Economics of Individual Lending Practices by Microfinance in Odisha

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Abstract: Group-based lending is most prevalent amongst Microfinance Institutions (MFIs) targeting the poorer sections of the community. It provides MFIs with the opportunity to reduce risk through joint-liability and guarantee arrangements within the groups. Over the last few years, MFIs are moving towards diversification of lending approaches, and have begun to offer individual loan (IL) products to its customers. In India, increasing numbers of MFIs are offering long-term clients individual loans once they graduate from group-based systems. MFIs hypothesize that customers exhibiting good repayment behavior over 4-5 loan cycles will continue doing so if offered larger ticket size loans without any joint liability. Demands from their higher value clients, and to better serve mature clients who have increased their repayment capacity and need larger loans, has led to MFIs offering a range of individual loan products to select customers. This study delves deeper into the MFI, as well as client perspectives on such products, and their needs and preferences on the individual loan products. This study has been conducted in two districts of Odisha – Sudargarh (Rourkela) and Ganjam (Berhampur) and focuses on 4 distinct categories of respondents' i.e clients who currently have individual loan outstanding, client who were offered an IL product but did not take it up, clients who defaulted on an IL product, and micro-entrepreneurs who have never borrowed from an MFI. This diversity in respondents provides an opportunity to have a 360-degree picture on barriers in uptake and preferences for IL products. In addition to these different categories of clients, interviewed to 2 leading MFIs have also been conducted to get the provider's perspective in terms of offering IL products to their clients. The study found that high preference for individual liability loan products across all loan categories of survey respondents. However, high interest rates seem to be the main deterrent to its take up. Since most MFIs charge a high interest rate, to lower their risks, a better way around this may again be robust cash flow estimations of clients to ensure repayment capability, rather than increasing interest rates. Policy makers at the apex level and industry investors can earmark soft and concessionaire funds to support MFIs engagement in commercialization of new products and services that meets the needs and aspirations of these specific customer segments that prefer individual loan products but find the repayment rates for the same to be too high.

Keywords: Joint Liability Group (JLG), Microfinance Institution (MFI), Individual Loan (IL)

I. INTRODUCTION

The Indian microfinance industry has been trying a graduation approach with its group lending customers, along with diversification of lending approach over the last three years. MFIs hypothesize that customers exhibiting good repayment behavior over 4-5 loan cycles will continue doing so if offered larger ticket size loans without any joint liability. It is also believed that such a product could enable customers to invest more in income-generating activities resulting in the growth of micro-enterprises and economic well being of low-income households. The low take-up rate of the individual loan products could be due to a number of reasons like customers finding it difficult to transition from group liability arrangement, repayment schedules not being suitable enough to allow efficient use of larger loan amounts, and loan officers and MFIs lacking capacity to evaluate customers and their cash flows. It was also found that the screening process for individual loans is also very strict when compared to JLG loans. These possible reasons clubbed with many other unknown factors are curtailing the growth of MFI clients and are also disrupting MFI operations.[3] It is very important that

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[3] http://www.microsaave.net/files/pdf/Individual_Lending_Booklet.pdf

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MFIs start the product development process with market research to understand the clients' needs and preferences and create a client responsive product offering.

II. REVIEW OF LITERATURE

Traditionally, microfinance has been based on a group lending model wherein individuals are part of a group and act as a guarantee for each other. These loans are typically small in amount and require weekly repayment schedule, although some of the MFIs are now moving towards fortnightly or monthly repayments for JLG loans. However, as the sector is growing, clients' needs are increasing and getting more diversified, there is a demand for higher loan sizes and customized loan products. To meet these client demands, a number of MFIs are getting out of the traditional space to offer individual liability loan products to its customers (Microsave).

Individual liability loan products differ from the joint liability loans in significant ways, and since this space is new to most MFIs, the processes and product design of individual loan products needs to be closely monitored. Individual liability loan products are given directly to the individual and do not require them to be part of a group. This in turn means, that in individual lending the monitoring, screening and enforcement falls on the institution as opposed to a group, as in the case of joint lending. Another difference is that in case of individual lending, loan officers would have prime responsibility of assessing the credit worthiness of clients, whereas in a group lending model, this task falls primarily on other group members. Hence, MFIs will need to strengthen their cash flow estimation process for IL loan products.

There have been no studies conducted in India on examining the differences between individual lending and group lending models. However, there have been a few studies in other parts of the world. Studies done in Kenya and Phillipines, have examined the impact of individual lending versus group lending. The study conducted in Kenya found higher default rates in individual lending as compared to group lending. At the same time, the study also found that MFIs in Kenya prefers the individual lending model and the loan interest rates and default rates are positively correlated whereas loan size and the default rate is negatively correlated (Kodongo & Kendi, 2013). The study in Philippines used two randomized control trials to test the impact of individual liability loan products, and found no difference in repayment as well as default rates (Gine & Karlan, 2010).

Another study conducted in rural Mongolia examines the impact of group lending, and individual lending using a randomized controlled trial. In terms of consumption and enterprise ownership, a positive relationship was found in villages that were offered group lending, whereas no significant difference in consumption and enterprise ownership was found in the individual lending villages. The study also found that informal transfers to family and friends are less likely in group lending villages as compared to individual lending villages. Similar to the study in Philipines, this study also found no significant difference in default rates between individual and group lending (Attanasio, O, Augsburg, B, De Haas, R, Fitzsimons, E, & Harmgart, H, 2014). Although these studies are few in number, the findings from all these studies indicate that there is a need to closely monitor individual lending. However, at the same time, since studies indicate at similar repayment and default rates for IL and JLG loans, moving towards IL loans does not involve a higher risk for the MFIs.

Several MFIs in India have also experimented with the individual liability loan products. Some of the prominent MFIs working in Odisha offer individual loan products for home improvements and small businesses. Annapurna Microfinance Ltd, which provides financial services to lower income households, introduced their individual business loan product. Although, IL loan products have been introduced by several MFIs, they are still in a nascent stage of development, both in terms of widespread adoption by MFIs, as well as product development. For all the MFIs we spoke to for the study, individual loans formed less than 15 per cent of their total portfolio. There are a number of reasons for this. As per Microsave, MFIs face several challenges in the domain of IL loan products. These include difficulty in getting a buy-in from regulatory bodies and banks, which in turn leads to a lack of funds for such products, lack of sophisticated MIS to cater to the needs of the IL product, lack of skilled employees and systems to assess the individual borrowing capacity of clients, and co-ownership of client assets that makes it difficult to be used as collaterals.

