

# Access to Credit in West Bengal Post Microfinance Crisis



*MicroSave*

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## TABLE OF CONTENTS

<b>EXECUTIVE SUMMARY .....</b>	<b>1</b>
<b>INTRODUCTION .....</b>	<b>4</b>
<i>Background of the Study.....</i>	<i>4</i>
<i>Microfinance Sector in West Bengal.....</i>	<i>4</i>
<b>RESEARCH OBJECTIVE AND METHODOLOGY.....</b>	<b>7</b>
<i>Objectives of the Study.....</i>	<i>7</i>
<i>Methodology – Tools Used and Sampling.....</i>	<i>7</i>
<b>RESPONDENT PROFILE.....</b>	<b>8</b>
<b>SOURCES OF CREDIT USED AND PURPOSE .....</b>	<b>10</b>
<i>Sources of Credit Used – Present .....</i>	<i>10</i>
<i>Sources of Credit Used – Past.....</i>	<i>12</i>
<b>CLIENT PREFERENCES – MFI Vs. OTHER SERVICE PROVIDERS .....</b>	<b>14</b>
<b>MFI - LIKES AND DISLIKES .....</b>	<b>18</b>
<b>SHG - LIKES AND DISLIKES .....</b>	<b>19</b>
<b>TRENDS - CHANGES IN USAGE OF CREDIT SOURCES.....</b>	<b>20</b>
<b>IMPACT OF THE MICROFINANCE CRISIS IN WEST BENGAL .....</b>	<b>22</b>
<i>Awareness amongst Clients .....</i>	<i>23</i>
<i>Impact on Clients .....</i>	<i>23</i>
<i>Credit Management and Coping Mechanisms Undertaken by Clients .....</i>	<i>24</i>
<b>RECOMMENDATIONS.....</b>	<b>26</b>
<b>CASE STUDIES – Importance Of MFI Loans For Low Income Segments .....</b>	<b>29</b>
<b>CASE STUDY – Credit Management During Lack of MFI Loans .....</b>	<b>30</b>

**ABBREVIATIONS**

AMFI-WB	Association of Microfinance Institutions – West Bengal
AP	Andhra Pradesh
BC	Business Correspondent
BPL	Below the Poverty Line
DRDA	District Rural Development Authority
FGD	Focus Group Discussion
FSTA	Financial Sector Trend Analysis
IDI	In-Depth Interviews
MFI	Microfinance Institution
MFIN	Microfinance Institutions Network
NABARD	National Bank for Agriculture and Rural Development
NRLM	National Rural Livelihood Mission
PRA	Participatory Rapid Appraisal
RBI	Reserve Bank of India
RPR	Relative Preference Ranking
SGSY	Swarnajayanti Gram Swarozgar Yojana
SHG	Self-Help Group
SHPI	Self-Help Group Promoting Institution

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## EXECUTIVE SUMMARY

Microfinance crisis of Andhra Pradesh has affected the sector across India, including the state of West Bengal. The MFIs in West Bengal were not able to disburse new loans because the banks significantly decreased their exposure to the sector. MFIs such as SKS and BASIX have stopped lending in most parts of the state. However, there is no discernable adverse affect on group discipline or repayment rates despite the lack of increase (or decrease) in the loans disbursed. This is mainly due to the conscious efforts made by MFIs to create awareness about the ongoing crisis amongst the clients, and educate them about the benefits of group discipline and prompt repayments. MFIs still have good relations with its clients, and group integrity and discipline is better in West Bengal as compared to other mature markets such as Andhra Pradesh.

At the industry level, the Microfinance Institutions (Development and Regulations) Bill has brought some clarity to the sector. Banks have resumed lending; however, they have become cautious and selective in lending to the MFIs. Banks have also significantly reduced the size of their loans to MFIs. Difficulty in raising funds in addition to the cap on margins has made it difficult for small and mid-sized MFIs to survive and operate in a sustainable manner. Due to this, some MFIs have started to consolidate their operations. The recent buyout of Arohan's portfolio by Intellecash in 2012 was a move in this direction.<sup>1</sup> Overall, the growth rate of MFIs has slowed down. However, bigger MFIs such as Bandhan have been able to secure adequate funding and investor confidence owing to its wide outreach and low cost of operations.<sup>2</sup>

The SHG movement in West Bengal has not been able to emulate the success of Andhra Pradesh. The SHG programme is still at a nascent stage with limited institutional development. Even though West Bengal has the second highest number of groups linked with loans (11% of total groups), it is behind Andhra Pradesh (35% of total groups) by a huge margin. Also, the average SHG loan size is amongst the lowest in the country at a mere Rs. 3,450 per member and Rs.43,000 per group.<sup>3,4</sup> SHG members in the BPL category get loan-cum-subsidy under Swarnajayanti Gram Swarozgar Yojana (SGSY).

Given the above context, *MicroSave* conducted a study in July 2012 to understand the impact of the microfinance crisis on clients' borrowing behaviour in West Bengal. The objective of the study was to assess the changes in the level of access and usage of financial services especially micro-credit post microfinance crisis. *MicroSave* conducted a similar study in Andhra Pradesh, the epicentre of the crisis, in order to draw a comparison and give recommendations to the various stakeholders for cohesive growth of the sector.

### Findings of the Study

#### Current Status:

- Some big MFIs such as SKS, BASIX, and Ujjivan have stopped lending in many areas. Bandhan which is the biggest MFI is still lending as it has being able to secure adequate funds.
- For MFIs that are still lending, the loan amounts have been reduced or at least have not being increased compared to previous loan cycle (mentioned by respondents in 50% of the sessions).
- Most of the respondents met during the research were aware of the reasons for reduced lending because MFIs have taken an initiative to create awareness. Wherever clients were not aware, there was uncertainty and dissatisfaction because they did not receive loans despite repaying on time.

#### Sources of Credit Used:

##### Formal Sources – Importance of MFI Loans for Clients:

- Loans from MFIs is one the most important sources of formal credit for the low-income segment in West Bengal. In 79% of the sessions respondents said that poor use MFI loans to meet their credit requirements.

<sup>1</sup>Refer to "[IntelleCash-Arohan: Leading the Way in Consolidating the Microfinance Industry in India](#)", Intellecash, 2012.

<sup>2</sup> In 2011, Bandhan raised Rs 1.35 billion (USD 30 million) from the International Finance Corp (IFC), in a private-equity deal. Refer <http://www.ifc.org/ifcext/spiwebsite1.nsf/1ca07340e47a35cd85256efb00700cee/7EE3CA5FCCDC2E83852578170069EBBC>.

<sup>3</sup>Srinivasan, N., "Microfinance India State of the Sector Report", Ch 2, Pg. no. 15 and 18

<sup>4</sup>Refer to "[Proceedings of the 114th State Level Bankers' Committee Meeting](#)"

- Apart from this, SHGs is another major formal source of credit and was mentioned by the respondents in 48% of the sessions. However, most of them said that the loans offered are not adequate to finance livelihood activities. A number of these SHGs are formed under SGSY.
- Most low income segment clients are reluctant to access banks directly due to strict eligibility requirements and cumbersome procedures. Some of the respondents had taken loans from HDFC through its microfinance branches using joint liability groups (mentioned in 19% of the sessions).
- Given the lack of access to bank loans and the limited financial support provided by of SHGs, MFIs are an important source of micro-credit for the low-income segment.

#### *Informal Sources:*

- Clients prefer to resort to informal sources such as pawn brokers/gold loans(58% of the sessions), moneylenders (35% of the sessions), and friends and family (25% of the sessions) in case of emergencies. Some clients also take short term credit from suppliers to finance purchase of goods (4% of the sessions).
- In the past, informal credit sources were used to meet all credit requirements. However, now they are used only in case of emergencies. People have always preferred gold loan over money lenders because of money lenders' high interest rates (up to 10% per month) and aggressive behaviour.

#### **Client Preferences:**

- *MFI Loans– Likes and Dislikes:* Clients find MFI loans convenient as they can be repaid over time in fixed weekly instalments. In 67% of the sessions, this was liked by the respondents. However, due to the ongoing fund crunch there have been delays in disbursement of MFI loans and loan amounts are not adequate. This was mentioned as a pain point in 25% and 50% of the sessions respectively. Another dislike about MFI loans is the loan tenure (mentioned in 23% of the sessions) which has been increased to 104 weeks for any loan greater than Rs.15,000.
- *SHG Loans – Likes and Dislikes:* Clients like SHG loans because of the low interest rates charged (mentioned in 40% of the sessions). They also like that they can get quick loans through internal group lending. They also like that they can delay the loan tenure if required (mentioned in 23% of the sessions). However, in 25% of the sessions, respondents mentioned inadequate loan size as one of the major drawbacks of SHGs.
- *Informal Source – Likes and Dislikes:* Clients prefer informal sources when they require quick loans as the processing time is negligible compared to formal sources. However, the associated high interest rate is one of the biggest pain points of informal credit. Another pain point is the loan tenure which is not pre-fixed and repayment frequency which is generally bullet payment for principal amount. Due to this, clients find it difficult to repay the loans on time and interest keeps increasing.

#### **Financial Sector Trends:**

- With the growth of MFI operations over the state in last five years, the popularity of informal credit sources has gradually reduced. Amongst the informal sources, gold loans are still popular and unlike earlier they are used only in case of emergencies.

#### **Coping Mechanism:**

- In 63% of the sessions, respondents said that they have to borrow from multiple sources (MFIs, SHGs, and informal) because of the absence of or lack of MFIs loans. In 27% of the sessions, they said that they have to resort to expensive sources such as gold loans and moneylenders. In 19% of the sessions, they said that they have postponed their expenses.

#### **Recommendations:**

##### **For Microfinance Institutions:**

To avoid a situation similar to the AP and to ensure high levels of client satisfaction, the MFIs need to:

- *Improve self-regulation* by adhering to a code conduct for lending and recovery practices, and ensure full disclosure to clients to allow MFIs to attract funders. Industry associations need to ensure that the member MFIs adhere to the code of conduct.
- *Develop and implement client protection principles and standards* and put in measures to avoid over-indebtedness, coercive collections, breach of client privacy, and frauds.<sup>5</sup>
- *Lend responsibly* to the clients based on client appraisals and credit history checks (based on client records shared with the credit bureaus). With regards to credit bureau, issues related to lack of digitisation of MFI data, lack of standardisation in data capture, and incomplete data needs to be addressed.
- *Ensure client awareness* about the current situation of the sector in order to retain client trust.
- *Maintain cordial relationships with key stakeholders* such as the state government, regulator, funders, general public, and media to showcase the importance of the sector and take feedback on any issues or complaints.
- *Offer a wider range of products and services by becoming business correspondents* for a bank. Given the increasing competition from banks, it is inevitable for banks to think of ways to offer multiple financial products in order to meet their client's needs.
- *Build a grievance handling mechanism* at the institution level to ensure client issues are resolved in time.
- *Expand the scope and role of state level microfinance association* to ensure adherence to code of conduct by member MFIs, share best practices, initiate constant dialogue with key stakeholders, conduct state level researches to understand customer needs, and push MFIs to offer quality products.

