MicroSave
Market-led solutions for financial services

Low Income Lives

Managing loan repayments

The use of credit is an essential part of how low-income households manage to smooth their consumption in the face of "double-whammy" combinations of income and expenditure shocks. The big push for microcredit in the past decade has led to an abundance of microfinance providers and other providers that offer standardised products. This provided a deep-reaching channel of credit access. Microcredit was particularly prevalent in regions like the rural parts of the Indian state of Tamil Nadu. Even while microcredit programmes around the world have demonstrated meagre effects on household income generation, microcredit may well be the "safety valve" needed to preserve existing income and consumption levels.

Where a one-size-fits-all approach of standard repayment schedules and loan amount caps may drive business efficiency and keep regulatory compliance simple, it may push households to use credit in unsustainable ways. This article highlights how low-income households in one district in Tamil Nadu use and manage their borrowings and repayments. It presents the cases of two households that use their access to credit extensively and adroitly to stay afloat in the face of lumpy expenditure and volatile cash flows.

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1. The author is grateful for Vaishnavi Prathap's valuable inputs.

In our sample, borrowing to meet existing loan repayment obligations is a common strategy among households. Up to 75% of households reported new borrowings as their go-to coping mechanism for making repayments and to tide over cash flow crunches at least once during our year-long interaction with them. However, the chronic use of borrowing to repay existing loans as a coping mechanism makes it incredibly expensive for households that lack more efficient alternatives for savings or insurance. Between our first and last interaction that lasted 12 months, the overall outstanding debt for more than 50% of households in our sample rose by a median value of about INR 7,600 (USD 116).

We interviewed both households as part of a financial diaries study[2] conducted between February, 2015 and May, 2016. We conducted the study in Krishnagiri district in Tamil Nadu located close to two other southern Indian states—Andhra Pradesh and Karnataka. Krishnagiri district has a higher estimated incidence of rural institutional indebtedness, amounting to 29% of households, as opposed to 22% across the country. Meanwhile, the median institutional debt outstanding per household that borrowed was INR 34,606 (USD 528), as opposed to INR 18,488 (USD 282) across India, as of 2012[3].

Our primary data collection exercise involved conducting detailed monthly interviews with 400 panel households for 12 months, half of which were self-identified users of microcredit. As part of this exercise, we surveyed in detail their demographic and socioeconomic characteristics, cash flows, access to market-prevalent financial services, and financial behaviour.

2. The data collection for this study was funded jointly by CGAP, FMO, and Dvara Research as part of an initiative to understand implications of suitability in microcredit.
3. Estimated from NSSO's All India Debt and Investment Survey, 2012.

