

## What are Clients doing Post the Andhra Pradesh MFI Crisis?

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**ABBREVIATIONS**

|        |                                                                                        |
|--------|----------------------------------------------------------------------------------------|
| AP     | Andhra Pradesh                                                                         |
| DFC    | Daily Finance Corporation                                                              |
| DRDA   | District Rural Development Agency                                                      |
| FGD    | Focus Group Discussion                                                                 |
| FSTA   | Financial Sector Trend Analysis                                                        |
| IKP    | <i>Indira Kranthi Patham</i>                                                           |
| JLG    | Joint Liability Group                                                                  |
| Mandal | Lowest Administrative Institution in Andhra Pradesh (sub-district level unit)          |
| MACS   | Mutual Aided Cooperative Society                                                       |
| MCP    | Micro Credit Plan                                                                      |
| MEPMA  | Mission for Elimination of Poverty in Municipal Areas                                  |
| MFI    | Microfinance Institution                                                               |
| MS     | <i>Mandal Samakhya</i> –Federation of Village Organisations at the <i>Mandal</i> level |
| NGO    | Non-Governmental organisation                                                          |
| RPR    | Relative Preference Ranking                                                            |
| SERP   | Society for Elimination of Rural Poverty                                               |
| SHG    | Self-Help Group                                                                        |
| VO     | Village Organisation (Village level federation of SHGs)                                |

## EXECUTIVE SUMMARY

### Background

Andhra Pradesh (AP) is the epicentre of the microfinance (MF) industry in India. The state is home to five of India's largest NBFC- MFIs. Many of these MFIs grew at a rapid pace and proliferated across AP and other parts of India. MFIs were alleged to have unethical practices, such as charging usurious interest rates, using coercive collection practices and profiteering from the poor, in their endeavour to grow rapidly. The Government of AP promulgated The Microfinance Institutions (Regulation of Money Lending) Ordinance, in October 2010 to clamp down these alleged practises. The [Ordinance](#) has imposed regulations like compulsory registration of the MFIs with designated authorities; requirements to make loan collections near local government premises; and forcing MFIs to shift to monthly repayments. The Ordinance, coupled with a huge negative publicity against MFIs, plunged the MFIs in deep crisis, impeding their operations and resulting in drastic fall in loan collections and disbursements.

### Objectives

MicroSave conducted this study to examine the impact of the crisis on borrowers by collating client experiences, opinions and needs so as to help policy makers and key actors to devise solutions suited to client requirements.

### The Research Methodology and Sample

The team conducted 76 sessions using participatory methods like focus group discussions, relative preference ranking and financial sector trend analysis during July – August, 2011 in three regions of Andhra Pradesh (Telangana, Rayalaseema and Coastal Andhra) covering a total of four districts (Anantapur, Krishna, Nizamabad and Adilabad). The team also interviewed several government officials, who are involved in SHG movement, bank officials who have experience in SHG-bank linkage, field staff of SHG-federations, field staff of MFIs and their borrowers and SHG members.

### Profile of the Respondents

The majority (84%) of the respondents were female as most of the sessions were conducted with women members of SHGs promoted by SERP and joint liability groups (JLGs) promoted by MFIs. More than 50% of the respondents were in the age group of 30 to 40 years and 22% of the respondents in the age group of 40 to 50 years. Out of the total respondents, 27% were self-employed and running their own businesses such as *kirana* shop, tiffin centres, cycle repair shop, tailoring, auto driving etc., while another 27% were involved in cottage industry such as *beedi* rolling, making jute bags, embroidery etc.

### Findings – Client Related

- **Credit sources in the absence of MFIs:** In 59% sessions, respondents said that they have taken loans from moneylenders in the absence of loans from MFIs. Moneylenders have increased lending in the past eight to ten months in areas with higher penetration of MFIs. The next most used source of credit for the respondents was the SHGs (37%) and “daily finance corporations” – another form of money lenders - (29%).
- **Pain points in accessing credit from alternate sources:** In 66% of the sessions, the exorbitant interest rate charged by sources such as moneylenders and daily finance corporations featured as the most significant pain point. In as many as 41% of the sessions, respondents said that loans taken from SHGs and/or banks are often inadequate, and do not serve the purpose. Respondents said that for loans taken from SHGs and banks the processing time was very high (24%). It has taken a minimum of one month and maximum of six months for processing of a loan.

- **Coping mechanism in the absence of MFI loans:** 24% of respondents who had plans for business expansion have postponed them as access to credit had become difficult. Many (32%) respondents said that they had reduced the scale of their business because of lack of access to alternate sources of credit. In 12% of the sessions respondents said that they sold their assets such as house, vehicle, cattle, jewellery etc., to meet their productive (agriculture related expenses) as well as essential non-productive expenditure (school fees, marriage etc.) which have to be met.

### Sources of Credit for the BoP Segment

SHGs were the most prominent (98%) sources of credit for the respondents. Respondents mentioned MFIs in 85% of the sessions and moneylenders in 88% of the sessions. Despite the good banking network in the region, the majority of the respondents did not like to source credit from banks. Respondents cited inordinate delays, cumbersome procedures, and the complex documentation requirements of banks as the major reasons for not preferring banks as a source of credit.

### Findings – Service Provider Related

- **SHGs:** Over the years, the SHGs have proliferated across AP, but still the SHG-bank linkage was not sufficient to meet credit requirements of the borrowers. The SHG bank linkage programme has some shortcomings, such as delay in loan sanctioning (more than 2-3 months in most cases), inadequate loan amounts, and no short term credit products. Many respondents approached moneylenders and daily finance corporations and took loans at exorbitant interest rates because they did not get loans on a timely basis from SHGs.
- **MFIs:** Presently the repayment rate for MFI loans was very low ranging between 6%-12%. Most of the clients stopped repaying as other members of the group and the community stopped repaying. There have also been instances of wilful defaulters pressurising the prompt payers not to repay the loans. Media, local activists and influential members of the community also played a major role in encouraging the borrowers to default.
- **Willingness to repay MFI loans:** Most of the respondents denied any harassment from the MFIs, but have heard about suicide deaths attributed to harassment by MFI staff through various forms of media. Almost 90% of the respondents said that they were willing to repay their loans if MFIs start disbursing fresh loans and if other members in the community also start repaying.
- **Respondents said that they liked some of features of MFIs:** Because they deliver timely loans (80%); with the convenience of repaying principal along with the interest (46%). In 29% of the sessions, respondents said that they like the door step delivery model of MFIs. On the other hand, MFIs' group responsibility (46%) came out to be one of the major dislikes for these loans. They also did not like the inflexibility in loan repayments (39%) as they are not given even a single day grace period when making repayments.

### Key Attributes – Different Service Providers

- **Timely loans:** Timely loans came as a key attribute in 89% of sessions. According to the respondents, daily finance corporations (DFCs) processed the loan instantly. There is minimal or no documentation required. Although it is an expensive source, people still borrow from DFCs to meet their immediate credit requirements. Moneylenders also process loans quickly. They are followed (in terms of speed of disbursement) by the MFIs. Respondents said that SHGs and banks take the longest time to sanction and release loans.
- **Interest rates:** Interest rate came as an attribute in 89% of sessions. SHGs charge the lowest rate of interest at 12%-13% per annum, but under the interest subsidy scheme the SHGs that make timely payments get loans at 3% per annum. MFIs charge 27%-45% per annum including insurance. Pawnbrokers charge 30-36% per annum, and moneylenders and DFCs are another expensive source of credit at 36%-120% per annum.

- **Staff behaviour:** Respondents associated ‘staff behaviour’ with the conduct of the staff of the credit institution in the event of delay in repayment or default. Respondents said that SHGs and IKP staff behave with them in the most respectful manner. They only visit the village and counsel the members about the benefits of prompt repayment. Respondents rated pawnbrokers and banks on equal grounds. MFI staff members generally behave in a respectful manner and maintain cordial relations with the members, helping them in filling the documents and processing of the loans. However, when it comes to repayment, MFIs are perceived to be strict. They put pressure on the members for repayments, encourage the group members to collect the loan from the defaulting member and stop group members leaving the meeting place until the default amount is collected.
- **Convenient instalments:** Most of the respondents felt that the monthly recoveries of SHGs and banks were more convenient when compared with weekly and daily recoveries of MFIs and DFCs. One of the reasons for such a response was that the majority of respondents in the study were self-employed petty business people (that want to maximise the capital in the business), *beedi* workers (with monthly cash flow and income cycles) and engaged in agriculture and allied (small and marginal farmers. and dairy) activities whose inflows not support weekly repayments.

### Purpose for Taking Loans

Respondents had taken loans for both productive (55%) and non-productive purposes (45%). In 44% of the sessions, respondents said that they had taken loans for agriculture and allied activities. Most of the respondents (85%) had taken loans to set up and/or expand their petty business such as *kirana* shop, tiffin centres, cycle repair shop etc; to meet lifecycle expenses such as construction of house, buying a plot of land, marriage and death. A significantly large proportion (61%) of the respondents said that they had borrowed from MFIs to redeem high cost loans from moneylenders, or to pay to other MFIs.

### Recommendations

- **For MFIs:** Apart from developing new products and delivery channels that are market driven, and customised to meet the needs of the customers, MFIs have to improve transparency in pricing their products. From the research, it is clear that most of the respondents do not even know the name of the MFI with which they have been associated for so many years. MFIs have to expand their level of engagement with the client to create customer loyalty, positive market positioning and increase in brand recall.
- **For MFIs:** Initiatives like a grievance redressal mechanism for clients, and a credit bureau to share borrower’s credit history could go some way in reducing defaults and restoring credit discipline.
- **For regulators:** As an industry level change, policy makers should come out with comprehensive regulations to provide a level playing field to all the financial institutions that provide credit to the poor. Once the robust regulations are in place there is a need for strong monitoring to enforce system and ensure that the regulations are implemented to safeguard the interests of the clients.
- **For state government /MFIs:** As the majority of the clientele of MFIs are members of SHGs promoted by the Government of AP, there are chances of issues of conflict between MFIs and the local machinery of the government. The government and MFIs should take initiative to establish a forum at both district and state level to resolve any conflicts.
- **For state government:** The state government should focus on how to provide a credible substitute to MFI loans to meet the credit needs of SHG members, otherwise members will continue to move into clutches of moneylenders. For example, during discussions, many of the SHG members noted that they need a supplementary loan to meet working capital and life-cycle needs like health and education – even when they have an outstanding, long-term, bank loan. The state government should also increase the efficiency of the SHGs it promotes and provide bouquet of credit products according to the requirements of clients. SHGs should educate members to avoid or minimise use of loans for unnecessary expenses like social events (e.g. marriage and birthday parties). For more detailed explanation on all the above, please see relevant sections in this report.

## INTRODUCTION

Microfinance has had a steep growth trajectory in India, with most of the growth taking place in the South Indian state of Andhra Pradesh (AP). In AP, the Society for Elimination of Rural Poverty (SERP)<sup>1</sup> has promoted around 0.95 million SHGs covering around 11.1 million clients, through a network of 1099 *Mandal* level Federations (sub-district level), and this enabled the disbursement of approximately Rs.71 billion (\$1.45 billion) as loans by the end of March 2011.<sup>2</sup> The MFI movement in India was largely initiated from within AP, where some of the earliest MFIs starting their operations in the late 1990s. Today, some of the largest MFIs in India are headquartered in AP. Many of these MFIs touched annual growth rates of 80% in the three to four years to October 2010. By November 2010, MFIs were reaching 9.7 million borrowers with Rs.72 billion outstanding.<sup>3</sup>

The unparalleled growth of MFIs, coupled with the efforts of the SHG movement, meant that the average household debt in AP was the highest in India. For instance, in November 2010 CGAP estimated that the average household debt in AP was Rs.65,000, compared to a national average of Rs.7,700.<sup>4</sup> The high level of indebtedness in the state was, largely, a result of multiple lending happening in the sector. SHG clients were often MFI clients and vice versa, and many customers would often be members of more than one MFI ... and many were also borrowing from the informal sector too.

MFIs normally have a weekly collection schedule and better field level monitoring systems. As a result, this usually meant that clients chose to pay instalments on MFI loans, rather than SHG loans (which normally have a monthly repayment frequency and minimal ground level monitoring). Unsurprisingly, this started to have an adverse effect on the credit discipline of SHGs. The stage was set for a conflict between the private sector MFIs and the state government and its SERP programme. The first sign of trouble was the Krishna District crisis of 2005-06 where the district administration closed 50 branches of four leading MFIs citing usurious interest rates, coercive collection practices and profiteering. This issue was calmed down by the intervention of Reserve Bank of India (RBI) and the central government, and assurances by MFIs to abide by a code of conduct.

**Table 1: Key Aspects of Andhra Pradesh Microfinance (Regulation of Money Lending) Act, 2010**

- Monthly collection is mandated
- Interest payment as a whole should not exceed the principal
- *Panchayat* office to be the sole collection centre
- Any new disbursement requires the approval of DRDA
- Prevents door-to-door collections, and disallows having loan collection agents who are not on the rolls of the MFI.
- All branches in a district to be registered

Issue came to the fore again in October 2010, when the Government of Andhra Pradesh promulgated an ordinance to protect the women SHGs from exploitation by the MFIs in the state. In December 2010, the Ordinance was enacted into [“The Andhra Pradesh Microfinance Institutions \(Regulation of Money lending\) Act, 2010”](#). The events surrounding the enactment of the Act have received widespread attention in India and among microfinance practitioners across the globe. There has been large-scale media coverage on the factors that led to the enactment of the Act and its likely impact on the sector.

The statement of objects and reasons of the Act states, *“The Government of Andhra Pradesh has made rapid strides in the field of financial inclusion of the rural & urban poor by organising women self-help groups (SHGs); and linking them with the banks for meeting their credit needs. Of late, many individuals*

<sup>1</sup> Society for Elimination of Rural Poverty (SERP) is an autonomous society of the Department of Rural Development, Government of Andhra Pradesh. The SERP is implementing Indira Kranthi Patham (IKP), a state wide community driven rural poverty reduction the project and acts primarily through SHG movement.

<sup>2</sup> [http://www.serp.ap.gov.in/SHG/files/ReportsGeneral/IKP\\_Annual\\_prgress\\_report.htm](http://www.serp.ap.gov.in/SHG/files/ReportsGeneral/IKP_Annual_prgress_report.htm)

<sup>3</sup> Andhra Pradesh 2010: Global Implications of the Crisis in Indian Microfinance, [CGAP Focus Note 67](#)

<sup>4</sup> Andhra Pradesh 2010: Global Implications of the Crisis in Indian Microfinance, [CGAP Focus Note 67](#)

*and entities have come up styling themselves as Micro-Finance Institutions and are giving loans to SHGs at very high or usurious rates of interest and are using inhuman coercive methods for recovery of the loans. This has even resulted in suicides by many rural poor who have obtained loans from such individuals or entities. In the larger public interest and to protect the poor from exploitation, and to regulate the lending of monies to the SHGs by the MFIs, the Government intends to bring into force a law containing the various provisions stated in this Bill in order to check the illegal acts of these MFIs. This Bill seeks to give effect to the above decision.”<sup>5</sup>*

The negative perception in government circles about MFIs is evident in the wording of the statement. It also brings to light the inherent discomfort the government has in the MFIs co-opting SHGs into their lending systems. Many observers point out that the crisis was in the making<sup>6</sup> for a long time. The supply of microfinance services in the state has always been relatively high risk, since the government was a competitor acting through SERP with its SHG-led microfinance model.<sup>7</sup>

The lack of customer orientation among MFIs themselves has significantly contributed to their problems. Most MFIs are mono-product credit companies providing standard, basic joint liability group (JLG) loans to customers. There has been only a limited focus on clients; be it in terms of assessing their capacity to repay or in developing appropriate products to suit their needs. *MicroSave* has often observed that despite the MFI managements’ belief and protestation to the contrary, most clients see MFIs as just another source of credit, rather than as institutions interested in client welfare. The rapid influx of capital resulted in rapid expansion in scale without adequate investment in developing customer relationships.<sup>8</sup> This, combined with intense competition within MFIs and the resultant multiple lending, led to a situation where clients refer to MFIs as “Monday MFI”, “Tuesday MFI” etc. depending on their collection schedules. This clearly demonstrates the lack of relationships between MFIs and their clients.<sup>9</sup>

The Act was a result of a combination of these factors. The stringent provisions of the Act immediately resulted in near-total suspension of MFIs’ operations. The Act requires loan repayments to be made at *Gram Panchayat* offices with a mandatory requirement of monthly repayment of loans, thereby effectively negating the two significant advantages MFIs had: doorstep service delivery and repayments in smaller amounts. The Act also requires MFIs to obtain prior approval from the District Rural Development Agency (DRDA)<sup>10</sup> before giving a loan to any SHG member, effectively strangling new disbursements.

The credit culture was severely damaged once the local activists compounded the problem by instructing clients not to repay MFI loans. To add to the troubles of MFIs, banks across the country stopped loan disbursements to MFIs, effectively shutting down MFI’s access to capital for on-lending. For MFIs depending on a cycle based approach (continual access to credit being a motivator for clients to repay in what is effectively unsecured lending), the inability to provide further credit due to lack of funding from the banks proved to be the last nail in the coffin.

<sup>5</sup> Refer [Andhra Pradesh Microfinance Ordinance](#)

<sup>6</sup> See *MicroSave* India Focus Note 55: [The Andhra Pradesh Crisis: Three Dress Rehearsals ... and then the Full Drama](#)

<sup>7</sup> See “[Microfinance in India: A crisis at the bottom of the pyramid, How the Government of Andhra Pradesh has severely damaged private sector microfinance and put 450 million of India’s rural poor at risk, Legatum Ventures](#)”<sup>8</sup> See *MicroSave* India Focus Note 42: [Microfinance In India: Built On Sales Targets or Loyal Clients?](#)

<sup>8</sup> See *MicroSave* India Focus Note 42: [Microfinance In India: Built On Sales Targets or Loyal Clients?](#)

<sup>9</sup> See *MicroSave* India Focus Note 41: [Microfinance – Time to Get to Back to Basics?](#)

<sup>10</sup> District Rural Development Agency (DRDA) is responsible for SHG movement at the district level and is implementing agency of SERP at district level.

