

## Is Microfinance Too Rigid?

*Sameer is a farmer who subsists on three acres of land in rural India. While much of the land is fertile, nearly 50% of his income goes towards the interest payments from money-lender loans, loans which are necessary to finance his crops. Moreover, some of his land is unused because he cannot profitably finance irrigation at the money-lender's rates (5 to 10% per month). As a result, his family's nutrition and education are compromised.*

*Angela runs a small provisions shop in the city. For her business she has many financing needs from working capital to longer term investments. Luckily there is an MFI nearby which she uses, yet she only uses it to finance a part of her needs. For the remainder she chooses to use the money lender who charges a much higher rate, even though she could borrow more from the MFI. When asked why she responds that she likes the money lender's "flexibility" of allowing her to skip payments during the hardest weeks.*

**We** feel these two examples illustrate how, despite years of stunning growth, MFIs still fulfill only a small fraction of the financial needs of the poor.

Being poor is not just about having too little income. It is about having insecure income. The income of the poor can vary dramatically from day to day, month to month, season to season. Contrast this with the single most salient fact of micro-finance: nearly all contracts are fixed in their repayment schedules. This mismatch between debt payments and income can create serious distortions. Are these distortions inevitable? The implicit presumption is that they are. Many good reasons have been articulated for using fixed debt contracts.

First, a flexible payment stream may generate many operational headaches. For instance, portfolio monitoring requires clear information on default status. It may be difficult (or impossible) to distinguish between someone exercising their flexibility and someone intending to default further. The faster lenders deal with default, it is often believed, the better they are able to recover the loans. Furthermore, depending on how the flexibility was structured it could cause confusion in the field. It is easier to train

staff to collect equal and constant weekly payments. The flexibility should be such that staff can easily understand and implement it.

Second, cash management problems may arise. If clients experience correlated shocks (e.g., floods or droughts), they may (should!) use the flexibility to help smooth out those shocks. This has implications to the lender, if they are seeing a shortfall in repayment at the exact moments they want to have more cash on hand to lend to individuals.

Third, flexibility may put the lender at risk of loan officer fraud. The loan officer, for instance, can claim that the client exercised their "flexibility" when in fact they repaid. Proper internal controls should be able to mitigate this risk, but it is an impediment nonetheless.

Lastly, varying contracts might weaken the repayment discipline of borrowers. Some argue that the key difference between debt programs and savings programs is that debt provides a commitment to make weekly payments, whereas with savings there is no such commitment. This is one reason ROSCAs and chit funds exist, to provide individuals a commitment to save. If the debt requirement allows some flexibility, some fear this will erode the repayment discipline. Borrowers may forget which weeks to pay and which not, or find it hard to switch on and off the habit of putting money aside to pay the loan. Either way, the fear exists that having a few weeks off will lead to lower repayment when the payments are needed most.

These costs of flexible contracts are often better articulated than the benefits. Yet qualitatively, the benefits could be huge.

First, rigid contracts may greatly constrain loan size. If I earn Rs. 50 some weeks and Rs. 550 other weeks, my debt capacity is not based on my average income of Rs. 300 but on the Rs. 50 that I can afford to pay in the bad weeks. As a result, borrowers with variable income and little means outside of money lenders to smooth that variability will be given a debt capacity much lower than is ideal.

Second, flexibility can actually save on loan officer time. If every monsoon, we know clients have a difficult time paying, might it not be more cost-effective to have lower or less frequent payments during that period rather than

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## Microfinance in Fisheries

Despite MFI penetration into rural areas, a large number of informal credit markets still operate widely within these areas. Fishers are one of the most vulnerable targets and often enter into exploitative relationships with money lenders that inhibit them from investing in production, establishing micro-enterprises, or scaling up their activities. One of the most frequently observed money lending schemes is operated by intermediaries. Under this system, fishers borrow money from an intermediary to purchase or repair a boat or to stock up on food and supplies for long fishing voyages. They are then required to sell the catch to the intermediary at 20 to 30% less than the market price instead of selling it directly on the open market. This acts as both principal and interest repayment. Fishers often receive credit from the same intermediaries in case of emergency to cover the expenses of marriage, to repair damaged equipment, or to purchase a new boat. In such situations, borrowers pay interest rates from 60 to 100% per annum. It is common to find fishers who have been unable to break out of the debt cycle and who continue to borrow in order to repay debt. Another practice is one where a boatless fisherman borrows a boat from a rich person with several boats. The boat owner decides whether to rent the boat out or not after reviewing the expertise and the past record of the fisherman. Under the terms and conditions of acquiring the boat, the fisherman is required to provide a share (65-75%) from the catch to the boat owner.

