

Regulatory Innovation in Microfinance The MACS Act in Andhra Pradesh

If the past is any guide, continued progress in addressing public challenges will require continued innovations—the efforts of individuals, groups, and communities who creatively employ new organizational forms, and in many cases new technology, to effect discontinuous change.

—Philip Auerswald and Iqbal Quadir
from “Introduction to the Inaugural Issue,” *Innovations* Winter 2006

What has been is what will be, and what has been done is what will be done; and there is nothing new under the sun. Is there a thing of which it is said, “See, this is new”? It has been already, in the ages before us.

—Ecclesiastes, 1.9 and 1.10

This paper is about an institutional innovation in microfinance. The innovation is a law regulating cooperatives under which savings and credit cooperatives providing microfinance services can operate—the Mutually Aided Cooperatives Societies Act (MACS Act). The law was enacted in the state of Andhra Pradesh in India in 1995, and has since been replicated, with adaptations, in eight other Indian states.¹ The focus of this paper will be on the Act in Andhra Pradesh, and its implementation there.

This innovation is different from many others that one sees in microfinance because it is not directly concerned with innovations in techniques for delivering microfinance services, but rather with providing an innovative enabling environ-

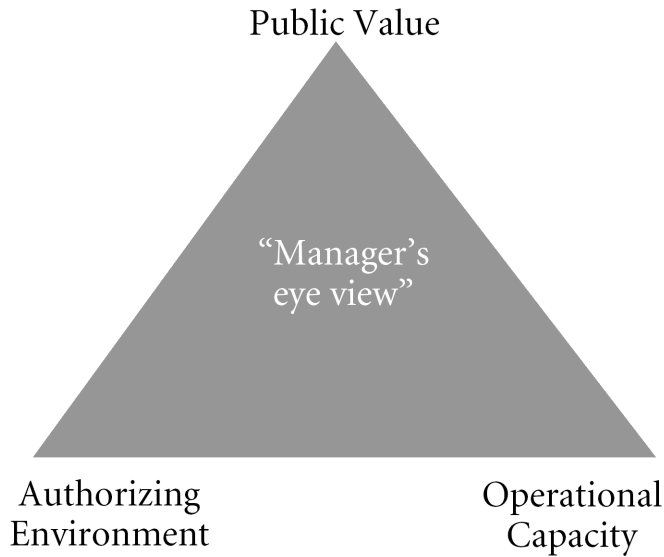
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ment in which cooperatives can provide such services. Nevertheless, it relates indirectly to innovations in techniques because a touchstone of the law is that it provides a liberal regulatory framework in which cooperatives are able to experiment with different organizational structures and techniques for delivering services.

There is an irony in calling the MACS Act an innovation. It is more an enactment of time-worn and time-tested cooperative principles that cooperatives around the world, especially in Europe and North America, have been operating under for over 100 years. But in the context of India at the end of the 20th Century, the act is an innovation, because it is a radical departure from the top-down, statist management of cooperatives that has plagued Indian cooperatives since the British first enacted the Credit Cooperatives Societies Act of 1904. This and subsequent acts, as will be documented in more detail below, espoused the fundamental principles of cooperatives related to self-help and mutual aid, but instituted a system of regulation in which members' rights, responsibilities, and risks were emasculated by the control exerted over the cooperatives by the state registrar of cooperatives. As a result, members had very little interest in ensuring the effective functioning of the cooperative, and the ability of the cooperative to deliver goods and services to its members was wholly contingent on the willingness and ability of the registrar and his designees to deliver such goods and services.

The argument of this paper is that the MACS Act is an innovation because it radically alters the rights, responsibilities, and risks of cooperative members. Specifically, it has given the members of the cooperative the rights and responsibilities to manage their own cooperatives to improve their own lives, and has diminished the powers of the state registrar to the point where his office is largely a depository of information about the cooperatives operating under the act, with some powers of inquiry. In taking on these rights and responsibilities the members are exposed to new risks that are not small. The paper also argues that though the innovation is a regulatory and institutional one—it changes the “rules of the game”—it is not sufficient for its success to simply put it in place and “let the chips fall as they may.” The MACS Act requires organizational capacity to succeed. Members of the cooperatives can supply some of that capacity, but civil society more generally has a role. And it remains an open question whether the innovation will survive its own initial success because there remain serious organizational capacity issues. Finally, building on these first two points, the paper makes clear that the innovation is not an uncontroversial one both within the arenas of state and national politics, on the one hand, and among microfinance practitioners on the other. Despite this controversy, I argue that the innovation is consistent with other innovations in microfinance and that it would be foolish, at this point in its history, to undermine it.

Implicit in the construction of these three points is an analytic framework that I will make explicit in the next section of this paper, as a way to orient the reader. The framework is that of public value, which provides the analyst of public policy questions with a way to understand the major concerns facing a practitioner in dealing with those questions on a day to day basis. The framework highlights the



need to pay attention to the value proposition inherent in the policy, the source of the authority for the policy and for the activities required to implement it, and the operational capacity to implement the policy.² Having explained this framework, the paper will describe the MACS Act and show how it is an innovation in comparison to other cooperative laws. It will then describe the organizational capacity that a particular NGO, the Cooperative Development Foundation, has brought to bear in promoting and supporting thrift cooperatives in three districts in Andhra Pradesh, and raise questions about the support that a large number of other thrift cooperatives registered under the MACS Act are or are not receiving. The paper will then discuss the current political and policy debate regarding the regulation of MFIs in India, and its relevance to the MACS Act. It will conclude by summarizing the arguments and the implications for the future of this regulatory innovation.