MFIs, which had boasted of recovery rates in excess of 95%, now found themselves staring at repayment rates of 10%-15%. Likely write offs are estimated to be around Rs.2,500–3,000 crore.<sup>11</sup> In the first half of FY2010 -11, MFIs had disbursed Rs 5,000 crore to borrowers in Andhra Pradesh, but this had been reduced to Rs.8.5 crore by the second half of FY2010-11.<sup>12</sup> In early December 2010, MFIN, the network of NBFC-MFIs reported that MFIs were not in a position to collect about Rs.7,200 crore worth of outstanding loans in Andhra Pradesh, and had missed the opportunity to lend about Rs.1,200 crore since October 2010 when the Ordinance was introduced. The operations came to a virtual standstill, and continue to be so at the time of compiling this report.

A lot of debate has already been conducted in the policy circles regarding the Act and its impact. The RBI appointed Malegam Committee, which has come up with its recommendations in response to the crisis. Based on the recommendations, RBI has issued detailed operational guidelines for the MFIs to comply with its [circular dated May 03, 2011](#) in the centre, the Union Government is also mulling introduction of a long pending Microfinance Bill, for which they have already issued the [draft guidelines](#).

Much of the debate as yet is based on priorities of the supply side actors – the government, RBI, banks and MFIs. The most important voice, which needs to be heard, is conspicuous by its absence – the demand-side voice of the clients. *MicroSave* conducted this study to collate clients' experiences, opinions and needs, so as to inform policy making and key actors and perhaps help devise solutions most suited to the requirements of the clients.

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<sup>11</sup> See [MFIs: Still in the doldrums, Hitting up the same borrowers is now illegal in AP, Shruti Sarma, Business Standard, August 18, 2011](#)

<sup>12</sup> See [Microfinance in India: A crisis at the bottom of the pyramid, How the Government of Andhra Pradesh has severely damaged private sector microfinance and put 450 million of India's rural poor at risk, Legatum Ventures](#)

## RESEARCH OBJECTIVES

This research was conducted by *MicroSave* with the core objective to assess the impact of the “AP crisis” on clients. The study attempts to understand the clients’ response to the crisis and the coping mechanisms deployed by them to manage their credit needs in the absence of MFI loans. We have also formulated recommendations to key stakeholders based on clients’ feedback.

The study aims to fulfil the following broad sub-objectives:

1. Understand avenues/channels that clients are accessing to meet their credit requirements in the absence of credit flow from MFIs.
2. Assess the constraints and challenges faced by clients to access loans from alternative financial sources compared to MFIs.
3. Detail the coping mechanisms adopted by clients in the absence of MFI loans.
4. Convey ground realities to opinion forming and public interest groups like media and civil society organisations.
5. Provide recommendations to policy makers/financial service providers.

## RESEARCH DESIGN

This section presents methodology, process, and sampling used in the market research.

### Research Methodology

Following tools were used for data collection:

1. **Focus Group Discussions (FGDs):** FGDs helped to understand the purposes for which the clients borrow, and the sources from where they borrow to meet their credit requirements. This is helpful, to understand positive and negative implications of accessing credit from alternative sources in the absence of MFIs. Please refer to [Annexure 1](#).
2. **Relative Preference Ranking (RPR):** RPR, a participatory rapid appraisal tool used within focus groups, helped to understand the relative preference of respondents between different financial service providers (formal and informal) for different features of loan products. The tool helped to provide insights into whether the various financial service providers were able to meet the expectations of their clients with regard to products and delivery mechanisms. Please refer to [Annexure 2](#).
3. **Financial Sector Trend Analysis (FSTA):** This tool was used to determine which credit institutions have been used over time by the members of the community and to understand the trends, if any, in the use/availability of such institutions over a period of five years. Please refer to [Annexure 3](#).
4. **Individual Interviews:** The team conducted individual interviews with stake holders to understand their perspectives on the crisis, and how they have been able to respond to the credit needs of the community, especially in the absence of MFIs. The interviews were conducted with select government officials responsible for implementing the SHG programme in AP, bankers, and MFI and NGO staff.
5. **Case studies:** Based on discussions with clients, a few case studies have been presented to help stakeholders understand the ground level situation and how clients are currently managing their credit needs, especially in the absence of MFIs.

### Market Research Process

#### **Preparation for the research: July 18-22, 2011**

- Tailoring of research guides.
- Coordination and planning with field partners.

#### **Market Research: July 25-August 19, 2011**

- Focus Group Discussions and Participatory Rapid Appraisal with clients of credit institutions such as SHGs promoted by SERP, MFIs and MACs; individual interviews with government officials associated with community finance, bankers and MFI staff

#### **Analysis and Consolidation: August 22-26, 2011**

- Consolidation and analysis of data.

### Sampling Strategy

The research was conducted in rural, semi-urban, and urban locations of the following districts, all of which have a significant presence of MFIs. The districts represent three regions of Andhra Pradesh. The selection of districts from three regions made purposefully so that the research would cover the situation across all the regions of the state.

1. Telangana – Nizamabad and Adilabad District
2. Rayalaseema – Anantapur District
3. Coastal Andhra – Krishna District

Apart from geographical diversification, an effort was made to incorporate institutional diversification by speaking to members associated with various credit institutions, such as SHGs promoted by SERP in rural and semi urban areas; SHGs promoted by Mission for Elimination of Poverty in Municipal Areas (MEPMA)<sup>13</sup> in the urban areas; JLGs promoted by MFIs in rural, semi urban and urban areas; Mutual Aided Cooperative Societies (MACS)<sup>14</sup> promoted by NGOs; and SHGs promoted by NGOs. The team also interviewed Project Directors of DRDA,<sup>15</sup> Municipal Commissioners of selected municipalities and several bankers (RRBs and Commercial Banks) who have experience in the SHG –Bank linkage programme.

### Sample Details

| Tool                 | Sessions Conducted | Respondents Covered |
|----------------------|--------------------|---------------------|
| FGD                  | 42                 | 326                 |
| RPR                  | 19                 |                     |
| FSTA                 | 15                 |                     |
| Individual Interview | 11                 | 11                  |
| Case Studies         | 3                  | 3                   |
| <b>Total</b>         | <b>87</b>          | <b>340</b>          |



<sup>13</sup> MEPMA- [Mission for Elimination of Poverty in Municipal Areas](#) is responsible for promotion of SHGs and Federation in urban areas and facilitate SHG-bank linkages

<sup>14</sup> MACS- Mutual Aided Cooperative Societies – SHG –Federations which are registered under 95 cooperative act of AP

<sup>15</sup> DRDA- District Rural Development Agencies are responsible SHG movement at district level in addition to implement other development program as a nodal agency.

### Graphic Presentation

In this study responses to the research questions have been presented in two different ways – for some of the questions, individual responses have been captured; while in other questions, the consensus response from the group as a whole is captured. Individual responses are presented for the questions related to the respondent's profile, such as age, occupation, education, and number of loans taken from MFIs etc. For the core research questions, group response is presented, as during a group discussion, it is very difficult to capture individual responses on the core questions. Such responses are captured only when a majority of group members reach a consensus. While presenting the findings, we have shown the percentage of respondents for responses captured from individual respondents and percentage of sessions, when responses are captured from a group.

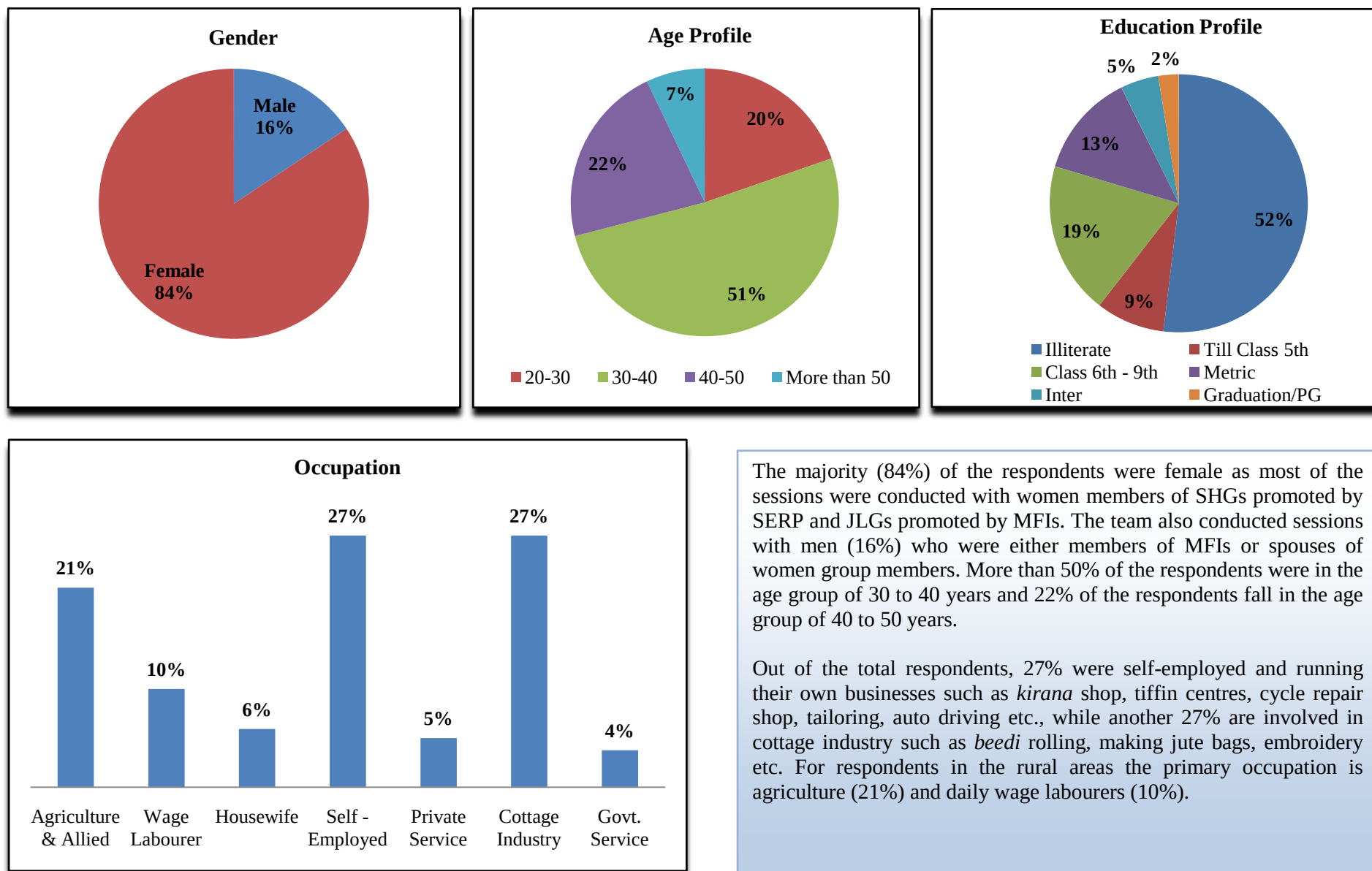
### Disclaimer

Qualitative research is designed to look beyond the percentages to gain an understanding of the customer's beliefs, impressions, and viewpoints. Gaining such insight into the hearts and minds of the customer is best acquired through tools like FGDs and PRAs with smaller, highly targeted samples. Qualitative research is not statistically representative, but is much more appropriate for research that seeks to understand complex human financial behaviour.



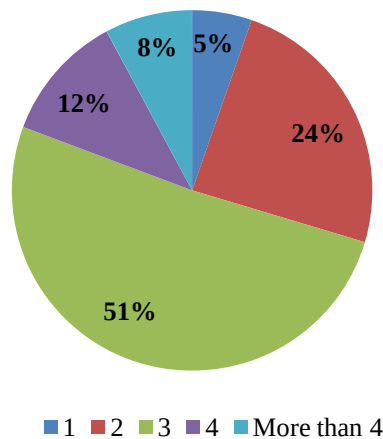
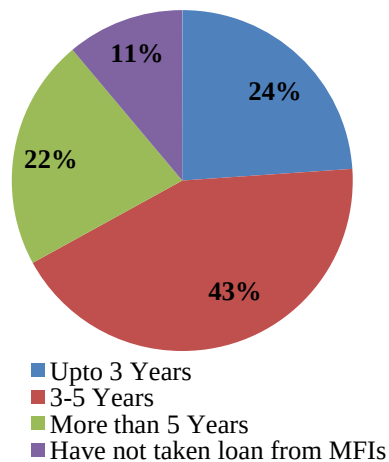
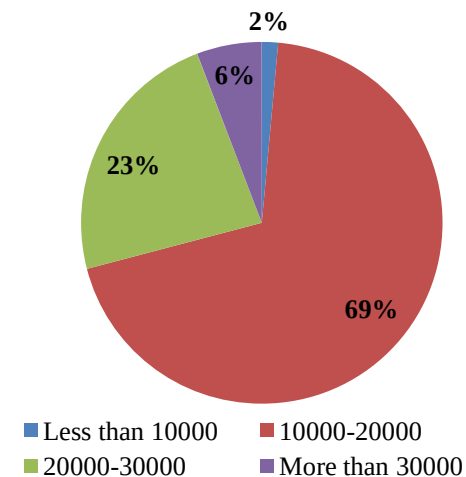
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## PROFILE OF RESPONDENTS



The majority (84%) of the respondents were female as most of the sessions were conducted with women members of SHGs promoted by SERP and JLGs promoted by MFIs. The team also conducted sessions with men (16%) who were either members of MFIs or spouses of women group members. More than 50% of the respondents were in the age group of 30 to 40 years and 22% of the respondents fall in the age group of 40 to 50 years.

Out of the total respondents, 27% were self-employed and running their own businesses such as *kirana* shop, tiffin centres, cycle repair shop, tailoring, auto driving etc., while another 27% are involved in cottage industry such as *beedi* rolling, making jute bags, embroidery etc. For respondents in the rural areas the primary occupation is agriculture (21%) and daily wage labourers (10%).

**No. of MFIs from which respondents had taken a loan****Association with MFIs****Amount of last loan availed from MFI (In Rs.)**

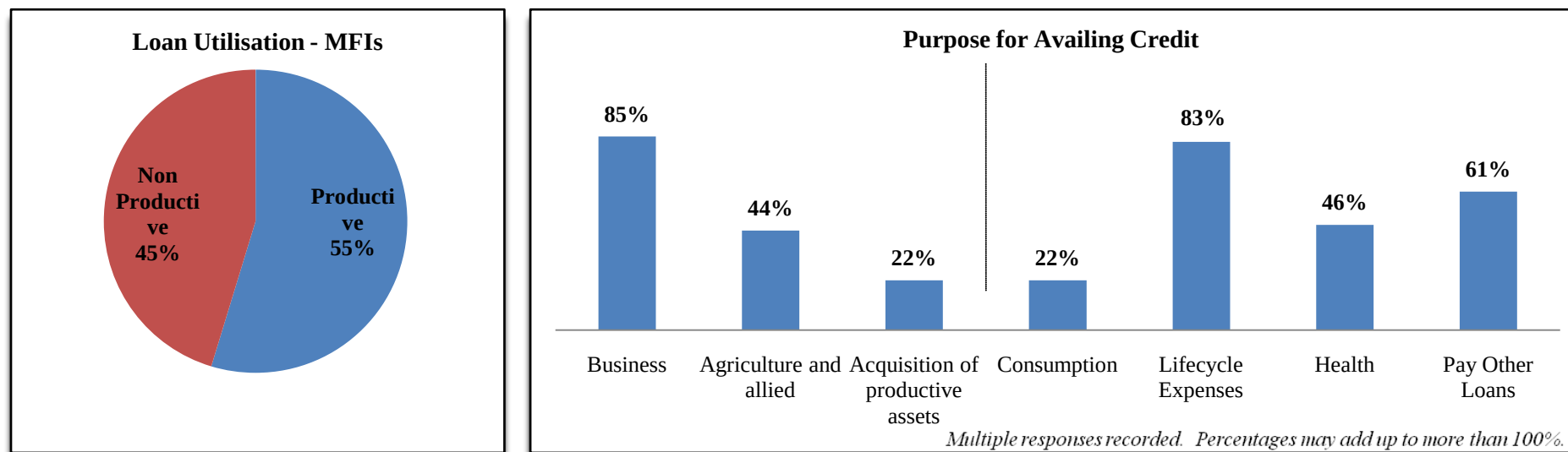
At the time of the crisis, more than 50% of the respondents had taken loans from three MFIs, while 24% of them had taken loans from two MFIs. About 12% of the respondents had loans outstanding with four MFIs.

In terms of time associated with MFIs, 43% of the respondents said that they have been associated with MFIs for three to five years. Twenty two percent of the respondents have been associated with MFIs for more than five years. These respondents generally came from areas with high penetration by MFIs. The last graph indicates the total amount of last loan taken by the respondents from the MFIs, before the start of the crisis.

Approximately 71% of the respondents indicated that they had taken a loan of less than Rs.20,000 and 23% indicated that their last loan was between Rs.20,000 to Rs.30,000. One can observe that majority of the respondents have taken multiple loans of Rs.10,000 and above from various MFIs.



## PURPOSE FOR AVAILING LOAN



### Rising Input Prices

“Chenakkaya dharalu pergipoyinayi. Naatadaaniki oka bag chenakkaya vittanam dhara Rs.400 nundi Rs. 1200 perigi poyindi. Appu tappani sariga teesukovalasosthondi” **(The groundnut prices have gone up from Rs.400 per bag to Rs.1,200 per bag. So we were compelled to take credit)**

### Persistent Pestering

“Valla intlo TV undani maa pillalu maa intiki vachi gola pedataaru. Andukani memu kooda TV teesukunnam **(Our children watch TV in neighbour’s house and pester us to buy TV. So we bought a TV for ourselves)**

### Multiple Loans

“Andaru loan ivvadam modalupettaru.Oka vaaram sangham nundi appu teesukoni inko vaaram sanghaaniki kattaamu **(Everyone was giving loans. We took loans from one weekly MFI to pay loans of other MFIs)**

“Vaddidaarulaku chillar vaddu mudda kaavaliantaaru. Aithe memu vaarasanghaala daggarnundi appuluteesukoni vaddidaarulaku ichesi vaalaaku vaaram vaaram dabbulu kadathaam **(Moneylenders ask for one time repayment of loan. So we take loans from MFIs to repay moneylender’s loans and then carry out weekly repayments to the MFIs)**

Many respondents (15%) chose not to respond to this question. Of those who responded, 45% had taken loans for non-productive purposes while 55% had used the loan for productive purposes. Given below are the various productive and non-productive purposes.

