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Centre for Microfinance and MicroSave

[ANDHRA PRADESH MFI CRISIS AND ITS IMPACT ON CLIENTS]

MicroSave
Market-led solutions for financial services

&

IFMR
CENTRE FOR MICRO FINANCE

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Abbreviations

AP	Andhra Pradesh
CMF	Centre for Micro Finance
DFC	Daily Finance Corporation
FGD	Focus Group Discussions
FSTA	Financial Sector Trend Analysis
IFMR	Institute for Financial Management and Research
INR	Indian Rupee
MEPMA	Mission for Elimination of Poverty in Municipal Areas
MF	Microfinance
MFIN – NCAER	Microfinance Institutions Network-sponsored National Council for Applied Economic Research
MFIs	Microfinance Institutions
NGO	Non – Government Organizations
RPR	Relative Preference Ranking
SBLP	SHG Bank Linkage Programme
SERP/DRDA	Society for Elimination of Rural Poverty/District Rural Development Authority
SHG	Self Help Group

INTRODUCTION

According to Microfinance State of the Sector 2011 report, MFIs have reached 31.4 million clients all over India today. The report mentions that in terms of "client outreach - borrowers with outstanding accounts" , there was growth of 17.6% MFI clients and 4.9% of SHG-Bank clients in the year 2010-11, highlighting that both SHG and MFI models co-existed and flourished over the years. Andhra Pradesh has the highest concentration of microfinance operations with 17.31 million SHG members and 6.24 million MFI clients. The total microfinance loans in Andhra Pradesh including both SHGs and MFIs stood at Rs.1,57,692 million with average loan outstanding per poor household at Rs. 62,527 which is the highest among all the states in India.

This data implicates that the state is highly-penetrated by microfinance (both MFIs and SHGs) giving rise to multiple borrowing. A CGAP study indicates that the average household debt in AP was Rs.65,000, compared to a national average of Rs.7,700.[1] This high penetration of both SHGs and MFIs also led to stiffer competition for client outreach between the state and private financial providers resulting in wider conflict of interest.

To arrest the growth of MFIs and to stem the alleged abusive practises adopted by the MFIs, the state government promulgated an ordinance on October 16, 2010. In December 2010, the Ordinance was enacted into "The Andhra Pradesh Microfinance Institutions (Regulation of Money lending) Act, 2010".

The ordinance was a result of a series of suicide incidents attributed to the alleged abusive practices of MFIs such as charging high interest rates, adopting coercive collection practises and lending aggressively beyond the repayment capacity of the borrowers rather than helping the poor get out of poverty. According to one report "more than 77 rural people have been driven to suicides unable to bear the coercion unleashed by their recovery agents".[2] One of the key steps the ordinance has proposed is setting up of fast-track courts in every district for MFI-related issues.

As of January, 2011, the MFI repayment rates fell from 99% right before the issuance of the ordinance to less than 20%. The stringent regulations set by the state government (such as monthly repayments, all MFI branches to be registered with the government, no door to door collection of repayments etc) coupled with active encouragement by the local politicians led to the fall in repayment levels.[3] Some MFIs such as Star MicroFin Society, a small NGO-MFI, faced 0% repayment rate in urban operation areas and 2% in rural areas, as compared to 100% before the MFI Ordinance.[4]

This, along with other reasons,[5] led to what is commonly termed as "the AP crisis". The crisis undermined the growth and indeed very existence of commercialised microfinance institutions. The crisis had an impact not only in the state of AP but also throughout India with many MFIs facing issues raising funds, expanding operations etc.

This is a joint report focussing the impact of microfinance among the clients. The report highlights the similar findings from quantitative study conducted by the Centre for Microfinance (CMF) at IFMR Research and qualitative study conducted by *MicroSave*. This paper features findings related to multiple borrowing, household indebtedness, loan purpose and client perspectives on availability of financing.

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[1] See CGAP Focus Note 67: Andhra Pradesh 2010: Global Implications of the Crisis in Indian Microfinance

[2] "Regulatory Issues in Microfinance Sector: A Case Study of Andhra Pradesh," Rajesh C. Jampala and Srinivasa Rao Dokku, 2010.

[3] Andhra MFI Ordinance mandates fast-track courts

[4] Microfinance Crisis: MFIs with sizeable presence in Andhra Pradesh on the brink of closure

[5] Refer to the newspaper reports Suicide leash on lenders and Group Borrowing Leads to Pressure

Description of studies

Prior to the crisis in Andhra Pradesh, the Centre for Microfinance conducted a household survey exploring households' access to finance in rural Andhra Pradesh in 2009. In 2009, CMF surveyed 1,920 households that were representative of the rural population of the state of Andhra Pradesh, spanning eight randomly selected districts. The timing of this original study was such that it provided a snapshot of the use of financial services by rural households prior to the action taken by the Andhra Pradesh government against MFIs.

Given the consequences of restrictive regulatory changes and surge in non-repayments by clients, MFIs in Andhra Pradesh greatly reduced or stopped lending operations after November 2010. To investigate the impact of this reduction in MFI lending on the finances of households, the CMF completed a follow-up survey during the summer of 2011. This survey revisited 428 households interviewed for the original study, spanning two of the eight original districts, Kadapa and Visakhapatnam. The survey took place at approximately the same time of year for both studies to avoid seasonal differences. The same questionnaire was used for both the original and follow-up survey so that a before and after analysis could be completed. Also, a couple of additional modules were added to explore incidences of multiple borrowing and households' perception about the effect of changes in availability of finance on their regular needs.

