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THE BURDEN OF SERVICING FOR-PROFIT MFI DEBT: IMPLICATIONS FOR PANDEMIC AFFECTED RURAL INDIA

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The rural economy of India is yet to recover from the impact of Covid-19 pandemic. The living conditions of households in a perennially distressed economy is worsened due to pandemic. Provisioning of finance in adequate quantity and reasonable terms could have been the hope of households for livelihoods. Unfortunately, it is marred by "U" turn in traditional social banking policy in the auspices of banking sector reforms. Diluting the role of the commercial banks in the rural economy, the banking sector reforms, in the name of productivity and efficiency, have given a new set of institutions known as "microfinance". Although, the microfinance movement in India was initially led by the NGOs with social objective, over the years it has been dominated by the for-profit MFIs. In fact, taking the advantage of vulnerability of rural populace and neo-liberal reforms, the not-for profit MFIs have metamorphosed into for-profit entities. Despite the criticisms of their lending practices from Andhra Pradesh in 2010 to Assam in 2020, they have grown phenomenally without any course correction. Against this backdrop, the present research intended to assess the burden of servicing the for-profit MFI debt on rural households through a sample survey. The study finds that debt servicing payments take away a significant portion of their income and deny many of them their minimum necessary consumption. The burden is higher on the poor than on the less poor. In order to tide over the crisis, they resort to multiple borrowing and plunge into deep debt trap. Finally, to tide over the problems, the study proposes longer tenure of loans, reasonable gaps in the repayment schedules, higher size of loan and repayment moratorium in initial phases of the loans delivered by the for-profit MFIs, apart from the creation of a comprehensive regulatory framework for the for-profit MFIs.

1. INTRODUCTION

Three years have been passed since the onset of Covid-19 crisis in India. The economy has

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almost recovered. Now the corporate, banking and non-banking sectors have healthy balance sheets. The GDP growth rate after plummeting to -6.6 per cent in FY 2020-21 has reached 7 per cent in FY 2022-23, and is expected to grow between 6-6.8 per cent in the current financial year i.e. 2023-24. Private consumption expenditure as a percentage of GDP has been 58.4 per cent, the highest among the second quarters of all the years since 2013-14. The housing sector shows significant decline in inventory, thanks to the return of the migrant workers. The urban employment is back on track (Economic Survey, 2023). As the economic survey 2023, suggests this has been possible largely due to two things; one is the increased capital expenditure by central government, which increased by 63.4 per cent in the first eight months of FY 2023, and the other is the credit growth to the micro, small and medium enterprises (MSME) sector which has been remarkably high, over 30.5 percent on an average during Jan-Nov 2022. However, the picture is not entirely rosy. Although, the agricultural growth has marginally improved to 3.5 per cent in 2022-23 from 3.3 per cent in 2020-21, it is nowhere closer to its pre-pandemic level, a growth rate of 5.5 per cent 2019-20. Unrehearsed mechanism, processes, and policies has given a big blow to informal rural economy (Sharma and Singh, 2022). The rural economy still shows distress in terms of under-employment, unpaid family labour, decline in wages and poverty, apart from deterioration in health and living conditions. The number of agricultural workers which was declining consistently since 2004-05 both in absolute and relative terms, has increased considerably owing to reverse migration induced by Covid-19 lockdowns, and decline in rural non-farm activities in recent years. The share of agricultural workers in total workforce was 49 per cent in 2004-05, which declined consistently to 42.5 per cent in 2018-19, but it again rose to 46.5 per cent in 2021 (Mehrotra and Parida, 2021). It not only has dampened the rural wages but also has resulted in an increase in unpaid family labour, especially that of women, which is otherwise construed by the Govt. as the rise in female participation and self-employment in the rural economy (Mehrotra and Parida 2021). Overall, the pandemic has adversely affected the women, marginalized social groups, and youth, largely due to the nature of their employment (He et al, 2023). Succinctly, a story of downward transitions emerges, with movements out of the labour force, into more informal and lower-paid types of work in agriculture and rural areas (He et al, 2023). As consequences, poverty, health, living conditions and sustainability have been severely affected in rural India (Sharma and Singh, 2022). Vatta et al. (2023) through a primary survey of 1100 household in the state of Punjab in India found that the pandemic has induced disruptions on food security and farm income. They have also found that after the pandemic, there has been a significant rise in input costs in agriculture and have advocated for increased provisioning of credit supply in rural Punjab. Velguri et. al (2022) through a longitudinal survey of 1437 farmers across 12 states in India found that 75% , 25% and 30% of the agricultural households reported loss of income, selling of assets and increased borrowing, respectively, as consequences of the pandemic. They also found that despite the Government support, there has been an increase in food insecurity in general and it is more pronounced for small and marginal farmers, in particular. Thus, the various studies across the board suggest that the perennially distressed rural economy of India is yet to recover from the big blow it received from the pandemic.

