MAKING MARKETS WORK FOR THE POOR

The Small Investors' Fund

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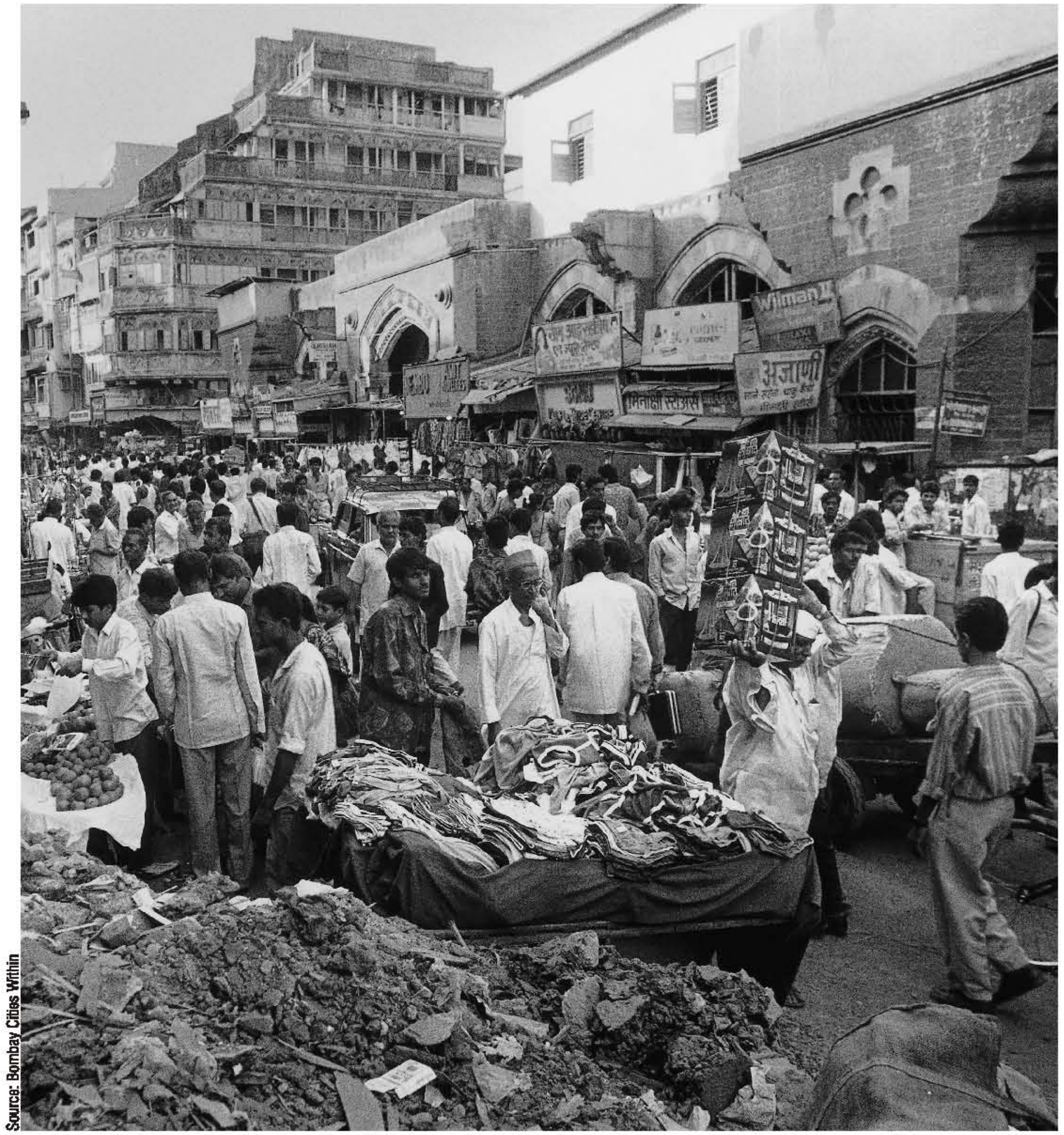
Synopsis: A small investors' fund, which offered an opportunity for many poor slum- and pavement-dwellers in Mumbai to invest money, was an outcome of tremendous effort put in by an alliance of social organisations. But, unfortunately, after successful growth over five years, the scheme, run in collaboration with the UTI, was forced to close because of various reasons. Such schemes, with suitable modifications, need to be revived as they meet the needs of the poor.

