

MicroSave India Focus Note 39

Diagnosing Financial Stress in Group Methodology

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Introduction

Micro credit evolved and became successful on the basis of its group lending methodology, with “peer pressure” and “joint liability” as the building blocks. Now, four decades after its beginnings, the group methodology is under scrutiny, especially in India, with many stakeholders (particularly elements in the political and religious establishments) alleging that it is causing financial (and indeed other) stress to the women clients. The recent past has seen instances in the south of India where groups refuse *en masse* to repay, which has, unsurprisingly, challenged MFI operations. The reasons for this are many, including the competitive environment, multiple borrowing¹, the perceived threat from MFIs to the SHG movement and the increasing attention being focused on the sector.

This triggered *Grameen Koota (GK)*² to look at their group lending methodology from a different perspective, and to ask questions about the financial stress levels of the *kendras*³, if and how this can be diagnosed. *MicroSave* as the technical support partner, designed and jointly conducted a research study, “The Voice of the *Kendras*: Diagnosing Internal Stress”, to answer these questions.

The objective of the study⁴ was to identify the financial stress of members, sources/reasons for this stress and indicators for measuring it, and to identify strategies for mitigating financial stress amongst *kendra* members. This focus note presents the learnings from the study, and authors’ experience in the sector.

Key Findings

For the purpose of the research, and for this focus note, financial stress is defined as: “a difficulty that causes worry due to the financial factors”. Financial stress is caused by a combination of factors that affects individuals, groups and *kendras* differently.

Delinquencies within *kendras* are one of the major sources of stress for members. Other life cycle and seasonality related issues also affects members’ income and expenditure patterns and add to the financial stress.

1. Delinquency Related Stress Factors:

- In the majority of cases, the amount due from delinquent member(s) must be repaid by other group/*kendra* members. If the delinquent amount is low, (usually) 2 to 3 group members take the



burden of repayment; if the amount is high then all the group/*kendra* members contribute equally.

- Financial stress also varies according to the time/season members have to pay for delinquent member, the amount and the seasonality of their business, and when the delinquency occurred.
- Migration without notice (leaving other members to make the repayments) and over-indebtedness due to multiple borrowing are the major causes of serious delinquency in *kendras*, as well as their major causes of financial stress.
- The selection of inappropriate members, leading to delinquency, also causes stress. Recruitment of people who could not be trusted with debt in the first place, and/or cannot attend meetings regularly, affects the *kendra*’s chances of getting subsequent loans, further adding to the pressure.
- At times, to access multiple loans, entire *kendras*/groups enroll *en masse* in several MFIs. In this case, if any member becomes delinquent or defaults, the stress levels of other members can become very high as they often have to pay the delinquent amount on behalf of the delinquent/defaulting member to many (or all) the MFIs in which they have enrolled.

¹See *MicroSave India Focus Note 33 “Why Do Microfinance Clients Take Multiple Loans?”*

²Grameen Koota, a division of Grameen Financial Services Private Limited

³*Kendra* is akin to a Centre in Grameen model

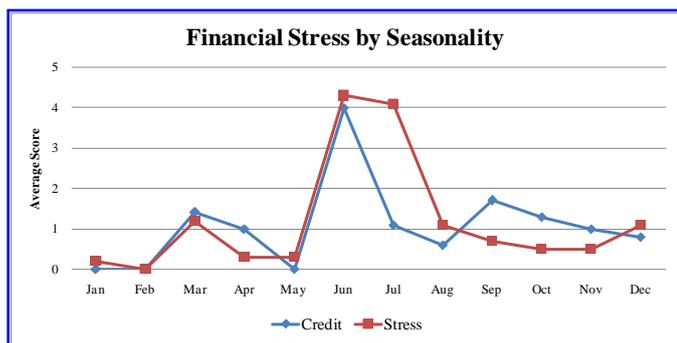
⁴The study was conducted in 8 districts in Karnataka, covering 13 branches, 65 *kendras* and 341 respondents.

2. Life Cycle Event Related Stress Factors

- Unsurprisingly, major life cycle events such as marriage, education of children, business start up or expansion, house construction, festivals etc. cause financial stress. However, this is not just due to the size of the expense. For instance, some very high costs (like house construction, maternity, business expansion, higher education etc.) can involve relatively low financial stress, as timelines are predictable, relatively long and flexible. This gives members the ability to mobilise more resources, more systematically under conditions that entail less pressure.

3. Seasonality Related Stress Factors

- Income, expenditure patterns in certain months causes financial stress. For instance, the month of June is the most difficult for many GK members. In this month, members face very high costs for children's education, and take credit to meet these costs - school fees, books, uniforms etc. These loans must be repaid from other income, as the investment in education does not add to their immediate earning capability. June is also the period in the year when many members face very low levels of household income.



Indicators for Measuring Financial Stress

Identifying indicators that give an 'instant' measure of financial stress of members is easier said than done. However, during the study some observations were made in terms of which factors, if tracked over a period of time (combined with some qualitative research inferences, of course), can portend the building up pressure within the *kendras*.

- **Delinquent payments and defaults** can be due to reasons such as: to attend emergencies; over indebtedness due to multiple borrowings; family problems; loss of wages/business; dearth of an earning member of the family; emergency expenses; and wilful defaults. This will add to more financial stress if: (a) the burden is huge and (b) the entire burden falls only on a few members.
- **Drop outs** that lead to delinquencies and vice versa

are potential source of stress. Delinquency and default problems often exacerbate drop out problems since the group/*kendra* members have to pay to the MFI on behalf of delinquent members. And, of course, clients dropping out often leave without paying. So it is worth investigating the reasons for such drop outs and to analyse the resultant financial stress levels.

- **Group/*kendra*'s** behaviour in terms of who takes responsibility for making up delayed or delinquent payments - whether only a few members take up the responsibility all the time or all the members share the burden equally - also affects stress.

Role of *Kendras* in Managing Stress

One major lesson that emerged from the study was also that *kendras* have their own coping mechanisms in terms of paying for the delinquencies and for managing financial stress. *Kendras* are capable of learning and improving over time, and MFIs could play a key role in facilitating this process.

Some of the strategies adopted by *kendras* included: careful selection of new members (by checking candidate's income sources, livelihoods sources, family background, family support etc); conducting their own loan utilisation checks; expelling the delinquent members; sanctioning loans in subsequent loan cycles based on the member capacity; reducing loan sizes as penalty; and (as a last resort) recommending to the MFI to stop loans to delinquent members.

Kendras vary widely on two critical dimensions that affect their performance in managing delinquency. These are: the quality of their leadership and their capacity to collectively learn from experience based on a certain level of mutual trust ('social capital').

Conclusion

Kendras that manage financial stress best are those that anticipate these events in advance; while those that experience the greatest financial stress are those that least expected them. Delinquencies due to migration without notice, and over-indebtedness owing to multiple borrowing, are major causes of financial stress. If MFIs can study such delinquencies and observe any pattern, this type of research might identify ways for MFIs to increase awareness and preparedness of its *kendras* in future.

Also, it is important to note that many of the largest sources of financial stress faced by *kendras* are (to a large extent) within the control of *kendras* and their leaders. Hence, MFIs should attempt to facilitate *kendra* empowerment, decision-making and action.