

Interest Free Loan –An Experiment

Al-Khair Cooperative Credit Society experiment is a process in which both theoretical as well as practical aspects run side by side. The society is in its fourth financial year. It has the permission of Central Registrar to operate in four states (Bihar, Uttar Pradesh, Delhi and Jharkhand) but it operates presently only at Patna, that too limited to seven km stretch. If both the concern of interest free micro credit on ideological plane and viability on practical plane are achieved then it will extend its area of operation. Some aspects have been achieved, some in the process of experiment and some yet to be tried.

There is no credit facility for 85% of population either through formal or non formal sector in Bihar. More or less is the situation all over the country, according to a recent study on India by the World Bank and the National Council of Applied Economic Research, some 70 percent of rural poor household do not have a bank account and 87 percent do not have access to credit from a bank or other formal institution (Praful Patel, vice president, south Asia region, World Bank). Estimates suggest that Indian micro-finance currently reaches 12 million customers directly through credit services. This, however, is sorely inadequate in a country where 300 million people live in poverty. This figure talks of four percent of micro-credit facility but the figure for poverty can be contested through other studies. Utsa Patnaik in her paper “Theorizing food security and poverty in the era of economic reforms”, argues that the quantum of poverty is grossly underestimated and poverty is not declining but it is increasing. “... far from the percentage of population in poverty declining as claimed, the factually correct position on the basis of current data is that poverty is very high, affecting at least three quarters of rural and over two-fifths of the urban population”.

A study was done by Shashi Bhushan on “Small credit needs and institutional financing gap” in the settlements around Phulwari Shareef to Patna Junction in Patna town. This study suggests that an overwhelming size (71.48%) of households is in serious need of small credit support. The demand levels are very low but appear to squarely affect the lower rung population, their livelihoods or any initiative towards new opportunity of economic betterment. About forty percent (37.5%) households are in need of small credit. Their demand level is as low as Rs 2000. Even twenty-three per cent (22.83%) of the families seek not more than Rupees 1000 at one point of time. Another slab of Rupees 2000 to 5000 emerges as the most common credit demand coming from 35.77% households. The size that looks for Rupees 5000 to 10000 also comes close to about twenty three (22.73%) percent.

Other successful experiments in micro credit put the quantum as low as Rupees five hundred. This situation is very much present in rural areas. Farmers' suicide in Andhra Pradesh and Maharashtra are extensively reported. But their credit need is not very high. It ranges from Rupees 10000 to 40-50 thousands.

Nature of credit is broadly of two types i.e. supportive to consumption gap and supportive to capital need. Supportive to consumption gap includes occasional gaps, occupational breakdown, festival expenses, marriage related expenses, medical treatment, and litigations / civic hazards. The major among these are

medical treatment and occasional gaps. Health needs caused by sudden afflictions or protracted illness seems to cause maximum number of borrowings. In fact, in poor strata households health problems affect in two ways—it necessitates extra money for treatments and at the same time it disrupts routine earnings. Thus they cause breakdowns in occupation at work and eventually upturn the balance of domestic economy. Unavailability of timely credit makes them more vulnerable in terms of treatment cost and in bringing down their earning levels and then even higher cost on further borrowings. Ironically the maximum demand level of such credit needs is only up to Rupees 2000 and in no way beyond the repayment capacity of even the poorest strata income groups except the fact that a sensitive and efficient credit network is not available.

The second group, that is, supportive to capital needs group includes seasonal business needs, business extension, house construction/repairs, educational needs and others.

The credit to poor is normally available at 120 percent annual rate of interest. This is the normal rate of interest, in several cases it is 180 percent and compoundable also. Gravity of the situation is such that hunger, illness, unable to use medical facility, hunger, death and suicides are due to non-availability of credit and burden of interest if credit is available.

In the age of globalization, reports from Andhra Pradesh and Maharashtra, the otherwise darling states of development highlights the gravity of situation. Suicide by farmers is a regular feature and they are mainly due to the interest and loans. The first budget of UPA government, presented in 2004, put the farmers in focus because farmers were under heavy debt and the interest on them were taking their life. Chandra Babu Naidu and his party got badly defeated in Andhra Pradesh assembly election. In spite of change of guard interest continues to take its toll.

To address the micro finance it is accepted that social intermediation is a must for financial institution. As banks are not capable of addressing the micro credit, the role of social organizations has been emphasized.

Presently the most emphasized model for micro finance is SHG (Self Help Group). A voluntary group of 11 to 19 persons are formed. They deposit agreed amount on agreed periodicity in a box and on fixed time they distribute the deposited amount as loan among members on priority basis. They transact their business on the basis of signed bye-laws by each member and decision taken in the meeting in a democratic manner. They are entitled to open account in banks in the name and style of SHG. SHG and/or its members can be granted loans without any collateral security after they have been graded and properly linked with the banks. The linking with the banks is a major attraction for forming SHG. NGOs have made the greatest contribution in the formation of SHGs.

