Access to Credit in Andhra Pradesh Post Microfinance Crisis

MicroSave

Market-led solutions for financial services

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Contents

List of Abbreviations

AP	The state of Andhra Pradesh
MFI	Microfinance Institution
MFIN	Micro Finance Institutions Network - Industry association for microfinance sector in India
SHG	Self Help Group
WB	The state of West Bengal
DFC	Daily Finance Corporation – An informal credit service provider
WFC	Weekly Finance Corporation– An informal credit service provider
JLG	Joint Liability Group
BC	Business Correspondent
RBI	Reserve Bank of India – The central bank of India
NBFC	Non Banking Financial Company
DRDA	District Rural Development Agency – Principal organ at the district level that implements state/central governments poverty alleviation programmes
FY	Financial Year
SERP	Society for Elimination of Rural Poverty - an autonomous society promoted by Government of AP. The SERP implements community driven rural poverty reduction programme through SHGs
NOF	Net Owned Funds
PRA	Participatory Rapid Appraisal
BOP	Bottom of the Pyramid
FGD	Focus Group Discussion – A qualitative market research tool
RPR	Relative Preference Ranking – A qualitative market research tool
FSTA	Financial Sector Trend Analysis – A qualitative market research tool
MEPMA	Mission for Elimination of Poverty in Municipal Areas – Implementing agency of the government of AP of poverty alleviation programmes in urban areas through SHGs
ROSCA	Rotating Savings and Credit Association
CEO	Chief Executive Officer
CReSA	Centre for Rural Reconstruction through Social Action – A small MFI in Andhra Pradesh
LUC	Loan Utilisation Check

Executive Summary

Two years after the enactment of "The Andhra Pradesh Microfinance Institutions (Regulation of Moneylending) Act, 2010, microfinance institution (MFI) operations have almost come to a standstill. MFIs, which boasted more than 95 % recovery rates, found themselves staring at repayment rates of 10%-15% in 2011, and these further fell to below 1%in 2012. As MFIs were the major sources of credit for the low income households, their absence created a big credit gap in the market. The State Government of Andhra Pradesh (AP) took initiatives to meet the credit gap through increased supply of credit to SHG members. This was done through the SHG Bank linkage programme[1] and establishment of '*Sthree Nidhi*' Credit Cooperative Federation Ltd.[2] This, however, benefitted only SHG members with bank accounts, and not the other poor.

According to MFIN,[3] after the State brought in the Ordinance regulating MFIs, the sector which used to lend over Rs.70 billion, has not been able to lend anything to the poor, many with no access to bank loans or alternate sources. As a result many poor households had no recourse but to go back to moneylenders and other informal sources for credit; even though the moneylenders charge exorbitant interest rates, much higher than those for which MFIs were blamed.

In addition, the credit bureaus are treating the entire client base of nine million in Andhra Pradesh (AP) as defaulters. This means they cannot access loans from any other financial institutions until they repay the loans taken from MFIs. With this backdrop, and all the changes the sector is witnessing, *MicroSave* conducted a study in July 2012 to understand the changes in access to credit by the low income households in Andhra Pradesh, especially in the absence of MFIs. *MicroSave* also conducted a similar and concurrent study in West Bengal (WB), a state with good presence of MFIs, to compare and contrast the changes in access to credit by the poor in the two states.

Major observations

Current status

- Clients believe that MFIs will not return to re-commence lending. This perception is encouraging them to default on the loans they have taken from MFIs. The willingness to repay MFI loans has also reduced significantly. In 47% of the sessions, people noted that they want to repay MFI loans. This is much lower in comparison to the study conducted in August 2011 study, in which in 90% of the sessions,[4] respondents were willing to repay the loans.[5]According to the respondents, the main reason for this is the uncertainty around whether or not the MFIs will return and start functioning again. The other, related, major reason is a lack of incentives for the clients in the form of fresh loans after repayment of the previous loan, which used to be an important motivator.

Alternative financing options - formal

- Loyalty to SHGs has increased tremendously as people do not have any reasonable alternative sources of credit. In 79% of the sessions, respondents said that they borrow from SHGs to meet their credit requirements.
- Though the State Government has initiated *Sthree Nidhi* bank to meet the needs of SHG members, it has not been able to mobilise sufficient funds to meet their credit requirements. As of September 2012 it had a loan portfolio of only Rs.2 billion against Rs.11 billion (estimated Rs.10 million per each *mandal* level SHG-Federation).
- There is an increase in bank loans to SHGs, but mostly banks do not give timely loans (SHG members need to wait for at least one to two months, sometimes up to 6 months to get a

[1] SERP Progress Report
[2] Refer to *Sthree Nidhi* website for further details
[3] MFIs seek dialogue with State to end logjam– The Hindu newspaper, August 22, 2012
[4] *MicroSave* conducted its first study on the impact of AP MFI crisis on clients in August 2011. Refer to the report - What are Clients doing Post the Andhra Pradesh MFI Crisis?
[5] Refer to *MicroSave* India Focus Note 59 - The Andhra Pradesh Crisis – Clients' Perspective

loan). Many SHG members take loans from moneylenders instead, and repay it when they get the bank loan.

- Bank loan amounts are not sufficient to meet the credit needs of SHG members, and they do not get a subsequent loan from banks until they repay their previous loan. SHG savings are very meagre and insufficient to meet the credit needs of the members through intra-group borrowing from pooled savings. In the majority of cases, bankers ask SHGs not to withdraw their savings until the bank loan is repaid.

Alternative financing options - informal

- In the absence of MFIs, SHGs, moneylenders and daily finance corporations (DFCs) are increasingly becoming poor people's sources of credit. SHGs figured in 79% of the sessions as alternative source of finance as compared to 37% in the August 2011 study. This is because the government initiated a major push to increase the bank credit linkage to SHGs after MFIs stopped their operations. The amount of loan disbursed through SHG bank linkage has increased from Rs.65billion in 2009-10 to Rs.78.66 billion in June, 2012.
- On the other hand, moneylenders (landlords, jewellers and other traditional moneylenders) are still prominent as an alternative source of credit in the absence of MFIs. They figured in 48% sessions in the latest study as compared to 59% in the August 2011 study. This reduction is possibly due to increase in DFCs and SHG bank linkage programme. Respondents take credit from moneylenders even though the rate of interest is high, ranging from 78% to as high as 120% per annum. In the rural areas, people are predominantly resorting to loans from moneylenders; traders from wealthier neighbourhoods visit poor areas to fill the credit gap by lending at exorbitant interest rates. Even *kirana* shop owners have started lending to the former MFI clients.
- DFCs as an alternative source of finance, figured in 29% of the sessions in the August 2011 study. This has increased to 48% in the present study. Many enterprising individuals identified the credit gap in the market and set up their own DFCs to lend ex-MFI clients. They predominantly lend in urban/semi urban areas, and villages to self-employed individuals such as owners of *kirana*, tiffin and cycle shops, tailors, vegetable sellers etc. They charge almost the same rate of interest as moneylenders. However they have a daily repayment schedule and collect repayments from the clients' doorstep.
- In the rural areas many people have returned to agricultural labour for want of credit to finance their enterprises. While the MNREGA programme has increased daily wage rates, the dependence of agricultural labourers on landlords for their wages affects their bargaining power. Likewise, where they have taken loans from landlords, the marginal farmers are forced to sell their agricultural produce to the landlords from whom they have taken loans – often resulting in significantly less income than they might have derived on the open market.
- Moneylenders are using the erstwhile MFI–JLG group leaders and SHG leaders as their community level point persons to identify credit-worthy clients to give loans, and to collect repayments.
- High rate of interest is the biggest pain point (in 76% of the sessions) in accessing loans from alternative service providers in the absence of MFIs.
- Another downside with moneylenders and daily finance companies is that they are selective in the clients they lend to, unlike MFIs which gave loans to everyone based on social collateral. Normally the loan amount from moneylenders and DFCs depends upon the asset base of the client.

Recommendations to the State Government of AP

- ***Conducive Environment*:** The government should adopt the Micro Finance Institutions (Development and Regulation) Bill, 2012 and allow microfinance institutions to re-start their operations in Andhra Pradesh. This way, the State Government can provide a level playing field to all the credit service providers and enable them to co-exist in a competitive and well regulated environment.
- ***Continuous Loan to SHGs***: Banks often delay loan disbursal to the SHGs. They usually take 2-3 months to process the loan request, because of which SHG members have to resort to borrowing

from informal sources such as moneylenders or DFCs at a higher rate of interest. To avoid these delays, banks can create a separate window for SHG loan processing at block/district level.

- ***Alternative Sources of Credit***: If the State Government is to rely on the *Sthree Nidhi* to replace the MFIs and reduce the influence and reach of moneylenders, it will have to capitalise the bank to a significantly greater extend. It is not clear how feasible this is; if it is not feasible, the State Government will need to revisit its strategy to reduce the dependence of the poor on moneylenders.
- ***Reviving Credit Discipline*:** The current crisis has done irreparable damage to the credit discipline nurtured by MFIs in 5-6 years to 2010. It will now require a collective effort from all the actors to revive the much-needed discipline that is core to the success of financial services industry in general. Some politicians and SHG leaders continue to actively discourage MFI loan repayments. The core incentive that is driving borrowers to pay SHG loans is the prospect of repeat loans and the interest subsidy that is linked to prompt repayment.

Recommendations to Regulators

- ***Avoid Dual Regulation***: While the Reserve Bank of India is the regulator for the NBFC MFIs, the State Government promulgated a law[6] equating MFIs with moneylenders. Due to this duality of regulation MFIs have completely stopped operating in the state, closing the major source of credit for the poor. The Supreme Court recently gave an interim order to SKS Microfinance to resume operations in Andhra Pradesh. The AP government should take the order in cognisance and allow the MFIs to work in Andhra Pradesh.[7]
- ***Close Monitoring***: To avoid another MFI crisis across the country, the regulator should closely monitor the lending and recovery practices of the MFIs. Actions also need to be taken to avoid over indebtedness among the borrowers. For this a strong monitoring system can be incorporated in the MFI bill 2012 and RBI can take monitoring responsibility for MFIs registered as NBFCs – they may be small in terms of financial assets, but they are large in terms of the number of clients they serve.
- ***Incorporate Changes in the MFI Act as per the Emerging Needs*:** The regulator (RBI) needs to undertake periodical assessment of the sector to understand clients' needs and MFIs' practices. RBI may appoint a board comprising distinguished members from MFIs, banks, development sector, government etc. The board should periodically advise RBI on incorporating changes in the MFI act to suit the requirements of the sector.
- ***Grievance Redressal Machinery & Credit Bureau*:** Grievance redressal procedures, mandatory enrolment in credit bureaus and code of conduct enforcement through industry associations are also essential. MFIs should maintain transparency and share credit information with credit rating bureaus. This will help to avoid over indebtedness among the borrowers.

Recommendations to MFIs

- ***Transparent Pricing*:** MFIs need to educate their clients on the effective rate of interest charged by them. They also need to communicate all other charges to clients transparently. Transparent pricing and communication eliminates suspicion among clients and other stake holders about the interest rates charged by the MFIs.
- ***Changes in Group Responsibility***: Members prefer individual responsibility for the loans they have taken even though groups are used for loan disbursement and repayment collection. MFIs can consider offering collateralised individual loans to members who prefer individual liability. For non-collateralised loans, MFIs need to reinforce the joint liability concept among the borrowers through intensive group resource training and centre meetings (rather than doing it hastily in aggressive pursuit of targets).

[6] AP Microfinance (Regulation of Money Lending) Act, 2010

[7] See SC gives interim order allowing SKS to resume ops in Andhra Pradesh

- ***Cordial Relationships*: ** MFIs should maintain cordial relationships with other stakeholders in the sector including State Government, regulators, media and clients. They need to be transparent in their work, maintain high corporate governance standards, and adapt client protection and responsible finance practices to gain credibility among stakeholders. MFIs also need to show case their work and the impact they create to the stakeholders through various platforms such as policy workshops, industry conferences, newspapers and other communication tools.[8]
- ***Client Centric Products*:** As they mature, MFIs move away from offering standard products to all customers. They should adopt a client centric approach to meet the needs of the clients. The products should be tailored to be geographically and culturally relevant. MFIs need to gain insights into their customers, such as: existing cash flows (both inflows and outflows); nature of occupation; type of credit requirement; pain points in accessing credit from existing sources etc. before developing the products. This can be done by constantly engaging the clients and seeking their feedback through market research and systematic product development systems.
- ***Explore Opportunity to Become Business Correspondent (BC) for Banks***: MFIs can explore opportunities to become BCs for banks so that they can use their existing resources (staff and knowledge) to provide a broader range of financial services to their clients. BC partnerships could provide significant value proposition and additional revenue to cash strapped MFIs.[9]

[8]See *MicroSave* Briefing Note # 131 Public Relations Policy in MFIs – A "Nice To Have" or Necessity?
[9]See *MicroSave* research paper Are Banks and Microfinance Institutions Natural Partners in Financial Inclusion?

