Effects of Reserve Bank of India (RBI) Regulations on Public Sector Lending for Micro Finance Institutions (MFIs)

Microfinance Researchers Alliance Program (MRAP) Study

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This study is a collaboration of six MRAP professors and two CMF researchers. The study involves researchers interviewing 32 MFIs across 7 states to understand practitioners' outlook towards the strengths and weaknesses of some of the Malegam Committee recommendations and Reserve Bank of India (RBI) regulations. The researcher also acknowledges with appreciation the help from Kenny Roger Moise in editing the report.

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BACKGROUND:

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The series of unprecedented suicides stemming from microfinance (MF) in Andhra Pradesh allowed the influx of criticism toward microfinance institutions (MFIs) from all over the world. Pointing out some MFIs' inappropriately high profits, coercive money collection practices, and over lending to the destitute, critiques question the mission drift of these MFIs of helping the poor get out of poverty. The incident resulted in the Andhra Pradesh Government passing the Andhra Pradesh Microfinance Ordinance 2010, which includes a number of measures that greatly restricts microfinance institutions' operations.[1]

The impact of the Ordinance on MFIs in Andhra Pradesh has been significant with the drastic drop in loan repayments. As of January 2011, the MFIs' collections had fallen from 99% prior to the issuance of the ordinance, to less than 20% of the loan amount due, while some of them such as Star MicroFin Society, a small NGO-MFI, faced 0% repayment rates in urban operation areas and 2% in rural areas, where it used to be 100%.[2]

Following the AP Microfinance Ordinance, the Reserve Bank of India (RBI) created a committee, the Malegam Committee, to make regulatory recommendations for the MFI sector.[3] This committee aimed to address the primary customer complaints that led to the crisis, including coercive collection practices, usurious interest rates, and selling practices that resulted in over-indebtedness. The Malegam Committee released their recommended regulations in January 2011. These recommendations were "broadly accepted" by the RBI in May 2011, though specific guidelines were only released regarding which microfinance institutions qualify for priority sector lending at this time.[4] Priority sector lending is a government initiative which requires banks to allocate a 40 percentage of net bank credit to investment in specified priority sectors at a reduced interest rate.[5] Some of the noteworthy guidelines[6] that the study focused on are as follows:

1) A loan qualifies as a qualifying asset if and only if:
   a) The loan is disbursed to a rural household with annual income not exceeding Rs 60,000 or an urban household with annual income not exceeding Rs 1,20,000. Earlier, the

[1] Andhra Pradesh Ordinance 2010
http://indiamicrofinance.com/wp-content/uploads/2010/10/Andhra-MFI-Ordinance.pdf
[2] Raja D, J. S., & Rajashekar, M. (2011, January 13). Microfinance Crisis. Retrieved on July 8, 2011, from Economic Times
[3] Reserve Bank of India. Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI sector
http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/YHMR190111.pdf
[4] Kenny Kline and Santadarshan Sadhu (2011). CMF Working Paper. Microfinance in India: A regulatory structure.
http://www.centre-for-microfinance.com/wp-content/uploads/attachments/csy/1602/IIM%20Regulation%20V11.pdf
[5] Reserve Bank of India. Priority Sector Lending. http://www.rbi.org.in/scripts/faqview.aspx?id=8
[6] Reserve Bank of India. Bank loans to Micro Finance Institutions (MFIs) – Priority Sector status.
http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/CIMAC030511.pdf

Malegam committee had recommended a common income cap for all households at Rs. 50,000.

b) The total indebtedness of the borrower does not exceed Rs 50,000 and the tenure of loan can not to be less than 24 months for loans over Rs 15,000, without prepayment penalty.

c) If the loan does not exceed Rs 35,000 for the first cycle and Rs 50,000 for subsequent cycles

2) The qualifying MFIs will also have to cut down on consumer loans as RBI conditions want at least 75% of loans be given for income generating purposes only.

3) Loans are to be issued without a collateral security and the borrower will have the choice over repayment schedule. Loan is repayable in weekly, fortnightly, or monthly installments at the choice of the borrower.

4) If the banks want the loans to be classified under priority sector, they have to ensure that the MFIs comply. The banks will have to ensure that MFIs to whom they lend do not further disburse loans at a margin of more than 12% while an overall cap of 26% has to be maintained. Which means MFIs must adhere to a margin cap of 12 percent and an interest rate cap of 26 percent to qualify for priority sector lending.

5) The banks should obtain from the MFI, at the end of each quarter, a Chartered Accountant's Certificate stating, inter-alia, that (i) 85% of total assets of the MFI are in the nature of "qualifying assets'', (ii) the aggregate amount of loan, extended for income generation activity, is not less than 75% of the total loans given by the MFIs, and (iii) pricing guidelines are followed.

Currently, an updated version of the Micro Finance Institutions (Development and Regulations) Bill 2011 is in the Ministry of Finance webpage for public comments,[7] which aims to provide a regulatory structure for microfinance institutions operating as societies, trusts, and cooperatives.[8] Despite this development in regulatory frontage, banks have still not resumed lending to microfinance institutions.

In this paper we will present the findings from the study that interviewed 32 MFIs all over India in the summer of 2011 to understand how microfinance institutions are responding to the new RBI regulations. This paper will review the responses from the MFIs and present the findings highlighting practitioners' outlook towards the strengths and weaknesses of some of the RBI guidelines mentioned above. This paper will also highlight the current funding situation among the interviewed MFIs and how these MFIs have changed their business strategies to fit into the regulations.

[7] Micro Finance Institutions (development and Regulations) Bill 2011. Ministry of Finance webpage. http://finmin.nic.in/the_ministry/dept_fin_services/micro_finance_institution_bill_2011.pdf

[8] Kenny Kline and Santadarshan Sadhu (2011). CMF Working Paper. Microfinance in India: A regulatory structure. http://www.centre-for-microfinance.com/wp-content/uploads/attachments/csy/1602/IIM%20Regulation%20V11.pdf

STUDY DESIGN:

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This study is a collaboration of seven MRAP professors and two CMF researchers. The study involves researchers interviewing MFI representatives to understand their perspectives on the effect of Malegam Committee's recommendations and recent Reserve Bank of India (RBI) guidelines for MFIs to qualify for priority sector loans. The study mainly focused on:

1) MFIs' view towards Malegam Committee recommendations and RBI regulations
2) MFIs' responses to RBI guidelines on clients choice of payment, loan usage and annual household income of clients
3) MFIs' responses to RBI's caps on interest rate and margin
4) Current funding scenario among the MFIs

For the study, we categorized MFIs into two groups Non Governmental Organisation (NGO) and Non Banking Financial Company (NBFC). NGO-MFIs include all Societies, Cooperatives, Trust and Section 25 Companies that are operating as non-profits and provide both microfinance and non-financial services. NBFC-MFIs are for-profit microfinance institutions that have access to capital markets and qualify for priority sector lending. The new regulation from RBI only applies to the NBFC-MFI category, and MFIs operating under other legal structures face minimal regulatory requirements, aside from registration, though recent drafts of the pending Micro Finance Institutions (Development and Regulations) Bill 2011 have included all microfinance institutions under the jurisdiction of the RBI.[9] In practice, the majority of NGO-MFIs are dependent on bank loans to carry out their microfinance activities, and so they are expected to fulfill the priority sector norms; hence, we have included NGO-MFIs for this study to understand how they are responding to new regulations.

Altogether, the researchers interviewed 15 NBFC-MFIs and 17 NGO-MFIs, a total of 32 MFIs in 7 states. Annexure 1 highlights the names of the MFIs in each state and legal structure of the MFIs interviewed. Annexure 2 highlights the detailed summary of findings.

[9] Kenny Kline and Santadarshan Sadhu (2011). CMF Working Paper. Microfinance in India: A regulatory structure. http://www.centre-for-microfinance.com/wp-content/uploads/attachments/csy/1602/IIM%20Regulation%20V11.pdf

DATA ANALYSIS

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View towards Malegam Recommendations and RBI Regulations:

When Malegam Committee recommendations came out in January 2011, the microfinance industry accepted it as a positive addition to the sector. CRISIL, a premier credit ratings organization, mentioned that "the Malegam Committee Recommendations, if implemented, would be a positive step towards boosting stakeholder confidence in microfinance institutions though certain recommendations would pose additional operating and compliance-related challenges."[10] Strong support came from many industry experts, including Mr. Vijay Mahajan, founder of Basix and chairman of Microfinance Institutions Network. He explained that "the Malegam committee report is a very good step forward to the whole controversy about microfinance institutions, particularly non-bank finance companies doing micro finance because that comes under RBI purview. So, the report has very clearly recognized the legitimate role of NBFCs and micro finance and has recommended new category of NBFCs for micro finance." [11]

Our study attempted to understand the opinions of MFIs regarding the Malegam recommendations and RBI regulations. Our study findings show that the reactions of the MFIs towards the recommendations have been mixed. As shown in Figure 1, 53% NBFC-MFIs and 59% NGO-MFIs thought that the Malegam Committee recommendations generally had a positive approach towards the microfinance sector whereas the rest were uncertain about the recommendations. While the practitioners seemed to be relieved by the developments taking place in the regulation of MFIs, some practitioners voiced their concerns over the interest rate and margin caps.

Some of the key concerns that the practitioners shared are:

- The Malegam committee recommendations created confusion among the bankers because of which the funding scenario dried up.
- The Malegam Committee's proposal that companies require a minimum net worth of Rs. 15 crore to register under suggested new category of Non Banking Finance Company (NBFC) would affect medium and small sized MFIs. As per data provided by Micro Credit Ratings International Ltd, only 26 MFIs have net worth of more than Rs. 15 crore and together these 26 firms have a market share of 85% of the total loan portfolio. The question now is what would happen to the remaining for-profit MFIs, which have net worth of less than Rs. 15 crore.