### **Productive**

**Agriculture and allied activities:** In 44% of the sessions, respondents said that they had taken loans for agriculture and allied activities. The respondents took loans to buy seeds and fertilisers before the sowing season and to reap, store and transport the produce during harvest season. The loan requirement has increased with the increase in prices of agricultural inputs such as seeds and fertilisers.

**Business:** Most of the respondents (85%) had taken loans to set up and/or expand their petty business such as *kirana* shop, tiffin centres, cycle repair shop etc. In such cases, the loan amount is used predominantly by the male members of the family, who are responsible for running the business. Women members used loans to buy sewing machines, tobacco and thread for rolling *beedis*, and raw material for preparing jute and bamboo items.

**Acquisition of productive assets:** About 22% of the respondents had taken loans to buy auto and commercial vehicles to run them on hire, and small machines related to their business. Examples include drilling machine for carpentry business, soda maker for a cold drink shop, grinding machine for a flour mill etc.

### **Non Productive**

**Consumption purpose:** In almost 22% of the sessions, respondents said that they had taken loans to meet expenditure related to children's education, for buying house hold items such as fan, mixer, TV and to incur expenses for festivals and functions.

**Life cycle expenses: (house, land, marriage, death etc.):** In 83% of the sessions, respondents said that they had taken loans for meeting life cycle expenses such as construction of house, marriage, death etc. Many respondents had taken loans to construct house to avail benefits under "INDIRAMMA"<sup>1</sup> scheme introduced by the Government of AP. Also marriage is a life cycle expense that involves huge cash outflow, and the majority of respondents said that they usually need to take a loan to meet these expenses.

**Health & medical expenses: (pregnancy and childbirth, illness, accidents):** Respondents had taken loans to meet expenses related to pregnancy such as doctor's fee, medication, hospital expenses, baby care etc. Unforeseen emergencies such as chronic illness of a family member and accidents also entail huge expenses for which the respondents have had to borrow.

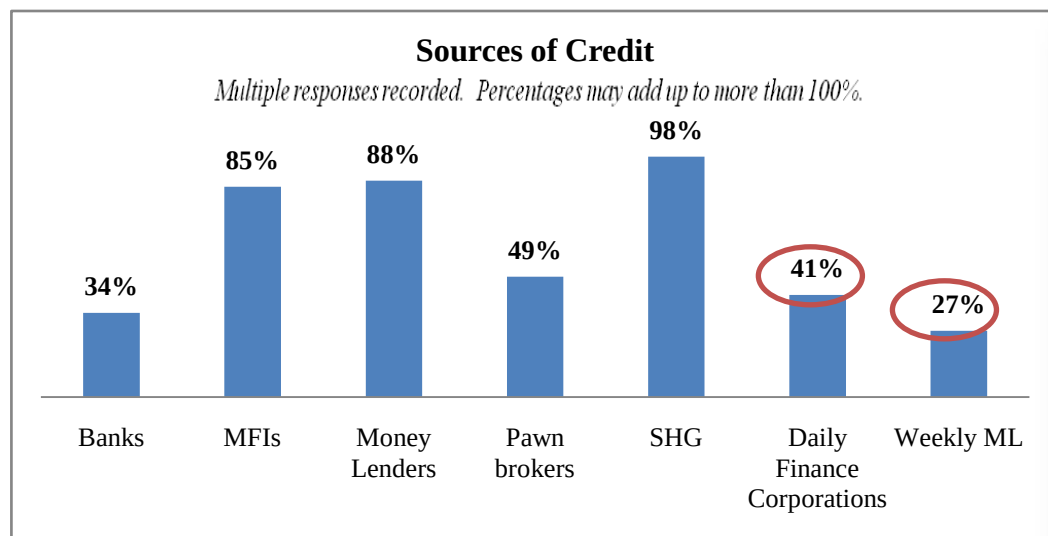
**Redemption of loan from other sources:** A significantly large proportion (61%) of the respondents said that they had borrowed to redeem high cost loans from moneylenders, or to pay to other MFIs.

*To repay moneylenders:* Usually loans from money lenders are at a very high interest rate. Clients take loans from moneylenders when there is an urgent requirement of funds and they are not able to get funds from other alternate sources. Moneylenders only accept onetime repayment of principal at the end of the tenure. As intended by the moneylenders, this large amount is difficult to accumulate, and so clients usually avail loans from multiple MFIs to repay the loan taken from moneylenders.

*To repay other MFIs:* Some respondents said that, when more MFIs started operations, they used the loans for consumption purposes. As a result, some the respondents found the need to borrow from one MFI to pay off loans taken from other MFIs.

**Note:** Many observers, *MicroSave* amongst them, would argue that many of these "Non Productive" uses are very productive indeed – particularly expenditures on health, education and retirement of more expensive debt.

## SOURCES OF CREDIT



*Sri Renuka*  
**SRI RENUKA ENTERPRISES**

Amount *250*... Date *13-8-11*...

Name *Amal*...

|    |  |  |  |  |
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16.08.2011 14:37

The graph shows the extent to which various credit sources have been accessed by the clients. It does not indicate the level of indebtedness that people have with these institutions. SHGs, moneylenders and MFIs have been the most prominent sources of credit accessible to people. In more than 80% of the sessions, these three institutions emerged as the most popular options that people have to meet their credit requirements. Despite the good banking network in the region, the majority of the respondents did not seem to like them. Respondents cited inordinate delays, cumbersome procedures and complex documentation requirements of banks as the major reasons for disliking banks as a source of credit.

Interestingly, two new categories of moneylenders (both weekly and daily) emerged in 27% and 41% of sessions respectively. The numbers for these sources might be slightly on a lower side since the majority of respondents in the sample were women, whereas these categories of institutions are mostly approached by men. The product details along with delivery mechanisms of respective institutions are explained briefly in the following table. The picture above shows a sample loan card issued by weekly moneylenders.

**Table 2: Product details of different service providers**

| Service Provider                        | Terms and Conditions                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Effective Interest Rate (Per Annum)                                                                                                                                                                         | Remarks                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|-----------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>SHGs</b>                             | <p><b>Amount</b> – Rs.5,000-50,000 per member</p> <p><b>Interest Rate</b> – Usual bank rates apply (12% - 14% p.a.). Under “Pavalavaddi”<sup>16</sup> scheme of government, an SHG can avail interest rate subsidy of 75% of the total interest liability if repayments are made to the bank on time.</p> <p><b>Loan Term</b> – 2-5 years</p> <p><b>Instalment</b> – Monthly</p> <p><b>Collateral Requirements</b> – Not needed</p> <p><b>Loan type</b> – Group based</p> | <p>3%<br/>(If loan is paid on time)</p> <p>12% -24%<br/>(For loans taken from internal resource generation through savings)</p> <p>12%<br/>(Interest rate in case group takes loan from the federation)</p> | <ul style="list-style-type: none"> <li>• In order to access loans from banks, group needs to save for first 6 months</li> <li>• The group can use their savings for internal lending</li> <li>• Mostly loans obtained as part of the bank linkage programme are unsecured. The group cannot access a new loan from bank unless the old loan has been paid.</li> <li>• Each group is linked to a village and <i>mandal</i> level federation which has corpus funds that can be used for internal lending in addition to the usual bank linkage loans.</li> <li>• Average loan amount per SHG under bank-linkage: <ul style="list-style-type: none"> <li>o First Loan – Rs.50,000</li> <li>o Second Loan – Rs. 100,000</li> <li>o Third Loan – Rs.150,000 – 200,000</li> <li>o Fourth Loan – Rs.250,000 – 500,000</li> </ul> </li> </ul> |
| <b>Banks (Crop Loans)</b> <sup>17</sup> | <p><b>Amount</b> – Depends on crop and land area</p> <p><b>Interest Rate</b> – Up to Rs.300,000 (7% p.a.), Above Rs.300,000 (BPLR + 0.5%-1%p.a.)</p> <p><b>Loan Term</b> – Up to 3 years</p> <p><b>Instalment</b> – Bulleted (two months from date of harvest)</p> <p><b>Collateral Requirements</b> –Hypothecation of crops/ additional security / third party guarantee</p> <p><b>Loan type</b> – Individual (Cash Credit)</p>                                          | 7%-13%                                                                                                                                                                                                      | <ul style="list-style-type: none"> <li>• Credit limit for KCC is decided on following parameters: <ul style="list-style-type: none"> <li>o Post-harvest/household requirements of the farmer at 10% of the limit fixed subject to a maximum of Rs.25,000 per farmer</li> <li>o 10% towards maintenance of farm assets subject to a maximum of Rs.25,000 per farmer</li> <li>o Provision for increase in loan size depending increase in cost of cultivation</li> </ul> </li> </ul>                                                                                                                                                                                                                                                                                                                                                     |

<sup>16</sup> Government of AP reimburses interest amount (above 3%) paid by all SHG members as incentive for on time repayment of bank loans. This is called “pavala vaddi” scheme which is nothing but 25 paisa interest per Rs.100 per month

<sup>17</sup> Refers to the Kisan Credit Product of Indian Bank <http://www.indian-bank.com/loans.php?by=23&ty=1>

|                                     |                                                                                                                                                                                                                                                                                                                                                                  |                                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|-------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>FIs (Weekly)</b>                 | <b>Amount</b> – Rs.5,000 – 30,000 per member in group<br><b>Interest Rate</b> – 12.5% - 15% p.a. (Flat)<br><b>Loan Term</b> – 50 weeks<br><b>Instalment</b> – Weekly<br><b>Collateral Requirements</b> – Group Liability. No physical collateral required<br><b>Loan type</b> – Individual (loans are given to individuals within the joint liability of groups) | 27%-45% <sup>18</sup><br>(Including processing fee insurance – credit linked/health) | <ul style="list-style-type: none"> <li>Other charges: <ul style="list-style-type: none"> <li>Processing fees – 1%-3% of loan amount</li> <li>Life insurance (credit linked) – 1%-2% upfront</li> </ul> </li> <li>Individual members can avail a top-up loan that is 50% - 70% of the first loan after 15 -25 weeks of taking the first loan</li> <li>Loan disbursement and collection is mostly done at/near to clients' houses</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                           |
| <b>MFIs (Monthly)</b> <sup>19</sup> | <b>Amount</b> – Rs.15,000 – 300,000 per member<br><b>Interest Rate</b> – 24%-28% p.a. (Diminishing)<br><b>Loan Term</b> – 1-5 years<br><b>Instalment</b> – Monthly and bulleted<br><b>Collateral Requirements</b> – Secured and unsecured.<br><b>Loan type</b> – Individual                                                                                      | 27% - 45%<br>(Including processing fee, insurance – credit linked/health)            | <ul style="list-style-type: none"> <li>There are MFIs which provide only monthly loans whereas some other MFIs provide both weekly and monthly loans</li> <li>For MFIs which provide both weekly and monthly loans, clients are expected to successfully complete 3-4 cycles of weekly loans before they become eligible for monthly loans</li> <li>Client is usually allowed to decide on amount of instalment and tenure of loan</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                        |
| <b>Moneylenders</b>                 | <b>Amount</b> – Up to Rs.200,000<br><b>Interest Rate</b> – 3% to 10% per month<br><b>Loan Term</b> – Not specified. Can continue for any time period<br><b>Instalment</b> – Monthly interest repayment. Bullet repayment of principal<br><b>Collateral Requirements</b> – Secured and unsecured.<br><b>Loan type</b> – Individual                                | 36%-120% <sup>20</sup>                                                               | <p>These are traditional moneylenders who normally give loans to the people with whom they have long term credit relationship and trust.</p> <ul style="list-style-type: none"> <li>Interest rate mainly depends on: <ul style="list-style-type: none"> <li>Borrowers urgency</li> <li>Collateral, if any (In case borrower offers collateral, interest charged can be lesser than usual rates)</li> <li>Credit history of borrower</li> </ul> </li> <li>Moneylenders give loans to only those who are known to them</li> <li>Moneylenders do not accept part payment of principal making it difficult for the borrower to clear off loans.</li> <li>Moneylenders usually are rich business class in the village who have a core business (agriculture, jewellery) besides money lending.</li> <li>Collaterals usually accepted by money lenders include:</li> </ul> |

<sup>18</sup> Transparent Pricing Initiative in India (Jan,2011) by *mfitransparency.org*

<sup>19</sup> Information collected from website of SKS, Spandana, Share and Asmitha (4 largest MFIs of AP)

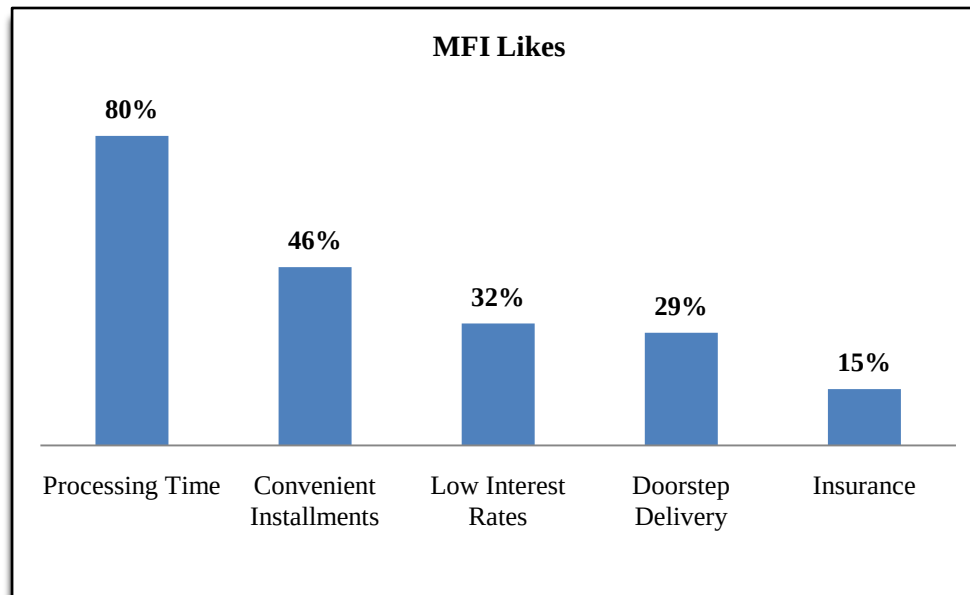
<sup>20</sup> For calculation of effective interest rates for money lenders and other informal institutions, *mfitransparency* effective interest rate calculation tool has been used

|                                   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                                                                                                                        | <ul style="list-style-type: none"> <li>o Gold</li> <li>o House/Land</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|-----------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Weekly Moneylenders</b>        | <b>Amount</b> – Rs.2,000-10,000<br><b>Interest Rate</b> – 15%-20% of loan amount (Upfront)<br><b>Loan Term</b> – 10 weeks<br><b>Instalment</b> – Weekly (Equal weekly instalment of principal)<br><b>Collateral Requirements</b> – None<br><b>Loan type</b> – Individual                                                                                                                                                                                                    | 160%-225%                                                                                                              | <ul style="list-style-type: none"> <li>• These moneylenders normally are outsiders (they come from different districts just to conduct money lending business)</li> <li>• Popularly called as “Kangali bank”</li> <li>• Operate more or less like MFIs, although there is no group lending involved</li> <li>• Collections at client’s doorsteps. Clients issued a loan card in which details of repayments are entered</li> <li>• No documentation required</li> </ul>                                                                                                                                                                                                             |
| <b>Daily Finance Corporations</b> | <b>Amount</b> – Rs.2,000 – 10,000 (the amount can stretch up to Rs.50,000 in some cases)<br><b>Interest Rate</b> – 10%-15% of loan amount (Upfront)<br><b>Loan Term</b> – 100 days<br><b>Instalment</b> – Daily<br><b>Collateral Requirements</b> – None<br><b>Loan type</b> - Individual                                                                                                                                                                                   | 78%-120%                                                                                                               | <ul style="list-style-type: none"> <li>• Popularly called “corporations” and “daily finance”</li> <li>• Target petty businesses like vegetable/fruit vendors, cycle/motor repair shops, small hotel owners, tailors etc.</li> <li>• These are individuals for whom money lending is their core business</li> <li>• Collections at clients’ doorsteps. Clients are issued a loan card or a small note book in which details of repayments are entered</li> </ul>                                                                                                                                                                                                                     |
| <b>Middlemen</b>                  | <b>Amount</b> - Rs.5,000-30,000 (can also be in kind i.e. agricultural inputs like seeds, fertilizers and pesticides)<br><b>Interest Rate</b> – 25% on value (flat)<br><b>Loan Term</b> - 6-12 months depending on crop cycle<br><b>Instalment</b> - Monthly interest repayment. Bullet repayment of principal<br><b>Collateral Requirements</b> - In most cases, farmer is required to pledge agricultural produce to concerned middlemen<br><b>Loan type</b> - Individual | 48%-75%<br>(Depends on crop cycle. In addition, they charge commission of 1.25% on the value of harvest they purchase) | <ul style="list-style-type: none"> <li>• Middlemen are traders of agricultural produce who provide agricultural inputs to farmers and also buy their harvest</li> <li>• Effective interest rate depends on crop cycle since middlemen charge interest as a fixed charge on the value of loan. Longer the crop cycle, lower the effective interest rate and vice-versa.</li> <li>• Loan recovery is done by adjusting the loan amount against the market value sale of the harvest</li> <li>• The market rates that middlemen offer are local market rates. Farmer is compelled to sell the harvest at that price even though the rates might be higher in other markets.</li> </ul> |

|                            |                                                                                                                                                                                                                                                                                             |                                                       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|----------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Gold Loan Companies</b> | <b>Amount</b> – 50%-80% of market value of gold pledged<br><b>Interest Rate</b> – 12%-30% p.a. (Diminishing)<br><b>Loan Term</b> – Flexible<br><b>Instalment</b> – EMIs or Bulleted<br><b>Collateral Requirements</b> – Gold<br><b>Loan type</b> - Individual                               | 12%-30%                                               | <ul style="list-style-type: none"> <li>The rate of interest is directly proportional to the value of loan availed as a percentage of value of gold pledged<sup>21</sup></li> <li>Popularity of such companies has increased recently due to marketing campaigns</li> <li>Branches are located primarily in towns and cities</li> </ul>                                                                                                                                                           |
| <b>Pawnbrokers</b>         | <b>Amount</b> – Depends on value of gold pledged. No fixed criteria to arrive at value of loan.<br><b>Interest Rate</b> – 2.5%-3% per month (flat)<br><b>Loan Term</b> – Flexible<br><b>Instalment</b> – Bulleted<br><b>Collateral Requirements</b> – Gold<br><b>Loan type</b> - Individual | 30%-36%                                               | <ul style="list-style-type: none"> <li>Pawnbrokers are the local jewellers who conduct money lending as their secondary business</li> <li>Since the loans provided by pawnbrokers are secured, the interest rates charged by them are lower than money lenders</li> </ul>                                                                                                                                                                                                                        |
| <b>Chit Funds</b>          | <b>Amount</b> – Rs.20,000 – 2,00,000<br><b>Interest Rate</b> – Depends on bidding process. In the range of 24%-60% p.a.<br><b>Loan Term</b> – 18-24 months<br><b>Instalment</b> – Monthly<br><b>Collateral Requirements</b> – None<br><b>Loan type</b> - Individual                         | 0%-60%<br>(based on discussion with clients)          | <ul style="list-style-type: none"> <li>Popular amongst business community</li> <li>Generally group of 20 members pool in monthly contribution and the total amount pooled is either given to a random member based on a lucky draw (each member can get the pooled sum only once in full cycle of 20 months) or the amount pooled is auctioned amongst group members. The member with the highest bid wins and differential amount is re-distributed among all 20 members as dividend</li> </ul> |
| <b>Friends/ Relatives</b>  | <b>Amount</b> – Rs.500-5,000<br><b>Interest Rate</b> – 0% - 20% flat value<br><b>Loan Term</b> – Few days or weeks<br><b>Instalment</b> – Bulleted with interest<br><b>Collateral Requirements</b> – None<br><b>Loan type</b> - Individual                                                  | 0%-100%<br>(Depends on time when repayments are made) | <ul style="list-style-type: none"> <li>People usually borrow in case of emergencies especially when they do not have enough money to pay weekly instalments of MFIs</li> <li>Interest is negotiable and depends on the understanding between borrower and lender</li> </ul>                                                                                                                                                                                                                      |

