT's Abdul Latif Jameel Poverty Action Lab (J-PAL) in collaboration with CMF uses such a randomized trial. The first randomized evaluation of microfinance, it takes advantage of the fact that Spandana was planning to expand into Hyderabad slums. As mentioned above, the evaluation design was done before the programme started. A baseline survey was conducted in 100 slums, among which 50, randomly selected, have started re-

ceiving credit. As the 50 slums were randomly selected, they are on average comparable to the 50 remaining slums and the only difference between them should be the micro-credit programme. A follow-up survey will be conducted after a loan cycle has been completed (i.e. after about a year). After the study is completed, the 50 remaining slums will receive credit as well. Note that the impact of credit may be different after one year and after 2 years. Ideally, the randomized evaluation would last as long as possible. However, there are practical difficulties in doing this, as the comparison slums will be eager to be brought into the program. The study is therefore scheduled to last about 18 months. It is important to highlight that by comparing slums with and without microfinance we will be evaluating the impact of having access to credit, not the impact of taking credit (which for the reasons highlighted above, is not possible).

Of course, the results of the Hyderabad-PAL study may not be true for all India, as context may matter. It is therefore essential to carry out other evaluations of micro-credit programs, using the same methods, in other parts of India. MIT's J-PAL, in collaboration with CMF, hopes to conduct similar evaluations in other states and in rural areas.

The Sewa Bank Recipe

Jayshreeben Vyas, managing director of Sewa Bank in Ahmedabad shares the secrets of the Sewa Bank success. Sewa's objective: helping clients come out of the vicious cycle of poverty. Sewa's approach: staying close to the women, looking at their lifecycle needs and learning from them.

Sewa Bank is a cooperative bank based in Ahmedabad. It is the financial unit of the Sewa network of organizations which was founded by Ela Bhatt more than 30 years ago to empower urban self-employed women and help them come out of the cycle of poverty. More than 93% of the economically active women are self-employed and often lack formal protection and access to capital. Through its numerous sister organizations Sewa provides a variety of services such as financial services, savings, credit, insurance, business education, health care, procuring and marketing of members' products, lobbying and labor organization. Serving exclusively women, a vast majority of whom are urban poor, with more than 100,000 clients, average annual growth of more than 30% for the past 5 years Sewa Bank has demonstrated that poor self-employed women are bankable

and make great clients.

Q: Starting in 1974, Sewa Bank is perhaps the oldest microfinance institution, older even than Grameen Bank. You have been with Sewa Bank for 20 years. During these years a lot of things have changed – the economy, the clients, their lifestyle and necessities. How has Sewa Bank evolved with its clients? Have the priorities changed in any way?

A: *SB didn't have a blueprint to follow, we always learned from our experiences and mistakes. What was very clear from the beginning was that we were focused on our women members. We knew the goal was to improve the economic condition of these women by offering financial services. The systems and mechanisms were not in place. This is what has been evolving on a daily basis as well as products and services. Initially, we had only one simple saving account and one loan for any purpose. Then, gradually we realized that they need different products to match their needs. We looked at their lifecycle needs and have come up with various saving products to mirror those needs – various recurring accounts, savings for buying gold, for education, for marriage, for old age, etc. Similarly, we have developed a range of products within credit. We realized that women need loans for housing, for improving their infrastructure, for water connection, etc. We try to provide livelihood finance by integrating various products or forming partnerships with external programs – for example in the Parivartan project infrastructure facilities are key for the financial upliftment of the poor, so while as a bank we provide financing, we seek to support a program which would provide a holistic solution. We try to identify the needs our clients are facing, analyze and understand them – do they increase the clients' income or productivity – and lastly we look for ways to most effectively provide financing to address these needs and to link them with other programs and organization. For home-based workers, their home is their productive place, so any improvement in the home helps them increase their income. Similarly, in Ahmedabad in*

particular, a large proportion of the men were employed in the textile mills. With the closure of the mills, many of our clients' family members were becoming unemployed. There was a need to help these particular families, to create employment in their houses. And because these people were already used to working in a factory or in a mill with machines, they were inclined to get involved in businesses using machines. So, we created a special loan for buying machines designed for the ex-mill workers.

