CHAPTER 9
SUMMARY AND CONCLUSIONS

9.1. Introduction
Micro-finance groups emerged not only to address the imperfection in the rural credit markets but also the concerns relating to poverty alleviation and women empowerment. In these groups, the transaction costs arising out of three main problems (namely, selection, monitoring and repayment) of the credit market can be reduced through familiarity of the members, small size of the groups and repeated interactions. Since these are small groups and members of such groups belong to similar socio-economic background, they can undertake collective action in the selection of borrowers, monitor the utilisation of the loan and ensure timely repayment of loans. The outcome of such collective action is expected to be reduced transaction costs and from which both lenders and borrowers benefit. The lenders are able to shift a part of the burden associated with borrower selection, loan administration and repayment enforcement onto the borrowers. Similarly, borrowers will be able to save transaction costs by not having to undergo the cumbersome procedure of filling out lengthy applications, and undergoing project and collateral appraisal (Bhatt and Tang 1998). Under micro-finance groups, large number of poor people without adequate individual physical collateral can access credit based on the social collateral. The peer pressure is the main force behind continued existence of the group. The joint liability provides incentives to (and/or compels) the group members to undertake those actions, which reduce uncertainty in the credit market (Ghatak and Guinnane 1999; Bhatt and Tang 1998; Morduch 1999b). Thus, collective action within the group is the key aspect of micro-finance groups. The reliability and the sustainability of micro-finance institutions, however, depend on how well they can enforce the contracts among the members. Micro-finance groups arrive at certain rules and regulations to ensure that the mechanisms concerning contractual relations are in operation. Similarly, the members are provided with adequate incentives to promote co-operation or to avoid the emergence of non-co-operative outcome.
Institutional mechanisms and incentives involved in the selection of borrowers, monitoring the utilisation of the loans and ensuring repayment of the loans are, thus, important in micro-finance programmes. The incentives and mechanisms for the selection of borrowers aim to rectify the problems of adverse selection, whereas, monitoring of the utilisation of loans looks into moral hazard problems and enforcing repayment tries to avoid the chances of free rider problems. Therefore, positive and negative incentives (Lin and Nugent 1995) need to be provided. The chance of getting a next and bigger loan can be considered as a positive incentive whereas punishment in case of default can be considered as a negative incentive to reduce free rider problems. Since the members dynamically interact at different points of time, incentives are to be directed to the members to avoid chances of free riding. The mechanisms like compulsory weekly savings contributions, repayment of loan in various instalments etc., are built into the system to ensure collective responsibility among the members and ensure timely repayment of the loan (Patten et al 2001).

It is in this context that this study has been undertaken to examine the incentives for and processes of collective action in different types micro-finance groups, the impact of mechanisms and incentives in undertaking collective action and the pattern of selection, monitoring and repayment. Such a study will be of some help for the policy makers in the context of considerable growth and spread of micro-finance groups in India in the last one-and-half decades.

Objectives

1) Understand the existence and the nature of collective action among micro-finance group members;
2) examine the mechanisms and incentives incorporated for collective action among micro-finance group members while selecting the borrowers, monitoring the utilisation of the loans and enforcing repayment; and,
3) analyse the impact of mechanisms and incentives for collective action among micro-finance group members while selecting the borrowers, monitoring the utilisation of loan and enforcing repayment.
Hypotheses

1) Appropriate mechanisms and incentives are not incorporated in micro-finance
groups for collective action in the selection of borrowers, monitoring and
enforcing repayment of loans;
2) Micro-finance groups do not select creditworthy borrowers, monitor the
utilisation of the loan and enforce loan repayment; and,
3) There are no differences between government and NGO initiated micro-finance
    group members in terms of their socio-economic profile and their performance in
terms of selection, monitoring and repayment.

9.2. Methodology of the Study
Wayanad, one of the backward districts of Kerala, was selected for the study as it
had high presence of government and NGO initiated micro-finance groups. This
district also had the highest proportion of households covered under micro-
finance programme.