Introduction

In October 2010, the State Government of Andhra Pradesh issued an ordinance to regulate microfinance institutions (MFIs) operating in the state, alleging exploitation of poor and ignorant borrowers. The ordinance, "*The Andhra Pradesh Microfinance Institutions (Regulation of Money lending) Act, 2010*" enacted in December 2010, had stringent provisions that immediately resulted in near-total suspension of MFI operations in the state. The Act mandates that all loan repayments must be monthly and have to be made at the *Gram Panchayat* offices. This effectively negated the two significant advantages the MFIs had: *doorstep service delivery* and *repayments in small, regular amounts*. The Act also requires MFIs to obtain prior approval from the District Rural Development Agency (DRDA)[10] before giving loan to any SHG member, effectively strangling new disbursements.

Two years after the enactment of the Ordinance, MFI operations have almost come to a standstill in AP. MFIs, which had boasted more than 95% recovery rates, found themselves staring at repayment rates of 10%-15% during 2011; and this fell further to below 1%[11] in 2012. In the first half of FY2010-11, MFIs disbursed Rs.50 billion to borrowers in Andhra Pradesh. This sharply reduced to a mere Rs.85 million by the second half of FY 2010-11.[12]In early December 2010, MFIN, the network of NBFC-MFIs reported that MFIs were unable to collect Rs.72 billion outstanding loans in Andhra Pradesh, and had missed the opportunity to lend Rs.1,200billionsince the Ordinance was enacted.

As the MFIs were a major source of credit to low-income households, the absence of MFIs created a big credit gap in the market. The State Government of AP took initiatives to meet this credit gap. The State Government increased the credit supply to SHG members through the SHG-Bank linkage programme.[13] The [Society for Elimination of Rural Poverty](#) (SERP), a society promoted by the State Government of AP has increased bank credit

Figure 1 Snapshot of the MFI crisis

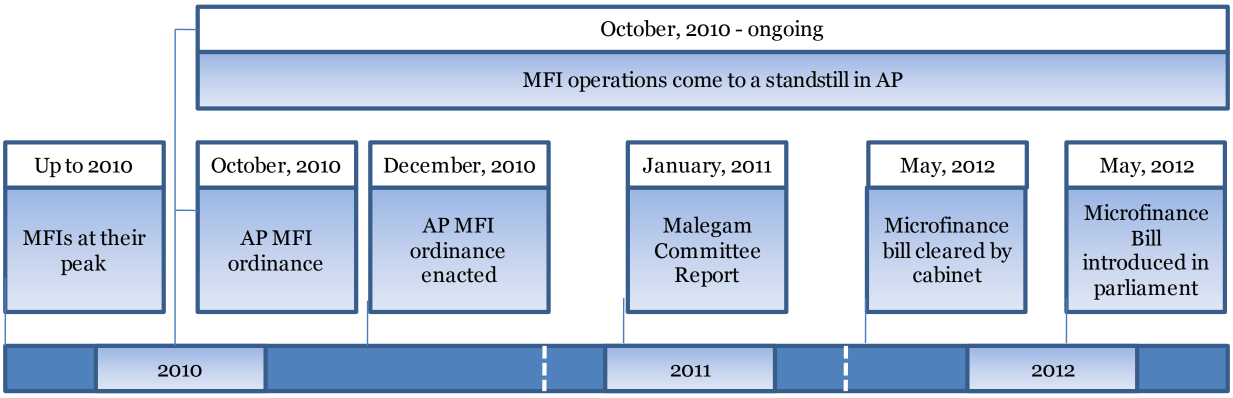


Table 1: Key Aspects of the AP Microfinance (Regulation of Money Lending) Act, 2010

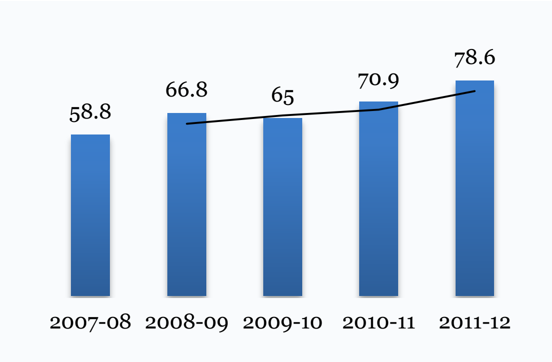
- Mandatory monthly repayments
- Interest payment as a whole should not exceed the principal
- *Panchayat* office to be the sole collection centre
- New disbursements require the approval of DRDA
- Prohibition of door-to-door collections and use of loan collection agents who are not on the rolls of the MFI.
- Registration of all branches with the respective government department

[10]District Rural Development Agency (DRDA) is responsible for SHG movement at the district level and is implementing agency of SERP at district level.
[11]Based on discussions with staff and management team of MFIs during July 2012 research

[12] See Microfinance in India: A crisis at the bottom of the pyramid, How the Government of Andhra Pradesh has severely damaged private sector microfinance and put 450 million of India's rural poor at risk, Legatum Ventures
[13]SERP Progress Report

linkage to SHGs from Rs.65 billion in 2009-10 to Rs.78.6billion in 2011-12.

Figure 2. Bank credit linkage (In Rs. billion)



To reduce the financial burden of SHG members, the State Government introduced an interest subsidy scheme called "*Pavala Vaddi*". The government reimbursed Rs.5.35 billion to 1,133,269 SHG members in 2010-11, which increased to Rs.8.7 billion reimbursed to 1,948,384 SHG members in 2011-12.

The State Government of AP, in association with the Mandal level Federations of SHGs, promoted *Sthree Nidhi* Credit Cooperative Federation Ltd[14] to address the issue of inadequate finance to low income households and to ensure timely (the target was set at less than 48 hours) availability of credit. Till June 2012, Rs.1.35 billion was disbursed to 100,721 members of 30,384 SHGs. According to MFIN,[15] though the banks were extending loans through the SHG-bank linkage programme and *Sthree Nidhi* is established to provide credit to SHGs, there is still a credit gap of Rs.50 billion in the state as of August 2012.

Given this background there are several questions that arise including: (a) do these initiatives successfully meet the credit gap created by the absence of MFIs? (b) what is the impact on cost of credit? and (c) what is the impact on convenience and access to credit for poor people? In order to answer these questions, *MicroSave* conducted qualitative research in August 2011 to understand the avenues/channels that clients are accessing to meet their credit requirements in the absence of credit flow from the MFIs. The research highlighted the various credit sources available to the clients and the pain points in accessing them. The research also shed light on the coping mechanisms adopted by poor people in the absence of the MFIs. The research helped to collate people's experiences, opinions and needs, to inform policy makers and key actors to devise solutions that suited the requirements of clients.

The AP MFI crisis created an impact all across India and globally. MFIs in other states of India faced liquidity crunch as banks / other funding agencies shied away from lending to them after the controversy over malpractices in the sector and their inability to recover the dues. MFIs' loan portfolios and the scale of operations[16] shrank because of the fund crunch. On its part, the Central Government introduced The Micro Finance Institutions (Development and Regulation) Bill in the parliament in May, 2012 to take MFIs outside the purview of state-level legislation and make Reserve Bank of India (RBI) the regulator of the sector. The RBI issued a notification for regulation of NBFC-MFIs based on the recommendations given by the Malegam Committee[17] and through stakeholder consultations. Table 2[18] highlights the key components of this notification. MFIs hope that the Microfinance Institutions Bill 2012 introduced in Parliament will get approval and soon put a full framework of regulations in place for the entire country.

[14] Refer to the link for further details
[15] http://www.thehindu.com/news/states/andhra-pradesh/article3804008.ece

[16] Small and mid-sized MFIs continue to reel under liquidity crunch
[17] http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/YHMR190111.pdf
[18] RBI Notification for NBFC-MFIs - August 03, 2012
*A loan becomes is qualifying asset if the borrower's household income does not exceed Rs. 60,000 for rural or Rs. 120,000 for rural and urban areas and his/her total indebtedness is less than Rs.50,000. Apart from that the loan size has to be between Rs. 35,000 and Rs.50,000, without prepayment penalties and collateral. For loans above Rs.15,000, the minimum tenure has to be 24 months and the repayment has to be weekly, fortnightly or monthly at the choice of the borrower. Refer to the RBI notification for further details

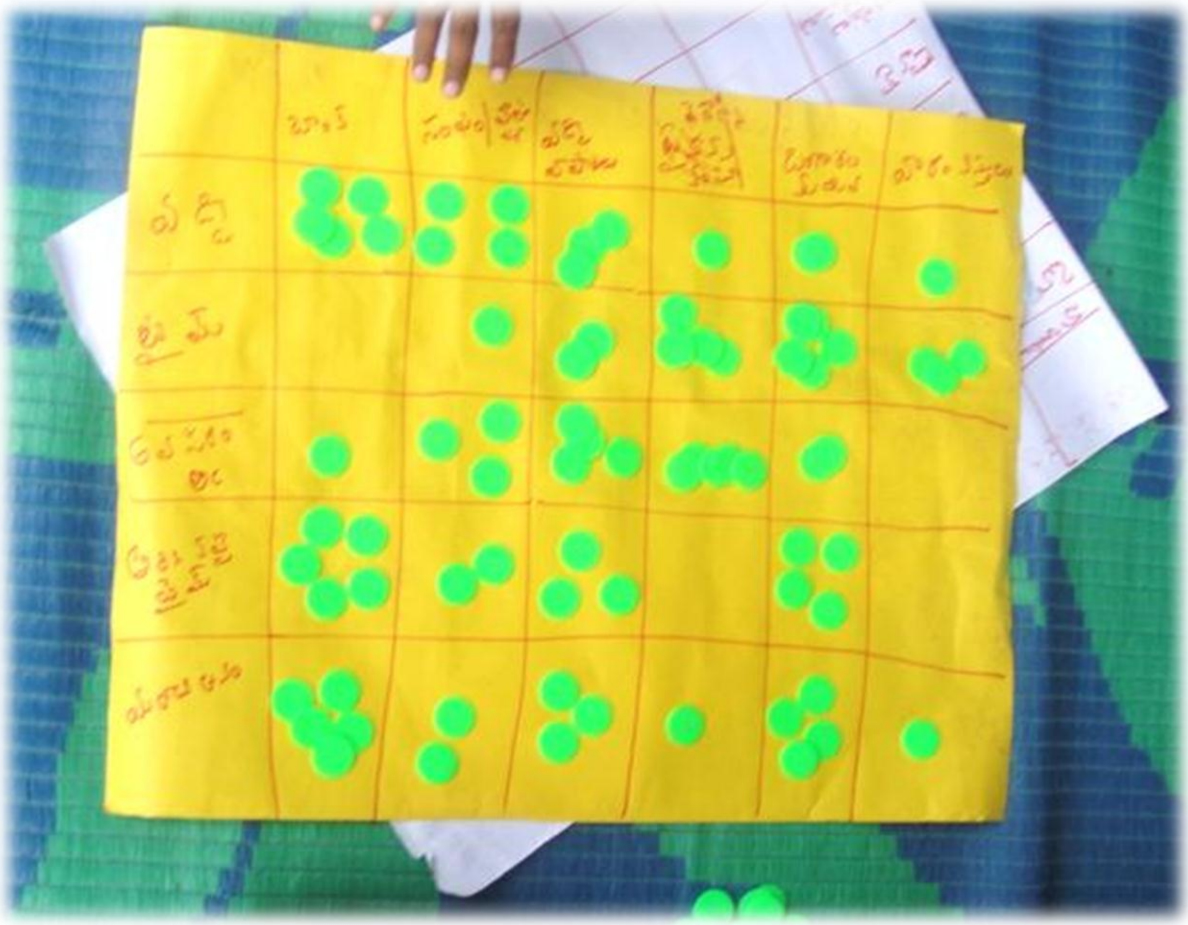
Table 2: RBI Notification on NBFC-MFIs

- Minimum Net Owned Funds (NOF) of Rs.30 million by March 31, 2013 and Rs. 50 million by March 31, 2014.
- NBFC-MFIs required to maintain minimum 85% of their net assets as 'Qualifying Assets'*
- Minimum 75% of the total loans should be extended for income generation.
- NBFC-MFIs have to ensure that a SHG or JLG or individual cannot borrow from more than 2 MFIs.
- Interest on loans may exceed 26% but the maximum variance permitted for individual loans between the minimum and maximum interest rate cannot exceed 4%.
- Interest rate margins capped at 10% for large MFIs and 12% for smaller MFIs.