However, if anything that can address the aforesaid distress in the rural economy, it is provisioning of finance. Provisioning of finance in adequate quantity and at affordable terms can go a long way in addressing the distress in the rural economy (Mallawaarachchi and Rahut, 2023).

Since early 1990s, in the framework of banking sector reforms, two basic changes have emerged in the provisioning of finance for the rural economy. One is the shift in the focus of traditional institutions, especially the Scheduled Commercial Banks (SCBs), and other is the; emergence of an alternate institutional mechanism; the 'microfinance'. The microfinance approach is viewed as a mechanism that is able to rectify the major weaknesses of the banking system itself, most notably, the "twin problems of non-viability and poor recovery performance" of the existing rural credit institutions (Rangarajan, 1996).

Microfinance as an alternate institutional mechanism for the delivery of credit has hugely expanded in the country through two of its major programmes viz; Self-Help Group Bank Linkage Programme (SBLP) and Microfinance Institutions (MFIs). It has been thirty years since the start of SHG movement in India. cumulatively, as on 31 March 2022, the SBLP has covered 14.2 crore families through 119 lakh SHGs and has outstanding collateral free loan of Rs, 1,51,051.30 crore. In FY 2021-21, the average outstanding loan per SHG was Rs. 2.24 lakhs (NABARD, 2023). On the contrary, although MFIs came into existence in 1996 but their momentum picked up after 2004. As of march 2022, they have reached 2,62,599 crores borrowers with more than 6 crore active borrowers (Sa-Dhan, 2023). However, in recent years there has been a greater reliance on MFIs for providing microcredit in rural India. They are supported Micro Units Development and Refinance Agency (MUDRA) banks, apart from the SCBs, NABARD, Small Industries Bank of India (SIDBI) (Mahammad and Mahammad, 2016).

MFIs associated with SBLP are not-for-profit MFIs or NGO MFIs and registered under the societies act. In the beginning of micro-finance movement in India, the MFIs were not-for-profit MFIs and were associated with SBLP. However, in due course, motivated by profit incentives, they metamorphosed themselves into for-profit entities (Pati, 2021). Alternately, the for-profit MFIs are known as Non-Bank Finance Company (NBFC) MFIs. Taking advantage of the vulnerability of rural populace, the for-profit MFIs have grown leaps and bounds. Their share in the rural microcredit has gone up whereas that of the not-for-profit MFIs has gone down considerably (Sangwan & Nayak, 2021). Among the MFIs, in 2007-08, the for-profit MFIs accounted for meagre 22 per cent and 26 percent of borrowers and their outstanding loans, respectively, the rest were by the not-for-profit MFIs (RBI, 2011). The situation however reversed by 2020-21. In 2020-21, the shares of the former became 97 per cent and 98 per cent in number of borrowers and outstanding loans, respectively, whereas the rest were accounted by the not-for profit MFIs.

Strikingly, over the years, criticisms have accompanied the phenomenal growth of for-profit MFIs. In the MFI lending crisis, from Andhra Pradesh (2010) to Assam (2020), the media has accused them for their role in suicide of MFI borrowers. Particularly, they have been criticized for their coercive and unethical lending practices. Such an assertion has not been refuted even by the RBI appointed committee led by Y H Malegaon in 2011. The issues identified by Malegam committee includes, unreasonably high interest rates, lack of transparency regarding interest rates and additional fees, multiple lending, upfront collection of security deposits, over-borrowing, the existence of "ghost" borrowers and the use of coercive method for loan recovery. While the scalability of MFIs has its limitations, for profit MFIs have nevertheless proliferated across India, despite harsh criticisms.