Cities are growing at a rapid pace. By 2020 half of India's population will be urban residents. But at the same time, the percentage of the poor within these cities is also increasing. While, on one hand, the city's growth is fuelled by the cheap labour of poor migrants, i e, slum- and pavement-dwellers, on the other, there are no provisions to plan for their housing. However, when the poor build houses in the empty spaces they can find, the city deems these illegal encroachments and demolishes the structures. Thus a constant war of attrition continues – while the city demands the poor's economic participation, it refuses to recognise them as legitimate urban citizens who are included in development plans. This results in the mushroom growth of slums. In Mumbai alone, about 60 per cent of the city lives in slums and the majority of these residents having lived in the same slum for decades.

Life in slums is characterised by complete informality. Since most slums are outside the purview of municipal allocations and management, people depend on informal methods for acquiring land, water, drainage, sanitation, safety and money, and they are extremely vulnerable to exploitation by middlemen, moneylenders, corrupt officials, politicians and policemen, all of whom charge high prices for their services. For instance, it is not uncommon for slum dwellers to pay higher rates for electricity and water than the middle class residents in their city. However, the poor are viewed – by the rest of the city – as free riders and encroachers who do not pay taxes and a huge burden on collective resources.

This complete sidelining from the rest of the formal city – in which urban planners, middle class residents and financial institutions primarily control how the city is run, managed and organised – produces disturbing social and political exclusions. Generally in Mumbai any middle class Indian can arrive and live in the city whenever she or he wants, but in the case of the poor, who is and who isn't a citizen of the city is determined by whether they can prove they have been living in a slum before a certain – politically decided – cut-off date. One of the most alarming instances of the city's drive against the poor is the recent large-scale demolitions. All those slum dwellers who had come to the city after January 1, 1995 – almost a decade ago – were considered illegal and became liable to having their homes demolished. Some 60,000 families were rendered homeless. Another instance of the severe hostility against the poor is a recent public interest litigation that was filed by several middle class citizens in Mumbai. This group argued that since slum dwellers lived on lands illegally, they should be treated as illegal residents and denied the right to vote – the fundamental democratic entitlement of all Indian citizens.



Source: Bombay Cities Within

Social and political exclusions also go hand in hand with the inability to practise financial citizenship. Since the urban poor lack land tenure or most formal proofs of residence, their engagement with both the private and nationalised banking sector is limited, and therefore they are unable to keep their money safe or invest wisely. Thus their wish to upgrade their homes is curtailed. As a result, financial scams and exploitation abound as the poor pay exorbitant rates for interest for loans they take from local moneylenders and are easily duped by opportunistic middle men who promise rich returns.

In light of the social, political and financial isolation of the poor discussed above, few examples (outside the literature on microfinance, which primarily involves the rural poor) exist of successful partnerships between the poor and their organisations, on one hand, and financial institutions on the other. There is a critical need for initiatives that demonstrate the mechanisms to bridge this financial divide, that view the poor as reliable financial citizens with assets to contribute, and that point towards strategies to tap into all the opportunities of an important untouched (and enormous) market. Moreover, it is important to have some concrete examples that illustrate how this can actually be done.

Significant Case Study

This case study is particularly significant because it documents an unusual and successful collaboration between the most unlikely of partners – poor slum dwellers, middle class activist and a financial institution. The paper presents the Small Investors' Fund (SIF) – the first-ever mutual fund specifically created for the urban poor. Conceived by the Unit Trust of India, an NGO called the Society for the Promotion of Area Resource Centres (SPARC) and a network of slum- and pavement-dwellers, it was a very successful scheme that ran for five years.

This case study is particularly useful for those NGOs that are interested in exploring similar engagements as well as for financial institutions that are serious about expanding and deepening their customer base. It points towards some of the social, organisational and regulatory issues concerning poor people that prevent them access to capital markets and discusses the need to re-examine and redesign regulations empathetically. It recommends two things – first that a similar scheme be set up, and second, that financial institutions invest in creating solutions that set the precedent for large-scale participation of the poor in the formal financial sector. This requires a shift in mindset towards recognising the poor as credible financial citizens who form a profitable market that has the means to contribute to as well as benefit from the overall progress of the Indian economy.

