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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

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MICROFINANCE CRISIS IN ANDHRA PRADESH AND REGULATORY RESPONSE

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ABSTRACT
The microfinance sector of Andhra Pradesh was recently impaired by a series of unfortunate incidents that happened due to extensive lending which resulted in over-indebtedness, defaults and in some cases some of the clients even committed suicide. The main reason for such incidences was said to be the high rates of interest and the marketing tactics such as collection methods adopted by MFIs. This paper explore the reasons behind the hardships of MFIs' clients, causes of inefficiency in operations which have increased the cost of credit and problems with the current marketing strategy and other related areas. This paper focuses the need for policy implications of the various regulatory measures that the Government subsequently should take to control and regulates micro-lending practices in the state.

KEYWORDS
Andhra Pradesh, Extensive lending, Microfinance crisis, Regulatory measures.

INTRODUCTION
Microfinance institutions (MFIs) have established as an effective way to empower the lowest levels of entrepreneurship by providing them continuous financial support that were hardly served by the banks and other financial institutions. The microfinance sector in India has expanded rapidly over the past few years by providing small loans to emerging entrepreneurs to start or expand businesses. Most MFIs in India are solely engaged in extending microcredit: a few also extend saving/thrift, insurance, pension, and remittance facilities. Since there is no comprehensive regulatory frame work for the microfinance sector in India, MFIs exist in many legal forms. Many mid-sized and large MFIs developed to acquire and float new companies so as to get registered as non banking financial companies (NBFCs) whose ultimate aim is to reach more customers and more areas to provide their services. As microfinance institutions expanded very quickly and hiring and training processes were inefficient, resulting in employees who engaged in inappropriate collection practices and lending models that led to customer over-indebtedness in some of the states like Andhra Pradesh (A.P) in India.

REVIEW OF LITERATURE
Anand (2008) states that MFIs can serve as a good vehicle for penetrating rural population, the commercial banks flushed them with funds in order to push their agenda of acquiring hold of rural market, diversifying risk, and serving rural economy.

Anurag Priyadarshee & Asad K.Ghalib (2011) mentioned as the outreach of microfinance sector has been poor over the past few years in India, it has morphed from being a savior of the poor to the whipping boy of the press, and a poster child of exploitation of the vulnerable.

Jessica Schicks (2013) states that although there is ample indication that microfinance can be highly beneficial for the poor, there is no consistent and robust proof to date that microfinance effectively promotes microenterprise development, that it increases the asset ownership of micro borrowers or that it positively affects borrowers' income.

Kenny Kline and Santadarshan Sadhu (2011) mentioned as microfinance institutions were subject to prudential requirements; however no regulation addressed lending practices, pricing, or operations.

MARCUS TAYLOR (2011) mentioned as the unprecedented increase in loans of MFIs was justified in terms of a massive unmet demand for credit by the poor, who are presented as living in a state of 'financial apartheid' that reproduces poverty through exclusion from the formal financial system.

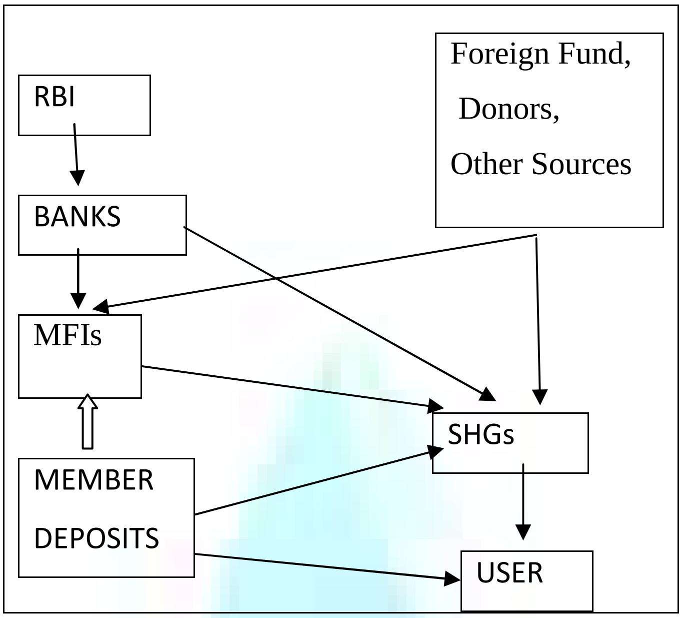
Renuka Sane and Susan Thomas (2013) expressed as MFIs lend to households and present no risk to households if they fail. Hence, regulators do not need to worry about the failure of an MFI from the consumer protection perspective

Subrata Kumar Mitra (2009) states that as the micro finance institutions (MFIs) began to mature, they started facing performance dilemma, and focus is gradually shifted towards profitability.