INNOVATION AND PUBLIC VALUE

One way to think about public policy is to look at it from the perspective of a senior manager, or an executive director of an NGO. Such a manager in a public sector or non-profit environment is in the business of producing public value using the operational capacity that is available to her and the authority vested in her by her authorizing environment.³ Public value is very simply what people value, as recipients of specific services and citizens. Operational capacity is the capacity to deliver something of value to the citizenry, whether they are direct clients of the organization delivering services, or citizens who have voted for and support the

delivery of a set of services or the enforcement of a set of regulations. The authorizing environment is the set of actors, decisions, and existing institutions that provide legitimacy and support to the manager engaged in the creation of public value. To succeed the manager must ensure the continued support of the authorizing environment.⁴

Microfinance has made its mark within the field of international economic development because of its innovations in defining new types of public value, and in developing new methodologies (operational capacities) for delivering that value. Microfinance began life as micro-credit. In that guise, it proposed and tested the idea that the poor need loans, they are able to translate that need into effective demand for loans, and they are capable of repaying those loans with interest. This ran contrary to the views or experience of mainstream banks and government-run credit programs, respectively, who either saw no market for loans among the poor (banks) or saw a wide variety of credit programs go wildly awry as poor farmers failed to repay loans (government programs). Microcredit proved that the poor can and will borrow money and repay it. In doing so, microfinance institutions (MFIs) developed a set of innovative practices that cost-effectively managed the risk of lending to the poor without collateral and without formal documentation of their income and character. The most famous, and ubiquitous, of these is the peer lending methodology, in which loans are made to individuals within groups, or the groups themselves, while holding each group accountable for the repayment of the loans made to them or their members. Because prospective clients of MFIs form the groups themselves, based on their mutual knowledge of each other and their willingness to trust each other, MFIs have, in essence, subcontracted out their risk management operations to the social structure of the market in which they are operating. Another common innovation that MFIs have used is the step-lending methodology, and the use of information systems that track the repayment behavior of the borrowers very accurately to enable follow-up on those clients who are even one day late on their payments.

In defining these new value propositions and developing these new operational capacities many MFIs did not find the need to innovate ways of managing their authorizing environments, though they still had to manage that environment. Many flew and still fly “under the radar”—working at the grassroots beyond the supervisory eye of government regulators. Others found *ad hoc* solutions. The most famous MFI, the Grameen Bank, managed its authorizing environment through the personal relations its founder, Muhammad Yunus, had with Bangladesh’s ruling elite. Such was his connectedness that since 1983 the Grameen Bank has been operating under its own law.⁵ And still others transformed themselves into fully licensed and regulated banks, operating under their countries’ general banking laws (for example Bancosol in Bolivia, and K-Rep in Kenya).

The strategy of “flying under the radar” worked well for many MFIs while they engaged in the extension of micro-credit only. Government regulators had little interest in regulating their activities. But MFIs have grown to a sufficient size and importance in many local economies that this strategy has run its course, and, as a

result, government regulators have shown an increasing interest in their activities. In addition, since the 1990s many MFIs have developed a new value proposition and new capacities for creating that value. The new proposition is that the poor can and do save, and that MFIs can mobilize funds from the poor to lend to the poor, and do away with the need for external financing. Concomitant with this value innovation, the MFIs have developed their operational capacity to manage the receipt of large numbers of small amounts of cash, something in which they already had some proficiency due to their micro-credit activities. But unlike with the micro-credit innovations, MFIs can not so easily “fly under the radar” with their micro-savings innovations—there are existing regulations in most countries that restrict the ability of organizations to mobilize savings from the public. As a result, MFIs have shown an interest in new regulations that allow them to mobilize savings without having to comply with all the current regulations that apply to mainstream banks.

The benefit of looking at innovation in any policy field through the public value framework is that it forces one to acknowledge three central aspects of public policy: its purpose, the source of its legitimacy, and the capacity required to implement it. It allows one to identify the locus of the innovation and then determine its implications for the other parts of the strategic triangle. In the case of microfinance, what we have is a situation in which the authorizing environment is catching up with innovations in the value proposition and the operational capacities of MFIs. In contrast, the MACS Act is an innovation in the authorizing environment that has as I will argue below, with some exceptions, required the cooperatives and the NGOs supporting them to build the organizational capacity to perform successfully under the new regulatory framework. The value proposition inherent in the MACS Act is not new—the idea of self-help and mutual aid, especially through financial cooperatives, has been around for a long time.

BRIEF HISTORY OF COOPERATIVES IN INDIA

The first effort to create formal, legally recognized credit cooperatives in India was the 1904 Credit Cooperative Societies Act passed under British rule. According to Moore:

Under the provision of this Act, local governments were authorized to appoint registrars with full powers to organize, register and supervise cooperative credit societies, with the object of encouraging thrift, self-help and cooperation among agriculturalists, artisans and persons of limited means.⁶

Ilbert reports that the act was “designedly very general and elastic.”⁷ He continues, “[m]uch is left to rules and by-laws, and a very free hand is given to the registrar, on whose personality much will depend,” giving an early indication of the registrar-centric nature of cooperative laws in India.⁸

The 1904 act was superseded by the 1912 Cooperative Societies Act, which

extended the law to cooperatives in general, not just credit cooperatives. The act was limited in its requirements, but it conferred on states extensive powers to make rules regulating the activities of cooperatives under their jurisdiction, and the 1919 Government of India Act devolved all regulation of cooperatives to the states. In the following years the various states in British India passed their own cooperative laws, which imposed extensive regulation of the cooperatives, and vested powers in the registrar. Throughout the early part of the 20th century there was a dramatic increase in the number of cooperatives in British India and nine Indian states.⁹ From an average of just under 2,000 in the 1906 to 1910 period to an average of just under 94,000 in the 1925 to 1930 period.¹⁰ Focusing on the post-1912 period Qureshi notes:

During this period more stress was laid on quantity than on quality, and the main criterion of promotion for the staff was the opening of more societies... The result was that the movement developed without the people realizing and feeling the need for the quality of the movement. Owing to the great enthusiasm of the employees of the co-operative department in persuading people to open societies, the movement indeed began to be regarded as a Government responsibility... The most distinctive feature, at least in theory, of co-operative credit is that it should be a controlled credit and be of local origin. That is why the official title of co-operatives societies is Credit and Thrift societies... In practice the thrift part of the movement was neglected and all the members were borrowing members. As no control over borrowings could be exercised in a group which was overwhelmingly dominated by borrowers, the result was serious.¹¹

