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Profiling of Micro Enterprises in Tamil Nadu and Uttar Pradesh, India

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Profiling of Micro Enterprises

1. Introduction

This investigation seeks to profile the micro enterprises carried out by clients of two microfinance institutions in India. The main objective of the research was to acquire insights into the key drivers of the enterprise selection process and accumulate data on return on investment, cost structure, growth opportunities and constraints.

The analysis will contribute to the understanding of the enterprise selection process and help identify opportunities for guiding clients towards more efficient use of loans. Such analysis will also provide a clearer estimate regarding the actual rate of return on investment as compared to the interest rates charged by microfinance institutions. Lastly, areas in need of further research will be outlined to identify design improvements or new MFI policies that better address the needs of their clients.

The research questions addressed by this investigation include :

1. What are the sizes of the loans? How are they being used?
2. How do clients select their micro enterprises?
3. What is the return on investment (ROI) of different business activities?
4. Do clients follow a long-term investment strategy?
5. What are the main constraints faced by clients for scaling up a business or starting a new one?

2. Methodology

This report presents the results obtained from interviews conducted with microfinance clients in India. The questionnaire can be found as Annex I.

In total, 105 interviews were carried out: 60 with clients of ASA- Grama Vidiyal in Tamil Nadu, India and 45 with clients of CASHPOR Micro Credit in Uttar Pradesh, India.

Although efforts were made to ensure variety within the sample, by interviewing clients from different communities, urban and semi-urban settings and different levels of experience with microfinance, the final selection of clients was done by MFI staff at branch offices. Thus, the sampling was not systematic and therefore, it is difficult to draw statistical conclusions based on the results of this sample. At the same time, it is merely the researchers' intention to identify possible avenues for further research. *(Ref: Table 1)*

3. Background on the MFIs

3.1 ASA-Grama Vidiyal

Activists for Social Alternatives (ASA) is a non-governmental organization (NGO), committed to contributing to poverty alleviation and empowerment of women. ASA has been operating in the state of Tamil Nadu since 1986. Grama Vidiyal (GV), meaning "Dawn of the Rural Poor," is ASA's Microfinance Program, registered as a Public Charitable Trust in the Year 1995 with the objective of improving members' standards of living.

Today, ASA-GV is one of the largest microfinance institutions in India reaching out to about 76,000 clients spread over 6 districts in Tamil Nadu and through 29 branch offices. As of April 2005, total number of loans disbursed was 231,059 (US$ 24.8 million) with a loan outstanding of US$ 3.8 million. Total savings of members amount to US$ 1.72 million.[1]

ASA- GV offers the following products to their clients:

- *Credit:* The credit products are the part of ASA's Economic Empowerment and Microfinance Program, which is being implemented by Grama Vidiyal. The Income Generation Program (IGP) offers loans ranging from 3,000 to 10,000 rupees to women members, which are repayable in 50 weeks at an annual interest rate of 12%. The purpose of IGP is to support and strengthen livelihood activities and rural enterprises owned by poor women in the villages. Loan amounts are set at 3,000 or 4,000 rupees for first timers and increase gradually as loan cycles are completed. A housing loan worth Rs. 35,000, repayable in 160 weeks was available until March 2003, but has presently been discontinued, although some members are still repaying their housing loans. Apart from the loans for IGP, Grama Vidiyal provides Festival Loans and Education Loans to its clientele.
- *Compulsory Savings*: Members contribute an amount of Rs. 10 per week during repayment of the first loan and this amount increases over time based on the size of loan. The main purpose of compulsory savings is to allow members to develop a regular savings habit and create assets of their own. In addition saving balances help to repay loans in cases of default.
- *Insurance:* Life insurance is offered in collaboration with mainstream companies such as Bajaj Allianz, AMP Sanmar, Max New York Life. The insurance policy provides a cover of Rs. 20,000 ($440) in case of death. Currently, 80% of the members are insured.

- ***Pension/Social Security Scheme for members***

Before setting up a new center with 20 eligible clients, ASA carries out an initial survey to identify eligible clientele, ensuring there are enough poor households in the area to form a full center. The criteria used in this survey are both qualitative and quantitative:

- Secondary Data Collection from Government offices
- Sixteen-point housing index (size of building, condition of structure, roof material, wall material, etc.)
- Land holdings of less than 0.5 acre of wetland or 1.5 acres of dry land
- Wealth ranking: annual income of the household should not exceed Rs.18,000 (US$ 391)
- Member should be living in the same area where the centre is to be committed (member should have been living there for a minimum of three years)

Once target clients are identified, a Compulsory Group Training (CGT) for five days is conducted to create a culture of credit discipline and to ensure that all members understand the programs and background. Groups (five women) and centers (four groups) are formed during these sessions among the women that show commitment and continued interest. ASA's rules for group formation include:

- A group must consist of 5 self chosen members
- All group members must be from the same village
- A group shall be formed with likeminded women, and are in similar economic condition and enjoy mutual trust
- There shall be no more than one member from the same household in a group. It is also not desirable for close relatives to be in the same group
- As each group is formed, it elects its own leader among the members. Four groups federate to form a center, headed by center leader[2]

Before being able to apply for loans, new groups have to pass a Group Recognition Test (GRT), where the Branch Manager or Field Manager tests the eligibility and readiness of group members to join the program. It is necessary that all group members pass the GRT to become recognized members of ASA.