III. APPROACH AND METHODOLOGY

Most MFIs in India have mastered the joint liability lending space and are now moving to the individual lending model.[4] However, there are gaps in terms of understanding the clients' needs and designing products, which meet their requirements. This study will attempt to understand the clients' perspective and shed light on the individual lending space in the microfinance sector. The objectives of this study are as follows:

- To understand the needs and reason for preference of individual/joint liability loan product by clients who have taken individual liability loans.

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[4]http://www.microsave.net/files/pdf/Individual_Lending_Booklet.pdf

- To understand the household consumption, income and other aspects of microfinance clients and their borrowing needs and sources.
- To understand the reasons for non-take-up of individual liability loan products by customers who have been offered the same.
- To understand the MFI's perspective in terms of introduction and growth of IL products as well as barriers faced.

This study has been conducted in two states in Odisha – Sudargarh and Ganjam. The two districts where MFI penetration is extremely high were chosen as locations for this study. The selection is based on HighMark's credit data (2016)[5]. Since we are covering different client segments within the MFI space for this study, choosing a high penetration area would ensure that we are able to cover all the client category requirements. In Sudargarh, the study was conducted in Rourkela, and in Ganjam, it was conducted in Berhampur.

Table 1: Sampling of the Study

Category	Number of clients-Ganjam (Berhampur)	Number of clients-Sudargarh (Rourkela)	Total number of clients
Clients who have an IL outstanding	28	25	60
Micro-entrepreneurs who have never borrowed from an MFI	15	15	30
Clients who were offered IL but did not take it up	5	6	11
Clients who defaulted on an IL loan	50	53	103
TOTAL	**98**	**99**	**197**

IV. DATA ANALYSIS

Our sample is composed of 98 clients from Ganjam (Berhampur) and 99 clients from Sudargarh (Rourkela) district. The majority of the respondents in our sample is female, as MFIs lend primarily to female customers. The mean age of the primary respondent was found to be 39 years. Their average annual income was found to be INR 33006, with a significant difference between the two districts. The average income of the primary respondent in Rourkela was INR 45702 and in Berhampur was INR 24500.

Figure 1: Education of the respondent

Fig.1: Education of the Primary Respondent
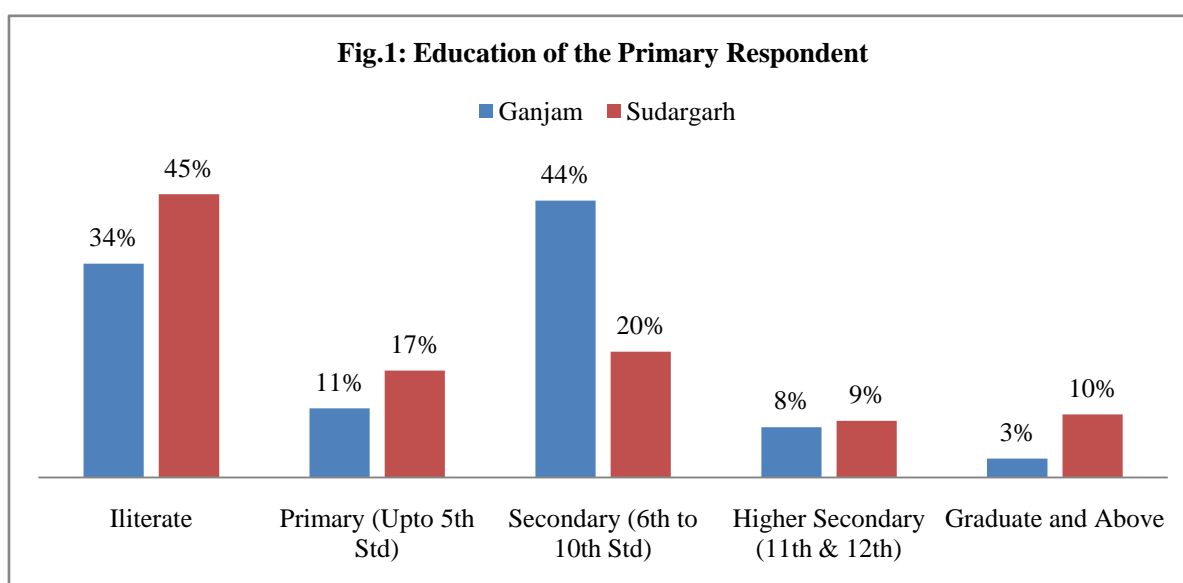
As can be seen from the above graph, the majority of the respondents in both Ganjam (Berhampur) and Sudargarh (Rourkela) have never attended school. This was followed by some schooling received between 5th to 10th grades. While a few of the respondents stated having completed high school, the number of people in

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[5]Highmark provided us with district level data for our study sites on request.

college or having a college degree was found to be extremely low. One of the explanations for this among cultivators or agricultural labourers was that this was due to the need felt to discontinue studies after school due to familial requirement in the management of their farm land. Additionally, as mentioned above our sample size was predominantly composed of women, and within patriarchal cultural set up, higher education for women from low income households in the area are less common. As an extension to this, it can be seen below that a large segment of the sample were primarily home makers, which means that even though the primary borrower is a woman, the business decisions are not made by her.

Figure 2: Primary Occupation of the respondents
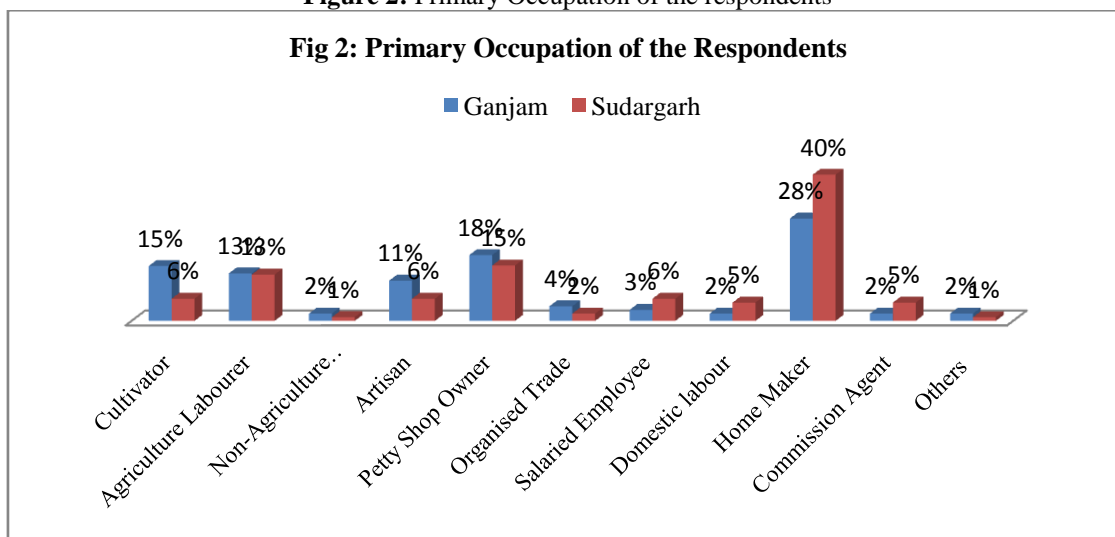
Household Income Information