1.1 Statement of the Problem and The Research Question

Amidst the Covid-19 pandemic in 2020-21, reports emerged that the for-profit MFIs were engaged in unethical recovery practices in various regions including Odisha, West Bengal, Assam and Punjab[1]. In Rourkela, Odisha, the for-profit MFIs charged a late payment fee of rupees 600, despite the three-month repayment moratorium mandated by RBI[2]. Recent reports have highlighted how women in districts of Mansa, Sangrur and Barnala in Punjab were heavily indebted to for-profit MFI loans[3]. Similar problems also emerged in the state of Assam. To address the issue and to regulate the operation of for-profit MFIs, the Assam Government introduced "The Assam Microfinance Institutions (Regulation of Money Lending) Bill, 2020". Additionally, the Assam Government announced a micro loan waiver package of 12,000 crore rupees, called the Assam Micro Finance Incentive and Relief Scheme (AMFIRS), 2021 for women borrowers of for-profit MFIs. In the light of these developments, it is evident that the Covid-19 pandemic has worsened the financial difficulties of for-profit MFIs borrowers of rural India.

Against this backdrop the major research question that arises is "does the for-profit MFI debt put the borrowers into financial stress?" In other words, the broad aim of the present research is to understand how burdensome it is to service the debt owed to for-profit MFIs by the rural household in India. In particular, does the debt servicing burden disturbs the household budgets? If so, are they pushed into the for-profit MFI debt trap, to tide over the situation, temporarily?

1.2 Review of Literature

Although there is a plethora of literature on for-profit MFI credit, there are not many studies that are directly or indirectly related to the aforesaid research questions. A few relevant studies on Indian context is discussed in this section.

The study by Taylor (2011) investigates the for-profit MFI crisis that occurred in the state of Andhra Pradesh in India in 2010. While acknowledging the over indebtedness of rural households to for-profit MFI credit, the study traces the reasons behind it. The study maintains that over-indebtedness could be attributed to several factors such as trade liberalisation, rising spells of drought, changing social relations, rising consumption and profit motives of the lenders. In a similar study, Mader (2013) maintains that financial distress in bound to occur for the rural borrowers of for-profit MFI credit as historically credit hs been used as a social policy. In a related study the phenomenal growth of for-profit MFIs is contexalised by Sarkar and Thapa (2020). Using the available secondary data the study maintains that thanks to neo-liberal reforms, the space vacated by formal banking in the rural economy is filled by the for-profit MFIs. The study holds the growth of for-profit MFIs responsible for persistent and chronic credit crisis in rural India. Taking the microfinance's core objective of improving the lives of the rural poor into consideration, the authors characterized the developments as mission drifts. Similarly, Agarwal (2021) shares the concern that increasing commercialization of microfinancing in India will be disasters for rural poor, because the state rather than rectifying existing lapses in the functioning of for-profit MFIs, has put renewed thrust on them. As an extension of Agarwal (2021), the study by Shareef (2022) prescribes that the Central and State Governments should take necessary measures to sustain the growth of the microfinance sector in India. Similarly, the study by Girijan and Ramachandran (2022), calls for legislation to regulate the MFI sector and various MFI players. The study is based on secondary sources analyses double bottom-line performance of Microfinance in India.

In contrast to the abovementioed studies, the study of Datasharam et. al (2015) is a more specific one. It examines the debt burden of MFIs, on 90 poor households in Ramnagaram town of Karanataka by using financial diary methodology. The study suggests that the household budget is severely affected by for-profit MFI loans. In particular, the regular repayment for the loans severely erodes their consumption pattern. As a result, the borrower households suffer from the problem of impoverishment and malnutrition. In a more recent study Guerin et al. (2021) discuss the problems arising out of intersections of Covid-19 pandemic and for-profit MFI lending in the state of Tamil Nadu in India. The study finds the for-profit MFIs during pandemic to be exclusionary, in contravention of their "so called" inclusive nature. According to the authors, Govt.'s Covid-19 relief guidelines for rural poor were not adhered by the for-profit MFIs. Specifically, they neither provided three months moratorium on loan repayment nor did they extend any fresh loans. As a result, the hardships of the rural poor during the pandemic worsened. In another departure from the conventional studies, Patel et al. (2022) analysis the delivery of microfinance credit from the perspective of caste-based discrimination. The study uses a sample size 3,144 female microfinance applicants for the analysis. The study finds that the applicants belonging to the lower castes despite having a higher credit score have a slim chance of availing credit in comparison to that of the upper caste.

