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Exploratory Work in Orissa

Who is the marginal client for Microfinance? Why do people repay so well?

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Contents

1. Introduction

The expansion of microfinance services in India has largely concentrated on women as the target client. Practitioners often allude to their high repayment rates as confirmation that microfinance works. This exploratory research aims to elaborate on the answers to two questions: (1) Who is the marginal client for microfinance? (2) Why do people repay so well? These questions will be addressed in the course of an analysis of two microfinance providers in the state of Orissa, India; one rural and the other urban. Particularly, it aims to elaborate on the elements that contribute to understanding the penetration of microfinance service and if the repayment system helps or hurts borrowers' welfare.

The issues addressed by the study regarding the first question include: Who are the clients who demand microfinance services? Who are the ones who do not and why? What motivations cause clients taking-up loans? Are clients borrowing from other sources? If so, why? How much does the social network matter? What elements determine different levels of penetration?

Concerning the "puzzle" of why people repay so well, some of the issues analyzed in the study comprise: Why do clients repay and how? How does staff enforce repayment? To what extent do clients consume less to repay their loans? To what extent do clients borrow from others to repay loans? How valid is the hypothesis that repayment may be enforced to the detriment of the household's overall welfare?

2. Data Collection and Methodology

These results were obtained through interviews and focus groups with clients, community organizers (COs)[1], manager staff and non-clients in Gram-Utthan (GU) and Swayanshree (SS). Gram-Utthan was the first institution visited. As the questionnaires were developed in the field while conducting the interviews, they varied considerably from the beginning to the end of the observation period. The basic qualitative results are similar in both organizations even though more data analysis is reported for Swayanshree. It was possible to collect more quantitative information in SS once the questionnaires had been refined in GU. Additionally, some information was provided by Gram-Utthan and Swayanshree from their records, which was essential in order to analyze repayment rates and loan usage.

Since this is an exploratory work, the main caveat is that the sample for data collection was not randomly chosen and thus no statistically significant conclusions can be derived from the results. Additionally, it turned out that people from the same occupation tend to group together, potentially adding biases in the results. Regarding the records provided for Gram-Utthan and Swayanshree, little historical or disaggregated information is available electronically. Both institutions are currently at different levels of progress in this area. Other biases could have arisen from using a translator or from using self-reported answers to some questions.

The charts summarizing the questionnaires and the main quantitative results are presented in the Appendix. 127 women were interviewed in SS. A similar number was interviewed in GU but quantitative information was processed for only 87 women. Most Community Organizers and managerial staff were also interviewed.

1 Community organizers are the main contact with the client. They collect savings, process and disburse loans, work to empower women, etc.

3. Background on the organizations

Both GU and SS work through the formation and support of self-help groups (SHGs.) GU is a non-governmental organization (NGO) that delivers services to its clients while Swayanshree is a federation of SHGs that supports and at the same time reports to its associates. GU works exclusively in rural areas while Swayanshree mostly in urban areas.

Gram-Utthan was created in 1990 and has adopted microfinance as its core program since 1995, reporting annually rates of growth of 73% between 2002-03 and 2005-06. At the end of May 2006 GU had 31,998 members in 2,436 SHGs (13 members per SHG) throughout 4 districts in rural Orissa[2]. The average savings was Rs 47 (USD 1)[3] and yielded 6 % per annum. The size of the loans is defined according to member's previous record and can be up to Rs. 15,000 (USD 330). The average loan was Rs 6,247 (USD 137.) The interest charged to SHGs by GU is 18% declining and SHGs charge an interest of 24% declining to their members and the payback period ranges between 12 and 18 months. Repayment is monthly. Future plans include doubling GU size by 2010[4].

Swayanshree is a federation of SHGs, created in 1994 gaining the legal status of a registered society in 1998. As of June 2006 it had 7,759 members in 584 SHGs operating in the urban slums of Cuttack City. The mandatory savings average was Rs 40 (USD 0.9) and yielded 4 % per annum. The maximum size for a loan is Rs 40,000 (USD 879) for productive purposes although other limits apply according to the type of loan requested. The average was Rs 3,180 (USD 70.) The classification for the loans, their payback period and interest rates are as follow: general loan which can be for consumption or production (24 months, 24% per annum); festival Loan (10 months, 18% per annum); and the loan for the "poorest of the poor" is named Asha loan, (18 months, 0%)

4. Main Findings[5]

4.1 Who is the "marginal" client for microfinance?

Women have been considered the main client for most microfinance providers in India. Although this seems to be true at first glance, this exploratory research suggests that in order to accurately define the mF client, the whole household (HH) must be included. Not only are women not the exclusive or even the main recipients of services, but the demand for certain type of products by HHs depends highly on the structure of the HH, its level of income as well as the stage of the life cycle the HH members are in. In this line, this analysis will consider women as a part of the client but will extend the analysis by taking into account some of the HH's characteristics that seem to define it as a client for mF services.

Households occasionally include extended family, but less frequently in urban than rural areas. The

2 Kendrapara, Jajpur, Bhadrak and Cuttack

3 Conversions through the document are at Rs 45.5/ USD 1

4 From GU power point presentation

5 The main findings refer to both organizations, unless otherwise stated and the results refer to the samples analyzed, unless otherwise indicated.

average HH comprises 7.2 members in GU and 5.7 in SS[6]. They have generally diverse but unstable income generating activities across all income levels. A significant proportion of women members do not have their own source of income. Only 20% of women reported having their own business or reported participating in the family business in GU. In the case of SS, these figures are higher: 36% said they have their own business or participate in the family business and 9% reported being employees outside of the house[7]. These differences seem partially explained by the fact that in rural areas women are not allowed to work in agriculture.

More often than not the mandatory monthly savings comes from the money the women are given to run the HH; 91% in GU and 75% in SS. However, the loan repayment is mostly a husband's responsibility; 84% in GU regardless of loan usage. In SS 66% of the loans with productive usages were reported having the purpose of husband's (or occasionally son's) business. It is important to note that both organizations reported having male groups in the past but that these groups were more difficult to operate and the repayment rates were not as high as the female groups. This does not necessarily suggest that men cannot be the primary client but could suggest that male groups are riskier under SHGs schemes and their participation is less risky when women are involved in the scheme.

