

Savings : the Beginning and the End of Microfinance Relationship

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It may come as surprise to those not familiar with microfinance that savings is the starting line of microfinance and the finishing tape of the marathon to end poverty. Microcredit or loans, which has taken the centre stage in the mindshare of microfinance is merely a vehicle to achieve that goal. A relationship in microfinance with a poor customer starts with small savings. Then the customer graduates to taking loans of various sizes depending on the cycle while continuing to save. The customer breaks out of poverty and like a lot of us in the middle class, reaches maturity in the life cycle with financial security of savings, pension, insurance and no loans. This is the vision which we microfinance practitioners dream of.

Microfinance in India has a number of stakeholders, the major ones are: the 600 million rural & urban poor, the microfinance institutions (MFIs), the Reserve Bank of India (RBI) – the regulator and banks & financial institutions – the providers of funds.

The poor have no access to organized financial services. Their need for a secure vehicle to make miniscule savings of Rs. 10-20 a week at their door step is equally important to accessing loans or insurance. It is impossible to keep the savings at home as invariably under the dire need to meet their daily expenses any 'money under the mattress' gets spent. The poor cannot afford to spend hours to deposit or withdraw these small savings in a bank or post office every week. They lose income from their jobs or business every hour they are away, as they struggle to earn a living. In their desperate attempt to save they have been serially duped by fly-by-night finance companies, unofficial chit funds, ponzy schemes etc.

MFIs in India including the Non-Banking Financial Companies (NBFC) are not permitted to accept deposits under the RBI Act Section 45 I (bb). The MFIs are totally dependent on financing from banks and financial institutions to fund their loan portfolio. This single source makes them vulnerable to funding risk and also increases their cost borrowing, as is more than abundantly experienced during this period of world wide deep recession. The long term solution for all MFIs as demonstrated by the Grameen Bank (GB) of Bangladesh, a world-wide industry leader, is to be self-funded. In January 2009, Grameen Bank had deposits of \$939 million as against loans outstanding of \$615 millions. Deposits were 142 % of the loan amount. Out of 2541 GB branches, in 1541 or 61%, the customer deposits exceeded loans. Ability to access deposits not only reduces financial vulnerability of MFIs but reduces their cost of funds, which they are free to pass on to customers by charging lower interest rates.

The RBI is paranoid, quite rightly so, about the safety of public savings, especially those outside the banking system. India has had a long and sordid history especially in the recent past by NBFCs who have duped the public of their savings and at the end RBI had the responsibility of cleaning up. The RBI also very laudably has executed their social responsibility of financial inclusion of the poor through the no frills account with banks. However, the problem with this scheme is that it does not meet the need of the poor as it does not provide the service at their door step. Depositing & withdrawing funds is very time consuming and cumbersome. The banks on the other hand who are required to open these accounts do not have the man power, systems & technology to effectively handle such large volumes. Even though a large number of accounts have been opened, they lie dormant and are of low value . The solution to make this program a success is as follows:

Banks must make transacting easy by providing ATM & cheque book facilities. If the customer is able to transact the balances in the accounts, it will automatically grow as seen historically in banking for such savings products.

Permit NBFC-MFIs to be Banking Correspondents as they have the largest and fastest growing financial relationship with the poor and they can transact with their customers through these accounts and reduce dependence on cash transactions..

The medium term solution would be for the RBI to create a special category of NBFC-MFIs. As these MFIs become 'systematically important' with loan outstanding exceeding Rs. 50 or Rs. 100 Crores; and based on evaluation of governance, systems, technology & controls, permit these MFIs to accept 'deposits' from their own borrowing customers. This would require change of regulations and mind set which is a time consuming and complex exercise.

The immediate solution for NBFC-MFIs, which is permitted under the present regulation, they should start taking security deposit against loans from customers. Under Section 45 I (bb) (v) (a) of the RBI Act, the definition of “Deposit” which is prohibited, excludes the “amounts, received in the ordinary course of business, by way of security deposit”. This must be reflected in the loan documentation. It not only provides a valuable cushion in their funding & credit risk but also reduces their cost of funds. For the customer it provides a valuable alternate savings vehicle. The acceptable security deposit is that which is taken upfront at the time of taking the loan disbursed and refunded at maturity. However this poses a significant barrier to the poor customer, who may not have this lump-some money at the time of taking the loan. Our recommendation for consideration by the RBI are as follows:

The more pro-poor system is to permit MFI customers to make weekly or monthly recurring security deposits in fixed small amounts through the life of the loan which they can afford. This does not require any change in regulation but is a matter of interpretation.

Banks & Financial institutions who take security deposits are permitted to pay interest to the rich, middle class or companies. From the point of view of financial equity, MFIs should be permitted to pay interest to poor customers. This change is more in terms of interpretation of what constitutes a ‘deposit’ permitted by RBI. It is worth the request.

If these changes are brought about, they will be valuable first steps in providing full services to meet the needs of the poor, reduce interest cost of MFI and consequently those charged to the poor; and reduce the funding & credit risk of MFIs without increasing the regulatory risk of the RBI. Facilitating savings of the poor in India are shock absorbers against severe economic recessions and will be an insurance against risks like the sub-prime crisis ailing the United States of America.