One of the factors accentuating the money lender dependency is that there is often intense competition amongst fishers. Fishers are hunters and gatherers competing for a common yet easily depleted resource. While there are plenty of fish in deep waters, small scale fishermen are unable to reach that distance since the boats they use only allow them to go a limited distance from the shoreline. As a result, people in fishing communities do not network as much to assist each other in times of need, and, in the absence of these safety nets, fishers increasingly turn to moneylenders. Having no access to formal channels of credit or collateral to do so only aggravates this situation.

Small scale fishermen, traders, and fish processors face the same problem as any other person from poor and marginalized communi-

use valuable loan officer time to chase down “delinquent” clients?

Third, the rigidity of contracts may effectively be keeping some lucrative borrowers from borrowing. Client retention is an issue for many MFIs. Perhaps many leave because they experience too many “close calls” and then drop out in order to avoid going into default. Or perhaps out of this fear, they never join in the first place. Thus flexibility may increase client retention and help attract more clients. Ironically, these clients who leave, or never join, because of fear of default are “dream” clients for the MFI. They are clients of such strong integrity that they refuse to borrow for fear of defaulting.

Finally, flexible contracts may greatly increase the impact of the loan. Clients with rigid contracts may take actions which reduce the return on their investments. Owners of milk animals may under-feed during difficult times. Asset owners may sell off (productive) assets to repay debts. Flexibility would prevent the destruction of this value and could be as useful as the initial loan itself. Moreover, this increased income could actually allow the MFI to further increase loan size.

Given these benefits, how can we practically implement flexibility in the current micro-finance structure? We give three examples, each highlighting a different element of flexibility.

First, we observe that flexibility can be pre-built into the contract. For example, the monsoon is a difficult time for everyone. Contracts could reflect this by reducing payments during this period in a pre-specified manner. Similarly, dairy farmers face two months a year without milk. Again, the contract could pre-specify a smaller loan during this period. Pre-specification of flexibility has many benefits. Notably, the client does not feel that she can negotiate down other payments. The flexibility is not after the fact. It is actually a “rigid” flexibility, with tightly delineated rules. As a result, it also eases concerns of MIS, cash management, and loan officer fraud.

Second, one could provide less rigid flexibility by pre-specifying a number of low payment periods, but not their timing. For example, one could give clients several tokens and tell them that each token can count for one weekly payment. In this way, the client agrees to a slightly higher payment each week in return for getting a few difficult weeks (of their own choosing) off. Again, the creation of a token ought to ease the logistical problems of MIS, cash management and fraud. Yet it still provides the borrower a great deal of flexibility.

Finally, consider an MFI who feels that their borrowers could handle Rs. 2,000 higher loans than they currently receive. Should they just increase the initial loan size? What if instead they told all borrowers that they would be eligible for a Rs. 2,000 second loan, at any point during the cycle? This second loan might actually help the client more than simply increasing the initial loan by Rs. 2,000 since it gives the client a safety valve in case of emergencies.

Will these products work? Or will operational hurdles prevent them from working? Will they erode repayment discipline and increase default? Or will they allow for much larger loan sizes and greater client income growth? We simply do not know. A common retort is that borrowers can use other sources of income or debt to fill in the gaps. This misses the basic point about the financial policy for the poor: these alternatives either do not exist or are very expensive. Why cede this important and potentially lucrative financial service without ever testing the waters? There is only way to know if microfinance can be more flexible: to test flexibility.

Much remains unknown in microfinance. We focus here on one issue in particular: the flexibility or rigidity of debt products. Nearly everyone feels they know how to structure a micro-finance loan. Yet everyone differs on the answer. We label these as unknown not because nobody knows the answer but because we all “know” different answers. The goal of our research around the world, as with the Center for Micro Finance in India, is to bring about consensus.

## Clearing the Smoke: Improving Health Using Smokeless Chulas

Take a guess. What do you think is the biggest killer among children under five years in India and elsewhere in developing countries (besides deaths from various perinatal conditions such as asphyxia or birth trauma)? Malnutrition? Unsafe water? Malaria? HIV/AIDS? No. The answer is acute lower respiratory infections (ALRI)<sup>1</sup>. Never heard of it? You shouldn't really blame yourself.

