CASE STUDY

RETHINKING RESERVE BANK OF INDIA (RBI) REGULATIONS FOR MFIS

AN ANALYSIS OF MICROFINANCE CLIENTS FROM URBAN AND SEMI-URBAN COMMUNITIES

Report by: Deepti Kc, Centre for Micro Finance

MRAP Professors Dr. Amita Dharmadhikary-Yadwabkar, Dr. Lakshmi Kumar, Dr. Mani Nandhi, Dr. Susmita Mukhopadhyay, Dr. Veerashekarappa

Other Researchers Saswat Barpanda (PhD student-IIT Kharagpur), Ashok Rao (CMF intern), Bharti Thakur (CMF intern)

This study would not have been possible without our dedicated surveyors, Regional Field Managers Sriganesh Pathy, Projjal Saha and Pramod Tiwari and West Bengal Research Associate Sitaram Mukherjee. We would like to thank Ajaykumar Tannirkulam and Amulya Champatiray for their guidance and feedback.

ABOUT THE CENTRE FOR MICRO FINANCE

The Centre for Micro Finance (CMF) is a non-profit, non-partisan research centre housed within the Institute for Financial Management and Research in Chennai. The mission of the Centre for Micro Finance is to improve the accessibility and quality of financial services for the poor through rigorous research, knowledge dissemination and evidence-based policy outreach.

ABOUT MICROFINANCE RESEARCHERS ALLIANCE PROGRAM (MRAP)

It is a research capacity development programme for Indian professors who are conducting or are interested in conducting research in Microfinance. Funded by the Ford Foundation, CMF ran this programme from February 2009 to May 2012.

ABOUT THE STUDY

CMF coordinated this study in collaboration with five MRAP professors. The primary focus of this study was to investigate the borrowing practices of existing microfinance clients, inclusion within a formal banking system, and spending patterns in relation to microloans. Furthermore, this paper attempts to understand whether the Reserve Bank of India (RBI) guidelines regarding the eligibility of microfinance institutions for priority sector lending align with the profiles of microfinance clients.

928 urban and semi-urban MFI clients were interviewed in the states of Karnataka, Maharashtra, Tamil Nadu, Uttar Pradesh, and West Bengal between January and March 2012. Although the sample was initially randomly selected, due to unforeseeable events such as absent clients and lack of time, a convenience sampling method was used. Therefore, we would like to point out the existence of the limitation of this study primarily a self-selection bias and thus the selection of the sample of this study is not the representative of the whole population of microfinance clients. Therefore, readers should be cautious not to infer causality from the data conveyed in this report. However, we believe that as the scope of this paper is to understand the nature of current MFI clients and not to establish causal relationships, the data should provide some useful insights for researchers, policymakers and practitioners.

KEY RESEARCH FINDINGS

- Entrepreneurial activity was not the major source of income for the majority of the households of interviewed clients
- Clients with pre-existing entrepreneurial activity had a high propensity to invest MFI loans in their enterprise.
- Although a majority of MFI clients had access to a formal banking system, it was not a primary source of credit.
- Clients preferred to avoid expensive credit from moneylenders.
- Clients perceived aggressive loan recovery methods to be inappropriate.
- Borrowing from multiple MFIs was not prevalent at the time of survey.

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BACKGROUND

A draft document of the Microfinance Institutions (Development and Regulation) Bill 2011 has been cleared by the Union Cabinet[1] and introduced to the Lok Sabha.[2] If approved, microfinance institutions (MFIs) would by regulation be required to register with the Reserve Bank of India (RBI). This would greatly expand the capacity of the RBI to control the flow of money in this industry, with the ability to cap interest rates, ensure fair practices, and set prudential norms.[3] In addition to the greater authority yielded to the Reserve Bank of India, a Microfinance Development Council, which consists of state councils and district committees, would be formed. These councils strive to advise the Central Government on policymaking. Indeed, the Central Government would replace the individual State governments as the primary actors in MFI regulation.[4]

The Reserve Bank of India (RBI) has already released specific guidelines regarding the eligibility of microfinance institutions for priority sector lending. Some RBI recommendations[5] related to clients include a maximum client annual household income of Rs. 1,20,000 for urban areas and Rs. 60,000 for rural areas. Furthermore, it is recommended that the total indebtedness of the borrower does not exceed Rs 50,000 and that the loan does not exceed Rs 35,000 for the first cycle and Rs 50,000 for subsequent cycles. MFIs will further be required to ensure that they cut down on consumer loans as at least 75% of loans be given for income generating purposes only. To protect clients from over-borrowing, the RBI recommends that not more than two MFIs lend to each client.

A typical client of microfinance is a low-income, self-employed, entrepreneur who does not have access to formal financial institutions.[6] In order to understand if the profiles of the current microfinance clients support the description of a typical client and accordingly, if the abovementioned RBI guidelines align with the current microfinance clients' profiles, we interviewed 928 urban and semi-urban microfinance clients from five states. Through our study we tried to explore different aspects of microfinance clients, including:

- The poverty level of microfinance clients.
- The extent to which clients currently borrowed from more than one MFI.
- The extent to which all MFI loans are directed towards entrepreneurial ventures.
- The access to formal banking systems among target clients.
- The means by which clients save money.
- The perception amongst clients towards loan-collection practices.

In this paper, we are presenting the findings on the above features of microfinance clients and to some extent; we have attempted to understand if the abovementioned RBI guidelines align with clients' profiles.

STUDY DESIGN

Using convenience sampling method, 928 existing MFI clients from urban and semi-urban areas of five states were interviewed (Karnataka, Maharashtra, Tamil Nadu, West Bengal and Uttar Pradesh). Detailed information about the study areas and sample size can be found in Table 1.

In order to understand multiple borrowing, we asked whether they had any current loan outstanding from banks, self-help groups, microfinance institutions, and any other informal sources. The distribution of spending for each loan was then investigated. In order to understand the poverty level of the clients, the Progress out of Poverty Index (PPI) was used. The PPI scores were calculated using the India Poverty Scorecard designed by Mark Schreiner.[7] The Poverty Scorecard is a proxy indicator that estimates the likelihood of a given household being under a given poverty line (in this case, India's National Poverty Line). Apart from PPI data, data was also collected on the nature of employment, income, and savings to understand the degree of impoverishment of the clients. Data on routine and non-routine expenditure was also collected to understand the minimum financial requirements of clients. Lastly, hypothetical questions on loan recovery practices were asked to understand whether clients consider these practices appropriate and to determine whether clients had faced such coercive practices before.

