COMPARATIVE ANALYSIS OF MFI AND SHG-BANKING MODELS

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EXECUTIVE SUMMARY

Title: Comparative Analysis of MFI and SHG-Banking Models
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Objectives: This study explores the two delivery models of micro-financing by doing a comparative analysis of SHG and MFI models. It intends to examine the pros and cons of the SHG-Bank Linkage and MFI models and analyse it under the following aspects.

- Financial and non financial costs incurred by the clients in both the delivery models
- Loan utilization pattern in both the models
- Challenges faced by the two models

The study also tries to identify opportunities for further improving the effectiveness of the two models of so as to achieve the goal of micro-financing.

Scope of study: The overall scope of the study spans across microfinance at a macro level, though the study was done in ten villages of Chittoor district which were considered as representative samples. It is believed that reliable generalisations and learnings could be drawn about the two delivery models of micro-financing in the nation, based on the outcome of the study.

Methodology: The data collected by using a survey questionnaire constituted the major source of primary information. Purposive sampling was done so as to include the beneficiaries of both SHGs and MFIs in the study as the main intention was to compare the two models based on various aspects. Checklists were used to conduct focus group discussions and informal discussions with bank officials and subject matter specialists. Secondary literature review was done so as to develop a basic conceptual understanding about the functioning of the two delivery models.

Major findings: The financial cost of borrowing was found to be much higher in the MFI model with an average effective interest rate (EIR) of 44.92 percent p.a while the SHG loans had an average EIR of 21.56 percent p.a. Also, the psychological difficulties associated with servicing the debt were found to be much higher in the case of MFI loans. The only aspect in which the MFIs positively outscored SHGs was time required to process the loans. Operational efficiency of the MFIs makes 'on-the spot' disbursals possible. An alarming phenomenon that was found out was that the penetration of MFIs was causing credit discipline and disintegration within SHGs.

Suggestions: More credit needs to be supplied through the credit starved SHG system and a diverse array of financial services needs to be distributed through the SHGs in an efficient and flexible manner. Only then can the end goal of total financial inclusion be achieved. The MFIs in the country need to be brought under the ambit of government regulation so as to protect the interest of their clients and to check the malpractices that seem to be creeping into the system.

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List of Abbreviations

BC - Backward Caste

EIR - Effective Interest Rate

FDIC - Federal Deposit Insurance Corporation

IGA - Income Generating Activity

JLG - Joint Liability Group

MFI - Micro-Finance Institution

MFO - Micro Finance Ordinance

NABARD - National Bank for Agricultural and Rural Development

OC - Other Communities

RBI - Reserve Bank of India

SBL - SHG-Bank Linkage

SC - Scheduled Caste

SERP - Society for Elimination of Rural Poverty

SHG - Self Help Group

SHPA - Self Help Promoting Agency

SME -Small or Medium Enterprise

ST - Scheduled Tribe

VO - Village Organisation

1.INTRODUCTION

Access to financial credit is a requisite precursor to the progress and development of any nation in the world. The smooth flow of funds from the savers to the borrowers in an economy is an initial impetus that snowballs into the growth of a nation and the advancement of its people. Financial institutions which assume diverse forms and structures act as intermediaries in this flow of credit between a nation's savers and borrowers. But, when the majority of a country's population cannot participate in this flow of credit, the economy can be said to be financially constricted and the population, financially excluded. This is a stranglehold which could bind a nation's economy in a state of developmental deadlock.

It is hard to ignore the correlation between the level of financial inclusion and development of a nation. Consider the following figures in Table 1.

Table 1: Level of Financial Inclusion and Human Development Index

Nation	Percentage of Population that had Access to Credit from Commercial Banks (2008)	Human Development Index (HDI)
U.S.A	91.0 %	0.902
Germany	90.2 %	0.885
U.K	88.0 %	0.849
India	9.4 %	0.519

Source: Website of RBI and Federal Deposit Insurance Corporation,U.S)

Credit is receivable either through formal channels like banks and other financial institutions or through informal channels like moneylenders and acquaintances of a person. While formal institutions are always preferred and recommended over informal sources, the truth of the matter is that there exists a small yet unbridgeable gap in terms of convenience and expedience between the two which necessitates the existence of such an informal sector in even the most developed nations. The only issue is the level up to which such a sector has taken over in an economy. This would give a fair insight into the competence of the formal sector in servicing the credit needs of the people. In rural India, [1]the distressing fact is that 52 percent of the households have no access to credit, be it formal or informal. 30 percent of the rural households are serviced by informal credit sources while only 27 percent of the households avail credit facilities from financial institutions. There is an overlap of 9 percent which comprises the households that access both formal and informal sources for their credit needs. This essentially means that almost three fourth of the rural population have no means of accessing formal sources of credit.

These figures are alarming reminders of the fact that our nation still has a long and arduous path ahead in the pursuit of complete financial inclusion. There needs to be innovative vision and practical thinking in the conception and implementation of such efforts. Scaling up of existing financial institutions overnight is not a feasible and viable solution in our vast nation of more than 110 crore people. Newer and more pragmatic ideas need to be thought of to link the rural households with mainstream financial institutions. Micro-finance is one such approach that seems to hold tremendous promise and potential in ‘reaching the un-reached’.

1.1 The Concept of Micro-finance

Micro-finance is the provision of financial services to the poor who are otherwise considered un-bankable or credit-unworthy. Even though this idea has been around for quite some time, modern micro-finance really took off in the 1970’s with the activities of the Grameen Bank which were pioneered by Nobel Laureate Dr. Mohammad Yunus. The initial success of Grameen Bank in alleviating poverty brought this concept into the global limelight and has led to micro-finance being touted as a panacea for poverty and under-development across the world.

Micro-finance operates on the principle that a group of individuals is more bankable than a single individual. A group of individuals is more traceable to the lending institution and the peer dynamics within such a group would ensure compliance and credit discipline to a considerable degree. Also, in most cases, since the group is jointly made liable for the loan, the risk is mitigated on the lenders’ side due to the high improbability of the group defaulting as a

[1] Report of the Committee on Financial Inclusion, C.Rangarajan, 2008

whole. But, it needs to be kept in mind that micro-credit is disbursed without the requirement of any collateral security and the lender has nothing to fall back on, other than the intangible assurance of the borrowing group. Micro-finance is an umbrella term that includes micro-credit, micro-savings, micro-insurance and a host of other financial services. There is no hard and fast definition with respect to the maximum quantum of loan that can be qualified as micro-credit, although the widely accepted figure is $1000 (around Rs 45,000).

In India, micro-finance has evolved considerably and is mainly delivered through either of two models, namely the SHG-Bank Linkage (SBL) model, which was championed by the NABARD in the late 90’s and the Micro-Finance Institution (MFI) model which resembles the Bangladesh Grameen Bank model.

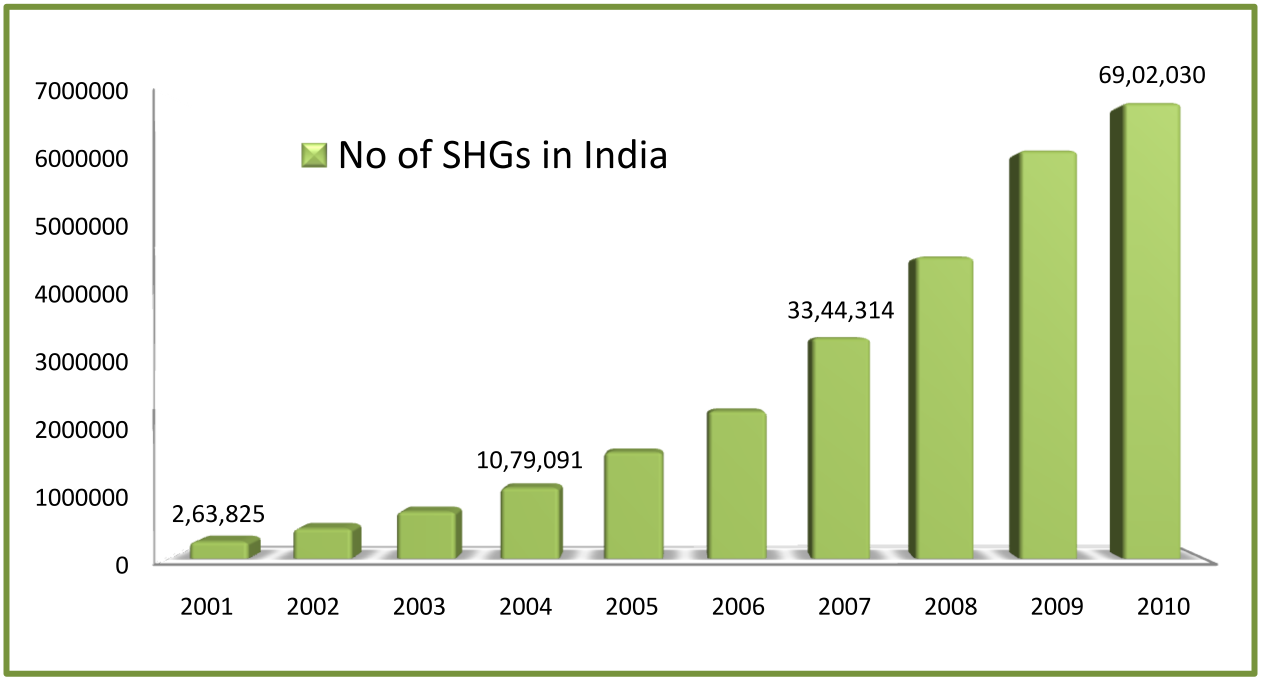
1.1.1 SHG-Bank Linkage (SBL) Model

The SBL model is a homegrown model of microfinance in India which was conceptualized and initiated by NABARD in 1996, when it launched nation-wide pilot projects to link the existing SHGs with banks. One of the major hurdles to this concept was overcome when RBI authorized the opening of bank accounts in the name of groups. Today, opening accounts in the name of SHGs is part of the regular operations in most banks.

According to NABARD, an SHG consists of an average of 12-15 members who are essentially from a homogenous economic or social class, who comes together to deal with common problems. Quite simply, as the name suggests, an SHG is a group of people who have congregated to help themselves. The group members rotate small pooled savings among themselves as loans within the SHGs. They keep the accounts of such transactions and when they become confident in themselves and their ability to handle larger volumes of credit, they approach banks for more sizeable loans. Such an SHG is effectively ‘linked’ to the banks, and thereby to the mainstream credit market of the economy. SHG’s are supported either by Governmental promotion agencies (for e.g. *Kudumbasree* in Kerala and SERP in Andhra Pradesh) or by a number of NGOs across the length and breadth of the nation.

In 2009 [2]there were over 61 lakh SHGs in India with a total savings of over 5500 crore rupees and outstanding bank loans to the tune of almost 23,000 crore rupees. The total client outreach of SHGs is well over 7 crore people, when it is considered that each SHG has an average of 12 members. The growth of SHGs in India in the past decade is represented in figure 1. The amount of loans given to SHGs by banks has also grown in tandem with the number of SHGs in the country.

Figure 1: Growth of SHGs in India



Source: Website of RBI and NABARD

Of all states in which the SBL program has been implemented, Andhra Pradesh and Kerala can be pointed out as the ones that have witnessed resounding success in terms of reach and scale. The SBL program in Andhra Pradesh boasts of scale and efficiencies that most other states cannot. The state also has the highest number of SHGs in India and has a significant share in the amount of bank loans disbursed to SHGs. The SHG movement in the state is promoted by the SERP, a state government agency that has been lauded very often for their success in poverty alleviation programs. There[3] are around 10 lakh SHGs in A.P which has a population of around 8 crore people. The normal size of an SHG is 12 members and the average household size in the

[2] Data obtained from www.indiastat.com
[3] Data obtained from the website of SERP, Andra Pradesh

state is 4.5. Through simple arithmetic, it can be seen that more than **5 crore** (60 percent) people in the state are associated with SHGs directly or indirectly, thereby making it a valuable and effective vehicle for any government to establish its popularity. This political leverage achieved through SHGs is one of the main reasons behind its successful existence in AP.

The SHGs in Andhra Pradesh have successfully formed a networked and federated structure in the form of Village Organizations (VOs), *Mandal Samakhyas* (Mandal Federations) and *Zilla Samakhyas* (District Federations) for the purpose of administrative ease and inter-SHG transfer of funds. This means that an average SHG member in A.P can source credit from three different sources- internal funds of the SHG, bank loans and loans from SHG federations. This imparts a much needed flexibility and brings in efficiencies to the SHG system in A.P which other states would do well to emulate.

1.1.2 Micro-Finance Institution (MFI) Model

Micro-finance institutions are organizations involved in the delivery of financial services to the population segment that is otherwise considered un-bankable. They may range from benign and socially responsible NGOs to profit-oriented NBFCs. There has been an explosive growth in MFI activity in India over the past decade as a plethora of NGOs and private organisations have converged into this field, some having the genuine intention of socio-economic advancement, while others cashing in on the 'fortune at the bottom of the pyramid'. There[4] were 237 MFIs operating in India in 2009 with a total client base of 2.66 crore people and a total loan amount outstanding of over Rs.18,000 crore.

MFIs generally source credit from donors, banks and other institutional sources to finance their lending operations. They may also provide other services like micro-insurance and remittance services to augment their product range. Due to the level of outreach any MFI needs, there is a high operational cost associated with them and this is transferred to the end client in the form of higher interest rates, making the borrowing of money from MFIs relatively costlier. Apart from the financial cost of funds borne by MFIs, they have to bear extra costs on agent salaries, social mobilization and day to day operations. This makes it imperative for the MFIs to

[4] Website of Sa-dhan, the Industry Association of MFIs

lend at interest rates over and above the market rates. Moreover, the regulatory authorities in the nation seem to accept this fact and hence have not imposed any strict interest rate restrictions on MFIs. This grey area of interest rates is one major reason behind profit oriented organizations being attracted to the micro-finance sector. It may also happen that organizations which started off with a genuine sense of social responsibility may experience a 'drift' in their mission and slowly slip into profit-oriented operations to ensure their continued growth.

MFIs, like SHGs operate on the principle of group lending whereby they form Joint Liability Groups where the liability of a loan lies with the group as a whole. MFIs structure these JLGs in such a way that peer pressure would ensure compliance of individual clients in most cases. Even though some MFIs also give financial services to individuals in rare instances, the overwhelming majority of their operations are restricted to giving loans to JLGs. Like in the case of the SBL program, Andhra[5] Pradesh is the leading state for MFI operations in India both in number of clients and amount of loans disbursed. This makes A.P the hub of micro-finance in India. The various aspects regarding the basic nature of SHG and MFI delivery models are given in table 2.

[5] Website of Sa-dhan, the Industry Association of MFIs

Table 2: A Look into the Basic Nature of SHG and MFI Delivery Models

	SHG	**MFI**
Basic Structure	12-15 people form a group and start an account with a bank. They start to build up internal funds through thrift and savings. Once this reaches a substantial level, they begin borrowing from the bank.	MFIs (registered as NGOs or NBFCs) form client groups of convenient sizes and start lending to them right away, often without the requirement of savings and thrift. In some cases, individual lending is also done by MFIs.
Capacity Building	Substantial capacity building is brought about through group meetings and training sessions.	Not much capacity building as most group meetings are restricted to the distribution of loans.
Sources of Funds for the End-Clients	Clients may source their credit from the internal funds of the SHG, bank loans and loans from SHG Federations.	The source of funds is the MFI alone, which may have borrowed from banks, donors, investors and other sources.
Quality of Service	Very low as loan processing is characterized by long delays and multiple formalities.	Ready delivery and easy processing of loans.
Interest Rates	Comparatively lower and hovers within the 12-24 % range.	Considerably higher. It starts at around 24 % and could be much higher than that.
Other Agendas	SHGs have other agendas like skill and awareness building of its members. Its overall goal is the socio-economic empowerment of its members.	Activities of an MFI are generally restricted within the financial domain.
Loan Repayment	Usually done on a monthly basis. Usually the internal repayments are more flexible according to the cash flows of the members in the SHGs.	Normally done on a weekly basis, regardless of the cash flows of the clients.
Operational Cost Borne by the Group	Higher. Due to book keeping and meetings to be conducted by the SHG.	Lower. As book keeping and meetings are paid for by the MFIs.

2. THE PROJECT

Microfinance has the potential to be a powerful tool for development and poverty alleviation. The stated purposes of all micro-finance ventures include socio-economic advancement, women empowerment and capacity building of the downtrodden.

2.1 Background of the Project

The state of Andhra Pradesh can be said to be the nucleus of micro-finance in India. The current crisis in Andra Pradesh regarding the issue of unscrupulous ways of functioning of microfinance institutions, renders an opportunity to ponder upon the 'mission drift' that has taken place in the very concept and purpose of microfinance.

The major criticisms that mooted the crisis was regarding the exorbitant interest rates and suicides committed by the clients due to coercive collection mechanisms of MFIs, which led to the conclusion that the failure of government run microfinance (Indira Kranthi Patham) paved way for the existing situation. It cannot be denied that political games are also in prevalence to put the blame on the inefficiency of SHG-bank linkage programme in meeting the credit needs of the people and thereby making them victims of private microfinance. However, the inability of government run microfinance to meet the credit needs of people, fierce competition between top microfinance institutions, rapid expansions leading to drift in microfinance ideals and target driven way of operations of MFIs are matters of serious concern.

The study intends to acquire a holistic understanding about microfinance by exploring and comparing the two delivery models of micro-financing which are in practice, namely the SHG- Bank linkage model (SBL) and Micro-Finance Institutions (MFIs). Both the models have positive aspects along with certain limitations. SBL model plays a significant role in empowering women and mitigating poverty. However, policy contradictions and loopholes in the entire system hinder its mission to meet the demand of credit by the people. Though MFIs charge high interest rates due to their high operational costs, people take loans from them. It pinpoints to the fact that timely availability of credit is more important than cost of credit. The study intends to compare the two models, taking into consideration the perspectives and expectations of the people.

2.2 Objectives of the Study

- To examine the merits and demerits of the SHG-Bank Linkage and MFI models of delivery of micro-financing and analyse it under the following aspects.
    - Financial and non financial costs incurred by the clients in both the delivery models
    - Loan utilization pattern in both the models
    - Challenges faced by the two models
- To identify opportunities for further improving the effectiveness of the two models so as to achieve the goal of financial inclusion.

2.3 Methodology

A wide array of tools was used to gather relevant information for the study. The primary information was collected mainly using a survey questionnaire which covered various nuances associated with credit needs of the people, benefits and costs incurred by them in getting loans from SBL and MFI models. Checklists were also used to conduct focus group discussions and informal interviews so as to collect primary information. Secondary literature review and discussion with subject matter experts served as the source of information to develop a conceptual understanding of microfinance, its delivery models and recent developments in the area of microfinance.

- Survey Questionnaire

Survey questionnaire was the major tool which was used for collecting primary information. A survey was conducted in 100 households in Chittoor district of Andra Pradesh. Chittoor district was selected for the study as it was recommended by APMAS, by taking into consideration the volatility of the situation regarding the current microfinance crisis. It was a place where violence against MFIs was not yet reported. Moreover, APMAS had its regional office in Palamener which also favored the selection of this particular place for the study. Since the intention of the study was to compare the two models, purposive sampling was done, such that the respondents of the survey were beneficiaries of both SHGs and MFIs. The survey was done in five mandals, covering two villages from each mandal. The selection of the villages and mandals was also done based on the criterion of finding beneficiaries of SHGs and MFIs. In each village ten people who met the criterion of being the beneficiaries of both SHGs and MFIs, were selected. The survey questionnaire used for the study is given in Annexure 2.

- Focus group discussions

Focus group discussions were done with members of eight SHGs in the area of study. Checklists were used to aid the discussion which provided information regarding the efficiency of functioning of the SHGs, difficulties encountered due to the prevalence of MFIs and the extent to which they stick on to the standard norms of operations of SHGs.

- Informal Interviews

Informal interviews were done with bank officials, subject matter specialists and the manager of a local branch of an MFI in the area of study. Checklists were used for this purpose so as to get a vivid understanding about the various aspects related to their operations and their opinions about the recent happenings in the field of microfinance. The checklists used for conducting discussions with SHG members, bank officials and MFI officials are given in Annexure 3, Annexure 4 and Annexure 5 respectively.

- Data Analysis

The data obtained from the survey was analyzed using statistical software so as to draw results and patterns based on the responses of the people.

2.4 Scope of the Study

The scope of the study was geographically limited to ten villages in Chittoor district of Andhra Pradesh. However, the overall scope of this study spans across microfinance at a macro level. The villages in Chittoor were selected as representative samples from which reliable generalisations and learnings could be drawn about the various aspects and nuances of the two microfinance delivery models in the nation.

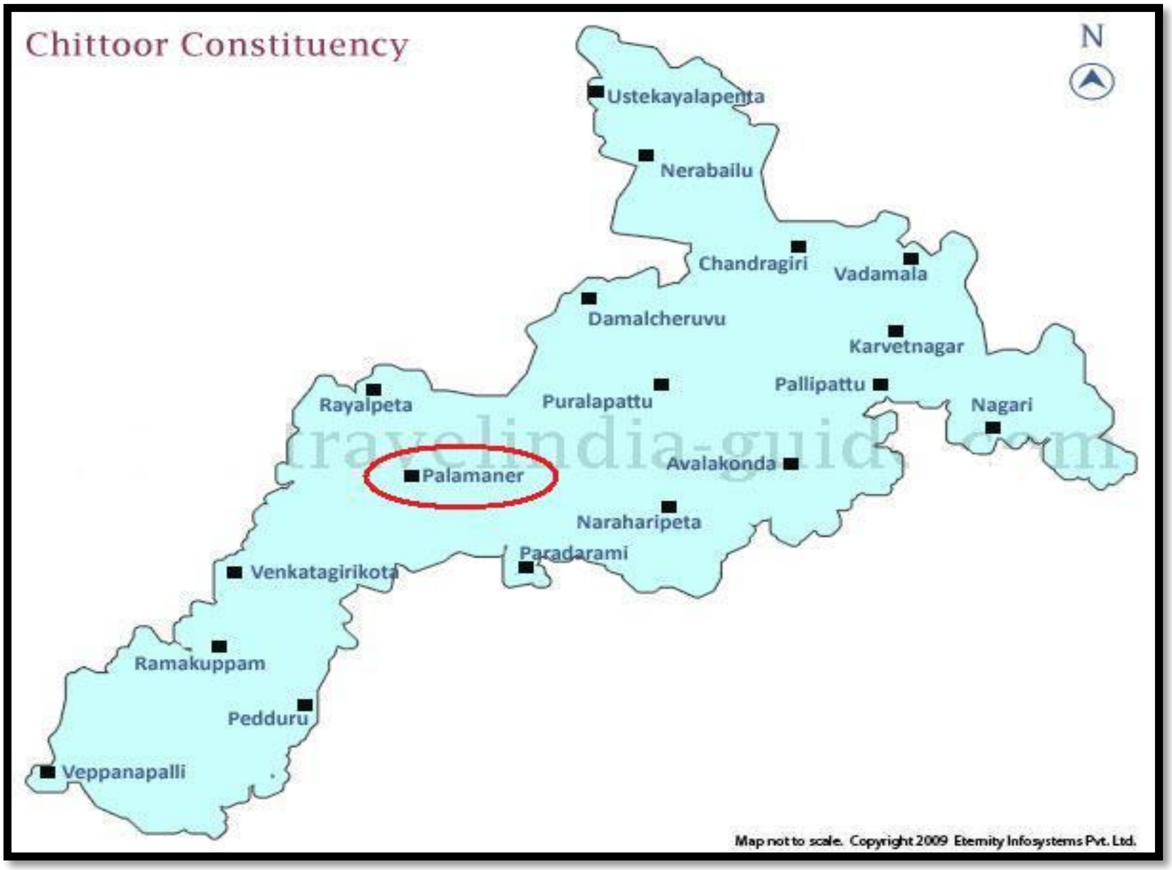
2.5 Limitations of the Study

The major limitation of the study was regarding the time during which it was done. The situation was very volatile due to the current microfinance crisis in Andhra Pradesh though it was not a very serious issue in the villages which were covered in the study. However, the employees of the MFIs functioning in the area of study were very apprehensive about sharing information which was of relevance in the study. The MFI ordinance was promulgated in the month of October, 2010 and many of the people had decided not to repay loans taken from MFIs, due to which the repayment percentage in case of MFIs dipped down. However, the study could not draw any cause-effect relation between fall in MFI repayment percentage and its effect on timely repayment in SHGs.