ALRI refers to various infections of the lower respiratory tract—mainly caused by bacteria in developing countries—the most serious case of which is pneumonia. Although ALRI is estimated to claim the lives of 256,000 Indian children each year<sup>2</sup>, only a limited effort has been made

1 WHO. (2003). *The world health report: Shaping the future*. Geneva: World Health Organization.

2 Desai, M.A., Mehta, S., & Smith, K.R. (2004).

to bring it to the attention of the international community—much less than what has been done for the fight against the other problems you might have guessed. “Air pollution kills infants in the US,” says Michael Greenstone, of MIT (one of the professors involved in a CMF study and an international expert on the health impacts of pollution), “but it is even more deadly in developing countries, such as India. Yet, this issue is not very often discussed there, and as a consequence reliable solutions remain elusive.”

According to Desai et al., 36% of all ALRI is attributed to indoor air pollution (IAP)<sup>3</sup> from the use of biomass fuels (fuelwood, animal dung, crop residues, etc.) for cooking, heating and lighting<sup>4</sup>. In a typical household cooking with biomass fuels, the level of particulate matter (PM10), which is one of the health damaging pollutants due to IAP, is as high as 300-3,000µg/m, 2 to 20 times higher than what the U.S. Environmental Protection Agency considers a safe level<sup>5</sup>.

And ALRI is not the only burden due to IAP. Studies have shown that chronic obstructive pulmonary disease (COPD) in women above 45 years has a strong and consistent association with IAP. COPD is estimated to claim 106,000 Indians every year<sup>6</sup>. Other outcomes for which evidence is moderate or tentative include otitis media, asthma, low birth weight, tuberculosis, cataract, perinatal mortality, and nasopharyngeal cancer and laryngeal cancer<sup>7</sup>.

IAP affects India more than other countries. It is estimated that 86% of rural and 24% of urban households still rely on biomass fuels<sup>8,9</sup> and that about 400,000-550,000 premature deaths are attributed annually to solid fuel<sup>10</sup>.

The victims of these diseases are predominantly women and very young children reflecting the

fact that women are responsible for cooking in many parts of the society where IAP widely prevails and the youngest child in a family is often carried on the mother’s back during cooking. Furthermore, in addition to these health impacts, there are indirect negative effects associated with the use of biomass fuels. Studies show that women and children spend one and a half to two hours a day collecting fuel<sup>11</sup>.

The burden of IAP is disproportionately higher among the most vulnerable populations in the society—women and children—and there is a vicious circle between IAP and poverty. Worsened health leads to higher health expenses and lower productivity, and thus lower income. Poverty exacerbates the dependence on more polluting energy sources and means less resources for pollution abatement and health care.

Interventions to eradicate IAP require orchestrated actions that range from changes in national energy policy and infrastructure of energy supplies, to changes at grass-root levels such as promoting trained health workers or changes in housing structure (more well-ventilated houses) and cooking behaviors. Some of these actions are resource intensive. Others may require decades to actualize.

One of the solutions that many believe can have an immediate effect is the adoption of smokeless chulhas (cooking stoves). The smokeless chulha, which is simple in design and mechanism, operates similarly to the traditional chulhas families are used to, except that it has a chimney. Its fuel efficiency is also higher<sup>12</sup>.

In the 1980s and 1990s, both India and China implemented large scale smokeless chulhas programs. But despite the scale of the Indian and Chinese programs, or similar programs elsewhere, only few evaluations of its effectiveness, in terms of health impact, reduction

11 Harwick, H. & Doig, A. (2004). *Smoke – the killer in the kitchen: Indoor air pollution in developing countries*. London: ITDG Publishing.

12 Although more detailed studies are necessary, smokeless chulhas on average achieve a reduction in the fuels by 30-50% compared to traditional chulhas.



in fuel usage, or economic outcomes, has been conducted up to date. This is particularly important for the following reasons: smokeless chulhas are a much cheaper option (a chulha itself costs about Rs. 200-300 or \$4-6) for rural populations compared to alternative interventions, such as LPG or electrification of rural India. It requires simple skills to build or repair, which is one of the primary factors for higher take-up and continuous use. Therefore, it has a high potential, if proven to be effective, as a remedy for and relief from the burden of IAP in India at least until these people finally receive the benefit of much cleaner fuels.

