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www.MicroSave.net
info@MicroSave.net

Policy Brief # 5

What Are Clients Doing Post The AP MFI Crisis?

Anjaneyulu Ballem, Denny George, Ghiyazuddin A. Mohammad, Raunak Kapoor, Shayandeep Chakraborty and Venkata NA

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Background

Andhra Pradesh (AP) is … or was … the epicentre of the microfinance (MF) industry in India. The state is home to five of India's largest NBFC- MFIs. Many of these MFIs grew at a rapid pace and proliferated across AP and other parts of India. MFIs were alleged to have unethical practices, such as charging usurious interest rates, using coercive collection practices and profiteering from the poor, in their endeavour to grow rapidly. The Government of AP promulgated The Microfinance Institutions (Regulation of Money Lending) Ordinance, in October 2010 to clamp down these alleged practises. The Ordinance has imposed regulations like compulsory registration of the MFIs with designated authorities; requirements to make loan collections near local government premises; and forcing MFIs to shift to monthly repayments. The Ordinance, coupled with a huge negative publicity against MFIs, plunged the MFIs in deep crisis, impeding their operations and resulting in drastic fall in loan collections and disbursements.

Objectives

MicroSave conducted this study to examine the impact of the crisis on borrowers by collating client experiences, opinions and needs so as to help policy makers and key actors to devise solutions suited to client requirements.

The Research Methodology and Sample

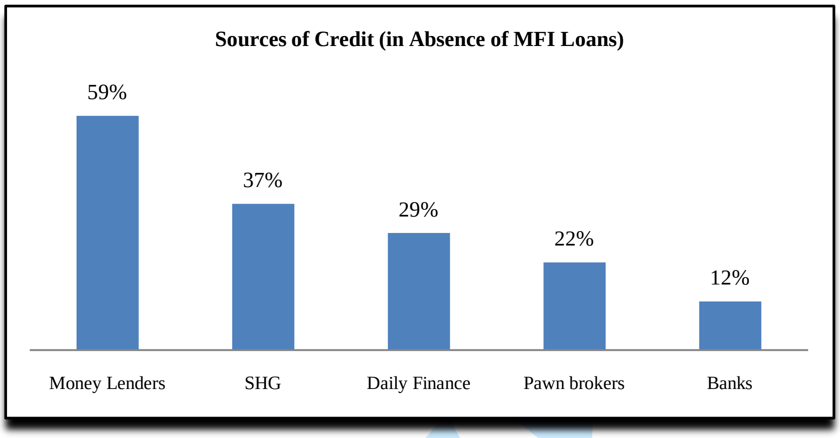
The team conducted 76 sessions using participatory methods like focus group discussions, relative preference ranking and financial sector trend analysis during July – August, 2011 in three regions of Andhra Pradesh (Telangana, Rayalaseema and Coastal Andhra) covering a total of four districts (Anantapur, Krishna, Nizamabad and Adilabad). The team also interviewed several government officials, who are involved in SHG movement, bank officials who have experience in SHG-bank linkage, field staff of SHG-federations, field staff of MFIs and their borrowers and SHG members.

