

Andhra Pradesh Microfinance Crisis and its Repercussions on Microfinancing Activities in India

Prabhjot Kaur¹ and Soma Dey²

*^{1,2}Management Studies, North Campus,
University Of Delhi, Delhi, 110007, India.*

Abstract

Microfinance institutions once considered as a tool for sustainable development are today themselves grappling with the issues of their own sustainability. Eruption of Andhra Pradesh Microfinance Crisis, 2010 endangered the existence and viability of operations of Microfinance Institutions (MFIs) in India. Enactment of *Andhra Pradesh Microfinance Institutions (regulation of money lending) Act, 2010* stifled the operations of MFIs very badly. Under the Act, provisions related to recovery of loans caused repayment of loans to fall from 99 per cent to 10 per cent only. Present paper attempts to look into the enabling reasons responsible for spawning the crisis. Further attempt has been made to trace the repercussions of Andhra Pradesh Crisis on the activities of MFIs. Analysis from the data accessed from the various reports like *State of Sector Reports* on Microfinance by ACCESSS, NABARD, *Microfinance Information Exchange* data and MCRIL Review Reports etc., have found that loan disbursement, clients served, cost efficiency and operational sustainability *etc.* of MFIs has been hampered by the crisis. However reprieved Microfinance Bill if passed can bring optimistic change in the sector. Credit bureaus are also playing important role to tackle the problems that caused the emergence of crisis in 2010.

Keywords: Andhra Pradesh Microfinance Crisis, Credit bureau, MFIs, Operational sustainability, Self Help Group etc.

1. Introduction

Microfinance began its journey by providing credit to the poor. Later on it embraced saving and insurance services and has now extended its ambit of financial services to provide micro remittance and micro pension *etc.* to very poor people who were otherwise deprived from the formal financial services due to the complexity of the system and due to lack of collateral. But, once considered as a tool for sustainable development, Microfinance Institutions (MFIs) are today themselves grappling with the issues of their own sustainability. This is true, especially, in case of India who is yet to overcome from the impacts of the Andhra Pradesh Microfinance Crisis, 2010. During 2005-10 Indian microfinance sector was one among the largest microfinance sector in the world and Andhra Pradesh was applauded as “the State that would reform India” (*The Economist, 2000*). However ripples of the Andhra Pradesh crisis were felt almost by every state of India and deformed their loan portfolios and their reach to the poor. Enactment of *Andhra Pradesh Microfinance Institutions (regulation of money lending) Act, 2010*, impacted micro-lenders’ profitability, loan recovery and turned their operations unviable. The crisis in the microfinance sector has left some microfinance companies with negative net worth due to which they are unable to borrow from the banks and hence their credit disbursal get affected by the crisis. Funding constraints, negative perceptions combined with higher operating costs are posing real challenges to the growth of the industry. All indicators, viz., clients, Gross Loan Portfolio, disbursements, branches, employees, portfolio quality and financial performance ratios *etc.* have deteriorated overall for MFIs in India (*The Microscope, 2012*). Present attempts to comprehend the reasons that were responsible for the eruption of the crisis in Andhra Pradesh and its repercussions on the activities of MFIs operating in India.

2. Andhra Pradesh Microfinance Crisis

In the wake of incidents like MFIs using unethical practices to recover the loans which apparently lead to suicides by the borrowers, allegation of multiple borrowing and charging high interest rates forced Andhra Pradesh (AP) Government to promulgate an ordinance in October, 2010 to save the borrowers. In December, 2010 Ordinance was enacted as *Andhra Pradesh Microfinance Institutions (regulation of money lending) Act*. Following the Act, operations of MFIs just came to halt. In 2009 growth of loan portfolio and clients were 95 per cent and 57 per cent respectively; it came down to mere 17% for both in the fiscal year 2010. Loan write-offs also increased in 2010 to 3 per cent from a mere 0.6 per cent for the same period one year earlier. Even with an offer to halve the interest rate charged on overdue loans, the industry was not able to increase recovery rates (*MIX Microfinance World, 2011*). Ordinance refrained MFIs from collecting money door to door and enjoined them to collect money from the public places mentioned in the Act on monthly basis instead of on weekly basis. Since use of forceful practices to recover loans were now punishable under the Act and in absence of cluster and centre meetings where MFIs usually used to collect money ,