MicroSave conducted qualitative research studies to assess the impact of AP MFI crisis on clients. The team from *MicroSave* conducted 76 sessions and covered 340 respondents. The research used participatory research methods such as focus group discussions (FGD), relative preference ranking (RPR) and financial sector trend analysis (FSTA) during July – August, 2011 in three regions of Andhra Pradesh--Telangana, Rayalaseema and Coastal Andhra covering four districts--Anantapur, Krishna, Nizamabad and Adilabad).

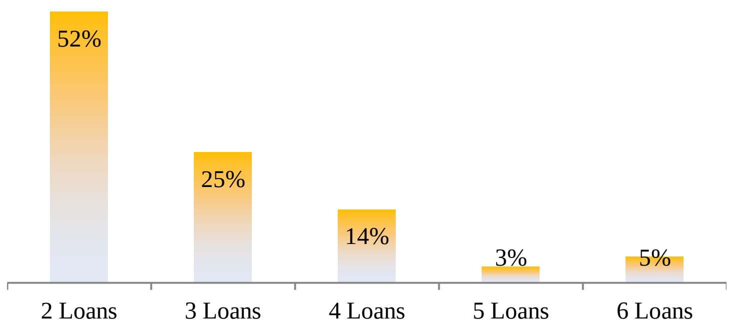
Table 1 - Sample Details

Sample	Location	Nature of research	Link to the report
416 households	Kadapa, Visakhapatnam	Quantitative	Access to Finance in Andhra Pradesh
340 respondents	Anantapur, Krishna, Nizamabad and Adilabad	Qualitative	Impact of AP MFI crisis on clients
46 MFI clients	Kolar, Mysore and Ramnagaram	Qualitative	Returning to Kolar: A case study on the Kolar crisis affected communities

MULTIPE BORROWING

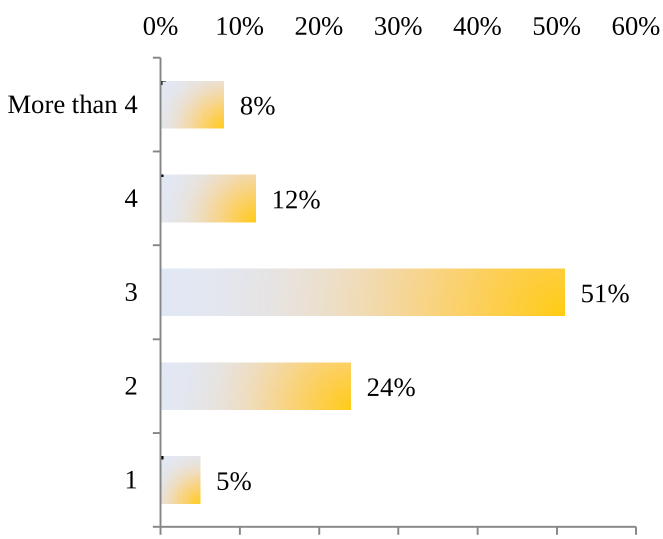
A key finding of the Centre for Micro Finance's (CMF) study on "Access to Finance in Andhra Pradesh" in the year 2009 was that multiple borrowing is extremely common among rural poor, with an estimated 84% of households having two or more loans from any source.[6] The findings also implied that many cases of multiple borrowing appear to be driven by an inability to obtain sufficient credit from a single source as suggested by data collected on timing and purposes of loans.[7]

Figure 1- Distribution of Total Loans Per Household (Within two successive months) – CMF study



CMF study further brought out that households had taken more than one loan within two successive months in the past year. 36% households of 428 households (153 households) that were visited in the summer of 2011 in Kadapa and Visakapatnam districts reported taking more than one loan within two successive months mostly from informal sources in the past year.

Figure 2- No of MFIs loans taken per household – *MicroSave* study



While 52% of these 153 households had taken two loans, 5% of households had taken as many as six loans within two successive months. The total number of reported loans taken by these 153 households within two successive months was 476, implying an average of three loans per household.[8]

MicroSave study[9] also indicated that multiple borrowing is common among MFI clients. The study found that at the time of the AP MFI crisis, more than half (51%) of the respondents had taken loans from three MFIs, 8% had taken loans from more than four MFIs while 12% of the respondents had taken loans from 4 MFIs. Interestingly only 5% of the respondents had loans from one MFI.

Both the studies highlight the phenomenon of multiple loans. With the availability of "easy loans", members of the community borrowed loans from multiple sources leading to increase in the level of household indebtedness. In some instances the same MFI lent more than one loan to the same customer (JLG loan, individual loan, top up loan etc.). In addition to that, the target based lending approach of the MFIs also fuelled the rise in indebtedness through multiple loans.

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[6] CMF research report, Doug Johnson and SushmitaMeka, "Access to Finance in Andhra Pradesh"
[7] ibid
[8] CMF Research report, Deepti Kc and Sebastien Gachot, "Multiple Loans- how frequently do rural poor opt for multiple borrowing?"
[9] *MicroSave* research report "What are Clients doing Post the Andhra Pradesh MFI Crisis?"

SOURCES OF CREDIT

CMF's study highlighted that respondents did not borrow from banks because they did not have enough savings to open bank accounts; they perceived opening bank accounts was expensive and a majority of them had no idea about the process for opening bank accounts.