Women members have low levels of education. In SS they reported having 4.7 years of education but 39% of them are illiterate[8]. While women seem to have a more important role than being just a means to get access to mF services, men play an essential role in the results of mF. In general, it was not difficult for women to convince their husbands of being part for the SHG[9]. The dynamics between women and men seems to have positive externalities for the HH as consequence of a greater involvement of women in the HH decisions after belonging to the SHGs[10].

Most HHs who demand mF services in GU and SS have "binding" expenses such as medical expenses, marriages and house repairing expenses that exceed their disposable current income after their minimum food requirements at different moments. Some clients also want to start a new business and do not have the necessary capital. This is explained by the fact that these HH usually have little discipline to save and also lack access to formal financial services or have access only to expensive informal ones. These factors lead most of them to be "natural" borrowers, almost regardless of their level of income.

Their low mobility also seems to explain part of the success of the system. For instance, in urban areas the nature of trust is slightly different since mobility is higher. Usually permanent residents group together and only occasionally non permanent residents that are perceived as trustworthy are allowed be part of the group. This implies segmentation but suggests that a higher mobility could hurt the system.

6 The question was: How many people live under the same roof?

7 Participating in the family business does not always imply income in cash for women or financial independence while being employed outside of the home usually does.

8 These figures could be much higher in the GU sample.

9 This is biased since the women who did not convince their husbands are not in the groups. However, it should be noted that respondents reported overwhelmingly that the process was not difficult.

10 In GU, less empowered women were more likely to have their husbands accompany them to the meetings. There was a case where, a husband has continued to pay the monthly savings even after his wife's death on the assumption that his next wife will also belong to the SHG. Nevertheless, the husband could not access credit directly. For example, when one's wife died, another woman had to ask for the credit for the funeral expenses. Some men were also taking care of the children while women go the meetings.

4.1.1 Three Dimensions: Income, Life Cycle and Products

The analysis of the mF clients will initially be approached from three dimensions through this section: income, life cycle and mF products. The income level highly determines if you can access to the services but most importantly it usually defines levels rather than need for mF services. The HH members' life cycle stage determines some of the important expenses that lead to the necessity of mF services. Finally, the products reflect which clients' needs are being covered by mF services.

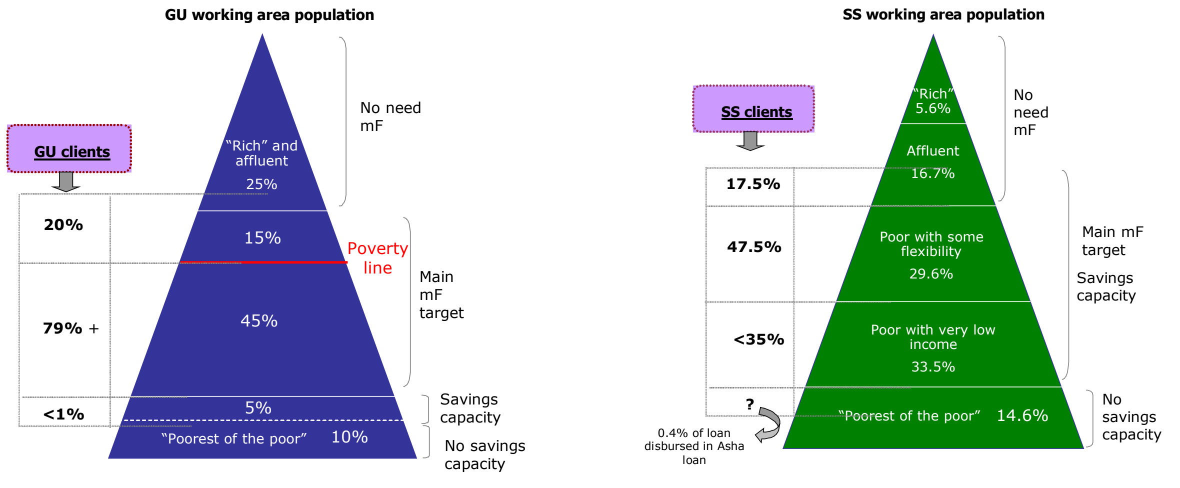
4.1.1.1 Income Dimension

In this dimension, access to mF is determined mainly through the savings capacity and the risk of being able to repay. The core of mF clients excludes the "poorest of the poor " and the most affluent people in the communities. These segments are often considered by the mF providers as risky segments.

The poorer the people, the more difficult it is to fit them in the scheme; in the extreme case, for the "poorest of the poor"[11] to plan or commit with fixed savings and repayment is more difficult because their short run is very immediate and their decisions are more extreme, generally on a daily basis and centered around basic sustenance. Money to save or payback the loan in these cases may be competing with having two meals rather than one.[12] In GU, loan officers and managers expressed their concern that more than 90% of the projects with the "poorest of the poor" fail. They also seem to have lower self-confidence which could be translated into more risk aversion or just more "reasonable" risk aversion. The poorest people also have less alternative resources since their neighborhoods rarely have extra money to lend them. In addition, this group lacks collateral to provide moneylenders (mostly jewelry); this typically makes the burden too high (interest rates double without collateral.) On the other hand, the better off the people (i.e. the more alternatives they have), the longer the time they need to trust in and the less they are committed to the scheme.

FIGURE 1

Estimated working area population (%) according to income level and estimated clients' distribution (%)



Source: estimations based on discussions, interviews and questionnaires with management staff and COs in GU and SS

Figure 1 shows estimations of the proportions of population belonging to different income levels in the GU

11 Throughout this document the expression "the poorest of the poor" will refer mainly to the people that, due to their low income, have no savings capacity in a way to fit with most mF providers' requirements.

12 It was more frequent to find people afraid of taking up loans in the poorest groups. One particular group primarily had been saving for 3 years. They reported having fear of failing to pay back the loans, which prevented most of them from getting loans.

and SS working areas. It also shows how client distribution is related to this income pyramid.

GU estimations indicate that in its working area 25% of people could be considered “rich” or affluent; 10% can be classified “poorest of the poor” where people have no savings capacity; 5% are just above the classification of “poorest of the poor” but have savings capacity and the middle 60% are the main target of mF services: 45% below poverty line (BPL) and 15% above poverty line (APL.)

