

# **Competition & the role of external agents:** The 2009 delinquency crisis in southern Karnataka

Revised (excluding client survey data not yet ready), April 2010



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### Preface

This is the report of a study of the delinquency crisis that broke out in the southern districts of the Indian state of Karnataka in the first half of 2009. It is based on a combination of qualitative research and analysis of the limited amount of client data presently available from some of the leading MFIs affected by the crisis and complemented by analysis of MFI level information. Focus group discussions (FGDs) were conducted in each of the affected areas (1-2 groups for each of the major MFIs operating in the area). In areas where clients refused to gather in groups for an FGD, short individual interviews were conducted instead. The team also conducted FGDs with branch staff, separately for each MFI in all the four affected areas.

**Table 1: Coverage of MFIs and towns by the study team**

Details	Kolar	Sidlaghatta	Ramnagaram	Mysore
<b>MFIs visited (FGDs held with clients and MFI staff)</b>	<ol style="list-style-type: none"> <li>1. Spandana</li> <li>2. SKS</li> <li>3. FFSL*</li> <li>4. Grameen Koota</li> <li>5. RORES</li> <li>6. Asmitha</li> </ol>	<ol style="list-style-type: none"> <li>1. Spandana</li> <li>2. SKS</li> <li>3. Ujjivan</li> <li>4. Grameen Koota</li> <li>5. RORES</li> </ol>	<ol style="list-style-type: none"> <li>1. Spandana</li> <li>2. SKS</li> <li>3. Ujjivan</li> <li>4. Grameen Koota</li> <li>5. Sanghamithra</li> <li>6. Asmitha</li> </ol>	<ol style="list-style-type: none"> <li>1. Spandana</li> <li>2. SKS</li> <li>3. Ujjivan</li> <li>4. Grameen Koota</li> <li>5. Sanghamithra</li> <li>6. Asmitha</li> </ol>
<b>Number of clients</b>	37	46	46	56
<b>Areas covered</b>	<ol style="list-style-type: none"> <li>1. Shahenshah Nagar</li> <li>2. Shaheed Nagar</li> <li>3. Noor Nagar</li> <li>4. Tippu Nagar</li> <li>5. Rahmat Nagar</li> </ol>	<ol style="list-style-type: none"> <li>1. Rahamat Nagar</li> <li>2. Patnool Street</li> <li>3. Gandhi Nagar</li> </ol>	<ol style="list-style-type: none"> <li>1. Rahmaniya Nagar</li> <li>2. Nagar</li> <li>3. Janata Colony</li> <li>4. Bus stand (town area)</li> </ol>	<ol style="list-style-type: none"> <li>1. Rajendra Nagar</li> <li>2. Ghousia Nagar</li> <li>3. Aziz Nagar (B.D. Colony)</li> <li>4. Shanti Nagar</li> <li>5. BMC Nagar</li> <li>6. Kailash Nagar</li> </ol>
<b>Others visited</b>	<ul style="list-style-type: none"> <li>• Anjuman Cttee</li> <li>• Municipal Councillor</li> <li>• Lead Bank Manager</li> </ul>			

The study team would like to thank the management and operational staff of all MFIs that cooperated in the study (see table above). We would also like to thank the leadership of the Association of Karnataka Microfinance Institutions (AKMI) – Mr Vivekanand Salimath, Mr Samit Ghosh, Mr Suresh Krishna – for asking us to undertake the study and CGAP for their support and cooperation in conducting the work. Thanks are also due to Mr Krishna Morab, Secretary of AKMI for his support in coordinating the work with the MFIs. Unfortunately, BSS, a notable participant in the microfinance industry in Karnataka, refused to participate in the study.

As indicated in the report, a field survey of 800 MFI clients has been completed in the affected areas and also in two control locations and analysis is currently in progress. The results of the survey are expected to add substance to (or modify) the findings of this study and will be included in a revised report.



### Competition & the Religion Conundrum:

Summary analysis of the delinquency crisis in microfinance in southern Karnataka

#### Growth and vulnerability

Growth and the associated vulnerability of microfinance institutions (MFIs) has become the essence of international microfinance over the past couple of years. Issues emerging from some of the major areas where the vulnerability of MFIs has become manifest have been documented by CGAP in a recently published paper.<sup>1</sup> The countries covered by the paper, Nicaragua, Morocco, Bosnia-Herzegovina and Pakistan have all experienced significant stress resulting from high growth rates and leading to local or national microfinance delinquency crises. To these areas experiencing stress on account of high rates of growth could be added many local delinquency crises (actual or potential) in India, Cambodia, Nepal and a number of other places afflicted by the ongoing “irrational exuberance” of the microfinance industry. This paper examines the delinquency crisis that affected microfinance in some southern districts of Karnataka state in south India in 2009.

In common with some other states of India, microfinance in Karnataka has grown at a rapid pace. With 64% growth in MFI clients during the financial year April 2008 to March 2009 (compared to the national average of 42%), Karnataka was the second fastest growing of the major microfinance states of India (second only to Maharashtra). The number of clients of the 27 MFIs operating in the state had reached 3.2 million by the end of the period. This was in addition to over 3 million members of some 232,000 self help groups (SHGs).<sup>2</sup> As elsewhere, this growth has not been spread evenly but has been largely concentrated in the more accessible, more densely populated and better developed southern districts of the state. As the CGAP Focus Note explains, MFIs follow other MFIs into local markets so that they can lend to the same borrower groups and benefit from the client acquisition processes undertaken by the early entrants. The CGAP note argues that while competition enables greater efficiency by lowering operating expenses, it undermines credit discipline by providing borrowers with alternatives and opportunities for multiple borrowing that enable them to juggle payments and skip between MFIs to avoid the restraints of rigid payment schedules, defaulting with one while retaining their relationship with another.

#### Tinderbox conditions created by multiple lending due to intense competition

The story of Kolar, and its neighbouring districts of Karnataka, is no different. While detailed, reliable field survey data will be available shortly,<sup>3</sup> the rough calculations undertaken for this paper show that in Kolar town, the epicentre of this crisis, microfinance clients are likely to have an average of three loans each. Client information from seven of the 9 MFIs operating in the

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<sup>1</sup> Chen, Greg, Stephen Rasmussen and Xavier Reille, 2010. “Growth and Vulnerabilities in Microfinance”. Focus Note 61. Washington DC: CGAP, February.

<sup>2</sup> Since there is extensive overlapping in MFI and SHG membership, this does not amount to 6.2 million microfinance users in the state. A reasonable guesstimate would be of the order of 4-4.5 million users.

<sup>3</sup> A field survey that should provide more reliable information on multiple lending is in progress (March 2010).



town shows that at least 33% of them have more than one loan and around 20% have three or more loans. More significantly, the opportunity for borrowing from multiple MFIs has resulted in debt from these seven MFIs of around 150 clients (out of 12,000) in Kolar town rising to levels of Rs45,000 (\$1,000) and beyond, mostly exceeding the commonly accepted definition of microfinance in India.<sup>4</sup> Adding information for (particularly) one other MFI is likely to increase the number with these high borrowing amounts to several hundred – more than sufficient to increase credit risk to unsustainable levels.<sup>5</sup> The fact that these borrowings and those at slightly lower (but still high levels) came from three or more MFIs meant that significant sums (in excess of the Rs41,000<sup>6</sup> – nearly \$900 – per capita state domestic product of Karnataka) were being provided to borrowers through group loans that entailed no specific assessment of their enterprises or repayment capacity.

Competition amongst MFIs was so fierce that as late as December 2008, when multiple lending was already an issue in the town, there were still MFIs entering the Kolar microfinance market for the first time. Yet an examination of the revenue and cost information of these MFIs shows that in terms of price (MFI yield around 32%) there was little to choose between them.

When conditions in the silk reeling industry in southern Karnataka deteriorated (partly on account of the global crisis) the strain of repaying large sums of money on a weekly basis was exacerbated by declining enterprise performance across the region. Discussion with clients in the four main affected towns shows that, in many cases, they were running from one MFI meeting to another spending 1-2 hours on a daily basis. Further, the push for growth had resulted in the engagement of agents in the process of recruiting microfinance clients leading inevitably to proxy borrowing by some of these agents. All of this created social as well as economic strains in families and neighbourhoods resulting in tinderbox conditions that only needed a spark to ignite.

### **An attempted suicide lights the tinderbox**

That spark was provided by the attempted suicide of a prominent member of the muslim community in Kolar on 30 January 2009. When his friends and relatives complained to the local religious establishment about the “trouble” caused by MFIs, the situation took a religious turn. The local Anjuman Committee, irked by months of complaints about women “neglecting” family duties, families led into crippling debt by the culture of “easy money” that had developed in the town and oath taking at meetings invoking hindu goddesses, intervened in the only way it knew: interaction between MFIs and muslims in the town was prohibited by religious edict.

The resulting delinquency crisis amongst muslim clients spread to other towns as a variety of vested interests came into play. In nearby Sidlaghatta, the religious ban of Kolar was sufficient to provide a breather from the daily round of financial juggling that went into repaying multiple microfinance loans without an adequate income from their household reeling enterprises. In

<sup>4</sup> Rs50,000 (currently \$1,100).

<sup>5</sup> BSS did not provide information for this study.

<sup>6</sup> Information for March 2008 in Economic Survey, 2009-10. New Delhi: Govt of India.



Ramanagaram, reeling factory owners faced with a labour shortage on account of the increasing independence of women with microfinance loans, appear to have influenced the local Anjuman to follow the Kolar example and ban the interaction of muslims with MFIs. In Mysore, an unrelated communal clash resulted in business losses that enabled a local political organization to pose as a saviour of the community by urging microfinance borrowers not to repay and by raising the possibility of a loan waiver. The tinderbox had been well and truly lit. The hold of religious leaders over their community aggravated the delinquency crisis but religion was neither responsible for the conditions that led to the crisis nor did any religious principle provide the trigger. To the extent religious issues have become a part of the imbroglio, these were more an *ex post* justification than a real cause.

### **Bruised egos prolong the crisis...**

The MFIs' response to the crisis was to come together under the aegis of their state-level association (AKMI) to initiate joint action. Initially they assumed that government intervention was needed to resolve the matter. In hindsight this was a mistake. AKMI appealed directly to the district authorities of Kolar to intervene. Having been sidelined in the matter, the Kolar Anjuman became adamant, insisting that they would wait for whatever action the government cared to take; knowing well that in a communally charged situation the options for the government were limited. Having issued the edict that started the mass delinquency, the Anjuman could now present itself as a champion of the rights of the minority community against MFIs. The lessons of Kolar were later applied elsewhere; in Sidlaghatta and Ramanagaram, better relations were maintained by MFIs with community leaders and the situation was kept under a semblance of control.

### **...while the basic tenets of the activity result in unintended consequences**

At this point, the role of the zero delinquency culture and group guarantees of microfinance loans, the basic tenets of microfinance bear examination. The zero delinquency principle must bear part of the responsibility for the tinderbox conditions that developed in the region. Multiple lending resulted in women members having to spend time attending multiple meetings but zero delinquency compounded the problem by not allowing MFI staff the flexibility to negotiate or reschedule payments when clients got into trouble. MFI staff required invariably to collect on time put various types of pressure on clients to repay. A common practice is to undertake a vigil outside the homes of defaulting clients until payments due are made good. This is usually a matter of 1-2 hours but, nevertheless, causes tension in the family and community. The spark that ignited the tinderbox of Kolar was the alleged verbal abuse of a client by an MFI loan officer. While the principle of zero delinquency was meant to ensure good collections, its rigid application in practice became a proximate cause of the crisis.

Equally importantly, given the high level of outstanding loans of some MFI clients, non-defaulting members of their borrower groups have started to resile from the principle of group guarantee. Helping others pay an instalment or two is still possible but taking full responsibility for cumulative debts of the order of Rs45,000 or more is not. This is especially so now when more than one member of a group could have difficulty in paying her loan instalments. Equally

importantly, the mass default having occurred, the group guarantee mechanism has unintended consequences; even those members of a group willing to pay see no point in doing so as they are branded as defaulters along with other members of their group, and there is no prospect of persuading MFI staff to consider their case separately. Thus, the default in southern Karnataka is more severe than it might have been. Women members of other communities – not otherwise defaulting – in mixed groups have, in particular, been affected by this phenomenon.