<sup>21</sup> This essentially means customers leverage the gold they pledge (assuming standard purity). Thus if I keep Rs.100 gold (market value) and demand loan of Rs85, then I will have to pay higher interest rate when compared a person who wants to avail loan of Rs.70 on same value of gold pledged. This is true with every gold loan company. Please see the link to see the charges that SKS has for gold loan: [http://www.sksindia.com/our\\_products.php#1](http://www.sksindia.com/our_products.php#1).

## MFI LOANS – LIKES AND DISLIKES



*“Time pe paisa milta tha vaaram sangham se...kisi ke saamne haath pasaarne ki jaroorat nahi padti thi”*  
**(From MFIs, we used to get money on time, we did not have to desperately ask for cash from other sources)**

*“Varam sangalollu mundu appu 25 varalu teerchagane inka 25 varala baki undagane malli appu istaru. Alane bankulu kuda maku appu undagane inko appu iste meminka varam sangapollu daggaraku vellam”*  
**(MFIs give us special loan after completion of 25 weeks of loan repayment. In the same way, banks should also give us special loan in the middle of the previous loan repayment so that we need not go to moneylenders for loans)**

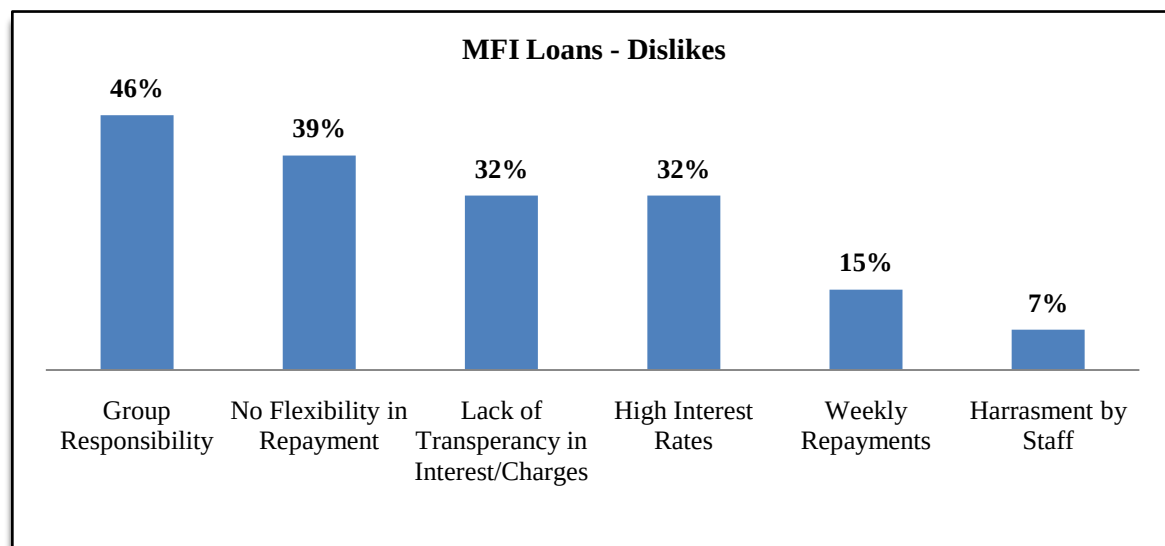
**Timely Loans:** In the majority (80%) of the sessions, respondents rated timely loans as one of the major advantages that MFIs vis-à-vis other formal institutional sources like SHGs and banks. According to the respondents, it takes a minimum of 7 days for MFIs to process a loan application, while the maximum time taken could stretch up to 15 days. In addition, the interim loans (top-up loan of a smaller amount provided while existing loan is still running) provided by most MFIs after 15-25 weeks of the main general loan, helps to meet the emergency requirements of borrowers.

**Convenient Installments:** The option of paying interest along with the principal installments helps people to repay the loans. In contrast, it is very difficult for the clients to make a bullet repayment of the loan as is required for loans taken from moneylenders. However, when respondents were asked to rate MFIs on the same attribute during the relative preference ranking exercise, they rated MFIs 'low' as the majority of them felt that weekly installments do not match their cash flows, and they would rather prefer monthly installments, as in the case of loans taken from SHGs or banks.

**Low Interest Rates:** In 32% of the sessions, respondents opined that MFI interest rates are relatively lower when compared with other costly informal sources. It is interesting to note that interest rate of MFIs also emerged as a major reason for dislike in equal number of sessions. The main cause for interest rate as a dislike was lack of transparency in pricing of MFI loans, which are expressed as "flat" interest rates along with other upfront charges. With increased awareness levels among the clients post Andhra crisis, respondents argued that although MFIs' interest rate looks low on paper once the rate is converted to diminishing basis and upfront charges are included, the rate becomes as high as the one charged by moneylenders.

**Doorstep Delivery:** MFI staff visits clients' doorsteps for both disbursements and collections. This saves time and money for the clients, which they can devote to their business or household chores.

**Insurance:** Although most of the respondents were not able to explain terms and conditions of insurance product of MFIs, but they feel that insurance was a differentiating factor of MFIs.



### ***Easy Loans – Tempting!!***

*“Har jagah se loan milne laga toh log saari company se uthaane lage...koi mobile khareed raha, koi TV...jab bharne ki baari aayi toh fir yahan ka paisa wahan karna”*

*(People started getting loans from all the companies. So they got tempted to take loans for buying TVs/mobiles. However, when it came to giving recoveries, they started taking more loans to pay off their previous loans)*

### ***Interest Rates - 12% or 36%***

*“Likhate hai 1 Rupay magar jab jode toh 3 rupay se bhi jyada wasoole”*

*(They state 12% interest rate, however, when we calculated we came to know that we ended up paying 36%.)*

### ***Harassment – Not with us!!!***

*“Paper me aaya tha ki kuch log suicide kiye the, hua nahi hua humko pata nahi par humare gaon mein toh aisa kabhi nahi hua”*

*(We read in the newspaper that some people had committed suicide because of harassment from MFI staff. We don't know whether it actually happened but such incidents have never happened in our village.)*

**Group Responsibility:** Most (46%) of the groups were quite critical of the group liability requirements of MFIs. Respondents said that because of defaults by one or two members, the whole group has to suffer. Not only do the other members have to contribute towards pending recoveries, but it also spoils relationships between members. The MFI staff members do not leave the collection centre, and make other group members sit for long hours until the group can arrange to pay on behalf of the defaulting member. Respondents argued that they have little control in choosing members in their groups. As a result, the existing members of a group have to induct other non-interested or non-creditworthy member from the village, to be able to comply with the group size requirements of the MFIs. The situation is worse if the loan amount is high, or if a member defaults early in the loan cycle. Respondents strongly believe that MFIs should introduce individual loan products. While the clients are willing to help the MFI staff to recover dues from delinquent members, they feel they should not be held financially responsible for defaults committed by other members.

**Flexibility in Repayments:** In almost 39% of the sessions, the respondents argued that MFIs are very rigid when it comes to recoveries. They do not provide even a single day grace period for making repayments. MFI staff members do not leave the clients' doorsteps until they pay the amount due. In such situations, staff members often resort to inappropriate language. Respondents said that every other institution, be it SHG, banks or even moneylenders and daily financiers, give them some grace period to arrange for funds. Respondents said that MFIs can charge late payment fees from them but should at least give them few days to arrange for pending amount.

**Transparency in Interest/Charges:** The demand from borrowers for increased transparency in interest rates and other charges is largely a result of increased awareness, post the Andhra crisis. Respondents admitted that they were under the impression that MFIs were charging interest in the range of Rs.1.5-1.75/100 per month. However, through media and other external agencies, they have come to know that the effective interest rate charged by MFIs is twice that of the rate mentioned in the loan agreement. Clients want MFIs to come up with a transparent pricing structure, clearly disclosing interest rates on a diminishing balance basis, along with other upfront charges. Clients feel that such a measure will help them in assessing the cost of credit from various formal and informal sources and that this will, in turn, enable them to take informed decisions while choosing a particular source. Respondents felt that they have been cheated for all these years by MFIs; in fact, some respondents felt that MFIs should not insist on repayment of loans outstanding as they have already collected huge amounts from them on the previous loans.

**High Interest Rates:** Respondents were divided as far as interest rate issue is concerned. In 32% of sessions, respondents felt MFI interest rates to be on higher side, while in another 32% of sessions, respondents considered lower interest rate to be an advantage for MFIs. While the latter half compared the interest rate of MFIs with that of moneylenders, the former attributed high interest rate of MFIs to lack of transparent pricing. Besides this, respondents also opined that MFIs have steadily increased their interest rates during the last two to three years. The fact that MFIs were charging interest in the range of Rs.2.5-3/100 per month, (including upfront charges) led a few groups to directly compare services of MFIs with that of moneylenders.

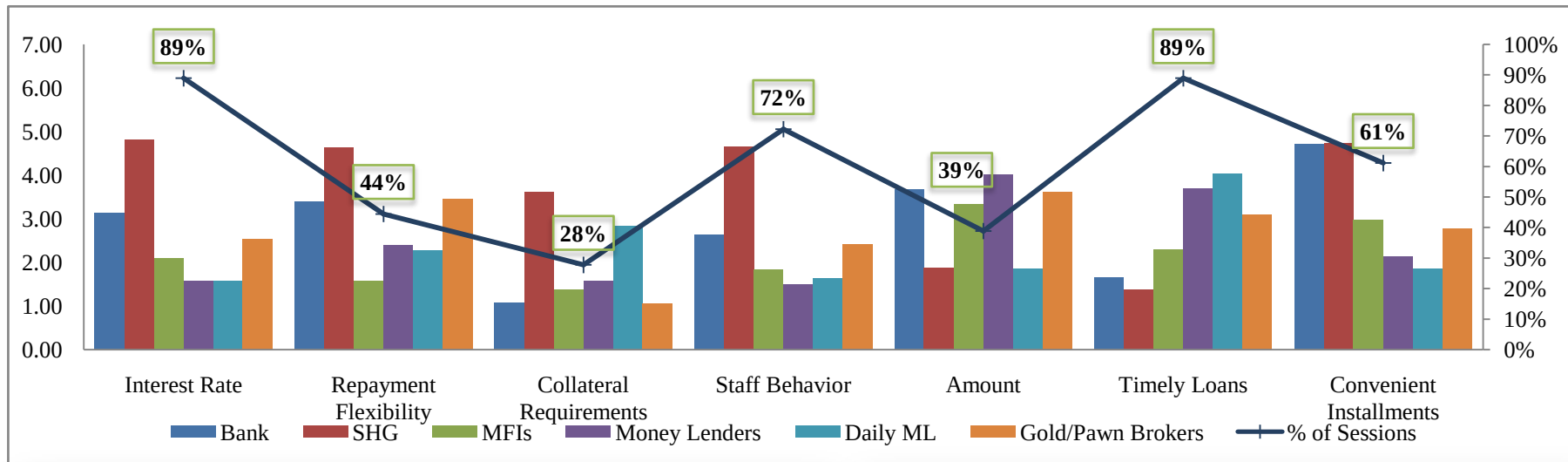
**Easy Availability of Loans:** Respondents, in about 29% of the sessions, opined that in order to avoid default by group members, MFI staff should do proper due diligence before sanctioning loans to group members. Respondent felt that in most cases, the MFI staff members, despite being aware of the repayment capacity of a borrower, sanction a loan much beyond her means.

The easy availability and options to get loans from several MFIs has, in the past, tempted the clients to borrow for consumption purposes. This often led to excessive debt burden on individual households. In order to repay these loans, the clients started borrowing from other sources (other MFIs, daily/weekly money lenders) leading to a debt trap. Some respondents said that government should allow only 2-3 MFIs to operate in a particular village. Some respondents also suggested a system whereby MFIs should make it compulsory for borrowers to get a certificate from other MFIs operating in the area. The certificate should clearly state the amount of loan that the concerned borrower had taken from the other MFIs.

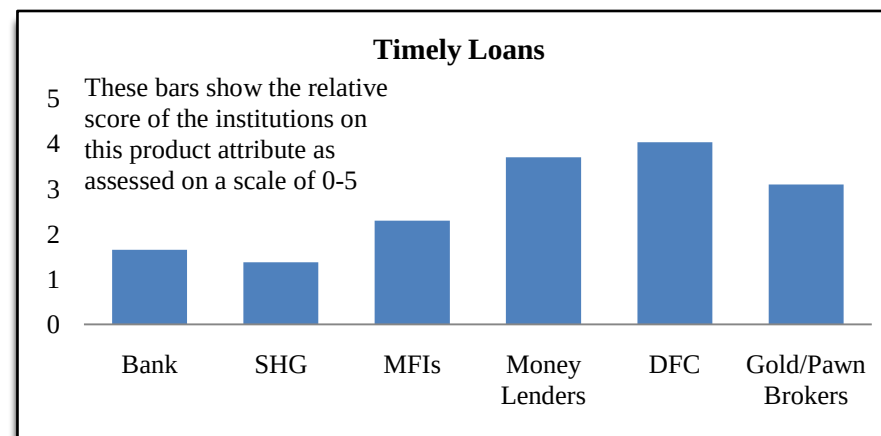
**Weekly Repayments:** Respondents were of the view that in addition to the usual loan products; they should be provided the option for monthly repayments as well. Repayment schedule essentially depends on individual's cash flows. Due to the dearth of monthly products from most MFIs, they are left with no option but to go for weekly loans. As such, it becomes difficult for them to manage frequent repayments. In addition, clients who have petty businesses find monthly recoveries more comfortable as funds remain invested in business for longer periods, resulting in higher turnover.

**Harassment by Staff:** Although there has been much discussion of harassment by MFI staff whilst making recoveries, this did not come out very much in the focus group discussions. In only 7% of the sessions, respondents said that MFIs' staff members used to harass them for recoveries. Respondents opined that, in general, MFI staff members are professional and efficient. However, in case of pending recoveries, they sometimes talk rudely. Some others said that even though MFI staff members do not use bad words, they do not leave the centre until they get the due instalment. They try to put pressure on other group members because of the group liability clause, because of which, the members start fighting amongst them. Against this background, most groups attributed harassment to the group liability condition rather than to staff behaviour.

# **MFIs vs. OTHER SERVICE PROVIDERS (FINDINGS FROM RELATIVE PREFERENCE RANKING)**



**Timely Loans:** In the majority (89%) of the sessions, respondents opined that the time taken for processing loans is an important criterion for them. Untimely loans often defeat the purpose for which they are intended. Respondents note that daily moneylenders process the loan instantly. There is minimal or no documentation required. Although it is an expensive source, and there are limitations on the amount that can be borrowed from daily moneylenders, people still borrow from them to meet their immediate credit requirements. Unlike traditional moneylenders and pawnbrokers, money lending is the core business of daily moneylenders; hence, they usually have enough liquidity to meet short term credit requirements of borrowers. In the case of traditional money lenders and pawnbrokers, it might take up to 1-2 days to get loans since traditional moneylenders generally take some time to arrange for funds (since it is a secondary business for them) or to verify credibility of borrower. Also, in case of secured loans from money lenders and pawnbrokers, it might take some time for the borrower to arrange for collateral. In case of MFIs, it takes usually 1-2 weeks to sanction a loan. In addition, most MFIs give an option of second loan after 15-25 weeks of repayment of existing loan. As far as SHGs and banks are concerned, respondents have had bad experiences in getting the loans sanctioned. In most cases, it has taken 2-3 months from the date of application to get the loans disbursed. People cite excessive bureaucratic procedures as one of the major bottlenecks in dealing with such institutions.



