Available online at http://www.ijims.com
ISSN - (Print): 2519 – 7908 ; ISSN - (Electronic): 2348 – 0343
IF:4.335; Index Copernicus (IC) Value: 60.59; UGC Recognized -UGC Journal No.: 47192

Microfinance Sector in India:Genesis and Aftermath of Andhra Pradesh Microfinance Crisis of 2010

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Abstract

Microfinance is India is primarily rural and semi-urban in nature. Microfinancing efforts have not yet yielded the desired results. This conceptual paper is an attempt to increase understanding about Indian microfinance sector. The paper tries to explain the Andhra Pradesh microfinance crisis of 2010 and its repercussions.The paper concludes that microfinance is not a silver bullet for financial inclusion of poor and should be properly regulated by the Government to achieve better financial inclusion.It is high time that microfinance model is made self sustainable through appropriate laws at centre to ensure its long term survival and to prevent crisis like Andhra Pradesh in future.

Keywords: Microfinance, Self Help Groups, Andhra Pradesh crisis, Financial Inclusion, Poverty

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"Today, if you look at financial systems around the globe, more than half the population of the world - out of six billion people, more than three billion - do not qualify to take out a loan from a bank" - Muhammad Yunus-Founder of Grameen Bank (2005)

Introduction

Financial inclusion has been the key priority of governments worldwide. However, even today we are far from achieving scalable and sustainable financial inclusion.For achievement of financial inclusion, it is vital to ensure that adequate banking facilities are available to the unserved and underserved people. In countries like India, where population is dispersed into numerous cities, towns and villages it is even more challenging to ensure people are financially included. Bank branches are mainly centered in and around urban areas. In India, there are 18.7 bank branches per 1 lakh adults in urban areas, but there are only 7.8 branches per 1 lakh adults in rural and semi-urban areas (RBI Report,2015).So, the advent of microfinance has been considered as a new frontier in financial inclusion of unbanked people especially in rural and semi-urban areas.

Microfinance emerged in its present form in Bangladesh. This concept of micro lending was developed by Mohammad Yunus, the father of microfinance, and there after it spread to other parts of the world. Microfinance sector extended its roots in India within a short span of time.The microfinance activities were concentrated in southern states of India. The sector was initially blessed with lax regulations, easy and highly subsidized loans from Government and Non Government sectors. Along with Government microfinance institutions, Private microfinance institutions also mushroomed and lending increased manifold.But the microfinance industry witnessed a severe crisis in 2010 in Andhra Pradesh which hampered the growth of the sector. The main reasons behind the alleged deaths of borrowers were unethical and abusive recovery practices followed by the private microfinance institutions.The Andhra state Government immediately reacted by passing a legislation named 'Andhra Pradesh Microfinance Institutions (regulation of money lending) Act'. This turned out to be a stringent law and tightened the screws on the sector.It resulted in effectively shutting down of many organizations in the state overnight butital so seemingly provided relief to borrowers who were being harassed by microfinance organizations. Central Government also introduced a bill to form a central law for Microfinance sector but is still unable to get it passed in both houses. Microfinance once considered a tool for poverty alleviation has been under fire from every nook and corner after the Andhra Pradesh Crisis. The objective of this paper is to provide an integrated view of microfinancing in India and to provide detailed analysis of Andhra Pradesh micro finance crisis of 2010. The paper has been divided into three broad sections. The first section traces the history of microfinance in world in general and in India in particular. The SWOT (strength, weakness, opportunities and threat) analysis of microfinance has been presented in this section. The second section explains the Andhra Pradesh microfinance crisis. And the third section presents the aftermath scenario of microfinance sector including the current situations. The paper concludes with some suggestions for policy makers.

Research Methodology

This descriptive study is based on secondary data collected from various sources. Related key words such as microfinance, self help groups and Andhra Pradesh crisis etc. have been used to locate the relevant studies for analysis. Research papers from various online sources such as JSTOR, Emerald etc. and reports of various national, international and private organizations and data from various government websites etc. have been used in this study.