By 1936-7 the share of outstanding loan balances that were past due in British India ranged from 40.8% in the Punjab to 92.5% in Bihar.¹² Turnell also notes that the Burmese cooperative system (also under British rule), after rapid growth in the 1910s and early 1920s began a collapse in the late 1920s that was completed by the Great Depression.¹³

Qureshi summing up his argument on the wisdom of promoting cooperatives in India on the eve of independence noted four reasons why he felt it was a bad idea. First, he argued that cooperatives were not suitable to “backward countries;” second, that there was undue emphasis on credit in the way Indian cooperatives were run; and, third, especially credit from external sources. In addition, he concluded:

Fourthly, and this we regard as the most important, the movement was entrusted to a type of civil servant who in spite of his proved ability and character in other fields of administration, was most unsuitable by temperament, environment and training to undertake an expert job of this type... If one reads a co-operative Act one finds that, as to God Almighty, all functions, responsibilities, directions guidance and control have been entrusted to the Registrar of Co-operative Societies...¹⁴

In sum, the experience of cooperatives under British rule was one of consistent failure. The cooperatives were promoted by zealous administrators who saw credit cooperatives as the solution to the problem of rural credit. Those same cooperatives became conduits for external credit, and the result was organizations which were cooperatives in name only and were burdened with overdue loans.

In the period after independence, 1950 to 1990, the lives of cooperatives became even more complicated by state government interference:

State policy came to be premised on the view that the government should ensure adequate supply of cheap institutional credit to rural areas through cooperatives... As the financial involvement of the government in cooperatives increased, its interference in all aspects of the functioning of cooperatives also increased. The consequent interference with the functioning of the co-operative institutions, often compelling them to compromise on the usual norms for credit worthiness, ultimately began to affect the quality of the portfolio of the cooperatives... Instead of tackling the root cause of their weaknesses, the State took responsibility for strengthening the institutions, by infusing additional capital and “professional” workforce. Both the State and the workforce then began to behave like “patrons”, rather than as providers of financial services.¹⁵

It was during this phase that the state of Andhra Pradesh passed the Cooperative Societies Act of 1964, which is still in force today. This act, like its predecessor (the 1932 Madras Act), gave extensive powers to the registrar. In addition, as noted above, cooperatives remained the instruments of state policy, with little or no autonomy. Thus by the 1990s financial cooperatives were in a situation in which their governance was subject to the whims of the registrar, they had become the conduit of both state and national policies to push cheap credit into the agricultural sector of the economy, and, as a result, they were rife with overdue loans and corruption.

THE MACS ACT—A REGULATORY INNOVATION

The MACS Act is a reaction to this history. Its main advocate is the Cooperative Development Foundation (CDF), an NGO headquartered in Warangal in Andhra Pradesh, which also promotes and supports cooperatives. The CDF and its allies were trying to solve a particular problem with the Act—the failure of cooperatives in the state to serve their members effectively due to interference from the state. The guiding principles behind the act were those of the International Cooperative Alliance, an organization of cooperatives whose history dates back to the mid-19th century and the northern England town of Rochdale.¹⁶ The result is an act that alters the balance of power between the membership of the cooperatives and the registrar, and, in doing so, also alters the respective responsibility for the effective functioning of the cooperative. Furthermore, by prohibiting the government from owning any share capital in the cooperatives, the act protects the cooperatives from

direct government influence through their financial stake.

There are three broad themes running through the MACS Act that make it distinctive from other efforts at regulating cooperatives: the autonomy of the cooperatives in how they govern themselves; the responsibilities and risks the members take on when they join a cooperative; and the restrictions on the powers of the Registrar and the government. The act requires a cooperative to develop a set of by-laws that cover a long list of governance issues—section 9 of the act, which specifies the by-laws that must be in place, lists 39 in total. A cooperative wishing to register under the act must have by-laws covering each of these issues. But the act does not specify the exact nature of the by-laws. The intent here is to ensure that each cooperative have its own rules covering important issues in the governance and operations of the cooperative, but not to specify what those rules should be.

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This does not mean that the act frees members to make up all their own rules. The act specifies the powers of the general body of the cooperative and its board of directors. It also specifies the timing of elections, the financial information each cooperative must keep, audit requirements, and procedures for amending the by-laws. In doing so, the act provides some minimal governance infrastructure within

which the members of the cooperative have a say in the running of the organization, through the membership in the general body, the election of the board of directors, control over the amendment of the by-laws, and access to basic financial information (assuming they are literate).

The central role of the by-laws in the governance of the cooperatives and the minimal governance infrastructure uphold the sovereignty of the membership of the cooperatives. In doing so, the act also requires that same membership to take responsibility for the running of the cooperative, and exposes them to a number of risks that come with that responsibility. Only members can contribute share capital to the cooperative. Cooperatives are prohibited from accepting share capital from the government, though they are allowed to receive government loans and guarantees, and the same from other non-members. As a result, only the members are the owners of the cooperative, and it is their capital that is most at risk. The act also requires that members cover any deficit incurred in the operations of the cooperative annually, through the use of reserve funds or by debiting the accounts of members “in proportion to the services they had availed or were expected to

avail of the cooperative society during the year.”¹⁷ It allows the cooperative society to invest its funds in any “non-speculative” investment, including its own business ventures. The act specifies that the board of directors is responsible for the hiring, monitoring, and firing of all staff, and that the membership take responsibility for setting rules and procedures for settling disputes. Only once all internal remedies have been exhausted can a dispute be referred to an external tribunal. Finally, cooperatives registered under the act are not protected from competition from other cooperatives, whether new or old—the act does not provide cooperatives with “jurisdictions” in which they have a monopoly and the Registrar has no powers to prevent another cooperative from providing the same services in the same geographical area.