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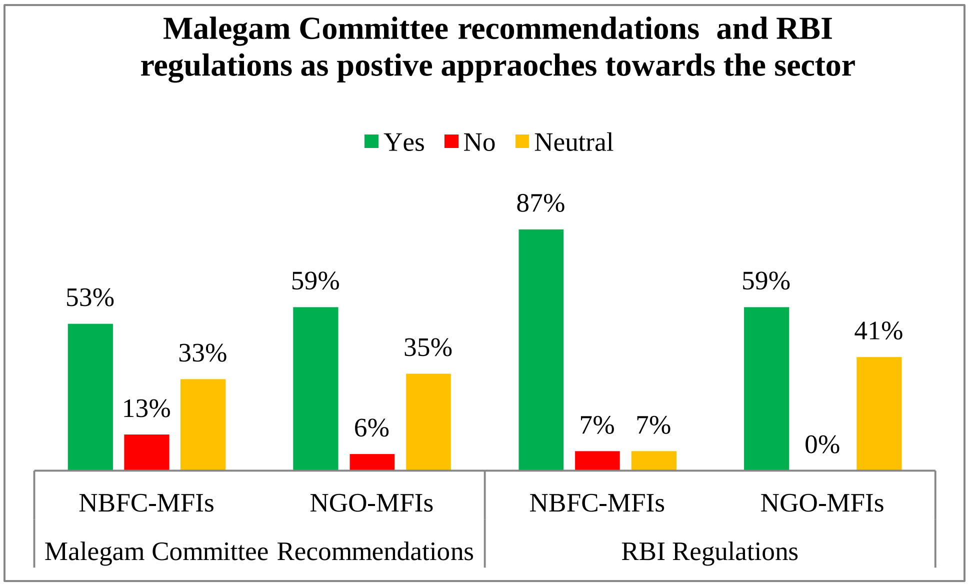
[10] The Economic Times. January 2011. Malegam Recommendations a positive step for MFIs: CRISIL. http://articles.economictimes.indiatimes.com/2011-01-20/news/28430597_1_mfi-sector-malegam-committee-positive-step

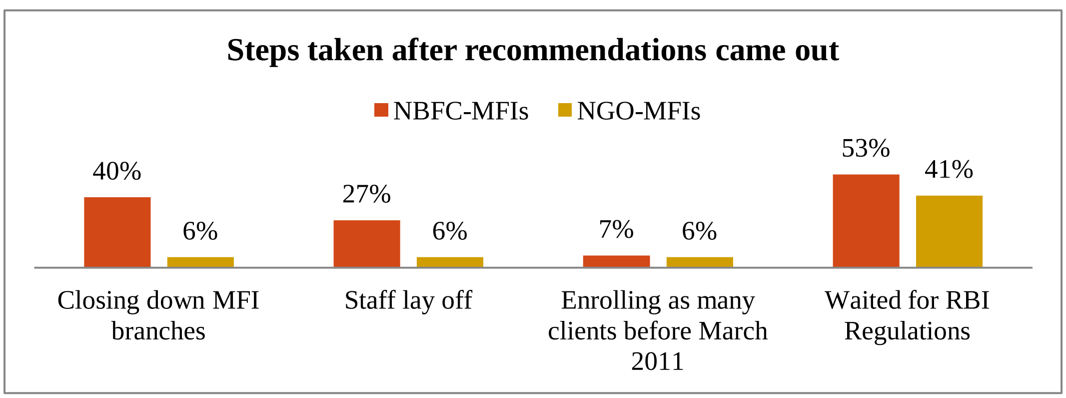
[11] Money Control. January 2011. Malegam Report: How does microfinance industry view it? http://www.moneycontrol.com/news/business/malegam-report-how-does-micro-finance-industry-view-it_514618.html

Figure 1: MFIs view towards Malegam Committee recommendations and RBI regulations



Even though the MFIs we interviewed were positively inclined towards the recommendations, some of them had to take certain steps to ensure the survival of their institutions following the AP crisis and subsequent recommendations. A large section of interviewed NBFC-MFIs (53%) and some NGO-MFIs (18%) changed their business strategies after recommendations came out to fit into the business environment. As shown in Figure 2, these MFIs closed down their branches and/or had to lay off numerous employees and/or enrolled as many clients as possible before March 2011.

Figure 2: MFIs' steps taken after Malegam Committee recommendations came out in January 2011



The Malegam Committee released their recommended regulations in January 2011. These recommendations were "broadly accepted" by the RBI in May 2011, though only specific guidelines regarding which microfinance institutions qualify for priority sector lending were released at this time. The RBI guidelines were well received by the sector. The CEO of Micro

Finance Institutions Network (MFIN), Mr. Alok Prasad mentioned "The guidelines give much needed regulatory clarity to the microfinance sector and represent a big step forward in putting the microfinance industry on the path to recovery."[12] Mr. Vijay Mahajan expressed, "Finance ministry and the RBI have done the utmost that they could do in order to support the sector. Therefore, MFIs all over the country with the exception of Andhra Pradesh can now go back to business of responsible lending in a uniform way."[13]

Overall, the 32 MFIs from our study have positive views towards the RBI regulations as well. As shown in Figure 1 above, 87% of NBFC-MFIs and 59% of NGO-MFIs thought that the RBI's approach towards the microfinance sector is a positive as this would now provide a platform for healthy growth. Some of the key factors that the practitioners shared are:

- Because of the RBI regulations, the non-NBFCs and smaller MFIs will have space to operate as they are now be supervised by banks.
- While a representative of a small sized NGO-MFI was very optimistic about the RBI regulation as she thought that the regulation would enable smaller entities to be in the same platform as NBFC-MFIs, another small sized NGO-MFI representative expressed his concern that the RBI policies should clearly mention the approach towards small and medium sized MFIs as there cannot be a uniform policy that is applicable to both large and small sized MFIs.
- Concern over the recommendation disabling MFIs especially small sized NGO-MFIs to take deposits as this would have a major impact on cash flows and liquidity.

When asked if there has been any change in business strategies to fit into RBI regulations, 67% NBFC-MFIs and 35% NGO-MFIs responded in the affirmative. Most of them mentioned that they would be more client-centric and provide products to suit their client needs. Some of the key strategies that these MFIs are planning to adopt are:

- Gradually shifting the repayment schedule, for example, from weekly to biweekly or from fortnightly to monthly.
- Withholding the plans of expanding to new areas as MFIs are aggressively focusing on client retention in the existing branches.
- Closing down branches that were not operational as the liquidity situation has not improved. A large sized Section 25 Company representative from Karnataka mentioned

Andhra Pradesh: *One NBFC-MFI that had loans outstanding worth Rs150 crores as of March 2011 had 109 branches at the end of September 2010 which has since been reduced to 50, and most of these branches were eliminated primarily from urban areas. Another NBFC-MFI that had Rs100 crores total loan outstanding at the end of March 2011 brought down its microfinance operations by 56% and is now focusing on diversifying its portfolio to other states. A small sized Society that we interviewed had to completely shut down its microfinance operation right after the crisis in October 2010 and is now pursuing cooperative banking.*

[12] India Infoline. May 2011. MFIN reaction to Monitory Policy issued by RBI. http://www.indiainfoline.com/Markets/News/MFIN-Reaction-to-Monitory-Policy-issued-by-RBI/5146484189
[13] Money Control. May 2011. RBI breathes life into microfinance, experts hail changes http://www.moneycontrol.com/news/business/rbi-breathes-life-into-microfinance-experts-hail-changes_540159.html

that they withdrew operations in some urban areas due to unhealthy competition from other institutions and not because of RBI regulations. An NBFC-MFI representative in Tamil Nadu mentioned that they closed down some branches and there was a consolidation of portfolios within NBFC/Society circles recently, however, the representative maintained that this was not due to the RBI regulations. Another small sized NBFC-MFI in Karnataka had to stop loan disbursement in two areas to overcome the “ghost membership” issue.

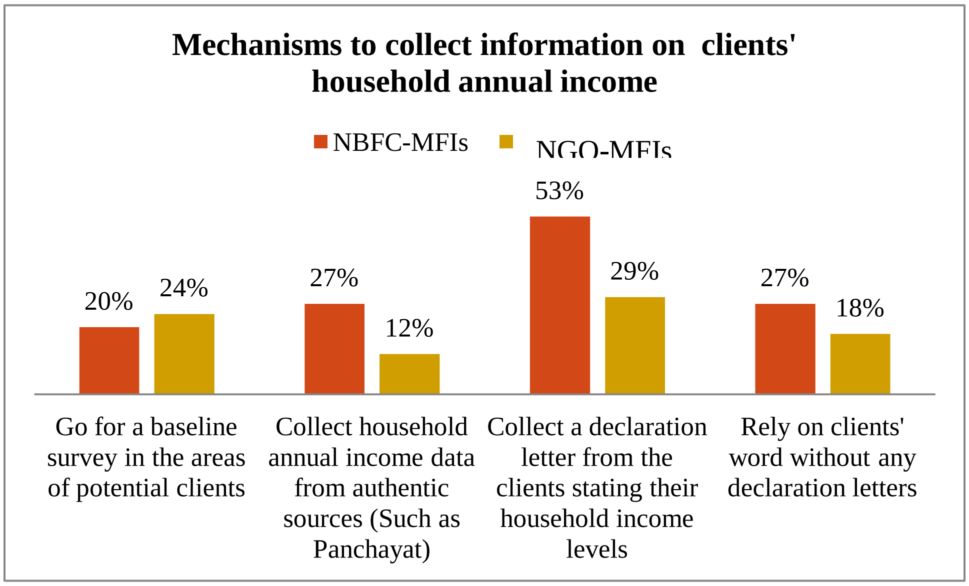
- In Orissa, a large sized NGO-MFI stated that it is now planning to transfer the entire microfinance portfolio to its NBFC unit so that its NGO unit could focus on social and development related issues.

Annual income of clients, borrowers’ indebtedness and loan usage:

Compared to Malegam Committee recommendations, RBI relaxed some of the parameters such as annual income limits for eligible households and over indebtedness. According to RBI rules, the borrower's household income should not exceed Rs 60,000 a year in rural areas and Rs 1,20,000 in urban areas. The RBI also suggested that the total indebtedness of the borrower should not exceed Rs 50,000 in at least 85% loans and the tenure of loan can not to be less than 24 months for loans over Rs 15,000, without prepayment penalty.

When we asked the MFI representatives how they are planning to ensure compliance with the above mentioned RBI limits, as shown in Figure 3, most of them mentioned that they would collect declaration letters from the clients stating their household income levels and/or collect household annual income data from authentic sources such as Panchayat data. Very few MFIs especially small NGO-MFIs mentioned that they would go for baseline survey in the areas of their potential clients to verify the income level.