FUNDING STRUCTURE OF MICROFINANCE IN INDIA
In India, the funding structure of microfinance is followed by two broad mechanisms:

(a) Microfinance Institutions which are operating in the form of Non-Governmental Organizations (NGOs) , or Non Bank Finance Companies (NBFCs); and (b) Self Help Group (SHG)-bank linkage. NGOs are not regulated by any specific law and are generally registered under the Societies Registration Act, 1860, the Indian Trust Act, 1982, or any other relevant state act. The sources of funding for NGOs are donors, governmental departments (usually under some scheme), and savings of its members. NBFCs are not-for-profit companies with a purpose of elevating commerce, art, science, religion, charity or any other useful object. These companies do not provide dividends, and excess of income over expenditure is used for the stated purpose. SHGs or Credit and Savings Groups, each usually with an average size of 8 to 12 members, come together to form a federation usually in the form of a cooperative society and provide microloans to their members. The most grass root level SHGs of them are not even registered as they usually work in an informal way. Apart from banks and NBFCs the other sources of funding for microfinance institutions include some private equity investors (venture capitalists, private investors), funding from abroad (loan, grant, investor), through charity (domestic and abroad), members fund, loans, and governmental support.

FIG 1: A GENERAL INDUSTRY FUNDING STRUCTURE



Source: Anand (2008) "High cost of Finance in Microcredit Business in Andhra Pradesh (India): Problems and possible solutions."

The above figure illustrates that MFIs as a generic term include NBFCs (working in microfinance area), NGOs, SHGs, and any such Cooperative Society, or Fund, which operate to provide credit in the form of microfinance.

For serving the need of credit seekers besides MFIs, other institutions such as National Bank for Agriculture and Rural Development (NABARD), ICICI Bank, RRBs, and cooperative banks are also in the supply side of MFI movement who serve as the major supplier of funds for MFIs and provide advisory and technical support to this sector. Both the central and state governments also use this as an instrument to support and uplift rural livelihood under specific schemes.

TABLE - 1: SOME IMPORTANT MICROFINANCE INSTITUTIONS IN INDIA

S.NO	NAME OF THEORGANIZATION	S.NO	NAME OF THE ORGANIZATION
1.	ANJALI Micro Finance	**6.**	MADURA Microfinance Ltd
2.	ASMITHA Micro Fin Ltd	**7.**	MUTHOOT Fin Corp
3.	Fusion Micro finance	**8.**	SKS Micro finance
4.	JANALAKSHMI Micro finance	**9.**	SURYODAY Microfinance Pvt. Ltd
5.	L&T Finance	**10.**	TRIDENT Micro Fin Ltd

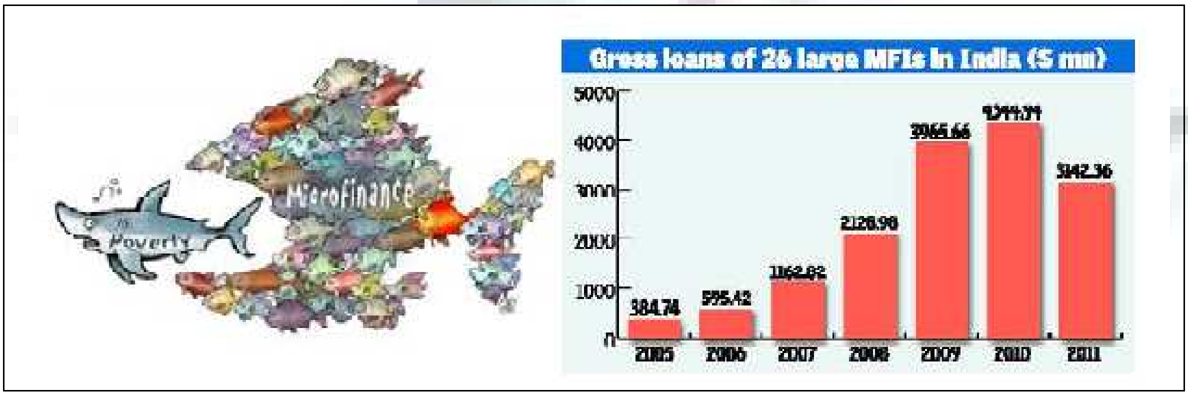
Source: CMI survey of MFIs, 2010.

