Interview with Vijay Mahajan

Micro-finance and India

"In Manninder Mann's face – to – face interview with Vijay Mahajan, the brain behind the micro finance company BASIX, an attempt is made to understand the background and the functioning of this innovative way of banking."

MM : It's good to have you with us Mr. Mahajan. We have been hearing a lot about micro finance and micro credit these days, especially as an effective way to reduce poverty. Why do you suppose it is so popular now, compared to 10 or 15 years ago?

VM : Well, providing credit to the poor in India has been a long term mandate of theb a n k i n g system and the banks were nationalized partly to provide agricultural credit and to lend to priority sectors and the weaker sections. Since the 1992 reforms in the banking sector however, the percentage of credit going to the small borrowers had been steadily declining. Alternate channels were developed to replace this, of which self-help group (SHG) bank linkage programs have been the most feasible. We now have more than 50 million women with access to credit from banks, and it helps in alleviating poverty.

I think the reason why micro finance is so widely recognized, both nationally and internationally, is because of the Grameen Bank of Bangladesh and because its founder, Prof. Yunus won the Nobel Prize in 2006. Before that, the UN declared 2005 as the year of micro credit.

MM : Are MFIs lobbying with the government to change the required 15% adequacy norm of the RBI? What are the other regulations that the micro - finance industry is pushing for?

VM : Imposing a 15% capital adequacy on MFIs is contrary to the spirit of Basel II norms as the quality of the MFI portfolios is sound with a long established track record of less than 1% default. A capital adequacy of 3 to 4% should suffice for MFIs, but since there is no such thing as separate NBFCs for microfinance, MFIs have to conform to the 15% norms set for NBFCs by the RBI.

MM : Aren't MFIs pushing for a separate NBFC entity for social enterprises?

VM : We have been recommending a separate category of NBFCs for micro finance ever since I was a member of the 1999 national microfinance task force, but the RBI is concerned about the overall financial system. It doesn't want to create a special window, for fear of misuse.

MM : The trend being witnessed across micro-finance sectors is the increasing ticket size of loans. Is it safe to over leverage the customer? Aren't we creating a bubble effect with that?

VM : The amount of lending in microfinance is less than Rs.10, 000 crore, so it can hardly qualify as a bubble effect, but yes, individual households can fall into the debt trap if too much credit is pushed to them. MFIs should ensure that loans are given for productive purposes and certainly not for consumer finance.

MM : Do MFIs allow loans for social functions and how do you ensure the actual use of the loan given?

VM : No we don't encourage those types of loans, but people do take loans for productive investments and then spend it on something entirely different. To ensure the actual use of the loan, we have thorough interviews, we gather information from different sources and we rarely grant a loan at a first meeting.

MM : There are a lot of regional disparities in micro lending. While it is a success story in South India, it hasn't made an impact in places like Bihar and UP: and micro finance has not been established in Punjab.

VM : The financial sector thrives at places where contracts are honoured, trust is widespread, basic infrastructure exists, and law and order is in practice. In the south, west and in some parts of the north India these criteria are fulfilled. In UP and Bihar, many institutions don't really work all that well, be it rural lending or government schemes. MFIs aren't present in Punjab, because unlike other states, Punjab farmers have problems that aren't usually related to poverty.

MM : What is your experience of Madhya Pradesh?

VM : Microfinance is growing across the entire central Indian belt and our experience, on the whole is a good one. It is slower, because the average loan size is smaller and it takes time to build up a portfolio. The purchasing power of people here is lower than that of those in the South, law and order is an issue and support from banks is not easy to come by. Law and order is a major issue in micro finance since most of the transactions happen by cash and the cash collector is a fairly well known person in the locality and therefore vulnerable to be targeted by anti social elements.

MM : Madhya Pradesh is a very patriarchal society and it's very hard to interact with women. How do you convince parda-clad women to borrow money and start their own enterprise?

VM : We do have women in the field for that contingency, but it is very hard to get women staff. Fortunately NGOs and the government formed a large number of self-help groups and we start by strengthening those that exist and reviving those, which are no longer functional. It's easier to talk to and convince a group of women than to individual women, and it's also something our male colleagues can do, though it remains a challenge in certain districts and with higher castes.

MM : How has BASIX dealt with the problem of the caste system?

VM : We train and sensitize our members about such issues, and we fix targets for our team according to the population of a district, which creates a push for them to focus on issues of caste and gender.

MM : How are MFIs perceived by naxalites? And aren't they inimical to outside moneylenders?

VM : We've had several brushes with them, particularly in Jharkhand. Genuine Naxals check us out and usually leave us alone when they realize the developmental intent of an MFI. There are some, however, who create trouble and try to extort money for themselves. But overall, when we have the support of a community, naxalites and other anti social elements do not have much power over us.

MM : There is some sort of process innovation being done by Equitas, by separating people in marketing and lending. How do you see them as future models of MFIs?

VM : Equitas has done a great job by re-engineering processes like loan origination, appraisal, disbursal, and recovery. I think that will do extremely well in high-density urban areas, where the standardized product is used. At BASIX, however, our lending process is customized to rural, low-density areas and varies according to each region's characteristics. This way we believe we can deliver greater livelihood benefit to our customers.

MM : So are there different ways to serve, different issues in urban and rural markets? How do you cater to both and keep the same system in place?

VM : We can't have the same systems for both; even in rural areas we have different systems depending on the target segment, but the major difference between the urban and the rural poor is the weak social glue, so to speak, among the former. The lack of trust and mutualsuspicion makes it harder to establish self help groups or even joint liability groups in some urban areas, which leads to individual lending. Taking physical collateral as security defeats the purpose, as it is hard to repossess. So we start by giving small loans and eventually, help them to slowly build a credit history with us.

MM : Are there any documented differences between the urban and rural default rates?

VM : Although urban lending is relatively new, there are no rampant defaults. A little modification of the existing systems can cause it to work.

MM : Microfinance is one effective tool for dealing with poverty. Which other methods should corporate India look at for eliminating poverty effectively?

VM : Microfinance is a tool which needs to be used in conjunction with other methods like skill training, market linkages, etc, because finance on its own is not enough to alleviate poverty in India. It is a necessary, but not a sufficient condition, for most cases. India's biggest resource is human resource. The "demographic dividend" can easily become a nightmare, unless India urgently invests in skill building of human resources. It requires an investment of around Rs 20,000 per person to make him/her a productive employable resource. That comes to around 12 to 15 billion dollars, which is not a huge investment when one compares it to the size of last year's loan waiver of 15 billion dollars. It will also have a positive economic multiplier and create demand at the bottom of the pyramid for goods and services. This 15 billion dollar investment needs to be made before it is too late, in the next 3 to 5 years.

Author's Profile

Manninder Mann

Manninder Mann is an alumnus of the Indian Institute of Management, Indore. He was a Post Graduate Participant when he interviewed Vijay Mahajan.