3.2 CASHPOR Micro Credit (CMC)

CASHPOR is a network of Grameen Bank-type Micro Finance Institutions (MFIs) throughout

Asia.[3] Cashpor Financial and Technical Services (CFTS) is a MFI that began its micro-lending program in Uttar Pradesh, India in 1996. After being advised by the Reserve Bank of India to discontinue its micro credit business in November 2003, CFTS transferred its entire micro credit portfolio to Cashpor Micro Credit (CMC), a section 25 company under the Company Act of 1956.[4]

CMC seeks to achieve a significant reduction of poverty throughout Asia by providing financial services to poor households. Its mission is to provide financial services to large numbers of poor women throughout Asia in a timely, honest, efficient and financially sustainable manner.

CMC has gone from serving 27,760 clients as of December 2003 to roughly 73,000 clients as of July 2005. It currently has 7 districts in operation, with expansion plans for 3 more in the near future. Cumulatively the organization has loaned its clients almost Rs. 112 crore ($25.5 million) at a recovery rate of 98.3%.[5]

3.2.1 Targeting and Qualification Requirements

CMC only targets the "hard-core poor." Much care is taken in identifying at the village-level the poorest villages and households. Instead of traditional indicators, CMC uses sources of household income, number of wage earners, and value of productive assets owned to measure poverty levels.

The number of poor households in a village is determined by use of the Cashpor House Index (CHI). Each house in a village is assessed systematically based on its structure and materials. Large houses made of brick or concrete and having re-enforced concrete or tile roofs that are unlikely to contain poor households are excluded. Small houses made from inexpensive materials and not having a permanent roof, that is houses that score of three or less on the CHI are listed. The whole village is covered in this way, and the number of potentially poor households is determined. If this number is forty or more, the cost-effective process of targeting of the poor households can commence.

To ensure that CMC is reaching the very poor households (VP), they must be distinguished from the Moderately Poor (MP) and the Non-Poor (NP). The following are the criteria for each category:

- Very Poor (VP): most household income from traditional sources, such as agricultural labor & no more than 2 earners & productive assets <Rs.5,000
- Moderately Poor (MP): have added self-employment as an income source, and at least 2 earners & productive assets valued between Rs.5000 & 35,000
- Non-Poor (NP): salaried work or large remittances or >3 income earners & productive assets >Rs.35,000.[6]

3.2.2 Service Delivery Approach and Financial Products

CMC exclusively targets the poor women using a modified Grameen approach. All clients are required to attend weekly meetings and adhere to the requirements of CMC credit discipline. Clients may receive the following types of loans:

- Income Generation Loans (Rs. 1,000 to Rs. 14,000)
- Emergency Loan (Maximum Rs. 1000 for 25 weeks)
- Marriage loan (up to Rs. 8000 but not widely utilized)

3.2.3 Creating Credit Discipline[7]

CMC has identified the following as important determinants of credit discipline:

1. Cost-effective identification of poor women in their villages
2. Client training that emphasizes the importance of the verbal contract
3. Group Recognition Testing that ensures that clients know and trust each other
4. Insistence on timely attendance at Center meetings, and proper seating among clients
5. Opening and closing meetings with the client and staff pledges
6. Unanimous approval of loan applications by the Center: this authority for the Center goes along with collective responsibility for full and timely repayment of the loans it approves
7. Loan utilization checking by the Group Chairperson, Center Chief and Field Staff; experience is that if loans are not properly utilized repayment is likely to be affected adversely
8. Under the No Cash Policy, if there are any arrears, there will be no further disbursement, until they are cleared

4. Main Findings

4.1 What are the sizes of the loans? How are they being used?

4.1.1 Size of Loans

Both ASA and CASHPOR offer loans ranging from Rs. 3,000 to Rs.10,000, repayable in 50 weeks at a weekly interest rate of 12%. In the case of ASA, first time clients can only access loans worth 3,000 or 4,000 Rs, while clients at CASHPOR had access to first loans as high as Rs. 8,000. In both cases, loan sizes increase gradually as cycles are completed. The maximum loan at ASA and CASHPOR is Rs.10,000 and Rs.14,000 respectively. Until 2003, a housing loan worth Rs 35,000, repayable in 160 weeks was available from Asa. Although housing loans are no longer being offered, some clients are still in the process of repaying their housing loans.

Clients covered in this investigation have completed 0 to 10 loan cycles and their current loan sizes range from Rs. 3,000 to Rs. 15,000 (35,000 if we include housing loans). The average loan amount for the 105 women interviewed was Rs. 7,117 (Rs.7,698 including the two housing loans).

As seen in Table 2, loan amounts tend to start small and increase consistently as new loan cycles begin. This is in part due to the rules set by the MFIs but also due to initial apprehension of the clients, who sometimes fail to borrow the maximum amount allowed by the MFI.