**Thus, though there is universal appreciation of the benefits of MFI support, low income muslim families in southern Karnataka are caught in a cleft**

Women clients of MFIs in southern Karnataka – both muslims as well as hindus – are unanimous in appreciating the benefits of MFI financing. It is universally accepted as having facilitated their lives and livelihoods. However, while of one community continue to repay normally (except in a few cases of genuine difficulty), other clients are caught in a cleft between the leaders of their community unable to resile from their drastic actions, on the one hand, and MFIs unwilling to violate their own cherished principles of zero delinquency, group guarantee and no refinancing, on the other. While the one threatens excommunication, the other threatens economic oblivion.

**Key lessons emerging from the study**

It is apparent that multiple lending, if not necessarily extensive overindebtedness, has been a key factor in the mass delinquency that occurred in southern Karnataka. The management of the crisis in the initial stages reflected the inexperience of the MFIs in the region with this type of problem. The lessons emerging from this crisis for microfinance operations are

- MFIs should share information on multiple borrowing, preferably through a credit bureau
- Some of the larger MFIs should develop the capabilities to undertake individual lending up to the level of Rs50,000 so that clients with larger needs are not compelled to become members of several MFIs
- This will also ensure that clients with higher levels of borrowing are assessed for that level of borrowing and not for smaller amounts per MFI; such clients may be in a position to repay smaller amounts but not to pay the much larger amount borrowed on aggregate
- MFIs need a more flexible approach to delinquency so that staff are encouraged to report cases of genuine economic difficulty to enable managements to be more responsive and flexible in situations of economic crisis. Loan rescheduling cannot be treated as a forbidden instrument in any and all situations.

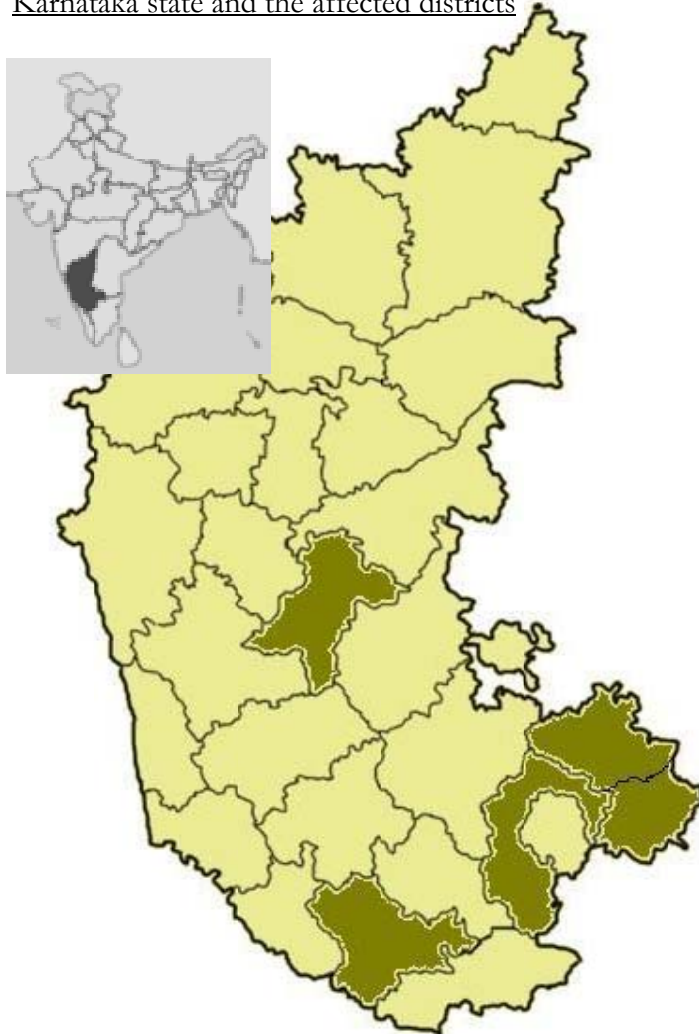
Finally, in the event of mass default, MFIs need to muster all potential sources of support, attempting to create a suitable business environment that will help to carry community leaders along with them as well as the government authorities. Thus, there are important lessons to be learnt from the crisis if the good work of MFIs with millions of clients is not to be washed away with the problems of a few thousand misled into mass default.

## 1 Karnataka and the state of Microfinance

Karnataka is the second largest state in India in terms of MFI coverage and outreach, and both SHG and Grameen models of microfinance have been applied there. There are reported to be 27 MFIs of significant size functioning in the state (**Table 1.1**) with combined outreach to over 3.2 million clients at the end of March 2009 and portfolio outstanding of the order of Rs2,150 crores (US\$470 million). Microfinance services are available through MFIs in all the 29 districts of the

**Figure 1.1**

Karnataka state and the affected districts



state, though to varying levels of intensity. All the ten districts of the state classified as amongst the poorest in India are covered by MFIs.

In 2007, the Association of Karnataka MFIs (AKMI) was formed to encourage dialogue, information sharing and problem solving amongst MFIs. AKMI has fostered cooperation among MFIs in Karnataka at the top management level as well as at the district level, where MFIs meet once a month to discuss local issues.

The map of Karnataka alongside shows all the districts in the state along with the four districts affected by the crisis. Davangere district has also been marked on the map since Davanagere and Nanjangud (Mysore district) towns have been used as control towns for comparative purposes.

**Table 1.1:** MFIs in Karnataka (March 2009)

No of MFIs (HQ) in the State	21
No of MFIs (HQ & branches)	27
Client Outreach	3,229,378
Portfolio Outstanding (in lakh Rs)	2,148
Portfolio Outstanding(in US\$ millions)	457
Number of Districts Served	29 (all)
of which, number of Poorest Districts	10

Source: Sa-Dhan, 2009. Bharat Microfinance Report



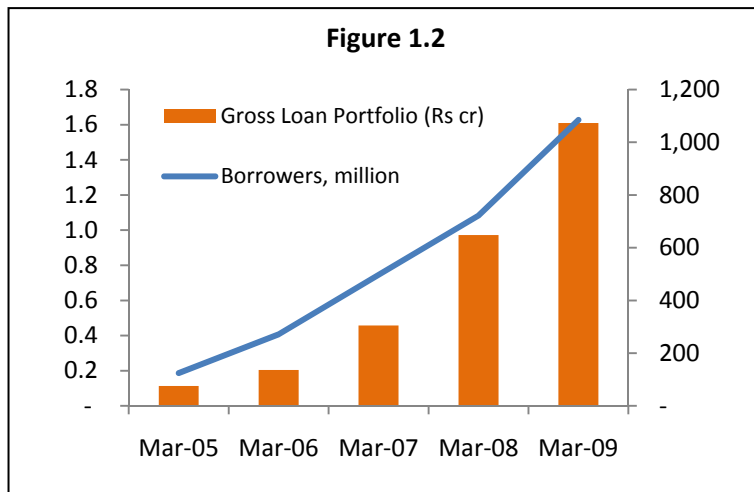
1.1 Karnataka MFIs match the growth of the largest MFIs in India...

MFIs operating in Karnataka can be classified into three categories as shown in **Table 1.2**. Of these, 13 are large MFIs with more than 50,000 clients each. Five of the six large MFIs registered outside Karnataka are some of the largest MFIs in the country each with more than half a million clients. Of the five large Karnataka-registered MFIs operating outside the state, four have more than one lakh clients each.

**Table 1.2**  
MFIs operating in Karnataka

Registered in...	Operating in...	Total	>50,000 clients
Karnataka	Karnataka only	11	2
	Karnataka + other states	8	5
Other states	Other states + Karnataka	8	6
<b>Total all types</b>		<b>27</b>	<b>13</b>

Detailed information on the distribution of clients of these multi-state MFIs between Karnataka and other states is not available so it is not possible to quantify their relative shares in the MFI market in Karnataka. For this reason, it is also not possible to quantify the actual growth of

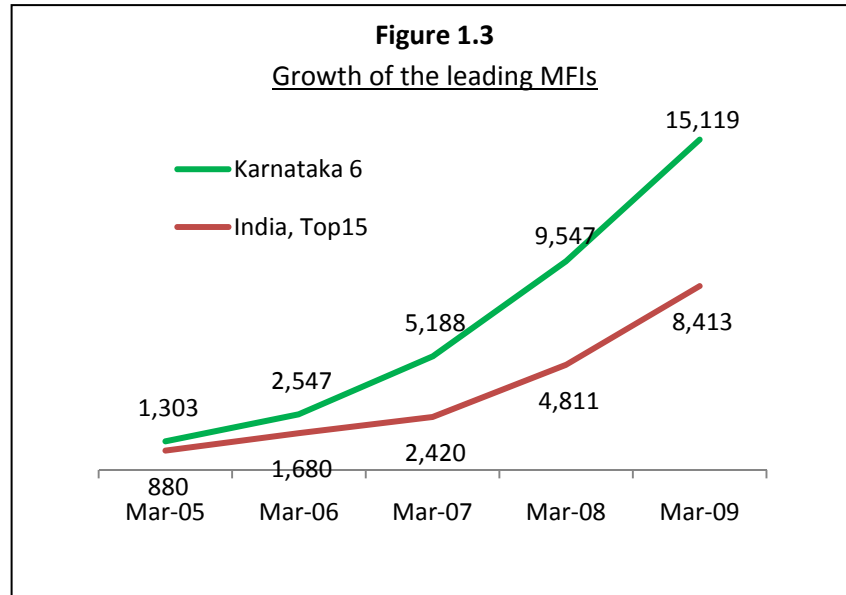


outreach by all MFIs in the state beyond the two years (2008 and 2009) for which aggregate information for the state is available. **Figure 1.2** shows the growth of microfinance outreach by the 6 largest Karnataka registered MFIs (henceforth referred to as the Karnataka 6. By March 2009, these MFIs together accounted for over 1.6 million client accounts with a loan portfolio of nearly Rs1,100

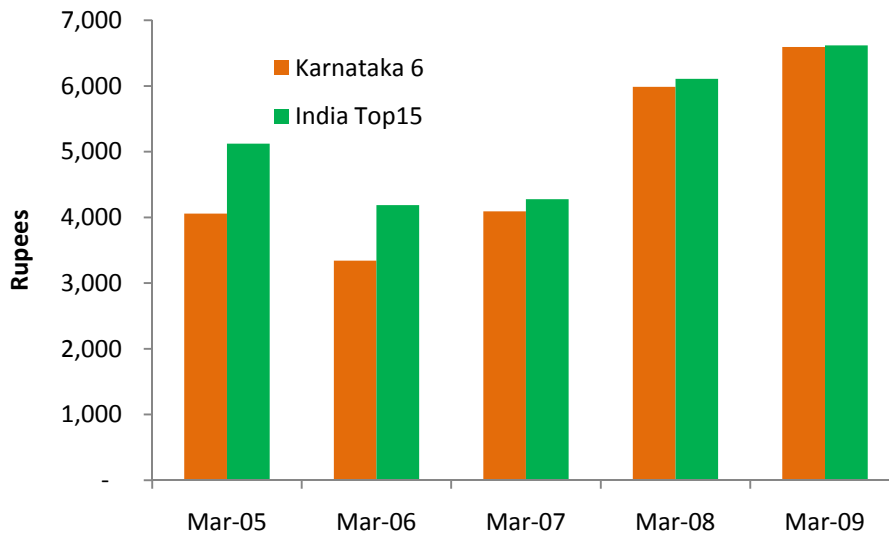
crore (\$240 million). These accounted for a 12.6% share of both the microfinance outreach of the 15 largest MFIs in the country and their loan portfolio. This compares with Karnataka's share of around 5% in the population of India.

