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RBI sub-committee to study issues and concerns of MFIs

To examine when loans to MFIs can be classified as priority sector lending.

Business line, 29 October 2010

Mumbai, Reviewing the definition of 'microfinance' and 'microfinance institutions' (MFI) for the purpose of regulation of non-banking finance companies (NBFCs) undertaking microfinance and examining the prevalent practices of MFIs in regard to interest rates, lending, and recovery practices are among the terms of reference set for the Reserve Bank of India's sub-committee to study issues and concerns in the microfinance sector.

Headed by **Mr Y. H. Malegam, a senior member of the Reserve Bank's Central Board of Directors**, the sub-committee will examine and make appropriate recommendations in regard to applicability of money lending legislation of the States and other relevant laws to NBFCs/MFIs. The committee will examine the role that associations and bodies of MFIs could play in enhancing transparency disclosure and best practices, and also recommend a grievance redressal machinery that could be put in place for ensuring adherence to the regulations.

It will examine the conditions under which loans to MFIs can be classified as priority sector lending and make appropriate recommendations. Besides **Mr Malegam, the other members of the Sub-Committee are: Ms Shashi Rajagopalan, Mr U. R. Rao, Mr Kumar Mangalam Birla, and Dr K. C. Chakrabarty, Deputy Governor. Mr V. K. Sharma, Executive Director, Reserve Bank of India**, will be the Member Secretary to the Sub-Committee. The Sub-Committee will submit its report in three months.



Sa-Dhan
The Association of
Community Development
Finance Institutions

Sa-Dhan: The Association of Community Development Finance Institutions (CDFIs) represents countrywide a total of 237 members across 19 states with loan outstanding of Rs. 18,344 crore (4 billion USD) and client outreach of 2.67 crore (26.7 million).



Sa-Dhan

The Association of
Community Development
Finance Institutions

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MFI body to cut interest rates

Business Line, Hyderabad, Oct. 21, 2010

Sa-Dhan, a national body for the microfinance sector in the country, has decided to cut lending rate by one to 2.5 per cent for its members. Presently, the rates of the Sa-Dhan members range from 24 to 28 per cent.

This is an immediate upshot of the developments in the microfinance sector in Andhra Pradesh

following the State Government introducing an ordinance that seeks to regulate and monitor the functioning of these institutions, which has rattled the domestic microfinance industry.

The decision to cut interest rates was taken here on Wednesday at a meeting of Sa-Dhan board members and officials, including members of the Micro Finance Institutions Network (MFIN), which has challenged the AO Government's ordinance in the High Court.

Sa-Dhan has 260 members, including societies, trusts, cooperatives, NBFCs and smaller MFIs. The step to snip rates is seen as part of the industry's fresh initiatives to clear its image in the wake of the suicides in rural Andhra Pradesh allegedly due to coercive methods employed by some MFIs to collect dues and the subsequent ordinance clamped by the State Government.

Sa-Dhan's 260-strong members at present serve about 22.3 million rural poor, with an outstanding portfolio of Rs 18,000 crore, out of which the exposure



in Andhra Pradesh alone is about Rs 5,000 crore. Public sector banks are the biggest contributor to Sa-Dhan members' portfolio with a share of 43.3 per cent, followed by private banks with 35.2 per cent and financial institutions 17.2 per cent.

Although Sa-Dhan has decided to cut interest rates, the extent to which it will be implemented is not immediately clear. "A majority of our members, including those who are part of MFIN, have agreed, but given the composition of our organisation, it may be difficult to monitor its implementation across our members," admitted Mr Vivekanand Salimath, Treasurer of Sa-Dhan.

Sa-Dhan also wants banks to reduce interest rates to help it further clip its own rates-banks are charging rates ranging from 11 to 13 per cent. "The rates will further be reduced by MFIs if the Government passes on the subsidy to MFIs that lend to self-help groups. We will take steps to prevent coercive recovery practices if any," Ms Jayshree Vyas, Chairperson of Sa-Dhan, told presspersons here.

Pranab Mukherjee urges Andhra to soften ordinance terms

Nivedita Mookerji
DNA, Oct 27, 2010

New Delhi, The Centre wants the Andhra Pradesh government to soften its recent ordinance on microfinance. “I have spoken to the **Andhra chief minister (K Rosaiah)** about making corrections in the ordinance so that the harsh conditions are taken off,” finance minister Pranab Mukherjee said at the Economic Editors' Conference on Tuesday.

Dismissing the buzz on having a regulator for the microfinance segment, the finance minister said, “I am not thinking of appointing any regulator at this point.” However, **Reserve Bank of India (RBI) and National Bank for Agriculture and Rural Development (Nabard)** are keeping a watch on the developments, he said. According to the finance minister, a code for microfinance should be evolved by the institutions themselves.

If the institutions fail to work out a mechanism, then perhaps the government can think of a regulator. Among the steps suggested by the Centre are that the interest rates should not be very high; coercive recovery methods should not be used by the institutions; and the microfinance companies must ensure that borrowers are in a position to pay back the loan. Earlier this month, the Andhra government issued an ordinance laying down stringent norms for microfinance firms for recovering money after a spate of suicides rocked the state.

Also, SKS Microfinance has been under the scrutiny of the Securities and Exchange Board of India (Sebi) for addressing investor concerns linked to dismissal of its CEO Suresh Gurumani soon after its IPO raised Rs 1,600 crore. Now that microfinance companies are complaining that it is difficult to recover loans after the new ordinance norms have come into effect, the Centre wants Andhra Pradesh government to take off some of the harsh conditions. Microfinance firms had moved court recently challenging the ordinance. According to estimates, outstanding loans of microfinance firms rose by 97% to Rs 11,734 crore in 2008-09 over the previous year.

According to the Andhra Pradesh Microfinance Institutions (regulation of money lending) Ordinance 2010, all microfinance institutions operating in the state shall within 30 days of the ordinance apply for registration before the registering authority of the district. They have to specify the villages and towns they operate in, the rate of interest being charged, system of conducting due diligence, system of recovery of money, list of persons authorised for conducting the activity or recovery of money which has been lent.

The ordinance also states that the registering authority will conduct verification of the details furnished by the institutions and then only accord registration for one year. It also contains stringent rules for renewal of registration. The registering authority will verify the performance of the microfinance institutions at the field level and also hear general complaints from the public before extending the registration of the institutions, it says. The Centre is not keen to set up a regulator for the microfinance segment.

The finance minister had to recently put it on record that he was not becoming India's de-facto super-regulator, as was alleged. “I have no such intention,” he said to a statutory resolution in Lok Sabha disapproving the ordinance promulgated by the President on the issue of unit-linked insurance plans or Ulips. Mukherjee said he had to intervene because the two regulators (Sebi and Irda) “continued to quarrel” over whose jurisdiction Ulips came under. He said regulators will be encouraged to resolve issues, but if “regulators think they can do whatever, it won't happen.” “There has to be a point where the buck stops. And, it is with the (finance) minister where the buck stops.”

The Securities & Insurance Laws (Amendment and Validation) Bill 2010 was passed in Parliament, replacing the Securities & Insurance Laws (Amendment and Validation) Ordinance 2010. The new bill is aimed at allowing insurance companies to sell Ulips without requiring the permission of Sebi.

Sa-Dhan's Efforts to Resolve the Situation in Andhra Pradesh

The microfinance sector in India through the Microfinance Institutions (MFIs) is performing a positive role by providing financial services to the poor throughout the country. As on 31st March 2010, the loan outstanding of Sa-Dhan members has already reached Rs. 18, 344 crore with an client outreach of 2.67 crore in 19 states. More importantly, many of these MFIs are operating in underserved regions of North, West and North East.

The state of Andhra Pradesh has been the leader in terms of growth of microfinance in the country with 51% of the total loan portfolio and 43% of the client outreach. Banks have disburse loans of Rs 9000 crore to the microfinance sector in Andhra Pradesh. Recently, the Andhra Pradesh government issued an ordinance to regulate microfinance practice in the state in response to the alleged coercive repayment practices and overlending by MFIs leading to overindebtedness. The Ordinance demands registration of MFIs with district authorities, along with repayments to be made in specific public places and restrictions imposed with regard to membership that the borrower can hold in different self help groups.. Within few days of the implementation of the registration process, the recovery rates of MFIs have come down from nearly 99% to 20% in rural areas, with nearly zero recovery in urban areas. The financial discipline inculcated in the poor has been severely vitiated, and the environment for flourishing of microfinance services stands contaminated. In the scenario of uncertainty in terms of poor recovery and government's intervention, the banks have nearly stopped fund flow to the MFIs for onlending to the poor, resulting in halt in the progress of "Financial Inclusion" movement in the State.

