MicroSave India Focus Note 85

The Collection Methodologies in Group Lending

Anant Jayant Natu, Ravi Kant, TVS Ravikumar and Sunil Bhat

December 2011

Background

What is it that sets microfinance apart from other forms of financial service provision? The list of differentiators is long, but one of the key ones is the regular and intensive engagement between client and the financial service provider. This sets microfinance apart from other forms of finance delivery. It is the convenience of doorstep delivery offered by microfinance that the client values most of all. For MFIs, the intensive engagement is an operational imperative that is absolutely vital to control the credit risk associated with non-collateralised and small loans.

But, providing 'close to home' or 'doorstep' service is a costly endeavour. MFIs have to employ a battery of field staff to maintain relationships with clients in the field. This makes microfinance the most labour intensive form of financial service provision. However, in view of the Malegam Committee recommendations suggesting a margin cap (over the cost of funds) of 10% for larger MFIs and 12% for smaller MFIs, and an interest cap regime (in the 24-30% range), MFIs will be severely tested in days ahead. Within that margin cap they will have to meet their operating costs, provide for loan losses and earn a sufficient surplus to sustain the business and keep their promoters/equity shareholders interested.

Collections - Key Driver of Costs

Banks have operational costs in the range of 2% to 5%. By comparison, any middle aged and fairly efficient MFI in India has operations costs in the range of 5% to 10%. This is so even though some key components of operational costs (like salary, rent, utilities etc.) are lower for MFIs compared to other financial institutions, since MFI branches are mostly in rural areas and cheaper to maintain. Thus, process related costs need further analysis. Processes like group formation, group training, loan appraisal, disbursement and loan utilisation checks are one-time events and of relatively short duration (spanning between few hours to few days). However, instalment collection extends for the entire duration of loan cycle (which is usually a year) and occurs at regular frequency (usually every week). This makes collections the single most critical driver of costs.

In the 1970s, when Grameen Bank started its operations, it kept a box at a designated location and clients passing by that box would pay the money daily. Within no time, quarrels began as to who had paid and who had not. Hence, it was decided that all collections would happen on a weekly basis at a 'centre' on a designated day, at a pre defined venue. This was the genesis of weekly centre meetings. In India, under the early SHG-bank linkage model, the facilitator NGO would collect instalments at SHGs' monthly meetings, conducted in the village. The field staff would bring the cash back to the NGO office. From there, NGOs would send the money to the bank, keeping part of the income as commission.

Microfinance has come a long way, and the MFIs have tweaked and innovated with these early prototypes, based on considerations like cost and customer service, to invent different ways of collection. Today, there are three dominant models for group lending.

Model 1: In this model, the field officer (FO) comes to a designated location (still called the 'centre') according to a pre-fixed (read sacrosanct!) schedule to collect instalments. All clients mapped to that centre are required to be present at this meeting. Attendance of these meetings is compulsory and strictly enforced. Many MFIs practising this model of collection have become efficient enough to finish the collection for the entire centre (20 to 40 members) in less than 15-30 minutes. Examples of MFIs following this model include: SKS, Share, Spandana and, its progenitor, ASA-Bangladesh.

Model 2: Operationally, this is same as Model 1, but in this case, the primary purpose of centre meetings is not to collect instalment in cash. These meetings serve to maintain continuity in client-MFI interface and foster group solidarity. Cash transactions occur separately (usually a day prior to, or immediately after, the meeting) when centre members deposits the cash in either a designated bank account or the MFI branch. FOs bring some documentary evidence of the cash transaction. Besides this, matters related to new loans, clients' businesses etc. are discussed. In some cases, for example Freedom From Hunger's Credit With Education approach, clients are also given information on health, business etc. topics. But this model is common amongst MFIs that are sensitive to cash handling costs and/or operate in areas with significant cash-carrying risks. Examples of MFIs following this model include: Sonata, Cashpor, Grameen Koota, Margdarshak and BWDA.

Model 3: The third model is predominant with MFIs operating in urban areas. In this case, the meeting between the clients and the FO happens on a scheduled day and time, but unlike the first model, attendance is not compulsory. Instead, FO collects the group's instalments from any one member of the group. There are no separate group meetings. MFIs that have lent to small businessmen in busy urban market areas are more likely to use this model. It has worked well for some MFIs (like BASIX and Arohan) but has had limited success in other places. The critics of this model say that such a system tends to dilute group cohesion and weakens the relationship between clients and their MFI.

