

FIRSTPOST.

Why the poor are willing to hand over their money to Sahara

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Abhijit V Banerjee and Esther Duflo in their book "Poor Economics" Rethinking Poverty & the Ways to End It write a very interesting story about a woman they met in the slums of Hyderabad. This woman had borrowed Rs 10,000 from Spandana, a microfinance institution.

They write: "A woman we met in a slum in Hyderabad told us that she had borrowed Rs 10,000 from Spandana and immediately deposited the proceeds of the loan in a savings bank account. Thus, she was paying a 24 percent annual interest rate to Spandana, while earning about 4 percent on her savings account".

The question, of course, was why would anyone in their right mind do something like this? Borrow at 24 percent and invest at 4 percent? But, as the authors found out, there was a clear method in the woman's madness.



It is easier for people to build a savings nest by borrowing and then repaying that loan, rather than by saving regularly. Reuters

When we asked her why this made sense, she explained that her daughter, now 16, would need to



get married in about two years.Â That Rs 10,000Â was the beginning of her dowry. When we asked why she had not opted to simply put the money she was paying to Spandana for the loan into her savings bank account directly every week, she explained that it was simply not possible: other things would keep coming up!The point, as we eventually figured out, is that the obligation to pay what you owe to Spandana " which is well enforced "imposes a discipline that the borrowers might not manage on their own."

The example brings out a basic point that those with low income find it very difficult to save money and, in some cases, they even go to the extent of taking a loan and repaying it, rather than saving regularly to build a corpus.

This includes a lot of very small entrepreneurs and people who do odd jobs and make money on a daily basis. Such individuals have to meet their expenses on a daily basis and that leaves very little money to save at the end of the day. Also, the chances of the little money they save, being spent are very high. As Abhijit Banerjee told me in an interview I did for The Economic Times: æThe broader issue is that savings is a huge problem. Cash doesnTMt stay. Money in the pillow doesnTMt work."

Hence, as the above example, showed it is easier for people to build a savings nest by borrowing and then repaying that loan, rather than by saving regularly.

Another way building a savings nest is by visiting a bank regularly and depositing that money almost on a daily basis. But that is easier said than done. In a number of cases, the small entrepreneur, or the person doing odd jobs, figures out what he has made for the day only by late evening. By the time the banks have closed for the day.

The money saved can easily be spent between the evening and the next morning when the banks open. Also, in the morning, the person will have to get back to whatever he does, and may not find time to visit the bank. Banks also do not encourage people depositing small amounts on a daily basis. It pushes up their cost of transacting business.

But what if the bank or a financial institution comes to the person everyday late in the evening, once he is done with his business for the day and knows exactly what he has saved for the day. Â It also does not throw tantrums about taking on very low amounts.

This is precisely what Subrata RoyTMs Sahara group has been doing for years, through its parabankers who number anywhere from six lakh to a million.Â They go and collect money from homes or work places of people almost on a daily basis.

The Sahara group fulfilled this basic financial need of having to save on a daily basis for those at the bottom of the pyramid (as the management guru CK Prahalad called them). The trouble, of course, was that there was very little transparency in where this money went. The group has had multiple interests ranging from real estate, films, television, and now even retail. A lot of these businesses are supposedly not doing well.

Over the last few years, both the Reserve Bank of India (RBI) and Securities and Exchange Board 

India (Sebi) have cracked down on the money-raising schemes of the Sahara group. In a decision today, the Supreme Court of India has directed that the Sahara group refund more around Rs 17,700 crore that it raised through its two unlisted companies between 2008 and 2011. The money was raised from 2.2 crore small investors through an instrument known as optionally fully convertible debentures. The money has to be returned in three months.

Sebi had ordered Sahara last year to refund this money with 15 percent interest. This was because the fund-raising process did not comply with Sebi rules. Sahara had challenged this, but the Supreme Court upheld Sebi.

The question that arises here is: why has Sahara managed to raise money running into thousands of crores over the last few decades? The answer probably lies in our underdeveloped banking system. In a November 2011 presentation made by the India Brand Equity Foundation (a trust established by the Ministry of Commerce with the Confederation of Indian Industry as its associate), throws up some very interesting facts. A few of them are listed below:

- Despite healthy growth over the past few years, the Indian banking sector is relatively underpenetrated.
- Limited banking penetration in India is also evident from low number of branches per 100,000 adults. The branched per 100,000 adults ratio in India stands at 747 compared to 1,065 for Brazil and 2,063 for Malaysia
- Of the 600,000 village habitations in India only 5 percent have a commercial bank branch
- Only 40 percent of the adult population has bank accounts

What these facts tell us very clearly is that even if a person wants to save it is not very easy for him to do so because chances are he does not have a bank account or there is no bank in the vicinity. This is where Sahara comes in. The parbanker comes to the individual on a regular basis and collects his money.

As a Reuters story on Sahara points out, "Investors in Sahara's financial products tend to be from small towns and rural areas where banking penetration is low. They see Sahara on television everyday as sponsor of the cricket team and that leads them to believe that this is the best company," said a spokesman for the Investors and Consumers Guidance Cell, a consumer activist group."

Sahara has built trust over the years by being a highly visible brand. It sponsors the Indian cricket and hockey team. It has television channels and a newspaper as well. Hence people feel safe handing over their money to Sahara.

The irony of this, of course, is that RBI, which has been trying to shut down the money raising activities of Sahara, is in a way responsible for its rise, given the low level of banking penetration in the country.

Vivek Kaul is a writer and can be reached at vivek.kaul@gmail.com

