

# MicroSave India Focus Note # 15

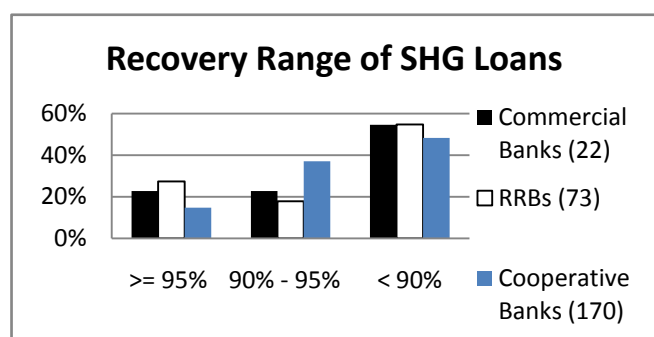
## Delinquency in Self Help Groups

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### Introduction

Delinquency in SHGs is starting to attract the attention of the organisations that promote and support them, and the banks that lend to them. Based on the study of NCAER (National Council of Applied Economic Research)<sup>1</sup>, the State of the Sector Report 2008 indicates that only 69.2 per cent of the SHGs had an excellent record of recovery. And, 22.6 per cent SHGs had recoveries of less than 75 per cent of demand.



Source: State of the Sector Report 2008

It has been generally observed that financial institutions are more concerned with repayments by SHGs to them, and not with the overall repayment behaviour within the group. This practice seems to be permitting a gradual escalation of hidden delinquency, which eventually puts bank-linkage portfolios at risk – as can be seen from the rapidly deteriorating repayment rates.

### Identifying Delinquency in SHGs

Detecting delinquency in SHGs is a big challenge for a bank. While members may be delinquent, SHGs might be able to continue repaying the bank on time, by dipping into the group funds. This can create a false sense of portfolio quality among the financial institutions, as the repayment behaviour of individual members is not tracked.

Terms and conditions for internal loans are generally decided by the group members. SHGs often expect their members to repay internal loans in a single 'bullet' payment at the end, rather than in smaller, regular

payments. This makes it difficult for the group to recognise delinquency, until the end of loan term. And, in cases where the loan becomes "delinquent", it might be too late to recover the amount due as the amount payable is large and beyond the normal means of the member. In such cases, delinquency could lead to conflicts within the group and result in the dissolution of the group.

Many SHGs do not maintain their books of accounts correctly. This also makes identification of delinquency difficult. An outsider would need to reconstruct the books to assess delinquency.

In some SHGs with large loans from banks, the members were found to have distributed their savings. However, sometimes, they account for these distributions as loans given to members. These "loans" are not repaid, and are not considered as delinquent loans. From an accounting angle, the SHG still has a corpus comprising of members savings and accumulated surplus, while in reality, the corpus is reduced/non-existent<sup>2</sup>.

In addition to hiding internal delinquencies, poor record-keeping creates a second problem. It hides situations in which the group is de-capitalised or operating only as a shell, to access external loans. From the perspective of a bank, this is a more serious problem – one which is likely to lead to rising delinquencies in the bank's portfolio.

### Delinquency Management by SHGs

SHG members feel that internal loans taken from the group can be repaid any time, as other members understand their difficulty. Therefore, seniority is given to other loans (banks, MFIs etc.) where the lenders do not "understand" and insist on on-time repayment.<sup>3</sup>

SHGs use peer pressure to ensure repayment from members. When a member does not repay on time, the group generally asks the delinquent member to repay at the earliest. When the group begins to view the loan as seriously delinquent, the members go to the borrower's home and pressure her and her family to repay.<sup>4</sup>

<sup>1</sup> NCAER, (on behalf of GTZ-NABARD), 2008, 'Impact and Sustainability of SHG Bank Linkage Programme'

<sup>2</sup> It is also misleading to mention the corpus as available, in SHG Balance Sheet.

<sup>3</sup> Competition in Microfinance – a study by APMAS in Guntur district, Andhra Pradesh.