The strengthening of the rights and responsibilities of the membership and the central role the by-laws play in the governance of the cooperatives have combined to diminish the ability of the Registrar to control the cooperatives. Furthermore, even in cases where the act specifies a role for the Registrar in the governance of the cooperatives, the act ensures that the Registrar is not the sole arbiter of the case—he cannot act as prosecutor, judge, and jury. The Registrar has the responsibility to ensure that the cooperatives’ by-laws conform to the act, and that the membership and board comply with the minimal governance rules specified in the act.¹⁸ The Registrar is also an information depository. Every year, 30 days after the annual general meeting, cooperatives must file certain reports with the Registrar. But this is not for supervisory purposes; rather it is to ensure that there is one, authentic copy of the reports held with a third party in case of any disputes within the cooperatives about such reports. The Registrar does have powers to hold inquiries into the operations of cooperatives, to conduct a special audit, and to appoint a liquidator of a cooperative that is no longer viable. But in most cases, these activities must be at the request of members of the cooperative itself or a third party who has a clear interest in the operations of the cooperative in question; and they must be carried out within a specified time period.¹⁹ Furthermore, in many instances the Registrar must leave the disposition of the case to a tribunal. The 1995 act follows the 1964 act in specifying how to constitute tribunals. Finally, the act provides no rule-making power to the Registrar or the state government overall—the act specifies all the rules necessary to implement the act, only the legislature can change the way the act is implemented.

The MACS Act provides a regulatory umbrella under which savings and credit cooperatives can operate. Sections 14.1 and 14.2 allow a cooperative society to “mobilize funds in the shape of... deposits, debentures, loans and other contributions” from both members and non-members.²⁰ As a result, a cooperative registered under the act can mobilize savings. Furthermore, the act places no restriction on the services a cooperative can provide its members, hence it is permissible for it to provide financial services, such as loans and insurance, so long as such provision is not in violation of other laws. But, as noted above, the MACS act limits the extent to which the Registrar exercises supervisory control over the cooperatives. As a result, despite the fact that they mobilize savings, the financial cooperatives

registered under the act are not subject to any prudential regulations. The reasoning here is that because the cooperatives are restricted to providing services to their members, and members have their share capital and deposits at risk, the general governance framework required by the act, including the by-laws of the cooperatives, will ensure the cooperative operates in a prudent manner. The act requires that members and their boards of directors take responsibility for the effective functioning of a financial cooperative in the same way as they do for any other cooperative.

There is an anomaly in the logic of Section 14: it allows cooperatives to mobilize deposits from non-member individuals. This is inconsistent with the idea of mutual responsibility—only members should have their deposits at risk, because only members have the authority to supervise the organization. This clause does not appear in the model act that CDF has promoted in other states, and does not appear in those states' Acts. It seems to be a product of a political compromise in Andhra Pradesh.

There are also exceptions to the absence of prudential regulations. These are cooperative banks, which engage in “banking” as defined by the 1949 Banking Regulation Act (Section 36-A). According to Section 5.1.b of the 1949 Banking Regulation Act (referenced in Section 36-A of the MACS Act), “banking” means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.” A cooperative that engages in banking is subject to Reserve Bank of India prudential regulations.²¹

The lack of prudential regulation of financial cooperatives operating under the MACS act is the subject of much political debate currently. I will discuss the arguments for and against such regulation below when I describe the current debate about the 2007 Microfinance Bill currently before the national legislature.

IMPLEMENTATION OF THE MACS ACT AND MICROFINANCE

As of January 31, 2006 there were 18,398 cooperatives registered under the MACS act, of which 7,589 were financial cooperatives. There has been a very rapid growth in the number of financial cooperatives registered under the MACS act over the past few years due to the large number of self-help groups (SHGs), promoted by the state government and NABARD, that have formed federations and registered under the act. This section focuses on the implementation of the act from the perspective of the thrift cooperatives promoted by the CDF, followed by a discussion of the SHG phenomenon. The argument of this section is that the activities of the CDF demonstrate the need for active support for the cooperatives as they develop their governance and information systems and their service methodologies. But those activities also demonstrate that this support has to be of a particular type—it has to enable the cooperatives to function without undermining their autonomy. I then raise the question as to whether SHG federations are

receiving the same type of support, and what the risks are if they are not receiving it.

CDF, Thrift Cooperatives, and the MACS Act

Upon passage of the MACS act in 1995 the CDF immediately started encouraging the thrift cooperatives it had promoted up until then to register under the Act. As of the end of 2005, 286 cooperatives were registered, 153 women's thrift cooperatives (WTCs) and 133 men's thrift cooperatives (MTCs). These were not all the WTCs and MTCs in operation at that time: there were 269 WTCs with a membership of 79,238, and 176 MTCs with a membership of 43,677 (CDF 2005, 2). During 2005 two (2) WTCs and nine (9) MTCs were dissolved. The total funds in the WTCs were almost Rs.176 million, of which Rs.152 million were out on loan to members of the WTCs; the total funds in the MTCs were Rs.198 million, of which Rs.169 million were out on loan. According to the CDF all cooperatives held their annual meetings for 2005 by March 31, 2006, as stipulated in their by-laws: participation rates in the cooperatives' annual meetings were just under 50%, while participation rates for the associations' AGMs were about 75%.²² Finally, the CDF reports that only 37 cooperatives, out of a total of 445, held elections using secret ballots to choose their board members; and only 45 cooperatives elected their presidents through a secret ballot of their boards of directors. The amount of loans in default at the end of 2005 was Rs.1.3 million in the WTCs and Rs.1.6 million in the MTCs. The average outstanding loan balances were Rs.138 million and Rs.154 million respectively, giving a default rate of about 1% in each case. The borrower default rate was higher: about 8% in the case of the WTCs and just over 10% in the case of the MTCs.²³ The default rate in terms of rupees is lower than in terms of defaulters because defaulters may well have paid off some of their loans before they went into default, and their thrift and other deposits served as collateral for part of the loan.