The project that the Centre for Micro Finance is currently undertaking in collaboration with the Abdul Latif Jameel Poverty Action Lab at MIT (J-PAL), the Joint Program on Science and Policy of Global Change at MIT, and Gram Vikas—an Orissa-based NGO—is the second study to date to rigorously evaluate the impact of intervention for IAP,<sup>13</sup> and it is the first such study with a focus on the impact of IAP on economic outcomes, such as labor supply, accumulation of wealth, and health expenditure, through a large scale randomized evaluation. “This project has the potential to clearly demonstrate what many have hypothesized, but no one has shown

13 The first randomized study on this issue is the study in the Guatemalan highlands, lead by professor Kirk Smith of UC Berkeley. See, Smith-Sivertsen, T. et al. (2004). Reducing indoor air pollution with a randomised intervention design – A presentation of the stove intervention study in the Guatemalan highlands. *Norsk Epidemiologi*, 14(2), 137-143.

*Indoor smoke from solid fuels*. Environmental Burden of Disease Series, No.4. WHO

3 Desai et al.

4 Although use of coal is another source of IAP, the discussion here is restricted to biomass fuels given the prevalence of the coal use to meet everyday energy needs in India is very small.

5 Desai et al.

6 Desai et al.

7 WHO. (2002). *Addressing the links between indoor air pollution, household energy and human health*. Geneva: World Health Organization.

8 The proportion of people worldwide relying on biomass fuels and coal is about 50%.

9 Balakrishnan, K. et al. (2004). *Indoor air pollution associated with household fuel use in India*. Washington, D.C.: World Bank.

10 Smith, K.R. (2000). National burden of disease in India from indoor air pollution. *Proceedings of the National Academy of Sciences*, 97(24), 13286-13293.

ties: they require small frequent loans and are unable to match collateral requirements of formal financial institutions. Additionally, formal financial institutions do not have the required outreach in terms of branch networks in the areas where small scale fishers live. Apart from business-related loans, there is also a big demand for consumption loans within fishing communities. In short, fishing communities are a good potential target customer segment for MFIs; given that credit products can be developed to service the specific business needs of these communities, there is ample scope for MFI involvement.

In the state of Orissa there are over 100,000 fishermen (both marine and inland) clustered into approximately 4,000 fishing villages. Note that women also play an active role in this sector, and that they are typically engaged in post harvest technology within the fisheries sector. Once the fish land on shore, it is the woman's responsibility to process and market the catch brought by her husband or relative. There are around 170,000 fisherwomen involved directly in post harvest activities associated with fisheries.

The CMF is currently undertaking a project in six coastal districts of Orissa to address the gaps in the provision of credit access to fishers and is helping fishers to develop skills and knowledge through tie-ups with training institutions, consisting mainly of government entities. More importantly, such institutions would be able to guide them with respect to quality, grade, and size requirements of the fish variety that is demanded in national markets. Moreover, the CMF is seeking to improve the market linkages for fishers either by directly linking producers to markets that will offer a better price or by supporting the development of cold chain infrastructure.

The main areas of focus have been:

- » Boats and nets finance (inland and marine fisheries)
- » Fish culture in small (sometimes leased) ponds of up to 1 ha water spread area (WSA)
- » Shrimp culture in ponds (up to 1 ha WSA)
- » Market linkages for low cost value added product (dry fish)

In Puri, the CMF is also working with KAS Foundation and the Gajlaxmi Primary Marine Fisherwomen's Co-operative Society (GPMF-



so far: sustained improvement in health and economic well being among beneficiaries" says Esther Duflo, the director of J-PAL and one of the professors involved in the study.

But why does the Centre for "Micro Finance" care about IAP?

Through this project we hope to see indisputable evidence that smokeless chulhas bring about better health and economic conditions. Subsequently, many MFIs will be able to market them to their clients with loans. Better yet, MFIs with health insurance services may be able to offer lower premiums to their clients with smokeless chulhas if it is shown that they lower the likelihood of contracting certain diseases like ALRI or COPD. We hope to see that smokeless chulhas provide users better health and higher productivity and help them become more solvent borrowers.

The Centre sees far into the future for the development of microfinance industry, and above all, for the rural populations who are suffering from this deadly smoke everyday.