**A respondent describing his experience with bank said:**

*“Bank mien jab loan key liye apply karna to ek Jodi chappal khareedna, fir jab loan mile toh doosari Jodi khareedna...itna daudate bank walen...loan milne se pehle chappal kharcha aata..ye paper hona, wahan sign hona keh ke satate rehte..kabhi kabhi 3-4 mahina bhi lag jaata”*

**(When I applied for loan in a bank I had a new pair of sandals. By the time the loan was sanctioned, I had to purchase another pair. They made me run like anything. They would say my documents are incomplete. At times, it takes 3-4 months before a loan is sanctioned.)**

**A SHG group leader describing her travails in getting the loan sanctioned from a bank:**

*“2-3 mahine se hamare group ka application pada hai bank mein...kabhi kehte hai documents complete nahi hai...kabhi kehte hai bade sir ke pass file chali gayi hai bus sign hona baaki hai..rooj koi naya bahana banate hai”*

**(Our group loan application has been pending with the bank manager for the past 2-3 months. Sometimes they give an excuse that our documents are incomplete, on other occasions they say that the file is with a senior manager for authorisation. Every day they have an excuse to delay our applications.)**

**Interest Rates:** In 89% of the sessions, respondents mentioned interest rates as one of the key factors for accessing credit from any source. Refer to table 2 for details on interest rates charged by different service providers.

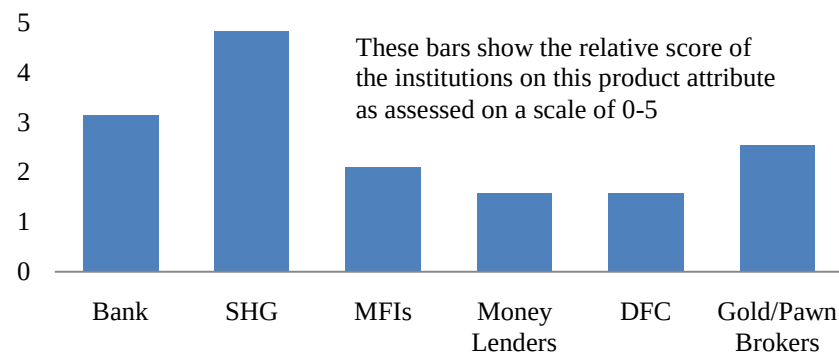
**Staff Behaviour:** Respondents relate ‘staff behaviour’ to the conduct of the staff of the credit institution in the event of delay or default. Respondents said that SHGs and IKP staff behave with them in the most respectful manner. They only visit the village and counsel the members about the benefits of prompt repayment. Respondents rate pawnbrokers and banks similarly. In most cases, the loans taken from banks are secured. Since both banks and pawnbrokers have collaterals, they do not bother respondents so much as far as recoveries are concerned. Respondents rate MFIs lower because of the repayment pressure that their staff exercise in the event of delay in repayments. MFI staff members generally behave in a respectful manner and maintain cordial relations with the members. But when it comes to repayment, they are perceived to be strict. Clients have a more negative opinion of moneylenders as they ridicule defaulting members and ill-treat them in the community.

***Client’s response on behaviour of MFI staff:***

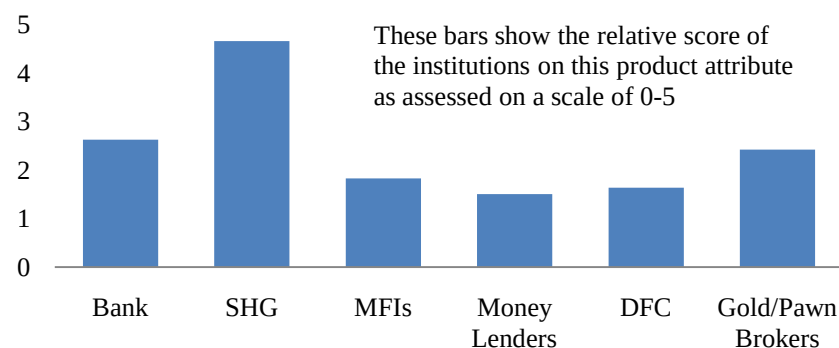
*“Varam kantula valla guravamichi matladutaru manchineelu kuda tesukoru kani okka subyuralu kattkapoyina chala serious ayipotaru group to maryada tappi matladutaru”*

*(MFI staff gives lot of respect to members in all interactions, they do not even take drinking water from us ... but even if a single member does not repay her installment amount, they become very serious and do not give respect to both defaulter or to the entire group.)*

**Interest Rates**



**Staff Behavior**



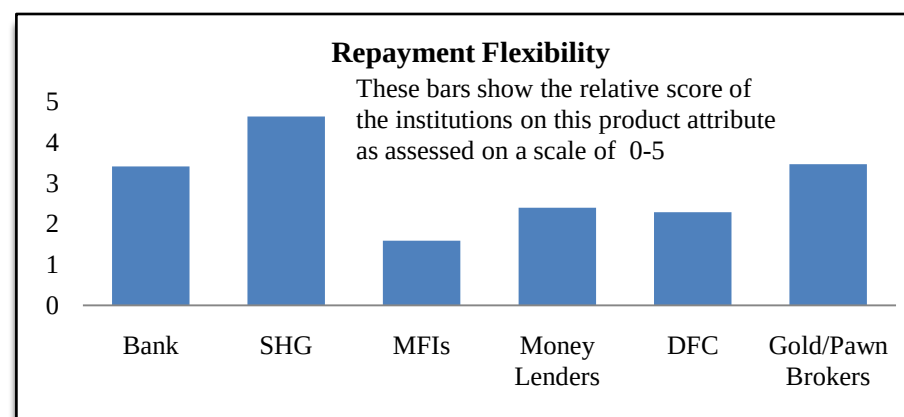
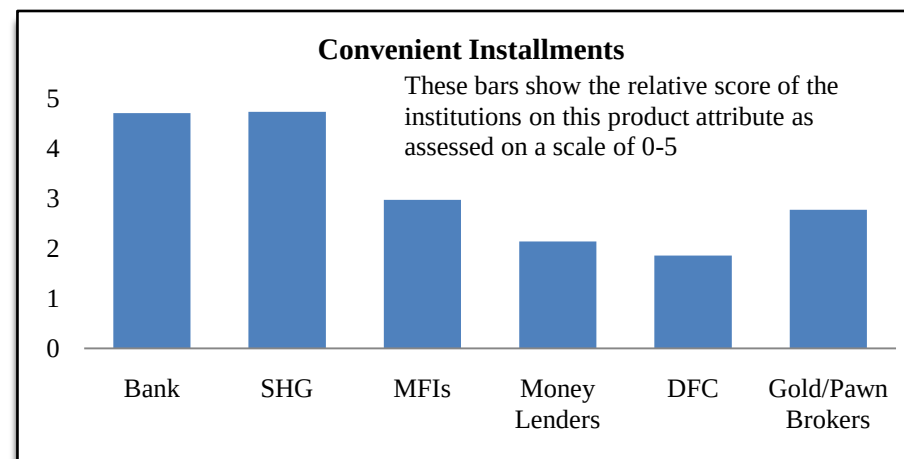
**Convenient Instalments:** Most of the respondents felt that the monthly recoveries of SHGs and banks were more convenient when compared with weekly and daily recoveries of MFIs and DFCs. One of the reasons for such response was that majority of respondents in the study were *beedi* workers or had petty business. *Beedi* workers are paid monthly and business men prefer retaining cash in business for as long as possible. They resort to daily money lenders only in case of emergencies. People also consider the ability to pay off both principal and interest components as part of instalment. In case of money lenders and pawnbrokers, only bullet payment of principal is allowed, making it difficult for them to clear their debts.

**Repayment Flexibility:** Respondents were of the opinion that they should be allowed some grace period when they are not able to arrange for loan instalments on the due date. In terms of repayment flexibility they have rated MFIs the lowest amongst all service providers. Even a single day grace period is not allowed. Respondents rated banks and SHGs high on this aspect primarily because they follow up for repayments only after 2-3 months post the due date. With regard to pawnbrokers and money lenders, respondents opined that they do not put much pressure on them as long as they get the interest component (since money lenders accept monthly interest payments and a bulleted principal repayment) on monthly basis. Even daily money lenders allow a grace period of 7 days, although they do impose late payment fees for missed instalments.

#### **Respondent's reply on rigid MFI recoveries**

*“Intlo evaru chachaara ani kuda choodaru. Loan iche varaku inti daggara nundi kadaluru. Maaku saadhyam kaakunte vere group member's daggara nundi teesukoni ivvamantaaru”*

***([MFI] loan officers do not even bother if anyone is dead in the family. Irrespective of what the reason is, they do not leave the premises till the repayment is done. If we are unable to pay, they insist on us taking funds from other group members and making the repayment.)***

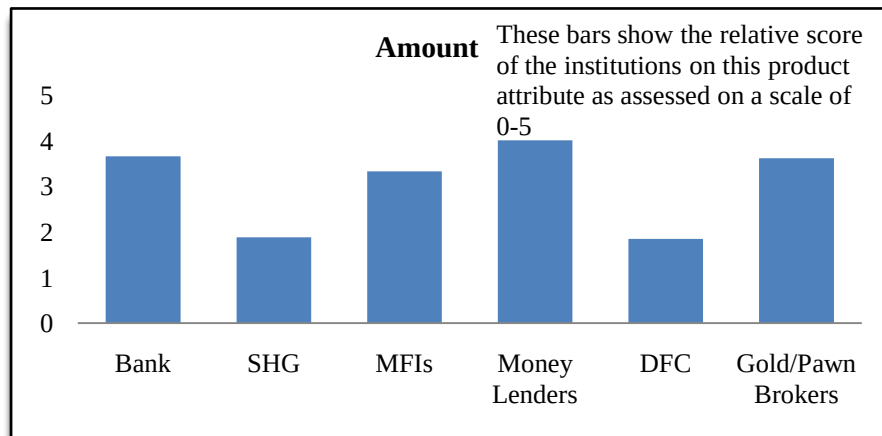


#### **Money lenders' installments:**

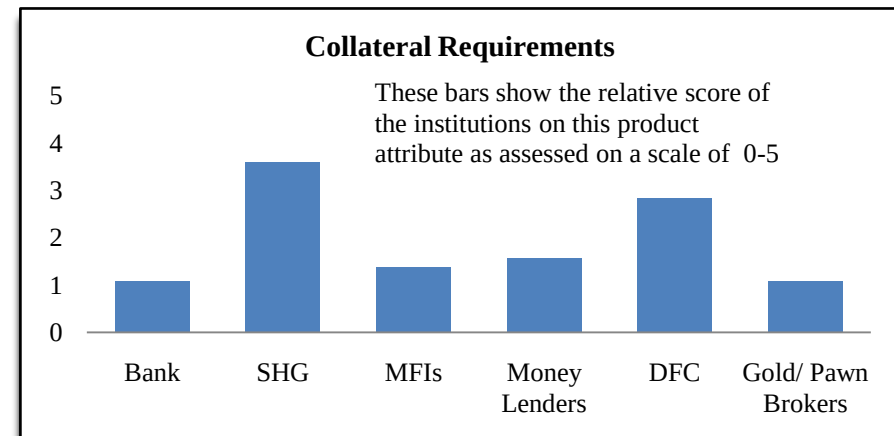
*“Vaddi kaduthoone untaam, assalu taggadu. Baaga ibbandi”*

***(We keep paying high interest amount and the principal amount never reduces. We are facing huge problems because of this.)***

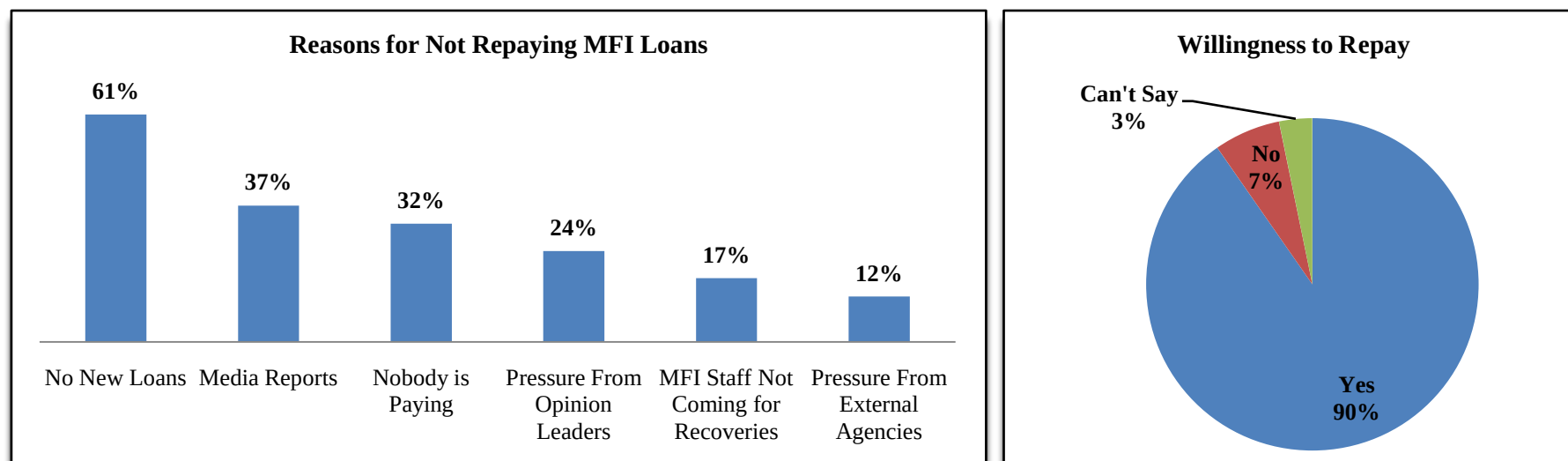
**Amount:** With regard to amount of loan, daily finance corporations and SHGs are the least preferred. Respondents say that daily finance corporations provide small loans of between Rs.2,000-10,000. The majority of respondents also complain of inadequate loan amount in case of SHGs. Although the average loan size for SHGs has gone up steadily over the years, it is still small when compared to other avenues like MFIs, moneylenders and pawnbrokers. This coupled with the fact that SHG loans are for a period of three years or more, limits the members from accessing another loan until the whole group prepaes the loan. Respondents rated banks, pawnbrokers and money lenders higher although the loan amount depends a lot on collaterals that the borrower is willing to pledge. MFIs come next as they provide relatively higher amount of loans for a shorter term. In addition, they have option of interim loans after 15-25 weeks of existing loans.



**Collateral Requirements:** Although MFIs do not take any physical collateral, the group responsibility requirement in MFI lending was the reason why respondents rated MFIs very low. Interestingly, even government-sponsored SHGs have a group liability feature, but respondents argue that other members tend to get away without sanction if any member of their SHG does not repay. In case of MFIs, the staff members are very strict and ensure that others contribute for defaulting members. Other institutions like banks, pawnbrokers and money lenders, in most cases, ask for security and hence have been rated lower. Daily finance corporations give individual loans without any collateral and hence score well on this attribute.



## REASONS AND IMPLICATIONS FOR DEFAULTS<sup>22</sup>



In 90% of the sessions conducted, respondents said that they are willing to pay their outstanding loans. However, such willingness to pay came contingent upon getting fresh loans from MFIs. People would like to carry forward their relationship with MFIs, given the fact that it is an economical and convenient credit option for them. Respondents argued that during the initial days after the crisis, MFI staff used to promise fresh loans if clients paid their outstanding loan amount. However, such promises were never fulfilled, and no new loans were disbursed, even to those clients who had cleared off their debt. Taking a clue from such examples, other people in the community who were willing to pay stopped repaying their loans. In 61% of the sessions, the respondents cited non-availability of fresh loans from MFIs as the major reason for not repaying their existing loans. Respondents admitted that it is very difficult for them to arrange for lump sum funds to clear off the outstanding loan of MFIs. They would require fresh loans, which can be adjusted with the outstanding portion of their previous loan. This would also give them working capital to invest in their business while, at the same time, relieve them from the burden of repaying a huge amount at one go.

In 41% of the sessions, respondents said that they came to know about the malpractices of MFIs, i.e. charging exorbitant interest rates, harassing clients etc., through media reports. They said they have personally not experienced any sort of harassment from staff or come across suicide cases in their locality. They said that the government has asked them not to repay MFI loans, by highlighting harassment related cases in newspapers and news channels.

Another prominent reason for not repaying MFI loans is 'demonstration effect'. Respondents argued that since none of the members from the community are paying, there is no incentive for them to pay either, especially in the absence of fresh loans from MFIs.

<sup>22</sup> Also see MicroSave India Focus Note 59: [The Andhra Pradesh Crisis - Clients' Perspective](#)

## What Are Clients Doing Post AP MFI Crisis?

Pressure from opinion leaders and local activists is also one of the reasons stopping people to pay MFI loans. Respondents admitted that there is lot of negative publicity about MFIs after the crisis. Local level activists, along with opinion leaders, are not only discouraging clients from repaying loans, but also threatening the MFI staff. In 19% of sessions, respondents opined that MFI staff is not coming for recoveries in their village. Although they do not know any specific reason for the same, they feel that MFI staff fears a backlash from politicians and opinion leaders.

### ***Recovery figures for MFIs – 10%?***

(A word from Branch Manager of a leading MFI in the state)

“Recoveries have gone down drastically after the crisis for both individual loan branches as well as weekly [group] loan branches. Currently, the recovery figures are in the range of 10-12% of the due amount for any given day. In the last 10 months, recoveries have gone down at an incremental rate and we fear it will be much lower than 10% in coming months. There are a total of 7-8 MFIs working in this district (apart from state government run credit programme) and recoveries for such MFIs is in the range of 8-12%, if not less.”

### ***From TIGERS to CATS!!! (Credit Discipline Implications)***

One respondent characterised the state of MFIs pre and post crisis: ***“MFIs used to be tigers before the crisis. After the crisis, they have become cats. Earlier we used to wait for them but now they wait for us. Earlier they will not accept a penny less, now they accept whatever we give, whenever we give.”***

### ***Some still prefer to pay!!***

(A word from Branch Manager of a leading MFI in the state)

“There are three categories of clients who are repaying their loans. First, there are clients whom we are able to convince by promising fresh loans on full repayment of the outstanding amount on existing loans. Second, there are clients who feel that the MFIs have really helped them by lending in times of emergency and have helped them to grow their business. Third, there are clients who want to maintain a good credit history, they fear that government might issue orders to repay MFI loans and they might not be able to arrange such large amounts at that point in time. So it is better if they repay their loans in small installment, rather than arrange for lump sum when such orders are issued.”

