

## THE ANDHRA CRISIS:

*The Beginning Of An End Or End Of A Beginning?*

***MicroSave***

*Market-led solutions for financial services*

**IFN 55: THE ANDHRA PRADESH CRISIS: THREE DRESS REHEARSALS  
... AND THEN THE FULL DRAMA**

## The 3 Ks...Krishna, Kanpur and Kolar



*... and the story of Microfinance sector so far...*

# The first K...Krishna

## *Chief Actors*

- The AP Government
- RBI
- AP MFIs

## *Flashpoints*

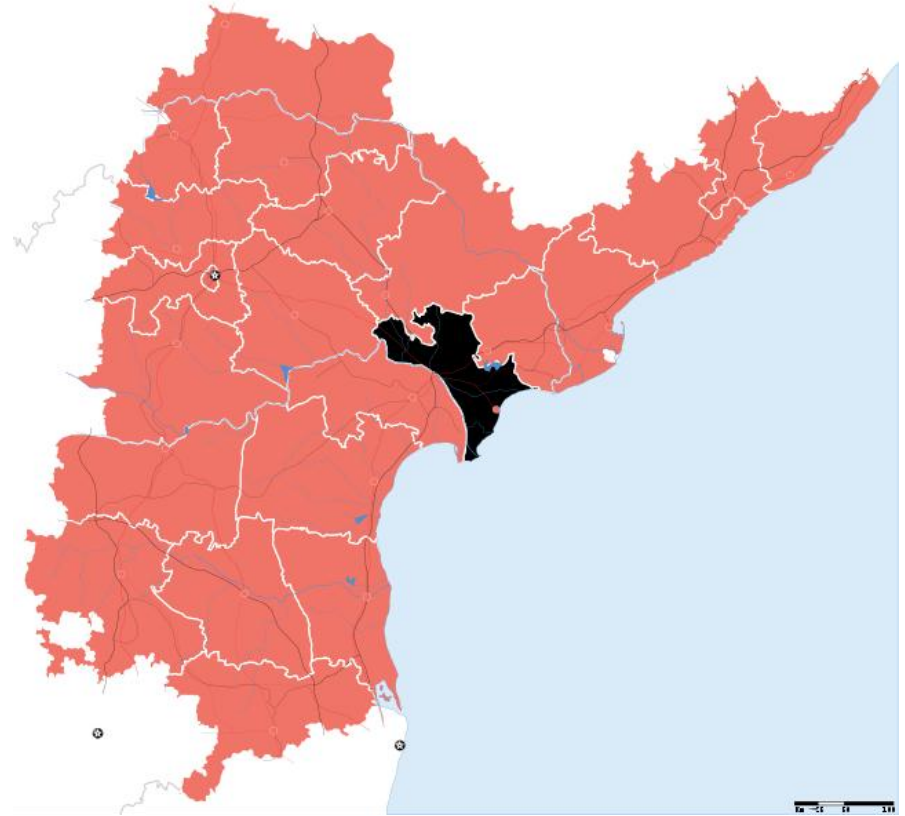
- MFI alleged with:
  - Charging usurious rates
  - Making super-profits on poor's back
  - Poaching on Government SHGs
  - Coercive collection practices

## *Immediate Effect*

- 50 + offices of leading MFIs closed
- Clients induced not to pay their loan

## *Long-term impact*

- MFIs promised interest rate reduction and introduce Code of Conduct
- Body blow to Partnership model as RBI questioned lax KYC
- Immediately cut off a key funding source as MFIs started scouting for equity investors-setting the stage for entry of PE investors