As there has been a delay in the approval of the MFI Bill in the Parliament, the MFIs have been facing severe problems across the country especially in Andhra Pradesh. *MicroSave* conducted a follow up study in July 2012 to understand the changes in access to credit for low-income households in Andhra Pradesh, especially in the absence of the MFIs. The objective of this study was to also help understand how the access to financial services has changed since the last study conducted by *MicroSave* in August2011. The study assesses whether the formal financial service providers have been able to fill the credit gap created by the absence of MFIs; and to understand if poor people are still borrowing from informal sources such as moneylenders at exorbitant interest rates. *MicroSave* conducted a similar study in West Bengal, a state with good presence of MFIs, to compare the change in access to credit to the poor in West Bengal with Andhra Pradesh.

*A loan becomes a "Qualifying asset" if– Borrower's household annual income does not exceed Rs. 60,000 or Rs. 120,000 for rural and urban areas respectively; Maximum loan size of Rs. 35,000 (first cycle) and Rs. 50,000 (subsequent cycles); Maximum borrower total indebtedness of Rs. 50,000; Minimum tenure of 24 months when loan exceeds Rs. 15,000; No prepayment penalties; No collateral; Repayable by weekly, fortnightly or monthly instalments, at the choice of the borrower

Research Objective and Methodology



Research Objective

This research was conducted to analyse accessibility of credit for low income people in Andhra Pradesh (AP) especially in light of the AP microfinance crisis. The study was specifically designed to:

a) Understand the different financial services used by the poor in the absence of the MFI loans.
b) Coping strategy adopted by the poor in the absence of readily available credit from the MFIs.
c) Understand if the poor are better or worse off with the decline/absence of the MFI sector.
d) Present a picture of the ground reality for interested groups like NGOs, financial institutions, government officials and so on.
e) Provide recommendations in light of the findings for government, financial and regulators to assist in policy advocacy for better access of financial services by the poor

Research Methodology:

MicroSave used Participatory Rapid Appraisal (PRA) tools during the research to get feedback of the targeted BOP segment. The emphasis of these tools was to generate quality discussion among the respondents to understand their view points. In addition, in-depth interviews were conducted with microfinance practitioners and government officials to understand their view points on the current status of access to credit by the poor. We have also presented some case studies from our observations during the field visits to highlight some key aspects of our findings.

About the Tools Used

Focus Group Discussions (FGDs) – FGDs help to understand the group's general and financial profile. They are also useful to have a discussion on the credit needs, use of credit in the community and different avenues available to access it. In addition, the tool is helpful to gather opinions of the community as a whole, on MFIs and impact of their decline/absence.

Relative Preference Ranking (RPR)- RPR helps respondents to provide relative ranking for the key attributes like interest rate charged, processing time for credit delivery by financial institutions and so on. Thus, it helps to capture respondents' relative preferences on product attributes amongst various financial service providers.

Financial Sector Trend Analysis (FSTA) –FSTA tool is useful to analyse reasons for the level of use of different financial services over a period of time by the community and thus to conduct trend analysis in the use/availability of such services over a period of time (usually five years).

Research Study Time Line

June, 2012-

- Planning and design of the research plan

July, 2012

- Conducted Market Research in 5 districts of Andhra Pradesh

August, 2012

- Analysis and Consolidation based on the findings from field

Sampling Methodology

The research was conducted in the rural, semi urban and urban parts of 5 districts of Andhra Pradesh. The choice of these districts was to ensure coverage of all the three different regions of the state.

1. Rayalaseema – Anantapur and Kurnool
2. Telangana- Medak and Adilabad
3. Coastal Andhra- East Godavari and Krishna

In addition, the research also focused on various interest groups during the course of study by including them in the discussions. Some of them are - Society for Elimination of Rural Poverty (SERP) promoted SHGs in rural and semi-urban areas; Mission for Elimination of Poverty in Municipal Areas (MEPMA); JLGs promoted by MFIs; and SHGs promoted by NGOs. The team also interviewed a promoter of an MFI, and government officials who are responsible for promotion of SHGs.

The study covered a sample of 343 respondents in 33 sessions across five districts of Andhra Pradesh. The use of different research methodologies and number of respondents is detailed below:

Methodology	No. of sessions	No. of respondents
Focus Group Discussion	33	343
Relative Preference Ranking	17	168
Financial Sector Trend Analysis	10	96
Case Study	2	2
Personal Interview	1	1

Profile of the Respondents

Profiling (General)

Figure 3. Gender of the respondents

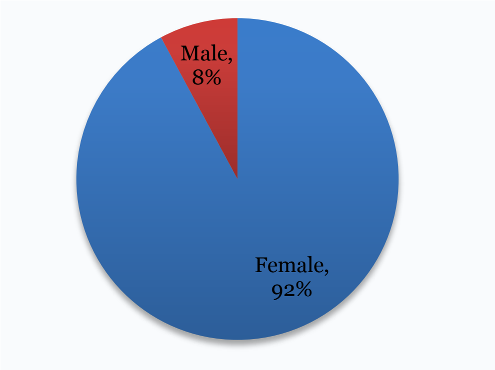
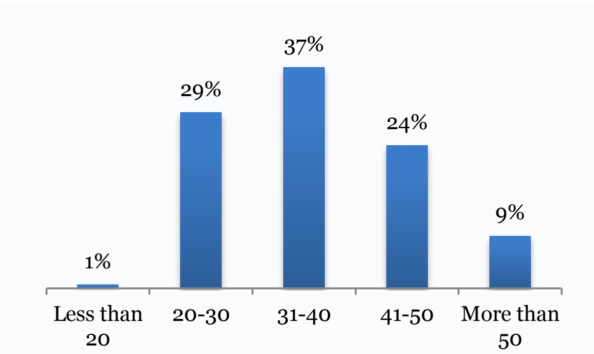


Figure 4. Age of the respondents

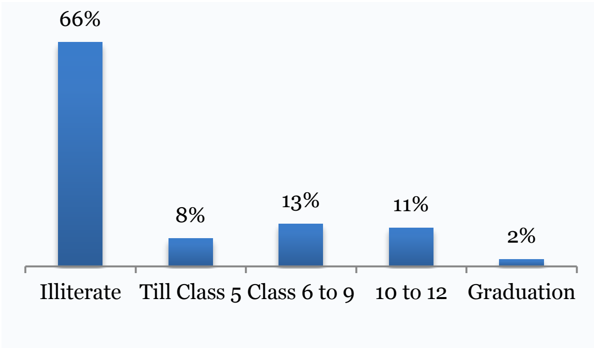


***Gender*:** Out of the total 343 respondents, 316 were female and the rest were male. The key reason for the higher number of female respondents was that most SHG credit linkage programmes and MFIs have targeted women. So, women in general are in a better position to provide feedback on the issues related to MFIs and other financial institutions. Male respondents were also mainly spouses of these SHG/MFI members' group.

Age: Close to one third of the sample (29%) was between 20-30 years, and 24% belong to the 41-50 years age group. A majority (37%) of the respondents were between 31-40 years, and 9% of the respondents were 50 and above years old.

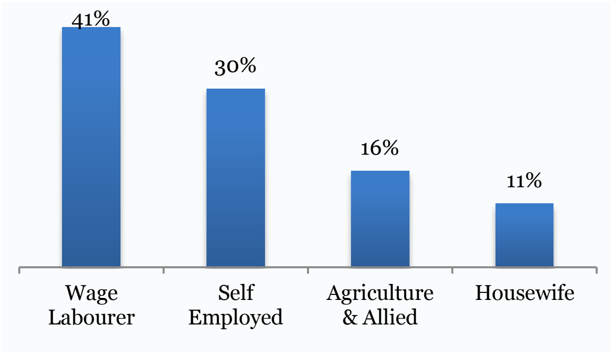
***Literacy*:** Sixty six per cent of the total sample has no formal education, while only 8%of them have completed their primary education. 23% of

Figure 5. Education



them have attended secondary education and 2%have a college degree.

Figure 6. Occupation



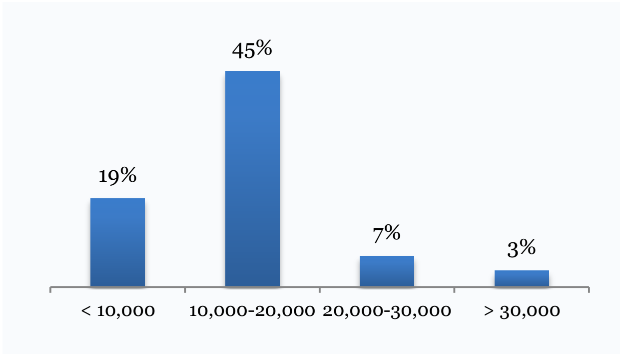
Occupation: More than 41% (140) of the total respondents were daily wage labourers; 30% were self-employed; 16% of the total sample was directly engaged in agriculture and allied activities like diary, livestock; and the rest 11% were housewives.

Profiling related to MFIs

The data represents position of the respondents as reported by them at the beginning of the crisis. More than 42% of the respondents were associated with two MFIs, 28% with three MFIs, and 12% with four or more MFIs.

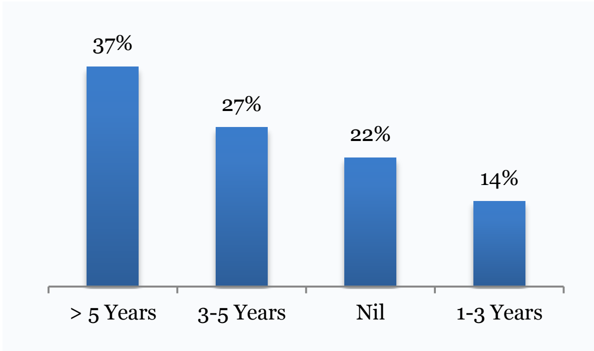
However, just 3% of the sample had loans outstanding of more than Rs.30,000. The majority of the respondents (45%) had a loan outstanding of Rs.10,000-20,000 at the time of the crisis. Approximately20% of the respondents had a loan outstanding of less than Rs.10,000.

Figure 7. Loan outstanding



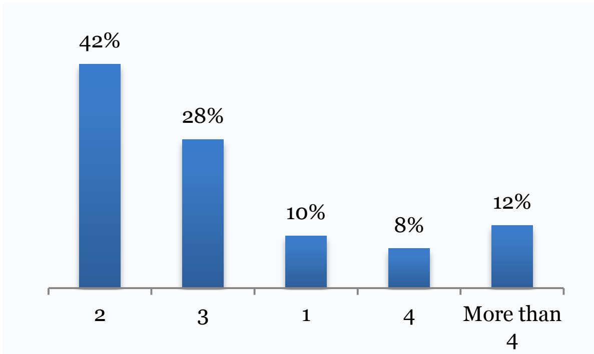
In terms of number of years for which clients were associated with the MFIs, 14% of the respondents

Figure 8. Respondents' association with MFIs (number of years)



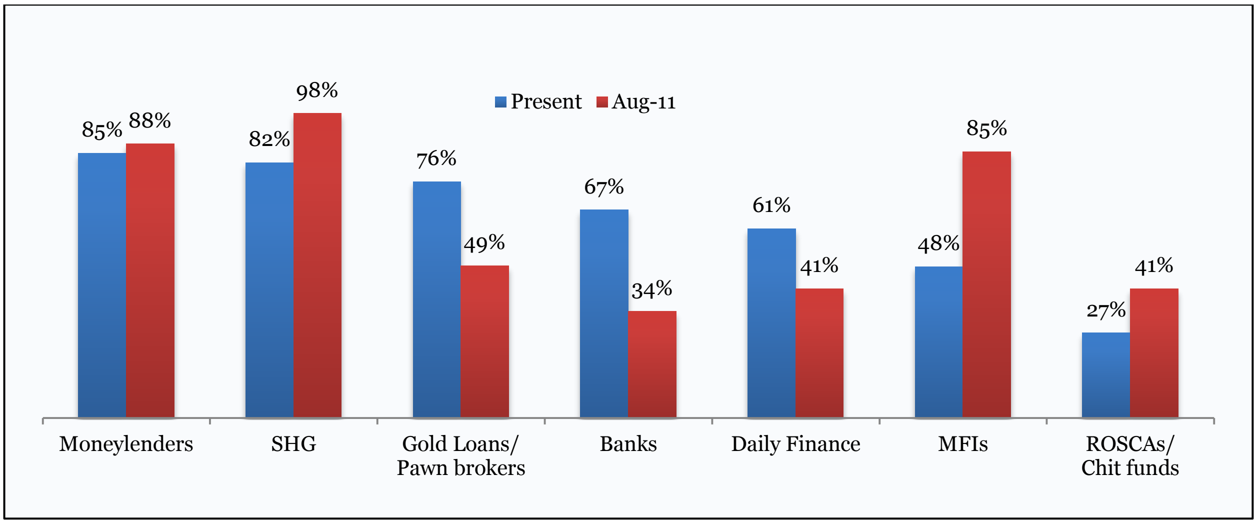
were connected with MFIs for 1 to 3 years; 27% of sample was linked for 3-5 years; while 37% of the sample was associated for more than 5 years.