Table 1: Distribution of sample and demographic information of study areas

	Karnataka	Maharashtra	Tamil Nadu	West Bengal	Uttar Pradesh
Sample Size	202	115	205	205	201
Areas covered	Bangalore Urban slums, Tumkur	Satara	South Chennai	Howrah, North 24 Parganas	Loni and Gaziabad
[*]MFI penetration [8]	Urban Bangalore: 7.4% Tumkur: 18.3% (with 3 big MFIs excluded)	Satara: 1.2% (with 4 big MFIs excluded)	Chennai: 24.4% (with 3 big MFIs excluded)	Howrah: 12.1% North 24 Parganas: 6.9% (with 4 big MFIs excluded)	Ghaziabad : 7.5% (with 4 big MFIs excluded)

[*] Developed by the Centre for Micro Finance at IFMR Research, map of microfinance is an interactive tool that provides information relating to microfinance and SHG penetration at the state and district level. For this table, we considered the penetration of MFI as reported in the year 2010 and the number of households was selected for base variable for penetration. www.centre-for-microfinance.org/mfimaps/maps.htm

KEY RESEARCH FINDINGS

Overview of clients' engagement with entrepreneurial activities

Entrepreneurial activity was not the major source of income for the majority of the households of interviewed clients

In a popular culture, microfinance clients are considered to be entrepreneurs with small businesses who lack access to formal banking and related services. In a draft document of the Microfinance Bill 2011, microfinance lending is defined as "providing credit and other financial services to the poor households and their micro enterprises as an extended arm of the banking system."[9]

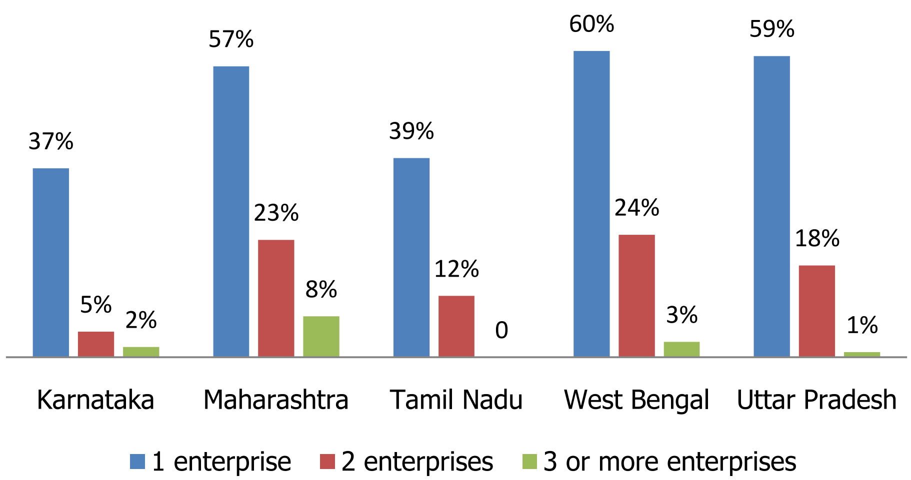
To this end, we asked our respondents about their employment status to understand whether these clients are engaged in some sort of micro-enterprises. In our study, we defined enterprises as any income generating activities ranging from sole enterprises such as petty shop or retail business to recreational enterprises such as selling sarees and other accessories from home. Only 24% of the interviewed clients indicated that the primary source of income for their households was from micro-enterprise activities. 32% of the interviewed clients indicated the wage employment as the main source of income for their households and 42% of clients indicated their households' reliance on multiple sources of income such as wage employment as well as seasonal micro-enterprise activities. It is to be noted that engagement in at least one type of enterprise was found lower in the Southern states.

Table 2: Nature of employment by State

Primary source of income	Karnataka	Maharashtra	Tamil Nadu	West Bengal	Uttar Pradesh
Wage employment only	56%	12%	50%	14%	23%
Enterprises only	16%	38%	16%	23%	35%
Both wage and enterprises	27%	50%	34%	63%	42%

From our sample, 33% of MFI clients' households did not have any micro-enterprise and the rest were engaged in one form of enterprise. For further analysis on clients' entrepreneurial activities, we have included those clients' households who had reported that they were engaged in at least one form of enterprise, even if enterprise not being the main source of income. Of those households engaged with at least one enterprise, 74% were engaged in running a single enterprise; 23% had two enterprises and the rest had 3 or more enterprises. When we looked at each state, we found that clients from Maharashtra had the maximum number of enterprises compared to other states as shown in Figure 1.

Figure 1: State-wise number of enterprises



When the sample was classified by length of MFI membership, our study found that the prevalence of entrepreneurship was greatest amongst clients who had been with an MFI for between one and three years, as depicted by Figure 2. 49% of the clients who joined MFIs less than one year ago had no enterprise. Surprisingly, we found that as the age of the membership increased, client involvement in income generating activities decreased as can be seen in Figure 2.

