Community at the Core
A Study of Sarvodaya Nano Finance Limited

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Abstract

The paper traces the evolution of Sarvodaya Nano Finance Limited (SNFL). At the outset we explore the background of SNFL, the motivation for the promoters to set up the organisation and how it has grown from the time it was taken over by the community trusts promoted by ASSEFA.

As a part of the study, we examine the unique legal structure set up for federating the small SHGs that were widely spread out in the areas of its operation. The idea of federating the SHGs was to leverage the dispersed savings and interest earned on the initial donor resources that were made available to the SHGs at their early stages. The aggregation of these dispersed resources into SNFL enables the women SHGs to mobilise funds from commercial banks and specialised MFI lenders, for an accelerated growth of the movement.

The paper examines the rationale for having this structure, its vulnerabilities and the possibilities for growth within the given structure. We argue that this is not a structure that can be replicated easily. We also argue that it cannot grow aggressively in the long run, unless some basic design changes are made. The paper also discusses the basic question on how to structure resources that are given by the donor community for the larger benefit of the poor; and when to bring in the individual stakes of the beneficiaries if one were to promote long lasting institutions.

The paper also raises critical questions on governance and management. While appreciating the impressive result achieved by ASSEFA and BASIX in getting a community owned professionally managed institution into being, it also raises questions on whether there are inbuilt mechanisms of carrying forward this effectively in future – given the structuring of capital and rights of each of the constituents.

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Background: ASSEFA

Association of Sarva Seva Farms (ASSEFA) was established in 1979 as a society under the Tamil Nadu Societies' Registration Act. Though the organisation began its activities in 1969, it was informally working with the communities even before that as part of the Tamil Nadu Sarvodaya Mandal. ASSEFA worked on the Gandhian principles, and its initial work was in bringing about community farming in the lands that were donated under the *bhoodan* movement[3]. Though the work started in TN and with *bhoodan* movement, the work of ASSEFA soon spread both in scope and geography. A major review and experimentation between the years 1982 to 1985 resulted in the transformation of ASSEFA from an organisation doing farm based development to village based development work. The work expanded to cover areas like animal husbandry village industries, afforestation housing, education and health, (Soumithri, u.d.)[4]. Geographically ASSEFA expanded to states like Maharashtra, Bihar, Madhya Pradesh, Karnataka and Rajasthan.

Given that the work was inspired not only by *bhoodan* by also associated principles of *gramdaan and shramdaan* the operating principles of ASSEFA were centered on the communities. The assets generated out of the grants received by ASSEFA were to be owned by the communities. Even benefits that were targeted at individuals were given as a soft loan to be contributed back to the community organisation, so that those resources could in turn be used for a larger good of the other members of the community. Thus all programmes undertaken by ASSEFA looked for a larger multiplier effect. Similarly it was also envisaged that not only the assets would be owned by the communities, but institutions set up for their benefit would also be ultimately owned by them.

Building on its work with rural women, ASSEFA was involved in promoting Self-Help Groups (SHG) from late 1980s, but the activity gathered momentum in 1991. The early groups were promoted in active collaboration with the Tamil Nadu Women's

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3 Bhoodan movement was spearheaded by Acharya Vinoba Bhave, who was a close follower of Mahatma Gandhi. This involved land owners voluntarily donating land to the communities. The land in turn would be used for development and made cultivable so that the poor communities could benefit from it. ASSEFA started work with trying to work on these common lands and later extended this philosophy to other areas of work. The operating philosophy of ASSEFA was "sarvodaya" (development of all). Both Bhoodan and Gramdan involved renunciation of private property in favour of commons. In case of Shramdan, it was assumed that since the poor did not have any property to gift, they would donate labour.

[4] Sowmithri, R (undated): Mid-Term Assessment of Women's Development Program of ASSEFA (internal document of ASSEFA).

Development Corporation set up by the TN government. This project actively partnered with NGOs to promote SHGs under a women's development programme which was supported by the International Fund for Agriculture and Development (IFAD). The partnership with the government came to a close in 1999, but ASSEFA continued the work of promoting SHGs and also worked towards provision of enhanced and continuous access to credit for the SHGs. Most of ASSEFA's groups were formed around savings and this savings pool was revolved as loans. While this was adequate at initial stages, it was also necessary to infuse external credit to accelerate livelihood generation activities in the groups. Under the IFAD project most of the SHGs were given capital development fund of Rs.15,000 per group as a grant. In most of the IFAD locations, ASSEFA had no prior projects and did not contribute any funds. The ASSEFA funds were in those locations where it had projects. All these funds were scattered in a large number of SHGs. It had not been possible to pool these funds and leverage larger institutional credit at competitive interest rates. One option available was to link the SHGs to the local banks. This process was time consuming and the effect would not have been uniform across several areas as the bank linkage largely depended on the enthusiasm of the local branch manager, and the encouragement that the bank gave to the linkage programme.

The thinking within ASSEFA was that leveraging funds from mainstream sources would give a fillip to the SHG movement and enhance the access to resources for the communities. ASSEFA then thought of having a financial institution that could access funds from the mainstream so that this could be on-lent to the communities. The challenge however, was to ensure an ownership structure that honoured the principles for which ASSEFA stood – putting communities at the core and ensuring that these institutions were owned by the communities. This was not a simple task and they had to find innovative solutions for making the entity community owned.

Background: Sarvodaya Nano Finance Limited

Sarvodaya Nano Finance Limited (SNFL) was established in the year 1996 as a part of the BASIX group of companies in Hyderabad. The initial design of BASIX was to use Sarvodaya to make very small loans to individuals, addressing the microfinance needs of the poor – landless, marginal and small farmers and women, while a related company Bhartiya Samruddhi Finance Limited would make larger loans to micro-entrepreneurs and commercial farmers, who in turn generated livelihood opportunities to the poor. However, at the end of the two years of operation, BASIX group found that it was better to carry out all the lending operations through a single company and SNFL became dormant since 1999.

