Welcome to Paradox Valley

A NOTE IN THE PAST FOR THE FUTURE

SATURDAY, AUGUST 22, 2009

Vikram Akula's Response to WSJ's article on Microfinance in India, by Ketaki Gokhale

Letter to The Wall Street Journal
Managing Editor
The Wall Street Journal
New York, NY

Dear Sir,

This is in regards to "A Global Surge in Tiny Loans Spurs Credit Bubble in a Slum" by Ketaki Gokhale on August 13, 2009.

We are deeply disappointed and shocked by this unbalanced and misleading portrayal of microfinance in India.

Ms. Gokhale reports that there is an over-indebtedness problem in one slum in one city in one state of India and goes on to assert that this indicates that there is a "credit crisis brewing in 'microfinance." Such a sweeping generalization based on anecdotal information from one neighborhood is absurd.

To the contrary, the data suggest a very different picture. Microfinance institutions in India, which serve 22 million clients, have consistent repayments rates of 95% and above—repayments that clients could not make if they were not generating regular income, given the weekly repayment schedule that most microfinance institutions follow.

In fact, the Microfinance Information Exchange (MIX), the Washington-based non-profit information platform, reports that the average repayment rate of leading MFIs in India—which have the lion's share of clients— is 98%. My own institution, SKS, which serves over 5 million clients spread across 70,000 villages and slums of India, has a 99% repayment rate. Meanwhile, our portfolio received a PR1+, the highest safety rating, from an independent external rating agency, for a debt instrument slated to list on the Indian stock exchange. The reporter did not even mention these high repayment rates or the fact that in tens of thousands of villages and slums across India, millions of microfinance customers are thriving and climbing steadily out of poverty—as shown by a number of independent studies.

It is surprising that such facts were deliberately excluded when talking about a "repayment revolt [that] has spread to other communitiesâ€¦and could reach further across India." In fact, this

About Me

Name:
Vee

View my complete profile

Previous Posts

statement is attributed to an unnamed observer. Who is the observer? What is the data that is the basis of this assertion? And how does this data compare with industry data or at least the data of the market leaders, such as those reporting to the MIX?

The reporter goes on to say that "Shantytowns in Ramanagaram, India, like this one are getting 'carpet-bombed' with loans from microfinance firms." What other shantytowns are getting carpet-bombed? How many did the reporter visit? Where is the data or the study that suggest this is a widespread phenomenon—or even that it is more than an isolated occurrence? The reader should have a chance to arrive at a conclusion from facts not assertions from unnamed "observers" or anecdotes.

The one pair of researchers mentioned by the reporter is the team of Rajalaxmi Kamath and Arnab Mukherji. But their study, "Ramanagaram Financial Diaries" involves a sample of only 20 clients over a short 3 month period of time. Clearly, this brief snapshot cannot suggest anything about the broader universe of microfinance in India. In fact, the researchers themselves even qualify their findings, writing, "are MFIs 'dumping money on borrowers' or is there an insatiable hunger for credit which they are fulfilling? It will be difficult answering these questions given the scope of our pilot study." Moreover, it is worth noting that the study's major finding is that the "greatest proportion of the total borrowings during this period went into repaying other loans (informal loans â€“ moneylender, chit-funds, finance companies)." That is, according to the study, when clients are paying off other loans with microfinance borrowings, it is to primarily pay off high-interest moneylender, chit fund, and finance company loans—not to pay off microfinance loans, a fact conveniently omitted in Ms. Gokhale's article.

Granted, it is still problematic that the loans of these 20 clients are not being used for productive purposes, as is more common in microfinance. But if lower interest microfinance loans are used to pay down higher interest moneylender or chit fund loans, this is not necessarily a bad thing.

As to the question of why loans in this neighborhood were not being used for productive purposes, there are several inter-linked causes—from the impact of the recession on the silk industry (in which many clients in this locale were engaged) to Hindu-Muslim religious tensions (which today are common in the state of Karnataka, in which Ramanagaram is located) to patriarchal hostility towards lending to women to intimidation from politically-connected traditional loan sharks. Unfortunately, the reporter fails to even mention such issues.

Coming back to the question of what the data says about over-indebtedness and repayment issues, there are in fact more comprehensive studies than that of Kamath and Mukherji. Consider, for example, a study by Karuna Krishnaswamy that analyzes qualitative data as well as quantitative information from a data set of over 500,000 client loan and repayment records from seven MFIs in Andhra Pradesh, one of the states in India that has even more microfinance penetration than Karnataka. The key finding of this study is that multiple borrowers have an equal or lower arrears rate than their single borrowing peers in the same branches and lower than the average rate for the overall sample. Moreover, a majority of the multiple borrowers interviewed said they used their loans primarily for investment purposes, none reported repayment difficulties, and there was no other evidence that multiple borrowers are experiencing repayment problems.

