ASSESSING THE EFFECTIVENESS OF SMALL BORROWING IN INDIA

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ACHIEVING balanced and inclusive economic growth is a major challenge faced by policymakers in countries around the globe. Even after sixty four years of independence a large section of India’s population, especially the poor and vulnerable is unable to access the gains of economic growth and is deprived of the opportunity participate in the growth process. Engaging these people in the economic mainstream is essential for balanced growth, which is crucial for the long-term sustainability of social development and economic uplift. Access to financial services is a key element of the process of socio-economic empowerment: only by providing financial services to poor and low-income people can they be brought within the ambit of economic activity. The rural economy demands a large amount of, savings credit facilities and risk mitigation products like insurance.

Britain was one of the first few countries to realise the importance of financial inclusion. The number of households without bank accounts in the UK may have fallen in recent years, yet access to banking services remains a problem for a significant proportion of lower-income households and those living in deprived areas. The government was so concerned that a Financial Inclusion Fund of £120 m was created and a Financial Inclusion Taskforce was formally launched in 2005 to monitor progress on financial inclusion and make suitable recommendations.

Financial sector policies in India have long been driven by the objective of increasing financial inclusion. For a financial system to be truly inclusive, it should meet the needs of everyone who can fruitfully use financial services, including the poor. Whereas in the past post office card accounts were treated as a benchmark for participation of poor in the financial system, this is no longer working. It is now realised that unless an instrument or product offers flexible and meaningful services, their possession alone does not constitute financial inclusion.

The delivery of financial services to lower income households in rural areas presents peculiar challenges. This customer segment is characterized by a high volume of low value transactions and requires doorstep services, flexibility in timing as well as simple procedures. These require skills completely different from those deployed by mainstream financial institutions. At the same time, traditional outreach modes like physical branch network are inappropriate due to the high costs involved. For developing countries like India, microfinance has come as a breakthrough in the philosophy and practices of poverty eradication, economic empowerment and inclusive growth. Microfinance encompasses a broad range of services such as deposits, loans, payment services, and insurance to poor and low-income groups and micro-enterprises. Over the last several years, the Indian microfinance industry has evolved considerably. It has helped the poor increase their income, build viable businesses and reduce their vulnerability to external shocks.

Though the microfinance industry has achieved phenomenal growth, the seemingly divergent objectives of profit maximization and helping the poor, have led many to question their motives and practices. Accusations have been raised against them of charging exorbitant interest rates, employing strong arm tactics and forcing multiple loans on the gullible poor. These accusations culminated in the Andhra Pradesh government imposing an ordinance which led to the establishment of the Malegam committee by the RBI. Although the RBI, based on the recommendations of the Malegam committee report, has announced a set of guidelines, many questions remain unanswered.

Existing research on MFIs in India suffers from paucity of data on the cost of borrowing by source, the prevalence of multiple borrowing and the interest rates. We are happy that these crucial issues have been dealt in the present report in a comprehensive manner. Some preliminary, indirect estimates of impact of MFI loans on poor households have also been provided. More focused research on the impact is necessary and can be a useful topic for future research. Given the controversy surrounding the MFIs, We hope this report will help in laying bare the facts in an unbiased manner.

It is important to note that the report is based on an extensive survey, spanning five clusters and covering over 10,000 households and should not be interpreted as nationally representable. We would like to thank Prof. Rajat Kathuria and the entire NCAER-CMCR team for making this report possible.
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List of Abbreviations

ADB Asian Development bank
AML Asmitha Microfinance Ltd
BC Business Correspondent
BRAC Bangladesh Rehabilitation Assistance Committee
BSFL Bhartiya Samruddhi Finance Ltd.
CAGR Compounded Annual Growth Rate
CMC Casphor Micro Credit
DFIS Development Financial Institutions
DWCRA Development of Women and Children in Rural Areas
FCRA Foreign Contribution Regulation Act
FGD Focus Group Discussions
GDP Gross Domestic product
GFSPS Grameen Financial Services Pvt Ltd
GVMFL Gramee Vidhiya Micro Finance Pvt Ltd
HBS Household Budget Surveys
IDBI Industrial Development Bank of India
IFMR CMF Institute for Financial Management and Research Centre for Microfinance
IFGVD Income Generation for Vulnerable Group Development
IRDA Insurance Regulatory and Development Authority
JLG Joint Liability Group
KYC Know–Your–Customer
LIC Life Insurance Corporation of India
MACS ACT Mutually Aided Co-operative Societies Act
MFIC Microfinance International Corporation
MFIN Microfinance Institution Network
MIX MARKET Microfinance Information Exchange or
MNREGS Mahatma Gandhi National Rural Employment Guarantee Scheme
NAB ARD National Bank for Agriculture and Rural Development
NBFC Non-Banking Financial Company-MFIs
NBFI Non-Bank Financial Institutions
NCDS Non-Convertible Debentures
NGO Non-Governmental Organisations
NOF Net Owned Funds
NPA Non-Performing assets
NSHIE National Survey of Household Income and Expenditure
NSSO National Sample Survey Organisation
OER Operating Expense Ratio
PACS Primary Agricultural Cooperative Societies
PAR 30 Portfolio at Risk that is 30 Days Overdue
PSL Priority Sector Lending
RBI Reserve Bank of India
RRBS Regional Rural Banks
SEBI Securities and Exchange Board of India
SHG Self Help Group
SIDBI Small Industries Development Bank of India
SKDRDP Shri Kshetra Dharamshala Rural Development Project
SKSMPL SKS Microfinance Ltd
SML Share Microfinance Limited
SSFL Spandana Sphoorty Finance Ltd
Summary

1. Most formal financial institutions are reluctant to serve the poor and microenterprises due to perceived risks, high cost of small transactions and low relative profitability. The poor and low-income households are forced to depend on informal sources like money lenders for their credit needs. This limits their ability to actively participate in and benefit from the development process.

2. The inability of the formal financial sector to adequately serve the needs of the poor and the vulnerable resulted in the emergence of microfinance institutions. Over time, the character of MFIs has changed. Now we have MFIs structured as NBFCs instead of NGOs and the mode of finance has also changed from donor-led to bank-led.

3. Evidence has shown that the poor can be served profitably, on a long-term basis - a doctrinaire approach towards poverty alleviation involving developmental aid, subsidies and governmental support is, however, unsustainable. For the MFI to succeed in their pro-poor activities/mission/initiatives, regulation has a role in ensuring that market oriented solutions to poverty alleviation co-exist with other social initiatives.

4. MFI growth in India is also remarkable – In 2009 there were about 27.5 million borrowers and 84 MFIs, with an estimated portfolio of US$4 billion. The annual growth over last 5 years was 62% in terms of clients and 88% in terms of portfolios.

5. A raging controversy has erupted over the role and anti-poor activities of MFIs in India, especially those operating in Andhra Pradesh. The charges against MFIs pertained mainly to usurious interest rates, strong arm collection tactics employed multiple lending and compensation received by top management. The present report is the outcome of a study conducted to empirically assess the effectiveness of small borrowing based on extensive primary data collected from over 10,000 borrower households across five states in December, 2010.

6. The first ever household survey on micro-credit access in India was conducted by the Institute for Financial Management and Research: Centre for Microfinance (IFMR: CMF) MFI loans formed only a small share of the total debt, for marginal farmer households and higher categories, 75% of the outstanding amount came from informal sources. This survey also revealed that multiple borrowing is a problem closely associated with informal loans, rather than lendings from MFIs.

7. The survey for the present study was conducted in five clusters in order to capture the experiences and current status of small borrowers from low-income category. The borrowers from MFIs formed the control group. The respondents were asked questions pertaining to awareness of different sources of borrowing; loan particulars such as source of loan, principal, interest charged and repayment schedule; usage details of loan, saving habits; as well as multiple borrowings.

8. The drawn sample contained nearly 45% female borrowers, the rural proportion was somewhat uneven across clusters (around 70%). In Hyderabad cluster, more than 80% of the borrowers were women in both rural and urban areas. In Kolkata cluster too, female borrowers were more in both locations while in Chennai cluster, female borrowers were more only in urban locations. Male borrowers dominated in other clusters.

9. Of all the activity categories, students borrowed the least. That all categories borrow is not surprising, because the sample was drawn mainly from low-income households. Debt is a permanent feature of these households, both rural and urban.

10. About 50% of rural and 65% of urban households have formal savings accounts. Still they regularly approach informal sources for loans. 50% or more borrowers of all types had a bank account - 64% borrowers from informal sources, 47% from MFI and 53% from SHG have bank accounts but still choose to borrow from the informal sources.

11. The most popular loan source is informal (51%) while the least popular is the formal (16%) one. Given the cumbersome procedure for getting a formal loan, this distribution truly reflects the ground reality. MFI loans are most common in Kolkata and Hyderabad clusters, but SHG loans outnumber MFI loans in the latter cluster.
12. As for amounts borrowed 47% are from the informal sector, while only 12% came from MFIs. The average loan size of MFIs varied from Rs 12,000 to Rs 20,000 across clusters while it is much larger for banks, except in Hyderabad cluster, where the informal source is supreme (<52000).

13. Indebtedness is not directly linked to MFIs. It is more likely to be the result of informal sector activity of all outstanding amounts, 32% came from informal sector and only 6% from MFIs. However, the repayment rate associated with MFIs (>90%) is very high.

14. Compared to other sources, MFIs and SHGs have, by far, greater penetration among the low-income groups as evident from lower average monthly incomes (Rs1411 and 2365 respectively) of borrowers from these sources. In aggregate, awareness is highest for informal lending, although in the clusters of Chennai, Kolkata and Hyderabad, households appear to be well aware of both MFIs and formal options. Over 50% of MFI borrowers are repeat borrowers. The majority of borrowers from MFIs and SHGs are female and younger compared to other sources.

15. Since MFI loans are smaller in size compared to other types of loans, the average outstanding amounts are higher for formal and informal loans. Normalising loan amounts by household income to gauge indebtedness reveals a similar result, Jaipur cluster having the highest level of indebtedness. The results reinforce earlier finding that indebtedness is much more closely associated with informal loans than MFI ones.

16. Related to indebtedness is the problem of multiple borrowing. About 11% (in Chennai cluster 7.5%, in Hyderabad cluster 2.3%, in rest of the clusters 1.2%) of the borrowers have multiple loans of which 21% involved a loan from MFIs. In our sample, multiple borrowing is captured only if a household has two or more loans from distinct source of borrowing (MFI, SHG etc). During Focus Group Discussions (FGD), participants pointed out that multiple borrowing from a single source is a feature closely tied with small borrowing, whether from MFIs or any other source. An earlier study has found that multiple borrowing is more common with informal loans than MFIs.

17. Whether multiple borrowing is a cause for concern or not, depends on the underlying reason for borrowing – if it is due to a credit constraint, it is not that serious, but if it is used to pay off an existing debt, then multiple borrowing is indeed a tricky problem. While it is difficult to precisely establish the reasons for multiple borrowing directly from the survey, it was found that for MFIs, the use of funds was largely in business. Further, multiple borrowing was mostly among males many of who are cultivators.

18. In rural areas bank loan are mostly used in agriculture (26%), while loans from informal sources are used largely for health and marriage-related expenses (46%). SHG loans are disproportionately used either for house construction or repair (19%), to finance consumption (14%) or for marriages (11%). The highest percentage of MFI loans are used for business promotion (45%), only 3% is used for paying off existing debt. Kolkata cluster has the highest percentage of MFI loan usage on business expansion (63%) with Hyderabad cluster (17%) and Chennai cluster (10%) accounting for the lowest percentages, the average for all the clusters being 45%.

19. It is difficult to justify the popular criticism that MFI loans are deployed in unproductive pursuits such as paying off existing debt or consumption in view of para 18. Nor does it support the claim that multiple loans are an entrenched feature of MFI lending. These features are more closely associated with informal lending. For example, marriage-related expenditure, consumption and medical emergencies together account for nearly 55% of the funds borrowed from informal sources.

20. Agents clearly pay a larger role in the Hyderabad cluster than elsewhere, and in this cluster, they seem to be much more involved in MFI activity than any other activity. This could be one of the reasons for higher borrowing and, at the same time, resentment against MFIs in Hyderabad. ‘Intermediation’ by agents is negligible in the case of informal sources of loans.

21. Costs incurred by borrowers are highest for formal sources across all clusters, followed by SHGs, MFIs and informal sources, in that order. These costs include wage loss due to time spent in getting the loan approved, cost of travel, money spent on food, etc., while travelling to the source of loan, charges paid for the preparation of documents, additional charges (like stamp duty), payment of bribes, and so on. The magnitude varies across clusters, but not the rank order. Formal sources are the most expensive across the five clusters. We know that the procedures in banks can be cumbersome and exacting. On the other hand, such costs are negligible for borrowing from moneylenders. However, this finding needs to be juxtaposed with the high interest rate charged by moneylenders with the significantly lower interest charged in the formal sector. A comparative representation of the cost of borrowing from various sources – formal and informal – is given in Table I.
The breakup of these costs of borrowing by loan type is provided in Table 2. Expectedly, documentation and processing requirements for informal loans are negligible, if not absent, and hence, borrowers do not incur transactions cost while obtaining such loans. On the other hand, the formal sector imposes exacting standards making these documentation costs the highest. Bribes and commissions are high and closely associated with formal bank loans rather than other loan types. This result, however, needs to be juxtaposed with the high interest rate charged by moneylenders with the significantly lower interest charged in the formal sector.

According to our primary survey, precise information of applicable interest rate on loans is not available to all borrowers. Therefore, we divided our sample into borrowers who knew and those who did not know the interest rate payable on their loan. The rationale for this division is the premise that those with incomplete information might end up paying higher interest charges compared to the rest. MFI borrowers are the least aware of the interest rates they end up paying; in fact, a vast majority of them do not know. On the other hand, awareness of interest rates from other sources is rife. A strong implication of this finding is the need to introduce greater transparency in publicising interest charges in the disbursement of all loans, with a special emphasis on MFIs. A comparison of payable interest rates in the 'know' and 'do not know' categories is presented in Table 3.

Although the basic interest rate for MFI loans is higher than that of formal sources and SHGs, the difference between total economic cost of SHG and MFI loans is small, while the gap between formal and MFI loans reduces after accounting for the transaction and opportunity costs. This implies that comparing different sources of loans looking only at the basic interest rates would be misleading.

In a white paper published by Intellecap, the estimated range of total cost for MFIs lies between 17% and 34% depending upon its size. The cost of borrowing as estimated in the present study falls within this range.

It has been brought out in the present report that MFI interest rates are lower than rates in the informal market and are, therefore, offering competition to moneylenders. Thus, the measures such as the Andhra Pradesh ordinance can only prevent the development of a healthy and competitive microfinance sector that could compete with local moneylenders.
Chapter 1

INTRODUCTION

India, with 70 percent of its population living in rural areas, is characterised by diverse natural, socio-economic and socio-cultural conditions and a complex developmental path – on one side there is marked underdevelopment and widespread poverty and on the other side the country is known for its spectacular growth and accelerated development in several modern sectors of economy. Starting from a low level the country has managed to improve the socio-economic condition of its people in recent decades.

Since the launch of Millennium Development Goals (MDGs) at the millennium Summit in New York in September 2000, the MDGs which are a set of time-bound human development targets to be achieved by 2015, have become a widely embraced yardstick of developmental efforts by governments, donors and NGOs. The targets include halving income-poverty and hunger, universal primary education, gender equality and women empowerment, reducing infant and child mortality by three fourths, and reversing the spread of HIV/AIDS and other communicable diseases.

Along with a big array of other countries, India too is committed to attaining the targets embodied in the Millennium Declaration.

Wide disparities exist in the country, in poverty, education, health outcomes, and reduction of gender bias across different sections of the population, across different regions, states and within states. India’s progress in achieving the MDGs depends crucially on the country’s ability to accelerate economic growth, maintain macroeconomic stability and provide appropriate social services to the population, especially the weaker and vulnerable sections. To achieve high growth rates on a sustainable basis, further substantial progress is needed in structural reforms, fiscal condition and improved governance.

India’s formal financial sector comprises mainly of commercial banks, regional rural banks (RRBs), as well a several cooperative banks and societies. Despite the existence of a deep and diversified infrastructure of financial institutions the majority of India’s rural population, especially of poor households and women, do not have appropriate access to financial services offered by the formal banking sector. According to a recent rural financial survey conducted in 2006 with World Bank support, nearly 60 percent of rural households do not have a bank account and only 21 percent have access to credit from a formal source.

Below-Poverty Line households often rely on informal sources (money lenders, traders etc. for their consumption credit needs, at exorbitant interest rates. The exclusion of a large section of the people from participation in the financial sector is a dilemma confronting not only the government of this country but most governments, world wide. Keeping this in mind, in 2003, the then Secretary-General of the United Nations, Dr Kofi Annan, had said:

“The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector. Together we can and must build inclusive financial sectors that help people improve their lives”.

1
Subsequently, the UN had gone on to develop a charter announcing the main goals of inclusive finance. India’s planners assert that financial inclusion is “integral” to the inclusive growth process and sustainable development of the country, but in the same vein admit that the products brought out by the different nationalised banks are unworkable and even unviable. Therefore, what is needed today is a system which makes banks and the financial sector, including insurance, that work for the poorest of the poor. It has been proved at the international level that micro-finance programmes play a significant role in achieving the MDGs. This includes verifiable impacts on the economic situation of poorer households and related effects on poverty alleviation, education, health and social status of women.

In recent years, several new approaches have been evolved to provide finance to India’s rural poor. Most prominent among them is the “Self-Help Groups (SHGs) – Linkage Banking” model, supported by the National Bank for Agriculture and Rural Development (NABARD). Other microfinance approaches involve partnerships between government, non-governmental organisations (NGOs), and banks. Additionally other institutional structures for microfinance have also emerged: these include mostly independent specialized microfinance institutions (MFIs). These microfinance institutions attempt to address the problem of financial exclusion by providing financial services to the lower income groups who traditionally lacked access to formal financial institutions.

Apart from impacting growth, there is now a growing appreciation of the ‘empowerment’ dimension of microfinance, of the extent to which it can provide to the ordinary and poor people access to opportunity and the ability to climb out of social and economic backwardness. It is perhaps symbolic of this thinking that the approach paper to the Eleventh Five Year Plan talks of microfinance as a springboard for entrepreneurial development (Planning Commission 2006). The broader vision is not just faster growth but also inclusive growth, that is, a growth process which yields broad-based benefits and ensures equality of opportunity for all.

In India, financial inclusion has always been a priority given the socialist beginnings of the Indian state. A policy of directed credit which obliges banks to lend between 32% and 40% of their net time and demand liabilities to ‘priority’ sectors at a rate lower than their prime lending rates called priority sector lending (PSL) is in place. This policy has met with limited success due to the banks’ inability to reach out to the intended beneficiaries; instead, they met their PSL targets by lending to other intermediaries such as Microfinance Institutions (MFI) that emerged due to the inability of banks to promote financial inclusion.

In the year 2008, the Committee on Financial Inclusion led by Dr. C Rangarajan defined ‘financial inclusion’ as the process of ensuring access to financial services, and timely and adequate credit needed by vulnerable groups, such as the weaker sections and low income groups at an affordable cost. This definition was later amended by the Reserve Bank of India (RBI) as follows: Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups, such as the weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream institutional players.

As a corollary, ‘financial exclusion’ can be defined as the lack of access to adequate, low cost, and fair financial services from formal institutions for some sections or segments of the economy. The financially excluded households often resort to high cost borrowing from informal sources, for instance, moneylenders, who charge anywhere between 60% and 100% in annual interest payments. This entire phenomenon of financial exclusion has a tendency to become self-reinforcing, thus making it hard for the affected persons to extricate themselves from the vicious circle. It is also likely to contribute to social exclusion, especially of the rural poor.

Two important consequences follow from financial exclusion. Firstly, financially excluded households and microenterprises have to deal entirely in cash. Therefore, they are susceptible to irregular and uncertain cash flows. Secondly, due to the lack of access to formal institutions like banks and other saving opportunities, the financially excluded segments have limited options for building assets or saving for old age. Microfinance attempts to address the problems of financial exclusion by providing financial services to such lower income groups who traditionally lack access to formal financial institutions.

However, the global microfinance industry has recently faced a crisis because the seemingly conflicting social and private goals have come to the fore. Many have argued that poverty reduction is at loggerheads with the iniquitous goal of profit maximisation pursued by MFIs. Profit making at the expense of the poor jarred the sensibilities of many, and there was widespread criticism of the public listing of a Mexican MFI called Banco Compartamos in 2007, worth US$1.6 billion. In India, SKS Micro-Finance was reportedly worth US$358 million when it was listed in 2010. The high valuation became the subject of intense and often acrimonious public debate, especially since many MFIs have access to funds at PSL rates which are in fact subsidised rates to help the poor. The profiteering charge quickly engulfed the entire industry and it was accused of charging usurious interest rates. As a result, MFIs today are frequently compared with the notorious moneylenders who derive profit from the misery of the poor.

For evaluating the financial inclusion role of the MFIs and suggesting credit-policy improvements, it is essential to empirically test the conduct of MFIs. MFIs have specifically been charged with the following: (a) extremely high and often usurious interest rates, (b) coercive debt collection practices, and (c) multiple lending. All the three problems relate to the interface between the borrower and the MFI.
the perspective of developing credible policy, it is vital that such a policy be the result of comprehensive analysis of both secondary and extensive primary data, rather than it being the outcome of anecdotal evidence.

Existing research on MFIs in India suffers from inadequate data on the total cost of borrowing by source, the prevalence of multiple borrowing and the impacts of microcredit on poor households. Since ‘usurious’ is a relative term, accurate benchmarking is necessary to establish whether rates charged by MFIs are usurious or not. This question has been addressed carefully. In this process comparable interest rates for alternative sources of finance have also been worked out. Estimating the impact of MFI loans is a difficult question, but a preliminary assessment based on reported usage of funds have been made. Reliance was also placed on focus group discussion (FGD) responses for more insights. However, more focused research on this topic is necessary, especially since money is often considered to be fungible.

The different sources of borrowing for this study have been classified in four groups, viz, MFIs (NBFCs, NGOs, Companies registered under Section 25), Formal source (commercial banks, Regional Rural Banks, NBFI, Government programs and schemes, Government employer), Informal sources (money lenders, landlords, chit-funds, friends/relatives, credit and thrift society, private employers) and the SHGs.

The report has been organised into five chapters. The second chapter, Banking the Unbanked: The emergence of microfinance Institutions(MFIs), discusses factors contributed to the emergence of MFIs, the world over, as agents of financial inclusion and economic liberation of the poor and vulnerable. The third chapter, Microfinance in India, provides a brief overview of MFIs in India, their genesis, performance as well as their brush with recent controversy. Also highlighted here are the geographical reach of MFIs, client profile and market trends. The fourth chapter, Results from Primary Survey, presents the results of the extensive primary survey of over 10,000 households in five major clusters between December, 2010, and January, 2011, a period immediately succeeding the passing of the MFI regulation ordinance in Andhra Pradesh. The fifth and final chapter, Looking ahead, apart from providing an overview of the salient findings that have emerged from the study, tries to delineate some issues for future investigation.

3. Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Ordinance, 2010
FROM time immemorial banks have not considered poor people as a viable market. Most formal banking institutions are reluctant to serve the poor and microenterprises in the unorganised sector because of perceived high risks, high costs involved in small transactions, perceived low relative profitability, and inability of the poor to provide the physical collateral usually required by such institutions. In technical terms, problems of adverse selection and information asymmetries make it difficult for financial institutions to screen and monitor credit decisions. Also, problems in monitoring and enforcing financial agreements make it unattractive for formal financial institutions to participate in the unorganised sector.

Lack of access to institutional sources of credit, most poor and low-income households are forced to rely on either inadequate self-finance or informal sources. Credit from moneylenders is extremely expensive, and the poor’s almost exclusive reliance on informal sources limits their ability to actively participate in and benefit from the development process. At the same time, it can be argued that the poor need more regular – and not less – access to financial services, including deposits, loans and other services. While they use financial services for the same reasons as anyone else, namely, exploiting business opportunities, smooth consumption, cope with emergencies, and so on, their demand for microfinance is largely inelastic due the fact that the poor value regular access to credit more than the cost of borrowing. However, financial services, even when obtainable, are often limited in terms of cost, risk and convenience. Left to the market, the poor and vulnerable will therefore, not get adequate, reliable and affordable access to financial services.

Figure 2.1 summarises the demand and supply side issues justifying the need for MFI model for credit market of small

<table>
<thead>
<tr>
<th>Demand Side: Why small borrowers avoid banks as a source of funds?</th>
<th>Supply Side: Why banks shy away from providing financial services to the rural poor?</th>
</tr>
</thead>
<tbody>
<tr>
<td>High uncertainty due to irregular/volatile income streams and expenditure pattern.</td>
<td>Products and services are not flexible enough to meet their volatile income and expenditure pattern.</td>
</tr>
<tr>
<td>High risk of default due to lack of adequate credit information.</td>
<td>Transaction cost of dealing with banks is very high.</td>
</tr>
<tr>
<td>High transaction costs due to small size loans, high frequency of transaction, large geographical spread, heterogeneity of borrowers and widespread illiteracy.</td>
<td>Time-taking and cumbersome procedures for opening deposit accounts or seeking a loan from banks.</td>
</tr>
<tr>
<td>Lack of collateral, and difficulties in contract design and enforcement.</td>
<td>Banks demand collateral against loans which poor households most often do not have or lack access due to unclear landholding titles.</td>
</tr>
</tbody>
</table>
| Increased government interference distorts banks’ incentives. Example: persistent interest rate restrictions | }
borrowers in India.

To address the small credit needs of poor household, especially those below the poverty line, MFIs have emerged as conspicuous actors in this realm. However, as demonstrated in this report, their character has undergone a shift from the time they commenced operations. The pioneer MFIs operated as nonprofit, nongovernmental organisations (NGO) with a strong social focus. They developed new credit techniques, such as reduction in risk through group guarantees instead of requiring collateral, appraisal of household cash flow, and small initial loans to test clients. Experience, since then, has shown that the poor repay uncollateralised loans unfailingly and are willing to pay the full cost of borrowing, thus underlining that access is more important to them than cost.6 Even in India, there has been a noteworthy shift from NGO-MFIs to Non-Banking Financial Institution-MFIs (NBFC-MFIs) in recent years.7 Also, there has been a change in the manner in which MFIs raise finance. From being primarily donor-led, MFIs are now increasingly funded by banks and more recently, by private and shareholder equity.8

Today, microfinance players include governments, philanthropists, social investors and commercial banks, and specialised institutions such as Grameen Bank, among others. Although microfinance has been around in various forms for thousands of years, its modern incarnation is most closely tied to Mohammed Yunus, the Grameen Bank founder.9 In some countries, the walls between microfinance and the formal financial sector have started disappearing. The commercial success of some MFIs has begun to attract the formal, mainstream actors. If microfinance can achieve commercial success, it can thrive without reliance on subsidies, which today total hundreds of millions of dollars.10

Evidence has shown that the poor can be served profitably, on a long-term basis, and in some cases, on a large scale. That, in itself, should be a good thing. A doctrinaire approach towards poverty alleviation that involves developmental aid, subsidies and governmental support treats the poor as the responsibility of the state and is, unlikely to be sustainable. Philanthropy and corporate social responsibility cannot take the process of engagement with the poor much ahead.11 The poor must become active, informed and involved consumers. Poverty reduction can result from co-creating a market around the needs of the poor.12 While it will be premature to pronounce that the modern MFI has achieved this goal, it certainly could be part of the solution. In this context, regulation has a fundamental role to play in ensuring that market oriented solutions to poverty alleviation coexist with other social initiatives. This point has been elaborated in the concluding section.

Microfinance offers the poor households and the women access to basic financial services such as loans, savings, money transfer services and micro insurance. People living in poverty, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption and manage risks. The sheer size of the MFI industry indicates the global pervasiveness of the small credit market. As of 2009, there were 1,934 MFIs globally, with an estimated borrower base of 92.2 million and a total outstanding portfolio of over US$66 billion as reported by the MFIs to the Microfinance Information Exchange or “MIX Market”. This does not include the MFIs that do not report to MIX Market. Including them would increase the number of borrowers to a staggering 200 million worldwide. The Microfinance Analysis and Benchmarking Report published by MIX in 2010 for Central Asia and Eastern Europe, reports 8,012 institutions providing microfinance services in the region, with a total loan portfolio of US$12 billion and 8.6 million borrowers.13 A similar report for Latin America and the Caribbean shows almost 14 million borrowers and a credit portfolio close to US$20 billion. Based on the data reported by MF Transparency, India has about 27.5 million borrowers across 84 MFIs. Over the five years ending 2008, the global industry experienced a growth in the number of borrowers at a compounded annual growth rate (CAGR) of 12% and the outstanding portfolio grew at a CAGR of 34%. Inter-regionally, South Asia, East Asia and the Pacific region had the highest growth rates in terms of borrowers while Latin America showed the highest growth in terms of portfolio outstanding. Latin America accounts for US$16 billion or 36% of the total global portfolio; however, South Asia has the largest global borrower base. Clearly, South Asia and Latin America, two of the fastest growing regions on the world, account for the lion’s share of the microfinance market.

It is important to note that MFIs alone will not offer any magic solution that will enable the poor to climb out of poverty. These need to be supplemented by targeted social programmes, because they supplement the favourable effect that rising economic growth has on poverty.14 This view has been most eloquently articulated by Professor Jagdish N. Bhagwati in his Lok Sabha lecture delivered in December, 2010. High and rising growth has helped poverty alleviation by offering gainful employment to the poor and providing larger volume of revenues for the government to adequately finance social programmes.15 Therefore, accelerating growth and public interventions are both necessary to enable the poor to participate in the market in a meaningful manner. MFIs are one such instrument of intervention, provided the regulations around it recognise the role they have to play in financial inclusion. Accordingly, policy has a vital responsibility to fulfill in this regard.

Financial exclusion is one of the symptoms of imperfections in the capital market that lead to relatively high levels of inequality in developing countries. Empirically, it has been established that nations with lower levels of financial exclusion tend to have lower disparities in income distribution. For example, in Sweden, less than 2% of adults
did not have a bank account in 2000, and in Germany, the corresponding figure was around 3% (Kempson 2006). Similarly, in Canada and Belgium, less than 4% and 5% of the adult population, respectively, did not have a bank account (Buckland et al. 2005). On the other hand, countries with high levels of disparity in income show a high level of financial exclusion, particularly bank exclusion. In Portugal, for example, approximately 17% of the adult population did not possess a bank account in 2000 (Kempson 2006). In India, almost half the country is unbanked and it has the highest number of households (145 million) excluded from Banking.

The income difference between the rich and the poor is rather significant in developing countries, such as in the Latin American and African regions, causing serious problems. Vast inequality in income leads to crime and political instability, and hampers the processes of economic development and poverty reduction. In India too, large disparities in income are present and are associated with high levels of financial exclusion. In order to ease inequality and develop the financial sector, it is necessary to deal with the financial exclusion of all sorts. Development of financial markets can be a powerful tool to lower inequality. Financial depth eases the credit constraints on the poor and increases their productive assets and productivity, thus contributing to poverty reduction. On the other hand, some argue that financial depth benefits only the rich. Since the poor depend mainly on informal finance such as borrowing from relatives or friends, development of the financial sector bypasses them. While this may be true, microfinance with its focus on the poor is a tool for financial depth endowed with the equalising effect. In a recent study across 61 developing countries, the authors confirm that microfinance directly eases the credit constraints on the poor and has a significant equalising effect. Therefore, along with economic growth, there is need for developing countries, like India, to leverage the potential equalising effect of microfinance for inclusive development.

Realising the encouraging role of MFIs in accelerating financial inclusion in developing countries, several case studies have been conducted to demonstrate their impacts. Given the context, innovative solutions have naturally been devised to deal with social problems and expediting the financial integration of the poor. Harvard Business School’s case study on Microfinance International Corporation (MFIC) presents an operating model which leverages immigrant remittances to improve the financial infrastructure for the unbanked in developed and developing countries. Since a significant number of the worlds’ poor households depend on income earned by family members working in industrialised countries, MFIC tries to maximise the economic capacity of the migrated bread-winners by offering them a line of financial services, including microcredit, in the USA. In addition, it also tries to ensure developmental impacts of the money these immigrants send by channeling remittances through professional financial institutions. To do so, MFIC offers a remittance solution to banks in the USA and MFIs in developing countries, thus enabling financial integration of the poor on either side. The CrediAmigo experience in Brazil suggests how multilateral organisations like the World Bank and other donors can play a catalytic role in microfinance development. The intervention of World Bank to the development of CrediAmigo has not been restricted to funding, but it has also contributed to the design, launch and growth of the institution by providing support by way of training staff and personnel, monitoring portfolio quality, and providing continual technical advice. The World Bank staff showed ultimate patience to nurture the development process of this MFI.

The growth of microfinance in Bangladesh is often cited as an example for other developing countries to emulate. A significant lesson learnt from the history in Bangladesh is the need to create an enabling environment. In countries like Malawi, the lack of macro stability deterred the growth of MFIs. Government regulations and policies are also crucial in creating a healthy environment for the growth of microfinance. In the presence of other non-credit interventions such as education, infrastructure development, the effectiveness of microcredit improves. As observed in the case of CrediAmigo and the Agricultural Bank of Mongolia, external donors like the World Bank have a big role to play in providing technical and financial assistance to infant institutions. The Bangladesh Rehabilitation Assistance Committee (BRAC) started in 1972 to provide relief and rehabilitation support, now showcases the success of its IGVGD (Income Generation for Vulnerable Group Development) programme that seeks to reach the hardcore poor to provide both livelihood protection (food aid) and livelihood promotion (skills training, microfinance, etc).

Given the sheer number of the poor, it is not surprising that the microfinance industry in India is among the largest in the world. However, it is highly fragmented. Outside of the top microfinance institutions such as SKS-Microfinance, BASIX, SEWA Bank, Spandana Sphoorty, Share Microfin, Bandhan, and so on, there are several other smaller initiatives that have demonstrated positive impacts on the lives of the rural poor. One such example is the Development of Women and Children in Rural Areas (DWCRA) initiative in Andhra Pradesh. Credit from DWCRA helped women start income generating activities on a sustainable basis. Another such initiative is Grameen Koota established in 1999 in Karnataka. The microfinance programme at Grameen Koota is also integrated with other social development programmes for women living in rural areas as well as urban slums.

Recently, Microfinance industry came under fire in the state of Andhra Pradesh when allegations of using coercive loan recovery practices and charging unsurious interest...
rates were raised against the MFIs. These charges resulted in the state governments passing the Andhra Pradesh Microfinance Ordinance 2010. There are reports that, following the passing of the ordinance, MFI disbursements in Andhra Pradesh have diminished, creating a shortage of much-needed finance to the rural poor. The impact of this regulation on the poor needs to be studied upon.

10. International Monetary Fund (June 2007), Finance & Development.
12. Ibid.
14. Social programmes need not necessarily be financed by government (Ibid).
16. Sweden had the lowest Gini Index (25) in 2000 among a set of 35 countries, as reported by CIA World Factbook. The corresponding figures for Canada and Germany were 32.6 and 28.3, respectively.
17. From the presentation of Dr. K.C. Chakrabarty, Deputy Governor, Reserve Bank of India at St. Xavier’s College, September 6, 2011.
18. Hisako, KAI and Shigeyuki (September 2009), Microfinance and Inequality, HAMORI Kobe University.
22. Hisako, KAI and Shigeyuki (September 2009), op cit.
23. Based on the Tendulkar Committee Report accepted by the Planning Commission of India, 37% people live below the poverty line in India.
Chapter 3

MICROFINANCE IN INDIA

The Indian microfinance sector presents a robust picture. Its growth was impressive even during the recent financial crisis and it sustained through the second half of 2009. Based on M-CRIL’s Microfinance Review (2010), there are approximately 27 million borrower accounts, surpassing those served by Regional Rural Banks (RRBs) by as much as 50%. MFIs serve 40% of the total number of micro-credit accounts with loan sizes not exceeding Rs 25,000. After adjusting for multiple counting in borrower accounts, the number falls to 18 million clients, still large by any standard.

Although the microfinance portfolio represented less than 1% of the total credit outstanding with the Indian banking system as on March, 2010, it constituted as much as 28% of the credit portfolio of RRBs. At current growth rates, microfinance would match RRBs and exceed the total portfolio of micro accounts held by all scheduled commercial banks within the next three years.

One major reason for the steady growth of MFIs in India has been the inability of the formal banking institutions to meet the credit needs of the poor, especially the rural poor. Although the numbers show marked growth of MFIs (Table 3.1), there are large sections of the population that are still uncovered, thus reflecting the vast potential for expansion.

The data on ownership of bank accounts by different segments of the population reveal a bias against the rural population (Annex I). The asymmetry of bank accounts in favour of urban and metropolitan population becomes more glaring when amounts, rather than the number of accounts, are considered.

The amounts in rural deposits represents a small percentage of the GDP, averaging approximately 23.5% for all the quarters from 2006-07 to 2009-10. In sharp contrast, the corresponding share for urban and metropolitan population was 189% for the same period. A similar pattern is observed for credit accounts. It is, however, observed that the rural credit shares are even lower than the rural deposit shares (Annex II). This implies that banks are intermediating rural savings into the metropolitan and urban areas, thereby worsening the problem of paucity of funds for rural areas. In addition, credit disbursed by the scheduled commercial banks includes a large portion of agri-credit.

<table>
<thead>
<tr>
<th>TYPE OF FINANCIAL INSTITUTION</th>
<th>REGULATED BY</th>
<th>NUMBER OF INSTITUTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Bank</td>
<td>RBI</td>
<td>80</td>
</tr>
<tr>
<td>Regional Rural Banks and Local Area Banks</td>
<td>RBI/ NABARD</td>
<td>86</td>
</tr>
<tr>
<td>State Cooperative Bank , District Cooperative Bank and Primary Agricultural Cooperative Societies (PACS)</td>
<td>State Government / NABARD</td>
<td>-96400 (PACS -96000)</td>
</tr>
<tr>
<td>NBFC</td>
<td>RBI</td>
<td>12740</td>
</tr>
</tbody>
</table>

**NBFCs** | RBI | -50
---|---|---
**Section 25 companies** | Central Government | 10
**Co-operatives, MACS and others** | State Government | 100
**Societies / Trusts** | Central Government/ State Government | 500
**Self-Help Groups** | Self-regulated/ Supervised by NGOs | 4 million

SOURCE: M-CRIL MICROFINANCE REVIEW 2010
commercial banks also shows a bias against agriculture and favouring industry (Table 3.2).

Thus, the banking system in India has not been allocating adequate resources to rural areas and low-income groups. Access to formal financial sources is skewed, with large segments of the population, particularly the rural poor in the unorganised sector, remaining underserved or completely left out of the formal banking system. In the absence of access to traditional bank credit, low-income borrowers have met their financial needs by borrowing from local moneylenders at exorbitant rates ranging from 60% to 100% per annum. Credit from moneylenders seldom contributes in building assets; rather it is predominantly used for consumption and other emergencies. These factors have contributed to the emergence of MFIs.

Despite the existence of relatively deep and diversified infrastructure of financial institutions, a major chunk of the rural population, especially the poor households, lack appropriate access to financial services offered by the formal banking sector. This leads us to the concept of financial exclusion: A household is considered financially excluded when it has either no access to some or all services offered by mainstream financial institutions in its country of residence or does not make any use of these services.

One estimate of financially excluded households in India is approximately 120 million (CRISIL Report 2009). Another comparable estimate puts the unbanked population in India to be about 60%. This percentage comes down to 54 when the estimate of 222.9 million total household is taken. Unsurprisingly, the Indian microfinance industry has grown substantially to occupy the space left uninhabited by the banking sector. A total of 70 million micro-credit accounts existed as on March, 2010, making India the world’s largest microfinance market, surpassing Bangladesh’s total of around 30 million accounts in 2006.

Two dominant models of microfinance have emerged. The first is the bank-led model promoted by the State through commercial banks that caters to groups of 10 to 20

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**FIGURE 3.1: LEGAL FRAMEWORK**

Legal Framework/Laws Impacting Delivery of Financial Services for Low Income Clients in India

- **Source:** Adapted from Thorat and Arunachalam.31
women called Self-Help Groups (SHGs). The second model comprises of private sector MFIs that lend to small groups similar to the SHGs. Both are based on the Joint Liability Group (JLG) method. Besides, cooperatives and Section 25 companies also coexist, although their presence is modest. The MFI sector is thus made up of NGOs, cooperative societies, Section 25 companies and NBFCs, the NBFCs emerging as the dominant legal form.

Figure 3.1 presents a snapshot of the current institutional framework prevailing in the microfinance system in India. The picture that emerges is not one of lack of regulation, but one in which there is multiplicity of regulation, which merits review in the interest of achieving the overarching goal of financial inclusion for the millions of deprived households in India.

Most leading MFIs globally operate today on a commercial basis using the techniques and disciplines of commercial finance. Donor and social investor capital diminishes as individual institutions and entire markets mature. For this reason, an increasing number of MFIs are getting licensed as banks or as finance companies, allowing them to finance themselves by accessing capital markets and mobilising deposits. Since getting registered as a bank is costly and the local area bank idea has not been successful, NBFCs have emerged as a nearest substitute for those MFIs who prefer the for-profit route in India as well. They can also enter the capital markets to mobilise resources using this route.

At present, MFIs registered as for-profit NBFCs represent 84% of all borrower accounts and manage 88% of the portfolio, although they only account for about 45% of the total number of MFIs. Like in other parts of the world, in India too, there has been an evolution from unregulated not-for-profit to regulated and for-profit MFIs. While cooperatives have been in existence for over 17 years and NGOs for nearly nine years, NBFCs/Section 25 companies are the youngest with an average age of about six years.

The share of NBFCs among the MFIs showed a continuously increasing trend after every alternate year during 2000-2010 whereas the share of NGOs increased in 2003 and then decreased every alternate year till 2009. The cooperatives also showed more or less the same trend as with NGOs (Figure 3.2).

The distribution of types of MFIs and their profit orientation is shown in Figure 3.3. The switch to the NBFC legal form is the single most fundamental change involving the microfinance industry in recent times and has been triggered by the shift in the primary sources of funding from donor-led to bank-led, since commercial lenders are more willing to lend large sums of money to NBFCs rather than to NGOs.

In India, microfinance has so far been synonymous with microcredit, since the latter is the most popular product in demand. Other financial services such as insurance and advice are peripheral, at best, although with potential. MFIs serve the poor in rural, semi-urban and urban areas across the country, but their presence is highest in the southern states. A vast majority of the loans advanced by the MFIs are in the range of Rs 5,000 to Rs 20,000, which are well within the range setup

### TABLE 3.2: AGRICULTURE CREDIT VERSUS INDUSTRY CREDIT

<table>
<thead>
<tr>
<th>YEAR</th>
<th>AS PERCENTAGE OF TOTAL GDP AT FACTOR COST</th>
<th>SHARE IN NON-FOOD GROSS BANK CREDIT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>AGRICULTURE CREDIT</td>
<td>INDUSTRY CREDIT</td>
</tr>
<tr>
<td>2000-01</td>
<td>2.6</td>
<td>19.0</td>
</tr>
<tr>
<td>2001-02</td>
<td>2.8</td>
<td>10.6</td>
</tr>
<tr>
<td>2002-03</td>
<td>3.2</td>
<td>12.7</td>
</tr>
<tr>
<td>2003-04</td>
<td>3.5</td>
<td>12.0</td>
</tr>
<tr>
<td>2004-05</td>
<td>4.2</td>
<td>14.4</td>
</tr>
<tr>
<td>2005-06</td>
<td>5.1</td>
<td>16.2</td>
</tr>
<tr>
<td>2006-07</td>
<td>5.8</td>
<td>17.7</td>
</tr>
<tr>
<td>2007-08</td>
<td>6.1</td>
<td>19.1</td>
</tr>
<tr>
<td>2008-09</td>
<td>6.5</td>
<td>20.2</td>
</tr>
<tr>
<td>2009-10</td>
<td>7.1</td>
<td>22.3</td>
</tr>
</tbody>
</table>

SOURCE: RESERVE BANK OF INDIA.
NOTE: GDP FACTOR COST AT CURRENT PRICES.

### FIGURE 3.2: CHANGING COMPOSITION OF MFIS IN INDIA BASED ON LEGAL ENTITY

![Figure 3.2: Changing Composition of MFIs in India Based on Legal Entity](source: M-CRIL MICROFINANCE REVIEW 2010)

### FIGURE 3.3: TYPES OF MFIS AND THEIR PROFIT ORIENTATION

<table>
<thead>
<tr>
<th>Societies</th>
<th>Credit cooperatives</th>
<th>NBFCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public charitable trusts</td>
<td>Private trusts</td>
<td></td>
</tr>
<tr>
<td>Section 25 companies</td>
<td>Cooperative banks</td>
<td>LABs</td>
</tr>
<tr>
<td>Not for profit/unregulated</td>
<td>for profit/regulated</td>
<td></td>
</tr>
</tbody>
</table>

SOURCE: M-CRIL MICROFINANCE REVIEW 2010
by the Government of India in the “Micro Financial Sector (Development and Regulation) Bill, 2007”, where they define the microfinance loans as loans with amounts not exceeding Rs 50,000 in aggregate per individual/small enterprise.