Figure 2: Prevalence of entrepreneurial activity versus length of MFI membership

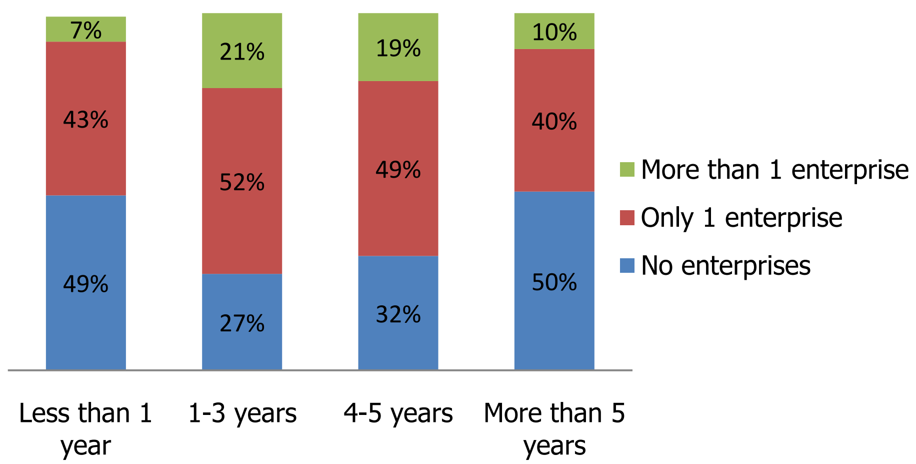


Table 3: State-wise primary focus of business investment

Karnataka	Maharashtra	Tamil Nadu	West Bengal	Uttar Pradesh
Retail/Petty Shop/ Pawn Shop (27%)	Tailoring (12%)	Retail/Petty Shop/ Pawn Shop (29%)	Retail/Petty Shop/ Pawn Shop (20%)	Retail/Petty Shop/ Pawn Shop (24%)
Saree/accessories business (18%)	Auto Rickshaw business (11%)	Saree/accessories business (17%)	Saree/accessories business (17%)	Tailoring and wholesale business (23%)
Auto business (12%)	Food mess and stall business (10%)	Tailoring (16%)	Piece rate work (8%)	Saree/ jewelries production business (15%)

57% of the households with enterprises reported that they had taken at least one loan for their business in the past six months and the majority of such loans were taken from microfinance institutions.

USAGE OF MICROFINANCE LOANS

Clients with entrepreneurial activity had high propensity to invest MFI loans in their enterprise

One of the RBI guidelines clearly indicates that the 75% of the loan should go to income generating activities. To this end, we asked clients how they used their microfinance loans. We found that 49% of clients mentioned that investment in the current business was one of the reasons for them to borrow from MFIs. Household consumption followed at 17%.

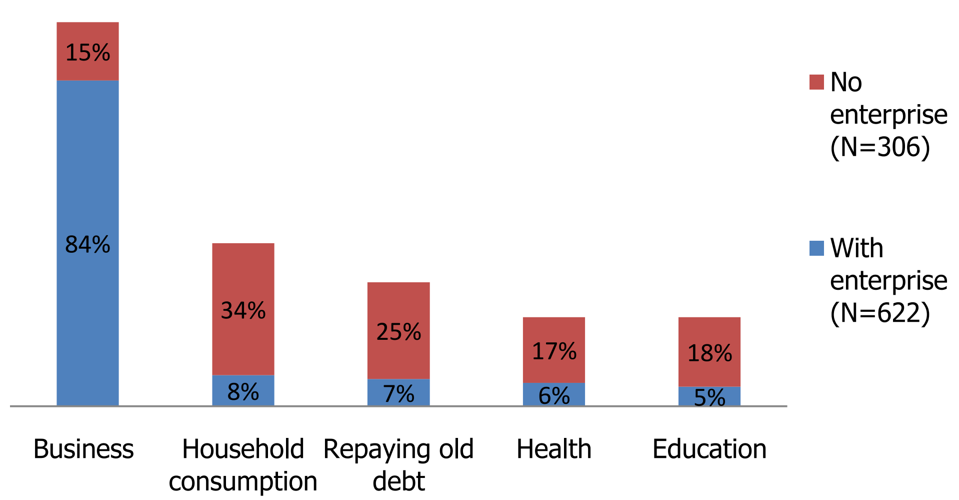
Table 4: Usage of loans

Purpose of loans	Usage of loans at HH level (%)
Existing business	49%
Household consumption	17%
Starting new business	14%
Paying old debt	13%
Health	10%
Education	10%

*Totals may be greater than 100% as loans may be used for more than one purpose.

We explored the usage of loans in relation to household engagement in enterprise. As depicted in Figure 3, 84% of those clients with at least one form of enterprise reported that they used the MFI loan for business purposes, only around 8% of clients with an enterprise used MFI loan for household consumption. Among the clients with no enterprise, 34% took MFI loans for household consumption, 25% for repaying old debt, 17% for education, and 16% for health. Notably, 15 % of this group claimed that they took loan to start a new business; however, at the time of the survey, they were not running any business.

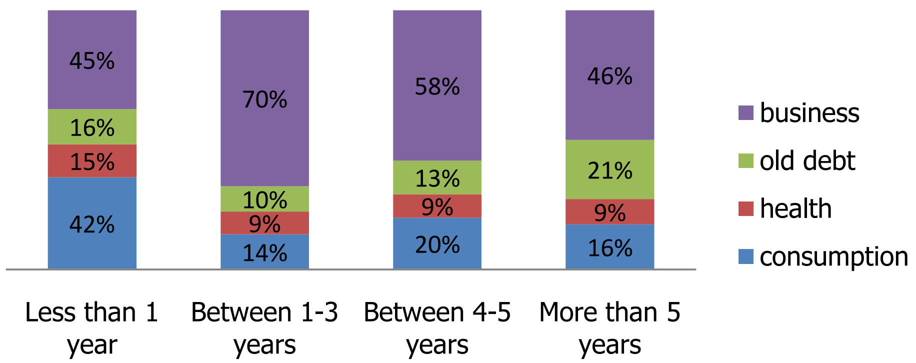
Figure 3: Proportion of the usage of loans corresponding to household engagement in enterprises



Usage of loans corresponding to length of membership

As noted above, it was found that entrepreneurial ventures were most evident amongst clients who had been members between one to three years. Surprisingly, as the length of membership increased beyond three years, the proportion of the loan used for business activity declined. In addition, 42% of new clients who joined less than one year prior to the survey reported that they used loans for consumption. Compared to other groups, the proportion of the usage of loans for paying old debts was highest among those who had been microfinance clients for more than five years.