message that was perceived by the borrowers was they are not required to repay their debt and in any case state government is there to protect them. The recovery rate plummeted from 99% to 10% (*Srinivasan, 2011*). Analysis of *M-CRIL Microfinance Review (2011)* indicates crisis left the MFIs in India to possess worst portfolio quality ratios in the world. Portfolio at Risk (PAR₃₀) sprang up from 0.67% (March end 2010) to 25.5% in 2011.

2.1 Genesis of the Crisis

However, Andhra Pradesh ordinance did not come out of the blue. Genesis of the Andhra Pradesh Microfinance crisis can be traced back in the year March, 2006 when Krishna district government closed down 57 branches of two largest MFIs (SHARE and Spandana) as well as those of few smaller MFIs. Decision to close down of these MFIs came because of the allegations of unethical collections, illegal operational practices (such as taking savings), poor governance, usurious interest rates, and profiteering (*CGAP, 2010*). There was even an allegation that 10 borrowers of MFIs in Krishna district committed suicide because they were unable to repay the loans taken from MFIs (*Shylendra, 2006*). *Ghate (2006)* cited near-saturation of Andhra with microfinance as one of the most important enabling cause for the crisis. The implication of above point is that borrowing from multiple sources like Velugu (SHG scheme backed by AP Government and assisted by World Bank), MFIs and moneylenders culminated in over indebtedness. Rapid expansion of bank credit as facilitated by initiatives like ICICI partnership model and availability of cheap credit in form of "Pavala Vaddi" scheme, motivated by political consideration, intensified the crisis. As diagnosed by *Shylendra (2006)* conflict between State supported SHGs and Civil society initiatives in form of MFIs as the major reason behind the eruption of crisis.

MFIs had to face the brunt of Act in 2010, for not learning lesson from 2006 crisis and ignoring all the warnings pertaining to high interest and growth rate, concentration of activities in the region etc. Over indebtedness in AP can be gauged from the fact that, in comparison to national average of Rs. 7,700, in Andhra Pradesh, the average debt outstanding per household was Rs. 65,000 (*CGAP, 2010*). Inability of borrowers to repay such huge amount resulted in stress on the part of borrowers and use of coercive methods on the part of MFIs to recover the loan payments, which ultimately resulted in suicides of the borrowers. The government had cited the death of 54 customers by suicide. However state Government backed SHGs were kept out of the purview of the Act though different studies are showing they were also responsible for multiple borrowing. *M-CRIL (2011)* study clearly stated if the number of MFIs loans is over 100% of the number of eligible, financially excluded families, SHG loans are actually 310% of that number. So keeping SHGs away from the ambit of Act, agonized MFIs and it was perceived by them as an Act to protect state Government backed SHGs from the competition from MFIs. So in the wake of incidents like over-indebtedness, hype created by the IPO of SKS Microfinance coupled with the reports of suicides in rural Andhra Pradesh resulted in ordinance of 14 October, 2010.

However crisis of 2006 to some extent was calmed down when MFIs espoused by Sa-Dhan appealed state government authorities to not to take any detrimental actions against them. Closed down branches were reopened as MFIs agreed to abide by public audit, a Code of Conduct (issued on 20 March, 2006) pertaining to transparency of rate of interest. MFIs released an indicative schedule of interest rates that could be possibly charged by them (21- 24 per cent), arrived at based on the prevailing cost structure of MFIs.

