Microfinance Post Andhra Pradesh Crisis -Towards Redemption

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Abstract

The Andhra Pradesh is an agrarian state, located in the southern part of the country which was also the epicenter for most of the MFI's before 2010. Before 2006 AP witnessed huge influx of funds poured by most of the public sector and commercial bank and PE Investors. The MF sector was designated as a priority sector by Government of and sector was glorified and appreciated for serving the neediest and deprived population of the country. The common names given to this population served by MFI were "Bottom of Pyramid", economically vulnerable class, who were supposed to be provided with the basic financial assistance in order to improve their financial conditions and living standards. The very purpose of sustainability which was addressed by Microfinance Institutions itself raised a question on their sustainability. Rapid sector growth and minimal regulatory oversight eventually led to predatory practices, widespread client over-indebtedness and allegations of abusive collection practices, culminating in 2010 with the sensational media stories of farmers in AP driven to suicide as a result of their inability to repay their loans. The deployment of untrained workfare and inefficient recovery and operational practiced paralyzed the sectors growth and raised concerns by various policymakers/stakeholders who were looking forward for change in the sector and economy. Andhra Pradesh was the only state which once became a heaven for most of the MFI's, started grappling with the issue of suicides of borrowers. The enactment of " Andhra Pradesh Microfinance Institutions (regulation of money lending) Act 2010, was a big blow to the very existence of the MFI's thereby squeezing their finances and giving a political mileage to political parties across Andhra Pradesh who took it as a political agenda to shine their political image. This paper focuses on post Andhra situation of MFI's; it's social, political and economic implication on Indian society.

Keywords: - Bottom of pyramid, MFI (Microfinance Institutions), Andhra Pradesh (AP) Microfinance Mangalam Committee, self-help groups, Integrated Rural Development Plan (IRDP).MFIB (Microfinance Institutions (Development and Regulation) bill.

Introduction

Microfinance began with an intension of serving the very poor and deprived community there by extending their support and serving to the remotest part of the nation. Andhra Pradesh remained at the epicenter for almost as all the major Microfinance Institutions which were having ambitious plans to grow aggressively. The word microfinance can also be interchangeably with microcredit indicating the very tiny nature of loans and advances for the needy people. The issue of sustainable development, financial inclusion once becomes a buzz word of the times. Most of the Microfinance Institutions received enormous response not only from the government but also from private equity players. But the situation suddenly worsened for all MFI's and their financial situation started deteriorating. The most objectionable discussion started when microfinance Institutions were alleged for usurious lending and coercive recovery practices. The unprecedented suicide epidemic of farmers in the fifth biggest state of India gave readymade issue to the opportunist political system in Andhra Pradesh to take a political advantage of the situation. The incompatibility of the MFI's to manage the political system of AP was the only reason for its failure argues Elizabeth Rhyne, ("On Microfinance: Who's to Blame for the Crisis in Andhra). Media started to get saturated with the stories and series of articles from BBC world news, Bloomberg, New York Times running number of articles like *"Microcredit faces collapse from defaults"*, *"India's Micro-finance suicide epidemic"*, *"Suicide in India Revealing How Men Made a Mess of Microcredit"*[2] .In the year 2010 SERP (Society for elimination of Rural Poverty came out with a stunning 70 number of deaths in AP. The blame was put against inefficient handling of recovery cases of MFI's. The critic and outrageous remarks of various politicians and media against MFI started building a political turmoil in AP. It forced the AP government to pass an ordinance to regulate the activities various MFI operating from its soil. The term which was used was multiple lending and loan offering without understanding and calculating the risk profile of customer which was clear from the interpretation of Reddy Subramanyam who advocated regulations and termed it as "hyper profits of the poor". The microfinance was criticized for using usurious lending activities and charging exorbitant interest rates. The sector had gone through three phases since last three years as High growth (2010), Volatile growth (2010-2011), consolidation (2011-2012), now is in a state of stability.

The reasons for such fallout can only be traced if we understand the working culture, style of functioning of MFI. Commercialization of microfinance was also one the main reasons as because non-government organization state funded subsidies, charities existed for a less time. However, commercialization was inevitable only because charity from donors, subsidy ceased and the accumulation of funds was possible only by attracting investors and PE institutions to deluge their funds in this sector and thereby earning financial incentives. But it resulted in suicide of farmers and economically vulnerable borrowers who borrowed from many sources and could not repay their loans. This issue was taken by media: suicide and prostitution (Guerin et al, 2009a; Mader, 2013; Taylor 2011). Whether all this was because of commercialization or usurious lending practices of MFI or government's inability to tackle this issue? Was it an outcome of unethical practices adopted by MFI's?