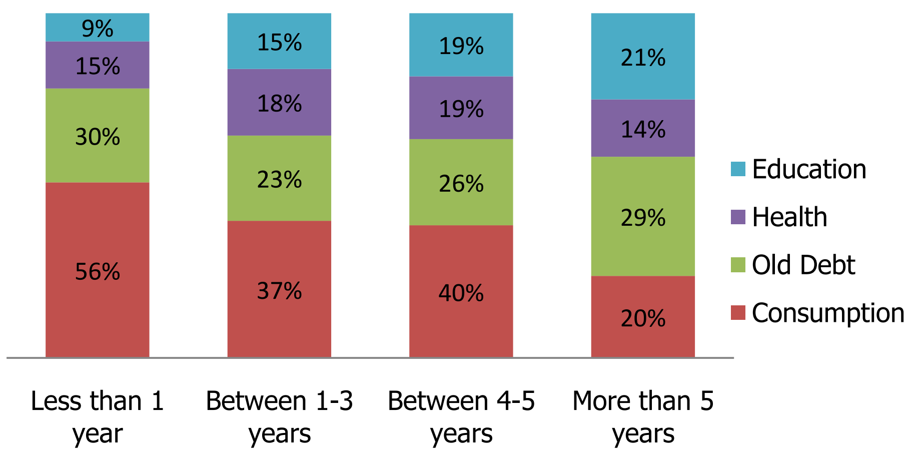
Figure 4: Proportion of the usage of loans (all clients) corresponding to length of membership



*Totals might be more than 100% as some loans are used for multiple purposes.

In our sample, there were clients without any entrepreneurial activity at the time of survey. Amongst such clients with no enterprise, our study reveals that the proportion of loans spent on education increased jointly with length of MFI membership as seen in Figure 5. Loan usage for consumption was the least among those who have been clients for more than five years, who instead, invested MFI loans on education and paying old debt.

Figure 5: Proportion of usage of loans (clients with no enterprises) corresponding to length of membership



*Totals might be more than 100% as some loans are used for multiple purposes.

OVERVIEW OF BORROWING

Although a majority of MFI clients had access to a formal banking system, it was not a primary source of credit.

Considering the low proliferation of formal banking systems throughout India, it is critical to understand the nature of this financial exclusion. Our study sought to understand whether the respondents had ever opened bank accounts. If so, had they ever taken loans from banks; if not, what were the major reasons for their financial exclusion. It was found that 62% of the client households had at least one bank account. This was mostly prevalent in Satara district of Maharashtra in which 71% of the sample reported that their household had at least one bank account. Likewise in other states except Loni and Gaziabad areas of Uttar Pradesh, most clients mentioned that their households had at least one bank account (61% in Karnataka, 59% in Tamil Nadu, 68% in West Bengal and 45% in Uttar Pradesh).

Despite the prevalence of formal banking amongst the clients, only 11% had ever taken loans from banks. This was especially so in Loni and Gaziabad areas of UP where only 1 % of the bank account holders had ever taken bank loans. Similarly, only 10% of West Bengal, 8% of Tamil Nadu and 9% of Karnataka bank account holder clients in our sample had access to bank loans. However, in Maharashtra, 30% of sample respondents with bank accounts had taken loans from banks, possibly due to the prevailing presence of co-operative banks in Maharashtra. [10]

Primary reasons for not taking loans from banks given by bank account holders were the following:

I. They did not require type of credit that banks provide (30%),
II. They found application procedures too complicated (25%), and
III. They had no knowledge about the products and services provided by the banks (11%).

Among those who did not have any bank account, 20% reported that they did not open bank accounts due to their low savings and/or low income, 19% reported that they had no idea about credit availability from banks or their financial products and 13% reported that their applications were rejected.

While these findings are insightful regarding the lack of formal micro-credit availability to households by banks in the study areas, this finding more importantly underscores the dependence of these households on micro-credit availability from the MFI sector.

Self Help Groups (SHGs) model was not popular among urban and semi-urban microfinance clients

Our study reveals that the Self Help Group (SHG) model was not a predominant source of credit among the clients from urban and semi-urban centres in the study areas as 76% of clients reported that none of their household members had any SHG account. 47% of these clients with no SHG account reported that they had no idea how SHG functions and 15% reported that they did not know any SHG member. This was predominantly found in semi-urban areas of UP, where 99% of the sample respondents were not part of SHGs. Likewise in urban areas of West Bengal and Tamil Nadu, 70% and 77% respectively, of clients reported that none of the household members were SHG members. In Satara district of Maharashtra, 42% of MFI clients reported that the household had at least one SHG account. In the urban slums of Bangalore, Karnataka, 87% of the clients (N=119) did not have an SHG account, however, 64% of clients (N=83) from semi-urban/rural areas of Nittur and Tumkur, Karnataka reported of having a SHG account.

Interviewed clients avoided expensive credit from informal sources

In our sample, borrowing from informal sources such as moneylenders, friends, neighbors and relatives in the six months prior to the survey was found to be quite low. Only 27% of clients reported that they had taken loans from informal sources in the past six months prior to this survey. Karnataka (38%) and Tamil Nadu (38%) had the highest percentage of clients that had borrowed from informal sources within six months prior to the survey, followed by West Bengal (26%). Maharastra (15%) and Uttar Pradesh (14%) had the lowest percentage of clients that had taken loans from informal sources within the last six months prior to the survey. The borrowing from informal sources was greater in the Southern states (Tamil Nadu and Karnataka) than the other states in this study. The survey findings indicate that due to irregular income flow and repayment capacity, credit from informal sources was perceived to be too expensive. For those who did not take loans from such sources, reasons included lack of need for credit from informal sources (48%), high interest rates (23%), and irregular income flows/repayment capacity (12%).

For those who had currently outstanding debt to an informal source, 49% were taken from moneylenders and 43% from friends, relatives and neighbors. For 17% of these outstanding loans, these clients reported that collateral was required. The main reasons for taking loans from informal sources were health (40%), marriage, funeral and festivals (33%) and business (13%).