#### **For State Government, Banks and Funders:**

- *Promote financial education for clients* about their rights, responsibilities and redress, and create awareness to enable them to better understand the products offered and make informed choices.
- *Build capacity of SHGs and train key staff* promoting the SHG programme by learning from other successful programmes.
- *Monitor MFI activities* to ensure that they offer appropriate products and services to meet clients' needs and lend responsibly. Banks and funders can incorporate principles of responsible finance and client protection to screen MFIs for their lending activities.<sup>6</sup>

#### **Regulators**

- *Push for greater transparency* by developing policies that incentivise MFIs that ensure transparent operations and governance, and submit complete information to credit bureaus. They can incentivise this by providing relatively easier access to funding.
- *Develop a mechanism to graduate older MFI clients* whose incomes no longer fall in the income limits prescribed under the regulations.

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<sup>5</sup> Refer to SPTF's [Client Protection Principles](#).

<sup>6</sup> Refer note for more details – *MicroSave Briefing Note# 125 "Developing a Tool to Assess Client Protection"*

## INTRODUCTION

### Background of the Study

The microfinance crisis which began in 2010 with the introduction of the Microfinance Institutions (Regulation of Money Lending) Ordinance by Government of Andhra Pradesh (AP) has decelerated the rapidly expanding microfinance sector in India.<sup>7</sup> While the act was applicable only to microfinance institutions (MFIs) in Andhra Pradesh, it had far reaching effect on the microfinance sector overall.

The strict provisions of the AP ordinance curtailed MFI lending in the state, which resulted in high rates of default and subsequent reduction in lending. This spiralled into a major crisis as a result of which banks and funders have been reluctant to lend to MFIs across the country. Institutions choked by unavailability of funds have halted their expansion plans. Even though banks have started fresh lending, and MFIs have reported increase in their gross loan portfolio towards the end of 2012, the overall growth of the sector has remained sluggish.

The Micro Finance Institutions (Development and Regulation) Bill,<sup>8</sup> introduced in May 2012 is expected to provide clarity on the future of the ailing sector and acknowledge its importance for the bottom of the pyramid or low-income market segment.

A study conducted by *MicroSave* in Andhra Pradesh in 2011 highlighted the importance of MFIs as a source of accessible micro-credit for the low-income segment. The study found that in absence of MFI loans, former MFI clients had to resort to high interest credit sources such as money lenders and daily finance corporations (with interest rates as high as 10-15% per month). Clients, who cannot afford credit at high rates, had to postpone their expansion plans or close their businesses.<sup>9</sup>

To further enhance understanding of the effect of the microfinance crisis on the clients two years after it started, *MicroSave* commenced another study in two states - Andhra Pradesh and West

Bengal. Both of these states have been home to some of the largest MFIs in India including SKS and Bandhan, and remain crucial epicentres of microfinance activity in India. This report presents the findings of the study conducted in West Bengal.<sup>10</sup>

### **The Micro Finance Institutions (Development and Regulation) Bill – Highlights**

- All MFIs required to obtain a certificate of registration under the Act.
- Mandatory disclosure of all inclusive price (comprising of the annual interest rate, processing fees or any other charge or fee levied) to each client.
- Minimum 75% of a NBFC-MFI's loan portfolio must be for income generation purposes.
- NBFC-MFIs required to maintain minimum 85% of their net assets as 'Qualifying Assets' which meets following criteria:
  - Borrowers' household income does not exceed Rs.60,000 and Rs.120,000 per annum for rural and urban households respectively.
  - Maximum loan amount per client has been restricted to Rs.50,000 with a limit of Rs.35,000 for the first cycle.
  - Repayment frequency can be weekly, fortnightly or monthly at the choice of the borrower.
  - Minimum tenure of 24 months when loan exceeds Rs. 15,000
  - No prepayment penalties
  - No collateral
- Cap on pricing including interest cap of 26%, margin cap of 12% plus processing fee of 1%.
- Provision of ombudsman for grievance handling.
- Possibility of permitting MFIs to mobilise thrift (small illiquid savings)

### **Microfinance Sector in West Bengal**

Microfinance institutions have been the frontrunners when it comes to providing financial services, specifically micro-credit to the low income segment in West Bengal. There are large MFIs such as Bandhan, Arohan, Village

<sup>7</sup>Refer to "[Microfinance Institutions \(Regulation of Money Lending\) Ordinance by Government of Andhra Pradesh](#)" for more details.

<sup>8</sup>Refer to "[The Micro Finance Institutions \(Development and Regulation\) Bill](#)" for more details.

<sup>9</sup>Ballem, Anjaneyulu, et al. "[What are Clients doing Post the Andhra Pradesh MFI Crisis?](#)", *MicroSave*, November 2011

<sup>10</sup> The findings of the study conducted in Andhra Pradesh are published in the report – "[Access to Finance in Andhra Pradesh Post Microfinance Crisis](#)", *MicroSave*, 2012





Financial Services, and Sahara Utsarga Welfare Society (SUWS), Village Financial Services Pvt. Ltd. (VFSPL), and Sahara Uttarayan that commenced their operations from West Bengal and are headquartered there. According to a CRISIL report in 2009, all these MFIs are amongst the 50 largest MFIs in India.<sup>11</sup>

Since the inception of microfinance programmes in 2006-07, major players such as Bandhan and Arohan have reported significant increase in the size of total disbursements and client base. According to the State of Sector Report 2011, West Bengal ranks seventh in MPI (Microfinance Penetration Index) and ninth in MPPI (Microfinance Poverty Penetration Index).<sup>12</sup>

The other major source of formal micro-credit is through Self-Help Groups (SHGs). The SHG-Bank Linkage Programme is still not stabilised in the state as compared to some of the southern states such as Andhra Pradesh and Tamil Nadu. The institutional of federations are still at a very nascent stage. This is evident from the fact that even though West Bengal has the second highest number of SHGs linked to credit (11.9% of all groups), the loan size is one of the lowest in the

country at a mere Rs.3,450 per member and Rs.43,000 per group.<sup>13</sup>

The government of West Bengal is also promoting SHGs under the *Swarnajayanti Gram Swarozgar Yojana* (SGSY) for below poverty line households. They receive a revolving fund from District Rural Development Authority (DRDA) and bank as a cash credit facility for livelihood purposes.<sup>14</sup>

**Table 1: Microfinance in West Bengal - A Snapshot<sup>15</sup>**

	2010/11	2009/10	2008/09
Total microfinance clients (in million)	10.85	10.09	8.26
Number of MFI clients (in million)	3.39	3.51	2.37
Number of SHG clients (in million)	7.46	6.58	5.89
MFI loans (Rs. Billion)	22.71	21.06	N.A.
SHG loan portfolio (Rs. Billion)	16.25	13.26	N.A.
Total microfinance loan (Rs.)	38.96	34.32	N.A.

<sup>11</sup> See CRISIL's "[India top 50 Microfinance Institutions: A Financial Awareness Initiative of CRISIL](#)", October 2009

<sup>12</sup>N. Srinivasan, N., "Microfinance India State of the Sector Report", Pg. No. 119, Access, 2011. MPI is calculated by dividing the share of the state in microfinance clients by share of population. MPPI is derived by dividing the share of the state in microfinance clients by share of the state in population of poor.

<sup>13</sup> Srinivasan, N., "[Microfinance India State of the Sector Report - 2011](#)", Ch 2, Pg. no. 15 and 18.

<sup>14</sup>Refer to [SGSY programme description](#) for more details

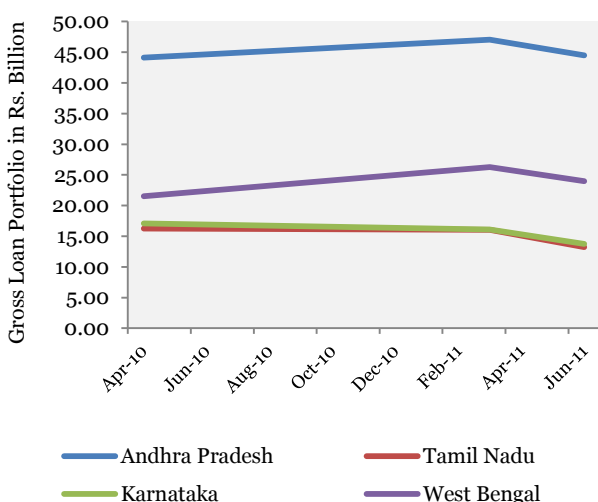
<sup>15</sup>Srinivasan, N., "Microfinance India State of the Sector Report", [2011](#), [2010](#), and [2009](#).

Billion)			
Loan outstanding per poor house hold	Rs.9,365	Rs.8,251	N.A.

improve access to formal financial services for the poor.

The above table shows that the overall microfinance activity in the state increased in 2010-2011, however, at a decelerated rate. Moreover, with the onset of the new financial year 2011-2012, states that had the largest exposure to microfinance such as Andhra Pradesh, Tamil Nadu, Karnataka and even West Bengal, started to register negative growth.<sup>16</sup>

**Figure 1: Gross Loan Portfolio of Top States from April 2010 to June 2011**



**Table 2: Rate of Growth in Gross Loan Portfolio of Top States**

State	FY 2010-11	Q1, FY 2011-12
Andhra Pradesh	7%	-5%
Tamil Nadu	-1%	-18%
Karnataka	-6%	-14%
West Bengal	22%	-9%

As MFI lending, which is one of the major sources of formal credit for the low-income segment, has diminished, *MicroSave* sought to understand the changes in client’s credit behaviour and their coping strategies. The findings of the study have been used to give recommendations to key stakeholders such as MFIs, government, and regulators to promote a vibrant and healthy microfinance sector and

<sup>16</sup>Shyamsukha, Rahul, “India: Post Microfinance Crisis Results”, MIX Market, November 2011

## RESEARCH OBJECTIVE AND METHODOLOGY

### Objectives of the Study

The research was conducted to understand the level of access to financial services, especially micro-credit services, for the low-income segment in West Bengal after the microfinance crisis. The objectives of the study were to gain an understanding of the following:

1. Sources of finance accessed by the low-income segment and the change in its level of use and access over time, especially after the microfinance crisis.
2. Client preferences for the various sources of finance available and reasons for these preferences.
3. Coping strategies adopted by the microfinance clients in absence of or inadequacy of MFI loans.