This paper focuses the reasons for fallout of microfinance and its future course. Starts with literature review, remedial measures taken by government post AP crisis followed by, consequences post AP crisis, recommendations and conclusion.

1. Theoretical Background and Literature Review

The concept of commercialization can be well understood as business without charity or for the purpose of booking profit without direct or indirect subsidy element (Armendariz and Morduch, 2010). MFI operating as commercial organization mobilize the funds by means QIP or Equity funding thereby distributing profits to their shareholders.

But there was always risk involved to trade-off between profitability and outreach termed as "mission drift" (Morduch, 2000;Armendariz and Szafarz, 2011). M. Younus of Grameen Foundation and others termed commercialization as 'ethics of conviction', (Schmidth, 2012) Whereas Max Weber's proposition of 'ethics of responsibility' formed the basis of commercialization in microfinance.

1.1 Commercialization "The real cause of Crisis in Andhra Pradesh"

The recent example of microfinance commercialization is Andhra Pradesh, a southern state of India. Microfinance operation in this 'hub' began in 1980s in small scale as NGO driven MFIs. But due to the state drive as the 'priority sector' and the World Bank funding in 1990s, it underwent expansion and commercialization (Taylor, 2011). Trade liberalization, state retrenchment of formal banking sector and transformation in the agricultural sector facilitate livelihood diversification. It bolstered MFIs as the new breed of private sector offering attractive profit to investors. Massive influx of capital from shareholders, commercial banks, and international and private investors cause exponential growth of loan portfolios of MFIs that finally push the whole state as an ideal breeding ground of debt dependency and over-indebtedness of the poor households (Mader, 2013; Taylor, 2011).

However, Andhra Pradesh ordinance did not come out of the blue. Genesis of the Andhra Pradesh Microfinance crisis can be traced back in the year March, 2006 when Krishna district government closed down 57 branches of two largest MFIs (SHARE and Spandana) as well as those of few smaller MFIs. Decision to close down of these MFIs came because of the allegations of unethical collections, illegal operational practices (such as taking savings), poor governance, usurious interest rates, and profiteering *(CGAP, 2010)*. There was even an allegation that 10 borrowers of MFIs in

Krishna district committed suicide because they were unable to repay the loans taken from MFIs (Srinivasan, [illegible]) [illegible] cited near-saturation of Andhra with microfinance as one of the most important snap[illegible] cause for the crisis. The implication of above point is that borrowing from multiple sources (like Velugu SHGscheme backed by AP Government and assisted by World Bank), MFIs and moneylenders culminated in over indebtedness. Rapid expansion of bank credit as facilitated by initiatives like ICICI partnership model and availability of cheap credit in form of "Pavala Vaddi" scheme, motivated by political consideration, intensified the

crisis. As diagnosed by *Shylendra (2006)* conflict between State supported SHGs and Civil society initiatives in form of MFIs as the major reason behind the eruption of crisis.

MFI despite so many warning issued faced the brunt of the situation arose during 2010 , for not learning lesson from 2006 crisis and ignoring all the warnings pertaining to high interest and growth rate, concentration of activities in the Andhra Pardesh region etc. Over indebtedness and multiple lending in AP can be gauged from the fact that, in comparison to national average of Rs 7,700, in Andhra Pradesh, the average debt outstanding per household was Rs. 65,000 *(CGAP, 2010)*.Most of the MFI's were concentrating their marketing activities only in one region that was Andhra Pradesh without understanding background of their clients who was already overburdened and indebted. Inability of borrowers to repay such huge amount resulted in stress on the part of borrowers and use of coercive methods on the part of MFIs to recover the loan payments, which ultimately resulted in suicides of the borrowers. The government had cited the death of 70 customers by suicide. However state Government backed SHGs were kept out of the purview of the Act though different studies are showing they were also responsible for multiple borrowing. *M-CRIL (2011)* study clearly stated if the number of MFIs loans is over 100% of the number of eligible, financially excluded families, SHG loans are actually 310% of that number. So keeping SHGs away from the ambit of Act, agonized MFIs and it was perceived by them as an Act to protect state Government backed SHGs from the competition from MFIs. So in the wake of incidents like over-indebtedness, hype created by the IPO of SKS Microfinance coupled with the reports of suicides in rural Andhra Pradesh resulted in ordinance of 14 October, 2010