## The Second K...Kanpur

### *Chief Actors*

- Nirman Bharati

### *Flashpoints*

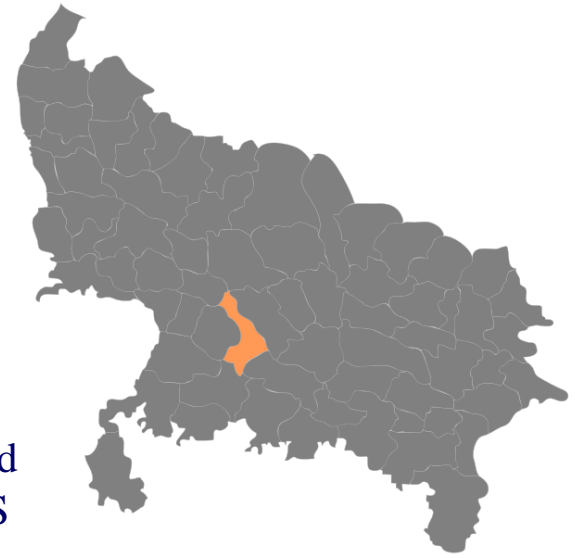
- Default on bank loans by NB

### *Immediate Effect*

- Brought into public view the inability of MFIs to manage the flood of debt financing due to poor internal controls, processes and MIS

### *Long-term impact*

- Exposed inability of Indian MFIs to manage their exponential growth – both in terms of maintaining the integrity of processes and systems and in terms of the real status of the portfolio



## The Third K...Kolar

### *Chief Actors*

- Anjuman Committee

### *Flashpoints*

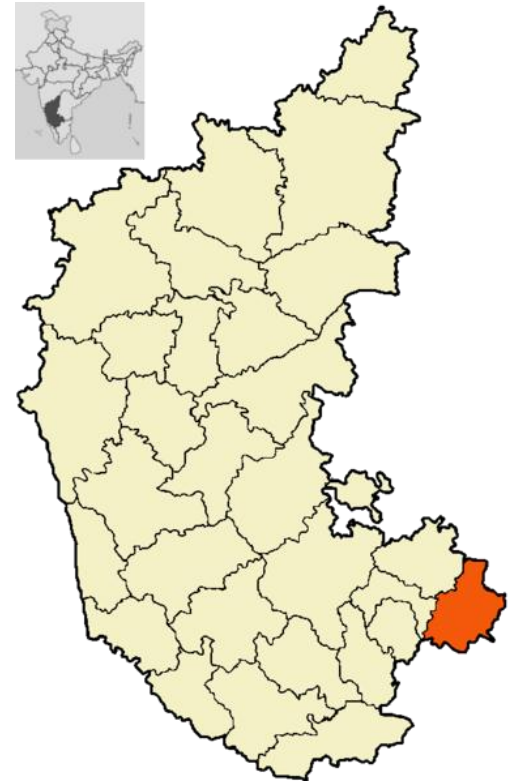
- Strike called by Anjuman committee, a local Muslim group, directing the Muslim borrowers not to repay
- Client fatigue with JLG processes
- Downturn in the local silk-reeling industry

### *Immediate Effect*

- Acknowledgment of the rampant multiple-lending
- More awareness about the risks associated with traditional, group-based lending operations

### *Long-term impact*

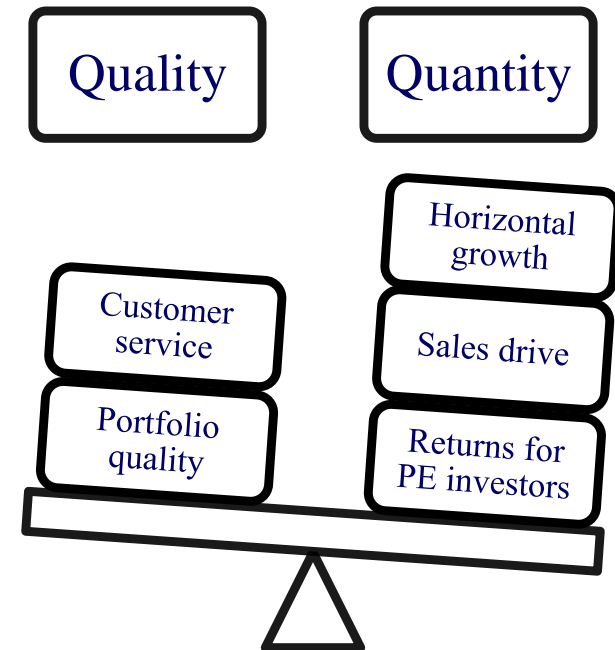
- Exposed lack of clout that MFIs have amongst their clients
- Culminated in formation of MFIN that started working towards establishing a credit bureau, enforcing transparent pricing and encourage MFI members to limit the lending to Rs. 50,000