3. OVERVIEW OF THE SAMPLE STUDIED

The study was done in Palamener cluster in Chittoor district which is towards the southern side of Andra Pradesh. The map of Chittoor district is shown in figure 2.

Figure 2: Map of Chittoor District



The survey was done in ten villages of Palamener, which is essentially a cluster of five different mandals which lies to the east of the district headquarter. The name of the villages and the mandals, where the study was done is given below in table 3.

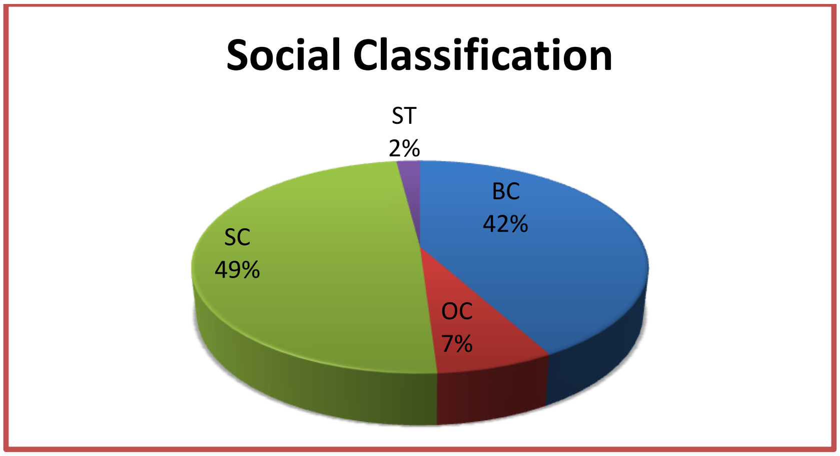
Table 3: List of Villages and Mandals

Name of the Villages	**Mandal**
M.P. Kotur, Samudrapalle	Palamener
Baireddypalli, Pathapetta	Baireddypalli
Kalakathoor, Kothapalli H.W	Gangavaram
Rayalpetta, Bommarajapalle	Pathepanjani
Bangarapalam, Samasenumitta	Bangarapalam

3.1 Profile of the Respondents

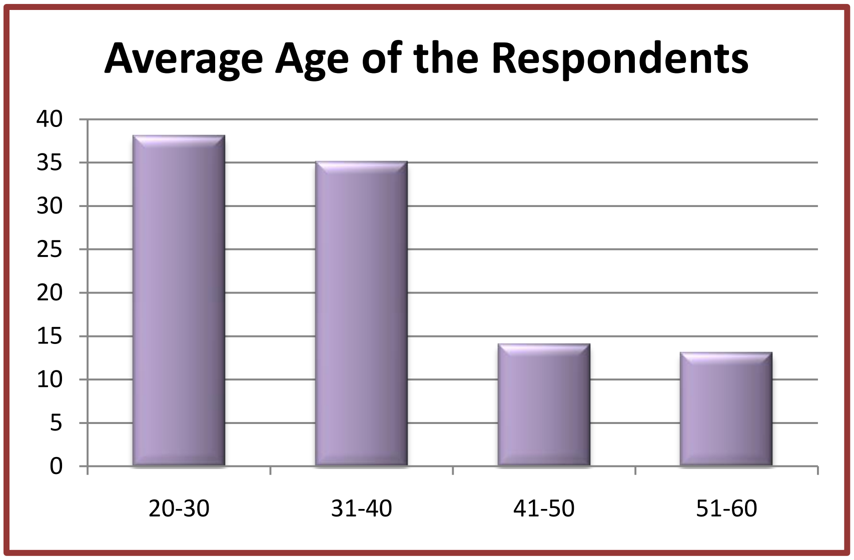
All 100 respondents who participated in the survey were women and they were purposively chosen in order to include only those who have borrowed both through SHGs and MFIs. The caste wise classification of the respondents of the survey is given below in figure 3. It was found that majority of the people belonged to SC and BC category.

Figure 3: Social Classification of the Respondents



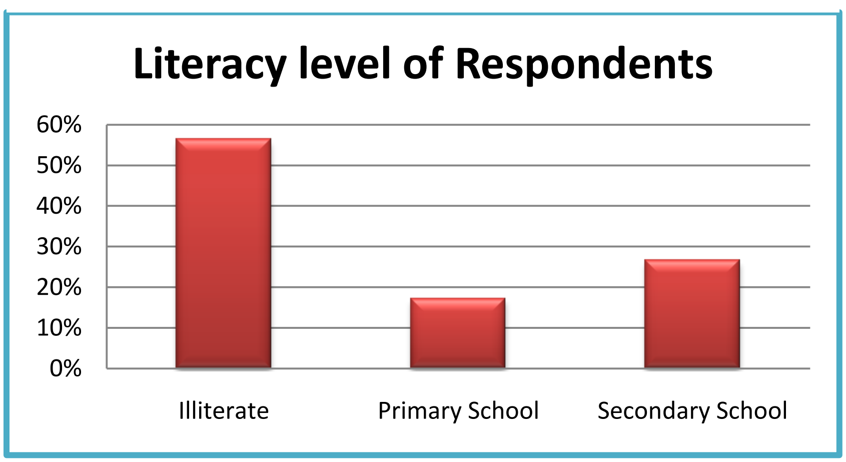
The age of majority of the respondents falls under the category of less than 40 years. This is mainly because young women in their twenty's were more active in getting involved in SHGs during the time of initiation of SHGs in 1996. The categorisation of respondents based on their age is given in figure 4.

Figure 4: Average Age of Respondents



The data on literacy level of the respondents showed that around 55% of the people were illiterate. The role of SHGs in making women more empowered and participative in activities associated with banking and finance management is noteworthy in the given context. The literacy level of the sample of people studied in the survey is given below in figure 5.

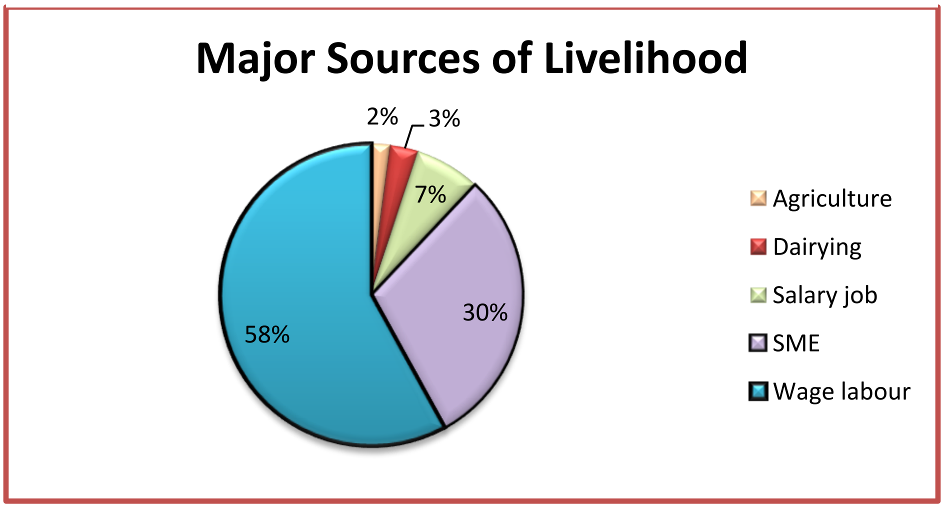
Figure 5: Literacy Level of Respondents



4. ECONOMIC SCENARIO OF THE SAMPLE

The initial part of the survey questionnaire which was used for the study, intended to cover relevant aspects regarding the economic situation of the people in the villages. All the respondents invariably belonged to BPL category. The majority of the people were wage labourers and agriculture was not their primary source of livelihood. The primary sources of livelihood of the people in the area of study are given below in figure 6.

Figure 6: Major Sources of Livelihood



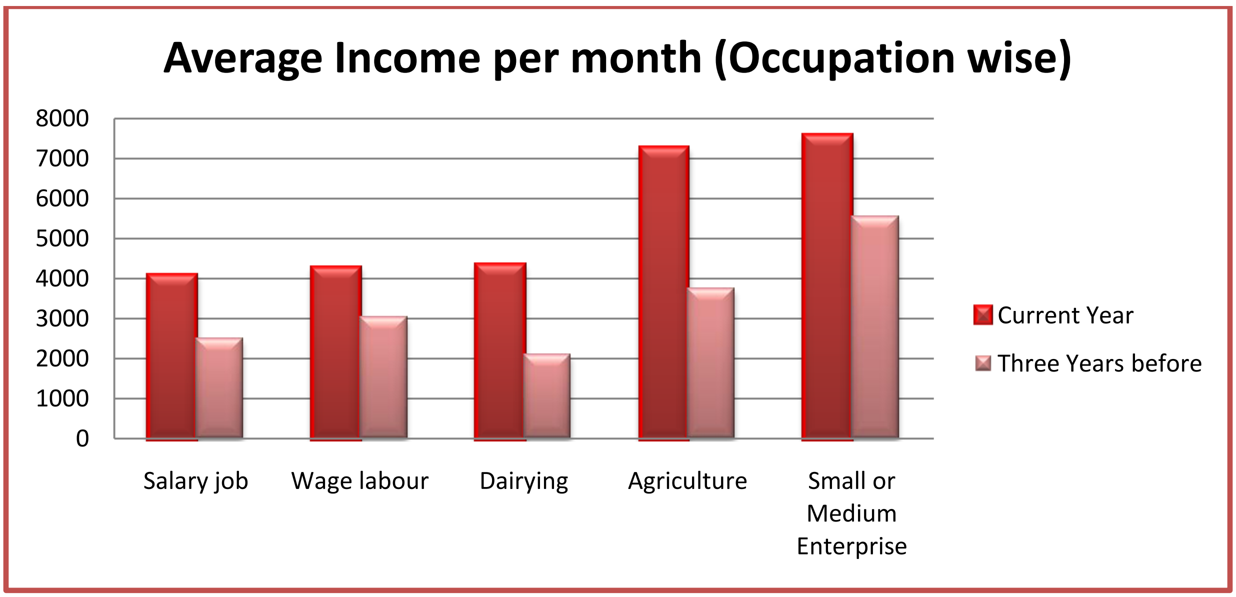
It was seen that only a very small fraction of the people was involved in agriculture and dairying. The shortage of water for irrigation was one of the major reasons for people not getting involved in agriculture. Around 64% of the people were landless and majority of them owned small and fragmented land holdings. The distribution of agricultural land holdings among the sample studied is mentioned in table 4.

Table 4: Distribution of Agricultural Land Holdings

Size of landholding (in acres)	Percentage of Respondents
Landless	64
Upto 0.5 acres	4
0.5-1.5 acres	13
1.5-2.5 acres	16
2.5-3.5 acres	3

The average monthly income of the people in the year 2009-10 was Rs 5300, whereas it was around Rs 3740 three years before. The details of average income per month of the people, involved in different occupations, showing the difference in income in the current year and three before are given below in figure 7.

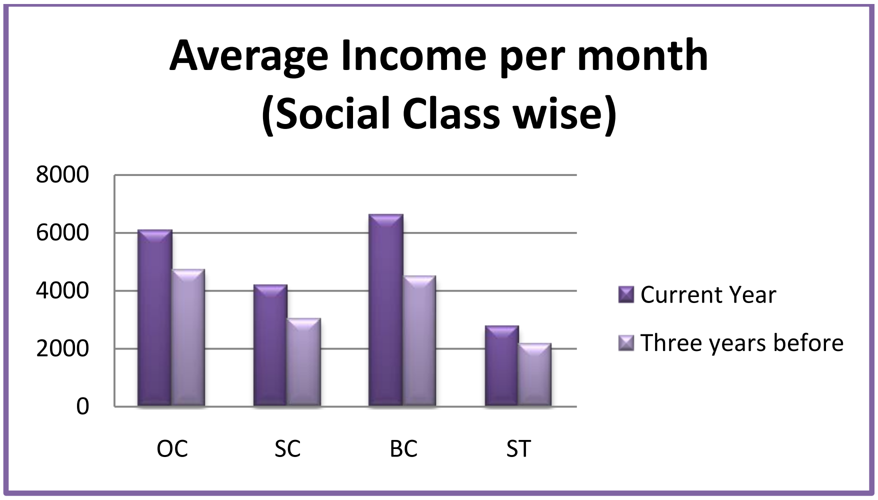
Figure 7: Average Income per month (Occupation wise)



It was seen that though the number of people involved in agriculture was very less, the average income obtained from agriculture was comparatively high. The major crops cultivated in this area of study are groundnut, rice and vegetables. It was found that 30% of the people were involved in small and medium enterprises and the average income that they get was also fairly good.

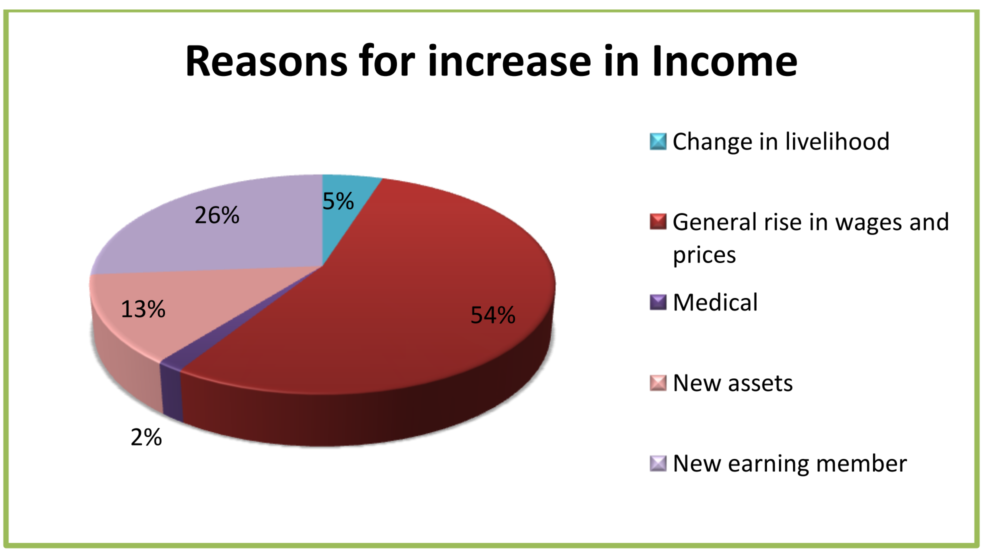
In a similar way, the particulars of average income of people belonging to different social classes, showing the increase in income in the current year is given below in figure 8.

Figure 8: Average Income per month (Social Class wise)



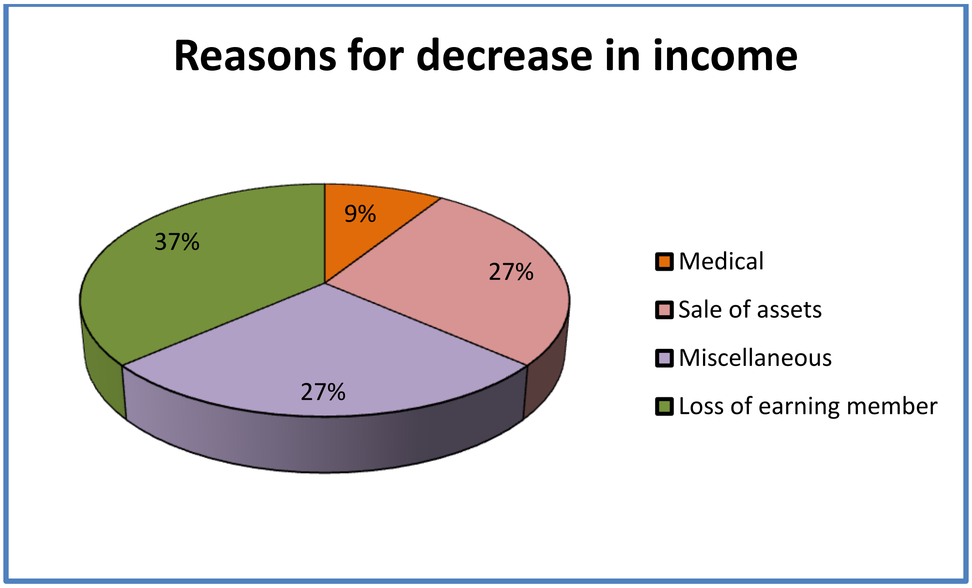
It could be seen that people belonging to BC and OC category had a higher average income than those belonging to SC and ST category. However, it was seen that there had been an increase in income of people in majority of the households over a period of time. The various reasons cited by people for the increase in their average monthly income are shown in figure 9.

Figure 9: Reasons for Increase in Income



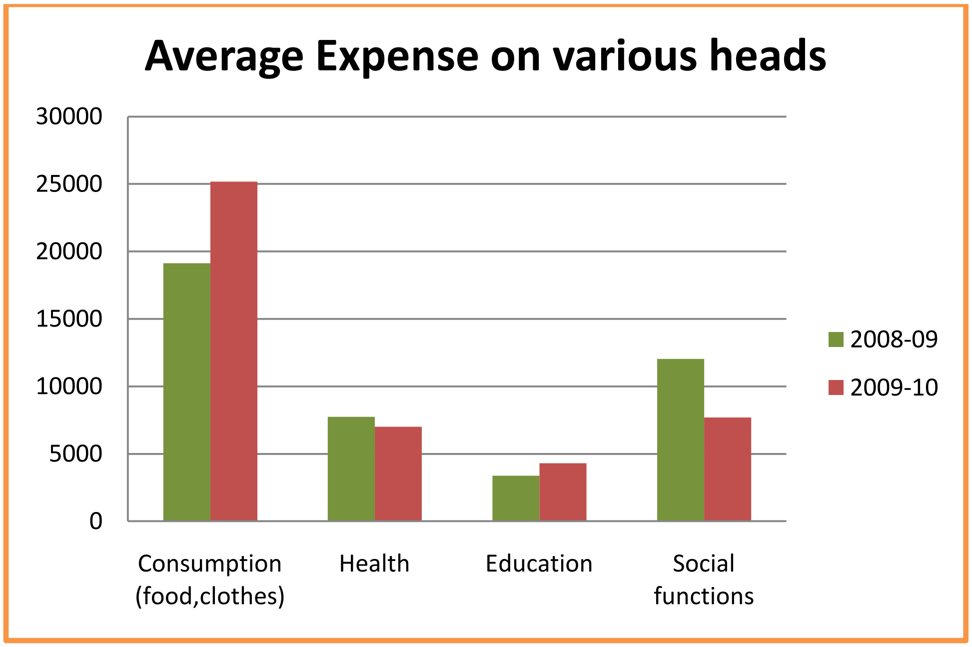
It is also found that 11% of the people came across with decrease in their average family income over the span of three years. The probable reasons for the decrease in income according to them are shown in figure 10.

Figure 10: Reasons for Decrease in Income



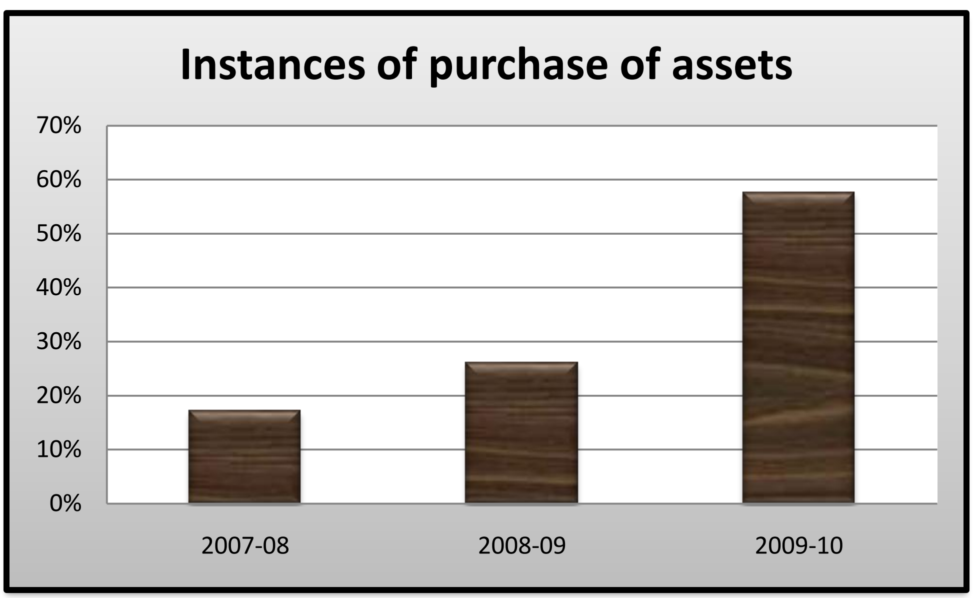
The expenditure of the people on various heads of expenses in the past two years was also compared. The average monthly expenditure in the year 2009-10 was Rs 3940. The average expenses incurred on the consumption of food and FMCGs were comparatively more than those in case of other heads of expenses. It was also found that the percent increase in expenses under this category of consumption of food and FMCGs over a period of one year is around 32%, which is relatively high compared to other cases of change in expenses. The details of expenditure incurred by people in the year 2008-09 and 2009-10 are given in figure 11.