In addition to the above, the study seeks to provide recommendations to government, financial service providers and regulators to improve access to formal microfinance for the low-income segment.

### Methodology – Tools Used and Sampling

In order to meet the objectives of the study, qualitative research was conducted with the key stakeholders - MFI clients and SHG members, staff and management of MFIs and SHG Promoting Institutions (SHPIs), and funders such as NABARD. The research was conducted with low-income clients in rural and semi-urban locations in five districts of West Bengal - South 24 Paragana, North 24 Paragana, Hoogly, Howrah, and Burdwan.

The research team used Participatory Rapid Appraisal (PRA) tools with the clients to understand their preferences. In-Depth Interviews (IDIs) were also conducted with the clients to get detailed information about the sources of credit used by them and the impact of the crisis. These have been presented in the form of case studies. IDIs were also used to gather information from MFI and SHPI staff.

**Table 3: PRA Tools used for the Study**

Tool	Purpose	No. of Sessions	No. of Respondents
<b>Focus Group Discussions (FGDs)</b>	To understand the profile of the microfinance clients; understand the sources of micro-credit used by the community in general currently and in the past; understand the purpose of taking loans from various sources and their preferences.	48	<b>278</b>
<b>Relative Preference Ranking (RPR)</b>	To understand the relative preference of clients between different micro-credit service providers (formal and informal) based on the key features of loan product such as loan amount, interest rate, and repayment frequency.	18	
<b>Financial Sector Trend Analysis (FSTA)</b>	To determine which credit institutions have been used by the community over time and to understand the trends, if any, in the use and availability of such institutions over a period of five years.	18	
<b>In-Depth Interviews (IDIs)</b>	To capture the view point of select government officials responsible for implementing the SHG programme, MFI staff and management, SHPI staff, and microfinance clients.	19	<b>19</b>
<b>Total</b>		<b>103</b>	<b>297</b>

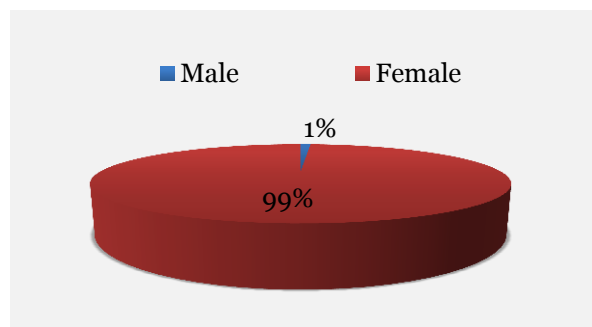
## **RESPONDENT PROFILE**

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### Gender

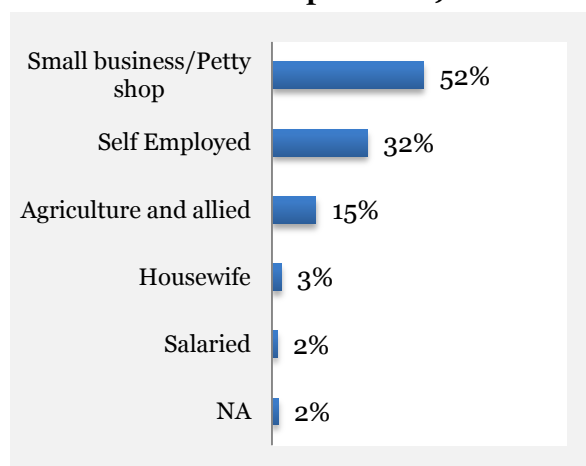
**Figure 2: Gender of Respondents (% of total respondents)**



A total of 287 respondents (microfinance clients) were covered in 48 focus group discussions. Majority of the respondents (99%) were women as mostly MFI clients and SHG members. Only 3 respondents out of 287 (1%) were male.

### Occupation

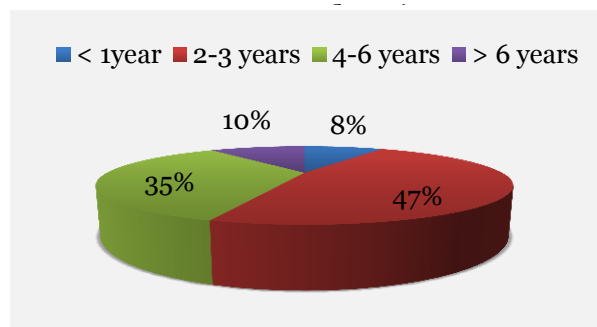
**Figure 4: Occupation of Respondents (% of total respondents)**



Approximately, half of the respondents (51.57%) were engaged in small business activities such as tailoring, fishery, carpentry, making *bidi*, incense sticks, sari making, petty shops, etc. About 14.98% were engaged in agriculture and allied activities such as livestock and farming. Out of the total sample, 32.40% were self-employed and engaged in occupation such as working as wage labourers. Some of the respondents (approximately 6%) were engaged in more than one occupation. The majority of respondents had taken loans for their husband's or son's business. Those who were housewives had taken loans for their family business.

### Association with MFIs or SHGs

**Figure 5: Number of Years of Association with an MFI or SHG (% of total)**



The majority of respondents have been associated with MFIs or SHGs for the past 2 to 3 years and less than half of them have been associated with MFIs for more than 3 years.

### Loan Amount

**Figure 3: Amount of Loan Taken by Respondents (% of total respondents)**

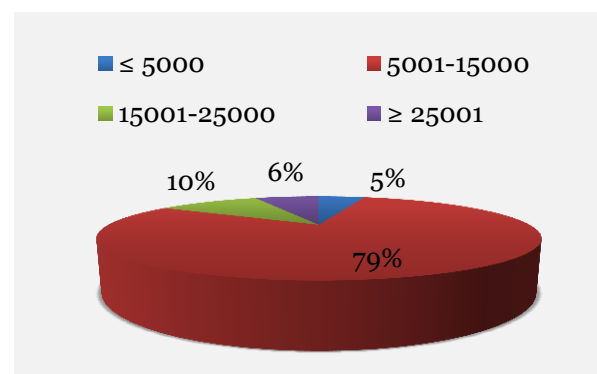
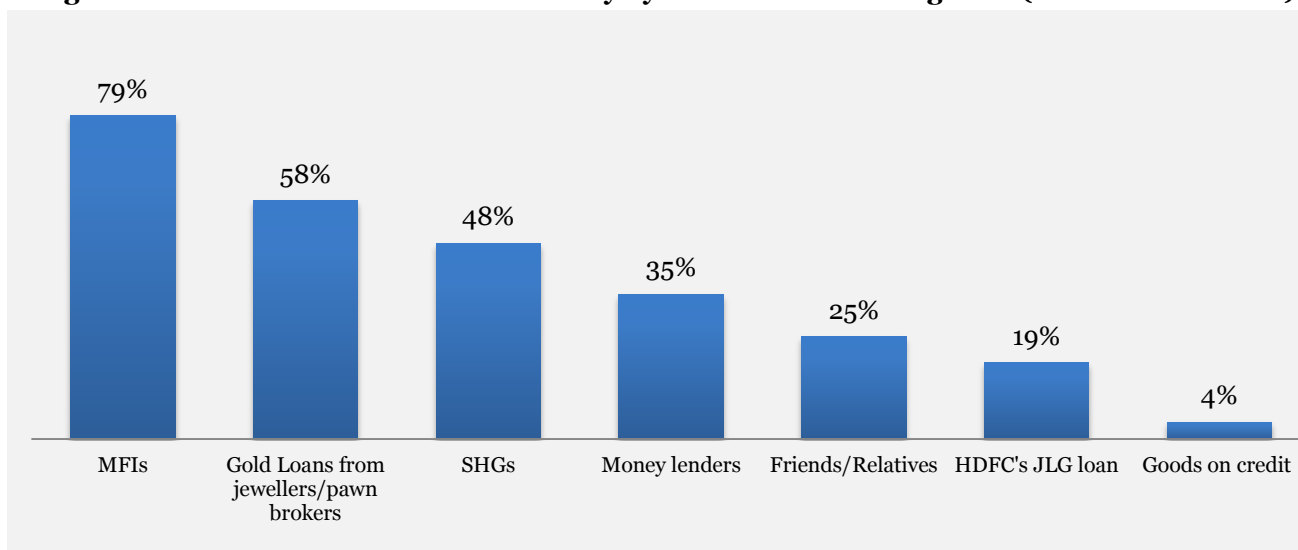


Figure 4 shows the amount of loan taken by the respondents in the current loan cycle. Since majority of the respondents had been taking loans since 2-6 years, they were in third or higher loan cycles. However, most of them had loan amounts of Rs.5,000-15,000 in the current loan cycle. This is because the loans size has either not increased or has decreased as MFIs faced the fund crunch.

## SOURCES OF CREDIT USED AND PURPOSE

### Sources of Credit Used – Present

**Figure 6: Sources of Credit Used Currently by the Low-Income Segment (% of FGD Sessions)**



The figure above shows the sources that the respondents and others in the community access when they require credit.

MFIs are the primary source of credit for loans of up to Rs.50,000 (mentioned in 79% of the sessions). These loans are generally used to finance working capital needs and for business expansion, or for consumption purposes such as house construction/ renovation. Some MFI clients, especially those who are below-the-poverty line (BPL) are also members of SHG groups formed by the SGSY scheme and have received credit from banks.

SHGs are the other formal source of credit for the low-income segment. This has increased over the last two years with increase in the number of groups formed under the SGSY scheme. However, the usage at the community level still remains low because of the insufficient loan amounts, uneven distribution of SHGs, and restriction of membership of SHGs under SGSY (which is only for BPL families).