The mean monthly household income, combining the two districts stands at INR 17793. The first quartile income was INR 7700 whereas the 75th percentile income was INR 20300. In terms of overall income distribution by district, Sudargarh (Rourkela) has the lowest average household monthly income of INR 14612, and Ganjam (Berhampur) had the highest average household monthly income of INR 21007 (Table 2).
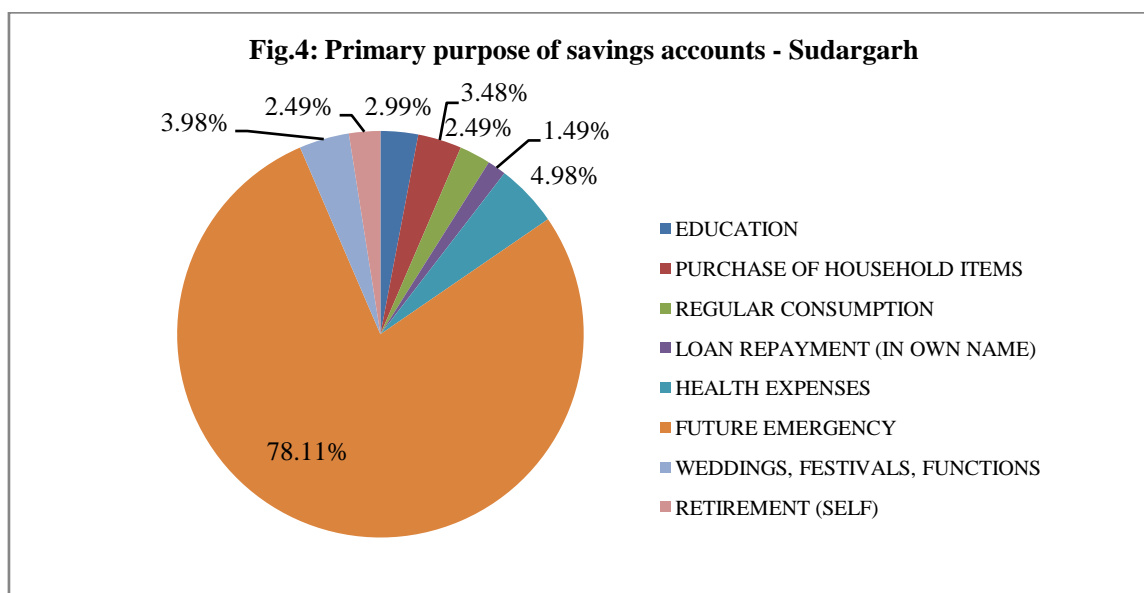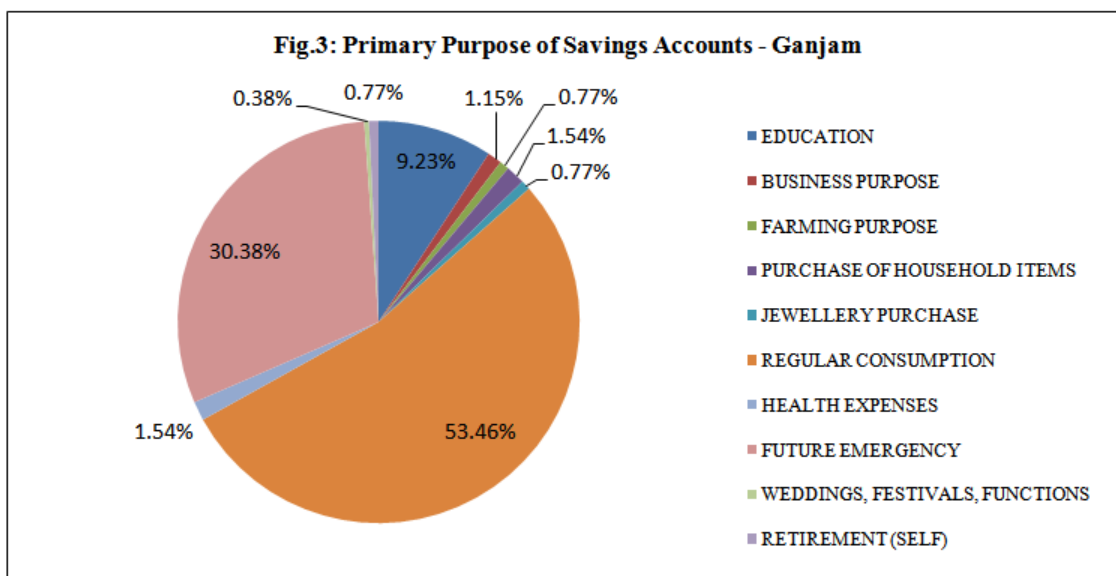
Table 2: Household Income

Particulars	Sudargarh (Rourkela)	Ganjam (Berhampur)	Total
Average household monthly income (in INR)	14612	21007	17793
Minimum household monthly income (in INR)	2000	833	833
Maximum household monthly income (in INR)	82000	180000	180000

The above table summarizes the household savings situation in our sample. The median number of savings accounts per household, combining the two districts, is 2. The average amount per savings account is INR 7902, with a higher average amount of INR 8935 in Sudargarh (Rourkela) district, as compared to INR 6439 in Ganjam (Berhampur) district.

Table 3: Household Savings

Particulars	Sudargarh (Rourkela)	Ganjam (Berhampur)	Total
Average number of savings accounts per household	2.78	2.08	2.4
Minimum number of saving accounts	0	1	0
Maximum number of saving accounts	8	9	9
Average amount in the savings account (in rupees)	8935.91	6439.24	7902.26
Minimum amount in the savings account (in rupees)	0	0	0
Maximum amount in the savings account (in rupees)	600000	90000	600000

The below two pie charts show the primary purpose of these savings accounts in both Ganjam, and Sudargarh districts. In Sudargarh, the purpose of majority of the savings accounts is for regular consumption purposes, whereas in Ganjam, the purpose of majority of savings accounts is for future emergency purposes.