**Figure 1.3** (next page) presents the CRILEX (M-CRIL's index of Indian Microfinance) for the Top15 MFIs in India and the Karnataka 6. CRILEX is a composite index combining growth in outreach and growth in portfolio. As the figure shows, Karnataka MFIs have grown much faster over the past five years than the Top15 MFIs in India. While growth in the number of clients (74% per year) has been slightly slower than the Top15 (80% per year) the increase in loan size has been faster in Karnataka resulting in higher overall growth of the Karnataka 6 at 85% per year compared to 76% per year for the Top15. The increase in average outstanding loan size is depicted in **Figure 1.4**. Though the average outstanding loan size of Karnataka MFIs was just

Rs4,000 in March 2005 (compared to Rs5,100 for the Top15 in India) the current average loan size of both sets of MFIs had reached Rs6,600 by March 2009.



**Figure 1.4**  
Change in average outstanding microfinance loan size per client

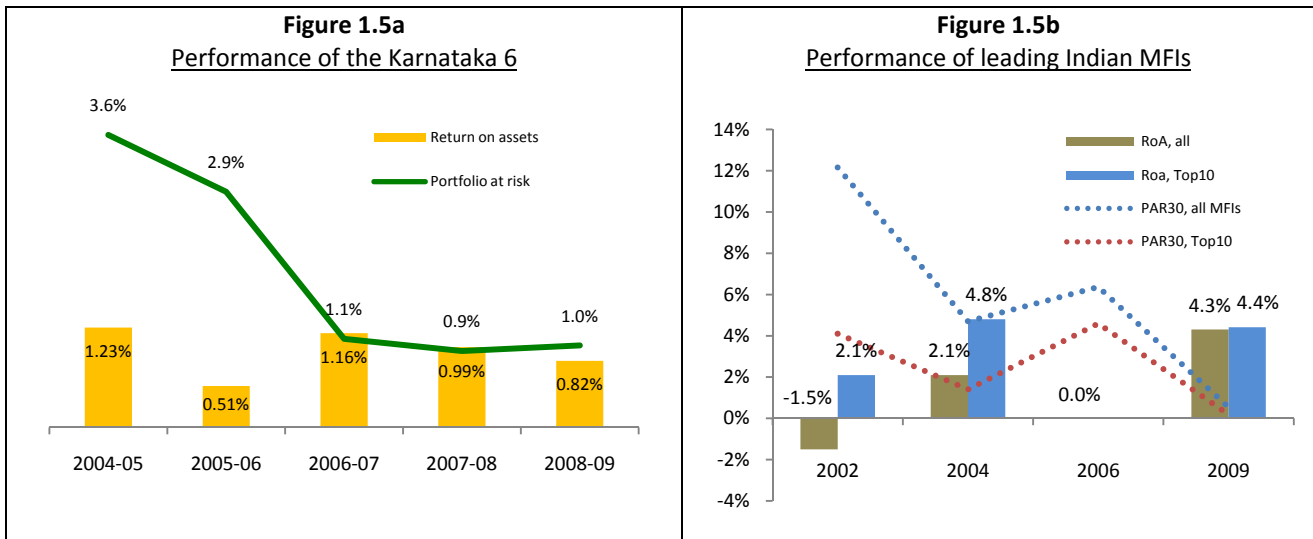


## 1.2 ...and their performance is good too

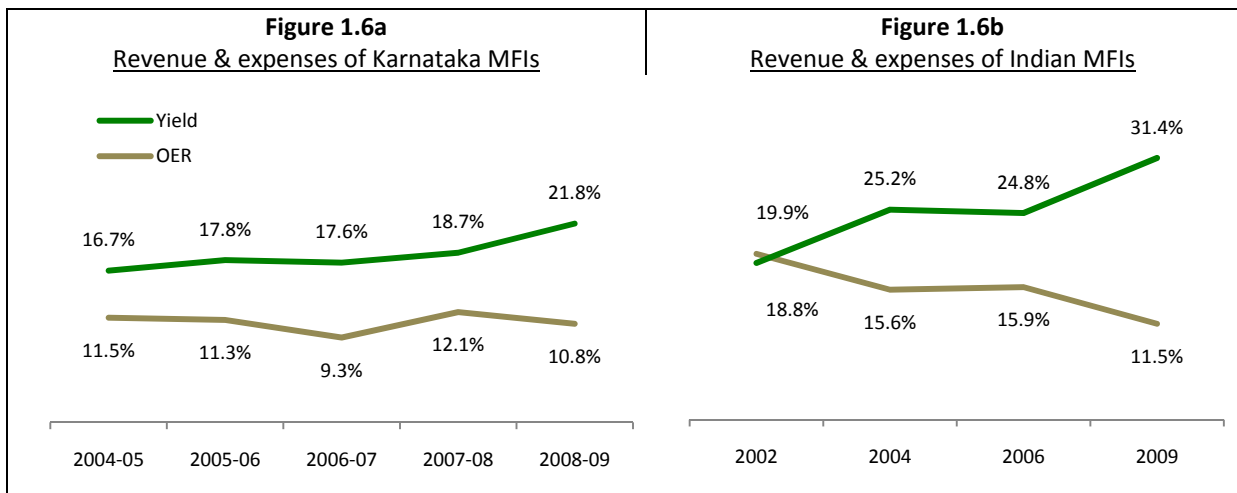
**Figure 1.5** (following page) presents the performance of the Karnataka 6 in comparison with the 50 leading Indian MFIs as well as the Top10 for India.<sup>7</sup> The portfolio quality of the Karnataka MFIs improved significantly in financial year 2006-07 and has remained steady at a PAR<sub>30</sub> of around 1% since. This compares with significant fluctuations in the performance of all Indian

<sup>7</sup> All information presented here consists of data taken from the MIX but analysed by M-CRIL. The India analysis is contained in M-CRIL, 2009. M-CRIL Microfinance Analytics 2009. Gurgaon, India.

MFI's for this period (affected by the delinquency crisis in Krishna district of Andhra Pradesh in 2006). The profitability of Karnataka MFI's has been steadier than that for the country as a whole and more reasonable too. While the return on assets (RoA) of all MFI's in India fluctuated between zero (in 2005-06) to more than 4% in 2008-09, that for Karnataka's leading MFI's was mostly around 1%. This is a reasonable return for financial institutions and is at the same level as the 0.9% to 1.3% RoA of the Indian banking sector.



This apparently more reasonable profitability performance of the leading MFI's in Karnataka is made possible by the overall reasonable interest rates charged by them (on average). As **Figure 1.6** shows, most recently the weighted average yield on portfolio of these MFI's has been in the 20% range while the operating expense ratio (OER) has been around 11%. This leaves a margin of 9%, of which around 8% is taken up by financing costs (average cost of borrowings as a proportion of the overall loan portfolio) with the remaining 1% being the margin of surplus. This is in sharp contrast to the wide margin that has appeared in the performance of MFI's in the country as a whole (see **Figure 1.6b**), driven by the high margins earned by some of the leading MFI's in India, most of which now operate in Karnataka as well. It is in this context that the delinquency crisis in some towns of southern Karnataka occurred.



2 What triggered the crisis

Table 2.1: Summary of events

	Kolar	Sidlaghatta	Ramanagaram	Mysore
<b>Date of first mass default</b>	2 February 2009	3-10 March 2009	8-9 May 2009	19 May/ 2-5 July 2009
<b>Trigger in the operating environment</b>	Attempted suicide led to Anjuman Committee edict that no Muslim client should repay MFI loans	Rise in input prices over the previous 6 months led to payment difficulties – Kolar provided excuse for mass default	Announcements from the local Masjids banning repayment of MFI loans	Communal riots led to business failure – local muslim organisation took advantage to enhance its standing

2.1 Kolar – of proxy borrowing, suicides and rampaging youth

Kolar is a district town located in the south-eastern corner of Karnataka state. Until recently, Kolar was famous mainly as the location of the only commercially viable deposits of gold in India. These deposits are now exhausted but the former Kolar Gold Field township has been converted into a tourist resort. Nevertheless, Kolar continues to be an economically important town since it is just 100km from Bangalore city on the highway to Chennai. It is also important both as one of a number of major silk cocoon markets and silk reeling centres in southern Karnataka and as the main town of a district supplying milk and vegetables to Bangalore city. The town had a population of 114,000 at the time of the 2001 Census and is currently estimated to have a population of 133,000. According to census figures, 11.8% of the population of the district in 2001 consisted of muslims. The study team estimates that 30% of the population of the town is muslim. As the market town for a semi-arid agricultural hinterland, a large proportion of its 25,700 families have low incomes and it is the estimation of the study team that some 70% are likely to be financially excluded. Muslims are reported by MFI staff to consist of 65-70% of all the microfinance clients in the town.

Since the population of Kolar constitutes a high potential market for the services of MFIs, by end-2008 there were nine formal microfinance institutions operating in the town. These are

- 1 Asmitha Microfinance
- 2 Bharati Swamukthi Samsthe
- 3 Future Financial Services
- 4 Grameen Financial Services
- 5 Outreach
- 6 RORES Micro-entrepreneur Development Trust
- 7 Sanghamithra Financial Services
- 8 SKS Microfinance
- 9 Spandana Spoorthy Financial Services



According to local sources there were also a number of informal MFIs (unregistered moneylending institutions) operating in Kolar in addition to the many individual moneylenders to be found in Kolar as in other parts of the country. Local information suggests that the number of informal MFIs operating in Kolar town lies in the range of 15-20 (in addition to the ten formal ones) but this is based on guesses rather than carefully considered estimates.

Discussions with key informants in the town suggest that the activities of these MFIs had grown to a level where there was substantial multiple lending to microfinance clients and, since MFIs prefer women clients, there was concern amongst the muslim community that the MFI requirements of group meetings at central places, contact with unrelated men and filing of personal photographs, were flouting the basic socio-cultural norms of the community. This was compounded by the feeling that women were “neglecting” their childcare and other household duties in order to attend MFI meetings.

The disquieting effect of this perception was aggravated by concerns about over-indebtedness on the part of a significant number of clients of MFIs resulting in inability to repay. There were complaints that Muslim women facing difficulties in repayment were being humiliated by group members and staff who used harsh language against them. This was compounded by reports of an MFI staff member eloping with a client’s daughter<sup>8</sup>, and some clients being taken outside Kolar for training.

When asked about the reason for the Anjuman announcement, clients said that “people had attempted suicide and the youth committee of the Anjuman took a serious view of this”. Clients said that this problem was the primary reason for the en masse default. Some clients felt that one of the Anjuman Committee members had incited the committee to ban MFI operations, after his wife (also a multiple borrower from MFIs) tried to commit suicide (this may be a reference to Sardar Khan’s case, detailed in **Box 1** below). This had caused an uproar in the Anjuman after which some Muslim youth had supposedly taken matters into their own hands. In Noornagar, clients stated that their councillor had told them not to repay. The Councillor denied any involvement and cited the Maulvi at the neighbourhood Masjid. This Maulvi confirmed that an instruction had come on the Anjuman letterhead requiring all mosques to announce a ban on repayments and on any financial dealings with MFIs.

Based on local information, it is apparent that during Friday prayers on 30 January 2009, announcements were made from a number of mosques in Kolar that the paying of interest constituted “haram” and was contrary to the tenets of Islam and, therefore, all muslim clients should immediately discontinue all financial dealings with MFIs. According to an article published in a local newspaper (see **Box 2** below) this announcement was made at the instance of two municipal councillors. News of the announcement spread over the next two days. Microfinance clients informed the study team that during the night of 1 February 2009, muslim youths under the aegis of a “youth committee” made the rounds of all the muslim *mohallas* of

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<sup>8</sup> The staff member in question was subsequently dismissed from the service of the MFI.



Kolar informing the people of the ban on dealings with MFIs and warning of dire consequences for anybody flouting the edict.<sup>9</sup> Pamphlets were handed out, detailing the dangers of dealing with MFIs and exhorting clients not to have any interaction with MFI staff.