Profile of the Respondents

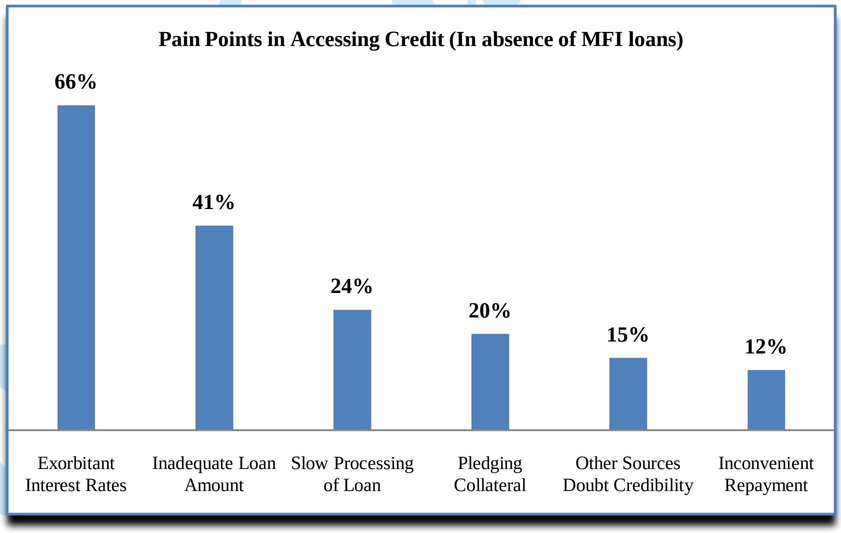
The majority (84%) of the respondents were female as most of the sessions were conducted with women members of SHGs promoted by SERP and joint liability groups (JLGs) promoted by MFIs. More than 50% of the respondents were in the age group of 30 to 40 years and 22% of the respondents in the age group of 40 to 50 years. Out of the total respondents, 27% were self-employed and running their own businesses such as *kirana* shop, tiffin centres, cycle repair shop, tailoring, auto driving etc., while another 27% were involved in cottage industry such as *beedi* rolling, making jute bags, embroidery etc.

Findings – Client Related

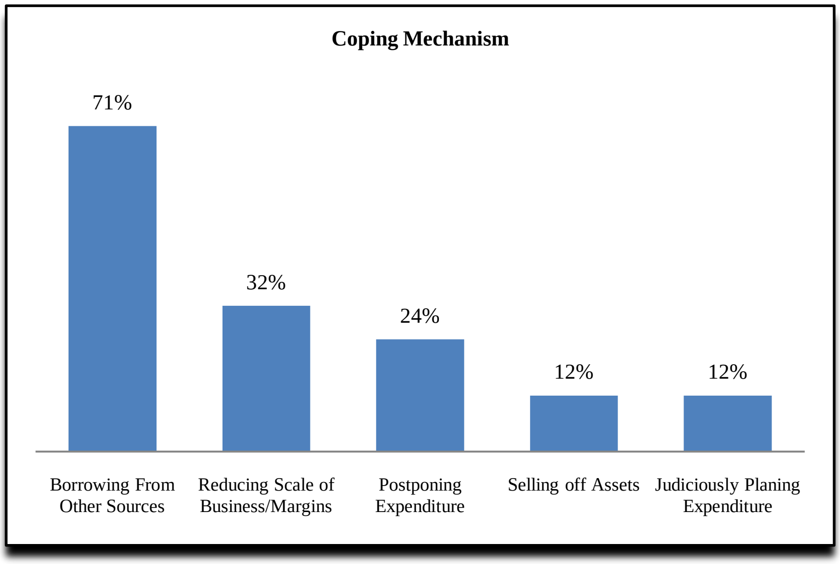
- ***Credit sources in the absence of MFIs***: In 59% sessions, respondents said that they have taken loans from moneylenders in the absence of loans from MFIs. Moneylenders have increased lending in the past eight to ten months in areas with higher penetration of MFIs. The next accessible source of credit for the respondents was the SHGs (37%) and "daily finance corporations" – another form of money lenders - (29%).



- ***Pain points in accessing credit from alternate sources***: In 66% of the sessions, the exorbitant interest rate charged by sources such as moneylenders and daily finance corporations featured as the most significant pain point. In as many as 41% of the sessions, respondents said that loans taken from SHGs and/or banks are often inadequate, and do not serve the purpose. Respondents said that for loans taken from SHGs and banks the processing time was very high (24%). It has taken a minimum of one month and maximum of six months for processing of a loan.



- ***Coping mechanism in the absence of MFI loans***: 24% of respondents who had plans for business expansion have postponed them as access to credit had become difficult. Many (32%) respondents said that they had reduced the scale of their business because of lack of access to alternate sources of credit. In 12% of the sessions respondents said that they sold their assets such as house, vehicle, cattle, jewellery etc., to meet their productive (agriculture related expenses) as well as essential non-productive expenditure (school fees, marriage etc.) which have to be met.