3. Repercussions of the Crisis

As criticized by *Legatum Venture (2011)* enactment of the AP Act has stifled the access of basic financial services to the poorest citizen of India and estimated to have effect on 450 million people. The crisis in the microfinance sector has left microfinance companies like *SHARE Microfin, Asmitha Microfin, Spandana Sphoorty Financial, Trident Microfin and Future Financial Services* with negative net worth (*Business Standard, 13 Sep, 2013*). According to norms, banks are not allowed to give fresh loans to companies that have negative net worth. Since Banks stopped lending to MFIs, they have not been able to disburse fresh loan to their clients. Banks were also hit by crisis as 80% of loans MFIs borrowed were from the banks. Of the Rs 21,000 crore that banks have outstanding to MFIs, roughly a third was borrowed from private banks (*Financial Express, 1 Nov, 2010*). Banks and financial institutions lost their trust on MFIs credibility to repay the loans. As shown in table 1, fresh lending to MFIs by banks during the year 2011-12 declined by over 38% as compared to last year. Loan outstanding against MFIs has come down by almost 17% during the year 2011-12. If the trend continues, microfinance sector is likely to face serious liquidity crunch and will affect their outreach to the poor. As shown in figure 2, client outreach has registered negative growth for the financial year FY 2011-12. In comparison to the previous year, Gross Loan Portfolio (as shown in figure 1) also shrunk by 14 per cent in FY 2011-12 and reduced to Rs. 172 billion (*Microscape, 2012*).

Crisis has made borrowing expensive. Cost efficiency of MFIs in India has deteriorated, as even for non AP- MFIs cost per borrower has increased by 60% (*M-CRIL, 2012*). Due to rising borrowing cost and inability to raise fund for growth, financing expenses have increased and it is further straining the Operational Self Sufficiency (OSS) and profitability of the firms. As shown in figure 4, OSS, for AP MFIs fell drastically from 150 per cent (FY 2009-10) to 40 per cent (FY 2011-12). Crisis has severely affected the Portfolio at Risk (PAR30) i.e. unpaid principal balance of loans Overdue by greater than 30 days, has worsened from 0.4 per cent to 62 per cent for AP MFIs (figure 3). On the profitability front out of 61 MFIs studied in *State of Sector Report(2012)*, 11 registered negative Return on Assets (RoA). There were mere 5 MFIs whose RoA were above 5 per cent.

However Microfinance Market Outlook (2013) gave some hope of recovery for the Indian microfinance industry, as they expected it to expand by around 20% in 2013. Role of Credit bureaus is applauded for bringing positive outlook of microfinance

sector as they helped in keep a check on multiple borrowing which was one of the major responsible reasons behind the eruption of the crisis. But many informal sources of finance are yet out of the purview of Credit bureaus. Enactment of Micro Finance Institutions (Development and Regulation) Bill, 2012, which is still pending with the Standing Committee on finance, has potential to catalyze the microfinance sector under the wise regulation of RBI.

Table 1: Loans disbursed and outstanding to MFIs under MFI-Bank Linkage Programme (In Rs. Crore)

Particulars	2008-09		2009-10		2010-11		2011-12	
	No. of MFIs	Amount	No. of MFIs	Amount	No. of MFIs	Amount	No. of MFIs	Amount
Loans disbursed by banks to MFIs	581 (12.2%)	3732.33 (89.4%)	779 (34%)	10728.50 (187.4%)	471 (-39.5%)	8448.96 (-21.3%)	465 (-1.3%)	5205.29 (-38.39%)
Loans outstanding against MFIs as on March 31	1915 (72.7%)	5009.09 (82.2%)	1659 (-13.4%)	13955.75 (178.6%)	2315 (39.5%)	13730.62 (-2.0%)	1960 (-15.3%)	11450.35 (-16.6%)
Fresh loan as a % of loan outstanding		74.5		76.9		61.5		45.5