## Complication

*MFIs' effect on the Government nurtured SHG movement was beginning to show, with falling repayment rates amongst households borrowing under both models-this was attributed to stricter loan collection regimes of the MFIs*

- The writing was on the wall but the sector chose to ignore and focus on rapid horizontal growth instead
- Even as these events were unfolding, Microfinance sector grew at a whopping rate



## ...and the Full Production Drama

### *Chief Actors*

- AP Government

### *Flashpoints*

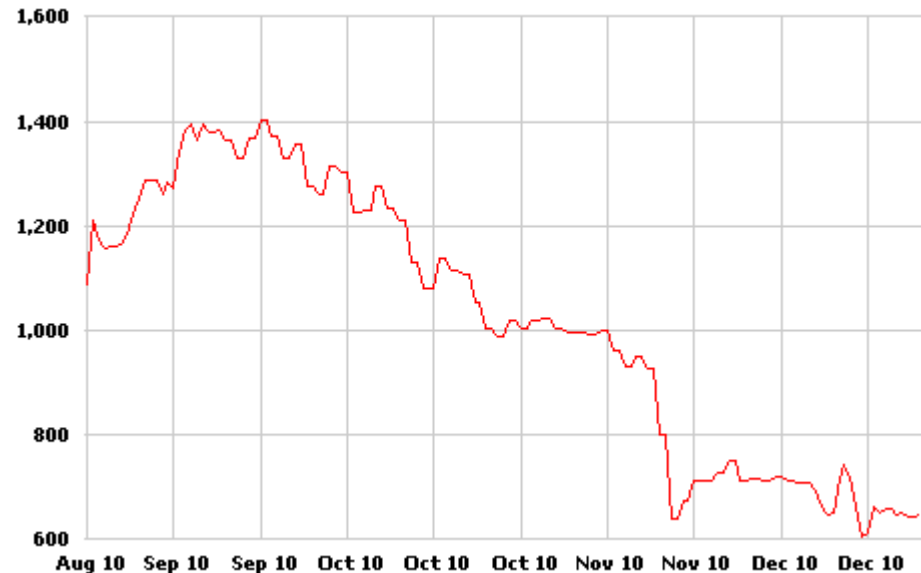
- Reported suicides

### *Immediate Effect*

- Collections on field take a nosedive
- Entire microfinance sector faces a bad publicity as MFIs are charged of:
  - profiteering at the cost of poor women
  - charging opaque and usurious interest rates
  - using strong-arm collection technique

### *Long-term impact*

- AP Microfinance Ordinance passed with a view to level the playing field with SHGs:
  - MFIs to register at local government offices
  - Loan repayment to happen monthly at the GP office
- In one stroke the ordinance would smother MFIs USP-convenience of small weekly repayments at the client's doorstep



*The SKS Share prices tumble*



***Ex-SKS Area Manager recalls:***

*One time the local communist party threatened to close our offices because we would not hire their nominees. In response, our clients surrounded their party office to tell them to leave SKS alone as it was providing a valuable service ...*

**...does it sound as if its a voice over from another era?**

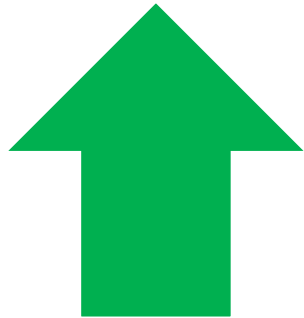
## IFN 56: THE ANDHRA PRADESH CRISIS: SO WHAT NEXT?

## ...the likely long-term scenario

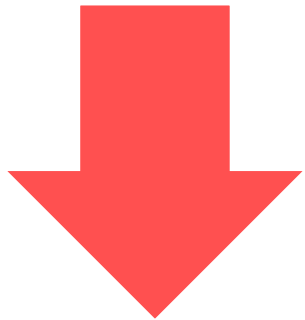
*The microfinance industry is undergoing a major shake-up. This is likely to accelerate a trend where two major shifts are likely to emerge (at the MFI level and the other at regulation level)*