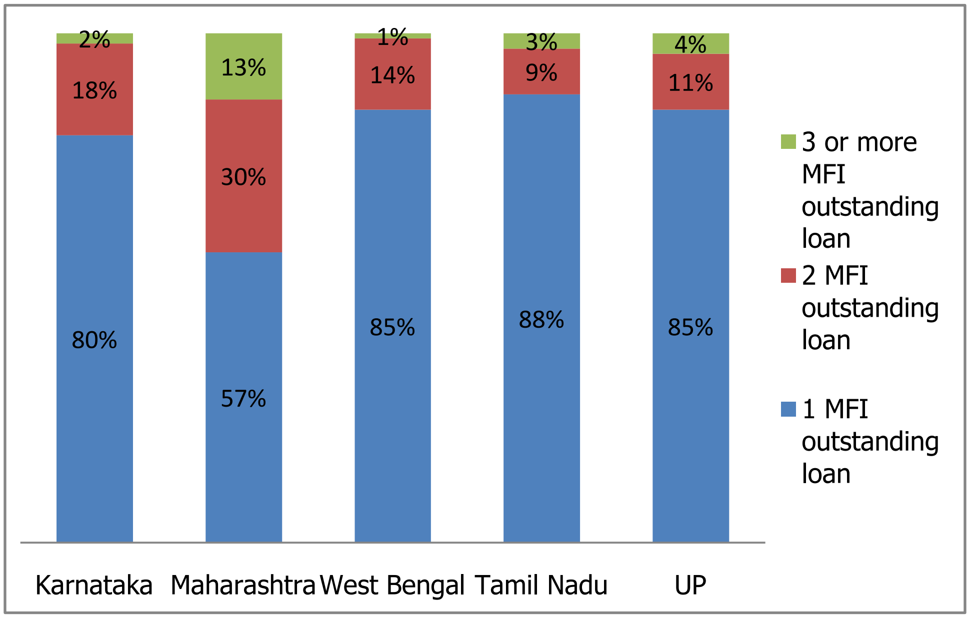
Similarly, clients lending to others was also found to be notably low in our study areas. Only 12% of our interviewed clients had lent money to others in the past six months- primarily to neighbors (59%). Lending to others was found higher in West Bengal where 34% of interviewed clients reported that they had lent money to others in the past six months, also primarily to neighbors (70%).

Borrowing from multiple MFIs was not prevalent

Our findings show that RBI’s recommendation that not more than two MFIs should lend to the same borrower is largely followed throughout target regions. It was revealed that even though several MFIs are operating within the given study areas, only 4% of the sample population had outstanding loans from more than two MFIs. However it should be noted that when we interviewed clients during January-March 2012, it was reported that banks were tightening the flow of credit to MFIs[11], which could have reduced lending to clients.[12]

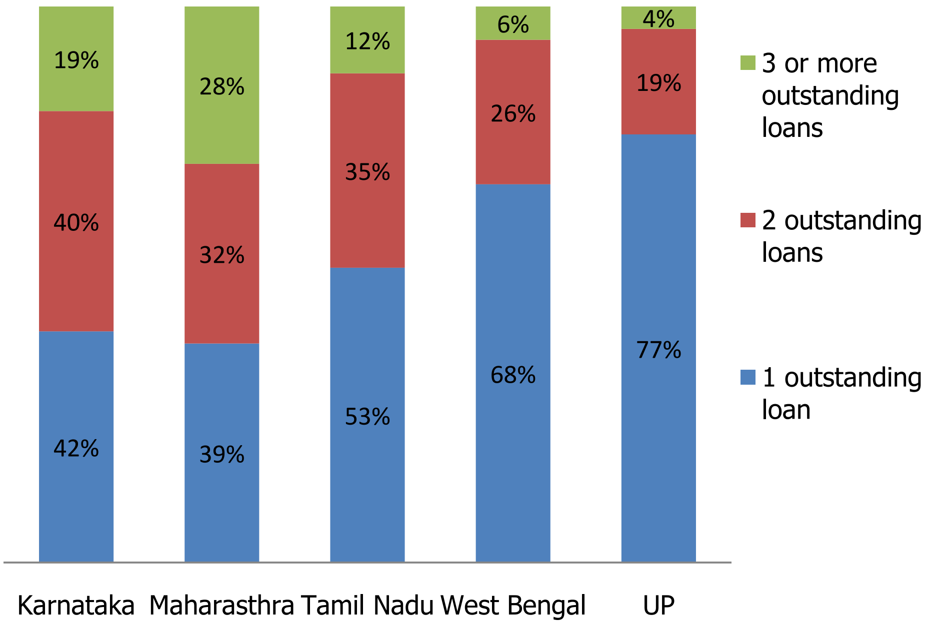
1143 MFI loans were taken by 928 clients, suggesting an average of 1.2 loans (~ 1 loan) per household. While exploring the distribution of the number of MFI loans for each household, the study reveals 81% of the clients had only one loan outstanding from one MFI (note that due to the nature of selection, *all* samples will have *at least* one loan) and 15% of clients had loans outstanding from two MFIs. Compared to other states multiple lending from more than two MFIs was higher in Satara district, Maharashtra as almost 13% of clients had existing loans outstanding from more than two MFIs.

Figure 6: Proportion of MFI loans held by households in each state



We also explored the proportion of loans from both formal and informal sources, including, banks, MFIs, SHGs and informal sources in each state and our study reveals that the majority of households did not have more than two outstanding loans at the time of interview as shown in Figure 7.

Figure 7: Proportion of loans (formal and informal) held by households in each state



Household level median loan outstanding corresponding to each source type

Though the study surveyed only those clients who reported to have microfinance outstanding loans, it was found that 9% of clients were not aware of the remaining loan amount that needed to be paid to MFIs. This was especially prevalent in Gaziabad and Loni areas of UP where 31% of clients with MFI loans had no awareness about the remaining amount of outstanding loans that they had to repay, indicating a low level of awareness relating to financial management. In order to understand the total amount of indebtedness among these clients, we considered a sub-sample of 843 clients who reported outstanding balance with an MFI and examined whether they had loan outstanding balance with other sources as well. The analysis of the reported outstanding loan amount from all sources including MFI loans of this sub-sample is shown in Table 5.