**Box 1: The case of Sardar Khan**

Sardar Khan's wife is a member of three MFIs (SKS, FFSL and RORES). She took multiple loans at the behest of her husband who had loans with moneylenders running to lakhs of rupees. He used MFIs' operations as an easy way to raise money to pay these debts. Posing as a person interested in social welfare, Sardar Khan helped MFIs form groups in his colony. (He mentioned during the interview that he had "formed and given MFIs over 100 groups"). He then used the MFI loans of his wife and several group members – to the extent of Rs7 lakhs – to pay off his debts. However, he had to repay the instalments of the women whose loans he had appropriated. When he was unable to repay the women were reprimanded by MFI staff for not making their payments. One of them came to Sardar Khan, saying that she had been humiliated for not paying her instalment and would swallow poison if he did not immediately give her the money to make the payment. Seeing no way out, he grabbed the poison from her and swallowed it. He was admitted to hospital for 6 days. This resulted in a complaint from friends and neighbours to the Anjuman that "people were committing suicide because of MFI loans". Since he was well known to the Anjuman Committee, they took a serious view of the situation and banned all Muslims from dealing with MFIs. While Sardar Khan was in hospital, local youths had already publicised the ban on repayments to MFIs. Despite the real story coming out afterwards the Anjuman was unwilling to reverse its stand.

Consequently, on 2 February 2009, clients in Kolar defaulted *en masse*. The default extended to a majority of Muslim clients. This was followed by further vigilante action – such as chasing away of MFI staff – by youths armed with sticks – from the muslim *mohallas* and the publication of the advertisement in the box below. The youth took clients' repayment cards away. MFI staff were also attacked and beaten up in some of the colonies. In one colony, some group members paid their instalments the following week but were harassed by their neighbours and other group members. They stopped repaying thereafter for fear that their neighbours would complain to the Anjuman. The latter had also stuck posters citing MFIs' repressive and anti-Islamic practices on the walls of houses in Muslim dominated areas.

The local administration has been inactive in the matter partly because the transient status of the senior officials makes it impossible to study the problem in sufficient depth and partly also for fear that the situation would take a communal turn. Attempts by AKMI to discuss the matter with the Anjuman have been rebuffed on the plea that it can only be done in the presence of the district administration.

<sup>9</sup> The threatened consequences include the cutting off of women's hair and denial of access to burial grounds for their families.

**Box 2: Article in Urdu Salar Patrika, 15 February 2009**

Muslim women should not go out of the house. Due to the intervention of MFIs, many women are going out and a complaint against the same has been made to the police and ten people have been arrested. The clients received loans of Rs10,000 from the MFIs. Every week MFI officials come to their houses and force and harass them to pay the interest. Many loan officers make passes at the MFI clients. There was one announcement made by the councillors – Bhemel Ahmed and Mukhtar Ahmed – instructing clients not to repay MFIs. Due to the intervention of the MFIs, many poor people are taking poison being unable to repay loans.

On 14 February 2009 a few people took poison and were admitted to hospital, therefore it was decided that all the MFIs should be shut down in the area. All the branch managers of MFIs have been told not to give loans to Muslim ladies. Those who receive loans from MFIs are not able to repay, therefore, they turn to prostitution.

Due to the MFIs, children are neglected by the clients to the extent that some are reported to have neglected the polio vaccination. Muslim ladies are supposed to do “Namaz” five times a day but they are not able to find time because they are busy attending MFI meetings. Many clients are neglecting all the religious practices. Therefore we should close all the MFIs.

There has been a very minimal “demonstration effect” amongst the other clients in Kolar. Despite the mass default amongst clients belonging to one community, other clients have continued to repay except in the case of a few borrower groups with mixed membership. This is despite the fact that the other clients have the same borrowing opportunities and, presumably, similar levels of multiple borrowing. It is apparent that the organising power of religious organisations has made the difference in this situation.

Despite a gap of a whole year, clients belonging to the minority community have not even started partial repayments. Unlike in the other areas affected by the default, clients in Kolar are adamant that unless the local religious leaders announce that they may repay, they will not repay even a single rupee. Only 2 MFIs reported cases of partial repayment by the defaulting clients, in negligible numbers.

Although it was contained in Kolar for a few weeks, the default spread sequentially to other towns: Sidlaghatta, Ramanagaram and Mysore. The gradual spread effect from Kolar to neighbouring areas (Sidlaghatta) and further west to Ramanagaram and Mysore is apparent. There has also been an impact in some of the urban slums of Bangalore and in Tumkur district resulting in the coverage of significant pockets of area across southern Karnataka.

**2.2 Sidlaghatta – crisis in the silk industry fuels a spill-over from Kolar**

Sidlaghatta is a small town (of around 50,000 people) in the old district of Kolar (now in the new Chikballapur district carved out of it). Rather like Kolar, Sidlaghatta has a substantial muslim



population and the reeling of mulberry silk is an important economic activity providing employment to significant numbers of its financially excluded population.

Sidlaghatta's default is largely wilful, and directly related to the Kolar incident. Analysis of defaulting client passbooks shows that all of them began to default around 3-10 March 2009. The Masjid Committee in Sidlaghatta, aided and abetted by the local councillor and a few local rowdies, declared that none of the clients should repay their loans to MFIs. Muslim clerics cited suicides in Kolar and voiced objections against "bad collection practices of MFIs", including lending to women and collecting interest. They also roughed up a few of the MFI staff. When the matter was explained to them and an FIR was filed, the district administration and police became supportive and promised action against anyone preventing MFIs from collecting their dues.

In the months preceding the onset of the delinquency crisis, several clients engaged in the silk reeling industry had borrowed from 3-6 MFIs, expanding their businesses, assuming that they would continue to earn good returns. However, the purchase cost of raw materials (mulberry silk cocoons) rose steeply during 2008-09 but, on account of the global economic crisis, the selling price of silk yarn did not rise in tandem. **[Global economic crisis]** This resulted in losses for most of the clients undermining their ability to service their loans. The Masjid edict came at an opportune time for borrowers to stop repaying, citing that they had no choice but to follow the clerics' orders. Defaulters admitted that the real reason for their failure to repay was losses in the silk business and that they would easily have been able to service all their loans, had their businesses continued to be profitable. A large proportion of Muslim clients and a few Hindu clients who were not engaged in silk reeling defaulted because other group members had stopped repayments and the MFIs had made it clear that they could only get subsequent loans if all group members cleared their dues. **[Group liability norms]**

There is no sign of a nexus between the Masjid Committee in Sidlaghatta and the silk reeling industry. However, some influential local people are informal lenders. Clients admitted that that they had previously borrowed from such informal lenders until the MFIs entered the fray. **[Possible business rivalry]**.

There is a small proportion of Muslim clients who have continued to repay, wanting to keep their credit record clear. Such groups have been given the next cycle of loans by the MFIs, despite being in highly affected areas. Some defaulting clients are now demanding new loans to repay the old ones and to channel the rest into their businesses. The MFIs are not agreeing to this. **[No refinancing]** Most MFIs have resorted to collecting whatever they can, (mostly door-to-door), which is Rs. 50-100 from each of the clients, usually once in the month. In most cases clients are not willing to schedule regular payments, and say that they will pay "whatever they can" on an irregular basis.



### 2.3 Ramanagaram – religion masks business rivalry and the silk industry crisis

The Muslim population in Ramnagaram is around 25% of the town's 95,000 people. However, as a proportion of the “microfinance client target segment”, Muslims constitute nearly 60% of the total. Ramanagaram is the largest mulberry silk producing district in India. Most of the silk production takes place in small factories (unlike Sidlaghatta where many members have home-based production units). The silk factory owners are the local moneylenders for most clients in Ramnagaram. They give loans to anyone who wants these in the form of an “advance”. The borrower then has to work in the factory for Rs70-120 per day (depending on the hours worked). Wages are paid to the workers once in 15-20 days. If the workers like they can pay back their loans from these earnings or from savings. If not, they continue to work in the factories. Some clients admit that they have worked in such factories since childhood and would most probably never be able to pay off their loans. In the event of their death, the loan is written off. Workers have to bear appalling conditions in the factories. They do not get any holidays, they are exposed to heat, noise, dust and poor lighting, as well as the terrible smell of boiling cocoons. The workers often suffer burns from the steam or from the hot reeled silk. Children are also employed in the factories.

The main Masjid in Ramnagaram made an announcement on 5 May 2009 that no client should repay any MFI loans or have any interaction with them. Clients were forbidden to attend group meetings. The reasons given included that women had taken loans under false pretences, had lied to their husbands about it, were not showing respect to their husbands and were neglecting their household work so that they could attend group meetings. Cases were cited of MFI clients selling their children, attempting suicide and resorting to prostitution to pay loans. Three suicide cases were cited, all related to multiple borrowing and inability to repay. Clients were threatened that their hair would be cut off, their faces blackened, they would be excommunicated and denied burial space if they were found to be repaying MFIs. For a month, groups of rowdies terrorized MFI staff in the Muslim colonies, preventing them from entering the area. Staff have not conducted meetings since, as clients refuse even to sit in groups for fear of being reported to the Masjid authorities.

A strong nexus between silk reeling factory owners and clerics who issued the announcement is suspected [**Business rivalry**]. Many of the muslim women who work as casual labour in the silk reeling industry have managed to free themselves from the factories, by taking MFI loans. These are only a small proportion of all the workers (around 15-20%). However, this has had an impact on the amount of labour in the factories. Another irritant has been women attending group meetings and arriving late for work in the factories (which normally start at 7 am). MFI staff see a nexus between the silk factory owners and Masjid Committee members and feel that the whole issue was engineered to put a stop to the work of MFIs.



In Ramanagaram the District Collector, police and Lead District Manager have been very supportive of the MFIs. On 9 December 2009 the District Collector, Ramnagaram held a meeting with AKMI members, and advised that

- MFIs should not publicise the list of borrowers, as multiple borrowing may come to light and create further problems for them. The MFIs are to seek clarification from the Reserve Bank of India (RBI) on whether a list can be given to the Anjuman Committee.
- MFIs should resume normal collections but should not use any force or pressurize clients in any way for repayments as this will lead to further problems.
- MFIs must ensure proper verification of customers and loan utilization before handing out loans. He said that it was regrettable that MFIs had given loans in large amounts without proper assessment or checks on multiple borrowings. [**Multiple lending**].

MFIs have re-commenced visits to the field and borrowers with lower loan outstanding have started repaying and taking repeat loans. However, most of the Muslim clients have refused to make even partial payments until the edict is revoked by their clerics. MFIs are now concentrating on increasing growth in the villages surrounding Ramnagaram where most of the clients are Hindus. No further groups have been formed in the town.

### 2.4 Mysore – communal riots, economic distress and delinquency

Mysore is a city of nearly one million people and the seat of the princely state of Mysore. It is a large commercial hub with many industries but also a significant engagement with the silk industry. Around 9% of the population of the district is muslim.

In April, communal riots broke out around Muslims building a mosque on what Hindus claimed was an ancient temple site. To control the riots, police declared a curfew as a result of which MFI meetings were disrupted for a couple of weeks. Also, several Muslims were rounded up and arrested; some of these were clients' husbands. This resulted in repayment problems once meetings resumed. Some clients refused to pay, claiming that their businesses had been destroyed or their husbands were in jail. Group members refused to pay on their behalf and default spread to other groups. In July, similar to the April incident, riots broke out again. This time, curfew was imposed for a longer period, and several more people were sent to jail. This resulted in even bigger disruptions of MFI operations.

Much of the communal tension is believed to have been incited by the local political group "Karnataka Foundation for Dignity", whose leading members were also taken into custody. Soon after the riots, a few members of the KFD (it is suspected that they wanted to attract positive attention to themselves) took part in a demonstration condemning MFIs and accusing them of charging high rates of interest and exploiting customers. Local rowdies also threatened MFI staff and those from two MFIs were beaten up while staff of other MFIs was threatened. KFD members visited slums, telling clients that they could repay outstanding loans to MFIs when they had adequate funds but that they should not take loans from them again. This story was given a variety of interpretations; some clients believed that their loans had been waived

altogether and default spread throughout the city. Among the pass books examined by the study team, the beginning of default appears to have been in mid-July for a majority of clients. This coincides with the protest march by KFD. The authorities were unable to intervene in Mysore as these matters do not come within their purview.