Figure 11: Average Expenses on Various Heads



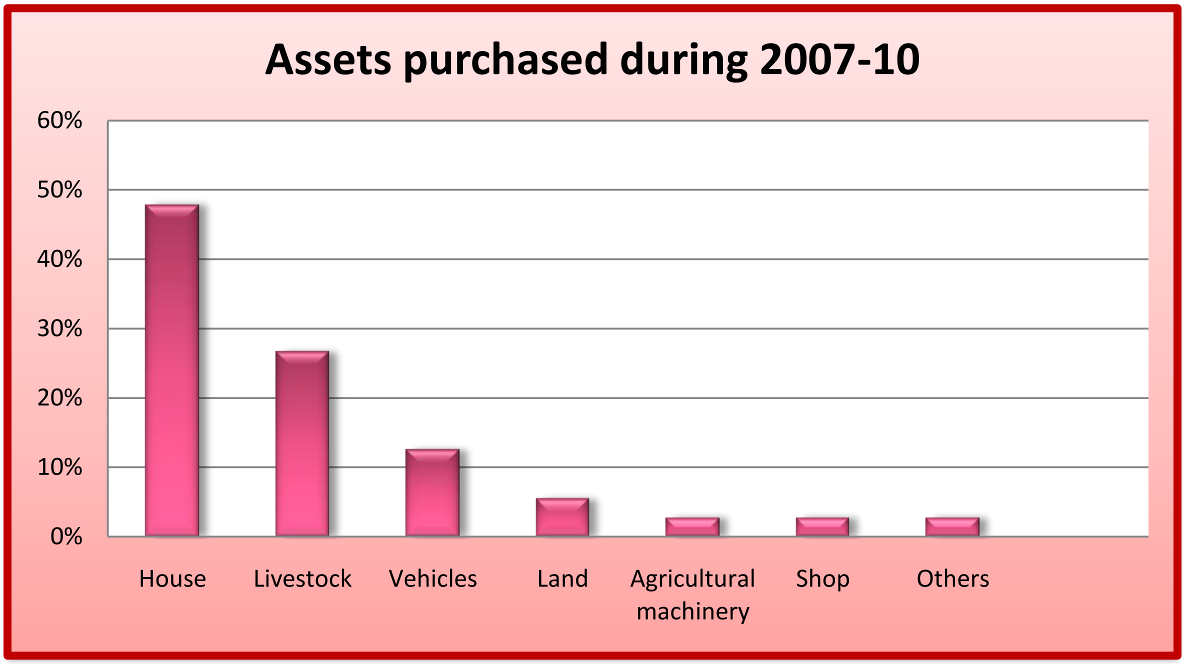
It was found that 28% of the people had not bought any assets during the past three years. However, the results of the survey showed that there had been an increase in the instances of purchase of assets over past three years. The increase in the instances of purchase of assets during past three years is depicted in figure 12.

Figure 12: Instances of Purchase of Assets



It could be seen that house was the major asset created by the people in last three years. This is because people received credit from the government as a part of a scheme. The instances when various assets were purchased during last three years are shown in figure 13.

Figure 13: Assets Purchased during 2007-10



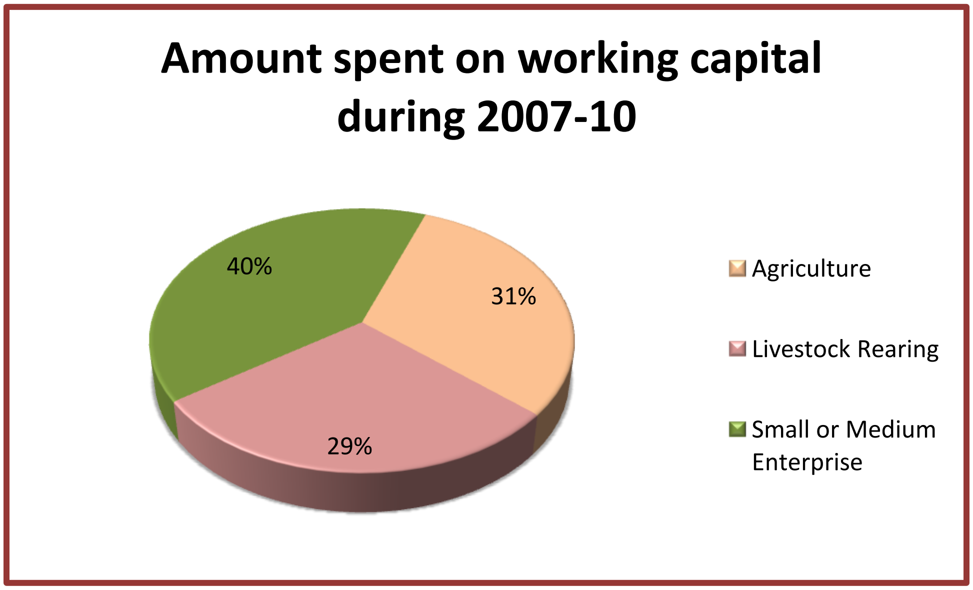
The average amount expended in the purchase of different assets is given in table 5.

Table 5: Average Amount spent for purchase of Assets

Asset	**Average Amount Expended (In Rs)**
House	40,000
Livestock	25,000
Vehicle	30,000
Land	120,000
Agricultural Machinery	20,000
Shops	45,000

The amount spent on working capital by the people did not show much difference in its three major heads of operations, during last three years. The particulars of amount spent on working capital in agriculture, livestock rearing and small or medium enterprises are depicted in figure 14.

Figure 14: Amount spent on working capital during 2007-10



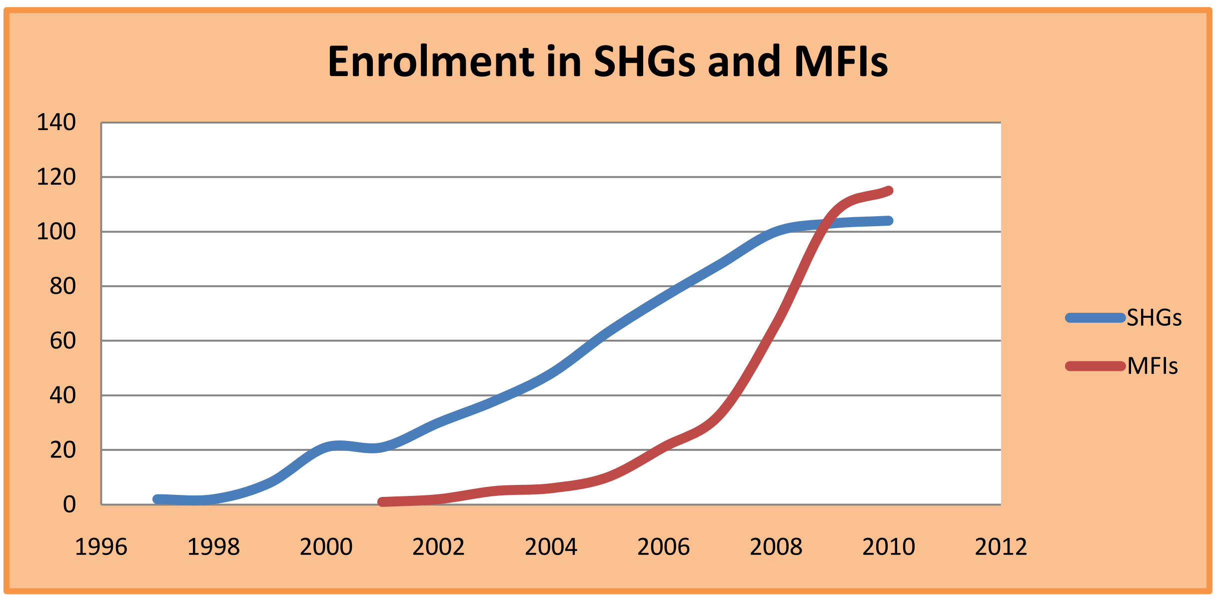
5. ANALYSIS OF THE MICROFINANCE DELIVERY MODELS IN THE AREA OF STUDY

The original mission of microfinance is to primarily do good to people. The comparison of functioning of SBL and MFI models of microfinance, based on various relevant aspects, was done so as to develop a holistic view about the real cost incurred by people and benefits they get, by being beneficiaries of microfinance. The various aspects regarding the growth of the two models of delivery, the details regarding demand for credit and its delivery through the models, the extent to which it has brought about a change in the lives of the people were being critically compared by the analysis of the two models. Though money lent by money lenders cannot be considered as microfinance, certain aspects regarding loans taken from money lenders have been included in the analysis. It is mainly because of the fact that rural people still consider money lenders as an important source of credit especially during times of urgent needs.

5.1 Growth of SHGs and MFIs

The purposive selection of beneficiaries of both SBL and MFI models for the study enabled better analysis of the working of two models. It was found that 8% of the people were members of SHGs since 1997. It was also interesting to find that 10% of the people were beneficiaries of MFIs before becoming members of SHGs. The details of the enrolment of people in SHGs and MFIs over a period of years, is depicted in figure 15.

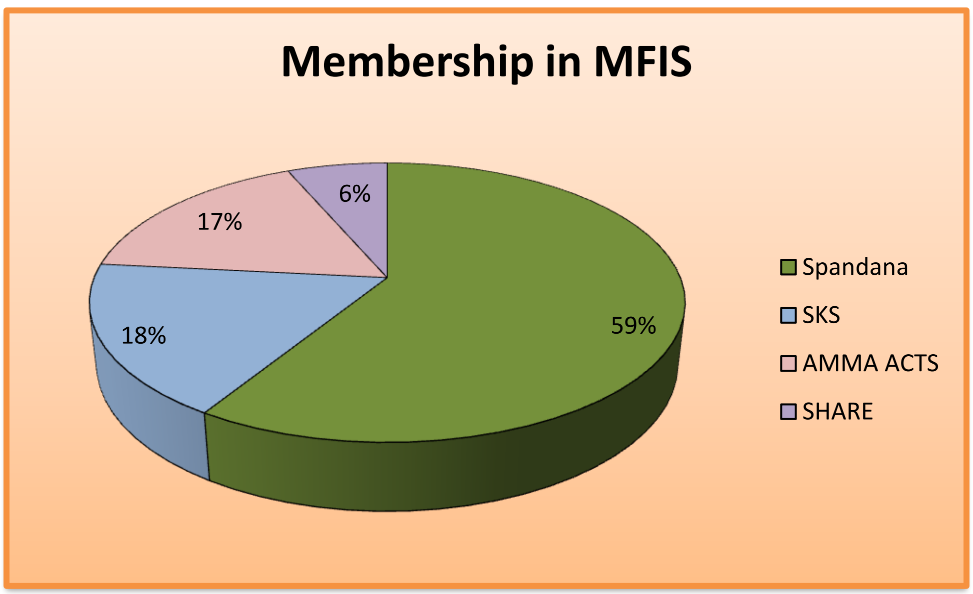
Figure 15: Enrolment in SHGs and MFIs



The memberships in MFIs started from the year of 2001. It was seen that there is an increasing trend in the enrolments in both SHGs and MFIs over these years. However, there was a steep increase in the memberships in MFIs from 2007 onwards and still shows an increasing trend. The increasing trend in SHG memberships is not very steep compared to that in case of MFIs and it almost shows saturation in the past three years. It could be because more people who were members of SHGs took membership in MFIs also, so as to get more credit. MFIs would also have found it easy to expand their operations into area where the social mobilization to create credit and savings awareness had already been done by governmental agencies. This is also a matter to be pondered upon as to whether the present situation indicates a tendency to make more people beneficiaries of microfinance rather than focusing upon the purpose of microfinance in making the people self reliant by means of mitigating poverty and meeting their credit needs in a fruitful manner.

Spandana, Swayam Krishi Sangam (SKS), AMMACTS and SHARE were the four major MFIs which had its operation in the area of study. The percentage of memberships of people in these four MFIs is depicted in figure 16.

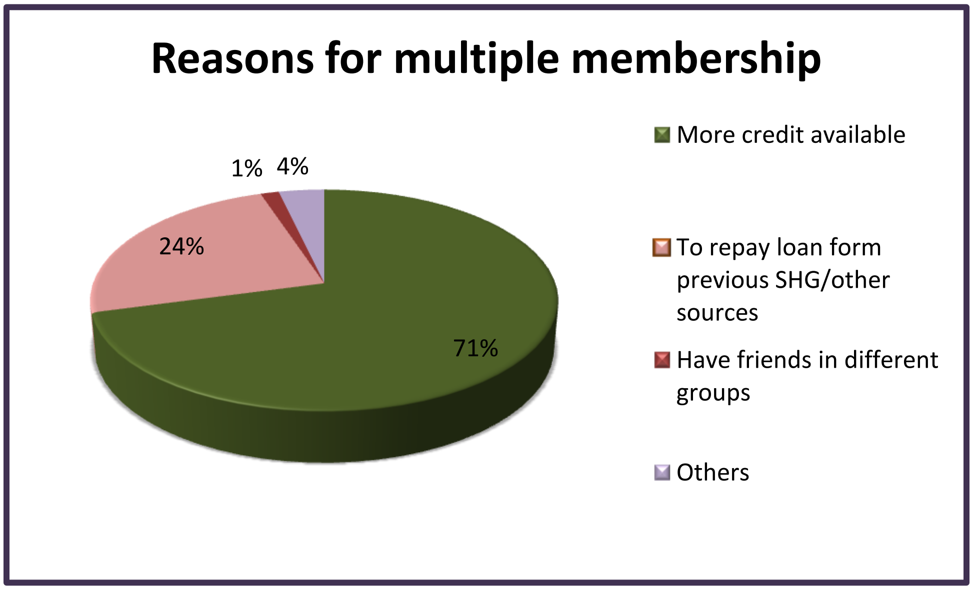
Figure 16: Membership in MFIs



Spandana had larger number of memberships compared to other MFIs. Though SHARE is among top five MFIs in the nation, it had the least number of memberships in this area of study.

SBL model can be considered to be one of the potent initiatives for alleviating poverty. However, it is a matter of concern as to why people resort to other private microfinance agencies and informal sources to get credit, though they have to pay higher interest in these cases. The immediate needs are of more priority to people and very often the long term effects are not considered at that span of time. The reasons for multiple memberships of people in different agencies for getting credit are shown in figure 17.

Figure 17: Reasons for multiple membership



According to the survey results, it could be said that people were not satisfied with the loan amounts that they got from banks through SHGs. The need for higher amount of loans and also its availability when they need money is a serious factor that often forces people to go for multiple borrowing. The propensity of people to take loans for repaying other loans is something which is against the intended goal of micro financing and has to be looked upon in future to prevent disbursal of loans for such purposes.

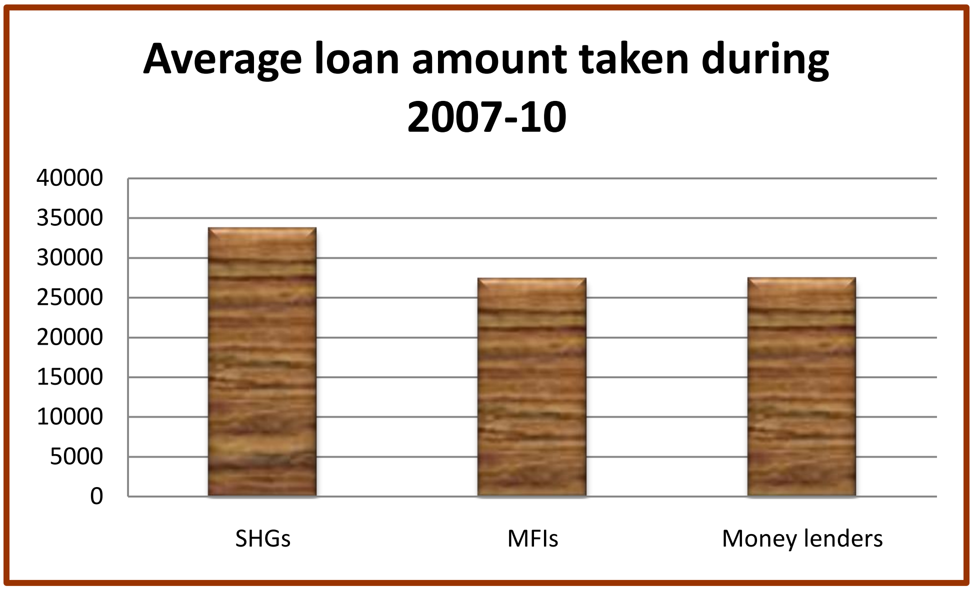
5.2 Demand and Supply Conditions of Credit

The credit needs of the people are increasing every year and the supply side or delivery models can be made more effective to enhance financial inclusion. The demand supply gap can be an issue in either cases of more demand and less supply or less demand and more supply. "[6]*It is also important to note that many regions, segments of the population and sub-sectors of the economy have a limited or weak demand for financial services. In order to improve their level of inclusion, demand side efforts need to be undertaken including improving human and physical resource endowments, enhancing productivity, mitigating risk and strengthening market linkages."* The present situation implies that people have got various alternative credit options

[6] Report of the Committee on Financial Inclusion, C. Rangarajan, 2008

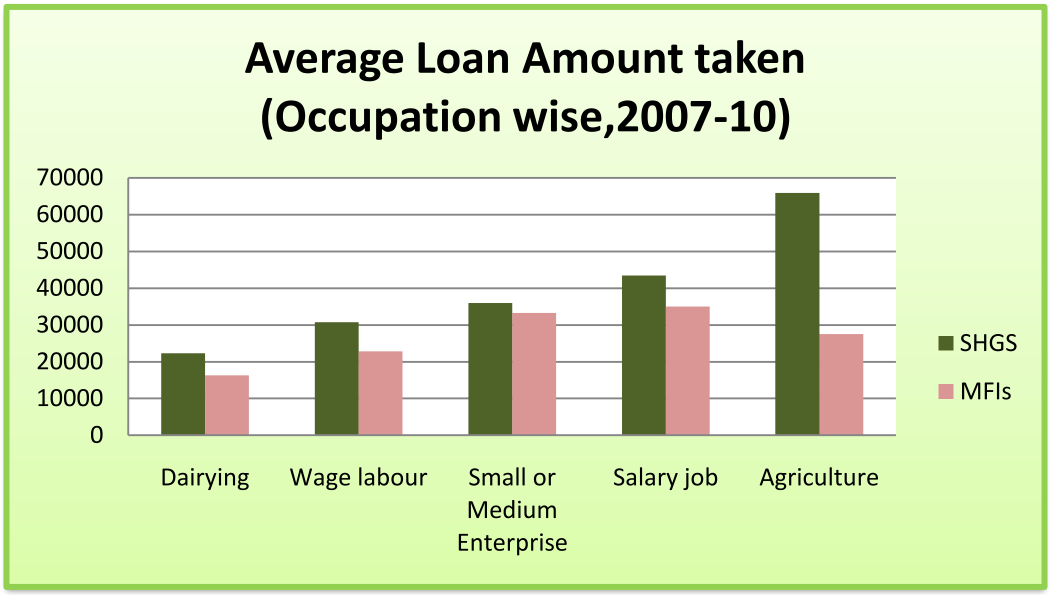
available to them but the extent to which they are financially included is still a matter of concern. The study had tried to look into the amount of loans availed by people and difficulties encountered by them to get credit through SBL and MFI models. The particulars of the loan amount taken by the people from various sources of credit are shown in figure 18.

Figure 18: Average loan amount taken during 2007-10



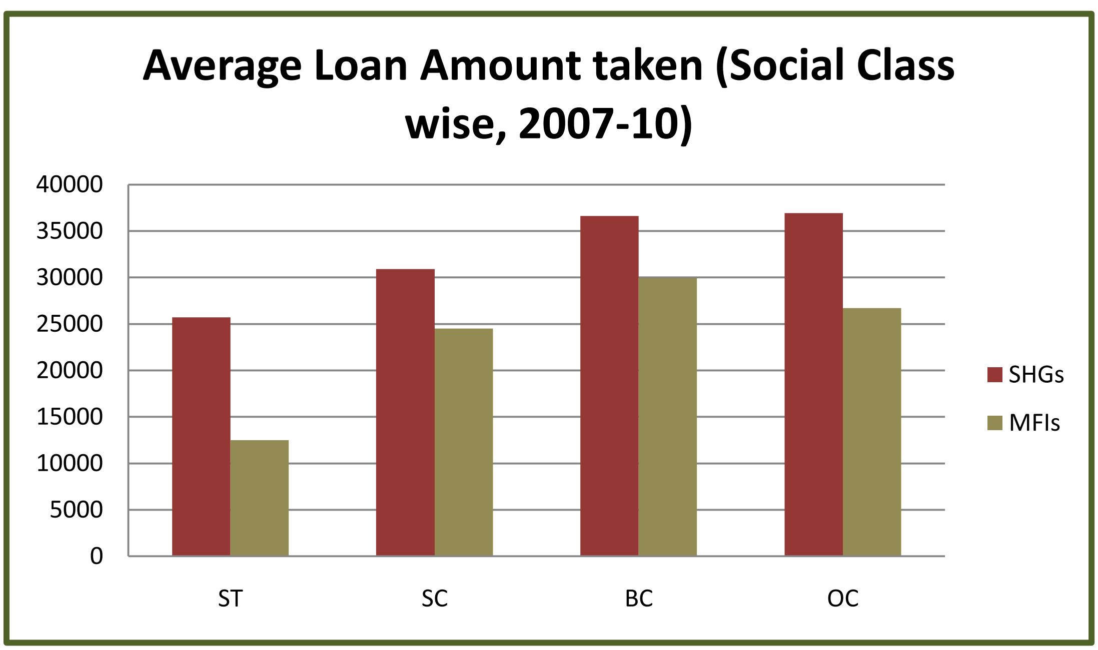
The average loan amount availed from SHGs and other sources are almost the same. The details of loan taken by people involved in different occupations, from SHGs and MFIs are given below in figure 19.

Figure 19: Average Loan Amount taken (Occupation wise, 2007-10)



It was found that though only a minority of the people was involved in agriculture, maximum amount of loan was taken by people having agriculture as their primary source of income. The details of loan amount taken by people belonging to different social classes are given in figure 20.

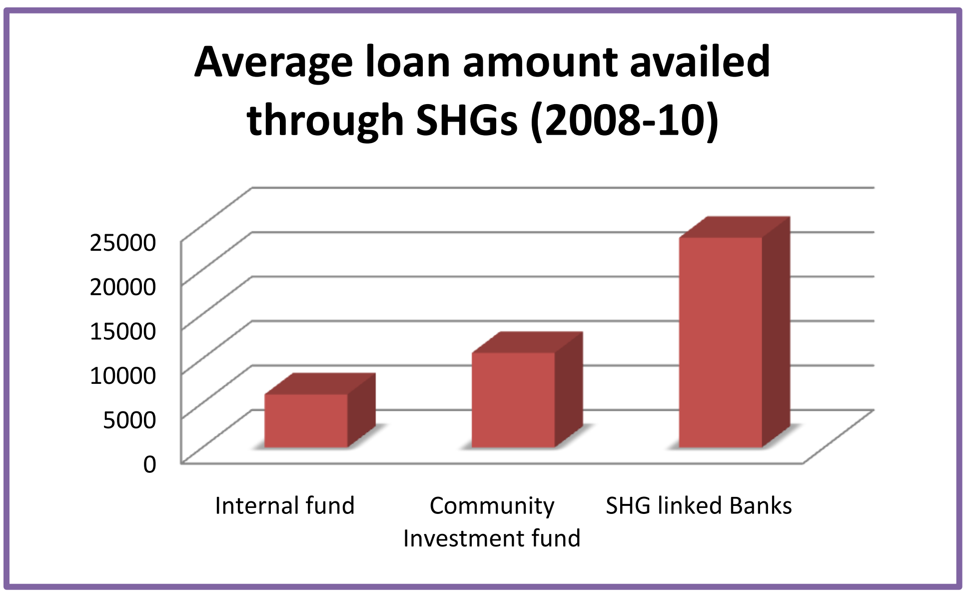
Figure 20: Average Loan Amount taken (Social Class wise, 2007-10)



In both the figures, showing the average loan taken by people based on their occupation and social class, it was seen that there was not much difference in the average loan amounts taken by people belonging to different categories, from SHGs and MFIs.