Creation of the Fund

The alliance: The alliance of the SPARC, the National Slum Dwellers Federation (NSDF) and Mahila Milan (MM) has been working on issues related to urban poverty for the past two decades. SPARC, an NGO, provides administrative and financial support for two people's movements of slum and pavement-dwellers – the National Slum Dwellers Federation and Mahila Milan – to mobilise around issues of housing and infrastructure. The NSDF organises and links poor communities, builds local leadership, and undertakes affordable housing and infrastructure projects. The MM is a network of poor women's collectives that manages savings and credit activities within slums and pavements and supports women in assuming positions of local leadership. Currently the alliance works in more than 70 cities in India. It also works with similar NGOs and community organisations in 15 Asian and African countries. This network is known as the Slum/Shack Dwellers International.

Looking for collaborators: In 1986, when SPARC and MM began encouraging the poor to save,[1] they realised that most of their members didn't have a safe place to put their money. The very process of opening a bank account was intimidating to illiterate poor women – involving filling in various kinds of forms and maintaining their records. When SPARC approached the Bank of Baroda to open accounts for its members, they found the bank very reluctant because depositing and withdrawing small amounts of money meant very high transaction costs. A lot of negotiations were carried out and after a big effort from the part of SPARC, the bank agreed to open a MM account which would be operated on a weekly basis – depositing the collected savings and withdrawing the required amount. Within a few years, opening MM accounts has become routine for the federation. And over time, on MM's recommendation, Bank of Baroda has opened several thousand accounts for the poor in their individual names.

By the mid-1990s, a considerable amount of community money was deposited in MM bank savings accounts earning an interest rate of barely 3 per cent-4 per cent a year. Then the alliance began to consider how to assist communities of the poor to invest, as was routine for the middle class, in better instruments that were available in the market. At the same time, the alliance wanted to explore a possibility that, although initiated by SPARC and its federated communities, would be easy enough for other NGOs and communities all over the country to also adopt and replicate.

When the alliance began to discuss this matter with various mutual funds, many of whom were interested in helping invest this money, but they wanted to deal only with SPARC and not the constituency of the urban poor. There were two main reasons for this. First, like the Bank of Baroda staff, they also did not want to deal with large numbers of poor people since they frequently deposit and withdraw small amounts of money. The transaction cost of dealing with so many small investors on an individual basis – especially those who didn't even have a bank account – was just too high. The second reason was that the existing mutual fund schemes at the time did not meet the special needs of the poor for small investments, i e, quick liquidity and low risk. Instead, these investment schemes required high initial investments or locked-in money for certain periods of time or had high reinvestment or carried a moderate amount of risk. Unwilling to make any concessions for these potential low-income customers, the mutual funds advised SPARC to invest the money as a lump sum in SPARC's name. Nonetheless, the alliance was clear that it did not want to compromise on its goal to create the conditions where banks would learn to deal with the urban poor, and see them as a valuable customer and market base. As a result, none of these discussions worked out because SPARC wanted each pavement/slum dweller to have an investment in his or her own name.

Collaboration with UTI: Then SPARC had approached Unit Trust of India (UTI). The UTI was set up in 1964 as a trust under an act of parliament and was the largest mutual fund in the country until 2003, when it was split into two institutions. One of the institutions, UTI Mutual Fund, inherited all the mutual fund schemes of UTI.

When SPARC began meeting with UTI in late 1997, it was apparent that the only solution was for UTI to start an entirely new scheme specifically tailored to the needs of slum dwellers. At the same time, the issue of high transaction costs was a very real concern for the bank. A solution needed to be devised which would address this issue as well as the fulfilment of Securities and Exchange Board of India's (SEBI)[2] highly regulated formal requirements.

UTI's executive trustee P J Nayak, immediately worked with a small team of very committed bankers and asset managers to devise an appropriate strategy that would keep transaction costs to a minimum as well as maximise secure returns. The team knew that if UTI was to maintain thousands of individual accounts and deal with them directly, its board would simply disapprove this scheme because it would be too expensive. The solution the team devised was simple yet clever. A well-established practice amongst mutual funds to keep transaction costs low is to use agents who collect investments from individuals and act as intermediaries between individuals and the mutual funds. In fact, mutual funds even incentivised agents by giving them commissions to do this because it reduced their operational costs substantially. The question was – why not make SPARC, an NGO, the agent in this case?