While most clients increased their loan size from one cycle to the next, they did not always borrow at the maximum level set by the institution. At least 40% of clients borrowed the same amount or less when going from the second cycle to the third. This dynamic also exists when moving into higher loan cycles. Such behavior explains why the increase in average loan cycles decreases as we move into higher cycles. Reasons for decreasing marginal loan increases include risk aversion, lack of concrete plans for expansion and uncertainty in beginning new businesses.

Another trend with loan sizes was that they were relatively uniform within the groups of five members. In 37% of the groups, all members were borrowing the same amount of money and 80% of the groups had a difference of Rs. 3,000 or less between the member with the largest and smallest loans.

4.1.2 Types of Activities

The most common use of loans can be classified into the following broad categories:

While most villages had a varying number of activities within the groups, some villages specialized in particular activities. This was true for production activities such as quarry business, carpet weaving, gem cutting and animal husbandry. A large branch variation in activities is evident when analyzing aggregated loan data. In the case of Cashpor, 53% of the total loans outstanding in Rajatalab have been taken for “production” purposes. This percentage equals 27% in Maharajganj and only 7% in Chaubeypur. Other activities such as trading or transportation are found throughout all villages interviewed. *(Ref: Table 3)*

As demonstrated in Table 4, production is the most common loan usage for CASHPOR clients followed by animal husbandry and trading. The fact that most Cashpor surveys were carried out in Rajatalab may explain why the data is biased toward production. The regional nature of this activity implies that sari or carpet weaving is the main productive activity for CASHPOR clients. In the case of ASA, production activities are the most common, followed by trading and then consumption. Such differences can easily be explained by regional differences, specialization and different contexts.

Despite the fact that both institutions claim that loans should only be taken for productive purposes, Table 4 shows that consumption plays a non-trivial role. ASA clients used consumption loans mainly to pay for children's education or to repair their houses, while CASHPOR clients mostly used them for wedding purposes.

Given the preponderance of using loans for consumption, perhaps a loan product targeted directly at weddings, education or medical emergencies could be a valuable asset to clients. CASHPOR used to offer a marriage loan of Rs. 7,000, but it was recently discontinued due to complicated payment terms and reported misuse leading to high default rates. In this case, improved product design and oversight may afford the opportunity to better meet the consumption needs of clients.

Table 5 shows that although trading and production are the most common activities in the initial loan cycles, clients diversify and tend to increase spending in animal husbandry, purchase (or lease) of agricultural land and even consumption. Over time, this may be due to the limited scalability of production and trading activities. Once these activities have reached maximum capacity, considering the availability of labor or physical capital, clients choose to allocate additional loans to other activities, rather than hire outside labor or rent more physical space. Such behavior can result either from a desire to diversify risk, a lack of know how, limited ambitions or lifestyle choices.

4.1.3 Uses of loans

Comparing the client's business activities before and after receiving microfinance, it seems that loans have a significant effect on the household's business activities and productive capacity. As a broad categorization, clients utilized their loans in one of the following ways:

a) To move into a more profitable or convenient activity

b) To scale up or increase capacity for the same activity

c) To purchase the necessary assets to conduct same work on their own (instead of working for another person)

d) To fulfill consumption needs

4.1.3.1 Changed Activities (55/105 respondents)

The most common usage of microfinance loans was as a catalyst to move into an activity that the client presumes to be more profitable. Nearly 52% of responding clients utilized the loan for this purpose. In most cases, clients went from less profitable and more labor intensive activities to activities with higher returns and a more comfortable lifestyle. For example, nearly 48% of CASHPOR clients changing activities discontinued work as an agricultural or construction laborer to move into animal husbandry, trading or production.

Many times this decision was primarily influenced by lifestyle considerations, rather than an increase in income. In poorer households, having a buffalo or cow at home was usually enough incentive to remain at home and care for the house and children, while attending to the needs of the animals.

In some households, the loan purpose was to provide the client with a productive activity that could be done in the confines of their home. In these cases, clients' activities augmented from household duties to generating some income. A typical example of this was a client that stayed at home that bought a sewing machine or buffalo to add to their activities.

In general, when changing business activities, the loan was used to purchase the primary physical asset necessary to move into a new activity. For trading activities this meant a pushcart or inventory of goods; and for production this included a loom, flour grinder, sewing machine or gem cutting machine. In most cases, loan amounts were high enough to afford these assets and no further borrowing was necessary.

4.1.3.4 Scaled up of Same Activity (28/105)

Nearly 27% of responders utilized loans for the same activities they were doing prior to microfinance. These were clients who already possessed physical assets to conduct a profitable activity. In these cases, the loans were used to scale up such activities and add necessary capacity for growth.

Some common investments included the purchase of additional sari and carpet looms for production, expansion of inventory for trading or hiring additional laborers to increase capacity.

4.1.3.5 Same Activity but on own Assets (16/105)

In an effort to increase personal autonomy and reduce exposure to risk, roughly 15% of responding clients utilized microfinance loans to purchase the necessary physical assets to conduct the same business utilizing their own inputs. Instead of renting a pushcart, gem machine, store space or agricultural land, the client was able to afford the asset themselves. By accumulating such assets, clients can reduce their exposure to loss in case of adverse business cycles and capture the full revenue of their production, without an employer as an intermediary. Also, such assets can be used for rental purposes in the future.