Only a few of the respondents access banks directly for loans in case they require loans of more than Rs.50,000 for business purpose or vehicle loans. The majority do not prefer to directly approach banks because of complex documentation process, requirement for a guarantor, and delays in disbursement. They also

### Swarnajayanti GramSwarozgarYojana (SGSY)

SGSY is a poverty alleviation programme of Government of India under which financial assistance is given to the poor families living below the poverty line in rural areas for taking up self employment. The persons taking up Self-Employment are called *swarozgaris*. They may take up the activity either individually or in Groups, called the Self-Help Groups.

The scheme is being implemented by District Rural Development Agency (DRDA) with the active involvement of *panchayats*, banks, and non-governmental organisations. The groups take up thrift and internal-lending activities. Once the groups are at least 6 months old and have shown capacity to use corpus for income generation purpose, they are eligible to receive a revolving fund sanctioned as a cash credit limit. The group is entitled to subsidy of 50% of the project cost subject to per capita subsidy of Rs. 10,000/- or Rs. 1.25 lakhs.

(Refer to [“Master Circular on Priority Sector Lending- Special Programmes - Swarnajayanti Gram SwarozgarYojana \(SGSY\)”](#) dated 1<sup>st</sup> July 2010 for more details)

believe that most of them will not be eligible for bank loans as they do not have regular incomes and collateral. However, some of the respondents had taken loans from HDFC bank through its joint liability group lending model.

Since the loans taken from formal financial institutions such as MFIs, SHGs, and banks are for a fixed period, the poor depend on informal sources to meet any credit needs that may arise during the term of the loan. These are commonly used to meet emergency needs mostly for medical or household expenses and sometimes for business needs. Most common is to borrow against gold from jewellers or pawn brokers, followed by money lenders, and friends and relatives. In case of emergency people prefer gold loans over money lenders because of the lower interest rate and to avoid aggressive money lenders.

*"Amederke to bank taka debena."* (Bank will not lend us.)

*"Sanstha toh bahut hai yahan par bahuto ne paisa dena band kar diya hai."* (There are lot of MFIs here, but most have stopped lending.)

#### **Loans Against Savings in Chit Funds**

Chit fund companies such as Sunmarg Welfare Society and Rose Valley are still prevalent in some of the districts of West Bengal despite opposition by the RBI.

Some of the respondents during the research mentioned that they have taken loan against savings in the chit funds. Once the clients have saved for a minimum period of 6 months, they are eligible to take loan out of their own savings. The loan tenure is usually for 6 months. Clients prefer chit funds as they can avail the loan in a short notice.

#### **HDFC Bank – Sustainable Livelihood Banking**

Over the past two years, HDFC Bank has accelerated its lending in the rural market through Sustainable Livelihood Banking (SLB) branches. HDFC SLB has been able to capture the market at a time when MFIs are not able to lend due to paucity of funds.

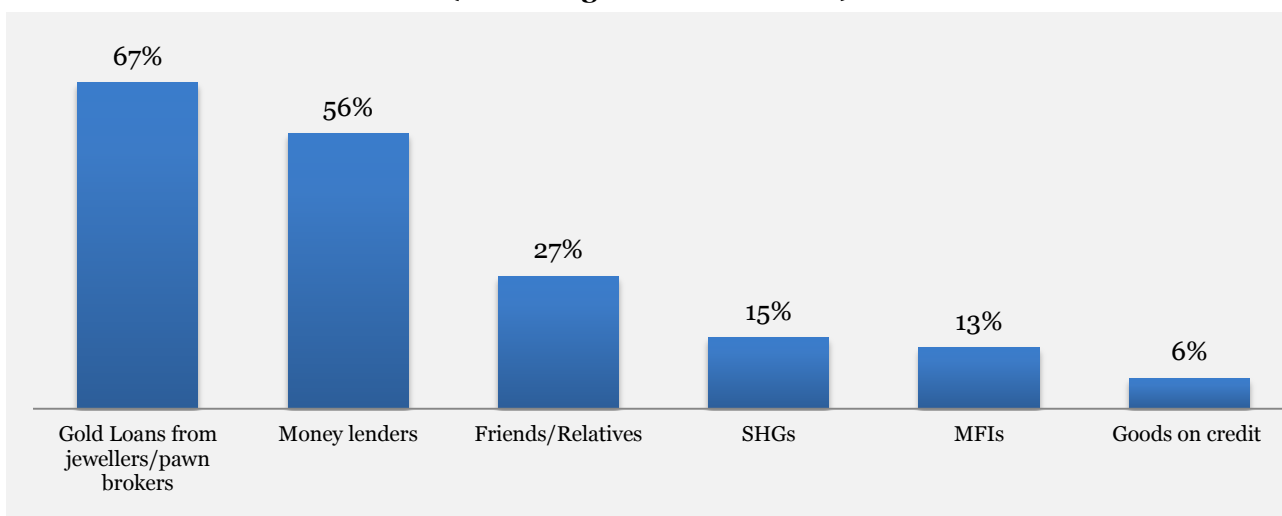
As of June 2012, the bank was present in five districts of West Bengal - Howrah, Hoogly, South 24 Parganas, Nadia, and Kolkata with a total of nine branches. One of the branches visited during the study had a client base of 3,000 and a loan outstanding of Rs.2.75 crores.

The loans are distributed through the joint liability model with a loan of up to Rs.10,000 in the first loan cycle, and an increment of Rs.2,500 in the subsequent cycles. The interest charged on the loan is 26% per annum. A no-frills savings account is opened for all the clients and the loan disbursements and repayments happen through this account. The field officer collects the repayments in the field using a point-of-sale device.

Other products offered include gold loan at 1% interest per month and recurring deposit facility. HDFC-SLB's competitive advantages are the availability of funds and the ability to offer a wider range of services to the clients.

## Sources of Credit Used – Past

**Figure 7: Sources of Credit Used in the Past (4-5 years ago) by the Low-Income Segment (Percentage of FGD Sessions)**



The figure above shows the credit sources used four to five years ago when most of the MFIs were still in their infancy. The use of formal credit sources was lower due to the limited presence of MFIs. Most people depended on expensive loans against gold and loans from money lenders. These were still preferred over other informal sources such as friends and relatives that lend small amounts for short term only and there is a

risk of negative impact on personal relations. Business men took goods on credit; however, this facility is available to only a few who have good rapport with their suppliers.

The following table summarises the features of the credit sources commonly accessed by the low income segment (present as well as past).

**Table 4: Summary of Sources of Credit Accessed by Low-Income Segment**

Sources	Purpose	Terms and Conditions	Interest Rate
<b>MFIs</b>	<ul style="list-style-type: none"> <li>Working capital and business expansion</li> <li>For house construction</li> </ul>	<ul style="list-style-type: none"> <li>Loan amount: As per RBI regulations, a client cannot take loan from more than two MFIs and the combined loan outstanding should not be more than Rs.50,000</li> <li>Loan tenure: Fixed loan tenure of 52 weeks for loans up to Rs.15,000 and 104 weeks for loans above Rs.15,000</li> <li>Repayments: Loan to be repaid in compulsory equated weekly, fortnightly, or monthly instalments</li> </ul>	<ul style="list-style-type: none"> <li>22-27% per annum on declining balance</li> </ul>
<b>SHGs</b>	<ul style="list-style-type: none"> <li>Livelihood generation</li> <li>Consumption</li> <li>Emergencies such as medical expenses</li> </ul>	<ul style="list-style-type: none"> <li>Loan amount: Loan up to 4-9 times of savings. Mandatory savings for 6 months to be eligible for loan</li> <li>Loan tenure: 6-12 months</li> <li>Repayments: Loan to be paid in equal monthly instalments; some flexibility in terms that instalment can be paid next month with additional interest</li> <li>Bank gives loan to the group which is distributed among the members by mutual consent</li> </ul>	<ul style="list-style-type: none"> <li>12-24% per annum</li> <li>The group is entitled to subsidy of 50% of the project cost subject to per capita subsidy of Rs. 10,000/- or Rs. 1.25 lakhs</li> </ul>



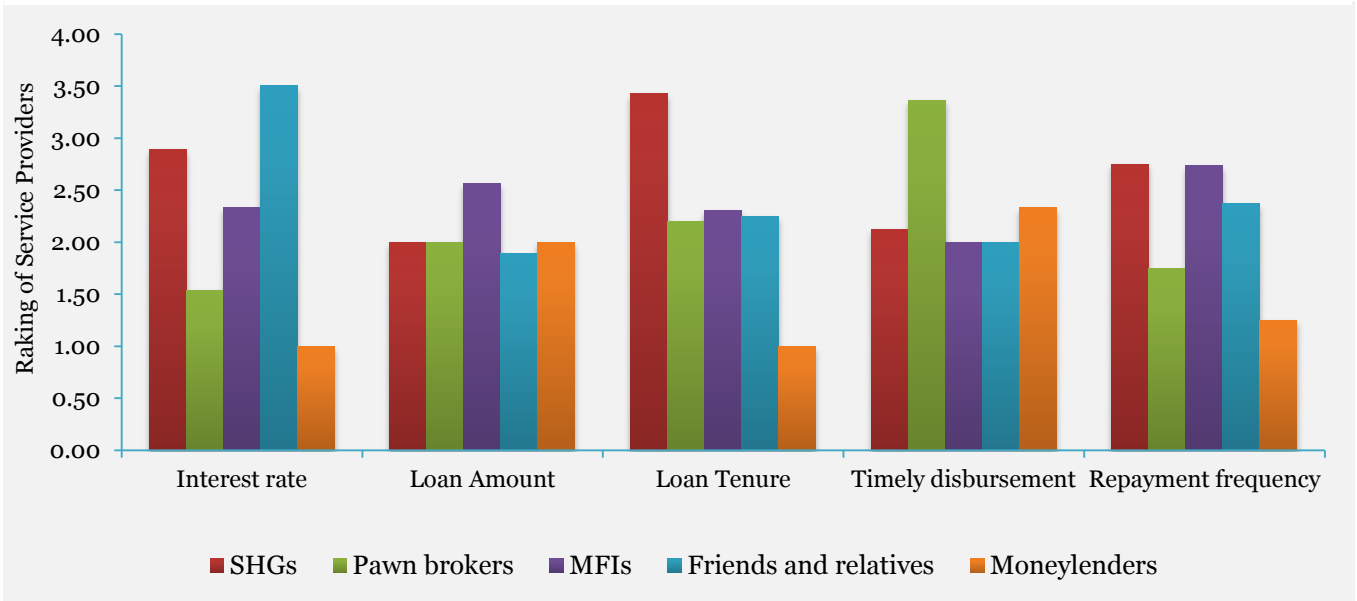
<b>Sources</b>	<b>Purpose</b>	<b>Terms and Conditions</b>	<b>Interest Rate</b>
<b>Pawn Broker (Mostly Gold Loans)</b>	<ul style="list-style-type: none"> <li>• Emergencies such as medical expenses</li> <li>• Sometimes for business and household expenses</li> </ul>	<ul style="list-style-type: none"> <li>• Loan amount: 50-60% % of value of the gold</li> <li>• Loan tenure: No fixed tenure</li> <li>• Repayments: Interest to be paid monthly and principal to be repaid as a bullet payment</li> </ul>	<ul style="list-style-type: none"> <li>• 36-60% per annum</li> </ul>
<b>Money Lenders</b>	<ul style="list-style-type: none"> <li>• Emergencies needs only</li> </ul>	<ul style="list-style-type: none"> <li>• Loan amount: Depends on rapport with moneylender and his assessment of borrowers' credit worthiness</li> <li>• Loan tenure: No fixed tenure</li> <li>• Repayments: Interest to be paid monthly and principal amount to be repaid as a bullet payment</li> </ul>	<ul style="list-style-type: none"> <li>• 96-120% per annum</li> </ul>
<b>Friends and Relatives</b>	<ul style="list-style-type: none"> <li>• Household expenses</li> <li>• Emergencies</li> </ul>	<ul style="list-style-type: none"> <li>• Loan amount: Depends on the need and capacity of the lender; generally small amounts of Rs.300-1000</li> <li>• Loan tenure: Short term borrowing for few days to a month</li> <li>• Repayments: As an when possible</li> </ul>	<ul style="list-style-type: none"> <li>• Nil</li> </ul>
<b>Credit from Suppliers</b>	<ul style="list-style-type: none"> <li>• Business purposes (to buy goods)</li> </ul>	<ul style="list-style-type: none"> <li>• Loan amount: Same as price of goods purchased</li> <li>• Loan tenure: 2 to 4 weeks</li> <li>• Repayments: Money to be repaid with the sale proceeds</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of cash discount; buyer is obliged to sell to the supplier and loses the power to bargain</li> </ul>