Figure 9. Number of MFIs associated with



Sources of Credit

Figure 10. Sources of credit (percentage of sessions)



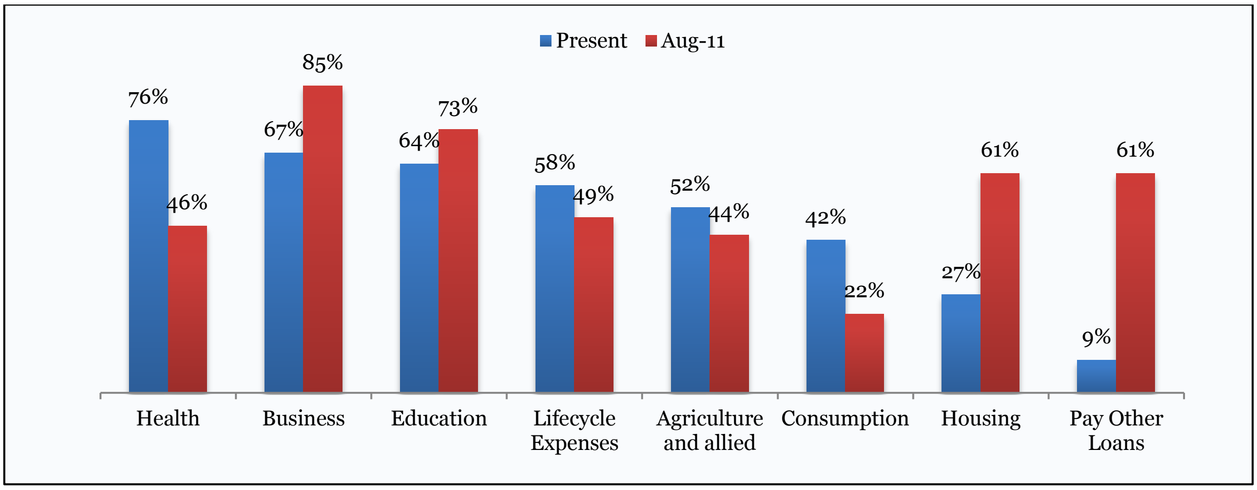
Moneylenders (in 85% sessions) and SHGs (in 82% sessions) are the most popular source of credit followed by gold loan companies/pawn brokers (in 76% sessions). Moneylenders have flourished in the absence of MFIs especially in the rural areas by offering credit to agriculturists and daily wage labourers. Credit through SHG bank linkage has increased over the years. SHG members also have access to the group's internal corpus of pooled savings for credit, as well as loans from the *Mandal Samakhya* (SHG Block level federation).

Gold loan companies/pawn brokers have proliferated in the absence of MFIs and provide loans against gold jewellery. Banks that provide agriculture loans and loans against collateral featured as a source of credit in 67% of the sessions. Daily finance corporations (DFCs) provide credit to self-employed individuals such as *kirana*, tiffin and cycle shop owners, tailors, auto drivers, and vegetable sellers etc. who have daily cash flows. Respondents mentioned DFCs as a source of credit in 61% of the sessions. MFIs and ROSCAs/chit funds feature in 48% and 27% of the sessions respectively.

Comparison with 2011 study:
Respondents have increasingly started availing credit from gold loan companies, banks and DFCs. All the three sources have witnessed a marked jump in their popularity as a source of credit since August 2011. Private gold finance companies such as Muthoot, Manappuram etc. have increased their branch network to cater to the credit demand. Many enterprising individuals have started DFCs to cater to self-employed individuals. Repayments are daily at clients' doorstep, which makes it convenient for clients with daily cash inflows. The popularity of MFIs has come down significantly. MFIs featured in 85% of the sessions in August 2011 study and came down to 48% of the sessions in current study. ROSCAs/chit funds featured in 27% of the sessions as compared to 41% in the previous study. However ROSCAs are still popular with *beedi* workers, agriculturists etc. as it helps them save for planned expenditure.

Purpose of Credit

Figure 11. Purpose of credit



Respondents access credit for the following purposes:

Health & Medical Expenses: (pregnancy and childbirth, illness, accidents): In 76% of sessions, respondents mentioned that took loans for health or medical expenses. These included expenses related to pregnancy, doctor's fees, medication, hospital expenses, childcare and so on. Unforeseen emergencies such as chronic illness of a family member or accidents also entail huge expenses, for which respondents borrow. Credit for health related expenses featured in most sessions (76%) in the current study– up from 46% of sessions in the previous study. This may be as a function of the time of year when the studies were conducted.

Business*:* In 67% of the sessions, respondents mentioned that they availed loans to expand business or to set up small businesses like *kirana* shops, *tiffin* centres, *saree* business, and cycle repair shops and so on. With respondents mentioning it in 85% of the sessions, credit for business remained the most important reason for availing credit in August, 2011 study. Some of the respondents also took loans to meet the working capital needs of their businesses. In some cases they took loans to buy auto and commercial vehicles and to give then out on hire; or to buy machinery related to their business.

Education*:* In 64% of the sessions, respondents availed loans to meet the education expenses of their children. As higher education is expensive, they are often forced to borrow money for this. This expense is slightly higher at 73% of the sessions in the previous study.

Life Cycle Expenses: (marriage, death etc.)*:* In 58% of the sessions, respondents said that they had taken loans to meet life cycle expenses such as for marriage or death. This increased from 58% in the August, 2011 study.

Agriculture and Allied Activities*:* In 52% of the sessions, respondents mentioned that they availed loans to meet expenses related to agricultural and allied activities. These include expenses on purchase of seeds and fertilisers; labour related expenses during the sowing and harvest season; and expenses for transportation. Crop loans given by banks are the primary source of credit to meet these expenses. Respondents preferred availing loans with monthly or bullet (single) repayments for agricultural and allied needs.

Consumption Purpose*:* Respondents mentioned use of credit for consumption needs in 22% of the sessions in August, 2011 study. In the current study this increased to 42% of the sessions. Consumption expenditure includes buying household durables such as fan, mixer, or TV; or to meet their living expenses (grocery, rent, functions, events etc.).

The cost of education, agriculture inputs and essential commodities such as rice, lentils, sugar, petrol etc. has increased in the past two years. This is the reason all these indicators figured in higher percentage of sessions in the current study.

Housing*:* Respondents in27% of the sessions mentioned taking loans to construct a new house or to repair their house. This has come down significantly from 61% in the previous study. One possible reason for this decline could be the increase in construction costs making it difficult to afford a house. But the other reason, clearly expressed by clients was the decrease in the availability and increase in the cost of credit in the absence of MFIs.

Redemption of Loans from Other Sources: In 9% of sessions respondents said that they had borrowed to redeem high cost loans from moneylenders or to pay off loans availed from other sources. This is a notable decrease from 61% in the previous study. This implies that many of the respondents were in a debt cycle at the height of MFI crisis. They borrowed loan from one MFI to repay other MFI loan. This phenomenon has significantly reduced in the current year's study as MFIs stopped their lending activity in the state.

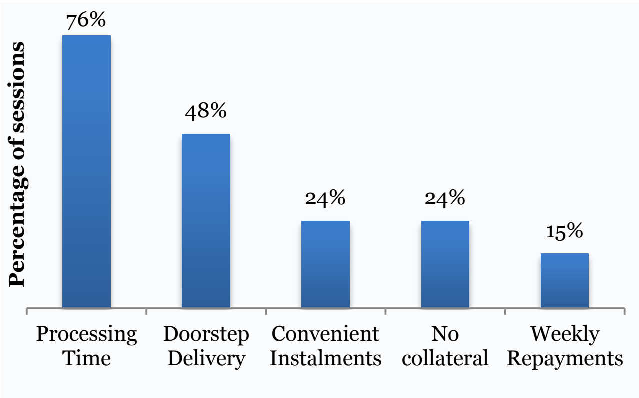
Microfinance Institutions – Client Likes and Dislikes

Faster Processing Time and Surety of Credit: In 76% of the sessions, respondents mentioned that they liked the fact that MFIs processed loans quicker than other credit providers. Another differentiating factor was that once the process for loan delivery started at an MFI, clients were sure to receive the loan within a week. This is unlike banks where they are not sure of loan delivery even after documentation has been satisfactorily completed.

Doorstep Delivery: In 48% of the sessions, respondents liked the fact that MFIs offer credit at their doorstep. Respondents preferred to avail financial services closer to their homes as it saves them time and resources.

No Collateral Requirements: In 24% of the sessions, respondents preferred MFIs as no "hard" collateral was required to borrow from them. MFI loans are given on the basis of social collateral or joint liability of the members in the group. This enabled asset-less the poor to avail loans.

Figure 12. MFI likes



Convenient Instalments: In 24% of the sessions, people liked the convenient repayment option offered by the MFIs. They said they can make interest payments along with principle in easy instalments. This is not possible for moneylenders who insist on bullet payment- paying interest and principal together at the same time. This often involves much higher sums due to the higher, compounding interest rates charged.

Weekly Repayment: In 15% of the sessions respondents liked making weekly loan repayments to MFIs. Daily wage labourers, who form 41% of the respondent profile, get regular cash inflows (from work in the fields during agriculture season and in MNREGA works during lean season) and find it convenient to pay in small weekly instalments. Some of them note that using cash to repay loans on a regular basis is better as otherwise they would spend the money on unwarranted consumption activities.

Apart from the above attributes, respondents also liked top-up loans and insurance schemes offered by the MFIs. Clients often use interim or top-up loans to meet emergency requirements. Also certain insurance schemes cover the group member as well as the earning member in her family. This mitigates the financial risk of the member in case of demise of the earning member.

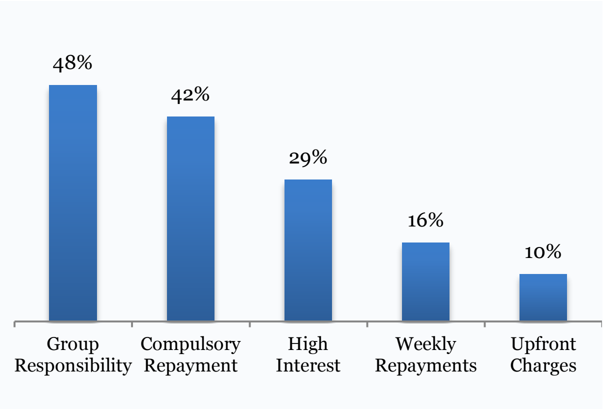
There are also several dislikes for MFIs.

Group Responsibility: In 48% of the sessions, respondents mentioned that they did not like the group liability concept of the MFIs. Respondents complained that they do not want to be responsible for others' defaults, as they took due care to repay their loans without delay. Respondents indicated that apart from additional financial burden, this also created rifts among the group members.

Compulsory on Time and Full Repayment: In 42% sessions, people complained that MFI staff put a lot of pressure on clients for complete repayment and did not leave the centre unless all dues are paid. This used to cause a lot of inconvenience for the members. Sometimes they had to sit for long hours at the meeting till the defaulting members paid their dues to the MFI staff. It was of course embarrassing for the defaulters. However they had to go through the same turmoil every time a default case came up.

High Interest Rate: In 29% of the sessions, respondents considered that the MFIs charged high interest rates. They mentioned that the interest rate charged by the MFIs is higher than the rates charged by banks and SHGs. Respondents mentioned that if the upfront charges were considered, then the effective rate of interest is higher than the rates quoted by MFIs. In the discussions, it became clear that the media also played a significant role in creating the opinion among respondents that MFIs charge high rates of interest.