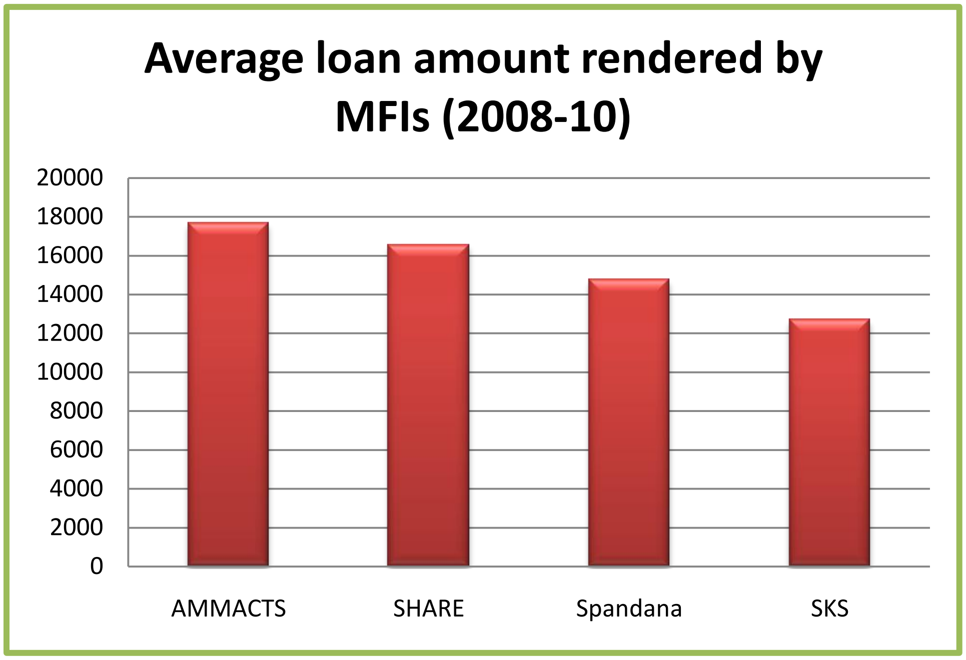
The loans are available to people from SHGs through three sources which are the internal funds, Community Investment Fund (CIF) and loans given from banks. The savings of the people in SHGs constitute the internal funds from which the members take money in case of urgent needs. However, the availability of funds within the SHGs depends upon the regularity in savings, repayment and internal rotation of money within the group. Community Investment Funds are loans provided by SHG Federations. In most of the cases banks would give loans to SHGs based on their timely repayment of previous loans and would give a maximum amount of ten times the savings of the group. The banks would also give higher loan amounts as an incentive for the credit discipline maintained by the group. Figure 21 shows the details of loans availed by SHG members from the three sources of credit during 2008-10.

Figure 21: Average loan amount availed through SHGs (2008-10)



The average amount given as loan by AMMACTS and SHARE was higher than other MFIs, though the memberships were less in these MFIs. MFIs usually gave loan amounts slightly higher than what they gave previously, based on the timely repayment of loan by the clients. SHARE might be trying to increase the number of their clients by giving higher amounts to the people as they are assured that people would take money when they are offered higher amounts, without considering its long term effects. The propensity to continue with this kind of motive can hinder the very purpose of uplifting the poor and would result in debt traps, further worsening the condition of poor people. The details of loan amount given by the four MFIs during 2008-10 are given below in figure 22.

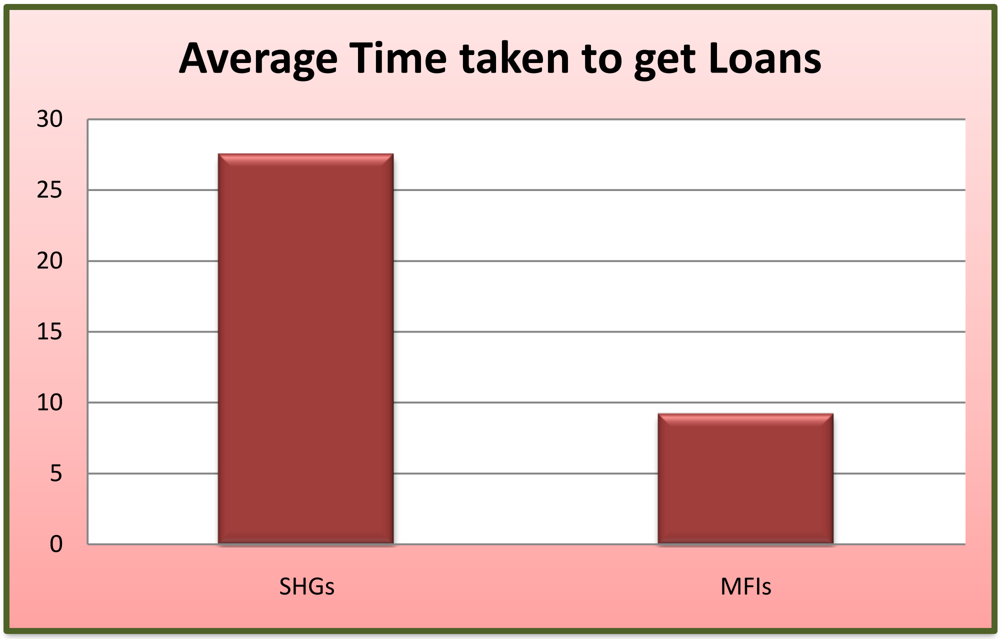
Figure 22: Average loan amount rendered by MFIs (2008-10



5.3 Time taken for Receipt of loans

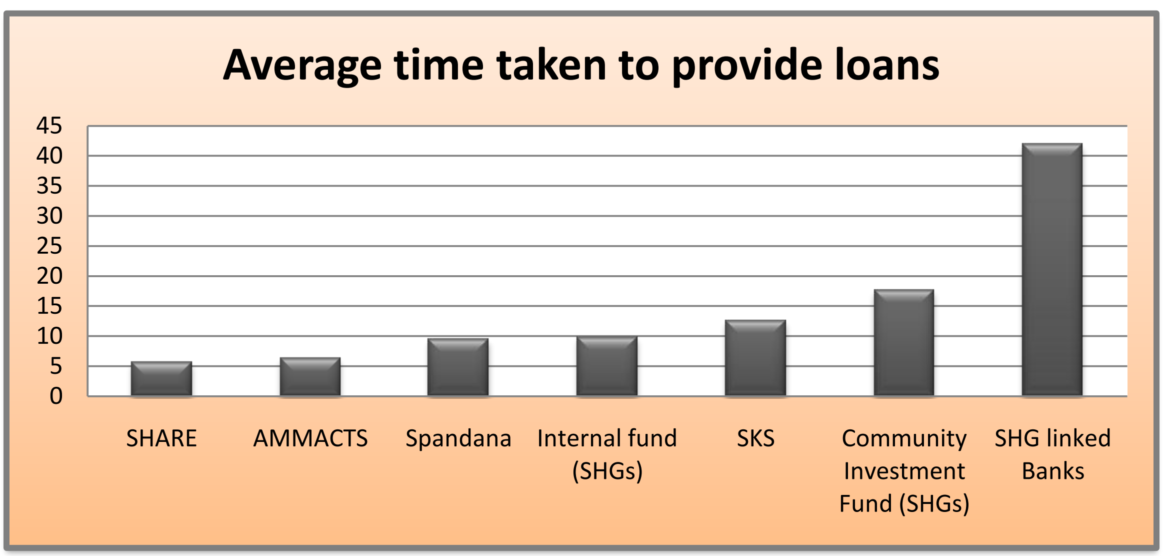
The major problem encountered by people is that they don’t get money when they need it. In case of banks and MFIs, loans are given to a group rather than to an individual. There are lots of procedures involved in getting loans from banks. The process of formation of groups also takes time initially. It takes an average of one month to get loans from banks after applying for it whereas it takes around 8-10 days in cases of MFIs. The average time taken to get loans from SHGs and MFIs are given in figure 23.

Figure 23: Average time taken to get loans (in days)



The time taken by different MFIs and the three sources of credit through SHGs, to disburse loans is depicted in figure 24 given below.

Figure 24: Average time taken to provide loans



It was seen that there was not much difference in the time taken by different MFIs in providing loans to their clients. The average time taken by banks was around forty days. The provision of credit without much delay is a key factor determining the increasing memberships in MFIs. MFIs also know about the relevance of timely credit and takes advantage of the vulnerable position of their clients by providing credit at higher interests. People know that the interest rates are higher than that in banks but still they take it from MFIs to meet their immediate needs.

Case Study No 1: Timely Help!

Timely availability of credit is very often considered to be one of the important priorities by people. T. Redamma was one of the respondents of the survey which was conducted as a part of the study. She was from Kothapally H.W. village in Gangavaram mandal. She was the only earning member in a family consisting of her husband and son. Her husband was bedridden due to chronic illness and her son was a student. She earned income by making baskets and selling it and all the expenses of the household was met by her income.

Redamma was a member of Indira1 SHG group since the year of 2000. The group is not functioning effectively during past few years. She received a bank loan of Rs 4000in the 2008 and she spent the money for meeting the expenses of her daughter's marriage. She didn't get any loans from internal funds of SHG and Village Organisation during the last three years. This was mainly because of the slack in repayment of loans taken by the members of the group.

The members had stopped the habit of regular savings in their group by taking into consideration the scope of loan waiver by the government if the Telugu Desham Party won the last elections. However, it didn't happen and the members were not yet able to revive the habit of regular savings and timely repayment of the loans taken from banks through SHGs. The whole amount of Rs 40000 which was taken from bank by Redamma remains to be repaid even after two years since the loan was taken. Due to all these factors, it was not possible for the members of Indira1 group to get credit through the SHGs.

Redamma became a member of Spandana in 2009. She needed money to treat her husband and she found it difficult to meet hospital expenses with her own income and there was no other options left before her but to take money from Spandana. "*I wanted some money to meet the expenses incurred to treat my husband. There was no money left in the internal fund of our group. So I took Rs 10000 as loan from Spandana. Now I find it difficult to repay the weekly instalment. The other members of my group formed in Spandana had created problems at my home once, when I said that I had no money to pay the weekly instalment. Now I regret about my decision to take loan form MFI, but I had no other way at that point of time."* says Redamma when asked about why she took loan from MFI being a member of SHG.

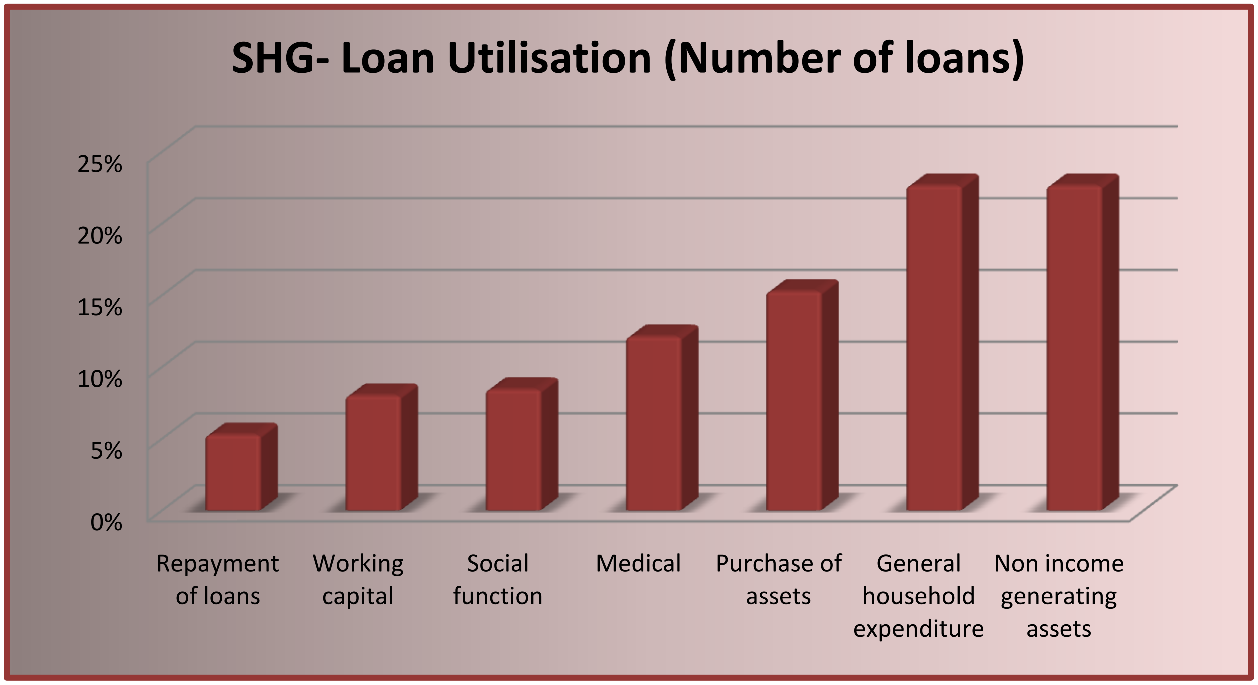
Redamma said that timely disbursal of loans was a matter of prime relevance to people like her and in most of the cases she didn't get timely loans through SHGs. This particular factor instils the propensity to take loans from other sources when multiple options of credit are available, though many times people don't think about its long term effects. Redamma also believed that MFIs should be banned completely but she also said that she would take money from them if it is available, when she had no other alternative sources of credit before her to get money for meeting immediate needs. It could be said from the case of Redamma that many times people approached MFIs for meeting their immediate needs and would never prefer it if they received timely loans from SHGs.

5.4 Loan Utilisation Pattern

The timely delivery of financial services is an important aspect to be considered. It is also necessary to monitor the pattern in which the loans are utilised by the people. The loans are given to people with the purpose that there would be an increase in the asset base created by people so that it would serve as a means to enhance their income and enjoy better standards of living. The reality reflects that the monitoring of loan utilisation by the people is not done in majority of the cases. So in this scenario, it is difficult to say whether the loans are utilised for the right cause. It is also to be pondered upon whether the concept of financial inclusion would be met just by providing access to financial services without taking into account the extent to which it has benefited the people by using the credit in the way it was meant to be used.

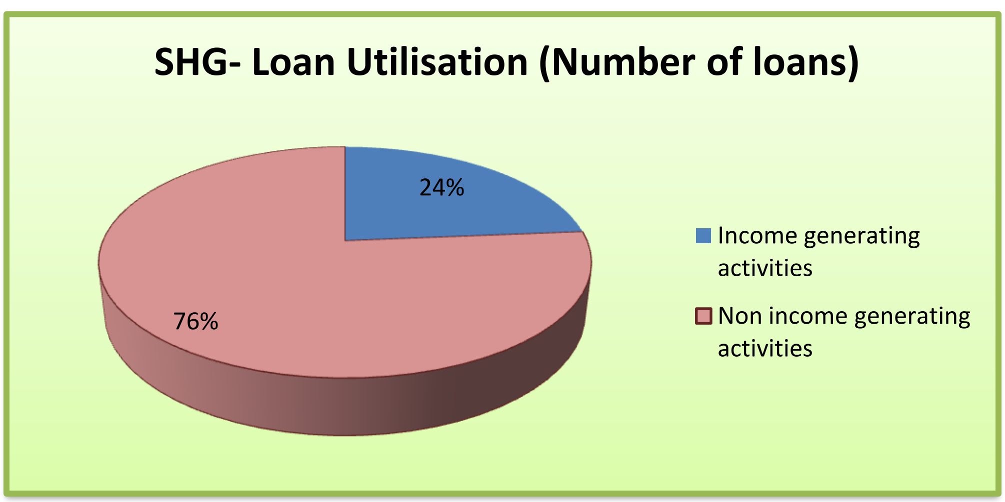
The utilisation of loans from SHGs and MFIs has been studied in terms of number of loans and also the amount of loans taken. The various purposes for which the loans taken from SHGs were utilised are shown in figure 25.

Figure 25: SHG- Loan Utilisation (Number of loans)



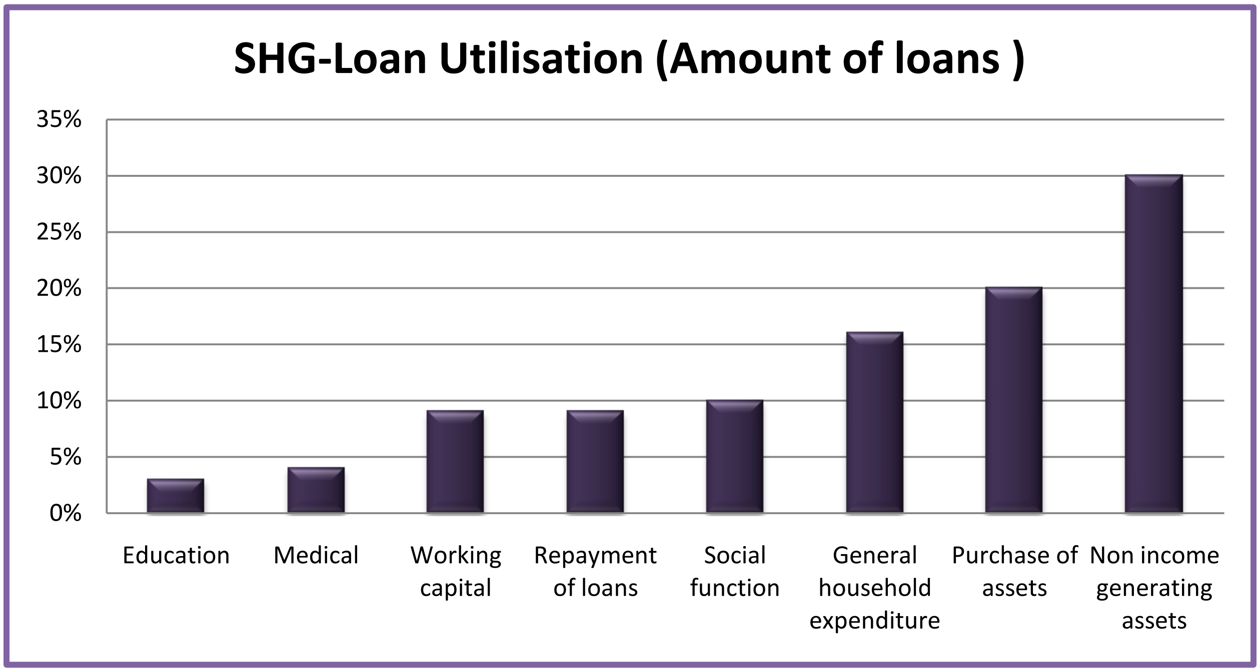
It is clear from the figure that the major chunk of loans were taken for meeting expenses on non income generating assets like construction of house, purchase of gold or purchase of vehicle. It was also seen that more number of loans were utilised for meeting general household expenditure. The utilisation of loans from SHGs has been categorised mainly into two sections based on whether it generates income or not and it is depicted in figure 26 given below.

Figure 26: SHG- Loan Utilisation (Number of loans)



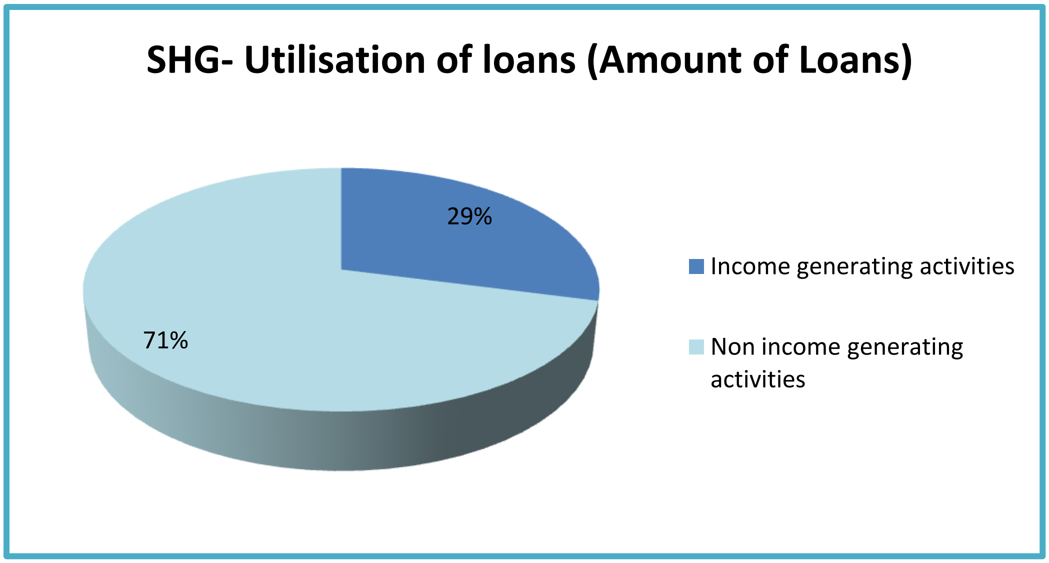
It was found that only 24% of the loans taken were utilised for income generating activities by the people. The utilisation of loans from SHGs, for various purposes in terms of amount of loans taken, is depicted in figure given below.

Figure 27: SHG-Loan Utilisation (Amount of loans)



It was found that more amounts of loans were used for the purchase of non income generating assets than for the purchase of income generating assets. The categorisation of loan amounts used for income generating and non income generating assets is given below in figure 28.