4.1.3.6 Consumption Purposes (6/105)

Almost 6% of the loans were used for consumption purposes. The primary expenditures in this case were home repairs, children's education and daughter's marriage. Such purposes varied by MFI. CASHPOR clients almost exclusively utilized consumption loans for daughter's weddings, while ASA clients utilized primarily for home repairs and children's education.

4.1.4 Loan Recipients

Although the loans are meant to promote activities carried out by the clients, it was not uncommon to find that some loans went to support husband's or children's businesses, without directly affecting the activities of the client.

Additionally, many times business are run by both the wife and the husband, as is the case in most of the kirana shops, or they have a certain division of labor where the husband weaves the carpets while the wife rolls the yarn and packages the carpets. These businesses have been classified as *"family businesses."* Animal husbandry has been classified as "*client business*" since it is mainly the client's responsibility to care for and milk the animals.

Table 6 shows the use of loans by different family members.[8]

In the case of CASHPOR, 45% of the loans were for client's businesses (mainly animal husbandry), and 25% were used to support family businesses (primarily sari and carpet weaving). 17% of the loans were used for exclusively husband businesses' such as trading and transportation using pushcarts. Finally, 13.7% of the loans were used for children's businesses, education or weddings.

Each loan is usually used only for one business, whether it is to support the husband, the son or the client's business. However, it is common for clients that have gone through several cycles to use some of the loans for the husband's business and others for the client's.

As demonstrated in the table, a higher percentage of loans were used for clients' businesses at ASA than CASHPOR, while fewer loans went to family businesses. Additionally, the same percentages of loans were destined for the husband's and children's activities at ASA (15.7%) which are also similar to the percentages found in Cashpor (16.4% for husband and 13.7% for children).

4.2. How do borrowers select their micro enterprises?

While the investment activities employed by clients varied greatly by branch and MFI, the selection process and sources of ideas were quite similar. Each branch had a majority of clients participating in one of five or six low-risk, low value added activities that were influenced by family members, friends or other villagers.

Considering the homogeneity of the enterprise selection process, clients did not generally demonstrate much innovation or entrepreneurial spirit.

The primary factors affecting enterprise selection were:

- Perceived profitability
- Perceived risk level and seasonal variations of activities
  - o Activities with high seasonal variation were less desirable
- Amount of education, experience and skills
  - o Skilled clients tended towards higher value-added activities
- Surplus of household labor
  - o Emphasis was placed on having all able family members participating in a productive activity
- Lifestyle impact
  - o Clients chose activities based on location, level of manual labor, transportation costs and convenience
- Emergency or urgent consumption needs

4.2.1 Sources of ideas

Business ideas came from a limited set of individuals. In general, much imitation was observed. The particular sources of ideas included:

- Village or regional specialization
  - o Limited number of acceptable activities allowed in group
- Caste specialization
  - o Eg. Yadow is animal husbandry caste
- Imitation of observed activity
- Family business for generations
- Influenced by friends, husbands and group/center leaders
- Knowledge from previous training or job experience

4.3 Business innovation and failures

4.3.1 Innovation

While most clients used their various loans for different purposes, those purposes were limited to five or six different activities across the village. Due to the predominance of such few activities, it was easy to identify clients with significant entrepreneurial spirit. Of all clients interviewed, only 5 out of 105 demonstrated some entrepreneurial spirit, in the sense that they have begun businesses that are different than traditional activities chosen by most other members. Innovative ideas included:

- Making soap
- Selling waste cloth from a cotton fabric to hardware stores
- Differentiating flower shop and acquiring new products
- Making bead necklaces
- Opening up a wedding planning service that rents tents, mattresses, cushions, electric generator, etc.

4.3.2 Failures

Roughly 16% of clients responded having experienced a business failure, where they tried some sort of business and had to close it after some time. All failed businesses were in the trading sector and constituted some kind of shop.

The reasons for failure included:

- Increase in competition from other villagers
- Illness leading to low availability of labor
- Poor financial management skills and selling goods on credit

4.4. What is the ROI of the different activities?

Acquiring accurate financial data proved challenging as clients either had limited understanding of their financial situation or incomes were too inconsistent throughout the year to generalize.

Specific complications derived from client's limited understanding of business concepts and confusion in distinguishing between revenues, profits and savings. Additionally, many clients relied on their husbands or sons to manage the household finances, not taking an active role in the day-to-day management of such matters.

Other complications in acquiring valid financial data came from the fluctuations and variability of household incomes. Clients found it hard to estimate average costs or revenues when revenues varied greatly by seasons, weather or availability of essential inputs. It was also common for family members to change activities throughout the year as well as maintain multiple business activities simultaneously. In such cases, it was difficult to get disaggregated financial information for specific activities as the various businesses were so intertwined.

When determining the returns to their business activities, all clients failed to account for the opportunity cost of their own labor or family labor as a cost of production. This might have to do with the fact that many clients were not working before obtaining microfinance and therefore the opportunity cost of their labor is effectively zero. However, opportunities for daily wage labor exist in the villages and therefore the opportunity cost of labor needs be taken into account in order to measure the actual return on investment.