As an Association, Sa-Dhan has responded swiftly to the situation in Andhra Pradesh with multi-pronged interventions, that included interaction with the RBI and Ministry of Finance at the national level and the state governments and local offices of RBI, NABARD and other key stakeholders in Andhra Pradesh, Orissa and West Bengal. We are also in constant dialogue with our members, specially in growth states of South and state of West Bengal and Orissa in the East. State government, local stakeholders, RBI and Ministry of Finance have been briefed on the possible implications of the Ordinance on the growth of microfinance in the State and beyond.

Here is a brief of Sa-Dhan's interventions:

At the National level

- Sa-Dhan had meetings with the RBI and senior officials from the Ministry of Finance to apprise them on the situation in Andhra Pradesh in terms of dropping recovering rate and declining fund flow to the sector in the state, provisions of the Ordinance, those have serious implications on the progress of the sector in future. A plea was made to intervene to resolve the present situation and restore fund flow to the sector, apart from communicating the commitment of members to improve practice.

In Andhra Pradesh

- In response to issuance of Ordinance by the government, Sa-Dhan had a emergency meeting with members 21st October 2010 to analyze the situation in the state and evolve a strategy for intervention in terms of engaging different issues arising from the crisis viz. field level issues, media management, interest rate and engagement with government officials. Attended by 37 participants, the meeting led to the formation of a "Working Committee" to look into the details of the Ordinance and its implications. A Press Conference was also organized to communicate sector's position on the Ordinance as well as the corrective steps that are being taken to improve practice of microfinance.
- Simultaneously, a meeting was held with Principal Secretary, Rural Development to apprise him on the concerns of the MFIs arising out of the Ordinance. An assurance of reviewing the provisions of the Ordinance and ease the process was obtained. Meanwhile, the Andhra Pradesh High Court announced interim relief for MFIs in response to the petition filed by MFIs.
- Sa-Dhan also sought clarification from the Principal Secretary on the applicability of the Court Order to MFIs other than the "petitioners" as mentioned in the

Order. As the Order was applicable to every MFI except the MACS, same was communicated to all the members in the state

- A separate team from Sa-Dhan was in constant touch with the member MFIs in the state monitoring the effect of the situation in Andhra Pradesh and the ongoing registration process of MFIs with DRDAs. As predicted, the recovery percentage was coming down very fast. Through a meeting, the Principal Secretary, Rural Development was apprised of the sharp drop in the recovery rates as well as the difficulties members were facing in registering themselves with the District level authorities.
- Sa-Dhan also facilitated a meeting of members with the Principal Secretary, Rural Development and banks, to make public announcement on reinforcement of Code of Conduct, and develop common minimum commitment on the issue of pricing, multiple lending and sharing of information etc. Attended by 70 participants including 24 banks, the meeting resulted in endorsement and support for Sa-Dhan code of conduct by members and banks, as well as assurance to look into the complaints of MFIs on interference in operations, after registering and compliance to the Ordinance by the Principal Secretary. A plea was also made to amend certain provisions of the Ordinance. As a result of this, some of the public sector banks have made public statements to reiterate that fund flow will continue.
- To respond to the allegation made against the MFIs, Sa-Dhan organized meetings of members in the State on the Code of Conduct and its adoption. Further, the process of seeking compliance report from the members was expedited.
- A team from Sa-Dhan visited the field in affected districts to understand the situation in the

field vis-à-vis the allegations as well as the nature of the household, cash flow and the corresponding financial products offered by the MFIs.

Preventive Measures in Growth States: Engagement with members and stakeholders in West Bengal and Orissa

As the crisis in Andhra Pradesh had the potential to spread to neighbouring states, Sa-Dhan undertook measures to communicate the implications of Andhra Pradesh like Ordinance through meeting with state governments in Orissa and West Bengal, RBI regional director, Ministry of rural development and NABARD. Further, separate meetings were conducted with members in Orissa and West Bengal to inform about the situation and its implication, apart from improving their practices on the ground. Members in these states are working towards increased emphasis on field level training for

enhanced client sensitiveness. Separate teams from Sa-Dhan also visited the field of operations of MFIs in Andhra Pradesh, Orissa and West Bengal to analyze the situation vis-à-vis the allegation made against MFIs' practice in Andhra Pradesh and looking at the nature of the poor households.

Ongoing Activities and Future Plans

- Sa-Dhan has plans to conduct nine workshops across the country including Andhra Pradesh and other high growth states. Two of which have already been conducted in Kurnool and Hyderabad in Andhra Pradesh. The focus of these workshops was reinforcement of "Code of Conduct" and its compliance and emphasis on "Social performance".
- We are planning to bring together

state level stakeholders in growth states specially the Principal Secretary, Rural Development and the banks with the members towards efforts on unrestricted fund flow to the sector.

- These efforts are to be substantiated by understanding the clients' perspective through a study on clients' perspective in five growth states.

To conclude, the present crisis situation has severely impacted the clients' repayment discipline and fund flow to the sector from the banks. This is a setback to the progress of the agenda of financial inclusion in the country. At this point, it is required that the stakeholders work together towards a framework to ensure that the provisions of financial services to the poor are available unhindered.

Life was not a Bed of Roses-Gowamma Turned It So

Twenty eight-year-old R.Gowamma of Bagalur, situated 11 kilometers away from Hosur,(Tamilnadu –State) had to run a family of four with a meager income of Rs.2500/-, which her husband earned by driving a private bus. Unable to meet all the expenses of the family, she had to often depend on private money lenders, who fleeced her. Eventually she was drowned in debts.

Gowamma's saviour

Vedavathy Magalir Sangha, a local SHG came as a blessing in disguise for Gowamma. The members educated her about the activities of the Sangha and how she could benefit by becoming a member there. Gowamma joined the SHG with great hopes and was not disappointed.

How the SHG changed Gowamma's life

Just four months after joining the SHG, Gowamma borrowed Rs.25, 000/- under OUTREACH'S Micro credit Scheme, added her portion of investment and bought an auto-rickshaw. She repaid this loan promptly and availed a second loan of Rs.50, 000/- from the Bank, this time to establish a nursery of roses. She availed a third loan of Rs.10, 000/- from AGB and invested it in sericulture. Out of the income from sericulture, she purchased a sewing machine and started a business of stitching bags. Gradually, she took sub-contracts from companies. All this did not happen in a day or easily. Gowamma worked very hard, earned the trust of one and all, by always being honest, sincere and prompt in repayment of loans and thinking of enterprises which

would require minimum investment but promised good and fast returns. She was able to learn the skill of identifying profitable micro enterprises through the entrepreneurship awareness and development programmes facilitated by OUTREACH.

Financial status of Gowamma as on date

Gowamma today earns around Rs.6,250/- per month net income, as follows:

Nursery	... Rs.3, 000/-
Autorickshaw	... Rs.2, 000/-
Silk rearing	... Rs.750/-
Tailoring	... Rs.500/-

Out of Rs.6250/-, she gets Rs.3500/- net income, after repaying the loan installment of Rs.2, 500/- and saving Rs.250/- with the SHG. Thus her family income has doubled because of her hard work and thoughtfulness.

Fringe benefits that Gowamma reaped

Gowamma had studied only upto Class V and was very shy and innocent. But after joining the SHG, she learnt many skills like communication skill, banking operations, mathematics, the art of saving and its importance and of course business acumen. Gowamma is a confident homemaker-cum-businesswoman today and participates actively in all the programmes of the SHG, setting a good example to the other members.

(Contributed by OUTREACH, Bangalore)

Microfinance to get a regulator in NABARD

The Economic Times, 25 October 2010

NEW DELHI: A worried government has put on fast track the proposed bill to regulate micro-lenders, as it seeks to ensure that over-regulation by states does not kill the sector that is envisaged to play a big role in furthering financial inclusion. The finance ministry could move a bill in the winter session of Parliament that will make Nabard responsible for regulation of all non-profit microfinance institutions structured as trusts, cooperatives, or mutual benefit societies.

“Finance minister Pranab Mukherjee has put the bill on priority list for winter session,” a finance ministry official told ET. At present, micro-lenders follow the relevant sector law, depending on the way they are structured. The new law will treat microfinance as a separate business and will also consider bringing non-banking finance companies in the microfinance sector under the ambit of the legislation. The decision to fast-track the bill follows the October 15 ordinance, or emergency law, issued by Andhra Pradesh that imposed severe restrictions and debt restructuring obligation on lenders following a spate of suicides that were blamed on coercion by micro-lenders to recover their dues.