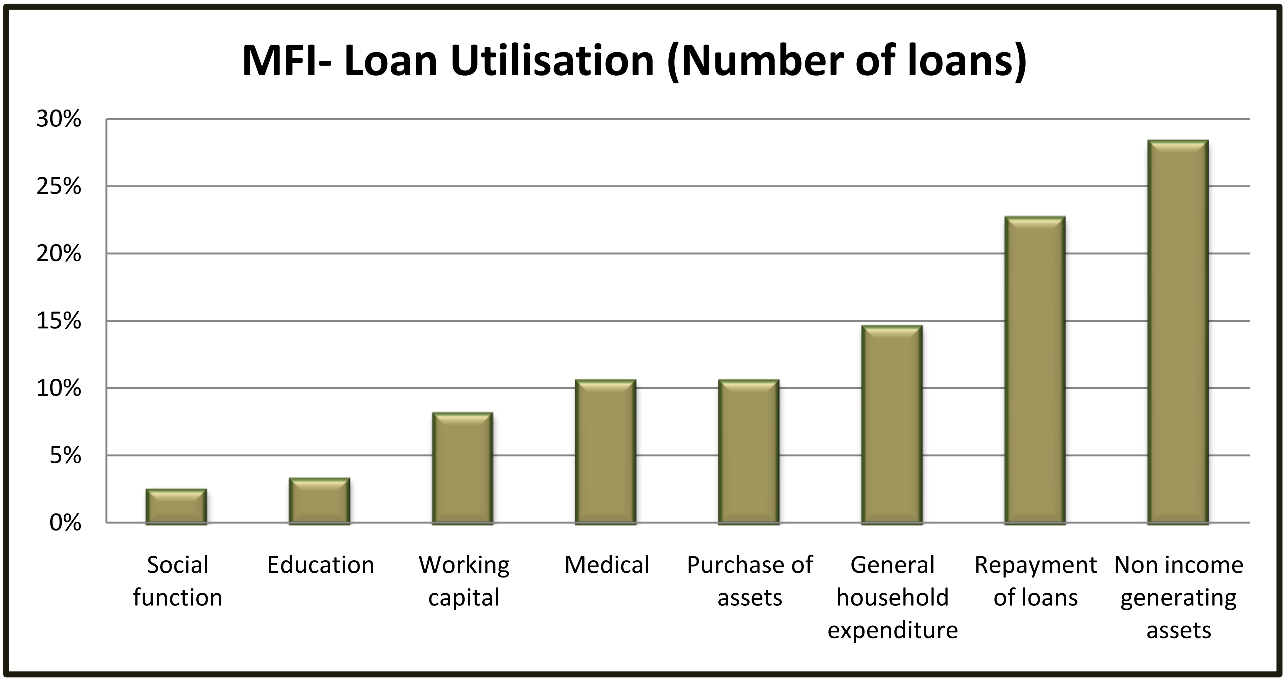
Figure 28: SHG- Utilisation of loans (Amount of Loans)



The loans are given to a particular SHG group rather than to an individual. In most of the cases this amount is equally divided among the members. The problem is that only a few members out of the ten members might really need credit at that point of time. However the other members would also take the money though they don't have any specific need for money at that time. In most of the cases, people would use it for some other purposes which need not be in accordance with the intended purpose for which the loan was given to them.

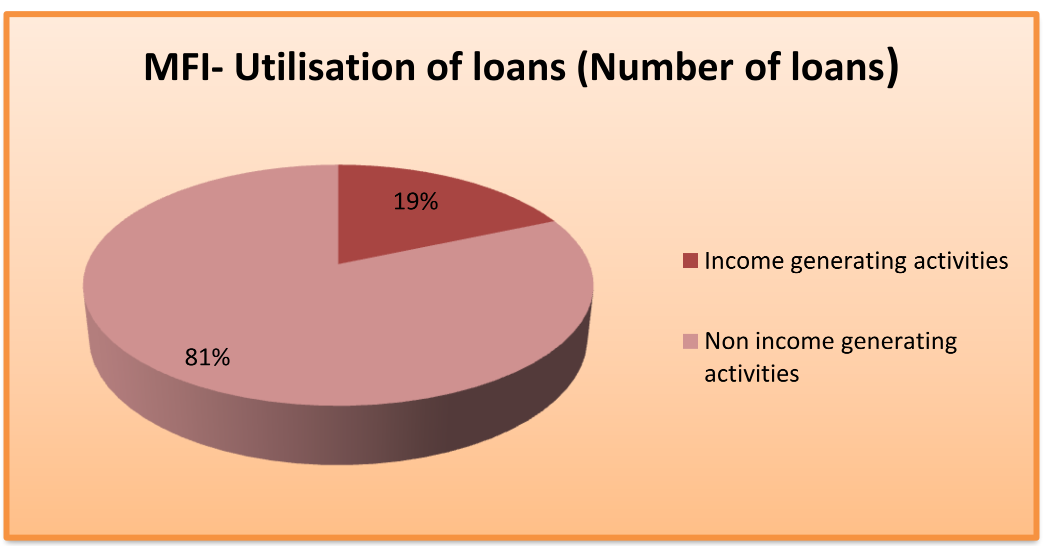
In case of MFIs, it could be seen that majority of the loans were used for purchase of non income generating assets, repayment of loans and for meeting general household expenses. The details of the various means of utilisation of loans from MFIs in terms of number of loans are given in figure 29.

Figure 29: MFI- Loan Utilisation (Number of loans)



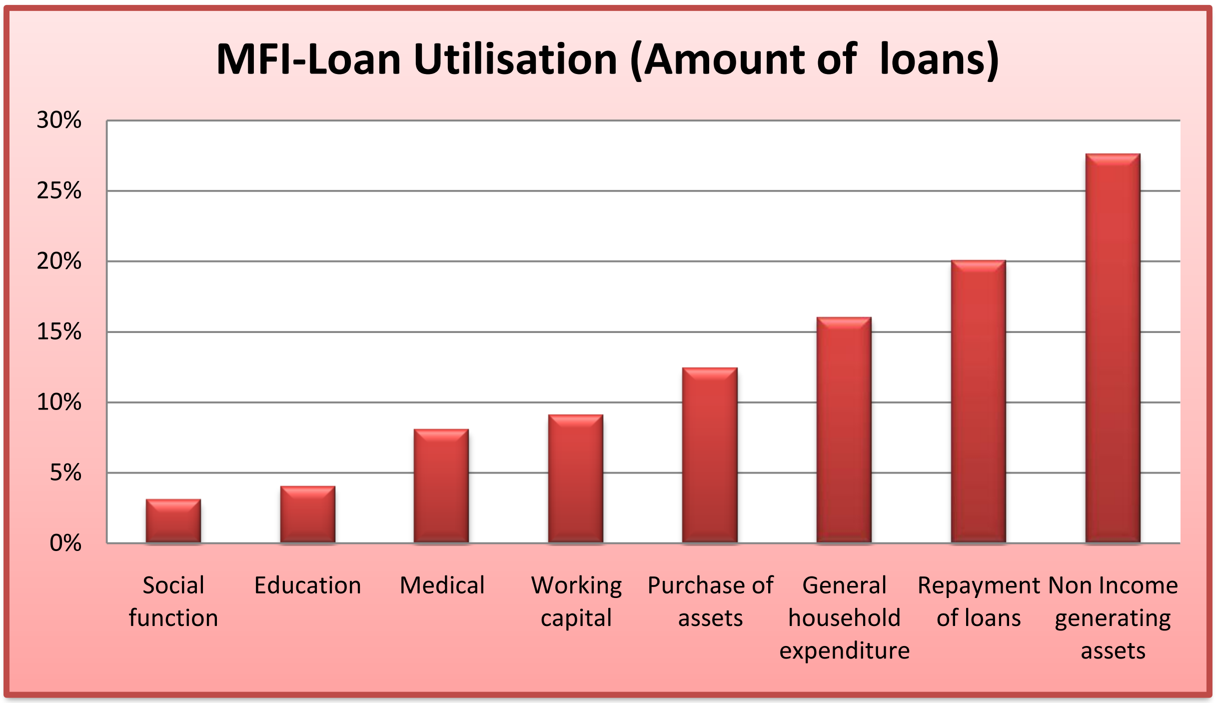
The percentage of loans utilised for income generating activities is around 19% and hence it could be said that more number of loans from MFIs were used for non income generating activities than that in case of loans from SHGs. The percentage of total number of loans taken from MFIs, which were used for income generating and non income generating activities, is shown in figure 30.

Figure 30: MFI- Utilisation of loans (Number of loans)



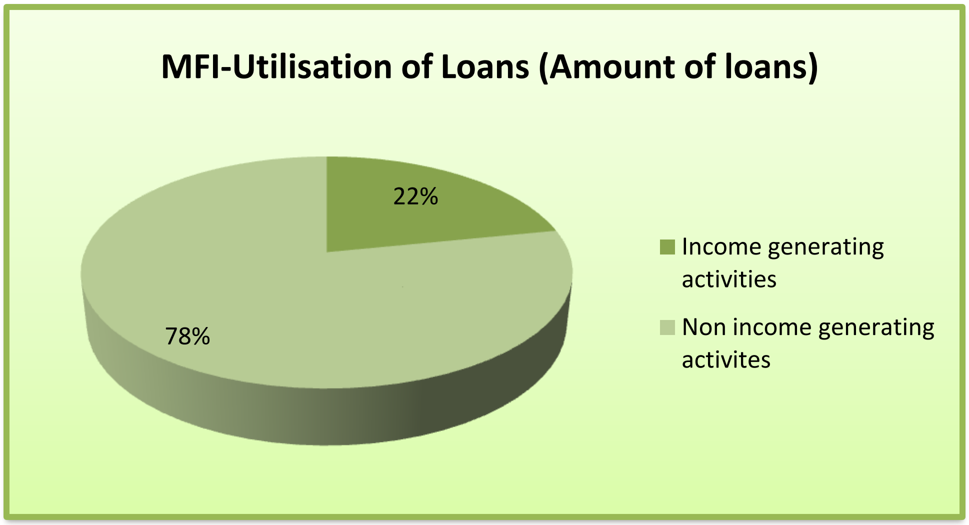
The utilisation of loans in terms of amount of loans taken from MFIs also showed the same pattern like that in case of utilisation of loans in terms of number of loans, especially in the major three purposes for which it was used. The details of loan utilisation in terms of amount of loan taken from MFIs can be seen in figure 31.

Figure 31: MFI-Loan Utilisation (Amount of loans)



The amount of loan utilised for non income generating purposes was more than that used for income generating purposes. It is shown in figure 32 given below.

Figure 32: MFI-Utilisation of Loans (Amount of loans)



It could be concluded from the results, that the loans availed by people were mainly used by people for non income generating activities and also it was more in case of loans taken from MFIs. MFIs also give loans to a particular group rather than to an individual. But it is different from SHGs in terms of its flexibility in changing the groups. For instance, ten people who really need credit can form a group and take loan from MFIs and next time they need not be a part of the same group. The availability of credit from MFIs without much delay also contributes to the fact that people naturally takes loan from MFIs for meeting their immediate needs. This could be one of the reasons for larger share of loans from MFIs being used mainly for non income generating activities. It could also be said that the formalities involved in getting loans from MFIs are less when compared to that of SHGs and the process of disbursal of loans from MFIs is more flexible than that in case of SHGs.

5.5 Cost of Borrowing

Any financial transaction entails a cost to the borrower. Such a cost can assume different forms depending on what the borrower has to 'expend' or 'part with' in the process. The costs may be financial, psychological or material in nature. But the costs of borrowing can be broadly classified as financial and non-financial.

5.5.1 Financial Cost of Borrowing

The single-most important factor that determines the financial cost of borrowing is the interest charged on a loan and is represented in terms of percentage per annum, though there are more costs that need to be factored before finding the real financial cost of borrowing. The following factors were taken into account in order to compute the real or effective interest rate (EIR) of the loans of the respondents.

- The stated rate of interest
- Processing charges
- Bribes and other costs incurred in acquiring the loan
- Wages forgone in pursuit of the loan.
- Payments toward institutional maintenance (Book keeping charges in case of SHGs)

The detailed explanation of the method used in computing the effective interest rates (EIRs) is given in Annexure 1.

Results on Effective Interest Rates

The 100 respondents who were interviewed had a total of 346 outstanding loans from SHGs, MFIs and money lenders. The EIRs or the real financial cost of each loan has been calculated and presented in table 6 and table 7. The results pertaining to the two models of micro-finance can be summarised as follows.

- **Average EIR of SHG loans = 21.56 % per annum** (WA* = 16.1 %)
- **Average EIR of MFI loans = 44.92 % per annum** (WA* = 43.2 %)

* WA is the weighted average of the EIRs where the weight assigned is the size of the loan. Weighted average of the EIR can be interpreted as the average interest rate on every rupee of loan that is disbursed.

Table 6: Financial Costs of SHG Loans

SHG Loans	Number of Loans	Average EIR (% p.a)	Maximum Value (% p.a)	Minimum Value (% p.a)	Standard Deviation (% p.a)	WA of EIR (% p.a)
Internal Loans	63	28.7	89.9	12	14.3	23.4
Loans from Federations	28	21.3	89.0	12	17.6	16.2
Bank Loans	98	17.1	52.0	12	7.1	14.9
Total	**189**	**21.56**	**89.9**	**12**	**13.1**	**16.1**

Table 7: Financial Costs of MFI Loans

MFI Loans	Number of Loans	Average EIR (% p.a)	Maximum Value (% p.a)	Minimum Value (% p.a)	Standard Deviation (% p.a)	WA of EIR (% p.a)
Spandana	72	47.3	81	23	14.2	45.2
S.K.S	22	49.9	87	28	21.1	42.5
AMMACTS	21	37.1	59	25	11.3	36.4
Share	9	35.1	55	28	12.4	33.1
Total	**154**	**44.92**	**87.2**	**23.6**	**16.3**	**43.2**

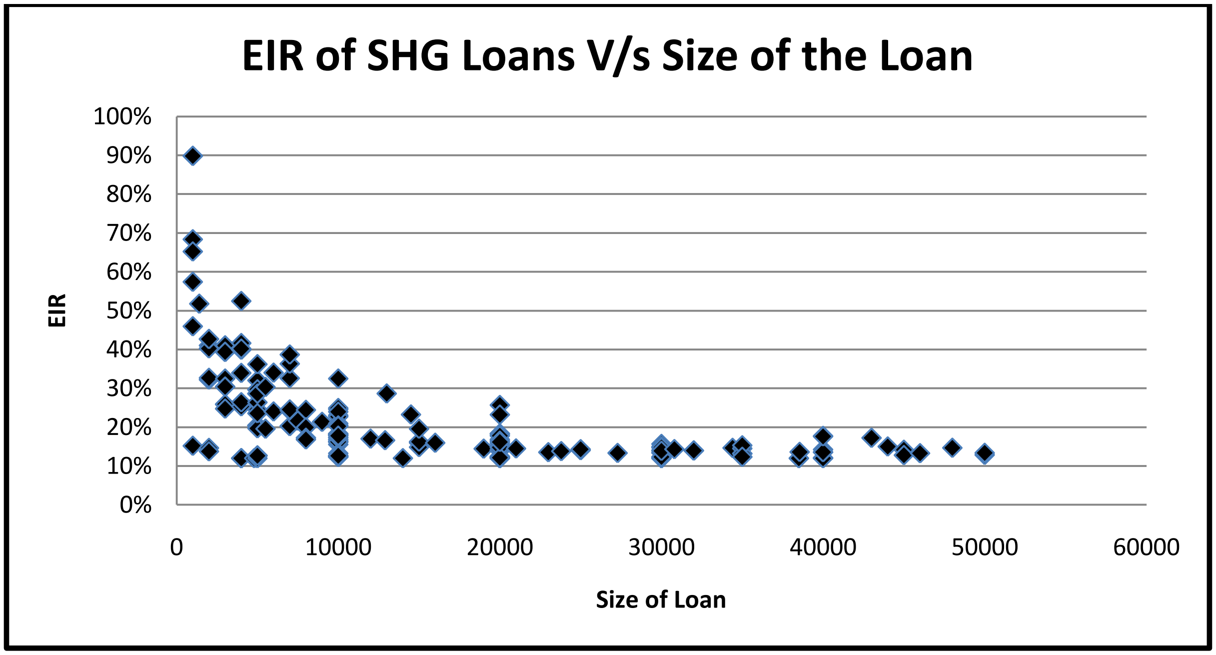
From the table, it becomes irrefutably clear that MFI loans carry a much higher financial cost as compared to SHG loans. Such a huge difference in interest rates raises serious questions on the viability of commercial MFIs as vehicles of micro-finance.

Additional Findings

Apart from the EIRs computed for each model of micro-finance, the level of variation of these rates also needs to be considered to analyse the financial implications of these loans on the end borrowers. Generally, there are some fixed costs associated with receiving a loan, especially for SHG members. An SHG member has to forgo her wages and pay a certain amount towards institutional book keeping regardless of the amount of loan received.

The EIRs of the 189 SHG loans against the size of those loans are plotted in figure 33

Figure 33: Effective Interest Rates of SHG Loans vs Size of the Loan



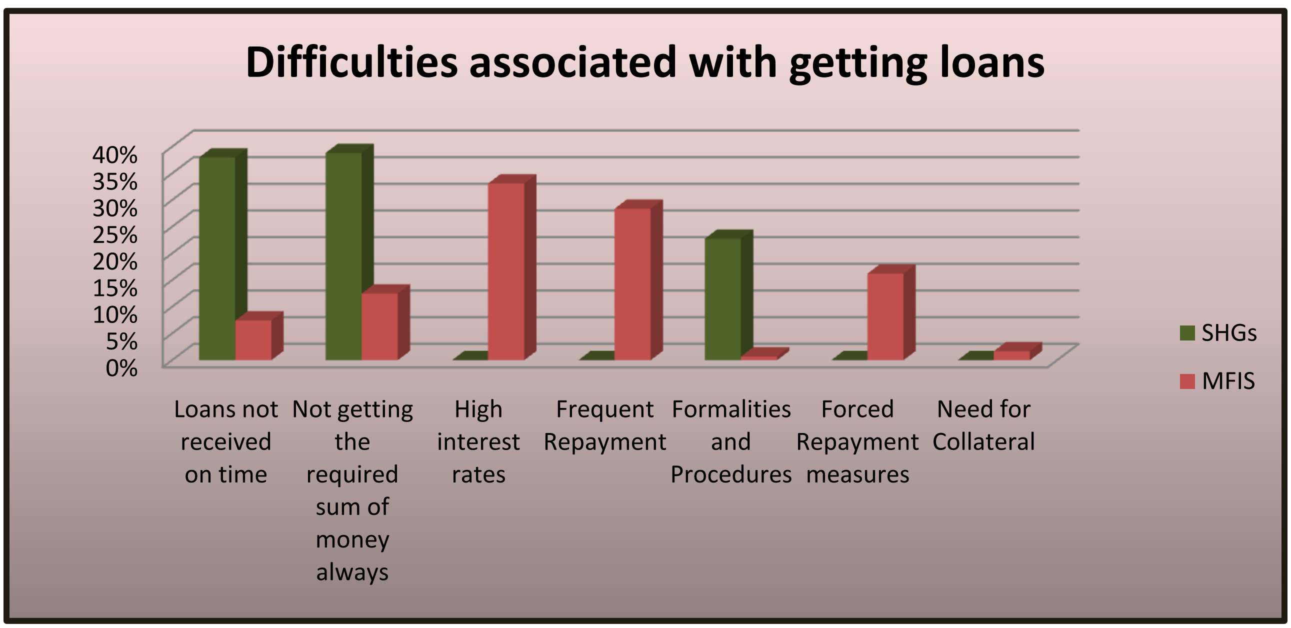
The above figure raises some serious equity issues associated with SHG loans. The level of variation in the EIRs of loans up to Rs 10,000 is significantly high. For instance, consider the top-most point representing a loan with an EIR of almost 90 %. It is the case of Meena from Bommarajapalle village who received a loan of just Rs.1000 from her SHG's internal fund. She had to forgo an average of Rs.75 in wages every month for attending meetings and needed to pay Rs 10 as institutional book keeping charges. She has received neither a bank loan nor a federation loan after years of membership in her SHG. Thus, all the wages she had foregone in the process was exclusively for this Rs 1000 loan. This can be an issue of equity in SHGs where some members maybe forgoing work to attend the meetings while some may be non-working housewives who don't have any such opportunity costs.

Hence, it is clear that lesser the number of loans and amount of loans availed by an SHG member, the higher are the interest implications on the loan, because many of the financial costs of borrowing are fixed in nature. The members have to lose out on a fixed amount of their resources regardless of the number and size of the loans received. Hence, it is highly recommended that SHG members be given higher amount of loans from different sources (like banks and federations) so as to mitigate the equity issues associated with loans of smaller size.

5.5.2 Non Financial Costs

The costs incurred by people other than the normal interest rates and other expenses which could be tabulated, usually goes unobserved. The real cost incurred by people hence remains partial and it is not considered to be a matter of relevance in the day to day lives. People encounter certain difficulties in getting loans from SHG and MFI delivery models and also during the repayment of loans. The percentage of people who considers these various factors as difficulties are represented graphically in figure 34.

Figure 34: Difficulties associated with getting loans



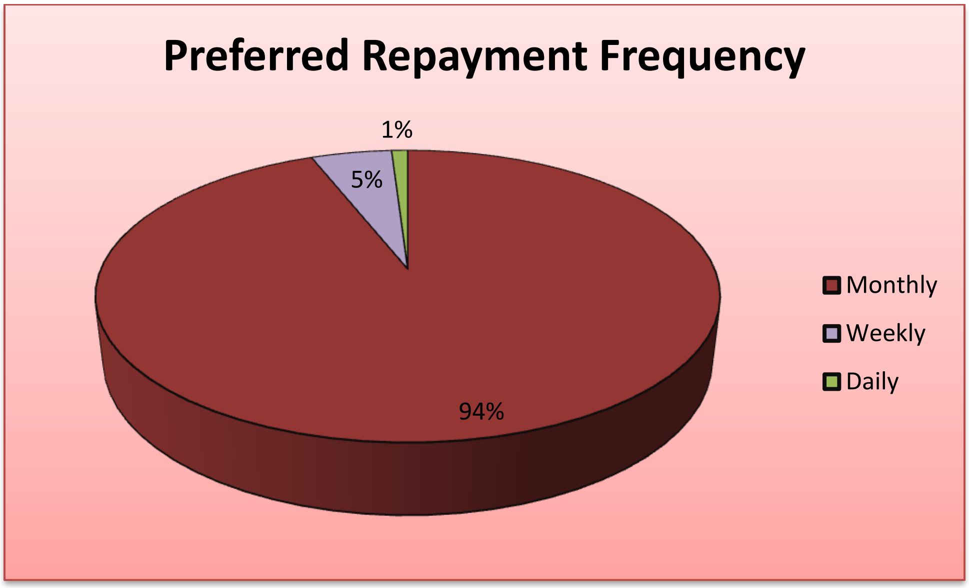
It could be seen that majority of the people considered the slack in timely disbursal of loans and unavailability of required amount of credit as the major problems, especially in case of SHGs. The formalities and procedures involved in getting loans from SHGs takes a lot of time and also there are lots of expenses involved in it. According to the survey results, 57% of the people had frustrations in attending the SHG meetings. There were cases where many of the women were not able to go to work since they had to attend the meeting. Also there were instances when family members had problems when women went for meetings without doing their daily chores.

Around 60% of the people said that they experienced some sort of stress and fear when they were forced to repay loans taken from MFIs every week. They had taken loans from MFIs mostly for meeting some immediate needs and found it difficult to repay every week. However, peer pressure and strict repayment terms of MFIs enforced them to arrange money for repaying the weekly installment. It had created a feeling of helplessness in the minds of the people and instilled some sort of dependence on alternate sources of credit. The mental trauma that people undergoes during the whole of process of getting the loans and while repaying it, has got its on effects on a particular household. The step taken towards mitigating these issues would indeed reflect a situation where it could be said that the delivery models of microfinance is able to supply credit to meet the demands of the people and also has enabled them to repay it on time.