At the same time, SHGs promoted by ASSEFA that were in existence since mid 1990s and yet were not able to mobilise funding from local banks. Thus ASSEFA was in search of a more reliable means by which mature SHGs with substantial own savings could access outside funds. ASSEFA's founder Executive Director, Shri S Loganathan, was a member of BASIX Board since inception, and BASIX founder Managing Director, Mr. Vijay Mahajan was on the Board of ASSEFA for a number of years. Thus they decided to collaborate to address this issue. ASSEFA requested BASIX to evolve a strategy which would leverage the dispersed funds of SHGs into a financial structure to which banks and MF wholesale agencies would be willing to lend to.

ASSEFA and BASIX carried out a detailed assessment of the finances and capacities of the SHGs and came up with a strategy for aggregating them into a single multi-tier entity. Three options were considered:

- Establishing an SHG Federation as a Society under the Tamil Nadu Societies Registration Act, in each block and state level confederation also as a Society
- Establishing a Savings and Credit Cooperative Society under the Tamil Nadu Cooperative Societies Act, Tamil Nadu, in each block and state level federation also as a Cooperative Society
- Establishing an SHG Federation as a Mutual Benefit Trust under the Indian Trusts Act, in each block and then these trusts invest in Sarvodaya Nano Finance Limited

The first alternative was not considered as the assessing team felt that a Society is not the appropriate legal form to undertake financial activities, such as bulk borrowing and on-lending to SHGs. While the concept of a mutual benefit company was widely used in Tamil Nadu urban areas, no examples existed of Mutual Benefit Trusts.

Incorporation and Structure

For ASSEFA to make the proposed organisation community owned there were limited options for incorporation. While a co-operative was ideally suited for such activities, the legislation in TN was control oriented with State constantly interfering in the governance and operational aspects. Moreover, ASSEFA found the co-operative legislation limiting due to geographical reasons. Co-operatives are governed by a provincial legislation and therefore it was difficult to establish a single co-operative that could have an area of operation spanning 3-4 states where ASSEFA's SHG activities were being carried out. It was necessary that the new entity eventually be able to operate in Bihar, Rajasthan and Maharashtra where some SHG work had already been initiated. Therefore promoting a co-operative was not a viable option.

Other forms of organisation were examined to see if it would suit the purpose of having a single entity that could be collectively owned by the communities. Since the object of the proposed organisation was to source bulk funds for on-lending to the SHGs, it was better if it were a commercial organisation. Therefore registering the entity as a Society or a Trust was not preferred. One possibility was to incorporate it as a company under Section 25 of the Companies Act[5]. However this was also not considered as this would still not attract adequate capital for the purposes of leveraging funds from outside[6]. Since ASSEFA wanted to set up an entity to access bulk finance for the SHGs, a for-profit company with adequate equity was considered the best option. The choice obviously was to have a company that could be registered with the Reserve Bank of India (RBI) under the Non-Banking Finance Company (NBFC) regulations.

[5] A Section 25 company is very much like a charitable institution – where, at the time of incorporation it is clear that the company does not intend to distribute surpluses to its shareholders. The residual even in case of liquidation would be used for a social cause rather than for compensating the shareholders. By definition, the share capital in such entities would be nominal.

[6] We shall later see a small fallacy in this argument, considering the operating details of SNFL.

By the time ASSEFA decided to promote an NBFC, the regulatory environment in the country had become extremely tight following a scam in the NBFC sector and it was difficult to promote new NBFCs. The process of registration was bound to take time even after the necessary minimum capital of Rs. 20 million was put in. Mr. Loganathan, the Executive Director of ASSEFA was on the board of the BASIX group of companies that owned a 100% stake in SNFL. SNFL had obtained the necessary registration from the RBI, but due to consolidation of activities within BASIX group, was lying dormant. It was therefore proposed that the communities assisted by ASSEFA acquire the share holding in SNFL.

While the decision was that the communities would own the company getting them to contribute share capital in the SNFL was not going to easy. The number of individuals participating in the SHG programme of ASSEFA had crossed 70,000 spread out in nearly 4,000 SHGs. It was difficult for each of these individuals to become share holders of the company because that would involve getting contributions for each individual. In any case, the plan was to pool in all the resources that was brought in from outside – the capital development fund given to the SHG, other financial resources brought in by ASSEFA into a centralised place, therefore it was pointless to approach individuals ASSEFA had records on how much each SHG had received as external funding and this was the amount sought to be brought into the proposed company as an equity base.

These common resources resided in individual SHGs as a group fund. In addition to the externally contributed group fund, interest earnings of SHGs were ploughed back into group fund. ASSEFA was interested in only tapping the donated resources from the group fund. At this level it meant getting SHGs to be shareholders in the proposed company. However as SHGs were only informal associations of people, getting them to be members of the company was not possible. ASSEFA had to find an intermediary mechanism that would address the issue of community ownership. The objective was to move the company towards community governance and if possible to community management – but the first step was to vest the ownership in the communities.

The design was to have an intermediary mechanism that would pool the resources of individual SHGs and then transfer these resources to SNFL as equity. While designing this, there was a larger objective – these intermediary institutions would not only act as mechanism for funnelling the financial resources from the SHGs, but would eventually become pivotal points for the larger work of ASSEFA with the communities. It was envisaged that these intermediary organisations could take up education, rights and other issues that affect the membership in general.

One of the options examined was to set up a series of Section 25 companies at the intermediary level. This did not find favour because companies could not have SHGs as members and having individual shareholders was difficult, given the large numbers. It was envisaged that these intermediary organisations would not only pool capital from SHGs, but also act as on-lending agencies when SNFL wanted to downstream loans to the SHGs. SHGs also had to be federated at some level so that common issues could be taken up. It was then decided that the confederating unit should be at the block level and these units could in turn hold the equity in SNFL. The block level units could by community managed, so that eventually, using the experience of management of block level units, some people could be inducted into the governance of SNFL.

It was envisaged that the block level confederation would be representing around 200 SHGs. However, it was found that this was a large unit, and further co-ordination would be needed. Therefore, the SHGs were federated informally at a cluster level. Each cluster would represent around 40 SHGs, and around 4-5 clusters would be represented in the block level confederation. It was also decided that the staffing pattern of SNFL would ensure that there would be a field officer in charge at each cluster and then a Manager at the block level. The cluster level set up was to be purely informal in nature and would only be used as an administrative unit. It was also envisaged that each cluster would throw up a representative from the community, who would represent them in the block level entity.