Source: Status of Micro Finance in India 2011-12, NABARD

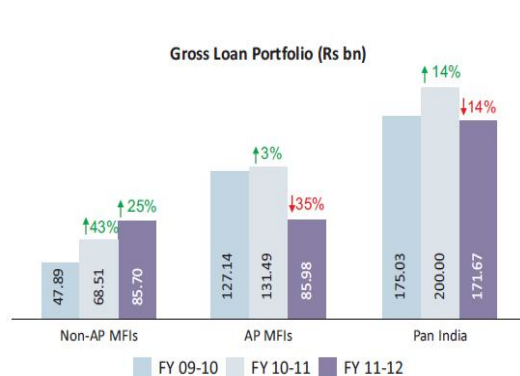


Figure 1

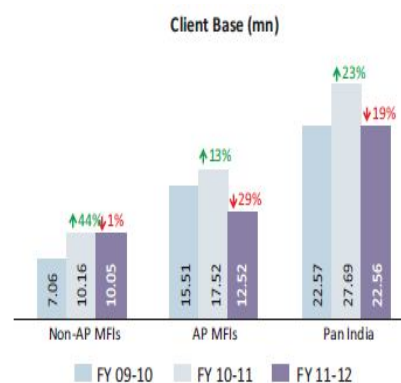


Figure 2

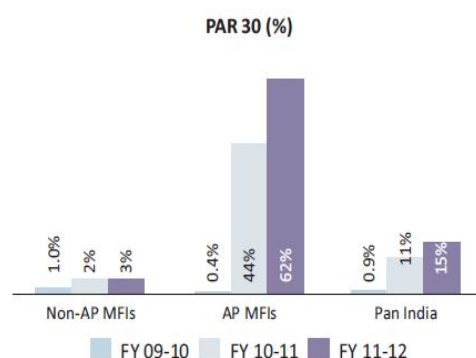


Figure 3

Source: The Microscape, 2012

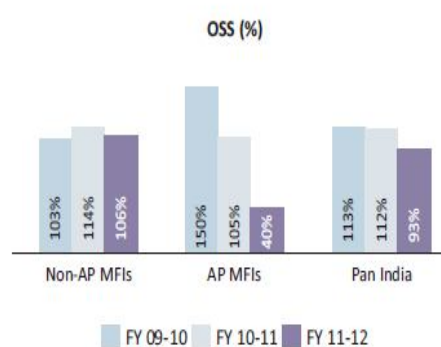


Figure 4

4. Conclusion

In Indian microfinance history year 2010 was certainly a bad year. Allegation of suicides due to unethical means of recovery of loans, charging higher rate of interest by MFIs, over-indebtedness in Andhra Pradesh resulted in the enactment of *Andhra Pradesh Microfinance Institutions (regulation of money lending) Act, 2010*. Stated objective of the Act was to protect the poor borrowers from the MFIs who were allegedly responsible for 54 suicides in Andhra Pradesh in 2010 due to their coercive recovery practices. But analysis of different studies is showing that the Act protected SHGs (which are supported by the state Government) from competition from the MFIs, who were charging higher rate of interest and yet widely accessed by the borrowers. SHGs were also responsible for multiple borrowing. *M-CRIL (2011)* study clearly stated if the number of MFIs loans is over 100% of the number of eligible, financially excluded families, SHG loans are actually 310% of that number. So keeping SHGs away from the ambit of Act agonized MFIs. Provisions of the Act related to recovery of loans seriously hampered the recovery rate and made it to fall from 99 per cent to 10 per cent. Prevalence of uncertainty and risk made banks reluctant to give loans to MFIs. Liquidity crunch affected client base, profitability and sustainability of MFIs. Crisis hit the Operational Self sufficiency of AP based MFIs very badly as it fell from 150 per cent to 40 per cent in FY 2011-12. Crisis affected the portfolio quality of MFIs to the extent to make it worst performer on the global platform. As pointed by *Srinivasan (2011)*, “The Andhra Pradesh regulation is right on intent, but wrong in its focus, coverage and application. Inappropriate regulation produces long-term damage that is difficult to remedy”. Repealed Microfinance Bill, 2012, if passed, can help in repairing the damage and nudge the Indian microfinance sector to gain the ground again. However year 2013 is showing some sign of recovery as it is expected to grow by 20 per cent during the year. Credit Bureaus have played important role in checking multiple borrowing but many informal sources of finance that are not covered by the credit bureaus are still issues of concern.

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