Figure 3: MFIs' mechanisms to collect information on their clients' household annual income data



Most of them believed that with this kind of regulation by the RBI, the borrowers would misstate their income level and debt details, which would affect the quality of their portfolio as well. Many of the MFI representatives said the implementation of the norm that not more than two MFIs should lend to the same borrower is very difficult in the absence of a proper credit bureau. With respect to the credit bureau system, the following are some of the views of the practitioners:

- A microfinance credit bureau would be able to adequately address the problem of concealed indebtedness. However, at the same time, these MFI representatives are skeptical about the current credit bureau system. They expressed that though credit bureau acts as a temporary bridging strategy for different adopted approaches of MFIs, the microfinance credit bureau would only work if the MFIs start sharing information which is currently lacking.
- Many MFIs do not share information about their clients or make such data available in a common place.
- Some NGO-MFI representatives mentioned that their normal procedures of forming groups and sanctioning loans in open meetings help them understand the usage of loans. They also added that they know their clients well as they are nurtured right from the inception of the

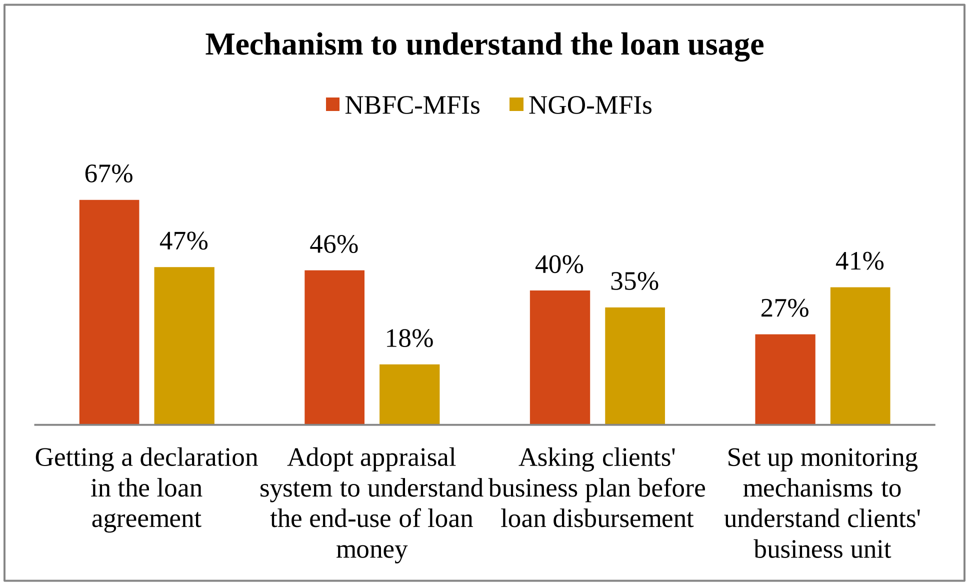
An NBFC-MFI representative in Andhra Pradesh mentioned that in the year 2007, his institution addressed the issue of multiple lending. However, his institution learned that the moment clients realized that loans were not disbursed if they had taken loans from three or more financial institutions, they started declaring that the loans from his institution was the third loan. Due to the lack of scientific methods to verify this, the institution had no option but to rely on clients' words and provide loans.

groups; this has enabled them to ensure that clients are using loans for income generating purposes and are not over borrowing.

- One of the representatives from a large sized NBFC-MFI expressed that even though his institution is using credit bureau report along with its own appraisal system to control clients' misstatements, however, whether Rs. 50,000 is a reasonable cap is debatable.

According to the RBI rule, the qualifying MFIs need to cut down on consumer loans as RBI conditions want at least 75% of loans be given purely for income generating purposes. When we asked the MFI representatives how they plan to address this, the majority of the respondents mentioned that they would get declaration letters from the clients and/or ask clients' business plan before loan disbursement and/or adopt appraisal system or monitoring mechanism to understand the loan usage as shown in Figure 4.

Figure 4: Mechanisms adopted by MFIs to understand the loan usage



There was a mixed reaction among MFI representatives when asked whether it would be an issue if clients took loans for consumption usage. The key points on consumption loans are as follows:

- Two NGO-MFI representatives from Maharashtra who are using SHG operational model acknowledged that the loans that they provide are used to repay old informal debts, yet, repayment has been steady as they ensure the repaying capacity of clients and they also use this phase to understand clients' financial discipline before the clients graduate to higher loans.
- If the institutions do not provide the consumption loan, then the borrowers would liquidate their own assets.

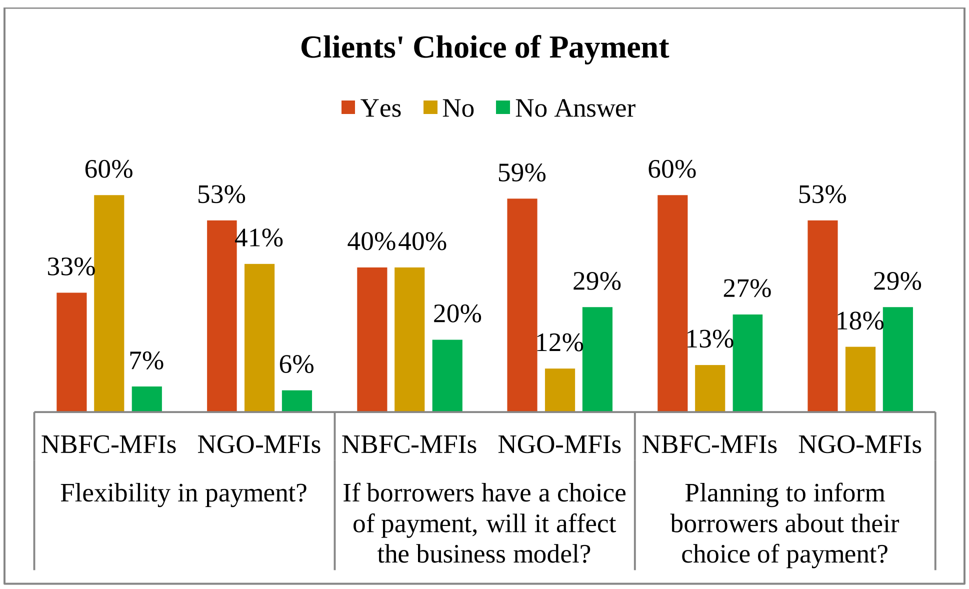
- When a micro finance loan is used for consumption smoothing, this still has an important impact on the lives of the poor; both in terms of alleviating poverty and preventing disinvestment during an income shock.

The majority of the MFI representatives believed that their loans are taken for income generating purpose only. In general, all MFI representatives agreed that income generating loans should be supplemented with the consumption loan.

Clients' choice of payment:

According to RBI rule, the repayment can be fixed as either weekly, fortnightly or monthly based on the choice of the borrowers. Regarding the repayment schedule, even though majority of the MFI representatives expressed that the borrowers should have the choice, only 33% of NBFC-MFIs and 53% of NGO-MFIs mentioned that their institutions have flexibility in payment as most of them expressed that their current repayment options have been designed to suit the cash flow of their clients. 40% NBFC-MFIs and 59% of NGO-MFIs mentioned that allowing borrowers to have a choice of payment would affect their business model. Some NGO-MFIs who are operating in SHG model reported that if their institutions opt for a weekly payment option instead of monthly, the transaction cost would increase.

Figure 5: Clients choice of payment

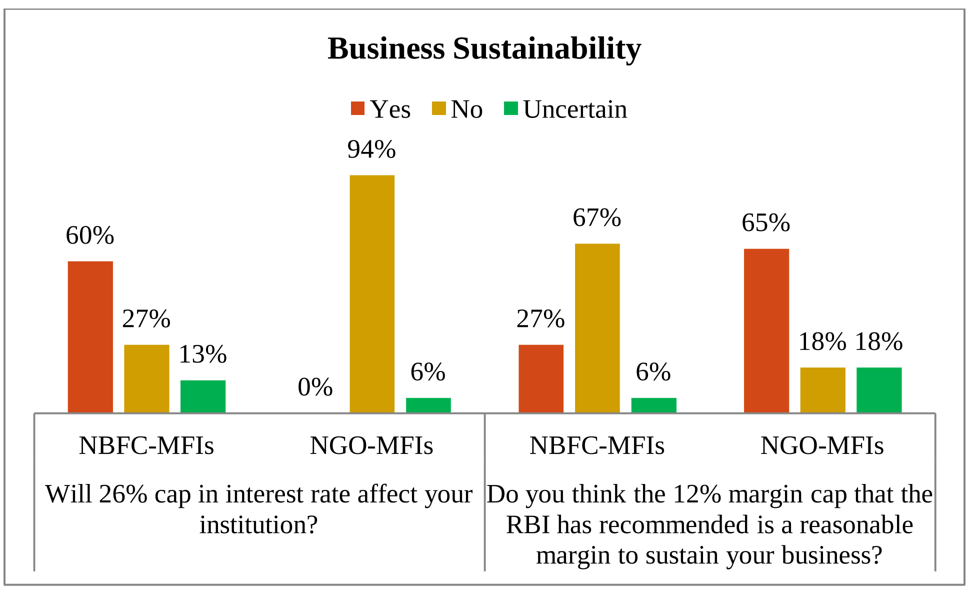


Caps on interest rate and margin:

The RBI guidelines highlighted that if the banks want the loans to be classified under priority sector, they have to ensure that the MFIs to whom they lend do not further disburse loans at a margin more than 12% while an overall cap of 26% has to be maintained. Which means MFIs must adhere to a margin cap of 12 percent and an interest rate cap of 26 percent to qualify for priority sector lending. At the same time, RBI also instructed that MFIs cannot take any security deposit or margin money from the borrowers.[14] Some MFI practitioners believed that the banking regulator's move to cap margins of microfinance institutions (MFIs) at 12% and mandate a minimum two-year repayment period for all loans above Rs. 15,000 is likely to hurt smaller firms giving out tiny loans to poor borrowers. As Chandra Shekhar Ghosh, chairman and managing director of Bandhan Financial Services Pvt Ltd. mentioned, "Smaller MFIs may not be able to survive with the margin cap of 12% and an interest rate cap of 26%. This would mean that the MFI will be forced to borrow at minimum 14% interest rate from banks even if they get cheaper loans."[15]