The next point of debate was whether to create an open ended or a close ended scheme. In the latter, the money would be locked in for a fixed amount of time, but it would receive higher returns. The team decided to create an open ended scheme because it was more important to the very poor to be able to take their money out at any time. Thus, the Small Investor's Fund was emerged. As outlined in the offer document, the objective of this plan was "for people – especially those with small investible surpluses – looking for building up capital without taking much risks of investment. Accordingly the plan aims at generating maximum returns as is possible through investments in a debt portfolio with high degree of safety."[3] Therefore, the mutual fund would invest only in very reliable AAA securities. This document also stated that the "scheme is meant for poorer sections of the society – normally bypassed by most financial intermediaries – who are looking for building up capital out of small savings."[4] As a result, the initial investment was kept low at Rs 1,000 and above and the additional investments were as low as Rs 500 and above. Units were Rs 10 each. Even those who did not have bank accounts could participate and have the investments in their name, as long as SPARC was a second and joint holder. For those who did have a bank account, redemptions were made directly in their names and in their account. Moreover, although people could withdraw their money at any point, because the scheme aimed at building up capital, it would not distribute any dividends, but reinvest profits back into the corpus. In order to deal with the problem of large transaction costs, SPARC was given the status of an agent and a resolution was passed that members purchasing the UTI units would deposit their investment – either in cash or from their individual accounts – into a Bank of Baroda account in the name of SPARC, from where a cheque would be issued to UTI, along with a document outlining the details of each individual member's account. In this manner, the scheme fulfilled all the needs of the poor for minimum risk, maximum returns and a high level of flexibility, and also allowed those people who did not have bank accounts to participate in their own right. It is to the great credit of both Nayak and the UTI team that they created such a fund because, in terms of UTI's portfolio, the SIF was small change for the institution. One branch at Ghatkopar was put in charge of all the required administration and documentation before sending the money to the UTI central office to manage the fund.

The scheme was introduced and inaugurated in April 1998 and the initial offer was opened for 45 days. At that time, 315 poor families who had organised themselves into 15 housing societies joined and invested Rs 14.21 lakh. By the time it had closed, these numbers had grown to 1,420 people from 57 different societies with investments at Rs 60.8 lakh.

Growth of the Fund

Compared to a savings account, where an investment would have grown at barely 3 per cent – 4 per cent a year, the SIF had an annualised compounded interest rate of 11.65 per cent a year. For most of the poor who participated, this was the first time that they were connected to the formal financial world which saw them as important customers. It was a matter of great pride first, that they had UTI accounts, and second, that they had made such sound investments. When the fund was started, both UTI and SPARC had envisioned that after a first couple of years of SIF where systems would be built up and refined, this scheme would be extended to other NGOs and community groups across the country. Unfortunately, this did not happen.

SPARC had promised that they would be able to channel about 1.5 crore within a few years into the SIF. Since the administrative costs of running the scheme were paid for by the returns the scheme generated, it was important that the principal amount kept growing on so that these operation costs did not affect into the returns. But unfortunately, SPARC was unable to move beyond Rs 60 lakh. There were two reasons for this. One, that many of the communities who had formed housing societies and had invested their money in SIF used to live along the railway tracks. In 2000, several thousand of their homes were suddenly demolished and they were forced to live in the open place for several months. Moreover, when these slum dwellers were moved into their new homes at a distance from their previous shacks, many of their expenses, such as travel and schooling, went up. Even though most of the families did not necessarily withdraw their money, they were unable to keep up their regular investments. Also, the federation was so involved in resettling families affected by the Mumbai Urban Transport Project families – who numbered a little over 60,000 people – that they were unable to focus on mobilising other poor communities to invest. Another problem was because of the US 64[5] scandal a lot of people started to withdraw money. But these redemptions were kept to the minimum, as the federation and SPARC spent much effort explaining that US 64 had little to do with SIF. In 2001, UTI representatives met with SPARC and the federation coordinator to encourage investments. Although the federation did increase its mobilisation efforts and started to increase its contributions by Rs 2-3 lakh a month, this amount was below the 8-10 lakh a

1 One of the most important community mobilisation tools of the alliance has been daily savings and credit facilities. Here, Mahila Milan groups visit members' homes on a daily basis to collect savings, distribute cheap credit and ensure repayments. Another important activity is to encourage people to immediately begin savings for housing which is a long drawn-out process that often takes decades. The idea is that once the house becomes a definite possibility, the savings can be used as a down payment for a loan, or as a contribution towards the construction costs.