### MFI Driven

- » Multiproduct
- » M-Banking/technology enabled
- » Individual based



- Mono-product
- Labour-intensive
- Group based



### Regulation Driven

RBI wants banks to be directly involved in lending through BC Model

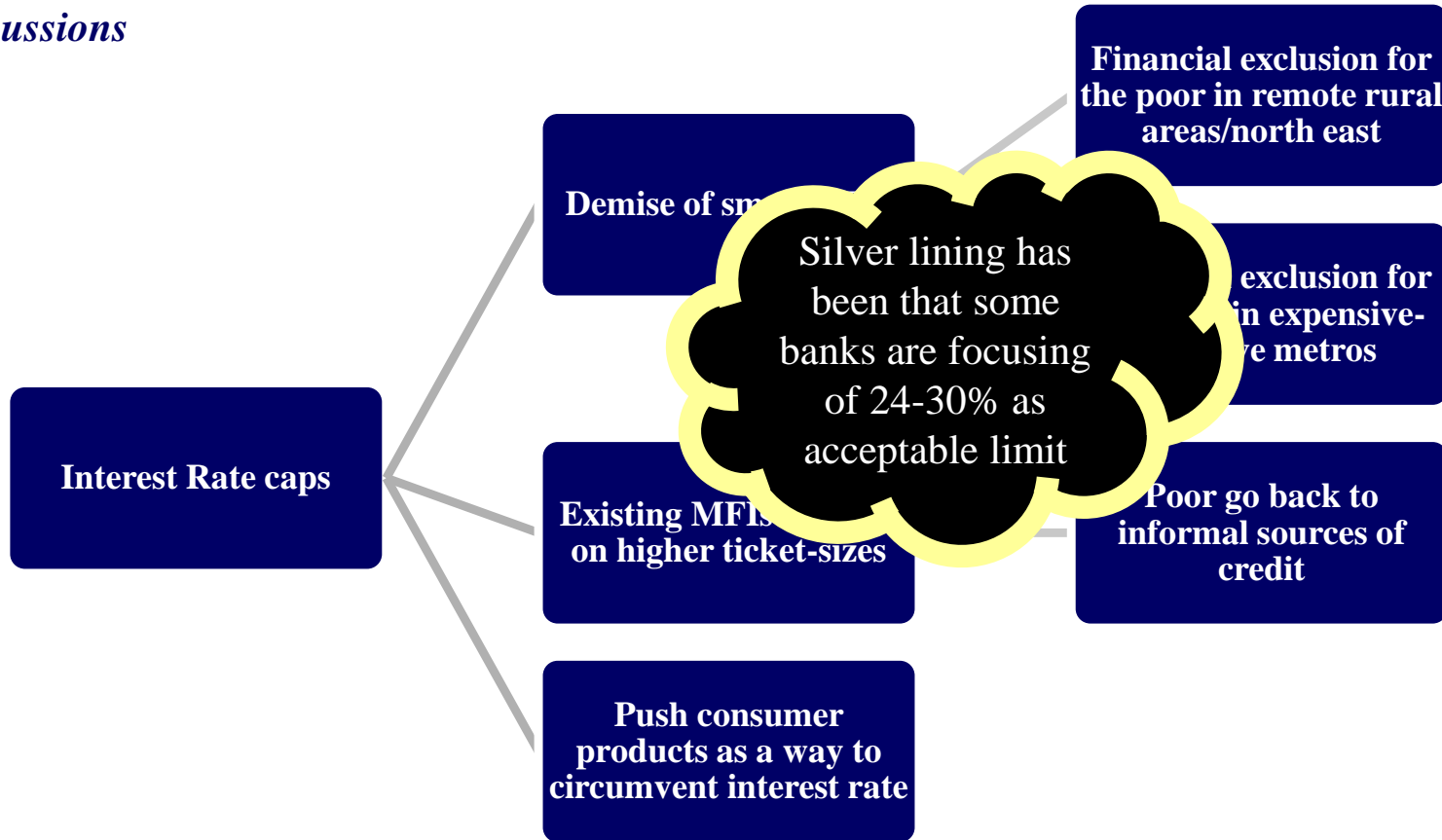
RBI would refine regulation till it becomes profitable for banks

MFI's may eventually end up as the agents of banks in rural areas, selling products and managing clients/repayments