History of Microfinance

Microfinance is providing financial services (borrowing, lending etc) to poor, unemployed or other people who lacks access to the traditional financial services due to lack of collateral or otherwise. This sector lends credit mainly for income generating activities with low rate of interest, easy process of disbursement, no collateral or security and less paper work. Microfinance has been existence in various parts of the world in various formats since centuries. However, modern microfinance originated in Bangladesh in mid 1970s. In 1974, a famine hit Bangladesh and worst sufferers of famine were poor who had limited access to credit. Mohammad Yunus, an economist,was determined to find solution to the credit problems of poor people. He made a group of women from 42 families who made bamboo stools. The women were in the circle of debt with local lenders and were unable to buy raw material for bamboo stools. He arranged small loans for them without any interest and collateral. The borrowing needs of all women in the group totalled to US$ 27. He later set up Grameen bank in 1976 for expanding micro credit to poor and otherwise ineligible borrowers.

Thus, the credit for origin of micro lending goes to Mohammad Yunus who tried to build upon the idea of small scale lending. Mohammad Yunus won Nobel Prize in 2006 for pioneering the concept of micro lending and microfinance and for setting up Grameen Bank in Bangladesh. The rationale for the award put forward by the Nobel Prize committee was that micro credit represents a way to take out people from poverty and that’s the way to ultimate peace in world.

The idea of this kind of microfinance institutions spread to other parts of world. Brazil, Peru, India and many other developing and developed countries started programs with similar principles and objectives. Microcredit has been defined by the Microcredit summit held in Washington D.C. in February 1997 as "*programs that provide credit for self employment, other financial and business services to very poor persons*".Microfinance supports entrepreneurial activity and help in improving the livelihood of borrowers in general. Microfinance also reduced dependency of people on informal sources such as money lenders. It is considered as essential tool for last mile connectivity in financial inclusion.

The existence of microfinance in India can be traced to SEWA (Self Employed Women’s Association) bank in Gujarat established in 1974 (Chen and Snodgrass, 1999).Microfinance in India has grown mostly in Southern India and Andhra Pradesh being a key state in its development. According to RBI (2008), microfinance models that prevail in India can be classified in following four types:-

SHG (Self Help Group)- Bank Linkage

In SHGs, small numbers of individuals become members of a group, and pool their savings on a regular basis to form a collective fund. This fund is then rotated as credit amongst the members through self generated norms (Satish, 2005).It is the most popular model in Indian microfinance sector.National Bank of Agriculture and Rural Development (NABARD) was set up in 1982 to facilitate rural prosperity. It played a key role in institutionalization and spread of microfinance in India.The Task Force on Supportive Policy and Regulatory Framework for Microfinance constituted by NABARD defined microfinance as“the provision of thrift, saving, credit and financial services and products of very small amounts to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their standard of living”.NABARD promoted the Self Help Group (SHG) model to deliver the financial services to the people at the bottom of pyramid.The examples of some microfinance institutions that follow SHG promotion approach are: SHARE Microfin Limited in Andhra Pradesh,MYRADA (Mysore Resettlement and Development Agency) in Karnataka, YCO (Youth Charitable Organization) in Andhra Pradesh, PREM (People’s Right and Environment Movement) in Orissa & Andhra

Pradesh, Anarde (Acil Navsarjan Rural Development Foundation) in Gujarat. There are three kinds of sub-models in SHF-Bank linkage.

I: SHGs that are promoted, guided and financed by banks.

II: SHGs that are promoted by NGOs/ Government agencies and financed by banks.

III: SHGs that are promoted by NGOs and financed by banks using NGOs/formal agencies as financial intermediaries.

Micro Finance Institutions (MFI)

MFI exists in India in various legal forms such as trusts, societies, cooperatives and Non banking financial companies (NBFC). MFI are comparatively loosely regulated due to multiplicity of regulators and registering authorities. MFIs can be registered as trust under the Indian Trust Act, 1882 or Public Trust Act of 1920, or as Cooperatives under the Mutually Aided Cooperative Societies Acts of the States or as societies under the Societies Registration Act, 1860. MFIs which are registered as NBFC can be registered under Section 25 of the Companies Act, 1956 or can be registered with the Reserve Bank of India (RBI). Most MFIs are in society's format as shown in Table No. 1 for year 2015-16

Table 1: Number of MFIs in India

Legal Form	**Number of MFIs**
Society	78
Trust	19
Section 25 companies	29
NBFC	13
Cooperative	12
Local Area Bank	1
NBFC-MFI	71
Total	223

Source : Sa-Dhan (2016)

3.3) Bank Partnership Model

Bank partners with MFI to extend finance to needy people. There are three levels in this model as shown in figure 1.

