

India's Microfinance Sector careens into Crisis

Providers lose their credibility – Credit provision in a regulatory vacuum – Suicide wave

By Philip Mader*)

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In these days in India a conflict is raging, which will expectably affect the future of microfinance. The question is whether its commercial success may come at the cost of the borrowers, and whether the poor must be protected from their self-appointed helpers. After 54 microborrowers took their lives, the state has rediscovered its regulatory role, and is heavy-handedly intervening into the small-loans business. The microfinance industry, for its part, is posing as the victim and is warning about an impending collapse of the sector.

In the light of large gains, too high interest rates, low proven benefits for the poor, and questionable practices amongst board members and employees, severe doubts about the ethical content of the financial business with the poor arise.

Hyderabad, India's fifth-largest city, is both a shining high-tech metropolis and India's second-largest film factory -- Tollywood, named for the regional language Telugu -- as well as the chosen home of Indian microfinance and a city racked by poverty and slum growth. Andhra Pradesh, the surrounding far poorer state, is the core market of Indian microfinance. No country in the world, except for Bangladesh, can boast as high a rate of saturation of the microfinance market as this part of South India. Already in 2008, 16% of all inhabitants had at least one microloan, and industry observers warned about the oversaturation of the market and a soon-to-burst bubble. The continuing growth of the microfinance sector -- the Indian micro credit portfolio grew in the year 2000 by 76% -- has further raised the saturation ratio and the multiple indebtedness, especially in Andhra Pradesh.

Overburdened debtors

Since September, reports have been surfacing according to which small loan recipients have taken their lives as a result of overindebtedness. 54 dead micro borrowers were counted by a government study last week. 17 of them were supposed to have been clients of industry leader SKS Microfinance. Some committed suicide immediately after altercations with employees of microfinance institutes [MFIs], by ingesting pesticide, hanging themselves or jumping into wells. While India already suffers from one of the highest suicide rates in the world, the victims usually are impoverished small farmers, indebted to local moneylenders. In the most recent suicide wave, however, mainly women and small traders lost their lives who had indebted themselves to internationally renowned MFIs, partly funded by socially motivated investors. Apparently, employees had threatened the debtors with violence, shamed them, or in the final instance, even pushed them to suicide.

Police intervenes

Andhra Pradesh has approximately 80 million inhabitants and at least 31 MFIs compete here for the poor as their clients. Until a few weeks ago, this competition went without state intervention. Then, enraged residents of small towns attacked several branches, the police had to intervene, and on October 14th, the state government in Hyderabad rushed through with an ordinance. Populist in its implementation and vague in its formulation, the primary goal of stopping the risk for life and limb was attained, but at the expense of chaos in the sector. The ordinance required all microfinance institutions to register within two weeks and lay open their business processes and interest rates to local authorities. However, many details were left unclear, especially whether in the meantime any business was allowed to continue at all. The industry body MFIN submitted a suit at the Andhra Pradesh High Court on the following day against the ordinance, and on October 22, the court officially permitted the conduction of microfinance transactions, while prohibiting MFIs from using any form of coercion.

Widespread refusal

From many towns a widespread refusal of credit repayment is now reported. SKS claims to have lost at least 600 million rupees [€0.7 million] in one week alone, due to the ordinance. The Reserve Bank of India has now involved itself as a temporary regulator, and soon a separate regulatory body for the microfinance sector is meant to be put in place. MFIN spokesperson Vijay Mahajan warned the entire sector "could collapse" if the state did not get behind it soon.

Already in 2006 there had been a similar, if smaller and more locally bounded, micro debt crisis in Andhra Pradesh, which was halted through a quick intervention by politicians and the introduction of a voluntary code of conduct. The business model has hardly changed, however, and credit was practically distributed with the watering can. Up until the end, the rates of repayment have remained high, but in many places, already a quarter of poor households had five or more micro loans, as a result of which they have come under ever higher pressure, as the economic Times in Bombay recently reported. If these numbers are true, then the growth had to end in shambles soon.

In the meantime, commercialization and profit-orientation have become the maxim of the entire microfinance sector. In India, this development reached its temporary climax with the public floating of SKS shares on the Bombay Stock Exchange in August. The IPO of SKS was 13 times oversubscribed and brought €75 million onto SKS's books. Founder Vikram Akula became India's best-paid banker through the sale of some €8 million in shares. His leftover shares were over €60 million for some time after the IPO. However, the public floating was highly criticized, among others by Mohammed Yunus, founder of the Grameen Bank,

who saw a drift away from microfinance's original social mission. Additionally, an important social investor, Unitus, withdrew from SKS and from microfinance completely shortly after the IPO.

Tollywood drama

Meanwhile, SKS shares have lost more than a third of their value as a result of the crisis in Andhra Pradesh as well as disorder at the management level. They last traded only barely above their issuing price of 985 rupees. On October 4th, barely a month after the IPO, SKS surprisingly showed their CEO Suresh Gurumani the door -- officially due to interpersonal differences. Meanwhile, a Tollywood drama continues in the public realm between founder Akula and his ex-wife, who accuses him of kidnapping their child as well as of fraud and bribing of officials in his role as SKS chief. In the past, SKS had already been bankrupt, but only survived due to cooking of the numbers, Malini Byanna claimed in the Indian media.