Figure 13. MFI dislikes



Weekly repayments: Weekly repayments associated with MFI loans do not match the cash flows of certain clients. These recommended that in addition to weekly repayments, there should be other options for repayment schedules (like monthly) to match the cash flows of the borrowers. Thus, instead of paying weekly, the money could remain invested in the business and would generate better returns. Weekly repayment not only creates additional pressure on these clients, but a lot of time is also wasted in transit and arrangements for meeting.

Upfront charges (10%) and centre meetings (6%) were other dislikes. Respondents mentioned that MFIs collected upfront charges in the form of first instalment repayment, insurance charges, processing fee, documentation, cash security etc.

However, despite the aforesaid dislikes for MFIs, a vast majority of clients had a preference to avail loans from MFIs and SHGs rather than from moneylenders and daily finance corporations.

MFIs vs. Other Service Providers (Findings from Relative Preference Ranking)

Figure 14. Relative Preference Ranking

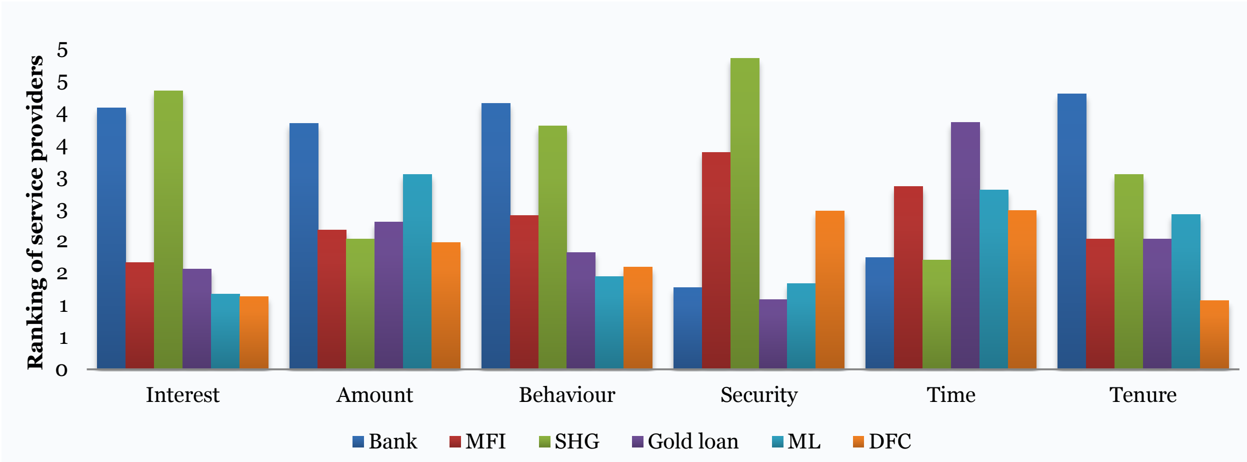
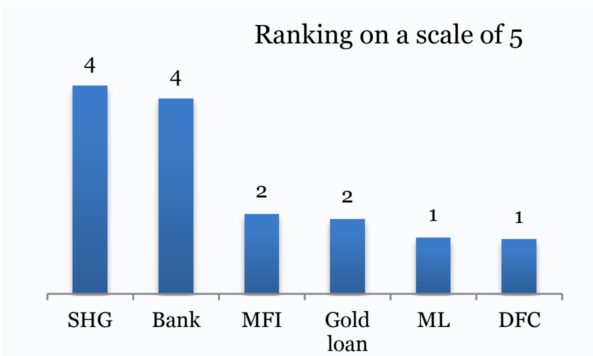


Figure 14 shows the rankings of various service providers given by respondents on major attributes. The ranking is on a scale of five.

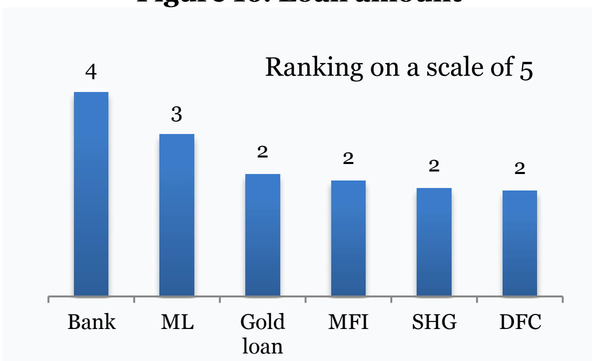
Interest: The interest rates charged by banks and SHGs usually range from 12%-15% and are lower compared to that of MFIs. Most of the respondents avail subsidised credit products, like crop loans, from banks. Political influence also results in interest/loan waivers. SHGs too offer credit at interest rates comparable to bank rates. The SHG-bank linkage, which is a major source of credit for women in AP, has interest rate subsidy in the form of interest reimbursement.[19]

Figure 15. Interest



Registered gold loan companies and MFIs charge higher interest when compared to banks and SHGs. Their interest rates range from 12.5% – 15% flat (some MFIs charge on reducing balance). Pawn brokers charge higher interest rates than registered gold loan companies like Muthoot and Mannapuram; and pawnbrokers' interest rates ranges between 24% - 36%. Moneylenders and daily finance companies are the worst as they charge interest rates which go up to 78%-120% per annum.

Figure 16. Loan amount



Loan Amount: Respondents appreciate the loan amount provided by banks and moneylenders. Moneylenders offer loans in the range of Rs.1,000 to Rs.40,000.The loan amount depends on the repayment capacity of the borrower and security deposit.

MFIs offer fixed amount depending on the loan cycle. Whereas gold loan companies provide loan on the amount of gold pledged. MFIs typically offer loans up to Rs. 25,000, though the advantage is that they offer top up loans and emergency loans (usually after 50% of the previous loan amount has been repaid). Though the loan amount offered by SHGs is higher (up to Rs.50,000), they score less, because members cannot avail subsequent bigger loan until the previous loan has been repaid. Normally the

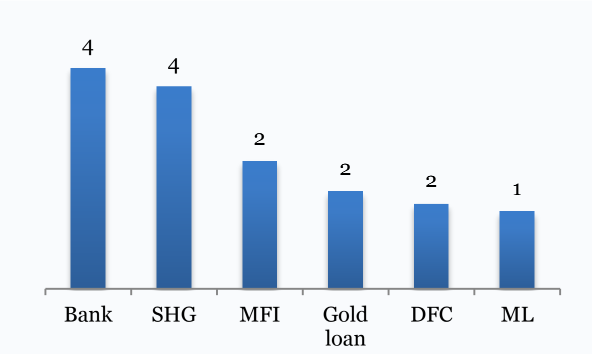
[19]Zero interest rate scheme– If the women repay the loan on time 100% of the interest is reimbursed to them by State Government

repayment period of such loans is 36 – 60 months. DFCs score the least as they offer very small sized loans ranging from Rs.2,000-Rs.10,000.

Staff Behaviour: Figure 17 gives the ranking of service providers in terms of staff behaviour. Respondents relate staff behaviour to overall client servicing with specific reference to the behaviour during repayments. Banks score the highest on this attribute, as staff does not use coercive measures if the repayment is delayed.

SHGs are community owned and self-regulated so their behaviour is friendly and polite. Detailed information on the products and services is shared with the group and queries are properly answered. However members feel there is influence of peer pressure in loan repayment.

Figure 17. Staff behaviour



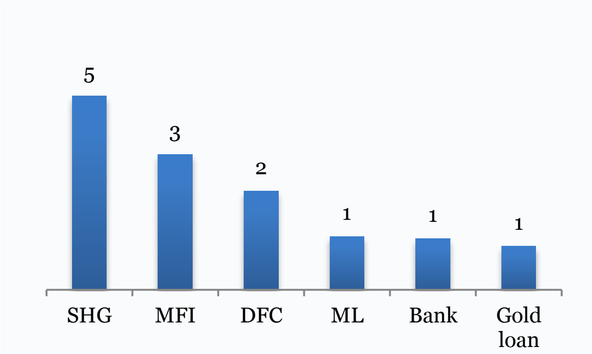
MFIs give clear counselling and explain all product details and norms in detail before offering credit. MFI staff is well behaved and polite even during repayment but use peer pressure to make sure the repayment happens.

> *"The staff is very good when it comes to giving loan but they are very strict and do not listen when it comes to repayment."* – A Microfinance client

Registered gold companies have well trained and professional staff, but they are not tolerant to delay in repayment and charge penalties or auction the jewels. Pawn brokers are rude, and are similar to moneylenders in behaviour. Staff members of daily finance companies are impolite especially during repayments. Moneylenders score the least as they do not show any empathy towards the clients. Moneylenders do not treat the clients with respect and show antipathy in case of default and late payment of loan amount. They are also partial and show favouritism.

Security/Collateral: Figure 18shows the ranks given by respondents to various service providers on security and collateral. SHGs offer credit without any collateral and are most popular among respondents for this attribute. MFIs also offer credit without demanding any security/collateral, but have joint liability as security. Daily finance companies offer credit without collateral, but only to people who have their own house and other assets.

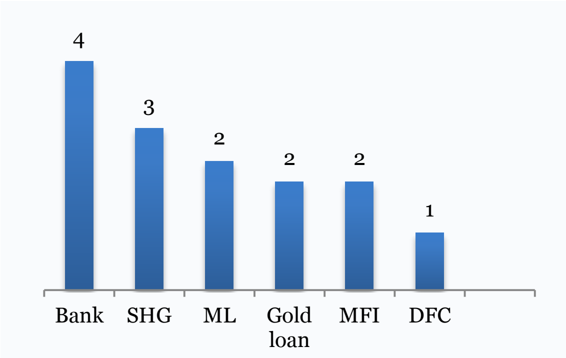
Figure 18. Security/collateral



Banks and moneylenders score low on this attribute because they demand the pledging of high value assets to collateralise the credit they provide. Bank loans also require guarantors, whereas moneylenders demand promissory notes. Gold loan companies score least as they demand gold as a collateral and do not accept other assets.

Loan Repayment Tenure: Figure 19 shows the ranks given by respondents to various service providers on repayment tenure. Respondents prefer the *long loan tenure* of the banks which range from 2 – 3 years, as it is easy and convenient for repayments. Members also have the option of choosing the loan tenure when they avail loans from banks. SHGs provide loans for 2 - 3 year tenure. Moneylenders also provide credit for a longer tenure. They provide the option of rollover of credit on payment of interest. Gold loan companies/pawn brokers and MFIs provide loans for a shorter duration of 1 year. The daily finance companies score the least in this attribute as they offer loans for very short tenure (around 3 months).

Figure 19. Loan repayment tenure

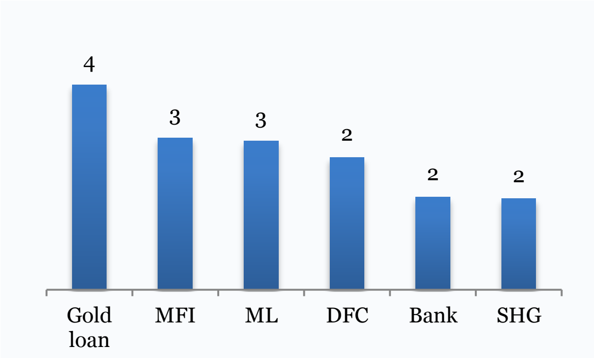


Moneylenders are preferred over MFIs and gold loan companies because of the ***flexibility in repayment tenure***. Moneylenders wait for the repayment and allow bullet repayments. If a creditor is unable to repay, the interest is compounded, but the tenure is extended. Pawnbrokers also extend the tenure as they can earn more interest, but formalised gold loan companies do not allow this. They wait for a fixed duration for repayment and auction the jewels. The flip side is that pawnbrokers do not allow part repayment.

Respondents linked the ***repayment frequency*** to the repayment tenure. Repayment frequency complemented the tenure in many cases if it matches the cash flows of the respondents. Respondents with monthly income preferred monthly repayments and respondents with weekly income preferred weekly repayment.

Processing Time: Figure 20shows the ranks given by respondents to various service providers on processing time. Gold finance companies have the fastest processing time and offer credit as soon as gold is given as collateral. Moneylenders also process loan requests immediately if they have cash. However, based on the urgency of the borrower, moneylenders increase the rate of interest. MFIs take one week to process loans. MFIs provide loans quickly after the completion of each loan cycle. Daily finance companies also process loans fast, but take 2 weeks for the first loan, as there is an intensive background check.