Table 5: Distribution of loans outstanding from different sources

Source	Number of clients	Average loan outstanding in INR	Median loan outstanding in INR
MFIs	843	8,475	6,680
Bank	45	63,108	25,000
SHGs	54	7,163	5,500
Informal	170	20,842	10,000
TOTAL	843 clients	16,505	9,000

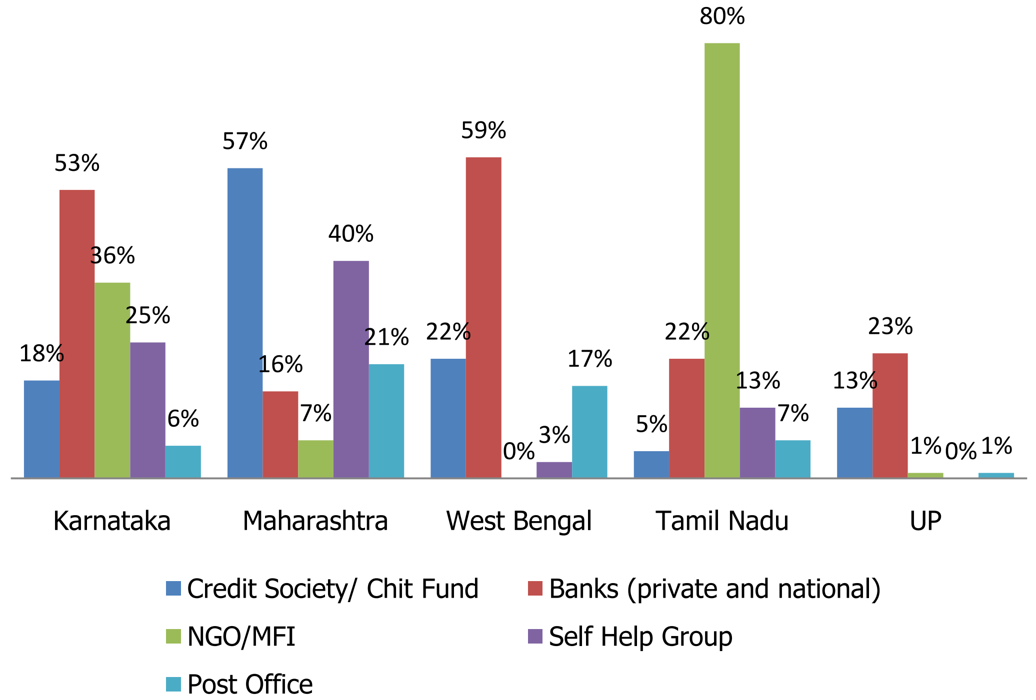
OVERVIEW OF SAVINGS

Saving was common among the majority of interviewed clients

Even though the draft of Micro Finance Bill has included "collection of thrift" in its definition for micro finance services[13], there is an ongoing debate on whether MFIs should be allowed to collect deposits from their clients. Recently, the Reserve Bank of India, which could be the sole regulator of microfinance in India, has conveyed concerns to a government proposal to allow MFIs to collect deposits.[14] Over the past several years, the RBI has launched several initiatives to increase access to savings accounts by encouraging banks to make basic "no frills" accounts available for the poor[15] and relaxing the Know your Customers (KYC) requirements for these accounts. [16]

We found that a staggering 75% of interviewed clients saved in at least one form as shown in Figure 8 in the three months prior to the survey. Saving in at least one form as described in Figure 8 was quite customary among the clients in Karnataka (86%), West Bengal (89%), Tamil Nadu (88%) and Maharashtra (79%) whereas in semi-urban areas of UP only 33% of the interviewed clients were saving. SHGs (40% of 115 clients) were the most popular form of savings in Maharashtra, whereas National Banks were used by West Bengal clients (40% of 200 clients), Karnataka (46% of 202 clients) and UP (21% of 204 clients). 80% of 205 clients from urban areas of Chennai, Tamil Nadu were using local NGO/MFI service as one of the saving forms. Fewer clients (21% of 202 clients) in Chennai, Tamil Nadu were using bank as an avenue for saving as can be seen in Figure 8.

Figure 8: Sources of saving



*Totals maybe more than 100% as one can save in more than one form

There was an increase in savings rate among those who had access to a formal banking system

Given that 62% of our sample had at least one formal bank account, our study explored if clients with bank accounts saved more than the ones with no accounts. Results from this study show that 88% of those clients with bank accounts saved in the past three months, out of which 47% saved with the national banks, 10% with private banks, 17% with chit funds and 16% with SHGs. When we examined the savings behavior of those clients who did not have any bank account, we found that only 54% were saving out of which 35% were saving with NGO/MFI, 11% with chit fund and 10% with SHGs.

Non-routine expenditures were overwhelmingly financed through savings

A majority (60%) of MFI clients made a non-routine expenditure of some type during the three months prior to the survey. The share of households that incurred major expenditures on medical treatment was 31% and by social commitment such as marriage, festival and funeral was also 31%. Our study reveals that majority of the households who faced non-routine expenditure in the past three months relied almost exclusively on their own savings to finance these non-routine expenditures as shown in Table 6.

Table 6: Share of non-routine expenditures financed through a given source

Source	Share of non-routine expenditures
Own Savings	64%
SHG/JLG	33%
Friends and relatives	33%
Moneylender	28%

OVERVIEW OF HOUSEHOLD INCOME

A majority of microfinance clients' household income likely to be more than the RBI's recommended household income

The RBI recommendation is that the annual household income of the clients should not be more than Rs. 1, 20,000 in urban and semi-urban areas. As such, the monthly household income of microfinance clients should not be more than Rs. 10,000 in urban settings.

A limiting factor of this study was the inability to capture income data from enterprise activities. We found that the incomes of the majority of our clients' households fluctuated during the past year and especially in urban economies, income flow of our respondents was very irregular which led them not able to recall incomes for the entire year. 57% of clients with at least one form of enterprise mentioned that the amount they spent and revenue generated from their enterprises varied from month to month in three months prior to the survey. The majority of clients who had enterprises did not correctly report the exact investment and revenue amount which has led the income statistics from our study to be of low quality. The study, however, was able to capture the monthly income of those 705 clients who were engaged in some type of wage and/or salaried employment. The monthly median declared household level salary from this sub-sample of 705 clients was Rs. 9,000. It should be noted that the majority of these clients were also engaged in some sort of self-employed enterprises. Thus, it is safe to state that, on an average, the majority of the interviewed clients household income is likely to be more than Rs.9,000 per month.

As it was complicated to estimate the exact income of clients due to their diverse nature of livelihood activities, the Progress out of Poverty Index (PPI) tool was used to measure the likelihood that clients fell below the national poverty lines as depicted in Table 7.[†] It was found that the majority of clients had less than 10% likelihood of being below national poverty line.

