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*Local/Global Encounters*

# The Other Financial Crisis: Growth and crash of the microfinance sector in India

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ABSTRACT *Christa Wichterich examines the integration of women into the financial market and the role borrowers of microcredits play. She argues that lending to women and microcredits as a main source of income has brought a financialization of everyday life to Indian villages resulting in a feminization of indebtedness.*

KEYWORDS *poverty; women; credits; debt; livelihoods; financial bubble*

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## Introduction

In recent years, India has experienced a financial crisis that shows striking similarities to the US subprime crisis, in its origins, the market mechanisms and the policy responses. Just as the cheap mortgage granted to low-income households in the United States, the microcredits given to poor women in rural areas worked out as financialization of everyday live and integration of poor women into the global financial market with its return-based logic. This jeopardized the social processes and the very objectives of the initial non-profit microfinance model. The growth of this sector led to an oversupply of microcredits in villages and in turn to the overindebtedness of women, the collapse of repayments and problems of liquidity of the microfinance institutions (MFIs). The centre of the crisis has been the South Indian state of Andhra Pradesh, which was praised for years as a hub of microfinancing in terms of number of loans disbursed and poor women reached, making for the world's highest microcredit density and 'penetration rate'. At the same time, Andhra Pradesh has become the state with the highest rate of indebtedness of private households in India. What seems at first sight to be a specifically Indian crisis or default of microfinance management is caused in fact by the market rationale of growth, the rapid commercialization of the sector, overheating and the crash of a bubble.

Different from the plethora of literature on microcredits that uses the empowerment paradigm as conceptual framework for assessing the impact of borrowing on poor women, the analytical framework used in this article is the integration of women into the financial market and the role borrowers of microcredits play therein. Lending to women and microcredits as a main source of income brought a financialization of everyday life to Indian villages – as financial services like mortgage, consumer and subprime credits, as well as credit and SMART cards, were coined by Froud, Leaver

and Williams in the United States (Froud *et al.*, 2007). Microcredits for poor women led to a feminization of financialization of village life, and resulted in a feminization of indebtedness.

## The microfinance boom

MFIs are at the centre of this financial crisis. Since the liberalization of the financial sector in the early 1990s, India witnessed the founding of thousands of MFIs or 'non-banking finance companies' that act as intermediaries between women borrowers at the grassroots level and commercial banks. As their services are limited by law to credit-lending, they would take loans at the usual interest rate from Indian and foreign banks (including the International Finance Corporation and the German 'Kreditanstalt für Wiederaufbau' (KFW)) to build up their own capital and guarantee liquidity. They would then relend the money to women with hefty interest rates and charges, initially 25–30 percent, thus turning the credit-lending process into a commercial financial service and subject it to the market mechanism of profit making. The collateral the MFIs assured to banks and investors was women's high repayment rate of more than 95 percent.

The prospect of good returns sparked a multiple boom. The number of MFIs soared to above 3,000 in India. The first and foremost aim was the penetration of areas with no access to banks, or, as the Indian government put it, the 'financial inclusion' of those who had been excluded from the formal financial institutions and services. The MFIs expanded and competed, and after a concentration process, rating agencies identified six market leaders in terms of assets, liquidity, reach out and profitability. Still referring to village women's repayment reliability and responsibility as collateral, they channelled more and more capital from the international financial market into Indian villages.

At the same time, the number of investment funds abroad (especially in Luxembourg) investing their capital in MFIs grew. Microfinance was established as its own asset class with an image of social responsibility. Microinvestment funds for refinancing MFIs were advertised as 'fastest growing segment in finance industries' with particular small risk for investors due to high repayment rate and widespread outreach. Photos of individual borrowers and stories of their small enterprise, presented on the website of those investment funds, give the impression that small investors could establish a direct relation to a borrower. On the basis of the appearance and the success stories, investors could choose women who seem to be suitable and reliable as object of investment. Thus, they were promised a double return on their investment, a financial return of 5–10 percent and an ethical in terms of clear consciousness. Investment in village women was claimed to be instrumental to development as microcredits were held up as a panacea to reduce poverty, empower women and promote small entrepreneurship.