The sudden sacking of **Suresh Gurumani as MD & CEO of the recently listed SKS Microfinance** on October 4 by the company's board has also drawn attention to the industry. As many as 15 states already have laws on money lenders in place under which they attempt to regulate the high interest rates and usurious practices followed by micro-lenders.

MFIs may get access to retail deposits

The state governments say although the

RBI protects the interests of the depositors, there is no framework to safeguard the interests of the borrower who are at times charged interest rates as high as 30%. The finance ministry wants to prepare a comprehensive law after discussing the issue with the regulators. Industry experts agreed that there is a need for some form of regulation. “The activities have to be supervised,” said **Mathew Titus, executive director of Sa-dhan, an association of microfinance firms.** “There is no framework for customer protection at present,” he said. **Microfinance Institutions Network (MFIN),** the industry body, had challenged the validity of the Andhra ordinance in the state high court, which allowed them to continue their business while they register themselves with the government. The court said the interest charged could not be more than the principal and that coercion cannot be used in recovery.

Even the finance ministry is keen to ensure that from an almost free run, the regulation does not swing to the other extreme and kill the industry that is still expected to play a big role in alleviating poverty by furthering financial inclusion. Therefore, while regulations are most likely to be tightened, they may also give microfinance institutions access to retail deposits that will allow them to raise cheaper funds and lend at lower interest rates.

The finance companies may also have to create a microfinance business distinct from their other business, such as car/truck loans, and asked to follow the new regulation. Andhra Pradesh chief minister K Rosaiah has written to the Union government asking it to bring

NBFC-MFIs under the ambit of the new bill. **The governments of Gujarat and Kerala** have attempted to put curbs on MFIs under their money-lending Acts and look for greater clarity on the regulatory framework of such institutions. The state governments are not equipped to handle supervision and a sector supervisor is the need of the hour, said Mr Titus.

However, the finance ministry has decided against suggesting a cap on interest rates in the draft bill, said another government official privy to the deliberations. He said the Andhra chief minister has pitched for capping interest rate spreads of microfinance lenders at 8%. Industry says the government should take into account the recent events when it finalises the bill. “The bill should consider what is happening at the ground level...regulator by itself is not the solution,” said Gautam Bharadwaj, director, Invest India Economic Foundation.

The Micro Financial Sector (Development and Regulation) bill was first introduced in Parliament in 2007 and referred to the standing committee on finance. However, the bill subsequently lapsed due to dissolution of the Lok Sabha and has been in the works since then as the government decided to again hold consultations with the stakeholders. The new draft of the bill defines the role of the regulator more explicitly. It has a provision for registration of microfinance organisations collecting thrift from individual members of self-help groups or through a group mechanism. The bill provides for creation of a reserve fund that would be 15% of a microfinance institution's net profit or surplus. The bill will also empower Nabard to appoint microfinance ombudsmen for settlement of disputes between microfinance organisations and clients.

Andhra passes law to regulate MFIs

The Economic times, 15 October 2010

HYDERABAD: THE Andhra Pradesh government on Thursday approved a law that will regulate microfinance firms, or MFIs, complicating efforts to resolve the suddenly resurgent issue of the interest rates poor borrowers need to pay for taking loans. The state Cabinet, which met in the morning, unanimously okayed a special ordinance that forces microfinance firms and borrowers to compulsorily register with local authorities. The proposed law will also force the companies to disclose the methods they use to recover money and the interest rates they charge. The penalty for non-compliance is three years imprisonment and a fine of Rs 1 lakh. The ordinance has now been sent to the governor for his signature.

Andhra Pradesh's move may muddy the waters as microfinance firms are likely to appeal to the courts against any law that curbs their ability to carry out normal business. Many MFIs are registered as non-banking financial service companies, (NBFCs), with the Reserve Bank and the firms will argue that they don't need to be registered again. The decision may also pit the state against the Centre, which is drafting a separate law to regulate microfinance firms, but which has shied away so far from the incendiary rhetoric of the southern state's politicians. The Centre has also denied any plans to cap interest rates, unlike the Andhra politicians who remain strongly in favour of it. he Economic times, 15 October 2010

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The Andhra Pradesh government says that it was forced to move against the MFIs after a spate of suicides allegedly due to harassment by employees of microfinance firms. The deaths have kicked up a furore with opposition parties and the State Human Rights Commission demanding action from the government. State chief minister K Rosaiah has held several meetings in the past three days with the Centre and also with bankers regarding the issue. He also held a video conference with collectors and superintendents of police, across the state directing them to check the illegal activities of MFIs and take appropriate action.

Officials at several MFIs in Hyderabad refused to speak to ET on the record saying that they have not seen a copy of the ordinance. Privately, many of them question the government's move and its legal tenability. This is not the first time Andhra or any state has sought to move against lenders or crack down on alleged usury. Earlier this year, Andhra had sought to bring non banking finance companies under its purview but the bill did not become a law. In the early years of the past decade, Tamil Nadu sought to cap the interest rates of lending companies but the measure was quickly stayed by the courts.

Industry insiders whom ET spoke to and who went through the ordinance copy say that microfinance firms may soon have to register themselves with the District Rural Development Project Officer at the rural level and with Mission for Elimination of Poverty in Municipal Areas at urban level. "MFIs will have to register within one month disclosing details of the recovery methods adopted and the details of interest rates charged," said a person familiar with the development.

Banks may see large defaults from MFIs over AP ordinance

The ordinance, which came in the wake of a series of suicide cases in the state, has still not led to legislation, but experts warn that banks could be burdened with higher bad loans in case MFI operations are hit in their largest market

Dinesh Unnikrishnan

Livemint.com, 29 October 2010

Mumbai: The increased regulatory heat on microfinanciers could scorch them as well as the banks from whom they have borrowed. A controversial ordinance by the **Andhra Pradesh government seeks to regulate microfinance institutions (MFIs)** in the state and put a stop to the coercion allegedly used by some of them to recover money from borrowers.

The ordinance, which came in the wake of a series of suicide cases in the state, has still not led to legislation, but experts warn that banks could be burdened with higher bad loans in case MFI operations are hit in their largest market. "It is likely that banks may see large defaults from MFIs in Andhra due to the operational issues following the ordinance. More importantly, talk on waiving the loans of MFI clients may further impact the credit culture of borrowers," said a senior executive with a private sector bank. He requested anonymity.

Senior officials in the microfinance industry hint at similar systemic risks. "If they (Andhra Pradesh) enforce the law, this may affect operations and the repayment from borrowers will not come on time. If the situation continues for a long term, there may be large defaults (on bank loans)," said **Chandra Shekhar Ghosh, chairman and managing director of Bandhan**, the fourth largest MFI in the country. Bandhan has borrowed around Rs1,600 crore from 30 banks and financial institutions.

Indian banks have a combined exposure of around Rs16,000 crore to MFIs, with around one-third of this in Andhra

Pradesh alone, according to **Credit Analysis and Research Ltd (Care)** a credit rating agency. "This (the ordinance) may impact the growth and the asset quality of various MFIs. Further, this may also have a bearing on resource-raising abilities and profitability of MFIs," said **D.R. Dogra, managing director and chief executive officer of Care**.

The Andhra Pradesh ordinance has several stringent clauses. For example, it prohibits MFIs from recovering interest dues that are more than principal loan amount. Also, MFIs will have to go through local bodies such as *panchayats* for loan recoveries from individual borrowers every month. Currently, a majority of MFIs collect from clients every week.

The ordinance also prevents a borrower from taking more than two microcredit loans at any given point in time. The regulatory steps taken by Andhra Pradesh are a litmus test for microfinance oversight elsewhere in India. The lack of clarity on regulatory matters has led to a "wait and watch approach" from banks who are already hesitant to offer new loans to MFIs, senior officials at two state-run banks said independently. They did not want to be named.

"We are awaiting for more clarity on aspects like regulation and the change in the mode of functioning of such firms. I would not be able to tell how long this situation will continue," one of the officials said. Among the banks, **Small Industries Development Bank of India Ltd** is estimated to have an exposure of around Rs4,000 crore to MFIs. **The country's largest private sector lender, ICICI Bank Ltd**, has lent around Rs. 2,000 crore to MFIs while State Bank of India, the country's largest lender, has an exposure of over Rs. 1,000 crore, according to data from Care.

Other banks, which have significant exposure to the microfinance sector include **Punjab National Bank, HDFC Bank Ltd, Indian Overseas Bank,**

Central Bank of India, Bank of Baroda, Union Bank of India and Andhra Bank Ltd, which have exposure in the range of Rs. 200-800 crore, Care data showed. "It is possible that any potential change in regulations may impact the sector's growth, access to funding, asset quality and operational costs over the near-to-medium-term," rating agency Crisil Ltd said in a report.