Fig.3: Primary Purpose of Savings Accounts - Ganjam

- EDUCATION
- BUSINESS PURPOSE
- FARMING PURPOSE
- PURCHASE OF HOUSEHOLD ITEMS
- JEWELLERY PURCHASE
- REGULAR CONSUMPTION
- HEALTH EXPENSES
- FUTURE EMERGENCY
- WEDDINGS, FESTIVALS, FUNCTIONS
- RETIREMENT (SELF)

0.38% 0.77% 1.15% 0.77% 1.54% 0.77% 9.23% 30.38% 1.54% 53.46%

Fig.4: Primary purpose of savings accounts - Sudargarh

- EDUCATION
- PURCHASE OF HOUSEHOLD ITEMS
- REGULAR CONSUMPTION
- LOAN REPAYMENT (IN OWN NAME)
- HEALTH EXPENSES
- FUTURE EMERGENCY
- WEDDINGS, FESTIVALS, FUNCTIONS
- RETIREMENT (SELF)

3.98% 2.49% 2.99% 3.48% 2.49% 1.49% 4.98% 78.11%

Reasons for preference of Individual liability loans

There seems to be a high preference for individual liability loan products. Despite the higher interest rate, most respondents from all categories under the study still preferred IL product. There were a few reasons that were cited predominantly for this preference. They included, main features of JLG model being constrained to believing that getting IL products is easier than a group loan. Since the above data points that interest rates and repayment installments are higher among individual liability products as compared to joint liability loan products, an analysis of both the interest rate and repayment amount for all the IL and JL loans in our sample was conducted. The results in the below (Figure-5) corroborate this finding.

Fig 5: Reasons for preference of IL loans

Fig.7: Actual purpose for borrowing for IL
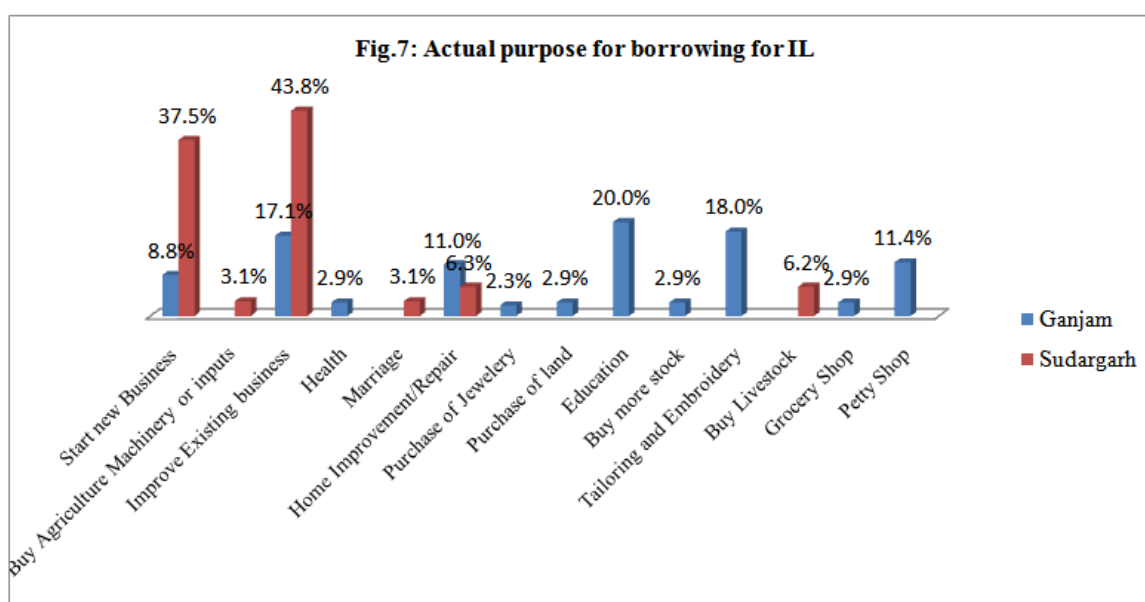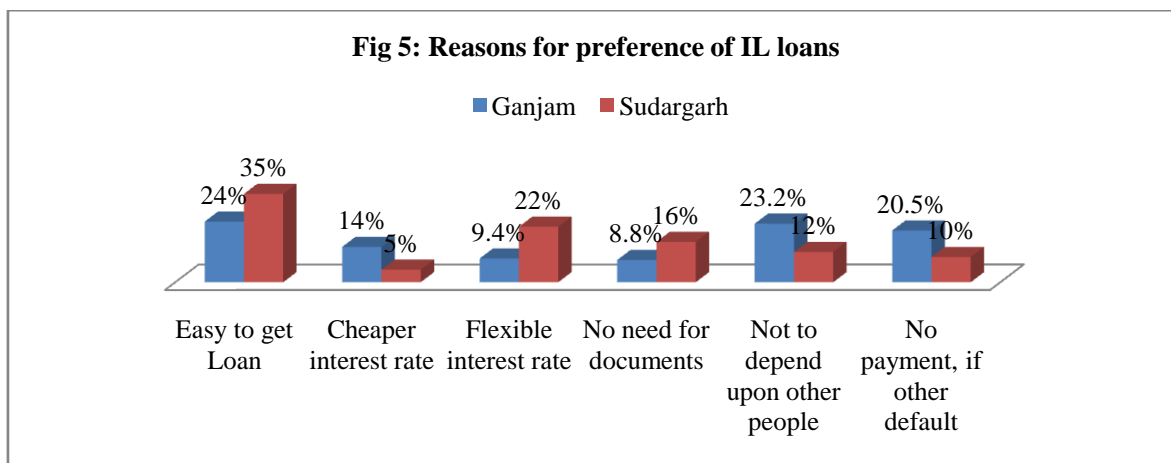
The above two graphs compare the primary stated and actual purpose of borrowing for individual loan products for both Ganjam and Sudargarh districts. Even though the primary stated purpose of borrowing for starting a new business or improvement of an existing business was high, this percentage drops when actual loan usage is taken into consideration. On the other hand, there is a sharp increase in the actual use of loans for household consumption smoothening, health emergencies and 'other' reasons. Even within the other category, the predominant use of the loan was for household consumption, education and other household expenses. While there were a significant number of people who said they would use the amount for starting a new business in Sudargarh, none of them ended up doing that and while predominately most people in Sudargarh stated intending to use the loan amount for improving business, repair or construction, the actual use of the loan amount for this category also saw a dip.