In Bihar alone around 70000 (to be more precise 69185) SHGs have been formed. But only 8262 groups have been linked with the bank (Sushil Kumar Modi, Deputy Chief Minister-cum-Finance Minister, *Hindustan Times*, Patna, Jan. 4, 2005). This shows how much preparedness is available in the society but on the other hand how much institutions are ill-equipped to address the demand. Apart from that the publicly funded micro enterprise programmes are structurally rigid and do not have the flexibility to adjust to the logic of an

informal financing system, the fund allocations are also too meagre. Recently N Balasubramanian, Chairman and Managing Director of Small Industries Development Bank of India (SIDBI) informed that the cumulative figure of assistance will be Rupees 460 crore by the end of March, 2006.

Women participation in micro finance is very encouraging. SHGs and thrift cooperative society run by women have many successful and inspiring stories. Their success is based on what they save regularly. At the same time, whether they are rich or poor, they borrow with caution, and regularly repay. This participation should be seen in the backdrop of the fact that an estimated 92 percent of the work force is in the informal sector and contributes 60 percent of national income. This work force constitutes half of women. "The poor, especially poor women are bankable." This is proved by several experiments by them.

For the majority of population the interest is an amount one has to pay after taking loan. They normally pay the interest to money lenders as bank is beyond their reach. In the case of banks, their reach is limited and savings accounts are not opened for earning interest. If one adds story of non-banking financing institutions (NBFCs) it will appear how they are robbing the poor man's earnings by alluring them that they will double and in some cases triple their amount. Interest is a pill that is not only bitter in taste but bad for health and is lethal enough to take one's life. Interest is the game of the rich. The number of individual billionaires in India increased from 71 to 311 in the last one year. This club has a net worth of Rs 364,000 crore. Sitaram Yechury did an interesting calculation, "At an 8 percent rate of interest, they would be earning Rs 29,000 crore a year or Rs 80 crore a day".

Interest free loan has a market and is accepted easily, but there is skepticism for interest free deposits. However the fact is that interest free deposits (not investment) are also available. It is a cruel joke that micro deposit facilities are not available or at least not reachable and suitable for the poor. Providing safety and liquidity to micro deposits is also a big service area. Another big field is the savings accounts holders in the bank. If an institution provides additional facilities to these account holders, they may opt for interest free deposits.

The driving force of morality for interest free economy is available in India. In truth interest charged by money lenders causes intense hatred. Here movements started against interest and literature produced against the vices of interest. Latest among the movements is Jharkhand movement. If one will go into the history of Jharkhand movement, the father of Shiboo Soren, Sobran Manjhi was moved by the plight of a widow at the hand of a money lender. The literature produced in the recent past and present against interest is also significant. In the recent past Rahul Sankritayan wrote a very forcefull novel "*Ek Sood Khor ki Maut*", recently a novel "Samar Shesh Hai"(War is on) of Vinod Kumar get appreciated. There are personalities also who spoke and struggled against interest. One can trace the personality from Dada Bhai Nouroji to Kishan Patnaik.

There is the classical debate on allocation of stock through market or government. In another terminology of public or private enterprises for creation of wealth has their logic and criticism against each one . Perhaps the basic question is who will be the owner. Ownership should include in fixing objects,

taking and implementing decisions and benefiting by the enterprise. Cooperative format is perhaps the third option available side by side public and private format and it satisfies the ownership and participation question.

In India earlier restrictive cooperative laws and oppressive regulations were the main feature of cooperatives. Cooperatives are not member-promoted, member controlled enterprises but government-promoted, government-controlled institutions, under the 'protective' umbrella of the government policy. But in 1995 Andhra Pradesh enacted "Andhra Pradesh Mutually Aided Cooperative Societies Act". This act aimed to promote member-centered cooperatives fully owned and controlled by members. As on date there are nine states with liberal cooperative laws. These states are Jammu and Kashmir, Uttaranchal, Bihar, Jharkhand, Madhya Pradesh, Chattisgarh, Orissa, Andhra Pradesh, and Karnataka. In other states old cooperative acts are in operation.

Besides state cooperative acts there is "The Multi-State Co-operative Societies Act, 2002". This act is for such societies whose objects not confined to one state and serving the interest of members in more than one state.

The salient features of liberal cooperative acts of the states and multi-state cooperative act of 2002 are as follows :

- Now the registration of the society is not waiting helplessly. Now in case no refusal is communicated within ninety days from the date of submission of application, the cooperative society shall be deemed to be registered.
- The cooperative societies can promote subsidiary organization and create a new organization with others.
- The conduct of elections is now the responsibility of the incumbent board.
 - Under these acts Central, federation and union of cooperatives can be formed where two or more cooperatives societies intends to.
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AL-KHAIR EXPERIMENT

This experiment was mooted by Al-Khair Charitable Trust. The trust was working in few slums on education, health, income generation and general awareness. The trust made, while working on income generation, few interventions like direct financial help, providing interest free loan, providing capital (rent) to landless laborers for acquisition of cultivable land so that they could do their own farming, providing cattle or poultry birds to rear, and assisting poor in official formalities in seeking financial help from governmental agencies or in reaching to different developmental programmes as beneficiaries. However the magnitude of needed help particularly in field of small credit turned out to be so enormous that Al-Khair on its own began to think of initiating an exclusive programme of small credit availability in its service area on interest free basis.