The Indian microfinance industry has had to face sharp criticism for high interest rates charged to borrowers and strong-arm business practices. **SKS Microfinance Ltd** has this week voluntarily cut lending rates. Microfinance Institutions Network, an industry body, had challenged the ordinance in the Andhra Pradesh high court on the ground that microfinance firms are under the regulatory purview of the **Reserve Bank of India (RBI)** and the ordinance could impact the operations of microfinance industry in the state.

Following this, on 22 October, in an interim order, the high court had allowed MFIs to resume normal business activities, but directed these firms to register their activities with the state government within a week as per the ordinance, and adhere to the sections of ordinance pertaining to interest rates charged on loans and coercive recovery practices.

While RBI is the regulator for those MFIs operating as non-banking financial companies, a majority of the remaining MFIs, which operate as self-help groups, trusts and non-governmental organizations, are unregulated. Even as the microfinance controversies have come to a boil, the sector has attracted policy attention. RBI has set up a sub-committee headed by chartered accountant Y.H. Malegam to study the issues in the microfinance sector. It is expected to submit its report in three months.

The finance ministry had recently written to state-run banks asking them to ensure that the lending rates charged by large MFIs from their borrowers are not more than 24% a year. Even for smaller MFIs, banks need to "finalize a road map" while sanctioning new loans to ensure that rates are brought down in a phased manner, the ministry had said.

Microfinance warns of collapse over credit freeze

Amy Kazmin
Financial Times, October 27 2010

Hyderabad India's microfinance industry has warned it is being pushed to the brink of collapse, as a result of a bank freeze on credit to microlenders triggered by a political crackdown. India's commercial banks, which normally provide about \$133m a week in credit to the microloan industry, have frozen those dispersals for the past two weeks, as companies wrestle with a backlash in one of their biggest markets, the state of Andhra Pradesh.

Industry executives have warned that if the uncertainty does not end, and credit flows do not resume, many companies could be forced to close in the next few weeks. "We are heading towards a financial crisis in our organisation," one executive wrote to the Microfinance Institutions Network, which represents 44 microfinance companies. "Cash flows are getting worse day by day . . . We cannot sustain this for long. We will be dead very soon."

India's microfinance crisis began in Andhra Pradesh, where microlenders

have about \$2.7bn in outstanding loans to 6.7m borrowers. That accounts for about 30 per cent of India's total microlending portfolio. After a series of suicides that local politicians blamed on harassment by microfinance debt collectors, state authorities passed an emergency ordinance to crack down on the sector, including an abrupt order to suspend collections this month.

Despite a court ruling on Friday permitting companies to resume collecting operations, industry executives say they are still being obstructed by local authorities, police and political workers. Many borrowers appear to have stopped repayments in the expectation of an imminent loan waiver. The crisis that began in Andhra Pradesh threatens to spill over to the entire sector, with other states already feeling ripples against the industry. That could trigger a wave of bank defaults nationwide and a rural liquidity squeeze.

"If credit doesn't resume, it triggers systemic risk for the banking sector," said Sajeev Vishwanathan, chief executive of Basix, a microfinance company. "It will be a cascading effect, starting with Andhra Pradesh and spreading." India's commercial banks, including state banks,

private banks such as ICICI and HDFC, and foreign banks such as Citibank and Standard Chartered, have a total exposure of about \$6bn to the microfinance sector – equivalent to 20 per cent of the Reserve Bank of India's daily interbank clearing volume.

The rapid growth of the microlending sector, which has been expanding at about 70 per cent a year for the past five years, has boosted rural liquidity, helping support a rural consumption boom that has buoyed India's economic growth. Kurapati Venkatnarayana, a Kakatiya University economics professor who has studied overindebtedness in Andhra Pradesh, said India's state banks should step in to provide rural liquidity. "Now there is a credit gap," he said. "Unless further remedial measures are taken, the crisis can deepen."

In New Delhi, Pranab Mukherjee, the finance minister, said he had written to the chief minister of Andhra Pradesh recommending "corrections" to the ordinance. However, he said he had no plans to introduce a separate regulator for the industry, saying the RBI was sufficiently vigilant. "We are not currently thinking about any regulator right now," he said. But he urged microfinance companies to avoid charging "abnormally high" interest rates or using coercive methods to ensure repayments.

Women entrepreneurs share experiences

The Times of India, Oct 6, 2010

PUNE: The Bhimthadi Jatra', a platform for women self-help groups (SHGs) to market their produce, has entered the fifth year with several success stories to its credit. Over 162 select SHGs from all over the country will participate in this year's jatra, to be held at the SSPMS ground near the RTO office from October 21 to 24. Women's groups from Mizoram, West Bengal, Karnataka, Himachal Pradesh, Orissa, Andhra Pradesh and Maharashtra will take part displaying a range of handicrafts and handlooms, besides a plethora of food items.

Some of the regular participants shared their experiences of bonding with the Bhimthadi Jatra and how it helped them improve their business. Vidya Mhatre, a part of the city-based Shri Swami Samarth Mahila Bachat Gat, has created a reputation for serving the best Alibaug special fish', besides other exotic seafood items. "I took the risk of offering these then-not-so-famous dishes at the jatra, and my earnings actually took off well. This also helped me start a catering service. Soon, I'll open a seafood eatery in Baner," said Mhatre at a press conference on Tuesday.

The Bahinabai-Purnache Mande self-help group is known for its mouth-watering Khandeshi recipes, especially the mande' (or large puran-

poli'). Today, the SHG supplies its specialities to outlets in Pune, Satara and Kolhapur. The Ambika Mahila Bachat Gat from Khutgaon in Daund has written one of the biggest success stories of the event so far. Known for formulating and manufacturing over 30 varieties of household masalas', the group of over 100 women worked as farm labourers over five years ago. Ambika, today, has clients as far as in Germany and Australia. "Some Rs 7 crore have been granted to us by the state government. This money will be used for pouch-packing, building our facility in Khutgaon on a piece of land approved to us and on other marketing initiatives," said Kamaltai Pardeshi, who heads the Ambika Bachat Gat.

Special laddoos' made from groundnut and sabudana' by members of the Gayatri Mahila Bachat Gat from Baramati are a hit at the Bhimthadi. "We are now selling our products to all sweet marts and major malls in and around Baramati," said Ashwini Dhongde, a member of the Gayatri group. "Over the years, these SHGs have significantly improved packaging of products. The women now have year-long orders and have become financially self-sufficient," said Sunanda Pawar, a trustee of the Agriculture Development Trust. The four-day Bhimthadi Jatra this year will have a dedicated space for women entrepreneurs, a separate hangar for organic products and a big cultural pavilion showcasing the traditional folk arts of Maharashtra and other states.

Needed, a common code

NBFCs and MFIs should remain under RBI supervision
Business Standard, October 26, 2010

New Delhi: The controversy into which the microfinance sector has recently been plunged has reportedly prompted the Union government to speed up its proposed legislation for the sector so that disparate action by individual states does not stymie its growth. This is just as well because it will be a tragedy if, in seeking to rein in the culpable, regulation ends up throwing the baby out with the bathwater. Microfinance is one of the best things that have happened to poor people and every effort must be made to nurture it as it stands at the threshold of self-sustaining growth.

To evolve regulation, which is both correct and judicious (over-regulation will stifle), it is necessary to know who is doing what in the sector. It has come to be dominated by the big boys, those which are for-profit and constituted as non-banking financial companies (NBFCs). They account for 90 per cent of the entire loan portfolio of the sector, according to the latest study by **Sa-Dhan, the umbrella organisation representing all microfinance institutions (MFIs)**. As it happens, these NBFC-MFIs are already under the regulatory supervision of the Reserve Bank of India (RBI). The top financial regulator is the best equipped to supervise large financial institutions and that is the way it should remain. RBI has, in fact, in the recent period stepped up its supervision of “systemically important” NBFC-MFIs with loan portfolios over Rs 100 crore.

What a Bill can do is bring the rest of the sector — MFIs constituted as societies, trusts and self-help groups — under a common regulator.

But more importantly, the Bill should lay down a code of conduct which will apply to all — big and small — and be more important for the health of the sector than the health of individual balance sheets. The first norm must be to ban multiple lending (the large MFIs engage in it extensively) and lay down a road map to slowly draw down and eliminate the current multiple-lending overhang. The present troubles of the sector began with the attempt by large MFIs in Andhra Pradesh to target the members of self-help groups, which are part of a micro-credit initiative of the state government and which together have borrowed substantially from public sector banks.