Table 4: Business Outlet, performance and Household Income of IL Loan clients

Sl. No	Particulars	Sudargarh	Ganjam
1	**Is your Business outlet-**		
1.1	Self-owned (in %)	83.33	63.16
1.2	Parent/Family owned (in %)	16.67	26.32
1.3	Owned with partner (in %)	0	10.53
2	**Business Performance of IL loan Clients' business (Amt. in INR)**		
2.1	Average yearly sale	371000	139236

| 2.2	Average yearly business expenses	59036	33508
2.3	Percentage of businesses in profit (%)	66.67	89.48
3	**Household Income (Amount in INR)**		
3.1	Average monthly household income	17385	34565
3.2	Average monthly household expenses	16256	14034
3.3	% of household where net surplus income	62.50	85.72

For this category of clients who presently have individual loan products, from MFIs, based on our data it can be concluded that:

1. There is a preference for individual loans over JLG loans, however, interest rate seems to be a deterrent in their further uptake
2. Even though individual loans are given for business purposes, the actual use of IL loans for business purposes is much lower and is often used for household consumption smoothening, or health purposes.
3. Since, Individual loans are given by MFIs to more mature clients usually; we looked at the data on their income and business sales. We found a high percentage of households that have a net negative income, and businesses which are in losses.
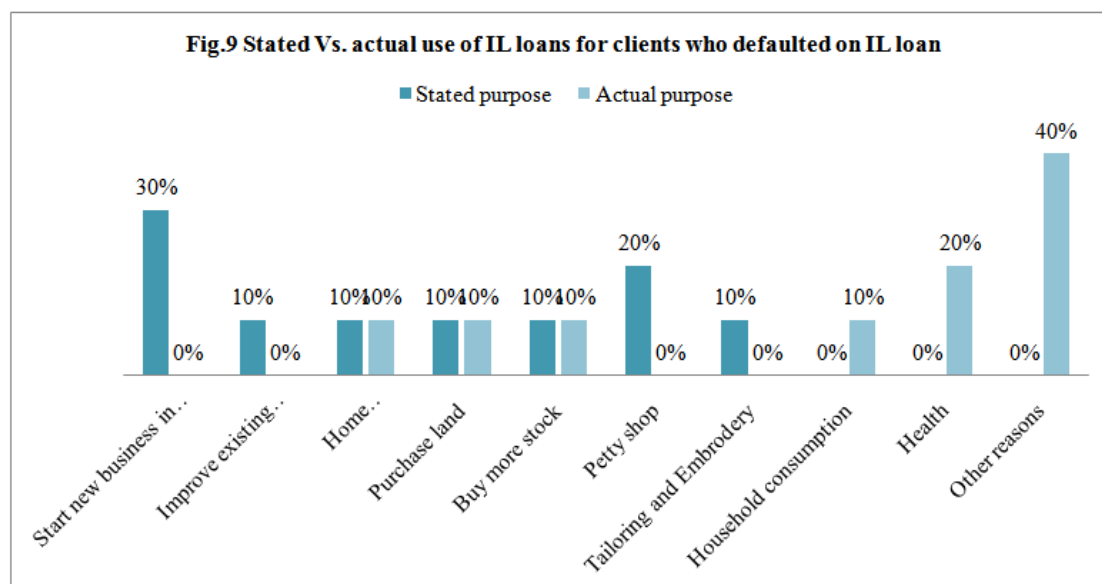
Clients who have defaulted IL loans

A set of clients referred from a leading MFI, who defaulted on an IL loan were also interviewed. As per their definition, the clients have missed repayment installments on their loans. Our data show that these clients missed a repayment, and 40% clients missed repayments three times in a row. These clients, who had defaulted on an individual loan were asked all the reasons for default, and they could choose more than one reason for why they thought they defaulted on the loans. The two predominant reasons for default were not having sufficient funds to repay (100% clients reported this) and to meet an emergency expenditure (80 per cent of those who defaulted on IL loans).

Since all the clients reported not having sufficient funds to repay the loan installments, other key variables for this client group were assessed to understand the inability to pay better. 60% of clients in this group said they did not report all their existing loans to loan officers when applying for an MFI loan. The majority of them stated the fear of being refused more loans as the reason for not reporting their existing loans. However, when asked whether they have ever felt that their income is insufficient to cover their living costs, 80% said they did not feel so.

Fig.8: Reasons for default on IL loan
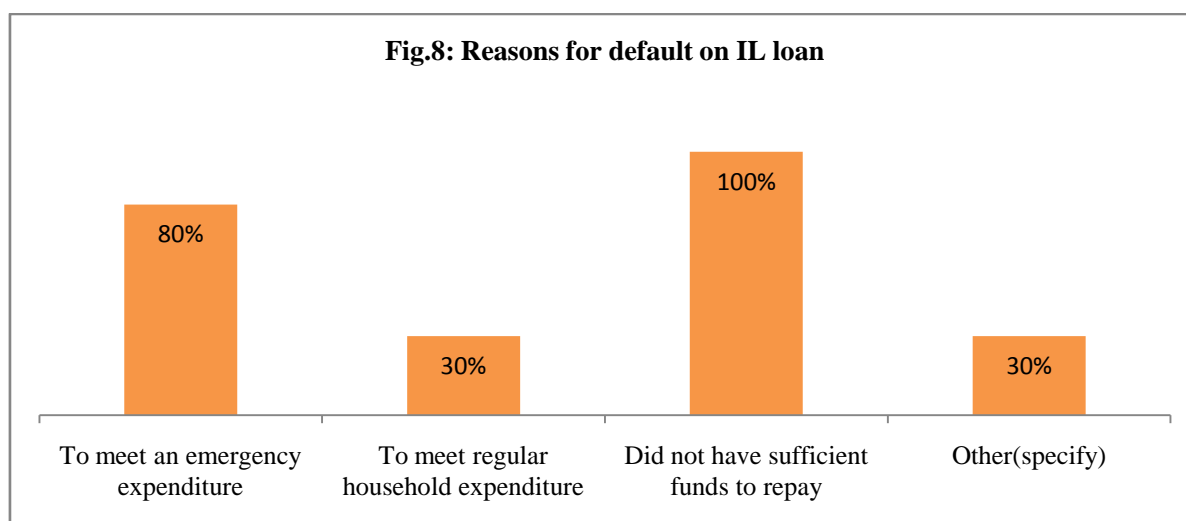
As pointed in the earlier section, most MFIs give out individual loans for business purposes, the loan usage stated and actual purpose for clients who defaulted on the IL loan is presented below. As can be seen from the graphs below, even though 40% of the clients stated the primary purpose of taking the individual loan as starting a new business or improving an existing one, none of the clients actually used the entire loan amount for business purposes. Consumption smoothening and health constitute 40% of the actual loan use even though they do not figure in the primary stated purpose of borrowing.

Fig.9 Stated Vs. actual use of IL loans for clients who defaulted on IL loan

Within the category of clients who defaulted on an IL loan, 70% of these clients do not have a business. Of the 30% who have businesses, all are either self-owned or family/parent owned, and have employees between 1-10. The table below details the household income for this category of clients. 50% clients have a net negative household income, which reiterates the reason majority clients stated for defaulting i.e. not having sufficient funds to make repayments (Table 5).