However, the scenario of microfinance funds is utterly confusing as development concerns and social objectives are mixed up with commercial interests or used to hide those. The 'microfinance-funds-universe' classifies only eleven funds as 'commercial' and 'seeking financial return', and 14 'commercially oriented' funds that 'eventually seek financial return'. Twenty-eight funds are classified as 'Development Funds' that do not seek financial return, among them the 'Deutsche Bank Microcredit Development Fund'. In addition, funds set up by development agencies, foundations, NGOs and others are listed, among them the German 'Kreditanstalt für Wiederaufbau'.[1] In 2006, the ten biggest microinvestment funds owned assets worth US$1 billion and attracted millions of private investors. The market perspective of the sector was to 'mainstream' microfinance in the capital market with a diversification of products, an 'upstreaming' of MFIs into the formal financial sector and a 'downstreaming' of commercial banks into microfinance (Ming-Yee, 2007). These marketization and investment strategies finally aim to extract capital from village economies and channel it into the mainstream of capital accumulation and profitability. This financialization goes beyond the very purpose of the credit sector to facilitate the real economy and serve the immediate needs of the market actors.

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## The building of a financial bubble

Ironically, the investment funds as well as the MFIs benefitted from the global crisis of 2008/2009, which saw investors searching for new return prospects for their capital roaming around. Total assets of the ten largest microfinance funds grew by 31 percent in 2008 and 23 percent in 2009 (CGAP, 2012). They were praised as anticyclical assets, which seemed to be delinked from the capital market trends. Advertisement of investment funds stressed that in earlier crisis situations, for example in Ecuador, women's small enterprises like roadside vegetable stalls or hair dressing were not adversely affected.

At the micro level in towns and villages, the MFIs became a huge source of employment, absorbing thousands of agents (mostly men) and motivating them by various incentive schemes and a bonus system. The practice of mobilizing clients was to encourage women to join 'joint liability groups' of five women who would be collectively responsible for repayment. A SMART Card made village women 'bankable' right at their doorstep, and facilitated 'mobile banking' for the MFIs and a weekly collection of interest. As agents of different MFIs went – additionally to field workers of NGOs – to the same villages, driven by competition they started client poaching, snatching costumers from each other and even encourage women below the poverty line to borrow who had no realistic repayment prospects. The average loan size increased while the interest rates jumped up to 40 percent.

In 2007/2008, the largest MFI, Swayam Krishi Sangam (SKS), registered a rise in net profit by 700 percent; the second largest MFI, Spandana Sphoorty Financial, had an increase of 1,700 percent (Srinivasan, 2009). In 2008/2009, the MFIs managed to reach 8.5 million female customers in Andhra Pradesh alone – a 60 percent rise compared with the previous year. Outstanding MFI credits amounted to 360 billion Rupees (approximately $8 billion) (Nair, 2010). One of the biggest MFIs, SKS Microfinance, recorded an average growth in business turnover of 162 percent in the past five years, and was able to hand out the highest salaries of the whole sector, as well as attractive bonuses. In order to raise more capital to finance further growth, SKS Microfinance listed on the Mumbai stock exchange in 2010 – the second initial private offering of a MFI in the world after the pioneering BancoSol in Bolivia. Massively oversubscribed, SKS Microfinance managed to raise $350 million of fresh money.

## The end of the gold rush

Until 2010, all stakeholders claimed a fantastic repayment rate of 95 percent. In part, this is the result of peer pressure exerted by the women's groups, but it is primarily due to multiple lending: the women took out several credits from various lenders, thus entering a borrowing chain in order to repay earlier loans. To keep up the repayment chain finally many women had to turn back to the local moneylender who normally asks interest rates of more than 50 percent. This development perverted the initial rationale for microcredits to liberate women from the dependency of local moneylenders and their strangling interest rates.

Over the years, this juggling of several formal and informal sources of capital led to an invisible debt chain and a feminization of indebtedness. When in 2010 the Indian press carried headlines on the suicides of overindebted women, this caused a public outcry and an erosion of the repayment myth. The MFIs denied any links to these events, justifying their interest rates and charges of up to 40 percent by the high transaction costs based on the labour-intensive loan disbursement and interest collection. The government of Andhra Pradesh, in turn, accused the MFIs of creating a new non-transparent corporate moneylending regime and of making colossal profits. When Indian media reported that the director of the listed SKS sold $13 million worth of private shares to a hedge fund in Singapore, this reinforced accusations of personal enrichment at the expense of women below the poverty line.