After examination of alternative forms – it was finally decided that the block level entities would be registered as "Mutual Benefit Trusts (MBT)". These would be private, determinable trusts, that is they would have specified beneficiaries/members and they would not be public charitable trusts, which is the most common form. These trusts would be promoted by ASSEFA, the Executive Director of ASSEFA being the settler making an initial contribution of Rs.1,000 to set up each trust. Each SHG would then be required to pay a one time non-refundable contribution of Rs.1,000 and also contribute to the MBT an amount equivalent to the capital development fund and other revolving funds given by ASSEFA. Though there was no legal binding on getting these monies into the MBT, the promoters felt that this was a fair demand to make of the SHGs. The Rs.1,000 contribution would be retained by the MBTs, while other funds received as contribution from the SHGs would be invested in SNFL as equity.

The MBTs would then be eligible to borrow and on lend it to SHGs. The equity and lending decisions were de-linked from the contributions and it was possible that an MBT having contributed significant equity did not get a proportionate loan, if its SHGs were not assessed as healthy. The MBTs would earn a small margin for intermediation. Since the returns expected were not significant and MBTs would only make small surpluses, taxability of the income was not a critical dimension that dictated the form of organisation. It was expected that the surpluses would be retained and added to the capital fund of the MBT. Over a period of time, it was expected that this fund could be used for activities beyond microfinance. It was not envisaged that the MBTs would contribute any further to the equity of SNFL beyond the amount identified initially.

Governance of MBTs

Each MBT has a governing body of 9 persons. The chairperson of the MBT was appointed by the settler. This was usually the ASSEFA Development Manager in charge of the block. This person was an employee of ASSEFA, on deputation to SNFL. There were two other persons nominated by the settler, thereby giving the settler a say in nominating a third of the trustees, including the chairperson. Four trustees were drawn from the community. This was done through an annual election at the cluster level and one person represented each cluster. Though the cluster was not a formal division, operationally that was how the trustees were elected. Two other positions were left for the seven trustees to co-opt. These positions were reserved for members of the community being benefited under the other activities carried out by ASSEFA.

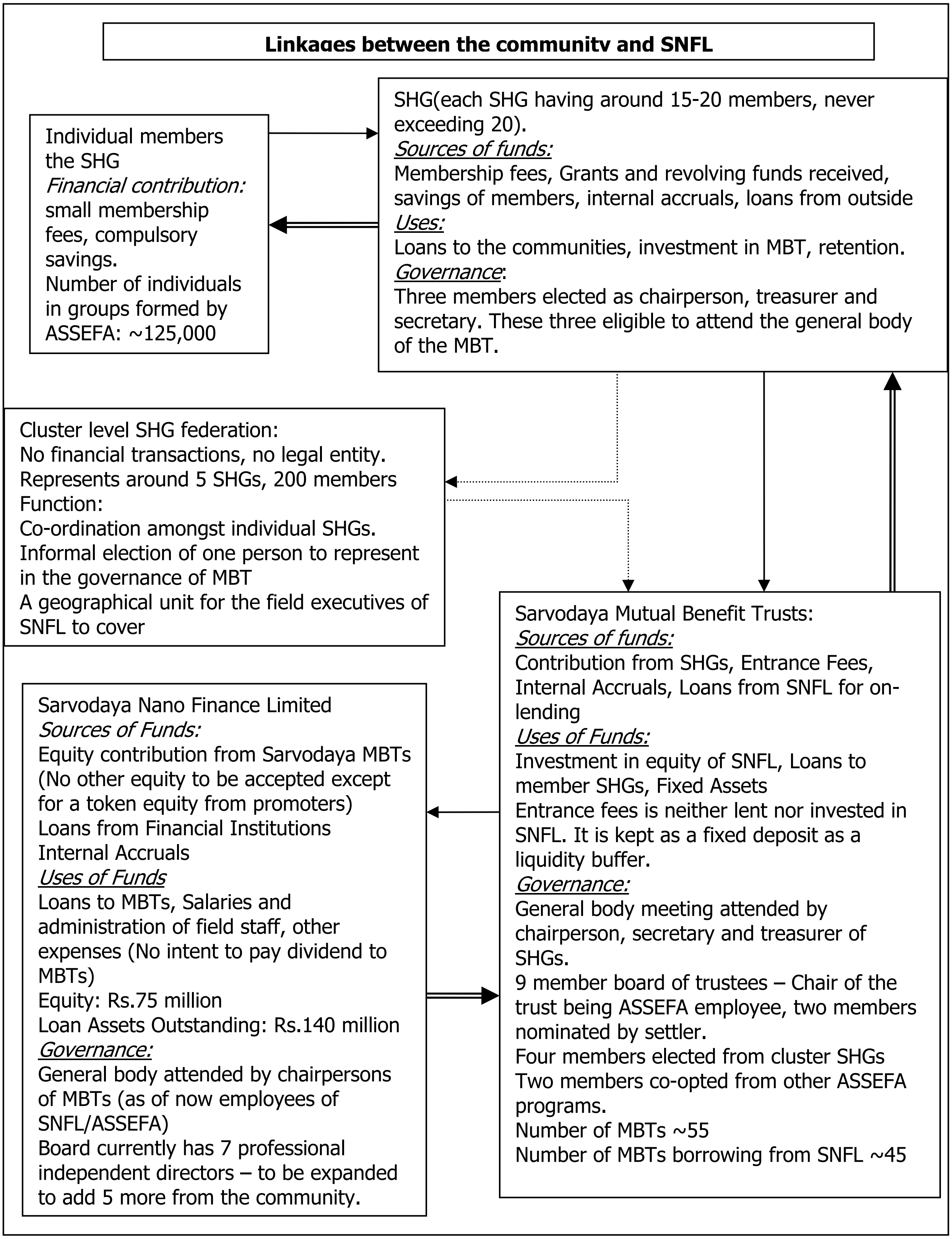
The process of forming MBTs started in June 2001. Each MBTs was not only registered properly by filing a trust deed at the Deputy Registrar's office in the District, they also held meetings regularly. All MBTs were audited by qualified chartered accountants and filed income tax returns. SNFL closely monitored the finalisation of accounts of the MBTs and also re-conciled the figures with its own books, before publishing its own accounts. This ensured that there was a close co-ordination between the MBTs and SNFL. SNFL saw this as a process of hand-holding till the MBTs learnt to manage their affairs independently. This worked because of perfect dovetailing – SNFL did not have any loaning to parties other than MBTs, nor did it source equity from elsewhere. MBTs were encouraged to source loans only from SNFL. Therefore it made immense sense to reconcile the books of these entities with each other.