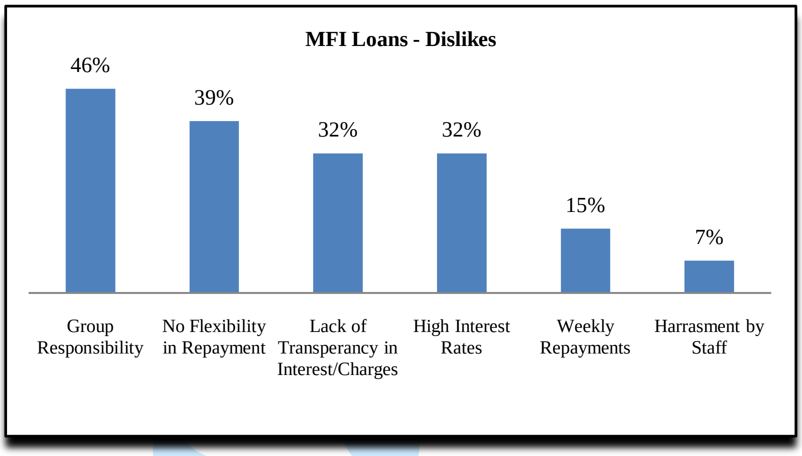
Sources of Credit for the BoP Segment

SHGs were the most prominent (98%) sources of credit for the respondents. Respondents mentioned MFIs in 85% of the sessions and moneylenders in 88% of the sessions. Despite the good banking network in the region, the majority of the respondents did not like to source credit from banks. Respondents cited inordinate delays, cumbersome procedures, and the complex documentation requirements of banks as the major reasons for not preferring banks as a source of credit.

Findings – Service Provider Related

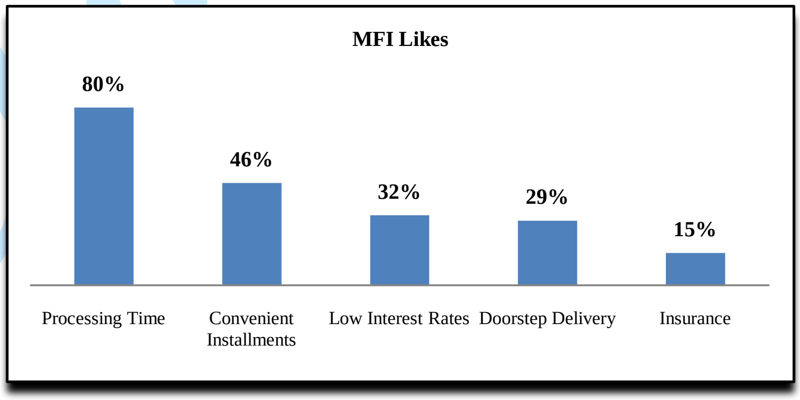
- ***SHGs*:** Over the years, the SHGs have proliferated across AP, but still the SHG-bank linkage was not sufficient to meet credit requirements of the borrowers. The SHG bank linkage programme has some shortcomings, such as delay in loan sanctioning (more than 2-3 months in most cases), inadequate loan amounts, and no short term credit products. Many respondents approached moneylenders and daily finance corporations and took loans at exorbitant interest rates because they did not get loans on a timely basis from SHGs.

- ***MFIs*:** Presently the repayment rate for MFI loans was very low ranging between 6%-12%. Most of the clients stopped repaying as other members of the group and the community stopped repaying. There have also been instances of wilful defaulters pressurising the prompt payers not to repay the loans. Media, local activists and influential members of the community also played a major role in encouraging the borrowers to default.