The 25% of people who are considered “rich” or affluent do not need, and mostly show no interest in, mF services. They have access to other alternatives. The bottom 15% of the pyramid is considered a risky target for GU[13]. SHGs formed by people from these segments and savings capacity are rare. Those with no savings capacity have only occasionally gotten mF services under special programs sponsored by members in SHGs. In those cases GU acts as an NGO, they would be dismissed from mF services, otherwise. The main focus of mF services is in the 60% of the population for whom the monthly savings is not an important burden and can manage to pay the loans. Figure 1 also shows how the GU clientele is distributed: 20% are APL, less than 1% belongs to the poorest segments and nearly 79% correspond to the middle 60% in the income pyramid.

In the SS estimates, nearly 22% of the people would belong to the segment “rich” and affluent, 14% would be in the bottom of the pyramid with no savings capacity and the middle would be the 64% of people who have savings capacity and some flexibility to fit into the scheme. Estimations based on this information would indicate that 17.5% of SS’s clientele are in the affluent segment, nearly 82% would be in the middle segment and less than 1% could be in the “poorest of the poor” segment.

The numbers in this exercise were constructed based on the knowledge of community organizers and management staff, rather than on income surveys and in this line the most important message is related with the qualitative conclusions: The “rich” segment is self-excluded from the system and the bottom of affluent segment as well as people from “the poorest of the poor” segments are demanding mF. This suggests a broader span for marginal clients. However, their profile imposes risks in the scheme for different reasons. It probably also suggests that different instruments will fit better with their profile. This study is concentrated on segments excluding the “rich” part and most of the affluent population.

Some ideas about occupations and what of income for mF clients

In SS the main occupation of women members is homemakers (55%), housemaids (9%), and the remaining (36%) work in their own business or the family business (12% producing food to sell, 9% in tailoring, 4% in shops, 4% with cows and 6% in other activities.) The main activities of their husbands were daily laborer (21%) running shops (20%), beggars (6%), food business (6%), rickshaw pullers (4%), mechanics (3%), tailoring (4%), not working (4%), farmers (3%), contractors (2%) and other activities (28%)[14].

Regarding incomes, estimations on daily earnings indicate that in SS area contractors could earn monthly Rs 3,860 (USD 85), followed by beggars Rs 3,000 (USD 66), rickshaw pullers Rs 2,100 (USD 46), daily laborers Rs 1,840 (USD 40) and housemaids Rs 1,670 (USD 47)[15]. However, these are highly variable incomes since no daily mean income, or even any income, is guaranteed. In SS 49% of women members re-

13 Unmarried women and affluent people are also considered risky.

14 This includes 8% for whom no answer applies.

15 No estimation for own business are register.

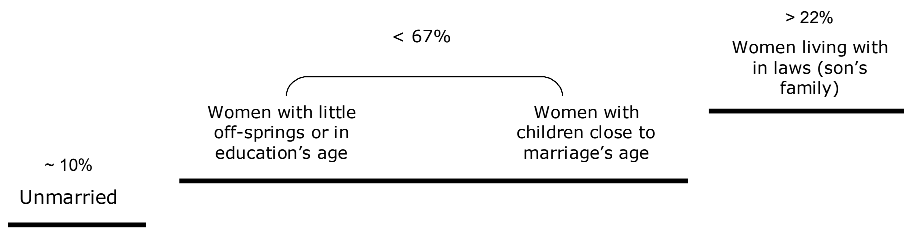
ported that at least two people have income generating activities in the HH. In the GU working area, a daily laborer in agriculture could earn monthly Rs 1,500 (USD 33), as well as somebody who has a little shop while a contractor could earn Rs 3,600 (USD 79). Most occupations for men were in agriculture activities (owners or daily laborers) and as shop owners.

The following example illustrates how these figures can be compared with a HH in "the poorest of the poor" segment in the GU area. The HH is composed of 5 members in the GU area. The woman works selling milk and is paid monthly by all consumers. Her husband due to constraints of age does not work since. Two daughters and a son live with them but they do not study. Some of the children have occasional jobs. According to her information, their monthly income could be estimated in a range between Rs 600—700 (USD 13—15). They have a loan with the moneylender of Rs. 2,000 (USD 44) taken to buy a cow and a recent one with GU of Rs 1,000 (USD 22) for a medical emergency. For the first loan they have only been paying the interest for the past 4 years ago.

4.1.1.2 Life Cycle Dimension: an approach

Regardless of income level, the interviewed households mainly lack savings discipline and are mostly "natural" borrowers at different moments because of multiple "binding" expenses that they have. These expenses include medical expenses, festivals, daughters' or family member's marriages and natural calamities that exceed their disposable current income after their minimum food requirements. Some of them are independent of their life cycle such as festivals and medical expenses, while others like daughter's marriages or children's education (if they study) depend on their children's age. They also usually lack the capital necessary to start a new business.

FIGURE 2
An approach to Life Cycle Dimension (SS)



Analyzing the women members in SS, it turns out that around 10% of the members are unmarried who usually do not work but act as means to get loans for any purpose that her family demands. Less than 67% of women members have children that are not yet of school going age, others are school age and others are of marriageable age[16]. When women members have children who are not school age, they were more likely to be planning to build or repair their houses. When the children were closer to marriageable age clients were more inclined to be planning for their children's marriages and weddings. Food, festivals, health and family member's marriages are expenses always present and some of them such as festivals and marriages can be planned for in advance. For more than 22% of women members their households include their son's family. Here, the cycle starts again for the cycle-dependent expenses of the family.

Figure 3 contains some information collected in SS on some of the expenses. Recall the mean HH has

16 No married women interviewed reported living without sons or daughters.

5.7 members. A mean HH spends around Rs 3,112 (USD 68) a month in food[17]. Festivals are an important expense that most HHs must bear twice a year since two important religious festivals take place annually[18]. HHs spent an average of Rs 1,619 (USD 36) on the last festival and they are planning to spend around Rs 2,600 (USD 57) on the next festival[19]. Expenses on health and education were recorded in a much smaller sample which makes the results very sensitive. In the case of health, women members reported having spent on average Rs 1,785 (USD 39) but the median was Rs 500 (USD 11)[20] while they reported having spent Rs 379 (USD 8) in the last month per school-going child. For daughters' marriages the range was mostly between Rs 100,000 and Rs 400,000 (USD 2,198—8,791), most of the values skewed towards the smallest amount. For a "the poorest of the poor" HH that value could be around Rs. 30,000 (USD 660).