Discussion with clients indicates that members who genuinely faced problems were relatively few in number. The KFD may have heard stories of a handful of over-indebted clients, and decided to launch an offensive against MFIs in general, stating that they followed bad practices and that clients should not have further dealings with them. Although the KFD has links with the Masjid authorities, formal announcements were made only in 1-2 of the smaller Masjids, unlike in the other areas, where there was a concerted effort to disrupt MFI dealings with Muslim clients. While a significant number of clients – even as many as 30% of the total according to one MFI – have begun to make payments and attend centre meetings, most of the defaulters have stopped payments altogether, stating that their businesses were destroyed in the riots (although this is true only for a few of them).

It is apparent from this review of the events leading up to and proximate causes of the delinquency at the study locations that the phenomenon of lending by multiple MFIs leading to over-indebtedness of a significant number of clients is an important allegation made by the religious and political organisations imposing bans on Muslims dealing with MFIs at the study locations. The following section examines the evidence available on this issue.

### 3 How important are multiple lending and over-indebtedness?

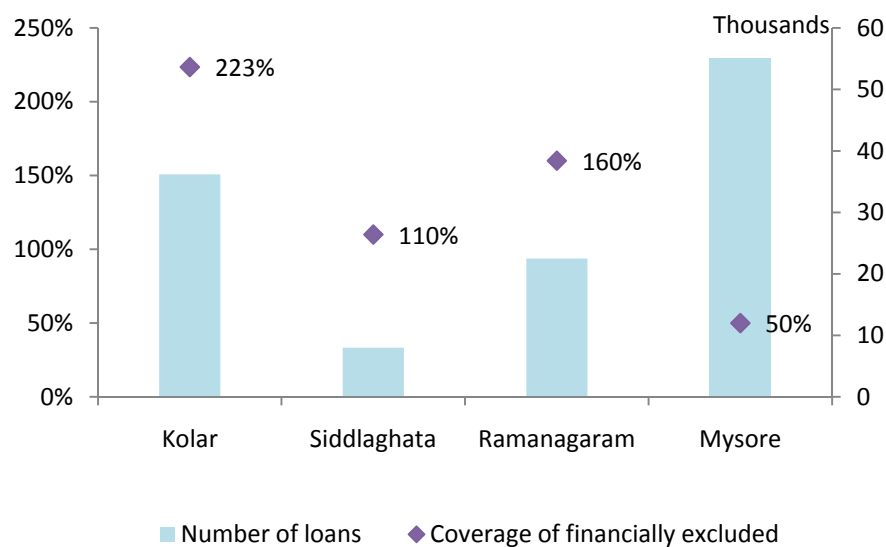
**Exhibit 3.1** presents a rough comparison of the numbers of financially excluded families in the study locations with the membership information (for March 2009) provided by the MFIs.<sup>10</sup> Assumptions have been made for the proportion of financially excluded families based on information available for Mysore city – since financial exclusion in the city is 60% that in the less economically vibrant areas is taken at higher levels. In calculating the extent of coverage in the table, the bottom 10% of the population has been excluded as unsuitable for microfinance. On this basis, the table shows that *even if the entire (available) financially excluded population is covered by MFIs*, lending in Kolar in March 2009 amounted to 2.2 times the market potential. This is illustrated in the figure. Since it is highly unlikely that the entire (potential) financially excluded population will have borrowed – as not everyone feels the need for credit – this calculation confirms the study team’s impression that clients in Kolar have an average of 3 MFI loans each.

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<sup>10</sup> Letter dated

**Exhibit 3.1:** Rough indication of multiple memberships in study locations

	Assumptions	Kolar	Sidlaghatta	Ramanagaram	Mysore
Population, 2001		113,299	41,105	79,365	799,228
(estimated, 2009)		133,000	52,000	100,000	1,000,000
No. of families	5.1 persons per family	26,100	10,200	19,200	192,000
Financially excluded families		70%	80%	80%	60%
		18,200	8,000	15,000	115,000
Borrowers, March 2009		36,200	8,000	22,500	55,000
Extent of coverage	Less 10% of financially excluded	2.2	1.1	1.6	0.5



In an attempt to undertake a direct count of the number of multiple memberships, the study team obtained client level operational information from 7 MFIs for Kolar and Ramanagaram (of the affected study areas) and, for comparison purposes, for Nanjangud and Davangere (unaffected by the delinquency). One MFI does not have client level information and one with significant operations in the region (unfortunately) refused to cooperate.

This information was analysed using name (and location) matching algorithms. **Table 3.2** presents the resulting analysis. The table suggests that 25-50% of clients have more than one loan from the 7 MFIs covered. Adding the clients of the MFI that did not cooperate would probably increase these figures to 40-70% and the addition of loans provided by SHGs would increase this further.

**Table 3.2:** Multiple memberships in affected and unaffected areas

Number of MFIs	Kolar		Ramanagaram		Nanjangud [Mysore district]		Davangere		Average amount, rupees
	Members	%	Members	%	Members	%	Members	%	
1	8,244	73.4	4,556	69.0	1,794	48.6	13,813	57.4	12,000
2	2,248	20.0	1,521	23.0	1,105	30.0	7,447	30.9	23,226
3	503	4.5	333	5.0	536	14.5	2,286	9.5	35,073
4	156	1.4	105	1.6	147	4.0	375	1.6	47,787
5	59	0.5	47	0.7	60	1.6	120	0.5	62,500
6+	16	0.1	36	0.5	48	1.3	37	0.1	60,000+
	<b>11,226</b>	<b>100.0</b>	<b>6,598</b>	<b>100.0</b>	<b>3,690</b>	<b>100.0</b>	<b>24,078</b>	<b>100.0</b>	
>1 loan	2,986	26.6	2,042	30.9	1,896	51.4	10,265	42.6	

Analysis by Karuna Krishnaswamy & Alejandro Ponce, CGAP

Though this analysis is only tentative confirmation of the findings of the rough calculation above it has substantial information gaps. In order to get more complete data, the study team (supported by CGAP) has commissioned a survey of 800 clients in and around the delinquency affected areas. This should provide a more accurate indication of the average number of MFI memberships per client.

What **Table 3.2** does show is that the extent of multiple lending (at least by the 7 participating MFIs) in the affected areas – Kolar and Ramanagaram – is actually lower than that in the unaffected Nanjangud and Davangere. Indeed, multiple lending in Nanjangud is significantly higher (at 51%) than it is for Kolar (27%) and Ramanagaram (31%). Davangere is also high at 43%. However, this seems to suggest that multiple lending *per se* is not what was responsible for the crisis.

Another aspect of the table above is the information on average levels of indebtedness for various multiples of loans. It shows that in Kolar, around 350 of the 11,226 clients for whom information is available had borrowed in excess of Rs40,000 (with an average of over Rs50,000 which is the threshold limit for microfinance borrowing per individual client, as designated by the Reserve Bank of India). This is a sufficient absolute number for a few dozen clients to get into trouble on account of over-indebtedness and for that to lead to adverse publicity about MFI lending practices. The situation at other locations (including unaffected locations) is no better.

Since religion has played a part *a priori* in the delinquency crisis, **Exhibit 3.3** (next page) disaggregates the multiple membership data by religion. Information on religion is not available from all the cooperating MFIs, so the total number of clients used for the analysis in the latter table is even less than in **Exhibit 3.2**. The figure here is interesting; the line graphs illustrate the almost constant proportion of clients with more than one loan in all four locations suggesting that there are not significant differences in the multiple membership situation. However, the bar graph shows that the proportion of muslim clients in the sample is highest for the two locations affected by the crisis – Kolar (83%) and Ramanagaram (59%) – while it is significantly lower for the two locations unaffected by the delinquency crisis – Davangere (47%) and Nanjangud (just



33%). It is interesting that the latter, in relatively close proximity to Mysore city (affected by the crisis) remains largely unaffected. It is apparent that the trigger having been set off by the attempted suicide by a person who siphoned off the loans of 15 clients to pay his pre-existing debts (and reinforced by rumours of further suicides) in Kolar, the crisis only erupted in urban locations which had high proportions of muslim clients.<sup>11</sup>

Further, for Kolar, feedback from clients during the qualitative investigation by the study team reveals that the **multiple borrowing level** of 3-4 loans per client in the area resulted from several individuals having taken on the task of forming groups and inviting MFIs to lend to them. Later these individuals used their influence with the clients to get commissions and kickbacks, or to appropriate entire loans of group members [**proxy borrowing**]. The following sections discuss the views of the Kolar Anjuman and multiple borrowing and other issues that reinforced the adverse factors resulting in the crisis.

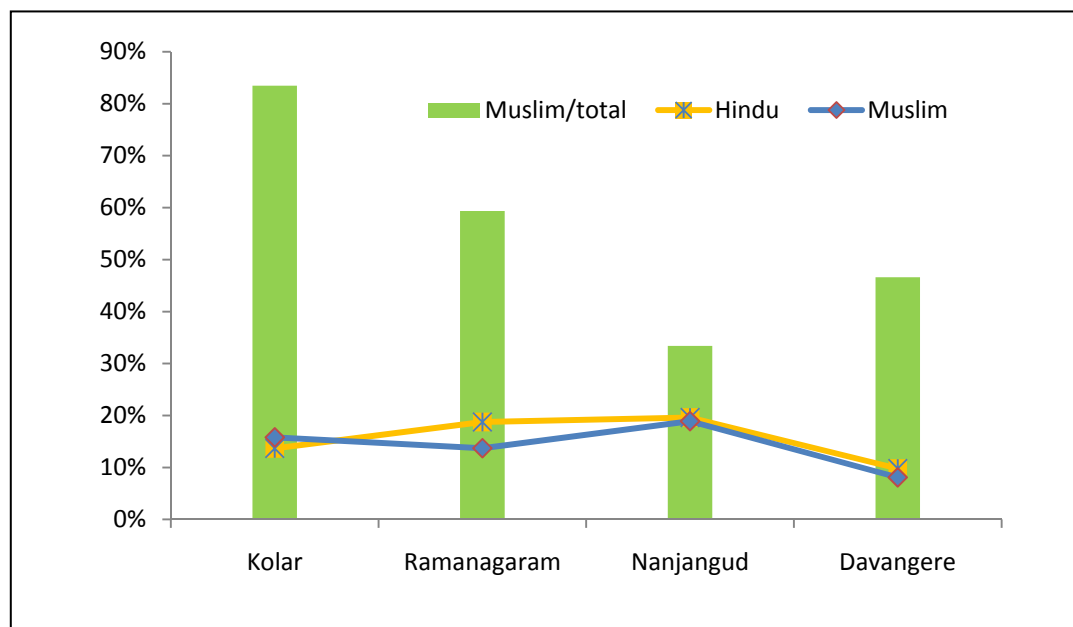
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<sup>11</sup> All the data used here is applies to urban clients only as rural operations of MFIs have been less affected and were, therefore, not included in the analysis.