Figure 20. Processing time



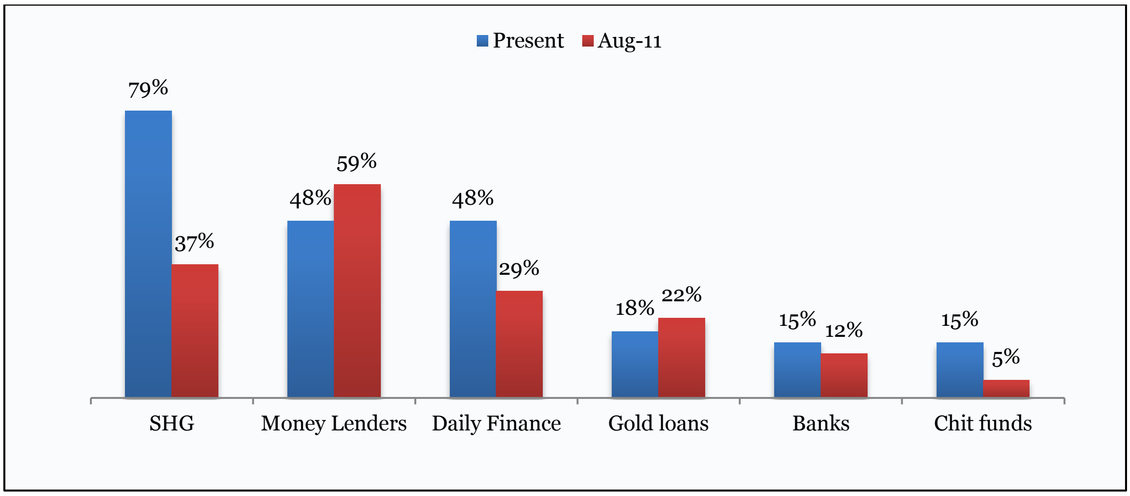
Banks have a minimum processing time of 1-2 months. Bank loans involve laborious documentation and lengthy approval process. The clients are made to visit the bank multiple times before approval. One respondent waited for nine months to get a bank loan and noted, *"My heels have eroded walking to the bank for the loan"*.

SHGs accept and process loan requests only during the monthly meetings. Though the member receives money instantly during the meeting (when the loan is disbursed from the internal fund of group), the member has to wait until the meeting, as there is no option to call an emergency meeting.

There is a further delay of one month if the member applies for a federation loan or bank loan through the SHG. An SHG member quoted on SHG bank linkage, *"It's either one month or two months or three months. I've even waited for five months"*.

Alternative Sources of Finance in the Absence of MFIs

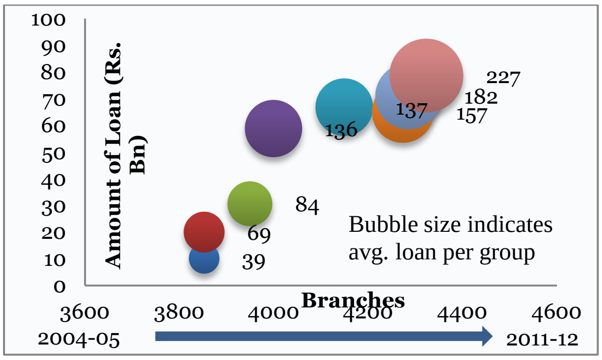
Figure 21. Alternative Sources of Finance



Members of the community availed credit from various other sources to fill the credit gap created by the absence of MFIs. SHGs dominated as the main source of finance in the absence of MFIs. In 79% of the sessions respondents said that they borrowed from SHGs to meet their credit requirements as compared to 37% in the 2011 study. This is because the Government of AP, through SERP, is promoting SHGs and providing bank linkage to rural women. After MFIs stopped their operations, the State Government initiated a major push to increase bank linkage credit to SHGs.

The Figure 22 below indicates the change in SHG bank linkage from 2004-05 to June, 2012.[20]

Figure 22. SHG Bank Linkage



X-axis indicates the number of bank branches disbursing loans to SHGs, Y-axis indicates the amount of loans disbursed and the size of the bubble indicates average loan size per group. The amount of loan disbursed has increased from Rs.65 billion in 2009-10 to Rs.78.66billion in June, 2012, an increase of 21%. It is interesting to note the 44% increase in size of loan per group, from Rs.157,000 in 2009-10 to Rs.227,000 in June, 2012. However the increase in bank linkage amount is not sufficient to meet the loan demand gap created by the absence of MFIs.

> *Vere ekkada appudorakka memu dorala daggara ekkuva Vaddi ichi appu techu kuntunnam saar. (Because of lack of alternatives, we take loans from moneylenders at higher interest rates).*

Moneylenders now figure prominently as a source of credit in the absence of MFIs. In 48% of the sessions respondents mentioned that they took loans from moneylenders to meet the credit gap. The respondents took loans from moneylenders even though the interest rates were high (3%-5% per month). However there has been a decline in moneylenders as a source of credit (59% of the sessions) since August 2011 study. The decline could be possibly due to increase in SHG bank linkage credit and also due to increase in loans from DFC.

Respondents mentioned DFCs as an alternate source of credit in 49% of the sessions. This is a marked increase from 29% sessions in August 2011 study. One reason for this is that many enterprising youth have established DFCs to lend to self-employed individuals who have regular cash flows. Customers prefer DFCs even though they charge the same interest as moneylenders as

[20] SERP - Progress Report, June 2012

they can make daily repayments from business locations.

Respondents (in 18% of the sessions) also took loans by pledging gold ornaments from gold loan companies, which have proliferated in the past three years. They also took loans from banks in the form of secured loans (crop loans, gold loans) by pledging property documents and gold to meet their loan requirements. In 15% of the sessions respondents stated that they have mobilised money through ROSCAs (chit funds).Use of chit funds has increased since the previous study especially among *beedi* workers and wealthy farmers. They usually enrol in chits to save and meet planned expenditure.

Mining Money

"Nenu nabidda pellikai mittiki yabai velu appu teesukunna. Nelaku Rs. 6,500 kistu kattali. Appu tese timelo Rs. 2,500 kagital kharchu kattina. Eppudaina 3 nelal minchi latayate Rs.1,000 malli kagital kharchu kattala. Appukosam singareni valla jamanat kavali malli danikkuda kharchu bettali, nenu Rs.1,500 ichina. Varam samstollu unte ikkada tesukone vallamkadu.

(I took a loan of Rs.50,000 from a local finance company for my daughter's marriage. I paid Rs.6,500 monthly instalment for 12 months in addition to Rs. 2,500 as documentation charge. I also provided a mine employee's surety to avail the loan which cost Rs. 1,500. The finance company also charged me Rs.1,000 for failing to pay three instalments on time. I would not have taken a loan from thee finance company, had MFIs been there)" – Narsamma, Ramakrishnapur near Singareni Collieries Company Limited, Andhra Pradesh. Narsamma pays Annual Percentage Rate (APR) of 110% for the loan she borrowed from the local finance company.

Girigiri Loans

Daily finance is called *Girigiri vaddi* in local parlance. Respondents said that many people have started daily finance companies in the last two years. Daily finance has become very attractive business and people who have even a Rs.100,000 started daily finance businesses, that are running successfully as there is a huge demand for credit.

"We have taken have taken loans from daily finance companies due to lack of any alternative source. They charge upfront interest of Rs.1,500 for Rs.10,000 and we have to pay Rs.100 per day for 100 days"- Rani, Manchiryal

Figure 23 Trends in Use of Financial Services

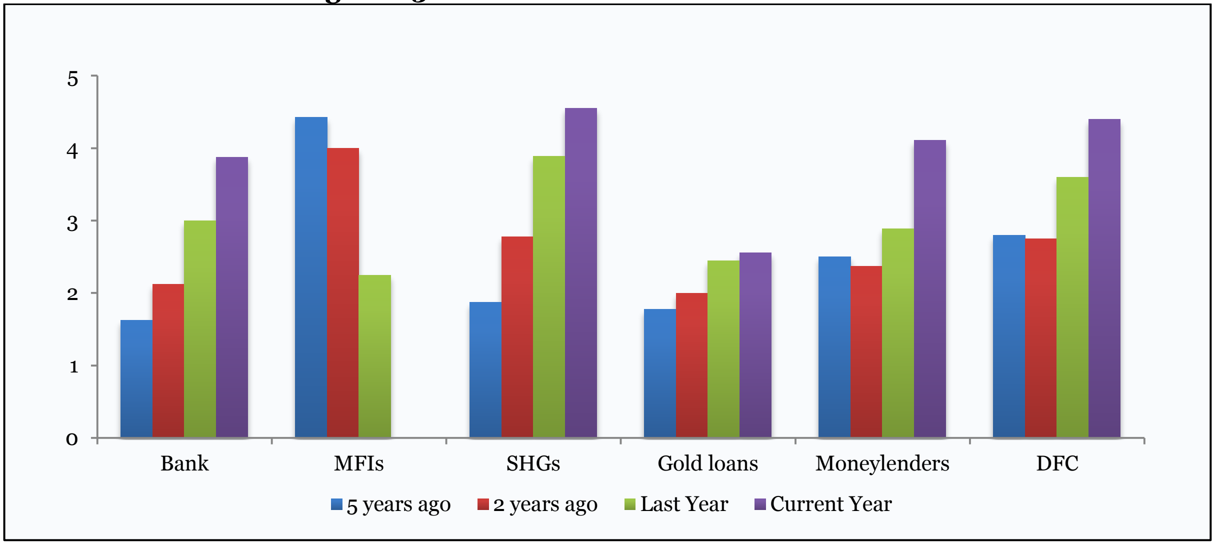


Figure 23 shows the trend in use of different financial institutions available to the community over a period of five years. During the session, the respondents were asked to score the service providers according to the level of usage in four different time periods- current year, last year, 2 years ago and 5 years ago respectively on a scale of 5. A higher score in a particular year indicates more usage of the particular institution. It should be noted that a higher score does not represent that the service provider was well known or a preferred one; higher score is a representation of greater use. Use could be due to easier accessibility or fewer other alternatives. The results provide a clear picture of changes in use trends for various financial service providers.

Findings

The graph above represents an average score of the availability/use of service providers for each year. Every financial institution except MFIs has a positive slope with the passage of time. There has been a steady rise in usage of each type of service provider except MFIs which are completely absent for almost 2 years. The scores of each financial institution are analysed below to understand the reasons behind the trend.

Banks: Credit accessibility through banks was not easy 5 years back and is reflected in the low usage scores. People opined that at that time, there were few bank branches; and banks were not forthcoming in providing credit. But in the last two years particularly with the decline of MFIs, banks have increased the credit availability either through direct lending or through other channels like SHGs, which has made it easier for people to access credit from banks.

In general, people prefer credit from banks for crop and other agriculture related loans. Loan amounts for crops have increased 2-3 times per acre in the past 5 years. So, many people with agricultural land have started availing bank loans. In addition, there is also an option to avail loans against gold from banks at a very low interest rate of 7% per annum. Rescheduling of loans and loan waivers are other (indirect and unpredictable) incentives which have pushed bank linkage.

SHGs: In the 2011 study, SHGs stood second (after moneylenders) as the most accessed source of finance. But in this study SHGs emerge as the most accessed source of finance. This is because credit amount accessed through SHGs has increased with better bank linkage and the increase in the internal corpus of savings of SHGs and their respective federations. In addition, the State Government has rolled out other benefits like insurance, interest rate subsidy, and scholarships for SHG members.

MFIs: MFIs were efficient and provided credit promptly. They were a major source to meet the regular (and sometimes the emergency) financial needs and this is clearly reflected in high score for MFIs till 2 years back. The use of the MFIs was higher due to their fast pace of expansion and availability of easy credit. But post the Andhra crisis MFIs do not feature at all. SHGs and banks have partially filled the void following the departure of the MFIs, but other formal and informal sources like moneylenders, gold loan companies and DFCs have gained more ground due to easy accessibility.