When asked if 26% cap in interest rate would affect their institutions, 60% NBFC-MFIs responded positively, however, none of the NGO-MFIs which are smaller in size mentioned that the 26% cap would affect their institutions as their interest rate is already less than 26%. As shown in Figure 6, it was the 12% margin that was worrying most of the MFIs we interviewed. 67% of NBFC-MFIs and 18% of NGO-NBFCs mentioned that they would not be able to sustain their business with that margin. 40% of NGO-NBFCs and 35% of NGO-NBFCs mentioned that with this interest cap under priority sector lending have affected their future business plan in terms of expansion to new areas. After RBI policy announcement, 25% MFIs increased their rate of interest (most being "not for profit" MFIs) and 16% MFIs reduced their rate of interest (all being "for profit" MFIs)

Figure 6: Business sustainability with 26% cap in interest rate and 12% margin cap



Some of the key concerns that MFI representatives raised are:

[14] Times of India. May 2011. RBI move may leash micro finance industry. http://articles.timesofindia.indiatimes.com/2011-05-06/nagpur/29515871_1_mfis-moin-qazi-priority-sector

[15] Live Mint. May 2011. Smaller MFIs may find it tough. http://www.livemint.com/2011/05/03221913/Smaller-MFIs-may-find-it-tough.html

- While the RBI recommends a margin cap and an interest cap, there is no cap on the interest rate charged to the MFIs by banks. Hence, there could be instances of bank charging 14% effective which then reduces the profit margin for the MFIs below 12%, making it difficult for them to remain sustainable.
- Cost of serving the poorest people in remote areas would have higher costs than 12% margin. Such margin would discourage MFIs to operate in remote areas.
- Fixing the interest rate and putting a cap on the margin is too stringent a restriction, which would discourage product innovation and expansion into remote areas as expansion and diversification require sunk costs which is difficult to recover with a 12% overall margin.
- One small sized NBFC from Delhi mentioned that the cost of operation is high for his institution and thus his institution has decided to diversify away from microfinance business and in the process of selling their NBFC status. Another MFI representative from Delhi whose institution brought down the interest rate from 30% to 24% within a year mentioned that his institution would now increase the volume of loans being disbursed.

Overall, the researchers observed that the general opinion of these MFI representatives is that while a cap on margin makes eminent sense, a slab system would create hardships for their institutions. They also believed that bigger MFIs with lower operational costs have an edge over the small and medium MFIs and smaller MFI s will find it difficult to survive in the sector.

Funding Scenario:

Associated Chambers of Commerce and Industry of India recently stated that the financial needs of the micro-finance institutions (MFIs) in India are estimated to reach $200 billion and hence new sources of finance are required for them.[16] However, the funding scenario for most of the MFIs has not improved after the difficulties faced by the sector post the introduction of stringent regulations by Andhra Pradesh in October 2010. The banks are still not issuing fresh loans to the sector and private equity investments in microfinance that grew rapidly through 2009-2010 have now totally dried up. [17]According to a Wall Street Journal article, "the number of deals involving microfinance companies has fallen this year although the quantum has remained almost the same. In the first half of 2010, seven investments worth $75 million were made in microfinance companies; so far this year, only four investments worth $69 million have been made, according to Venture Intelligence, a data provider." [18] Mr. Ramanathan, from

[16] Hindu Business Line. June 2011. Indian MFIs need $200 billion: ASSOCHAM.
http://www.thehindubusinessline.com/industry-and-economy/economy/article2109712.ece

[17] Times of India. June 2011. Social funds prop up cash-starved MFIs.
http://articles.timesofindia.indiatimes.com/2011-06-21/india-business/29682828_1_microfinance-institutions-sks-microfinance-ujjivan

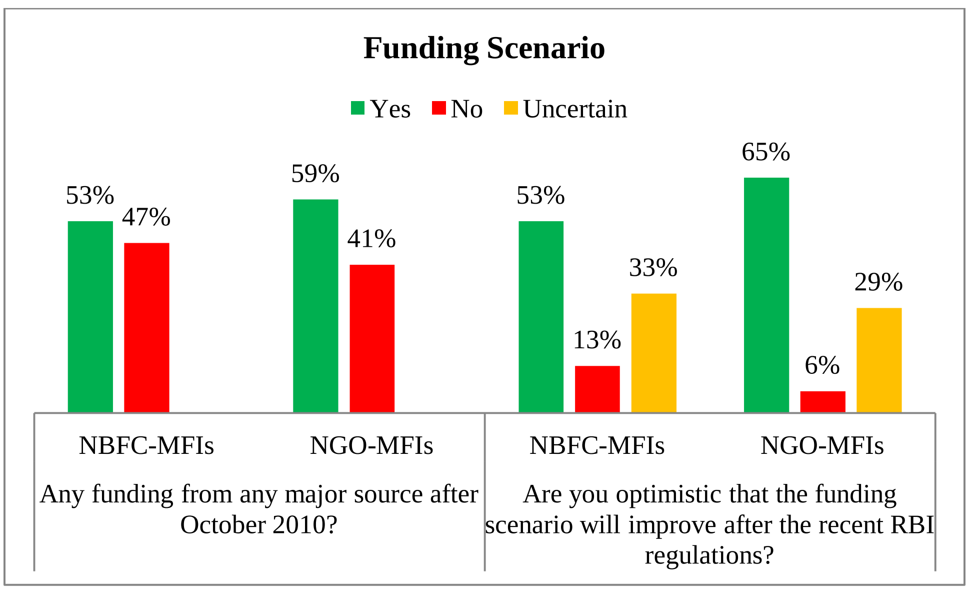
[18] The Wall Street Journal. June 2011. Microfinance firm gets fresh round of funding.
http://online.wsj.com/article/SB10001424052702304657804576402373420489998.html

Janalakshmi Financial Services Pvt. Ltd that managed to raise 650 million rupees from private equity, acknowledged, "The fund-raising was not easy. It was a very difficult process. There are two main concerns that I would say investors have: Is there a clear ecosystem to operate in? What is a company's business model?" [19]

At the same time, some MFIs found support from social and philanthropic funds. Chandra Shekhar Ghosh, CEO of microfinance lender Bandhan, mentioned that his institution received a $35 million funding commitment from World Bank's arm IFC. Other MFIs including Ujjivan, Svasti Microfinance, Rashtriya Grameen Vikas Nidhi, ESAF Microfinance and Saija Finance have also raised funds from social funds over the last few months. "The reason we are seeing greater support from social funds is that they are not entirely profit oriented. However you still have to convince them that you have a solid and unique business model," said Arun Kumar, founder of Svasti Microfinance, which raised Rs 4.5 crore from Blue Orchard.[20]

As shown in Figure 7, 53% of NBFC-MFIs and 59% NGO-MFIs raised funds after October 2010; however, some of the loans were sanctioned before October 2010 and disbursed later. These MFI representatives are optimistic that the funding scenario will improve after the recent RBI guidelines to the banks for priority sector lending.

Figure 7: Funding Scenario after October 2010



One small sized NGO-MFI from Andhra Pradesh that received 9 crores from NABARD mentioned that the loan was sanctioned before the crisis and disbursed after October 2010. Another NBFC-MFI representative from Andhra Pradesh mentioned that even though banks had sanctioned

[19] ibid
[20] Times of India. June 2011. Social funds prop up cash starved MFIs. http://articles.timesofindia.indiatimes.com/2011-06-21/india-business/29682828_1_microfinance-institutions-sks-microfinance-ujjivan

loans before October 2010, his institution did not receive the disbursement after the AP ordinance came out. Some expressed that fund flow would slow down as bankers would be more cautious about lending to MFIs which would affect small sized MFIs. One large sized NGO-MFI mentioned that it sold out a part of its micro finance portfolio to ICICI and manages it for a fee from the bank. The proceeds of the portfolio sold out to ICICI were transferred to its General Account. Its micro finance project received a loan from the same general account.

Our study also tried to understand MFIs opinion on how venture capitalist would act after the recent development in sector. Some venture capitalists are openly saying that they are still looking for other opportunities to invest in this sector and they see a huge opportunity in the sector as these investors believe that NBFCs will do well in India.[21] Yet, our study shows that MFI representatives are not too optimistic about getting funds from private equity firms as 60% of NBFC-MFI and 35% of NGO-MFI representatives mentioned that they think Venture Capitalist will decrease their investment now.

Almost all MFI representatives expressed that the microfinance sector could survive if the banks start lending money so that they could disburse fresh loans. One key question that was raised by almost all MFI representatives was to ask why they were still not getting money from the banks even though they had already acted in accordance with all the RBI regulations. Some small sized MFI representatives blamed banks for this crisis as the MFIs could have survived had the banks lent money enabling them to disburse fresh loans. At the time of these interviews in June 2011, some MFIs, especially those operating in Andhra Pradesh, Orissa and Tamil Nadu had stopped fresh disbursements as repayments have stalled.

[21] Live Mint. July 2011. Private equity firms see value in NBFCs. http://www.livemint.com/2011/07/13235328/Private-equity-firms-see-value.html?h=A1

SUMMARY OF DISCUSSION:

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Defining Client:

The concept of equating 'maximum annual household income bar' to define microfinance client is a well intentioned step, however, it still raises a big question on the described bar of Rs. 60, 000 for the rural and Rs. 120,000 for urban households. –Some of these questions include: what would be the accessible sources of finance for the households that are just at the par and a little above the suggested annual income bar, how would a household manage its financial needs if its income is highly irregular and thus making it difficult to interpret its annual household income, should the household income be the only prerequisite to decide the credit worthiness of a microfinance client and should other critical aspects be ignored?– These questions remain unanswered. In addition, a situation where a prospective client has to state the household income could also discourage them from revealing their true income, or even to reduce their household income for fear of losing access to finance from MFIs.

Monitoring the Indebtedness of Microfinance Client:

To regulate indebtedness of clients, RBI has recommended that the maximum loan exposure to an individual client should not exceed more than Rs 50,000. The concept of the upper cap on the exposure to a single client and relaxing the tenure of loan of Rs. 15000 and above are much appreciative steps. However, the maximum amount of Rs. 50,000 is debatable and may not always accommodate clients' financial needs if they want to diversify credit for different livelihood activities. In addition, a standard benchmark for both urban and rural clients is still questionable.