## No Nonsense: A Candid Interview with Malcolm Harper

Malcolm Harper has been working in development since 1970, initially in East Africa and then world-wide. He has since 1991 worked mainly in India. He has published widely on various aspects of self-employment, enterprise development and micro-finance. His research

and consultancy work has been supported by a wide range of national, international and non-government development agencies. From 1996 until 2006 he was Chairman of Basix Finance of Hyderabad, a leading 'new generation' micro-finance institution, and he is Chairman of M-CRIL of New Delhi, the pioneer of micro-finance credit rating in Asia. He was also the founding Editor-in-chief of the journal Small Enterprise Development, and is a director and trustee of a number of other institutions, including Homeless International, EDA (UK) Limited, APT Enterprise Development and Intermediate Technology Publications in the United Kingdom.

**Q:** BASIX has moved away from calling itself an MFI. What differentiates BASIX from other institutions?

**A:** *BASIX sometimes calls itself an MFI when it's convenient to do so. BASIX is a rural finance institution, although our head office is in Hyderabad. We deal with people who are not traditionally MF clients, because we believe they*

*create jobs for poorer people and that most people actually want to have jobs and don't want to be self-employed. Only approximately 30% of BASIX clients are women, who are the classic micro-finance client.*

*The main thing*



that differentiates BASIX from other MFIs...is the emphasis on livelihoods. We call ourselves a livelihood promotion institution and even at the level of the agents who work in the field—our customer contact people—we call them livelihoods promotion people. So it's about livelihoods, which is enormously difficult, but I think well worth doing. Anybody can do microfinance but livelihoods are more difficult.

**Q:** Anybody?

**A:** ...if you've got a few million people—or hundreds of million people as you've got in India—whose only source of finance has been the moneylender at 10% a month, and you come in with money at 2% a month, it's hardly surprising that they buy it. And if you're allowed to offer savings, and pay an interest that's secure and not run away with your savers' money to the next town or Dubai, and if you offer insurance as well, it's even easier. It is surprising that people make so much of microfinance.

**Q:** With livelihoods work more complex—this raises this question of the relative merits of microfinance and microfinance plus, and implications for sustainability and scaling up that may come along when MFIs try to provide more than narrow financial services.

**A:** I'm not to do with BASIX anymore and perhaps this sounds arrogant, but I don't think BASIX is a model for other institutions. As well as being the only local area bank—LAB—which is doing microfinance or development finance, it's also a "lab" in the other sense of being a laboratory. It's doing all kinds of interesting, experimental things, some of which fail, some of which work. It manages...to make a bit of money in the process, but it is not a model. It is a place where all kinds of innovative things are being done, from which we hope others will be able to learn.... I think anybody who tries to replicate the complete package of BASIX activities somewhere else would be making a mistake.

**Q:** If BASIX is non-replicable, will it become non-scaleable?

**A:** Not non-scaleable. It's growing very fast, though not as fast as some of the single-purpose MFIs.... It's growing pretty fast by normal standards, but at the same time it has been constraining its own growth by its insistence on providing livelihoods services to those clients who need them, as well as financial services.

**Q:** Do you think there are things BASIX should have done differently?

**A:** My regrets about BASIX—if that's the right word—apply to all microfinance in India and indeed the world over. It's pretty pathetic that we are still—not wholly, but quite importantly—dependent on foreign sources of money, although

Indian debt is becoming available so here the foreign money is mainly for equity now. I find it very sad that in a country as rich as India, something as small and modest and essentially local as microfinance should have to depend on the United States, or England, or Holland for its risk capital.

The second regret... is that BASIX had not focused our activities in fewer locations so that we could say "look at this place"—not even a district, but even one block or two—which had been somewhat revolutionized by our impact. There are good reasons for being all over the place, from Rajasthan to Jharkhand to Tamil Nadu, never mind our center in Andhra Pradesh. But it's expensive, time consuming, and impact-diluting to be scattered... although I supported that strategy in the beginning because it's good to take microfinance to underserved places.

**Q:** There is a huge inequality in access to financial services between the north and south. In Tamil Nadu, where the CMF is located, we're in the middle of diverse microfinance activity. But from our projects in the north and east we're constantly reminded of the differences in access and quality. Why is it so difficult for microfinance to get a toehold in the north?

**A:** Interestingly, three or four years ago Tamil Nadu went through something not as dramatic or extreme as Andhra Pradesh, but went through a usury act problem where they wanted to cap interest rates. They've managed to come out of that, but at the time Tamil Nadu might have been portrayed as the least attractive place in India for microfinance. But you speak rightly of Tamil Nadu as a good place to do business.