TABLE – 2: CLIENT DETAILS OF TOP 5 STATES OF INDIA AS ON MARCH 2010

States	Female Client	Total Client
Andhra Pradesh	5952301	6044972
Karnataka	3101153	3290095
Tamil Nadu	2787807	2804181
Orissa	1511795	1527225
West Bengal	2660503	2686067

Source: CMI survey of MFIs, 2011

FIG. 2: GROSS LOANS OF 26 LARGE MFIS IN INDIA



Source: The Hindu Business Line, Sep 17, 2012.

GROWTH AND DEVELOPMENT OF MFIS IN A.P.

The growth and development of the microfinance sector followed a unique course in Andhra Pradesh when compared to other states in India. The state government of Andhra Pradesh systematically nurtured and deepened the institution of SHG (Self Help Groups) through the use of public resources due to a number of political motives. The Andhra Pradesh government set up an autonomous body, called as Society for Elimination of Rural Poverty (SERP), which is implementing the Indira Kranthi Patham (IKP) project in all the 22 rural districts of Andhra Pradesh. Activities of the SHGs revolve around regular savings by their members, credit (from both internal and external sources) and regular meetings (weekly excepting in case of newly-formed SHGs). The SHGs, Village Organizations (Vos), Mandal Organizations (Mos) and the District Organizations (Dos) are being increasingly involved in implementing and monitoring various government development programmes through IKP. Due to this rich infrastructure base, the MFIs do not need to invest in organizing the poor and generating awareness on microfinance in Andhra Pradesh, unlike in other states.

Since Andhra Pradesh households had better access to microfinance than all the other Indian states through the state sponsored microfinance programmes; private MFIs accumulated in Andhra Pradesh to benefit on the SHG network that already existed in the state. Therefore it becomes much easier for private MFIs to enter and start their businesses in Andhra Pradesh than in other states which led to an oversupply of microfinance and finally resulted in bitter events among clients and crisis that was witnessed subsequently.

EXTENSIVE SUPPLY OF MICROFINANCE AND IMPACT

The easy access of credit in rural areas has brought about significant changes in the lifestyle, however, at least in some instances, at the cost of plunging poor households under debt. As poverty gets directly correlated with reduced cash flow, providing easy credit through a host of lending institutions created an illusion of 'feel good' situation amongst the rural poor. There were a number of cases which suggested that a large proportion of microfinance clients were worse off after availing loans. Since higher interest rates on microfinance loans did not provide scope for savings as well as for investing and microfinance seldom helped poor to come out of poverty. Further, there were not many businesses that could have generated any profit after paying an interest of 24-36 percent on capital invested, which was the usual cost of financing through microfinance.

TABLE- 3 INTEREST RATES OFFERED BY VARIOUS SERVICE PROVIDERS

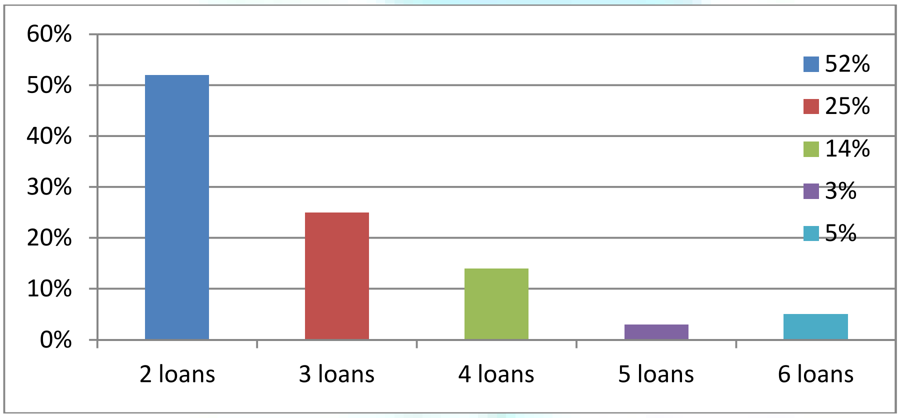
S.NO	SERVICE PROVIDER	INTEREST RATE
1.	SHG Pavala Vaddi	(3%)
2.	Moneylenders	(36% - 120%)
3.	Bank	(7% - 13%)
4.	SHG Internal loans	(12% - 24%)
5.	MFIs	(27% - 45%)
6.	Daily Finance Corporations	(78% - 120%)

Source: Centre for Microfinance and Micro Save (2012)

According to some news reports private MFIs usually paid very little attention to the core concerns of poor. For them the critical concern was to sustain and increase services against the emerging odds in a full of opportunity environment.