The individual, village-based cooperatives are organized into associations, which are, in turn, constituents of a confederation of associations. Figure 2 describes the structure of the cooperatives, associations, and confederation. The cooperatives and associations are free to adopt their own by-laws and run their operations as they see fit. Nevertheless, as Figure 2 implies, there is uniformity across all the cooperatives in their basic governance practices and in the services they offer to their members. This is because of the role the confederation plays in setting policy for all the constituent entities. It is at this level that the CDF provides the cooperatives with technical advice and assistance. The CDF also provides auditing services to individual cooperatives and associations, and has field workers actively monitoring the cooperatives and associations.

These data raise three important issues about the development and viability of cooperatives under the MACS. One issue concerns the role of the CDF as a promoter of cooperatives and a provider of technical assistance to them; a second con-

Swa-kru-shi
Cooperative Thrift and Credit Network


1. Structure : 
- Thrift Cooperative (TC)
2. Size of TC : 300-1000 Members
3. General Body (GB) : All members of TC
4. Joint Liability Group (JLG) : Voluntarily organised 5-member group
5. Board of Directors (BoD) : 12 members elected by General Body for a three-year term (with staggered terms, 4 members retire every year)
6. President : Elected by Board Members from among themselves for one-year term
7. Staff : At least one (Book-keeper)
8. Saving Products : (a) Compulsory Thrift
(b) Fixed Deposit
(c) Recurring Deposit
(d) Savings Account
9. Loan Products : (a) Three times of Compulsory Thrift in the initial stage; subsequently on loan utilisation and repayment capacity
(b) 85% of Compulsory Thrift, Bonus, Abhaya Nidhi Deposit (for non-JLG members)
(c) 85% of Fixed Deposit
(d) 85% of Recurring Deposit
(e) Three times of Abhaya Nidhi Deposit in the initial stage; subsequently on loan utilisation and repayment capacity
(f) Three times of accumulated Bonus in the initial stage; subsequently on loan utilisation and repayment capacity
10. Insurance Products : (a) Abhaya Nidhi Scheme
(b) Group Insurance
(c) Janatha Personal Accident Insurance Scheme (in MTCs)
11. Allocation of Surplus : Net surplus to be totally allocated as annual bonus to all members in proportion to their Compulsory Thrift and Bonus

Figure 2a. Governance and Operational Structure of Thrift Cooperatives Promoted by CDF

cerns the governance of the cooperatives; and a third concerns their economic viability.

As noted above, the CDF promotes cooperatives and has remained involved in supervising and guiding the cooperatives it has promoted. When it first began this work it sent an outreach worker into a village to talk to women in the village about how they might help themselves through the formation of a thrift cooperative. As the reputation of the cooperatives has grown the CDF has had to spend less time conducting outreach and more time responding to requests for help in forming

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12. Interest on Loan on Compulsory Thrift, Bonus & Abhaya Nidhi Deposit : Rates vary as per financial size of TCs and interest is charged on decreasing balances
(a) 18% pa in TC with less than Rs 5 lakh own funds
(b) 15% pa in TC with more than Rs 5 lakh and less than Rs 10 lakh own funds
(c) 12% pa in TC with more than Rs 10 lakh own funds
13. Meetings : (a) General Body Meeting
- Annual Meeting convened by BoD
- Ordinary Meeting convened by BoD
- Special Meeting requisitioned by Members
- Special Meeting held by Registrar
(b) Board Meeting
- Monthly Meeting convened by President
- Review Meeting convened by President
- Special Meeting requisitioned by Board Members
(c) JLG Meeting
- Association of thrift Cooperatives(ATC)
14. Size of ATC : 10-20 TCs within 15 Kms radius of ATC location
15. General Body (GB) : Board Members of all member-TCs
16. Board of Directors (BoD) : Presidents of all member-TCs
17. President : Elected by Board Members from among themselves for one-year term
18. Staff : At least two (Internal Auditor and Book-keeper)
19. Saving Products : (a) Compulsory Thrift
(b) Recurring Deposit
(c) Fixed Deposit
(d) Savings Deposit
20. Loan Products : Three times of Compulsory Thrift, Bonus and Abhaya Nidhi Deposits
21. Meetings : (a) General Body Meeting
- Annual Meeting convened by BoD
- Ordinary Meeting convened by BoD
- Special Meeting requisitioned by Members
- Special Meeting held by Registrar
(b) Board Meeting
- Monthly Meeting convened by President
- Review Meeting convened by President
- Special Meeting requisitioned by Board Members

Legal Status

TCs and ATCs are registered under the Andhra Pradesh Mutually Aided Cooperative Societies Act of 1995 (Mac's Act of 1995)

Figure 2b. Governance and Operational Structure of Thrift Cooperatives Promoted by CDF (continued)

cooperatives. The CDF is very conscious of the role it plays in the promotion of cooperatives, and the need to ensure that good governance policies are in place while also respecting the self-help, mutual aid principles of cooperatives.

An example of this balance is how the CDF provides audit services to the cooperatives and associations. The CDF audits each association monthly. It audits a new cooperative within an association every three months until it has matured to the point where the association auditor can audit it. The CDF continues to conduct a test audit of each cooperative in an association once a year, until the cooperative

has matured sufficiently not to need this level of supervision. At this point there is little direct supervision of a cooperative by the CDF, but the CDF still receives reports on the activities of each cooperative through monthly association reports. Furthermore, the CDF also provides on-going training to the accountants, directors, and presidents of the cooperatives.