One of the reasons for BASIX spreading itself is its desire to get out of the (until recently) easy environment of Andhra Pradesh and the south in general. We've been driven by livelihoods in the north, rather than financial services....

Microfinance in the north is difficult for the reasons that any development work is difficult: the nature of the work of this kind is that those who most need it are the most difficult to get it to. Whether you're talking of communications, or physical safety, or levels of corruption, or force of illegitimate interests that don't want you to do business there, or the apathy of people, all kinds of reasons that make it difficult to deliver health services, primary education, anything else.... I don't think there are any reasons peculiar to microfinance. It's just that the reasons places are poor also make it difficult to make them less poor.

*Microfinance in the north is difficult for the reasons that any development work is difficult: the nature of the work of this kind is that those who most need it are the most difficult to get it to.*

**Q:** What then is your take on the insistence by MFIs to lend only for productive purposes?

**A:** Luckily it doesn't work!

**Q:** Even in the South when client incomes may be relatively higher, many of us have seen "productive" loans being used for consumption. Is there value in MFIs holding clients to the discipline of borrowing only for productive purposes?

**A:** I think it's nonsense. And it does matter because it induces falsehood at an early stage of the relationship, which can easily lead to falsehood in more important things. If the client is forced to lie and say she's going to use it for a productive purpose and she's not, then that's the beginning of a slippery track to saying she's going to repay and she won't. It's nonsense. Luckily it's not nonsense that makes much of a difference as clients ignore it.

Moreover, it's overambitious in the sense that it assumes that it gives the impression that if someone is a client of an MFI she's automatically got a livelihood, which of course she hasn't. It also exaggerates the importance of loans as opposed to other services, because if you need to start a little business you need something to invest and therefore you need a loan before you need anything else which is rubbish. So it both exaggerates what microfinance can do and distorts the emphasis of the products that are offered. And at the same time it understates what it can do in that microfinance can provide a full range of services—insurance, all these things—that goes far beyond running your own business. So it's very damaging in every respect.

And it's part of a broader illusion and rhetoric that I still see coming out of some high-level meetings where they're still talking about micro-entrepreneurs—about microfinance being about creating this world of millions of self-employed women, which is totally unrealistic in terms of any long term goal. I've never seen what we would call a rich, developed economy which consists of millions of women sitting around selling bananas.

There is another aspect of this consumption and production division which continues to infuriate me, in which education and health are regarded as 'consumption', somehow as a bad thing to spend money on. So it's sad to see the same silly rhetoric still being pumped around.

**Q:** One of the primary justifications for lending for productive purposes is to keep repayment

CS). GPMFCS is an exclusive fisherwomen's cooperative, registered under the government's STEP scheme (Support for Training and Empowerment of Women Program). The women are engaged in fish vending. The fish is either sold in fresh form or undergoes a curing process whereby the fish is dipped in salt and left to dry before being sold in nearby wholesale markets. The women have been trained for processing and packaging of hygienically dried fish on elevated platforms. The elevated wooden racks serve as means to dry the fish in a hygienic way since prior to that, most women were drying the fish on the sand and got a lower price due to poor quality. After conducting an assessment of needs for the vendors, CMF approached KAS Foundation to find out whether they would be interested in developing a customized product that would address the requirements of this community. KAS responded by distributing loans of Rs. 5,000 /per member to a cluster of 85 women (grouped into five self-help groups consisting of 17 members each). The loan amount, which is larger than the general loans that KAS disburses (Rs. 3,000-4,000/member), is now large enough for the women to use as working capital. Clients have to repay over a period of 24 months. This is the first step toward livelihood finance that KAS Foundation has engaged in. As a result of this initiative fisherwomen are now able to purchase more supplies of fish which they can process in a better manner and sell at a higher price (20-30% increase). The next step is to identify a better market for their produce. Already, GPMFCS has been approached by a trader based in Assam who has contacted the group to purchase a monthly requirement of at least 10 tons/month of hygienically dried fish for 7 months/year at a price that is 60-140% higher than what they used to receive.



rates high. Some have started to suggest that recovery rates this high are either unsustainable or not optimal. The CMF's research unit is interested in the question of why recovery rates are so high—that is, why people repay.