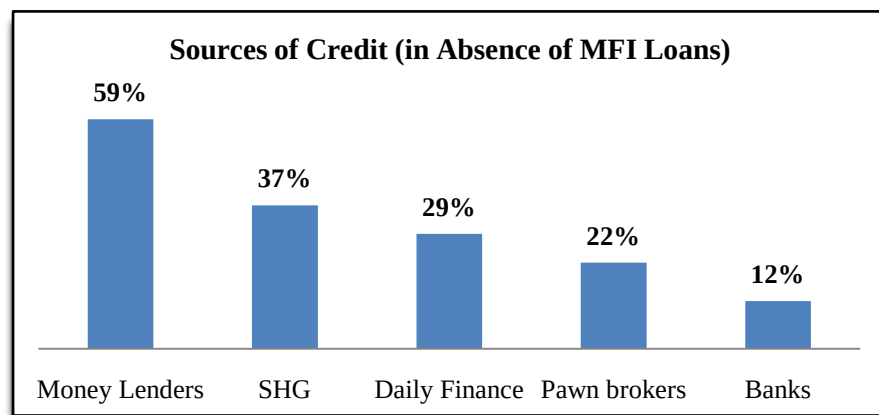


## CREDIT MANAGEMENT AND COPING MECHANISMS

The research also sought to understand if the clients are able to get credit from alternative sources in the absence of MFIs and if so, what are the pain points in accessing credit from such sources. It also tried to understand the mechanisms that the respondents are adopting to face the credit crunch.

## CREDIT SOURCES IN THE ABSENCE OF MFIs

The table below gives the sources of credit that respondents access to especially in the absence of MFIs.<sup>23</sup>



In 59% of the sessions, respondents said that they have taken loans from moneylenders in the absence of loans from MFIs. Moneylenders have increased lending in the past eight to ten months. The next most accessible source of credit for the respondents is the SHGs. However, SHGs have not been able to fully meet the credit gap created due to the absence of MFIs. Over last few years, the number of SHGs formed has increased, respondents say that the loan size, especially for new members, is small and the processing of loan for bank linkage programme takes a long time (usually 1-6 months). Consequently, respondents have no other option but to approach the moneylenders in case of urgent need.

Respondents who have petty business and generate cash inflows on daily basis take loans from daily finance corporations (DFCs). DFCs are mostly prevalent in urban and semi urban areas. The business activity of DFCs has increased over the past few months. Because of huge demand, they have become selective in offering loans to people who are known to them, or have approached them through some common acquaintance. Banks are the least preferred source of credit for the respondents. Many of the respondents opined that the process for taking a loan from bank is very cumbersome and involves a lot of time. Many of them say that they need a third party support to access bank loans and that bank staff demand bribes to finance them. Due to this, respondents prefer to resort to other sources of credit even though the interest rate of banks is nominally lower compared to other sources.

One of the respondents' mentioned "Vaarapu Sangalolu unnappdu vaddi vyaaparastula business chala taggipoyindi. Kaani gata 8-9 nelalanundi valla malli appulu ivvadam prarambhincharu"

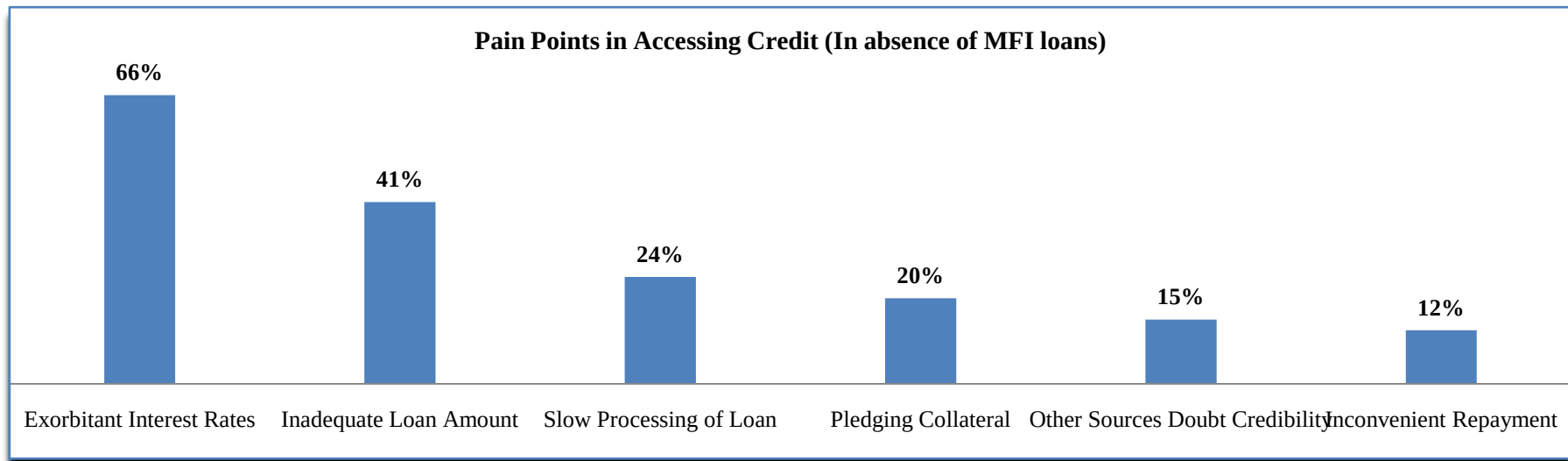
**(When MFIs were popular, the moneylenders' business went down drastically, but now they are back and demand for loans from them has gone up.)**

"Ippudu microfinance samstalu maaku appu ivvatledu kabatti malli memu vaddi vyaparula daggariiki vellalsi vasthunnadhi"

**(We have to approach the money lenders as MFIs are not disbursing the loans.)**

<sup>23</sup> Also see report published by MFIN – NCAER: [Assessing the Effectiveness of Small Borrowing in India](#)

## PAIN POINTS IN ACCESSING CREDIT FROM ALTERNATE SOURCES

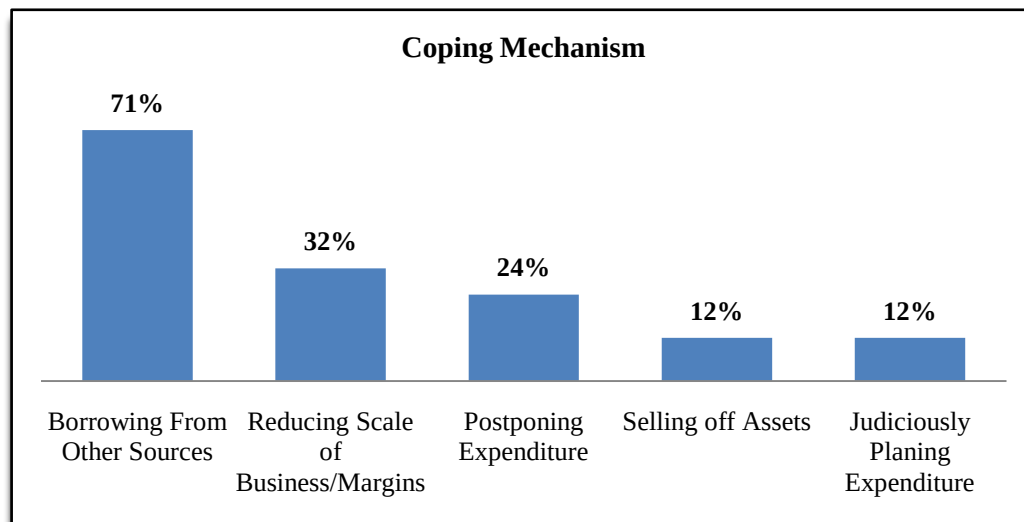


Exorbitant interest rates (66%) and inadequate loan amount (41%) came as the two major pain points for borrowings post MFI crisis. See table 2 for comparative analysis of interest rates and loan amounts charged/sanctioned by different credit service providers.

In addition, 24% of the respondents complained about slow processing of loans especially with regards SHG-bank linkage programme of the state government. Other concerns of respondents include pledging collaterals, inconvenient repayments (bullet payment of principle) for loans taken from moneylenders and pawn brokers. Respondents feel that post the crisis, other service providers (especially daily finance corporations and moneylenders) have become cautious in lending. They fear that such mass scale defaults can happen for loans that they have disbursed.



## COPING MECHANISM



*“Time ku nai milra paisa. Dhande pe paisa nai daal pare hum”.  
(Loans are not available on time to invest in the business.)*

*“Mundu vaarasanghala appulu dorukutunnepudu janaalu chicken fry chesukoni tine waaru. Ippudu annam pappu tintunnaru”.*

*(Earlier when MFI loans were available people used it for unnecessary expenditure, now they have stopped making any such expenditure.)*

**Borrow from other sources:** In 71% of the sessions, respondents said that they borrow from alternate sources of credit like moneylenders, daily financiers, banks, gold companies/pawn brokers and relatives, as mentioned above, to manage liquidity especially in the absence of MFIs.

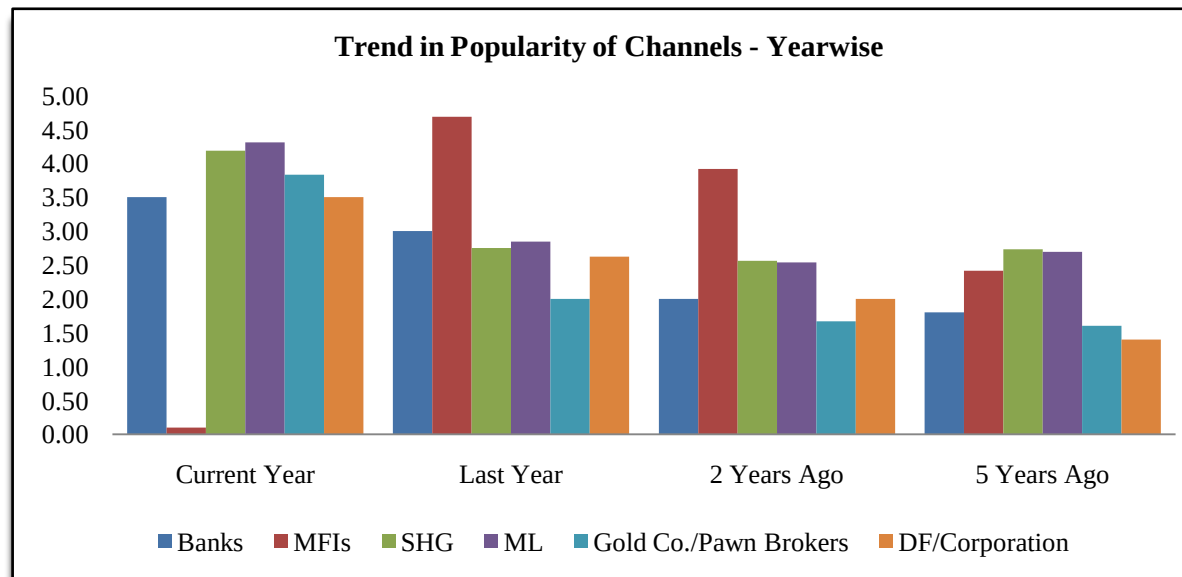
**Reduced scale of business/margins:** Many respondents said that their business has taken a beating in the absence of loans from MFIs. They are not able to get loans when they need them most; and even when they do get credit, they have to pay high interest rates. As a result, they are not able to earn high profit margins. Some of the respondents said that earlier, when credit was available from MFIs, they used to buy raw material in wholesale but that now they have had to start buying raw material in retail, which has reduced their margins. Respondents whose main occupation is agriculture said that they are not able to get loans on time and are therefore forced to reduce their area of cultivation, resulting in loss of agricultural income for them.

**Postponement of business expansion:** Respondents who had the plans of business expansion have postponed their plans as access to credit has become difficult. They do not want to take loan from alternative sources, such as MLs and DFCs, because it is not only difficult to get the required amount, but also because of usurious rates.

**Sale of assets:** In 12% of the sessions, respondents said that they have sold their assets such as house, vehicle, cattle, jewellery etc., to meet their productive (agriculture related expenses) as well as non productive expenditure (school fees, marriage etc.) which have to be met compulsorily.

**Judiciously planning expenditure:** Respondents also said that they have cut down on unnecessary expenditure such as repair and maintenance of house, buying clothes for family members and are making judicious use of loan funds towards productive purposes. Earlier when credit was easily available, clients used it extensively for consumption purposes.

## FINANCIAL SECTOR TREND ANALYSIS



### **Politicians turned Moneylenders post crisis !!**

*“Evaraite varam sangapollunu raniyakunda chesaro valle ippudu maku rojuvari applu istunnaru”*

*(Some of the local leaders who vehemently opposed the MFIs during the crisis have later started lending to us as DFCs)*

### **Business shot up for DFCs !!**

An informal source who worked with DFCs said :

*“Ek saal pehle Indevalli me daily finance walon ka business Rs 116 lac tha. Lekin ab ye problem shuru honeke baad se Rs. 91 lac hogaya”*

*(A year ago the loan outstanding with a DFC in Indravelli was Rs.16 lacs only, but it has gone up to Rs.91 lac presently)*

There has been an upward trend in the popularity of various credit institutions, over the last few years, with the only exception being MFIs. The major reason behind this is the increased credit needs of the people over time due to the increase in the cost of agricultural inputs, raw materials, education and health expenses and cost of living.

**Banks:** Over the years, the number and value of loans taken from banks has gone up as the general requirement of credit has gone up. For crop loans, the government has increased the loan per acreage and many farmers have availed these loans. The demand for individual loans from banks has also increased, especially in the absence of MFIs.

**MFIs:** Five years back, MFIs were present only in easily accessible areas with high requirement of credit. Even the loan size was smaller during initial stages. The popularity of MFIs was the highest last year and the year before as they were expanding rapidly and increasing their areas of operation. In the past two years, apart from giving fresh loans to new customers, MFIs also gave fresh/interim loans to the existing customers in the form of top up loans and emergency loans. Respondents also preferred loans from MFIs. (Please refer to the section [MFI Loans – Likes and Dislikes](#)).

However, during the current year, the MFIs' operations came to a standstill because of the Microfinance Act passed by the Government of AP. Due to mass defaults on loans and the requirement for DRDA permissions, MFIs have not been able to disburse fresh credit for the past seven to eight months.

**SHG:** Five years ago, SHGs were the most popular source of credit amongst all the credit institutions because of the increased focus of the state government on SHGs. But the popularity of the SHGs reduced over the past two years as MFIs started aggressive lending to SHG members. The popularity of SHGs has increased again in the current year in the absence of MFIs. SERP/DRDA is playing a key role in increasing the loan limit and providing more prompt service to the SHGs. But despite all the efforts, in terms of usage, SHGs are still less than moneylenders in the current year. SHGs are unable to cater to the credit demand because of slow processing time and the small loans offered in first loan cycle. Also, if they have any need for credit during the repayment period, when they cannot access supplementary loans, members have to approach other credit institutions.

**Moneylenders:** Moneylenders are the oldest source of credit amongst all the credit institutions. Five years ago, moneylenders were popular amongst the borrowers as they were the only source available apart from the SHGs. But with the proliferation of MFIs and SHGs, the popularity of moneylenders went down. Despite all their shortcomings, moneylenders' popularity has increased again since last year. Moneylenders, today, stand as the most popular source amongst all the credit institutions. This is because MFIs have stopped operating and the SHGs provide limited loans of smaller amounts.

**Gold Loan Companies/Pawnbrokers:** Pawnbrokers have been present for many years, but are not preferred to most other sources of credit. This is mainly because pawn brokers/gold loan companies give loans only on pledging of gold, while most of the other sources given credit without any collateral. The popularity of these institutions has gone up mainly because of lack of credit from MFIs.

**Daily Finance Corporation (DFC):** Daily financiers are the biggest beneficiaries of the MFI crisis. Five years back, there was very limited number of DFCs, but they have increased and have started aggressive lending, especially in the past seven to eight months in the absence of MFIs. Over the years, they have increased the number, as well as the size, of loans to the community.

## INTERVIEW OF STAKEHOLDERS

MicroSave team conducted informal interviews with government officials, bankers, and MFI staff to understand their take on current MFI crisis in the state. Below are details of three interviews, which are representative of the opinions that different stakeholders had on MFI crisis.

### *Interviewee - Branch Manager of a leading MFI*

#### ***What has been the extent of the hit on recoveries after the crisis?***

Recoveries have gone down over the past 10 months. As of now, we are able to recover only 5-6% of the total outstanding on any particular day. Our portfolio outstanding was around Rs.8 crore (for branch) when the Ordinance was introduced, since then (over 11 months) we have been able to recover only Rs.2.5 crore while no new loans have been disbursed during this time period. In October 2010, recoveries were around 70% and this went down to 20-30% by November/December 2010. The recoveries again went up to 50% in January 2011, but from there onwards it has fallen steadily.

#### ***What are the reasons for such pattern in recovery figures?***

Initially we were able to convince the clients regarding repayments by guaranteeing new loans. People started paying off their loans, but since we were not able to give them fresh loans, it has resulted in a fall in recovery rates. Even for the clients who had been paying, local activists and opinion leaders are discouraging them to repay their outstanding loans.

#### ***Tell us something about the clients from whom you are able to manage recoveries?***

The people from whom we have been able to manage recoveries were the ones who had last few installments left to be paid at the time of crisis. Such clients did not have much at stake as far as the outstanding amount was concerned, hence, they paid remaining balances hoping to get fresh loans once normal MFI operations are restored. Recovery rates have been very poor from clients who had borrowed just 1-2 months before crisis. Earlier we used to follow up with all the clients, but now we only visit those clients who are giving us recoveries.

#### ***Does your staff face any problems while going for recoveries in field?***

Our staff members are threatened by local activists. There have been few instances of our offices being ransacked by a mob of people. Also, in few cases we were called by clients to collect recoveries, but as soon as we reached there we found media persons questioning us and reporting harassment cases in the next day's newspaper.

