# The microfinance crisis in India: the road ahead

## Round table // Microfinance

### Moderator

**Vipin Sharma**
CEO, ACCESS Development Services

### Speakers

**Arvind Ashta**
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**Royston Braganza**
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CEO, Grameen Koota

**Alok Prasad**
CEO, MFIN

### Executive summary

The microfinance crisis erupted in India last October and microfinance institutions were accused of provoking a wave of suicides in Andhra Pradesh. However, although MFIs exert some pressure on their clients, which is necessary for the repayment of the loans, the correlation between the suicides in Andhra Pradesh and microfinance hardly stands, all the more so as the clients of Indian MFIs are mostly women.

Now is the time to research the causes of this crisis and to implement solutions to prevent further abuses. For the speakers, it is not a crisis of microfinance generally speaking, but rather a crisis of one approach. In India, the sector skyrocketed and customers were the first to be neglected. Some of the Indian microfinance features may explain how this crisis emerged:

- A sector characterized by different interest groups in conflict with each other, even though it is important to link social and commercial objectives;
- The lack of self-regulation – the government has a role to play in the implementation of best practices in microfinance –;
- The «single-product» approach – MFIs do not have the capacity to keep savings and thus depend on private investors' equity.

The decision made by the Government of Andhra Pradesh, which was perhaps too prompt, had a significant impact on liquidity (especially as MFIs in India are not allowed to collect savings from their customers). The banks stopped lending to MFIs; in addition, politicians told borrowers to stop repaying their loans and the repayment rate hence dropped from 99% to 9%.

It is necessary to review microfinance practices and implement a number of actions:

- To focus on responsible lending and on the MFIs' social mission by creating a label;
- To limit interest rates without casting away certain MFI customers or certain MFIs;
- To develop healthy competition (the government should not dominate the market but establish partnerships);
- To abandon the single-product model, be more flexible about the design of the products and the repayment rates, and accept savings.

**Vipin Sharma**: The largest MFIs were affected by the crisis in India last October. It is necessary to identify the causes and the consequences and search for the solutions and the challenges that this crisis has raised.

To discuss this, Convergences 2015 invited high-level professionals, including 3 Indian citizens:

- **Suresh Krishna** is the director of **Grameen Koota**, which is one of the 20 largest MFIs.
- **Alok Prasad** has worked on business strategy; he is today the president of **MFIN**, a new MFI network in the country.
- **Royston Braganza** has spent 12 years in commercial banking. He is now the director of **Grameen Capital**, set up by the IMF foundation and the Grameen foundation.
- **Arvind Ashta** is a professor at **ESC Dijon-Bourgogne.** He wrote a book on advanced microfinance technologies.

**Vipin Sharma**: Did MFIs play a part in crisis that they have experienced?

**Royston Braganza**: Our industry is waiting for new regulations. Two months ago, a series of rules were set out, which were a little upsetting for the sector. While new orientations have been given to the sector, the causes that are inherent to the crisis must be sought.

India has an economy which is both complex and interesting at the same time. Various interest groups are in conflict with each other, and the customers' interests are sometimes forgotten. Volumes increased significantly and some sectors felt threatened. Going too fast on these paths led many to jump off the cliff. Policies, investors' divergent interests, competition from state-funded programs, high failure rate in some areas, and ill-trained staff as well as political issues laid the ground for the crisis. All these factors led to a conflict between MFIs and the government. This crisis is more the crisis of one approach than a microfinance crisis.

The global context should be taken into account: India is not an isolated case. This dashing development cannot come without some damages. The sector emerged with different objectives. There must be a commercial and a social component: the two must coexist.

All of the necessary data on microfinance was available; but regarding social impact, it was far more complicated. Interest rates did not decrease while return on investment increased. The customer was originally at the centre of the business and yet this stance has changed. A sector that requires two legs has been left with only one.

**Vipin Sharma**: The problem is that MFIs were accused of being responsible for the suicides.

**Arvind Ashta**: Indeed it is a critical issue between fund donors and customers. If a MFI is seen as a dangerous animal, we must be able to tame it and it is the State's responsibility. For a long time, there had been no regulation, which allowed microfinance to grow significantly. Today, regulation exists, which is good, but it severely hinders the sector.