**CLIENT PREFERENCES – MFI Vs.  
OTHER SERVICE PROVIDERS**

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**Figure 8: Relative Preferences of the Low-Income Segment for Various Service Providers**

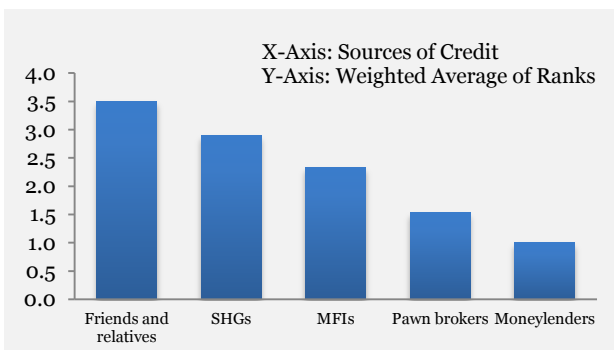


MFIs are considered the most preferred source of credit. Informal sources of credit are used in case of emergencies wherein there is an urgent need of cash. Loans from MFIs, and also from SHGs are preferred to start or expand their enterprise. The following section explains the relative preferences of the clients for the various sources of credit based on the key product parameters. The figure above shows the ranking of the sources on product parameters that the clients consider while selecting which source to access - interest rate, loan amount, loan tenure, timely disbursement, and repayment frequency.<sup>17,18</sup>

interest rate on the loan amount. Other informal sources such as pawn brokers, who lend against gold, charge very high interest rates of 3-5% and 8-10% respectively. Amongst the two, gold loans are preferred as they charge relatively lower interest as it is a secured loan. Amongst the formal credit sources, SHGs are preferred over MFIs since the interest rate is lower and there is a subsidy for groups under SGSY. Please refer to table 3 for details on interest rates.

**Interest Rate**

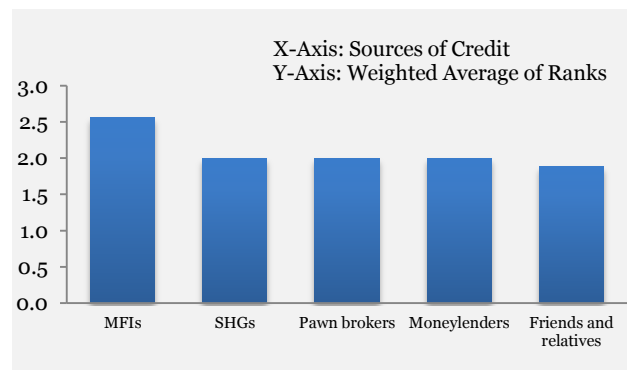
**Figure 9: Interest Rate (Scale of 5)**



Friends and relatives are preferred over other sources because there is generally no cost or

**Loan Amount**

**Figure 10: Loan Amount (Scale of 5)**



MFIs are the most preferred source and the loan amount provided ranges from Rs.5,000 to Rs.50,000 and the loan size is increased with every consecutive loan cycle. MFIs usually increase the loan amount by Rs.2,500 to Rs.5,000 with each loan cycle for clients with good credit history.

Other sources are rated at par on this parameter.

<sup>17</sup> The product parameters considered for the relative preference ranking (RPR) are based on discussions with the respondents during FGDs as well as RPR.

<sup>18</sup>The graphs show weighted average of the ranks for each service provider on the product parameters in 18 RPR sessions.

SHGs can do intra-group loans using their savings, but the amount of these loans is small (between Rs. 2,000 and Rs.5,000). SHG members are eligible to receive loans from bank only after they save for at least six months and the loan amount is restricted to 4-5 times of the savings corpus. Most of the respondents complained of the inadequate loan amounts, due to which they have to borrow from multiple sources.

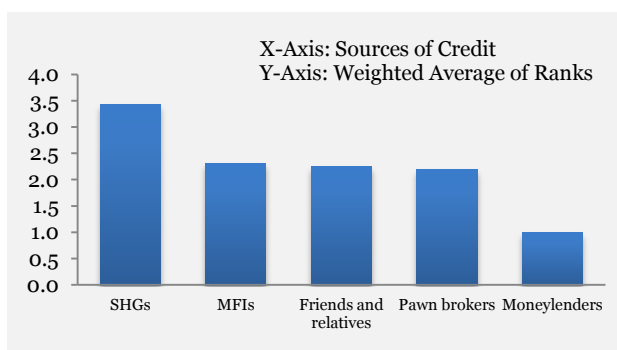
With regards to moneylenders, the amount of loan is uncertain since it depends on familiarity or rapport that the client shares with moneylender.

In case of gold loans, the amount of loan is only 50% to 70% of the value of gold. Moreover, poor clients do not have enough gold to pledge.

Friends and relatives are the least preferred because they are either reluctant to lend or do not have the required amount to lend.

**Loan Tenure**

**Figure 11: Loan Tenure (Scale of 5)**



The majority of respondents prefer formal sources as these have a fixed loan tenure unlike informal sources. This creates discipline amongst the borrowers to repay the loan within time.

Respondents prefer SHG loans over MFIs because the loan term is relatively flexible (members can choose between 6 to 12 months). Also, it is possible to pre-pone or delay the payment if required. This is not possible in case of MFIs as the loan term is fixed to 52 weeks or 104 weeks.<sup>19</sup> Also, respondents do not like the increase in the loan tenure for any amount greater than Rs. 15,000 to 104 weeks which

<sup>19</sup> Since past one year, the loan tenure for all loans greater than Rs.15,000 has been increased to 104 weeks.

means that they can get the next loan only after 2 years.

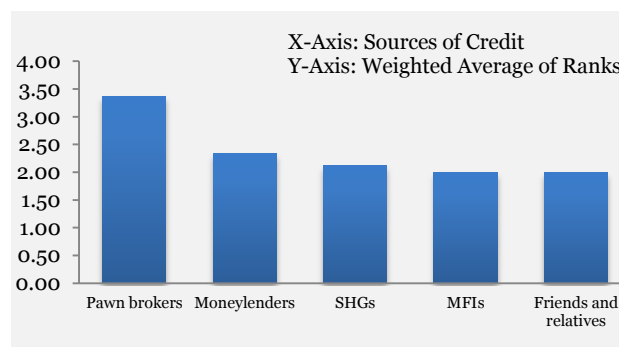
*"Loaner shomoye ta aage theke theek kora thake. Tai jonno aamra shotorko thaki je loan ta chokate hobe."* (The tenure of a loan is fixed. This forces us to pay off the loan within time and be diligent about loan repayment.)

*"Aamra jodi MFI shonsthaaner theke 18,000 taka dhaar nei, aamaderke ek bochorer jagaye dui bochor e taka ta shod korte hoi. Aemni howa ucheet na."* (If we take a loan of Rs.18,000 from an MFI, the term is 2 years instead of 1 and we have to wait for 2 years for next loan. We do not like this.)

Friends and relatives are ranked lower because the loan term is very short, generally a few days to a month. However, they are still preferred over other informal sources as the term is mutually agreeable and relatively flexible. Moneylenders are least preferred as they do not have fixed loan tenure. This is not desirable because of the high interest charge which keeps on increasing if the repayment is delayed

**Timely Disbursement**

**Figure 12: Timely Disbursement (Scale of 5)**



Pawn brokers give instant loans against collaterals and are used in case credit is required urgently. Moneylenders also give instant loans; however, it is based on the moneylenders' judgment of borrowers' repayment capacity. If the moneylender does not know the borrower personally, then he may delay or deny the loan. Friends and relatives are ranked lowest as they usually delay lending if they are not willing or do not have the required money.

In case of SHGs, the members need to save for 6 months before then are linked to bank and bank linkage takes around a month. While intra-group

borrow is quick it may take two to four weeks to receive the loans from bank. MFIs might take two to three weeks' time to process and disburse a new loan (includes group formation, documentation, training, etc.). For subsequent cycle loans, there is usually a cooling period of one to two weeks.