Apart from geographical concentration in the southern region (although it is changing), large MFIs dominate. The top 10 MFIs account for 77% of all borrower accounts and 79% of the credit portfolio. In 2006, about 73% of the active borrowers were serviced by NBFC-MFIs; by 2010, the share increased to about 84%. In March, 2010, there were 25 MFIs classified by the RBI as systematically important, with portfolios in excess of Rs 100 crore, although only two were licensed for deposit mobilisation. The reluctance of regulators to permit MFIs to collect deposits is one of the many factors impeding financial inclusion.

Since most MFIs cannot legally accept deposits, they are limited to small amounts of client deposits as cash security. The average contribution of deposits ranges from 4% to 8% of loans outstanding compared to 30% to 40% in Bangladesh and Indonesia.

The primary data of 66 firms collected by M-CRIL for the 2010 report shows that the average size of an NBFC’s MFI portfolio is about Rs 579 crore (US$121 million), although for the largest 10 MFIs, it is Rs 1600 crore (US$ 340 billion), reinforcing the dominance of large MFIs in the market.

Portfolio quality of MFIs is judged by either of two methods — nonperforming assets (NPAs), that is, loans that are 180 days past due and portfolio at risk that is portion of the portfolio that is 30 days overdue, commonly referred to as PAR 30. PAR30 above 5% is a sign of trouble in microfinance. Strong group pressure and efficient collection has resulted in high repayment rates, although there is some variation across types of MFIs. For example, NGO-led NBFCs have a more relaxed approach towards repayments and thus report higher PAR30 on average. PAR30 values for different legal entities under MFI are presented in the Figure 3.4.

Compared to banks, MFIs report superior portfolio quality. NPAs for MFIs are between 0.2% and 3% compared to the NPA range of 3% to 10% for commercial banks. However, following the Andhra Pradesh crisis of 2006, there has been growing concern over portfolio quality in neighbouring Karnataka as well. This concern eventually led to the issuance of the ordinance by the Andhra Pradesh government in October, 2010. The long-term trend in portfolio quality presented in Figure 3.5 shows the sudden increase in PAR30 in 2006.

Although lower risk and better asset quality are innate features of MFIs, the Indian ones report better statistics

| TABLE 3.3: TOP 10 MFI’S IN INDIA (AS ON SEPTEMBER 30, 2008) |
|---------------------------------|----------------|----------------|----------------|----------------|
| NAME                           | LEGAL STATUS  | HEADQUARTERED IN (STATE) | LENDING MODEL | LOAN OUTSTANDING (RS MN) | NET WORTH (RS MN) |
| SKS Microfinance Ltd (SKSMPL)  | Pvt Ltd Company (NBFC) | Andhra Pradesh | JLG          | 18227          | 2395           |
| Spandana SphoortyFinance Ltd (SSFL) | Pvt Ltd Company (NBFC) | Andhra Pradesh | JLG Individual | 11987          | 1225           |
| Share Microfinance Limited (SML) | Pvt Ltd Company (NBFC) | Andhra Pradesh | JLG Individual | 8568           | 1448           |
| Asmitha Microfinance Ltd (AML)  | Pvt Ltd Company (NBFC) | Andhra Pradesh | JLG          | 4944           | 475            |
| Shri Kshetra Dharamshala Rural Development Project (SKDRDP) | Trust | Karnataka | SHG          | 4060           | 157            |
| Bhartiya Samruddhi Finance Ltd. (BSFL) | Public Ltd Company (NBFC) | Andhra Pradesh | Diversified | 3882           | 317            |
| Bandhan                         | Society       | West Bengal   | JLG          | 3389           | 435            |
| Casphor Micro Credit (CMC)      | Section 25 Company | Uttar Pradesh | JLG          | 1431           | 93             |
| Grama Vidiyal Micro Finance Pvt Ltd (GVMFL) | Pvt Ltd Company (NBFC) | Tamil Nadu | JLG          | 131            | 231            |
| Grameen Financial Services Pvt Ltd (GFSPL) | Pvt Ltd Company (NBFC) | Karnataka | JLG          | 1287           | 127            |

than their global counterparts. The average PAR30 in India is 0.67%, as compared to the global average of 3.1% and Asian median of 1.5%. The low PAR30, however, has to be seen in the context of ‘ever-greening’ resulting in under estimation of the PAR30.

The financing pattern of the microfinance industry has undergone a noteworthy change over the last decade. As opposed to banks, Indian MFIs, barring a few, cannot raise money via deposits. Instead, their funds come from donors interested in the goals of poverty alleviation or from formal financial institutions, including banks, motivated by profits. In the aggregate, donor finance is being increasingly replaced by banks, and somewhat by private and shareholder equity. The availability of debt financing from both private and public sector banks has greatly helped the rapid growth of the industry. Since bank loans to MFIs are classified as Priority Sector Lending (PSL), banks have met their statutory requirements via this route. As of March 31, 2009, 72% of the debt funding to MFIs originated from banks, both public and private, resulting in a total exposure to MFIs of over Rs 10,000 crore. Portfolio securitisation is an auxiliary source of funding, largely accessible only to established MFIs. Some big MFIs have begun sourcing debt funds by floating ‘non-convertible debentures’ (NCDs). In M-CRIL’s sample of 66 MFIs, equity constitutes 10.7% and retained earnings about 7% of

![Figure 3.5: Changing Trend of Reported PAR30 for All MFIs](source: M-CRIL Review (2010))

![Figure 3.6: Funding for All MFIs](source: M-CRIL Microfinance Review 2010)

![Figure 3.7: The Financial Marketplace for Microfinance](source: Adapted from Thorat and Arunachalam.)
total funds available to MFIs (Figure 3.6). It is perhaps fair to assert that the long-term success of microfinance depends on the ability of MFIs to raise resources at a reasonable cost and also on their ability to optimise operational costs in characteristically high-cost rural environments. The financial marketplace for microfinance in India is presented in Figure 3.7.

As mentioned earlier, one area of discord in the public discourse on MFIs has been the rate of interest charged by them, equating it with that charged by local moneylenders. In the next chapter, we shall provide estimates of total cost of borrowing from a variety of sources, including MFIs, and compare them across loan types. Notwithstanding the magnitude of the loan, the rate of interest levied by any player is likely to be influenced by, inter alia, the cost of funds and the cost of operations (see Annex IV for operational features of different MFI models). In respect of efficiency, Indian MFIs perform respectfully in managing the operating expense ratio (OER). The weighted OER for the sample MFIs reported by M-CRIL (2010) is just 8.8%, which is significantly lower than 15.9% reported in 2007. The global median is 20%. In real terms, the cost of serving microfinance borrowers has declined from Rs 620 in 1999–2000 to Rs 298 in 2009–10 at 2002 prices. The average loan size has a significant impact on expense ratio, there being a clear downward trend in OER as loan size increases (Figure 3.8).

The evidence of efficiency or relatively low OERs for Indian MFIs cannot be seen in isolation from the business model of the MFI. Relative to a bank, administrative costs of servicing microloans are naturally higher in percentage terms. Reaching clients in rural areas with very low population densities is a costly exercise. Providing doorstep services adds to the cost. While transaction costs also exist for bank loans, the drivers are dissimilar. To be meaningful, therefore, cost comparisons of loans from different institutions should include all relevant costs which are normalized for size and tenure. This will be kept in mind when the total cost of borrowing for different sources is considered in the next chapter.
Chapter 4

RESULTS FROM PRIMARY SURVEY

MICROFINANCE, which started as a fledgling and informal service, has now transformed itself into a large and diversified industry. There are a large number of stakeholders in this welcome development – NGOs, MFIs, commercial banks, Nonbanking Financial Companies (NBFCs), moneylenders, RBI and its subsidiaries, other intermediaries and, of course, the clients. The supply side represents a continuum of institutions, from the really small to the very large, which are governed by a variety of institutions (Figure 3.2). As opposed to popular perception, regulation is not absent, but varies by type of institution. NBFCs that are allowed to raise deposits are the most strictly regulated while there is no or very little regulation in the informal sector. There is no doubt that governance is at a nascent stage in the sector and needs considerable strengthening. At the same time, just as we insist on transparency and regulation for NBFCs, it is important that these demands are not avoided by others, including NGOs, although the level of regulation can – and should – be different.

The recent developments in the state of Andhra Pradesh leading to the promulgation of the Andhra Pradesh Microfinance Institutions Ordinance 2010 and the Malegam Committee recommendations have stirred a crisis in the microcredit market of the country. One thing is clear, the MFIs on their part have not tried to clearly demonstrate the achievement of the avowed social objective of financial inclusion. At the heart of the conflict is perhaps the struggle to reconcile the idea of microfinance as a profit making enterprise, while at the same time inspiring attainment of social goals in an environment that throws up limited opportunities for the poor.

A stylized fact emerging from our assessment of secondary data is the shift away from donor to bank and equity finance. This has been corroborated by other recent studies. This shift naturally meant that in the new model, profit making cannot be eschewed; rather it has to go hand in hand with the social objective. Forcing banks to give loans without collateral failed and resulted in massive bad debts in our early development efforts.

The microfinance institutions made the breakthrough by rejecting collateral and adopting peer monitoring to mitigate risk. In recent times however, the sector has suffered from a crisis of legitimacy that resulted in the Andhra Pradesh government passing an ordinance called Andhra Pradesh Microfinance Institutions (regulation of money lending) Ordinance – 2010 in October, 2008, severely restricting activities of MFIs in the state, with countrywide repercussions. The case against MFIs is built on the following premises: (a) they charge usurious interest rates; (b) they use coercive and questionable debt collection methods against defaulting clients driving them to commit suicide, and (c) multiple lending is widespread and they pursue profit maximisation at the cost of other social objectives.

One of the primary objectives of this chapter is to discuss the loan interest rates charged by different lending agencies including MFIs and the cost of borrowing involved so as to find out the extent to which the MFIs have fulfilled their role of offering micro credit at reasonable rates.

It appears that the first ever extensive household survey in India on access to microcredit was conducted by Centre for Microfinance at Institute for Financial Management and Research (IFMR: CMF). The report of this survey was published in November, 2010. Some of the salient results of this survey are presented here as a prelude to the present investigation. The survey covered 1,920 households, across eight districts and 64 villages in Andhra Pradesh.

The report put in perspective some of the commonly
voiced protests against MFIs in the state. For all household types, MFI loans formed only a very small share of the total debt. In marginal farmer households as well as higher categories, 75% of the amount outstanding is sourced from the informal sector. The informal sources are the dominant source of loans for households with at least one loan.

According to the IFMR-CMF report 2009 there was excessive amount of indebtedness among rural households, with 93% households reporting of borrowing from some source or the other. Of these, only 11% of them had borrowed from MFIs, compared to 54% from SHGs, 37% from banks and 17% from moneylenders. If anything, MFIs have only begun to compete with the other sources of credit that are presumably much better established in the state. Multiple borrowing is very common with 84% of the rural households reporting more than one loan outstanding. The survey, however, found that incidence of multiple borrowing, that is, concurrent borrowing from the same source is most prominent among those who borrowed from informal sources. Whereas 3% of all households have two or more loans outstanding from MFIs, a staggering 70% have at least two loans outstanding from informal sources. Of the households which have an MFI loan outstanding, 82% also have other formal loans outstanding. The corresponding figure is 58% for households that have SHG loans, and 74% for households that have bank loans against them. Recall that much of the recent debate regarding multiple borrowing has been over the extent to which microfinance clients borrow concurrently from multiple MFIs. The IFMR survey report does not throw any light on this issue. On the contrary as per the IFMR-CMF 2009 survey report, multiple borrowing is a problem more closely associated with informal loans, rather than with MFIs.

While the IFMR survey covered only Andhra Pradesh, the primary sample in the present investigation covers five clusters across different states in an attempt to capture the realities of microfinance over an extended geographical area to develop a more reliable basis for the findings arrived at.

**THE SURVEY SAMPLE AND RESEARCH CONSIDERATIONS**

The survey was conducted in five clusters, namely Kolkata, Hyderabad, Jaipur, Lucknow and Chennai, during November–December 2010. A sample of 10,000 households comprising 10,188 individual borrowers from these clusters was randomly selected. The sample consisted of 2,000 households from each cluster and was made up of several activity status categories, namely, Agriculture Labour, Non-Agriculture Labour, Self-Employed, Regular Salary/Wage Earners and Others as per the distribution of various activity status categories obtained in the listing phase from both urban and rural segments in the clusters. The 2,000 households from each cluster were drawn such that approximately 30% of the households were canvassed in urban locations (25 households per block covering 24 urban blocks) and around 70% canvassed in rural locations (100 households per village covering 14 villages around the periphery of the city (Table 4.1).

The criterion for including a village in the sample was that it should have approximately 400 households. The 14 villages in rural areas were chosen covering all four geographical directions from the city as shown in Figure 4.1. Accordingly, beginning in the south-east, we chose four villages within the 0-4 km range from the city periphery, equidistant from each other, that is, one village each within 0-1 km, 1-2 km, 2-3 km and 3-4 km range, respectively. A similar procedure was followed in the other three directions, the only difference being the distance to the villages from the city periphery. For the north-east, each of the four villages were chosen such that they were equidistant in the 4-8 km range from the city periphery, that is, one village each within 4-5 km, 5-6 km, 6-7 km and 7-8 km range, respectively. Analogously, three villages were selected within the 8-11 km range from the city periphery for the north-west region, and three villages were selected from the south-west region in the 11-14 km range from the city periphery.

For each city, the wards selected for the survey were the same wards as in an earlier survey conducted by NCAER (NSHIE 2004-05). A total of 25 households in each of the 24 wards were chosen to obtain the urban sample of 30% households. From the list of households available from the earlier survey, a shortlist of approximately 100 households was prepared and the information for these households was updated. From this shortlist, a sample of 25 households was finally chosen in proportion to the different activity status categories of households in the NSHIE 2004-05. In case, the number of

### Table 4.1: Sample Distribution of Rural and Urban Households in the Five Clusters

<table>
<thead>
<tr>
<th>CITY</th>
<th>RURAL</th>
<th>URBAN</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kolkata</td>
<td>1,366</td>
<td>570</td>
<td>1,936</td>
</tr>
<tr>
<td>Chennai</td>
<td>1,401</td>
<td>712</td>
<td>2,113</td>
</tr>
<tr>
<td>Lucknow</td>
<td>1,453</td>
<td>657</td>
<td>2,110</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>1,365</td>
<td>648</td>
<td>2,013</td>
</tr>
<tr>
<td>Jaipur</td>
<td>1,439</td>
<td>577</td>
<td>2,016</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>7,024</td>
<td>3,164</td>
<td>10,188</td>
</tr>
</tbody>
</table>

### Figure 4.1: Geographical Distribution for Selection of Villages

![Figure 4.1: Geographical Distribution for Selection of Villages](image)
wards covered under NSHIE 2004-05 was less than 24, additional wards were selected. The choice of households in rural (urban) locations giving adequate representation to the five activity categories in the sample infuse the population characteristics in the sample. Another component of the primary survey was the qualitative analysis undertaken through the Focus Group Discussion (FGD) with borrowers conducted in one urban and two rural locations in Andhra Pradesh and West Bengal. The verbatim transcript of FGDs conducted at various locations is given in Annex VI.

The target respondents of the study were either heads of households or other earning units, who had outstanding loans from any source of micro-credit, male or female. The mean age of the respondents was 39 years, there being no significant difference between the respondents’ age across rural and urban locations. Most respondents were in the 31-40 years age group, except Lucknow, where the average age was 42 years. Sixty nine percent of the respondents were from rural areas while 55% respondents were male. Both quantitative and qualitative research modules were undertaken. The quantitative module consisted of face-to-face interviews conducted with the target respondents using a structured questionnaire. FGDs as mentioned the preceding paragraph above were conducted in Kolkata and Hyderabad both in urban and rural locations.

The research questions addressed in the present investigation look into the following issues:

- What is the total cost of borrowing across different sources of loans?
- What is the level of incidence of multiple loans across different sources?
- How do borrowers use the loan amounts?
- Does utilisation influence the source of borrowing?

The implications of the analysis are of great practical utility: if we find that MFIs make worth while contribution in achieving financial inclusion then one would like to find out a suitable supervisory mechanism that can ensure the regulatory mandate.

The survey has targeted the lower income groups in both rural and urban areas. The living conditions and the extent of poverty that characterise rural India are dramatically different from urban areas. In general, rural areas suffer from lesser opportunities, poorer infrastructure and lower number of financial institutions. As one moves away from cities, the quality of the infrastructure begins to diminish considerably. The survey has tried to capture the experiences and current status of a group of small borrowers from the low-income category. For this purpose, the borrowers from MFIs are treated as the control group, and sufficient caution is taken in interpreting the differences between this group and the rest, since the same household could borrow from multiple sources and hence, accounting for any observed differences between MFI borrowers and others becomes problematic. However, certain differences between the two groups can be safely attributed to MFI borrowing.

Since the survey was conducted at one point in time, it is not possible to capture the impact of small borrowing on a debtor household over a period of time. This could be an area for future research. A few tentative impacts have been assessed by interpreting the responses to some relevant survey questions. For example, respondents were asked to identify the barriers to securing a loan, if any, and its proposed deployment. From the usage of loan, one can attempt to infer impacts, although the panel data of respondents (which we don’t have) is better suited to draw more conclusions. The dimensions on which respondents were asked questions included:

- Awareness of different sources of borrowing.
- Loan particulars: source of loan, loan principal, cost of borrowing, interest rate charged, repayment schedule and instalment amounts.
- Use of borrowings whether for consumption or productive purposes or both.
- Extent of multiple borrowings.
- Saving habits of rural households.
- Barriers to different sources of borrowings.

### DESCRIPTIVE STATISTICS

By design, the vast majority of our sample consisted of rural households (almost 70%). The actual proportions of rural households across the selected clusters are as shown in Table 4.2.

In aggregate, the sample includes about 45% female borrowers but the distribution is somewhat uneven across the clusters. In Hyderabad, more than 80% of the borrowers are women in both rural and urban areas, and in Kolkata too, female borrowers outnumber male borrowers. In Chennai, the proportion of female borrowers in urban locations is higher, while male borrowers dominate in rural locations. In Jaipur and Lucknow the male proportions are higher in both rural and urban areas (Table 4.3). The interesting facet of these observations is that in states where NBFC and banked SHG microfinance activity is enormous, women borrower proportions are much larger since these institutions lend primarily to women. The distribution by gender, therefore, reflects the type of MFIs operating in a specific location. In locations where informal microfinance is more active, male

### TABLE 4.2: PERCENTAGE DISTRIBUTION OF RURAL AND URBAN HOUSEHOLDS IN THE FIVE CLUSTERS

<table>
<thead>
<tr>
<th></th>
<th>Rural Households (%)</th>
<th>Urban Households (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kolkata</td>
<td>70.6</td>
<td>29.4</td>
</tr>
<tr>
<td>Chennai</td>
<td>66.3</td>
<td>33.7</td>
</tr>
<tr>
<td>Lucknow</td>
<td>68.9</td>
<td>31.1</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>67.8</td>
<td>32.2</td>
</tr>
<tr>
<td>Jaipur</td>
<td>71.4</td>
<td>28.6</td>
</tr>
<tr>
<td>Total Sample</td>
<td>68.9</td>
<td>31.1</td>
</tr>
</tbody>
</table>
borrowers are likely to outnumber women borrowers.

Figure 4.2 shows average age of borrowers in rural and urban areas as well as for the whole sample. It can be appreciated that the majority of borrowers of microcredit belonged to the 31-40 years age group, that is, in the productive age category, which needed credit most, in the absence of regular and productive employment opportunities. There is also hardly any rural-urban difference in the average age of borrowers.

Borrowers’ education attainment, observed for seven ordered categories on the other hand, throws up some interesting but predictable variations. The percentage in the rural area is higher for all categories except for the graduate and above category (Figure 4.3). The disparity between rural and urban proportions is highest for illiterates -there are 55% more illiterates among rural households. It is important to note that a vast majority of borrowers are either illiterate or had ‘below primary’ education, reinforcing the presumption that microfinance borrowers generally belonged to the least educated sections. In addition, they are also from the low-income categories in both rural and urban areas, although the average income of urban micro-credit borrowers are about 50% higher than rural (Figure 4.4).

Average annual income of rural and urban borrower-households for different clusters are presented in Figure 4.4 along with the overall(pooled) values. It is observed that the pooled average annual income for rural households is Rs 71,852 and for urban households is Rs 1,06,606, with Kolkata showing the highest difference and Hyderabad the least between rural and urban segments.

### TABLE 4.3: DISTRIBUTION OF LOANS BY GENDER ACROSS CLUSTERS

<table>
<thead>
<tr>
<th>CLUSTER</th>
<th>LOCATION</th>
<th>FORMAL</th>
<th>SHG</th>
<th>MFI</th>
<th>INFORMAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MALE</td>
<td>FEMALE</td>
<td>MALE</td>
<td>FEMALE</td>
<td>MALE</td>
</tr>
<tr>
<td>Kolkata</td>
<td>Rural</td>
<td>132</td>
<td>17</td>
<td>34</td>
<td>56</td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>2</td>
<td>4</td>
<td>0</td>
<td>6</td>
</tr>
<tr>
<td>Chennai</td>
<td>Rural</td>
<td>447</td>
<td>57</td>
<td>299</td>
<td>245</td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>46</td>
<td>75</td>
<td>89</td>
<td>217</td>
</tr>
<tr>
<td>Lucknow</td>
<td>Rural</td>
<td>144</td>
<td>9</td>
<td>24</td>
<td>33</td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>38</td>
<td>13</td>
<td>15</td>
<td>27</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>Rural</td>
<td>72</td>
<td>174</td>
<td>25</td>
<td>754</td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>12</td>
<td>31</td>
<td>4</td>
<td>238</td>
</tr>
<tr>
<td>Jaipur</td>
<td>Rural</td>
<td>228</td>
<td>8</td>
<td>5</td>
<td>38</td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>96</td>
<td>7</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Total Sample</td>
<td>Rural</td>
<td>1023</td>
<td>265</td>
<td>387</td>
<td>1081</td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>194</td>
<td>130</td>
<td>114</td>
<td>489</td>
</tr>
</tbody>
</table>

Focusing on borrowers instead of households reveals an interesting feature. Due to the presence of multiple earners in a household, the average income of borrowers is far below the average income of households. Further, the income disparity between rural and urban areas is also much lower for borrowers compared households. Interestingly, the disparity is least for Kolkata and Hyderabad, the two clusters where MFI activity is most pronounced. These two clusters also account for the lowest borrower income (Figure 4.5).