**Table 5: Household Income of clients who have defaulted on IL loan**

Sl. No	Particulars	Amount
1	Average monthly household income	14,800
2	Average monthly household expenses	15,629
3	Percentage of households where net income is negative (in %)	50

For this category of clients, who have defaulted on an IL loan, we can make the following conclusions based on the data:
1. Even though these clients have defaulted on IL loan, 90% of them still prefer an IL loan
2. Even though a significant percentage of clients' stated loan purpose was business related, none of them used the entire amount for business purposes
3. The predominant reason for the default was not having sufficient funds
4. Despite feeling that they would have not defaulted had it been a JLG loan, these clients still preferred having individual loans.

Clients who were offered an IL loan, but did not take it up

To understand barriers in the uptake of IL products, potential clients who were offered IL loans by MFIs but did not take it up were interviewed. The primary reason for this group of respondents for not taking up an IL loan, in Ganjam, was not feeling the need for a loan, followed by not feeling the need for an IL loan in particular. On the other hand, in Sudargarh, there seemed to be two primary reasons for this trend – not feeling the need for an IL loan and preferring a JL loan over an IL loan. Another point to note is that all these clients, had an outstanding JLG loan from an MFI.

Fig. 10: Reasons for non-take up of IL loans when offered by MFI
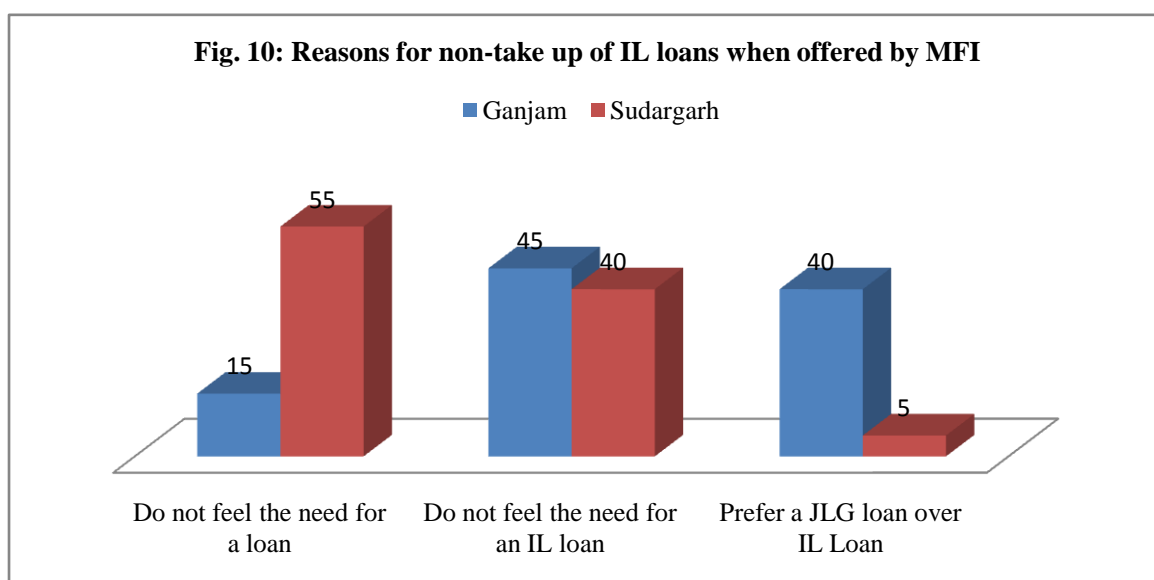
Clients indicated a variety of changes that could increase take-up of the IL product. Primarily, a reduction in the interest rates was stated as a factor that would make these respondents reconsider not taking up an IL product. This corroborates with our above mentioned finding of the prime reason for default in IL loans being high interest rate and repayment amount, and also cheaper interest rates being the prime reason for preference of JLG loans. Within this category, more than 50 percent of the respondents from this segment had a business. All the businesses in both districts were self-owned and had employees in the range of 1 to 10. The table below shows the annual average sales and expenses of the businesses. Both average yearly sales and expenses were much higher in Sudargarh as compared to Ganjam. However, in Sudargarh, there were fewer businesses in profit (66.67%), as compared to all profitable businesses in Ganjam (Table 6).

Table 6: Business performance and Household Income of clients who were offered IL but did not take it up

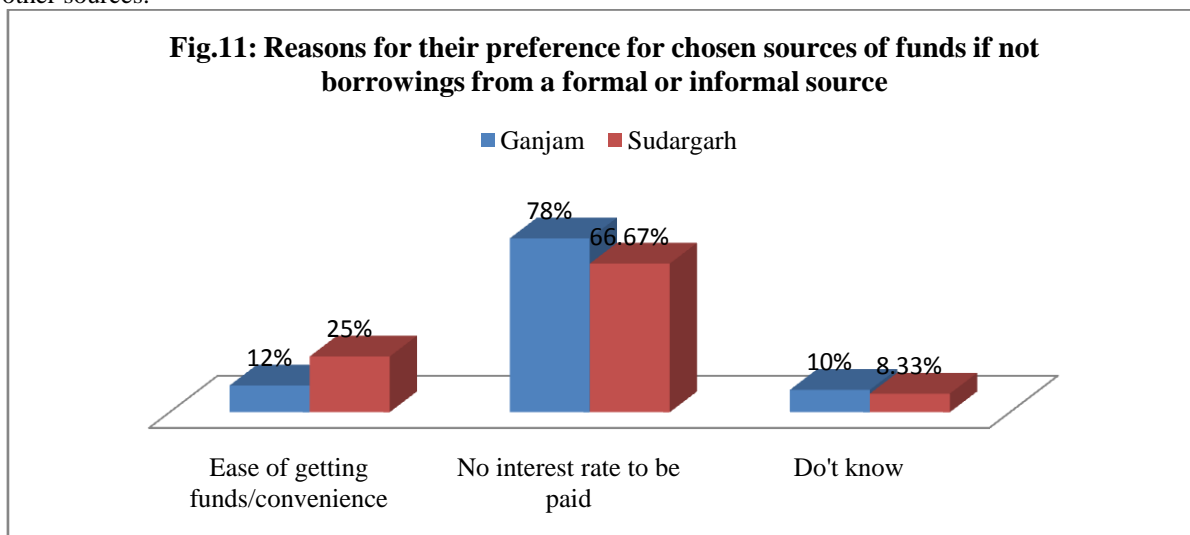| Sl. No	Particulars	Sudargarh	Ganjam
1	**Business performance of clients who were offered IL & did not take it**		
1.1	Average yearly sale	8,53,868	3,28,333
1.2	Average yearly business expenses	8,85,667	7967
1.3	Percentage of businesses in profit	66.67%	100%
2	**Household Income of clients who were offered IL but did not take it up**		
2.1	Average monthly household income	24,566	46,800
2.2	Average monthly household expenses	23,495	10,474
2.3	Percentage of households where net income is negative	16.60%	0%