From this district, two panchayaths - Sulthan Bathery and Noolpuzha – were
randomly selected from Sulthan Bathery block, where the incidence of micro-
finance groups was high. Equal number of groups was selected from these
panchayaths based on the assumption that there was no difference between
government and NGO initiated groups in so far as the performance was
concerned. Accordingly, 8 NHGs (government initiated) and 8 SHGs (NGO
initiated) were selected from each of these panchayaths and a total of 32 micro-
finance groups were selected randomly. From each of these groups, 6 members
were randomly selected. The total number of sample member households
selected for the study was 192. A structured questionnaire was used for collecting
information from the sample member households. The information collected
included socio-economic details of members, profile of members, access to loans,
utilisation and repayment of loans, the presence and compliance of the rules
relating to mechanisms and incentives in the selection, monitoring and repayment
of loans. Another questionnaire was used to collect data on the micro-finance
operations at the group level. Checklists were prepared to gather information
about the groups from bank officials, NGO and government personnel.
9.3. The Context

Among various states in India, Kerala is widely recognised as a state in which micro-finance programmes have been successfully implemented. Micro-finance in Kerala was introduced at a time when there was an active debate on the sustainability of Kerala model of development. The introduction of micro-finance coincided with the democratic decentralisation campaign initiated in Kerala during 1990s, following the 73rd Constitutional Amendment. It was pointed out that Kerala economy could be recovered from stagnation in the productive sectors mainly through the mobilisation of funds from voluntary services, beneficiary contributions in development projects, small savings through SHGs of women and loans from financial institutions (Mohanakumar 2002; Tharakan and Rawal 2001; Isaac et.al 2001). Thus, the proponents of decentralisation expressed their hope in the local elected bodies. Micro-finance programmes were introduced mainly through these local bodies.

Kerala is one of the firsts states in India, which adopted micro-finance programmes as a part of the state’s reforms on decentralisation. In 1999, the Government of Kerala implemented the state poverty eradication mission (also called Kudumbashree) and introduced micro-finance groups called NHGs all over the state through local elected bodies. This study has examined the functioning of micro-finance groups initiated by the government and NGOs in Kerala specifically looking into the institutional aspects.

It is essential to keep the agrarian economy of Wayanad district in our mind in so far as attempt to examine the micro-finance programmes. Most of the people of this district are small and marginal farmers engaged in the production of cash crops for the international market. But, the fall in the prices of these products such as coffee, pepper, etc., since 2000 adversely affected the agrarian economy of the district. The studies (Mohanakumar and Sharma 2006; Sainath 2005) show that the financial condition of a large section of the people also has rapidly deteriorated. Many of these people, who borrowed from the formal and informal financial sources for agriculture and other purposes, found it difficult to repay
their loans. The agriculture of this district has reached a point of crisis and this is reflected in the high number of farmers’ suicides reported from Wayanad district in the recent years (Krishnaprasad 2004; Mohanakumar and Sharma 2006). Another important feature of this district is the high population of tribals. They are the original inhabitants of this district and are socially and economically backward as most of them are landless labourers.

Social service organisations of the church administration in the district have been initiating development activities since 1960s. A few of these organisations have started micro-finance programmes as well. However, the *Kudumbashree* programme received wider popularity as the government channelled most of the development assistance to the poor through NHGs. For those poor who were interested in obtaining government assistance, membership in NHGs became a prerequisite. This influenced the members of NGO initiated SHGs to register their groups as NHGs.

Though both the NHGs and SHGs were initiated by two different institutions, the internal operations relating to savings and credit were almost the same. Only women were the members of these groups. The average period of stay for SHG members was 3.4 years, whereas it was 2.3 for NHGs. Thus, SHG members had relatively longer years of experience in micro-finance groups. Most of the members knew each other even before joining the programme, and this might have contributed positively towards the collective action within the groups. From 78 per cent of the groups, one or the other member left largely due to the inability to make regular saving contributions and migration. This indicates that the poorest households were finding it difficult to stay in the groups.

The size and homogeneity varied across the groups. The average size of SHGs was 16 members, whereas it was 17 for NHGs. As far as homogeneity was concerned, 87.5 per cent of the groups were homogeneous. The NHGs were

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54 A group is said to be homogeneous, if more than 50 per cent of the members in a group belonged to particular caste.
more homogeneous, as most of the members in these groups were tribals. Households living below the poverty line constituted a majority of members in both types of groups; but, the proportion was high in NHGs. In terms of level of education and annual income, NHG members were backward as compared to those in SHGs.