Table 2- Outstanding loans from different sources – CMF study

Major Source	Percentage of Households with Loan Outstanding	
	2009	2011
Any Bank	34%	33%
SHGs	55%	57%
MFIs	9%	6%
Informal	**67% ***	**64% ***

*For comparison purpose, CMF considered only those loans dispersed in 6 months prior to the survey in 2009 (479 households) and 2011(428 households).

The median loan outstanding size from service providers (banks, SHGs, MFIs and informal) increased slightly in the year 2011 compared to the year 2009.

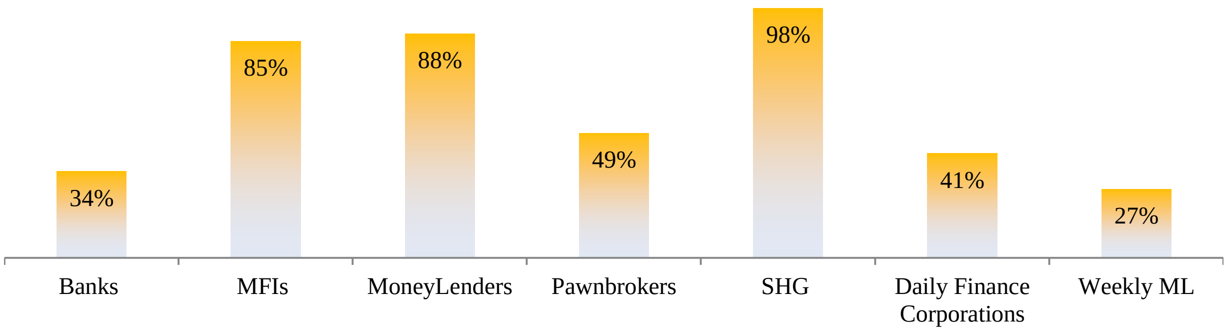
Table 3- Median loan outstanding size – CMF study

Major Source	2009	2011
Bank	Rs. 20,000	Rs. 26,700
SHGs	Rs. 5,575	Rs. 7,343
MFIs	Rs. 8,000	Rs. 8,900
Informal	**Rs.12,400***	**Rs. 15,000 ***

*Outstanding loans dispersed in the past 6 months prior to the survey are considered.

According to the study conducted by *MicroSave*, in more than 80% of the focus group sessions, respondents listed SHGs, moneylenders, and MFIs as the most popular options in order to meet their credit requirements. The majority of respondents did not prefer banking services despite the presence of banking network in the study areas. Respondents cited inordinate delays, cumbersome procedures and complex documentation requirements of banks as the major reasons for not preferring banks as a source of credit. Apart from that, two other categories of moneylenders (both weekly and daily) emerged in 27% and 41% of sessions respectively.

Figure 3- Sources of Credit – *MicroSave* study



*Multiple borrowings exist. Percentages may add upto more than 100%.

PURPOSE OF CREDIT

Both studies note that loans were used for productive and non productive uses, including consumption. Figure 4 highlights how the 153 households from Kadapa and Visakapatnam districts who had taken more than one loan within two successive months used their loan money. Data on loan usage reveals that 27% (the largest share for any one line item) of loans were used for household consumption. And when analyzing usage at the household level, we find that 47% of the respondents mentioned household consumption as one of the reasons for them to borrow. Health followed with 22% of households claiming that health was one of the reasons to borrow, followed by purchasing agricultural machinery or inputs (16%).