All the borrowers, irrespective of their activity status take...
micro-credit (Table 4.4). This is not surprising because the borrowers come from low-income households who frequently need finance for reasons, such as, smoothing consumption, building assets or even for paying off existing debt. Students borrow very little compared to other categories. The group categorized as ‘housewives and others’ have accounted for the highest borrower percentages in Kolkata (49%), Chennai (30%) and Hyderabad (36%) while ‘Non-Agricultural Labour’ borrows the most in Jaipur (32%) and Lucknow (27%). It is a fact that MFIs give loans to only female members and they are most active in the two the clusters Kolkata and Hyderabad. Similarly, in Chennai cluster, the SHGs which also aid women are quite active. It is for this reason that in the clusters of Kolkata, Chennai and Hyderabad the highest percentage of borrowers come from ‘housewives and others’ category. It is important at this juncture to point out that debt is a permanent feature of low income households whether they reside in rural or in urban India. Given their need for borrowing, they will be forced to look for other – often unattractive – alternatives, if one source of funds is choked.

**FINDINGS**

*AN INTERMEDIATE PROPORTION OF HOUSEHOLDS HAVE SAVINGS ACCOUNTS*

The findings of our survey show that the share of rural households with a formal savings account is 55%, while the corresponding figure in urban areas is 65%. Insufficient savings, lack of awareness of savings products, and cumbersome procedures are some well-known reasons for low penetration of bank accounts. Accordingly, in the last few years, the RBI has launched several initiatives to ease access to savings accounts, such as basic ‘no frills’ accounts with low or minimal balance requirements and usage fees, relaxation of Know-Your-Customers (KYC) requirements and, more recently, notification of the Business Correspondent (BC) model to allow mobile banking, thus taking advantage of the rapid proliferation of mobile phones in remote rural areas. Increasingly, the Mahatma Gandhi National Rural Employment Guarantee Scheme (MNREGS) payments are being delivered directly to the beneficiaries’ accounts, thus encouraging households to become banked, thereby improving transparency.

Despite owning bank accounts, low-income households regularly approach other formal and informal sources to meet their funding needs, since bank accounts are used for receiving government transfer payments, rather than obtaining credit. Our data corroborates this result. Of about 11,309 borrowers in the sample, 58% or more had a bank account. 64% borrowers from informal sources had bank accounts but still choose to borrow from moneylenders. This is true for about 47% MFI borrowers and 53% SHG borrowers. Access
to a savings account, therefore, does not guarantee access to credit from the bank.

**“MFIS ARE NOT THE DOMINANT SOURCE OF BORROWING”**

The survey has revealed that the most popular loan source for the poor people is ‘informal’, while the least widespread are formal sector loans (Figure 4.6, Table 4.5). Given the paper work associated with obtaining a formal loan, this observation is possibly a true reflection of the ground reality. The absence any formal banking institution in the vicinity of the borrower to open an account could be another reason.

The distribution of loans by source and clusters reveals differences across clusters. MFI loans are most common in Kolkata and Hyderabad, although SHG loans outnumber MFI loans in the latter cluster. In the entire sample, informal loans constitute almost 46% of all loans. The dominance of informal sources, made attractive by its ease of access, suggests that we may not have as yet seen the demise of the once ubiquitous moneylender.

The above result, that MFI is not the dominant source of loans, gets strongly reinforced when we consider the loan size. For example, the average size of an MFI loan is in the range Rs 12,000 to Rs 20,000, while it is consistently much larger for formal loans except in Hyderabad, where the informal source is paramount. The average loan size from informal sources exceeds Rs 50,000 in Hyderabad and it, therefore, offsets the lower number of loans from this source shown in Table 4.5 above.

Combining the two results cited above confirms that MFI loans for all household types make up a small portion of the overall debt. Thus, 47% of the total amount borrowed by households originate from the informal sector and only 12% of the amount is disbursed by MFIs. Figure 4.7 below shows the loan disbursement pattern in each cluster through different sources of Borrowing. Only in the Kolkata cluster, the total amount disbursed by MFIs is greater than other sources; for the rest, MFIs are the lowest or among the lowest in total amounts disbursed.

Indebtedness, therefore, is not a phenomenon that can be directly linked to MFIs, if anything, it is the result of informal sector activity. Our data shows that 32% of all outstanding amounts originated in the informal sector and only 6% were on account of MFIs. This is not at all surprising since MFIs, by design, dispense small loans with extremely low default risk. Empirically, studies have confirmed very high repayment rates (>95%) associated with MFIs. The repayment rates are better than that of student loan and credit card debts in the United States.

Poor households with cash flow problems often sell assets to avoid the burden of embarrassment, bondage or a sullied reputation that could have an adverse impact on their obtaining future credit. We wanted to ascertain the prevalence of asset sales to pay off existing debt and relate this occurrence to loan type. The highest incidence of asset sales was reported in Hyderabad for paying off informal loans; 20% of the households reportedly resorted to selling of assets to repay informal loans. For the entire sample, the corresponding percentage for

<table>
<thead>
<tr>
<th>FIGURE 4.6: USAGE PATTERN OF SOURCE OF LOAN BY BORROWERS</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Kolkata</th>
<th>Chennai</th>
<th>Lucknow</th>
<th>Hyderabad</th>
<th>Jaipur</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal</td>
<td>8.0</td>
<td>9.7</td>
<td>14.4</td>
<td>13.8</td>
<td>7.8</td>
</tr>
<tr>
<td>SHG</td>
<td>5.0</td>
<td>2.0</td>
<td>20.3</td>
<td>20.1</td>
<td>40.3</td>
</tr>
<tr>
<td>MFI</td>
<td>41.8</td>
<td>33.3</td>
<td>21.7</td>
<td>33.5</td>
<td>21.7</td>
</tr>
<tr>
<td>Informal</td>
<td>37.2</td>
<td>5.0</td>
<td>28.7</td>
<td>20.4</td>
<td>10.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TABLE 4.5: NUMBER OF LOANS BY SOURCE OF BORROWING</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Formal</th>
<th>SHG</th>
<th>MFI</th>
<th>INFORMAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kolkata</td>
<td>155</td>
<td>96</td>
<td>1370</td>
</tr>
<tr>
<td>Chennai</td>
<td>625</td>
<td>850</td>
<td>105</td>
</tr>
<tr>
<td>Lucknow</td>
<td>204</td>
<td>89</td>
<td>28</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>289</td>
<td>1021</td>
<td>715</td>
</tr>
<tr>
<td>Jaipur</td>
<td>339</td>
<td>15</td>
<td>200</td>
</tr>
<tr>
<td>Total</td>
<td>1612</td>
<td>2071</td>
<td>2418</td>
</tr>
</tbody>
</table>

| FIGURE 4.7: LOAN DISBURSED BY DIFFERENT SOURCES ACROSS CLUSTERS |

<table>
<thead>
<tr>
<th>Kolkata</th>
<th>Chennai</th>
<th>Lucknow</th>
<th>Hyderabad</th>
<th>Jaipur</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFI</td>
<td>0.80</td>
<td>0.75</td>
<td>0.60</td>
<td>0.50</td>
<td>0.40</td>
</tr>
<tr>
<td>SHG</td>
<td>0.30</td>
<td>0.25</td>
<td>0.10</td>
<td>0.05</td>
<td>0.00</td>
</tr>
<tr>
<td>Formal</td>
<td>0.15</td>
<td>0.10</td>
<td>0.05</td>
<td>0.02</td>
<td>0.01</td>
</tr>
<tr>
<td>Informal</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TABLE 4.6: AVERAGE LOANS SIZE FOR DIFFERENT SOURCES OF BORROWING</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Formal</th>
<th>SHG</th>
<th>MFI</th>
<th>INFORMAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kolkata</td>
<td>44,560</td>
<td>7,646</td>
<td>12018</td>
</tr>
<tr>
<td>Chennai</td>
<td>36,698</td>
<td>14,097</td>
<td>12235</td>
</tr>
<tr>
<td>Lucknow</td>
<td>43,279</td>
<td>12,140</td>
<td>19661</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>33,366</td>
<td>14,848</td>
<td>14990</td>
</tr>
<tr>
<td>Jaipur</td>
<td>96,632</td>
<td>35,667</td>
<td>16012</td>
</tr>
<tr>
<td>Total</td>
<td>50294</td>
<td>14240</td>
<td>13325</td>
</tr>
</tbody>
</table>
informal loans is 6.6%, while for MFIs it is less than 2%.

“MFIS CATER TO THE RELATIVELY LOWER INCOME BORROWERS”
The a priori information suggests that microfinance lenders generally cater to low-income groups. The primary survey results corroborate this hypothesis. Compared to other institutions, MFIs and SHGs by far have greater penetration among the low-income borrowers (Figure 4.8, Table 4.7). There are intercity variations in the average monthly income of borrowers. Nevertheless, the mean income of borrowers is the lowest for MFIs in all clusters except Lucknow. This is a significant result. Borrowing is a choice made by households, sometimes in the presence of alternatives and sometimes in their absence.

“INDEBTEDNESS MORE CLOSELY LIKED TO INFORMAL LOANS RATHER THAN MFI”
Since MFI loans are smaller in size and fewer in number compared to other types of loans, it is not surprising that the average outstanding amounts are systematically higher for formal and informal loans, in almost all the clusters (Table 4.8).

Normalising loan amounts by household income to gauge indebtedness reveals a similar result. Indebtedness, defined as loan size per unit household income is more closely associated with informal loans, and is more a rural phenomenon than an urban. Among clusters, Jaipur reports the highest level of indebtedness, but this has to be tempered due to the small size of the Jaipur sample (Table 4.9). Our results reinforce earlier findings in this respect that indebtedness is much more closely associated with informal sector loans than with MFI activity.

Other stylised facts emerging from our primary survey are as follows:
1. Most borrowers were self-referred to their source of loan or learnt about it from friends and relatives. The role of agents and brokers is observed to be significant in Hyderabad.
2. Borrowers from MFIs and SHGs are relatively younger than the ones from informal and formal sources.
3. Education attainment of borrowers from different sources reveals no predictable pattern. Borrowing is a feature more closely associated with low income, which in turn, could be a function of education attainment. Relatively higher borrowing is reported up to or below the secondary/matriculate level education categories.
4. Most borrowers from MFIs fall in the self-employed or others category, while borrowers from formal and informal sources are either cultivators or non-agricultural labour.
5. Majority of the borrowers from MFIs and SHGs are females while those from formal and informal sources are males (Table 4.10).

“MULTIPLE BORROWING EXIST, AND IS DUE TO CREDIT CONSTRAINTS”
Related to indebtedness is the problem of multiple borrowing. Of all the borrower households, 9,079 households had single loans, 1,085 had two loans and 21 had three loans (Table 4.11). Thus, there were 1,106 cases of multiple loans, a little
less than 10% of the total number of loans. Of these, 21% involved a loan from MFIs. Chennai reported the largest number of multiple borrowers with more than one loan.

Multiple borrowing is captured in the sample only if a household has two or more loans from a distinct source. The incidence of multiple borrowing would naturally be higher for households having two or more loans from any source which is not captured in the survey. In our FGDs, participants pointed out that multiple borrowing from a single source is a feature closely tied with small borrowing, whether from MFIs or any other source. An earlier study had found that multiple borrowing is extremely common but it is more closely linked with informal loans rather than MFIs. Whether multiple borrowing is a cause for concern depends on the underlying reason for the borrowing. If used to pay existing debt, then multiple borrowing is indeed a tricky problem. If, on the other hand, borrowing from multiple sources reflects a credit constraint, because of one lender not meeting the fund requirement, then multiple borrowing is not that problematic. While it is difficult to establish precisely the reasons for multiple borrowing directly from the survey, it will be shown later that the MFI credits are overwhelmingly deployed in business promotion. Further, multiple borrowing is mostly prevalent among males, almost 23% of the multiple borrowers are cultivators and the educational level of the majority of the group is middle or matriculate. (Figure 4.9) Chennai and Hyderabad have the highest incidence of multiple borrowing. From the limited data on multiple borrowing available from the sample and from the FGDs, it can be inferred that multiple borrowing reflects the existence of credit constraints, rather than people using one loan to pay off another.

**USAGE OF BORROWED FUNDS VARIES BY LENDER TYPE**

Data on usage of loans reveal that loans from different sources are used to meet varied objectives (Table 4.12). For example, bank or formal loans are used in agriculture (e.g. purchasing...
agricultural inputs) in rural areas (26%) to a much greater extent than loans from other sources. Loans from informal sources are used much more for health and marriage-related expenses (48%). SHG loans are mostly used to either construct or repair the house or to finance consumption. It is also found that an exceptionally high percentage (42% rural, 49% urban) of borrowing from MFIs is for business expansion and other productive purposes compared to any other source.

In the two clusters where MFI penetration is most, Kolkata has the highest percentage of respondents using MFI funds for business expansion (63%), while in Hyderabad it is just 17 percent as compared to the average pooled over all the clusters being 45 percent (Table 7 of Annex VIII). In this regard, Hyderabad appears to be an outlier, since the usage of MFI funds are distributed across various other needs such as consumption (17%), purchase of house or construction and repair of houses (23%), medical emergency (8%) and even repayment of existing debt (5%). It is worth noting that the usage of funds by Hyderabad borrowers as determined from the present survey is strikingly similar to the result of the IFMR-CMF survey cited earlier.

Based on our results it is difficult to justify the popular criticism of irresponsible lending against MFIs. Our data do not support either the claim that multiple loans are an entrenched feature of MFI lending or that such funds are deployed in unproductive pursuits such as paying off existing debt or consumption. These features are, in fact, much more closely associated with informal lending. For example, marriage-related expenditure, consumption and medical emergencies together account for about 60% of usage of borrowed funds from the informal sector.

**“AGENTS’ ROLE IS MOST PREDOMINANT IN HYDERABAD CLUSTER AND MUCH LARGER FOR MFIs AND SHGs”**

Agents clearly pay a larger role in Hyderabad cluster than in any other cluster, and within Hyderabad, agents are seen to be most visible in MFI activity (Table 4.13). This could be one of the reasons for higher borrowing and hence the resentment against MFIs in Hyderabad. ‘Intermediation’ by agents is almost absent in the case of informal loans.

**“COSTS OF BORROWING OF MFI LOANS ARE LESS COMPARED TO LOANS FROM SHGs AND BANKS”**

Informal money-lending has been prevalent in India, and indeed in the rest of the world from ancient times. Traditionally, moneylenders have held a prominent position, have been aligned along ethnic lines and have been known by various names.
ous names like shroff, seth, sahukar, mahajan, and chetti, in different parts of India.\textsuperscript{52} It is, therefore, not surprising that, in the aggregate, awareness is highest for informal lending, (Figure 4.10) although in Chennai, Kolkata and Hyderabad, households appear to be somewhat aware of both MFIs and formal options.

It was demonstrated earlier that MFIs cater to the low-income groups more than banks do. At one level, the revealed preference of low-income categories to MFIs (and also SHGs) can be interpreted as an option exercised by the household in the presence of other alternatives. On the other hand, it may be that the borrower household did not have a choice. In the latter case, introductory economics predicts that it should result in a ‘high’ cost of borrowing from the monopoly source.

As stated earlier, the most serious allegation against MFIs is the imposition of usurious interest rates on their loans. Usury has attracted severe penalties since ancient times across the world.\textsuperscript{53} Since MFI loans overwhelmingly serve the low-income groups, if the charge of usury against MFIs were to stick, then strict action is doubtless justified. This judgement, however, must be made with the benefit of rigorous empirical – rather than anecdotal – evidence. One of the main objectives of this study was, therefore, to make a fair assessment of the total cost that borrower incur in securing a loan, excluding the interest rate. In environments where educational attainment is low and infrastructure is poor, the costs associated with securing a loan could be non-trivial. Therefore, it is important to recognise that interest is only one of the many costs that have to be borne by borrowers. Other costs include the following:

- Wage loss due to time spent in getting the loan approved (opportunity cost).
- Cost of travel.
- Money spent on food, etc. while travelling to the source of loan.
- Charges paid for preparation of documents.
- Additional charges (like stamp duty).
- Payment of bribes.
- Other charges (e.g., insurance).

Ignoring such costs will give a misleading comparison of the total cost of a loan. Further, whether the MFI interest rate or total cost is excessively high or not has to be judged against a benchmark. The comparison can be made either with the own cost of raising funds incurred by the MFI or with the price of the competition, namely, banks (formal sector), SHGs and the moneylenders (informal), in the sample.

The total cost incurred by borrowers (excluding interest) from various funding agencies, across clusters are given in Table 4.14. These charges are highest for formal sources across all cluster, followed by SHGs, MFIs and informal sources, in that order. The magnitude varies across clusters, but not the rank order. Cluster-wise analysis of these costs shows that the costs, in addition to interest rates, incurred by MFI borrowers were higher in Hyderabad and Jaipur as compared to Kolkata and Chennai (Lucknow has a very small sample). We have already seen MFI activity is more pronounced in Hyderabad, Chennai and Kolkata, presumably because of higher presence of MFIs there.

The breakup of these costs by loan type is provided in Table 4.15. Clearly, documentation and processing requirements for informal loans are negligible, and, hence, borrow-

<table>
<thead>
<tr>
<th>TABLE 4.13: LOANS REFERRED BY AGENTS FOR EACH SOURCE OF BORROWING</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Kolkata</td>
</tr>
<tr>
<td>Chennai</td>
</tr>
<tr>
<td>Lucknow</td>
</tr>
<tr>
<td>Hyderabad</td>
</tr>
<tr>
<td>Jaipur</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TABLE 4.14: COST OF BORROWING (WEIGHTED) FROM DIFFERENT SOURCES FOR A SINGLE LOAN (RS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KOLKATA</td>
</tr>
<tr>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>Formal</td>
</tr>
<tr>
<td>SHG</td>
</tr>
<tr>
<td>MFI</td>
</tr>
<tr>
<td>Informal</td>
</tr>
</tbody>
</table>
ers do not incur any cost while obtaining such loans. On the other hand, the formal sector imposes exacting standards, making these documentation costs the highest. Bribes and commissions are high and closely associated with formal bank loans rather than other loan types. This result, however, needs to be juxtaposed with the high interest rate charged by moneylenders with the significantly lower interest charged the formal sector.

Cluster-wise analysis of these costs shows that the additional charges paid for MFI loans were higher in Hyderabad and Jaipur clusters as compared to Kolkata and Chennai clusters. We have already seen MFI activity is more pronounced in Hyderabad, Chennai and Kolkata clusters, presumably because of the higher presence of MFIs there. Interestingly, in Hyderabad cluster households pay the highest transaction costs among these three clusters.

Normalling for loan amount, we obtain a similar rank ordering for the costs incurred with a couple of exceptions. Tables 4.16 and 4.17 present the costs for a Rs 1,000 loan by type and location across the five clusters. For urban Hyderabad, the costs are highest for SHGs; ditto for rural Kolkata. For other observations, the costs observe a definite pattern: lowest for the moneylender and highest for banks, with MFIs and SHGs sandwiched in between. Another interesting result is the higher costs incurred by rural households for obtaining bank loans compared to their urban counterparts. Given their higher illiteracy and greater perceived risks, rural households in general incur more costs to obtain a loan not only from banks but other sources as well.

Very little was known of the relative magnitudes of cost components earlier. the present survey has not only been able to quantify the magnitude of these costs and show that these are non-trivial but it also captured interesting intercity variations in these costs for the same type of loan. Cost incurred by bank or formal loans borrowers was three times the cost incurred by MFI borrowers in rural areas and 1.8 times in urban locations. On an average, Hyderabad households incur almost three times the cost incurred by their Kolkata counterparts in rural areas for MFI loans. needless to say, caution needs to be exercised in the interpretation of these estimates, since interest rates are sensitive to loan amount, duration and repayment schedules. the qualitative result that formal sector loans are associated with high transaction costs, especially in rural areas and among the lower education attainment groups, is however robust.

**“INTEREST RATES ON MFI LOANS SUBJECT TO THE HIGHEST INFORMATION ASYMMETRIES”**

The primary survey has revealed that precise information of applicable interest rate on loans was not available to all the borrowers. The borrowers, therefore, divided into two groups, those who knew and those who did not know the interest rate payable on their loan. The rationale of this division is that those with incomplete information might end up paying higher interest charges compared to the rest.

Table 4.18 provides the proportions of respondents who knew and those that did not know the interest rate for each source of borrowing. The results are interesting. MFI borrowers are the least aware; in fact, a vast majority of them(87%) did not know the interest rates payable. In contrast, awareness of interest rates of other sources is quite rife. A strong implication of this finding is the need to introduce greater

| TABLE 4.15: BREAKUP OF COSTS OF BORROWING BY LOAN TYPE |
|-----------------|-------|------|------|------|
| Wage loss incurred because of traveling for getting loan approved | 159 | 97 | 16 | 34 |
| Traveling cost | 59 | 32 | 7 | 16 |
| Money spent on food while traveling | 38 | 25 | 5 | 7 |
| Stamp duty | 40 | 12 | 17 | 1 |
| Bribe/ commission | 1863 | 428 | 11 | 0 |
| Extra charges paid during the loan period (e.g., insurance) | 42 | 6 | 222 | 0 |

| TABLE 4.16: COST OF BORROWING (PER RS 1,000 OF LOAN), RURAL BY TYPE OF LOAN |
|-----------------|-------|------|------|------|
| CLUSTER         | RURAL AREAS |
|                 | FORMAL | SHG | MFI | INFORMAL |
| Kolkata         | 21 | 22 | 8 | 2 |
| Chennai         | 24 | 12 | 31 | 5 |
| Lucknow         | 47 | 35 | 25 | 9 |
| Hyderabad       | 43 | 31 | 23 | 3 |
| Jaipur          | 24 | 7 | 14 | 3 |
| Total           | 30 | 24 | 13 | 6 |

| TABLE 4.17: COST OF BORROWING (PER RS 1,000 OF LOAN), URBAN BY TYPE OF LOAN |
|-----------------|-------|------|------|------|
| CLUSTER         | URBAN AREAS |
|                 | FORMAL | SHG | MFI | INFORMAL |
| Kolkata         | 11 | 8 | 6 | 0 |
| Chennai         | 16 | 13 | 27 | 3 |
| Lucknow         | 30 | 18 | 12 | 8 |
| Hyderabad       | 33 | 61 | 29 | 3 |
| Jaipur          | 21 | 5 | 34 | 4 |
| Total           | 22 | 32 | 18 | 5 |

| TABLE 4.18: DISTRIBUTION OF RESPONDENTS FOR THE ‘KNOW’ AND ‘DO NOT KNOW’ CATEGORY |
|-----------------|-------|------|
|                  | “KNOW” | “DO NOT KNOW” |
| INTEREST RATE (%) | 85.1 | 14.9 |
| INTEREST RATE (%) | 89.6 | 10.4 |
| INTEREST RATE (%) | 12.8 | 87.2 |
| INTEREST RATE (%) | 74.7 | 25.3 |
transparency regarding interest charges of different loan sources, especially the MFIs.

Since a vast majority of MFI borrowers do not know interest rates, it was of interest to know their profiles. These borrowers are mostly women with primary levels of education, without any defined earning activity. The highest number of such ‘uninformed’ borrowers is found in Kolkata, followed by Hyderabad. In the next section, we shall examine whether the information asymmetry leads to higher interest on MFI loans as economic theory would predict.