The Bill can also make it obligatory for all MFIs to state upfront what their lending rate is after taking into account various methods used like insisting on security deposits, which raise the effective rate of interest above what is claimed. Once this information is available, discussion can begin on what is an acceptable range of lending rates for the sector. Finally, the practice of obtaining and enforcing group guarantees should be ended. Peer pressure lies at the root of the coercive recovery methods, which have reportedly led to suicides. It is ironic that the crisis in microfinance lies in its success. The aggressive and successful NBFC-MFIs which were able to attract global private equity (PE) now have the latter breathing down their necks, making it imperative for them to post good performance and achieve high valuations so that the PE players can exit at a profit.

Is It Micro Usury?

Outlook India.com, 8 October 2010

Ethics runs smack into profit in the debate on the small loan business
LOLA NAYAR, MADHAVI TATA, DOLA MITRA

“Capping Interest Rates For MFIs Will Hurt The Poor”

In an interview to Outlook, Vikram Akula, founder and chief of SKS Microfinance, defends the for-profit model

Micro Gain, Macro Pain

Microfinance institutions make big claims, but critics point at the holes.

Financial inclusion

- By March-end 2009, over 22 million people were beneficiaries
- Rs 25,000-30,000 crore deployed in the system
- Large funds flowing to sector from banks and equity investors
- Reach out in areas where banks have been tardy in providing service
- Rapid scaling up through innovation/ technology to cover remote areas
- Loan repayment remains over 95%

Opaque benefits

- A significant percentage of clients exist only on loan books
- Poor may be benefiting but high MFI profitability raises questions
- Steep interest rates, sometimes over 40%, defeat purpose of helping poor
- Tight schedule of weekly repayments putting tremendous pressure
- Proxy agents flourishing due to lack of checks and balances
- No data available on indebtedness

India's microfinance institutions (MFIS) have often hit the headlines. But this time, they are doing so not necessarily for the right reasons. They have been accused of making huge profits and ensuring their own topline growth at the cost of the poor whom they aim to help with easy and affordable credit. SKS Microfinance, one of the biggest MFIS, hit the high streets with a very successful IPO and listing in August. But this raised questions about the firm's operations and profit motives. What particularly drew strong criticism was SKS chairman Vikram Akula and other top management making millions through stake sale and ensuring high returns to equity investors. This criticism came from none other than the father of modern microfinance, Nobel laureate Mohammed Yunus, with whom Akula first worked at Grameen Bank in Bangladesh. Questions are also being raised about the coercive tactics used in many cases to ensure weekly repayments and the steep interest charged by the MFIS, sometimes over 40 per cent. In what way are these charges justified?

Though the avowed intention of MFIS and banks providing microcredit is to help small borrowers, there is increasing evidence to show its cumbersome processes are forcing landless farmers and traders to seek out the traditional moneylender. On the flip side, loan beneficiaries often face undue pressures. Last month, over 1,000 women members of 50 self-help groups in Bhubaneswar protested against the high interest charged by MFIS. The first farmer suicide in drought-hit West Bengal this year is also traced to the harassment over loan repayment.

“The big MFIS restrict themselves to safe terrain. The small and medium or start-ups seek difficult terrain.”

Mathew Titus, Sa-Dhan

On October 5, the Andhra Pradesh Human Rights Commission ordered a probe into the functioning of MFIS in the tribal and Dalit-dominated areas of Warangal, Anantapur, Karimnagar and Rangareddy districts following six suicides in three months by debt-trapped farmers and labourers due to the alleged excess by MFIS. All this is a rude shock. Just a few years back, MFIS were being lauded for helping the poor get access to credit. Today, horror stories abound across the hinterland about MFIS adopting the same tactics and goals of big banks and money-lenders. What has gone wrong?

In a complaint to the state government in February, Khammam district collector V. Usharani had alleged that MFIS have not only been violating state regulations for

tribal areas but have also been indulging in unfair practices, including taking their property as collateral. “Due to coercive recovery methods,” she said, “certain borrowers have committed suicide.”

Prof K. Venkata Narayan of Kakatiya University, Warangal, substantiates this, pointing out that as each of the 7-10 members of a self-help group are held responsible for ensuring other members repay the weekly instalment on time, defaulters face the humiliation of others staging a dharna in front of their houses to put pressure. Often, they are forced to sell off their belongings to fund repayment. In Palivelpula village of Warangal, Banda Elisa sold her mangalsutra and mortgaged her house for Rs 30,000. Today, she pays Rs 600 as rent to live in her own house and has even mortgaged her ration card. Reports of harassment and suicide have also emerged from different parts of the country, particularly from states like Orissa, West Bengal and Uttar Pradesh.

Driven by reports of malpractices, the Reserve Bank of India and the finance ministry have woken up to the issue. Last year, the RBI completed a study on how to improve the reach of microcredit and ensure greater operational transparency. “MFIS have no doubt been able to provide access to finance to segments of people left behind by the formal financial sector. The high interest rate charged by them, however, remains a contentious issue and banks funding these entities need to be sensitive to this issue of public policy,” says an official RBI response to *Outlook*. Recently, the finance ministry issued an advisory to public sector banks, giving funds to the sector to “try to persuade MFIS to restrict the lending rate to 20-24 per cent all inclusive”, official sources state.

MFIs justify their high interest rates, saying the cost of delivering and collecting small loans is very high.

Obviously, MFIS defend their actions, specially the high interest rates. **Mathew Titus of Sa-Dhan, an umbrella organisation for MFIS in the country**, points out that the smaller the loan size, the bigger is the cost of delivery and collection. As such, it is easier for big players (with average loans of Rs 5,000-20,000) that have reached a critical scale of over 1.5 lakh clients to reduce the interest rates “but for small ones lowering even 0.5 per cent interest rate may be a challenge”. Rather than putting a cap on interest rate, Titus moots fixing a rate “band”.

Interestingly, a study report covering 60 MFIS in 2009 by M-Cril, a global rating agency of microfinance institutions, revealed that while their yield has increased from 18.8 per cent in 2002 to 31.4 per cent in 2009, their operating expenses ratio (OER) has come down from 19.9 per cent to

11.5 per cent during the same period. What's more, the report indicates that 'portfolio at risk' has also come down from 12.2 per cent to just 0.5 per cent in the same period.

“These two factors have improved the return on assets significantly across the sector from an average of -1.5 per cent in 2001-02 to 4.3 per cent in 2008-09 as compared with the global average of 1.5 to 1.8 per cent. Based on the above data, it can be said there is room for reduction of interest rate,” is the official response of the state-run National Bank for Agriculture & Rural Development (NABARD). It stresses that larger MFIS, which cover nearly 80 per cent of the market, “need to take a lead in this”.

“Though large MFIs are paying investors huge returns, they've been tardy in bringing down lending rates.”

Harsha Moily, Mokshayug Access Society

As expected, the government's move to cap the interest rate has not gone down well with most players. Akula says “an interest rate cap would hurt fledgling MFIS the most” as providing microfinance to the rural poor is a labour-intensive and costly affair. But G. Padmaja Reddy, founder and MD of Spandana, one of the biggest MFIS, says it “will overall sanitise the sector from the accusation of charging high interest rates.”

Reddy buttresses her point to state that “as per traditional wisdom, if we add up 12 per cent cost of funds, 10 per cent cost of doorstep delivery of service and 2 per cent risk, overall interest rate chargeable amounts to 24 per cent just to break even”. This thumb rule applies to all MFIS with the doorstep delivery cost being determined by the number of borrowers.

cost of funds, 10 per cent cost of doorstep delivery of service and 2 per cent risk, overall interest rate chargeable amounts to 24 per cent just to break even”. This thumb rule applies to all MFIS with the doorstep delivery cost being determined by the number of borrowers.

This is where the catch lies. Experts admit there is no verified data about the number of clients each mfi has. Many clients also borrow from multiple sources to meet their needs or even juggle the weekly loan repayments, thereby getting sucked into the vicious debt cycle. Another worrying issue—that of “ghost client” and “proxy” agents—has also surfaced in recent years. Ramesh S. Arunachalam, a microfinance practitioner, has detected 7-9 per cent ghost clients in many sampled portfolios and 6-12 per cent of portfolios in non-microfinance clients. He

suggests a large group can visit randomly selected MFIS and concurrently perform a rigorous client, portfolio and systems/mis audit in their operational areas—including following the entire trail of money and process flow (back and forth, right up to HQ).

Also, the emergence of broker agents (who supply joint liability groups to MFIS) is a scary phenomenon, as their presence makes traceability of priority sector funds rather difficult. Arunachalam recalls first coming across a broker agent in 2005. Today, they are in many fast-growing and urban areas. “The excesses attributed to MFIS are perhaps due to broker agents, who are not accountable to the microfinance system in any way,” he underlines.