The purpose of these activities is to ensure that the cooperatives keep accurate information about their activities and that the leaders of the cooperatives do not de-fraud the members. But, as much as possible, these supervisory activities are delegated to members of the cooperatives themselves, especially to those working at the association level. These associations play a vital role in the workings of each cooperative because they are composed of peer organizations, from different villages. As such, these peer organizations understand the challenges facing individual cooperatives, but they also have the ability to force the cooperatives to abide by their own rules because there is a social distance between them—the fact that they are from different villages enables them to hold each other to account without damaging personal and social relationships within the village. A lesson from the behavior of the CDF is that cooperatives operating under the MACS act still need external supervision, but the preferred supervisor is a peer group of cooperatives and/or an NGO.

It should also be noted that the 2005 CDF annual report states that 11 cooperatives failed in that year and were dissolved. This is not necessarily a bad sign. It is indicative of the fact that the CDF allows the cooperatives it promotes to fail—its interest is not in having cooperatives exist for their own sake but in having successful cooperatives actively serving the interests of their members.

As noted above, the CDF annual report identifies very few cooperatives where elections for the leaders of the cooperatives (directors and presidents) are conducted by secret ballot. Most elections are in public meetings where people can see how each person votes. This is less than ideal for organizations based on democratic principles. Furthermore, Stuart documents that among the WTCs there is a tendency for the presidents to be from the higher castes, though directors are more representative of the membership of the cooperatives as a whole.²⁴ He concludes that one can not divorce the functioning of the cooperatives from the social structure within which they are operating, but, despite flaws in the democratic processes of the cooperatives, many basic accountability measures seem to be working. In particular, he finds that there is no caste bias in the distribution of loans, once one takes into account the savings individuals have accumulated and the length of time they have been members of the cooperatives, and that there is strong compliance with a key lending rule relating loan size to the amount saved.²⁵

A final issue raised by the data on the cooperatives promoted by the CDF is the fact that the cooperatives have mobilized excess funds that they have not lent out to their members. In many cases they have deposited these funds in commercial banks. There is a concern within the cooperatives that the rule that stipulates that a member can only borrow three times the amount they have deposited in the thrift restricts the borrowing of some members, in particular higher income mem-

bers, who could productively use a larger loan. This policy stems from a strict interpretation of the cooperative principles of the ICA and embodied in Section 3.d) of the MACS Act, which stipulates that:

The economic results, arising out of the operations of a cooperative society belong to the members of that cooperative society and shall be distributed in such a manner as would avoid one member gaining at the expense of others...

With the encouragement of the CDF, the cooperatives have maintained their adherence to the “three times” rule, but with the result that not all the funds are used for loans to members. As a way to address this issue, the CDF has promoted dairy cooperatives in an effort to encourage widespread economic activity, which will increase the demand for loan funds across all members of the thrift cooperatives. They have successfully promoted two dairies thus far, both of which supply milk to the growing city of Warangal.

In sum, the activities of the CDF, the advocates behind the MACS Act, clearly demonstrate that having the right authorizing environment is not enough to enable the formation and effective management of cooperatives in rural Andhra Pradesh. The cooperatives need advice and training—they need assistance in building their operational capacity. The lesson does not stop here. A further requirement is that these capacity-building efforts take place in a manner that respects the autonomy of the cooperatives. The membership and the leaders of the cooperatives cannot rely on the CDF to bail them out if they make mistakes; they have to rely on themselves and each other. This is the only way to build capacity while staying true to the intent of the authorizing legislation.

MACS Act and Self-Help Groups

The Self-Help Group (SHGs) movement in India is massive and growing rapidly. SHGs are groups of between 10 and 15 women who come together to engage in activities of mutual benefit. A key component of the groups’ activities is mobilizing savings and gaining access to credit by linking to a bank. State governments, NGOs, and, now, banks promote the SHGs and provide them with advice and support. According to the National Bank for Agriculture and Rural Development (NABARD) there were 2.2 million Self-Help Groups linked to banks as of March 31, 2006, amounting to almost 33 million people (almost all women). In the period between March 2005 and March 2006 620,000 SHGs linked to banks.²⁶ The majority (54%) of SHGs are in the south of India, with half of these being in Andhra Pradesh—about 500,000. In addition to linking SHGs to credit through banks, the program of promoting SHGs also provides grant funding to those organizations that promote them so that they, in turn, can build the capacities of the SHGs. The grant money also goes towards subsidizing the SHGs themselves through subsidized credit and other subsidized goods or services.

Unlike in the case of the thrift cooperatives, the SHGs were not intended to turn into cooperatives registered under the MACS act. The initial promotion of SHGs began in Andhra Pradesh in 1995. In the late 1990s this effort attracted the

attention of the World Bank, which agreed to fund efforts to promote more SHGs and to build their capacity. In the Bank's planning documents for the *Velugu* program, bank staff anticipated the formation of Village Organizations (VOs) made up of 10 to 30 SHGs (or CIGs, Common Interest Groups, in the language of the World Bank document) and federations of VOs called Mandal Samakya. But both of these types of federation would be "unregistered and informal federations," and there was no mention of the MACS act anywhere in the Bank's 119 page document.²⁷ By 2003, in the mid-term reports from three of the six districts targeted by the *Velugu* program, it is clear that those on the ground were encouraging VOs to register as cooperatives under the MACS act. The mid-term report from the Adilabad district suggests that all 1,076 VOs formed in that district were being encouraged to register under the MACS act.²⁸ In Mahabubnagar, the officers in charge of implementing *Velugu* held a training regarding MACS for members of SHGs and VOs, and have also encouraged the registration of VOs and mandal-level federations under MACS. As of September 2003 they had formed 951 VOs.²⁹ In the Srikakulam district the Mid Term Review Report boasts the existence of 837 VOs (down from 1643 in 2002-3) which, according to the report, have registered under the MACS act.³⁰ The Chitoor and Ananthapur reports did not mention MACS, and the Vizianagaram report only mentioned an exposure visit to another district to learn about the operations of MACS.³¹ Overall, Adilabad, Mahabubnagar, Srikakulam, and Vizianagaram have the largest number of thrift cooperatives registered under MACS in the whole of Andhra Pradesh, as of January 31st 2006.