Figure 4- Usage of loan money – CMF study

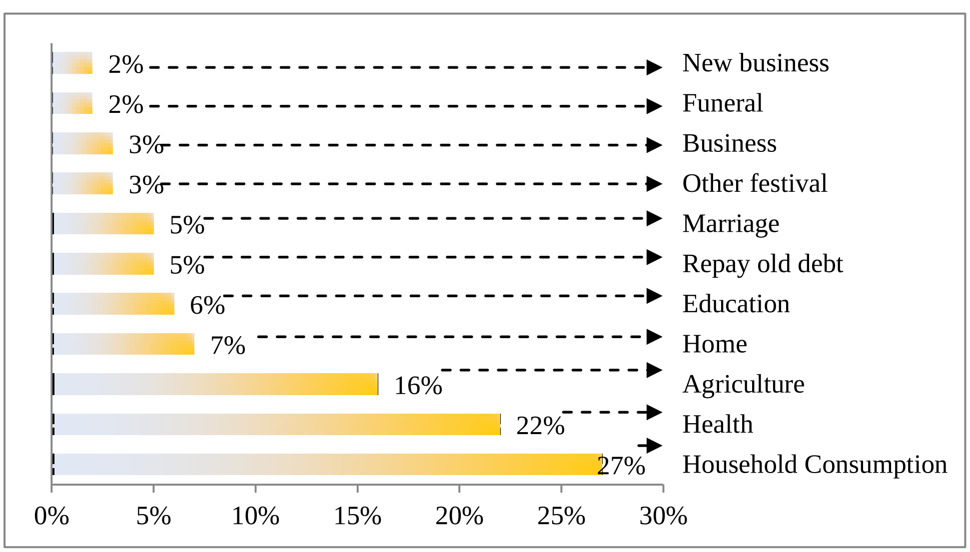


Figure 5 Changes in Usage of Loans From a Given Source - CMF Study

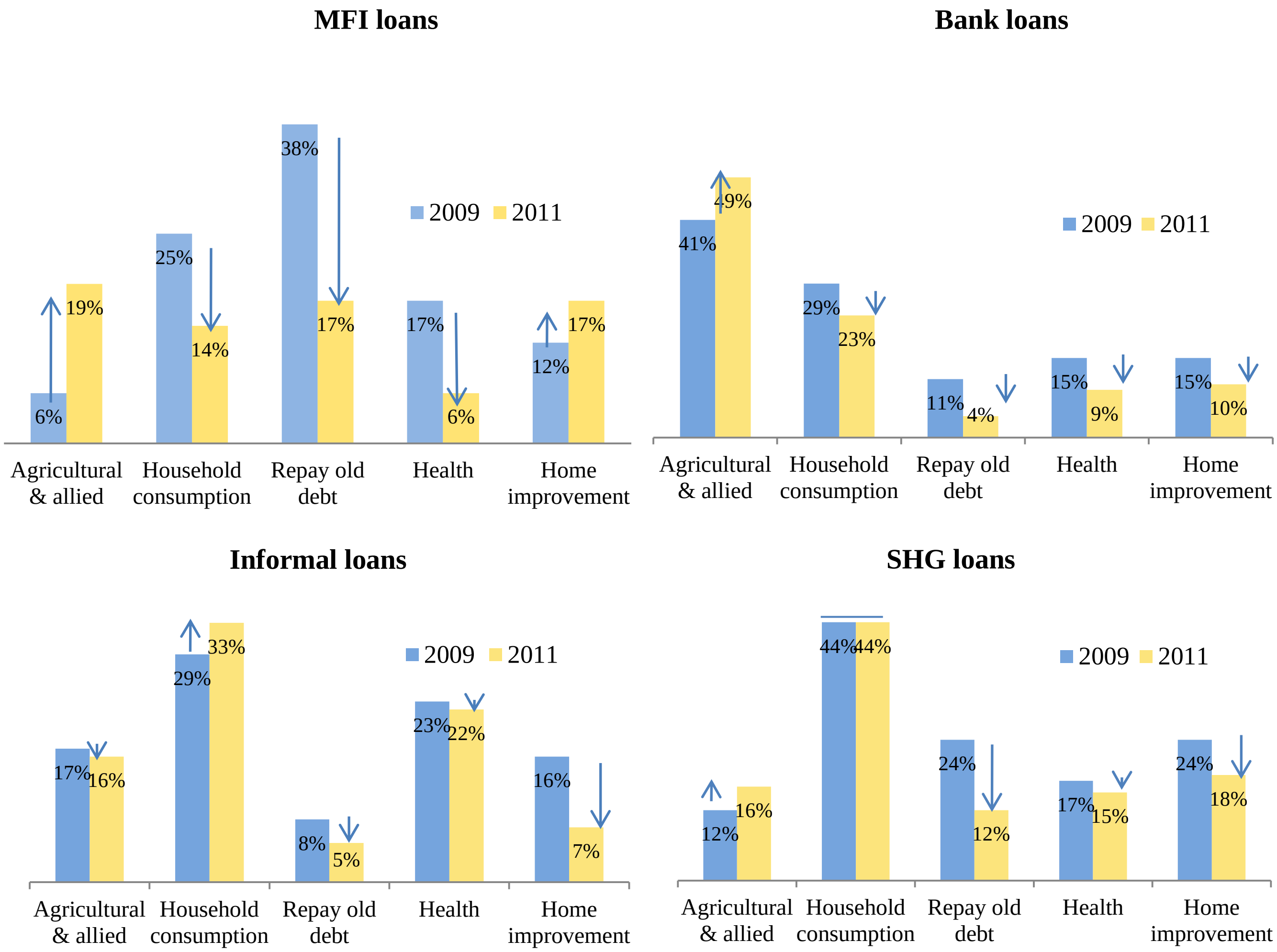


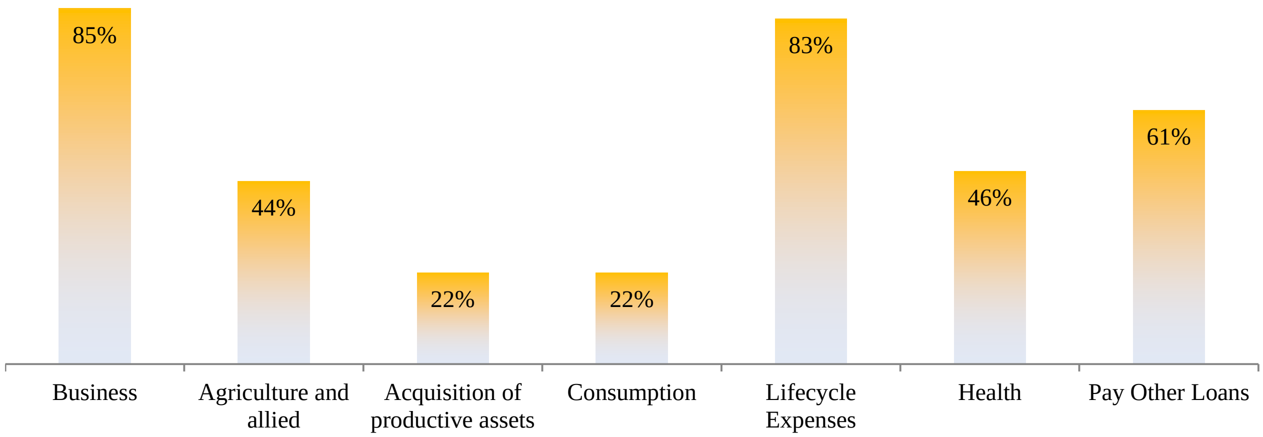
Figure 5 describes the change in usage of loans from several sources in the year 2009 to 2011. The usage of loans for household consumption, health and repayment of old debt through MFI loans has come down significantly from 2009 to 2011. However respondents claim that the usage of MFI loans to meet agriculture and home improvement expenses have increased from 2009 to 2011.Both the studies indicate that the majority of loans taken by clients are used for meeting lifecycle expenditure, agriculture and house hold consumption.

