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Microfinance, India's sub-prime crisis

VIVEK KULKARNI

MFIs were in a hurry to grow and lend, thanks to their private equity investors.

Imagine that your maid borrowed Rs 30,000 from you, promising to repay within a year from her monthly wage of Rs 4,000. Do you think you could cut Rs 2,500 from her monthly wages, every month? First of all, do you expect her to repay anything? Would you charge any interest on your lending?

Most likely, you might write off the entire amount, considering her child's education and husband's health problems.

Microfinance Institutions (MFI) are in a similar situation. According to the Government of Andhra Pradesh, more than Rs 25,000 crore has been lent to over 80 lakh poor families. On an average each family owes Rs 30,000. Most MFIs charge 27 per cent interest on loans. Some MFIs seem to use strong-arm tactics in loan recovery, with a few reported suicides. The Andhra Pradesh Government reacted with an ordinance to regulate MFIs. Most likely, the MFIs might be forced to write off a big chunk.

HOW IT UNRAVELLED

First, MFIs were in a hurry to grow fast. SKS Microfinance, a listed company, has grown 90 per cent annually for the last four years (see Table), from just two lakh members to 40 lakh members in less than three years.

The loan disbursements have gone up from just Rs 150 crore to over Rs 4,400 crore in three years. Growth prompted investment grades from rating agencies. Whenever loans are disbursed in haste, one can anticipate problems later.

Second, the concept of self help group (SHG) was not followed. The concept involves forming groups of 15-20 women, who meet regularly, understand each other's problems and bond for a while. They are expected to save a small amount, keep the money in bank and earn interest.

A member could borrow when she falls ill and can't go for work. She would return the money with 18-24 per cent interest to the group. The recovery is almost certain, due to peer pressure and bonding with the group.

Such group formation and bonding takes a minimum of six to nine months. The MFI did not have so much time and wanted to grow rapidly in tune with their private equity investors. They went in for the Joint Liability Group (JLG) method. Their agents would persuade five women to form a group and each guaranteed the others' loans. Most members of JLG could not develop the special bonding they would have in SHG.

Third, the MFI apparently charged lower interests of 12-18 per cent in JLG, compared with that of 18-24 per cent charged by SHGs primarily run by the PSU banks. MFI interest rates were non-transparent and effective rates often were over 27 per cent, considering loan processing fees, penalties and hidden charges.

WHAT GOES UP .. COMES DOWN!

Operational Information	2006	2007	2008	2009
Branches	80	275	771	1354
Districts	19	102	235	336
Staff	574	2389	6425	12814
Members (lakhs)	2	6	18.7	39.5
Loan (Rs. Cr)	152	445	1679	4399

THE SUBPRIME BUBBLE

How did the borrowers repay? Many adopted what is now known as 'ever greening' tactics. They would borrow on Mondays from one MFI and repay to the other MFI on Wednesdays. Since all of them were growing with plenty of funds from the private sector banks, the party went on.

Of late the PSU banks too joined the party. For instance a major PSU bank that had Rs 1,000 crore exposure to SHG based loans, lent another Rs 60 crore to MFIs.

Should we credit the Government of Andhra Pradesh for bursting the MFI bubble? Has the lending reached many subprime borrowers? Prima-facie the evidence seems in favour of the government.

Each poor family seems to have borrowed over Rs 30,000 per year. While every MFI claims that it has lent just Rs 10,000 per family, multiple lending suggests a higher figure.

Most MFIs claim they have lent for income-generating activities. In reality, most lending has been for consumption purposes – buying a TV, repairing a house, paying for school-college fees or for serious illness of a family member.

Thus, indiscriminate lending and irresponsible borrowing was encouraged, leading to the subprime bubble.

THE WAY OUT

First, the sector has to be regulated by the state governments. They can, however, go overboard and stifle the sector. Politicians would be too happy to ask people not to repay their loans to banks. The Andhra ordinance expects MFIs to obtain approval to make tiny loans, which is impractical. Hence, regulation has to be tempered by a sensible institution like RBI.

Second, the regulation should encourage bonding their members, with savings, self-help, education, and not just credit. Money has to be lent only when the economic viability of projects is well established. The capacity of a village or a cluster to support income-generating activities has to be worked out to cap MFI lending geographically.

Third, the MFIs who give credit to crores of women groups don't employ women to the same extent. Most show just 3-4 per cent women employees. This percentage must go up drastically. A holistic scheme to help the poor has to include – health insurance, self-help, education, employment and finally credit. Many MFIs overturned this philosophy by concentrating just on credit.

(The author, a former IT Secretary, Government of Karnataka, is founder of Brickwork Group.)

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