Some of the MFIS admitted that there could be fraud cases of “proxy borrowing”, and even some bad characters emerging as ringleaders or “brokers” who help push loans in some areas and use strong-arm tactics for recovery.

Suresh K. Krishna, MD of Grameen Financial Services, points out that “it's a people-intensive sector. There is need to have a regulatory system. Of course, that would add to the costs.” Krishna has been trying to minimise bad practices through audits and staff transfers.

NABARD, a major funds provider to self-help groups through NGOs and banks, has been promoting the concept of “savings first” before providing credit. This is a concept most NBFCS and NGOs would like to promote but are barred under present RBI rules. There could be a change if any of the NBFCS or MFIS are able to get banking licences. At present, while there is a divide on whether MFIS have added to the agrarian crisis and contributed to the suicides, experts like Arunachalam feel that “the burgeoning growth of microfinance, coupled with the decentralised model, is perhaps responsible for a serious deterioration in portfolio quality.”

MFIS are looking forward to the upcoming microfinance credit information bureau to help them reduce risk of default and people getting into debt traps. Privately though, a few MFIS admit that if there was a freeze in lending activity, there could be a default of 50 per cent. That would be catastrophic, as some Rs 30,000 crore has been spread over 22 million people. Are we then skating on thin ice when we claim that microfinance is robust and growing?

“Most MFIs have very high operating costs. Salary packages and ESOPs are higher than in financial firms.”

Vijayalakshmi Das, Friends of Women's World Banking

Analysing the MFI cost structure

Business line, 27 October 2010

Interest rates in the microfinance industry will fall with greater competition and the emergence of disruptive business models that offer similar services at far lower costs through process innovations.

Having understood the deep transformative potential of access to finance and the barriers to accessing it, here's a look at the fundamentals of the MFI cost structure in delivering finance. Broadly, an MFI's costs consist of four components. The first is the rate of interest at which the MFI borrows. MFIs do not accept deposits; the rates at which they raise money thus form the base rate for them to be able to lend. The second component is the cost to the MFI of running its operations — staff costs, and office and administration costs. The third component is the loan loss reserve for anticipated defaults. And the fourth is the cost of capital.



Most MFIs have limited options for raising on-lending funds. The main source of funds are the banks, which often lend to MFIs at a current rate of not less than 12 per cent per annum for the majority of players. There are instances of smaller organisations managing to raise resources at over 14.5 per cent. Thus, despite low levels of defaults, low temporal risk compared to project finance or infrastructure finance (microfinance loans are usually just for one year), and grading by rating agencies such as **Crisil, MCRIL and SMERA (for larger MFIs)**, the borrowing cost is still high.

Despite priority sector lending benefits being extended to banks, the flow of money to the microfinance sector has not increased. A recent report on the microfinance sector by CGAP, aptly titled *Banana Skins*, rated liquidity as the biggest risk factor for Indian MFIs. Key to this could be the perception of risk that the

sector carries. While repayment rates in the sector, for the most part, have remained high, microfinance continues to carry the burden of a legacy of write-offs on politically motivated or badly originated rural loans. Several bankers do not separate the experiences of rural lending from microfinance. What makes it even more challenging is that all group lending is classified as microfinance.

Several NGOs in the past have linked groups formed for causes such as promotion of health practices to banks to access finance. Some of these groups, in reality, are completely out of sync with the basic tenets of microfinance. Generalised perceptions of the microfinance sector can make the industry seem riskier, thereby resulting in higher risk premium in the form of high lending rates to microfinance institutions, and also lead to a lower leverage (loans extended to MFIs in relation to the capital brought in by them). Capital market investors such as mutual funds and pension funds are also not yet active. Certain costs associated with the delivery of microfinance, such as administration/ head-office costs and information technology do not vary directly in the proportion to the change in scale of business.

For an organisation working at less than full efficiency, the costs of delivering finance to customers in far-off villages and collecting instalments on a weekly basis, could be extremely high. For a small organisation, or one in the start-up stage, this could be as high as 30 per cent. However, as the scale improves and processes reach the desired efficiency, the costs fall very sharply. The cost of operations also varies with aspects such as accessibility and density of the population served. There is a general acceptance that the cost of operations is close to 10 per cent, even for the larger and more efficient MFIs.

However, there is an anomaly here. Even the largest organisations have shown growth rates upwards of 70 per cent per annum. This means that while there is a part of the organisation that is working at full efficiency levels, the new branches pull the overall efficiency numbers down. Hidden in this 10 per cent number is the cost of financing the expansion of business. Can the cost of lower efficiency during the early periods of a new branch be capitalised as financing growth? Is this not the role of equity?

Also, most MFIs continue to focus mainly on credit. Some of them offer bundled insurance, but there clearly is room to offer a suite of financial services and spread costs over a larger number of products, bringing the loan cost down and, in the process, offering the client the mix of services required for them to fully leverage the power of finance. Loan loss provisioning is a prudent practice and does not offer any scope for reduction from the 2 per cent industry average that one notices. Cost of capital, however, becomes very relevant in light of the explanation of the two components mentioned above.

Most lenders to MFIs, as also the regulators, demand that the MFI brings in a certain amount of capital. The cost of capital, that forms a part of the total cost, is a function of the capital required and the return expectations of the investors which, among other things, is influenced by the risk perception. With debt providers holding a higher risk perception for the microfinance industry, a higher amount of capital is required as capital adequacy. For most MFIs, expansion is financed by equity as well, increasing the demand for capital significantly. The regulatory requirement of capital is 15 per cent; however, most of the MFIs require capital in excess of 23 per cent.

Also, the perception of higher risk is not limited to lenders; equity investors also factor in such higher risk perceptions into pricing. Return on equity for microfinance has been quoted to be close to 20 per cent (presuming pre-tax return). However, the actual requirement may go well beyond this number. Also, equity currently chases the very few larger MFIs that have achieved some scale, meaning that MFIs will continue to find other ways to finance their growth. It is no surprise, then, that several MFIs achieve a breakeven within 18-24 months.

This brings us back to our original question. With all these factors, if one were to add the cost of finance, operating costs at a steady-state level, loan loss reserve and the capital costs, the optimal interest rate is closer to 20 per cent than 30 per cent. The reduction of interest rates will happen with competition in the industry and the emergence of disruptive business models that offer similar services at far lower costs through process innovations.

State-run banks ask MFIs to lower rates

Some microfinanciers unwilling to reduce rates citing fear of closure; other sources of funding sought

Dinesh Unnikrishnan,
livemint.com, 4 October 2010

Public sector banks have started insisting that **microfinance institutions (MFIs)** that borrow from them do not lend the money at exorbitant interest rates, following a government order. But MFIs are unwilling to bring down their rates to the levels being demanded by the banks. While some MFIs say the move may force smaller funds to close down, others are willing to turn to alternative sources of funding.

MFIs typically borrow at 10-12% from banks and lend small sums to poor farmers and small entrepreneurs—who are often outside the banking net—at 22-36% without asking for collateral. A finance ministry note in September asked public sector banks to make sure that MFIs that borrow from them lend on the money at reasonable rates, so that the small loans are not a burden on the rural poor. It also asked them to prevent the practice of evergreening—under which a lender gives a fresh loan to a borrower to repay an old loan.

“This is particularly essential for the large and well established MFIs,” the note said. Although the banks were initially reluctant to abide by these directives, many of them are now planning to enforce a 24% interest rate cap on loans issued by MFIs. “From now on, MFIs will have to sign an agreement, assuring us that they will not lend at more than 24%. If they fail to do this, they will not be given the financial support,” Bank of India’s executive director M. Narendra said.

S. Govindan, general manager of Union Bank of India, said: “We have decided not to lend to MFIs unless they submit a specific plan to bring down their interest rates to 22-24% over a period of time. After assessing the cost structure of such firms, we will set a cut-off date for them to do this.” T.Y. Prabhu, chairman and managing director of Oriental Bank of Commerce, said unless MFIs come up with a road map to bring down high interest rates, “they may not get the support”. Another larger public-sector lender, Bank of Baroda, has put in place a clause in loan agreements with MFI to ensure that they do not charge “abnormally high rate to their borrowers”. “Fresh loans will be given only with a condition that the ultimate beneficiary

will not be charged more than 22-24%,” said N.S. Srinath, executive director with Bank of Baroda.

The country’s largest lender, State Bank of India (SBI), said it does not lend to MFIs who charge unusual rates even now. “We are not lending to any MFI who charge abnormally high rates,” chief financial officer S.S. Ranjan said. SBI has an MFI portfolio around Rs.1,500 crore, including loans given to self-help groups, he said. Public sector banks are required to channel 40% of their advances into agriculture and small-scale industries, dubbed as priority sector loans.