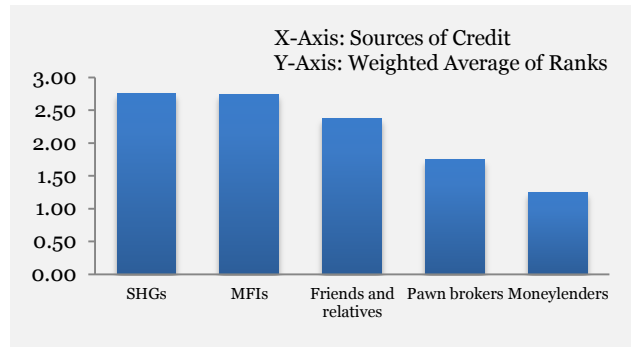
While MFIs disburse loans relatively quickly, SHGs are ranked higher due to the delays in disbursement (taking up to a month) by MFIs that are facing a fund shortage.

*"Aaj kaal to kichu MFI sonsthar theke du teen mash deri hoye jaaye loan pete. Bandhan to tau dhaar shomoy moto dae"* (Nowadays, it take approximately 2-3 months to get loan from some of the MFIs. Bandhan on the other hand, provides loans on time.)

**Repayment Frequency**

SHGs and MFIs are both equally preferred depending on the cash flows of the clients. Respondents with monthly cash flows prefer SHGs. SHGs also provide the flexibility of delaying or postponing the repayment. Small business owners, self-employed or daily wagers with weekly or daily cash inflows prefer MFIs because of weekly repayments. The instalments are smaller making it easy to repay.

**Figure 13: Repayment Frequency (Scale of 5)**

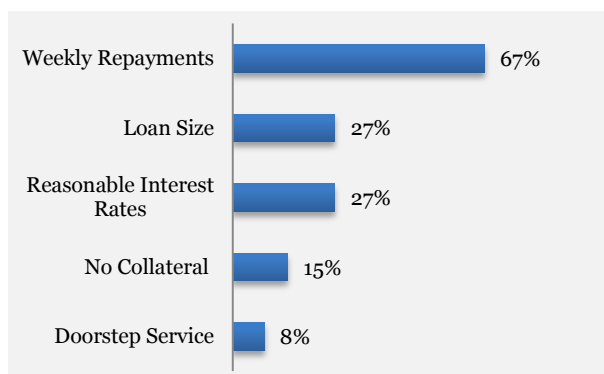


Amongst the informal sources, friends and relatives are preferred the most since they can be repaid as and when cash is available. Pawn brokers and moneylenders are the least preferred since they do not have a fixed repayment frequency. In case of moneylenders, while the interest is paid monthly, the principal has to be repaid in a single instalment, which is difficult for the low-income clients.



## MFI - LIKES AND DISLIKES

**Figure 15: MFI Likes (% of Sessions)**



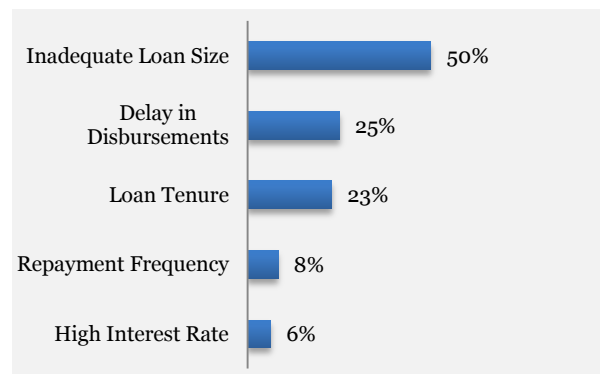
**Weekly Repayments:** In 67% of the sessions, weekly repayments came up as the biggest advantage of MFI loans. This is convenient for many clients as it matches their cash flows which are daily or weekly. Weekly instalments are smaller in size and therefore, it is easier for them to save to meet them.

**Interest Rates and Loan Size:** Interest rates charged by majority of the MFIs range between 22% and 27%, and are much lower than other informal sources. MFIs give loans ranging from Rs. 5,000 to Rs. 50,000 and the size increases with each loan cycle.

**No Collateral:** In 15% of the sessions, respondents preferred MFIs because there is no hard collateral to avail MFI loans.

**Doorstep Service:** Respondents also mentioned that they find MFI loans more convenient because the service is provided within their village. Unlike banks, they are not required to go to branch office, incur expense for conveyance and complete complex documentation.

**Figure 14: MFI Dislikes (% of Sessions)**



**Inadequate Loan Size:** In 50% of the sessions, respondents said that the loan amount is insufficient to fulfil their requirements. This can be attributed to two reasons. Firstly, the credit needs for older groups (more than 4<sup>th</sup> or 5<sup>th</sup> cycle) is higher. Secondly, recently some MFIs have reduced the loan amount or have not increased it due to lack of funds. This has caused dissatisfaction amongst the clients. As a result, they have to borrow from multiple sources which is inconvenient.

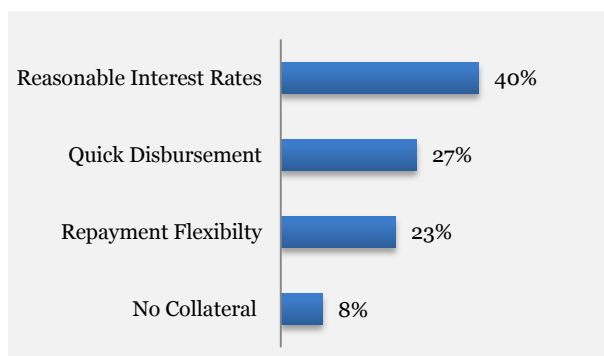
**Delay in Disbursements:** In 25% of the sessions, respondents mentioned that there is a delay of 3-4 weeks in issue of fresh loans as well as next cycle loans. This is due to the on-going crisis and fund crunch faced by MFIs. Earlier the loans were disbursed within two weeks. As a result, there is uncertainty among the clients, due to which they find it difficult to plan their businesses and expenditure.

**Loan Tenure:** Following the guidelines provided by the RBI, the loan tenure has been fixed at 52 weeks for loans up to Rs. 15,000 and 104 weeks for loans above Rs.15,000. In case of the latter, the clients have to wait for two years before they can borrow again to invest in their business. This came up as a dislike in 23% of the sessions.

**Repayment Frequency and Interest Rate:** Some of the respondents (mostly members of SHG groups), disliked the weekly instalments and high interest rates charged by the MFIs.

## SHG - LIKES AND DISLIKES

**Figure 17: SHG Likes (% of Sessions)**



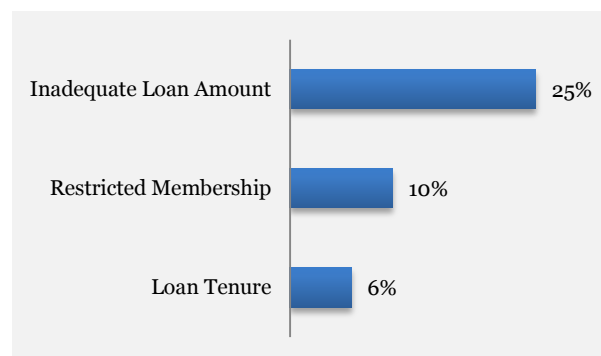
**Reasonable Interest Rate:** In 40% of the sessions, respondents opined that SHGs charge reasonable interest on loans. They also like that a part of the interest collected is retained as SHG savings and helps them to grow the corpus. Moreover, under the SGSY scheme, members who belong to BPL category also receive an interest subsidy on loans (refer to table 3).

**Quick Disbursement:** In 27% of the sessions, respondents mentioned that they get loans from SHGs whenever they need and there are minimum delays. In case of intra-group borrowing, it takes two days to disburse the cash after the group passes the resolution. In case of bank loans, it takes two weeks after the resolution is passed, which is same as MFIs and much faster compared to direct bank credit.

**Repayment Flexibility:** The repayment of SHG loans is more flexible than for loans from MFIs. When they are unable to pay the monthly instalment for an SHG loan, they can pay it along with the next month's instalment with some additional interest.

**No Collateral:** A few of the respondents mentioned that they liked SHG loans compared to direct bank loans or gold loans because they are not required to provide any collateral.

**Figure 16: SHG Dislikes (% of Sessions)**



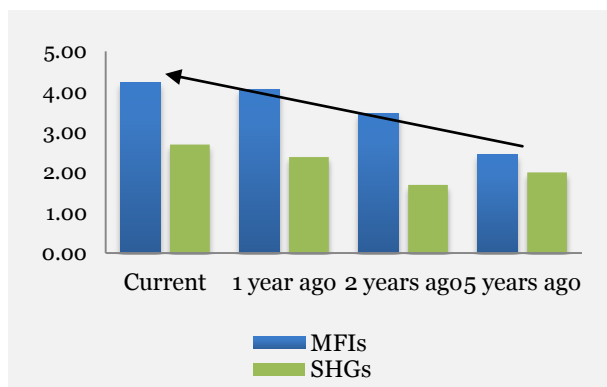
**Inadequate Loan Size:** In 25% of the sessions, respondents mentioned inadequate loan size as the major shortcoming of SHG loans. The amount of loan is dependent on the savings corpus of the SHG, which is generally low. The loans received usually range between Rs. 3,000 to Rs. 5,000 per member which is not sufficient for business needs and are generally used for consumption purposes.

**Restricted Membership:** In 10% of the sessions, respondents disliked SHG loans because in order to get loan they must be part of an SHG and should have saved for at least six months. Moreover, for SHGs formed under SGSY, only people from BPL category can avail loans and the subsidy. There are no such conditions in case of MFI loans.

**Loan Tenure:** In 6% of the sessions, respondents said that they dislike the loan tenure of SHG loans. This is generally in case the loan size is larger (more than Rs. 25,000) and clients find it difficult to repay within 6-12 months.

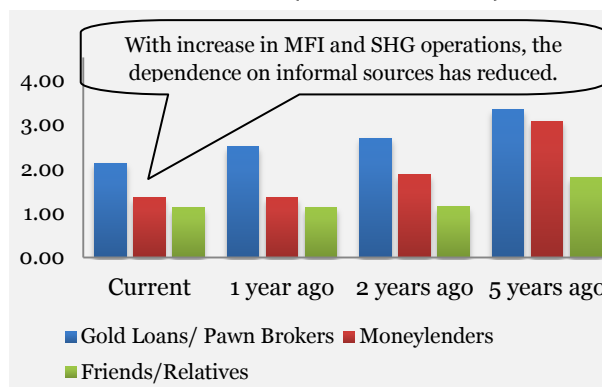
## TRENDS - CHANGES IN USAGE OF CREDIT SOURCES<sup>20</sup>

**Figure 19: Trend in Popularity of Formal Credit Sources (Over Five Years)**



Over the last five years, there has been a significant increase in the popularity MFIs as a reliable and affordable source of credit. As a result, the popularity of costly informal sources such as money lenders and pawn brokers, which were frequently used earlier, has reduced. Over the same period, the outreach of SHGs has also increased, though it still remains low when compared to penetration of MFIs. These two together are the most important sources of micro-credit for the low income segments in rural and semi-urban West Bengal. The use of direct bank loans, as discussed earlier, still remains very low in this segment.