**Table 3.3: Multiple memberships by religion**

[Analysis by Karuna Krishnaswamy & Alejandro Ponce, CGAP]

No. of MFIs	Kolar				Ramanagaram				Nanjangud				Davangere			
	Hindu		Muslim		Hindu		Muslim		Hindu		Muslim		Hindu		Muslim	
1	1,131	86.3%	5,576	84.2%	1,760	81.3%	2,731	86.3%	1,866	80.4%	943	81.1%	10,592	90.2%	9,426	91.9%
2	152	11.6%	790	11.9%	313	14.5%	360	11.4%	332	14.3%	165	14.2%	1,038	8.8%	737	7.2%
3	26	2.0%	196	3.0%	77	3.6%	63	2.0%	89	3.8%	48	4.1%	102	0.9%	80	0.8%
4	1	0.1%	52	0.8%	16	0.7%	11	0.3%	25	1.1%	7	0.6%	10	0.1%	12	0.1%
5			7	0.1%					9	0.4%						
6			1	0.0%												
	<b>1,310</b>	<b>100.0%</b>	<b>6,622</b>	<b>100.0%</b>	<b>2,166</b>	<b>100.0%</b>	<b>3,165</b>	<b>100.0%</b>	<b>2,321</b>	<b>100.0%</b>	<b>1,163</b>	<b>100.0%</b>	<b>11,742</b>	<b>100.0%</b>	<b>10,255</b>	<b>100.0%</b>
>1	179	13.7%	1,046	15.8%	406	18.7%	434	13.7%	455	19.6%	220	18.9%	1,150	9.8%	829	8.1%
<b>Muslim/ total</b>			<b>83.5%</b>				<b>59.4%</b>				<b>33.4%</b>				<b>46.6%</b>	





### 4 The Kolar Anjuman – basking in the attention

The Anjuman Committee in Kolar has received a lot of attention from visiting journalists and researchers and has been invited for discussions with MFIs at the office of the Minorities Commission in the state capital, Bangalore. This has put them in a prominent position where they feel that they will be seen to have let down their community if they withdraw their action. In discussion with the study team, committee members actually denied responsibility for the episode. They blamed the MFI staff (who they say were already facing repayment problems) and some religious leaders (misrepresenting themselves as Anjuman youth members) for spreading rumours regarding a ban on repayment. They said that the debacle was brought about by MFIs because of their over-lending to poor people. They had lent large sums to poor people and their repressive practices had resulted in problems at the field level.

The Anjuman members laid the blame for the crisis on the “field workers” of MFIs, saying that they had lent indiscriminately, and when problems broke out in the field, they had blamed the Anjuman. When asked why they took responsibility for the issue when they had nothing to do with it, they said that they had to represent the sentiments of Muslim borrowers. However, discussion with one of the Municipal Councillors and a Maulvi revealed that the Committee had sent notices on its own letterhead to all Maulvis in the area asking them to make the announcement of a ban on repayment to MFIs.

The President of the Anjuman Committee also said that MFIs should have clarified with the committee and sought a solution, before complaining to the DC and Minorities Commission. Once MFIs had complained and the Anjuman members were called by the DC’s office for a meeting, the matter was taken out of their hands, and now it was up to the DC and Minorities Commission to take action.

The Anjuman members declined to give any details on what needs to be done until an internal meeting took place a few days later. When they were contacted after this date, they said that the entire committee was up for re-election and would not take a decision till it was reconstituted. It is likely that the committee will ask for interest to be waived and that clients would be asked to pay back smaller instalments of principal. They may also require that MFIs not lend to Muslim women again.





### 5 Further issues emerging from discussions with microfinance clients

It is apparent from the above discussion that it was the edicts by muslim leaders (religious or political) that was the proximate cause of the crisis in Kolar and elsewhere in southern Karnataka. The fire of delinquency spread fast due to the hold of local religious leaders (and their youth committees) over their community but it was provoked by the overheated lending environment created by competition amongst the many registered MFIs and an unknown number of unregistered lenders. At the study locations and also in some slums in Bangalore, the “Kolar trouble” was used, almost gleefully, by local leaders in similar overheated conditions to provoke similar crises. There were, however, factors in addition to multiple lending that contributed to the situation. These were

#### 5.1 Unwise practices in the microfinance business

Clients in Kolar referred to cases of group formation by agents (such as the notorious Sardar Khan), and pipelining of loans (one person taking over the loans of several people), saying that they should not be penalised for the MFIs’ own indiscriminate lending and bad practices. One of the clients said that she had tried her hand at 2 new businesses, both of which failed. Since she had no business profits to pay the interest on her loans she started rotating loans between MFIs, finally resorting to the moneylender to pay her instalments. She and her husband were vehement in their criticism of MFIs and their indiscriminate lending practices. They said that MFIs were not taking the signatures of the husbands of group members. Some of their group members had taken loans without their husbands’ permission, or had got signatures from third parties posing as husbands.

Although most clients said that multiple borrowing was not the cause of the repayment crisis, some stated that MFIs should be more careful while giving loans. One client said “When poor people can take loans from 5-6 places, why won’t they? It is up to the MFIs to exercise caution and make sure that clients do not get indebted.”

#### 5.2 Genuine repayment problems on account of business losses

Clients in Sidlaghatta, engaged in silk reeling cited business losses as the main reason why they stopped repaying. Some clients categorically stated that they were not influenced by the activities in Kolar. They quoted the rising price of cocoons and lack of commensurate rise in rates received for reeled silk, as the reason for their business losses. Many clients and their husbands who had home based units now work in silk reeling factories as wage labour since their own businesses are no longer viable<sup>12</sup>. Clients admitted that they had expanded their businesses quite fast, not expecting that cocoon prices would rise so steeply. If the prices had not risen, they would have been able to

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<sup>12</sup> Businesses collapsed because of the increase in silk cocoon prices by 100% without a commensurate increase in the price of reeled silk (finished product). In the past clients earned around Rs500-1,000 profit from the business every 2-3 days. Now they lose 5-10% on sales, but have to sell just to maintain liquidity.



## Delinquency crisis in Microfinance in Southern Karnataka

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manage their multiple loans quite well. Some clients added that they would not be making partial repayments had they been influenced by the Masjid leaders. Also they claimed that since the people in this area do not have any other skills, they have to survive the phase of loss-making, until margins adjust to the prevailing circumstances in the silk industry.

In Ramanagaram, on the other hand, clients asked about losses in the silk business (in comparison with Sidlaghatta), said that the prices of cocoons had gone up but this did not have an impact on them as they work as labour in reeling units so they do not have to bear the losses.

Clients in Mysore were not able to conduct business during the communal riots and some had lost their capital when their homes were attacked and husbands of a few were arrested. They had to take loans from informal financiers, while their husbands were in jail, to run their households. Some clients who claimed their businesses had completely collapsed because of the riots seemed to be lying: one defaulter (with a thriving shamiana – marquee – business) seemed to be capable of repaying. The same was the case with another client who had a profitable paddy business and had taken loans from 2 MFIs. However, both cited business problems as the reason for non-payment.

### 5.3 Staff behaviour and the zero delinquency syndrome

In Kolar, clients mentioned that staff sit for a long time outside a client's home if her payment is overdue; this makes husbands and other family members angry. The staff of some MFIs with very strict zero delinquency norms do not give much leeway on their loans and talk rudely with them, making them sit at meetings for long hours even during Ramzan.<sup>13</sup>

Elsewhere, clients said that MFIs had brought improvement to their businesses, because the interest rate was much lower than that charged by local moneylenders. One group mentioned that there was no problem posed by staff; they would wait for 1-2 hours for the clients to repay, in case the full payment had not been received at the meeting. Most clients said that there had been no acrimonious exchange with MFI staff. Only a few reported an incident in which the staff of one MFI sat outside clients' homes till late at night and caused considerable inconvenience in the neighbourhood.

At other times, some clients found it difficult to attend all meetings, and some MFIs have particularly strict norms about attendance, even if one member is not present the staff keep everyone waiting; which is unacceptable.

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<sup>13</sup> Two MFIs in particular were cited repeatedly in this context.



### 5.4 Break down of group solidarity as a loan guarantee mechanism

In a situation of multiple lending and overall borrowings of the order of Rs35,000 to Rs50,000 (or more), the principle of group collateral has come under considerable strain. In Kolar, a group (which had borrowings from 4 MFIs) said that one of their members had run away and they did not want to pay for her. Another group of clients had faced repayment problems in the past but had pooled funds to repay for their group members. They said they did not like having to call fellow members from their homes, or to humiliate them by demanding payment in public. When, however, 5 members of the group defaulted it became impossible for the rest to repay. At this stage their family members had begun to complain about the system.

Some clients in Sidlaghatta said that they knew that MFIs would not lend in their area again, so there was no point in paying the current loan. They felt that they should not be expected to make payments for willful defaulters in their groups though they were willing to repay for 1-2 weeks on behalf of those facing genuine difficulties.

In a mixed group in communally charged Ramanagaram, when clients from one community approached the other community members to repay, the situation became tense and turned into a communal issue. The former quickly retracted and have not tried to persuade their neighbours from the other community to repay since then. Clients from one community have continued to pay on time so that they can continue to access credit, irrespective of what the other group does. However, such cases pose a problem for the MFIs who have, so far, been reluctant to split groups and reconstitute them into groups of good clients.

Many clients in Mysore said they had enough money to pay their full instalments but would not pay since their group members were not paying and, as a result, the group as a whole would not get a subsequent loan. Some of the Muslim members were still paying regularly in the hope of obtaining credit again. One Muslim client had repaid the entire amount during the problem months. However, her group members had all defaulted. Despite her good record, she had to resort to a loan from a local financier since her group had defaulted and she had not been able to get a new loan.

A group leader recounted that despite going house to house to call members for meetings the group had refused to assemble. She herself had defaulted subsequently, but continued to collect partial payments from willing group members and remit these to the staff of the concerned MFI. Some clients in the riot-hit areas of Mysore were making partial payments of Rs50-100 whenever they could. However, they said that they could not afford to repay their regular loan instalment of Rs540 per week. When asked why they had not attended meetings, they said that since other members refused to come for meetings, they too had stopped. Some of the clients from defaulting groups (who have repaid in full) feel that they should be given a new loan, but MFI staff are unwilling



because they feel that the concept of joint responsibility will be abrogated if they reorganise the group.

### 5.5 The gender bogey

In the context of Indian society in general but muslim communities in particular the microfinance norm of male staff interacting with women's groups is sometimes seen as a matter of potential concern. The feedback from clients in southern Karnataka on gender issues is that husbands and other male relatives do not have problems with the women attending group meetings, or with the fact that they interact with male staff. Husbands' involvement in all cases helps to extend a guarantee at the time of the loan application. Not many men have borrowed from banks, chit funds or other schemes. Most have relied on the loans taken by their wives from MFIs. One of the husbands mentioned that before the MFIs came, men would negotiate with informal moneylenders for loans, but now women could access finance with MFIs; since it was a convenient (doorstep) service and there was no haggling involved. All the clients stated that they had the unstinting support of their male family members in taking MFI loans. However, most of the defaulters' husbands now claim that they are not responsible for their wives' loans. Else, they cite the same reasons as their wives for non-repayment. No issues of staff behaviour vis-a-vis gender arose in any of the study team's discussions.

Husbands interviewed said that they had no objection to their wives attending meetings, and that they were quite happy to access MFI credit since none of them had any access to bank credit. A member of the Anjuman committee in Mysore said that the problem was not specific to Muslim clients, and was a city-wide problem because of MFIs' wrong lending practices (multiple lending). The issue of Islam was not raised at all at the client level but the group lending norm emerged as a clear obstacle at this stage of the game. Both clients and their husbands seemed to think it was not worthwhile repaying so long as their group members did not repay.

### 5.6 Stoppage of MFI credit – a constraint for enterprises

Many of the clients in Kolar criticised the Anjuman Committee for causing them problems and breaking their relationship with the MFIs. A majority of the clients said that their businesses had been badly affected by the break in the credit flow. Many have already resorted to chit funds and moneylenders to sustain their businesses<sup>14</sup>. The borrowers find the rate of interest high with these credit providers, but have to keep their businesses going. They appreciated MFI staff coming to their homes to collect repayments, as they do not have much mobility outside their homes. Some clients who remonstrated with the Anjuman youth, were told that the Anjuman would give money to clients (without interest) after a year or two, but only if the clients refused to interact with MFIs.

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<sup>14</sup> Interest is cut in advance (moneylenders charge Rs. 150 interest on a loan of Rs. 1,000 over 10 weeks).



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Before MFIs started operating in Sidlaghatta, businesses (especially silk reeling units) were financed by moneylenders to whom clients paid 30-40% interest per annum. Ever since the crisis, many clients admitted that they have returned to moneylenders to meet their credit needs. However, they were confident that the repayment crisis had not been triggered by the vested interest of moneylenders, since the latter are not associated with the Masjid leaders in any way.

