Microcredit in India

Microsharks

HYDERABAD

Rapid expansion of Indian microcredit leads to a turf war with the government

MONEYLENDERS bad; microcredit good. That has been the common view about financial services in much of the Indian countryside. Traditional moneylenders charge extortionate interest rates to those in desperate need. Microcredit-providers, which are charities that lend tiny amounts to the poor without necessarily expecting to make a profit in return, are globally trendy and socially responsible. So it came as a shock earlier this year when the government of Andhra Pradesh, the Indian state where microcredit has spread fastest, accused some leading microfinance institutions (MFIs) of behaving no better than old-style usurers. The lenders say they are being defamed, in a row that raises questions about their future in the state.

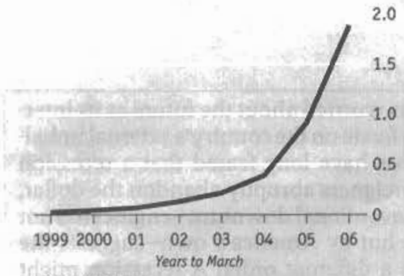
The dispute centres on one poor rural district, Krishna. Some women were reported to have killed themselves because they could not repay the MFIs. In March a top government official in Krishna temporarily shut 50 branch offices of four MFIs, seized and destroyed their records and told their borrowers not to repay their loans. He accused the microfinance groups of charging exorbitant rates.

Udaia Kumar, who runs SHARE, one of the affected four, says that, in fact, its loans cost about 21.5% a year—not excessive, since its cost of funds is 11% a year, the administration of a portfolio of more than 800,000 small loans in Andhra Pradesh is expensive, and not all loans are repaid. It is also less than half the rate a moneylender would charge or what a poor borrower would end up paying for a bank loan. Even so, SHARE has since agreed to cut its rates by about four percentage points.

There had been abuses. Viswanatha Prasad of Bellwether, a fund that finances microcredit-providers, blames "indiscriminate expansion" (see chart on next page). The MFIs were flush with money, partly because commercial banks saw them as a good vehicle for lending to rural areas. Some microcredit lenders were charging interest rates on the full amount of a loan, rather than the declining balance, and some borrowers were bullied and humiliated. Aggressive competition and a failure to share information meant some people were in hock to numerous lenders. That is what seems to have led to the suicides. Mr Kumar says SHARE's own average outstanding loan was only 4,000 rupees ($86).

Not so micro any more

Number of active borrowers from the four biggest microfinance institutions in Andhra Pradesh, m



Source: World Bank

The root of the dispute, he says, is competition between non-governmental MFIS and a subsidised microcredit scheme, financed by the state and central governments and the World Bank. According to the bank, some 30% of SHARE's clients overlap with government-supported "self-help groups". Mathew Titus, of Sa-Dhan, an association of Indian microcredit institutions, sees the row as a "battle of ideas"—between the non-government sector and those ideologically opposed to its working with the poor.

The fear is that the state government will now try to regulate the lenders, perhaps by capping interest rates at levels that could put them out of business. Legally, this would be difficult. SHARE and the other big MFIS are regulated as "non-banking financial companies" by the central bank, the Reserve Bank.

Bellwether's Mr Prasad thinks the scandal could even have some positive consequences. The microcredit groups will have to stamp out abuses, adhere to a code of conduct and recognise that they cannot ignore the government. For its part, the government will have to realise that the MFIS are a force to be reckoned with, and that their mission is not necessarily to exploit the poor.

It is not as if too much credit is available. There should be room for both private lenders and subsidised schemes for the very poor. There may even be room for the despised moneylenders, whose local knowledge and extensive business mean they cannot be ignored either. According to one survey, 30% of MFI clients in Krishna took loans from moneylenders. Nationwide, moneylenders are estimated to account for about one-third of the debt owed by rural households. The Reserve Bank is reviewing the laws on moneylending. One option is for banks to lend to registered moneylenders, using them as intermediaries. Priya Basu of the World Bank, an expert on India's rural credit market, thinks the idea makes sense "if they can co-opt moneylenders into the formal system". Microcredit good; moneylenders not so bad after all. ■