“MFI INTEREST RATES ARE MUCH BELOW FORMAL AND SHG LOANS RATES ”

A description of the method of estimating interest charges is provided in the Annex VII. It takes into consideration the duration, the repayment schedule and the principal borrowed. Following this interest rates were calculated separately for the ‘know’ and ‘do not know’ categories. In the case of SHGs and informal loans, repayment is in monthly mode. For formal loans, it could be either in monthly or annual mode. MFIs have the shortest repayment cycle, ranging from one week to one month. The interest rates for ‘know’ and ‘do not know’ categories are presented in Table 4.19.54

The interest rate for MFI loans is much higher than that of formal sources and SHGs. If we take into consideration the costs discussed earlier, the difference between the total costs of SHG and MFI loans becomes negligible, while the gap between formal and MFI loans narrows but is still substantial. On the other hand, informal interest rates are almost twice as expensive as MFI loans. Benchmarking against their own cost of raising funds also does not show that interest rates charged by MFI are exorbitant. Our survey and FGDs indicate a specific function served by MFIs in the space not served by formal financial institutions.

The economics of MFI operations described in the introduction results in higher cost due to the higher risk perceived, small transaction size and lack of scale economies in serving remote and rural locations. In a white paper published by Intellecap, the estimated range of total cost for MFIs (after including all cost components) is between 17% and 34%, depending upon its size (Table 4.20).

Based on our estimates of interest charges across loan types, there is little evidence to establish usury by MFI institutions. On the other hand, informal loans are almost twice as expensive as MFI loans. Benchmarking against their own cost of raising funds also does not show that interest rates charged by MFI are exorbitant. Our survey and FGDs indicate a specific function served by MFIs in the space not served by formal financial institutions.

### Table 4.19: Interest Rate for the ‘Know’ and ‘Do Not Know’ Categories by Type

<table>
<thead>
<tr>
<th>Source of Fund</th>
<th>‘Know’</th>
<th>‘Do Not Know’</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal</td>
<td>12.7</td>
<td>12.7</td>
</tr>
<tr>
<td>SHG</td>
<td>18.1</td>
<td>21.7</td>
</tr>
<tr>
<td>MFI</td>
<td>25.1</td>
<td>24.3</td>
</tr>
<tr>
<td>Informal</td>
<td>44.0</td>
<td>*</td>
</tr>
<tr>
<td>Total</td>
<td>30.9</td>
<td>@</td>
</tr>
</tbody>
</table>

*INSUFFICIENT DATA.

@ IN THE ‘DON’T KNOW’ CATEGORY IN THE CASE OF INFORMAL LOANS, LOANS AVAILED FORM FRIENDS AND RELATIVES DO NOT CARRY ANY INTEREST RATE. HENCE THE RATE OF INTEREST IS ‘0’. IN SUCH A SCENARIO CALCULATION OF THE OVERALL INTEREST RATE FOR THIS CATEGORY IS NOT APPROPRIATE.

### Table 4.20: Calculation for Interest Rate Based Operation and Financing Cost for MFIs

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>&lt; 50 Crore</th>
<th>&gt; 500 Crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch Cost</td>
<td>11-12%</td>
<td>6-8%</td>
</tr>
<tr>
<td>Area Office and HO Cost</td>
<td>4-5%</td>
<td>3-4%</td>
</tr>
<tr>
<td>Loan Loss Provision</td>
<td>1-2%</td>
<td>1-2%</td>
</tr>
<tr>
<td>Total Cost of Operations</td>
<td>16-19%</td>
<td>10-14%</td>
</tr>
<tr>
<td>Cost of financing</td>
<td>13-15%</td>
<td>12-14%</td>
</tr>
<tr>
<td>Total Cost</td>
<td>29-34%</td>
<td>22-28%</td>
</tr>
</tbody>
</table>

SOURCE: INDIAN MICROFINANCE CRISIS OF 2010: TURF WAR OR A BATTLE OF INTENTIONS? AN INTELLECAP WHITE PAPER

42. See Annex V for NSHIE Sample Selection.
43. These are Illiterate, Below Primary, Primary, Middle, Secondary, Higher Secondary, and Graduate and above.
44. See, for example, the Andhra Pradesh survey of IFMR: Research Centre for Micro Finance.
46. Ibid.
48. The household survey on access to microcredit by IFMR: Centre for Microfinance also shows that multiple borrowing appears to be more common among the better off.
49. Refer to Table 7 in Annex VIII
50. Doug and Meka 2009, op.cit., p 16
51. For example, the Jews practised moneylending in England and across Europe in the eleventh and twelfth centuries.
54. For the ‘know’ category, the annual interest rate has been estimated for each of the durations separately. For the ‘do not know’ category, since we know the loan amount received, the duration, the frequency of payments and the payment amount, we have estimated the interest rate for each duration separately. The interest rate has then been converted into an average annual rate. The final figure...
DESPITE the Indian economy making rapid strides in the past decade, a sizeable portion of the population, especially the vulnerable people belonging to the weaker sections and low income groups, continue to remain excluded from even the basic opportunities and services provided by the financial sector. The World Bank-NCAER Rural Finance Access Survey conducted in 2003 with World Bank support (Basu, 2006) had revealed that nearly 60 percent of rural households did not have a bank account and only 21 percent had access to credit from a formal source. The access problem was more severe for the poorer households: 87% of the poorest households surveyed did not have access to a loan and 71% did not have access to a savings account from the formal financial system. As a result, the Below-Poverty Line households are compelled to borrow from informal sources (money lenders, traders etc.) for their consumption credit needs, at exorbitant interest rates. Opportunities for depositing their small savings and access to loans during emergencies and micro-investments are the most urgent needs of many rural households. To address the issue of financial exclusion in a holistic manner, it is essential to ensure a range of financial services are made available to every individual at affordable cost.

Most formal financial institutions are reluctant to serve the poor and micro-enterprises in the unorganised sector because of the perceived high risks, high costs involved in small transactions, low relative profitability, and the inability of the poor to provide the physical collateral, usually required by such institutions. In the absence of access to institutional sources of credit, most of the poor and low-income households are forced to rely on inadequate self-finance or on informal sources, most commonly, the moneylenders. Therefore, what is needed today is a system which makes banks and the financial sector, including insurance work for the poorest of the poor.

For developing countries like India, microfinance has come as a breakthrough in the philosophy and practices of poverty eradication, economic empowerment and inclusive growth. It has come a long way from the non-profit organizations championed by Mr Yunus in the 1970s. In recent years, several new approaches have been evolved to provide finance to India’s rural poor. Most prominent among them is the “Self-Help Groups (SHGs) – Linkage Banking” model, supported by the National Bank for Agriculture and Rural Development (NABARD). Other microfinance approaches involve partnerships between government, non-governmental organizations (NGOs), and banks. Additionally other institutional structures for microfinance have also emerged: these include mostly independent specialized microfinance institutions (MFIs). These microfinance institutions attempt to address the problem of financial exclusion by providing financial services to the low-income groups who traditionally lacked access to formal financial institutions.

Microfinance has shown how the poor people are credit-worthy, how through regular savings and loan repayments, using group guarantee, they have alleviated distress amongst low-income households, enabled consumption smoothing and promoted self-employment and micro-enterprise. For borrowers who had to rely on moneylenders and loan sharks, microfinance provided easy access to formal sector finance with very little documentation.

However, the microfinance industry has recently come under severe attack on ground that the interest rates are ‘usurious’, strong arm tactics are being employed, multiple loans are forced on the gullible poor and investors in such MFIs have obtained huge returns on their equity. In India, matters
came to a head in 2010, when the Andhra Pradesh Government enacted an ordinance that effectively stopped collection of micro-debt and prohibited any new micro-loans in the State unless certain conditions were met. In this context, the RBI set up a committee under one of its Board directors, Mr Y. H. Malegam. This Committee submitted in January 2011 making a wide range of recommendations aimed at consumer protection.

It was against the backdrop of the credit curbs in Andhra Pradesh that NCAER’s Centre for Macro Consumer Research (CMCR) conducted a cluster based household survey covering over 10,000 households (70% rural) coming from five clusters namely Hyderabad, Chennai, Kolkata, Jaipur and Lucknow to study the effectiveness of small borrowing in India. The report, “Assessing the Effectiveness of Small Borrowing in India” is a comprehensive summarisation of the salient findings emerging from this investigation which might be helpful in allaying the worst fears raised against the MFIs, at least, to some extent.

Existing research on MFIs in India suffers from non-availability of data on the total cost of borrowing by source, multiple borrowings and the impacts of micro-credit on poor households. These questions have been addressed in the present investigation for alternative sources of borrowing. Estimating the impact of MFI loans is a difficult question, but a preliminary assessment based on reported usage of funds have been made. Reliance was also placed on focus group discussion (FGD) responses for more insights. However, more focused research on this topic is necessary, especially since money is often considered to be fungible.

For evaluating the performance of MFIs and suggesting credit-policy requirements from financial inclusion angle, it is essential to empirically test the conduct of MFIs vis a vis other agencies. From this perspective it is vital that such a test be based on comprehensive analysis of both secondary and extensive primary data, rather than it being based anecdotal evidence. This report attempts to do just that.

The sheer size of the MFI industry indicates the global pervasiveness of the small credit market. As of 2009, there were 1,934 MFIs globally, with an estimated borrower base of 92.2 million and a total outstanding portfolio of over US$66 billion as reported by the MFIs to the Microfinance Information Exchange or “MIX Market”. MFI growth in India is also remarkable – In 2009 there were about 27.5 million borrowers and 84 MFIs, with an estimated portfolio of US$4 Billion. Annual growth over last 5 years was 62 percent in terms of clients and 88 percent in terms of portfolios.

The NCAER-CMCR Survey-2010 has revealed that in an aggregate, 45 percent of the micro-credit borrowers were female; distribution was fairly uneven across clusters. In Hyderabad, more than 80% of the borrowers were women in both rural and urban areas, and in Kolkata too, female borrowers were more in both locations while in Chennai, female borrowers were more only in urban locations. Male borrowers dominate in other clusters. The interesting part of this result is that in states where NRFC and bank-led SHG microfinance activity is high, women borrowers dominate our sample since these institutions lend primarily to women. The gender distribution in the sample is a reflection the type of MFIs operating in a specific location. In locations dominated by informal lenders, male borrowers are likely to outnumber women borrowers. It was also found that majority of the borrowers belonged to the 31-40 years group, i.e. the productive age category, which needed credit most in the absence of employment opportunities. It was further observed that a vast majority of borrowers were either illiterate or had studied only up to primary level of education, reinforcing the presumption that microfinance borrowers, in general, belong to the lower education attainment categories. In addition, they also belong to the low-income categories in both rural and urban locations, although the average income of urban micro-credit borrowers is about 30 percent higher than rural.

All the borrowers, irrespective of their activity status take micro-credit – and this is not surprising because the borrowers come from low-income households. Students borrow very little compared to other categories. The group categorized as ‘housewives and others’ accounted for the highest borrower percentages in three clusters, Kolkata (49%), Chennai (30%) and Hyderabad(36%) while ‘Non-Agricultural Labour’ borrowed the most in Jaipur (32%) and Lucknow (27%) clusters. It is a fact that the MFIs give loans to only the female members and the MFIs are most active in the two the clusters Kolkata and Hyderabad. Similarly, in Chennai, the SHG which also aid women are quite active. It is for this reason that in the clusters of Kolkata, Chennai and Hyderabad the highest percentage of borrowers come from ‘housewives and others’ category.

A finding is also that 55 rural households and 65 percent of urban households have savings bank accounts. Despite owning bank accounts, low-income households regularly approached other formal and informal sources to meet their funding needs, since bank accounts are used for receiving government transfer payments, rather than obtaining credit. Of about 11,000 total borrowers canvassed, 50 percent or more had a bank account. Looking at the different loan sources it was found that 64 percent borrowers from informal sources, 47 percent MFI borrowers and 53 percent SHG borrowers had bank accounts but still chose to borrow from moneylenders.

This predicament is the result of the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and finance needs of low-income households. On the supply side, serving the rural poor is a high-risk, high-cost proposition for banks. Not only is there uncertainty about the repayment capabilities of poor rural borrowers due to their irregular and volatile income streams, but the absence of credit information drives up default risk. Such problems are further aggravated by the borrower’s lack of collateral. Additionally, costs of borrowing of rural lending in India are high predominantly due to the large geographical
spread, small loan sizes, high frequency of transactions, and widespread illiteracy.

On the demand side, rural banks do not provide flexible products and services to meet the income and expenditure patterns of small rural borrowers. They require that borrowers who have a stable source of income out of which principal and interest can be paid back according to the agreed terms. The cost of dealing with formal banks are high and the entire process, right from applying for a loan to receiving it is very time consuming. Procedures for opening an account or seeking a loan are cumbersome and costly with borrowers having to pay hefty bribes to access loans. This makes the ultimate cost to borrowers very high. Additionally, banks demand collateral, which poor rural borrowers lack.

Under these circumstances, banks should be encouraged to lend to alternative delivery systems and treat them as an extension of the formal banking system. Innovations to bring cost-effective and improved products and services to the poor should be encouraged, particularly using mobile telephony. For example, some of the best-managed MFIs can be allowed to take deposits on a restricted basis, only from the borrowers and cover them with deposit insurance.

The CMCR survey found that the most popular loan source among the poor people was informal (46%), while the least popular one the formal (14%) one. It is interesting to find that MFI loans constitute 18 percent of all the loans and is the second most popular source of micro-credit. Given the cumbersome procedure for getting a formal loan, this distribution is a true reflection of the ground reality. MFI loans are most common in Kolkata and Hyderabad clusters and the opposite is the case with informal loans. The dominance of informal sources, made attractive by its ease of access, suggests that we may not have seen the demise of the once ubiquitous moneylender as yet. Talking in terms of loan amount, 47 percent of the total amount borrowed was from informal sector and only 12 percent came from the MFIs. The mean loan size of MFIs varied from Rs 12,000 to Rs 20,000 across clusters while it is much larger for banks, except in Hyderabad cluster, where the informal source is supreme (>52000). This result is perhaps a reflection of the squeezed MFI activities in Andhra Pradesh following the 2010 Ordinance. Only in Kolkata cluster, the total amount disbursed by MFIs is greater than other sources; for the rest, MFIs are the lowest or among the lowest in total amounts disbursed.

Compared to other sources, MFIs and SHGs had, by far, the greater penetration among the low-income groups as evident from lower mean monthly incomes Rs1411 and 2365 respectively of borrowers from these sources. Over 50 percent of MFI borrowers were repeat borrowers. The majority of borrowers from MFIs and SHGs were female and younger compared to other sources.

Andhra Pradesh Micro Finance Institutions (regulation of money lending) Ordinance, 2010, which had referred to earlier had a lot of repercussions in the country. Liquidity was adversely affected, since banks froze lending to MFIs and debt collection efforts received a severe setback in Andhra Pradesh, with borrowers refusing loan repayments as urged by the state government. New loans almost came to a standstill as the ordinance prohibited any new microloans in the state. It must be remembered that excessive regulation can only impede the development of a healthy and competitive microfinance sector capable of competing with local moneylenders. For that matter any regulation must reflect a proper understanding of the dynamics of the microfinance market in India. Given the inability of the banking sector to enter the microfinance market and the vulnerable segment of the population that MFIs serve, the MFIs should be encouraged, albeit with reasonable restrictions, to serve the low-income and vulnerable people.

The main allegations MFIs pertained to usurious interest rates, multiple loan induced indebtedness and the use of strong arm collection tactics. The NCAER-CMCR Survey has not found any concrete evidence to show that MFIs contribute to indebtedness of the borrowers. Since MFI loans are smaller in size compared to other types of loans, the average outstanding amounts were higher for formal and informal loans. Considering the loan size per unit household income as a measure of the household’s indebtedness, it was found that the indebtedness coefficients were much lower for the MFIs compared to the informal loans this reinforces the earlier finding that indebtedness is much more closely associated with informal loans than MFI ones.

Closely related to indebtedness is the problem of multiple borrowing. The NCAER-CMCR survey discovered that only about 11 percent of the borrowers had multiple loans of which 21 percent involved a loan from MFIs. This means, the multiple loans attributable to MFIs is only about 2 percent of all the loans. It is revealed that the MFI loans – ranging from 16,000 to Rs 20,000 – are used mainly for asset creation and the borrowers are mainly women. The highest percentage of MFIs loans were in fact used for business promotion (45%) and only 3 percent was used for paying off existing debt. MFIs are only one among the many sources of funds for small borrowers and are far from being dominant. Unless borrowers obtain multiple loans from MFIs, it is highly unlikely that indebtedness is an MFI related problem. We have already seen that multiple borrowing from MFI’s is not of any significant dimension.

The data also shows that 32 percent of all outstanding amounts came from informal sources, only 6 percent were on account of MFIs. An earlier survey by IFMR:CMF had found that MFI loans formed only a small share of total debt of marginal farmer households and higher categories, 75 percent of the outstanding amount came from informal sources. Now, the CMCR survey also revealed that multiple borrowing is a problem closely associated with informal loans, rather than MFIs.

It is, therefore difficult to buy the popular criticism that MFI loans are deployed in unproductive pursuits such as paying off existing debt or consumption. Nor can it be said...
that multiple loans are an entrenched feature of MFI lending. These features are more closely associated with informal lending. For example, marriage-related expenditure, consumption and medical emergencies together account for nearly 55% of the funds borrowed from informal sources. Although multiple lending is not common in our sample, risks associated with it demand that oversight be strengthened to check this tendency.

Coming to the interest rate and other questions, the pertinent question is not how much should MFIs charge, but how their charges compare with others? Do microfinance lenders charge lower interest rates than moneylenders do? The answer is again in the affirmative.

The CMCR survey has found out that the MFI interest rates are much lower (25%) than those charged by informal agencies (44%). The interest rates for commercial banks as reported by the respondents were lower. However, there were typically “unofficial” charges associated with loans which were much higher in the case of the formal sector. In rural areas, these transaction costs for MFIs (1%) were, on an average, lower by two thirds compared to bank loans (3.3%). In urban areas the costs were 46 percent lower than banks (2.6%). In Hyderabad urban the highest cost was accounted by SHGs (6.7%) rather than banks (4.2%). In all other cases the costs observed a definite pattern: lowest for money lenders, highest for banks and the MFIs and SHGs falling in between. For MFIs the highest interest in rural areas is accounted by Lucknow (2.5%) and lowest by Kolkata (0.7%).

A direct indicator of unofficial borrowing costs is bribes paid by applicants, which are much higher in the case of commercial banks (33%) than MFIs (6%). The processing time is also substantially higher in the case of commercial banks compared to MFIs. If one compares the gap between the loan amount applied for and the amount approved or the amount approved and that actually received, MFIs scored much better than their formal counterparts. Thus, there is no basis to conclude that the interests charged by the MFIs are exorbitant or usurious.

Lower interest rates will help increase the depth and breadth of availability of affordable micro-credit for poor households. Capping the interest rates is not at all a wise step. Charging prices high enough to cover costs is essential for any business enterprise to survive in the marketplace. This is true for microfinance institutions as well. Lenders will incur losses if a ceiling on interest is placed at a lower level than required for cost recovery, adversely affecting an MFI’s willingness and ability to expand operations, and discouraging potential investors from supporting the industry.

Further, rate-ceilings are likely to reduce the creditworthiness of MFIs, and their ability to borrow from the market to finance their operations, and resuultantly prompting a decline in the supply of credit. Because small-scale loans are costlier than large loans, rate ceilings could motivate microcredit lenders to desert poorer, small-scale loan clients. As the ceilings depress the profitability and viability of MFIs, savers may be reluctant to place deposits in them. This will aggravate the institution’s funding problem. Capping interest rates and margins need to be avoided to the extent possible, espeically when the avowed objective of the policy for financial inclusion is to promote healthy competition in microfinance activity for the benefit of a vast majority of poor Indians.

Asked about their awareness about the interest charged, 87 percent of the MFI borrower-respondents had replied in the negative – in fact they were the least aware. In aggregate, awareness was highest for informal lending, although in the three clusters Chennai, Kolkata and Hyderabad, households appear to be well aware of both MFIs and formal options. A strong implication of this finding is the need to introduce greater transparency regarding interest charges of different loan sources, especially the MFIs. Since a vast majority of MFI borrowers did not know interest rates, it was of interest to know their profiles. These borrowers were mostly women with primary levels of education, without any defined earning activity.

Growth should force change. There are reports that the suicides were the result of borrowers taking too much credit from multiple sources. Credit practices must be reformed to check multiple borrowing. Lenders should be made to disclose interest rates to stimulate competition. This requires intelligent regulation.

It needs to be realized that meaningful policies cannot be formulated in the absence of authentic data. Therefore, the necessity of collecting, collating and analysing reliable data to arrive at valid conclusions cannot be overemphasised. The NCAER-CMCR(2010) Survey was an important step in this direction.

All facts and figures presented in this report are essentially based on two factors: the population covered by the survey and the responses from the respondents canvassed. It is important to keep these limitations in mind while drawing any conclusion from the results presented in the report. There are several critical areas like the ‘menace of multiple borrowing’, impact of ‘MFIs on poor’ which could not be addressed objectively due to non-availability of data in the chosen sample. These can form the topics of investigation in future surveys.

It is hoped that the insights in the report will be useful to economic analysts, policy makers, marketers, researchers and a host of other readers.
## Annex I

### DEPOSIT ACCOUNTS BY POPULATION (in Lakhs)

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<th>DEPOSIT ACCOUNTS</th>
<th>POPULATION WISE</th>
<th>NO. OF ACCOUNTS</th>
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<th>NO. OF ACCOUNTS</th>
<th>PER CENT</th>
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Source: Reserve Bank of India.
Deposits and credit amounts in scheduled commercial banks (Percent of GDP at current market prices)
### Accounts by Population Segment as Percentage of GDP

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*Source: Reserve Bank of India and Central Statistical Organisation.*
LEGAL REQUIREMENTS FOR MFIS IN INDIA

SOCIETIES ACTING AS MFIS
The societies are governed by the Societies Registration Act 1860. These entities are established as voluntary, not for profit organizations, under the same legal status and requirements their microfinance activities and functions are also defined and regulated.

The Societies Registration Act claims that “a society can be formed for the formation of literature, science or the fine arts or the diffusion of useful knowledge/political education or for charitable purposes”. The legal sense of the term charity for a society to be formed comprises the following:

i) Relief of Poverty
ii) Advancement of Education
iii) Advancement of Religion
iv) Purposes beneficial to the community or a section of the community

For the purpose of this act the public nature of microfinance activities of a society and the widely accepted notion that such activities empowers the poor of the rural areas especially are interpreted in the civil society as being charitable. Under this law, however, a society is required to mention its microfinance activities as “charity” in its Memorandum of Association.

