"Over-indebtedness – the flip side of Micro Finance"

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An abstract

The practice of Micro finance was and has been observed India for the last so many years may be two decades or so. The inspiration was mainly drawn from Prof Muhammed Yunus, who is considered to be the brain child of micro credit and micro finance and the founder of the Grameen Bank, Bangladesh. The Grameen model has been replicated almost all over the world. But then there is one serious concern that needs to be attended to, that is the over indebtedness of the micro finance clients and also the transparency and the client protection part. Micro Finance can be considered as a developmental instrument for inclusive growth as it mainly caters to those who are at the bottom of the pyramid. Micro finance has been championed by many institutions such as Banks, NGOs, SHGs, JLGs, Churches in the North East India etc in the country. The central bank of India, the RBI and NABARD have been playing a very instrumental role in spreading and promoting the self help groups (SHGs) and linkage of SHGs to the banking system through refinance support and other initiative measures of proactive policies and systems. This initiative in fact has become an important component in the poverty reduction strategy. Under the umbrella of micro finance activities, there has also been promotion of micro and small enterprises development. This article attempts to discuss on the over indebtedness, the flip side of the Micro Finance, which may also be considered as one aspect to building a self sufficient Micro Finance Institution.

Introduction:

It is understood that the Micro credit or micro finance programme had seen its early emergence way back in the year 1976 when Professor Mohammed Yunus conducted an experiment in a village called Jobra in Bangladesh near the Chittagong University. In the experiment, loans were provided to the poor who did not have anything to mortgage as collateral security to the lending institution. The experiment did something opposite to what the conventional or ordinary banks in Bangladesh did. Collateral free loans were provided to the poor and the repayment result was found to be excellent. As a result, the Grameen bank's model has a lending guidelines and procedures favouring women clients wherein about 97% of the borrowers belong to women. This same model has been replicated in a number of countries and has been found to be doing very well in terms of clients selection and repayment of loan. However, to make the micro finance practices successful, the micro finance practitioners and those institutions involved in lending activities should make a serious effort in understanding the borrowers' over indebtedness and while also putting in place the transparency and client protection mechanism in the operation in order to meet the goals and objectives of micro finance.

A reflection on Prof. Muhammad Yunus' statement:

Wherein the Professor said, ***"Poverty is not created by poor people. They are very hard working and intelligent people. Poverty is created by the system that we built, the system that we learnt in our University classes. If we change the system, poverty will be gone because it is not the fault of the person. It is externally imposed phenomenon and not internally generated phenomenon"***. What we can observe and learn from this statement is that the poor if given a level playing field and the opportunities to exploit their potentials, they can also excel in life. They can easily come out of poverty if they are provided with the right kind of resources needed to leverage their economic activities of course at the right time and place. The beauty of micro finance is that it cherishes and recognises the economical activeness of the clients however poor they may be. We can also learn from that statement that the micro finance practitioners must be upfront about what they do to their clients with respect to the client selection, the interest rates they charge, the repayment terms and conditions, fees and commissions they charge and be straight forward in their dealings. The Micro Finance Institutions (MFIs), instrumental in spearheading the micro finance activities prior to anything else should clearly understand the very basic objectives of micro finance and its sustainability for consistent growth and expansion in terms of breadth of outreach (the number of clients) and depth of outreach (levels of poverty reached) which can be achieved only and only if over indebtedness is addressed along with keeping in place the principle of transparency and client protection. It may also be apt to mention that Micro finance activity is not the end in itself but is an enabling act which can impact upon the life and living standard of the poor people.

Over-indebtedness in micro finance:

Over indebtedness means giving too large a loan to a person with too modest a means to pay it back. This in fact is a very serious issue faced in the micro finance industry as of today. Many borrowers today are borrowing from more than one Micro Finance Institution (MFI) or they end up borrowing from one MFI to repay the loans of another MFI which has become a real problem for the micro finance practitioners as well as the borrowers. The micro finance industry must have to figure out a way to deal with this practice so that over-indebtedness in the industry may be curbed to a certain extent. If this practice is not addressed in time, it may lead to crisis and may have the domino effect to escalate the crisis throughout the micro finance industry. Thus, there could be potentially high levels of loan default leading to accumulation of non-performing assets (NPAs). It can also be observed that over-indebtedness occurs because of too many MFIs (players) in the market and proper identification of clients not done. There have been instances where one client has two to three identities in different names and addresses etc. The question here is as to how to operationalise or prevent over indebtedness. The fact of the case is that there has been mushrooming of micro finance institutions lately in the country and in their greed to earn and survive, they may neglect the over indebtedness part while simply increasing the size of the loan portfolio. Therefore, there must be a check and balance well placed in order to avoid unnecessary lending. The following mechanisms discussed below will in certain ways help in curbing over indebtedness and as a result improve the NPA status of the lending institutions, the micro finance practitioners. It is of course understood that the survival of the industry depends only through the interest income. Interest income is subject to lending of loans in large numbers as big amount of lending is not allowed in micro finance. The loans lent are the assets of the organisation and these assets must be healthy in order to prevent the organisation from falling. Therefore, if they are followed in letter and spirit by the micro finance practitioners, the micro finance industry will shine and instil hopes in the poor borrowers who are genuinely in need of credit for their economic activities.