However, though the existing literature paints a wide variety of concerns pertaining to for-profit MFIs credit and validates our research questions, provides no clear answers for those questions. Hence, the present study intends fill this gap in literature by analyzing the burden of servicing the for-profit MFI debts on the basis of a small sample survey.

This paper is organized as follows. Apart from the current introductory section, there are three more sections. The second section discusses the nuances of survey data while the third section analyses the data and makes assessment. The fourth and final section is the concluding section that summarizes the entire discussion, suggests policy measures, highlights limitations and outlines future direction for research on this topic.

2. DATA & METHODOLOGY

The study is based on a small sample survey of 100 rural household who were active borrowers of for-profit MFIs. Since the latter lends to women members by forming a joint liability group (JLG) of five members each, the household borrows either through self (if the head of the household is women) or through female members of the family. Importantly, the purpose of the loan taken for-profit MFIs was difficult to ascertain, although most of them indicated that it was for productive purposes. In fact, it is difficult distinguish between production and consumption credit in subsistence rural economy (Bhaduri, 1982) and of course, the problem is more precarious due to the pandemic.

The survey was conducted in six different villages in Odisha spread over two different rural blocks in one of the districts of Odisha. Before conducting the survey, aggregate information about active borrowers in each were collected from then operating for-profit MFIs. Accordingly, house listing and sample selection was done on a proportionate basis (Table 1)

Table 1: Sampling Framework

Cluster	Village	Borrowers of For-Profit MFI	Households Share of in Total (%)	Sample Size
Block 1	Village 1	75	14	14
	Village 2	45	9	8
	Village 3	100	19	18
	Total of Block 1	220	42	40
Block 2	Village 1	100	19	20
	Village 2	50	10	10
	Village 3	150	29	30
	Total of Block 2	300	58	60
Grand Total	520	100	100	

Source: Authors

As far as the distribution of for-profit MFIs in the sample data is concerned, the surveyed borrowers were spread over six well known MFIs but their names have been withheld owing to sensitivity issues. However, their relative strength in sample in terms of total number of loans, loan amounts and operational experiences in the study area is depicted in Table 2.

Table 2: Distribution of for-Profit MFIs in Sample Data

For-Profit MFI	Total Number of Loans (Clients*)	Share in Total (%)	Amount of Loan (in INR)	Share in Total (%)
1. MFI_1	55	35.3	8,76,000	40
2. MFI_2	47	30.1	6,63,000	30.3
3. MFI_3	38	24.4	4,61,000	21.1
4. MFI_4	10	6.4	1,19,000	5.4
5. MFI_5	5	3.2	55,000	2.5
6. MFI_6	1	0.6	14,000	0.6
Total	156	100	21,88,000	100

Source: Field Survey

Note: *: For MFIs each loan implies a client since none of them provides more than one loan to the same client.

Finally, before analysing the data, purification is made and due care is taken to ensure that appropriate statistical requirements are met.

Debt servicing burden is defined as the repayments as a proportion of monthly income (Brickell et al. 2020). However, in the field survey it was observed that the repayment schedules of for-profit MFI debts were weekly whereas the income of the household varied from daily, weekly to semi-annual (on the basis of harvesting seasons) but mostly daily. Hence, both the repayments and income were averaged out on monthly basis.

3. ANALYSIS AND ASSESSMENT

The debt servicing burden on the households is analyzed both in absolute and relative terms. It is also contrasted against economic inequality. Besides the impact of debt servicing burden on household budget is analyzed and their economic vulnerability in terms of multiple borrowings is assessed.

3.1 Debt Servicing Burden on the Households

As mentioned in the previous section, debt servicing burden defined as debt repayments as a percentage of household income per month. It ranges from as low as 2 per cent to as high as 63 per cent. Viewed in terms of its mean, it hovers around 20 percent (Table 3). Definitely, a household spending one fifth of the monthly income on debt servicing that to in rural Odisha, is not a healthy sign. Of course, the median value indicates that there are relatively more households in the below 20 per cent range.

Table 3: Debt Servicing Burden on Households: Key Statistics

Key Statistics	Debt Servicing Burden (in %)
Mean	20
Median	14
Standard Deviation	18.51
Range	60.5
Minimum	2.3
Maximum	62.8

Source: Authors

Nevertheless, a better picture in this regard emerges when we look at the same distribution by various slabs of debt servicing burden. Accordingly, we classified the debt servicing burden into various categories and analyze the distribution of households across those slabs. The analysis suggests that around 75 percent of the households spend around 20 per cent or more of their monthly income on debt servicing. In fact, it is more than 30 per cent for one fifth of the households (Table 4). This precisely because of the shorter tenure of the loans. In the field survey it was observed that the for-profit MFIs loans were usually for one year and in limited number of cases it was for 2 years, which was in contravention with Malegam committee recommendations.