FIGURE 3
Some HH's expenses—SS

Purpose	Rs		USD		No. Observations
	Mean	Median	Mean	Median	
HH members	5.7	5.0	NA	NA	127
Food (monthly)	3,112	3,000	68	66	124
Festivals (Main two in a year)					
Last	1,619	1,000	36	22	104
Next (e)	2,597	2,000	57	44	88
Health (in the last month)	1,785	500	39	11	35
Education (if children studying)	379	333	8	7	23
Daughter's marriage	100,000 - 400,000		2,198 - 8,791		From group questions
Relative's marriages	5,000		110		
Housing reparing/building	Depnding on the project				
Production					

Source: Interviews with clients—classification and calculations are the author's

From this perspective access to mF is considered risky for unmarried women (change of residency when married), women older than 55 and younger than 18 (GU case).

4.1.1.3 The Products Dimension

Products, in this case mostly services, are the main reason why clients join mF providers. It seems that for now this is more supply-driven. Members reported liking the mF scheme because it allows them to manage their needs through saving and borrowing in a convenient way. However, "savings" in these schemes work more as a "collateral" since members cannot withdraw the money and it becomes the base to calculate the ratio for the maximum loan they can take. This way of savings acts as an insurance since it multiplies the resources they will get when needed.

In case of SS when members were asked about the three reasons why they most value being part of the federation, the answers could be grouped into three options: low interest loans (42%), savings scheme (25%) and group cooperation (33%). Other elements that appeared more common as second and third choices but still important were the doorstep service and having a periodic amount and a fixed day and place to conduct

17 Estimation based on the answers to the question: for how many days will the members in your HH eat with Rs 500 if you have to buy everything?

18 For Muslims and Catholics there is only one festival important a year.

19 In Orissa, it is relevant to note that the main festival takes place in the second half semester.

20 This data would be biased at least for two reasons: first, the data was collected at the end when two groups in a leprosy zone were visited; second, there were some HH reported surgery which disproportionably increases the average for a small sample.

transactions. On the other hand, the community organizers thought that their clientele valued savings and loans [savings (50%), loans (13%), savings and loans (25%)] more and assigned a lower value to group formation (13%). In GU, COs thought their clients more strongly valued doorstep services (31%), followed by low interest loans (25%), savings (19%), social empowerment elements (12.5%) and others (12.5%)

The three most visible services expanded through mF are loans, savings and insurance and those will be analyzed in this section.

Savings

Most members in GU reported they had never saved before (at least in cash.) In SS 75% of the groups reported the majority of women had never saved before. Both institutions demand monthly mandatory savings, a minimum Rs 30 (USD 0.7) but voluntary savings were also allowed. Members usually pay the savings from what they receive to run the HH. In SS that figure is 75% and in GU is even higher which represents less than 1% of the average food expenses in a month.

Savings in the SHG model is difficult to compare with other schemes of savings where resources are available. However, members highly value this particular way of savings which allows them a way to better plan their indebtedness. They value the importance of savings, although they are mostly indebted. It seems that mF clients value the "locked" savings as a transaction that will yield a future utility when a loan will be needed. This is a more financially expensive way than to save ex-ante for smoothing their cash flows shocks, but it is probably the only viable way they can commit to.

Some of the newest clients join SHGs only to save as a kind of insurance (i.e. having the alternative of taking up loans in the future) even if they are not planning to get a loan yet. Field work proved this to be an underdeveloped instrument compared with client needs and potential demand

This greater sense of the importance of savings is reflected in other types of savings that were found among people after joining mF providers, particularly in the urban area. In SS it was found that in 43% of the HH at least one of its members had a savings account in his or her name (post office service, other institutions, other SHGs.) In particular, 19% of women reported at least one of their HH members has savings with Sahara (USD 0.1—0.4). For this people, these recoveries reached an average of Rs. 358 a month (USD 8) but 67% of them were in a daily recovery scheme at Rs 5—Rs 20 a day (USD 0.1—0.4).

Insurance[21]

Although none of the institutions currently offer life insurance at the moment there were people with life insurance at different levels of income[22]. In SS 43% of women reported at least one member of their nuclear family had life insurance: 31% of the husbands had life insurance, 13% of the members have at least one son or daughter with life insurance and 10% of the members had life insurance. In one of the poorest villages visited in GU, almost all 120 HH had life insurance. High coverage was also found in more affluent villages as well as individually in poorer groups. An important element that seems to explain the penetration is the group's influence (as well as in the expansion of other mF services) and the presence of an agent from the insurance company belonging to the community (this had an even larger influence if the agent was a rec-

21 This will be focused in life insurance as this was the most common type of insurance held.

22 Some institutions did require mandatory life insurance which only covered the cost of the debt to be paid to the institution or in some cases the cost of the death.

ognized leader.)

However, later it was found that most of them have a particular life insurance a scheme where if the person does not die after a given time, he or she can start withdrawing the money. Therefore, this is both a form of insurance and of savings.

For a smaller sample, more detailed information shows that most people prefer paying contributions in a quarterly basis (75%) and the monthly equivalent payment ranges between Rs 160 and Rs 210 (USD 3.5—4.6), although these values depend on the profile of the insured and the insured amount.

Loans

Most mF clients continue to have one or more additional sources of loans (relatives, friends, societies and moneylenders) that they use according to their necessities (e.g., loan sizes, emergency.) For instance, 52% of members in SS and 40% in GU reported having loans with a moneylender when interviewed, even though this is a source of last resort and also the most expensive source of money. The purpose of obtaining loans from moneylender included repaying debts, building, repairing the house, health, education, business, and marriage—exactly the same reasons people pursued mF services[23]. However, for most of these people, mF represents the cheapest source of resources in a way that increases the likelihood to repay the principal of the loans. That makes an important difference. Some clients have loans with banks but this was very infrequent and mostly in the urban area.

There is an ongoing debate about what loan usages are most convenient for mF, particularly whether consumption should be an important usage. However, the data from GU and SS suggest that in practice the demand for non-productive purposes is at least as important as for productive purposes, while health and education are less important. This section analyzes loans for non-productive purposes, health and education and productive purposes[24].

