MICROFINANCE CRISIS: A CASE OF SOUTHERN INDIA

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ABSTRACT

In southern India, the microfinance crisis was a call for steps to be taken in directions of regulation, monitoring and adopting ways to enhance efficiency of the industry which, if not regulated could have resulted in national disaster. US subprime crisis was also a result of undoubtable confidence of investors in the big banks. The present study provides some suggestions to increase the efficiency of MFIs in India including regulatory changes in repayment, awareness and loaning system, as well as recommend investment in the area of research and development, so that new products and services may also develop.

Keywords:, *Microfinance Banks, India, Financial crisis.*

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INTRODUCTION

The ancient Indian civilizations along with other human races across the world had a value base that supported truthfulness, great patience levels, sharing and helping the needy and intermingling with people. But, with the evolution of industrialization the urge for new and better products and services increased in the people, the values lost their meanings and greedy slowly creped in the human race. The society was thus classified in various categories on the basis of earning capabilities, job performed, ideologies and then more complex patterns of society emerged over time. With dwindling paths of socialism and increasing capitalism the life of poor people turned into a bane. Further, with the era of globalization where the world economies trade on a common platform and capitalism gained prime focus it became of great importance to include the rural and the unbanked population of the world in the existing financial system.

This led emphasis on the introduction of the concept of microfinance to cater to the rural people. Microfinance acted as a hope of silver line in the dark clouds. With its evolution from Bangladesh, it gained momentum and was spread across the world with major and minor variations to suite the geographical conditions of the country and regions. Microfinance is of importance for all, the developed, developing and least developed nations. However, its importance in the developing and under developed nations cannot be compared. It led the path towards sustainable and inclusive growth of the economy.

AN EVIDENCE FROM US

Prasad and Reddy (2009) says in their study that the reasons for US subprime crisis financial crisis are varied and complex. Some of them include boom in the housing market, speculation, high-risk mortgage loans and lending practices, securitization practices, inaccurate credit ratings and poor regulation. In United Sates, the banks borrowed lots of money from the federal reserve which they distributed in the form of loans to public. This gave an initial boost to the stock market. US Subprime Crisis was a result of undoubtable confidence of investors in the big banks. Thirty years of financial deregulation paved the way for financial lobbists. Banks were allowed to make riskier investments and the leverage limits had declined. Along, with this came a financial innovation in the form of derivatives and the securitization food chain. Huge amounts of loans were given to home buyers which were combined to form toxic CDOs or the Collaterised Debt Obligations which were sold to investors. These CDOs had AAA rating which made them the safest instruments and all pension money was invested in them. Further, insurance companies came with products to insure risks against these CDOs. They defied a basic rule of insurance that only the person who possesses the asset can insure for it. Rather, everyone could insure for CDOs which they traded but did not actually hold. With the burst of this bubble, there was no one who was left unaffected in the US economy. People had lost all their money as a result of bankrupsy of major banks, insurance companies and other financial institutions.

A CASE OF ANDHRA PRADESH

In India, the microfinance sector gained momentum in late 1980's prior to which the local money lenders played the credit game in rural India. Microfinance in India is largely a "southern" affair. In 2005 about 83 percent of the households reached by Microfinance were in the southern states.

Eastern India came next with 13 percent of the households while conscious efforts are being planned to rectify this regional bias, it is likely to take a some time before the regional distribution of Microfinance approaches uniformity.

After the US subprime crisis, microfinance industry in developing nations was looked upon as a prospective investment industry and as a way to hedge risks associated with the global markets. It was studied as a prospective risk minimization and diversification area for the investors.

The industry witnessed a fulcrum phase of development with increased future potential and prospects until the crisis in Andhra Pradesh in October, 2010. Till this point of time, the systems were quite organized and there were many players in the market including banks, NGOs, business correspondents, post offices, panchayats and Microfinance Institutions (MFIs). The debt trap was majorly due to the role of MFIs. This crisis was carried on to nearby states majorly affecting Tamil Nadu. It followed a cyclical process. The core objective of the MFIs shifted from helping the poor to creating profits for the organisation. This made them distribute the profits without proper analysis of the person's financial position with no check on prior debt repayment patterns and existing debts the person had. The poor had easy access to credit and no one regulated or supervised them. The poor people took loan from several MFIs at the same point of time. Loan from one bank was taken to repay the debts of other. Soon, the people realized that they won't be at a loss even if they did not repay the loans. The defaults had then started. The MFIs then resorted to coercive actions which then involved government intervention and the MFIs could not recover their loans.

This event resulted in lack in faith of the investors and posted a major question in front of the Indian regulatory bodies to ascertain ways and means to stop this turmoil from spreading across the nation.

The microfinance crisis in southern India was a call for steps to be taken in directions of regulation, monitoring and adopting ways to enhance the efficiency of the industry which, if not regulated could have resulted in national disaster. There were quick steps been taken by the government of Andhra Pradesh to stop the crisis from spilling but a few initiatives were also required to improve the long term life of the industry.

SOME SUGGESTIVE MEASURES ARE MENTIONED AS UNDER:

1. Need for a regulator who can keep an eye on the activities of all the intermediaries and thus a requirement to pass the microfinance bill which enables regulation of MFIs.
2. The borrower must be informed. He should know both his duties and responsibilities while taking a loan. For this purpose, financial literacy is of key importance. It would not only improve repayments but would also develop an understanding of the financial system to the person.
3. Loaning to SHG members or through federations rather than personal loaning to borrowers. This would create a peer pressure and thus an obligation on the part of the borrower to repay the loan.

4. Develop new products and services by increased investments in research and development.

On the other part, in order to be successful in long run MFIs need to attain sustainability. Here sustainability means financial viability of lower order. MFIs are mainly responsible for poverty alleviation rather than profit making but to sustain in long run they should be able to cover their operating cost. They should be able to pay wages and service the loans that they might have taken. They should be able to pay interest on the savings that they might be collecting. Banks incur fixed cost to maintain client account no matter how small the amount it. Micro-loans are generally more expensive than formal financial institution loans due to their relative high overhead costs. Thus, to achieve self-sufficiency, MFIs may need to charge relatively high interest rates. The determination of an optimal interest-rate to be charge to borrowers is another challenging task. If MFIs charge rates too high, it may hinder their ability to help the poor in pulling themselves out of poverty. In order to cover the cost they may require charging high interest rate. Excessive interest rates may also cause increase in default and delinquency cost. Using empirical tests with data fro m 72 MFIs, Benchmarks (2005) found that sustainable MFIs that target poorer borrowers must charge higher interest rates, as they have higher staff costs, and are less leveraged. In contrast, Reddy and Elisabeth (2006) analyzed mid -19th century Irish loan funds and found that MFIs were able to lend to the poor at competitive interest rates without subsidies. Muhammad Yunus has recently made much of this point in his latest book that Microfinance that charge more than 15% above their long operating costs should face penalties. Interest rate ceiling do indirectly hurt poor people by preventing Microfinance Institutions from covering their costs which chokes off the supply of credit. There has also been much criticism of high interest rates charged to borrowers.

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