As a result, far from helping people in generating wealth, easy credit was being used to encourage 'primary producers' at the farm level, to become 'distributors and consumers' of consumer products and durables. Consequently, the profit maximizing mindset resulted in an impulsive distribution of loans without understanding the feasibility of the purpose. The problem was aggravated due to the intense competition and failure to share information among MFIs about the creditworthiness of a borrower and some needy people were in the hooks of enormous lenders.

FIG 3: EXTENSIVE LENDING LEADS TO MULTIPLE BORROWING



Source: Centre for Microfinance and Micro Save (2012)

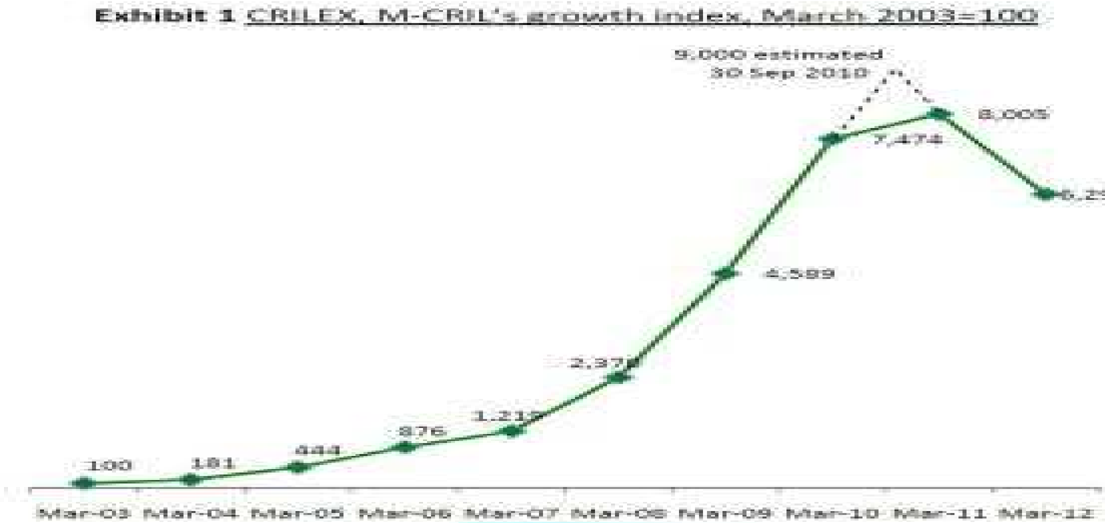
Due to multiple borrowing when the clients were not able to pay their dues, these companies were showing this as a pretext and used different kinds of unethical and illegal methods to collect the dues which resulted in some cases some of the clients even committed suicide. As reported in almost all the major news media, the concocting crisis in Andhra Pradesh not only exposed the unreasonable practices of MFIs but it also raised serious questions about the regulatory measures available and applicable to them.

As crystal clear finally it appeared that MFIs did not deliver on what was promised. Many observers came to feel that the growth of some MFIs was accomplished by the use of sharp practices in taking away consumers from bank-led SHG programmes. Although some policy makers have expressed concern about multiple borrowing from MFIs, it clearly shows that borrowing per poor household in A.P is three times higher than the Indian average is widely treated as evidence of over-indebtedness though it could alternatively be interpreted as reflecting the credit constraints faced by poor people in the rest of India.

NEED FOR REGULATING MICROFINANCE INSTITUTIONS

The Andhra Pradesh crisis has been something of a turning point in public assessment of microfinance, with the unfortunate incidents of suicide cases caused by widespread over indebtedness badly tarnishing the sector's image in India as well as other countries. Some of the Indian politicians are now recognizing the idea of alleviating poverty with microfinance as "crap".

FIG. 4



Source: M-CRIL Microfinance Review 2012

According to Microfinance State of the Sector report, MFIs have reached 31.4 million clients all over India at present condition. The report mentions that in terms of "customer outreach - borrowers with outstanding accounts," there was an increase of 17.6% MFI clients and 4.9% of SHG-Bank clients in the year 2010-11, highlighting that both SHG and MFI models co-existed and flourished over the years. Andhra Pradesh consists of highest concentration of microfinance activities with 17.31 million SHG members and 6.24 million MFI clients. The total microfinance loans in Andhra Pradesh including both SHGs and MFIs stood at Rs.1, 57,692 million with average loan outstanding per poor household at Rs. 62,527 and it is the highest among all the states in India.

This data implicates that the state is highly penetrated by microfinance (both MFIs and SHGs) giving rise to multiple borrowing. According to CGAP study the average household debt in AP was Rs.65, 000, compared to a national average of Rs.7, 700. This high penetration of both SHGs and MFIs also led to stiffer competition for client outreach between the state and private financial providers resulting in wider conflict of interest.