5.6 Repayment of Loans

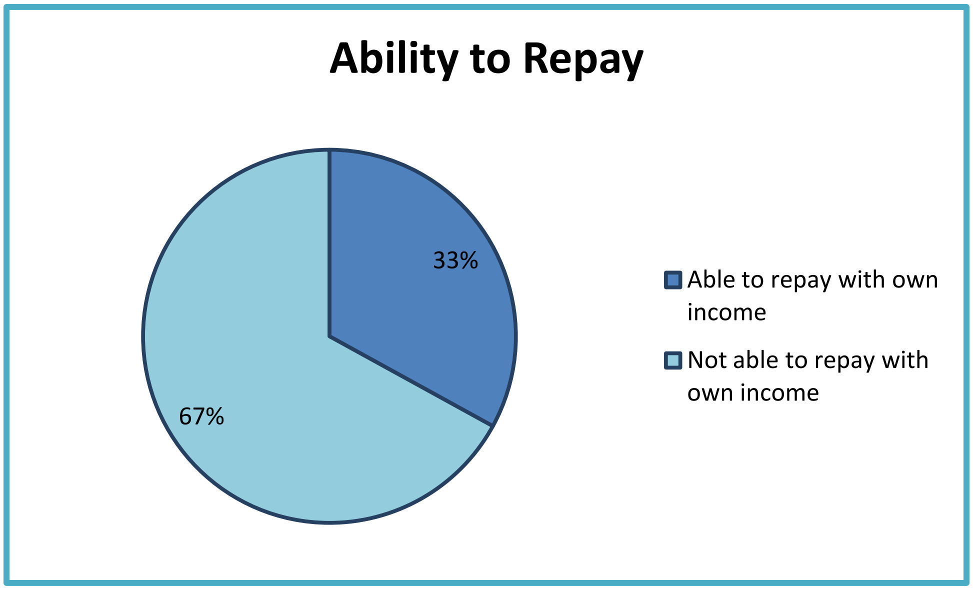
The ability to ensure repayment of loans by people is as important as improving the efficiency of the delivery models of credit. Moreover, timely repayment of loans indicates the extent of credit discipline among the people. There are various factors that can directly or indirectly affect the repayment of loans by the people and it includes even the promises that the politicians make during election campaigns and the policy interventions related to credit. The perspectives of people regarding their preferences of repayment and the means adopted by them to repay their loans had been included in the study. The preferences of the people regarding the repayment frequency of loans are shown in figure 35.

Figure 35: Preferred Repayment Frequency



It is very well evident that monthly repayment is preferred by majority of the population. Eighty percent of the people who preferred weekly repayment were wage labourers. The reason that the people gave for preferring weekly repayment is that they would get daily wages and find it easier to repay the loan installment weekly. Only one person preferred daily repayment and it is done in case of repayment of loan taken from AMMACTS. The source of livelihood of the people and the frequency at which people get income from it is very relevant in deciding upon the repayment frequency. The percentage of people who are able to repay loans with the income that they get from their source of livelihood forms a minority out of the total people surveyed. It is shown in figure 36.

Figure 36: Ability to Repay

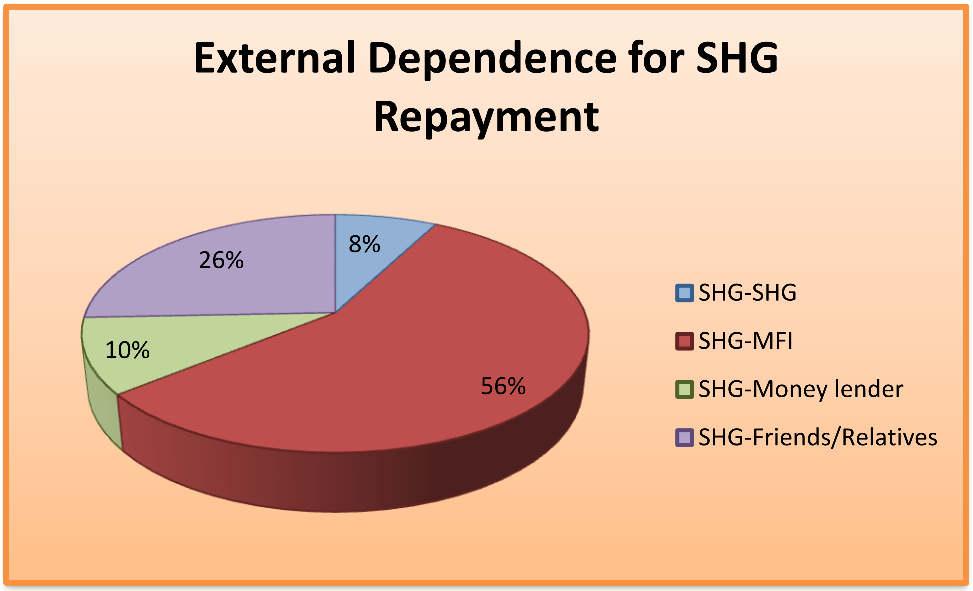


It is very clear that it is not of much benefit if the loans are being disbursed unless people are able to repay it with their own source of income. It also indicates that not much improvement has occurred in increasing the income of the people by means of taking credit from SHGs and MFIs. It could also lead to a situation where people get ensnared in debt traps by lending money from informal sources of credit.

5.6.1 Rolling of Debt

The external dependence for repayment of loans taken from one source of credit is a very common phenomenon being followed by majority of the people. It mainly indicates the inability of the people to repay their loans or a situation of oversupply of credit without monitoring the purposes for which it is used. It is evident from the results shown in figure 36. The extent of external dependence of the people to repay loans taken from SHGs is being depicted in figure 37.

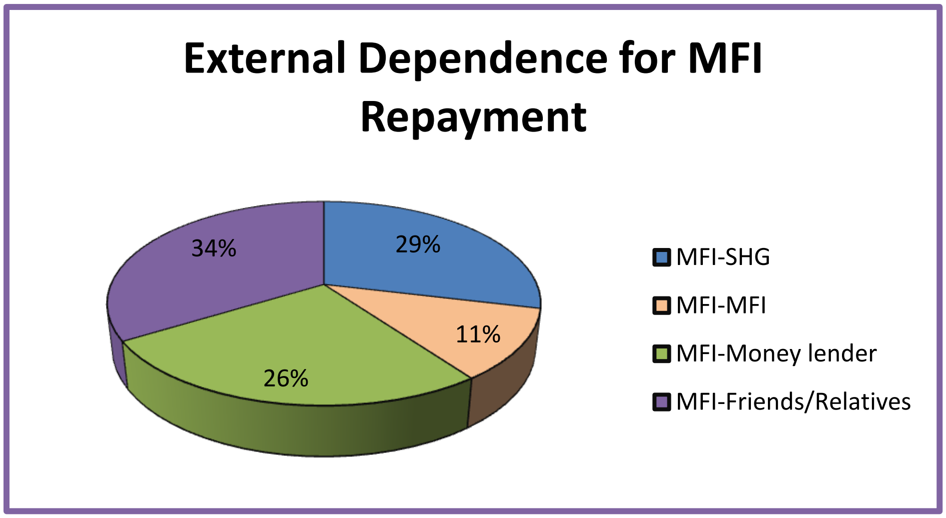
Figure 37: External Dependence for SHG Repayment



It was seen that majority of the people depended on MFIs to repay the loans taken from SHGs. This clearly indicates the need for monitoring the purpose for which the loans are being utilised by people or else the very concept of making the women empowered through SHGs by making them self reliant would fail in its purpose.

The external dependence of people to repay loans from MFIs showed an almost equal dependence on the various sources of credit. The percentage of people dependent on other MFIs to repay loans taken from an MFI was comparatively low compared to dependence on other sources of credit. The particulars of external dependence to repay loans from MFIs are shown in figure 38 given below.

Figure 38: External Dependence for MFI Repayment

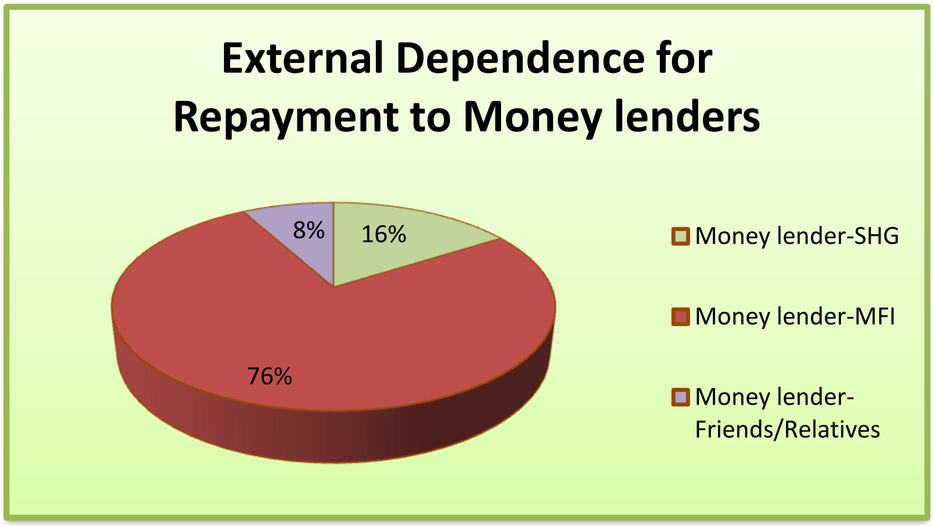


The fast growth of MFIs was perceived as a replacement of informal sources of credit. However, it could be seen that the prevalence of MFIs had actually contributed to the existence of money lenders. A considerable percentage of people had taken money from money lenders to repay loans taken from MFIs. It was also seen that 29% of people took money from SHGs in order to repay loans taken form MFIs.

Based on the results of the study, it cannot be vividly vouched that prevalence of MFIs had led to decreased repayment rate in SHGs. But it is very well clear that the continuation of the existing practices can severely affect the effective functioning of SHGs because timely repayment forms a strong base for the effectiveness of working and sustainability of SHGs. The respondents of the survey belonged to 52 different SHGs and out this; there was no savings in six of the SHGs. It is also found that internal loans are not given from these SHGs to its members as there is no savings and timely repayment of loans. It implies further scope of malfunctioning of SHGs given the current scenario persists.

The external dependence for repayment of loans taken from money lenders is shown in figure 39. It was seen that majority of people took loans from MFIs to repay money taken from money lenders. So the existing situation implies a state of mutual aid between MFIs and money lenders in expanding their scale of operations at the cost of the poor.

Figure 39: External Dependence for Repayment to Money lenders



Case Study No 2: From the Frying Pan to the Fire: A Case of Entanglement in Debt

B.Gayatri (name changed), aged 36, from Bangarupalam mandal in Palamner is seriously considering migrating to another district with her entire family. The reason: An inescapable maze of debt. She has been a resident of this village all her life and her eyes were welling up with tears at the thought of having to leave her birthplace. She, her husband and two daughters have exhausted all options of servicing their debt and feel cornered by a web of MFI agents, money-lenders and co-members at her SHG.

From 2005, She and her husband has been running a small electrical appliances store near her home which is in a crowded part of the village which almost qualifies as small town. They had started this business with loans received from friends, relatives and money-lenders. They incur a significant fixed cost on this establishment because of the rent attached to it. Since, the business never really took off and the debt and costs kept piling up, they turned to other sources of finance to keep themselves afloat. Gayatri took as many loans as she could from her SHG, *SaiSakti* and also turned to AMMACTS for micro-loans. Even so, the business remained unprofitable and kept eating away from all loans that were taken. Since, Bangarupalam was semi-town there was an abundance of MFIs operating in the region. Soon, she found herself having loans outstanding with all the MFIs operating in the region (AMMACTS, SKS, Share and Spandana). She found herself in a constant cycle of debt rolling whereby she serviced old loans with fresh loans. In doing so, she did not realize that she was servicing lower interest loans with new high interest loans. In effect, she was jumping from the ‘frying pan to the fire’. And to top it all, the business has never registered a net profit to this day. In simple terms, their business had done them no good from day one.

(Continued …….)

Currently, she has loans outstanding with the following:

- Her SHG (Both Internal Loan and Bank Linked Loan)
- All four MFIs in the area (AMMACTS, SKS, Share and Spandana)
- Three different money lenders
- Two friends and one relative

The total of these loans amount to more than 2.5 Lakh Rs. MFI loans make for the majority of her credit portfolio and she has to make payments to all four MFIs every week with money that she does not have. She says she is waiting for her daughter in Class 10 to finish her academic year so that she and her husband can make a 'final' decision. But it is all too evident that they don't have much choice other than to sell their paltry home, settle the debts with their relatives and friends and migrate to another district where they can hopefully start life afresh.

5.6.2 Level of Repayment

All the loans taken through SHGs and MFIs were analysed for their levels of repayment. In the context of this report, level of repayment means the adherence of the borrowers to the installment schedules of each loan. Put simply, it checks whether the clients are repaying their loans in a prompt and timely manner.

Since the time during which the study was conducted coincided with the promulgation of the microfinance ordinance, there was no reliable way to ascertain the overall level of repayment of MFI loans till date. The reason was that MFI agents had ceased coming for loan recovery into the villages fearing a government backlash. Some MFIs reported that their recovery rates had dwindled to less than 5 %. This, being the result of an extreme circumstance cannot be factored in to find out the overall level of repayment associated with MFI loans. But informal discussions with MFIs operating in the area and their beneficiaries revealed that more than 99 percent of the loans were being serviced promptly before the ordinance came into effect. The level of peer pressure was so high in JLGs promoted by MFIs that the credit discipline of each beneficiary remained impeccable. But, the same cannot be said about the loans taken from SHGs. Before proceeding further, the following terms need to be defined:

- *Ideal Amount Outstanding*: This is the amount that should have been outstanding in a borrowers loan account if she had been paying all her loan instalments in a timely fashion.
- *Actual Amount Outstanding*: This is the actual amount outstanding as registered on the borrowers loan account.
- *Credit Indiscipline or Credit Overdue*: This is defined as an instance where the actual amount outstanding is more than 125 percent of the ideal amount outstanding. This simply means that the borrower is displaying a significant degree of indiscipline in servicing her loan.
- *Default*: This is a situation where the loan was received more than 12 months ago and the actual amount outstanding is more than 500 percent of the ideal amount outstanding. This either means that the borrower has stopped paying her instalments a long time ago or that the payments she made are extremely low, such that it borders on non-payment.

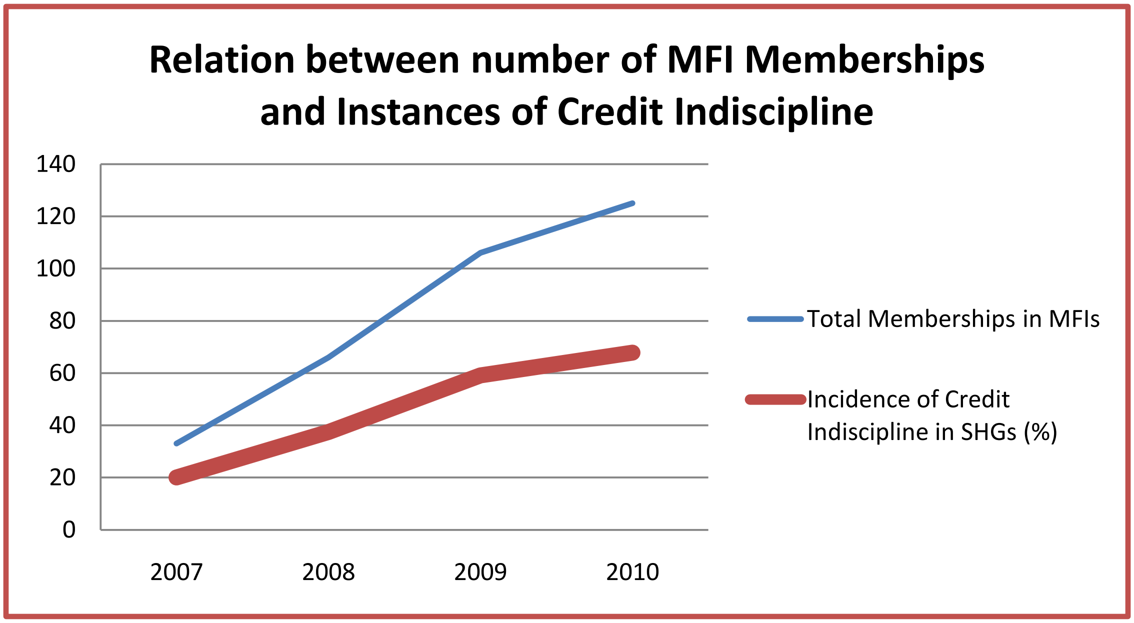
The results pertaining to the repayment level of SHG loans are given in table 8.

Table 8: Results pertaining to Repayment Level of SHG Loans

Particulars	**Number of Loans**	**Cases of Credit Indiscipline**	**Cases of default**
SHG- Internal Loan	63	36	7
Federation Loan	28	13	0
Bank-Linked loans	98	57	5
Total	**189**	**106**	**12**

It is alarming to note that more than 50 percent of the currently outstanding SHG loans are suffering from credit indiscipline on the part of borrowers. Particularly distressing is the fact that such instances of credit indiscipline in SHGs are correlated to the MFI activities in the area. Figure 40 denotes the relation between the number of MFI memberships and the instances of credit indiscipline within the SHGs over the last four years.

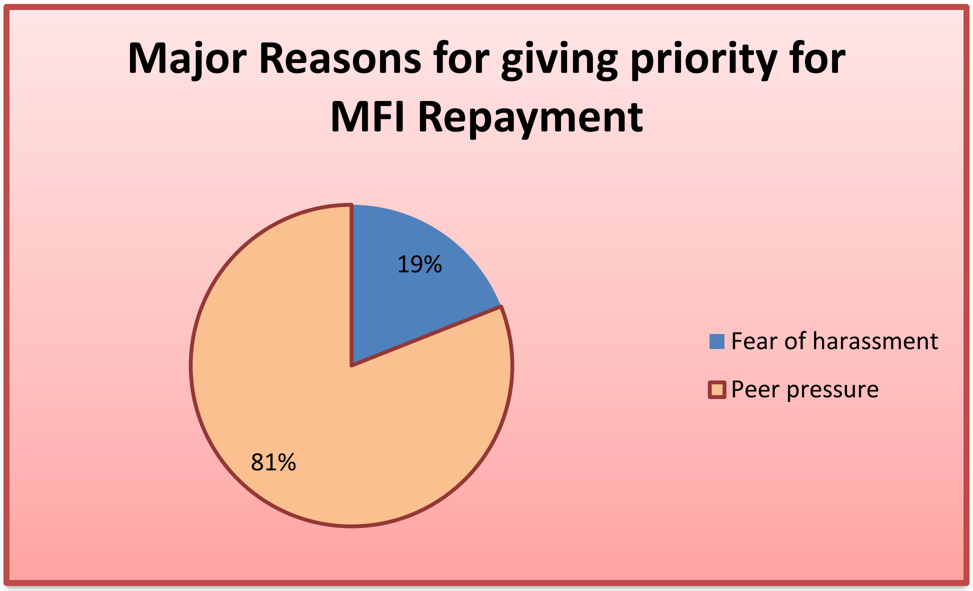
Figure 40: Relation between number of MFI Memberships and Instances of Credit Indiscipline



The blue curve (thinner curve) shows the growth in the number of MFI memberships among the sample population in the last four years. The red curve (thicker curve) shows the instances of credit indiscipline within SHGs in a certain year as a percentage of the number of loans outstanding during that year. It is truly alarming to note that there is a very strong correlation between the two (greater than 0.99). This clearly points out that servicing the MFI loans is of top priority to the respondents, even at the expense of their SHG loans.

According to the results obtained from the survey, it was seen that 97% of the population would give preference to repay MFI loans first after which only they will think about repaying loans to SHGs and money lenders. The propensity of people to give priority for repaying loans from MFIs has the potential to deter timely repayment in SHGs which in turn can affect the effectiveness and sustainability of SHGs in future. The major reasons for giving priority for repayment of MFI loans are described graphically in figure 41.

Figure 41: Major Reasons for giving priority for MFI Repayment



Peer pressure was considered to be a more important factor forcing people to repay loans from MFIs than the fear of harassment by MFI agents. There were no cases of harassment by MFI agents in the villages which were included in the study but in many instances, people had told that their group members had created problems when they failed to repay loan installment on time. It indicates the indirect means used by MFIs to ensure timely repayment which is against the culture and concept promoted through SHGs. The internal bonding created within SHG groups is not found in groups formed by MFIs. So it could be said that the repayment terms are very rigid in case of MFIs compared to that in case of SHGs.

Case study No: 3: An SHG on the brink being defunct

SHGs are considered as the most potent initiative to empower women and make them more self reliant. It has been successful to a great extent in bringing about the desired changes especially in making women more confident in dealing with management of finance. It has a tremendous effect on bringing about a marked improvement in the role of women in family and society. However, the efficiency of the functioning of SHGs is dependent upon various factors and timely repayment and savings are important for ensuring the sustainability of SHGs in the long run.

Venkateshwara was one of the SHG groups which were considered for the study. It was formed ten years before during the time when SHG revolution was initiated. The present state of functioning of Venkateshwara group is a matter of concern which has to be dealt properly so as to improve the efficiency of operations of SHG groups. There were thirteen members in this group at present. The existing situation revealed that only a very few members contributed to savings in the group. So there was no proper internal rotation of funds and the members of the group were not able to take loans from their internal funds when they needed it, as majority of them failed to put savings and repay the loans taken on time. The members told that they didn’t get enough amount of loan from the banks also. If the repayment of a previous loan is not complete, then they won’t get further loans from the banks. It is very well clear that the group is not able to meet the credit needs of its members.

The importance given to timely repayment of loans had a great effect on the effectiveness of SHG group. The main problem encountered by Venkateshwara group was regarding this aspect of timely repayment. All the thirteen member of the group had taken loans form MFIs also. The members themselves admitted that they gave more preference to repayment of loans taken from MFIs. Though they knew that taking money from MFIs can affect repayment in SHGs, they borrowed money from MFIs as they wanted money for meeting their immediate needs at that particular point of time.

The case of Venkateshwara group very well exemplifies the potential of increased influence of MFIs in deterring the existence of SHGs. The values associated with SHGs can never be found in MFI groups which use peer pressure as a means to get money from people. Though people are aware about it they depend on MFIs for getting loans on time for meeting their immediate needs. The shortfall on the part of SHGs in providing timely credit and also higher amounts of loans can be considered as the major reason for the increased prevalence of operations of MFIs.

6. AN EXAMINATION OF THE MERITS AND DEMERITS OF SHG AND MFI MODELS

The two delivery models of micro-finance in India, namely the SHG and the MFI model have many merits and demerits associated with them. These pros and cons have been analyzed from a macro perspective and also from the perspective of the end user who is the rural borrower.

Merits of SHG-Bank Linkage Model from an Overall Perspective

- It leads to an increased solidarity in the areas where it is implemented due to the ‘community based’ model it follows. This leads to an **enhanced social capital** in the villages which could result in a plethora of direct and indirect benefits.
- Significant credit mobilization in the village happens as a result of the linkage between SHGs and banks. The importance of this is that the **money stays in the village and gets accrued** in the form of savings and corpus funds. Also a money multiplier effect would come about in villages with the functioning of SHGs due to the credit being mobilized from the banks and federations.
- Apart from the credit based functioning of an SHG it may have plenty of other positive agendas as well. For example, training programs for developing literacy and numeracy among the members, skill development for livelihood based activities, awareness building about female health, family planning etc contribute towards the **knowledge and capacity building of the rural masses** as a whole.
- Because the SHG movement has the potential of reaching to the masses and being a part of almost all rural households in the nation, other **government programs and interventions could be easily implemented through SHGs**.