Jayshreeben Vyas was born and brought up in Ahmedabad, the home of Sewa Union. Trained as a chartered accountant, she started her career at the Central Bank of India where she spent 8 years as a financial analyst. Jayshreeben joined Sewa Bank in 1985, 11 years after the Bank was founded. For her 20 years at the head of Sewa Bank she says "every day is a challenge, and every day is a satisfying day because you see that you are being able to help the poor... You feel more effective, because you see that you are able to contribute to something." (photo: Taisie Berkeley)



Q: You have been talking about analyzing the problems and coming up with holistic solutions. You are also aware of the debate between the supporters of the livelihood approach - providing a package of services (such as education, health care, etc) together with credit - and the advocates of a more specialized microcredit-only approach which promotes the benefits of scale and argues that the beneficiary is in the best position to deploy the funds most effectively. Sewa Bank has a unique model: while it is a cooperative bank and specializes in financial services, it is a part of the large Sewa network through which it has access to clients' lives from multiple angles. How does it balance these two models and take advantage of its position?

A: *It does not need to be one or the other. We started very simple – with one loan and one savings account. Looking at the lifecycle needs of our clients we and at their reasons for borrowing – to repair the house, for marriage. And then the question arises: is it right to encourage them to spend on things such as marriage?*

"We have to remain close to our customers. If somebody asks – what is the learning point? – [banking the poor] is a relationship based on trust, and not simply a customer service."

On the other hand – who are we to teach them what to do? Thus, business training emerged naturally, as a way to empower them by giving them more information. Similarly, insurance arose from a survey among defaulters that we

fee to its milk producing clients.

3) A very large portion of the milk market in India is still in the hands of the unorganised sector (only 22-24% is accounted for by private companies and cooperatives). MFIs could identify the areas in which there is a need for better forward market linkages by identifying milk producer clusters and encouraging companies to procure milk from them (KAS Foundation is exploring such opportunities in Orissa with the Orissa Milk Federation). We are also exploring and measuring milk in a transparent way as well as transportation vehicles (two/three wheeler finance).

The consultation was organized by CMF in association with the Indian Society for Agribusiness Professionals (ISAP) and was sponsored by ICICI Bank. The MSU has also launched a discussion group where participants from the consultation and interested parties may take part to post further comments, requirements and opportunities for partnerships between MFIs and other stakeholders. To subscribe to this group please send an e-mail to cmfmsu-subscribe@yahoo.com.

Impact Study of Insecticide Treated Nets (ITNs)

In collaboration with BISWA, the CMF is undertaking a study to examine the impact of ITNs on health (particularly malarial morbidity and mortality), household productivity and labour supply, and willingness to pay and suggest the best mechanism to encourage uptake of treated nets, led by Professors Aprajit Mahajan (Stanford University) and Alessandro Tarozzi (Duke University).

The ITN study seeks to answer the following questions: what are the most appropriate preventive measures to combat malaria from a medical and behavioral perspective; what factors, financial and other, determine the usage of malarial prophylactics by the households and what are the intra-household patterns of utilization; what is the direct effect of these preventive measures on the lives of the individuals in the households; and the extent of externalities – the indirect effect of prophylactics on the other members of the community.

This project attempts to identify a high impact intervention which is complementary to micro finance and can have a strong and near-term impact on the household. If a positive impact is clearly discernable, it may be possible to design micro finance products to encourage the households to buy the nets and thus produce positive income and risk effects through increased productivity and lowered risk of ill-health, possibly maximising the impact of micro finance.

conducted. All of them had suffered a health shock or an accident in the family, which either exhausted their savings or forced them into indebtedness. Thus we realized that if we wanted to help them form capital we had to help them address the hindrances which were beyond their control. So, although we started from one savings and one loan account, now we offer Credit, Savings, Insurance. Looking at the lifecycle we have designed products and services, and have evolved them over time.