They can also lend to MFIs to meet the target, as these firms then issue the loans to farmers and small entrepreneurs. Self-help groups also seek short-term funds from MFIs. Indian MFIs form a Rs.18,500 crore industry. The country has nearly 800 MFIs, according to Nabard website, but only the top 10 reach 100,000 clients. The sector added 8.5 million consumers in fiscal 2009, up 60%, taking its consumer base to 22.6 million, according to a study by research and consultancy firm Access Development Services.

SKS Microfinance Ltd, the country’s largest MFI, had disbursed loans of Rs.14,300 crore until March to nearly 6.8 million borrowers. Shubhankar Sengupta, managing director of Kolkata-based **Arohan Financial Services Ltd**, said most MFIs will have to shut down if banks enforce the 24% cap. “There will not be any microfinance companies in the country except a few bigger ones (that can afford such interest rates),” he said. “You need to reach a certain size to bring down your rates. One cannot survive lending at 24%. Banks have to be vigilant and need to look at the operating cost and structure of their MFI clients.”

Arohan has a Rs.120 crore loan portfolio and 230,000 clients across Bihar, West Bengal and Assam. Samit Ghosh, managing director of Bangalore-based microfinance firm **Ujjivan Financial Services Pvt. Ltd**, one of India’s top 10 MFIs, said the sector won’t suffer a lot even if state-owned banks shut the door on them. “There are private sector banks who are active in the area,” he said. Ujjivan has about 800,000 customers and a loan portfolio of around Rs.500 crore. A finance ministry official said the government has not set a cap on MFI interest rates. “By saying 24%,” the official said, “we were just giving an example (to banks). At the end of the day, banks have to see at what rate they can lend.”

Mixed response to interest rate concerns

The finance ministry had asked public sector banks to ensure that MFIs levy 'reasonable' rates of interest

Aveek Datta

Livemint.com, 8 October 2010

Some of India's microfinance institutions (MFIs) have reacted sharply to government concerns that they were charging very high rates of interest, mostly to poor borrowers, while others said some moderation was required. In September, the finance ministry had asked public sector banks to ensure that MFIs using their funds charge "reasonable" rates of interest. "What nationalized banks could not achieve in 40-50 years, MFIs have done in five years. The growth of microfinance cannot be stopped because people have enjoyed the benefits of it," said S. Pattabiraman, president of **ASA Grama Vidiyal, a Tamil Nadu-based MFI**. "If the policymakers try to stop this industry, they will face repercussions."

At least three public sector lenders said they have asked MFIs who borrowed from them to keep interest rates at 22-24%, though the ministry had not suggested any cap on rates, *Mint* reported earlier this week. Industry executives at an industry seminar on Thursday said if rates were capped, it could lead to many small MFIs shutting shop. "It will be very difficult for the smaller players who are just starting," said S.V. Raja

Vaidyanathan, chairman and managing director of **Asirvad Microfinance Pvt. Ltd.** "It takes time to build scale and adopt technology that can then lead to lowering of interest rates."

"The unprecedented financial success experienced by MFIs might have made a lot of other stakeholders uncomfortable," said K. Sree Kumar, chief executive of **Intellectual Capital Advisory Services Pvt. Ltd** (Intellectap), an investment bank that deals with microfinance. Kumar did not name any stakeholders. According to Intellectap, the microfinance industry had lent Rs.21,500 crore to around 24 million clients as on 31 March. "Microfinance in India has the potential to become a \$600 billion industry 10 years from now. It could potentially be an economy within an economy," said Sajeew Viswanathan, managing director of **Basix**, a microfinance lender based out of Hyderabad. "If this direction is to be followed, the peripheral noises have to die down."

Viswanathan and Pattabiraman said microfinance should be looked at as a commercially viable model to promote livelihood and not be treated at par with the priority sector lending activities of banks. However, **Vijay Mahajan, chairman of Basix** and a microfinance industry veteran, admitted interest rates in microfinance needed to come down. "The biggest concern for

MFIs is some of the players themselves," he said. "They are over-leveraging their capital."

Mahajan said interest rates had to come down for the sake of the industry. "We are in talks with players to bring down the interest rates and it is necessary for the very survival of the industry."

Mahajan is also president of the Microfinance India Network, an association of MFIs that account for 85% of the microfinance business. Many MFIs have begun lowering rates depending on where they operate and the scale achieved there. "With sizeable scale and increased competition in the market, interest rates will come down naturally," said **Vineet Rai, chief executive of Aavishkaar India Micro Venture Capital Fund and chairman of Intellectap**.

A case in point is Kolkata-based **Bandhan Financial Services Pvt. Ltd**, which has cut rates to 18.5% from 24%. "We reduced rates as that gave us greater bargaining power with banks to persuade them to lower the cost of funds for us," managing director Chandra Shekhar Ghosh said. MFI executives also said regulators such as the Reserve Bank of India had little reason to worry about the industry as it had not yet reached critical mass in India to affect the financial system.

A self study of “Self Help Groups”

Chitra Ahanthem

kangla-online.com, October 3, 2010

As is happening in other parts of India, **Manipur** also has its plethora of **self help groups (SHGs)**, which are instituted through NGOs working in various sectors. SHGs as the name indicates is a support group wherein the members of the group help each other through various mechanisms like organizing prayer meetings, charity drives, forging support systems for people who have gone through difficult circumstances: the loss of a loved one, physical handicaps, addictions and the like. However, most activities mentioned here are seen in urban areas and in Manipur, SHGs are often the domain of the NGO sector and are almost always a group of about 20-25 women who have availed service delivery from that particular NGO. The members often contribute a certain amount of money as per the group decision at time intervals: weekly, fortnightly or monthly. The amount thus collected is used according to the needs of the group members with the lowest rate of interest. But apart from the idea of keeping a fund corpus for needs of the group members, SHGs foster meetings among like-minded group members, thereby facilitating an emotional support system for people who often have no other means: widows, sex workers, drug users.

Having worked in the NGO sector for over ten years and seen a variety of NGOs go through their stumbling infancy period to them taking some steps; one cannot help make certain observations. Often, family members object to widows going of the house even though they won't come forward to helping them financially and it often takes a long process to convince family members that they should indeed allow

the women in the family (widows specifically) to step out of the house and get basic trainings on SHG formation, getting some skills to eke a living etc. Once the SHG comes through from this phase, it is a beautiful exercise to see women bonding, reflecting and sharing common pain. With time, one gets to see these same women who have been beaten by the vagaries of life get out of their own 'victimhood' and rally together to address issues faced by other women outside of their own group as well. This often heralds in a sense, a political awakening where they question their nature of existence and demand what is rightfully theirs.

Yet, most SHGs are woefully straight jacketed and cannot make much difference in the lives of the women apart from giving them a platform for emotional support and taking them towards the beginning of 'empowerment'. 'Beginning' because almost all SHGs that one sees in Manipur are propped up by NGOs and have not managed to sustain themselves on their own. There is also the larger issue of whether the NGOs treat them as 'clients' or as equal citizens of a society, for there is a major difference between the two. In the case of the former, SHG members are to be given help only till the time there is project funding and that such help is centered around what the NGOs deign best: trainings for embroidery, making decoration items, making pickles and aggarbattis. Considering them as equal citizens on the other hand would mean asking the women in the first place what they want to take up. More often than not, the training given to SHG members and the subsequent activities that are encouraged by their parent NGOs not only fall into gender stereo-types where women are supposed to only do embroidery, food preservation etc but

ends up adding more physical burden on them as it is only women who do household work within their own homes. The death knell of most SHGs in the state is also to do with the fact that almost all SHGs come out with exactly the same items to sell in the small market that the state has. Added to this is the lack of packing and marketing skills and a failure to be able to take in bulk product orders. Compare this with the **Shri Mahila Griha Udyog Lijjat Papad**, which started in the year 1959 with a seed capital of Rs. 80 but today has an annual turnover of around Rs. 500 crore with Rs. 250 crore in exports and providing employment to around 42,000 employees. This group which is behind a most popular consumer product, Lijjat Papad is considered as one of the most remarkable entrepreneurial initiatives by women that is identified with female empowerment in India.

End-point:

What stood out of the **Shri Mahila Griha Udyog Lijjat Papad enterprise** with a meager amount of Rs.80 when it started out with 7 semi literate Gujarati women was their understanding of market demand and the nature of buying and selling. Instead of going door-to-door sales, they concentrated on bulk buyers and ensured that orders were honoured. Thus, it was only natural that the group grew to the status of a Co-operative Society with major turn-over of income and profit. Contrast this with Manipur where at any given Mela, one sees the same product thereby failing to make earnings that even out investments for the SHG members. There needs to be a serious strategy re-think in terms of approaches for SHG functioning and their survival as independent and thriving units.