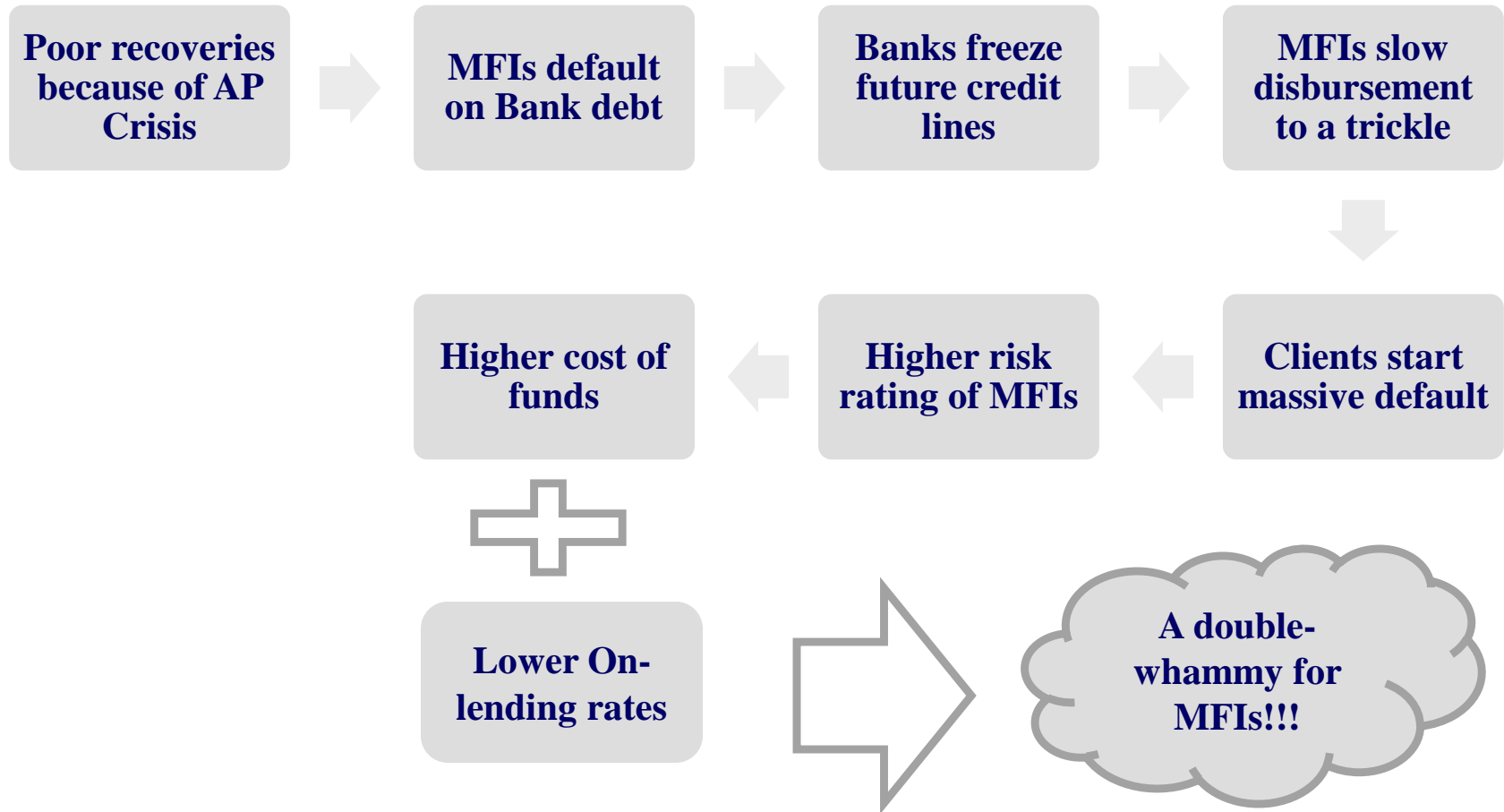
## The worst case scenario (1/3)

*An interest rate cap of 24% (even though being pushed informally) is likely to have negative repercussions*



*Role of players like Dia Vikas Capital, Maanveeya Holding (Oiko Credit) etc. will enhance as their capital supply lines are made independent of Indian banks*