***How has clients' attitudes changed after the crisis?***

Clients who had large outstanding balance are taking advantage of the situation. People say that they have been asked by the government not to pay back loans taken from MFIs. Even for clients who are giving us recoveries, we have to collect instalments in parts. However, in spite of the crisis, people are ready to pay us on the condition that we disburse new loans.

***What has been the impact of such crisis on clients' cash-flows and how are they coping up with the situation?***

People are borrowing from moneylenders and pawnbrokers. In addition, they are not able to take advantage of business opportunities due to shortage of working capital.

***How many new loan applications have you submitted with DRDA for approval and what is the status?***

For the entire district including our branch, our head office based at Hyderabad has submitted around 10,000 applications. We have been informed that only 1,000 of them meet eligibility criteria. Out of these 1,000, we have not got approval for even a single client. Rather, DRDA has approached these clients to disburse its loans to them.

***What do you think is the major reason for such crisis?***

The reasons are political. The media has created a lot of hype around suicide cases and attributed every suicide case to the so-called malpractices of MFIs. The district and state level politicians also motivated the clients not to pay MFI loans during their visits to settlements. The government feels threatened by MFIs since they are competing with their SHG movement.

***What strategy is your management adopting to cope up with the situation?***

We are trying to retain our old staff and are converting them into permanent employees from a contractual status. Whatever recoveries we have been able to manage is because of business relationships that they have maintained with the clients. Clients do not recognise MFIs; they only know their staff and retaining them would help us a lot once the situation improves.

***Interviewee – A Senior Government Official Responsible for the SHG movement***

***Can you provide us with an overview of the financial services landscape for the poorest of the poor in your district?***

The savings and credit needs of the people are predominantly being met through SHG-bank linkage programme under IKP programme of government, which is being supported by SERP. The district has more than 5.5 lakh women members organised in 52,000 SHGs spread across rural and urban areas. Considering the total household population of around 6.5 lakh in the district, we have been able to cover around 90% of households. Over a period of time, there has been a significant increase in lending to the SHGs. The average credit available to each group has increased from Rs.96,000 in 2008-09 to Rs.186,000 in 2010-11. Last year alone we disbursed Rs.360 crore (\$70.3 million). Efforts are also being made to provide livelihood support to members so that credit and savings can be channelled for productive purposes in order to ensure long term sustainability of such community based institutions.

***How have the repayment rates been for SHGs over a period of time?***

Repayments have gone up over a period of time. Currently, it is around 95%. A few years back, the repayment rates were around 52% and politics was one of the key reasons behind these low rates. We have been able to overcome such issues through proper monitoring and follow up jointly by IKP and bank staff.

***Do you think that ongoing MFI crisis is also one of the reasons for such rise in repayment rates?***

Yes, it is definitely one of the reasons. Earlier people used to get easy money from MFIs. MFI operations have come to a halt in the last 10-11 months, resulting in higher level of dependency on SHG-bank linkage for meeting credit requirements. As a result of this, members want to maintain good credit history with these institutions. Groups which were defunct have started functioning again as members recognised the importance of SHG as an institution.

***Tell us something about MFI operations in your district and what has been the impact of AP micro finance Act on such institutions?***

There are some 9-10 MFIs that are operating in this district and jointly they have disbursed close to Rs.450 crore. MFIs are institutions that knock at the door and give money. After the AP Act was enacted, the awareness has spread among poor people regarding malpractices of these institutions. They charge exorbitant interest rates and are not transparent in communicating the same to their clients. They take advantage of lack of awareness amongst illiterates. They also harass their clients for recoveries to the extent of forcing them to commit suicide.

People have rejected MFIs and these institutions have become irrelevant in present context. MFIs have lent multiple loans per client and most of this money is being used for consumption purpose as a result people have fallen into vicious circle of multiple debts. It is a human tendency to take loans if credit is available so freely and MFIs have taken advantage of this.

In the last 10-11 months there has been mass scale default of MFI loans and recovery figures are in the range of 5-10% for different MFIs.

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***What has been the impact of such crisis on clients' cash-flows and how are they coping up with the situation?***

The crisis has not had a significant impact on the cash flows of the clients. As I said, MFIs were giving easy money to people which their clients did not require. MFIs were lending way beyond the requirements of a household. Hence, poor people are not facing any problems in absence of MFIs. Whatever genuine credit requirements they have are being met through SHGs. We have communicated the same to members: that is in case they require loans they need not approach MFIs, they can directly come to us and we will meet their credit requirements.

***What has been the impact of MFI crisis on demand for credit under IKP programme of government?***

The average lending to the groups has been on a rise as mentioned earlier. Bankers are more than willing to lend higher amounts to SHGs if they have a good track record. However, such growth is a result of improved systems and processes. The impact of MFIs crisis would not be very significant in increased demand for credit through SHGs. Since MFI loans were not actually required by their clients hence there isn't a vacuum that needs to be filled by SHGs/banks.

***What are some of the other institutions that are competing in credit space for poorest of the poor?***

Apart from MFIs, there are moneylenders and SHGs being promoted by NGOs. As far as money lending is concerned, it has been an age old institution and will always remain there in spite of moneylenders' usurious interest rates. However, the dependence of people on such informal sources has been steadily going down. When it comes to NGOs, they do not have enough funds to meet credit requirements of members. They are also not able to match our interest rates (12% p.a.). Also, members of SHGs promoted under IKP have an advantage of interest rate subsidy (75% of interest paid) under "Pavalavaddi" scheme. Of late, many SHGs promoted by NGOs are coming under the net of IKP to avail greater benefits.

***What is the future of MFIs considering the current crisis?***

MFIs would be more relevant in some of the other states since banks are not that active in those states. In AP, the situation is different and banks are more than willing to lend to poor people, which makes MFIs' presence irrelevant here. MFIs need to improve their practices if they are to start their operations again. They should lower their interest rates, communicate policies/procedures in a transparent manner and should focus on individual lending to men because they are the primary bread winners of the family. We created motor able roads in form of SHG infrastructure and MFIs are trying to use these roads without paying tolls. If MFIs want to support SHG federations, we could work in a collaborative manner.

### ***Discussion with Regional Manager of a Bank That Provides Loans to SHGs under SHG Bank-Linkage Programme***

#### ***Shortcomings of the SHG-Bank linkage programme:***

- **Target driven:** Loans are not given according to the need of the members, but according to the disbursement targets set by the government
- **No short term products:** SHGs only meet the long term needs of the members. There is always a need for interim loans. Once a loan is given, a new loan cannot be given till the entire group repays the first loan. So the members have to wait for the entire repayment period to get a fresh loan.
- **Poor appraisals:** Bankers do not assess or appraise the loans given to SHGs in a proper manner. They just depend on the MCP (Micro Credit Plan) prepared by the SHG-Federation staff and then disburse the loan accordingly.
- **Political intervention:** Some politicians make promises to the people and then insist that bankers issue more new loans, and reschedule old ones.

#### ***Improvements required in SHG-Bank linkage programme:***

- **Collaborative appraisals:** Bankers should collaborate with SHGs for preparation of MCPs and credit appraisals. Just as bankers appraise any other loan; they should have stringent appraisal norms for granting loans to SHGs. This would ensure proper financial planning and credit discipline amongst the borrowers. More importantly this would make sure that only the right candidates get loans and the recovery rates would also be high.
- **Livelihood activities:** It is not enough to give finance to the members. It is more important to train them and help them make use of the funds in a judicious and productive manner. So banks as well as the government should train the members on livelihood activities like animal husbandry, tailoring, handicrafts and other employment generation activities.
- **Financial Literacy:** In the long run, the focus should be on educating the members of the community so that they can come out of the clutches of poverty.
- **Empowering members through rotational policy:** It has been observed that the SHG group leaders are very dominating and take undue advantage of their position (like taking the major portion of the loan, exploiting the ignorant members of the group, taking commissions for processing and granting loans etc.) To avoid this, every member of the group should be given a chance to become a group leader with no one member remaining as a leader for a long duration of time. Also, the name SHG group leader should be changed to SHG group coordinator to eliminate the vanity associated with the word “Leader”.
- **Transparent communication:** Proper communication about programmes like “Pavalavaddi”. Most of the group members are not aware of the terms and conditions for which the scheme applies. They are of the view that they get the interest subsidy as soon as they apply for the loan.
- **Short term products:** Cash credit limits should be provided to the SHGs to meet their short term credit requirements. Members have emergency loan requirements which the SHGs are not serving in the existing environment. That is one of the main reasons for members to borrow credit from alternative loan providers.
- **Field visits by bank staff:** To avoid rush in the banks and to focus on core clientele, the bank staff should go to the clients, rather than clients coming to the bank. One bank official along with a clerk can be deputed to visit villages for issuing loans, doing appraisals and collecting reimbursements.
- **Capacity building:** In order to reduce the number of documents that are processed and to reduce the monitoring, building institutions like Village Organisation (VO) and *Mandal Samakhyas* (MS) is very important. Once these institutions are strong enough to manage the resources, loans can be given directly to them and they, in turn, can on-lend to SHGs and be responsible for monitoring the utilisation and repayment of loans.

### **Shortcomings of MFIs**

- **Lack of transparency in communicating charges:** MFIs charge usurious interest rates. They also have many hidden charges like insurance, processing charges, late repayment penalty etc.
- **Coercive recovery practices:** The recovery methods adapted by MFIs are very inhuman and include:
  - o Compulsory repayment irrespective of the situation of the client.
  - o The recovery agents also have strict targets and commissions/incentives linked to on-time recovery of funds. So they insist on repayments.
  - o Use of foul language and disrespectful behaviour by the recovery agents if the repayments do not happen on time.
- **Target driven:** MFIs are purely money minded. They have targets to disburse, and they disburse it without looking at the needs and the repayment capacity of the clients.

### **Strengths of MFIs**

- **Doorstep delivery:** Most of the borrowers are women who are wage labourers, agriculture workers or house wives. They do not like going out for their credit requirements as they have to lose their day's wage if they venture out. So, they find it very convenient if the loan transactions take place at their doorstep.
- **Right product and faster processing of loans:** Members have many short term needs like education fees, health, unforeseen expenses etc., for which they require credit. MFIs offer timely and easily accessible credit which is exactly what the members want.
- **Robust Systems:** They have good systems, procedures and standards in place: MFIs have very good internal control and monitoring systems because of which the processes involved are much less and more efficient. This enables them to expand rapidly and offer quick services to the clients.

### **On AP Microfinance Act**

- Under the *Pavalavaddi* scheme, the interest rate of 3 % pa is becoming a big burden for the government. The programme was intended to subsidise the interest rates to the SHGs who repay the loans promptly. Later on this subsidy was extended to all SHG borrowers irrespective of their repayment track record. Of late, the government has begun re-imposing the rule of subsidy only to those SHGs who make their repayments promptly. This has led to increase in the repayment rates.

### **Loan Repayments in SHGs/MFIs:**

- **MFIs:** Earlier the repayment rates for MFI loans were very high. It was close to 97-98%. But after the crisis the repayment rates fell down from 50-60% in November- December 2010 to 10% presently.
- This is because the government has clearly instructed the borrowers to stop repayments to the MFIs unless they give a specific permission.
- **SHGs:** For bank linkage programme, the repayment rates were close to 75-80% one year back. Presently, the repayment rates are close to 90-95%
- One of the reasons for lower repayments was that most SHGs members were also the members of MFI-JLGs. Since MFIs had strict repayment norms, many members made the repayment to MFIs first and then chose to repay the SHG loans.
- After the MFI crisis the repayments rates have increased because the SHG-Federation staff have increased the focus on recoveries as banks insisted on better repayment rates before fresh loans were disbursed.
- As MFIs stopped lending, the other source that members have is loans from SHGs. So, they do not want to default/delay on loans taken from SHGs so that they get new loans promptly.

## RECOMMENDATIONS

### For MFIs

**Transparent Pricing:** The lack of transparency by MFIs in communicating the effective cost of loans has drawn lot of flak from regulators, media, government, and most importantly, clients. Camouflaging effective interest rates by breaking down the interest rates into multiple charges/fees and adopting opaque methods (flat rate basis) to communicate these has been a common practice in the industry. Even though the charges might be fair and clients may be more than willing to accept them (as most MFI practitioners suggest), the need for communicating charges in a transparent/standardised manner is clear. The majority of the respondents in the study understood the difference between flat rate interest rates and diminishing balance rates, thanks to the media coverage that industry has received in the last year. The regulatory norms should clearly define and prescribe the basis for calculation and transparent disclosure of effective interest rates.

The MFIs should be required to abide by transparency of pricing standards and disclose the actual cost of their services, thus helping potential clients make an informed choice. As part of the microfinance transparency initiative,<sup>24</sup> close to 86 MFIs have shared their data for calculation of effective interest rates. The same can be used as the basis for communicating interest rate to the potential clients. In addition to this, complex products like insurance schemes, are often bundled with loans and sold to clients without communicating the terms and conditions. This is an avenue that MFIs have often abused to secure higher commissions without providing much value to the end user. In most of the cases, even MFI staff is unsure of product details. Communication standards for such products should be defined by regulator and, if possible, caps should be put on insurance fees that MFIs are eligible to collect for providing such services. The study shows that effective interest rates of most MFIs go up by 5%-15% if insurance is taken into consideration. In addition to this, some MFIs also charge training fee on the name of business development or livelihood services.

**Product Development and Re-engineering Delivery Channels:** Pushing plain vanilla products is an appropriate strategy for rapid scale up.<sup>25</sup> However, in an effort to achieve exponential growth rates, the MFIs neglected the feedback of the clients. This study shows the discomfort that clients have with a mono-product offering, and its uniform group liability mechanism and weekly recoveries. MFIs should institutionalise market research, customer satisfaction monitoring and systematic product development systems, thereby offering products that are market-led.<sup>26</sup> Global experience demonstrates that a shift towards individual lending products is inevitable in the long run. This will also require refining delivery mechanisms in addition to new product development.<sup>27</sup> MFIs will need to leverage technology to optimise the value proposition for the clients and achieve competitive edge through increased client loyalty and reduced operational costs. In some places in the world, MFIs are shifting towards e/m-banking solutions to replace routine field tasks like disbursements and collections with these technology-driven solutions. In the long run, implementing such solutions will lower the operational cost for MFIs and make them more competitive and economical for their target segment.

<sup>24</sup> <http://www.mftransparency.org/data/countries/>

<sup>25</sup> See MicroSave India Focus Note 25 “[Dinosaurs and Rabbits – Indian Microfinance Market Evolution](#)”

<sup>26</sup> See MicroSave Briefing Note 17 “[Client-Focused Microfinance: A Review of Information Sources](#)” and Briefing Note 19 “[Market Orientation As The Key To Deep Outreach](#)”

<sup>27</sup> See MicroSave Briefing Note 88 “[Breaking the Barriers: Market Expansion through Individual Lending](#)”

**Differentiation, Brand Building and Customer Service:** It is high time for MFIs to start making a *name* for themselves and creating a positive market position for both microfinance services and the individual institutions providing that service. Being only recognised as “Monday MFI”, “Tuesday MFI” and so on, especially after 7-8 years of operations, is a profound indictment of the players. It shows the level of engagement that these institutions have had with their clients.<sup>28</sup> Broadening the bouquet of product and services will be crucial to achieve the much-needed differentiation and building a loyal customer base.<sup>29</sup> MFIs should not look at their clients as merely a number in progress reports, but instead as an ecosystem of individuals with dynamic needs that cannot be met by “one size fits all” kind of a credit product.

**Explore Opportunity to become Business Correspondent (BC) to Banks:** MFIs can explore opportunity to become BCs of banks/s so that they can use their existing resources (staff and knowledge) to provide a broader range of financial services to their clients.<sup>30</sup>

### For Regulators

**Robust Regulations:** The unfolding of post Ordinance events highlights how institutions can be destroyed in absence of overarching regulations. There has always been a concern about the lack a common regulator for the industry, but stakeholders have conveniently overlooked this in the light of massive growth the sector witnessed in last five years. Microfinance as a sector did not have a regulator, and different legal entities providing microfinance services had their own set of regulations. The recent Ordinance by AP state government has made the situation worse. Irrespective of the intentions, it has set a bad precedent for the industry in general. The prospect of similar regulations in other states remains a concern. Following the Malegam Committee recommendations, the RBI has issued operational instructions on bank finance to MFIs, and the classification of these loans as priority sector. The central government, too, has released a draft MF bill that seeks to provide comprehensive regulatory powers to RBI for the operations of MFIs. The Bill also gives powers to RBI to devise rules on the conduct of business between MFIs and their clients, thus raising concerns about the possible micro-management of MFIs, and the capacity (or desire) of RBI to take on functions other than regulation and supervision. There is a clear need for regulators to take a step back and create an integrated, and ideally consolidated, set of regulations to replace what appears to be a growing patchwork that invites regulatory arbitrage.

**Fair Competition:** The recent state government Act regulating MFIs in AP, has created an environment where the only institutional source of credit available to low income market segment is through SHGs. While earlier people were spoilt for choice, now they are damaged for the lack of it. As the current study suggests, many have already gone back to their traditional exploiters i.e. moneylenders. Fair competition would be an appropriate aim for the regulators drafting policies and procedures that govern the sector.

**Grievance Redressal Machinery & Credit Bureau:** Grievance redressal procedures, mandatory enrolment in credit bureaus and code of conduct enforcement through industry associations are also essential. Better information sharing within the industry through credit bureaus will go a long way in

<sup>28</sup> See *MicroSave India Focus Note 42* “[Microfinance In India: Built On Sales Targets or Loyal Clients?](#)”

<sup>29</sup> See *MicroSave India Focus Note 26* “[Market Strategy Development and 3rd Generation Microfinance in India](#)” and *India Focus Note 60* “[Speculation on the Future of Financial Services for the Poor in India](#)”

<sup>30</sup> See *MicroSave India Focus Note 75* “[Microfinance in India – Is Business Correspondent the Way Forward?](#)”

rebuilding credit discipline – though some question their role as a “magic bullet” in this context.<sup>31</sup> The draft guidelines for MFIs<sup>32</sup> seek to address most of these issues. Apart from state and national level councils as proposed in bill, regulations should also consider setting up grievance redressal bodies at district/*mandal* level for quicker redressal of client complaints.