For this category of clients, who were offered IL but did not take it up, the following conclusion can be made based on the data:
▪ Majority clients have a JLG loan and do not feel the need for a loan or for an IL loan
▪ Half of them own business, yet do not want to take up individual loans.
▪ High interest rates and repayment amounts seem to be the deterring factor to take up of IL loans

Micro Entrepreneurs who have never borrowed from an MFI before
The study has interviewed 30 micro-entrepreneurs, 15 each in Sudargarh (Rourkela) and Ganjam (Berhampur) districts respectively, who had never borrowed from an MFI before. These interviews shed light on their reasons for not taking up any loan product from an MFI, and their borrowings from other sources. We can

see that majority of the micro-entrepreneurs who never borrowed from MFI, had also not taken a loan from any other sources.

Fig.11: Reasons for their preference for chosen sources of funds if not borrowings from a formal or informal source

The above graph shows that, micro-entrepreneurs preferred individual liability loans to joint liability loans, if they were to take a loan from an MFI. The significant reasons stated for this preference was the ease in getting loans from MFIs, and non-dependence upon others for the loan (as in the JLG model), and less or no interest rates.

Fig 12: Preference of Individual Vs. Joint Liablity Loans
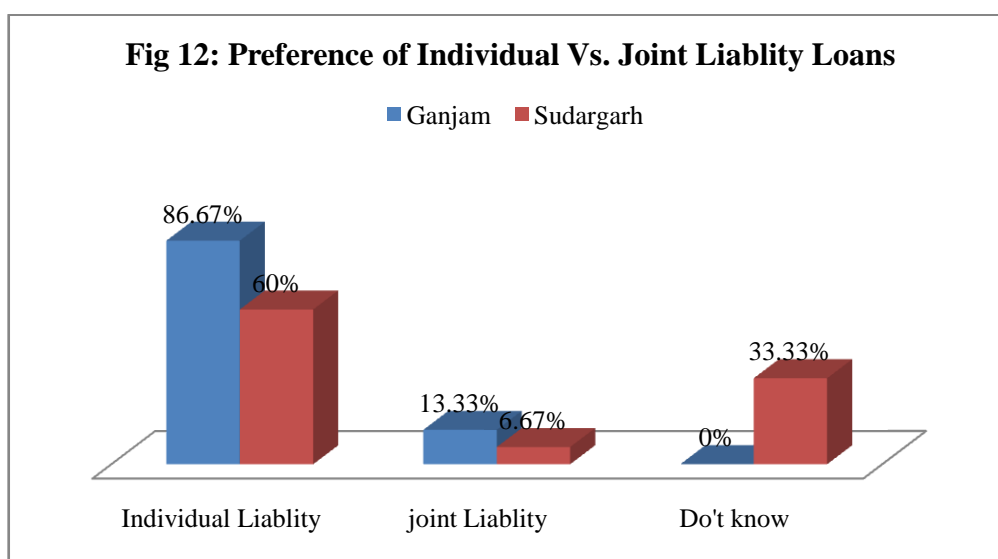
For this category of clients, who have never borrowed from an MFI, we can make the following conclusions based on our data:

- Interest rate seems to be an important factor in deciding the source of loans
- High reliance on friends & family, or other sources of own income to support the business
- If these clients borrow from an MFI, majority of them would prefer an individual loan over a joint liability loan.

Comparisons across different categories

        The below tables compares the income and business related indicators across all the 4 different categories of clients. There are significant variations by district on certain parameters. We can see that among all the categories, Clients who have IL loan have lowest ownership of business. On the other hand, the highest ownership of business is found in Micro entrepreneurs who have never borrowed from an MFI. In terms of income indicators, clients who have been offered an IL but did not take it up, have the highest percentage of net surplus income as well as average monthly household income.

Table 7: District wise average HH monthly income, % of HH with net surplus, Ownership of Business and % of business in profit

Sl. No	Particulars	Average HH Monthly Income (in INR)		% of HH with net surplus income		Ownership of business		% of business in Profit	
		Sudargarh (Rourkela)	Ganjam (Berhampur)	Sudargarh (Rourkela)	Ganjam (Berhampur)	Sudargarh (Rourkela)	Ganjam (Berhampur)	Sudargarh (Rourkela)	Ganjam (Berhampur)
1	Clients who have IL Loan outstanding	17385	34565	62.50	85.72	25	67.86	66.67	89.48
2	Clients who have defaulted on an IL loan	14800	-	50	-	30	-	100	-
3	Clients who were offered IL but did not take it up	24566	46800	83.4	100	50	60	66.67	100
4	Micro Entrepreneurs who have never borrowed from an MFI	8111	21166	26.6	46.6	100	100	86.67	100

V. RECOMMENDATIONS AND CONCLUSION

The main findings from our study suggest that though individual district they are borrowing for income-generating purposes, there is a disparity between stated and actual usage of loan wherein a large number of individuals use the loan for household consumption, marriage and health. Secondly, there is a significant variation in respondents who own a business; about 46% of the sample does not have a business in the household. Thirdly, individuals tend to prefer IL products, even if they were of lower loan amounts. These key findings suggest MFI/SFB's can innovate in their current product designs to include tailoring of products to ensure MFI profitability, flexibility in repayment structures and product designs, better assessment of credit worthiness and products targeted toward differing consumption needs. Based on this, the study provides the following conclusions and recommendations:

1) ***Account for adverse shocks when assessing the loan uptake capacity of the client prior to loan disbursement and diversification in financial products offered:*** As is evident from our data above, a number of loans (both IL and JLG) get used for consumption smoothening and household emergency purposes. These findings are further substantiated by other studies conducted on MFI loan uptake and usage in different parts of the country, which point to similar results.[6]The use of loan amounts meant for productive purposes being used for emergency purposes, health reasons or for consumption smoothening was seen as a dominant trend across all the JLG and IL clients we interviewed for the study. Though this information is not unheard of, it is surprising that the sector has been trying to address this concern for a long time but hasn't been able to. According to RBI guidelines, not less than 50% of total loans given by the MFI should be toward income generating activities and especially for IL products. As the data indicates delays in repayment on IL and usage of the loan for consumption purposes, this would have a negative effect on the profits that MFI's expect. Thus, there is a need to tailor products and design products that respond to these consumer needs that are predominant among clients. Designing and offering products such as emergency loans, health insurance, consumption boost loans that carefully cater to such needs of borrower households and attempt to match actual use of loans on the client end is imperative.