The "non productive" side: This category includes consumption, debt repayment, marriage and house repairing/building. It was surprising but somewhat reasonable to find the "non-productive" side is almost as important for mF clients as the productive side. Due to the lack of planning and savings culture and the variable income, clients do not know exactly how much they earn or spend every month. Thereby, smoothing consumption becomes a very important usage for mF loans.

Figure 4 shows the same classification for loans taken for clients in GU and SS. In the GU case the analysis comes from data for all the loans disbursed in April 2006 while for SS they come from the sample of members interviewed. The "non-productive" purposes accounted for the 41% and 43% of the total value in GU and SS accordingly. The figures also indicate that in terms of number of loans, 38% of the loans were dedicated to "non-productive" purposes in GU, while 60% corresponded to SS. The difference is almost entirely attributable to festivals since a particular loan dedicated to this usage exists in SS but not in GU[25].

23 Affluent people usually lend money but are not always considered moneylenders. That was not taken into account when the question was formulated, thereby the percentage could be undervalued.

24 The classification of education, health and other consumption expenditures that can contribute to the HH productivity out of the productive category is arguable. However, it was more convenient to do it that way now because it seems loans dedicated to these purposes are more difficult to repay (maybe because their impact in productivity is lagged or the loan is not repaid in the time allotted.

25 Managerial staff in GU expressed that there is some inevitable diversion from productive purposes to consumption but the levels are low.

An important category across the organizations is housing repairing/building with ranges between 17%-21% both for values and number of loans. This indicates mF is being significantly used as an instrument for housing demands. Figure 5 shows a narrower classification calculated from SS records with a greater sample.

FIGURE 4

Loans by Usage GU and SS

Gram-Utthan
All loan disbursements in (April 2006)

Classification	% Value	% of loans
"Non Productive"	**41%**	**38%**
Consumption	*3%*	*3%*
Debt Repayment	*12%*	*13%*
House repairing/building	*21%*	*18%*
Marriage	*6%*	*4%*
Health and Education	**5%**	**7%**
Education	*0.4%*	*0.4%*
Health	*5%*	*6%*
Productive	**53%**	**56%**
Total	**100%**	**100%**

Swayanshree
*Sample**

Classification	% Value	% of loans
"Non productive"	**43%**	**60%**
Consumption	*6%*	*9%*
House repairing/building	*18%*	*17%*
Festival	*9%*	*26%*
Marriage	*7%*	*5%*
Debt Repayment	*4%*	*3%*
Health and Education	**12%**	**11%**
Productive	**45%**	**29%**
Total	**100%**	**100%**

Source: Interviews with clients SS, records GU—classification and calculations are the author's

** This data comes from the answer to the question: which was the amount and the purpose of the last two loans you have taken?*

Health and Education: This is a less important category representing 5% of the value and 7% of the loans in GU and in 12% of the value and 11% of the loans in SS. The data shows that these values are mostly concentrated on unexpected medical expenses. Microfinance loans are not frequently used for educational purposes.

The productive side: This category represents 53% of value in GU figures and 45% in the case of SS. In term of number of loans it represents 56% in GU and 29% in SS. However, this difference could partially be explained by the fact that productive loans have a maximum of Rs 40,000 (USD 879) in SS against Rs 15,000 (USD 330) in GU. The activities are highly correlated with the main activities in the region. Shops are important in the rural as well as in the urban area while agriculture usages are more frequent in the rural area. Most members asked for loans for the husbands; business and occasionally for a son's business as was pointed out previously.

FIGURE 5

Loans by Usage—Records SS (June 30, 2006)

Classification	% Value	% of loans
Consumption (1)	10%	23%
Festival (2)	20%	25%
(1) + (2)	**30%**	**47%**
Mixed (includes 1 and 2)	34%	22%
Production	**37%**	**31%**
Total	**100%**	**100%**

4.1.2 Why do people join? Why do they not join?

Other elements influencing why people join or do not join mF include: Trust for the mF provider, social networks and group influence, risk attitudes and other financial alternatives.

If loan officers do not know anyone in the community, they try to convince the leader of the community or of a neighbor community of the benefits of the mF services. Leaders are also very important in the SHGs; people respect and follow them. Some people will join afterwards just as a means of belonging to the social network and benefit from the benefits of major cohesiveness.

The element that seems to trigger mF expansion in a community is the group's influence. Once some SHGs are formed and the community can see others are benefiting this constitute a proof they can trust the institution, usually when the first groups start receiving loans. They seem to follow as a result of the social influence. This could be interpreted as a kind of herding behavior or collective behavior but it is not clear how the co-ordination works, if there is any, for taking the decision. However, it seems a rational decision to follow others when they have limited information or capacity to determine if they can trust. What seems clear is that leaders have an important power to move the people because they have proved before they look for the community's welfare.

Competition also explain why the penetration of one mF provider get stuck; GU's COs expressed that there are in average 2.5 other mF providers in their working area while SS'S COs said their average was 4.6. The capacity of the borrowers is also a limitation for growing in value. For instance some clients expressed they could have bigger amounts of loans but they do not have the place to sell or the way to invest the money. People did not seem inclined to open a new business just for the resources availability.

The low penetration of mF is mainly explained by: (i) People have no trust: Sometimes they have been cheated before and occasionally are influenced by the moneylender; (ii) People do not have enough money to save; (iii) The area is geographically difficult to access and (iv) People do not need it: "rich" or affluent people (the level of trust is also lower in this segment).

4.2 Why do people repay so well?

The repayment rate in the sector is usually measured on principal and not on total recovery (principal plus interest.) Two ways to consider repayment rate are cumulative repayment rate and current repayment rate. Cumulative repayment rate is the ratio of principal recovered (net of pre-payments) to the principal due since the beginning. On the other hand current repayment rate is the ratio of principal recovered (net of pre-payments) to the principal due during the period in analysis. This is a measure for portfolio quality but it would not necessarily imply long term sustainability if the business is not being profitable, that is, if the costs are not covered.

