The Microfinance sector in India has shown significant growth over the past few years. Until 2014, Microfinance Institutions in India issued 12.7 million loans worth Rs. 1508.61 billion.

Despite such efforts, two-fifths of rural households are still dependent on informal credit. Given the difficulties in tracking the cash flows and actual debt burden of a household, MFIs, unaware of other sources of borrowing, could potentially offer products to people who maybe at the risk of being over-indebted and could default in future. On the provider side, this can put the institutional stability and sustainability of the industry at serious risk, On the borrower side, easily available loans could lead to a situation where borrowers continuously struggle with repayment.

The Murmurs

Nationwide growth of MFIs was impacted severely by the Andhra Pradesh (AP) crisis of 2010. While data suggests that MFIs activities have recovered after the 2010 crisis, there have been reports of fresh incidents of over-indebtedness in regions of Madhya Pradesh, Karnataka and Uttar Pradesh this year. These have been associated with pipeline loans (taking loans using their KYC for others and ending up with multiple loans), spending entire or more than the recommended spending limit of the loan on consumption purposes rather than income generation.

Some reports have argued that these incidents are a cause of worry for they point to deeper problems within the system. According to Inclusive Finance India Report 2015, while the MFI portfolio grew to Rs. 390 billion in FY2015 from Rs. 240 billion in FY 2014, this growth wasn’t accompanied with concurrent growth in the number of MFI branches, employees and clients. This could mean that the infrastructure, employees and clients of MFIs are being stretched beyond capacity. This runs the risk of multiple borrowing by clients, without proper checks and governance of these borrowings. On the other hand, some reports such as a recent one by IFMR Capital argues that new reports of over-indebtedness are sporadic events and detailed analysis of data from credit bureaus does not indicate overheating of the system.

The Evidence

Although present evidence does not permit a conclusion about the actual prevalence of over-indebtedness in the market, a recent study carried out on over-indebtedness in few saturated market areas of three states (UP, MP and Karnataka), identifies a series of factors (see chart) that pre-disposed MFI borrowers to be more likely to reach unsustainable levels of debt.

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3. In 2010, Andhra Pradesh was highly penetrated by both MFIs and SHGs giving rise to multiple borrowing. Some of the causes identified for multiple borrowings include clients poaching and loan pushing on the MFIs side, and loan recycling on the clients’ side. A CGAP (Consultative Group to Assist the Poor) study indicated that the average household debt in AP was Rs. 65,000 compared to the national average of Rs. 7,700.
7. Study on the Drivers of Over-Indebtedness of Microfinance Borrowers in India: An In-depth Investigation of Saturated Area (IFMR-LEAD 2016)
Multiple borrowings were found to be significantly correlated with over-indebtedness. This could be the consequence of the difficulty in managing and planning for multiple loan cycles, as well as the increase in the monthly repayment burden.

**Implications**

Data from multiple studies\(^8\) demonstrate that getting access to loans is not an issue for most clients. From a client perspective, cross-borrowing takes place due to many reasons ranging from inadequate sizes of MFI loans for cash flow smoothening to limited capacity of MFIs to lend for ‘productive’ purposes. From the lender’s perspective, multiple borrowing maybe a result of the inability to calculate the debt capacity of clients due to foreseeable (relying on client’s self-reported income figure for debt assessment) and unforeseeable reasons (limited knowledge on the number of outstanding loans held by the client from formal and informal sources).\(^9\) The likelihood of being over-indebted depends on:

- borrowing to deal with adverse economic shocks
- use of loans for non-productive purposes
- borrowing to cope with repayments on existing loans

<table>
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<tr>
<th>Findings of IFMR-LEAD’s Study on Over-Indebtedness</th>
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<td>• Taking on a second loan increased the likelihood of being over-indebted by 150% and taking 3 loans (as opposed to 1) increased it by as much as 576% for the study sample.</td>
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<td>• Using loan for consumption/non-productive purposes(^1) increased the likelihood of being over-indebted by 50%.</td>
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<td>• Households whose main source of livelihood was cultivation or wage labour in agricultural or non-agricultural avenues were significantly more prone to over-indebtedness, mainly as a result of their high ratio of monthly consumption expenditure to monthly income and consequently low level of surplus to service loan repayments.</td>
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<td>• Over-indebted households were more likely to use borrowings as a source to make repayments on loans, as compared to households that were not over-indebted.</td>
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An Access-Assist study shows that while 80% of MFIs interviewed confirmed having an organizational policy in place to check on the loan utilization by clients, verification of loan usage happens only at the time of first instalment collection or within 30-45 days of loan disbursement. From the clients’ perspective, borrowers with different economic and occupational backgrounds and difference in usage of loans give rise to different repayment hurdles and warrant different responses to repayment difficulties. Such nuances have important implications for the development of measures against over-indebtedness. In such a scenario, it is not more access to finance but rather a more focused, customized access to credit needs of the individual borrower that would enable households to improve their financial situation.

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\(^9\) Access-Assist study on MFI lending practices (2016)