Likewise, according to *MicroSave* research, took loans to meet the following requirements:

Productive Uses	
Agriculture and allied activities	To purchase seeds, fertilisers etc for agriculture activities
Business	To set up and/or expand small businesses such as *kirana* shop, *tiffin* centres, cycle repair shop etc. To buy sewing machines, tobacco and thread for rolling *beedi's*, and raw material for preparing jute and bamboo items
Acquisition of productive assets	To buy auto and commercial vehicles for renting, and small machines for their business activities such as drilling machine for carpentry business, soda maker for a cold drink shop, or grinding machine for a flour mill etc.
Non Productive Uses	
Consumption purpose	To meet expenditure related to children's education, for buying house hold items such as fan, mixer, TV and to incur expenses for festivals and functions

Life cycle expenses	To meet life cycle expenses such as house, land, marriage, death etc.
Health & medical expenses	To meet expenses related to pregnancy such as doctor's fee, medication, hospital expenses, baby care etc. Unforeseen emergencies such as chronic illness of a family member and accidents also entail huge expenses
Replacement of loan from other sources	The respondents borrowed to redeem high cost loans from moneylenders, or to pay to other MFIs

Figure 6 Usage of Loans - *MicroSave* Study



In Figure 6 above, in 85% of the sessions respondents mentioned that they used loans for business while in 83% of the sessions respondents mentioned that they used loans for lifecycle expenses such as construction of house, purchase of land, marriage, death etc. Usage of loans on non productive expenditure such as household consumption, lifecycle expenses etc features in both the studies – and is a common phenomenon worldwide. What is surprising to note is that even though the level of household indebtedness in AP was as high as Rs. 65,000, the MFIs kept lending without assessing the repayment capability and creditworthiness of the clients. With majority of the loan amount going towards non income generating activities and with no repayment capacity the crisis was waiting to unfold! The crisis exposed the lending practises adopted by MFIs i.e., not lending for productive purposes, no proper loan utilisations checks, target based lending rather than requirement based lending etc.

CHANGE IN ACCESS TO CREDIT POST THE AP MFI CRISIS

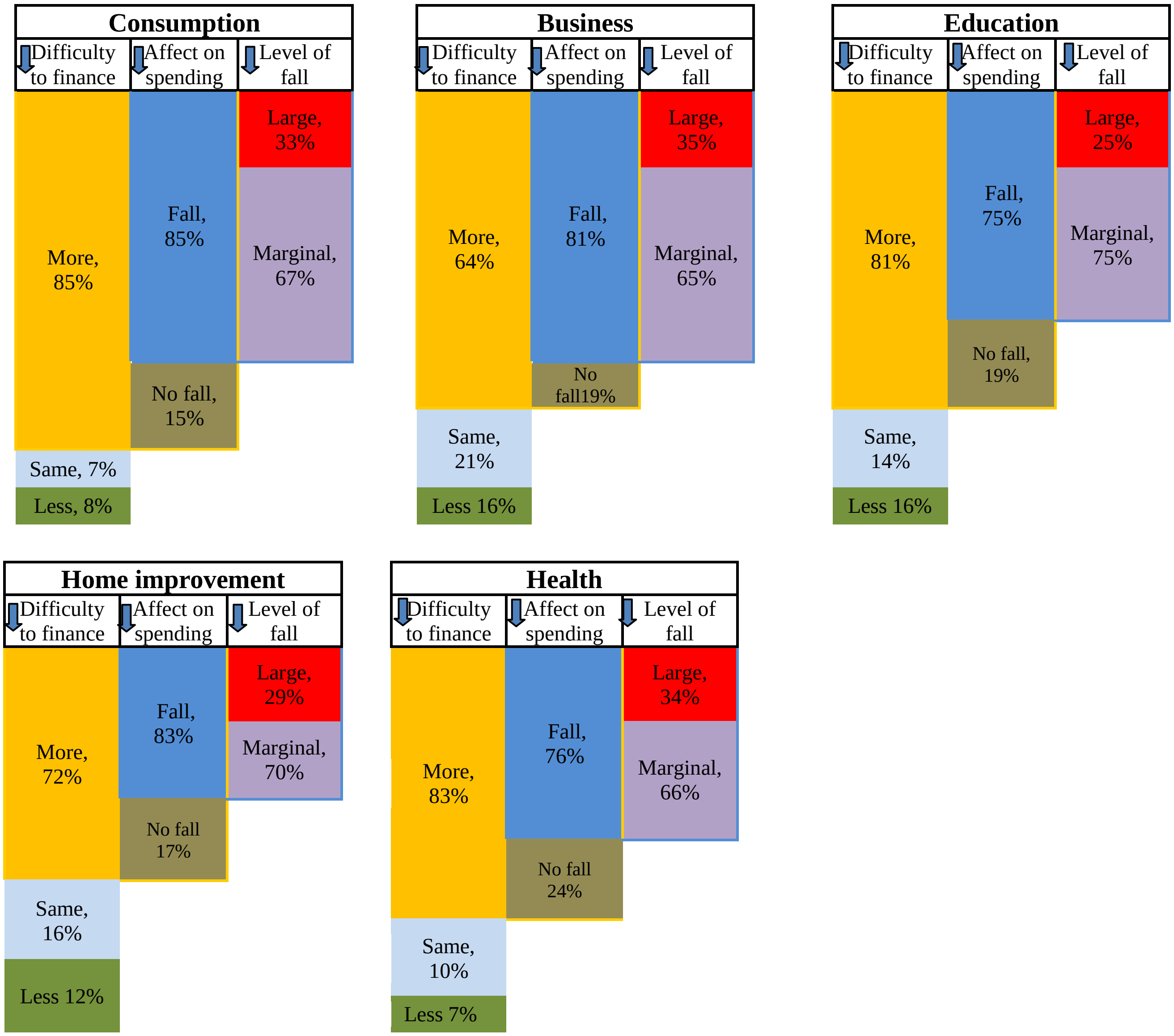
The studies indicate that there has been a significant impact in terms of difficulty getting credit because of which respondents had to reduce the scale of business.