Regulating Interest Rate and Margins:

Regulating the price of microfinance loan products may not help the clients in the long run even though there is a need of fairness and transparency in loan transactions for client protection. If the RBI chooses to set cap on interest rates and margins, this might dramatically reduce the investment capital flowing to the sector, especially the equity capital as they require maintaining minimum capital adequacy going forward while still making substantial profits. Bigger MFIs with lower operational costs have an edge over the small and medium MFIs and smaller MFIs will find it difficult to survive in the sector. Further, with the margin of 12% and upper cap of 26%, bankers might charge as high as 14% on loans to MFIs, which would make it very difficult for medium and small sized MFIs to sustain their business..

STORIES FROM THE FIELD:

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This section include the stories from each state that provide valuable insights into how MFIs from different states are viewing and responding to the new RBI regulations

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State: Andhra Pradesh

Researcher: Deepti Kc, Centre for Micro Finance (CMF) Researcher

Number of MFIs interviewed: 4

Legal structure: 2 NBFCs, 1 Society and 1 Cooperative.

View towards regulation: The representatives from all four MFIs reported that overall their institutions believed that the Malegam Committee's recommendations and RBI regulations are positive additions to the microfinance sector. However, all these MFIs had to take certain steps to ensure the survival of their institutions following the AP crisis and subsequent recommendations.

Change in business strategies: One NBFC that had loans outstanding worth Rs150 crores as of March 2011 and had 109 branches as of the end of September 2010 has since reduced its number of branches to 84. At the time this interview took place in June 2011, this institution was planning to bring down the branches to around 50. Most of the branches were primarily eliminated from urban areas, particularly in Hyderabad. This particular NBFC was also looking at individual lending options in order to sustain its business. The other NBFC that has Rs. 100 crores total loan outstanding at the end of March 2011 and has been operating in 28-29 districts of Andhra Pradesh, Maharashtra, Orissa and Tamil Nadu brought down its microfinance operation by 56%. This particular NBFC started focusing on diversifying its portfolio to other states right after the AP ordinance came out. The representative of this institution mentioned that he was waiting for the microfinance bill as it might have some impact, till then there would be no regulation risk as they changed their business strategies right after AP ordinance. The representative of the cooperative MFI (loan outstanding of Rs. 21 crores as of March 2011) mentioned that his institution was planning to open new branches in 2010; however, right after the AP crisis, this plan was discarded. He mentioned that his institution's portfolio decreased by 30% after the crisis. The small sized society that we interviewed had to completely shut down its microfinance operation right after the crisis in October 2010 and has currently switched to cooperative banking.

Annual income of client: In response to the new RBI rule on annual income of clients, these MFIs mentioned that 80-100% of their clients incomes are within the limit. However, they mentioned that they rely on declaration letters from clients stating their annual household income. All of them believed that imposing this kind of regulation would encourage the borrowers to misstate their income levels, which would adversely affect the quality of their portfolio as well.

Borrowers' indebtedness: In response to the new RBI rule on borrowers' indebtedness, all four MFIs that were interviewed stated that it would be likely that borrowers could easily misstate details regarding their debt. When asked how their institutions were planning to address this issue, one NBFC representative expressed that when he started his institution in the year 2007, the issue of multiple lending was addressed. However, his institution learned that the moment clients realized that loans were not disbursed if they had taken loans from three or more financial institutions, they started declaring that the loans from his institution was only the third loan. Due to a lack of scientific methods with which to verify this, the institution had no option but to rely on clients' words and provide loans. Both the representatives from two NBFCs we interviewed expressed faith that a microfinance credit bureau would be able to adequately address the problem of concealed indebtedness. One NBFC representative suggested that a successful introduction of a credit bureau could only work if a unique identification number system is introduced. He acknowledged that many of his competitors (other MFIs) in Andhra Pradesh do not share information about their clients or make such data available in a common place. While the Malegam Report has recommended that a common credit bureau be created, this NBFC representative reported that many MFIs in Andhra Pradesh are still reluctant to join. The other NBFC representative acknowledged that multiple lending is the major problem in AP. He also suggested that SHG data also be part of this bureau.

Business sustainability: Furthermore, the representatives from these NBFCs also expressed concern over several of the RBI regulatory changes. All MFI representatives reported that the 26% interest rate cap would not affect their institutions, although, they also mentioned that their clients had rarely reported problems with the interest rate in the past. However, they stated that the 12% margin cap proposed by RBI is unreasonable, and should be removed from the recommendations.

Funding scenario: None of the MFIs that were interviewed received funding from major sources after October 2010. One small sized NGO-MFI mentioned that acquired 9 crores from NABARD; however, that loan was sanctioned before the crisis and was disbursed after October 2010. The story, however, was different for the NBFCs. The NBFC representative mentioned that even though banks had sanctioned loans before October 2010, his institution did not receive the disbursement after the AP ordinance came out. Almost all MFI representatives expressed that the microfinance sector in AP could have survived if the banks had lent money so that they could disburse fresh loans. At the time of these interviews in June 2011, all MFIs had stopped disbursing new loans and were focusing solely on collecting payments.

State: Delhi

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Researcher: Dr. Indrani Roy Chowdhury, MRAP Professor

Number of MFIs interviewed: 4

Legal structure: NBFCs

View towards regulations: The representatives from all four NBFCs had mixed feelings towards the Malegam Committee's recommendations, and only two representatives thought that the RBI regulations are positive additions to the microfinance sector.

Change in business strategies: Two NBFC-MFIs had to close down some of their branches to ensure the survival of their institutions following the Malegam Committee recommendations. Two MFI representatives shared that their institutions are gradually shifting the repayment mode (one from weekly to biweekly and the other from fortnightly to monthly) in order to fit into RBI regulations. The other MFI representative shared that the expansion into new areas have been withheld as of now, and his institution is aggressively focusing on client retention in the existing branches only.

Annual income of clients: Most of the MFIs mentioned that 80-100% of their clients' income comes within the limit. Two MFI representatives mentioned that they rely on declaration letters from clients stating their annual household income. One large sized MFI mentioned that they collect household annual income data from authentic sources whereas the smallest MFI that has 750 clients mentioned that they prefer going for baseline survey in their clients' areas to understand their socioeconomic status.

Borrowers' indebtedness: All four MFI representatives stated that it would be likely that borrowers could easily misstate details regarding their debt. When asked how their institutions were planning to address this issue, almost all NBFC representatives voiced the need for a proper credit bureau system.

Business sustainability: The representatives from these NBFCs also expressed concern over the 26% cap in interest rate. One small sized NBFC who expressed that the cost of operation is high for his institution said that his institution has decided to diversify away from microfinance business and in the process of selling their NBFC status. Another MFI representative whose institution brought down the interest rate from 30% to 24% within a year mentioned that his institution would now increase the volumes of loans being disbursed. All MFI representatives stated that the 12% margin cap proposed by RBI is unreasonable. They believed that fixing the interest rate and putting a cap on the margin is too stringent a restriction, which would discourage product innovation and expansion into remote areas as expansion and diversification require sunk costs which with 12% overall margin is difficult to recover. One MFI representative shared his concern over increase in funding costs citing that within two months, the interest rate has increased from 12% to 14%. He believed that the regulation failed to touch the supply side problem as banks are too irregular in disbursing loans. Only one MFI got funding from any major source after October 2010.

All MFI representatives voiced that the situation is very uncertain and difficult for small and medium sized NBFC-MFIs. The situation is demanding too much of standardization which is difficult for small MFIs to achieve given their financial capability, knowledge base, experience and manpower strengths. They believed that the key to survival would be to maintain a balance between the motive of making profits and social objectives. At the same time, they also believed that NGOs, Society, Trusts should be under the same code of conduct as this would improve accountability and transparency in the sector as a whole.

State: Karnataka Back to Index

Researcher: Dr. Veerashekarappa, MRAP Professor

Number of MFIs: 4

Legal structure: 2 NBFCs, 1 Society and 1 Section 25 Company.

View towards regulations: The MFI representatives had mixed views towards the Malegam Committee recommendations, RBI regulations and intended microfinance bill. Three out of four MFI representatives welcomed the RBI regulations as they thought this would now legalize microfinance sector and provide a platform for healthy growth. The representative of the large sized NBFC believed that because of the RBI regulations, the smaller NGO-MFIs will have space to operate as they are now be supervised by banks. Both the NBFCs interviewed by the researcher mentioned that there would be change in business strategies in the near future to fit into RBI regulations by being more client-centric and provide products to suit their client needs.

Change in business strategies: One NBFC that has a large scale operation is not intending to change any operation to fit into the regulations whereas the smaller NBFC representative mentioned that in order to fit into these recommendations, his institution had to change the business strategies by closing down branches that were not operational as the liquidity situation has not improved. This resulted in huge staff layoffs. He mentioned that they have now started lending less than Rs. 15,000 after May 2011 and after consulting with weak borrowing clients, they have introduced a weekly repayment option. To overcome the “ghost membership” issue, this particular NBFC had to stop loan disbursement in Hubli and Devangere areas. Similarly, a large sized Section 25 Company representative mentioned that they withdrew operations in some urban areas due to unhealthy competition from other institutions, and not because of RBI regulations.

Clients choice of payment: Regarding the repayment schedule, majority of them expressed that the borrowers should have the choice and their current repayment options have been designed to suit the cash flows of their clients.

Purpose of the loans: Three MFIs mentioned that they rely on clients’ declaration on loan agreement and ask for clients’ business plan before loan disbursement. Only two NBFCs mentioned that they have monitoring mechanisms to verify clients’ business unit performance periodically. When asked if it would be an issue if clients took loans for consumption, only one NBFC representative mentioned that if his institution does not provide the consumption loan, then the borrowers would liquidate their borrowers’ assets. The rest of the MFI representatives believed that their loans are taken for income generating purposes only. In general, all MFI representatives agreed that income generating loans should be supplemented with the consumption loan.

Annual income of clients: Three MFIs mentioned that borrowers' misstatement of their annual household income would affect their institutions' portfolio quality though the same three institutions were relying on clients' words regarding their annual household income. Only 1 MFI collects household income data from other sources such as Panchayat data.

Borrowers' indebtedness: When asked how their institutions address the issue of borrowers' indebtedness, one NBFC representative mentioned that his company surveys the area before commencing the operation and eligible members are selected from the survey for loan disbursement. The other NBFC was relying on clients' self declaration hoping that an effective credit bureau would be established which would address this issue.