When we carefully examine the structure described above, we realise that the equity funds in SNFL were coming only partially out of the resources of the community, while a substantial part was coming from the grant funds received by ASSEFA and given to the groups. Given that these were community resources, it made sense to have the share holding in a community organisation rather than in the name of the poor individuals. However we cannot ignore the implications on the governance of MBTs, in terms of dependence on ASSEFA We shall discuss this in greater detail later. However at this point it may be important to look at what it meant to the stakes of the people who would benefit from the programme.

Poor individuals were members of the SHG movement. They had built stakes in the SHGs through their initial contribution, periodic savings and accumulated surpluses from the loaning programme. Therefore, the members had a strong incentive to govern and ensure that the group functioned as long as the lending programme was useful. The design was that the groups would continue in perpetuity – any withdrawal from the group gave the members access only to their own savings on termination of membership and not a share in the common resources. Therefore in the minds of the members, the common resources in the group would not have found a place of primacy.

At the same time we have to remember that these funds *actually* came to the SHGs and therefore the SHGs would had a sense of collective ownership on the funds. The time lag between the funds coming into the SHGs, and going out as contribution to MBTs was significant. The groups had also put these funds to good use, by lending internally. Therefore when these funds were being taken out of circulation to be upstreamed against a promise of higher loans, the SHGs asked questions and in some instances had to be convinced that this was in their larger long term interests. This was building in accountability. SHGs felt that it was their common fund that was going in and not some grant money that was going into the structure.

ASSEFA gradually reduced its grant based activities in areas where MBTs were formed and put its efforts on promoting microfinance based activities in these areas. This gave a message to the SHGs that, as they became more and more stable, they would be dealt with in commercial terms rather than developmental terms. SNFL was the commercial face, and all support was to be expected from there, rather than ASSEFA.



[7] All statistics are rounded off and represent the position on 31 March 2004.
A dotted arrow indicated informal relations, a double lined arrow indicates the movement of loan funds and a regular arrow indicates equity investments and governance relationships.

Governance of SNFL

Organisationally this structure ensured that the common funds of the groups that came from external sources were pooled in a single place. This could be leveraged to raise more resources for the communities. However, the question was who would be in charge of the funds so pooled? At inception, it was agreed that SNFL would not accept equity investments from institutional sources. There was a potential of BASIX group having some equity, as they were the initial promoters and there was no conflict of interest. The Small Industries Development Bank of India through its SIDBI Foundation for Micro Credit (SFMC) was another potential source from which equity funds could have been tapped so that the base could be significantly expanded to leverage more funds. However, SNFL wanted to be truly community owned save for a token equity of initial promoter individuals which added up to less than 1% of the total equity.

There were some ideological reasons to have this company as (almost) fully owned by the community MBTs. However, while SNFL was community owned, it was not community governed. One could say that SNFL was professionally governed. Like several widely held companies listed on the stock exchange, the ownership of SNFL was de-linked from the management. SNFL had members on the board who were there for reasons of merit rather than share-holding. The board of SNFL consisted of seven directors. Three of them were promoter directors of BASIX. Two others were chief executives in two BASIX companies. The chief executive of SNFL was also on the rolls of BASIX and had been seconded to work full time with SNFL. The only person representing the communities was the Executive Director of ASSEFA, who was also the Chair of SNFL.

The constitution of the board was based on trusteeship. Like in most organisations in the development sector, the board had little representation from the community. One of the reasons was that the SHG members were not ready to take up governance positions. The structure was complicated and it needed professionals to manage it. What was surprising in the SNFL – MBT structure was that the representatives of the communities had limited say in the General Body of SNFL. This was because the MBTs were represented by their respective chairpersons in the annual general meeting of SNFL. We have to remember that these chairpersons were appointed by the settler and were employees of SNFL – either directly or indirectly. The participation of the SHG-members was limited to electing 4 representatives to the MBT board. The only way that the trustees could influence the governance was by advising their respective chairpersons to air the concerns and raise issues in the annual general meeting. As we can see, this link was bound to be weak.

SNFL was aware of this issue. There were plans to expand the board and induct five members from the SHGs. The process of induction into the board of SNFL was to be in the format of a co-option rather than an election. The process of election from amongst more than 70,000 members was complicated. It was envisaged that the community representation would be restricted to women, and they would be chosen from MBTs where they had shown leadership qualities – had been on the board of the MBT for at least a year, had some basic education (should have passed intermediate examination) and had a potential to contribute to the governance of SNFL. In addition, the proposed director should have been a member of a non-defaulting group and she herself had no outstandings. These aspects were expected to be minuted and the articles of SNFL amended to formally acknowledge the change in governance structure. This change was to be effected in 2004-05. As of now, one could only say that SNFL was a community owned, professionally governed institution. Even in the future, two factors were etched in the trust deed of the MBTs that were difficult to change:

1. The chairperson of the MBT would represent the Trust in the general body of SNFL.
2. The chairperson of MBT was to be appointed by the settler - the Executive Director of ASSEFA.

This meant that representation in the governance structure of SNFL would always be on a nomination. However, the change that could occur as the trusts grew stronger would be that the chairpersons who were Business Development Managers and employed by ASSEFA/SNFL could be employed and accountable to the MBTs. To that extent they would be under the overall supervision and control of the community representatives on the trust.

Management of SNFL

SNFL entered into a management contract with the BASIX group. Under the contract, the operations of SNFL were managed by BASIX through a representation on the board and also by seconding a chief executive to look after the day-to-day operations.

Management of MBTs

The MBTs were designed to function independently as they grew. To ensure this, each MBT had hired a chief executive officer – who was fully paid by them. There was a cluster-in-charge who was hired by the MBTs and would manage one cluster. Eventually it was expected that the chief executives hired by the MBTs would carry on the larger agenda of working towards social causes beyond microfinance.