The sheer volume of registrants under the MACS act as of 2006 is not necessarily a positive sign. There are serious concerns about whether members of the VOs registered under MACS even know that their VOs are registered, and what rights and responsibilities this registration confers on them. A study by Mahila Abhivruddhi Society, Andhra Pradesh (APMAS) in 2003 concluded that:

Governance is a key area, which requires immediate attention... Federations and Village Organisations are being registered under the APMACS Act, and almost all Board members are unaware of the bylaws and compliance of the same along with compliance of the APMACS Act. In certain situations, legally, the Board ceases to exist, due to noncompliance of the Act, which could create a legal problem.³²

APMAS also observed a heavy reliance of members and directors of federations on the staff of the promoting NGO, and noted that staff working for the federations tended to see NGO staff as their bosses, not the directors of the federation. The report also noted that:

Systems and Operating Processes is another area requiring immediate focus. Quality and regularity of book keeping and MIS are the two major areas which need to be improved. Though the records maintained at the SHG level are adequate, accuracy and timeliness in recording information is low.

The APMAS findings are from research conducted in 2003, and from a small sample. Since then the state government and NGOs have continued to provide support and capacity building to SHGs, VOs, and MSs. But it is unclear whether these efforts are sufficient, especially given the fact that the number of SHGs continues to grow rapidly. The rapid promotion of VOs across the state harkens back to the experience with cooperatives under the British, in that the enthusiasm for the cooperatives comes from the promoters not the members. Furthermore, a chief motivation behind the formation of VOs is to enable the SHGs' access to external funding from government and commercial banks. As in the past, the emphasis is overly focused on credit activities, while ignoring the controlling hand that having one's savings at risk plays in ensuring that members manage the risks inherent in lending to each other. Finally, as Sinha *et al.* report the SHGs themselves, on which the VOs and MSs are built, are not in the best condition. For Andhra Pradesh, where they studied 60 SHGs in 28 villages, they report that 45% of SHGs have good or adequate records, 59% have up-to-date passbooks (in which savings are recorded) and the portfolio at risk is 35% of outstanding loans.³³ Given these developments there is a distinct possibility that a spate of scandals involving the mismanagement of cooperatives promoted under the *Velugu* program will occur. And this may prompt a rethinking of the wisdom of the MACS Act's liberal approach to cooperatives' regulation. What this suggests is that the innovation that MACS has brought to the authorizing environment in Andhra Pradesh requires continued attention to the operational capacity of the cooperatives and the NGOs that support them. But this point may be moot, because the MACS act faces another, more powerful threat, that of being superseded by legislative and regulatory efforts at the state and national levels.

THE FUTURE OF THE MACS ACT

Apart from the challenges outlined in the previous section, the MACS Act faces challenges from policy changes at both the state and national levels. At the state level the legislature passed a bill in 2005 to remove dairy cooperatives from the MACS Act, and return them to the supervision of the 1964 Cooperative Societies Act. Though the bill does not apply to thrift cooperatives there is a concern that if the legislature is successful in removing the dairy cooperatives from the MACS Act, it can then move on to other cooperatives, such as thrifts. As this article went to press, the High Court of Andhra Pradesh decided in favor of allowing the dairy cooperatives to remain under the MACS Act.

At the national level on February 22, 2007 the Union Cabinet (the cabinet of the national government) approved the Micro Financial Sector (Development And Registration) Bill 2007, the intent of which is to provide a legal framework for the entities engaged in micro finance and facilitate an environment for development of micro finance services in the country with greater transparency, effective management and better governance.³⁴

The bill poses a challenge to the MACS Act because it proposes that NABARD

regulate microfinance organizations that “offer thrift services.” The regulations contain a number of requirements such as a minimum capital requirement of Rs.500,000, that it be well managed, that it have an annual audit, and that it build up a reserve fund. But most importantly it includes the phrase “any other condition, which may be specified by regulations in this behalf.” This clause essentially gives NABARD the power to promulgate regulations beyond those specified in the bill. The bill also requires that all MFOs, including those not providing “thrift services” submit certified financial reports to NABARD. Should the bill pass it would apply to the over 7,000 thrift cooperatives currently accepting thrift deposits from their members, and registered under the MACS Act, and also Village Organizations registered under the Societies Act (1860). It would also, it seems, apply to self-help groups that collect savings from their members. If this act becomes law, then the VOs in Andhra Pradesh will have come full circle, back to where cooperatives were before the MACS Act: they will be cooperatives with little membership support, accessing external credit, and subject to a regulator with extensive powers to intervene in its operations.

CONCLUSION

The MACS Act is a regulatory innovation in microfinance. It is not an uncontroversial one, in that its purpose is to give member-owned and member-financed cooperatives the freedom to manage their own operations with little government regulatory supervision, even though they are mobilizing savings. At the same time, the act does enable the membership of the cooperatives to provide as much oversight of their own operations as they see fit, and exposes them to potential losses if they fail to do so. As such, the MACS Act is very similar to the intent of micro-credit operations whose purpose is to put the tools of development, in the form of credit, in the hands of the poor, allows them to decide how best to use the money, and requires them to bear the risk entailed by that decision. The borrower takes on the rights and responsibilities for the use of that money. Furthermore, peer lending is, essentially, contracting out the management of risk to the peers of the borrower, because it is asking the borrower’s peers to: screen the borrower before they enter into a loan contract with the MFI, support the borrower if she gets into trouble with her loan, and hold the borrower accountable if she proves unwilling to repay the loan. As such it is taking advantage of local knowledge and the mutual accountability structures already in existence within the community to manage the risk of the loan. In the same way, the MACS Act allows members of a cooperative to formulate their own by-laws by which they will hold each other accountable. The assumption is that the members will adopt by-laws that best suit their own situation, including the pre-existing accountability structures in their community.