Heavy commercialization

In searching for the systemic causes of the ongoing events in Hyderabad, factors internal as well as external to the sector must be taken into consideration. Externally, there was until now a lack of regulation through Indian finance supervisors, since most MFIs in India are registered as non-bank financial companies [NBFCs] and therefore exempt from banking regulation. On the Indian national level, for years a law for the separate regulation of microfinance has been in preparation, but was never passed. In early 2010, finally a draft was circulated to MFIs for review and discussion, but has remained there until now. The root causes of the current crisis are, however, to be found primarily in the commercialization of the sector, and are homemade. Intra-sectoral self-regulation has not been put into practice, as the national industry body Sa-Dhan recently admitted.

Increasingly tougher competition

Given the lack of supervision and the striving for commercial exploitability of their activities, so as to attract investor capital, many MFIs have engaged in ever tougher competition for market shares. Similar to the banks in the US subprime credit crisis a few years back, they attempted to attract or hold even non-creditworthy or highly indebted poor people with ever larger loans -- "carpet bombing with loans" as an industry observer has called the practice. That social aims could have received short shrift surprises only the sector itself.

Warnings also came from science, but were however ignored in a bubble-typical manner. In 2009, the results of a long awaited study, which in Hyderabad intended to finally answer the question of how much microfinance really does for the poor, were published. The MIT researchers behind the Hyderabad study concluded: "Microfinance may not be the miracle that is sometimes claimed on its behalf." Even after several long cycles they found on average no improvement in socio-economic indicators, and most households had

not invested their loan in a small business, but rather used it for consumption.

Perverse incentives

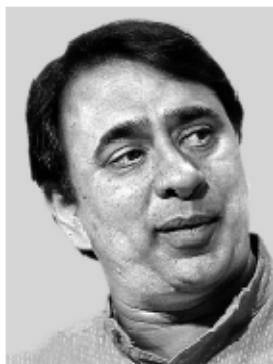
Furthermore, the microcredit industry seems to have unconsciously created two perverse incentives for the suicides of its clients, and thereby brought the political reaction upon itself. First, the small loans usually are covered by insurance which reimburses the debt to the bank in case of death. Second, it is common practice for bank employees to be salaried on the basis of repaid loans -- earning on average 56 percent in addition to their fixed salary, and among the most profitable MFIs the success premium is higher. In connection with the life insurances it seems to have been a small step for some employees to realise that a dead client is worth more for the paycheck than a defaulting client.

Thanks to its lost credibility as a helper of the poor, the microfinance sector in India is now stuck in a deep, multidimensional crisis of confidence. Whether it can recover again is unclear. The trust between MFIs and their clients is shaken; and the trust of the MFIs in the state, and vice versa, is damaged. Still, India supports microfinance as a "priority sector", but that support could soon be retracted. Above all the trust of the public and of donors in the professed social mission of the MFIs is shaken.

To calm the troubled waters the entire sector recently lowered its interest rates by 0.5 to 2 percentage points. But given yearly rates from 26 to over 40 percent, this looks like a drop in the ocean, and the Indian media have apparently correctly interpreted this as an image campaign. Most importantly, the move reveals that lower rates to benefit the poor were possible, but neither came about through competition nor through market dynamics, nor were viewed as necessary until the sector fell into political discredit.

The current crisis is as yet a crisis of confidence; but it could balloon into a finance crisis if the debtors no longer can repay or no longer feel inclined to repay, or if the financiers lose interest in the sector. At present, they would have sufficient reasons.

The author works as a researcher on microfinance at the Max Planck Institute for the Study of Societies in Cologne. In the course of his work, he has spoken with hundreds of microcredit borrowers in the slums of Andhra Pradesh.



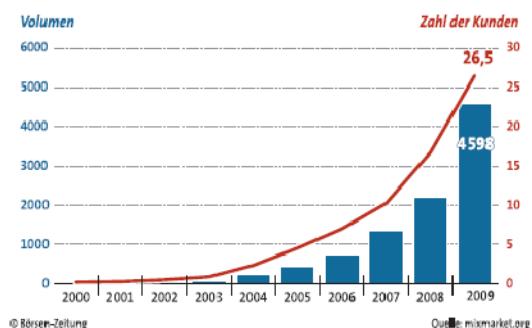
Vikram Akula

SKS Microfinance



Der Mikrokreditmarkt in Indien ist rasant gewachsen

Portfolio in Mill. Dollar und Zahl der Kunden in Millionen



The microcredit market in India has grown rapidly. Portfolio in millions of Dollars and number of clients in Millions.

Die größten Mikrofinanzinstitute Indiens

Institut	Sitz	Portfolio (Dollar)	Kunden
SKS Microfinance	Hyderabad	960 793 988	5 795 028
Spandan a	Hyderabad	787 304 262	3 662 846
SHARE Microfin	Hyderabad	490 923 201	2 357 456
Bandhan	Kalkutta	332 462 204	2 301 433
Asmitha	Hyderabad	315 429 786	1 340 288
BASIX	Hyderabad	223 229 799	1 114 468
SKDRDP (Selbsthilfegruppen)	Belthangady	136 728 666	1 225 570
Equitas	Chennai	134 597 374	888 600
Grama Vidyal	Tiruchirapalli	134 568 751	772 050
Ujjivan	Bangalore	82 447 140	566 929

The largest microfinance institutions in India