It was expected that when an MBT grew beyond a certain limit, it would be split. This was designed to ensure that the MBTs did not become too unwieldy. If a target of more than 300 SHGs in the membership and Rs.900 million in outstanding was achieved; it was considered a fit case for a split.

The MBTs would maintain their own accounts and get them audited at the end of every financial year. They would also file tax returns and hold a general body meeting where the performance would be presented and the members to the trust were elected. It was expected that the surpluses made by MBTs would be retained. Every year 10% of the surpluses were to be kept as general reserve, and the rest of the surpluses allocated to the groups in proportion to their initial contribution. However this money could not be withdrawn even on termination of membership of the SHGs.

The new SHGs that joined in the MBTs were expected to get in contributions only if they had received group or development funds from donors/ASSEFA. Otherwise, no new group was expected to contribute to the corpus of the MBT, except for the initial contribution of Rs.1,000. The contribution of the SHGs, over and above this initial contribution of Rs.1,000 would be invested in SNFL. The shares in SNFL were held in the name of each MBT and the application and other documents would be signed by the chairperson. The MBT would pass a specific resolution authorising the chairperson to sign and acquire shares in SNFL.

The only source of finance for MBTs was SHG contribution and borrowings from SNFL. It was again etched in the trust deed that the MBTs would in no way be accessing the savings of the poor parked in the SHGs. The SHGs were free to use the savings for internal lending purposes or deposit them in the bank. The margins of the MBTs came from the spread between their borrowing from SNFL at 12% per annum declining and the lending rate to the SHGs at 15% per annum flat. This spread was sufficient for the maintenance of the MBTs and retain a small surplus. In addition it is important to consider the following observation made by M-Cril "The operations of the MBTs are also subsidised by ASSEFA to a great extent. ASSEFA in turn meets the costs from grants for its integrated rural development interventions (through various international donors)".[8]

The SHGs in turn did not retain any margin. Most of the work for the SHGs was done by the employees of the MBT, including maintenance of books. Therefore the SHGs possibly did not need too much of a margin. However, they did have a margin on the internal lending of member savings that was collected monthly. The SHGs did not pay any interest on the member-savings and the spread coming out of this was sufficient for the SHGs to break even and make some margins.

Management of SNFL

SNFL was managed by professionals. The chief executive was on deputation from BASIX and he was assisted by a chief operating officer and other staff. Most of the other staff were hired by ASSEFA and deputed to SNFL. There was a well defined structure of reporting and performance appraisals.

At the very outset, recognising the need to manage the company professionally, ASSEFA signed a contract with BASIX to provide a range of management services all the way from deputing a COO (who later became the CEO), to specifics like installing an MIS. The following were the main points covered in an MOU signed.

- Business Plan 2001-2001
- Developing appropriate products and delivery channels
- Software for Sarvodaya – financial accounting and MIS for loan portfolio, incl training of staff
- Operations Manual for loan appraisal, approval, disbursement, monitoring and recovery
- Internal Control and Audit Systems – establishing and staff training
- Statutory compliance systems for RBI NBFC regulations, Company Law, Income Tax and other applicable laws establishing and staff training
- Business Plan Quarterly Review training
- Assistance in raising additional borrowings from India and abroad
- Staff training in accounting, appraisal, fund management

[8] MCril 2004: Microfinance Rating-Risk Assessment. Reproduced with the permission of SIDBI who commissioned the ratings and have copyrights on the rating document.

The senior management of BASIX, apart from serving on the Board of SNFL, also made periodic trips to SNFL and gave detailed guidance notes to the COO. An example of one such is attached in Annexure 2. As can be seen the role of BASIX has been crucial in the management of the SNFL and ensuring that the company is run on the lines of a trusteeship of a community owned institution.

The Role of SNFL vis-a-vis SMBTs

The role of SNFL was two fold – the first was to source equity from the MBTs to ensure that they had adequate capital. A target on how much capital had to be sourced from each MBT was spelt out based on the records of ASSEFA's contribution to the common fund of the group. Around Rs.75 million were already sourced from the MBTs and it was expected that Rs. 135 million would be collected in about 4 years time. The annual target for increasing equity was Rs.15 million per year in the next four years. This was not easy as the funds had already gone into the circulation within the SHGs. They had to be convinced that investing in SNFL via the MBT was in the larger interest of a greater multiplier. Collecting share capital from MBTs was somewhat similar to loan recovery as the old common funds were being asked to be turned in. Follow up was needed if the MBT had not invested their common funds fully in SNFL or when new SHGs were admitted into the MBT. While the initial contribution of Rs.1,000 to the MBTs were maintained as a liquidity buffer within the MBTs, the other contributions were passed on to SNFL. The share allotment committee of SNFL met once in a month and allotted the shares to these MBTs. This was later ratified in the quarterly board meeting. The allotment of shares was termed as private placement, done on a routine basis without much regulatory intervention. The regulatory intervention was limited because SNFL was a privately held, non-listed company.

The second role of SNFL was to provide adequate finances to the SHGs. As a related activity, SNFL had to raise loans from the external market to leverage the equity put in by the MBTs. SNFL had an internal appraisal system and the loans were given according to the ratings obtained by the SHGs. While the loans were actually made to the MBTs, it was individual SHG applications that were appraised. The SHGs would put in an application to the MBT for a loan; these applications would be pooled and presented to SNFL. SNFL would in turn appraise each SHG application, and make a bulk loan to the MBT, indicating to which SHG it had to be on-lent.

There were some small problems in the field pertaining to the loan amounts. The equity raised from SHGs through MBTs was based on the common fund available. This formed the base for SNFL to leverage loans in the market. However the same formula was not used as a base for approval and disbursement of loans to SHGs. There the appraisal was based on the overall health of the SHG based on a scoring system. Since the contributions were based on the past donor funding made to the groups, it was likely that the contribution of the older groups were much higher than the recent ones (which did not have IFAD capital development grant). This anomaly between contribution and the ultimate loan amount approved created some dissonance amongst the groups.