## ...Worst case scenario (2/3)

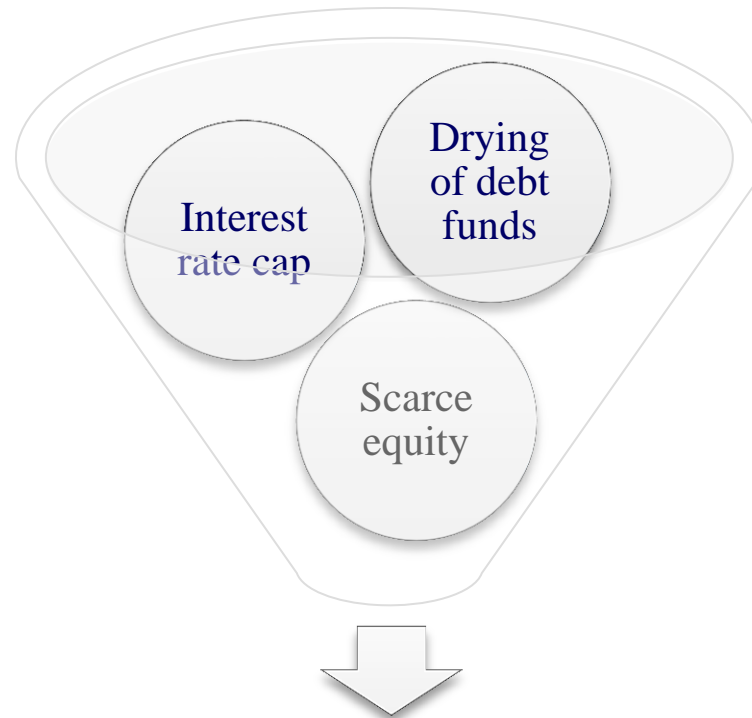


*Add to that a potential withdrawal of priority sector status for debt funds extended to MFIs- likely to exacerbate the downward spiral!!!*

### *Even equity funds will be scarce and valuations modest*

- ✓ With lower fund flow higher equity inflows will be needed- but conventional private equity players may not find the sector attractive enough
- ✓ Long term, patient social equity will be needed but at present, this is scarce in India
- ✓ MFIs will have to settle for lower value and book multiples

*But....*



*May trigger a re-look at the whole model of microfinance*

## ...the UP side

MFIs and banks will experiment with different forms of agent models that could form basis of reducing costs and cross-selling products such as savings and insurance

Risk management will be heeded closer look- esp. political and reputational

Emphasis on brand building and differentiation- away from “Monday MFI”, “Tuesday MFI” and choose their position on the basic perceptual map

MFIs are likely to have to move closer to what *MicroSave* has been calling 3rd generation microfinance which is:

- harnessing technology
- collaborative arrangements to offer a range of financial services to their clients
- move to individual cash flow-based lending for many MFIs

Which would necessitate:

- better quality manpower and more emphasis on HR systems
- client relationships are better managed and the brand name of MFIs is not compromised
- reduced profitability and lesser margins



## IFN 57: THE ANDHRA PRADESH CRISIS: WHAT SHOULD MFIS DO?



## What Happens...

- ✓ Techniques at obfuscation: charging basis, grace period, tenure, prepayment, bundled products
- ✓ Just doing the bare minimum-charging interest in APR terms



## What Should Happen...

- ✓ MFIs should commit to help clients to understand the real cost of their loans
- ✓ Need for an industry standard way of pricing

## Transparency of Operations and Governance

Discussions with bankers repeatedly show that the price of loans advanced to MFIs depend greatly on perceptions of their transparency and governance

In a politically and social sensitive environment like microfinance, it is essential to be, and be seen to be, transparent and honest in all dealings

*Should not only do good, but should also be seen to be doing so.*

# Improved Analysis and Dissemination of Social Performance

- ✓ Client data typically remains on loan application forms, unanalysed, in branch offices
- ✓ Very few MFIs are currently tracking their social impact
- ✓ The existing tools promote focus on depth of outreach rather than how best to serve the poor
- ✓ Analysis that includes *client satisfaction and loyalty* as the basis can be more effective in not just describing how the MFI is performing to external stakeholders, but also in enhancing client responsiveness of the MFI