The Indian government is, in turn, being criticized for not regulating the unfettered industry, and at the same time slashing more than a third of its investments in small-scale farming in the past 20 years. The income of smallholders has fallen by 20 percent; half of all rural households

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nationally are overindebted, which has led to the suicides of more than 200,000 farmers. While the oversupply of microcredits to poor women occurred, it became increasingly difficult for small- and medium-scale farmers to get loans. Statistically in Andhra Pradesh eight microcredits flowed into every poor household. This resulted in the indebtedness of 82 percent of rural households – much above the Indian average.[2]

The repayment rate collapsed, meaning the crucial collateral of the MFIs eroded. Banks and investors 'lost confidence' in MFIs; they faced a liquidity crunch when it became difficult to find new capital on international financial markets. SKS Microfinance showed a net loss of $15.7 million in March 2011, against a net profit of $14 million one year earlier. SKS shares fell by 77 percent. The returns on investment funds fell from 5 to 2 percent, and growth of the sector fell to 4.1 percent in 2010 (CGAP, 2012).

The regulation promised during the crisis has been as half-hearted as the regulation of the financial markets in the West. In an attempt to mitigate the damages, the Government of Andhra Pradesh passed an ordinance on MFIs but without effectively protecting female borrowers from exploitation. National and foreign banks (including the US-based Citi Group) created a safety net for the MFIs by offering capital aid. Though the talk of recovery of the sector was quickly launched, the burst of the bubble delegitimized the whole microcredit industry.

## The stages of microfinance in India

Over the past years, microfinance business in form of MFIs crowded out earlier non-profit-driven types of saving and credit institutions for poor women in India. The first was the *sangham* model. Since the 1970s, village women have been joining groups to tackle their problems together, be they in the field of health or sexual violence. Women's empowerment was at the centre of those grassroot organizations based on solidarity, and saving and lending were used as a tool for that very purpose. The group itself determined the use of credits according to individual needs against a backdrop of poverty, emergencies, the caste system and the oppression of women (Sriram, 2010b).

The second type were self-help programmes for groups of women drawn up by the government with the support of World Bank credits and implemented by NGOs. The Grameen model was the inspiration for the schemes, which were mostly financed via the development bank NABARD. With the expansion of this type of self-help initiatives, the government of Andhra Pradesh took over the community- and sangham-based model and became an important actor in the microfinance sector linking communities with large banks. In the self-help model supported by the government, like in the *sangham* model, saving and lending served a public purpose.

The liberalization of the financial market was the beginning of the commercialization of microlending and the financialization of everyday life. Rapid growth, competition, client and profit chasing became characteristics of MFI financial services that increasingly outcompeted development-oriented projects and organizations. The emphasis thus shifted from saving to borrowing, from need- and community-oriented activities to market and business-driven service, from empowerment of women to returns for the investor, from poverty reduction to growth of the sector, and from solidarity to competitiveness. In fact, chasing profit became an end in itself for this complex system of financial transactions (Kannabiran, 2005).

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## The development aid bubble

At the same time, however, there was a second bubble that burst, the hype claiming that microcredits would be an effective aid instrument to empower women socially and economically so that they could generate their own income and free themselves from poverty. The main economic assumption working in tandem with the microcredits was that poor women would invest the loan in a productive way and would become entrepreneurial and self-responsible market and development actors. The architect of this hype, the Nobel laureate and founder of the Grameen Bank, Mohammed Yunus, had the brilliant idea to link

credits with teaching women financial discipline, entrepreneurial skills and modernizing the role of women by practicing family planning and engaging in a broad range of development activities in villages.

Yunus called for a 'human right to credit' and established a link between the United Nations' human rights paradigm on the one hand, and the formal financial market and neo-liberal mainstream on the other by calling on big banks and investment companies to enter commercial business by granting microcredits. What he promised to commercial and welfarist moneylenders in return was to contribute to banishing 'poverty to the museum'. With its market orientation and the intertwining of business and development objectives, the Grameen Bank started already to encompass the logic that would make MFIs into a fully fledged business circuit. In Bateman's well-informed analysis, the Grameen Bank pioneered the commercialization of the microcredit sector and the later 'local neo-liberalism' (Bateman, 2010).