**Reviving Credit Discipline:** Experts say that the current crisis has done irreparable damage to the credit discipline nurtured by MFIs in last 7-8 years. Some of the findings of current study also corroborate this. Every stakeholder (i.e. MFIs, government, regulator, media and even clients themselves) played their part in dismantling credit discipline.<sup>33</sup> It will now require a collective effort from all these actors to revive the much-needed discipline that is core to the success of financial services industry in general. While MFIs need to become more transparent and client friendly, regulators will have to come out with robust regulations, government will have to support MFIs to build positive image, media will have to be more responsible and supportive, and most importantly clients will have to impose self-discipline for their own good.

### For the State Government

**Improve SHGs Efficiency Levels:** Lack of competition from MFIs may be an opportunity for SHGs to register growth and ensure higher recovery levels. However, in long run the SHGs might lose the battle to the informal sources like moneylenders if the system’s weaknesses are not addressed. Excessive delay in sanctioning of loans, lack of products to meet different needs of borrowers, improper monitoring structures resulting in poor recoveries etc. are daunting challenges yet to be addressed. Besides this, the demand for 10% of loan as fixed deposit, pressure to buy insurance policies, blocking savings in lieu of loan repayments are some of the deeply unpopular practices that have been prevalent in existing SHG-bank linkage programmes. In order to meet the larger social goals that these institutions aim to achieve, it is critical that they align their systems and processes with needs and aspirations of the segment they intend to serve.

**Alternative credit sources to SHGs:** SHGs should be provided alternative sources of credit, as currently SHGs completely depend on bankers for their funding. SHGs and staff of SHG-Federations have been spending a lot of time to convince bankers to offer them loans. Many SHG members have had to take loans at higher interest rates from informal sources due to delay in approval of bank loans.

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<sup>31</sup> See *MicroSave India Focus Note 57* [The Andhra Pradesh Crisis: What Should MFIs Do?](#)

<sup>32</sup> [The Micro Finance Institutions \(Development and Regulation\) Bill, 2011](#)

<sup>33</sup> See *MicroSave India Focus Note 59* “[The Andhra Pradesh Crisis – Clients’ Perspective](#)”



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## Case study I: Management of Credit Needs in the Absence of MFI Loans

### Sujatha: From Optimum Employment to Under-employment

Sujatha and her husband belong to a small village in Krishna District of Andhra Pradesh. They depend on agriculture and wage labour for their livelihood. Sujatha's family does not own any land in the village, so they lease land from the local landlord to grow vegetables and paddy. Cultivation of land and paying advance lease amount involves a huge cash outflow and Sujatha has to take loan from external sources to meet these expenses. Earlier Sujatha used to take loan from moneylenders at a high interest rate of 3% to 5% per month as she did not have any other option. Seven years ago, SHGs promoted by the government of AP were set up in their village and Sujatha became member of a SHG group and took loans from the SHG in addition to the loans taken from moneylenders. Three years ago, MFIs also started lending in their village and Sujatha started taking loans from two MFIs (Share and Spandana). Once SHGs and MFIs proliferated in the area, Sujatha stopped taking loans from the moneylenders. She felt that interest rate of MFI loans are lower than that of moneylenders, in addition to this she can repay MFI loans (principal + interest) in a small weekly instalments through the sale of vegetables and the wages they earn. However, moneylenders do not accept part payments of principal amount and insist on lump sum payment of principal amount. During the year 2010, she took Rs.20,000 in loans from MFIs and cultivated about 3 acres. However, due to MFI crisis this year, she could not get any loan from MFIs and as a result, Sujatha and her husband decided to take only one acre of land for lease.



Venkatamma's family who belongs to the same village also reduced their cultivation from 5 acres to 2 acres this year for the same reason (non-availability of MFI loans). When asked why they cannot take loan from other sources like moneylenders, they said in the recent past the investment required for agriculture has become high. Moneylenders do not give big loans to them as they do not have their own land. At the same time they are not prepared to take big loans from moneylenders at such high interest rates because of the risk of crop failure.

Like many other families they did take loan from weekly moneylenders who give a maximum loan of Rs.2,000 (lender deducts Rs.200 upfront and gives only Rs.1,800 to borrower) but borrowers have to pay Rs.2,000 in 10 weekly instalments. Sujatha and Venkatamma have used loan to invest in agriculture and to pay school fees. Loans taken from SHGs have been used for lifecycle events like the construction of house and for marriage. However, they cannot get any fresh loan for next two years from SHGs as they do not disburse fresh loans until the completion of existing loan. With all these difficulties in accessing credit from other credit institutions, both Sujatha and Venkatamma are looking forward to a reliable credit source similar to the MFIs so that they can take more land for lease and meet their family financial requirements.

## Case study II: Management of Credit Needs in the Absence of MFI Loans

### Rehana Begum: A *Beedi* Worker Missing the Opportunity to Reduce Costs

Rehana Begum lives in Uttoor village of Adilabad district in Andhra Pradesh. Rehana rolls *beedis* at home for a living. She rolls 800 to 1,000 *beedis* in a day and earns Rs.70-80 for the work. Rehana is a member of a JLG (joint liability group) promoted by an MFI and has been taking loans from the MFI for the past five years to buy *beedi patti* (leaves to roll *beedi* – also called *tendu* leaves) and to meet education expenses for her children.

Like Rehana there are about 100 women engaged in rolling *beedis* in this village and most of them take loans from MFIs to buy *beedi patti*. Rehana purchases *beedi patti* once in a year for the entire year during harvest season as the rates are cheaper and she can save up to Rs.5 on each pack of *beedi patti*. During harvest season, each pack of *beedi patti* costs Rs.10 and in the rest of the year, the prices increase to Rs.15 per pack. Every year she takes loan from MFIs and purchases *beedi patti* for the entire year, but this year she could not make this purchase because of the lack of loans from MFIs. She now has to buy the *patti* from retail markets at higher prices, because of which she loses Rs.5 on each pack.

She finds it difficult to get loans from other credit institutions such as SHGs, moneylenders (MLs) and daily finance corporations (DFCs). SHGs loans are often inadequate and it takes a lot of time to process them. MLs charge usurious interest rates and the loans are given only to people whom MLs trust and are familiar with. DFCs are not present in their village and are present only in urban areas. Because of all these issues, not only Rehana but most of the *beedi* workers in her village, miss the opportunity to earn more.



### Case study III: Management of Credit Needs in the Absence of MFI Loans

#### Shankar: From an Entrepreneur to a Daily Labourer

Shankar is a resident of model colony in Adilabad. He has a family of five members (wife and three sons). He started a cloth business 12 years back with capital of Rs.5,000. He managed the initial capital amount from savings that he had accumulated from his work as a day labourer. He used to buy clothes from Adilabad market and sell them from his motorcycle to customers in nearby villages. On a typical day, he sold clothes worth Rs.1,500-2,000 and made a profit of 15% on the value of sales.

Shankar started borrowing from MFIs five years ago to expand his clothes business. He admits that for the occupation that he is in, it is very difficult to get loans from any other sources apart from MFIs.

Whereas he borrowed twice from BASIX (monthly loans), his wife borrowed four to five times (weekly loans) from Share and Spandana. He says that he never considers interest rates while borrowing from MFIs, because he has no other option from where he can get loans to finance his clothes business. For any loan taken from MFI, he spends 30-40% of the amount on consumption purposes and invests rest of the amount as working capital for his business.

Shankar took Rs.10,000 loan from BASIX five years ago to help to buy motor vehicle to increase daily customer visits. He took a second loan of Rs.15,000 from BASIX to buy inventory for his business. At its peak, he had stock worth Rs.35,000 in his business. However, currently his stock has been depleted to a mere Rs.2,500. Shankar says that his family expenses have also gone up and he has to periodically plough in the revenues from his business to meet these. Even the price of clothes has gone up by 70-80% over the past five years – thus requiring additional capital infusion.

Shankar laments that in the absence of MFIs, he has not been able to manage working capital for his business. He approached moneylenders (daily finance) many times but to no avail. He says that moneylender does not lend him even Rs.5,000 since he was not known to him. He says that in the absence of credit flow, he cannot sustain his business. Three months ago he completely gave up his business and started working as a daily wage labourer again. He is unable able to recover credit from his customers since he is no longer in business. He says that he can recover this amount only if he has a running business. Shankar says that doing business is something he enjoyed as he does not need to follow any instructions, and there is a greater sense of self-respect. Shankar feels that MFIs should start lending again; he is willing to pay his outstanding loan and get new loans to restart his business.



**ANNEXURES****Annexure I: FGD guide for clients**

|                    |                              |                                 |
|--------------------|------------------------------|---------------------------------|
| <b>Date -</b>      | <b>Location -</b>            | <b>No. of Participants -</b>    |
| <b>Moderator -</b> | <b>Assistant Moderator -</b> | <b>Rural/Urban/Semi Urban -</b> |

**Group Profiling**

|                                                                       |                 |
|-----------------------------------------------------------------------|-----------------|
| <b>Gender</b>                                                         | <b>Male -</b>   |
|                                                                       | <b>Female -</b> |
| <b>No. of respondents who are giving MFI loan recoveries?</b>         |                 |
| <b>Total no. of MFIs operating in that area?</b>                      |                 |
| <b>No. of MFIs for which respondents are still giving recoveries?</b> |                 |
| <b>No. of respondents who have taken loan from MFIs after crisis?</b> |                 |

**Individual Profiling**

| <b>Respondent Name</b> | <b>Education</b> | <b>Age</b> | <b>Occupation</b> | <b>For how long have you been borrowing through MFIs</b> | <b>How many MFIs were/are you associated with?</b> | <b>For what purposes had you taken loan?</b> | <b>What is the average loan that you took/take from MFI</b> |
|------------------------|------------------|------------|-------------------|----------------------------------------------------------|----------------------------------------------------|----------------------------------------------|-------------------------------------------------------------|
|                        |                  |            |                   |                                                          |                                                    |                                              |                                                             |
|                        |                  |            |                   |                                                          |                                                    |                                              |                                                             |
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|                        |                  |            |                   |                                                          |                                                    |                                              |                                                             |
|                        |                  |            |                   |                                                          |                                                    |                                              |                                                             |

**FGD Details**

| <b>Issues</b>                                                        | <b>Observations</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | <b>Scope &amp; Recommendation</b> | <b>Relevant Quotes</b> |
|----------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|------------------------|
| <i>Sources of credit and purpose that it served</i>                  | <p>a. <i>What are the different sources of credit?</i></p> <p>b. <i>What are some of the purposes that credit from such institutions serve?</i></p> <ul style="list-style-type: none"> <li><i>Give them an example of a productive and a non-productive purpose and pose a hypothetical question i.e. if I needed loan for business/agriculture which institution would best serve me?</i></li> <li><i>Was there any difference in purpose for which an MFI loan was used when compared to credit accessed from other sources?</i></li> <li><i>Check if funds mentioned in application form while accessing loan were utilised for the same purpose. Also check if Loan Utilisation Checks (LUCs) were conducted by concerned institutions</i></li> <li><i>Probe to check if people used loans to pay off other loans especially when they graduated to 3-4 loan cycle and started borrowing from multiple sources?</i></li> </ul> |                                   |                        |
|                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                   |                        |
| <i>Pros and cons of accessing credit from different institutions</i> | <p>a. <i>What is the need of accessing credit from multiple sources?</i></p> <p>b. <i>Since you have experiencing in dealing with different set of institutions what are your likes and dislikes(pain points) for these institutions/channels</i></p> <ul style="list-style-type: none"> <li><i>Probe around 8Ps for each such institution. Try to bring out both pros and cons (banks, MFIs, SHGs, moneylenders, friends/relatives)</i></li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                   |                        |
|                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                   |                        |
| <i>Awareness about</i>                                               | a. <i>We have come to know that in past few months the loan companies have stopped lending. Can you tell us reasons for the same</i>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                                   |                        |

|                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |  |  |
|--------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|--|
| crisis                                           | <p>b. If they come out with some reason, check if they buy that reason or is it a domino effect</p> <p>c. Check if they are willing/non-willing to pay if MFIs were to resume services? (probe around their concerns about paying or not paying recoveries)</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |  |  |
| Effect of lack of credit flow in absence of MFIs | <p>a. Since the credit has dried up and you haven't been able to get loans from MFIs (or fresh loans have significantly dropped) in past few months and given the fact a household essentially requires credit to manage cash-flows, in such circumstances how are you meeting your credit requirements.</p> <ul style="list-style-type: none"> <li>• Check if in last few months they have approached any other institution for loans and what were the difficulties that they faced in doing so?</li> <li>• What are some of the purposes (at present) for which you require credit. Since the credit has dried up, how are you planning to meet fulfil them? Probe if they would like to sell assets to create necessary cash flows or postpone expenditure or any other strategy.</li> </ul> |  |  |
| Changes that people would like to envisage       | <p>a. What are the changes that you would like to see in the way MFIs used to operate after this crisis?</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |  |  |

**Annexure II: Relative Preference Ranking (RPR)**

**Purpose:** Relative Preference Ranking allows us to see how clients and potential clients perceive the loan providers and components of the services they provide. It also helps challenge pre-conceived notions about poor people's attitudes towards loan service providers, what matters to them, and why they have those preferences.

**Procedure:**

1. Find people who are interested and willing to try.
2. Get participants to list all loan providers in the area (Both formal and informal loan providers) Probe to ensure that you have a complete list and try to ensure that the participants have a reasonable level of knowledge of the services they provide. Follow up with points of interest and encourage participation by different people.
3. Put this list along the top of the relative preference-ranking matrix.
4. Get the participants to list the most important elements of a loan product/service that are being ranked. Probe for further criteria/components. Follow up with points of interest and encourage participation by different people.
5. Get participants to list all the criteria/components generated in this way on the left hand side of the matrix. Remember to make negative ones positive/neutral (e.g. "high costs" becomes "cost" or "low trust with the provider" becomes "trust with the provider").
6. Ask participants to rank the loan providers for each component of the loan product feature they provide by putting bottle-tops/stones/seeds in each box.
7. Probe - ask participants questions like the following:
  - a) Why is this feature better at meeting this component/criteria?
  - b) Why is this better than that one? etc.
8. Listen and learn from the participants – particularly as they discuss the merits of each loan provider/criteria.
9. You should then finish with a table that looks something like:

**Loan Product/Services**

|                            | <b>MFI</b> | <b>Bank</b> | <b>SHG</b> | <b>Money lender</b> |
|----------------------------|------------|-------------|------------|---------------------|
| Interest rate on the loan  | 1          | 2           | 3          | 4                   |
| Duration of the loan       | 4          | 2           | 1          | 3                   |
| Repayment schedule         | 2          | 1           | 3          | 4                   |
| Friendly Staff             | 2          | 1           | 3          | 4                   |
| Security                   | 3          | 2           | 1          | 4                   |
| No penalties               | 1          | 2           | 3          | 4                   |
| Faster processing of loans | 1          | 4           | 2          | 3                   |
| Opening hours              | 2          | 1           | 3          | 4                   |

Note: The totals of these columns are of little value unless each score is given a weighted value according to the relative importance of each of the components/criteria.

**PITFALLS:**

Sometimes PRA participants do not know enough about the loan product/services in an area to complete the exercise. The moderator should be sure when recruiting clients for the group, that she has selected clients with an understanding of the various loan providers used by the community.

**Annexure III: Financial Sector Trend Analysis (FSTA)**

**Purpose:** This tool is useful in determining which financial services have been used over time and thus understanding the changes in the use/availability of a variety of financial services over time, and why participants used them. The listing of financial services here is only tentative and will require modification based on the participants' knowledge and awareness of the various products.

In this research, we will use this tool to understand the various channels that the clients use to avail loans. It will give the trend or changes in preferences in availing loans from various financial services over a period (This year, last year, 2 years ago and 5 years ago)

**Procedure:**

1. The exercise is best done in a closed area with the assistance of a small working group of 6-8 individuals from the same socio-economic stratum. While selecting the participants research team should be very care about the participant economic strata. All of them should be of almost same strata.
2. The research team should develop an initial list of loan providers (formal and informal) available and used by the respondents.
3. Work with the respondents to review, edit, and develop/expand the list of loan providers that are/were available and used in the area. This part of the exercise should be undertaken with care and as much probing as possible.
4. Once the list has been developed, turn it into a matrix by making columns for "This Year", "Last Year", "2 Years Ago" and "5 Years Ago". Respondents should then be asked to place 0-5 stones/seeds/bottle tops to indicate the use level/popularity of the different loan providers available.
5. Once step 5 has been completed, respondent should do the same for this year.
6. Once step 6 has been completed, respondent should do the same for the situation for around 2 years before.
7. Once step 7 has been completed, repeat the same for 5 years before.
8. Alternatively, some find it useful to ask clients about the use level/popularity of one of the loan provider this year, last year, 2 years ago and 5 years ago (i.e. completing the row first before moving on to the next channel).
9. Either way ensure that you CHECK by comparing both vertically and horizontally as the final step to complete the exercise.
10. Listen and learn from the respondent – how have the product and delivery aspects changed over a period of 5 years.
11. The final matrix will look something like:

| <b>Financial Service (Loan Provider)</b> | <b>This Year</b> | <b>Last Year</b> | <b>Two Years Before</b> | <b>Five Years Before</b> |
|------------------------------------------|------------------|------------------|-------------------------|--------------------------|
| <b><u>Formal:</u></b>                    |                  |                  |                         |                          |
| • Bank                                   | *                | **               | **                      | **                       |
| • NBFC                                   |                  |                  |                         |                          |
| • Gold loan companies                    |                  |                  |                         |                          |
| • MFIs                                   |                  |                  |                         |                          |
| • SHGs                                   |                  |                  |                         |                          |
| <b><u>Informal:</u></b>                  |                  |                  |                         |                          |
| • Money lenders/ Private financiers      | **               | **               |                         |                          |
| • Chit funds                             |                  |                  |                         |                          |

|                                |       |     |     |       |
|--------------------------------|-------|-----|-----|-------|
| • Pawnbrokers                  |       | *   | *** | ***** |
| • Through Friends and Relative | ***** | *** | *   |       |
| • Landlords                    |       | **  | **  | *     |