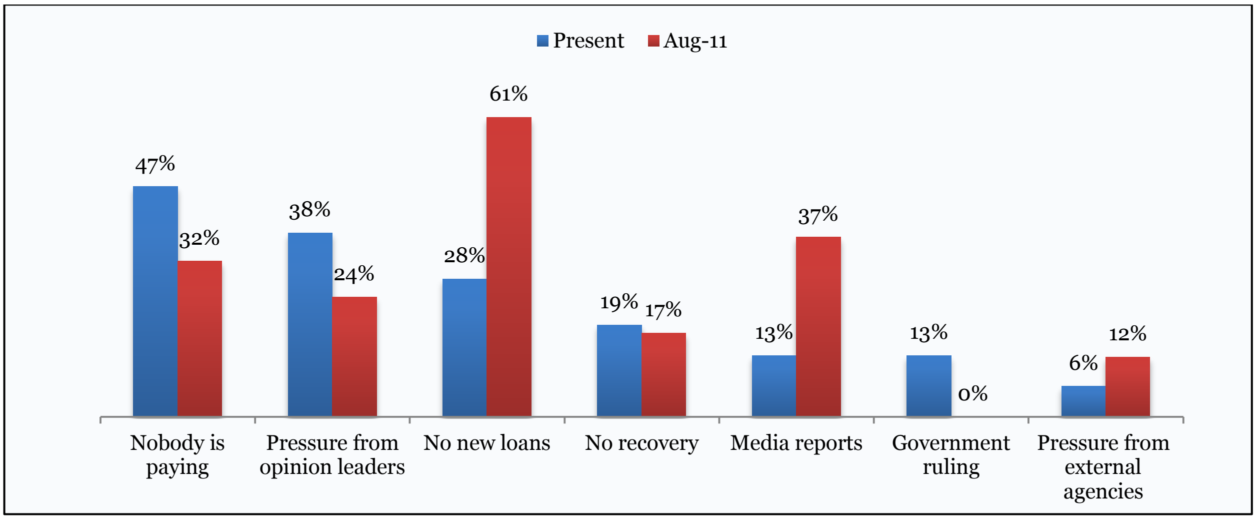
Daily Finance Corporation: There has been a rapid increase in the access of DFCs especially after the MFI crisis. Their influence as a credit institution was very limited when MFIs were doing well. But their use has grown significantly in the last one and half years amongst the low income segment. A major reason for this is easy availability of credit without any collateral. Also, like MFIs, DFCs provide door step service for disbursement and collection. The loan term is convenient with daily and weekly repayment schedules. The downside with DFCs is they provide loan only in the range of Rs.2,000-Rs.3,000 (going up to Rs.10,000 for the few people who they think are highly reliable), so the masses who need higher loan amount, have to turn to other institutions like gold loan companies and moneylenders.

Gold Loan Company: Another credit institution that has made in roads after the decline of the MFIs is gold loan companies. Both formal lenders like banks, Muthoot Finance and Manappuram as well as informal lenders (within the village) have increased their portfolio, with people accessing their services to get credit for various needs by pledging gold. In addition, gold loan companies have tailored their business to the needs of people by providing loans quickly, offering flexible access timings, easy instalments, lower interest rates (than moneylenders) and various sizes of credit to suit requirements for different needs of the clients. The major impediment for the poorer segment to access gold loans is the lack of gold to pledge.

Moneylenders: There has been a steady rise in the use of the local moneylenders t. Moneylenders are, however, not preferred compared to SHGs and gold loan companies. The rates that moneylenders charge are higher than those of a gold loan company or other formal and informal channels, so people use them only as a last resort for credit. However, they now play a much larger role in the sources of credit for people than they did earlier.

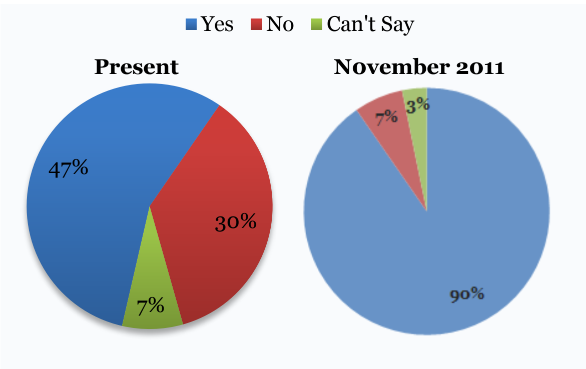
Unwillingness to Repay MFI Loans and Reasons Thereof

Figure 24. Reasons for Not Repaying MFI Loans



In 47% of the sessions, respondents were willing to repay the MFI loan. This has come down dramatically from 90% in the 2011 study. One prominent reason cited was that nobody is certain if the MFIs will return and start functioning again, after the government's ruling. Due to this uncertainty, the majority of the MFI clients are not willing to come forward to repay.

Figure 25. Willingness to Repay



Among the clients who were not willing to repay (in 30% of the sessions), the main reason cited is that nobody in their neighbourhood is repaying the loan. This demonstration effect has increased from 32% of the sessions in the previous study to 47% in the current study.

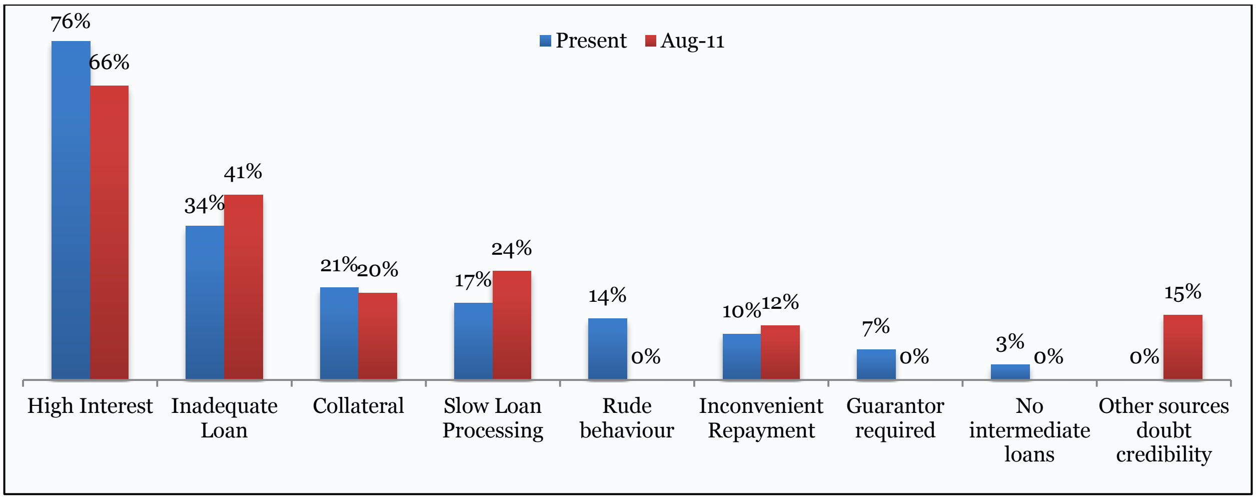
In 28% of the sessions clients refused to repay because no new loans are available and so there is no incentive to repay. This has more than halved from 61% in August 2011 study, when people thought that new loans still might be available. Now most people do not believe that the MFIs will return – so the question of new loans scarcely arises. In fact, those who did repay their previous MFI loan on time believe that they committed an error by doing so. This created a ripple effect and many borrowers started defaulting on the loans. Opinion leaders from political and social fields have also put pressure on MFI clients to default.

In 19% of the sessions, people said that MFI staff has not approached them for repayments. In some cases, people mentioned reacting to media reports, stating MFIs' harassment of the clients and the exorbitant interest rates charged by them. This has resulted in many clients having a fear of facing MFIs to repay.

Media, especially local language media, played a key role in influencing the clients to not repay MFI loans by highlighting the alleged suicides due to harassment by MFI field staff. In the August 2011 study, respondents in 37% of the sessions did not repay because of media reports. This came down to 13% of the sessions in the current study as the media have dedicated less time to this issue.

Pain Points in Accessing Credit from Alternate Sources

Figure 26. Pain Points in Accessing Credit from Other Sources



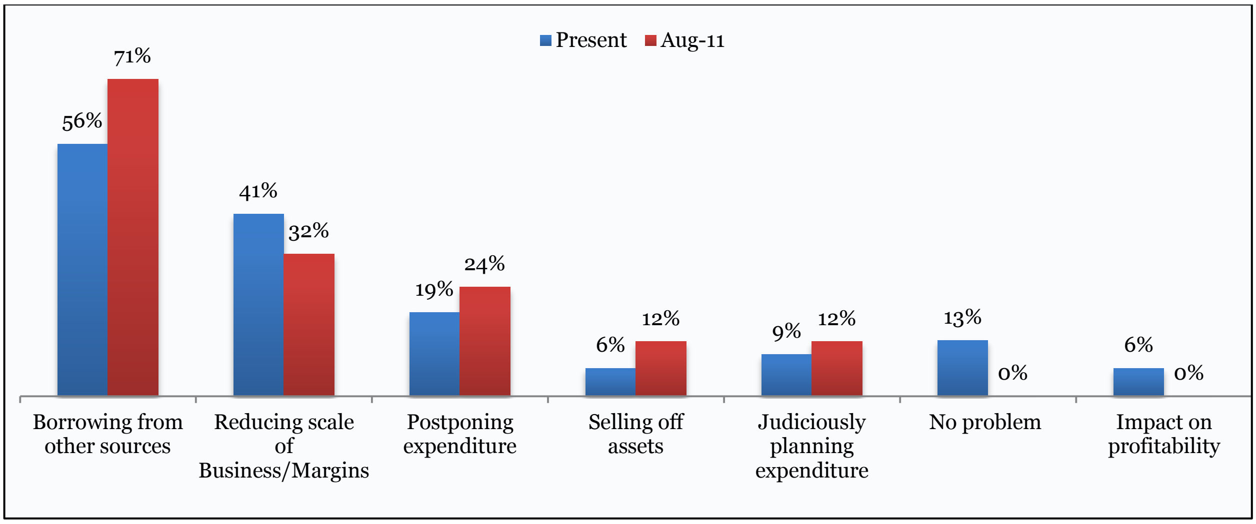
High rate of interest still remains the biggest pain point in accessing credit from alternate sources. Respondents in 76% of the sessions mentioned high rate of interest as a pain point in the current study. This has increased from 66% of the sessions in the previous study. This coupled with the fact that the inadequate loans as a pain point has reduced (in 34% of the sessions as compared to 41% in the previous study) clearly suggests that clients are having to meet their credit requirement through loans from moneylenders and DFCs even at higher rate of interest.

In21% of the sessions, respondents mentioned that they faced issues with pledging collateral, especially for gold loans and bank loans. In some cases moneylenders also demand gold and other assets as collateral before disbursing the loan. Apart from that respondents had to bear with the rude behaviour (14%) of the service providers and slow processing time (17%).

Refer to section on relative preference rankings for a detailed analysis of performance of various service providers on major attributes. One of the respondents noted:

> *"Memu ilane undalani anukunte maku appulu avasaram ledu kani memu unnavallam kavalante maku pettubadi kosam appulu kavali". ("If we want to live like this (in poverty) we do not require loans, but if we want to come out of poverty and become rich we need loans to invest in our business")*

Figure 27. Coping Mechanisms



Difficulty in availing credit from alternate sources has impacted the economic activity of the respondents. But the effect of crisis seems to have reduced over the last two years. Clients seem to have accepted the reality that MFI loans are hard to come by. Respondents mentioned that they postponed their expenditure (in 19% of the sessions) due to lack of sufficient credit from alternate sources. This has reduced from 24% in the previous study mainly due to increased availability of loans alternate sources. In 41% of the sessions, respondents affirmed that they reduced the scale of their business or completely shut it down for want of credit. The same factor featured in 32% of the sessions in the previous study. Due to the high rates of interest especially from moneylenders and DFCs, interest cost is now a major component of expenditure, eating into profit margins of the borrowers. In some sessions, respondents have sold off their assets such as house, cattle, gold etc.to meet their productive as well as non-productive expenditure.

It is interesting to note that 13% of the respondents mentioned that they do not face any problem in the absence of MFIs, while this factor did not figure in the previous study. Respondents realise that it is already two years since the MFIs closed down their operations and they have started to adjust to life without them. They think that the prospect of MFIs returning to their areas to lend is bleak as the government is not favourable to MFIs; and there is huge loan outstanding which is almost impossible to recover.

Recommendations

Recommendations to MFIs

Transparent Pricing: Clients are not sure about the effective interest rate charged by MFIs and want them to follow simple methods of calculating the interest amount that they can comprehend easily. After the crisis many poor people have started viewing the interest rate charged by MFIs with suspicion and this notion needs to be dispelled.

Changes in the Group Responsibility: Members prefer individual responsibility for the loans they have taken, even though the groups are used for loan disbursement and repayment collection. MFIs can consider offering individual loans with collateral to longer-term, high value, customers with an established track record who prefer individual liability. For non collateralised loans, MFIs need to reinforce the joint liability concept among the borrowers through intensive group resource training and centre meetings (rather than doing it hastily in aggressive pursuit of targets).

Cordial Relationships: MFIs should maintain cordial relationships with other stakeholders in the sector, including State Government, regulators, media and clients. They need to be transparent in their work, maintain high corporate governance standards, and adopt client protection and responsible finance practices to gain credibility among stakeholders. MFIs also need to show case their work and the impact they create to the stakeholders through various platforms such as policy workshops, industry conferences, newspapers and other communication tools.