It should be noted that from the very first day the concern of the trust was not of interest free investment but interest free micro credit.

Deposits are raised without any liability for payment of interest or other charges. Deposits and borrowings can be raised only to the ten times of the sum of paid up share capital.

There are two types of deposits, one is called deposit and other is time deposit.

Call deposits are main base of the society. It is eighty-eight percent of total deposit. This statement is important in the background of the claim that "we

don't block your amount". Those who are providing micro deposit instrument, they block the deposit. When such depositors are in need of cash they cannot use it smoothly. The interest payment on such deposits is also not attractive. Daily deposits, monthly deposits and special daily deposits are recurring account. It is being collected from the door step of depositors by the collectors of the society. Profile of recurring depositors are the underprivileged section of the society. A good number of them are those who earlier deposited their savings in interest based instrument. Other time deposit instruments are Amanat and Child account. Amanat account is like any savings account sans interest.

There are two time deposit instruments i.e. *Sahyog* (Cooperation) and *Ear Marked Fund*. Sahyog account was launched in the initial stage of the society. This account was targeted at good Samaritans, who can deposit maximum ten thousand without interest for a period of six months to three years. In the initial few months it helped in providing loan. Ear Marked Fund account is a special account. If one wants to give loan to some one. He can deposit the amount in EMF account and identify the person. The society assesses the identified person for loan. The society also collects repayment of loan. The EMF account is blocked for the time of repayment of loan.

Loans are granted to members only. They are entitled ten times amount of loan to their paid up share capital. The loanable fund is presently sixty five percent of deposit balance. There are three loan instruments i.e; Demand Loan, Short Term Business Loan and Cost plus finance. The demand loan and short term business loan is the main object of the society and cost plus finance aimed at making project viable. The demand loan and short term business loan is sixty-seven percent of total loans.

The big problem of micro credit is absence of collateral security among the users. The use of Joint Liability Group is being now extensively used for micro credit. The experiments to grant demand loan on two personal securities one from family member and another from a member of the society. This loan is granted to such members who first open a deposit account in society and regularly saves for three months. His deposit is not blocked. He can withdraw his deposit according to his need. After regular savings a member is entitled hundred times loan on his daily deposit.

Demand loan is provided on one time processing fee which is variable on different amount slab. This processing fee is effectively 6-7 percent on each transaction. The maximum amount provided under this loan scheme is Rupees ten thousand. The repayment period presently is maximum one year.

Short term business loan is provided to small business persons on profit sharing basis. The maximum amount provided is Rupees twenty thousand. The loan period is normally four months. Ten to thirty per cent of the profit is shared by the society on different loans, which is effectively 3-4 percent of each transaction.

Cost plus finance is provided for consumer durables. The society purchases the goods on whole sale price and transfers it on retail price to its members. The difference between the two is earned as profit. The maximum amount is thirty thousand for this category. The repayment period is normally six months. The effective profit earned is 9 percent on each transaction.

The recovery of loan is very satisfactory. The cumulative figure of loan disbursed amount is Rupees ninety three lakhs to one thousand six hundred fifty accounts. Out of this only Rupees sixty thousand is nonperforming. This figures out to be 0.65 percent of the total disbursed loan.

The incomes of the society are processing cost on demand loan, profit sharing in short term business loan, profit earned from cost plus finance, admission charge, donations and fee and commission. Fee and commission is earned through various services provided to members. Services presently provided are draft making, issuing cash at par cheques, submitting telephone and electricity bills. It was projected in the project that from the third year the society will achieve break even point. As on 31st Jan. 2006 the gross profit of society is Rupees sixty-four thousand. It is around fifteen percent of paid up share capital.

As it was earlier stated that the concern of society is theoretical also. It did several ideological interventions. Here three important lectures should be noted. Interest Free Banking in India: Prospect, process and challenges (Hindustan mein bila soodi bankari: imkanat, tareeqe aur masaeel) was delivered by Dr Abuzar Kamaluddin at the preparatory workshop of society. Another lecture on Poverty and Islam was also organized by the society.

A major intervention of the society is a lecture by Late Kishan Patnaik, leading socialist thinker. His lecture on interest free economy which was widely reported in national dailies and reproduced in magazines generated a wider debate in activist circle.

Development of adaptable model: The first challenge was test of viability of interest free micro credit and it has been achieved. But to develop it in adaptable model is still a challenge. □□□

[This is a slightly shortened version of a paper presented at an International Seminar on Islamic Banking held recently in Delhi]