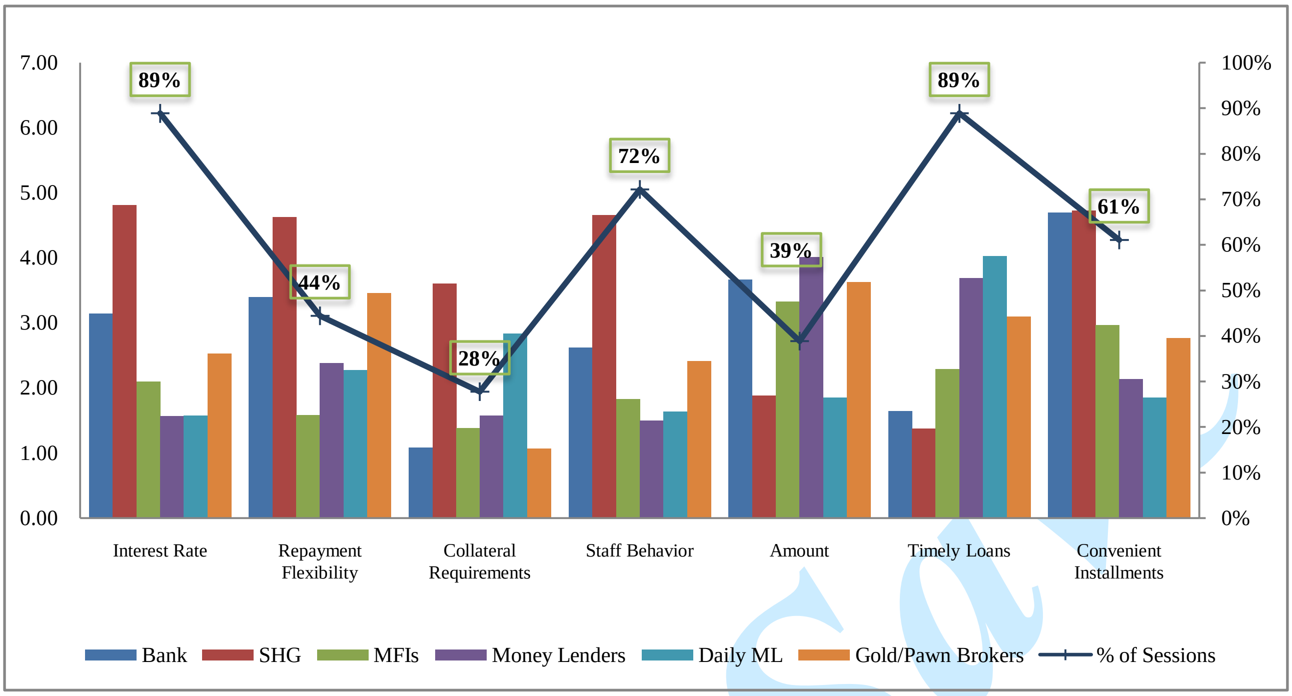


- ***Willingness to repay MFI loans*:** Most of the respondents denied any harassment from the MFIs, but have heard about suicide deaths attributed to harassment by MFI staff through various forms of media. Almost 90% of the respondents said that they were willing to repay their loans if MFIs start disbursing fresh loans and if other members in the community also start repaying.

- ***Respondents said that they liked some of features of MFIs:*** Because they deliver timely loans (80%); with the convenience of repaying principal along with the interest (46%). In 29% of the sessions, respondents said that they like the door step delivery model of MFIs. On the other hand, MFIs' group responsibility (46%) came out to be one of the major dislikes for these loans. They also did not like the inflexibility in loan repayments (39%) as they are not given even a single day grace period when making repayments.



Key Attributes – Different Service Providers



- ***Timely loans***: Timely loans came as a key attribute in 89% of sessions. According to the respondents, daily finance corporations (DFCs) processed the loan instantly. There is minimal or no documentation required. Although it is an expensive source, people still borrow from DFCs to meet their immediate credit requirements. Moneylenders also process loans quickly. They are followed (in terms of speed of disbursement) by the MFIs. Respondents said that SHGs and banks take the longest time to sanction and release loans.

- ***Interest rates***: Interest rate came as an attribute in 89% of sessions. SHGs charge the lowest rate of interest at 12%-13% per annum, but under the interest subsidy scheme the SHGs that make timely payments get loans at 3% per annum. MFIs charge 27%-45% per annum including insurance. Pawnbrokers charge 30-36% per annum, and moneylenders and DFCs are another expensive source of credit at 36%-120% per annum.