4.4.1 Characteristics by Activity

4.4.1.1 Weekly Profits by Type of Activity

The average weekly profit for all clients interviewed was Rs. 707 per week, but ranged between Rs. 25 and Rs. 3,000. As these numbers show, there are large profit variations among clients and averages are highly influenced by the presence of outliers. Thus, when excluding outliers, the average for ASA was Rs. 435 per week and Rs. 408 per week for CASHPOR.[9] *(Ref: Table 7)*

Aside from the difficulties previously mentioned regarding the financial data, some general conclusions can be drawn. In general, transportation and construction had the highest returns within the sampling of clients. Both these activities are predominantly male activities, done by the husbands or sons.

Production and trading yield similar results in terms of average income generated, although trading is subject to less seasonal variation. Thus, it is not surprising that a large percentage of the loans were used for kirana shops, vegetable shops or other kinds of trading as such activities involve less risk.

Some of the activities undertaken have very low value-added and therefore generate minimum returns. Examples of this are flour grinding and flower tying, which are popular among women without specific skills. Such businesses are not scaleable and have limited room for growth. Often such activities are chosen because of their low skill requirements.

Since microfinance enables clients to enter into new businesses, it is reasonable to expect that some markets may see a large increase in supply leading to negative externalities. Many CASHPOR clients weaving saris commented on the decline in profitability of their businesses. Multiple clients indicated that the returns per sari had decreased by as much as 60% in the past 5 years. The saturation of the sari producing market, as well as the introduction of the power loom, has apparently led to lower margins and forced many clients out of the business. Those that stayed in the business claimed to have no other skills to leverage.

The issue of market saturation or decline in profitability of certain businesses should be considered as a negative side effect of micro credit. If clients in such businesses fail to find alternative businesses opportunities, given their skills or capital constraints, perhaps the MFIs can help this process by providing training or linkages to accessing outside markets. For example, MFI's may help clients weaving saris move into other markets or products requiring similar skills and resources.

4.4.1.2 Variance throughout the Year

According to client responses, those doing agriculture and animal husbandry experienced the most seasonal variation in income. While most of the variation was predictable, due to monsoons and animal mating seasons, unpredictable events such as illness or death to animals did occur. Clients doing certain forms of production (gem cutting, tailoring), transportation and trading (tea shop, veg shop, kirana) saw little variance throughout the year, except in case of electrical power cuts in villages.

At the same time, other forms of production (sari and carpet weaving) experienced significant variance throughout the year. Such variance was primarily due to low availability of labor in harvest and festival seasons as well as the harmful effects of humidity and moisture from the rainy season. Activities such as tailoring and flower selling peaked during festival seasons.

The fact that 67% of responders identified variations in their regular income is of great importance to microfinance schemes based on regular weekly repayments. Many clients not experiencing a default mentioned "having a steady income" as one of the main reasons for non default. Closer analysis of the businesses that fluctuate can lead to better understanding of client income cycles and allow for more appropriate repayment schemes that adapt to this reality. Another alternative is for MFIs with compulsory saving schemes to allow their clients to withdraw from these accounts during lean season, when repayment is made more difficult.

On the other hand, a regimented credit discipline scheme is thought to be essential for microfinance to be sustainable. Without standardized procedures, both transaction costs and the potential for defaults may increase. Further research is necessary to better understand seasonal risks assumed by MFIs and ways to implement flexibility into repayment schemes, including prepayment, to mitigate exposure to such risks.

4.4.5 Size of Businesses

As a result of large family size and the availability of family labor, nearly 70% (66/95) of client's current business activities received some form of assistance from another family member.

In contrast, only 18% of enterprises hired outside employees. In many cases the hiring of outside employees was not for an extended period of time. Rather, 39% of clients hiring employees did so specifically for harvest time or seasonal increases in demand.

Given the scarcity of outside employment opportunities, most clients used family labor (even in-laws or parents) as a substitute for outside employees. In general, family labor is seen as more trustworthy and less of a financial burden.

The size of client's business activities was typically quite small. Only 5% (5/100) had 5 or more employees. The larger enterprises were concentrated among clients with productive assets before receiving microfinance, which used the additional capital to increase capacity. Examples include sari and carpet weavers with multiple looms, larger land-owners or husbands doing construction work.

4.4.6 Debt Situation

With the availability of microfinance, there was a decline in the number of clients with outside debt in the sample. Only about 10% of clients admitted to having outside debt, while nearly 18% said that they had debt before microfinance. In some cases the first loan from ASA or CASHPOR was used specifically to payoff this debt from money lenders.

All clients that acquired outside debt in addition to their microfinance loans used it for consumption or emergency purposes. Some particular reasons for taking the debt include daughters' wedding, house construction, children's education or family illness.

While ASA and CASHPOR clients have been less dependent on outside sources of debt since receiving micro finance, there is still a need for quick loans that can fulfill emergency or consumption needs.

4.5. Do clients follow a long-term investment strategy?

4.5.1 Planned Activity for Next Loan

When asked whether they expected to take a new loan in the following cycle, 88% of respondents said yes, and provided a concrete amount they wanted to borrow, ranging from Rs. 3,000 to Rs. 50,000. Only 2% said they did not want to borrow again, and 9% said they were "undecided".