Transparency in Micro Finance in curbing over-indebtedness:

As far as the concept of Micro finance is concerned, it is a very powerful and beautiful concept in its own frame of glory. However, principles and policies laid down by the micro finance practitioners must be adhered to in letter and spirit by the Micro Finance practitioners operating across the world. The people in the base of the society, the un-banked section of the society who are the poor, the down trodden and most neglected ones in fact have difficulties in accessing the formal banking systems for finance or for any other financial products as they cannot fulfil the criteria of lending for simple reason that they have no collateral to mortgage to the bank and also they are thought to be not bankable. There is no doubt that the poor are already considered to be potential NPA's (non performing assets) by the conventional banks even before the lending takes place. In light of this issue, the one platform that is easily accessible by the poor undoubtedly is the micro finance programmes and the micro finance practitioners and Institutions dealing in micro finance activities. However, trust is the dominant factor and main vehicle for sustainability of the micro finance programmes. Thus, in order to instil trust in the organisation, there is a need to maintain transparency and client protection. If there is transparency in the MFI's dealings by the practitioners, transformational effects on the lives of the poor section of the population served can definitely be observed and noticed. That is why, the practitioners in the field of micro finance activities need to be upfront in whatever they do and the stake holders particularly the clients and the regulators should not have negative attitude towards what the Micro Finance Institutions are doing. Some people may be inclined to say that interest rates charged by the MFIs are abnormally high as most of the

MFIs are in fact charging rates much higher than what the conventional or commercial banks charge. However, the justification here is that, the MFIs do charge higher rate of interest but unlike scheduled commercial banks or organised Financial Institutions, they deliver credit and other financial services instantly and at the doorsteps of the clients. This practice of course sounds foolish, impossible and impracticable for the commercial banks. The capital requirement in the case of micro finance is need based or emergency need which is not encouraged by the commercial banks because of the fact that the interest incomes the commercial banks will get out of them are not attractive. The decision of charging higher interest rates by the MFIs than other organised players in the market on different counts can therefore be justified for reasons stated above. As already mentioned, the Micro Finance practitioners must be upfront and transparent of what they do to their clients. Fulfilling the social objectives is one of the main objectives of the micro finance programme. At the same time, in order to fulfil this objective, the MFIs also need to focus on the sustainability aspect and as such charging a higher interest rate than the rest of the lenders in the market will enable the MFIs to take the good cause forward because the micro finance practitioners do not have huge capitals as the commercial banks and also their target borrowers are small ticket borrowers. The MFIs should also be transparent about Interest income being the only income of the MFIs and that the practitioners have to get margins sufficient to sustain their institutions. For all the above cited reasons, what features in the minds of the poor borrowers, who are outside the banking fold is the MFIs when it comes to accessibility of financial services. Poverty as we have discussed is not institutionalised but is pathological which can be done away with if the cause of poverty is found out and if opportunities are given to them. The poor can definitely turn around in life provided they have the opportunities to exploit their potentials. The MFIs should be transparent about the system they create to address the financial services need of the poor borrowers and the have-nots, the hardships faced by them in accessing finance. The policy makers, especially the regulators and the MFIs must address this issue which has been in discussion very seriously so as to enable the poor live a meaningful life. MFIs are also doing their bids in this area to lessen the pains of the society. The MFIs therefore must clearly pronounce that they are upfront and transparent in whatever they do and must instil hopes in the clients that they are there to help them. This trust will make the clients cling to MFI and restrict themselves from borrowing from other funding agencies which will definitely curb over-indebtedness to a great extent. The idea here is to reflect upon the realities in life by creating opportunities and avenues for the poor clients who indeed need transformation.

Client Protection with respect to over-indebtedness:

While appreciating the positive aspects of the micro finance programmes and policies, it is also apt to give a thought on the negative aspects that might potentially harm the clients as well as the resource providers. A case in point here is the cause of micro finance crisis that occurred in Andhra Pradesh way back in the year 2010 that affected the whole micro finance industry in the country including the states of North Eastern Region. The crisis as understood had started after some borrowers of micro finance Institutions who were unable to service the debt committed suicide. Another fact leading to the crisis that was established was the micro finance lenders using coercive methods to recover the loans from the clients. In one's wild imagination it may be established that one of the reasons for being unable to repay the loan could be because of over-indebtedness. There has been a tremendous growth in the micro finance industry in recent times, which is believed to have caused the increase in the number of micro finance players in the market. Sa Dhan, in its study stated that there is a demand of micro finance services of about Rs. 26 billion in the North Eastern Region alone. This provides big business opportunities to the individual promoters as well as to the corporate houses. This implies the entry of many players in the sector which would in turn increase the competition thereby proliferating also the chances and growth of over-indebtedness to the borrowers as the borrowers would have many alternatives to choose from. This is to say that many borrowers will be availing loans from many lenders at any opportunity available to them without necessarily having the capacity to repay the loan. The poor borrowers would then have too many accounts to service when there are no sufficient cash inflows to their favour. Therefore, it is desirable for the micro finance practitioners to put in place a system to protect the clients by providing them a cushion to fall back in times of financial crisis in the form of revival package, counselling, mentoring, project identification et al. Thus the interest of the clients may be safeguarded and protected by ascertaining that over-indebtedness is avoided