**Figure 18: Trend in Popularity of Informal Credit Sources (Over Five Years)**



### Microfinance Institutions

With the expansion to different parts of the state and the entry of new MFIs, the popularity of MFI loans has increasing over the past five years. Five years back the MFIs were present only in easily accessible areas and awareness about them was low. Overtime, clients have realised that MFIs offer cheaper loans compared to informal sources. The level of popularity of MFIs has not reduced even after the microfinance crisis. This is because some of the bigger MFIs such as Bandhan are still lending.



<sup>20</sup>The section presents findings from the Financial Sector Trend Analysis (FSTA). The tool has being used to map the changes in the sources of credit used over last five years.



### **Self-Help Groups**

The popularity of SHGs has increased gradually over last two to three years, but the increase has not been substantial as compared to MFIs despite having a relatively higher outreach. This could be attributed to uneven distribution of SHGs and small loan sizes. Also, for SHGs formed by SGSY, the membership is restricted to BPL category clients only (20-30% can be non-BPL clients).

However, SHGs are still more popular as compared to informal credit sources primarily due to low interest rates

### **Gold Loans**

There has been a decline in the popularity of loans from pawn brokers with the increase in MFI and SHG operations. However, loans from pawn brokers still remain the most popular amongst the informal sources and are used to meet emergency needs.

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*"Sona to poreo kamiye newa jete para jaaye, kintu aattoshomaan ek bar gele pore abar pherot pawa jaaye na."*(Gold can be earned back but self respect cannot be earned back.)

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### **Money Lenders**

Five years ago, money lenders were the most important source of credit after gold loans, despite their high interest rates. This was because formal sources were sparse and not easily accessible, while money lenders provided quick loans without collateral. But with the proliferation of MFIs and SHGs, moneylenders' popularity is going down.

### **Friends and Relatives**

Friends and relatives are lenders of last resort and ranked lowest amongst the informal sources. People still do not prefer approaching friends and relatives for loans as they are afraid of compromising their relationship.

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*"Bondhu-sombondhi der kache nijeyi paisa thake na dewar jonne".* (Friends and relatives themselves do not have enough money, how will they lend to us?)

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## IMPACT OF THE MICROFINANCE CRISIS IN WEST BENGAL

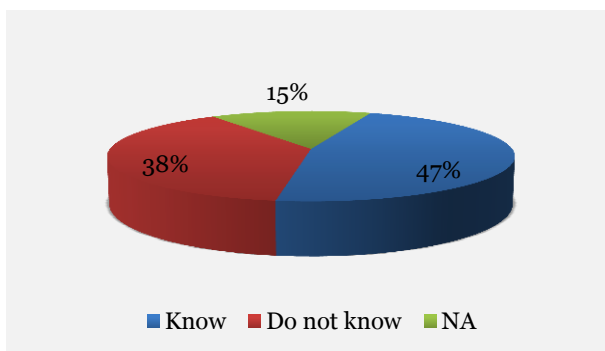
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The tremors of the microfinance crisis have been felt as far as West Bengal. The sector is affected to the extent that microfinance institutions are facing challenges to raise funds. Most MFIs, with an exception of a few such as Bandhan which have secured adequate funds, have either shrunk or halted expansion plans. Still, even for Bandhan the growth rate decelerated from 100% annual growth before crisis to 40% during 2010-2011. Other big MFIs such as Arohan, Village Financial Services, and ASA had very few disbursements. SKS, Basix, and Ujjivan had stopped lending. While the repayment rates were not affected to the extent similar to Andhra Pradesh, MFIs that had stopped disbursements faced defaults especially in the southern part of the state (urban areas of Kolkata and Bardhaman).

**Awareness amongst Clients**

**Figure 20: Level of Awareness about the Current MFI Crisis (% of respondents)**



Some MFIs have taken initiative to educate their clients about the current situation and the reasons underlying it. This has reduced anxiety among the clients. Most of the respondents were aware that MFIs are not able to lend and/or increase loan amounts because banks are not lending to MFIs. They were also aware that they cannot take loans from more than two MFIs or loans greater than Rs. 50,000, and that this can be tracked through the credit bureau.

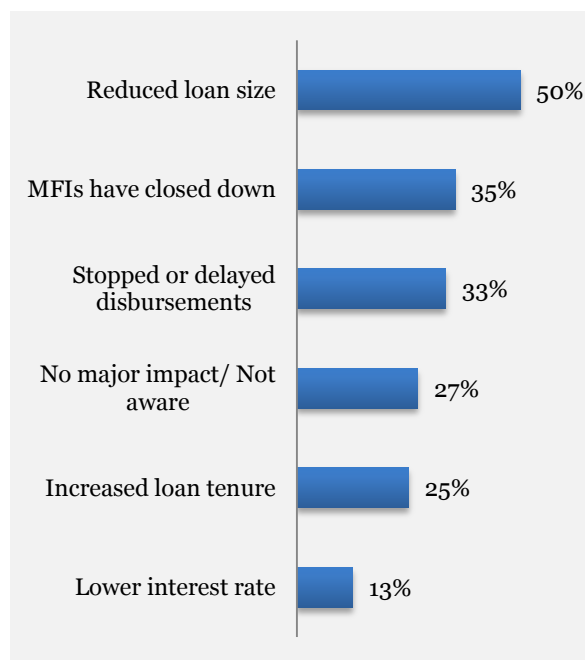
Despite the slow-down in MFI lending, client credit discipline remains intact and all groups are still repaying loans. This was observed based on discussions with the management and staff of the MFIs visited during the research. According to senior management of the MFIs interviewed, this can be attributed to the prompt action taken by all the MFIs to decide a strategy to reduce the impact of Andhra Pradesh crisis and to inform and create awareness amongst their clients.

**Impact on Clients**

**Reduced Loan Size**

In most of the sessions (50%), the respondents mentioned that the loan size either reduced or not increased in the new loan cycle. This was applicable to older groups associated with the MFI for more than two years. Initially, the MFIs used to increase the loan amount by at least Rs. 3,000-Rs. 5,000 in the subsequent loan cycle, subject to credit worthiness and capacity to repay of the client. However, the cash strapped MFIs have not been able to increase the loan amount in this manner, despite the expectations and increasing credit demand of their clients.

**Figure 21: Impact of the Crisis as Observed by the Respondents (% of Sessions)**



**MFIs have Closed Down**

Clients were aware (in 35% of the sessions) that some MFIs closed lending operations in their area, the major one being SKS, which is cautiously keeping away from the state and has stopped lending in most of West Bengal.

**Stopped or Delayed Disbursements**

In 39% of the sessions, respondents mentioned that the loans provided to them had been delayed by 4 to 6 months, where generally they receive the next loan within 2 weeks. Disbursements are not being made to all groups and many are still waiting for their next loans. It was seen that the clients who were not informed about the real situation faced by the MFIs felt that it was unfair



that they did not receive loans despite a good repayment record.

**No Major Impact**

Since some of the big local MFIs are still lending (though at lower amounts or with delayed disbursals) many clients said that they did not observe any changes in the last two years. This is mostly because Bandhan is still lending in most of its operational area and has also been increasing the loan amount with every subsequent cycle.

**Increased Loan Tenure**

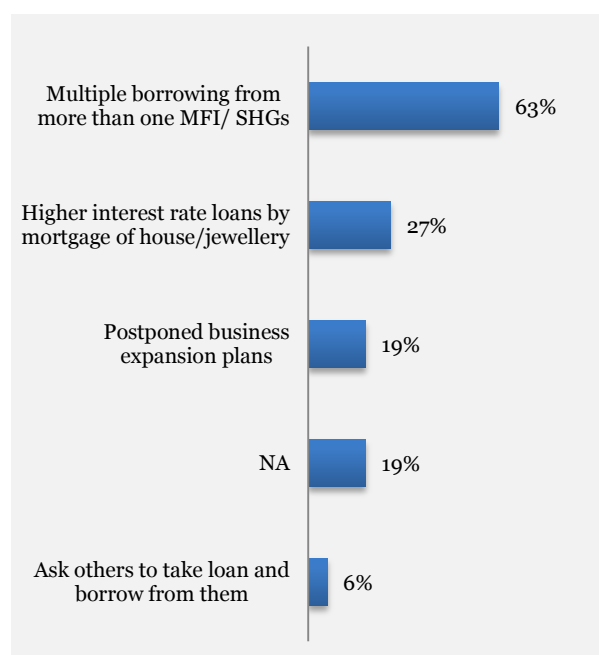
As a result of the [RBI circular](#), the loan tenure for all loans less than or equal to Rs.15,000 has been increased to 52 weeks and for loans greater than Rs.15,000 it has been increased to 2 years or 104 weeks. There was a mixed response to this change from the respondents. While some appreciated it because longer loan tenure means reduced repayment instalments; but the majority of respondents said that now they have to either wait longer for the next loan (when they take more than Rs.15,000) or borrow a smaller amount so that they can get the next loan earlier. Clients who have credit requirement of Rs.16,000 to Rs.18,000 find it the most difficult as the loan tenure is doubled for a marginal increase in loan amount.

**Lower Interest Rate**

With the cap on the interest rate and margin, some of the MFIs have marginally reduced their interest rates in the past one year. For instance, Bandhan has reduced its interest rate to 22.9% per annum (reducing balance) which is appreciated by the clients.

**Credit Management and Coping Mechanisms Undertaken by Clients**

**Figure 22: Coping Mechanisms for Clients Due to Inadequacy of MFI Loans (% of Sessions)**



As a result of the reduced lending by MFIs, clients have adjusted their credit management by either reducing or delaying their expenses, or by borrowing from multiple sources. Figure 21 shows the various coping strategies adopted by the respondents in lack of MFI loans.

#### ***Multiple Borrowing from More Than One MFIs and SHGs***

The majority of the respondents (in 63% sessions) said that due to reduction in loan amounts or delays in disbursements, they have to borrow from more than one MFI to meet their credit requirements. Some of them have to also take loans from their SHGs. Clients do not like this because of the inconvenience of attending more than one group meeting.