- ***Staff behaviour***: Respondents associated 'staff behaviour' with the conduct of the staff of the credit institution in the event of delay in repayment or default. Respondents said that SHGs and IKP staff behave with them in the most respectful manner. They only visit the village and counsel the members about the benefits of prompt repayment. Respondents rated pawnbrokers and banks on equal grounds. MFI staff members generally behave in a respectful manner and maintain cordial relations with the members, helping them in filling the documents and processing of the loans. However, when it comes to repayment, MFIs are perceived to be strict. They put pressure on the members for repayments, encourage the group members to collect the loan from the defaulting member and stop group members leaving the meeting place until the default amount is collected.

- ***Convenient instalments***: Most of the respondents felt that the monthly recoveries of SHGs and banks were more convenient when compared with weekly and daily recoveries of MFIs and DFCs. One of the reasons for such a response was that the majority of respondents in the study were self-employed petty business people (that want to maximise the capital in the business), *beedi* workers (with monthly cash flow and income cycles) and engaged in agriculture and allied (small and marginal farmers. and dairy) activities whose inflows not support weekly repayments.

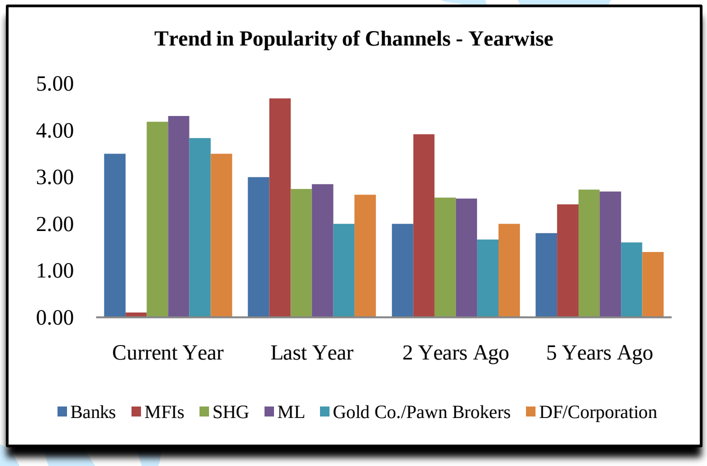
Purpose of Loans

Respondents had taken loans for both productive (55%) and non-productive purposes (45%). In 44% of the sessions, respondents said that they had taken loans for agriculture and allied activities. Most of the respondents (85%) had taken loans to set up and/or expand their petty business such as *kirana* shop, tiffin centres, cycle repair shop etc; to meet lifecycle expenses such as construction of house, buying a plot of land, marriage and death. A significantly large proportion (61%) of the respondents said that they had borrowed from MFIs to redeem high cost loans from moneylenders, or to pay to other MFIs.

Recommendations

- ***For MFIs*:** Apart from developing new products and delivery channels that are market driven, and customised to meet the needs of the customers, MFIs have to improve transparency in pricing their products. Furthermore, from the research, it is clear that most of the respondents do not even know the name of the MFI with which they have been associated for so many years. So MFIs have to expand their level of engagement with the client to create customer loyalty, positive market positioning and increase in brand recall.

- ***For MFIN:*** Initiatives like a grievance redressal mechanism for clients, and a credit bureau to share borrower's credit history could go some way in reducing defaults and restoring credit discipline.



- ***For regulators*:** As an industry level change, policy makers should come out with comprehensive regulations to provide a level playing field to all the financial institutions that provide credit to the poor. Once the robust regulations are in place there is a need for strong monitoring to enforce system and ensure that the regulations are implemented to safeguard the interests of the clients.

- ***For state government /MFIs:*** As the majority of the clientele of MFIs are members of SHGs promoted by the Government of AP, there are chances of issues of conflict between MFIs and the local machinery of the government. The government and MFIs should take initiative to establish a forum at both district and state level to resolve any conflicts.

- ***For state government*:** The state government should focus on how to provide a credible substitute to MFI loans to meet the credit needs of SHG members, otherwise members will continue to move into the clutches of moneylenders. For example, during discussions, many of the SHG members noted that they need a supplementary loan to meet working capital and life-cycle needs like health and education – even when they have an outstanding, long-term, bank loan. The state government should also increase the efficiency of the SHGs it promotes and provide bouquet of credit products according to the requirements of clients. SHGs should educate members to avoid or minimise use of loans for unnecessary expenses like social events (e.g. marriage and birthday parties).