2 SEBI is the regulator for capital markets, including the mutual funds.

3 UTI Small Investors' Fund Offer Document April 1998, p 1.

4 UTI Small Investors' Fund Offer Document April 1998, p 2.

5 The UTI's flagship scheme US64, was a scheme that millions of middle class investors put their lives' savings into. Unfortunately, when this scheme's value started to weaken, it was coupled by a lack of transparency about this fund, and it eventually crashed and millions lost their money.

month that was required.

But the final blow to the scheme came in February 2003, when, SEBI changed its rules, forcing mutual funds to re-examine their portfolios and close those schemes which were not its most profitable. Moreover, SEBI disallowed third party intermediaries from holding investments. That means, in terms of SIF, SPARC could no longer be a joint account holder for those slum- and pavement-dwelling families who did not have bank accounts. This affected a fifth of all the SIF members.
In August 2003, UTI had issued a newspaper notice listing all the closing schemes. The SIF was one of them. Although at the time of closing, the SIF unit which had cost Rs 10 at the time of launching, had grown to an impressive Net Asset Value (NAV) of Rs 17.44,[6] in the end, it was just too small to maintain.

Analysis of the Scheme

The SIF had been a very special fund, conceived in a unique manner, for the people living in slums and on pavements. A great deal of effort was spent on designing such a scheme, which, could meet the specific needs of poor people, especially when most of the formal financial institutions seldom take the initiative since they consider their investments as non-profitable. At the same time, the fund met the stringent policy regulations that all mutual funds must follow. And this collaboration produced an innovative product which was challenging and exciting for everyone, and in terms of rate of return, this eventually turned out to be one of the most successful mutual funds run by UTI. For the slum dwellers that took part, the SIF was a sound investment because it protected their assets and grew them in a previously unprecedented manner.

Several lessons emerge from this experience. First, that there is a way of getting around the problem of transaction costs, as demonstrated by this case study, by giving NGOs the status of agents. This mechanism can be used both by banks as well as mutual funds.

Second, since SEBI requires that all investors have a bank account, it is important for banks to reach out to NGOs to act as intermediaries so that they can help the poor open bank accounts. The bureaucratic requirements of both banks and mutual funds are complicated and intimidating such as filling in boxes and forms, being regular in instalments, producing various forms of identification, etc. It means that what works for formal customers, works against informal customers living in slums and pavements. Hence, it is essential to have an intermediary for a poor illiterate woman who wants to go through this process so that she can build her capital and asset base while working towards housing and other priorities. In fact, there are regulations that allow for such interventions. RBI regulations state that “no bank shall pay brokerage in any form to any person except commission to pay an agent employed to collect door to door deposits under a special scheme.”

Indians driven by success

Tech-Savvy & Well-Informed, He Knows What He Wants

By Amrita Nair-Ghaswalla/TNN

Mumbai: A multi-tasking, interactive, digitally-driven consumer, that's the young Asian. Aspiring and consumption crazy, youths across Asia are money-focussed, though moral. While school is important, success is everything for 8-24 year-old Asians.

Providing an essential finger on the pulse of what defines Young Asians today, a new study released by leading global market research company Synovate terms India's youth as sensible, social and sporty. “Today's Young Indian is sassy and sets priorities at an early age,” says Amit Adarkar, Director, Synovate India adding: “These internet buffs rely on it not just for product or service information, but also for news and current affairs. To top it all, the Young Indian, a first at adopting new technology, wants to use the internet even more in the times to come.” Interestingly, across the region, the young Indian also has the biggest say in family expenditure. Consumption clout is seen in categories as diverse as cars, computers, family vacations, packaged goods and entertainment. “Across all these categories, the Young Indian plays a deciding role in 50-75% of purchases,” said Adarkar.

The study also has noted that pester power is alive and strong, with eight in ten young Asians influencing family's shopping for soft-drink and snacks, three-quarters influencing the family visit to fastfood joints and six in every ten influencing the TV channel being watched. However, it's not all about sport and shopping. Today's Young Asians worry about what being an adult may hold in store for them. A secure job is the number one concern for 19% of Young Asians, while 16% worry about being financially stable and 9% worry about adult responsibilities.