Self-Regulation: MFIs should develop a self-regulating authority that is strong and influences its member organisations to follow fair trade practices with clients and fellow competitor MFIs alike. Practices such as multiple lending, coercive recovery practices, staff behaviour and so on can be addressed by having a strict and monitored code of conduct for all member organisations. At the organisation level, MFIs should adopt a code of ethics and professional principles on various aspects such as lending policy, staff behaviour, recovery practices, and adhere to it.

Product Development: The mono-product offering and standardised processes of the MFIs do not match the needs of the clients. As a result clients drop out or face discomfort in matching their cash flows with their loan repayment obligations. To offer client centric products and to create positive impact in the lives of the poor, MFIs should constantly seek client insights through market research, customer satisfaction monitoring and systematic product development approaches.[21]

Re-engineering Delivery Channels: Global experience demonstrates that a shift towards individual lending products is happening. This will also require refining delivery mechanisms in addition to new product development.[22] MFIs will need to leverage technology to optimise the value proposition for clients and to achieve competitive edge through increased client loyalty and reduced operational costs. In some places in the world, MFIs are shifting towards digital finance solutions to replace routine field tasks like disbursements and collections with these technology-driven solutions.[23] In the long run, implementing such solutions will lower the operational cost for MFIs and make them more competitive in their target segment.

Explore Opportunities to become Business Correspondent (BC) to Banks*:* MFIs can explore opportunity to become BCs[24] of banks so that they can use their existing resources (staff and knowledge) to provide a broader range of financial services to their clients. MFIs can also explore opportunities to act a distributor for micro pension and life insurance schemes to enhance their revenues.

Recommendations to the Government

Conducive Environment: Rather than having regulations that effectively outlaw proper functioning of MFIs, the government should promulgate regulations that create a level playing field and provide conducive environment for all forms of formal financial service providers to co-exist.

Alternative Sources of Credit: If the government wants to rely on the *Sthree Nidhi* as a

[21]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"

[22]See *MicroSave* Briefing Note 88 "Breaking the Barriers: Market Expansion through Individual Lending"

[23]SMEP in Kenya was the first MFI to link into the M-PESA platform for group loan repayments. See http://www.smep.co.ke/mpesa.html
Musoni is the first MFI in the world to go 100% mobile, using mobile money transfer services for all loan repayments and disbursements. See Musoni

[24] See *MicroSave* research paper "Are Banks and Microfinance Institutions Natural Partners in Financial Inclusion?"

suitable alternative to the MFIs and save poor people from the clutches of money lenders, it will have to look at ways to infuse huge capital in the bank. Looking at the lacklustre response of the *Mandal Samakhya*s and banks as well as the financial position of the State Government, the options for capital infusion seems limited. Absent significant capital infusion, the State Government will need to revisit this part of its strategy to reduce the dependence of the poor on moneylenders. Currently, the absence of MFIs and the limited lending by banks and *Sthree Nidhi* has driven the poor right back into the arms of a range of moneylenders charging high interest rates.

Recommendations to Regulators

Avoid Dual Regulation*:* The regulator should influence the State Government to exempt NBFC-MFIs from "The Andhra Pradesh Microfinance Institutions (Regulation of Money lending) Act, 2010" and allow them to resume operations in the state. The regulator should take guidance from the recent interim order by the Supreme Court of India allowing SKS Microfinance to restart operations in the state. [25]

Close Monitoring: It is said that the root cause of the AP crisis was the trouble that happened in Krishna District during 2005-06 where the district administration closed 50 branches of four leading MFIs citing usurious interest rates, coercive collection practices and profiteering. This issue was settled with the intervention of Reserve Bank of India (RBI) and the central government, and assurances by MFIs to abide by a code of conduct. After that no one was assigned the task of monitoring the MFI practices. The issue came to the fore again in October 2010, when the Government of Andhra Pradesh promulgated an ordinance to protect the women SHGs from exploitation by the MFIs in the state. To avoid a repetition of the crisis in other parts of the country, a mechanism of close monitoring of MFI practices is required to address the issues before they become major problem.

***Continuous Loan to SHGs*:** SHGs have to spend 2-3 months after closing one loan account to get a repeat bank loan. To meet their credit needs in the intervening period, SHG members are forced to take loans from other sources like moneylenders, who charge higher interest rates.

Deficient services, especially for poor and uneducated customers, is not only limited to Andhra Pradesh. This is already and become ever more endemic as the SHG movement expands further across various states. To respond to this, the regulator should consider appointing an ombudsman to specifically focus on problems faced by SHG women.

Incorporate Changes in the Act as per the Emerging Needs: The regulator can initiate periodical studies to understand the client needs, experiences and demand, and MFI practices. This would allow it to undertake changes under the Act, according the evolving situation and needs. Such changes will help the Act to stay relevant and client responsive.

Reviving Credit Discipline: The current crisis has done irreparable damage to the credit discipline nurtured by MFIs over the5-6 years to 2010. Some of the findings of the current study also corroborate this. Every stakeholder (i.e. MFIs, government, regulator, media and even clients themselves) has played a role in the dismantling of credit discipline. It will now require collective efforts from all these actors to revive the much-needed discipline that is core to the success of financial services industry. While MFIs need to become more transparent and client friendly, regulators will have to come out with robust regulations, government will have to support MFIs to build a positive image, media will have to be more responsible and supportive, and most importantly clients will have to impose self-discipline for their own good.

Grievance Redressal Machinery & Credit Bureau: Establishing grievance redressal procedures, mandatory enrolment with credit bureaus and enforcing the code of conduct through industry associations are also essential steps. Better information sharing within the industry through credit bureaus will go a long way in rebuilding credit discipline (though some question their role as a "magic bullet" in this context). The draft guidelines for MFIs seek to address many of these issues. Apart from state and national level councils, as proposed in the bill, regulations should also consider setting up grievance redressal bodies at district/*mandal* level for quicker redressal of client complaints.

[25]See SC gives interim order allowing SKS to resume ops in Andhra Pradesh

Case study I – Village Crop Chits

Saradamma lives in Mailaram village in Medak District in Andhra Pradesh. She owns two acres of land and grows paddy and vegetables for a living. She borrowed from MFIs regularly to buy agriculture inputs. She preferred MFIs over other sources as she got the loan within one week after applying for it. She also liked the fact that MFIs offered loans at cheaper interest rates when compared to moneylenders. Sardamma also took loans from MFIs to meet the expenses of her elder daughter's marriage.

After the AP MFI crisis, Sardamma faced problems to access credit. But as time passed, she started adjusting to the new environment without MFIs. Sardamma took SHG bank linkage credit and also started participating in the village crop chits.

Sardamma, along with other many other women in her village find crop chits to be very suitable for their cash flow needs. She pays contribution towards the chits every six months, which coincides with crop harvest. As she gets money from the sale of harvest she can easily manage to pay the chit contribution. Sardamma has eight chits totalling to Rs.40,000 which she pays every six months. She is saving money for her younger daughter's marriage through these chits.

Modalities of the chit

- Number of members in the group - 20
- Contribution per member – Rs.5,000
- Total contribution amount Rs.100,000
- Contribution frequency – six months

Auction Method

- The group meets every six months to pay the contribution and to auction the total contribution amount collected at the meeting.
- The auction process identifies the person who offers the maximum discount for winning the total contribution amount. For example if the highest bid in the auction is Rs.40,000 the winner gives a discount of Rs.40,000 and takes Rs.60,000.
- The auction discount amount (Rs.40,000 in this example) is distributed among the remaining members of the group at an interest of 2% per month for six months till the next contribution date.
- If the remaining members do not require any loan, the auction discount amount is carried forward to the next contribution meeting.
- If any member wants a higher loan amount then the group decides and gives a higher

loan amount to the member at the same interest of 2% per month.

- After three to four contributions, when the auction discount amount equals Rs.100,000 (which is the total contribution amount) , the auction is conducted twice during the meeting.

The winner of the auction takes the fund and signs the acknowledgement of receipt of funds. A guarantor guarantees timely payment of the remaining contribution instalments by the auction winner.

The group receives income from the discount offered by the auction winner and also from the interest on loans given to the members from the auction discount amount. The income is not distributed among members, but the members save instalments if all the members draw money before the stipulated time. (For example, in a 20 members group the auction period would be 20 six monthly payments. So if all the 20 members participate and draw money before the scheduled 20 six monthly payments, they save on the instalments).

Case study II – PushpaSarees and Dress Materials

"Nenu naa aayanaku Victor bike kooda konipettina saar."

(I purchased a bike for my husband with the profits from my saree business)

Pushpa is an enterprising women residing in Mahbubnagar Colony in Guntakal, Anantapur District. She benefitted a lot from MFI loans.

Pushpa had a flourishing saree business. Her business prospered and grew rapidly with the presence of MFIs. Pushpa borrowed from MFIs to buy sarees, lehengas and other dress materials from Surat, Ahmedabad, Mumbai, Pamidi and other places and sold these to the women in her community during MFI centre and SHG meetings. She bought the dress material at Rs.150-200 per piece and sold it in her community at Rs.250-300 making a profit of Rs.100 per sale. She took loans of Rs. 40,000 to Rs. 45,000 from two MFIs to fund her purchase of sarees from the wholesale market. Pushpa made good profits from the business. She repaired her house, married her daughter and she even gifted a motor cycle to her husband.

Now in the absence of MFIs, she is not able to get enough credit to fund her bulk purchases in the wholesale markets of Surat and Mumbai. As a result her business has reduced drastically. She has almost closed down her business as she has to purchase dress material from the retail market and the profit margins are very thin.

Case study III – Interview with Mr. Prabu Das, CEO CReSA

Mr. Prabhu Das started Centre for Rural Reconstruction through Social Action (CReSA) as an NGO in 1977 to serve the area of Diviseema in Krishna District in Andhra Pradesh which was struck by tidal waves. He started MFI operations in the 1997 with the help of Grameen Bank, Bangladesh. The MFI operations slowly gathered pace and at the time of the crisis CReSA was operating in two districts of East Godavari and West Godavari. By 2005 all the major MFIs entered into the area and started lending. At the time of the crisis there were 14 MFIs operating in the area.

Borrowing:

- CReSA had exposure to six banking and finance institutions at the time of the crisis i.e. ICICI Bank, HDFC Bank, Axis Bank, FWWB, Indian Overseas Bank, Bank of India, SIDBI and Reliance Commercial Finance.
- The loans are yet to be paid and one of the lenders has sued the MFI for non-payment of dues.
- For smaller MFIs like CReSA, banks have rescheduled the loans only for one year.

Where are clients borrowing from in the absence of MFIs?

- The clients are primarily borrowing from moneylenders at an interest rate of 5%-6% per month.
- The banks are also not coming forward to lend fearing defaults/delays in repayment.
- In some cases staff of the MFIs are conniving with group leaders and are offering individual loans of smaller denominations to the MFI clients.
- Group leaders among MFI clients with political influence are also acting a source of finance for members of the community.

Impact of non-availability of MFI loans:

- Many of CReSA's MFI clients have sold their dairy business because of lack of adequate capital to support them.

Reasons for the downfall of MFIs:

- ***Multiple Borrowing***: With the advent of bigger MFIs in the market, the competition grew tougher. MFI loan officers started lending to the clients not on the basis of their requirements, but on the basis of the targets given to them by their bosses. This led to the phenomenon of multiple lending with every client borrowing from 3-4 MFIs.
- ***Media Reports:*** Media played a precipitating role in the downfall of MFIs. By exaggerating the negative MFI practices and by showing certain bad practices as a general industry phenomenon, media (both print and TV) was able to grab the attention of the viewers and spread bitterness against MFIs.
- ***Bad practices by certain big MFIs:*** Practices like target based lending, no loan utilisation checks, charging upfront interest rates, lack of transparency in calculation of interest rates and charges, all played key role in the MFIs' downfall.

Impact of the crisis on CReSA:

- There are hardly any repayments happening now. The recovery rate is only 0.1%-0.5%. At present CRESA has loan outstanding of Rs.240 million.
- At the time of the crisis CReSA had 24 branches. Now the branches have been downsized to 8.
- The MFI has reduced the branch staff from 5 to 2 in every branch as no MFI operations are taking place.

Coping Mechanism:

- The MFI has registered a MACs society under the APMACS act of 1995. Now the lending is happening in small amounts through the savings contribution of the MACS members.
- The MFI is also acting as a distributor of micro-insurance schemes of LIC and other insurance companies in its area of operation.
- The MFI is also looking at becoming a Business Correspondent for the banks operating in East and West Godavari.