Clients in Ramanagaram indicated that their businesses had already taken a hit due to the lack of fresh credit, and that they would resort to local financiers for small loans (at the rate of 4% p.m). They regretted that they were unable to access MFI loans till the Masjid lifted its ban. They said that MFI interest rates were much lower and they had been able to expand their businesses considerably in the past 2-3 years, using credit from MFIs.

### **5.7 Willingness to repay – can the lending cycle be resumed?**

Several clients in Kolar said that they would be happy to repay if they had permission from the Anjuman committee. When a few borrowers approached the local Masjid leaders, asking them if they could resume repayments to the MFIs, the Masjid authorities said that they would first like to see a letter from the Anjuman allowing MFI operations, else they would be forced to take action against anyone in the community who had any dealings with the MFIs.

Some clients felt that if the Anjuman were to grant permission, they would find it difficult to repay their full instalments at first, but could start with smaller amounts. Others said that many of their centre members had run away and they could not be expected to repay now, even if the Masjid and Anjuman committee permitted them to repay. Clients essentially want refinancing from the MFIs, failing which they say it will be difficult to re-start payments.

Clients in Sidlaghatta wanted MFIs to reschedule their loans so that instalments are paid monthly. Currently, a significant number of silk-reelers cannot attend meetings to make regular payments, because they have gone back to working in reeling factories, after facing losses in their home based units. They pay “whatever they can” when MFI staff come for door to door collections (usually Rs50-100 every 3-4 weeks from the records).

Ramnagaram clients said that if the religious authorities ordered them to repay they would immediately make the repayments, but that they were helpless when faced with the threat of excommunication although they had the capacity to repay.

Mysore clients said that they could not make regular repayments but would go on paying Rs50-100 “whenever they could”. When asked whether they would want loans from MFIs again, they said that they would only want to take 1-2 loans, as multiple borrowing was too much of a risk. When asked



why they did not attend meetings, they said it is because they are expected to repay when they attend, and in any case other members do not come to meetings.

### 6 The staff perspective

#### 6.1 The community issue – incitement by Muslim leaders

**Kolar:** At the street level, problems had been brewing for a month or two before the crisis. Some members had been complaining that MFIs required them to recite an oath which was not acceptable because it had religious connotations. Others were complaining about the strict attendance norms. The Anjuman Committee wanted to build its image among the people, and took up the cause of a few affected borrowers to highlight its own concern for Muslim clients. Staff feel that certain aspects of MFI operations had angered the Anjuman. Multiple lending, women borrowing and attending meetings, photos of women (without a burqa), prayers with religious overtones, sitting in meetings for long hours, were the common complaints heard by staff who approached the Masjid authorities. The staff feel that the Anjuman wants to gain popularity and that multiple lending was just used as an excuse. The election campaign of April-May 2009 added to the problems, since some of the candidates created the expectation that there would be a loan waiver for MFI clients.

**Sidlaghatta:** Most of the staff feel that Sidlaghatta's default is a mix of the Kolar spillover<sup>15</sup> and a business downturn, but the extent of default is more due to the former than the latter. Staff believe that clients are taking advantage of the Masjid issue, to make up for their business losses.

**Ramnagaram:** A complaint was submitted by 40 clients of both communities to the local Masjid (on stamp paper). This complaint detailed client indebtedness and asked the Masjid authorities to intervene. Staff are convinced that the complaint was engineered by vested interests to incite trouble. A newspaper article had appeared on the front page of a leading Kannada daily, citing the suicide attempt of Shivamma (a client of two MFIs) and blaming these two MFIs, saying that their staff had forced their way into her house and seized her TV/ DVD player to sell it. This was later discovered to be false and the persons who had done this were discovered to be touts of local moneylenders. However, in terms of negative publicity, the damage had already been done. Staff feel that this negative publicity was engineered by silk factory owners, who have a nexus with the clerics. They feel that the default is largely wilful, and that clients are taking advantage of the clerical diktat.

One Branch Manager said that the entire issue stemmed from a nexus between silk merchants (factory owners) and the Masjid committee. He had seen a large number of factory owners having a meeting in the Masjid shortly before the diktat was issued. He was certain that the committee had been instigated by the factory owners, who are mostly rich and influential Muslims. They are

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<sup>15</sup> Several MFI staff were accosted (some beaten) in attacks by rowdies, incited by the local Councillor. There were rumours that 2-3 microfinance clients committed suicide in Kolar, and this sparked off the Mahbubnagar issue.



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disgruntled because they have suffered shortages in labour, women had started coming late to meetings, and some had started their own businesses and freed themselves from the factories by repaying their debts. This made the silk merchants progressively unhappy. When 2-3 clients were alleged to have attempted suicide, it was the perfect time for them to lodge a complaint with the Masjid that un-Islamic activities were being encouraged by the MFIs. The Masjid Committee complained that women call the MFI staff “Master”, and do not show similar respect to their husbands, they recite a pledge at meetings, they neglect housework because they are attending meetings, and that charging of interest is un-Islamic.<sup>16</sup> The Masjid committee also mentioned that women were selling their children and taking to prostitution because of severe debts. These accusations seem to have been inspired by the Kolar issue.

According to the staff, 50% of the Muslim members are thinking of short term gains (it suits them to have their existing loans written off), while other want to repay and access further loans but are afraid to do so because of the severe threats from religious authorities. However, it is possible that clerics received genuine complaints from 1-2 clients who wanted their loans waived. Staff have the general feeling that this is a situation of wilful default instigated by community leaders.

**Mysore:** Staff agreed that the problem had started with the curfew and disruption of meetings. Also the gap in attendance had broken centre discipline. However, they felt that the Kolar trouble has affected Mysore and members of one community have taken advantage of the riots and curfew to stop repayments. Some of the religious authorities in Mysore propagated anti-MFI propaganda and a political organisation also distributed pamphlets citing the negative aspects of MFIs and how they were cheating the poor clients by charging high rates of interest and bullying clients. A few staff also felt that moneylenders and “daily financiers” may have instigated the political organisation in order to get back at MFIs for ruining their businesses.

MFIs who faced problems like beating/threatening, were those which had oppressive rules regarding centre attendance, and all group members having to attend group disbursements. Most of the older clients are in default because they have become acquainted with MFI operations and know that no action can be taken against them if they default *en masse*.

Staff of one MFI mentioned that when the communal problem broke out in April, they still managed to make 80% recoveries. However, the second wave of communal clashes in July had a greater impact on repayment, especially due to the involvement of a political party linked to one community. Staff feel that 20% defaulters might have faced financial problems shortly after the riots, but that sufficient time had passed since then for them to have recovered their losses. Doorstep collections have resumed since December.

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<sup>16</sup> The MFIs deny that clients call their staff “master”. They describe this as a misrepresentation of the term “sir”.



### 6.2 AKMI's interactions

**Kolar:** AKMI district level meetings had not been effective in building cooperation amongst the MFIs. The MFIs also aggravated the problem by placing a lot of emphasis on the Anjuman Committee announcement rather than just ignoring it for a few months and restarting collection efforts thereafter. Furthermore, AKMI approached the District Collector instead of the Anjuman directly to solve the problem. This annoyed the Anjuman members, who then refused to cooperate.

**Mysore:** Many staff complained that during AKMI meetings all MFI representatives would promise not to refinance or lend in affected areas, but they would go back and do as they pleased and deny it later. Staff felt that AKMI meetings are limited to discussions of future plans, but none of the member MFIs have taken serious note of multiple lending during the meetings. Most branch level staff feel that efforts to increase coordination between MFIs would not help, since MFIs would not give the right information about borrowers, and even if they were to cooperate and withhold lending to some clients, someone else would step in and lend.

### 6.3 Competition, multiple lending and unsuitable business practises

**Kolar:** Across MFIs, staff agreed that Kolar was not a place with the potential to support 10 MFIs and a host of informal lenders pretending to be MFIs. This had resulted in over-lending, which was an important factor behind the crisis. Also, business potential for MFI clients had been affected – where there used to be one juice vendor, now there were 3 – so clients' ability to repay had been affected. Staff estimate that a high proportion of clients have a total of Rs50,000 or more in loans from multiple MFIs. Multiple borrowings would cover 30-40% of the clients according to staff estimates. Moneylenders have also lent in the guise of MFIs, charging exorbitant interest.

Some staff mentioned that competitor MFIs had also indulged in bad practices such as withholding salaries of staff for not bringing back 100% repayment. This had resulted in staff putting pressure on clients to repay. The MFIs have been short sighted in their operations, only wanting to increase their market share, instead of trying to develop their clients as people. Those MFIs whose staff used high-handedness with clients caused problems for the others. Since the outbreak of delinquency clients now know that the MFIs do not hold any serious threat if they do not repay. Staff of an MFI engaged in individual lending feel that group meetings are one of the negative aspects of MFI operations, since clients spend at least 1-1.5 hours a day in meetings, thereby neglecting their household duties.

**Sidlaghatta:** Staff indicated that some MFIs conduct a housing survey (which involves all 25-30 members of a centre visiting each member's house). This had caused anger and outrage, since people's privacy had been affected.





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**Ramnagaram:** Some staff feel that the problem has partially stemmed from multiple borrowing and the resulting debt burden. They feel that some clients may have complained to the Masjid committee that they could not repay their debts.

**Mysore:** Staff feel that MFIs are not transparent about sharing borrower details, and that each MFI thinks that if they do not lend to clients who have 1-2 loans, someone else will do so in any case. Older clients have defaulted in greater numbers than the newer ones. Centre leaders have also taken advantage of the situation by first taking as many loans as possible, acting as commission agents for staff (to form groups), and inciting default later. Multiple borrowers were the first to create problems, citing that their husbands were in jail and they could not repay. When they defaulted, no action was taken against these clients. Staff tried to motivate them rather than threaten them. Once other clients saw that no police/legal action was being taken they too decided to default.

There has been a general lack of coordination among the MFI heads to stop the default, despite repeated discussions. Staff of one MFI feel that the use of business-persons as Banking Correspondents, downscaling of banks and “hijacking of SHGs”, fraud committed by group book-writers, and indiscriminate lending by multiple MFIs have affected the quality of operations in Mysore. Even SHG clients have been affected since money saved within groups, for the purpose of internal lending, has been lost as group members have refused even to pay back internal loans.

Another problem that has surfaced during the crisis is refinancing of loans (giving a new loan from which the old loan is cleared and the client repays the balance amount over 50 weeks). Staff from other MFIs said that one particular MFI had “refinanced” defaulting clients with low outstanding balances. They also mentioned that this MFI had achieved its “annual target for 2009” in October, despite the default, which was an indicator of how irresponsibly it was focussing on growth, despite the bad situation in Mysore. The MFI concerned categorically denied both these allegations.

Political organisations are said to have latched onto MFIs’ indiscriminate lending practices and used over-indebtedness of 1-2 clients to condemn MFIs in general. Staff indicated that some MFIs had reduced the quality of risk assessment by shortening the group training period in order to make quicker disbursements. Group solidarity had not worked in practice since 1-2 defaulters could result in the entire group being affected.

Some staff stated that 90% of the clients were likely to have at least 2 loans and that multiple lending was as significant a problem as the communal issue. They said that while a few MFIs follow credit discipline and insist on attendance, others do not do this and have spoilt the environment for lending. However, staff admitted that maintaining discipline has a flipside. One MFI’s staff apparently received beatings because clients were fed up with their long meeting timings and stringent attendance rules. They also said that there is a lot of pipelining of loans through ‘agents’,



who form groups for MFIs by appointing *benami* clients in large numbers and then appropriating their loans.

### 6.4 Efforts to recover dues and re-organise lending – the refinancing conundrum

**Kolar:** One MFI printed a pamphlet which was widely distributed among Muslim clients during Ramzan, explaining their interest rate, purpose of microfinance, and reasons why clients should repay and renew their ties with the MFI. This yielded some results in Srinivaspur but Kolar clients insisted that they would not repay till the Masjid permitted them to do so.