## Concrete steps that MFIs should take

### Client Protection

- Transparent and fair pricing
- Address multiple borrowing
- Balanced collection practices

### Client Delight

- Offer range of high quality, client-centric and flexible financial products

### Develop Strategy

- Develop institution specific strategy and not a 'cut-copy-paste'

### Communicate

- With stakeholders such as government officials, media
- Communicate about social side of the microfinance

### Grow and Expand

- ...but at rates that are manageable and enables human resources to be integrated into the institution

## Move to 3<sup>rd</sup> Generation Microfinance

### *Full range of financial services*

- Use BC to offer the full range of financial services and thus real financial inclusion to the poor of India
- In such a case it is expected that clients would repay loans to secure on-going access to wide range of valued financial services rather than because their group and a credit officer were pressurising them to do so

### *Move to Individual Lending-Credit Bureau vs. thorough cash flow analysis*

- *MicroSave* calculates that loans of Rs.20-25,000 are adequate to cover the costs of conducting a cash-flow analysis of and reference checks on the borrower's business
- Performed well, such analysis (while not perfect) may offer a better chance of assessing the risk of over-indebtedness than a credit bureau

### *Use of technology*

- The mobile phone technology could take care of loan reminders, collections and initial follow-up; thus allowing staff to focus on origination, appraisal, monitoring/client relationships and the (hopefully) few cases delinquency

## IFN 58: WHAT SHOULD THE GOVERNMENT DO

## What should Government do...(1/2)

### *Recognise*

- It is only with active support from the Banking industry that MF industry has been able to grow very rapidly
- Banks find it difficult to extend credit for enterprises in informal sector with credit needs of Rs.200,000 to 500,000 and MFIs are best placed to fill this gap

### *Enforce Transparency*

- RBI should take up the challenge of regulating the sector
- Reporting standards be developed
- Prevent reporting arbitrage by common reporting formats and measures for sharing of information across banks
- Promote and encourage a truly double bottom-line approach to providing financial services to the poor

### *Regulate for responsible lending*

- An Ombudsman-like institution should be created for MFI clients to be able to provide a forum for redress
- Adopt an area approach in bank lending to MFIs-ensure greater care and supervision by the banks
- Enhance its own capacity to regulate and supervise NBFC-MFIs

## What should Government do...(2/2)

### *Using PSL targets*

- Limit the amount of lending per MFI that can be counted towards PSL requirements
- Access to PSL funds should be made contingent on MFI's presence in remote areas, transparency & provision of wide range of financial services

### *Develop Union level legislations*

- MFIs, in all regulatory formats, should be exempt from state-specific money lending and other legislation and be brought under a pan-India regulation

### *Interest Rate Caps?*

- To address concern of some MFIs making super profits, it is the RoEs that must be capped

### *Enhance and encourage BC*

- Use BC for full and comprehensive financial inclusion
- leverage the outreach and networks already created by MFIs for some products

### *Industry Associations*

- Recognise a industry collective that is credible and well-resourced
- Hold it accountable

### *Soul-searching on SHG model*

- Why MFI had space to lend at 24% against SHGs 3%?

## IFN 59: ANDHRA PRADESH CRISIS CLIENTS' PERSPECTIVE



## Client Reactions to the Ordinance

*Broadly speaking, three kinds of reaction are emerging from the clients*

### Still willing

- Willing to pay but unable to do so because of the prevailing situation
- Either MFI loan officers arrested by police or villagers not allowing them entry
- Others fear that no further loan would be sanctioned and are willing to repay on promise that future loans will be sanctioned

### In doubt

- Influenced by the Government campaign not to repay
- Would want to wait for Government to make a formal announcement
- Local political representative won't let MFI staff in unless they get a official letter from the Government.
- Expecting Government waiver

### The defaulters

- Use this as an opportunity to default on or renegotiate their loans
- Many feel that they have overpaid and been fleeced by MFIs
- This segment is the most active in spreading the negative image of MFIs

## Non-Client Reactions to the Ordinance

Prejudices about, MFIs have been strengthened...and media has played a big role



**MICROFINANCE: DEATH TRAP?**

IBNLive.com

CNN  
IBN

Most believe that MFIs are charging rates higher than moneylenders and use coercive practices for repayment

THANKS