Table 7: PPI Ranges and corresponding likelihood of clients falling below national poverty line

PPI Ranges	Likelihood of being below national poverty line	Percentage of interviewed clients falling under this range					
		Overall	KA	MH	TN	WB	UP
5-14	51-59%	0%	1%	0%	0%	0%	1%
15-29	21-36%	3%	21%	1%	0%	1%	6%
30-44	10-19%	11%	21%	6%	3%	8%	16%
45-100	Less than 10%	85%	72%	93%	96%	91%	77%

[†] Scoring was calculated based on ten questions on assets provided by Mark Schreiner's "A poverty score card for India", page 63. URL: http://microfinance.com/English/Papers/Scoring_Poverty_India.pdf. We opted for estimating the likelihood that clients fall below the national poverty line, the poverty line that defines the poorest half below the national poverty line. (Page 69, Figure 4: (National poverty line): Estimated poverty likelihoods associated with scores)

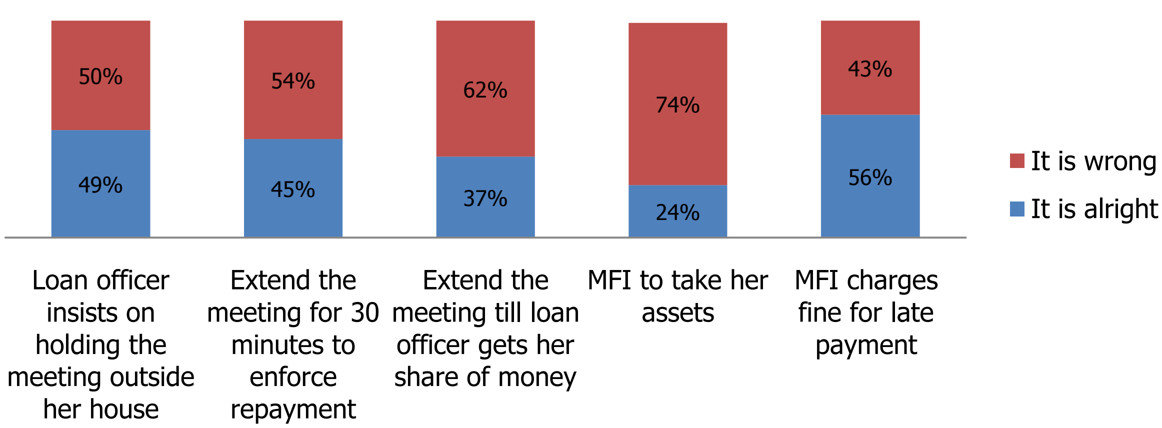
CLIENTS' PERCEPTION OF MICROFINANCE

Clients perceived aggressive loan recovery methods to be inappropriate

The series of unprecedented suicides stemming from microfinance in Andhra Pradesh ushered a wide spread influx of criticism toward microfinance institutions (MFIs) in India, pointing out some inappropriately high profits earned by MFIs and coercive money collection practices and resulting in Andhra Pradesh Government passing the Andhra Pradesh Microfinance Ordinance 2010.[17] The incident eventually resulted in the Reserve Bank of India (RBI) releasing recommendations for the MFI sector, and the recommendations strived 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.[18] The draft Microfinance Bill has also stated that the Central Government can establish State Advisory Councils and District Level Committees whose main function is to monitor whether lending activities undertaken by MFIs are resulting in over-indebtedness and whether recovery practices adopted by MFIs are fair and transparent.[19]

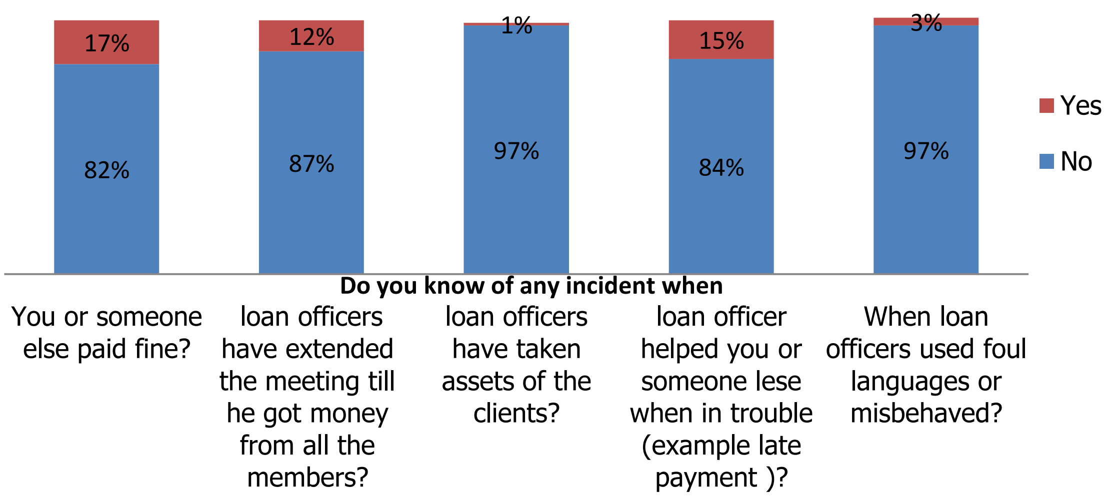
Our study tried to examine what clients think of some of the traditional recovery methods that some MFIs have opted. We presented a situation/scenario in which an imaginary member, Lakshmi, failed to pay, resulting in redistribution of her loan to others in the group. We presented various hypothetical scenarios which are considered coercive collection practices by mainstream media and industry leaders and tried to understand whether the clients too find these practices unacceptable. Surprisingly, even though 83% of these clients mentioned that they feel obligated to pay somebody else's installment, a majority of them reported that the collection practices –especially relating to confiscation of assets and extension of meeting time till loan recovery takes place -were inappropriate as shown in Figure 9. It may be noted that a majority of our sample (56%) concurred with the practice of charging a fine for late payment and that there was a very thin margin of difference between those who agreed and disagreed about a loan officer holding the meeting outside Lakshmi's house.