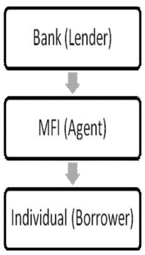


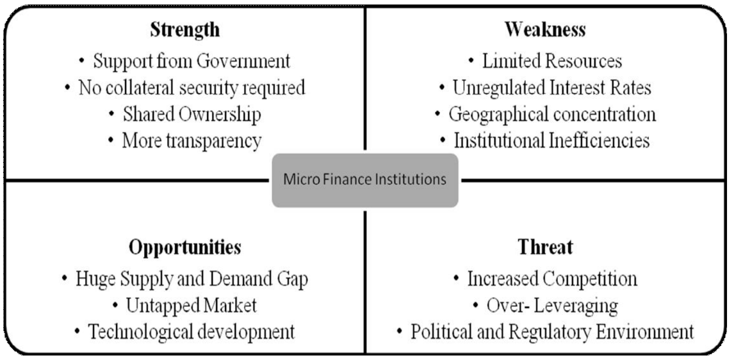
Figure 1: Microfinance supply chain in Bank partnership model

The MFI acting as agent of bank handles credit supervision, monitoring and recovery. The MFI is the linking pin between banks and borrowers.

Banking Correspondent (BC)

The concept of banking correspondent came to reality in 2006 when RBI gave permission to banks to use non-governmental organizations and civil society organizations etc. to act as intermediaries in providing financial services.BCs increase the effectiveness and responsiveness of financial and banking services' supply chain to provide last mile connectivity. After 2008, banks were allowed to use retired bank employees, ex-servicemen and retired government employees as their business correspondents.

A brief SWOT analysis of Microfinance sector in India has been presented below in figure 2.



The 2010 crisis of Andhra Pradesh

The microfinance sector boomed in first decade of 21st century. A survey of 78 countries conducted by Microfinance Information Exchange (2007)showed that Indian microfinance sector saw the largest per-MFI percentage increase in active borrowers in 2005 than any other country. Like rest of the country Andhra Pradesh having the highest concentration of microfinance institutions also witnessed a surge in MFI institutions and active borrowers.

Before the Andhra Pradesh troubles started, the decade of 2000 had been a rosy one for microfinance in India.Policy makers and regulators have been kind to the sector. Towards end of 2002, RBI allowed commercial banks to treat unsecured loans and advances to SHGs at par with secured advances. In 2004, RBI allowed lending to microfinance operations through intermediaries to be part of priority sector lending as well. This boosted the microfinance sector and led to the belief that golden age of microfinance had arrived.Many considered it bubble like growth of the market (Rozas & Sinha, 2010). Critics also pointed towards saturation and possible oversupply in the markets like Andhra Pradesh. The oversupply is believed to be caused from multiple lending by client poaching to meet targets by organizations.

Back in 2005-06, the signs of crisis started to surface in Andhra Pradesh in Krishna district. It was termed as ‘Krishna crisis’ and resulted in Government shutting down 57 branches of two large MFIs- SHARE Microfin. Limited and SPANDANA (Spandana Sphoorty Financial Limited) as well as those of few smaller MFIs (Shylendra,2006). It was alleged that these organizations charged exorbitant interest rates from clients and followed abusive recovery practices and illegal operational practices (CGAP, 2010).Though the shutdown harmed lending and recovery cycles but it had limited impact and was averted quickly.However, the loan disbursement increased manifold in coming years. By 2010,microfinance companies alone had given out 80 million rupees of loans to borrowers in Andhra Pradesh (Biswas, 2010).