Business sustainability: When asked if 26% cap in interest rate would affect their institutions, 2 MFIs said it would not, and one MFI said it would. Both the NBFCs mentioned that the 12% margin cap that RBI has recommended is not a reasonable margin to sustain their business. One NBFC representative mentioned that the cost of serving the poorest people in remote areas would have higher costs than 12% margin. Such a margin would discourage MFIs to operate in remote areas. However, an MFI operating under Section 25 Company Act expressed that its cost of operation is only 3.8% which is the lowest in the industry; hence, this margin in cap would not affect their business model.

Funding scenario: 3 MFIs got funding after October 2010, though one NBFC representative expressed that fund flow would slow down as bankers would be more cautious about lending to MFIs which would affect small sized MFIs. The MFI representatives suggested that smaller MFIs under any legal structure should now cut down their cost of operation, opt for improved technology, diversify the products, and reach out to those areas where credit gap is huge.

State: Maharashtra

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MRAP Researcher: Dr. Amita Dharmadhikary-Yadwabkar, MRAP Professor

Number of MFIs interviewed: 4

Legal Structure: 2 Societies and 2 Cooperatives and all of them are operating in SHG model.

View towards regulations: All representatives mentioned that they see both Malegam Committee recommendations and RBI regulations as a positive approach towards the microfinance sector.

Change in business strategies: Only one MFI changed its business strategy after the recommendations by modifying credit policy, revising loan size downwards, and applying stricter monitoring of repayment and undertaking awareness drives to sensitize staff and clients about Andhra Pradesh crisis and RBI regulations. In addition, the areas which experience stemming from local politicians have been removed from the MFIs scope of operation.

Clients' choice of payment: All MFI representatives mentioned that providing flexibility to clients might affect their business model. All of them are offering monthly repayment option and they expressed that if their institutions opt for a weekly payment option, the transaction cost would increase.

Purpose of the loans: To understand the true purpose of the loans, these MFIs have devised a mechanism wherein they solicit information during the application process. When asked about consumption loans, two MFI representatives clearly acknowledged that the loans that they provide are used to repay old informal debts, yet, repayment has been steady. One MFI representative mentioned that whilst providing consumption loans, her institution ensures the repaying capacity of the client and they also use this phase to understand clients' financial discipline before the clients graduate to higher loans. One MFI representative mentioned that they generally direct clients to meet consumption loans through SHG savings.

Annual income of clients: Out of two MFI representatives one mentioned that they are planning to go for a baseline survey in the areas of potential clients to understand socio-economic status of potential clients' households where as the other MFI had already done such a baseline survey. The third MFI representative mentioned that they would only collect a declaration letter from the clients stating their annual household income. The fourth MFI representative mentioned that the clients reveal their income status in the open meeting during the application process in front of everyone and peer pressure acts as a check on this declaration.

Borrowers indebtedness: All MFI representatives mentioned that their normal procedure of forming SHGs and sanctioning loans happen in open and during such meetings, they ask their clients about their annual household income, how they plan to use money and if they have taken loans from other institutions. They expressed that as there is no other scientific way to verify clients' loans from other sources; they are relying on clients' words. They also added that they know their clients well as they are nurtured right from the inception of the groups; this has enabled them to ensure that clients are not over borrowing and using loans for income generating purposes. When asked if the proper credit bureau system can address this, the MFI representatives had mixed feelings about it. Even though all 4 representatives acknowledged that a proper credit bureau would help them in effective selection of clients, they were skeptical about the implementation of such a system as clients are getting loans from informal resources as well. They believed that information on borrowers' indebtedness could be rather obtained through personal interaction with the clients.

Business sustainability: All MFI representatives mentioned that 26% in interest rate would not affect their institutions. In general, all MFI representatives felt that 12 % margin is reasonable, although one MFI felt that if the banks lend at a lower rate than the usual interest rate, this 12% margin is also a non-issue. One of the MFI representatives mentioned that the RBI should provide capacity building grants to small and medium sized MFIs so that such MFIs can learn how to make their business more client-centric and lower their transaction costs. He shared that his institution is struggling to break even as they cannot increase the interest rates and at the same time facing competition from bigger institutions who are offering better deals. One MFI representative suggested that as SHG model involves higher transaction costs of lending, all small MFIs working with SHG should collectively lobby with the banks to provide funds at lower interest rate for lending.

State: Orissa

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Researcher: Dr. Debashis Acharya, MRAP Professor

Number of MFIs: 5

Legal structure: 1 Society, 2 Cooperatives, 1 under Section 25 Company Act and 1 NBFC

View towards regulations: All but one of the five MFIs interviewed had a positive attitude towards both Malegam recommendations and RBI regulations. One MFI representative expressed that the Malegam committee recommendations created confusion among the bankers because of which the funding scenario had dried up.

The representative of the large sized MFI mentioned that the Malegam Committee's proposal that companies would require a minimum net worth of Rs. 15 crore to register under a new category of Non Banking Finance Company (NBFC) would affect medium and small sized MFIs. He expressed his concern by stating that only 26 MFIs have net worth of more than Rs. 15 crore as per data provided by Micro Credit Ratings International Ltd. Together these 26 firms have a market share of 85% of the total loan portfolio. The question now is what would happen to the rest of the for-profit MFIs, which have net worth of less than Rs. 15 crore. He also added that this is not necessarily good for borrowers as it reduces competition.

One small sized MFI representative expressed his concern that the RBI policies should clearly mention the approach towards small and medium sized MFIs i.e. Section 25 companies, societies and trusts as there cannot be a uniform policy that is applicable to both large and small sized MFIs.

Change in business strategies: The largest NGO-MFI that is operating in all 30 districts of Orissa stated that it is now planning to transfer the entire microfinance portfolio to its NBFC unit so that its NGO unit could focus on social and development related issues. Only 1 MFI enrolled as many clients as possible before March 2011. Another MFI representative mentioned that his institution would now aggressively focus on clients' protection strategies by making clients disclose their family annual household income and total debt and would expand livelihood finance to 75%. The researcher learnt from his interaction with several practitioners that many small MFIs of different forms such as Darbar Sahitya Sanand, BANDHU, KAS foundation (members of Sadhan) have either closed down or are planning to close down in the near future. The portfolios of these MFIs are between 2-7 crores.

Clients' choice of payment: Two MFI representatives mentioned that they do not encourage clients to have different choices of repayment. They practice the monthly repayment model, and clients are encouraged to follow that. One MFI representative mentioned that offering flexibility based on loan products is part of their new strategy and would be officially declared in the near future.

Purpose of loans and borrowers' indebtedness: In response to loans for income generating purpose and over indebtedness issues, 3 MFI representatives mentioned that they rely on clients' words by getting declaration in loan agreement forms and they also set up monitoring mechanisms to understand clients' business unit performance on a periodical basis. All five MFIs believed in their system of tracking individual performance and the performance of group loan. When asked if they favor consumption loans, two MFI representatives mentioned that when a micro finance loan is used for consumption smoothing, this still has an important impact on the lives of the poor; both in terms of alleviating poverty and preventing disinvestment during an income shock. When asked about the role of a credit bureau to address the issues of over indebtedness, the MFI representatives expressed that though credit bureau acts as a temporary bridging strategy for different approaches adopted by MFIs, the microfinance credit bureau would only work if the MFIs start sharing information which is currently lacking.

Business sustainability: Regarding the 26% interest cap, all MFIs except one mentioned that this cap would not affect their business model. Two MFIs mentioned that 12% margin is not reasonable. The researcher gathered that the general opinion of these MFI representatives is that while a cap on margin makes eminent sense, a slab system would create hardships for their institutions.

Funding scenario: Regarding the funding scenario after October 2010, none of the MFIs received any fresh funding except some that received funds sanctioned before. One large sized MFI mentioned that it sold out a part of its micro finance portfolio to ICICI and manages it for a fee from the bank. The proceeds of portfolio sold out to ICICI were transferred to its General Account. Its micro finance project received a loan from the same general account. The other small and medium sized MFIs mentioned that they have stopped fresh disbursement as repayments have stalled. One MFI representative mentioned his institution is getting repayment from 3 districts where his institution is the only MFI operating. However, the same MFI has been facing difficulties with respect to repayment in 5 districts where 2-3 other MFIs are also operating.

One key question that was raised by most of the MFI representatives was to ask why they were still not receiving money from the banks when they had already acted in accordance with all RBI regulations. Some small sized MFI representatives expressed that the crisis is led by banks as the MFIs could have survived had the banks lent money enabling them to disburse fresh loans. As they are not able to disburse any fresh loans and new MFIs have started sanctioning fresh loans to their clients, clients have lost confidence in them and have decided not to repay the old debts.

State: Tamil Nadu

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Researchers: Dr. Lakshmi Kumar, MRAP Professor and Amulya Krishna Champatiray, CMF Researcher

Number of MFIs: 4

Legal structure: 3 NBFCs and 1 Society

View towards regulations: The representatives from 3 MFIs reported that overall their institutions believe that the RBI regulation is a positive addition.

Change in business strategies: Only 1 NBFC representative mentioned that they had closed down some branches and that there was a consolidation of portfolios within NBFC/Society circles recently, however, the representative maintained that this was not due to the RBI regulations. The other NBFC tried to enroll as many clients as possible before March 2011. This particular NBFC also mentioned that they have brought down their interest rate from 28% to 26% in order to comply with the RBI regulation.

Purpose of the loans: In response to loans for income generating purpose, one MFI representative expressed his concern regarding the RBI's rule of 75% of loans going for income generating purpose. The representative of this particular NBFC mentioned that only 60% of their loans are utilized for income generating purpose, and the rest are utilized either for consumption purpose or repaying old debts. He also expressed that only 5% of their loans go for education and health purposes. When asked how they are planning to ensure that the clients are using their loans for income generating purpose, almost all MFI representatives mentioned that they would get a declaration in the loan agreement forms stating that the clients are using loans for income generating purposes.

Annual income of clients: In response to the new RBI rule, these MFIs mentioned that 80-100% of their clients income fall below these limits. One MFI representative mentioned that they generally collect data of household annual income from authentic sources and the other MFI representative mentioned that they collect declaration letters from their clients stating their annual household income. They were confident that as groups are promoted and trained by them, they would have no issue selecting clients as they know their clients well.