Another important feature was that while the loan from SNFL to the MBTs went as a single bulk loan in the books, the basis of approval was through individual application forms submitted by the SHGs to the respective MBTs. MBTs in turn forwarded these applications to SNFL and loans were approved and disbursed based on a consolidation of these independent SHG applications. Operationally MBTs were having only a limited role in deciding the lending norms, which was centrally decided. MBTs had a role in lending decisions at their level. This assumed greater significance as the business development managers of SNFL also doubled up as the chairpersons of the MBTs.

The transition from a decentralised ASSEFA managed programme to a more centralised SNFL was not easy. In the earlier dispensation since each region had an ASSEFA person, and this person was overall in-charge of the resources and also had fair amount of decision making powers on the nature of utilization of resources. When this activity got professionalized and centralised the older staff resented it. However this did not pose a great hurdle in consolidation, but in some cases made the consolidation slow.

SNFL for itself had small spread. As the MCril report points out, some aspects of SNFL's operations were cross subsidised by ASSEFA. This might not be the case in future, but with a thin spread, it was unlikely that SNFL would plough back significant amounts of profits into circulation, even if they continued the present policy of "zero dividends". As SNFL would not like the MBTs to invest more money than the group funds that came as grants, there would be an issue with re-capitalisation in future, particularly if SNFL wants to work with newer groups and increase funding for the existing groups.

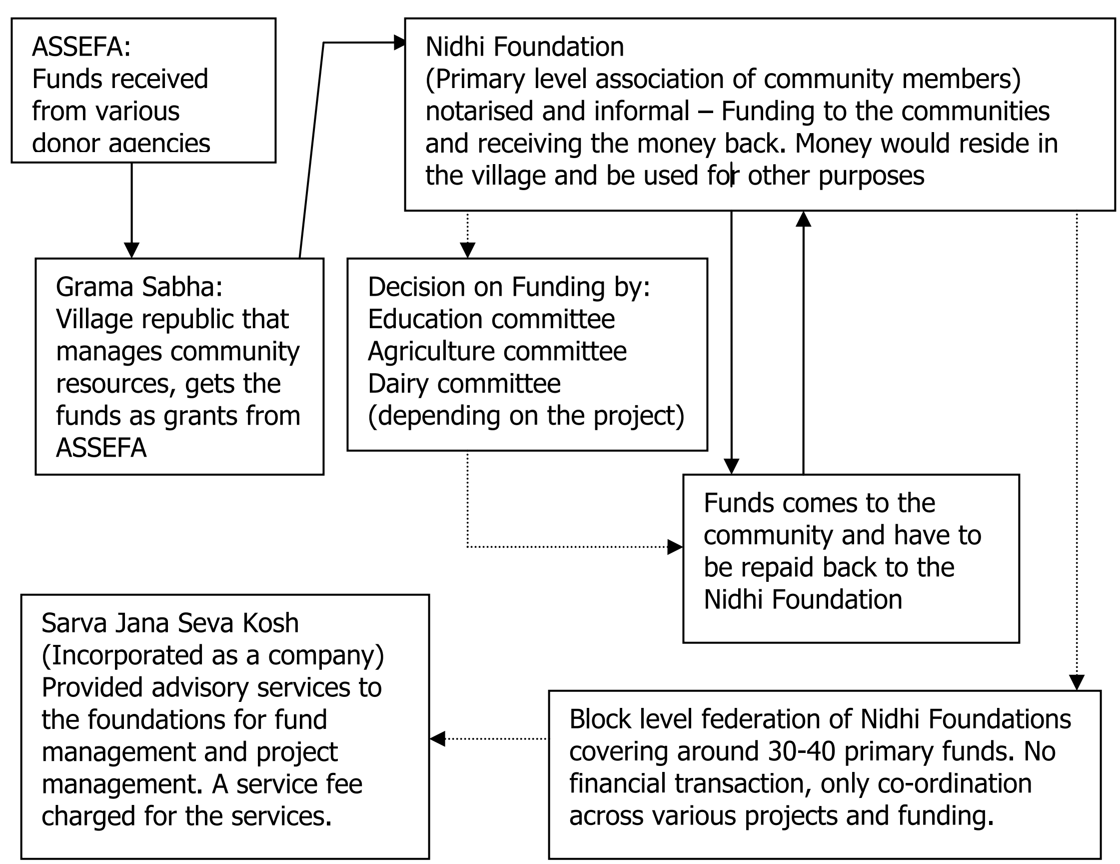
Future Plans

SNFL had set an aggressive target of reaching out further in TN and also reaching out in other locations where they were active. The targets for the next few years were to increase the current membership from 55 MBTs to 100 MBTs, achieving an outstanding for Rs. 1 billion (current outstanding – Rs. 470 million) and keeping the repayment rate at 100%. The MBTs would be from TN, but they expected to form around 15 to 20 MBTs in all from Bihar, Maharashtra and Rajasthan states. To achieve this level of lending, it was imperative that SNFL had to borrow a fair amount from the market. It was possible to raise resources from the market as there were willing institutional lenders to chip in. However SNFL itself had to have adequate capital for leveraging external funds.

A Rs. 1 billion lending programme entailed an equity base of around Rs.200 million for the lenders to be comfortable. The pooling of the community funds would at best fetch a cumulative amount of Rs. 150 million. Therefore, there was a need for SNFL to look at alternative ways of raising capital. Getting in institutional equity and from other individuals was not acceptable in principle and therefore there had to be a mechanism wherein the communities would continue to get involved in the process. SNFL had some plans for this.

In the late 1980s Mr.Loganathan, Executive Director of ASSEFA felt that the funds raised from various donors was being spent routinely and there had to be some order in the way these funds were channelised and managed. In 1989, with the active support of ASSEFA, Sarva Jana Seva Kosh (SJSK) was incorporated as a company. This was expected to be a financial services company that would manage the community resources of the entire programme. In fact the early seeds of the SNFL idea were sown in SJSK. However, as SJSK was not adequately capitalised, it did not manage to get registration to function as an NBFC when the new norms came into place in 1997. The structure of SJSK was similar to that as SNFL, but it was thin and hollow. The Nidhi Foundation at the primary level was similar to an SHG, except that it dealt with other livelihood generation projects and not microfinance. Similarly there was a block level confederation of these Nidhi Foundations. The structure is depicted in the flow chart below (Figure 2). MBTs for SNFL were mostly being established in places where the Nidhi Foundations were weak, or did not exist, to ensure that there was minimal overlap. It was planned that the funds with Nidhi Foundations would also be eventually consolidated in SNFL, through SJSK. All foundations would – through a similar structure contribute to SJSK and SJSK in turn would make a bulk investment in SNFL. In doing this, all the funds belonging to the communities could be gathered at a centralised place and could be used for better leveraging. The restructuring of SJSK and the process of procuring a registration from RBI was going on.