In 2010, the rapid growth of the sector with minimal regulatory oversight eventually led to predatory lending practices, client over-indebtedness,and abusive recovery practices and thus worsened the situations for borrowers in Andhra Pradesh. Over indebtedness can be gauged from the fact that, in comparison to national average of Rs. 7700, in Andhra Pradesh, the average debt outstanding per household was Rs.65000 (CGAP, 2010). The sector has moved away from its original vision, termed as ‘mission drift’ by Bornstein(2013).According to estimates by Srinivasan (2010), the total number of microfinance clients in Andhra Pradesh was 25.36 million (out of which 19.11 million were SHG members and 6.25 million were MFI customers).The total outstanding debt for SHG and MFI totalled Rs. 165 billion. The crisis surfaced when reports of abusive recovery practices by intermediaries of Private MFIs were reported in vernacular press initially and subsequently in national media. Over 70 suicides were alleged to be linked to people’s inability to repay loans to MFIs (Biswas, 2010).These suicides were cited as basis for state government’s intervention to protect citizens from unethical practices by private MFIs.Oppressive practices and harassment by intermediaries were widely criticized.The Andhra Pradesh Government promulgated an ordinance in October 2010 to protect the interests of borrowers. In December 2010, the ordinance was enacted as Andhra Pradesh Microfinance Institutions (regulation of money lending) Act, 2010.

The act provided for registration and verification of every microfinance institution operating in the state, disclosure of interest rates and procedures to be adopted in case of recovery.Also no microfinance institution shall employ any recovery agent for recovery of the loans except the employees and granting multiple loans has been considered as an offence. Procedure for complaints and prosecution of cases has also been specified in the act.

The crisis halted the expansion of microfinance sector in Andhra Pradesh and made many microfinance institutions unsustainable. The sector suffered from serious liquidity crunch and it affected the outreach to people. Andhra Pradesh Microfinance Institutions Act literally caged functioning in the sector. The ripples created by the crisis were in felt in other states also. Bad loans piled up as borrowers refused to pay back and banks declining to give loans to MFIs. Growth rates for both loan portfolios and clients slowed down quickly. The recovery and lending was affected adversely. It affected collections for microfinance institutions (collection rates for organizations based in Andhra Pradesh fell from 99% to 20% (Ghiyazuddin & Gupta, 2012).

Aftermath of Crisis

The central government strongly responded to the crisis and formed a committee under Y.H.Malegam, former board member of RBI and former president of ICAI (Institute of Chartered Accountants of India) to investigate the situation in Andhra Pradesh and review the working of microfinance sector in general. Based on recommendations of this committee,RBI regulated the interest rates and defined the loan norms.Also, the margin between the cost of borrowing and the price at which loans are given was capped. In December 2011 RBI created the new recommended category of NBFC MFIs to regulate lending to MFIs (Vasudevan, 2012).Two credit bureaus- Equifax Credit Information Services Pvt. Ltd and CRIF High Mark Credit Information Services Pvt. Ltd has been created to help the industry to take more appropriate financial decisions and arrest multiple lending. Also, a Code of Conduct has been introduced to ensure good governance and client protection. These credit bureaus are now a repository of at least 100 million loan records.

The central Government released a draft of the 'Micro Finance Institutions (Development and Regulation) Bill' in July, 2011. The objective of the bill is to form a National regulatory framework for MFIs in India, with the main authority with RBI. This bill will replace individual state regulations as a nationally enforceable policy, and is currently awaiting parliamentary approval. Salient features of this bill include regulating margins charged by organizations, locations for operations, recovery methods. MFIs are in favor of a unified bill but have apprehensions as national practices may be unsuitable for the local context.This bill was introduced in Lok Sabha, in May 2012, subsequently recommended to the Parliamentary Standing Committee on Finance and finally rejected by it. The grounds for rejection were that the bill lacks in consensus, have inadequate groundwork and requires deeper study of vital issues.

Without doubt, the reputation of the microfinance sector suffered due to crisis; however Microfinance sector survived the crisis and is growing in healthier way afterwards. The growth of the microfinance sector slowed a bit for few years but gained momentum lately.

The table shows the growth in microfinance sector in India from 2009-10 to 2014-15. The client outreach decreased after the Andhra Pradesh crisis and started increasing back around 2013. However, the figure of outstanding loans does not represent a very good scenario.