Transparent and Responsible Pricing with respect to over-indebtedness:

Transparency in one's dealings is not a very difficult thing to do. It is in the mindset of the practitioner. Being transparent is the need of the hour and business requires it as much as it requires capital because transparency can help create long term relationship with clients. The Micro Finance Institutions can come forward and say; look, we are very upfront and straight forward about what we are doing. At the same time, the doors of the micro finance practitioners should be kept open for scrutiny and audit ascertaining that the MFIs are not committing anything illegal or unlawful. However, pricing of the loan and being responsible about pricing depends a lot on different factors such as where from the money is raised, the source of fund for running the micro finance programmes of the micro finance practitioners. The question here is, if the money comes from high risk investor who is expecting to make 40-45% return on equity, and then can the MFI do responsible pricing? It is doubtful as the one who gives MFIs the money is the one who exercises authority and control over the purse string and he is the master. The lenders in this case are not purely driven by social benefits which will make the micro finance practitioners very difficult to on lend the money to the clients just at the cost of fund. And this cannot happen and is not going to happen because organization has to grow in order to survive and earn money. For the MFIs to lend at very low rate of interest, they will have to find out social investors or low risk investors whose expectations are not as high as those of the high risk investors. When the micro finance institutions are unable to find low risk investors, they will either sell off the organization or go to high risk investors, looking to make huge return on equity. Once money is taken from such investors, they would start dictating terms. And in such instances, the probability of default by the clients is very high as they would be borrowing at higher interest rates. Left with no option, the clients may resort to borrowing from the second micro finance institution to pay off his dues to the first MFI. This process may continue with other micro finance institutions to pay off the previous loans so on and so forth. Thus, the borrower here will become over-indebted and will never be able to come out of poverty. Therefore, it is the responsibility of the MFI to do responsible pricing in order to prevent over-indebtedness.

Appropriate Collection Practices with respect to over-indebtedness:

In order to ensure free and fair transactions in the micro finance programs, there should be appropriate collection practices other than coercive way of recovering money from the borrowers. We know very well that business environment is very uncertain which also applies to the small borrowers, the micro finance clients. The cash flows of the borrowers may sometimes be erratic and irregular due to adverse market forces which are beyond the control of the borrowers. In such cases, if the lenders without understanding the ground realities of the borrowers use coercive method of loan recovery, the micro finance clients will be left with no option rather than borrowing from other MFIs to repay the previous loans. Again this will lead to over-indebtedness and this over-indebtedness will land the borrower in trouble and he will never be able to come out of poverty. It is therefore immensely important for the MFIs to put appropriate collection practice in place and for this to happen, the MFIs must go extra mile in tracking the outstanding portfolios and checking if there is any delinquent loans. If there is one, from day one of default, the MFIs should approach the defaulting clients and find out the reasons of default and in the case of genuine defaults ways and means can be worked out to extend revival package in order to bring the asset back to track. This process indeed will help the clients avoid over-indebtedness.

Conclusion:

The micro finance industry is one such service industry which has been facing many challenges in various fronts be it in the principles, policies, the pricing, the repayment terms and conditions, recovery of loan, marketing inputs to the clients, the training practices etc. In spite of all these ills confronting the micro finance industry, the micro finance practitioners should be able to stand out and say that they have the moral high ground of helping the poor by strictly following the micro finance principles and policies of over-indebtedness, transparency, collection practices and client protection in letter and spirit to let the good cause of micro finance continue to prosper for generations to come. The sanctity and morality of micro finance should be protected and cherished by winning the trust and loyalty of the people across the society, especially all the stake holders. The MFIs should be proud to say that they are helping the poor and people should not say that they are accumulating huge personal wealth and not passing the benefits to the clients. The reality in fact is that the MFIs will come under the scanner and they will have to be scrutinized almost on daily and weekly basis with regard to what and how they are functioning and performing and the rate of interest charged. All these practices in letter and spirit will definitely help the micro finance practitioners curb the incident of over-indebtedness, the flip side of micro finance. This will result to healthy assets of the MFIs which will then make them become financially self-sufficient and in the process; they can contribute to solving some of the myriad problems faced by the micro finance clients.

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