TRUSTS ACTING AS MFIS
MFIs registered under Indian Trust Act 1882 are either public charitable trusts or private determinable trusts with specified beneficiaries/members.

i) According to Section 6 of the Indian Trust Act 1882 the important constituents of a trust are:
   ii) Three parties- the author, trustees and beneficiary
   iii) Declaration of a trust
   iv) Certainty of the subject matter of a trust and
   v) Certainty of objects of the trust

As per Section 3 of this act the author or settler of the trust is the person who preposes or declares confidence in another person, in some property for the benefits if the beneficiary. In case of MFIs the author is an individual with noble intention of providing financial services to the poor. The author of the trust arranges funds and then deploys the fund to the trust to use them for the charity purpose for which it has been established.

The section defines trustee as a person who, while holding the legal ownership and or possession of, or dominion over, the subject matter of the trust is bound to allow the beneficial enjoyment of the property to be reaped by another called the beneficiary.

There also exists a third party in a trust for whose benefit the confidence is reposed by the author or accepted by the trustee and this party is the beneficiary. However, the author of the trust may also be the beneficiary. According to the Indian Trust Act, every individual capable of holding property may be the beneficiary under the Trust (the capacity to hold property is the only requisite qualification in this regard).

PROBLEMS FACED BY MFIS DUE TO THEIR REGISTRATION AS SOCIETIES OR TRUST
There are several disadvantages that MFIs face when they are registered as societies and trusts, following are the disadvantages:

1) As societies and trusts are charitable institutions therefore inappropriate for financially sustainable strategic goal of microfinance operations.

2) In these institutions as there exists no system of equity investment or ownership, thereby makes them less attractive for commercial investors interested in microfinance.

3) Commercial investors generally regard the investments in such institutions which are established on the grounds of charity as risky propositions mainly because of lack of professionalism and managerial practices and are therefore reluctant to commit large volumes of funds to such MFIs.

4) As per Section 45S16 of the RBI Act 1934, no unincorporated bodies are allowed to accept deposits from the public. Organisations registered under the Societies Registration
Act and the Trust Act are considered as unincorporated bodies, hence as per law are not allowed to collect savings from their clients. Therefore societies and trusts do not have access to a cheap source of funds in the form of savings. These organisations are made vulnerable due to the use of ‘Usurious interest prevention acts’ by various state governments as the status of microfinance is still debatable as charitable activity.

**SECTION 25 COMPANIES ACTING AS MFIS**
Under this an organization is given license under Section 25 of Companies Act 1956 and hence allowed to be registered as a company with limited liability without the addition of the words ‘Limited’ or ‘Private Limited’ to its name. Such companies are exempted from some of the provision of the Companies Act 1956. For the existing companies which are already registered under the Companies Act 1956, the central government is convinced that the objectives of the company are restricted to the promotion of commerce, science, art, religion, charity or any other useful purpose and the constitution of such company provides for the application of funds or other income in promoting these objects and prohibits payment of any dividend to its members, then it may allow such a company to register under Section 25 of the Companies Act.

**PROBLEMS FACED BY MFIS DUE TO THEIR REGISTRATION AS SECTION 25 COMPANIES**
There are several disadvantages these entities face in their role as MFIs, for instance:

1) They face the same restrictions as the societies and trusts in case of deposit mobilization.

2) These institutions registered under Section 25 of Companies Act are prohibited from distributing dividends, therefore these entities find it difficult to attract investors.

3) Although microfinance defined by RBI provides for financial services of very small amounts, the RBI instructions exempting Section 25 companies from registration and reserve requirements for NBFCs stipulate that loans should not exceed Rs 50,000 for non-housing purposes and Rs 125,000 for housing purposes.

**NBFCS ACTING AS MFIS**
According to Section 45-I of the RBI Act, an NBFC is a company which carries on any of the following activities as its business or part of its business:

- Lending
- Receiving of deposits (as the principal business)
- Acquisition of shares, stocks or other securities
- Hire-purchase or leasing
- Insurance
- Chit funds and
- Lotteries

According to this definition if a company undertakes microfinance it automatically becomes an NBFC.

**LEGAL REQUIREMENTS FOR CARRYING ON THE BUSINESS OF AN NBFC**
Under Sub-section 1 of Section 45-IA of the RBI Act, no NBFC can commence or carry on the business of a non-banking company without complying with the following two essential pre-requisites:

- a) Obtaining a certificate of registration from RBI; and
- b) Having Net Owned Funds (NOF) + shareholder equity + internally-generated reserves of Rs 200 lakh. This limit was earlier Rs 25 lakh only, it has now been increased to Rs 200 lakh by RBI. Vide notification no DNBS 132/CGM (VSNM)-99, dated 20-4-1999, the RBI specifies the “net-owned fund” (NOF) to be Rs 200 lakh, for an NBFC which commences the business of an NBFC after April 21, 1999. Thus, this specification of higher "(NOF)" is not applicable to NBFCs that commenced business before April 21, 1999. These requirements are cumulative and not alternative. As such, if a for-profit company wants to carry out microfinance operations, it must comply with the above requirements.

Though RBI prescribes a set of compliance norms (prudential and non-prudential) for all NBFCs, the norms become more rigorous (prudential) for NBFCs accepting public deposits.
its. However prudential norms are not applicable to the companies which are not accepting public deposits. It is, therefore, important first to understand the meaning of public deposits. The definition of public deposits given in the RBI Act, 1934 is exclusive rather than inclusive. Section 45-1 (bb) of the Act defines ‘deposits’ in general terms to include any receipt of money by way of deposit or loan or in any other form. The Act then excludes the following items from the definition:

i) Amounts raised by way of share capital.

ii) Amount contributed as capital by partners of a firm.

iii) Amounts received from scheduled banks, cooperative banks or other notified financial institutions.

iv) Amounts received in the ordinary course of business, by way of, security deposits, dealership deposit, earnest money or advance against orders for goods, properties or services.

v) Amounts received from registered moneylenders, provided that such moneylender is not a company; and

vi) Amounts received by way of subscription in respect of a chit.

Paragraph 2(1) (xii) of the directions also excludes certain deposits from the definition of public deposits. This comprises of the amounts received from the following:

- From the central or any state government or under its guarantee From a local authority.
- From foreign government or any foreign citizen, authority or person.
- From institutions like LIC, IDBI, ICICI, IFCI, ADB, IFC or any other institutions specified by RBI.
- From one company to another company.
- As subscription to any shares, stocks, bonds or debentures.
- From a director/shareholder of a private company, or a private company which has become a public company under Section 43A of the Companies Act, subject to the director/shareholder furnishing a declaration to the effect that the amount has not been given out of borrowed funds or from the amounts accepted from others.
- From mutual funds governed by the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.
- Received as hybrid debt or subordinate debt the minimum maturity period of which is less than 60 months;
- Received by issuance of commercial paper, in accordance with the guidelines Issued by the Bank via circular no. IECD 3/08.15.01/2000-2001 dated October 10, 2000.

Barring these exclusions, all receipts of an NBFC come under the category of public deposits.

**PROBLEMS FACED BY MFIS DUE TO THEIR REGISTRATION AS NBFCS**

The following are the disadvantages for MFIs being registered as NBFCS:

i) The minimum capital requirement stipulated for obtaining license for establishment of NBFC (Rs 2 crore) is quite high. However, given the nature of microfinance in India and the relatively small size of MFIs in the country, mobilization of such an amount of minimum capital becomes a major impediment for the prospective start-ups. This is further complicated as the promoters of such NBFCS are largely societies that are not allowed to make equity investments, lest they lose their tax exemption status.

ii) NBFCs are allowed to mobilize deposits only after completion of two years of operations and obtaining an investment grading. For a MFI to get an investment grading is a herculean task even for those with strong portfolios as the conventional credit rating agencies designated by the central bank for this purpose consider lending to the poor and in rural areas as inherently risky. However, deposit services are an important element of microfinance and if the poor are excluded and denied this service then the very purpose of microfinance stands defeated.

iii) There are several restrictions imposed on NBFCs to access foreign capital especially foreign direct investment and venture capital. FDI in equity is allowed for NBFCs but must be for a minimum of $0.5 million and cannot exceed 50 percent of the equity of NBFC. This implies that the NBFCs acting as MFIs must be able to raise more than $0.5 million from the domestic sources to become eligible for accessing the foreign capital via foreign direct investment.

### RESTRICTIONS AND DIRECTIONS ON DEPOSIT MOBILISATION

<table>
<thead>
<tr>
<th>PARTICULARS</th>
<th>NATURE OF RESTRICTIONS &amp; DIRECTIONS</th>
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<tr>
<td>Demand Deposits</td>
<td>Acceptance or renewal of any public deposit which is repayable on demand is prohibited</td>
</tr>
<tr>
<td>Period of Deposit</td>
<td>The period of public deposit should be for a minimum of 12 months &amp; for a maximum of 60 months from date of acceptance or renewal</td>
</tr>
<tr>
<td>Ceiling on rate of interest on public deposit</td>
<td>Rate of Interest not to exceed 11% per annum, Interest should be paid or compounded at rests which shall not be shorter than monthly rests</td>
</tr>
<tr>
<td>Brokerage</td>
<td>Brokerage, Commission, incentive or any other incentive for public deposit had to be paid to a broker should not be more than 2% of the amount of deposit so collected.</td>
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## OPERATIONAL FEATURES OF DIFFERENT MICROFINANCE MODELS IN INDIA

<table>
<thead>
<tr>
<th>OPERATIONAL FEATURES</th>
<th>SHG</th>
<th>GRAMEEN</th>
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<tbody>
<tr>
<td>CLIENTS</td>
<td>PRIMARILY WOMEN</td>
<td>PRIMARILY WOMEN</td>
<td>PRIMARILY MEN</td>
</tr>
<tr>
<td>Groups</td>
<td>15 to 20 clients per group</td>
<td>Usually 5 clients per group (organized into ‘centres’ of 4-6 groups)</td>
<td>Individual clients</td>
</tr>
<tr>
<td>Service focus</td>
<td>Savings and credit</td>
<td>Credit – regular cycle</td>
<td>Credit</td>
</tr>
<tr>
<td>Role of MFI staff</td>
<td>Guide and facilitate(groups may develop autonomy)</td>
<td>Organise (groups dependent on staff)</td>
<td>Organise</td>
</tr>
<tr>
<td>Meetings</td>
<td>Monthly</td>
<td>Weekly</td>
<td>Individual transactions–often daily</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>Rs20-100/month</td>
<td>Rs5-25/week</td>
<td>Flexible</td>
</tr>
<tr>
<td>Interest on savings</td>
<td>Bank rate (4.25%) + profit share</td>
<td>6-9%</td>
<td>6% +</td>
</tr>
<tr>
<td>Initial Loan Size</td>
<td>Rs5-10,000</td>
<td>Rs2-5,000</td>
<td>Rs5-15,000, Rs35,000a</td>
</tr>
<tr>
<td>Effective interest rate</td>
<td>24-28%</td>
<td>32-38%</td>
<td>23-38%</td>
</tr>
<tr>
<td>rate (usual range)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>At a very preliminary stage: usually loan linked, some Life and Health. Sometimes, links to national companies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Development Services</td>
<td>Some associated programmes</td>
<td>A few small social projects</td>
<td>Enterprise support</td>
</tr>
</tbody>
</table>

SOURCE: DATA FOR SAMPLE MFIS IN INDIA, A IN THE SECTOR CO-OPERATIVE
Annex V

SAMPLE SELECTION

The National Survey of Household Income and Expenditure (NSHIE) was primarily aimed to generate more robust and reliable estimate of household income besides other sets of information such as demographic profile of households (religion, caste, education, occupation, and so on), estimates of market size and the penetration of manufactured consumer goods (consumables and durables), and ownership patterns. The target population of the survey was the total population in the country, with states and urban/rural categories as sub-populations or target groups, for whom representative estimates were also sought.

The survey methodology and sampling design adopted is similar to that used by the National Sample Survey Organisation (NSSO) in its Household Budget Surveys (HBS). This is a household survey and a list of households (sampling frame) is a prerequisite to selecting the representative sample from which to collect the desired information. The sampling frame needs to be up to date and free from errors of omission and duplication (which is particularly problematic). In developing countries like India, such a sampling frame is neither readily available nor can it be easily prepared, since developing new frames is an expensive proposition. A three-stage stratified sample design was adopted in which a readymade frame was used at least for the first two stages, and a sampling frame, that is, list of households, was developed in the last stage.

It has been the experience of the National Council of Applied Economic Research (NCAER) with socio-economic surveys in India that more than the total sample size, it is the geographical spread over the country that is more important from the point of view of statistical efficiency of estimates. This applies perhaps even more to income and expenditure, whose distribution across the population is likely to show a large degree of heterogeneity. Consequently, a notable feature of the survey design is that the sample of households was selected from a wide cross-section of households in the country, covering both rural and urban areas, with the objective of enhancing the precision of the estimates. The rural sample for the survey was selected from a representative number of districts across the country, while the urban sample covered a range from big cities to small towns with populations below 5,000.

While the first two stages of stratification in the survey used pre-existing sampling frames, the survey developed a sampling frame of households at the third and last stage. In the absence of a definitive list of households, households in the selected villages and urban blocks were randomly selected by adopting systematic random sampling. In the case of large villages/urban blocks, only a fraction of households were listed in view of time and cost constraints. These households were randomly chosen.
VERBATIM OF THE FOCUS GROUP DISCUSSIONS

FOCUS GROUP DISCUSSION – RURAL 1
Village: Bairagaguda Village;
Mandal: Rajendra Nagar
District: Ranga Reddy District;
State: Andhra Pradesh

FGD WITH BORROWERS

OCCUPATION MIX OF PARTICIPANT GROUP: A majority of the participants were employed either as masons or carpenters. A few were engaged in petty vegetable business and as domestic help. The chief occupation in the village is that of masons with a few households involved in agriculture as well. Women in the village are mostly employed as school ayahs, or as domestic help. The average household income ranges from Rs. 1500 – Rs. 3000, with approximately 10 days of work per month. This being a village of ‘masons’, all the houses were pucca structures, painted and well maintained. The women wore gold ornaments, and apparently, the household income was higher than reported, or there were savings. The men were job workers, and their earnings per day was between Rs.200 to Rs.300.

PARTICIPANTS: The participants for the focus group discussions were females across different age groups.

NEIGHBOURHOOD: Bairagaguda Village is a small village, consisting of only 40 to 60 households. Houses here are mostly self-constructed. And the population was dominantly Hindu population with most inhabitants belonging to Scheduled Castes. Few Muslim households also resided in the village.

NATURE OF INDEBTEDNESS: All the participants mentioned that the main MFI operating in their village was SKS, that they were members and had availed of their loan facility. Spandana was also mentioned as being operational in the village.

With the exception of two members, most of the participants were second or third time borrowers. Their starting loan was reported to be Rs.10,000 in all cases. Loans were usually taken for single purposes and were usually business related. Over half the participants reported taking the loan for themselves commonly to start an independent livelihood activity; either a small shop or to invest in their spouses activity.

Most people apply for the loan showing the purpose of borrowing is investment on business. However participants mentioned while some use it for business purposes, in instances where lower amounts of loan are given (e.g. Rs. 10000 is given while Rs. 30000 is ideally required), the money is used for consumption expenditures.

There are a total of 20 borrowers from this village, 15 of who are currently managing two simultaneous loans, and 5 are on single loans. Participants reported that the borrowing was mostly for businesses, while only one mentioned that she had taken a loan for education purposes.

REPAYMENT PATTERN: Repayment is on a weekly basis on each Wednesday (7 a.m.).

AVERAGE LOAN SIZE: The minimum loan size ranges from Rs. 6000 to Rs. 10000. The previous/first loan as recorded for all participants who were on their second loan cycle is Rs. 10,000. The repayment period is 50 weeks irrespective of the loan size and the interest is fixed at 2.25 % (Rs. 225 on Rs. 10000; Rs. 135 on Rs. 6000).
DETAILS OF MFIS WHO HAVE PENETRATED THE LOCALITY:

SKS MICROFINANCE:
- Starting loan amounts are from Rs. 6000 to Rs. 10000 depending on borrowers need and confidence in their repayment capabilities.
- The interest charged is a flat 2.25% and the repayment period is 50 weeks.
- No security deposit is taken nor any collateral required, however Rs. 100 as a processing fee is levied at the time of loan application, and members are required to pay an additional Rs. 200 towards an insurance premium for themselves. An exception is made for widows; they do not require to pay a processing fee towards the loan but have to pay the mandatory Rs. 200 for insurance.
- Each group consists of 5 persons and the each member is responsible for the other (joint liability guarantee).
- Documents required at the time of joining are photographs of the member and her husband, a photocopy of the borrowers ration card (in order to ascertain address proof and economic status as per card) and a copy of their Voter ID card.
- Home ownership is not checked and therefore is not a criterion for eligibility of loans unlike most other MFIs which insist on current address proof to minimize the incidence of defaults.
- Members can take up to 3 different types of loans simultaneously (In addition to the initial business loan, members can apply for minor loan amounts like festival loans or livestock loans. However this also ensures that the woman is continually in debt albeit at lower interest rates).
- Participants recalled two incidents of members when the death of their spouse occurred. In the first case SKS waived the balance Rs. 5000 (of the Rs. 10000 loan) but did not offer any other financial assistance which is usually the case with other MFIs. In the second incident, the woman’s spouse expired after only 1 week of loan repayment. This prompted the loan officials to ask back the entire loan amount. However, apparently despite pressure to repay the woman refused.
- As per participant responses majority of the loans are taken for business purposes.

REASONS FOR TAKING LOANS:
- Business (presumably for husband as husband is repaying) – Rs. 16000 (2nd time loan)
- To start a petty shop – Rs. 10000 (1st time loan)
- Education loan – Rs. 10000 (1st time loan)
- To invest in a shop – Rs. 16000 (3rd time loan)
- For husband’s carpentry business – Rs. 6000 (2nd time loan)
- To invest in a shop – Rs. 18000 (2nd time loan)
- To invest in a shop – Rs. 18000 (2nd time loan)
- For husband’s masonry business – Rs. 10000 (2nd time loan)
- Saree shop for self – Rs. 16000 (2nd time loan)
- To start a vegetable shop – Rs. 6000 (2nd time loan)

DEFAULTER HISTORY
did not occur earlier. However after October 14th 2010, SKS insisted that the earlier loan be repaid in full prior to talking a new loan. The participants reported that despite the announcement households in the village kept paying (presumably for additional loans taken and additional deposits as well) till January 2011 in the hope that new loans would be given. However SKS did not disburse any new loans and the pre-condition was set, unless all member households in the village cleared previous loan dues they would be officially designated as defaulters.

OTHER LOAN SOURCES:
- Spandana
  - People were refused loans as most of the households in the village were already borrowing from SKS.

DWCRA
- Rs. 30 to Rs. 50 is paid per month as savings
- Rs. 30000 is given to each group
- Interest charged is Rs. 0.25 per Rs. 100 (0.25%). This works out to Rs. 600 per month. Part of this interest amount was also returned after completion of the loan.
- Other benefits include LIC account for the member, access to scholarships (for members children), and Rs. 30000 in case of death due to health reasons.

Gold shops
- Usually the only option for money in emergencies given that there are no alternative sources of credit in the village.
- Collateral is Rs. 20000 worth of ornaments for a Rs. 10000 loan.
- Interest charged is Rs. 4 per Rs. 100 (4% which is significantly higher than that being charged by SKS)
- If loan is not repaid within 11 months then ornaments are confiscated.
- In case the individual has paid for 3 months and is unable to continue, the repaid money is returned but the gold is lost.

MFI
- Participants feel that if MFIs give only one loan, that loan should be of a bigger amount (in order to prevent multiple borrowing and recurring debt)
- People prefer a monthly repayment cycle as compared to a weekly repayment format
- The amount recovered or paid back should include ‘both the principal and the interest’. Participants said that individual calculations for the two are confusing leading to limited understanding of loan repayments.

Savings
- Chit funds were earlier functioning in the village but since
the entry of MFIs has since shut down.
- People used to save Rs. 1250 per month for a period of 16 months leading to an accumulated saving of Rs. 20000.

**DISADVANTAGES OF MFIS AS MENTIONED BY THE PARTICIPANTS:**
- Weekly payments are a must and no default is forgiven.
- The security for loan repayment has to be ensured by the group (something they are not comfortable with in case of defaults)
- LIC for which they have to pay the premium amount is not of sufficient value
- The process for death claims is convoluted, as the borrower has to produce the death certificate (of the spouse) within a week to get the insurance benefit. However, given limited accessibility, and insufficient understanding of insurance claim processes, this becomes difficult for them to comply with.
- The rate of interest charged for loans is too high.
- While monthly repayment cycles are preferred, the amount has to be paid at the beginning of the month as advance. This poses difficulties for those engaged in informal and erratic work patterns such as daily wage labourers.
- While pre-payment of loans is allowed, this has to be made in lump sum. Additionally, the borrower has to go and sign each week and the advance is adjusted against the interest and principle.

**FOCUS GROUP DISCUSSION – RURAL 2**
**Village: Gandipet Village,**
**Mandal: Rajendra Nagar**
**District: Ranga Reddy District (18 km from Hyderabad)**
**State: Andhra Pradesh**

**FGD WITH BORROWERS**
**OCCUPATION MIX OF PARTICIPANT GROUP:** The participants were only women and mostly Muslims. A majority were involved in family businesses, while very few had independent livelihood activities. Among those who did, tailoring was involved in family businesses, while very few had independent livelihood activities/needs of other family members, in a majority of cases, the son, husband or daughter are the ones who repay the loan amount. Only in some instances where the women take the loan to begin some enterprise, they themselves are wholly responsible for repayment.

**NATURE OF INDEBTEDNESS:** They borrowers mentioned that loans were usually taken for multiple purposes, where in addition to financing some sort of business for other household members (e.g. loan for son’s shop, repairing of husband’s auto) they were also meant to contribute towards domestic, health and education expenses. In very few cases the participants claimed to have taken the loan to start an independent livelihood activity such as a tailoring shop or a saree business. However, the loans were shown as being taken for business, and no one came to check on the use of loans after these were disbursed. The MFIs were only concerned that weekly installments were paid, and there was no focus to check/monitor, encourage and motivate the borrowers to get into livelihood activities with the loans.

**REPAYMENT PATTERN:** As most of the loans are taken for livelihood activities/needs of other family members, in a majority of cases, the son, husband or daughter are the ones who repay the loan amount. Only in some instances where the women take the loan to begin some enterprise, they themselves are wholly responsible for repayment.

The weekly repayment amount ranges from Rs. 225 to Rs. 600 depending on the loan amount and is inclusive of an additional deposit. The additional deposit (meant to act both as an informal savings mechanism for the women and as an informal collateral measure in case of non repayment for the MFI) does not follow any fixed pattern and is presumably up to the financial ability of the member. However, the women report that the additional amount was mandatory for them to pay, and usually this was equivalent to the weekly interest amount.