Previous research in low-income Kenyan households led to the development of a combined savings-and-loan product, M-Shwari, which works through the mobile money wallet, M-PESA. Once customers have deposited a minimum amount in their M-Shwari account, they are eligible for differing loan amounts with a reasonable interest amount that they can access whenever the need arises, thereby primarily targeting customers' emergency needs. When the requirement arises, customers can request a 30-day loan up to a credit limit determined by M-Shwari's repayment algorithm, and this loan amount is instantly credited to the users M-PESA account. Given the recent push toward digital transactions and an increase in the use of mobile money wallets such as PayTM, Airtel Money, MobiKwik, this type of product design would be ideal for SFB's and MFI's who can partner with the mobile wallets. The payment banking facilities offered some of these wallets currently

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[6]See "A report on over-indebtedness of MFI clients in saturated areas", IFMR-Lead 2017
Also see, "Gold as a tool for financial inclusion", IFMR-Lead 2017

could form the base of the savings component of this combined product. Thereby, given the Indian context, a combination savings-and-loan product or even a simple credit product with immediate disbursal through a mobile money wallet could most efficiently target consumer needs.

A horizontal expansion as such would not only enable the sector to contribute towards the drive to sustainable financial inclusion, but also add to the sustainability of the loans being offered and reducing risks of delinquency. Additionally, this will lead to responsible lending and follow the principle of suitability as was highlighted as a requirement in the Mor committee report[7].

2) ***R&D for offering a variety of individual loan products that cater the aspirations of the various sections***: There seems to be high preference for individual liability loan products across all loan categories. However, high interest rates seem to be the main deterrent to its take up. Since most MFIs charge a high interest rate, to lower their risks, a better way around this may again be robust cash flow estimations of clients to ensure repayment capability, rather than increasing interest rates. Additionally, Policy makers at the apex level and industry investors can earmark soft and concessionaire funds to support MFIs engagement in commercialization of new products and services that meets the needs and aspirations of these specific customer segment who prefer individual loan products but find the repayment rates for the same to be too high.

In terms of product design, IFMR-Lead has tested out some flexible repayment products that coincide with the seasonality of cash flows and productivity. To this end, one ongoing study offered IL customers a flexible repayment structure wherein repayment was relaxed during the peak season of business activities[8]. Businesses were allowed to take two "holiday periods"; 3 consecutive months during the 24 month repayment period during which amount repaid is less than the regular installment amounts. This innovative product caters to business owner needs; the 15% take up rate of this product indicates that borrowers seem to prefer repayment relaxation during the peak season of their business activity so that they can re-invest the increased profits into their business to further strengthens activity, even if they are required to pay 2% more interest. The features of the product are elaborated below. This novelty in design allows for seasonality of business activities and boosts the business growth and thereby capacity to repay.

Product Features of Flexible Loan	
Repayment period	24 months
Rate of interest	23.99% + 2% (2% higher than for the regular loan product)
Number of 'holiday periods' – extension of credit	2 holiday period – 1st allowed in 4th-12th month and 2nd in 13th-24th month
Minimum gap between holidays	3 months

Another study in this area has tested out designs intermediated lending for the individual loan product MFI's offer. In one study, researchers used behavioral economics insights to design a product that relies on a structured finance approach that used crop predictability as collateral, had a simplified payment collection structure and varying credit limits. The product was tested on sugar cane farmers; to meet consumption needs before harvest, farmers rely on informal loans from moneylenders and then spend most of their income from harvest on repaying the moneylender. With this product, farmers could borrow money through the mill at which they process their cane at harvest time. This intermediary approach ensures cheaper and ensured payment collection. This intermediary approach can be modified within the MFI/SFB context to provide relaxations and benefit from the social network knowledge.

Researchers have tested an example of this - TRAIL (Trader-Agent-Intermediated-Lending) product[9]. This IL product harnesses local information and incentives to select individuals with a good repayment capacity and credible history. TRAIL loans incorporate informal traders/lenders with extensive experience of lending to lower-income households, chosen randomly from the local community. These agents are required to recommend local clients for these TRAIL loans, and are incentivized with commissions and deposits from customers depending on the referred customers' repayment behaviour. Customers are motivated to repay as they can then obtain a higher loan amount in the next cycle, thereby from small IL loans they can upgrade to larger amounts. This product meets the RBI goals of lending to the poorer sections at lower interest rates, using a reasonable variant of the BC/BF mechanism.

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[7]https://rbi.org.in/Scripts/FAQView.aspx?Id=102
[8]http://ifmrlead.org/a-study-on-repayment-flexibility-contract-choice-and-investment-decisions-among-indian-microfinance-borrowers/
[9]http://ibread.org/bread/system/files/bread_wpapers/375.pdf

Product Features of TRAIL	
Loan cap amount	Rs. 2000
Repayment period	4 months
Rate of interest	18%
Requirements	No savings/collateral requirement
Borrower repayment incentive	133% of current loan repaid available in next cycle

Product innovations such as these could help MFI's/SFB's further develop their IL capacity and lending portfolio.

3)   ***Strengthen cash-flow analysis by having innovative measures to check loan usage of clients***: Our study points towards the need to have standard robust methodologies in place to assess the cash-flow of client that rely on more than just self-reported income data. This could include bank record analysis, or business site field-visits on part of the loan procurement officer. Even though individual liability loan products are given for business purposes, our data shows that a large number of loans are not actually used for the same. Although, MFIs conduct checks to verify the loan usage, this was being practiced only by a few MFIs interviewed and usually done within two weeks of loan amount disbursed. It is necessary that MFIs conduct more robust and regular checks to verify the actual loan usage, apart from assessing the loan amount of clients accurately.

As incorporating further checks depends on the operational capacity of each lending institution, strengthening the back-end systems in place to analyze cash flow, credit history estimations and quick digitization of data would be the first step toward ensuring fewer discrepancies in cash-flow and loan usage. Strengthening the quality of the data that is initially fed into the system would help with better customer assessments and monitoring at all further levels. Software such as ARTOO can be included in the MFI/SFB operational structure as it ensures doorstep credit assessment, feeds data from the field digitally, better MIS management and comprehensive repayment tracking. Using these software could form the base of measures taken by lenders to ensure correct usage and proper cash flow estimation. Additionally, better digitized information can help MFI's in understanding their customer segments better and lead to product innovation and diversification.

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[7]   http://www.swadhaar.com/pdf/Appendix%201-%20Background%20Note%20on%20Individual%20Lending%20at%20Swadhaar.pdf

[8]   http://www.microsave.net/files/pdf/Individual_Lending_Booklet.pdf