In the follow up 2011 survey, CMF probed clients' perspective on the difference between the current availability of financing as compared to the period before August 2010 (the onset of AP crisis). The questions required the respondents to provide qualitative answers by recalling their situation prior to August 2010. The respondents were asked whether the incidence of distress asset selling had changed. Close to 73% of the clients indicated that there was no change in the amount of distressed asset selling, while 16% indicated an increase and 11% indicated a decrease in distress asset selling.

To gauge whether the households are facing problem in financing their regular needs the respondents were asked to rank the degree of difficulty for financing certain needs, including consumption, business, education, home improvement, and health. Majority of the clients indicated that raising credit had become more difficult after the AP MFI crisis. Household consumption, education, and health experienced change in ability to raise finance for, with 85%, 81%, and 83% of clients respectively indicating that financing for these needs has become more difficult. Approximately a third of clients reported large fall in spending across all needs.

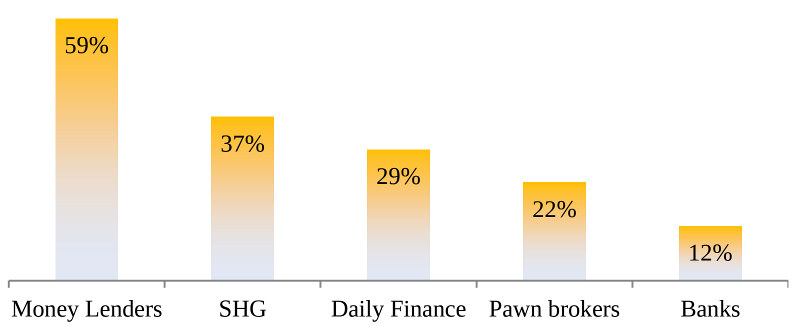
The figures below show how the **consumption patterns of borrowers** are dropping significantly after the MFI Crisis in Andhra Pradesh.

Figure 7 - Extent of fall in spending – CMF study



MicroSave study found that, respondents had taken loans from moneylenders in the absence of loans from MFIs. Research studies conducted in December 2010-January 2011, revealed that moneylenders had increased lending in the past eight to ten months in areas with higher penetration of MFIs. The subsequent accessible sources of credit for the respondents were SHGs (37%) and "daily finance corporations" – another form of money lenders - (29%).[10]

Figure 8- Sources of credit (in absence of MFI loans) – *MicroSave* study



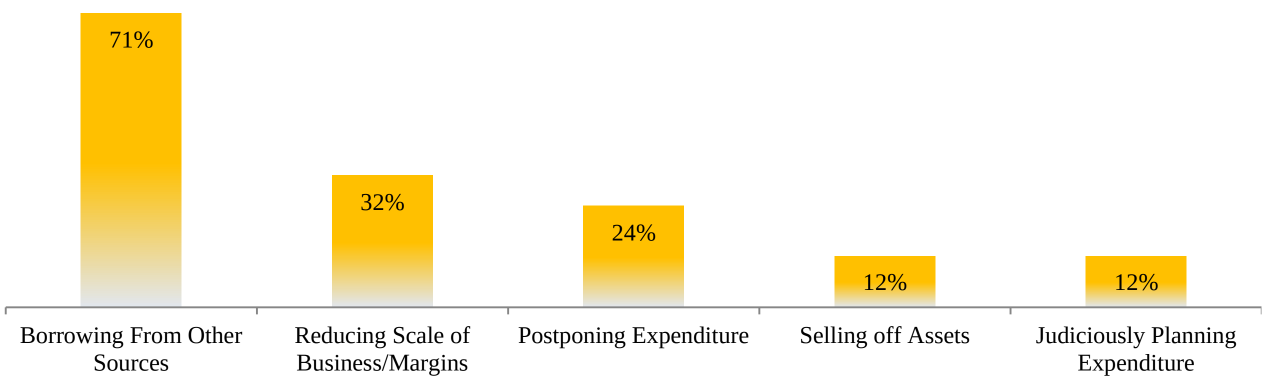
[10] Also see report published by MFIN – NCAER: Assessing the Effectiveness of Small Borrowing in India

MicroSave study further revealed that the alternate sources of credit have not been able to meet the credit gap created by the absence of MFIs. Even loans through SHGs have not been able to meet the credit demand in the absence of MFIs. The demand for loans from moneylenders and daily finance corporations has shot up. Due to huge demand and shortage of funds, moneylenders have become selective in offering loans to people familiar to them and with good credit history, thereby increasing difficulty in raising loans.