Table 4: Distribution of Manufacturing Households across Various Slabs of Debt Servicing Burden

Debt Servicing Burden(Various Slabs)	Households(in %)	Cumulative %
> 0 but < 10	25	25
> or = 10 but < 20	35	60
> or = 20 but < 30	15	75
> or = 30 but < 40	14	89
> or = 40 but < 50	5	94
> or = 50	6	100
Total	100	

Source: Authors

However, since the poverty ridden household usually have large families, we assess the aforesaid distribution in terms of in terms of their per capita income and by below and above poverty line (BPL and APL) categories. In this regard our analysis suggests that compared to the top 25%, the debt servicing burden on the bottom 25% is quite high (Table 5). This is because, on an average per month, not only their debt servicing payments are high but also their incomes are low, compared to that of the former (Table 5). Importantly, the high average debt servicing payments implies the high average size of their debts. This also indicates that on an average, the poor borrow more than the less poor.

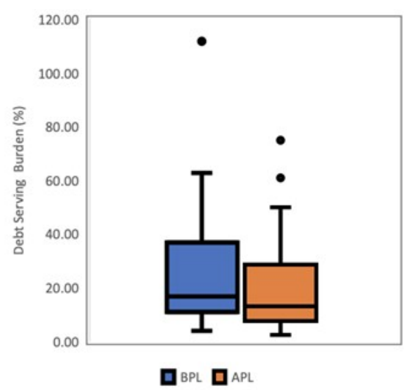
Table 5: Inequality in the Debt Servicing Burden

Economic Hierarchy (Based on Per capita Income)	Average Debt Servicing payments per Month	Average Household Income per Month	Debt Servicing Burden (in %)
Bottom 25%	1,855	7,728	24
Top 25%	1,544	17,661	9

Source: Authors

Similarly, compared to the APL households, the debt servicing burden is quite high on BPL households (Figure 1)

Figure 1: Debt servicing burden on BPL and APL households



Source: Authors

Thus, it appears that the debt servicing burden has been relatively higher, for the bottom quarter of the households, in general and for the household below the poverty line, in particular. Strikingly, although microfinance caters the poor, the poor is not a homogenous category, at least as far as the sample data is concerned, rather there exists economic inequality between them. As a result, debt servicing burden is higher on those who are more poor than on those who are less poor. Hence there is every possibility that debt servicing burden may push the people on the margins of poverty line to BPL or extreme poverty. Further, since dept repayment out goes erodes the households' budgets, we also look at their retained earnings.

3.2 Debt Servicing Burden and Retained Earnings of Households

The debt servicing payments reduces the household's disposable income. Naturally, after making the debt servicing payment the household is left with a portion of disposable income which it has to use for consumption and other purposes including savings. Importantly, if the consumption expenditures and other necessary expenditures can be deducted from the disposable income, left after making the debt servicing payments, one can get a picture of retained earnings or surpluses and hence may able to observe the debt burden on the household bit more closely. Unfortunately, since there are no appropriate estimates of all necessary expenditure of a household, we use Niti Aayog's (erstwhile planning commission) estimates of poverty line Monthly Per-Capita Consumption Expenditure (MPCE) based on mixed recall period methodology as per Tendulkar committee's recommendation. The available poverty line MPCE estimates for rural Odisha is rupees 695 at 2011-12 prices[4]. But since the prices have gone up substantially since then we inflate it by the CPI figures (Base 2012=100) of June 2022 for rural Odisha i.e. 175.5[5]. Hence, we inflate poverty line MPCE of 695 by 75.5 per cent and hence considered rupees 1220 as minimum MPCE. Accordingly, the minimum expenditure on consumption per month at the household level is computed by multiplying the respective household size with rupees 1220. Finally, the retained earnings of the households per month is estimated by deducting the minimum required expenditure on consumption and debt servicing amounts from its income.