<sup>4</sup> For more examples see Self Help Groups in India: A Study of Lights and Shades for more examples

Though arrears are high among internal loans of SHGs, this does not necessarily translate into a high default rate. Almost all SHGs are successful in the eventual collection of loans owed by members. This is because, for many poor members, cash flows do not correspond to monthly loan instalment schedules, but rather depend on seasonal income such as agriculture and animal husbandry.<sup>5</sup>

However, over a period of time, having a repayment schedule and not adhering to it could lead to credit indiscipline in repayment of not only internal loans, but also external loans, particularly when the loan sizes become large and where the SHGs do not have adequate buffer of internal funds to tide over internal delinquencies.

### **Current Delinquency Prevention Strategies**

#### *Banks*

The anticipation of a subsequent and a larger loan from the bank motivates the group to repay a bank loan, and the risk of an adverse credit history acts as a disincentive to the group to default. Government schemes (such as reimbursement of interest paid above 3% paid on SHG-bank linkage loans repaid on-time in Andhra Pradesh), also motivate the SHGs to repay on time.

Prior to lending, banks assess SHGs by using the Critical Rating Index (CRI)<sup>6</sup> or a similar quality assessment tool. Most banks also ensure that the groups get loans as a multiple of their accumulated savings (approved multipliers typically range from 1:1 up to 1: 8, at the discretion of the banker). Thus, the prospect of a subsequent and larger credit motivates the SHGs to make regular repayment of existing loans.

#### *SHPIs and MFIs*

Peer pressure is the dominant method adopted by self-help promoting institutions (SHPIs) and MFIs in addressing delinquency in SHGs (e.g., *Indira Kranti Padham* (IKP) in AP and Chaitanya promoted Federations in Maharashtra).

- The Mutual Benefit Trusts (MBTs) supported by Chennai-base Sarvodaya Nano-Finance Ltd suspend fresh loans to all SHGs in a village when one SHG is seriously delinquent. This triggers pressure on the delinquent group for immediate loan repayment, and has ensured high repayment performance.
- BWDA Finance Limited (BFL) based in Tamil Nadu conducts internal auditing and rating of all SHGs prior to receiving loan applications. The leader of the SHG

gets 0.5% of the loan amount as incentive, if repayment is on-time during the entire term of the loan. The branch staff also receive an incentive for on-time repayment by the SHG.

- The SHG Federations promoted by Chaitanya, an NGO in Maharashtra, use clusters and federations to put pressure on delinquent SHGs. Federation staff conduct regular auditing and rating of SHGs prior to accepting loan applications.

### **Conclusion**

Some financial institutions are advancing loans to SHGs, based on the repayment performance, without reviewing the SHG's internal repayment performance. Where a member fails to pay, the group repays the loan from its internal funds – savings and reserves. While this is in line with the group concept, it buries the problem, and the financial institution might be lending to a group of defaulting members, of whom it is not even aware!

In the case of SHGs, many financial institutions seem to be focussing on managing delinquency while the focus should be on detection and prevention. New measures must be taken to ensure that SHGs that receive loans are capable of repaying them.

Banks have to make it mandatory to assess the group performance before sanctioning a loan, and not just decide on the basis of previous loan repayment. As with the best performing Joint Liability Group-based MFIs, SHPIs, MFIs and banks may have to create systems to track repayment behaviour of the individual members within the groups, and not just repayment by SHG as a whole.

Periodical monitoring of the SHG performance and portfolio quality will provide insights to the potential delinquency problems. SHPIs have to promote simple and compulsory book keeping system in the SHGs and encourage the SHGs to update their books regularly. This will help all, the SHGs, the SHPI and the lending institutions to assess the functioning of the SHGs and take an informed decision.

SHGs seem to be able to collect internal loans from their members, though based on a quite different logic of timeliness and repayment discipline than that of a bank. But the “indiscipline” in repaying internal loans, unless addressed could later affect the repayment of the SHG's external borrowings.

<sup>5</sup> L.B. Prakash. Value for Money – Cost of Promoting SHGs Consultative Group to Assist the Poor (CGAP), Occasional Paper No. 12, Aug 2007.

<sup>6</sup> Critical Rating Index (CRI) has been designed by the NABARD, and circulated to all the banks to assess the SHG prior to lending