Responses to questions about forward looking activities and loan cycles demonstrated a lack of investment strategy. Almost 10% (9/95) of responders had not thought about the next cycle and could not conceive of a use for the next loan. Evidently the burden of the weekly payments as well as income fluctuations hindered their ability to plan for the future.

The most common responses to future loan plans included scaling up current activities, expanding inventories for kirana shops, and increasing capacity for the production of saris and carpets. Only one client responded with a clear strategy on how to spend the next three loans.

4.5.2 Size of next loan

The size of the next loan varied according to the size of the current loan and the number of loan cycles completed (these two variables are highly correlated, 0.73, since loans get bigger as cycles progress.) The clients planning on borrowing the largest loans in the next cycle all had matured through a minimum of 5 cycles. Such willingness to borrow at high levels may demonstrate a level of confidence that clients acquire over time. When controlling for current loan size (or the cycle number), neither the MFI nor the type of activity had a statistically significant effect on the amount the clients wish to borrow next. Table 8 shows the results of the regressions.

Most clients (48%) answered that they wanted the next loan to be Rs. 1,000 - Rs. 3,000 higher than the current loan. 20% wanted a next loan that is Rs. 4,000- Rs. 6,000 higher, while 14% were planning on a loan that is Rs. 7,000 higher or more. Also, 18% wished to take a next loan that was equal to or smaller than their current borrowing amount. Graph 1 illustrates the relationship between the current loan amount and the desired size of the next loan.

4.6. What are the main constraints faced by clients for scaling up a business or starting a new one?

In order to better understand the primary constraints faced by clients, they were asked whether or not they would be doing a different enterprise if they were given training or additional resources.

4.6.1 Training

Nearly 31% of all responding clients said they would be doing a different activity if they had access to training, while 69% said they would not. When asked what kind of training they desired, 63% said they "had no idea, but were willing to try something new." In other words, they demonstrated no business ideas or strategy, but desired something other than their current work. The second most popular response was to have training to open a kirana or other type of shop. Other types of training included basic reading, writing and math skills to manage the shop.

The clients not wanting training cited the following reasons:

- No time available to receive training
- No interest in a new business
- Can't think of any relevant training they desire
- Women are limited to certain activities in their villages
- Uneducated and unable to acquire skills
- Husbands won't let them
- Happy with current activities and lifestyle

4.6.2 More Money

Similar results were found for clients desiring additional money. Nearly 43% said that they would change their activity, while 57% said they would not. Of those wanting to change their activity, 22% said they had no idea of the activity they would move into and 37% said they would move into some form of trading such as grocery, tea, paan, or kirana shops.

Only 22% of clients, when prompted, were able to identify a specific amount of money they needed to conduct such activities. In most cases, these were round figures that did not represent accurate estimates of actual costs of such activities.

4.7. Further Research

In analyzing the results of this investigation, several themes emerged which would benefit from further research.

Based on the data on loan sizes across cycles, it is evident that clients are not always borrowing at the maximum levels allowed by the institution. If the presumption is that the clients are credit constrained, it should be expected that clients borrow at the maximum level. Particular research questions include:

- Why are clients not borrowing at the maximum level? Is it due to risk aversion? Lack of investment strategy? Lack of ideas? Prohibitive interest rates? Not enough repayment capacity? Lack of outside labor?

Such research is important for the opportunity it brings of raising the scale of the MFIs.

In reference to the sequential use of loans and tendency to move away from production and trading over the loan cycles, research should be oriented towards better understanding this trend.

- Are clients moving away from scaling up their original businesses due to constraints that cannot be overcome even with microfinance?
  - o Distrust in hiring outside labor?
  - o Capital constraints?
  - o Lack of ambition or unwillingness to disrupt lifestyle?
  - o Lack of training or skills?
- Is such behavior a rational way of minimizing risk by diversifying activities?
- Do they use later loans for consumption to improve quality of life?

As demonstrated by the small size of client enterprises, clients almost exclusively utilize family labor rather than hire outside labor (except in the case of agricultural labor). A further look into the labor market may illuminate some of the reasons preventing clients from hiring outside labor and therefore scaling up their businesses.

Regarding the activity selection process, it became clear that microfinance clients choose their enterprises on the basis of what they have previously been doing, or what people around them do. Among the limited number of options available to each, the determining factors have to do with profitability levels and lifestyle choices (choosing something they can do from their own home).

Given the threat of potential market saturation and overexposure of MFIs to shocks in particular sectors, it would be interesting to analyze alternative business possibilities, and ways in which clients can be encouraged or assisted in diversifying their businesses. For example, if clients were given training or were exposed to new ideas, would we observe less imitation behavior?

Also, considering the low value added and low profitability nature of most clients' activities, research should address potential opportunities to move clients towards more innovative and higher value added activities.

Given the difficulties that were found in assessing quality financial data, more detailed inquiry into the financial aspects of various business activities should be undertaken to properly understand actual rates of return on investment for the different activities. This would involve obtaining more precise information on revenues, input costs, labor costs, opportunity cost of labor and cost of capital.