MicroSave study highlighted the impact on non-availability of credit from MFIs on the borrowers.

> One of the respondents' mentioned "*VaarapuSangalolluunnappduvaddivyaaparastula business chalataggipoyindi. Kaanigata 8-9 nelalanundivallumalliappuluivvadamprarambhinchaaru"*
> (When MFIs were popular, the moneylenders' business went down drastically, but now they are back and demand for loans from them has gone up.)

Figure 9-Affect on clients due to absence of MFI loans – *MicroSave* study



The graph suggests that apart from borrowing from other credit providers (71%), 12% of respondents sold their assets such as house, vehicle, cattle, jewellery etc., to meet their productive as well as non productive expenditure which have to be met compulsorily. In 32% of the sessions respondents said that their scale of business and profit margins have reduced because of difficulty to get credit from alternate sources on time and also because of higher rate of interest.

Both studies validate the fact that the members of the community face issues raising credit in the absence of MFIs. Members of the community have reduced their spending on important aspects such as health, education and business because of non availability of adequate credit from alternative sources. Moneylenders are having a field day with the absence of MFIs. Members of the community are falling back to moneylenders who charge usurious rates of interest to meet their credit needs. Though the Government of Andhra Pradesh took steps by increasing facilitation of bank credit linkage to SHGs (from Rs. 6501.35 crore in 2009-10 to Rs.7866.26 crore in 2011-12)[11], the credit gap created was too big to be met. As a result moneylenders are back in the business!

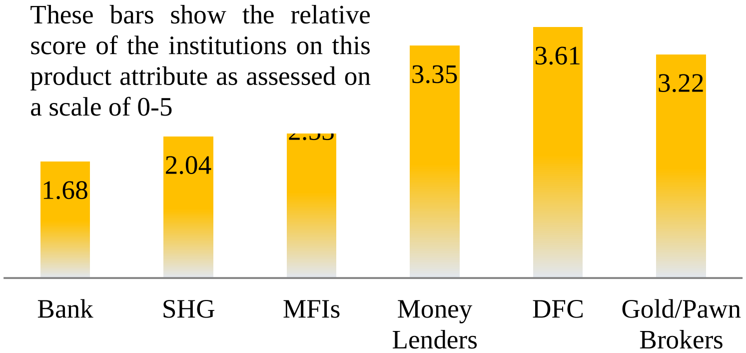
CURRENT FORMS OF ACCESS AND RELATIVE PREFERENCES

MicroSave report revealed the attributes, on which respondents' chose one credit provider over another. The study of relative preference for one service provider over another highlights where MFIs were not able to meet client needs/expectations. The findings are mentioned below.

[11] SERP Progress Report

Timely Loans: Respondents noted that the time taken for processing loans is an important criterion for them. Respondents note that daily finance collectors (DFCs) process the loan instantly. Although it is an expensive source, people still borrow from them to meet their immediate credit requirements. Secured loans from money lenders and pawnbrokers might take some time for the borrower to arrange for collateral. In case of MFIs, it takes usually 1-2 weeks to sanction anew fresh loan. As far as SHGs and banks are concerned, respondents faced inordinate delays for loan sanction. In most cases, it has taken 1-2 months for disbursal of loan.

Figure 10-Timely loans – *MicroSave* study



Interest Rates: In 89% of the sessions, respondents mentioned interest rates as one of the key factors for accessing credit from any source. Details of interest rates charged by different service providers are given below.

Figure 11- Interest Rates Offered by Various Service Providers

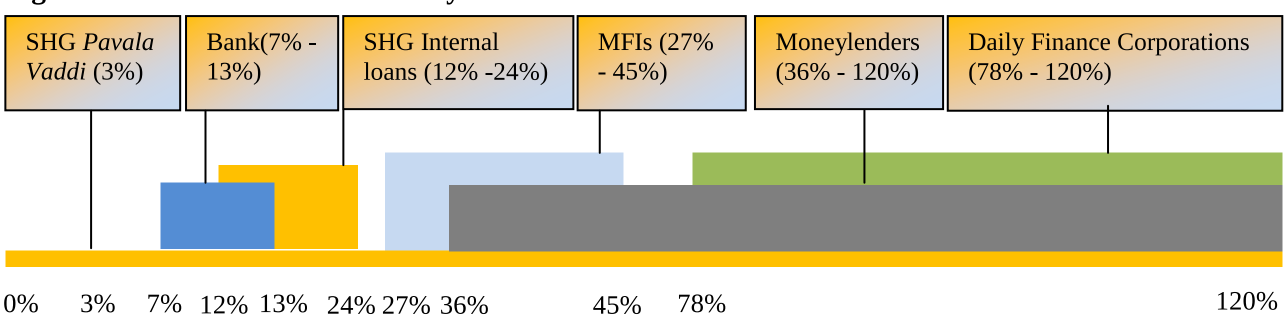
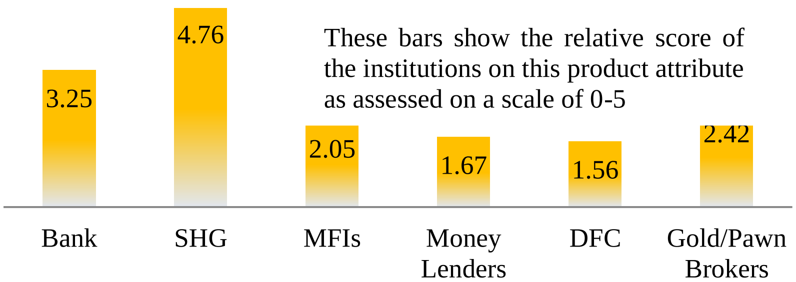