Each group consists of 10 members and has two leaders (First Leader and Second Leader – as termed by the members) who are entrusted with the collection of the repayment amounts from other group members, checking and handing over the exact amount due from that group in a week to the loan officer. The group’s weekly debt payment is encouraged as a group responsibility, as in case a member is unable to pay, the group has to collect from members to make up for the missing payment.

The participants mentioned that every week during repayment they have to recite a poem/oath which signifies their seriousness in using the loan productively to help them achieve a better quality of life for themselves and their family.

**AVERAGE LOAN SIZE:** The minimum loan size was of Rs. 10,000 extending up to Rs. 26,000 for older members.
put pressure on the member who had defaulted on the Rs.10,000 loan amount to pay up. While the member repaid some of the money, the rest of the loan could not be recovered.

**DETAILS OF MFIS WHO HAVE PENETRATED THE LOCALITY: SPANDANA AND SKS**

**Spandana**
- Starting loan amounts are from Rs. 10000 up to Rs. 20000. Borrowers with a poor/less than satisfactory repayment record or persons who had not regularly attended the weekly repayment meetings (although having sent across the payment amounts) are eligible for slightly lower loans (Rs. 18000).
- In addition to the initial loan amount of Rs. 10000, members are eligible to take an additional (or top up) loan after 20 weeks. For the first year the additional loan amount is fixed at Rs. 4000, for those in the second year it is Rs. 6000 and for the third and fourth year the loan amount is Rs. 8000 and Rs. 10000 respectively.
- No collateral is required, however a processing fee is charged on the loan which is fixed at Rs. 450 (on a Rs. 10,000 loan) or Rs. 500 (for Rs. 20,000 loan). Rs. 200 of the processing fee goes towards payment of an insurance premium (one time payment only) for the customer, and Rs. 250/Rs. 300 accounts towards loan processing charges.
- The interest was reported at Rs. 20 per Rs. 1000 (or 2 %) (Principle + interest).
- The loan repayment period is fixed at 50 weeks, and weekly pre payment deposits are allowed where borrowers deposit the weekly amount plus the additional deposit amount (as an informal savings product/scheme).
- To incentivize the practice of additional deposits, the waiting period of the next/subsequent loan is reduced to 15 weeks from 20 weeks if the accumulated additional deposit is equivalent to 5 weeks worth loan repayment amount. Alternatively, in case of failure on part of the borrower to repay an installment, the additional deposit amount is adjusted against the repayment amount. Additional deposits are ultimately adjusted against the remaining loan amount.
- Documents required at the time of joining are two (family) photographs and a photocopy of the borrowers ration card (in order to ascertain address proof and economic status as per card). Additionally, Rs. 450 (on a loan of Rs. 10,000) has to be paid upfront as processing fees on the loan amount. Rs. 250 goes towards processing fees (transactions) and Rs. 200 towards an insurance premium for the customer.
- Women combine themselves in groups of 10 each, following which a senior officer from Spandana comes and explains the loan reimbursement and repayment process. Thereafter, the officer helps the women fill up their joining forms. Each prospective member is then asked to stand outside their respective house with their ration card in hand. The MFI official verifies the house number and address as per the information in the ration card.
- Post confirmation of the address, the officer then checks inside the house and lists the household assets in order to ascertain the loan eligibility criteria of the applicant.
- The member is clearly told that in the event of death of the borrower the outstanding loan amount will be waived, and additionally Rs. 5000 will be given to the family towards funeral expenses and financial support during the crisis.
- Loan repayment occurs on a weekly basis every Thursday and continues for a period of 50 weeks. Given the paucity of saving or regular cash, members reportedly take loans from other sources to ensure weekly repayment resulting in further indebtedness. Some participants mentioned household problems and arguments (presumably with spouses) on Wednesdays over pressure of repayment the following day.
- For members taking a large loan of Rs. 18,000, additional deposits are mandatory (these serve as informal security deposits / collateral against the loans). However, it was learnt that all loan repayments have ceased since October 14th (2010).
- The women were very articulate in resenting the additional petty sums that they were required to deposit weekly. They claim, that the additional amounts even though small, amount to a fairly large sum across different groups, which enter into the MFIs kitty, and is used to for other loan disbursements, without paying interest to the borrowers, who had to deposit these amounts with additional stress and payment pressures.

**REASONS FOR TAKING LOANS:**
- Repair of auto for Husband – Rs. 10000 (1st time loan)
- To start a petty shop herself – Rs. 20000 (2nd time loan)
- Loan for sons’ toddy shop – Rs. 20000 (2nd time loan)
- Son’s vegetable shop and medical expenses – Rs. 18000
- Start shop on beauty saloon for daughter and household expenses – Rs. 10000 (1st time loan)
- Repair of sons’ auto – Rs. 18000 (2nd time loan)
- Education loan – Rs. 18000
- Tailoring business and household expenses – Rs. 20000 + Rs. 6000 (4th time loan)
- Saree shop for self – Rs. 18000 (4th time loan)
- Education and consumption household expenses – Rs. 18000 (4th time loan)

**OTHER LOAN SOURCES:**

**Daily financiers**
- Given only to shop owners and other moneyed people in the village
- For a loan of Rs. 9000, Rs. 10000 is repaid @ Rs. 200 per day for 5 consecutive days.
- Loan collectors sign after taking the money

**DWCRA**
- Rs. 50000 is given to a group of 10 women (Rs. 5000 for each member)
- Every month an affordable amount is repaid which varies with the members repayment ability, e.g. Rs. 300/month; Rs. 500/month; Rs. 750/month for 10 months
While the loan amount for the first year is initially low, if the repayment is good then the group gets Rs. 1 to 3 lakhs or more in subsequent years.

**Gold shops**
- With collateral (gold ornaments) and charge Rs. 4 per Rs. 100 for 11 months.
- If loan is not repaid within 11 months then ornaments are confiscated.
- Advantage is that they get money instantly which is useful especially in times of emergency.

**Banks**
- Difficult to get bank loans, therefore MFIs are more popular sources of loans.
- Some mentioned that MFIs give loans on request as well.

**Savings**
- Chit funds are popular saving mechanisms with each person putting in Rs. 500 each amounting to Rs. 50000 to Rs. 1 lakh.

**SKS Loans**
- Loans have apparently stopped since the last three years after the initial loan disbursement.
- Despite requests, officers were adamant in discontinuing the loan process.
- The initial security deposit of Rs. 1000 (which is quite high with regard to security deposits in other MFIs) was given by some people in the village. However after completion of the loan when borrowers demanded back the security deposit along with interest, SKS refused to return the complete amount. Some participants mentioned that Rs.400 to Rs.600 was offered as a repayment of the security deposit by the MFI.

**Awareness of Incident:**
- The women of the village had heard that there were a couple of incidents, where the borrowers married to drunkards who were considered a liability. They used to pressure the women to take loans and then beg them for the money. There was no help in repaying the weekly amounts, and the women had to take up petty jobs to repay the loans and run domestic expenses, where they again faced pressure from husbands for money for liquor. Taking advantage of the clause in the loan repayment that is the spouse died that pending loan amounts were forgiven and the amount that was paid by the borrowers was returned to them, they apparent killed their husbands (who were both unemployed and alcoholics) in order to stop taking on unproductive loans and further debt and to claim the loan insurance amount.
- The group leader mentioned that there were group leaders in the neighbouring village, who take ‘informal’ commissions from persons wishing to get loans from MFIs, and this commission constitute approximately 10% of the loan amount (Rs. 500 – Rs. 1000).

**Advantages of MFIs:**
- It is an immediate source of money unlike when borrowing from banks.

**Disadvantages of MFIs:**
- Repayment is quite difficult especially when loans are taken for consumption purposes. In such cases borrowers are often forced to take multiple smaller loans in order to make weekly repayments.

**Suggestions From Current Small Borrowers:**
- Repayments should be monthly to ease the pressure of weekly payments.
- Repayment period of 50 weeks is fine, but the interest rate should be reduced.
- The advance payment of the processing fee should be done away with.
- Instead of Spandana offering multiple add on loans, the practice of handling one loan at a time would be better.
- The initial loan amount of Rs. 18000 (plus Rs. 6000 as the additional loan amount) should be increased to Rs. 20000 - Rs. 25000.

**Focus Group Discussion – Urban 1**

*Urban Location: Hanuman Nagar*
*District: Hyderabad*
*State: Andhra Pradesh*

The participants for the focus group discussions were females aged between 28 to 40 years. The majority of women who participated were engaged as vegetable seller, doing work as domestic help. None of the participants had a secured source of incomes. And their spouses were also engaged in small business such as the vegetable vender, saree and bangle businesses, there were few involved in agriculture. Drinking was very rampant among the male members of the society.

**Nature of Indebtedness:** The participants had reportedly taken loans from the Micro Finance Institutes (MFI) namely ‘Spandana’ and SKS, there were few of them were member of another MFI named Equitas.

Microfinance which is actually a means for self-empowerment and the loans that are distributed are for the purpose of income generation; however, majority of the participants accepted the fact that the loans that they took from the MFIs for purpose of expansion of the enterprises run by their spouses, was actually used for consumption purposes for the households.

Across all participants the first loan that they had taken was forcibly used by their husbands mainly for drinking. And because of the non productive use of the loans, repayment was difficult. One of the borrowers in their villages had actually run away as she was unable to repay the loan and the...
burden of repayment fell on the other members of the group to pay off her loan.

There was unanimous acceptance that the loans were taken on the pretext of starting or improving the business, the source of income generation were actually used for payment of school fees for the children, for consumption and repayment of other previous loans. This was a common phenomenon during the first or second cycle as MFI members.

The participants were very open to recount their experiences. One of the participants disclosed how her husband pushed her to get the second loan on the promise that he would take the responsibility for repayment of the loan, however after she got the loan, the same cycle of drinking and enjoying his life, and burden because of his squandering behavior fell on her and she had to cope up with weekly loan repayments.

The size of the loan varied as per requirements. For the few persons who pursued business opportunities, vegetable vending and saree/bangle businesses were mostly opted for. Interestingly all loan were taken showing that these were for business purposes though interactions with the group revealed that debt servicing and consumption are expenditure priorities. Additionally, in most of the cases, the husband was reported as being the one who repays the loan indicating that the loan may have been taken to finance their spouse’s enterprises.

**AVERAGE LOAN SIZE:** The loan amount varied between the new and older members of the MFIs. The new members were eligible for loans up to Rs. 10000, however the older members could take loans up to Rs.16000/.

**MULTIPLE LOANS:** The root problem of the recently reported problems of the MFI borrowers was because of the multiple loans they had taken. In some cases the borrowers had multiple loans from same MFI and in some cases they were repaying loans taken from multiple MFIs.

Multiple borrowing was a quite common phenomenon in this place, with one of the participants was reportedly servicing 4 loans currently (Spandana, SKS, Equitas, Trident). Although the participants have mentioned that they were using to paying loans suggesting comfortableness with juggling multiple loans (multiple loans also invariably mean that the household has no savings; making them more vulnerable to economic and health shocks). Only two of the participants of the FGD reported to have only one loan for which they were repaying through the weekly installments.

** DETAILS OF MFIS WHO HAVE PENETRATED THE LOCALITY:** SKS, Spandana, Trident, Equitas, were the most visible MFIs in this area.

Each MFI had different set of rules some of them as mentioned by the participants are laid down.

**SPANDANA SPHOORTY FINANCIAL LIMITED:**
- Starting Loan amount is Rs. 7000 and goes up to Rs. 18000 for older members
- Loan disbursement period is 5 days (which is quite fast as compared to other MFIs where the initial disbursement period is at least 1 week, and in some cases 2 weeks)
- The application form is filled by loan officer and the loan is disbursed after one week of filling in the application. This process takes place at the meeting in the committee hall in their village.
- The Interest charged per Rs. 10000 is Rs. 225
- Frequency of payment is weekly which happens on every Monday at 8.30 a.m. where the entire group of member has to be present. In case a member is absent beyond 2 meetings, the group members are asked to go and fetch the member.
- Insurance premium and Processing fee is Rs. 300
- Loan period fixed at 50 weeks

**TRIDENT MICROFINANCE PRIVATE LIMITED:**
- Loan amount is Rs. 12000
- The Interest charged is 12.5% flat, which is 24.5% annualized interest rate
- The weekly installment amount is Rs. 270 (Rs. 240 for Principle amount + Rs. 30 as Interest amount)
- Frequency of payment is weekly
- Loan period fixed at 50 weeks
- Insurance premium and Processing fee is Rs. 300

**EQUITAS MICROFINANCE INSTITUTION:**
- The loan amount to the new members to the MFI starts at Rs.10000
- Annualized interest is 29.2%
- The weekly installment amount is Rs. 270
- Frequency of payment is fortnightly
- Loan period fixed at 49 weeks
- As per the participant’s member card, the loan and meeting date is the 1st of each month. The card also has the branch name and number under which the ward falls.
- Insurance premium and Processing fee is Rs. 300

**SKS MICROFINANCE:**
- Starting loan amount is Rs.10000
- Total interest amount charged is Rs. 1250
- The repayment amount is Rs. 225 (Rs. 200 as Principle + Rs. 25 as Interest), and they are collected in the weekly meetings
- Frequency of payment is weekly
- Loan period fixed at 50 weeks
- Insurance premium and Processing fee is Rs. 300

**REASONS FOR LOANS TAKEN BY THE PARTICIPANTS OF THE FGD:**
- Took two loans of Rs. 7000 and Rs. 10000 from Spandana – for starting a tailoring business. And has taken a loan of Rs. 20000 loan from SKS, for which she is currently repaying.
- Took a loan of Rs.10000 from Equitas – for starting a vegetable vending business and is currently repaying this loan.
Took two loans from Equitas amounting to Rs. 17000 (7000 + 10000) for starting a vegetable vending business. And is currently repaying the loans from Equitas and Spandana (loan amount of the loan from Spandana was not mentioned).

One of the participants had been taking multiple loans from the different MFIs for the saree business that she runs along with her husband. Took 4 loans from SKS amounting to Rs. 33000; 1 loan of Rs. 12000 from Trident; 2 loans from Spandana amounting to Rs. 17000 and has also taken a loan from Equitas. Currently only 2 loans from Equitas and Trident were being repaid.

Another participant who had been taking multiple loans from multiple MFIs, took 4 loans amounting to Rs. 50000 from Spandana, SKS, Trident and Equitas.

Took loan of Rs. 14000 from SKS for business and is being currently repaid.

4 loans from SKS amounting to Rs. 50000 and 3 loans from Spandana amounting to Rs. 29000 for bangles and saree business that the participant runs along with her husband. She was currently repaying loans SKS, Trident and Equitas.

LOAN USAGE: A very common feature that was highlighted during the FGD was that the reason for taking loan was not necessarily the same for which it was consumed.

Most reported initial loans that they had taken were used for debt repayment and consumption expenditures.

A participant reported that she took a loan for starting a saree business of her own (in contrast to the normal cases where loans were taken for their husbands for starting a business). However her first loan of Rs. 7000 went towards the construction of her house while her second and third loan (Rs. 10000 and Rs. 12000 respectively) were used for household / consumption expenses. With her fourth loan which she took from SKS, she finally started her saree business at home. The loan installment amounts were paid off by her husband. Her income now was around Rs. 5000 – Rs. 6000 per month indicating infrequent work. Most of her business happened during festival times (This is in accordance with several livelihood interventions where the woman would rather operate out of the house despite lower profits due to domestic responsibilities and/ or a lack of confidence especially if she is starting work or a business for the first time).

Her profit was Rs. 50 – Rs. 100 per sari, but since most of the saris were sold during the festival months, the income in the other months was mostly low. The saris were also sold on installment basis, and there was a lot of work on following up on payments. Due to her low profits (and presumed lack of savings) her business stopped post October 14th 2010 when loan disbursement ceased.

Some participants reported going into business. One member said that in 2007 she purchased a ‘recco’ / tailoring machine from her first loan. The burden of repayment was shared by her husband. She was then earning between Rs. 1000 – Rs. 1500 per month. She used her second loan to buy ‘saree fall’ (lining of the saree border) in order to expand her business. This boosted her monthly income to Rs. 2500. Her husband continues to share responsibility for repayment. She used her third and fourth loan for domestic purposes.

UNTOWARD INCIDENTS:

One of the members husband died in September 2010. She had taken a loan of Rs. 14000 from SKS and had paid Rs. 10, 700 over three months. The remainder of the loan was waived and the money paid by the member was returned to help in the time of crisis.

Participants recalled another case where a member’s ailing, unemployed husband had died. The woman had taken an initial loan of Rs. 10000 which she had repaid in full. She had taken a second loan of Rs. 8000 and was paying Rs. 500 weekly (a combination of a large and small loan repayment). She had 6 weeks left when her repayments stopped in October 2010. In a contrasting reaction, SKS paid only Rs. 1000 (toward funeral expenses) but did not return the repaid loan amount. The members mentioned that the reason showed for refusing to pay the insurance amount is that the guardian’s name of the spouse has incorrect spelling in the death certificate. This was corrected and the insurance claim was resubmitted in Feb 2011. The MFI has reportedly said that they would pay.

People saw the news of some suicides over pressure to repay loans on TV. When loan officers came, the people incidentally physically threatened them as they demanded gold and in one case even daughters instead of the payment. Post this, SKS officers came to diffuse the situation and people paid. However after this media coverage, all MFIs stopped sending loan recovery officers, and the loans were left unrecovered.

LOAN SOURCES DURING EMERGENCY:

Usually gold shops

With collateral (gold ornaments) people are charged Rs. 3 per Rs. 100 for silver and Rs. 4 per Rs. 100 for gold. A further loan is fixed at Rs. 2.50 per Rs. 100

For loans between Rs. 10000 – Rs. 12000, Rs. 20000 worth of gold is taken as a collateral.

Payment period is 1 year, failing repayment the gold is supposed to be confiscated. However, gold shops extend the repayment period if it is agreed that additional interest on the principal amount would be paid for the second year along with the interest amount of the first year. And on full repayment of the loan amount and the interest amount the gold could be redeemed.

Participants mentioned that people in their neighbourhood prefer MFI loans as they are easy to access, ask for little documentation, and could be availed whenever the borrowers are in need of additional cash.
**SUGGESTIONS FROM CURRENT SMALL BORROWERS:**
- Increase of loan amounts to Rs. 40000 – Rs. 50000.
- Because of the danger of multiple borrowings, only one MFI should operate in an area. [This however would not be acceptable by the expansion goals of the MFIs especially NBFCs like SKS, Spandana and Equitas where monthly expansion targets are set for each branch.
- Repayment capabilities should be adequately assessed before disbursing of the loans.
- Repayment should be flexible and in accordance with member’s repayment ease and ability (not all members are in the same occupations, and each occupation has its own income cycle, therefore establishing a fixed date for repayment is not ideal).
- Participants also mentioned that they would prefer monthly installments of Rs. 1000 to Rs. 1500. The ideal loan amount would therefore be Rs. 30000 with a monthly repayment of Rs. 1685.
- Interest rate should be reduced (which is a common suggestion across groups).
- In light of the October 14th incident, borrowers said that they would prefer to take new loans from new MFIs (indicating that since they were not required to re-pay the old loans as per the general trend, they would prefer not to continue the payment taking advantage of the situation).

**SAVINGS:**
**Chit fund**
- With 6 members each.
- Women mentioned that they saved Rs. 462 every month for 16 months, and last two months Rs. 625 was deposited.
- If one member borrows money, she has to repay it with a higher rate of interest.

**DWCRA**
- SHG – women save Rs. 100 per month (limited savings though more secure than a chit fund)
- Groups are 3 years old; however no loans have been issued as yet.
- MFIs and NBFCs as per RBI guidelines are not allowed to offer any savings products (with interest) to members. Additional deposits are a measure to work around this though this too has its negative consequences. Recently some MFIs such as Ujjivan and SKS (in some states) have introduced post office savings and “no frills” banking for second cycle customers onwards.

**FOCUS GROUP DISCUSSION – RURAL 1**
**Village:** Narikela Village  
**Neighbourhood:** Jaleshwar 1  
**District:** North 24 Parganas  
**State:** West Bengal

**FDG WITH BORROWERS**

**OCCUPATION MIX OF PARTICIPANT GROUP:** The participants were mainly women (one male participant was present). They represented occupations such as Dasa Karma stores, shoe stalls, firewood business, ready made garment business, biscuit business and saree business. In terms of business opportunities, this village provided more variety. However, most of the participants reported having family businesses (in which they seemed to be actively involved) rather than individual business.

The majority of the participants were females with only one male participant and the group aged between 20 to 55 years

**NATURE OF INDEBTEDNESS:**
Most of the women participants reported to having loan experience with only MFIs. This village had a large group which had borrowed primarily from Bandhan, but there were members who had parallel loans operating with SKS. They mentioned that three MFIs were largely operating in their village, the primary being Bandhan, while the others were SKS and Asha.

The size of loans varies from small to quite large. Most women who invest in their own business appear to borrow small amounts while those borrowing for family business, borrow large amounts and take multiple loans.

The participants were mostly old borrowers, with the newest member having taken loan for two year (currently running), while the oldest borrower has taken loans for 5 years or more.

All the women were strongly motivated to pay their weekly installments, and also to use the loans strictly for business. They understood that they would not be able to pay back if the loans did not facilitate earning more income.

However, there were a few women, who mentioned that in time of necessity, they would temporarily sub-let part of their loans to trusted friend/relatives, who would pay back with the same interest rate or the loan repayment protocol. Thus, in case a borrower had taken Rs.15000 loan from Bandhan and sub-let Rs.5000 to a nephew. Then each week, the borrower would pay Rs.250 and the nephew would pay her Rs.125 to be included in her weekly payment of Rs.375.

**DEFAULTER HISTORY**
In this group, there was a history of a defaulter. There was a women member, who was a resident of the village for many years, but lived in a rented accommodation. She and her husband had taken loans from multiple sources, including more than one MFI, as well as multiple loans from a single MFI (Bandhan). This aspect was probably not well investigated – especially the repaying capability. Apparently, the loan amount was siphoned off by the adult children, and the family had to flee their home as they did not use the money for their livelihood, and was thus not in a position to pay.
The borrower’s group took the responsibility for the first week’s outstanding, but they decided that they could not pay back the entire outstanding amount from multiple loans from Bandhan. The group members also made their own inquiries about the whereabouts of the borrower (even visited their parental homes in other villages, spending a full day and resources to do the same). However, the location of the couple could not be found out, and the group made a representation to the lending institution that they were not in a position to pay the large outstanding each week. An issue which emerged from this was that the lending institution should be discouraged from providing multiple loans to borrowers with overlapping payment cycles.