Finally, given the seasonal variability of many clients' income and the relationship between income fluctuations and repayment possibilities, perhaps there could be some benefit obtained by establishing flexible repayment schemes that respond to various business cycles, seasonal variation or savings schemes. Although repayment has yet to present a serious problem, higher flexibility in repayment schemes will better address clients' needs and minimize MFI exposure to negative external shocks.

Annex I: Questionnaire

Date of Interview:
Name:
Client ID:
Center Name:
Branch:
MFI:

Joint Liability

1.1 When did you receive the first loan from the Bank/MFI?

1.2 How many loan cycles have you completed?

1.3 How have you spent the past loans? How much? Your business or your husbands?

1.3.a Cycle 1:

1.3.b Cycle 2:

1.3.c Cycle 3:

1.3.d Cycle 4:

1.3.e Cycle 5:

1.4 What amount are you currently borrowing?

1.5 What amount are you currently saving per week?

2. Screening

2.1 Did you know ALL the other members of the group before forming the group?

2.2 How did you chose the members in your group?

2.3 Did you know about group members income levels and sources before joining the group?

2.4 Did you know about group members debt levels before joining the group?

2.5 Do you know what activities group members plan to do before joining the group?

2.6.a Has your group always been the same?

2.6.b How many members have changed? Why?

2.6.c If a new member had to join the group, how was that member chosen?

3. Monitoring

3.1 Do you know ALL group members activities and how much in loans they have?

	Name	Loan Amount	Purpose
3.2.a			
3.2.b			
3.2.c			
3.2.d			

3.3 How often do you talk to group members outside meetings about your business? When?

3.4 Do group members visit each other's businesses to ensure they are working?

3.5 Who is responsible to visit other group members businesses? (member or group leader)

3.6 Why was your group leader chosen?

3.7 What responsibilities does the group leader have?

4. Enforcing

4.1 How many times has a group member defaulted on a weekly payment?

4.2.a If Never, what would happen if someone defaulted?

4.2.b Why do you think nobody defaults?

4.3.a If Yes, what happens when someone defaults?

4.3.b Are the defaulting members usually the same?

4.3.c Have you removed a defaulting member from the group after completing the loan?

4.3.d Why or why not?

5. Maturing into larger loans

5.1.a How much is the max you would be willing to borrow?

5.1.b Why?

5.2 How much is the max you would be willing to guarantee for other group members?

5.3 Does this vary for different group members? Why?

5.4 Which activity would you absolutely not support for other members?

5.5 Given the same repayment schedule and interest rate, would you rather have group or individual lending? Why?

Microenterprise

6. Current Investment Activities

6.1 What were you doing before you obtained microfinance lending?

6.2 What type of enterprise do you operate now?

6.3 How long have you been doing this enterprise?

6.4 Why did you choose this enterprise? Or why did you change activities if you did?

7. Financial Status of Enterprise

7.1.a Do you have any debt other then the MFI?
7.1.b Who did you borrow from? Why?
7.2 How many family members help you with your business? Which ones?
7.3 Do you have paid employees?
7.4 How many hours do they work per week?
7.5 How much do you pay them (a week/a day/per hour)
7.6 What material inputs are necessary for your enterprise? How much do you spend on them per week?
7.7 How much are your total costs per week?
7.8 What are your average revenues per week? (or day)
7.9 What is your estimated weekly profit?
7.10 Does this vary through the year?
7.10.a If yes, what have caused these fluctuations in the past?

8. Characteristics of the Value Chain

8.1 Where/who do you buy your inputs from?
8.2 Do you buy from one supplier or several?
8.3 Who do you sell your output to?
8.4 Who determines the price of your good or service?
8.5 What does your buyer do with the products?
8.6 Is your buyer willing to buy more of your product?

9. Investment Strategy and Scaling Up

9.1 Do you expect to take another loan? How much?
9.2 What will you do with your next loan? Scale up current business?
9.3.a If you were given training, would you rather be doing a different enterprise?
9.3.b Which one?
9.4.a If you were given training, would you rather be doing a different enterprise?
9.4.b Which one?
9.4.c. How much more money would you need?

10. Sources of Alternative Business Ideas

10.1 How many different business ideas did you try?
10.1.a Which ones?
10.1.b Why did you pick them?
10.2. Have any of your ideas failed in the past?
10.2.a. Which ones and why?

Annex II: Classification of loan activities by recipient family members

Recipient Family member	Loan activity
Client	Gem cutting Quarry Business Tailoring Grinding Flour or Rice Flower Business Candle making / glass painting Animal husbandry Kirana shop / Tea shop / Vegetable shop
Family	Agriculture Kirana shop / Tea shop / Vegetable shop Sari and Carpet weaving House construction /repairs
Husband	Construction work (centering work, painting) Van / rickshaw driver Pushcart
Children	Education Weddings Gem cutting Mechanic Shop Rickshaw

References

1 ASA-GV internal powerpoint presentation

2 http://www.asadev.org/MFP

3 http://www.cashpor.org/about/

4 http://www.gfusa.org/programs/partners/cfts_cashpor/

5 CMC Internal PowerPoint Presentation (7/9/2005)

6 CASHPOR India Group Operating Manual

7 CASHPOR India Group Operating Manual

8 Responses were not self declared. See Annex II for classification of beneficiary by loan activity.

9 Outliers declaring less than Rs. 50 or more than Rs. 2,500 per week were removed from the sample for these calculations.