The estimated retained earnings as a percentage of household income is divided into four exclusive categories such that each successive category indicates better conditions for the household and distribution of households across these categories is looked into. The distribution of estimated retained earnings shows negative retained earnings for 18 per cent of households. This indicates that because of monthly for-profit debt service obligations, close to one fifth of household are not able meet their minimum monthly consumption expenditure necessary for their survival. And around 47 per cent of the households have less than 25 per cent of their monthly income as retained earnings (Table 6).

Table 6: Distribution Households across Various Slabs of Retained Earnings

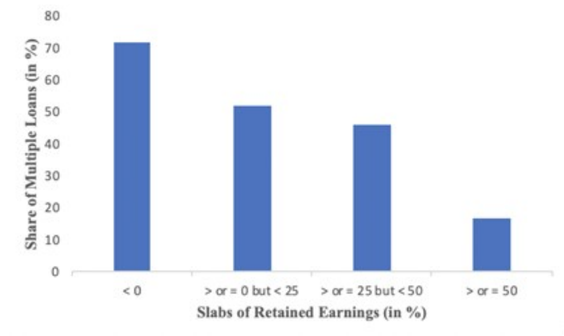
Retained Earnings as % of Monthly Household Income(Various Slabs)	Households in %	Households Cumulative %
< 0	18	18
> or = 0 but < 25	29	47
> or = 25 but < 50	24	71
> or = 50	29	100
Total	100	

Source: Authors

Thus, it appears that close to half of the household are left with less than 25 per cent of their monthly income after making the debt servicing payments and minimum necessary consumption expenditure. This certainly indicates a distress situation for the households since 25 per cent of the income is too meagre for a household for other necessities, given the fact that these rural households who are compelled to borrow from for-profit MFIs owing to their pathetic economic conditions. In fact, even for the rest of the households the situation is not very rosy. Barely 30 per cent of the households have retained earnings above 50 per cent of their respective income. In other words, for more than 70 per cent of the households the retained earnings are less than 50 per cent of their monthly income.

Thus, quite similar to the findings of Datasharam et. al (2015), the study finds that across the board, the debt servicing payments has eroded the retained earnings of the household and has pushed many of the households into distress conditions. Obviously to tide over the situation they have resorted to multiple borrowings. There seems a negative relationship between the retained earnings of the household and number of loans. The households with relatively less percentage of income as their retained earnings have largely resorted to multiple borrowings whereas those with relatively larger proportion of retained earnings have less resorted to multiple borrowings (Figure 2).

Figure 2: Share of Multiple Borrowings in Retained Earnings



Source: Authors

In particular, as one goes upward in the direction of retained earnings proportions, the share of multiple loans decreases and the opposite happens as one moves in the downward direction of the retained earnings. Undoubtedly, the multiple borrowings, although eases the household economic conditions, in the short-run, aggravates the same in the long run, leading to a perpetual debt trap.

4. CONCLUSION

The analysis of field survey data suggests the for-profit MFI debts puts a large burden on the rural households. The debt servicing payments takes away a considerable proportion of monthly income for a large number of households. Moreover, because relatively higher debt and lower income, on an average the poor bears more burden than the less poor. As a corollary of it, the burden is higher on BPL borrowers than on APL borrowers.

Further, the debt servicing burden significantly disturbs the monthly budget of the rural poor. The disturbance is such that a significant proportion of household fail to meet their monthly necessary consumption expenditure. Quite similar to the previous, the poor are more affected than the less poor. And to tide over such a distress situation they resort to multiple borrowings.

In fact, there appears to be a positive relationship between household distress and multiple borrowings. The poor resort to more multiple borrowings than the less poor. Thus, as observed by Agarwal (2021), it appears that the for-profit MFIs have brought more woes than panacea for the rural poor. To add salt to injury, Covid-19 pandemic has aggravated the conditions of rural distress. As a result, rural poor are compelled to borrow from for-profit MFI and fall into the deep gorge of debt trap.

However, since at this juncture the rural poor needs credit and it should be provided, the policy implication of this study could be provisioning of credit at concessional terms. Apart from other things, the concessional terms should include longer tenure of loans, reasonable gaps in the repayment schedules, higher size of credit and repayment moratorium in initial phases of the loan.

In spite of the findings and aforesaid policy suggestions, the study suffers from the limitation of small sample survey and large focus on debt servicing burden. Hence, the way forward could be a thorough examination of various causes of high debt servicing burden, including interest rates, upfront charges, insurance payments, pre-payment charges and other hidden costs to borrowers, with the help of a large set of survey data.

Notes

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