DETAILS OF MFIS WHO HAVE PENETRATED THE LOCALITY: BANDHAN, SKS AND ASHA

**BANDHAN:**
- Most of the participants reported to have taken loan from Bandhan at one point time. The amounts varied from Rs.10,000 (first time borrower) to Rs.26,000 (4 year repeated borrower) from Bandhan (maximum of total borrowing ranging to Rs.31,000 from multiple loans).
- Charges Rs.25 per Rs.1000 borrowed - for 42 weeks
- All other conditions of processing fee being paid along with 10% of loan as security deposit, nominal fee for form, and insurance cover for forgiving outstanding loan at the time of death has been reported.
- The group also mentioned that the processing fee was for the payment of a loan booklet given to each borrower. After having paid off the loan, in case a borrower would not like to take a further loan immediately, Bandhan encourages the person to retain the loan booklet at a small fee of Rs.100. This will facilitate the next borrowing without any further formality, except being part of a group, and this amount is re-paid when taking fresh loan.

**SKS:**
- Charges Rs.22.50 per Rs.1000 borrowed - for 50 weeks
- Disburses loan at door step on the second week after application of loan.
- Some of the members of this (Bandhan) group have also loans outstanding from SKS, as they wanted a larger borrowing which was not offered by Bandhan.

**REASONS FOR TAKING LOANS:**
- Dasa karma store and shoe business combined – Rs.15,000 from Bandhan and Rs.10,000 from SKS
- Wood selling business – Rs.25,000 from Bandhan and Rs.26,000 from SKS
- Ready made garment business – Rs.10,000 from Bandhan and Rs.10,000 from Asha
- Biscuit business – Rs.26,000 from Bandhan and Rs.20,000 from SKS
- Saree business – Rs.15,000 from Bandhan and Rs.24,000 from SKS
- Supply of ‘pudding’ for fitting glass sheets in windows – Rs.18,000 from Bandhan and Rs.26,000 from SKS
- Iron grill business – Rs.15,000 from Bandhan
- Rice mill and local ‘haat’ contracts business – Rs.20,000 from Bandhan and Rs.18,000 from SKS

**LOAN SOURCES DURING EMERGENCY:**
- Usually gold shops
- With collateral (gold ornaments) and charge 2% interest per month
- Without collateral the charge is 2.5% per month

**REASONS FOR NOT TAKING LOANS FROM BANKS OR POST OFFICE:**
- 2 years is apparently the maximum loan period
- Loans have to be paid back at one go, which is difficult to manage
- Require more documentation during loan application and approval
- Does not offer easy and repeated access to small loans

**SOURCES OF SMALL SAVINGS:**
- Local unemployed youth and students who are trusted by the community have introduced small savings scheme in the village. The participating households pay Rs.5 – 10 daily for a year. The money is collected by the local unemployed youth or students themselves. They return with interest after 1 year. The youth/students invest the money in different kinds of business and earn enough to pay back the lending households.
- SKS has a scheme of Rs.20 collected from households on a weekly basis for 5 years, and the entire amount paid back with interest.

**AWARENESS OF INCIDENT IN ANDHRA PRADESH:**
- Group reported hearing about suicides by borrowers because they could not pay the weekly instalments
- Their opinion was that discipline in utilization of loan amount and repayment was required to participate in the scheme, and self-respect that no one should have the opportunity to rebuke them on account of non-payment.
- They also mentioned that the group should be formed in a manner that most members are dependable about re-payment, and that they should cooperate in case of an occasional problem with a member, who in turn has the responsibility of paying back the group for the week in which her payment was missed.
- They also mentioned that there should be a reduction in interest charged by reduction of a couple of instalments.

**SUGGESTIONS FROM CURRENT SMALL BORROWERS:**
- Decrease in the security amount – from 10% to 5% of the loan amount
• Decrease in interest rate by reducing the number of weeks of loan payment.
• Allow both monthly and weekly payment cycles.
• Should allow pre-payment of loan if the borrower is able to generate sufficient funds/savings at any point of time
• In a year, a MFI should allow only one loan to a borrower. This will reduce the burden of loan guarantee by group members.
• Total loan requirement of the borrower should be assessed and higher amounts should be allowed as loans, so that the dependence of multiple loan cycles with different borrowers stop. This will ease the payment formality – only one day a week can be invested in terms of time.

FOCUS GROUP DISCUSSION –RURAL 2
Village: Dakshin Rampur
Neighbourhood: Ghosh Para
District: North 24 Parganas
State: West Bengal

FGD WITH BORROWERS
The participants of the FGD conducted in Village Dakshin Rampur were young females aged between 20 to 35 years.

OCCUPATION MIX OF PARTICIPANT GROUP: The participants were mainly from homes which had key occupations of the Chief Wage Earner as agriculture, vegetable vendors, private employment (like security services/night guard), self-employed (rental car business), etc. The women themselves were mostly involved in the family or the husband’s business, and only a few had petty businesses of their own for which they had taken loans.

The Ghosh Para neighbourhood of Dakshin Rampur village has both electricity and piped water supply – although not all parts of the village have piped water. All the participants belong to households, who take small loans and are currently indebted. The economy is largely agrarian, with rice, mustard and jute being the major crops of the people in this neighbourhood. Elsewhere in the village, there are farmers who grow vegetable crops as well. There are households who have petty business (like steel or wooden furniture, dress-making, ready-made garments; under-garments shops, saree shops, dairy, etc.) and there are some who are employed in the transport trade as conductors or bus drivers. Yet other households have auto-rickshaws and operate the same. The village is very close (about 30 km) to the India-Bangladesh Border.

NATURE OF INDEBTEDNESS: All the participants reported that they only borrowed from MFIs, and have no history for having taken loans for livelihood purposes from banks or any other lending institutions, although, some of them mentioned that their husbands used to take loans. Most of the women mentioned that their taking loans is only possible with MFIs, as they had little or no documentation for identity of self or their residence, which was required in formal lending institutions like banks.

Some of the women had reported borrowed from money lenders and gold shops during time of need – mostly for consumption purposes or emergencies.

The size of loans varies from small to quite large. Most women who invest in their own business appear to borrow small amounts while those borrowing for their family business, borrow large amounts and take multiple loans.

The participants were mostly old borrowers, with the newest member having taken loan for one year (currently running), while the oldest borrower has taken loans for 4-5 years.

Some of the participants have concurrent loans operating with different MFIs, and this is primarily because their loan requirement is higher than the loan availability from a single source.

Participants report borrowing for both small and big businesses. They describe small business as dairy, old clothes business, etc. The big business is defined as steel and wooden furniture shops, car repairing factory, etc. Loan amounts are reported to vary based on the scale of business.

DETAILS OF MFIS WHO HAVE PENETRATED THE LOCALITY: BANDHAN, SARALA, SKS

BANDHAN:
• Most of the participants reports taking loans from Bandhan. The amounts varied from Rs.5000 (first time borrower) to Rs.40,000 (4 year repeated borrower)
• Starting loan amount Rs.7000 currently, but was Rs.5000 earlier. For every completed year of loan repayment, the borrower can take Rs.4000 additional loan.
• Loan period was earlier fixed as 45 weeks, but is now reduced to 44 weeks.
• Most borrowers are not aware of the interest percentage. They are aware of the installment amount per Rs.1000 which is Rs.25 per week for 44 weeks.
• Process of application for loan – time lag between application and disbursement of loan varying from 3 weeks to one month
  • First Week: first visit. Representatives visit the village and call 30 – 35 potential small borrowers at one place and explain the loan programme and conduct discussions. They collect Rs.10 from each applicant and provide application forms. Request copy of Identity Card or ration Card and photos of applicant and spouse. The potential borrowers have to apply and fill up the form. The completed application form has to be submitted in the Bandhan office within a few days of receipt of form.
  • Second week: Groups have to be formed with minimum of 10 persons. Each group has to have a President, Secretary and Treasurer elected by group members.
  • Representatives of Bandhan visit the applicant in their
homes, and check on house ownership. Applicants have to live in their own homes, so that their bearing is fixed and the repayment schedule proceeds undisturbed. It is assumed that in case of tenants, the place of payment would vary based on their current residence, and therefore difficult to track, and as a policy, tenants are not allowed to take loans.

* Third Week (after submission of form or form in first week):* All members of the group applying for individual loans has to visit the Bandhan Office – as a group – and record their group composition. They have to pay Rs.200/- for processing fee and 10% of the loan amount as security. Against this, they are provided the full loan. No collateral is required. Usually, applicants do not have to undertake repeat visits to procure loan. They are given specific dates when to visit the office.

- Insurance on the loan is provided in case of death of borrower. At the time of death during loan payment tenure, the outstanding loan amount of the borrower is waived off. Insurance papers are provided to the borrowers.
- Each borrower is given a card with loan installments listed, and columns for date and signature.
- The members of the group have to stand guarantee for weekly repayment. Thus, if one of the members are not able to pay in a certain week, it is the responsibility of the remaining group members to contribute to the weekly installment of the person, and retrieve the amount from the person who had not paid at a later date, and usually within the week.

- The amount repaid (principal plus interest) is Rs.25 per every Rs.1000 borrowed – weekly for 44 weeks. Thus, if Rs.40,000 is borrowed, Rs.1000 has to be paid weekly for 44 weeks. One cannot pre-pay the installments and reduce the borrowing period. Only the last few installments get adjusted against the security amount.
- Loan repayment happens every Wednesday at 10 a.m. and all borrowers have to be physically present and sign on the card against the installment paid. In case, someone cannot physically attend, the person’s installment is taken by a group member for payment, and not on the respective person’s card. However, the gap in attendance is noted, and missed repayment meetings are actively discouraged. It is the responsibility of each person in the group to spend the required time each week to pay back the loan. The system does not allow for the delegation of the responsibility.

**SKS:**
- Charges Rs.270 per Rs.1000 borrowed – for 50 weeks
- Processing fee is Rs.300, no collateral, but 10% of loan to be paid by borrower as security.
- LIC insurance provided with SKS loans
- Some of the members of this (Bandhan) group have also loans outstanding from Asha and SKS, as they wanted a larger borrowing which was not offered by Bandhan.

**REASONS FOR TAKING LOANS:**
- Rs.40,000 loan amount – for purchasing steel sheets in a furniture business run by husband
- Rs.30,000 loan amount – for purchasing Auto in a transport business run by husband
- Rs.6,000 loan amount – for purchasing sewing machine for own business
- Rs.23,000 loan amount – for purchasing vests for an under garments business run by husband
- Rs.5,000 + Rs.5000 – two loans taken – for purchasing a cow for dairy business run by borrower

**LOAN SOURCES DURING EMERGENCY:**
Usually gold shops
- With collateral (gold ornaments) and charge Rs.25 per month for every Rs.1000 borrowed
- Without collateral the charge is Rs.100 per month for every Rs.1000 borrowed

**SUGGESTIONS FROM CURRENT SMALL BORROWERS:**
- MFIs should offer choice of monthly and weekly payment cycles. Groups could be formed on the basis of the payment cycle.
- Decrease in interest rate – preference for shorter cycle with slightly higher recovery per week or month
- Should allow pre-payment of loan if the borrower is able to generate sufficient funds/savings at any point of time

**FOCUS GROUP DISCUSSION –URBAN 1**
**Locality:** Beleghata
**Neighbourhood:** Jora Mandir
**District:** North 24 Parganas
**State:** West Bengal

**FGD WITH BORROWERS**
The participants were females aged 20 to 55 years

**OCCUPATION MIX OF PARTICIPANT GROUP:** Women having their own petty business or associated with the business run by their husbands/family such as food shops or dhabas, saree business, old clothes business, undergarments business, tailoring business.

The family occupation profiles show minimum 2 earning hands per household, with adult children also earning part time in many cases. The men are in occupations as in transport (auto) or in petty business, while the women earn in separate livelihood activities. Thus loans taken by women are mostly for livelihood activities started by the women, although, a couple of women participants mentioned that they had taken loans to support the family business.

**NEIGHBOURHOOD:** is an urban slum, with small one room or two room tenements, interspersed with a few more formal pucca houses. Main road is metal topped, but side streets are narrow alley ways, barely for a single person’s move-
ments. The locality has piped water which are mostly street taps shared by 5 – 10 households. There is electricity supply available. Most participants belong to households, who take small loans and are currently indebted.

**NATURE OF INDEBTEDNESS:** All the participants were women. They reported that they only borrowed from MFIs, and the habit of borrowing for investment into future earning had also started with the advent of MFIs. Most of the women did not borrow from banks, although some of them borrowed from money lenders and gold shops during time of need – mostly for consumption loans.

- The women are mostly allowed to borrow from the MFIs, and for small loans, which increase with each subsequent year of borrowing. Men have reportedly been given loan only by Bandhan, and at the same interest rate as the loans to women. However, their starting loan varies from Rs.20,000 to Rs.50,000.
- The participants were mostly old borrowers, with the newest member having taken loan for two years running, while the oldest borrower has taken loans for 5 years running.

**AVERAGE LOAN SIZE:** Rs.5000 to Rs.15,000 for new borrowers, and Rs.25,000 – 30,000 for old borrowers.

**MULTIPLE LOANS:** Some of the participants have multiple loans that they service concurrently and with different MFIs. The loan periods of these loans could differ or could overlap. For different loans, the women are members of different loan groups, and have different days in the week when payment is made. Multiple loans are taken primarily because the loan requirement is higher than the loan availability from a single source.

**DETAILS OF MFIS WHO HAVE PENETRATED THE LOCALITY:**

**BANDHAN:**
- Started operations in 2002 in this area.
- Most of the participants report taking loans from Bandhan. The amounts varied from Rs.5000 (first time borrower), Rs.23,000, Rs.30,000, Rs.40,000 (4 year repeated borrower)
- Starting loan amount Rs.7000 currently, but was Rs.5000 earlier. For every completed year of loan repayment, the borrower can take Rs.4000 additional loan. Thus, the loan for the first year would be Rs.7000, the second year would be Rs.11,000, the third year would be Rs.15000, and so on...In exceptional cases, higher loans are granted after checking the enterprise and understanding pay back capacity
- Loan period was earlier fixed as 45 weeks, but is now reduced to 44 weeks.
- Most borrowers are not aware of the interest percentage. They are aware of the installment amount of Rs.25 per week for every Rs.1000 borrowed and this amount includes both principle and interest. The number of installments were said to be 44.

- Potential borrowers have to apply and fill up the form. Representatives of Bandhan visit the applicant in their homes, and check on house ownership. Applicants have to live in their own homes, so that their bearing is fixed and the repayment schedule proceeds undisturbed. It is assumed that in case of tenants, the place of payment would vary based on their current residence, and therefore difficult to track, and as a policy, tenants are not allowed to take loans.
- Loan processing time is usually one month from date of application.
- Each borrower is given a card with loan installments listed, and columns for date and signature.
- Loans are not provided to single applicants. The women have to form groups of 10 persons, and apply together for their individual loans. The members of the group have to stand guarantee for weekly repayment. Thus, if one of the members are not able to pay in a certain week, it is the responsibility of the remaining group members to contribute to the weekly installment of the person, and retrieve the amount from the person who had not paid at a later date, and usually within the week.
- No collateral is required. However, the borrower has to pay 10% of the loan amount as security. When the loan is disbursed, the full amount of loan is paid (not adjusted against the security amount). The borrower has to gather the security amount and pay before obtaining loan.
- Rs.20 for every Rs.1000 borrowed is separately taken as the LIC premium as a one time contribution, for which insurance papers are given to the borrowers. It is however, clearly mentioned, that in the event of death of the borrower or the spouse, the loan amount outstanding does not have to be repaid, and the insurance is collected for this purpose.
- In earlier years, the rule was that on the event of death, not only was the outstanding loan dismissed, but the amount of loan paid was handed back to the borrower to tide the crisis. This has changed now, and the loan amount that had been paid by the borrower are not returnable at the time of death of borrower or spouse, but the outstanding loan amount is dismissed. The change of rule is brought about with no charge for insurance separately on the new loans.
- The amount repaid (principal plus interest) is Rs.25 weekly per every Rs.1000 borrowed for 44 weeks who has borrowed from ‘Bandhan MFI’. Thus, if Rs 40,000 is borrowed from “Bandhan”, one has to pay Rs. 44,000 to pay off the loan.
- One cannot pre-pay the instalments and reduce the borrowing period. Only the last few instalments get adjusted against the security amount.
- The borrower is eligible for applying the next loan only when the last 4-5 installment of the previous loan remains for which the MFI already has a security deposit.
- Loan repayment happens every Tuesday and 8:00 am and all borrowers have to be physically present and sign on the card against the installment paid.
SARALA:
- Sarala is in operation from 2007 in this area.
- The terms and conditions of borrowings is almost the same as Bandhan. Rs.5000 was the starting loan amount for new borrowers, which is now revised to Rs.7000.
- The repayment of loan is Rs.125 (for borrowed sum of Rs.5000) for duration of 45 weeks. Thus, Rs.25 per Rs.1000 borrowed is the weekly payment amount.
- Processing time for loans is one month from date of application.
- Does not provide insurance papers to the borrowers.

ASHA:
- Asha has provided loans first in this area – even before Bandhan. However, most of its loans have started being disbursed 5 – 6 years ago (2004 - 05).
- Does not provide insurance papers to the borrowers.

SKS:
- Charges Rs.22.5 per Rs.1000 borrowed, but the pay back period is longer and at 52 weeks. If Rs.40,000 is borrowed from “SKS”, one has to pay Rs. 45,000 to pay off the loan amount.
- Recently they have reduced the period from 52 to 50 weeks - keeping the installment amount unchanged. This has slightly lowered the interest rates.
- It is reported that the loan that has been applied is provided in 2 installments – the first half of the loan up front, and the next installment midway down the period at 25 weeks.
- It could not be ascertained whether the interest for the full loan amount was recovered for all the weeks, or the installments varied in the first half and the later half of the loan period, depending on the actual amount outstanding. Since there were few borrowers from SKS in the FGD, this could not be further clarified.
- Does not provide insurance papers to the borrowers.
- There are other MFIs like Ujian and Arah, who charge processing fee. Ujian charges Rs.200 for a loan of Rs.8000 and Arah charges Rs.300 for loan of Rs.7500.

Savings and Investments:
Most of the participants in the group mentioned that they save Rs.1200 – 2000 per month after investing Rs.10,000. However, this savings cannot al- ways be kept aside, as it funds household expenses. Most meet their expenses from the business. The savings are either kept at home and or invested as gold. Some of the savings are spent on personal extravagances during festival seasons. Only two of the participants mentioned that they save as monthly installments in Bank and Post Office accounts.

Loan Rejection: has not happened

Suggestions from the Participants:
- The weekly payment should change to fortnightly or monthly payments
- Increase in loan amount particularly whose repayment record is good. In this case they don’t have to look for multiple sources for getting loan.
- If possible, decrease in rate of interest

Remarks: Overall the borrowers are very happy with most of the MFIs. They are getting the loan at their doorsteps with minimum paperwork and simple procedure. Also they are getting loan at their demand and at lower rate of interest as compared to the local available informal money lenders. Some quotations from the participants may be highlighted in this regard

- “MFIs have helped us women to get into small business – this would not have been possible with easy access to small loans on a repeated basis”
- “MFIs have saved/eased our life”
- “If MFIs go away, it will be very difficult to sustain our own business”
- “MFIs have given us women a sense of confidence and achievement and empowered us to better our lives”.

One of the key questions that were asked was why they did not stop the borrowing cycle by saving in a routine manner from their earnings, so that in the next year, their own savings can act as their small capital requirement. All the participants without exception mentioned that they spend their monthly profit/savings on domestic and business requirements, and they do not differentiate. However, their savings is not enough to replace the following year’s borrowing requirements, due to domestic expenditure pressures, and the need to live a little better. They are comfortable and secure to borrow money and making it work for their sus- tained livelihood, as they are confident of their ability to pay in this small instalments cycle.
INTEREST RATE AND COST CALCULATIONS

INTEREST RATE CALCULATIONS
1. For each household, the first step entailed estimating the annualized interest rates.
2. These interest rates were calculated separately for each time period.
3. The final interest rates for each category are the average interest rates for all durations weighted by the respective household loan amount received.

COST CALCULATIONS
1. For each category of loan, all types of costs were first added to get a total cost figure.
2. The final cost figures are the average cost figures weighted by the respective loan amount received for each household.
Annex VIII

ADDITIONAL TABLES

TABLE 1: AVERAGE HOUSEHOLD SIZE OF THE BORROWER HOUSEHOLDS

<table>
<thead>
<tr>
<th></th>
<th>RURAL</th>
<th>URBAN</th>
<th>TOTAL</th>
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<tbody>
<tr>
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<td>4.1</td>
<td>4.2</td>
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<td>4.6</td>
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<tr>
<td>Jaipur</td>
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TABLE 2: PERCENTAGE DISTRIBUTION OF BORROWER HOUSEHOLDS BY OWNERSHIP OF HOUSE CURRENTLY LIVING IN

<table>
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<td></td>
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## TABLE 3: PERCENTAGE DISTRIBUTION OF BORROWER HOUSEHOLDS BY STRUCTURE OF THEIR HOUSE

<table>
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<th>Pucca</th>
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<tr>
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<tr>
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## TABLE 4: AVERAGE ANNUAL INCOME AND EXPENDITURE OF THE BORROWER HOUSEHOLDS (RS. TERMS)

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<td>Chennai</td>
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## TABLE 5: PERCENTAGE DISTRIBUTION OF BORROWER HOUSEHOLDS BY THEIR MAJOR SOURCE OF INCOME

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<th>Source of Income</th>
<th>Agriculture</th>
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<th>Non-Agriculture Labour</th>
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<td>2.9</td>
<td>21.1</td>
<td>25.8</td>
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<td>3.8</td>
<td>100.0</td>
</tr>
<tr>
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<td>11.2</td>
<td>27.8</td>
<td>12.1</td>
<td>15.1</td>
<td>1.9</td>
<td>100.0</td>
</tr>
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<td>0.6</td>
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<tr>
<td>Total</td>
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<td>23.9</td>
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<td>2.6</td>
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<td>11.1</td>
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<td>19.6</td>
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<td>2.5</td>
<td>100.0</td>
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<td>100.0</td>
</tr>
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<td>31.9</td>
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<tr>
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### TABLE 6: PROFILE OF BORROWERS

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<thead>
<tr>
<th>LOCATION</th>
<th>MEAN AGE</th>
<th>AVERAGE MONTHLY INCOME (RS. TERMS)</th>
<th>DISTRIBUTION OF BORROWERS BY SEX</th>
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<tr>
<td></td>
<td></td>
<td></td>
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### TABLE 6: PROFILE OF BORROWERS (CONTD…)

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<th>LOCATION</th>
<th>DISTRIBUTION OF BORROWERS BY EDUCATION</th>
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### TABLE 6: PROFILE OF BORROWERS (CONTD…)

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<th>NON–AGRICULTURE LABOR</th>
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<th>SALARIED</th>
<th>STUDENT</th>
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### TABLE 7: USAGE OF BORROWED FUNDS

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### TABLE 7: USAGE OF BORROWED FUNDS

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