#### ***Higher Interest Rate Loans from Informal Sources***

In 27% of the sessions, respondents said that with the lack of MFI loans, they have taken loans from informal sources at a higher interest rate. This is mostly from pawn brokers by pledging gold and in some instances their land or house. While these sources are preferred for urgent credit requirements only, in the absence of adequate MFI loans, some clients are using these to meet business requirements as well.

#### ***Postponed Business Expansion Plans***

Since clients are unable to obtain required amount to invest in working capital, their business is not growing at the same pace. Instead of borrowing from multiple sources or from informal sources at a higher rate, some of them prefer to wait for their loan amounts to increase.

#### ***Ask Others to Take Loans on their Behalf***

A few of the respondents (in 6% of the sessions) said that because MFIs are not lending the required amount to them, they ask others to take a loan on their behalf from MFIs or SHGs.

## **RECOMMENDATIONS**

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The following section presents recommendations to MFIs, State Government, and Regulators based on the findings of the study.

### Microfinance Institutions

In light of the consequences of the on-going AP crisis, MFIs need to pre-empt the events that led to the crisis. They also need to respond to the changing needs of their clients to increase client satisfaction and thus reinforce the importance of the sector.

- **Improve Self-Regulation:** MFIs need to maintain high levels of transparency and corporate governance standards to be able to attract funders. They must follow and adhere to a strict code of conduct for lending and recovery practices, and ensure full disclosure to clients. The code of conduct must be disseminated internally within the MFI through operations manuals and staff training. Industry associations such as Sa-Dhan or the Association of Microfinance Institutions – West Bengal (AMFI-WB) need to play a proactive role to ensure that its member MFIs adhere to the code of conduct.<sup>21</sup>
- **Develop and Implement Client Protection Principles:** MFIs could put in place client protection principles and standards that when adhered to will reduce chances of causing harm to clients (by preventing over-indebtedness, coercive collections, and client privacy). Platforms like Social Performance Task Force have developed such principles.<sup>22</sup> *MicroSave* has adapted its ServQual tool to assess an MFI's adherence to client protection principles.<sup>23</sup>
- **Share Client History for Responsible Lending:** In order to avoid over-indebtedness, it is critical that there is seamless sharing of client information amongst the financial institutions. While credit bureaus have been set-up by microfinance networks, and all members are

compulsorily required to submit client data (also mandated by RBI for all NBFC-MFIs), still certain issues such as lack of digitisation of data, lack of standardisation, and incomplete data capture needs to be addressed.<sup>24</sup>

- **Ensure Client Awareness:** One of the major reasons for the continuing credit discipline amongst MFI groups in West Bengal was the prompt action taken by MFIs to inform clients about the existing situation. Some of the MFIs have also taken initiatives to inform clients about the credit bureau, multiple lending, and transparency of interest rates. This should be emulated by all MFIs to avoid dissatisfaction amongst clients and to retain their trust.
- **Maintain Cordial Relationships with all Stakeholders:** MFIs should be proactive to maintain constant dialogue with all key stakeholders (state government, regulator, funders, general public, and media). This is essential to showcase the importance of the sector and also take feedback on any issues or complaints.
- **Consider Becoming BCs for Banks to Offer Wider Product Range:** The need to offer a wider range of financial services to low income clients is being widely recognised by the MFIs. While a couple of big MFIs are adequately capitalised to apply for banking licenses whenever permitted by the RBI, the mid-sized and smaller MFIs can become business correspondents (BCs) for banks and distribute their products leveraging their existing infrastructure.<sup>25</sup>

In an already highly competitive market, MFIs are expected to face increasing competition from banks in the future. Banks such as HDFC have already experimented with its branch based microfinance model offering a wider range of savings and credit services. All public sector banks have appointed business correspondent agents in villages with population less than 2000. In

<sup>21</sup>RBI has reviewed the "[Guidelines for Fair Practices Code for NBFCs](#)" to incorporate NBFC-MFIs. Also, industry associations Sa-Dhan and MFIN have issued a unified "[Code of Conduct for Microfinance Institutions in India](#)"

<sup>22</sup> Refer to SPTF's [Client Protection Principles](#).

<sup>23</sup>Refer note for more details –Giri, Anurodh, Agrawal, Sonal, and Ledesma, Jesila, "[BN#125: Developing a Tool to Assess Client Protection](#)", *MicroSave*, 2012

<sup>24</sup>Refer to RBI circular "[Checklist for NBFCs, Non Banking Financial Company-Micro Finance Institutions \(NBFC-MFIs\), Non Banking Financial Company Factoring Institutions \(NBFC Factors\) and Core Investment Companies \(CICs\)](#)"

<sup>25</sup> Refer research paper for details – Ignacio et al., "[Are Banks and Microfinance Institutions Natural Partners in Financial Inclusion?](#)", *MicroSave*, India, 2012

addition, the government is scaling up programmes such as National Rural Livelihood Mission (NRLM) through which clients can access savings and credit facilities at lower rates.

- **Build a Grievance Handling Mechanism:** Even though the Microfinance Bill has provisions to appoint an ombudsman to address customer grievances, it is still essential for MFIs to set up mechanisms to resolve customer grievances/ and complaints at the local level. Prompt resolution of customer complaints will help avoid customer dissatisfaction.
- **Larger Role for State MFI Association:** The state level association of MFIs needs to play a more pre-active role to promote a healthy microfinance sector in the state. This can be done by ensuring adherence to code of conduct by member MFIs, sharing of best practices, initiating constant dialogue with key stakeholders, conducting state level research to understand customer needs, and pushing MFIs to offer quality products.

### State Government

- **Financial Education for Clients:** Over-indebtedness is not a commonplace in West Bengal and the credit discipline in West Bengal is better as its microfinance operations are relatively new. Despite this, taking lessons the AP crisis, it is essential to educate clients about their rights, responsibilities and redress. Awareness needs to be created to enable them to better understand the products offered and make informed choices.

Clients also need to be educated on other less expensive credit sources available such as bank loans. Only a few respondents covered during the research have taken loans from banks and do not prefer them due to complex procedures.

- **Capacity Building of SHGs and Training Key Staff:** When compared to other states such as Andhra Pradesh, the SHG movement in West Bengal is still nascent in terms of capacity building and skill development. The state government needs to strengthen the SHG programme by applying lessons from other successful

programmes as Andhra Pradesh. They can send key staff for training to observe other successful programmes. Key government staff can be trained to emulate successful SHG programmes.

### Banks and Funders:

- **Monitor MFI Activities:** Banks should resume lending to MFIs, and at the same time constantly monitor their activities to ensure that they offer appropriate products, lend responsibly to the end client, and follow the code of conduct in delivering the services to clients (regarding processes, staff behaviour, transparency, etc.). The funders/lenders can follow principles of responsible finance and client protection in their lending activities.
- **Push for Greater Transparency:** Policy should be such that MFIs that ensure transparent operations and governance have relatively easier access to funding. This should also be applied to MFIs that share complete information with credit bureaus. Therefore, more transparent MFIs will have better chances to raise stable and less costly funds.

### Regulator

- **Provide for a Mechanism to Graduate Older MFI Clients:** The regulator needs to build in provisions to graduate MFI clients whose incomes have grown with time and no longer fall in the income limits prescribed under the regulations. Also, MFIs need to offer individual lending products for older clients whose credit requirements are higher and their business does not permit them to attend group meetings.
- **Incorporate Changing Needs of the Clients:** The regulator must periodically evaluate the Act based on feedback from industry leaders and most importantly the clients. Client side researches could be undertaken to gather feedback on changes introduced (for instance increase in the loan tenure for amounts greater than Rs.15000 to two years) and to modify the guidelines based on client's emerging needs.



## CASE STUDIES – Importance Of MFI Loans For Low Income Segments

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### From Housewife to Entrepreneur



Manisha, a housewife, was unfortunately detected with a tumour three years back. She was required to undergo a surgery at a very short notice of three hours. She needed Rs.30,000 urgently for the surgery and the only option was to pledge her gold jewellery and take loan. She got the money immediately and it helped her meet the medical emergency. Within a few days, she and her husband repaid a considerable amount by withdrawing their savings from bank.

After a month, an MFI's office was set up in their area and she applied for a loan. With the loan, she repaid the pawn broker and got her jewellery back. She was left with some excess loan amount and this encouraged her to start a business of her own. She started her garment business which is running successfully today. She regularly borrows from MFIs to scale up her business.

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### Rising Business and Income

Binoy started off with a small shop (selling *pan-beedi*) in 2005. When the MFI opened up operation in his village he urged his wife to join it. They got a small loan of Rs.5,000 and started a poultry shop. With time his loan amount increased and he opened up a grocery store occupying a portion of his house. The last loan they took from the MFI was for Rs.50,000 and they used this money to renovate the shop and to purchase goods for grocery and poultryshops. He still continues with his poultryshop, which supplements his income from the grocery shop. He wants to start wholesale business of grocery items and he feels that he can afford a higher loan with his current income.

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## CASE STUDY – Credit Management During Lack of MFI Loans



With Durga Puja just around the corner, clients are facing lack of funds to build up their inventory for *puja* sales. The months of August and October are festival months because of month long Ramzaan followed by Durga Puja. This is the peak season of the year and most businesses build inventory before the season and sell during the festivals when prices increase.

Ranjit Pramanik, is a fruit vendor at a local market in Memri block of Burdwan. He manages his working capital needs by borrowing from MFIs and buying goods on credit from his suppliers. He and his wife together had taken loans for Rs.10,000 each from two MFIs, and Rs.40,000 loan from a third MFI. He took these loans last year before the festival season to increase working capital in his business. Even though he has already repaid the two loans of Rs.10,000, he has not received the next cycle loan.

In addition to MFI loans, he regularly buys fruits on credit from his suppliers. He buys fruits from two to three suppliersevery day who gives him credit for 2-3 days, and he repays them every day after taking out profit from the daily sales. Over period, his dependence on the suppliershas reduced as he has started using MFI loans. He can buy goods at a better rate in cash and thus earn a higher margin.

However, this year he is doubtful if he will be able to arrange money for the increased working capital needs during the festival season. His cash flows have also been disrupted because he needs to repay the suppliers regularly and without the capital infusion from MFI loans, this has become very difficult.