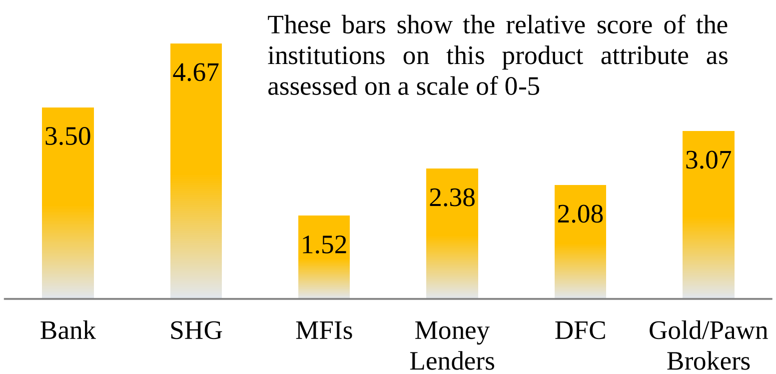
Figure 12- Interest rate –*MicroSave* study



Respondents preferred SHGs because of the subsidised interest rates provided by the state government. Moneylenders charge usurious interest rates ranging from 36% - 120% per annum. Respondents also took loans from DFCs who offer trade loans for high interest rates. Respondents opined that MFIs charge 27%-45% rate per annum.

Repayment Flexibility: Respondents were of the opinion that they should get some grace period when they are not able to pay instalments on due date.

Figure 13- Repayment flexibility – *MicroSave* study

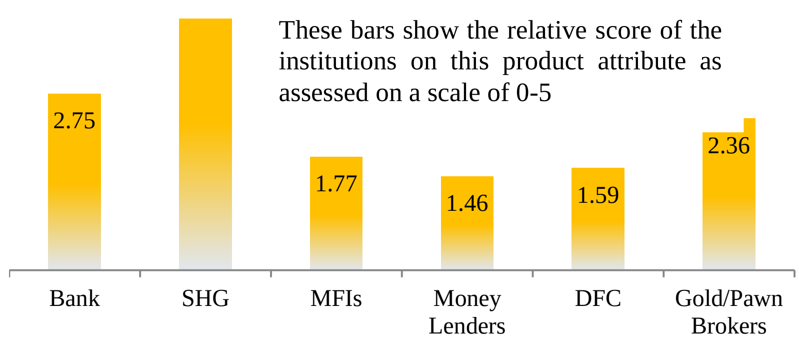


Respondents rated banks and SHGs high because they follow up for repayments only after 2-3 months post the due date. Pawnbrokers and moneylenders do not insist on principal amount as long as they get the interest. Even DFCs allow a grace period of 7 days with a penalty for late payment. Respondents rated MFIs the lowest as

MFIs do not allow late payments. Respondents gave a low score to MFIs for repayment flexibility and interest rates and moderate score for timely loans. Despite scoring low on these attributes, clients still prefer MFIs because of "easy credit". This fact is complemented by the study conducted by CMF in Kolar district in the state of Karnataka.

Behaviour of Staff: Respondents rated MFIs lower than SHGs, banks and gold/pawn brokers because of the repayment pressure that staff exercise in the event of delay in repayments. Respondents opined that MFI staff members generally behave in a respectful manner and maintain cordial relations with the members. But when it comes to repayment, they are perceived to be strict.

Figure 14- Behaviour of Staff - *MicroSave* study



CMF conducted a qualitative study* in Kolar district in the state of Karnataka. As part of the research CMF investigated the satisfaction with recollection practises of different loan service providers. It is noteworthy that MFIs are considered least satisfactory when it comes to collection practices across all the three time-frames. This was put down to inflexibility in repayments, joint liability considerations and the pressure from group members and loan officers.

The study highlights the failure of MFIs when designing market led products and processes. MFIs, in the process of rapid scale up and single minded pursuit of exponential growth targets, ignored the needs of the clients. The study clearly shows the discomfort of the clients with inflexible repayments, interest rates and behaviour of the staff especially when it comes to repayment. The crisis highlights the urgent need for the MFIs to institutionalise market research, customer satisfaction monitoring and systematic product development systems, thereby offering products that are market-led.[12] The best way to achieve long-term financial self sufficiency and achieve deep outreach is to identify the needs and wants of the poor and to provide products of value to them.

*Returning to Kolar: A case study on the Kolar crisis affected communities

[12] See *MicroSave* Briefing Note 17 "Client-Focused Microfinance: A Review of Information Sources" and Briefing Note 19 "Market Orientation As The Key To Deep Outreach"