

India's Major Crisis in Microlending Loans Involving Tiny Amounts of Money Were a Good Idea, but the Explosion of Interest Backfires

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Agence

Indian activists of the All-India Democratic Women's Association (AIDWA) and their supporters protest at the Reserve Bank of India on Oct. 13.

The microlending movement that was supposed to help lift millions of people in India out of poverty has in recent weeks fallen into chaos.

Urged on by local government officials and politicians, thousands of borrowers have simply stopped paying lenders, even though they have the money. The government has begun ratcheting up restrictions, fearing that borrowers are being buried by usurious interest rates. In some cases, officials have even arrested lending agents for allegedly harassing borrowers.

Local politicians, meanwhile, have blamed dozens of suicides on microlenders and are urging borrowers not to pay back what they owe.

Though so far the backlash has been confined to a southern Indian state of Andhra Pradesh, what happens there is frequently a bellwether for microlending in India, and programs around the world. Hyderabad, the state capital, is home to some of the world's biggest microlenders, including SKS Microfinance Ltd., Spandana Sphoorty Financial, Basix & Share Microfin Ltd. The state accounts for about 30% of the loans for all of India, one of the world's biggest microfinance markets.

"This is potentially going to devastate lending to rural areas for a long time," said Vikram Akula, founder and chairman of SKS Microfinance, India's largest microlender by loan volume, which recently listed its shares in India. "We are confident that we will survive, but certainly this is going to change how things could and should be done."



Arlene Chang/The Wall Street Journal

The son of Satyama Ayrene, left, hanged himself. It was because he owed money to loan sharks, she says—not because his wife, Laxmi Narsamma, at right, owed \$220 to microlenders.

Microcredit is the lending of tiny amounts of money, usually less than \$200, to entrepreneurs who use the loans to start or expand small businesses such as a vegetable stand or a bicycle repair shop. Most microcredit firms lend money through women's groups and reach out to borrowers who are either too far from or too poor to borrow from a bank. The repayment rate on the loans have tended to be better than that of richer borrowers. Interest rates, however, can be high, from 25% to 100% a year, mostly due to the cost of administering millions of tiny loans in remote areas.

The crisis is in some ways reminiscent of recent debt problems in the U.S. Microfinance is targeted at a population that is overlooked by the mainstream banking industry, the same social niche targeted by payday and subprime lenders in the U.S.

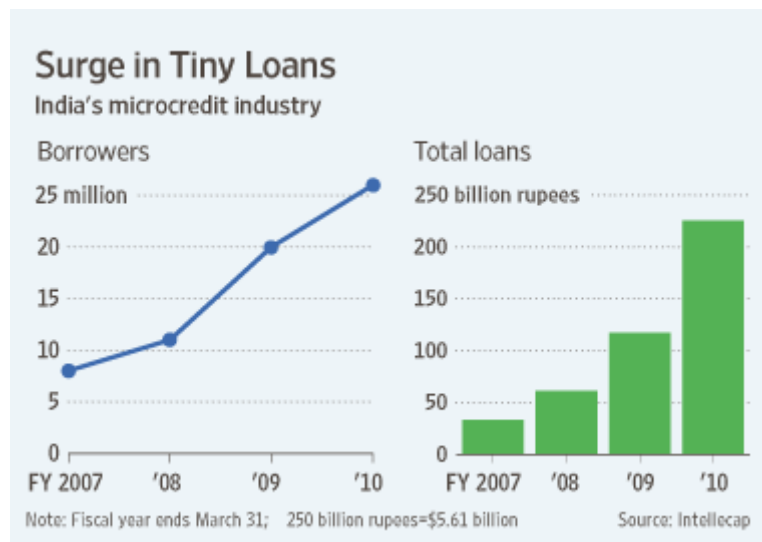
As the microfinance industry has grown, it has attracted international capital that has greatly boosted the size of the industry, much as payday lending and subprime borrowing soared until two years ago in the U.S. In a significant move that showed international investors' interest in the industry, SKS recently sold \$350 million of its shares on the Indian stock market.

But along with that has come concern among politicians, regulators—and indeed some in the industry—that unfettered expansion was leading to poor lending practices, multiple loans to the same borrowers, and fears of widespread repayment problems.

While they have been much in demand wherever they have been introduced as they provide a kinder, cheaper alternative to the village loan shark, some economists are skeptical about whether the small loans actually help lift people out of poverty.

And in regions where there are more than one microlender competing for clients, some experts are concerned that the poor are being encouraged to take on more debt than they can bear.

Private-Equity Money



So far, the repayment rate across the microlending industry has remained extremely high. But Andhra Pradesh's payment strike could presage a turn—and put the capital that has flooded into the industry at risk. Mainstream Indian and international banks have backed the microlending industry in India with more than \$4 billion of loans this year, with private-equity funds pouring more than \$250 million into the industry in India last year alone.

The repayment strike is a rare black mark for an industry that has long been viewed as a social benefit. One of the industry's leaders, Muhammad Yunus of Grameen Bank in Bangladesh, won the Nobel Peace Prize in 2006 for pioneering the system. The industry has spread across emerging Asia, Africa and South America. India, with its giant population and hundreds of millions of people living in poverty, is one of the most important markets.

The industry also was the first to reach out to those that make less than \$1 a day. It had been so successful that it has spawned efforts to bring everything from insurance to cellphones to solar lights to groceries to the poor.

Andhra Pradesh slapped new restrictions on the industry that effectively shut it down last week. While a state court order put the restrictions on hold and allowed the lenders back in the field this week, close to half of all borrowers are continuing to avoid payments, microlenders say.

State officials say they are trying to protect the poor from usurious interest rates and heavy-handed practices, which they say have triggered more than 70 suicides in the state.

Microlending companies say that often where they have investigated suicides attributed to their lending, they have found that microloans were among the smallest of the many problems of the people that have killed themselves.

In Sankarampet village about 2½ hours from Hyderabad, Satyama Ayrene is still in mourning over the death of her son who hanged himself. While local police say they have been told to investigate whether microdebt caused the death, Ms. Ayrene says it was the \$2,200 he owed loan sharks that was bothering him, not the \$220 his wife owed to a microlender.

Misplaced Blame?

"He did not commit suicide because of the [microloan] companies," said Ms. Ayrene, 55 years old. "He was burdened with loans from the local moneylenders and didn't know how to pay them back."

Micro lenders say they are being punished for the success at reaching the poor and that if the resistance continues, many of them will go out of business. Many have been taking steps to create good will to try to avert the situation from worsening. The biggest lenders who account for the majority of borrowing say they will cap their rates at around 24% and form a fund to help troubled borrowers reschedule their loan payments.

They say they are ready to comply with more government restrictions as long as they are given time to meet new requirements. But in the meantime, the industry has ground to a halt.

When SKS agents arrived in a village called Shanti Nagar about 150 miles from Hyderabad, the capital of Andhra Pradesh, on Wednesday morning, they could tell right away something was wrong. The borrowing group of 20 women was milling around the dusty village square, instead of sitting in order in a circle with their weekly payments as SKS procedure requires.

While the group wanted to pay its loans, they had been forbidden by a local political leader and their husbands, the women said.

The political leader, A. Subramanyam, arrived and told the SKS agents not to harass his neighbors.

"I told them if they don't have the money, they don't have to pay," said Mr. Subramanyam. "I have seen them sell their wedding jewelry to pay the installments, why should they do that? No one here has prospered with these loans."