The second component is mechanisms. Everyone will say – what is so new in Sewa Bank? True we do the same door-to-door banking that everyone does. But especially with women we have found that we have to remain closer to them. If somebody asks – what is the learning point? It's a relationship based on trust, and not simply a customer service. For example during the riots, when the women were in relief camps, we went to see them just for concern and relationship. Especially in times of crisis, you have to remain close to them. Continuous contact – the reason we came up with the daily loan was that our NPA rate was going high after the shocks in Gujarat – earthquake, flood, riots. We realized we have to remain close to the women, to keep contact through transactions, and that is why we came up with bank sathis and daily repayment schemes.

Q: I can see how building trust and relationships is important, but doesn't that take up too much time and resources? Is it feasible in terms of maintaining growth?

A: *It depends on your structure. A neighbor trusts a neighbor more than an outsider. So, when you build a structure where the neighbor is given the power and the education about it, she becomes the best ambassador. And now, Sahara and others are starting to use this model too. You have Sahara agent in each slum, and Sahara is growing incredibly fast. But the biggest concern of course is quality. You need very good monitoring and control mechanisms.*

Q: So, would you say that the sathi level is the bottleneck to growing if you want to maintain quality?

A: *I wouldn't call it a bottleneck, but it is definitely a challenge. It needs to be a perfect system of monitoring. And even with the bank sathi model we can take advantage of collective monitoring. There are constant verifications and once a month all clients get together for a meeting and while talking about anything and everything, everyone's balance is read and tallied with our accounts. And thirdly, informal networks, which are perhaps the most impor-*

tant in our case. There is so much informal networks in Sewa Bank, that if anything were to go wrong in the field, you would get to know at the latest in 15 days. Look at the general manager and the head office manager – anyone can walk in their office and talk to them at any time. This is what keeps the flow of information right to the top to the decision maker. It is these informal system within the system which are crucial for monitoring. The message is there – the doors are open, our clients know that they can always come and talk to us, to Elaben even. And it's not just about being a good person - it is our strategy and it works.

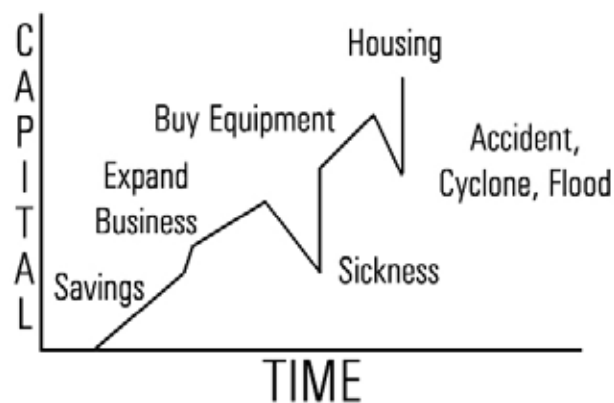
Q: We talked a lot about lifecycle needs and addressing them to get people out of the poverty trap. Are there mechanisms in place to graduate clients into more mainstream financial institutions?

A: *Like any other bank we don't want our clients to go elsewhere – we're a for profit organization. Our average loan size used to be Rs 500, now it is more than Rs 15,000. The maximum loan size has also increased to Rs 50,000 and we give up to Rs 100,000 in some cases. We do increase the limit and try to change with our clients so that we don't lose them. Coming back to lifecycle needs: the women who come to us initially are not at zero capital; they are at negative capital, indebted to moneylenders. They start saving, they start taking loans – initially small, to cover past debts. We have tried to find out what is the capital formation process and when do they fall back, when are they most vulnerable, what are the linkages. Then we try to design specific products. They have three kinds of needs. First, emergency needs – accident, sickness – and we have developed insurance to address them. Second, consumption needs – marriages, festivals. These needs can be planned. For them we have designed specific savings products and promote education and discipline. The third kind is productivity needs for which we design credit products. But the problem is in marketing these products. Our clients are people who live and think on day-to-day basis, from one crisis to another crisis. They don't know what insurance is, they don't know the difference between credit and savings, if a money lender offers a loan, they wouldn't bother to think about the interest rate, but would pay it as it is a social obligation. Thus, we started the financial literacy program to explain the importance of planning, what credit is and how savings accumulate to large amounts in the future.*

Q: How have the needs of your clients changed? You now have a special telephone loan, for ex-

ample. How does the way people's needs and way of working change reflect in their relationship with the bank?

