MicroSave India Focus Note 6

Savings Services for the Poor – An Old Need and A New Opportunity for MFIs in India

Sanjeev Kapoor

Microfinance in India has brought a revolutionary shift in the approach to providing financial services to the poor. Over the past decade, it has been claimed vigorously that microfinance has had a positive impact on the poor in terms of increased household income. However, focusing only on static measures of household earnings and income ignores the other side of poverty, the vulnerability of the poor to risk. Unfortunately, in India microfinance remains primarily a supply-driven, credit focused endeavour, with a limited number of methodologies applied to provide mainly working capital loans to poor women. Over the past few years, the focus of microfinance in India, as elsewhere, has shifted to providing a wider range of financial services to a diverse group of vulnerable households engaged in complex livelihoods. With this perspective, practitioners in microfinance industry have recognised that the poor require a range of financial services to manage risks and thus, in the long run, improve the quality of their lives.

In terms of risk mitigation, savings appears to be the most desirable and effective strategy for poor households to avoid potential loss of economic status or independence as a result of a crisis. While microcredit has proved to be a valuable and effective way to protect the poor against risk in an *ex ante sense* (ahead of time), the limited credit products offered by most of the microfinance institutions (MFIs) in India are less suited to provide poor households the support needed after a shock (*ex post)*. The time difference between the shock and the response by way of securing a loan makes formal credit a less useful option.

The importance of savings to allow poor households to reallocate expenditure across time has been persuasively articulated by Rutherford (2000). Using three different approaches, namely “saving up”, “saving down”, and “saving through”, the author has demonstrated that agglomeration of money is the basis for all financial services that the poor require to smoothen inflows and outflows in the household economy[1].

A study by the author on understanding saving behaviour of rural poor and urban slum dwellers in Uttar Pradesh indicated that there was a significant variation in the flow of income and expenditures (both in terms of time and magnitude) in the households for all livelihood categories. There were several time periods when the expenditures outweighed the income stream. This was exactly the time for which most of the rural households wanted to save … so that they could meet the inevitable expenditures with the help of their past savings - at least to some extent, if not fully.

The debate whether poor can save or not has become obsolete. Large scale success of Self-Help Group (SHG) movement has proven the ability of the poor to save. Although poor households have fluctuating amounts of surplus cash available, women are able to save a fixed amount on a regular basis in their groups. This is possible due to the regular discipline promoted in the SHG approach. However, there is an inherent limitation in the SHG methodology for providing saving services to rural poor. The SHG approach enables savings to accumulate in the form of a corpus to be managed locally by poor and often illiterate women. It requires considerably high level of trust, confidence and financial management skills amongst the members.

Our observations from field study confirm that SHGs can provide only a very limited saving service. In the course of our discussions with a large number of women members of SHGs, it became clear that women wanted to save more money on a regular basis for needs like illness and other emergencies, as well as for long term needs like marriage of their daughters and their children’s education. However, interestingly, when the possibility of increasing the amount of instalments within the SHGs was discussed, members did not seem to agree. This aversion to entrusting larger instalments of savings to SHGs might be because of lack of trust and confidence required amongst the members to manage large amounts of corpus money. It emerged that the SHG channel for savings may be appropriate so long as the savings of individual member remains small. The staff from the Self Help Promoting Institution also felt, perhaps rightly, that very large amounts as corpus funds in SHGs become unmanageable for the members, and at times leads to differences within the group and eventual break-up of the groups.

[1] See *MicroSave* Briefing Note # 13 “Money Managers: The Poor and Their Savings”

Thus, SHGs can provide a limited risk management fund for poor women by providing small-sized loans through mobilising small amounts of savings. But, there is still a crying need, and ample potential, to meet the real saving needs of rural poor. However, a major portion of the potential remains untapped; a trend clearly reflected in the market research exercise which bought out the need and desire of rural/urban poor households to save. However, to date, access to suitable and reliable saving services for the urban/rural poor in India, is unfortunately very limited, or non-existent.

MFIs in India typically offer a variety of loan products to the rural poor. Today these organisations are struggling with a challenging question: should they offer savings products also; and if so, what types of products, and how? The biggest bottleneck in Indian microfinance industry is that mobilising savings from the clients is not a permissible activity for MFIs registered as Societies, Trusts or Section 25 Companies, especially in the light of the amendment to Section 45S of the Reserve Bank of India (RBI) Act.

Similarly, the larger MFIs are transforming to become NBFCs in order to meet their lenders' requirements to strengthen their institutional form. While these larger MFIs typically have the more robust systems and management, and are thus better suited to offer savings services, they too are not permitted to mobilise deposits.

In a major step forward, January 2006 RBI permitted deposit mobilisation by MFIs appointed as Business Correspondents by the banks (RBI/2005-06/288, DBOD.No.BL.BC.58/22.01.001/2005-2006, dated January 25, 2006). The salient features of this circular can be summarized as follows:

- NGOs/MFIs set up under Societies/Trust Acts; Societies registered under Mutually Aided Cooperative or the Cooperative Societies Acts of States; Section 25 companies; registered NBFCs not accepting public deposits; and Post Offices may act as Business Correspondents. However, NBFCs were debarred from acting as Business Correspondents by a subsequent circular issued in March 2006.
- The scope of activities to be undertaken by the Business Correspondents will include: (i) disbursal of small value credit; (ii) recovery of principal/ collection of interest; (iii) collection of small value deposits; (iv) sale of micro insurance/mutual fund/ pension/other third party products and; (v) receipt and delivery of small value remittances/other payment instruments.
- Banks may pay reasonable commission/fees to the Business Correspondents, the rate and quantum of which may be reviewed periodically. However, the agreement with the Business Correspondents should specifically prohibit them from charging any fee to the customers directly for services rendered by them on behalf of the bank – a provision that has discouraged many MFIs from acting as Business Correspondents.

Designing saving services for rural clients requires new products and innovative distribution mechanisms. There are two important facts which have to be addressed while designing delivery channel for saving products to rural customers:

- The clients are spread over a large geographical area, and collection needs to be frequent.
- Business with each client is very small in value, and often high in volume.

After the introduction of "Banking Correspondent Model", financial institutions can start collaboration with MFIs/ NGOs. This partnership is very advantageous for the financial institution, the MFIs and their clients. The financial institution gains access to new markets with reduced transaction cost; the MFI can expand the portfolio of its financial products and gains a new income source; and the clients accumulate a large pool of money over time by accessing an alternate and more robust savings channel.

MFIs may (rightly) apprehend the increased chances of fraud in their organisation, in response to which they will need to develop stringent internal control mechanisms to manage the provision of savings services. However, this has been done before in many places and there are plenty of lessons that can be learned … without bitter experience[2]…

Sanjeev Kapoor is an Associate Professor and the Indian Institute of Management – Lucknow

[2] See *MicroSave* Briefing Note # 2 "Introducing Savings into a MicroCredit Institution – Lessons from ASA"