Borrowers' indebtedness: In response to borrowers' indebtedness, almost all of them mentioned that they rely on clients words during open meetings and they do not have any fool-proof mechanisms to ensure that the clients have not taken loans worth more than Rs. 50,000. Only 1 MFI representative mentioned that his institution is using the credit bureau report along with its own appraisal system to control clients' misstatements. He favored that the concept of having upper cap on exposure is good; however, whether the Rs. 50,000 cap is reasonable is debatable. When asked if the credit bureau could help them address this issue, 3 MFI representatives were skeptical about the current credit bureau system, while 1 MFI representative believed that credit bureau is the right platform to use and every MFI should participate in it.

Business sustainability: When asked if 26% interest rate cap would hurt their institutions, all except one large sized MFI mentioned that it would not affect their institutions; however, all 4 MFIs expressed concern over the 12% margin cap proposed by the RBI.

Funding scenario: Funding scenario for all these MFIs has become worse after October 2010. One of the MFI representatives expressed that as his institution was not getting any funds from the banks, his institution is now focusing on getting back the repayment from the clients and depositing that money in the banks instead of providing fresh loans to the clients because of the increased risk in lending.

State: West Bengal Back to Index

Researchers: Dr. Indrani Roy Chowdhury, MRAP Professor, Dr. Susmita Mukhopadhyay, MRAP Professor and Saswat Barpanda, Research Assistant

Number of MFIs: 7

Legal Structure: 3 NBFCs, 3 Societies and 1 under Section 25 Company Act

View towards regulations: Out of 7 MFIs, 3 MFIs had a positive outlook towards the Malegam Committee's recommendations, whereas 5 MFIs welcomed the RBI regulations. Only one NBFC-MFI representative mentioned that the revision of the interest rate for different products was done right after recommendations came out. The same representative also mentioned that the operation policy was also revised so as to align with RBI guidelines for the microfinance sector. The Section 25 Company representative expressed his concern over the recommendation disabling MFIs to take deposits. He mentioned that without any sufficient prior notice this cannot be stopped immediately as it would have major impact on cash flows and liquidity. The representative of a small sized Society was very optimistic about the RBI regulation as she thought that the regulation would enable smaller entities such as NGOs, Societies etc to be on the same platform as NBFCs, which would eventually increase their responsibilities and challenge them to work in a better manner. The representative of a Section 25 Company expressed that the RBI has failed to direct banks to provide loans to MFIs immediately, which is the need of the hour.

Change in business strategies: All three representatives from the NGO-MFIs mentioned that their institutions would now be more client-centric and would focus on existing clients only. One Society representative shared that his institution would reduce growth in operational expansion and loan disbursement with no recruitment of new clients. The Section 25 Company representative mentioned that his institution is looking forward to becoming an NBFC to reach more people, and thus, they would now focus on getting equity funds. All 3 NBFCs interviewed by the researchers expressed that they have made gradual changes in their repayment model, for example, from weekly to bi-weekly basis and so on.

Clients' choice of payment: In response to clients' choice of payment, only 2 MFIs mentioned that their institutions have flexibility in payment and 5 MFIs mentioned that if the borrowers were offered a choice of payment, it would affect their business model. When asked how their institutions ensure that clients have taken loans for income generating purpose, almost all MFI representatives mentioned that they get declaration in the loan agreement. Almost all representatives mentioned that they are frequently monitoring their clients' utilization of loans and they are confident that their clients are using their loans for income generating purpose. When asked about consumption loans, all MFI representatives voiced that their institutions do not encourage consumption loans, though two representatives acknowledged that clients taking consumption loans is not an issue.

Annual income of clients and borrowers indebtedness: In response to annual household income of clients, two MFIs collect households' annual income data from authentic sources whereas the rest collect declaration letters from clients stating annual household income. When asked how their institutions ensure that the clients' indebtedness was not more than Rs. 50,000, the MFI representatives mentioned that they rely on their field officers who know clients well. Some NBFC representatives advocated for a credit bureau system to address this issue.

Business sustainability: When asked if 26% cap in interest rate would affect their institutions, all 4 NGO-MFIs said it would not whereas all 3 NBFC-MFIs said it would. All except one NGO-MFI were satisfied with 12% margin. They believe that for non-profit organizations, this is a reasonable margin. Two NBFC representatives were not happy with this margin. One NBFC representative expressed that while the RBI recommends a margin cap and an interest cap, there is no cap on the interest rate charged to the MFIs by banks. Hence, there could be instances of bank charging 14% effective which then reduces the profit margin for the MFIs below 12%, making it difficult for them to remain sustainable. The other NBFC representative also had a similar opinion. He said that the fund cost was 10-11% in the past, which has increased up to 14-15% in the recent months; however, RBI has failed to provide any guidelines to the banks to charge lower interest rate for the priority sector lending. Another representative of a large sized NBFC-MFI who had a neutral view towards this 12% margin cap expressed that MFIs are partly responsible for this and there was so much greed and lack of transparency and credibility in the sector. Overall, all believed that the RBI guideline on fixing of the margin caps, interest rate reflects a clear signal that the institution should have the capacity to charge 26 % and run their business. They also believed that bigger MFIs with lower operational costs have an edge over the small and medium MFIs and smaller MFI s will find it difficult to survive in the sector.

Funding scenario: Regarding the funding scenario, all except 1 NGO-MFI got funding after October 2010, though all representatives expressed that fund flow has slowed down.

APPENDIX:

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Table 1: Names of Microfinance Institutions

State	Researchers	Names of MFIs
Andhra Pradesh	Deepti Kc, Niranjana Narayanan	Trident Microfinance SICI Hope Integrated ABC
Delhi	Dr. Indrani Roy Chowdhury	*Mimoza* Enterprises Finance Satin Credit Care Network Shikhar Microfinance We The People
Karnataka	Dr. Veerashekarappa	Grameena Financial Services Vikasana Sangha Mithra Rural Financial Services Navachetana Microfin Services
Maharashtra	Dr. Amita Dharmadhikary-Yadwabkar	Grameena Mahila Swayamsiddha Sangh Samsruddhi Sampada Trust Development Initiative for Self Help and Awakening
Orissa	Dr. Debashis Acharya	Bharat Integrated Social Welfare Agency (BISWA) Khandgiri Madhyam Samba Sangh Swayamshree Micro Credit Services Mahila Vikas Prathmika Sanchaya Samabaya Adhikar Microfinance
Tamil Nadu	Dr. Lakshmi Kumar and Amulya Champatiray	BWDA GM Smile Equitas World Vision India
West Bengal	Dr. Indrani Roy Chowdhury, Dr. Susmita Mukhopadhyay and Saswat Barpanda	Bandhan Financial Services Arohan Financial Services Village Financial Services Kajla Jana Kalyan Samity Society for Model Gram Bikash Kendra Kalighat Society for Development Foundation Sarala Women Welfare Society

Table 2: Legal structure of the MFIs

Legal status	NBFCs	Society	Cooperative	Trust	Section 25	TOTAL
No. of MFIs	15	7	3	1	6	32

Table 3: Summary of findings

		NBFCs	NGO-MFIs[22]
Total Number MFIs interviewed		15	17
MFI's views towards Malegam Committee's recommendations and RBI regulations			
Do you see the Malegam committee recommendations as a positive approach towards the micro finance sector?	Yes	53% (8)	59% (10)
	No	13% (2)	6% (1)
	Neutral	33% (5)	35% (6)
Did your institution change the business strategy to fit into those recommendations?	Yes	53% (8)	18% (3)
	No	40% (6)	71% (12)
	No Answer	7 % (1)	12% (2)
Have any of the following steps been taken after the Malegam Committee recommendations came out?			
Closing down MFI branches		40% (6)	6% (1)
Staff lay off		27% (4)	6% (1)
Enrolling as many clients before March 2011		7% (1)	6% (1)
Waited for RBI Regulations		53% (8)	41% (7)
What kind of approach do you think the RBI has towards the micro finance sector?	Yes	87% (13)	59% (10)
	No	7% (1)	0% (0)
	Neutral	7% (1)	41% (7)
Will there be any change in business strategy in the near future to fit into RBI regulations?	Yes	67% (10)	35% (6)
	No	26% (4)	47% (8)
	No Answer	7% (1)	18% (3)
Clients' choice of payment: RBI has stated that borrower should have choice of repayment.			
Does your institution have any flexibility in payment?	Yes	33% (5)	53% (9)
	No	60% (9)	41% (7)
	No Answer	7% (1)	6% (1)
If your institution allows borrowers to have a choice of repayment, will it affect your current business model?	Yes	40% (6)	59% (10)
	No	40% (6)	12% (2)

[22] NGO-MFIs include Society, Trust, Section 25 and Cooperatives

	No Answer	20% (3)	29% (5)
Are you planning to inform borrowers about their choice of payment?	Yes	60% (9)	53% (9)
	No	13% (2)	18% (3)
	No Answer	27% (4)	29% (5)
Loans for income generating purpose: 75% should go for income generating purpose			
How are you planning to address this?			
Getting a declaration in the loan agreement		67% (10)	47% (8)
Adopt appraisal system to understand the end-use of loan money		46% (7)	18% (3)
Asking clients' business plan before loan disbursement		40% (6)	35% (6)
Set up monitoring mechanisms to understand clients' business unit		27% (4)	41% (7)
Annual income of clients: Not exceeding Rs. 60,000 in rural and Rs. 1,20,000 in urban areas			
Go for a baseline survey in the areas of potential clients		20% (3)	24% (4)
Collect household annual income data from authentic sources (Such as Panchayat)		27% (4)	12% (2)
Collect a declaration letter from the clients stating their household income levels		53% (8)	29% (5)
Rely on clients' word without any declaration letters		27% (4)	18% (3)
Borrowers indebtedness: Not exceeding Rs. 50,000			
Do you think that the borrower can easily misstate their debt details?	Yes	47% (7)	53% (9)
	No	47% (7)	24% (4)
	No Answer	7% (1)	24% (4)
Funding scenario			
Any funding from any major source after October 2010? (Data includes loans sanctioned before October 2010 and disbursed later)	Yes	53% (8)	59% (10)
	No	47% (7)	35% (6)
	No Answer		6% (1)
Are you optimistic that the funding scenario will improve after the recent RBI regulations?	Yes	53% (8)	65% (11)
	No	13% (2)	6% (1)
	Uncertain	33% (5)	29% (5)
In your opinion, how do you think the Venture Capitalist will act	Increase	13% (2)	0% (0)

after the recent development in the sector?	Normal	20% (3)	24% (4)
	Decrease	60% (9)	35% (6)
Business sustainability			
Will 26% cap in interest rate affect your institution?	Yes	60% (9)	0% (0)
	No	27% (4)	94% (16)
	Uncertain	13% (2)	6% (1)
Do you think the 12% margin cap that the RBI has recommended is a reasonable margin to sustain your business?	Yes	27% (4)	65% (11)
	No	67% (10)	18% (3)
Will the new interest cap under priority sector lending affect your future business plan in terms of expansion into new areas?	Yes	40% (6)	35% (6)