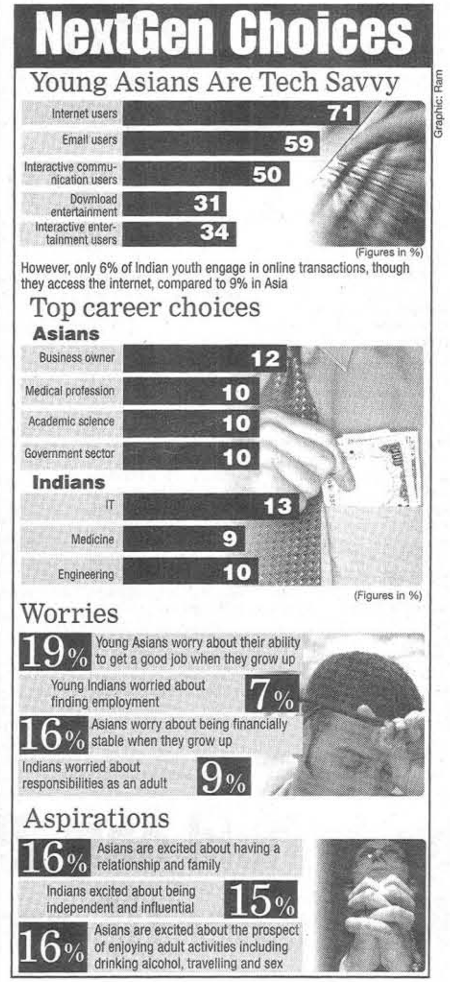
A Young Indian, on the other hand, is extremely optimistic and bullish about the future, and is eagerly waiting to take his/her own place under the sun. Adarkar noted that the young Indian is pragmatic and strongly believes that changes in the social fabric and governance are critical for change in the world order.

The central desire to stay connected with their peers only shows the extent to which digital technology has affected the lives of the world's first generation of people, the study noted. So, while 62% of them own mobile phones, 45% use their desktop PC.

At least half the number in 12-24 years slot call the internet as ‘the most helpful medium, 32% like the TV for product and service information and 10% trust the good old newspaper. And the trend is expected to grow, with one-third of them showing signs of spending more time on the net next year when compared to this year.

In a bid to discern internet usage among Young Asians, the Synovate study noted that young Asians use the internet for everything. While 71% search for information at most times, 59% access email whenever they are logged on.

While around 50% access interactive communication, 31% download entertainment and 34% access interactive entertainment.However, only 6% of India's youth engage transactions while online, compared to 9% regionally.



Source: The Times of India

Third, and what this case study makes apparent, is that the poor do have the means to contribute towards the overall progress of the country and are an important market in themselves, which can and should be tapped. What is significant about this particular intervention – no matter how small it is or whether it was ultimately successful – is that it points towards concrete solutions for how such enormously different worlds can be bridged, and what institutional and financial arrangements and mechanisms – at all three levels, UTI, SPARC and the slum dwellers themselves – need to be in place to ensure the smooth functioning of the scheme.

Fourth, it is clear that SIF-type schemes need to achieve a significant amount of scale to be self-sustaining. As mentioned before, there are millions of urban slum dwellers whose financial resources, while individually not very significant, can collectively add up to an impressive figure. The SIF's risk, return and liquidity features also incorporated the institutional arrangements that allow for large numbers of the urban poor to take part in the market. However, in order to avoid the problems of growth that the SIF faced, it is important to actively pursue more low-income customers. One way is by including more NGOs who will provide information to and increase access to community groups. The onus of bringing in more small investors must be shared by the mutual fund as well as the organisations involved.

Finally, it is important to create a committed group of people within the financial institutions as well as within the NGOs who will not only help create such schemes, but also sustain them.

Conclusion

The paper recommends that it is very important to have another SIF-type scheme, based on the lessons that have emerged from the previous experience. It can create the opportunities for even the poorest citizens to participate in and benefit from India's markets. It also recommends that financial institutions invest in approaching established and reputable NGOs to act as intermediaries. Such initiatives are representative of the true spirit of democratic participation because they pave the way for the inclusion and access of the urban poor to the financial market – an institution from which they have been traditionally excluded. The creation of such a scheme acknowledges not only that the poor can be the beneficiaries from a healthy and growing economy, but that they are an important market in themselves, with resources to contribute to the general development of the economy – both privileges typically limited to the middle classes. The authors believe this case study points towards win-win partnerships that can be developed and that are beneficial to everyone concerned – financial institutions, the poor, and the overall economy.

6 This Net Asset Value indicates the value of each individual unit. For a person who has bought the unit at Rs 10 when it was initially offered this NAV means that each unit now costs Rs 17.44. As mentioned before, this works out to an annualised compounded rate of 11.65 per cent a year, compared to bank interest on savings at 4 per cent a year.