A correlation has been found between microfinance penetration and the number of male suicides; however microcredit is primarily aimed at women! While some pressure is exerted by microfinance institutions on their beneficiaries, there is no correlation between microfinance and suicides. If no pressure is exerted, no one pays back.

**Vipin Sharma**: In 2008, there was another crisis in Karnataka.

**Suresh Krishna**: There were some early-warning signs. For me it was not an actual crisis. We had to take a break and see how to deal with microfinance. As there were many new MFIs, we needed to consider first what was happening at the customer level, then at the level of investors and regulators.

Microfinance in India focuses on women. The experience in Bangladesh shows that women are better at managing money. This is why men have been left aside. Indeed, today, women may be the main source of revenue for the household. This change is hard to accept for men. Each woman receiving a microloan had to wait for all the women in the group of borrowers to pay back. This model was the driver of the MFIs' success, but it was also the root of the problem because it was replicated in a way that lacked flexibility. The women had to face enormous responsibilities. We have heard a lot about financial performance, without any concerns about customer service. Many borrowers started to lend money on their own. The MFIs did not consider this problem soon enough.

**Vipin Sharma**: The sector is in dire condition and left without fresh investment, although a few years ago everyone wanted to be part of the microfinance business.

**Royston Braganza**: We received an order from the government and suddenly all the activities in Andhra Pradesh stopped. This had an impact on liquidity. The banks stopped lending to the MFIs and were worried about the impact the crisis could have on their own sector. Since there was no liquidity, there was no more money to fund the next loan cycle. In addition, the government went to see people in villages to ask the borrowers to withhold their repayment: the reimbursement rate went down from 99% to 9%! As MFIs were not allowed to collect savings, they ended up completely cash-deprived.

**Arvind Ashta**: In Bangladesh, regulation was interpreted as giving MFIs the right to receive deposits from customers. This is not allowed in India. Debt collection practices require some pressure which is necessary for reimbursements to take place.

**Vipin Sharma**: How are practices in India going to be impacted?

**Alok Prasad**: Indeed, it is important to think about this for the future. We need to focus on responsible lending, create a label for the MFIs. The profitability will decrease, and interest rates will be limited. There must be some competition to give MFIs the choice. We must set partnerships with the government as they cannot be a dominant player on the market.

**Vipin Sharma**: We could establish a code of conduct. Are we proactive in terms of social performance? Have we started to implement the double bottom line or the triple bottom line? What should be done in terms of transparency?

**Arvind Ashta**: The relationship between men and women is changing in the family, but we need to lend to men as well. In addition, MFIs should be able to receive deposits from their customers; it would instil a balanced relationship between MFI agents and their customers. Finally, the loans must take the customer's conditions into account and set out limits. Microfinance works out in countries that have good governance, without corruption!

**Suresh Krishna**: In India, we have had a single-product approach, which is one of the major reasons for our failure. We should accept savings, be more flexible in terms of product design, more flexible with respect to our tolerance on repayment rates. In addition, although assistance groups have limitations, peer pressure is a good tool for reimbursement. In fact we have mostly dealt with numbers and things must be changed.

**Alok Prasad**: Have we drawn some lessons or do we hope that the good days will come back? I think we have understood that the customer is most important. We might have ignored the early-warning signs of this crisis. Self-regulation is inadequate; the government must be present and may commission interventions. We are all together in this situation: banks, MFIs, and regulators have to work together.

**Royston Braganza**: We have drawn lessons from over-confidence in the banks' debt. How do we bond with the capital and bond markets to diversify cash flows? How do we select investors? They should understand our mission and be able to support us. We need to set out a code of conduct to make it our industry's DNA. We need to ensure that MFIs know their customers well enough to keep clear of bad practices and offer limited interest rates, while regulators bear in mind that capping interest rates will turn some customers away. Finally, some profit should be transferred to the customers.

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