A: We're finding a shift in purpose for which



Came out of the clutches of moneylenders

clients take out loans. Initially, there weren't many education loans for instance, but now people are seeing the importance of education – and not only school education but higher education as well. One of our directors is a rag picker – her daughter has become a doctor. And we see that education has become a priority for many of our clients whose sons and daughters have gone on to higher education.

The second thing is saving capacity. I don't know if it is because of the change in culture, whether they have formed a habit and that is the reason why they are able to save more, or whether their capacity to save has gone up. And this is visible also in the proportion of fixed deposits which has increased considerably to a point where now our fixed deposits are higher than the savings deposit. Thus, our clients have gradually started converting their savings into investment.

Q: In the past couple of years it seems that microfinance has been picking up speed with the entry of new players and interest from a wider range of investors. Do you think Sewa Bank will be faced with increased competition and would it change the way you operate?

A: I think the biggest advantage we have is that in 1974, when the 15 founding members decided to start the bank, when there was no other microfinance organization, they somehow came up with the right format. Tomorrow, I am going to Delhi for discussions about the designing a legal structure for the MFIs. But if you think about it, people came up with the appropriate structure 30 years ago – you have to be able to provide savings, to provide credit. The majority of the MFIs are able to provide credit, but

they are not able to legally collect savings. For example, I see a few organizations coming up in Ahmedabad but they are not a bank – and now the situation with cooperative banks is such at the moment that they will not be able to get cooperative bank status. Thus, they are not able to provide savings facilities and to achieve our range of products and services. Thus, competition is not really an issue at this point. On the contrary, most of them use our savings facilities for their clients' accounts. And this is not necessarily due to the characteristic of Sewa Bank in particular – what is great is the structure.

Q: So, would you say that regulation is the biggest bottleneck for the sector to take off?

A: Yes, but it's not going to get sorted out that easily (laughs). But if we want the sector to grow, four things have to happen: first is capacity building. There are 370 million informal workers in the country who are not getting access to financial services and who are economically active and who need financial services. Only 10% of them are getting these services. There is a need for building the capacity of the existing microfinance organizations, there is a need to build a cadre of experts in microfinance, particularly grassroots level experts, and there is a need to build an environment where a larger number of new organizations come up.

Second, there is a need for low-cost free flow of funds to the microfinance sector. Of course, this flow has considerably increased recently, but cost is also a factor. And this is especially important for the small microfinance organizations.

Third is legal structure. All said and done, most MFIs are SHG federations. They are registered as trusts and they cannot earn interest. If it is a NBFC (Non-Banking Finance Company) it can give credit, but it cannot collect savings. If it is a credit society, then yes, it can provide savings, but there are very few credit societies because of the high state control. In only a few states has the Mutual Aided Cooperative (MAC) Act been passed allowing credit societies to exist without government control. What we're saying is that the poor need three basic financial services - credit, saving, and insurance – and the structure should allow for that. We are also asking for an apex organization which will oversee the sector – not only monitoring, designing prudential norms, but also ensuring that the funds are channeled properly and fa-

cilitating the environment by rating the MFIs, registering and recognizing them. It will be both a regulating and a facilitation and development body – it will regulate the sector, but it will also ensure that good organizations get funds.

And the fourth thing: the need for microfinance is so much that unless the formal banking organizations get involved in the microfinance system, the MFIs alone will not be able to cover the need. In the past 30 years, we have either developed structures, the SHG model, the MAC Act, or adopted existing structures; we have designed products and services, we have designed mechanisms; and we have proved to the country and to the world that the poor are bankable and that it can be done at a low cost. Ultimately, what we want is access to financial services to all who need it, and I don't think that the microfinance sector alone can do it – the formal banking sector has to step in. Because 90% of the working population is in the informal sector, and only slightly over 20% have a savings account. And I see savings as the biggest potential for the poor – they need individual savings, they need voluntary savings... if motivated and facilitated, they can save!

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