1.2 Development post AP Crisis:-

Post the AP ordinance in October 2010, there was regulatory uncertainty over the microfinance activities undertaken by the MFIs. To overcome or reduce uncertainty and bring MFI activities under single regulator and avoid multiple lendings, Government of India initiated Microfinance bill. The MFI bill aims to address the concerns and regulate the MFI sector and it is with the parliament. Furthermore, in May 2011, the Reserve Bank of India (RBI) issued guidelines to regulate NBFC MFIs and retain priority sector lending status for micro-finance institutions. It issued specific guidelines for NBFC MFIs, to ensure that the clients are offered services in a transparent manner including clear communication of lending rates, tenure of loans, repayment flexibility etc. The guidelines further ensure that NBFC MFIs assess the indebtedness level of the clients and disburse loans. In addition to this it also mentions that MFIs need to have customer redressal mechanism in place to address customer grievances. In totality the guidelines were aimed at customer protection principles by the NBFC MFIs. Recently RBI has given recognition status to self-regulatory organizations which adhere to set of functions and responsibilities prescribed by RBI. The table below shows the timelines and amendments of guidelines by RBI for the microfinance sector:

2. **Malegam committee**

   Post Andhra crisis various issues pertaining to the sectors growth were discussed nationally and internationally. Malegam committee was the way forward to provide structural past to the estranged sector thereby developing a new image.

1. **October 2010** Formation of Malegam Committee by RBI to study the issues and concerns in microfinance sector.
2. **January, 2011** RBI released Malegam Committee recommendations for the Microfinance sector

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...lay, 2011 Acceptance of broad framework of Malegam Committee recommendations ... Monetary Policy Statement 2011-12 including: Retention of priority sector lending status for ... ...ans to MFIs, margin cap at 12% and interest rate cap at 26%.

...ecember, 2011 RBI introduced new category of NBFC and termed as 'Non-Banking Financial ...ompany-Micro Finance Institutions' (NBFC-MFIs). Some of the key points include

a. Minimum Net Owned Fund of Rs.5 crore for new NBFC MFIs and for existing NBFC MFIs w. e. from April 1,2012.

b. Capital Adequacy Ratio of 15% (relaxation for AP based MFIs for FY12 and for NBFC MFIs With loan Portfolio less than Rs.100 crore)

c. Margin cap at 12%, interest rate cap at 26% and processing charges at 1% August. 2012 Amendment to NBFC MFI guidelines by RBI which included

d. Registration compulsory for NBFCs intending to operate as NBFC MFIs by October 2012.

e. Relaxation in meeting norm of Minimum Net Owned Fund of Rs.5 crore for existing NBFC MFIs. It has to be met in tranches with Rs.3 crore NOF by March 2013 and Rs.5 crore by March 2014.

f) Removal of interest rate cap and linked to borrowing rate plus fixed margin. Margins are capped at 10% for large MFIs and 12% for others July, 2013 Amendment to NBFC MFI guidelines by RBI which include relaxation in margin cap for all NBFC MFIs irrespective of size at 12% till March, 2014. However from April, 2014, margins are capped at 10% for large MFIs and 12% for others Nov, 2013

g) RBI has allowed recognition of industry association of NBFC MFIs as Self-Regulatory Organization (SRO).

Feb, 2014 Amendment to NBFC MFI guidelines by RBI with respect to pricing of credit: it would be lower of two

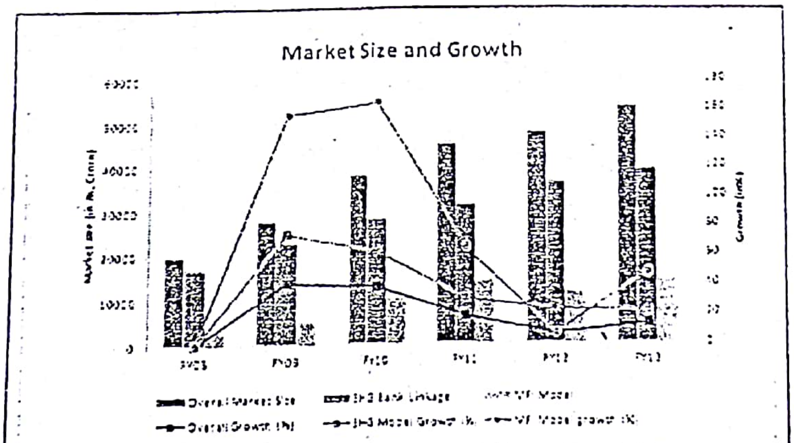
- The cost of funds plus margin
- The average base rate of the five largest commercial banks by assets multiplied by 2.75