**A:** *Well, just now I'm looking on my 'screensaver' at a picture of a women's group. The women are clutching their books and looking nervously at me, the photographer, and it's pretty obvious they've got no place else to go. If you only have one place to get financial services from, you keep it clean. You repay. So one reason is the weakness of the client groups and the relative monopoly position of the service provider. Of course that monopoly position is being eroded now, so things are changing.*

*Another reason is the group mechanism, which is enormously strong—destructively so sometimes—people repay because their neighbors will do horrible things to them if they don't.*

*Another reason of course is that the interest rates are very high and if you owe money to several different people, whether the local moneylenders or banks or whatever, the one that charges the most is the one that gets repaid the fastest. And MFIs often are nowadays the ones that charge the most, so get repaid fastest.*

*And as we found with the recent EDA study of the light and dark sides of self-help groups, although this also applies to all clients with some form of group guarantee, a lot of defaults can be concealed and never appear in the books because the lenders help each other out informally. If the bank lends money for a SHG for three years, and members are lending that money within the group at shorter intervals, there's a lot of room for adjustments going up to a three year period which will keep the bank's repayments at 100% even though repayments within the group are of a much lower quality. The EDA study found extraordinarily high rates of portfolio at risk if you take a one-year repayment as being the average.*

**Q:** For a lot of things we've been discussing there's been little to no reliable data or systematic research. What are some of the gaps in microfinance research and research questions you think should be addressed?

**A:** *The actual rates of on-time recovery within groups, self-help groups in particular. But one needs to go further than finding the rate of default and pose the question, "does it matter?" ... If people are repaying because they're being helped by their neighbors, and then they're helping their neighbors the next time around, one needs to examine whether the notion of on-time repayments and so on really is relevant when what people really need is an overdraft facil-*

*ity....Is the term loan an effective form of finance? It isn't to me, and I don't think it is for them. It is for me when I need to buy a car, but I don't think it is for me or them in their day-to-day financial environment.*

*Another research question is how do the high interest rates charged by some MFIs compare with the returns earned by some borrowers on their investments, particularly investments in farming and manufacturing? And, is this high cost of money tending to create trading and service economies, petty shops and vendors, rather than growing and making things, and does it matter? Related to what I just mentioned, are MFI interest rates justified by the costs of doing what they do, doorstep delivery and all the things microfinance enthusiasts go on about, or are they caused by inefficiency, excessive wages and other costs, lack of competition, or just plain gouging? The recent problems which arose in Krishna District of AP, and some MFIs' responses, suggest that their previous interest rates may have been higher than necessary, but this needs to be studied.*

*Another question is to what extent microfinance clients borrow from more than one microfinance source at a time, such as from their bank-financed SHGs and from SHARE, and is this actually good or bad for them—in terms of sensible diversification, filling gaps in time or amounts, vs. a spiral of increasing over-indebtedness, and too much time in meetings—and good or bad for the banks/MFIs?*

*A related question is to what extent banks or MFIs engage in market sharing, cartel-making behavior, "you take this village and I'll take that," and what effect does this have on their customers? In other words, the extent to which competition between MFIs is such a bad thing that they should be allowed to form cartels and engage in monopolistic behavior.*

*I think one area that still has not been covered sufficiently is some assessment of the value added by clusters and federations. I haven't seen anything systematic on that. Do SHG federations and clusters and all that add value more than cost, should they stick to social vs. financial intermediation, are they just creatures of NGOs who need to create new (and permanently dependent) entities in order to justify their own existence, and of politicians who need vote banks?*

**Q:** What about the competition between the SHG bank linkage model and the Grameen model?

**A:** *Well the methodological competition I think is the wrong way to look at it. I see them as complementary. When you've grown out of the extremely transaction cost intensive (if you're*

the borrower), somewhat demeaning, and very rigid, inflexible method of Grameen, then you're ready for self-help groups—to run your own bank, it could be argued. And when you've grown out of that you're ready for joint liability groups, if you want to go that far. If you want to go even further you go to an individual account. So I don't see SHGs with bank-linkage and MFIs as competitive in that sense. I see them as different rungs on a ladder.

And as far as competition between institutions is concerned, I guess banks cannot and never will be able to do the Grameen method, because you've got to set up a specialized dedicated system for that method. Therefore the market segmentation which presently obtains in India, where MFIs do on the Grameen method, and banks do SHGs, is fine. But the MFIs should be only too happy to pass their 'graduating' clients on to SHGs which are linked to banks. This whole notion of whether the different methods are competitive or complementary needs a lot more study.