Gram-Utthan and Swayanshree reported repayment rates on principal at 98% and 96% correspondingly for the month of June 2006. These high repayments rate has been the more persuasive indicator used to assert that microfinance works. The literature frequently points out that grouping mechanisms reduce the adverse selection and moral hazard problems and this would explain importantly the repayment rate levels in the sector. However, mF through individual lending also reports high repayment rates which challenges the notion that only group pressure and monitoring would be the main causes of high repayment rates.

While group pressure or its influence seems to explain partially why mF clients repay so well, what the mF alternative represents for clients seems also to have an important role. Members expressed that they value the pay-back period for loans and the doorstep service. Having to pay a large amount at once is always difficult (as also happens with the moneylender.) Along with a low interest rate, those elements help people plan and increase their ability to repay. Therefore, mF becomes an alternative people want to keep available. In addition, feelings of duty and trust for the institution made people not want to be defaulters. Where the mF providers have the "monopoly", feelings of trust, gratitude and "duty" are stronger than where there is more competition. However, in some communities, people belong to one or two additional SHGs. That seems to be an important threat for repayment rates in the future since competition will likely continue to increase. As long as more competition emerges, it seems that mF providers will likely be seen as regular financial intermediaries.

In SS clients express it is important for them to pay on-time because: the group will suffer, otherwise (42%), they will have less burden (25%), moral duty (17%), they could get another loan (8%)[26] or they do not want group pressure (8%). The loan officers answered to the same question that the fact that people attend the meetings (38%) explains high repayment, group accountability (25%), proper investment of the loan (25%) and getting another loan (13%) were also other explanations. GU's COs consider that the most important elements to encourage on-time repayment are: A fixed place and day (31%), the awareness that the whole group will suffer if they do not pay (25%), and the training on how to use the money properly (19%).

According to the COs people repay more easily and more regularly when loans were taken out for productive purposes than when they are used in "non productive" purposes. When loans are used for productive purposes, the repayment usually comes from the business it was utilized for. Conversely, the repayment of "non-productive" loans, health or education implies reallocation of consumption. This implies that in many occasions they are consuming less to repay the loan. However, in the absence of mF this reallocation takes place anyway to a higher cost (moneylender or alternatives more expensive than mF.) Thereby, a lesser consumption for paying the loans does not imply a decrease in the HH welfare when the contra-factual is taking loans with other more expensive sources that often are moneylenders no matter the destination of the loan. In this way, it could be argued that mF is improving HHs welfare either because it increases consumption due to a lesser interest rate through (income effect), and or for an additional increase in income that will likely result when the loan is used for productive purposes.

An interesting result came from the analysis of individual information for clients, as well as the repayment rate on the interest due. The high values in repayment rate do not seem to reflect that repayment is a less regular habit than the "traditional indicator" suggests. Overall the recoveries are still high but irregular repayment habits could be a destabilizing factor threatening the sustainability of the system in the future. It seems that better indicators should be analyzed in the sector to keep track about this variable. Management on both institutions expressed they recognize this is not an ideal practice. Overall it is not clear how much this hurts or helps the system.

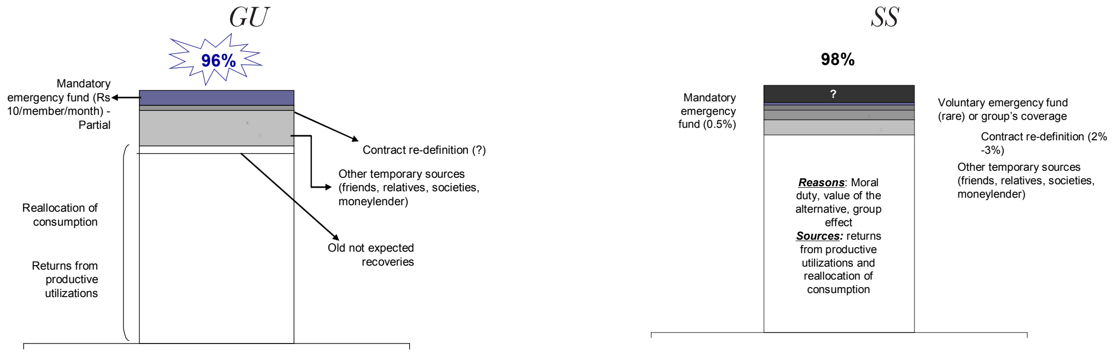
Additional to the fact that the repayment rate is only focused on principal, other elements which make it difficult to establish a "clean" repayment rate for mF include: Some times the contract is re-negotiated. According to GU this occurs only in emergencies, that is, in 2% to 3% of the cases. There is a mandatory emergency funds that covers some defaults; clients definitively get other loans to repay as well as like they get loans from mF to repay other loans but it is not possible to know to what extent this roll over is being used. Figure

26 This was the second most preferred option for 50% of the SHGs.

6 shows a graphic illustration of what could explain the high repayment rates in general, however, how much every element or other no considered elements have is a big question mark.

FIGURE 6

What explains the high repayment rate?—Principal recovery



What is default for clients?

Although it was clear for COs and manager staff that being a defaulter implies an incomplete payment either in the principal or the interest due, the concept is blurry in practice in both organizations[27]. By and large, neither the staff, nor the groups' members, treated someone like a defaulter if she paid an incomplete amount. Thus, it is difficult to find groups that consider having had defaulter problems. In SS 56% of groups declared having never had default problems and 44% claimed to have had defaulter problems rarely; both figures are contrary to what the evidence indicates in the following sections. This is important since it seems to explain two important elements:

The results show that clients are smoothing their shocks with prepayments or underpayments. When they have additional income they prefer to prepay and vice versa. These habits are more the rule than the exception. Second, explicit peer pressure seems to appear more often when the person fails to pay the complete amount and group influence seems to act differently, otherwise since most people are paying a different amount from what is due at any moment.

What do the figures say?

Figure 7 shows how principal and interest collected or overdue compare with what was schedule for SS. Although more data on SS will be presented, the qualitative information gotten in field indicates that both organization, GU and SS, share all these patterns although the values would differ[28]. In the case of SS figures include all outstanding loans as of June 30, 2006.

On the whole, total principal and interest collected exceeds what was expected by 4%, with different patterns for principal and interest recoveries. Regarding principal recoveries, the indicator that is mostly used in the sector, the collected value was 96.2% (current repayment rate) which implies an overdue amount of 3.8%. However, 9% corresponded to prepayments and 0.9% more to collections that were not scheduled.[29]

27 Although prepayments could be classified as a default from the contractual point of view, in this document it refers to an incomplete payment.