Microfinance post Andhra crisis:

The following graph indicates the sector performance of MFI post regulatory steps taken by ...ernment of India post 2010.

Data Analysis & interpretaion

Fig No. 1



Source: NABARD Report "Status of Microfinance in India" from FY09 to FY13

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Table 1:- Equity infusion in the microfinance sector (20011-2013)

Year	Name of the MFI	Amount of equity infuesion (in crores)
2011	Bandhan Financial Services Pvt. Ltd.	135
2011	Satin Creditcare Networks Ltd.	42.4
2011	Janlakshmi Financial services Pvt. Ltd	65
2011	SKS Microfinace Pvt. Ltd.	263
2012	Equitas Microfinance Pvt.Ltd.	140
2012	Annapurna Microfinance Pvt. Ltd.	17
2012 and 2013	Ujjvan Financial Services PvT. Ltd.	127.9 and 47.3
2013	Utkarsh Microfinance Pvt L;td.	20
2013	Grammen Financial Services Pvt. Ltd.	53.2
2013	Arohan Financial Services Pvt. Ltd.	48.7
2013	Janlakshmi Financial services Pvt. Ltd	325

% change in investment(in crs) = $\frac{\text{(Investment in 2013 - Investment in 2011)}}{\text{Total investment in 2011}}$