Table 2: Growth in Microfinance Sector

Year	Outstanding Loan Portfolio (Rs Crore)	Loan Disbursed (Rs Crore)	Client Outreach (in lakhs)
2009-10	22544	29330	267
2010-11	24332	35176	317
2011-12	24607	22635	275
2012-13	25699	25635	275
2013-14	33517	38558	330
2014-15	48882	58680	371

Source: NABARD Report,2016

The geographic concentration of MFIs has been lopsided with higher concentration in mainly Tamil Nadu, Andhra Pradesh and Karnataka. However during last few years, although slow but a correction in geographical distribution can be seen. Figure 1 shows Region-wise Distribution of SHGs. The percentage increase in number of SHG has been increasing for last 3 years in uniform manner in India. And surprisingly the number of SHGs has been decreasing in southern India since past 3 years.

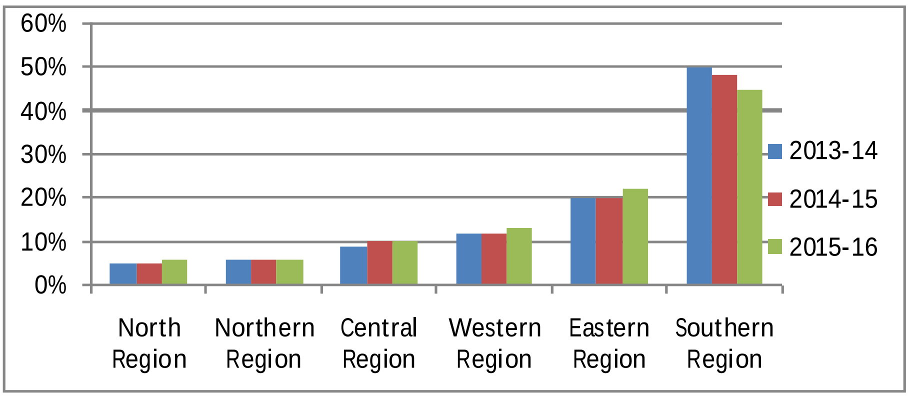


Fig.3: Region-wise Distribution of No. of SHGs with Savings Linkage (%)

Source: NABARD Report,2016

The entire picture is not so black and white. Abusive practices of MFIs such as charging high interest rates, adopting coercive collection practices and lending aggressively beyond the repayment capacity of the borrowers has been deepening problems for the economy. This forces poor deeper into vicious cycle of poverty rather than helping them get out of poverty.Maharashtra which consists of 12% of the total microfinance portfolio is under scanner lately. As per the report 'Indian Microfinance - Crisis Brewing'by Religare Capital Markets report (2015), 47% of the poor households in Maharashtra have taken loan from microfinance firms. Since last quarter of 2016, there have been reports of troubling times for microfinance institutions in Maharashtra. Excessive lending and political interference have been cited as main causes, demonetization has aggravated the situation. A special investigation team has been set up by state government to investigate the matters. Microfinance is considered as panacea for poverty and an important tool to achieve financial inclusion. But till date there is no comprehensive centralized regulation in place for microfinance sector. The unregulated activities of microfinance organizations led to the unfortunate crisis in Andhra Pradesh and can cause further problems.

Conclusion

It is quite evident that the microfinance industry in India has followed a fairly typical product life cycle: a slow start, a period of high growth, a crisis and a subsequent lull. Microfinance has proved to be wild child in absence of proper regulations.The 2010 Andhra Pradesh crisis has been eye-opening for Indian government. However today unlike in 2010, the microfinance sector is comparatively tightly regulated industry in terms of size of loans,clients, purpose and interest rates.

The government of India needs to acknowledge that microfinance is built on the failure of the formal financial sector. And thus it is essential to not lose sight of the financial inclusion for all Indian citizens. Pradhan Mantri Jan Dhan Yojana is a welcome move in this direction. The commercial banks should work on making accounts opened under this scheme more functional. It is saddening that microfinance is not clearly mentioned as a subject on either the state or the central Government list in India, which determines who will be the final authority. It is essential that there should be central regulating body for microfinance institutions to remove ambiguousness.

Also the current Government should work on the next draft of the bill to ensure that it gets translated into law. This is high time that private MFIs take responsibility of the impact of their actions, because microfinance is not just a for-profit venture but is a part of agenda for poverty alleviation. Microfinance can play a key role in financial inclusion especially in countries like India, where greater fraction of population is scattered into numerous tiny villages and towns.

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