The financial services and products offered by MFIs to village women implemented the 'business approach to the alleviation of poverty', which should allow 'individuals to work their way out of poverty' as declared and planned by the Microcredit Summit 1996.[3] This shift of responsibility to the individual woman as market player and potential entrepreneur introduces the neo-liberal element of self-responsibility into the social project of supporting poor market actors like rural women. From a Foucaultian perspective, microloans are a technology of neo-liberal domination through which women learn self-regulation and become integrated into the financial markets as self-responsible subjects. If the objective of lending is profit maximization, at the end of the day the very objectives of financial services and loans are perverted: instead of serving the requirements of the real economy and the needs of poor people, the real economy and poor people serve the financial sector and its basic rationale of capital accumulation.

## A shift in discourse

The crisis of the microfinance sector caused an astonishing shift in the language and discourse around microcredits. After their positive impact on poverty and women's high repayment morale were praised for over two decades, the concepts of poverty eradication, empowerment or even group solidarity have evaporated completely. All the criticism of the microcredit system that had been voiced for years and ignored by big NGOs, MFIs, as well as by Western donors, have suddenly been confirmed (Mayoux, 1995; Singh, 1997; Kabeer, 2005; Batliwala and Dhanraj, 2007).

It is now common knowledge that in India at least half of the women use the credit to repay other debts, cope with emergencies, for example a surgery, or for consumption and that they take out new loans to repay the microcredit. While the repayment rate has been used as main indicator of economic 'success', no correlation could be established between repayment and productive investment of the loan. A study in Eastern India showed that although 97 percent of women borrowers had repaid the microcredits, in only 9 percent of all cases did it really improve their economic situation in the long term.[4] Forbes called it a failure of microcredits in India that less than one-third are used for income generation (Chatterjee, 2010).

The rise in consumption and liquidity in poor households made it easier to manage poverty, stabilized the survival strategies and did reduce vulnerability; however, it did not necessarily lead to eradication of poverty. On the contrary, the new overindebtedness creates new poverty and misery. If women fail to manage dues and debts and are unable to maintain their complex chains of multiple lending and multiple repayment, the whole system defaults.

If the credit is invested in production, for example in chicken farming and the egg business, there soon occurs a phenomenon of local oversupply, with women outcompeting each other. This was also the case with the Grameen Bank, where women in villages began renting out telephone time with Nokia mobile phones. When rural women offered yoghurt from the French corporation Danone with whom Yunus set up a 'social enterprise' project, they did not find sufficient demand in the villages as all women make their own yoghurt. However, through this kind

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of credit-funded projects new markets for the corporations are opened up while women operating a franchise are taking on turnover risks. This results – as in the example of Danone yoghurt – in a marginalization of local women's work and the village economy.

Even if often this process enables women to gain recognition and bargaining power at home and with the authorities, there is no doubt since the crash that even the best microcredit is no substitute for social policies and development programmes that redistribute and secure livelihood for women. Microcredits are not a tool for sustainable poverty eradication. Structural changes to eliminate poverty remain necessary.

## Conclusion

While the microfinance industry is hoping for its recovery, the debate is only just emerging in India on how to reintegrate saving and credit into social contracts and structures of a solidarity economy. The well-known organization of informal women workers SEWA in Gujarat, where lending is need-oriented with a strong focus on savings, centres around the SEWA bank and is embedded in other programmes, was not affected by the crisis. Even in Andhra Pradesh there are crisis-free pockets: the NGO Deccan Development Society (DDS) developed a system of small-scale farming based on local biodiversity and aiming at food sovereignty without loans from outside.

Taking into account that in present conditions for many poor women loans are survival tools, a tool to cope with poverty – not to move them out of poverty (Collins *et al.*, 2009) – the challenge is how to get back to non-profit-driven types of saving and lending, and to self-organized and self-controlled social contracts around borrowing. It is crucial that the revenue generated by the poor is not siphoned off from outside but that it stays in local circles to ensure the survival and livelihood of poor people.

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### Notes

1 http:/www.microcapital.org/microfinance-fund-universe, visited 20 July 2011.
2 The debt burden in Andhra Pradesh was eight times higher than the Indian average (Srinivasan, 2009; Sriram, 2010a).
3 James D.Wolfensohn, President,World Bank, 11 July 1996. See: Microcredit Summit, Declaration and Plan of Action, Washington 2007.
4 Forbes, 10 November 2006.

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