The groups encouraged members to attend weekly meetings and contribute savings regularly. Though a majority of the members regularly attended the meetings, the attendance was less among tribal members. The tribal members contributed lower savings amounts as most of them were poor. A majority of both the NHG and SHG members made regular saving contributions and this was more among SHG members where almost 90 per cent saved regularly. The financial benefit of getting loans from the group was the major reason for contributing savings to the groups. A majority of the members depended on husbands for making saving contributions. The dependence on male relatives was less among NHG members, as a majority of them were working as daily wage labourers with a better possibility of having their own income.

9.4. Findings of the Study
It is often noted that the three problems of rural credit markets, namely, selection, monitoring and repayment, can be solved in micro-finance groups, as the problem of asymmetric information is dealt through collective action. For this, groups must incorporate institutional mechanisms and incentives. Let us now examine the study findings relating to the extent to which these were present in the groups, and whether they helped in solving the problems of selection, monitoring and repayment.

9.4.1. Selection of Borrowers
In the absence of information on borrowers, adverse selection is the common problem in rural credit markets. We have, therefore, examined different aspects relating to selection of borrowers in micro-finance groups formed by the government and NGOs.
The sample micro-finance groups introduced four types of norms to ensure proper selection of borrowers. As per these norms, a member will be issued a loan only when (a) she completes certain duration in the group, (b) fulfils attendance requirement, (c) has savings in certain proportion of loan amount requested, and (d) has repaid her previous loans. Though a majority of NHG and SHG members had followed the first three norms, the proportion of members following repayment norm was about 70 per cent. The exact norm followed differed across the groups; but, within a group a norm was uniformly applied to all the members.

All the members except three from NHGs had received at least one loan. Though close to 80 per cent of the members from both the types of groups received 1 to 5 loans, about 28 per cent of the SHG members received more than 5 loans. In terms of the cumulative loan amount received, 60.4 and 25.0 per cents of SHG and NHG members, respectively, received loans above Rs. 7,500.

What factors influenced the loan amounts received by the members? A regression analysis with total amount of loan as dependent variable was undertaken to address this question. The results show that those members who were non-tribal and had longer duration of stay in the group received larger loan amounts. The SHG members received relatively larger loan amounts as they were in micro-finance for a longer period of time. An interesting finding was the positive association between the size of borrowing from sources other than micro-finance groups and loan amount. In other words, those members who were borrowing heavily from informal agencies were the ones receiving larger loan amounts. This implies that members often borrowed to repay the loans contracted from other agencies including informal ones. Surprisingly, there was no association between the loan amount, and mechanisms and incentives incorporated for good selection. In other words, the members who did not follow the institutional rules were the ones who received larger loan amounts.
Loan amount is, perhaps, not an appropriate variable to examine the impact of mechanisms and incentives on selection. We, therefore, asked the sample microfinance group members on their views on the selection procedure. The responses were three-fold: very good, good and not good. An overwhelming majority of the members termed the selection procedure to be either 'very good' or just 'good'. In order to arrive at two variables amenable for estimating a logit model, the responses of 'not good' and 'good' were combined into one category, whereas the 'very good' responses as one category. This enabled us to have a dichotomous variable on the perception of the members. The dependent variable was the perception of the members on selection procedure. The members belonging to SHGs, large groups, attending meetings regularly and participating in group discussions relating to selection are likely to term the selection procedure to be very good. However, there was no association between incentives and the member perceptions on type of selection procedure adopted in the groups.

Why incentives for the selection of borrowers did not work?
The above analysis makes it necessary to closely examine two issues; How did the sample members obtain loans even though they did not follow the norms? What would be their reaction to those members who did not comply with the norms and yet asked for loans? Though responses to the second question would be hypothetical, they have been analysed because they would have been shaped by their previous experience in the group.

The results show that despite the fact that some of the members did not comply with the norms, they obtained loans because of the following reasons. First, these members had urgent credit needs. Second, since the groups simultaneously disbursed both internal and external loans, the norm relating to repayment could not be strictly enforced. Third, non-conduct of regular meetings was the reason for not fulfilling the attendance norm by a few members. Fourth, since there was no other borrower and the group wanted to disburse loans in any case, a few of the members obtained loans though they did not comply with savings norm.
What was the reaction of members to those who did not comply with the norms? The responses show the following. First, the proportion of members stating that they would reject the issue to loans to non-complying members was high (well over 50 per cent) in the case of repayment norm. This was because the repayment norm insisted that if a particular member was not making timely repayments, others were liable to make repayment. Second, among the members who stated that they would reject the disbursal of loans to non-complying members, SHG members constituted a relatively larger proportion in the case of all the three norms. Third, in the case of the norms relating to attendance and savings-linked-to-credit, the dominant responses were that these could be relaxed if the credit need was urgent or if the group was confident of repayment.