Table 4: Summary of data obtained from 15 NBFCs in 6 states

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
State		**AP**	**AP**	**KA**	**KA**	**DL**	**DL**	**DL**	**DL**	**OR**	**WB**	**WB**	**WB**	**TN**	**TN**	**TN**
Area of operation																
State wise		4	3	4	1	6	2	7	3	3	18	3	2	1	5	3
District wise		29		46	5	35	3	63	13	17	174	23	18	20		12
Total loan outstanding at the end of March 2011		100 crores	150 crores	250 crores	11.01 crores	50 crores	10 lakhs	230 crores	8.57 crores	35 crores	2502 crores	89.8 crores	112 crores	170 crores		102.64 crores
Client outreach		1.45 lakhs	2.54 lakhs	4 lakhs	22,022	90,000	750	2.4 lakhs	13,007	75,000	32.55 lakhs	2.15 lakhs	2.22 lakhs	4 lakhs		4.63 lakhs
Interest rate in	2009-2010?	24%		24%	15% flat		28%	31.5%	30%	23.5%	23.56%	24.13%	12.5% flat rate	28%	27%	18%
	2010-2011?	26%	12.5% flat 22% diminishing	26%	13% flat		28%	After May 11, 25.83% Before May, 27.5%	24%	22%	22.90%	24.13%	19.1% reducing balance	26%	26%	21% reducing balance
Will 26% cap in interest rate affect your institution?		No	No	No	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No
Will your business sustain with 12% margin cap?		No	No	No	No	Yes	No	No	No	Yes	Yes	No	No	No	No	No
Any funding after October 2010?		No	No	Yes	Yes	No	No	Yes	No	No	Yes	Yes	Yes	Yes	No	Yes
What kind of approach	Malegam Committee	+ve	+ve	+ve	+ve	-ve	-ve	+ve	+ve	+ve	+ve	+ve	Neutral	+ve	+ve	+ve
	RBI regulations	+ve	+ve	+ve	+ve	Not clear	Neutral	+ve	+ve	+ve	+ve	+ve	+ve	+ve	+ve	+ve
Did your institution take any of the following steps after Malegam Committee recommendations and/or RBI regulations came out?																
1.Closing down MFI branches		Yes	Yes	Yes	No	No	Yes	Yes	No	No	No	Yes	No	No	No	No
2.Staff lay off		Yes	Yes	Yes	No	No	Yes	Yes	No	No	No	No	No	No	No	No
Any withdrawal from existing		Operation came	109 branche	Closed down a	Disbursement		Closed the	Closed 6 branche	No	Yes	Withheld expansio	No	Expansion plans	No	X	No withdraw

areas?	down by 56% in AP	s till Sept 2010, now 84, reducing to 50	few non-operational branches	stopped in Hubli & Devangeri due to "ghost membership" issues		operation in 2 out of 3 districts.	s in Rajasthan and 3 branches in UP			n plan. No withdrawal.		withheld, no recruitment of new clients and staff.			al. 2 branches merged
How will your business strategy change in the near future to fit into RBI regulations?	Diversifying to other states as business has gone down in AP	Get into individual lending.	Becoming client-centric	Focused on customer needs	yes		Gradually shifting from weekly to biweekly repayment mode. Watching the market.	Focusing on client retention, no expansion immediately. Focusing on existing branches only.	Yes	No change in business strategy	Gradual shift towards mthly repayment model, venture out other revenue streams and fee based income generating activities	Repayment schedule from wkly to fortnightly basis.	Yes	No change in business strategy	Work on 2 key constraints: 1. 75% IGA loans 2. Annual HH income level of clients (60k rural and 120k urban.)
Clients choice of payment															
Does the institution have any flexibility in payment?	Yes	No	Yes	No	no	Yes	Yes	No	No	Yes	Yes	No	No	Yes	No
If the clients have a choice of payment, will it affect your business model?	Yes	Yes	Yes	No	no	No	No	Yes	Yes	Not applicable	No	Yes	Yes	No	No
Are you planning to inform clients about their choice?	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Not applicable	Yes		No	Yes	Yes
According to RBI rule, 75% of loans be given for income generating purposes only. How does your institution address this?															
1.Getting declaration in loan	X	Yes	Yes	Yes	X	Yes	Yes	X	Yes	Yes	Yes	Yes	Yes	Yes	Yes

agreement															
2.Asking clients' business plan before loan disbursement	Yes	X	Yes	X	Yes	Yes	X	Yes	Yes	Yes	X	X	X	X	X
3.Adopt appraisal system to understand the end-use of loan money	X	X	Yes	Yes	Yes	Yes	X	Yes	Yes	X	X	X	Yes	Yes	X
Annual Income of clients not exceeding Rs 60,000 in rural and Rs. 1,20,000 in urban households. How does your institution address this?															
1.Baseline survey in the areas of potential clients.	x	X	Yes	Yes	X	Yes	X	X	X	X	X	X	X	X	X
2.Collect HH income data from other authentic sources	X	X	Yes	X	x	X	Yes	X	Yes	X	X	Yes	X	X	Yes
3.Collect declaration letters from clients	Yes	Yes	Yes	Yes	Yes	X	X	Yes	X	Yes	Yes	X	Yes	X	X
What fraction of your existing clients has income below the limit?	85%	100%	80%	100%		85%	97%	80%	100%	90%	90%	85%	100%	80%	55% under 50K, 30% under 50-75K
When clients misstate their income to become eligible for a loan, will that affect your portfolio quality?	No	X	Yes	X	No	No	Difficult to say	X	Yes	No	No	No	X	Yes	X

Table: Summary of data obtained from 17 NGO-MFIs in 7 states

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
State	**AP**	**AP**	**KA**	**KA**	**WB**	**WB**	**WB**	**WB**	**OR**	**OR**	**OR**	**OR**	**TN**	**MH**	**MH**	**MH**	**MH**
Area of operation																	
State wise	1	1	1	3	1	1	1	2	8	1	1	1		1	1	1	1
District wise	1	3	1	13	5	2	13	26	54	24	11 panc	5		7		8	
Total loan outstanding at the end of March 2011	20000000	210000000	1540998	795400000	109331000	21244413	470000000	29700000	3069957365		1815832	6700000	60000000	99992878	5662118	57379377	1068125
Client outreach	4800	23000			23823	10875	108707	15000	1094029		336	12000	40grps	36073	338grps	124727	76 grps
Interest rate in 2009-2010?		19.2	12.5% flat	16%	12.5% flat	16.4%pa	28%	24%	19%	21%	24%	24%		21%	18%	12.5% flat	18%
Interest rate in 2010-2011?	12% Flat	19.2	12.5% flat	18%	14% flat	16.4%pa	23.6%	18%	24%	26%	24%	24%		21%	18%	12.5% flat	18%
Will 26% cap in interest rate affect your institution?	No	No		No	No	No	No	No	No	No	No	No	No	No	No	No	No
Will your business sustain with 12% margin cap?	Yes	Yes, only small MFIs with investment < 10 crores will suffer		Yes, Our cost of operation is 3.8% which is the lowest in the industry	Yes, we are non profit org. Our main motto should be social welfare. If we increase our margin for profit making activities, our motto will be lost.	No	Yes, if bank provide the funds – if not repayment will fall and sustainability will be a question.	Yes, from social point of view, this is reasonable margin. People are lamenting because they are shattered by the loss of prospects of earning high profit margin, which they used to	Yes, While a cap on margin makes eminent sense, a slab system will create hardships for the BISWA MFI crossing the Rs 100 crore threshold.	No	Not Clear	No	12% ,margin depends on cost of operation and if the cost of capital is dynamic.	Because our current cost of operation is 7%. It is a member based org. The growth of our org is not funded through this margin - for this donor funds are used.	Yes	Yes	Yes

								enjoy in the past.									
Any funding after October 2010?	No	Yes, NABARD 9 Crores	No	Yes, SBI and Indian bank	Yes, Maanaveeya Holdings Rs.25000000, Ananya Finance for inclusive	No	Yes, Manaveeya holding 10 cr, world bank- 20 cr, ananya finance- 20 cr	Yes, 2 Crores Bengali Grameen Vikas, 37.95 lakhs Rastriya Mahila kosh	Yes, BISWA General Account	Yes	No	Yes, Ashiva		No	Yes, Ananya	Yes, NABARD	No
Any withdrawal from existing areas?	Completely shut down MF operations and switched to cooperative banking.. as business lost everything.	No but planning to open new branches in 2010 but after the discarded the plan. Our portfolio has decreased by 30%.		Operations have been withdrawn in the past year from urban areas t o avoid unhealthy competition .		We have withdrawn from 2 areas due to political issues ,violence and competition was too high.		We are withdrawing from the Sundarban area because of high operational costs.								The areas which were politically motivated and sensitive were dropped. .	
How will your business strategy change in the near future to fit into RBI regulations?	Completely shut down MF operations and switched to cooperative banking. .			Since we provide credit linkages to SHGs we don't need any changes in our approach. Our rate of interest is much below the RBI stipulated interest rates.	Design new loan product according to RBI rules, Decrease growth in operational expansioa nd loan disbursement and close new member admission.	Provide service to client regarding their repayment schedule and reschedule the loan	Change to NBFC to reach more people. Plan for equity funds.	Intensify focus on existing client base. Provision of thrift collection, working on repayment schedule. Removed 10% security deposits, reduced interest	continue its expansion by consolidation of operations in existing branches , transfer micro finance portfolio to its MFI unit in phased manner	The avoidance of multiple borrowings , disclosure of family annual income, total				Will be focused on increasing loans for income generating purposes			

								rates with introduction of 1 month moratorium period.	and complete transfer of mf portfolio by end of 2015.	borrowings							