REGULATIONS AGAINST MICROFINANCE INSTITUTIONS

To prevent the growth of MFIs and to stem the alleged abusive practices adopted by the MFIs, on October 16, 2010 the state government promulgated an ordinance. In December 2010, the Ordinance was enacted into **"The Andhra Pradesh Microfinance Institutions (Regulation of Money lending) Act, 2010"**.

The ordinance was a result of a series of suicide incidents attributed to the alleged abusive practices of MFIs such as charging high interest rates, adopting coercive collection practices and lending aggressively beyond the repayment capacity of the borrowers rather than helping the poor get out of poverty. According to research report "more than 77 rural people have been driven to suicides unable to bear the coercive collection methods by their collection agents". As per proposed by one of the important key steps of the ordinance, it is must for setting up of fast-track courts in every district for MFI-related issues.

Two key efforts in proposing a framework for the Indian microfinance industry after the 2010 A.P legislation was passed are the Malegam Report (2011) and the Microfinance Institutions (Development and Regulation) Bill, 2011 (Ministry of Finance 2011). Both focus heavily on micro-prudential norms and corporate governance issues for MFIs.

THE MALEGAM COMMITTEE REPORT

The Malegam Committee report (Malegam 2011) was initiated by RBI. Being the regulator of both NBFCs and banks, RBI had a twofold interest in this issue since several MFIs with large exposure to the Andhra Pradesh defaults was structured as NBFCs and their collapse would affect bank portfolios since banks were the largest source of funding to NBFCs. The report has consequently focused on the question of NBFC-MFI. It begins with a definition of NBFC-MFI and lays down conditions related to net worth and assets that it had to satisfy as a NBFC-MFI. The Malegam Committee report requires NBFC-MFIs to maintain a capital-adequacy ratio and provisions for loan losses. NBFC-MFIs are also required to follow certain corporate governance norms.

The approach of the committee as contained in the report towards consumer protection has been to prescribe conditions on who can be consumers of MFI and the manner in which MFIs can grant loans. The report goes on to stipulate rules on (1) the purpose for which MFIs can disburse loans (i e, 75% of the loans will be sanctioned only for productive purposes), (2) fixing pricing of loans and the quantities and rates that can be charged (a margin cap of 26%, which is the difference between the amount charged to the borrower and the cost of funds to the MFI), (3) location – where sanctioning and disbursement of loans can take place, and (4) individuals who can be consumers (an individual who should have an annual household income of less than Rs. 50,000 and he should not be a member of more than two groups).

THE MICROFINANCE INSTITUTIONS BILL, (2011)

The Microfinance Institutions (Development and Regulation) Bill, 2011, has been drafted with the objective to provide a regulatory structure for the microfinance industry. The bill enables thinking before taking deposit by MFIs. However, it implies that these same fixed deposits would be then lent to micro-borrowers who could be depositors themselves. It means that the savings of the poor would be lent to risky credit products. Great care needs to be implemented here, particularly given the problems that have been experienced in India with cooperative banks and deposit-taking NBFCs. Even if it were felt that MFIs should become banks, the appropriate legal implementation for this should be within the Banking Regulation Act and not a new parallel legislation.

CONCLUSION

The recent tumult witnessed within the microfinance sector of Andhra Pradesh was keenly observed by the world over as incidences unfolded to reveal weaknesses in regulatory and policy mechanisms. This paper discussed the causal factors that led to such happenings and argues that the richness of Self Help Group infrastructural base developed as a result of certain state sponsored programmes attracted private-sector MFIs. Such MFIs, in an attempt to maximize their profits oversupplied credit to the poor. Easy availability of credit made the poor households victims of a social phenomenon called aspiration paradox due to which they could not adequately assess their repayment capabilities. The situation was compounded due to some MFIs offering credit in terms of consumable items such as televisions that did not generate income and further worsened their indebtedness. The poor multiple borrowers thus started defaulting on repayment and the MFIs resorted to compelling methods to recover their loans. The series such incidents led to some borrowers taking extreme steps to end their lives, thus bringing greater attention to the crisis. The government subsequently adopted certain regulatory measures in order to address the issue. These, however appear to focus on the symptoms and not on the root cause of the situation. As discussed at length above, the situation arose primarily due to the unequal distribution of the community institutional infrastructure base for delivery of microfinance among different states, and the one-side focus of private-sector MFIs on maximizing their profits in an inefficiently regulated environment. The absence of such policy measures may definitely lead the private microfinance sector in the future to face similar situations in different Indian states.

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