Although the proportion of norm-complying members was high, the proportion of those stating they would reject the proposals from those not complying the norm was less. This difference could be attributed to considerations among members that urgent needs should be met regardless of whether members complying with norms or not. This can be explained in terms of humanitarian considerations that members had on the others in the group. The humanitarian considerations arose largely due to the agrarian crisis in the district, widespread distress faced by people and dire need for credit.

This also led to reciprocal relationship. The tendency of the members to relax the selection norms indicates that there existed mutual understanding among the members to help each other even though some borrowers had not fulfilled the norms. In other words, there existed some leniency at the time of disbursal of loans. Thus, there was reciprocal understanding and relaxation of the rules against the formal stipulations to benefit each other.

The net result of the above tendencies was that certain institutional rules had been gradually weakened. This can be found out from the following. First, the members who had not complied with the norms were likely to state that the
norms should be relaxed in cases of urgent credit needs and if group had trust. Second, a higher proportion of those complying with the norms was likely to state that proposals from those not complying with the norms should be rejected. Third, the proportion of norm-complying members stating that they would reject the proposals from non-complying members was very high in the case of repayment as compared to attendance and savings norms. This shows that the members were alert in so far as free-riding in the groups was concerned, and that they would reduce the chances of selecting bad borrowers. The strict enforcement of the repayment norm was due to the fear among members that if a loan was beyond member's ability to make repayment, this might lead to her indebtedness and thereby the failure of the group.

Thus, in groups with familiar members having diverse types of credit needs in the wake of agrarian crisis, strict enforcement of the group norms was found to be difficult while selecting the borrowers. Hence, relaxation to the compliance of norms (except, to significant extent, in the case of repayment) was given to the members based on humanitarian considerations and expectations of future cooperation from their peers. This suggests that certain institutional rules would not work in the communities where people are known to each other and share their problems and in the context of widespread problem such as agrarian crisis.

9.4.2. Monitoring the Utilisation of Loans
Moral hazard problem in the credit markets arises when borrowers undertake those actions that may adversely affect the chances of repayment. The microfinance groups undertake monitoring to ensure that borrowers utilise the credit productively for the stated purposes and help them in succeeding in economic activity (undertaken with the loan from micro-finance group) so that repayment is prompt and timely.

*Types of and incentives for monitoring*
The groups incorporated four types of monitoring mechanisms. They are monitoring of purpose of loan utilisation, skills, availability of raw materials and marketing opportunities. The evidence shows that monitoring was limited to loan
utilisation wherein groups sought to ensure that loan amounts were not diverted. The sample groups did not, however, strictly enforce the monitoring mechanism to ensure that the loans were utilised for economically productive purposes. In other words, the members enjoyed considerable freedom with respect to the utilisation of the loans.

Three types of incentives were prevalent in the sample groups. Of them, two were positive incentives, while one was negative incentive. The positive incentives were sharing of profits and regular access to credit. The negative incentive was the liability to make repayments in case of default by other members. A larger proportion of sample members stated that the positive incentive of ensuring loans to other members and the negative incentive of liability to repay in cases of default were present, either to a large extent or partially, in the groups.

For monitoring to be effective, there must be meetings and discussions among members relating to monitoring. The data on frequency of participation in the group discussions relating to monitoring show that a larger proportion of SHG members participated either regularly or occasionally. The proportion of members stating that they rarely participated in the group meetings was relatively high among NHGs. The important reasons why members rarely participated in the group discussions relating to monitoring were lack of capacity and poor governance.