Figure 2: Other community organisations and funds managed under ASSEFA



Overall, it was expected that the funds with the communities would be sufficient to fund all expansion plans in the medium range. The challenge was, however to go beyond TN and look at other states. The plans were that the Bihar operations would start in June 2004 and the Rajasthan operations would pick up by 2005-06. In addition to getting funds from the communities, SNFL also expected to raise some funds for softer aspects like capacity building from organisations like SIDBI Foundation for MicroCredit (SFMC). Therefore there were no serious problems expected in the medium term. With the current capitalisation structure, it was possible to leverage adequate funds from external sources – particularly from institutions interested in microfinance such as SFMC, ICICI Bank, ABN-Amro Bank and other commercial banks.

The MBTs were not expected to plough back their surpluses to SNFL, though they were expected to have some surpluses on account of the spread they got from the financial intermediation they did between SNFL and SHGs. As ASSEFA's larger interest was in holistic development, MBTs were expected to utilise the surpluses for larger social good. For instance, some of the MBTs were already engaging themselves in hiring teachers for the community schools, arranging for mass marriages so that consumption expenses on social events could be minimised. Some were investing in health and other projects. The structure was designed so that the external funding received for the various projects would form the basis for leveraging more commercial funds for the poor, while all the surpluses generated by the communities would be ploughed back to the communities. SNFL as a community owned, professionally managed institution was involved in intermediation and leveraging that was sorely needed by the poor.

Concerns about the current structure

While the current structure did consolidate all the funds that were floating around inefficiently in the system, it raised some concerns in the short and long term, which were to be addressed. It is true that for the type of operations that is expected out of SNFL, a company could be ideally suited as it has to leverage funds from the mainstream and was most accepted in the banking circles. But the concern that this structure raised was that of centralisation of decision making in the Executive Director (ED) of ASSEFA. This was specific to the ASSEFA-SNFL situation and need not be an essential feature of the MBT-NBFC design. This was because the ED was the settler of all the MBTs and the chairmen who represent the MBTs in the general body of SNFL are appointed by the ED. This was a vulnerable structure in case proper succession with appropriate checks and balances were not set up for the office of the ED.

In addition, while the structure did have a logic in sourcing funds from SHG/MBTs and linking the amount of funds to be sourced from SHG/MBTs to the common donor funds, it did not translate into proportional control rights for MBTs that put in greater amounts of funds. The amount of funds sought from the MBTs also did not bear any relation to their borrowing capacity, while SNFL itself was structured in such a way that its net-owned-funds (contributed by MBTs) became critical in sourcing money from outsiders. Dividends in any case were not to be declared. So, either way little incentive was built within the organisational structure for further capitalisation. It also did not foster informal control because of a lack of link with MBT stakes and the service usage. Even the basic co-operative principles of patronage based stake and control did not seem to be in work here.

The justification for a for-profit NBFC weakened when we considered that SNFL did not intend to make large margins. Their spread at the time of the study was 2% on borrowed funds (Interest charged was 12% per annum and borrowings from SFMC was at 10% per annum).[9] In addition to the fact that the spread was low, there was no intent to pay dividends. In such a case, there was no reason to dispense with the idea of setting up a section 25 company rather than and NBFC.

The MBTs themselves had an open structure and the SHGs could join in at any stage as long as they fulfilled the criteria. However, unlike co-operatives the SHGs could not sever the relationship with the MBT – as there was little incentive to do this even if MBTs did not perform. Since this was a Trust, all contributions from the independent SHGs would be in the form of non-withdrawable stakes. This was unlike co-operatives where one could withdraw the share capital on termination of membership or in case of companies where the shares could be sold if there was a market. Similarly we need to understand that MBTs contribute to the equity of SNFL, which was difficult to liquidate, unless there was an active stock market on which the shares of SNFL were listed. It was unlikely that a sound secondary market to the shares of SNFL would exist if it had an avowed policy of not declaring dividend and not having any other members.

In case of SHGs that were investing in MBTs, they continued to be vulnerable. Technically if an SHG dissolves, all the residuals in the group were to be shared amongst the members themselves in a pre-agreed proportion. However, the SHG itself could not encash its investment from the MBTs. If there was a run on some of the SHGs for loss of faith, it would be really difficult to recoup the situation. However, experience indicates that SHGs being closely knit cohesive entities are unlikely to have a run. But this technicality may have to be considered in case of replication of such structures.

This design assumed that the communities are at the core, but the programme was to be governed and managed by professionals. It encouraged community participation, but this was more through co-option than through democratic processes. This is seen as a transitional arrangement and perhaps in five to seven years since inception, the company will get substantially managed by the members. Already some of MBTs have women members as CEOs. There was a mismatch between people's stakes and governance rights. Though the stakes that were in the name of SHGs had come from the efforts of ASSEFA, these were in circulation in the groups for a while. Therefore the communities assumed a right to use these funds. Setting a target to recoup the grants as equity contribution negated the voluntariness of association and participation. The structure would have made more sense if the stakes of the MBTs and in turn the stakes of SHGs in MBTs had some linkage to the patronage and business rather than in the form of recouping common funds. This would have provided greater scope for further investments from the groups if they found the services of SNFL satisfactory.

The plan for getting investments from the SJSK and also other wings of ASSEFA such as the habitat fund also did not look very convincing, because the core benefits of investments went back to the microfinance SHGs. In any case – subscribing to equity in SNFL could not be considered as a great investment opportunity as SNFL did not intend to give great returns. However, given that the institutions belong to the same family of entities, the consideration for investment need not have been returns, but the larger benefit of the communities. To that extent, one could expect further investments to flow in.

[9] M-Cril (2004): Rating report.