Factors like the MFI's mission, location, risk appetite, client segment and strategy determines the choice of collection methodology. In the short term, the cost variation across the 3 models is not significantly different as each requires the FO to visits the field. Comparative analysis of the 3 models in presented here:

Features	**Model 1** *(collection & meeting)*	**Model 2** *(only meeting)*	**Model 3** *(only collection)*
Client-interface	High	High	Low
Attendance requirement	Strict	Strict	Flexible
Cash-carrying risk	High	No risk	High
Transaction Point	Doorstep	Doorstep	Market
Core Objective	Collection & relationship	Relationship maintenance	Only collection
Time taken	15-30 mins.	10-30 mins.	10-20 mins.

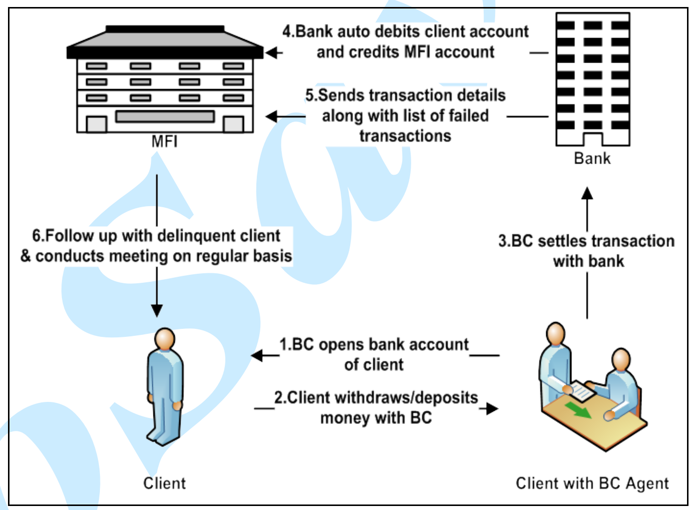
Recently, some MFIs have shifted to a technology-driven system wherein transactions are recorded on a mobile or a hand held device thus removing the need for lengthy collection sheets. This is expected to not only bring down the cost, but also save time.

Way Ahead: On to Banking Infrastructure

MFIs now have the opportunity to partner with banks as their banking correspondents (BC). Banks acknowledge the wide reach of MFIs in rural/underserved areas and see in them a ready-made channel that reaches 'the last mile'. They will be keen to capitalise on this network to realise their financial inclusion targets.

MFIs have an existing pool of clients that can become bank customers and open 'no-frills accounts' on behalf of the banks as their BC. Once the account is activated, a host of possibilities emerge that were hitherto not present. In the context of this Note, one such possibility is to reduce the cost of disbursement and collection.

An MFI can tie up with bank for auto-debit facility for a list of client accounts that have taken MFI loan and who also happen to be bank customers. The clients would have to authorise banks to debit their account for this purpose. Thereafter, prior to the scheduled repayment date, the MFI can send a reminder to client, following which, the client deposits money at the nearest BC agent location to ensure that there is sufficient balance in her account. On the scheduled date, the bank debits the instalment amount from client's account and credits the MFI's account. The MFI receives debit transaction details (including failed transactions) from the bank, based on which it follows up with any delinquent clients.



If the model is implemented successfully, it does have the potential to reduce costs significantly, while addressing many challenges associated with other collection models like cash-carrying risk, meeting attendance fatigue, opportunity cost of time for clients and fraud. However, the practical difficulties for MFIs in implementation of model cannot be ignored, as they will have to coordinate with the bank and manage BC agents as well. Further, such a system does not preclude the need for the MFI to maintain regular client interface.

Finally, whichever collection mechanism is used, MFIs will have to devise ways to ensure continuity in their interface with clients. Banking is based on trust and thus technology can never replace the person-to-person contact. Any MFI that compromises this aspect on grounds of reducing operating costs will pay dearly in the long run – as the larger MFIs have recently found out.[1]

[1] See *MicroSave* IFN 42 "Microfinance In India: Built On Sales Targets or Loyal Clients?"