*Purpose-wise distribution of micro-credit*

The loans disbursed by NHGs and SHGs were used predominantly for consumption and repayment of old debts. As much as 59.9 per cent of the total loan amount disbursed by SHGs and over 35 per cent of that distributed by NHGs were utilised to repay the past debts. About one-third of the total credit was used for various types of consumption, and this can be understood in the context of lack of reliable and sufficient social security from the government. Of the total loan amount disbursed by NHGs since inception, only 22 per cent was utilised for income generation. The proportion was much less in the case of SHGs at 6.8 per
cent. This can be attributed to the agrarian crisis in the district. The socio-economic profile of the study area portrays that as this district had been going through an agrarian crisis, the members had borrowed from various financial sources mainly to meet the consumption requirements such as repayment of earlier loans, conduct of marriages and medical treatment (Mohanakumar and Sharma 2006). Under such situations, we can argue that it is quite natural for the micro-finance groups to meet the immediate credit demands of the members. Otherwise, the members would have to depend on sources other than micro-finance at higher costs to meet their consumption requirements. Secondly, in the absence of support towards skill acquisition and marketing, members were unwilling to take up income generating activities. Third, the past experience was not encouraging. The members, who started economic activities such as soap making, food processing etc., were forced to close down the enterprise because of the stiff competition from the established products in the market and fluctuations in the prices of raw materials. The members also did not receive any support from either micro-finance groups or promoting agencies towards marketing.

About 67 per cent of the NHG members and 70.8 per cent of the SHG members were not involved in any IGA; the proportion of members not involved in any IGA was higher in the case of tribal members. The income generation activities that had been taken up by members were mostly related to livestock rearing and agriculture. This implies that the members were reluctant to undertake risky income generating activities probably due to agrarian crisis in the district. What factors influence the members whether to undertake IGAs or not? The results of logit regression show that the variables of provision of training, income of the household and loan amount positively influenced the members in undertaking IGAs.

Did the groups monitor the IGAs undertaken by the members?
In the case of as many as 90 per cent of the members undertaking IGAs, the loan amount was less than the investment on the activity. In the case of 60 per cent of the members, the loan amount constituted less than 75 per cent of the total
investment. The deficit was met either through borrowing or sale of assets. A larger proportion of tribals depended on moneylenders to meet the deficit. This had the following negative implications. First, the costs of borrowing were higher than that in the case of micro-finance loans. This resulted in considerable leakage of income from the activity. Second, the income generated from the activity constituted a small portion of the total income of the household. The above implies that the groups did not monitor the actions of the borrowers and this had resulted in certain practices (such as borrowing from moneylenders) leading to poor incomes. This brings us to another important issue of what factors influence the success of groups in monitoring.

*How did the group members characterise their monitoring behaviour?*

The monitoring of the loans was stated to be effective or extremely effective by 69 per cent of SHG members as compared to about 57 per cent of NHG members. What factors would influence a member to perceive that their monitoring was effective? A logit model was estimated for this purpose. In this model, the dependent variable was a dummy with ineffective monitoring as zero and effective/ very effective monitoring as one. The independent variables included member and household characteristics, group characteristics, mechanisms and incentives for monitoring. The results show that homogeneity, mechanisms (attendance in meetings) and incentives for monitoring would positively influence the members to perceive that the monitoring in their groups was effective.

### 9.4.3. Repayment of Loans

Repayment is the final stage in a credit transaction. The micro-finance groups incorporated certain mechanisms and incentives to motivate the members to repay on time. The dynamic incentive of disbursement of second and higher amount of loan if the previous was repaid was incorporated in the sample groups. The social pressure also existed in the sample groups. The groups adopted two types of mechanisms, namely, repayment in monthly instalments and repayment within the stipulated duration. However, 70 per cent of the members did not follow the
instalment pattern of repayment and about 50 per cent delayed their repayment. At the same time, no member defaulted in repayment. In other words, a majority of the members repaid the loan amounts in one go either on the date of maturity or at a later stage.

**What factors influenced the delayed repayment?**

The regression results with number of days of delay as dependant variable show that the delay was less in the case of higher income households and literate members. More importantly, both mechanisms and incentives significantly influenced the members to repay on time. It was found that longer the duration lesser would be the delay. This suggests that the micro-finance programmes should arrive at realistic repayment schedules. The incentives also influenced the members to repay on time. If micro-finance groups introduced the incentive that every repayment would lead to next and bigger loan, the delay tended to be less. Similarly, in the case of those groups, where social pressure was intense, the delay tended to be lower.