The MFI also assured clients who repaid their debts that they would get a fresh loan. However, such clients had to provide their insurance policy/house title/any important document as collateral. Some 35 people repaid their outstanding amounts and new disbursements were made to them. However, the MFI is clear that it will not refinance (lend to clients with existing outstanding), which is what most of the clients are demanding. It feels that MFI clients will not be able to repay even if the Anjuman committee gives them permission to do so, because most have suffered business losses, or used up their capital for consumption purposes in the interim.

Another MFI has refinanced 20 clients, (with outstanding balances of Rs5,000), by lending Rs15,000 to them, against post-dated cheques and other guarantees. However, this is an experiment and they do not plan to refinance further till they are sure of the repayments from these 20 clients. If they extend refinancing to other defaulters in the future, it will be against collateral.

A third MFI is now promising to give loans to those who repay their outstanding. It is not going to refinance any borrowers. Another MFI has organised special meetings with defaulters, but is not undertaking any doorstep visits or attempting individual collections since the clients are unlikely to repay. It does not plan to lend to Muslim clients again. Most of the other MFIs have also taken this decision.

**Sidlaghatta:** Clients are requesting new loans of higher value to pay back the old ones and invest the rest, but this is unacceptable to most of the MFIs. One MFI has given new loans in Rahmatnagar to groups that have good borrowers and no repayment problem. The staff are hoping that this will be an incentive for defaulters to repay in the hope of accessing fresh credit. Another MFI has not undertaken any formal rescheduling of loans but staff have resorted to doorstep collections, and take whatever the clients give them, using persuasion and promises of higher loans if the defaulters pay their outstanding dues.

**Ramnagaram:** The staff are sure that they will not be able to collect a single rupee from defaulting clients until the edict is revoked. After the meeting with the DC and the letter from the police, the MFIs now have the confidence to work in the field on a regular basis. However, they still cannot



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arrange meetings in many of the slums and dare not use anything which can be construed as forceful behaviour with the clients. They have also been instructed not to work after 6 pm, which makes doorstep collections quite difficult as clients are usually not at home during the day.

One MFI is willing to give loans to selected good groups which have paid well, but is unwilling to reconstitute groups just for lending to good clients. Another MFI is working on collecting overdues from mixed groups while motivating clients to get together and defy the Masjid diktat, citing that they were better off with the MFI's credit. This does not seem to be generating much enthusiasm among the defaulting clients. A third MFI has been visiting clients door-to-door encouraging them to repay, but without significant success.

**Mysore:** An MFI has organised mass meetings with clients, called special meetings (10-30 members) to encourage repayment. Muslim clients have taken the most loans and have the most multiple borrowings according to staff. Of these, 20-30% are making partial payments, but this is more because of staff persistence in visiting their homes every week rather than because of a serious intention to repay. Good payers have also suffered because they have not got subsequent loans if they are in bad groups. Many of the clients are demanding refinancing of their loans, and the MFI has to find a way of working around this demand. Branch staff have divided the clients into green (good clients, good groups), yellow (good clients, default group), and red (default clients, default group), and lend only to those in the green and yellow categories. Yellow clients will be re-grouped, and given only emergency loans to begin with. If their repayment remains good, further loans will be extended.

There have been discussions between another MFI Area Manager and some of the KFD members. However, KFD refuses to back down and has advised MFIs not to conduct meetings. No special strategy has been adopted for recovering overdues, because members still refuse to come for meetings, the primary reason being that if they attend the meeting, they will be expected to make at least a partial payment. The MFI will not lend anymore in affected areas, not even to partial or reconstituted groups.

A third MFI is splitting clients into good and bad payers and reconstituting the groups so that they can re-lend to good clients. This is in order to encourage repayment by the defaulting clients, who may repay in full so as to get another loan. These MFIs are now looking at rural areas for growth and have temporarily stopped lending in the city. They will lend only in unaffected areas and will not lend to defaulters in the future, regardless of whether they repay in full. Group formation in the city has been stopped altogether.

### 7 Views of the Lead Bank Managers

The Lead Bank Manager of Kolar has his own views on the matter. He said that none of the clients had defaulted to Canara Bank or any other banks in a similar manner, and so the problem was much



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more because of a direct retaliation against MFIs than because of genuine inability to repay. He indicated that the MFIs should have spoken to the Anjuman before approaching the DC to complain about them. Perhaps when they started operations they should have maintained a good rapport with the Anjuman. However, he said that MFIs should think of the reasons why they are being targeted. He thought

- 1 They charge high rates of interest and deceive people by telling them the flat rate rather than the reducing balance rate of interest. According to him moneylenders charge only 18-24% which is still less than the MFIs' effective rate of interest.
- 2 MFIs lend without really assessing the creditworthiness of the borrowers
- 3 They have unsustainable levels of competition, thereby resulting in over-lending
- 4 MFIs should have agreed to ensure that no borrower has loans of over Rs50,000.

Though some local leaders announced loan waivers during their election campaigns it is of interest that this had no impact on the bank loans at all. They have also made inquiries about MFIs at the District Level Bankers' Committee meetings because they were worried that MFIs were acting as moneylenders, since they do not have signboards outside their branches and operate informally (meeting women in groups in their colonies rather than at designated branches).

The Lead District Manager at Ramanagaram, on the other hand, has been very supportive to the MFIs. He has helped in enabling the district authorities to understand the situation.

### 8 Summary of the situation

#### **Kolar**

- It is clear that Kolar is a relatively small town that does not have the scope to support competition from 8-10 MFIs. There are also several "financiers" who operate in the guise of MFIs forming groups and handing out money, but charging high rates of interest.
- Clients have taken multiple loans from MFIs, seeing this as an easy source of money. MFIs, on their part, have also not undertaken stringent risk assessment of clients, and despite AKMI district meetings, there has been no coordination and information sharing at client level to ensure that they do not lend to the same clients again. This has resulted in clients rotating one loan to pay another, and eventually having to go back to the moneylender to make repayments to MFIs.
- Had the situation with Sardar Khan's attempted suicide not been publicized, the Anjuman Committee the situation may not have blown up in this manner. However, there are also indications that "tinderbox" conditions were building up in Kolar and the attempted suicide acted as a trigger for the Anjuman to take up the issue. The youth committees also over-reacted taking up the cause with greater fervor than was necessarily intended.



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- The Anjuman have now painted themselves into a corner. They have nothing to gain by continuing the default since low income families of their community are suffering, but cannot give instructions to repay as they have denounced the MFIs in public and will lose face if they contradict themselves.

### **Sidlaghatta**

- There is a clear spill-over effect from the Kolar crisis, given the timing and nature of the crisis (started a few weeks after Kolar, concentration among Muslim clients)
- This was combined with existing difficulties of one segment of the clients (silk reelers), who were facing a business downturn, and might have already experienced difficulty in repaying
- Multiple borrowing for quick expansion of business was partially to blame. On the other hand, MFIs who tried to ration loans became more liberal when they realized that they could lose their clients who would meet the rest of their needs from competitors.

### **Ramnagaram:**

- The situation in Ramnagaram is comparable with Kolar, but has spread to some non-Muslims also. Most of the clients have wilfully defaulted despite having the capacity to repay, because of the Masjid diktat. The incidents in Kolar and Sidlaghatta gave further impetus to the Ramnagaram Masjid authorities.
- It is clear that there is a nexus between irate factory owners and the religious authorities.
- Multiple borrowing is definitely a part of the overall problem, but only a few clients appear to have been severely indebted beyond their capacity to repay. Others who had taken loans from 1-2 MFIs appeared to have been making repayments with ease.
- When clients were asked about advances from employers (leading to bonded labour conditions), most indicated that factory loans were a chronic feature of their lives and, at some point in the past, they had paid off the loans, only to return to being wage labourers when had to borrow again within 6-12 months.

### **Mysore:**

- The situation in Mysore is different from that in Sidlaghatta and Ramnagaram, in that it is not entirely a spill-over from Kolar. By the time the problem spread to Ramnagaram in May, the first round of communal trouble and riots had already taken place in Mysore. However, July was the time of the massive default in Mysore, following more riots, and the KFD's protest march accompanied by anti-MFI propaganda.
- The KFD is a politically motivated Muslim organisation. There is no direct nexus between KFD and moneylenders/vested interests (such as that in Ramnagaram between silk merchants and clerics). Clients seem to have wilfully defaulted, taking their cue from the default of group members (some of whom were really affected by the riots) and from the encouragement of the KFD.



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- Clients feel that all MFIs should follow the example of refinancing by one MFI. The other MFIs resent this deeply and there has been a lack of cooperation in tackling the mass default.
- Client complaints about MFIs are minimal compared to Kolar, Ramnagaram and Sidlaghatta. No clients quoted MFI rules as being unacceptable, neither were there stories about suicides.

Ultimately, the degree of support of the district authorities has been critical in determining the extent to which the MFIs have been able to manage the crisis. In Sidlaghatta and Ramanagaram the MFIs have been able to make some, if slow, progress in managing the situation because of the support of the local authorities and because the lines of communication with local community leaders have been kept open ever since the crisis began. In Kolar, where the crisis first broke, the unsuccessful attempt to appeal directly to the district authorities created a negative impression amongst the community leaders and appears to have retarded attempts to resolve the crisis.

### MFIs operating in Kolar

	Operating since	Active Borrowers	Gross Portfolio, Rs lakhs	Borrowers overdue	Principal overdue, Rs lakhs	Default, %
SKS	3 years	11,538	731.65	2,849	71.30	9.7%
GK	Nov 2008	1,810	110.00	107	10.16	9.2%
BSS	2006	3,700	214.84	2,756	153.91	71.6%
Spandana	3 years	1,543	88.39	2,450	170.00	
Asmitha	Feb 2008	1,890	107.00	1,458	75.00	
Sanghamithra	2005	134	35.12	nil	Nil	
RORES	5 years	3,570	204.44	2,310	46.82*	22.9%
FFSL	5 Dec 2007	7,174	518.47	3,730	173.28	33.4%
		29,800	2009.91	15,660	700.47	34.8%

\*after adjusting the security deposit of Rs146 lakhs.

Source: This table and those below have been pieced together from sporadic information available from the MFIs.

### MFIs operating in Sidlaghatta

	Operating since	Active Borrowers	Gross Portfolio, Rs lakhs	Borrowers overdue	Principal overdue, Rs lakhs	Default, %
SKS	2007	3,210	183	~1,000	~50	8%
GK	Nov 2008	1,620	90	39	2	2.2%
Ujjivan	2008	2,825	130	632	28.3	21.7%
BSS	Oct 2006	3,245	201	740	6.7	26.8%
Spandana	Dec 2008	1,148	66	nil	nil	
RORES	Dec 2006	595	32	197	7.3	22.5%



## Delinquency crisis in Microfinance in Southern Karnataka

### MFIs operating in Ramnagaram

	Operating since	Active Borrowers	Gross Portfolio, Rs lakhs	Borrowers overdue	Principal overdue, Rs lakhs	Default, %
SKS		2,353	129	222	13.5	10.5%
GK	2005	9,825	770	678	46	5.9%
Ujjivan	2006	7,252	490	2,450	134	27.3%
BSS	2001	3,452	241	nil	nil	nil
Spandana	2006	3,456	200	1,405	75	
Asmitha	2008	2,209	180	450	30	
Sanghamithra		101 groups	98.4	99 groups	29.3	29.8%

### MFIs operating in Mysore

	Operating since	Active Borrowers	Gross Portfolio, Rs lakhs	Borrowers overdue	Principal overdue, Rs lakhs	Default, %
SKS	April 2007	10,565	638	917	57	8.9%
GK	2005	9,959	747	5,874	454	60.7%
Ujjivan		8,669	478	393	19	3.9%
BSS	May 2007	4,205	252	62	0.5	1.9%
Spandana	Dec 2006	22,000 (5 branches)	1,868	2,800	nil	nil
Asmitha	April 2007	~8,000	187	~5,500	35	nil
Sanghamithra	2005	183 groups	190	800 clients	9.6	5%