**Q:** What do you think are the big innovations of the last decade? At least in terms of terminology, the big shift has been from "micro credit" to "microfinance."

**A:** The addition of micro-insurance is probably the major single thing in the last ten years, and BASIX has been one leader in that. Looking back I would say we started the wrong way round.... We should have started with savings, and then we should have gone to insurance, then to loans.

Livelihoods is still very much in its early stages, but there are some quite remarkable things being done.

There's a lot being done in technology. There are some quite remarkable applications of hand held devices and so on which can increase security and reduce costs.... Perhaps if you look at the full cost of the equipment, particularly at the software and the training, they are not yet economic. But they soon will be.

I think it's fair to say, which I would have not have said ten years ago, that even in a desperately low-cost, skilled labour economy like India, you could not be running something like Cashpor or Share if you had manual accounting. I don't think it would be possible to do it.

**Q:** What are the big challenges you think microfinance will be facing in the next decade?

**A:** If we're speaking of MFIs, as opposed to microfinance, then I hope the major challenge will be the entry of banks. Let's hope they peace-

fully remove lots of MFIs from the scene. So that's a major competitive challenge for MFIs.

For microfinance in general, there are both horizontal and vertical challenges. The main horizontal challenge is to get microfinancial services—mainly savings and insurance, but also remittances and loans—to the vast untouched parts of the country and get out of this grotesque over concentration on the least needy parts of the country—not that there aren't needy people there. The vertical challenge is to get people beyond the Rs. 5,000 or even Rs. 10,000 loan ... and cope with the greater risks that are involved in lending to men, who are more likely if they succeed to go on to form businesses that employ lots of other people who do not want to be self-employed or run their own businesses.

In short, I think the challenges to microfinance are to make the less poor much less poor, and to reach the hundreds of millions of people who aren't being reached at all.

**Q:** To reach these unserved areas will take new MFIs and approaches. What would you say to someone starting his own MFI?

**A:** I would say, don't try to go into this on your own. Look for partnerships, collaborations, and alliances. For products, think out of the box and don't think of just starting with loans; focus on insurance and think of legal and secure ways of helping people to save. Don't necessarily try to build your staff with highly trained and expensive people; try to think of ways of motivating and managing people with much lower qualifications who are much more available and need employment. Focus in a rather narrow area, don't worry too much about covariant risk, and see if you can really make a difference at a block or city ward level. Don't think you've got to follow the BASIX example of spreading yourself all over India.

**Q:** Are there other countries we can look to from which we can draw some useful lessons?

**A:** Indonesia is one place to look at. BASIX learned a lot from BRI, particularly in the context of starting our own bank. And some countries in Africa are finding interesting ways of regulating MFIs which enable them to provide a full range of services without compromising the safety of their clients' money.

... India should look to Bangladesh particularly for some of the research and experiments that are being done by BRAC and others on really reaching the poorest people. I think it's pretty clear that 'plain vanilla' microfinance is not

much good for those who are really 'at the bottom of the pyramid'....

South Africa has other lessons, demonstrating the links between classic consumer finance and microfinance. Lending someone money to buy a motorbike or a refrigerator which may be a tool for business is also microfinance. And of course in IT applications, and the use of ATMs.

In Ghana, lots of interesting things have been done by linking with informal savings collectors... to banks, and formalizing those links for the benefit of banks and their clients.

India can also learn from the mistakes of others. I think one of the reasons for the relative stagnation in Bangladesh is the focus on Grameen method. The Grameen method is very good at helping people far down the poverty scale but it's not so good at real individual 'empowerment', it's not so good at reaching men, and it's not so good at enabling people to 'graduate'. India has something which is beginning to look like a ladder. It probably doesn't have the bottom rung as they do in Bangladesh, for people who are too poor to benefit from even standard Grameen groups, but India has very fast-growing standard Grameen groups, and it has SHGs, and then joint liability groups, and it has a massive branch banking network offering individual accounts to people who need and are ready for them..

But people used to say—and I also used to say—that Indians should learn from elsewhere. And I'm hearing lots of people from elsewhere saying now that they can learn from India... which is great.

## Upcoming Conference:

**August 18**

*Indian Financial Institutions: Issues and Policies. "How should NBFC-MFIs be regulated?" Moderated by Rati Tripathi, CMF with Vijay Mahajan and M. R. Umarji, Chief Legal Advisor—Indian Banks' Association. For more information, please contact aruna@ifmr.ac.in*

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