28 Some information was available from GU but the prepayments were very high and it was not possible to differentiate them with exactitude in order to ascertain a "clean" repayment rate. However, the field work indicates that underpayments and prepayment habits are similar to what it was found in SS.

29 These are past overdue, though it was not possible to know exactly how old they are. In both cases I found it was not clear to determine if past overdue payments were included in the next payment due (I found that this was not the case in GU.)

FIGURE 7

Principal and interest value collected/overdue vs. scheduled SS - All loans. As on June 2006

	Principal	Interest (as % of value scheduled)	Total
Schedule (1)	100%	100%	100%
Collected (2)	106%	90%	104%
Schedule (2.1)	96.2%	84.5%	94.5%
Prepayments (2.2)	9.0%	4.9%	8.4%
Not schedule at all (2.3)	0.9%	0.6%	0.9%
Overdue - Schedule but not collected (3)	3.8%	14.9%	5.4%

	Principal	Interest	Total
Repayment rate (current)	96.2%	84.5%	94.5%
Default rate (current)	3.8%	14.9%	5.4%

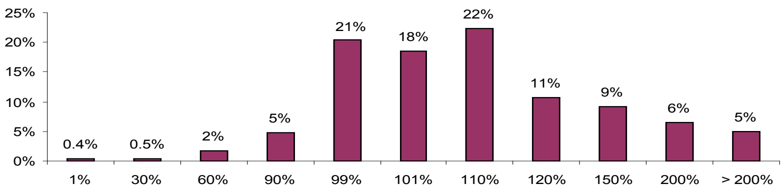
Source: records SS—calculations are the author'

The interest figures which are typically not part of the analysis of success of mF are more striking: 90% of due interest was collected. However, the current repayment was 85% which implies an overdue amount of 15%. Prepayments reached 5% and collections not scheduled were 0.6%.

Overall the repayment rate is still very high at 94.5% since interest represents a much lover value than the principal does. Furthermore, as Figure 8 shows, the distribution of collected versus scheduled is positively skewed towards overpayments. The 18% of the value that is situated between 101% and 99% indicating 18% overpayments or underpayments represent a low percentage of what was scheduled. However, this places an important query about the repayment habits of mF clients, an essential point for guaranteeing the system's sustainability.

FIGURE 8

Collected/Scheduled (principal Plus Interest) As on June 2006



Source: records SS—calculations are the author's

What the figures suggest regarding repayment habits?

Figure 9 indicates that mF clients more often than not pay a different amount from what was scheduled. In this chart, loans are individually considered in order to determine how the practices of paying the even amount, overpayments or underpayments are. Overall the frequencies for overpayment and underpayments are higher than in the previous section were only values were analyzed.

Again, the figures differ considerably between principal and interest. For principal payments 41% of loans paid the exact due, 49% prepaid, 10% underpaid, and 2% corresponded to past overdue. In contrast, 3% of clients reported having paid the exact value of due interest, 31% prepaid, 66% underpaid and 3% corresponded to past overdue

FIGURE 9

Repayment Habits—% of loans paid exactly, underpaid, overpaid—SS All loans. As on June 2006

	Principal	Interest
	(as % of No. of loans scheduled)	
Schedule (1)	100%	100%
Records (2)	102%	103%
Even (2.1)	41%	3%
Prepayments (2.2)	49%	31%
Underpayments - Default (2.3)	10%	66%
Not schedule at all (2.4)	2%	3%

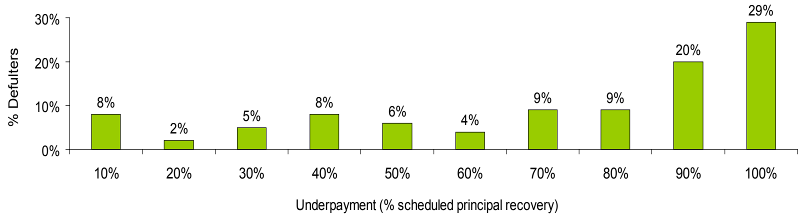
Source: records SS—calculations are the author's

Figure 10 shows the frequency of underpayments and overpayments for principal and interest as a percentage of what was scheduled. Excepting underpayments of principal, all other indicators have skewed distributions to lower percentages. For instance, the largest proportion of people overpay or underpay less than 10% of what was scheduled for principal overpayments (31%), interest overpayments (48%) and interest underpayments (35%). Conversely, the distribution for principal underpayments is skewed to the right, 49% of the time the underpayment for principal was between 80% and 100%.

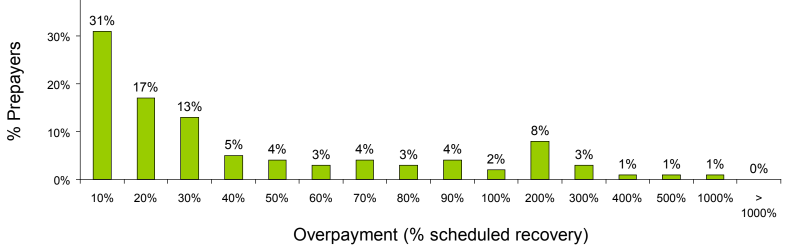
FIGURE 10

Frequency of Overpayment and underpayment—SS—All loans

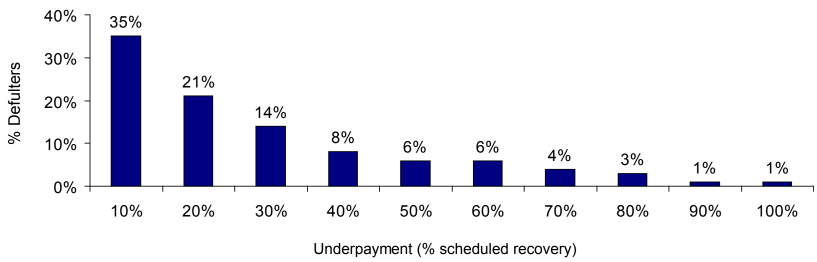
Frequency of Principal Underpayments (Underpayment/scheduled recovery)