Should microfinance rates be capped?

Business Standard, October 13, 2010

New Delhi, There is undoubtedly a need to make microfinance institutions more transparent but capping lending rates will hurt numerous smaller MFIs operating in remote areas and thus may not help the poor.



P Arunkumar CEO, Svasti Microfinance

Interest rate caps could force MFIs to avoid remote areas where the process of delivering loans and collecting repayments is people-intensive and quite expensive

According to reports, the finance ministry has suggested that public sector banks should ensure that microfinance institutions (MFIs) to whom they lend set a cap of 22 to 24 per cent on lending rates. Most MFIs in India charge customers 28 to 33 per cent (all-in costs including interest rate and processing fees). We must understand why MFI interest rates are what they are. All lenders suffer three types of costs — cost of capital, loan loss provisions and transaction costs. Transaction costs for making many small loans are much higher than they are for making fewer larger loans. MFI clients live in remote areas. They do not have credit histories, collateral or financial documents to establish creditworthiness. The process of delivering loans and collecting repayments from them requires frequent physical interaction, is extremely people-intensive and quite expensive.

SKS Microfinance, India's largest MFI, has reported total operating costs of around 12.66 per cent for fiscal 2009 in its IPO prospectus. Add to this the cost of funds for MFIs, which is around 11 to 12 per cent for the top MFIs and one to two per cent higher for smaller ones. Add further loan loss provision of two per cent, and you get 26 to 27 per cent as merely the break-even rate. Remember that banks were charging all-in rates exceeding 45 to 55 per cent a couple of years back when they made small-ticket personal loans to lower middle-class customers. The only reason this business has halted today is the heavy losses and frauds. Even today, credit card and personal loan rates that banks charge are comparable to, if not higher than, MFI lending rates.

A directive requiring MFIs to operate at a cap of 24 per cent will create panic among those institutions with systems, processes and infrastructure that, as currently designed, would make it difficult to immediately shift to dramatically lower rates. This is significant for the numerous start-up and smaller MFIs operating in remote or underserved areas that lose money for many years before breaking even.

Capping interest rates for MFIs is advocated as a means of client protection, but it could have the opposite effect. Interest rate caps could force MFIs to avoid remote areas where it may be more expensive for them to operate. It could also make MFIs reluctant to reach out to the poorer segments of the population that require smaller loan sizes, which are more expensive for MFIs to administer. It may force excessive competition amongst MFIs servicing particular segments of the poor in particular regions that are relatively easy or less expensive to service, leading to multiple loans being made to these segments.

Also, most MFI loans are of one-year tenure with instalments collected weekly. A drop in interest rate from 28 per cent to 24 per cent on a one-year loan of Rs 10,000 translates into a total savings in the hands of the borrower of less than Rs 300 per year. This translates into reducing their weekly instalment by less than Rs 6 per week. In my experience of interacting with MFI borrowers, their top priority is to get bigger loan sizes and better service. MFI interest rates are far cheaper than the other available sources of credit for the poor, such as moneylenders. Availability of institutional finance is more important to the poor than a reduction in interest rates.

As MFIs establish their business model in each new market, compete for customers, capital, employees and banking relationships, economies of scale kick in and they adopt new technologies, they will innovate to reduce transaction costs and interest rates. Some leading MFIs have already announced a drop in rates and we will see more of this in the coming years. As observed by the **Raghuram Rajan Committee on financial sector reforms**, liberalising interest rates would allow the formal sector to lend to the poor and keep them from the moneylender, though doing so would require the political will to accept the widespread evidence that low interest rate ceilings simply do not help the poor.

Instead, regulators must focus on improving MFIs' lending practices, making them more transparent, ensuring clients understand the rates and terms of the loans and making sure MFIs take measures to reduce multiple lending to segments such as agricultural labourers for personal purposes. These are all important issues that deserve more attention and debate than MFI interest rates.



R Subrahmanyam Principal Secretary,
Andhra Pradesh government *

Microfinance institutions are achieving hyper profits at the cost of the rural poor, further impoverishing the already distressed rural sector

Microfinance lending is the story of how a system can move from “charity” to “robbery” led by avaricious elements raking in hyper-profits from the meagre surplus available with the rural poor. The atrocities being committed by microfinance institutions (MFIs) in the garb of lending to the poor and the resultant suicides in rural areas underline the urgent need to regulate this activity. The irregularities committed by MFIs operating in Andhra Pradesh range from usurious interest rates, lack of transparency, cheating and using coercive mechanisms to recover loans, unveiling a new and a more cruel form of the moneylender system. Many of these MFIs have amassed huge profits and become commercialised at the cost of the rural poor, flourishing due to a lack of regulation.

Andhra Pradesh has, over the past decade, built the community-based self help group (SHG) movement. It has organised more than 10 million rural poor women into SHGs and federated them at the village, mandal and district levels. The government of Andhra Pradesh's **Society for Elimination of Rural Poverty (SERP)** has achieved financial inclusion by linking these SHGs with the banks. Today, these SHGs have more than Rs 20,000 crore outstanding loans with the banks, bringing a radical decline in rural poverty.

It is this green pasture that MFIs have entered. MFI activities in Andhra Pradesh raise alarm bells for various reasons: One, MFIs are poaching on the SHGs by showing them as joint liability groups (JLG) formed by them. SHG members are being induced to join JLGs by inducing the group leaders through promises of freebies.

MFIs, therefore, are not helping spread financial inclusion, but are including themselves in existing set-up built over decades by SHGs.

Two, MFIs are resorting to multiple lending without conducting a due diligence exercise on the capacity to repay, purpose for the loan and its end use. As a result, prudential norms are being violated at will. This can destabilise the financial sector due to the possibility of large-scale defaults, thereby increasing non-performing assets, which can have a cascading effect on the balance sheet of the banks. Three, in the case of non-payment or default, MFIs are using coercion and unethical means of recovery ranging from confiscating household articles, using goondas, forcing defaulters to take further loans for repayment and forcing poor women into prostitution, all resulting in considerable distress for the rural poor, driving some of them to commit suicide.

Four, there is no transparency on effective interest rates. Since the effective interest rates are concealed by weekly recoveries, the poor are unable to understand that the actual interest rates are over 30 per cent in most cases. Finally, unlike SHGs, which are the community financial institutions, MFIs are achieving hyper profits at the cost of the rural poor, further impoverishing the already distressed rural sector. So far, the Reserve Bank of India (RBI) has taken a stand-offish attitude to the problem, leaving a regulation vacuum. It needs to change its outlook given that the nature of these MFIs has changed over the past five years and they have become money-spinning businesses raking in hyper-profits.

Naturally, the Andhra Pradesh government cannot be a silent spectator to this “loot and scoot” system of MFI functioning. Since the RBI has stated that the state government is the best agency to regulate the activities of MFIs, we will certainly be looking at legislative measures to reign in their activities. We also feel that the draft Bill before Parliament to regulate the MFIs should be expedited. This will ensure that the unregistered MFIs' activities can be curbed. We are in dialogue with the RBI to advise banks about the need to examine the activities of MFIs that register as non-banking financial institutions before lending to them. We strongly feel that the interest rate spread of MFIs may be limited to 8 per cent. They may also be mandated to disclose the “effective interest rates” to clients. The use of coercion and unethical practices in loan recovery should be strictly banned. Any distress deaths caused by MFI agents should be considered homicide and action should be taken under relevant section of Indian Penal Code.



Important Upcoming Events

- Programme on "Data Management Skills", 7-9 December, 2010, organized by IRMA
- Programme on "Enhancing Managerial Effectiveness", 13 – 18 December 2010, organized by IRMA
- Programme on "Removing Poverty: Constraints, Opportunities and Strategies", 14 – 17 December 2010, organized by IRMA
- Programme on "Gearing for Competitive Challenges ? Making Organizations More Efficient", 14 – 17 December 2010, organized by IRMA
- Programme on "Marketing Essentials for Development Professionals", 21 – 23 December 2010, organized by IRMA
- Programme on "Rural Development through Dairy Cooperative Societies (DCSs) in India", 27 – 28 December 2010, organized by IRMA
- Programme on "Everybody Wins: Negotiating Skills for Managers", 18 – 21 January 2011, organized by IRMA
- Programme on "Strategic Management: Essential Concepts for Managers", 18 – 21 January 2011, organized by IRMA
- Programme on "Credit Management Programme for Credit Officer/Branch Managers", 17 – 21 January 2011, organized by NIBM