Regulatory Issues

The case of SNFL and all its inter-relations indicates the lack of an appropriate legislative framework in the country to ensure that grant and donor funds can be leveraged to the larger good of the poor communities. When we look at some of the large successful developmental programmes in the country like the operation flood programme implemented by the National Dairy Development Board (NDDB), we find that these programmes have been successful by harnessing inexpensive aid from multilateral sources and using the aid as a basis for large scale replication of economic programmes. For instance, in case of NDDB, it received large amounts of commodity aid from Europe which was then sold here at market prices to create a basic fund for setting up this country's largest developmental programme in the dairying and livestock sector. The multiplier effect was achieved not because aid was used to transfer benefits to the end users as a one way flow, but because aid was used as a base capital for getting a multiplier effect.

If we examine the trend in the microfinance in particular and development sector in general, the funding is moving more towards providing "revolving funds" to groups of individuals rather than one time front-ended subsidy. Experience shows that this could be more lasting than a one time aid. Unfortunately there are no appropriate legal structures where these funds could be consolidated and used for the larger benefit of the poor.To that extent one could see the MBT structure as an innovation to garner such dispersed grant funds. When we examine NDDB experience, we find that it was possible for NDDB to adopt this strategy as the state established NDDB as a body corporate, with all the exemptions granted including taxation benefits till the network was fully established.

We do not seem to have such a unified strategy for financial services in the country, though there are several attempts at reaching out basic capital and offer savings facility to the poor.

Ideally, given the considerations of building stakes of the beneficiaries and pooling of resources, the co-operative legislation would have been most appropriate for the type of activities that ASSEFA-SNFL have been carrying out. The basic contours of the programme of ASSEFA were:

1. Open-ness to take new members and new groups as the programme grew;
2. Build in a large community stake so that the professionals remain accountable to the people for whom the aid was meant; and
3. Extending the benefits of the programme for activities beyond just microfinance.

A co-operative provides for open membership, democratic control and also allows enough flexibility for organisations to do multiple activities with its members. Since co-operatives are expected to be user-owned organisations, one does not see potential conflicts of interest even if multiple activities are taken up as long as the activities meet the common needs of the membership.

Unfortunately the co-operative legislation in India never lived up to the principles and spirit of co-operation. The legislation is also restrictive and due to successive interference by the State, has become an anathema for development practitioners. As co-operation is a state subject, organisations working in multiple states find it difficult to carry out activities under this legislation.

There are some other questions SNFL case opens up to us. It is important to examine if the legislation governing trusts does indeed provide a stable solution for harnessing the community resources. Since there have been no significant issues pertaining to the legislative framework in the microfinance sector, that have gone for litigation and review, this is an unexplored area.

Issues for scaling up and replication

Irrespective of the legislative options, the structure adopted by ASSEFA-SNFL is complicated. While the SHG structure is simple and well tested and is working across the country, what is lacking is an intermediary federal structure. ASSEFA-SNFL model chose to have private MBTs as an intermediary structure. While a great deal could be built into the MBTs in the way their deeds are framed, it seems to be a complicated structure to undertake intermediation in commercial microfinance. While there seem to be democratic systems operating in the intermediary MBTs, we find that ultimately the representation in SNFL is given through a nominated chairperson. The process in nominating the chairperson or the election to the board of trustees of the MBT does not recognise the stakes built in by the individual SHGs. Of course, it is not necessary that in replication of this structure, the same feature should be followed, and we could have internal structures that recognise the stakes and the patronage systems. Since trusts are not organisations having share-holding, the rights on residual claims on liquidation does not belong to the members of the trust. This is justified because the stakes were never built out of the personal resources of each of the members, so it is just as well that the residual claims on liquidation belong to the society at large.

While there is no internal contradiction in the structure – that resources given to the community are held by the community and is structured in a manner that no individual benefits, the structure does not foster growth, as there is no incentive for the individual beneficiaries to contribute back their own resources in the long run when they are indeed in a position to do so. Secondly, this structure cannot attract outside equity easily. While in the short run, it is an effective marriage of community ownership and professional management and governance, in the long run it is vulnerable to adverse usage.

Obviously this structure has impairments in scaling up to significance in future. If indeed SNFL were to scale up, it had to have a hybrid ownership of communities and financial institutions. In fact if the financial institutions as a group hold the majority stake and the stakes of the communities could be designed to reflect their patronage it would be a good combination to work with and scale up. The structure could be replicated only if there is a strong systems oriented culture to back up the entire effort. The structure may we worth some more experimenting to cover the loopholes, but seems difficult at this stage for stand alone microfinance efforts to replicate. However it is possible that this structure adequately modified at the intermediary level to have non-for profit companies might be a bit more stable. SNFL with its MBTs assumes a mature governance structure and given the state of microfinance in India, there possibly would be very few entities that could show the same level of maturity.

Sir Ratan Tata Trust Fund for Research Collaborations in Micro finance

Micro finance has been widely acknowledged as a tool for mobilising the poor and reaching quality financial services. The field, especially in India, has developed largely based on practitioner experience. While the sector has expanded, largely through replication, over the past few years, there has also been an increased realisation on limitations of micro finance. The Sir Ratan Tata Trust Fund for Research Collaborations in Micro finance at Indian Institute of Management Ahmedabad (IIMA) supports cutting-edge, field-based research, which reviews and guides experience, especially in the Indian context. The project envisages work on diverse themes such as:

- Understanding financial flows of the poor over long horizons
- Understanding financial flows of seasonal migrants
- Documentation of transformation experiences of Indian microfinance institutions
- Documentation of the role of mainstream banks in microfinance.

Research in progress is put out as working papers. Completed research would be published as papers and books. In addition there would be dissemination through focussed workshops and training programmes for the practitioners.

The Sir Ratan Tata Trust is a grant making foundation with interests in the thematic areas of education, health, rural livelihoods, arts and culture and enhancing civil society and governance. (www.srtt.org)

IIMA is a leading management institute which offers postgraduate and doctoral programmes in management. In addition to research in mainstream areas of business and industry IIMA also undertakes extensive work in social sectors such as agriculture, education, public systems and infrastructure. The SRTT Fund is hosted in the Centre for Management of Agriculture at IIMA. (www.iimahd.ernet.in)