**How did the members make repayment?**

How could all the members repay their loans when the district was going through agrarian crisis and a majority of the members did not undertake IGAs? This question can be answered as follows. First, repayment was not with income generated by the member or from the IGA. Secondly, the borrowing either from the micro-finance group or elsewhere constituted a significant source of repayment. The results of the study show that members borrowed from the group soon after the repayment either to repay moneylenders from whom they had initially borrowed. This shows that the purpose of micro-finance programme was defeated. The members, instead of obtaining cumulative benefits through borrowing from the groups, had been only circulating money obtained through borrowing from informal agencies to micro-finance groups and *vice versa*. Such a practice, no doubt was due to agrarian crisis, would not lead to sustained poverty alleviation among the members.
9.5. Conclusions

*Group size*

Theories on collective action note that the groups function effectively when they are small in size (Olson 1965). Stiglitz (1990) has stated that the members in a group would take up the responsibility to monitor only if the number of members involved in a group was small. The chances of free riding would be less or the incentives to act collectively would be more in a group where the number of members is less.

In the present study we have taken group size as a variable influencing the selection, monitoring and repayment. It has been observed that the members belonging to smaller sized groups received lower amounts of loans. Moreover, the members belonging to small sized groups did not express a better opinion about the selection procedure followed in the group. Similarly, the monitoring was less effective in small sized groups. This indicates that the outcomes with respect to selection and monitoring had not produced the expected results with respect to the group size. On the other hand, the members belonging to small sized groups were better in enforcing repayment. In the study area, we have examined that members belonging to some of the smaller groups stating that they became smaller in due course of time due to conflicts within the groups. Thus, small groups need not necessarily be democratic and inclusive especially when they were large to begin with and become small due to internal conflicts.

*Homogeneity of the groups*

Another important variable discussed by collective action theorists as having a bearing on collective outcome is homogeneity of the groups. The members belonging to homogeneous socio-economic conditions provide familiarity to one another and contribute towards social networking and produce positive impact on collective outcome.

Instead of resulting in better outcomes in terms of selection, monitoring and repayment, homogeneous groups in our study area resulted in a mutual
adjustment with regard to the relaxation of selection, monitoring and repayment mechanisms. Members were finding it difficult to close their eyes to the plight of their neighbours and it was for this reason that the members became lenient when it came to enforcement group mechanisms.

One of the reasons behind poor performance of homogeneous groups in our study area may be because of high presence of tribal members. Perhaps because of the financial backwardness and lack of awareness, the groups in which tribal members were the majority experienced poor outcomes with respect to selection, monitoring and enforcement. The study, therefore, suggests that homogeneity of the groups need not always contribute positively towards collective action.

**Mechanisms and Incentives**

The study has revealed that in a community where the members had close face-to-face interactions with each other, it was difficult to enforce norms and regulations. This was the reason behind strong reciprocal adjustment among members with regard to selection, monitoring and repayment. Moreover, the absence of an alternative credit source for a majority of the members forced the members to relax the norms. Therefore, in the context of homogeneity of the groups and absence of alternative credit sources, it was difficult for the members to strictly enforce group mechanisms. The study has revealed that both the positive and negative incentives had worked effectively towards collective action in so far as monitoring and repayment are concerned.

To conclude, the micro-finance groups have incorporated certain mechanisms and incentives to encourage and/or force the members to participate in collective action relating to selection, monitoring and repayment of loans. The members in these groups, however, exercised their own judgement on which of these were to be complied with based on genuine credit needs of member households facing several hardships due to agrarian crisis and their own capacity. The institutional rules relating to mechanisms and incentives led to desired impact only in the case of monitoring and repayment of loans. But, the outcome of the collective action
did not always result in the cumulative benefits to member households. Thus, although collective action existed in the groups, the nature was such that it did not result in sustained poverty alleviation. This was largely due to the agrarian crisis in the district, which adversely affected not only the employment and incomes of households depending directly and indirectly on agriculture but also investment and marketing opportunities in the areas. This was also an important reason why there was not much of difference between government and NGO initiated groups in the outcomes of collective action, though the latter were formed earlier than the former ones. Institutional mechanisms and incentives are thus important in facilitating collective action. But, whether the members comply with these mechanisms and incentives in such a manner that they result in beneficial outcomes is context specific.