Merits of SHG-Bank Linkage Model from the Perspective of the End User

- The **interest rates are quite bearable** in the case of internal lending practiced by SHGs. From the study, the effective interest rates of loans from SHGs were found to be at an average of 21.56 percent per annum, which is considered quite manageable and bearable. (As opposed to the average EIR of MFI loans which came to 44.92 % per annum)
- The SHGs **do not resort to strong arm tactics** and pressurizing measures to ensure repayment of outstanding loans. They normally rely on peer dynamics for instilling credit discipline in the members.
- The **repayment terms are generally more flexible** and realistic with SHGs as opposed to MFIs which often demand regular weekly installments. This is especially true in the case of loans taken from the internal funds of the SHGs.
- Apart from the servicing of credit needs, the regular activities of SHGs **contribute to the members' overall skill enhancement and empowerment.**

Case Study No: 4
From Helplessness to Hope: A Story of Empowerment through SHG

Nagalakshmi, aged 27, has been a resident of Samudrapalle village in Palamner for over seven years since her wedding in 2002. She and her husband are hard working wage labourers who work on the fields of richer farmers. After the marriage, their life was a constant struggle to make ends meet especially during the times when the agricultural work in the area was restrained due to droughts. In the past, they had temporarily migrated to nearby districts in search of much needed wages. The problems were compounded by the medical expenses that accompanied her father-in-law's illness and consequent death in 2006. Nagalakshmi felt suffocated in this web of abject poverty, helplessness and the futility of their laborious efforts.

Nagalakshmi had been a founding member of the *Jeevanajyothi* SHG in her village from 2004. The SHG which was promoted by SERP had 12 members, all from similar backgrounds. The SHG had a jittery start in the beginning due to the reluctance of some members to give the mandatory thrift deposit every fortnight. Even Nagalakshmi admits that she was inconvenienced in many occasions due to this requirement. But *Jeevanajyothi* overcame these initial hurdles and soon became known for the impeccable discipline among its group members. The savings slowly started building up and there was regular rotation of these thrift funds among its members.

(continued...)

The regular meetings that the group held gradually developed a sense of unity and solidarity among the members.

She admits that she even felt empowered due to the identity that the SHG gave her. By 2007, the SHG had adequate experience with the basic concepts of savings, credit and instalments. Their internal savings had grown to almost 25,000 Rs and had become a matter of pride for the members. The group became eligible for its first bank loan in 2006 and received an amount of Rs.1,20,000 from Indian Bank which was the lead bank in the district. This amount was equally divided into loans of Rs.10,000 each for all members and Nagalakshmi received her share with the others. But, she had to spend this amount for the medical expenses on her father-in-law who passed away in the same year.The turning point in her family's welfare came in 2008 when *Jeevanajyothi* received a fresh bank loan of Rs. 300,000 after successful repayment of its previous loan.

The 25,000 Rs share that Nagalakshmi got from this new loan was used for purchasing a cow. The animal started giving milk within one year and the family income improved significantly. The uncertainty of wage labour was mitigated by the cash inflows from the sale of milk to a nearby private dairy. She proudly pointed out that their family income, which hovered around 1500 Rs per month a few years back has more than doubled in the last year. The feeling of pride and independence that's associated with being the owner of an asset was evident from her words. The couple are expecting their first child soon and she now feels confident in raising a child in her family. She is also eager to receive her next loan so as to buy one more cow. There seems to be a new hope in her, a hope that can be seen in anyone who has broken free from the shackles of uncertainty and helplessness.

Demerits of SHG-Bank Linkage Model from an Overall Perspective

- It is often seen that **insufficient credit supply coupled with the general disinterest of banks** to lend to SHGs is a huge problem being faced currently. Since the incentives in lending to SHGs are at a minimum, financial institutions are often hesitant in supporting this movement.
- **Lack of diversity in the credit services** being offered by the SBL model has been frequently cited as a main reason for its ineffectiveness. Since most SHGs only give small scale credit and offer no other financial products like insurance, savings and remittance services, total financial inclusion, both in letter and spirit remains as an unachieved goal.

- Normally, the social mobilization that precedes any SHG movement is taken up by the state. Since it is the government which initiates such community based programs on a huge scale, this **could be a burden on the exchequer.**
- The very outreach that the SHG movement boasts of could also have negative consequences if it gets used as a vehicle for unscrupulous **politicization by the various stakeholders involved** (Government, Opposing Parties, People in the Community)

Demerits of SHG-Bank Linkage Model from the Perspective of the End user

- Since the SHGs are essentially linked to banks for their credit needs, it often results in **long delays in the processing of the loan**. Also, the members lose out on many productive hours due to the numerous meetings and training sessions they have to attend as part of their SHG membership.
- The SHGs generally incur a **high operational cost within the group** in maintaining each member's financial records and conducting meetings and training sessions.
- The **credit availability per member is quite low** in the case of SHGs and it often falls short of the total credit requirements of each member's household. This results in multiple borrowing by the SHG members which could result in undue debt burden.
- Since each SHG is modelled as an entity where the group takes responsibility for individual defaults, there are many **possibilities for internal conflicts and disintegration** within the SHGs.
- The SBL model of microfinance **lacks in quality of service** and falls pathetically short of the commercial MFIs which can give ready delivery of loans and offer a wider range of credit services.

Merits of Micro-Finance Institutions from an Overall Perspective

- Since most commercial MFIs function under the principles of financial returns and organizational growth, it can contribute in bringing **efficiency to the distribution of micro-finance** all over the nation.
- Under the MFI model, the social mobilization cost involved in introducing microfinance at the village level is borne by private parties and hence there is **no burden on the state exchequer.**
- The funds required by the MFIs often come from institutional sources and capital markets, hence **facilitating credit mobilization in the nation** as a whole.
- Since the MFIs come under the tax purview of the government, their operations could result in **increased revenue for the state**.

Merits of Microfinance Institutions from the Perspective of the End User

- MFIs are able to offer **higher quality of service and ready delivery of loans**. This arises from the operational efficiencies they enjoy due to the huge workforce they employ and the incentive structure given to them.
- Unlike SHGs, the **client groups formed by MFIs do not incur much operational expenses** since most of the record maintenance work and group meetings are paid for by the MFI itself.
- Also, there is a **ready availability of credit and minimal hesitation by the lender** when it comes to borrowing from an MFI.
- The **processing time required for receiving loans from an MFI is minimal** and they can almost be considered as 'on-the-spot' loans. Also, the clients do not have to spend time attending numerous meetings and training sessions which would have been mandatory in case of SHG memberships.

Demerits of Microfinance Institutions from an Overall Perspective

- Due to the commercial nature of most MFI ventures, the **ultimate goal of poverty alleviation would be disregarded in the pursuit of growth and profit maximization**.
- The eagerness of MFIs to disburse loans could result in unnecessary credit being pumped into rural households with low credit absorption capacities. This, coupled with the higher interest rates of MFIs **could result in a nationwide debt burden with affiliate consequences like collapse of MFIs, client suicides and distress migrations**.
- Most MFIs, in order to keep their operations sustainable, need to employ a huge workforce at the field level. This, accompanied with many other reasons contributes to a **very high operating cost in the running of MFIs**. Often, this increased cost is transferred to the end client in the form of high interest rates and processing charges.

Demerits of Microfinance Institutions from the Perspective of the End User

- The most glaring disadvantage to borrowing from an MFI is the **high interest rates** that they charge. From the study, the effective interest rates of loans from MFIs were found to be at an average of 44.92 percent per annum, which is considered unbearable. (As opposed to the average EIR of SHG loans which came to 21.56 % per annum)
- The **repayments are often too frequent and unrealistic** as they do not match with the cash flows of an average rural household. Most MFIs demand weekly installments that are inconvenient to the borrowers.
- **The borrowers may have to face strong arm tactics and intimidation** when they become unable to meet their debt requirements. The clients often feel harassed and dehumanized in such instances.
- The **clients are not aware of the real financial implications of the MFI loans** since the terms of such loans are misleadingly presented in a shroud of flat rates and 'convenient' installments.

7. CHALLENGES FACED BY THE TWO DELIVERY MODELS OF MICROFINANCE

The SHG and MFI models have its own set of challenges that need to be encountered in the near future, if they are to remain sustainable and contribute towards the goal of total financial inclusion.

7.1 Challenges faced by SBL Model

- Challenge in getting sufficient and timely credit from banks

  The availability of credit has always been an Achilles heel in the operation of SHGs as the loans disbursed by banks often tend to fall short of the real needs and requirements of the SHG members. Another big problem is the timely availability of credit to SHGs. The average loan cycle is 3 years for an SHG that has borrowed from a bank. This cycle seems to be highly unrealistic as it does not match with the cash flows of normal rural livelihoods
- Insufficient focus on the poorest of the poor

  It can be seen that, although the SHG movement in few states was a resounding success in terms of scale, it often fell short when it came to addressing core issues. For example, abject poverty still exists in the rural hinterlands of AP and the socio-economic empowerment of the most downtrodden segments like SC/ST, handicapped and landless people is still a distant dream.

- Minimal diversity in credit products

  The financial operations of the SHGs are still restricted to savings and small loans which are often taken for emergencies or consumption purposes. For an SHG to receive higher amounts of loans from a bank, it needs to articulate clearly that such a loan is for an IGA (Income Generating Activity). But most SHGs do not borrow at that level and restricts itself to borrowing for consumption. A diverse range of financial services (Insurance, Remittances and Flexible Loans) need to be introduced at the SHG level to achieve financial inclusion in both letter and spirit.

- Non-Compliance and Defaults

  It was seen that there is a rising occurrence of non-compliance in the area and this was attributed mainly to the influence of commercial MFIs. More and more SHG members are defaulting and splitting away from the groups where MFIs have become active. It often occurs that a person would be a member of multiple groups for personal advantage. When a default occurs, the banks have no collateral to fall back on and have to rely solely on the internal peer pressure of SHGs. Revenue recovery methods have been attempted in some cases but this is a long and cumbersome litigation process and is not practical. This increasing wave of non-compliance fuelled by the alleged unscrupulous practices of MFIs is turning out to be a real headache for the SHG movement in AP, according to Mr. G.V.S Reddy, Program Manager at SERP.
- Insensitivity on the part of SHPAs

  Most Self Help Promoting Agencies in the country are working on a target mode to create as many SHGs as they can. Such a tendency can result in standardization and centralization of their operational procedures which makes these interventions lose touch with the ground realities and community differences in the target areas. Such an insensitivity coupled with the inadequacy of training given to SHGs would, in effect, make the SHG movement counter-productive to the goals of true financial inclusion.
- Equity Issues in SHGs

  From the study, it was found out that different members in the same SHG often bear different financial costs on the loans they have taken. For instance an SHG member who is a labourer may have to forgo a certain amount of wages due to the operational requirements of an SHG while a housewife in the same group has no such opportunity cost. This results in different financial costs for these two members on the same amount of loan.
- Political Leverage of the SHG Movement

  Since the SHG movement in certain states like Andhra Pradesh and Kerala have an extensive reach into the population, governments and political parties tend to use it as a vehicle in establishing their popularity. This may result in the pushing of agendas and ideologies through SHGs and their federations. This makes the stakeholders lose sight of the true intent and purpose of community based organizations.

7.2 Challenges faced by MFI Model

- High Operational Costs and Interest Rates

  Due to the very outreach that an MFI needs to have into the rural regions of the nation, they have to bear a high amount of operational costs in the form of salaries and social mobilization cost. They may also have a high financial cost on their funds as they may have borrowed it from some other financial institution in the first place. Such a high cost associated with the functioning of MFIs gets transferred to the end client in the form of higher interest rates and processing charges. This makes MFIs a very unpopular model of micro-finance.

- Tendency for 'drift' in mission

  Since most MFIs are commercial ventures operating with borrowed funds and maintaining a huge work-force, the initially stated goal of poverty alleviation may eventually take a backseat to profit maximization and organizational growth. Such a tendency has been seen in many MFIs that started off as NGOs and later changed into the form of NBFCs. Although this shift from NGO to NBFC may have been for many reasons, it can never be denied that any organization consisting of many different individuals would have a tendency to shift their mission from social empowerment to profit creation.

- Difficulty in Acquiring Funds

  Since most MFIs do not amass savings from their clients, they have to look elsewhere for acquiring their funds. They may source these funds from banks, investors, donors and other sources. Since this is not an assured source of funds, many MFIs may face difficulties in continuing with their operations, especially when there is a wave of default from their client base.

- Negative Image of MFIs

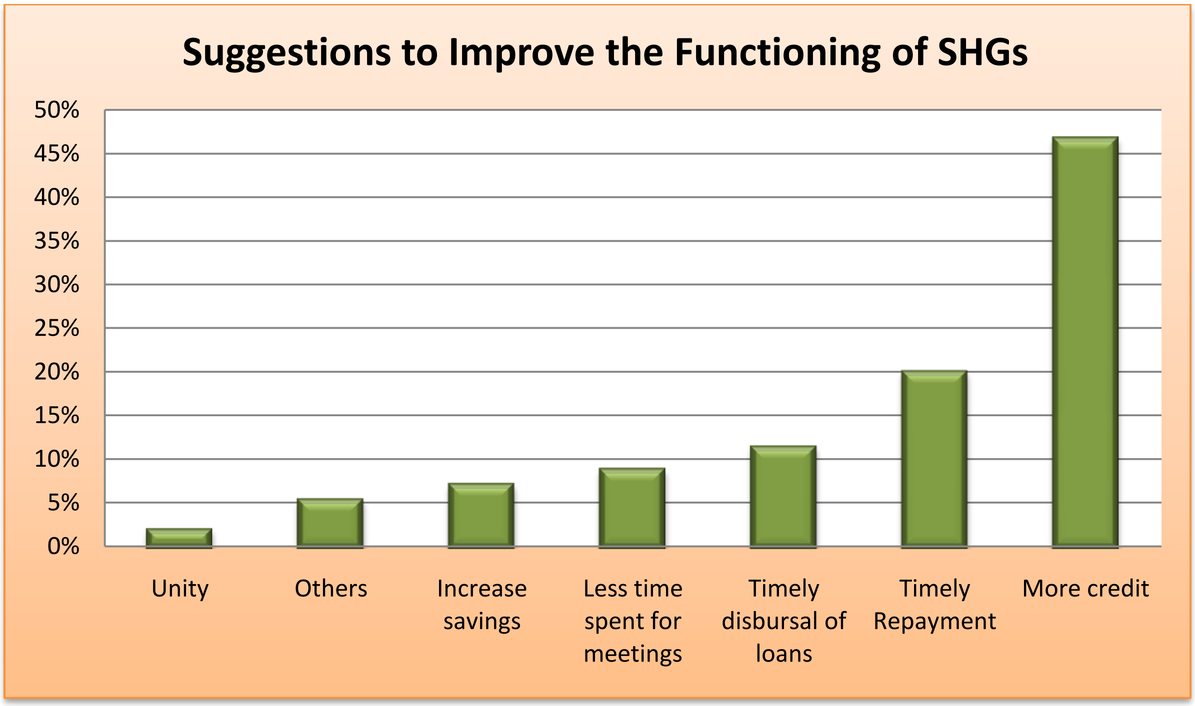
  There is a negative image associated with MFIs due to their high interest rates and alleged unscrupulous loan recovery tactics. Such a negative image, fuelled by the media often results in the Government cracking down on all MFIs. Such a crackdown may affect even the most ethical of MFIs as the clients may stop repayment because of their confidence in a 'protective' government. For instance, the manager of an MFI branch in the area of study reported that the recovery rates of their loans fell from more than 99 percent to less than 5 percent in the aftermath of the media outcry and the Micro-Finance Ordinance in October-2010.

8. SUGGESTIONS FOR IMPROVING THE TWO MODELS OF MICRO-FINANCE DELIVERY

The sustainability of the existing models of delivery of micro-financing needs to be ensured for which there is a need to identify the drawbacks in the existing systems. This will help in bringing about necessary changes to improve their effectiveness. It would be prudent if the perspectives of the clients and beneficiaries are considered while thinking about the aspects of such an intervention. Such a consideration can be considered bottom-up in nature. People had their own suggestions to bring about relevant changes in the existing system. The following are the suggestions given by the respondents themselves.

The suggestions given by the people to improve the functioning of SHGs are given below in figure 42.

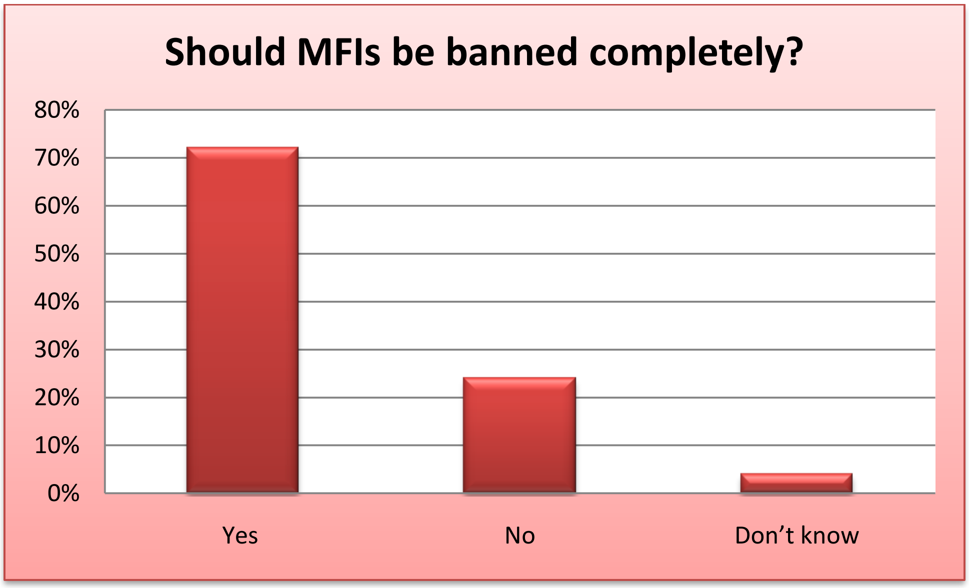
Figure 42: Suggestions to Improve the Functioning of SHGs



The majority of people have put forth the supply of more credit as one of their prime requirements. "I prefer that MFIs would continue their work as I would get money from them when I need it without much delay. I don't get timely loans and sufficient amounts from SHGs and that is the reason for approaching MFIs for money" says B. Mangamma, who was one of the respondents from Kalakathoor village. A few had suggested that they wanted to start savings again in their SHG groups and increase internal rotation of money within the group.

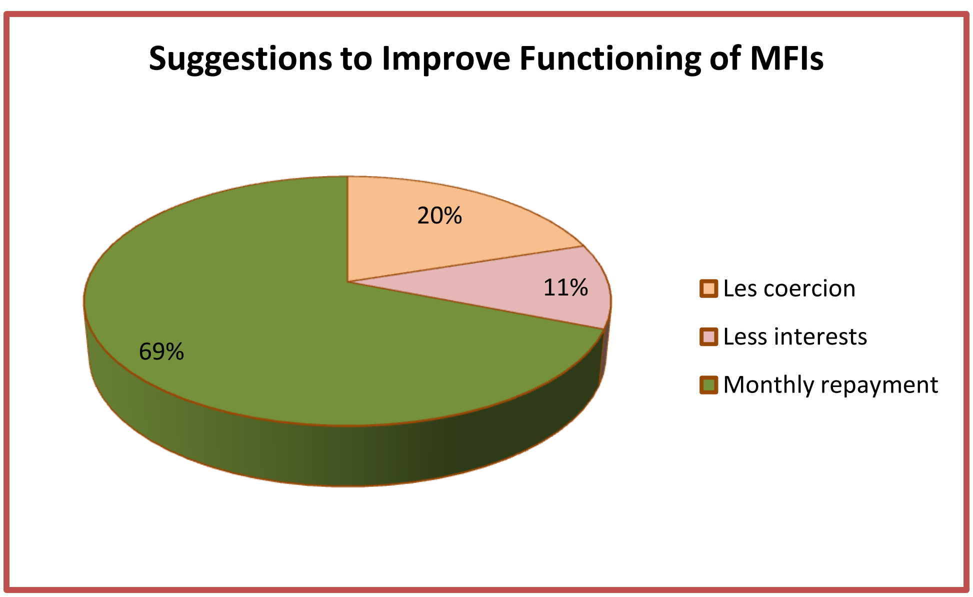
It was seen that though people would take money from MFIs when it was available, majority of them were of the view that MFIs should be banned completely. This could be mainly because of the psychological difficulties experienced by the people in repaying the loans taken from MFIs. It has been noticed that 60% of the people felt dependent on MFIs and had a feeling of helplessness. The response of the people regarding the banning of MFIs is given below in figure 43.

Figure 43: Respondents Opinion on banning MFIs



People had their own suggestions to improve the functioning of MFIs. Many of them found it difficult to repay loan installments every week. Though people were not aware of the exact interest rate that they were paying to MFIs, they knew that it was higher than what they paid in banks. The major suggestions for improving the functioning of MFIs are given in figure 44.

Figure 44: Suggestions to Improve Functioning of MFIs



There were no suicides due to problems created by MFI agents in the villages which were visited. In Kalakathoor village, people told that MFI agents had not come for collection of money for the past few weeks. In Bangarapalam, people decided among themselves not to repay loans taken from MFIs. During meetings at the SHG Federations, SHG members were instructed not to take money from MFIs and asked to repay the loan amount at the normal interest rates. There was circulation of notices by the federations against borrowing of money from MFIs. All these events implied the volatility of the existing situation regarding MFIs. However it was seen that only 24% of the people knew about MFI ordinance and this was mainly through the news shown in televisions. They didn't exactly know what the provisions in the ordinance were, but just knew that it was something against the MFIs.

It was found that 54% of the people felt that the ordinance was needed while the rest gave the response of being neutral as they didn't know whether it was needed or not. None of them told that the ordinance was not needed. Around 66% of the people said that they would not mind even if the MFIs left the state after the MFO comes into full effect.

Case Study No: 5 Recovery Rates: A Question of Survival to MFIs

Mr. Ratnakumar, the manager of the Palamner branch of Share Microfin Ltd has been facing the biggest crisis in his career for the past few weeks. It was not just his career that seemed to be wobbling underneath his feet, but the survival of his organisation and even the whole sector of commercial micro-finance were in question. Although he had been through similar crises in his career before, this one was unprecedented in terms of scale and public outcry. Even though he told that losing his job was out of the picture, one could not help but notice the weakness in his beliefs.

Ratnakumar has been working for eight years with Share Microfin Ltd, which is currently among the top five MFIs in the country. He has had extensive experience in the sector and had worked in four different districts in the state prior to his appointment as Branch Manager at Palamner in Chittoor district. He has held this designation for more than 18 months and knows his way around the different communities in the area. There are 6 field agents who work under him who are in charge of social mobilisation, disbursal of loans and their recovery. Although his organisation is among the market leaders in the state, they have had no strong foothold in the micro-finance playground of Chittoor which is dominated by Spandana and SKS. The organisation had planned to establish strong foothold in this district by 2010 and this was one of the reasons behind Ratnakumar's posting in Palamner. Upon this, he embarked upon a massive venture to market the organisation's services to the rural populace in his operational territory. (continued…)

He admits that he was on a target mode, which meant that checking the needs and repayment capacity of the clients often took a backseat to the organisations aggressive marketing and expansion drive. He was not willing to reveal the exact number of fresh loans that he disbursed in the area, even though he told that 2009-10 was the period that saw the largest loan disbursal drive by Share Microfin in Chittoor. He remembers being lauded by his superiors on his performance in Palmaner just a few months ago.