10 In the regressions, the excluded MFI category is Cashpor and the excluded activity category is production.

Table 1: Branches Covered in the Investigation

MFI	Branches Covered
ASA - Grama Vidiyal	Chozan Nagar, Kattur, Kovil Patti, Manikandam, Somarasampettai, Srigangam
CASHPOR Microfinance	Maharajgang, RajaTalab, and Chaubeypur

Table 2: Mean Loan Amount by Lending Cycle

	Mean Loan Amount	Obs
Cycle 1	4,584.6	65
Cycle 2	6,238.1	63
Cycle 3	7,463.4	41
Cycle 4	8,350.0	20
Cycle 5	9,615.4	13
Cycle 6	8,000.0	6
Cycle 7	10,000.0	8
Cycle 8	7,500.0	2

Table 3: Categories of Activities

Agriculture	Buying land, leasing coconut fields, agriculture
Animal husbandry	Buffalo, cow, goat
Construction	House painting, centering work, electricity
Consumption	House repairs/construction, cancellation of previous debts, children's education, weddings
Production	Carpet weaving, sari weaving, sewing machine, gem cutting/polishing, quarry
Trading	Grocery shop, vegetable/fruit selling, tea shop, petty shops, cloth selling, flower selling
Transportation	Auto rickshaw, bicycle rickshaw, pushcarts

Table 4: Loan Usage

	ASA	**CASHPOR**	**Total**
Agriculture	8.4	1.5	5.4
Animal Husbandry	11.8	29.2	19.9
Construction	9.6	0.0	5.4
Consumption	14.0	6.6	10.7
Production	24.2	31.4	27.1
Trading	20.8	24.1	22.1
Transportation	11.2	7.3	9.5
Total	**100.0**	**100.0**	**100.0**

Table 5: Loan Usage by Lending Cycle

	Loan Cycle 1	**Loan Cycle 2**	**Loan Cycle 3**	**Loan Cycle 4**	**Loan Cycle 5-8**
Agriculture	0	4.6	9.1	12.9	10.3
Animal husbandry	19.2	15.9	16.4	22.6	33.3
Construction	3.9	5.7	5.5	6.5	7.7
Consumption	6.7	9.1	18.2	12.9	12.8
Production	35.6	28.4	21.8	19.4	15.4
Trading	27.9	27.3	16.4	16.1	7.7
Transportation	6.7	9.1	12.7	9.7	12.8
Total	100.0	100.0	100.0	100.0	100.0

Table 6: Loan Beneficiaries

	CASHPOR	ASA	TOTAL
Client	45.3	55.1	50.8
Family	24.5	13.5	18.3
Husband	16.5	15.7	16.1
Children's:			
Education	0.0	7.3	4.1
Business	7.9	7.3	7.6
Weddings	5.8	1.1	3.2
Total	100.0	100.0	100.0

Table 7: Weekly Profits by Activity

Activity	Frequency	Average Weekly Profit	Median Weekly Profit	Minimum	Maximum	Sources of Income Variation
Agriculture	5	Rs. 272	Rs. 250	Rs. 175	Rs. 375	Seasonal and weather variations
Animal Husbandry	10	Rs. 316	Rs. 258	Rs. 100	Rs. 500	Weather, health of cattle, reproductive cycle of cattle
Construction	3	Rs. 1500	Rs. 750	Rs. 750	Rs. 3000	Less work during rainy season
Production	40	Rs. 543	Rs. 375	Rs. 30	Rs.3000	Rainy season, festival season, availability of electricity, labor supply
Trading	19	Rs. 520	Rs. 300	Rs. 25	Rs. 2760	Festivals
Transportation	4	Rs. 943	Rs. 735	Rs. 500	Rs. 1800	Little variation

Table 8: Dependent Variable: Size of Next Loan[2]

	Regression #1		Regression #2		Regression #3	
	Coef.	T - Stat	Coef.	T - Stat	Coef.	T - Stat
Size of Current Loan	1.5039	8.59 (*)			1.067911	5.26 (*)
Number of Cycles			3383.334	6.88 (*)	1845.139	3.48 (*)
MFI (1=ASA)	2619.5	1.61	985.4762	0.56	1421.386	0.93
Agriculture	-8336.5	-2.33 (*)	-8068.593	-1.95	-13270.2	-3.73 (*)
Animal husbandry	-2191.5	-0.95	-2196.847	-0.87	-2996	-1.41
Construction	-1259.9	-0.3	-4802.353	-1.03	-3177.22	-0.82
Trading	-1192.4	-0.68	-578.4452	-0.3	-659.809	-0.41
Transportation	495.84	0.09	1464.314	0.23	1614.926	0.3
Constant	-634.57	-0.35	783.5423	0.42	-2066.15	-1.2
Number of Obs.	64		64		64	
R-squared	0.6411		0.541		0.7058	
Adj R-squared	0.5962		0.4866		0.663	

Graph 1: Amount planned to borrow next and current loan amount