Ms. Gokhale unfortunately did not take the time to look at such statistically robust studies but relied instead of the 20-client pilot study.

Worse yet, Ms. Gokhale draws a parallel between microfinance and the U.S. mortgage crisis. Yet she neglects to explain how different the process of microfinance is from that of mortgage approvals in the US; the reader is misled into believing that loans are disbursed willy-nilly. On the contrary, leading microfinance institutions like SKS follow a strict process to ensure loans can be comfortably re-paid.

We first require potential members to take three hours of financial literacy training and pass a test indicating they understand interest rates, loan installments, and other product features; we make small loans exclusively for income-generating activities, not for consumption; we lend only to women who borrow in interdependent groups of five and who are known to be more careful with their use of loans than men. SKS' rigorous process of approving loans is completely different from the lax system in the US for approving mortgages that led to the sub-prime crisis. Some microfinance institutions—particularly new entrants—may violate these norms. But to go from the exception to a sweeping generalization about the sector is at best unbalanced; at worst, downright irresponsible.

She also makes the claim that microfinance is similar to the US mortgage industry because "in India, microlenders' field officers are often paid on commissions, giving them financial incentive to issue more loans." Had the reporter checked with the vast majority of microfinance institutions in India, she would have found out that this is simply not true. At SKS, for example, we have no loan officer commissions for larger loan size. Even if some microfinance institutions in India incentivize their loan officers this way, isn't it incumbent on the reporter to mention that the majority—with the lion's share of clients—do not?

There are other glaring examples of amateurish imbalance in Ms. Gokhale's story. It is bizarre that the reporter quoted an investor in Luxembourg who comments about a "bubble" in microfinance in India, but whose fund focuses on regions other than India and "has no exposure to India." It raises the question as to why she did not reach out to any of the investments funds that participated in the 54 deals in India in the last 18 months, mentioned by the reporter herself.

The reporter also makes far-fetched leaps of logic. For example, she cites the fact that "average Indian household debt from microfinance lenders almost quintupled between 2004 and 2009, to about $135 from $27." She goes on to say that the industry is expected to grow another 20%, suggesting that this is worrisome. But she failed to find out that the reason for the quintupling of loans is that microfinance institutions deliberately start with small loans sizes and increase the loan size year-on-year as a borrower demonstrates her credit-worthiness each year. This gradual increase in loans is a substitute for the lack of a credit score among the poor—something that this neglected and largely undocumented segment do not have—and is a standard practice in the microfinance model pioneered by Nobel Prize winner Muhammad Yunus.

Moreover, even at $135, microfinance institutions are still lending well below the typical credit need of a poor household in India, which is $400 (based on survey data from an independent study commissioned by the government's Small Industries Development Bank of India). This data suggest that, on average, there is no over-lending issue for the sector.

In addition, the statement that microfinance institutions do not disclose their accounts is downright false. The microfinance institutions mentioned in the article, along with other large players such as SKS, disclose their financials to the MIX, the Washington-based non-profit, which posts this on its website. SKS also files its financials with India's Ministry of Corporate Affairs and it is available to the public on the Ministry's website.

Finally, the article implies that micro-lending to Muslims has stopped. This, Ms. Gokhale says is ironic because, for years, "Indian microlenders have touted themselves as bankers to the nation's impoverished minority Muslim community." First of all, microfinance in India has made no such claims. Moreover, the assertion that microlenders have stopped lending to Muslims is not consistent with the data. In reality, the sector serves a disproportionately larger segment of Muslims than in the general population because microfinance targets the poor—and Muslims are, as a group, more impoverished than the general population. For example, at the end of the fiscal year in March 2009, 18% of SKS clients were Muslim compared to the 13.4% of the general population that is Muslim.

In microfinance, there is a similarly disproportionately large representation for other impoverished groups, such as lower castes and other minorities. If the reporter had sought out the data, she would have realized this.

For all these reasons, Ms. Gokhale's article is a poor and irresponsible piece of journalism. We normally have high regard for The Wall Street Journal and have worked closely with and have great respect for other WSJ reporters. It is a shame that the esteemed journalistic standards normally found in your newspaper have been trampled upon with this story.

Regards,

Vikram Akula

posted by Vee @ 14:50 1 comments

1 Comments:

At 8/23/2009 12:44:00 PM, Vinod said...

Thank you for your strong rebuttal to WSJ's article. It is probably sign of times - with newspaper publishers losing money, they are favoring articles that generate buzz rather than provide solid fact-based journalism.

Working with a non-profit that focuses on Micro-finance (United Prosperity - http://www.unitedprosperity.org) I couldn't be more miffed by WSJ article, and couldn't be more thankful for your rebuttal.

Post a Comment

<< Home