Then, all hell broke loose in the months following September-2010 with a huge media outcry regarding the predatory lending practices of MFIs in the state. In the following period, the very institution of commercial micro-finance scathing criticism from the, economists, analysts, politicians and the media who had initially touted micro-finance as the magic bullet to fight poverty across the world. The big blow came in the form of the Micro-Finance Ordinance promulgated in October by the Government of A.P which threw commercial micro-finance into a state of chaos and uncertainty. MFIs, fearing a government backlash slowed their recovery activities and the many clients, confident in a 'benevolent' government stopped making their payments to the MFIs. Share Microfin which had a loan recovery level of 99% in Palamner till then was shaken to the core when recovery dwindled to less than 5 percent. Suddenly, the very loans that Ratnakumar had so efficiently disbursed in the area are threatening to end his career in the sector. He and his six field agents are in a state of being 'benched' by the government, a state from which they hope to recover before it is too late.

8.1 SBL Model – The Way Forward

- **More Credit**: Even though this suggestion may sound too simplistic, the truth is that the SHG movement all across the country is starved for credit. The entire banking establishment in the nation needs to take the initiative and be more proactive in supporting this movement. Also, many of the equity issues associated with loans given through SHG could be mitigated if bigger loans are made available. Most of the financial costs associated with loans from SHGs are fixed in nature. For instance, the opportunity cost of wages lost and institutional book keeping charges remain the same regardless of the size of loan availed. Hence, the percentage financial cost associated with bigger loans tends to be lower, thereby making them financially attractive to the borrower.
- **Diversity in Credit products**: The current array of activities in SHGs is more or less limited to the micro-savings and micro-credit. While these two aspects are the back bone of any micro-finance model, additional products like micro-insurance and pension schemes could also be actively included into this basket of services. It needs to be pointed

out that insurance and pension services are being provided in all the SHGs promoted by SERP in Andhra Pradesh. Other states would do well to imbibe these aspects into their SHG programs. Only a diversified range of financial products suiting every need of the average rural household would ensure the complete financial inclusion of the rural populace, both in letter and spirit.

- **Monitoring the Utilization of Loans**: From the field study that was conducted, it was found out that invariably all SHGs applied for bank loans by stating untrue requirements. All of the loans were officially applied for the purpose of buying income generating assets like livestock, agricultural machinery and working capital for SME. But the distressing fact was that more than 75 percent of these loans were actually being used for consumption purposes. This is in effect, contradictory to the true goal of financial inclusion.

  The first step towards achieving financial inclusion is instilling the fundamentals of credit discipline among the poor. In the initial phase of any such intervention, it should be automatically assumed by lenders and the concerned authorities that the poor households would use such loans for consumption purposes and not for any enterprising activities. And policies should be framed in order to curb such a tendency among the borrowers. Thus effective monitoring mechanisms should be set in place either by the SHPAs or the lending banks to ensure that these loans end up being used productively. Only in such a situation can micro-finance be the ‘magic-bullet’ against poverty.

- **More Flexibility in the Disbursal of Loans**: The average cycle for loans received from banks is 3 years for an SHG. This cycle seems to be highly unrealistic as it does not match with the cash flows of normal rural livelihoods. For this, a remedy has been proposed by SERP and is expected to be implemented shortly in A.P. If the banks were to give large loans to the SHG federations at the district or state level, they could distribute such loans internally according to the needs and convenience of the SHGs. This would impart credit flexibility which is much required in this sector and would help the SHGs to diversify from the current 3 yr loans to a whole new range of credit products. So, it is recommended that all SHPAs encourage the formation of SHG federations for imparting administrative ease, operational efficiency and credit flexibility to the SHG system.

- **Elevating the Priority and Status of SHG Institutions**: SHG institutions should be considered as part of social infrastructure like schools and health centres. The Government should invest in the development of these institutions, which could be instrumental in mobilizing, organizing and educating the poor and marginalized sections of the country.

8.2 MFI Model – The Way Ahead

- **Governmental Regulation**: Since most of the MFIs may face a gradual 'drift' from their original mission of poverty alleviation and socio-economic advancement, the Government needs to step in and bring MFIs under its regulatory ambit. Even though it may not be fair to impose interest rate restrictions on MFIs because of the variation in operating costs from MFI to MFI, the authorities must check for compliance to a wide array of operational practices right from the disbursal of loans to their recovery.

- **Mitigation of Operating Costs with Technology:** Operating costs form the biggest overheads borne by MFI. The outreach that they require necessitates the maintenance of a large work force. Through the efficient and innovative deployment of technology, these costs can be brought down by a considerable degree. Newer technologies for expansive client outreach are being developed across the world and MFIs need to adopt such technologies after 'indianising' them so as to ensure its 'fit' with operations in rural India.

- **Handling the Issue of Multiple Borrowing**: The issue of multiple borrowing by MFI beneficiaries have become a headache for the institution of micro-finance all across the nation. Many clients are borrowing beyond their repayment capacity and ending up in debt traps. Effective monitoring against such practices is required in order to curb such tendencies. The setting up of a centralized client database would be tremendously helpful in curtailing such practices and ensuring credit discipline among the end users.

- **Realistic Repayment Schedules:** Most of the MFIs require weekly repayments from their clients. This is a huge burden on the borrowers since it may not match with their cash flows. The MFIs adopt these measures to ensure that their clients are constantly reminded of their liabilities. MFIs need to deal with this paranoia and come up with more realistic and manageable repayment schedules. This could be a win-win situation for both the client and the MFI since most clients find monthly repayments to be more bearable while the MFIs get to cut back on their operational costs by going for monthly recoveries instead of weekly recoveries.

- **Clear Communication Regarding the Cost of Borrowing:** Many MFIs veil the real financial cost of a loan transaction by presenting it in terms of flat interest rates and 'convenient' instalments. MFIs must mandatorily disclose the real or effective interest rate associated with every loan so that the beneficiaries are made privy to their true financial implications.

9. CONCLUSION

The efficacy of micro-finance as an instrument of poverty alleviation greatly depends on the channel through which it is delivered. In the wrong hands, it could end up being counter-productive to its intended goal. Both the SBL and MFI models of micro-finance delivery have their own merits and demerits. Still, it has to be mentioned that, if implemented efficiently, the SBL model of micro-finance would be much more superior to the MFI model.

The direct and indirect social benefits that germinate from the solidarity spread by SHG institutions are just not replicable in the MFI model. MFIs behave as mere commercial entities whose prime concern is the lending and recovery of loans and sometimes even deteriorate to the status of 'glorified money-lenders'. Still, the operational efficiency of MFIs is difficult to achieve by the SBL model. So, the ideal situation in the country would be one in which the SBL model caters sufficiently and promptly to the needs of the rural poor, while MFIs may exist only to fill the minute unbridgeable demand gaps that would inevitably exist in any system. The SBL model of micro-finance holds the promise to lead India to a state of total financial inclusion and a brighter tomorrow.

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ANNEXURE 1 : Method Adopted in Computing the EIR

Any financial transaction is reducible to a series of cash flows spaced over a period of time. The spread of such a cash flow would mathematically reveal the real interest rate associated with it.

For example, consider a loan transaction where a borrower receives Rs.10,000 as credit in the beginning of a year and pays back Rs.889 at the end of every month for a period of 12 months. Her resultant cash flow can be simplistically represented as follows.

Jan 1	Jan 30	Feb 28	Mar 30	Apr 30	May 30	Jun 30	Jul 30	Aug 30	Sep 30	Oct 30	Nov 30	Dec 30
10,000	889	889	889	889	889	889	889	889	889	889	889	889

The initial cell is a cash inflow for the borrower and the shaded cells are all outflows. Thus a loan essentially consists of an initial inflow and subsequent outflows. Microsoft Excel can instantaneously compute the interest rate of a series of cash flows when entered in a similar fashion. For instance, in the previous example, MS-Excel would return the interest rate as 1% for the period specified. Here, the periodicity is in terms of months, hence the 1% would have to be multiplied with 12 to calculate the EIR per annum. Therefore, the effective interest rate in the previous example would be **12 percent per annum**.

Now, consider a case where the borrower is an SHG member or an MFI client and has to do the following to avail the loan:

- Pay an initial processing charge of Rs. 500 to avail the loan.
- Give a bribe of Rs.300 to an official.
- Incur a travelling cost of Rs.50 in pursuit of the loan.
- Lose out on a productive day every month due to the meetings held by her SHG. (Consider that a day's wage = Rs 100)
- Give an amount of Rs 10 per month as book keeping charges of the SHG

Before proceeding, further explanation needs to be given regarding the opportunity cost of attending SHG meetings. Most SHGs that were interviewed conducted monthly meetings of their SHGs on a fixed weekday of the month. This meant that the members had no control over the day in which such meetings were held. Almost all such meeting lasted for 3 to 5 hours around lunchtime. All the respondents reported such a day as unproductive in terms of wages since they were spending the better part of the day for the meeting. Also, it was ascertained from informal discussions that the probability of getting work on a given weekday was around 0.5 or 50 percent. Thus, the Rs 100 wages foregone in the illustration has to be multiplied with 0.5 before factoring it in, making it financially equivalent to Rs 50.

Also, if the borrower has availed more than one loan from the SHG, this Rs.50 needs to be divided by that number. For instance, if the borrower has availed loans from the SHG's internal funds and also from the bank linkage, the Rs 50 needs to be divided by 2, since she is losing out on the same wages to avail two different loans, making the wage implication on each loan equivalent to 25 Rs per month (i.e. [100 x 0.5] / 2. where 100 is the daily wage rate, 0.5 is the probability of getting work on a given day and 2 is the number of loans she has availed through SHGs)

Taking all these factors into account, the following changes would have to be made to the cash flows.

- The following amounts need to be deducted from the initial inflow
  - Processing charge of Rs 500
  - Bribe of Rs 300
  - Travelling Cost of Rs 50
- The following amount needs to be added to each subsequent outflow
  - Wages lost of Rs 25 (i.e. [100 x 0.5] / 2)
  - Rs 10 spent on book keeping charges.

(Cont'd……..)

Thus, the real cash flows could be represented as follows:

Jan 1	Jan 30	Feb 28	Mar 30	Apr 30	May 30	Jun 30	Jul 30	Aug 30	Sep 30	Oct 30	Nov 30	Dec 30
9150	924	924	924	924	924	924	924	924	924	924	924	924

Here, the interest rate is **37 percent per annum**. This is the real financial cost that the borrower has to bear due to this loan and is called the Effective Interest Rate of the loan. MS-Excel commands like IRR and RATE can be used to compute the EIR of any given loan.

ANNEXURE 2-
SURVEY QUESTIONNAIRE

1. Schedule No_______________

I. Identification - Basic Details

2. Name of the Respondent:___________________ **3.** Village___________________

4. Mandal______________________ **5.** District___________________

6. Caste_____________ **7.** BPL/ APL__________ **8.** Land holding_______ acres

9. Family size: ________

a. Male_____ b. Female_______ c. Boys__________ d. Girls_______

10. Number of earning members _________ and details:

No	Relationship	Age	Male/ female	Education	Occupation
1	Self (Respondent)				
2					
3					
4					

II. Family Level Economic Changes

11. Major source of income and changes

No	Current year	3 years ago (2008)
1		
2		
3		
4		

12. Reasons for change in income sources

a. ______________________________________

b.____

13. Average family monthly income now Rs.______________ and 3 years ago Rs.________

14. Reasons for change in income

a. ______________________________________

b.____

15. Major items of assets acquired and capital formation during last three years

Assets purchased	**2007 – 08**	**2008 - 09**	**2009 - 10**
1. Land			
2. House			
3. Livestock			
4. Agriculture machinery			
5. Vehicles ______________			
6. Shop _______________			
7. Implements/ tools _____			
8. ____________			
9. ________________			
10. _____________			

16. Reasons for change assets/ capital formation

a. ______________________________________

b.____

17. Major items of working capital and amount during last three years

Working capital	**2007 – 08**	**2008 - 09**	**2009 - 10**
1. Agriculture			
2. Livestock **rearing**			
3. M.E. _______________			
4. M.E. _______________			
5. M.E. _______________			

18. Reasons for change in working capital

a. ______________________________________

b.____

19. Total consumption and other expenditure during last 3 years

1. Consumption (food, cloths, etc)	**2007 – 08**	**2008 - 09**	**2009 - 10**
2. Health			
3. Education			
4. Social functions________			
5. Social functions________			
6. Social functions________			
7, Miscellaneous needs			

20. Reasons for change in consumption expenditure

a. ______________________________________

b.____

<u>III. Credit Portfolio of the Household</u>

21. Family membership in SHGs and JLG ***<u>including old and defunct and resigned Groups</u>***:

No.	Name of member	Age	Year Joined	Name of SHG/ JLG	Promoter
1					
2					
3					
4					
5					
6					

22. Reasons for taking membership in so many Groups

a) More Credit Available	b) Took an extra membership to repay loan from previous SHG/ Other Sources
c) Have friends in different groups	d) Others- Specify

23. Do Promoting Agencies know about your family's membership, If yes who all

a. ______________________________________

b.____

24. No. of Groups defunct ___________ And reasons

a. ______________________________________

b.____

25. Are family members continuing membership in all Groups? a. Yes b. No

26. If they have given up membership, which are they and reasons

Group name	**Reason 1**	**Reason 2**

27. Cumulative loan amounts for last 3 years

Source	Amount		Amount
SHGs (all)		Individual loans - Banks	
MFIs (all)		Money lenders	
Other Groups -Banks		Relatives & friends	

28. Details about latest active or closed loans from each source

Source	Amount taken	Year of taken	Purpose	Interest rate	Instalment frequency	Repayment period	Amount outstanding
SHG – 1: Internal							
SHG – 1: CIF							
SHG – 1: Bank							
SHG – 2: Internal							
SHG – 2: CIF							
SHG – 2: Bank							
MFI – 1							
MFI – 2							
MFI – 3							
MFI – 4							
Bank – 1							
Bank – 2							
Relatives and Friends – 1							
Relatives and Friends – 2							
Money lenders – 2							
Money lenders – 1							

29. Major issues in obtaining loans

Source	How many days the process took	Person days lost to the family	Has family work lost due to visits	Amount paid as a fee and charges, bribes, etc	Security given	Monetary Difficulties in repayment	Psychological difficulties
SHG – 1: Internal							
SHG – 1: CIF							
SHG – 1: Bank							
SHG – 2: Internal							
SHG – 2: CIF							
SHG – 2: Bank							
MFI – 1							
MFI – 2							
MFI – 3							
MFI – 4							
Bank – 1							
Bank – 2							
Relatives and Friends – 1							
Relatives and Friends – 2							

Money lenders – 2							
Money lenders – 1							

IV. Different services under SHG and MFI model and costs

30. Financial services

Service	**SHGs**	**JLG/ MFIs**	**Remarks**
Credit size, availability, etc			
Savings			
Insurance			
Pension			
Remittance			
Others__________			

31. Livelihood enhancement services

Service	**SHGs**	**JLG/ MFIs**	**Remarks**
Input supply e.g. seeds			
Marketing of your products (dairy)			
Food security			
Technical services (Livestock health)			
Vocational Training			
Support to start ME			

Training & Placement			
Others__________			

32. Social services derived by you and/ or others in the community

Service	SHGs	JLG/ MFIs	Remarks
Sense of unity			
Family disputes			
Gender /Child labour			
School functioning			
Health/PHC			
Panchayat functioning			
Overall awareness			
Gov't Schemes			
Others__________			

33. Various costs involved with membership of SHGs and JLGs/ MFIs

Type of costs	SHGs	JLG/ MFIs	Remarks
No. of days lost P. M.			
Working days lost P. M.			
Wage amount lost P. M.			
Contributions for institutional functioning (book keeper)			
Guarantee for other members' loans			
Compensation for other members' default			
Frustrations in large meetings and visits			

Feeling of dependence and helplessness			
Over work of Groups			
Others__________			

V. Repayment of loans

34. Current repayment frequency____________ And your preference:

Frequency	
a. Weekly	c. Flexible
b. Monthly	d. others___

35. Are you able to repay your loans by the income that you get from your source of livelihood?

a) Yes b) No c) Most cases d) Rarely

36. Which are the sources of finance that you avail in order to repay loans on time?

Loans to be repaid	**Various options to prevent default in repayment**					
	Own Income	**SHGs**	**MFIs**	**Banks/ Cooperatives**	**Money lenders**	**Friends/Relatives**
SHGs						
MFIs						
Banks/ Co-operatives						
Money lenders						
Friends/Relatives						

37. Assuming you have equal repayments to be made with the following sources of credit, which would you repay first, second and so on?

Source	Rank	Reason
SHG		
MFI		
Bank		
Money Lenders		

38. Major Difficulties and Problems associated with the loans from SHGs.

a.Loans not received in time.	b.Not getting the required sum of money always
c.High Interest Rates	d.Frequent repayment
e.Formalities and Procedures	f.Forced Repayment Measures
	g.Need for Collateral

V. Suggestions for improvement of microfinance situation in the state

39. Are there any suicides in the village due to MFI coercive actions?

a. Yes b. No c. If, yes number_____________

40. Should MFIs be banned completely a. Yes b. No

41. Suggestions for improve the functioning of MFIs

a. ______________________________________

b. ____

42. Do you know about MFI Ordinance a. Yes b. No

43. Is the Ordinance is needed a. Yes b. No

44. Do you suggest any modification in the Ordinance

a. ___________________________________

b. _____________________________________

45. If, Ordinance implemented, MFIs may leave the state. Do you like that situation

a. Yes b. No

46. Suggestions for improve the functioning of SHGs and federations

a. ___________________________________

b. _____________________________________

c. ____________________________________

47. Researcher's observations and comments

____

____

Date_________ Researcher sign________________

Place___________ Researcher name________________

ANNEXURE 3 – Checklist for SHGs

The effectiveness of the functioning of the SHGs would be assessed by using a tool listing the optimal condition expected in the functioning of the SHGs and thereby comparing to what extent the SHGs are complying with the standards of operations.

Major aspects considered to evaluate effectiveness of functioning of SHGs

1. **Governance and management**
    - Awareness about objectives of SHG programme
    - Awareness about member wise savings and loan
    - Awareness about rules and regulations of the group
2. **Frequency of group meetings**: Regular meetings, Meetings held at the convenience of the members, Irregular meetings. Are all financial transactions take place in meetings?
3. **Ownership**: Who write the books? Where the books are kept? Who write checks and carry bank transactions? Who take decisions in the SHGs? Are SHG follow SERP orders? Can group take loans from bank without the support of SERP staff?
4. **Support from Federations and SERP**: What support you get from SERP and Federations? What are your payments/ contributions for Federations' functioning and services? Will your group function without the support of Federations and SERP? What changes are require in Federations and SERP?
5. **Savings**: What is the thrift rate? Why cannot members save more? Is there any return of savings? Why? Where is the saving amount? Is it regularly rotated for internal lending? Is the group paying any interest or bonus on members saving?
6. **Credit:** Is the Group able to meet all credit needs of members? What kinds of loans are being given?
7. **Repayment from Members:** Are you getting repayments as per schedule? What is the percentage of repayment? What are the reasons for less repayment, if any
8. **Linkage with banks**: Are you getting bank loans regularly and sufficient amout? What the problems with bank linkage
9. **Repayment to Banks**: Are you repaying bank loan regularly? Are you facing any problem in repayment of bank loan? There are reports of increasing defaults to banks by SHG? What are the reasons

10. **MFI transactions:** Are any members (including all other groups) borrowing from MFIs? How many? How much? Why? Are any SHG member committed suicide of facing severe stress due to MFIs' recovery

11. Should MFIs be banned completely a. Yes b. No

12. Suggestions for improve the functioning of MFIs

a. ___________________________________

b. _____________________________________

c. ____________________________________

13. Do you know about MFI Ordinance a. Yes b. No

14. Is the Ordinance is needed a. Yes b. No

15. Do you suggest any modification in the Ordinance

a. ___________________________________

b. _____________________________________

16. If, Ordinance implemented, MFIs may leave the state. Do you like that situation

a. Yes b. No

17. Suggestions for improve the functioning of SHGs and federations

a. ___________________________________

b. _____________________________________

18. Researchers observations and comments

____

____

____

ANNEXURE 4- Checklist for Banks in the Area

General Queries

- The number of SHGs having an S/B Account with the bank.
- Do any of these SHG members have individual loans outstanding with the bank?
- The average loan outstanding of the client SHGs
- The maximum amount of loan given to an SHG
- The average interest rates charged on loans given to the SHGs.
- The different purposes for which loans are taken by SHGs (Percentage break-up, if available)

Operations

- How does the bank assess the credit worthiness of its client SHGs?
- Which are the different levels of loans given to the SHGs and the requisites for bigger loans?
- How does the bank monitor the usage of loans forwarded to the clients?
- Does the bank monitor the general functioning of the SHGs?
- Has collateral been asked for in any special circumstance?
- Is the bank involved in training and capacity building of the SHGs?
- Does the bank also lend to MFIs?

Compliance of the SHGs

- In case of defaults, what does the bank do?
- Has the bank ever resorted to revenue recovery?
- What are the incentive systems built by the bank to ensure credit discipline among its clients?

ANNEXURE 5-Checklist for Microfinance Institutions (MFIs)

- Mission of the institute
    - Steps taken to ensure that the company works according to its mission

- Operations of MFI
    - How do they mobilise client groups
    - Difficulties encountered while mobilising client groups
    - Why do they prefer Joint Liability Groups
    - Have they ever done individual lending, if so what are the measures taken to ensure repayment capacity of the client
    - Do they have any mechanism to ensure that the client groups is capable to repayment and that they are using the loan amount for the intended purpose
    - Interest rate charged by the MFIs and on what basis do they fix the interest rates
    - What are the cost items involved in promoting a client group
    - Average promotion cost per group
    - How do they collect money back from clients
    - Do they feel that JLGs (peer pressure) are really effective in ensuring timely repayment from the clients
    - Frequency of repayment stipulated
    - What are the measures taken if the clients fail to repay money on time

- Sources of funds
    - Major sources of funds
    - Categorisation based on the kind of institutes providing funds (Banks, private agencies, Donations)
    - Terms and conditions involved in getting the funds
    - Difficulties involved in getting funds for operations

- Operation costs
    - Various items of cost incurred
    - Reasons for high operation costs
    - Can it be said that high operations costs are the prime reason for high interest rates charged by MFI
    - Have you taken any steps to reduce the high operation costs incurred
    - Opinion about adoption of new technology so as to reduce operation costs

- Client groups
    - How many clients are there under their institute
    - Maximum amount of loan given to clients
    - Frequency of collection of repayments from clients

    - Default rate of repayment by clients
    - Profile of their clients
- Opinion about the current crisis in AP

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