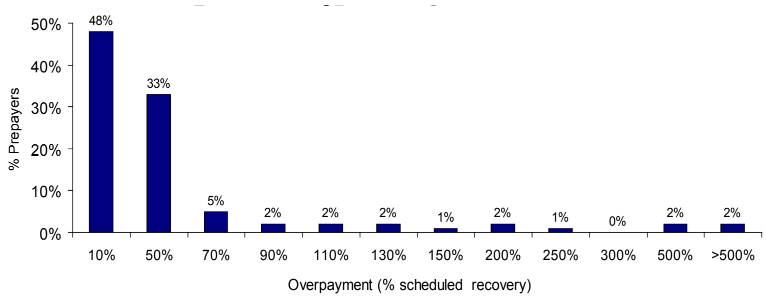
Frequency of Principal Overpayments (Overpayment/scheduled recovery)



Frequency of Interest Underpayments (Underpayment/scheduled recovery)



Frequency of Interest Overpayments (Overpayment/scheduled recovery)



Source: records SS—author's calculations. All figures as on June 2006.

These figures suggest either that people do not consider the amount they should pay as binding or their income flows are just not stable enough to commit with the proposed schedules, or both. In any case, this is a key issue for at least three related reasons: first, at the fast rates of growth in the sector, these unbalances threaten its sustainability. Second, these clients will hopefully be in the future in the formal sector where the habit to fulfill commitments is essential.

This also implies that a greater default is accounted in the interest recovery but never appears publicly.

How does staff encourage repayment?

The staff meets with the groups once a month for and spends one to two hours with the group, half of the time collecting savings, and half of the time in the borrowing process, enforcement and empowerment. They enforce repayment reinforcing messages of duty to be on-time as a pay-off for having the services, as a way of getting new loans, and as a duty with the group that will suffer if there are defaulters. Members usually show respect towards the COs. The punctuality and willingness to help them was something emphasized by members.

In determining whether or not a member is likely to pay off a loan, SS's COs consider first, how diligently she attends meetings, saves, and has paid off previous loans (50%), if she uses the loan properly (25%) and 13% look to the family income source. The COs' messaging strategies to encourage on-time repayment include: the promise of receiving another loan (25%), the emphasis on strictly attending to the scheduled date of repayment (13%), the awareness that members would otherwise have more financial burdens (25%) and the possibility that loans to the entire group will be stopped (25%). For GU, the strategies to encourage on-time repayment include group pressure (60%) and group pressure that loans will no longer be available (33%). However, according to the field observation, it did not seem that the threat of discontinuing loans was often enforced. When the peer pressure is not enough, staff makes individual visits and asks for legal help to overcome repayment problems.

What do the group members do?

When somebody does not pay first, the group usually evaluates the situation and acts accordingly. The decision is taken by the group depending on the member. In case of SS, if a woman did not pay the entire amount, group members alternate between pressuring her to pay (38%) or supporting her if she is a good member (38%). If she does not pay anything at all (less than 0.5% of loans)[30] some pressuring strategies, as

30 Data for SS as on June 2006

reported by COs include:

» Group members stand in front of the delinquent house until the payment is recovered
» Some times the persons is forced to quit the group
» The group will take some costly items from the defaulter
» The delinquent will be taken to the village meeting (Panchayat)

5. Concluding Remarks and Further Research

The following points summarize the main findings for the two organizations. These findings are also issues for further research:

- Defining the mF client requires including the whole household (HH) and not only women. Loan repayment is mostly a husband's responsibility no matter the usage. Loans with productive usages were mostly for husbands (or occasionally sons) businesses.
- Both organizations reported having male groups in the past but that it was more difficult to administer the loans to them and that the repayment rates were not as high as they were for groups with women members. This does not necessarily suggest that men cannot be the primary client but could suggest that male groups are riskier under SHGs schemes and their participation is less risky when women are involved in the scheme.
- Income level highly determines if a HH can access to the services but most importantly it usually defines levels rather than need for mF services. The HH members' life cycle stage determines some of the important expenses that lead to the necessity of mF services. The products reflect which clients' needs are being covered by mF services. By and large, the "poorest of the poor" and the most affluent do not access mF services.
- Members value being part of the mF schemes, among others, due to loans at low interest, savings scheme, group cooperation, doorstep service, a periodic amount and a fixed day and place to do their transactions.
- Savings seem to be a product that mF clients would demand more and mF could potentially better fit the needs of certain clients, nevertheless, the most important product now is loans.
- Clients highly value the importance of savings, although they are mostly indebted. They value the "locked" savings as a transaction that will yield a future utility when a loan will be needed. Other types of savings were found among people after joining mF providers (even to repay debts).
- Although none of the institutions offers life insurance at the moment, there were people with life insurance in different levels of income. However, most of them were a way of savings that allow withdrawals after some years if the insured person has not died
- Most mF clients continue having one or more additional sources of loans that they use according to their necessities. A high proportion of clients had moneylender loans at the moment they were interviewed for exactly the same reasons people pursued mF services.
- Other elements influencing why people join or do not join mF include: Trust on the institution, the social network and group influence, the risk attitude and other financial alternatives.
- The element that seems to trigger mF expansion in a community is the group's influence, which

could be interpreted as a kind of herding or collective behavior but it is not clear how the coordination works, if there is any, for taking the decision. Leaders are also very important; people respect and follow them

- Although management staff and COs have clear the concept of defaulter, it is blurry in practice. By and large, neither the staff nor the groups' members treat a person as a defaulter if she pays an incomplete amount.
- While group pressure or its influence seems to explain partially why mF clients repay so well, mF becomes an alternative that they want to keep available and this is a powerful incentive to repay.
- People do consume less to repay the loan. However, in the absence of mF this reallocation takes place anyway, but at a higher cost. Thereby, a lower level of consumption due to payments on loans does not necessarily imply a decrease in HH welfare.
- Individual information for clients indicates high repayment rates do not seem to reflect that repayment is a less regular habit than the "traditional indicators" suggest. It would be interesting to track individual patterns of repayment since the information can be built in some organizations.
- Clients are smoothing their shocks with prepayments or underpayments. When they have additional income they prefer to prepay and vice versa when they have periods of lower income. People do not consider the amount they should pay as binding, their income flows are not stable enough to commit to the proposed schedules, or both.
- A greater default is accounted in the interest recovery but never appears publicly.