Despite this similarity, there is one major difference between the MACS Act and a micro-loan in terms risk and responsibility. In the case of a micro-loan the borrower is not likely to have to manage a complex organizational structure with

which she is unfamiliar. It is likely that the money will be used in the context of her household and enterprise—two organizations with which she is highly familiar. In the case of the member of a thrift cooperative, she is signing on to a new organization that requires a governance structure, information systems, and the willingness and ability on the part of the member to participate in decisions within that governance structure based upon the information emanating from the systems. This is a more complex requirement. As a result, it is not surprising that the Cooperative Development Foundation, which fought hard for the MACS Act, and has promoted a large number of well-run cooperatives, provides the cooperatives it has promoted with advice and technical assistance. The members of these cooperatives and their leaders need such advice and assistance. The CDF meets that need, but it does so in a way that attempts, as far as possible, to respect the autonomy of the cooperatives and their associations. In doing so, it is attempting to comply with the spirit of self-help and mutual aid that is the central tenet of the principles on which the MACS Act is founded, and to ensure that the cooperatives develop to a point that they no longer need the advice and assistance of the CDF.

One potential threat hanging over the success of the MACS Act is that the large number of cooperatives recently registered under the MACS Act have not had the benefit of the same type of advice and assistance. The APMAS evaluation suggests that the registration of the VOs and MSs under the MACS Act has not always stemmed from the efforts of the membership and their duly elected leaders, but rather from the efforts of the NGOs that promote and support those federations. As a result, the membership may not have a full sense of their rights and responsibilities under the act. For now, they have the support and oversight of the NGOs that promoted them. But it is unclear whether this support and oversight will result in increasingly autonomous cooperatives.

The other potential threat hanging over the MACS Act is from those who believe that it is not an innovation, but bad policy. As noted above, the parallels between the MACS Act and the innovation inherent in extending uncollateralized credit to the poor are strong. So it is harder for the critics to make the case. This is especially so because the cooperatives are mobilizing savings and extending services to their members, who have the rights and responsibilities defined by their by-laws and the basic governance infrastructure required by the act, and they are not engaging in regular “banking” activities that might impact the broader financial system. If there is one weakness in this argument, with respect to the MACS Act, it is that the Act allows the mobilization of savings from non-members who are individuals. This should be changed, because it opens the door for individuals who have no say in the running of the organization to put their money at risk. But history tells us that this weakness is small compared to the weakness of cooperatives that are heavily regulated by a government entity that emasculates the rights, responsibilities, and risks that belong to the membership.

1. These are: Bihar, Chhattisgarh, Jammu and Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Orissa and Uttaranchal. Government of India (2004). “Task Force on Revival of Cooperative

- Credit Institutions. Draft Final Report.”
2. M.H. Moore (2000) “Managing for Value: Organizational Strategy in For-Profit, Nonprofit, and Governmental Organizations.” *Nonprofit and Voluntary Sector Quarterly* 29(1): 183-204.
 3. Ibid.
 4. Ibid, p. 15.
 5. See chapter 7 of Muhammad Yunus (2003), *Banker to the Poor: Micro-Lending and the Battle Against World Poverty*. (New York: Public Affairs), to read a description of how the law was passed.
 6. F. Moore. (1954). “Money Lenders and Cooperators in India.” *Economic Development and Cultural Change* 2(2): 139-159.
 7. Illbert, C. (1906). “Review of Legislation 1904, British India.” *Journal of the Society of Comparative Legislation* 7(1): 81-89.
 8. Ibid, 85.
 9. The nine states covered by Qureshi’s data were: Mysore, Baroda, Hyderabad, Bhopal, Gwalior, Indore, Kashmir, Travancore, and Cochin.
 10. A.I. Qureshi, *The Future of the Co-Operative Movement in India*. Madras (Chennai), (Oxford University Press, 1947).
 11. Ibid, p. 17-18.
 12. Ibid, p. 58.
 13. No reference in bibliography
 14. Qureshi, *The Future of the Co-Operative Movement in India*, p. 63.
 15. Government of India (2004). “Task Force on Revival of Cooperative Credit Institutions. Draft Final Report.”
 16. These principles are explicitly stated in section 3 of the act under “Cooperative principles and byelaws.”
 17. MACS Act, 17.2
 18. For example, when a cooperative registers under the act it must provide the registrar with a copy of the by-laws which should cover the 39 issues specified in the act.
 19. It is no longer possible for a Registrar to decide to wind up a cooperative on his own volition, appoint a liquidator and then allow the liquidator to take years to do his job, while receiving payments for the work from the assets of the cooperative. (CDF Comment 44)
 20. References to sections, sub-sections, and clauses of the Act will be according to the following: Section 14.1.b refers to section 14, sub-section 1, clause b of the Act.
 21. The difference between such a bank and a thrift cooperative is that the latter plays no active role in the monetary system of the economy—it can not issue “money” that is accepted outside the cooperative, whereas a bank whose customers write cheques, enable their clients to create “money” by writing a cheque drawn on a bank.
 22. Cooperative Development Foundation, Thrift Cooperatives around Warangal City, Andhra Pradesh, Performance Report: 2005, (Warangal, Andhra Pradesh: Cooperative Development Foundation, 2005).
 23. Author’s calculations based on data in Cooperative Development Foundation, Thrift Cooperatives around Warangal City, p. 13-14 and 19-20.
 24. Guy Stuart (2006). “Caste Embeddedness and Microfinance: Savings and Credit Cooperatives in Andhra Pradesh, India.” Cambridge, MA, Harvard University-John F. Kennedy School of Government, KSG Working Paper No. RWP06-037.
 25. Ibid, p. 29
 26. National Bank for Agriculture and Rural Development, Annual Report, (Mumbai, 2006).
 27. World Bank, Project Appraisal Document on Proposed Credit in the Amount of SDR 82.9 million (US\$111.0 million equivalent) to India for the Andhra Pradesh Poverty Initiatives Project, (Delhi, World Bank, 2000).

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