Figure 9: Clients' opinion on hypothetical scenario given to respondents



We also asked whether clients have ever experienced or witnessed any such coercive practices, and unexpectedly, a large proportion of them did not report of any such incidence as can be seen in Figure 10. However, in Karnataka and Maharashtra, a segment (40% and 31% respectively) of clients reported that they had experience with someone paying fines for late payment in the past.

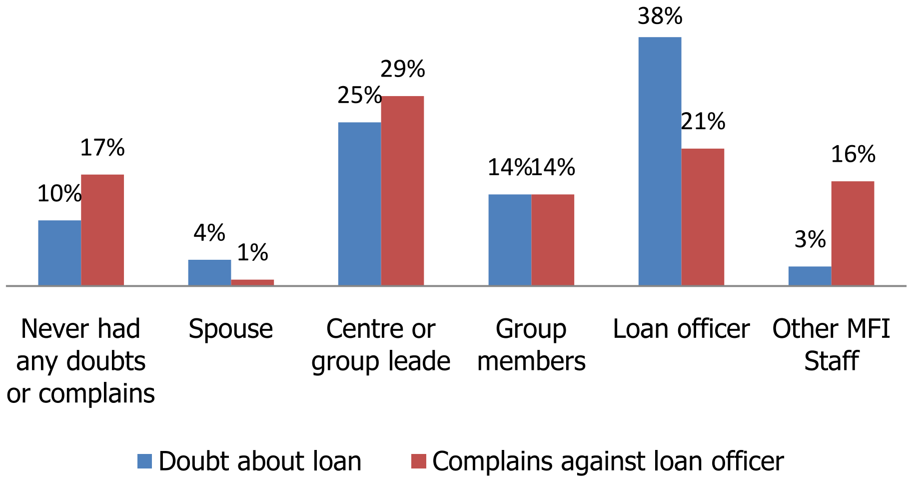
Figure 10: Clients knowledge of any inappropriate practices



Clients relied on each other when in doubt

We asked clients to whom they refer when in doubt regarding loans or complaints about the loan officers. Clients predominantly relied on each other when in doubt; however, it was encouraging to see as shown in Figure 11 that a significant proportion of these clients also asked loan officers or other MFI staff when in doubt.

Figure 11: Sources that clients count on when in doubt



A plurality of clients joined MFIs for the first time because credit was easily available

When each client was asked the primary factor that drove her to an MFI, 42% of clients stated that the loans from MFIs were easily available for them, and this encouraged them to join Joint Liability Groups in their respective communities. Other reasons included the low interest rate (26%), neighbors and friends joining the groups (13%) and need of credit at the time of joining (12%). When asked what clients liked the most about MFI loan, 61% cited easy availability of credit followed by convenience (30%) and low cost (15%). When we asked them what they would like to change about MFI loan, 19% suggested MFIs to reduce interest rate, 13% reported that timing of payments was inconvenient for them, and 10% requested MFIs to increase loan amount.

KEY RECOMMENDATIONS AND FUTURE RESEARCH AREAS

Considering the findings outlined in this report based on studies in the five states of Karnataka, Maharashtra, Tamil Nadu, Uttar Pradesh, and West Bengal, there are several recommendations listed below that could bring greater efficacy of MFIs around India. A key pattern in each of the findings of this study is that the effect of micro-loans varies greatly by different subgroups within a target area. For example, between those who have been with an MFI for many years, and those for none. It would be highly beneficial for policy-makers to consider various groups before instituting a regulation. Detailed below are several suggestions that hopefully set direction for policy:

1. As it is difficult to acquire the accurate income data from the clients, pure income might not be the best metric to regulate this industry. It is perhaps more suitable to calculate overall welfare of a household using core indicators such as assets. A set of such assets may then be weighted, perhaps, to form an index assessing the overall welfare of a household.

2. The concept of equating maximum annual household income bar still raises a big question on the described bar of Rs. 60,000 in rural and Rs. 120,000 in urban households. It is very much possible that a typical microfinance client's household income is more than the suggested bar, however, further study is needed to understand the accessible sources of finance for the households that are at the par or a little above the suggested annual income bar.

3. It was noted that as the length of MFI membership increases, the nature of spending by clients changes. For example, entrepreneurial investment peaked amongst those clients who had been with the MFI for two to three years and after that, investment in business dropped. Further rigorous research is needed to confirm this trend of entrepreneurial investment. If this trend of entrepreneurial investment is valid, then for such clients, the return on investment could possibly be increased if appropriate business training is provided.

4. Data suggests that amongst those who did not invest in business, there is a direct correlation between education spending and length of MFI membership. These findings suggest that as clients mature, MFIs should be able to offer them with different sets of financial products, as for example, education loans. We also suggest that the education loan portfolio of the MFIs be considered as a part of qualified asset by the RBI.

5. It is not surprising that among the clients who did not invest in business activities; those who borrowed from an MFI noted a usage of loans in consumption. If by regulation MFI loans were capped at 75% for income generating activities, further research studies are needed to understand if families with unmet credit needs due to this cap rely on informal sources such as moneylenders.

6. It was found that those clients who used a formal deposit account reported higher rates of savings than their counterparts who did not. Further research studies are needed to understand if the ones who used a formal banking system perceived the need for saving accounts due to a higher income. In addition, further research is needed to understand

different savings alternatives (both formal and informal) that the low income clients are using.

7. For those who did not have access to formal banking, primary reasons included a lack of need, complicated application procedures, and a lack of awareness. Reasons such as complicated procedures and lack of awareness should not hinder the inclusion of these groups into the formal banking system. Therefore greater awareness campaigns might be useful in promoting savings. There might be value in encouraging formal banking not as a means to borrow but as a means to save. Furthermore, relaxing KYC guidelines might accommodate larger section of the population as many clients do not have the required documents.

The main limiting factor of this investigation included a self-selection of clients for this survey. However, even if causality could not be established for certain procedures, for example that formal banking increases savings rates, the correlation by itself yields useful insight for policy-makers. Therefore it can be concluded that despite the self-selection bias mentioned above, and the lack of a truly random sampling, the findings in this study can set the direction of new policy making initiatives concerning the pending draft of Microfinance Bill.

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