% Change = $\frac{(494 - 505.4)}{505.4}$ = - 0.022%

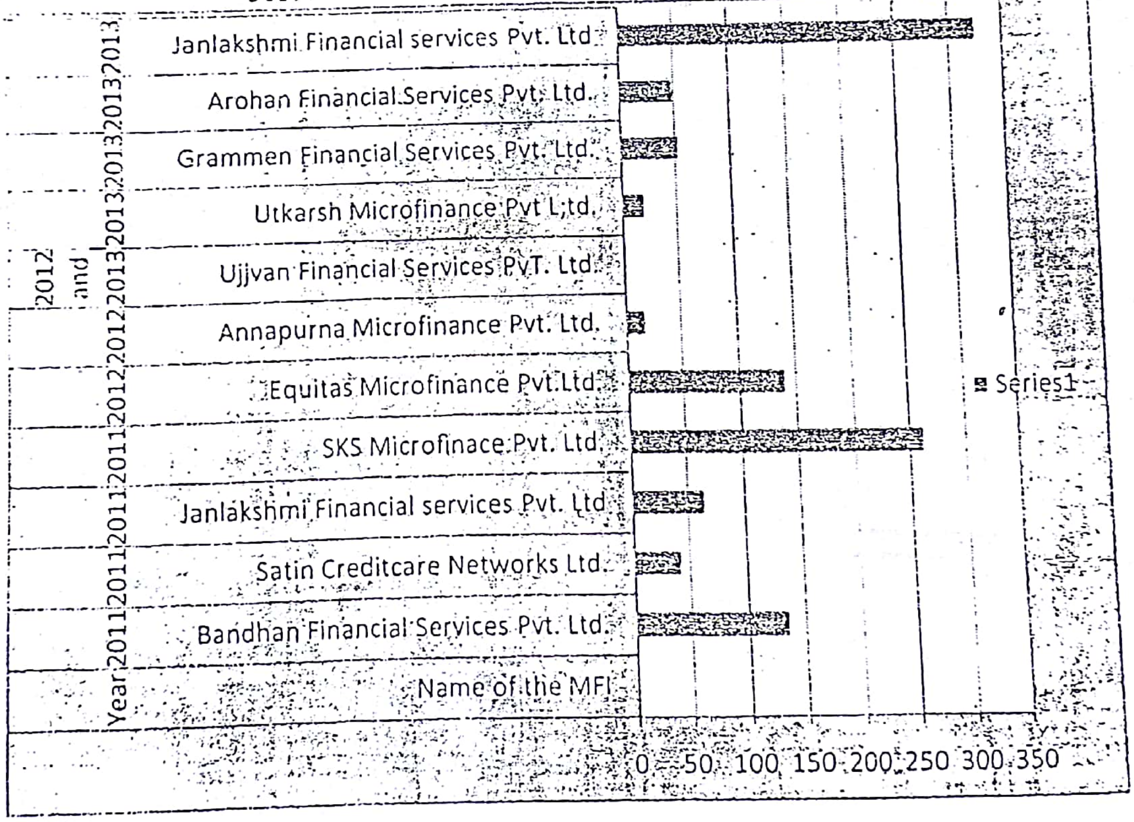

Figure 2 - Year v/s Investment in crores

The figure number 1 indicates the fluctuating growth pattern of MFI and its recovery from the fallout. The figure no.2 indicates the amount of equity infusion in MFI by various investors which is also showing signs of recovery. The sector is trying to stabilize itself in the regulatory environment post Andhra crisis.

Recommendations

For the Microfinance industry to self-regulate and bring operational efficiency and mitigating the following recommendations are suggested.

- Earn customer respect and thereby achieving customer retention.
- Bring transparency in terms of interest rates while dealing with customers especially in case of delayed payments (*Arguello et al, 2013*).
- Know your customer history before disbursing loan
- Full disclosure of pricing so that customers are well informed.
- Developing discipline in the field officers thereby ensuring adherence to the code of conduct while dealing with any client.
- Develop an environment of mutual trust especially while dealing with recovery matters.
- Stop aggressive marketing for competing in order to grow the customer portfolios.
- Random, surprise visits by seniors MFI staff members to track field officers performance (Burk, 2009) thereby achieving strict compliance and monitoring system.
- Develop early warning systems so that the client can be informed in case of future default condition.
- Develop a culture of savings and create awareness towards insurance among the group members.
- Develop close link between Aadhar and telecom sector to identify customers and bring connectivity.

Limitations

With a huge customer portfolio it is virtually impossible to track each and every individual. The customer's database cannot be maintained as there is no such mechanism which is existing in MFI. The new Aadhar card scheme is yet to fully implement in various parts of India due to poor connectivity and failure to rich the masses. There is a retention problem when it comes to maintaining the staff. Educated youths do not consider it as a best career option. Some of the group employees and staff members encouraged over-indebted members to commit suicide and claim for insurance. The credit life insurance is taken in a negative manner by the clients which used it as a tool for committing suicide and their families claiming for insurance. The classic example can be taken from the Bollywood movie *"Peepli Live", a story of "Nattha"*, an over-indebted farmer. Some of the clients were found to be misusing their over-indebtedness to gain political and media attention. The microfinance institutions have to get themselves acquainted to the rules and regulations related to financial and risk management. It's quite clear from above facts which make it difficult to fully implement all these recommendations.

7. Conclusion

The Indian Microfinance sector was remembered as controversial and worst post 2010 crisis. Unethical ways of loan recoveries, governments inability to tackle the situation, multiple lending causing over-indebtnesss of clients, suicides and the political turmoil, high rate of interests charged by MFI's, which resulted in *Andhra Pradesh Microfinance Institutions (regulation of money lending) Act, 2010.* Stated objective of the Act was to protect the poor borrowers from the MFIs but it worked in adverse manner due to which the sector saw a declining growth since past two years and yet to heal its wounds. This situation not harmful to the poor but it has also reduced investors trust who should be given be full credit for its growth. The situation even more worst for MFI's post losing their confidence from investors who are finding difficulties for maintaining liquidity, lost hope of making profits. This issue is going spread like an epidemic thereby jeopardizing (Gonzalez, 2008; Wichterich, 2012; Mader, 2013) this sector and spilling it across the world. This situation has endangered the social and financial objectives and also hampered Indian economy.

Indian government needs to implement an effective mechanism to ensure the sector growth and also to mitigate various risks originated from the AP situations that it wont get repeated again. The lesson is also learned by various MFI's, who were operating unprofessionally and inefficiently. The situation for all these MFI''s is like walking on a tight rope. On one hand they have to regulate themselves and the other hand they have to ensure steady growth and sustainability along with maintaining profitability.

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