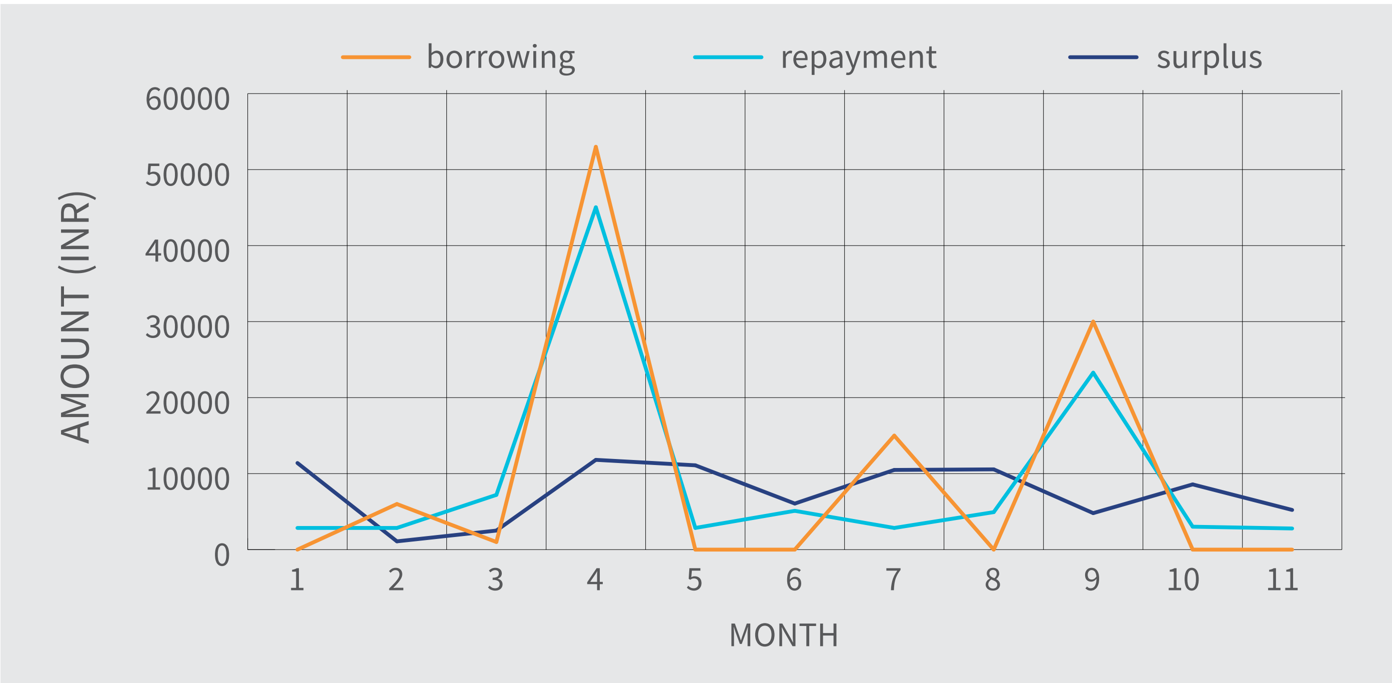
HOUSEHOLD A

When we first met household A, it had four loans outstanding that amounted to INR 37,650 (USD 574). In the last month of our interaction, it had three different outstanding loans that amounted to 84,870. In a given month during our year-long diaries[4], it managed between three to six outstanding loans. The household used new borrowing primarily to make repayments and to close its outstanding loans.

The main breadwinner of household A was 50-year old Perumal. He worked as a salaried government employee to provide for his wife, two children aged 20 and 25, and a 100-year-old father. He has a daughter who works as a nurse in a private hospital. With a government salary, their surplus cash flows (income minus consumption) tended to remain fairly stable, with a mean of INR 7,600 (USD 116) and a standard deviation of INR 3,829 (USD 58). As expected, most of the volatility in surplus cash flows were driven by changes in month-to-month changes in consumption.

Through the course of our diaries, Household A used its access to credit strategically to open as many as seven new loans between INR 1,000 (USD 15) to INR 53,000 (USD 808) with a total of INR 105,000 (USD 1,602). At the same time, it closed nine outstanding loans. The household borrowed significant amounts at three points during our diaries, as illustrated by the three peaks in the "borrowing" line in the chart[5] for Household A.

HOUSEHOLD A



4. Data shown for the latter 11 months.
5. The chart illustrates the interaction of its monthly household surplus cash-flows (income net of consumption) with its monthly borrowing and monthly repayment.

- In month 4, the household borrowed INR 53,000 (USD 808) (their biggest borrowing in a single month during our diaries) in two separate loans from a commercial bank and a self-help group (SHG). It used about 85% of this borrowing to close five outstanding loans.

- In month 7, the household borrowed another INR 15,000 (USD 229) from a self-help group (SHG) and a non-banking financial institution. It used about 20% to make repayments without closing any outstanding loans.

- In month 9, the household borrowed INR 30,000 (USD 459) from a provident fund. It used about 80% of this to close three outstanding loans.

All the borrowing of this household was from formal financial institutions, aided by the stable and verifiable income that a salaried government job provides. To tide over unforeseen shocks, such as temporary stays by guests, major repairs to their house, illnesses, and festivals, it was able to tap into its savings comfortably to keep its consumption smooth – turning to new borrowings only as a way to consolidate previous debt.

HOUSEHOLD B

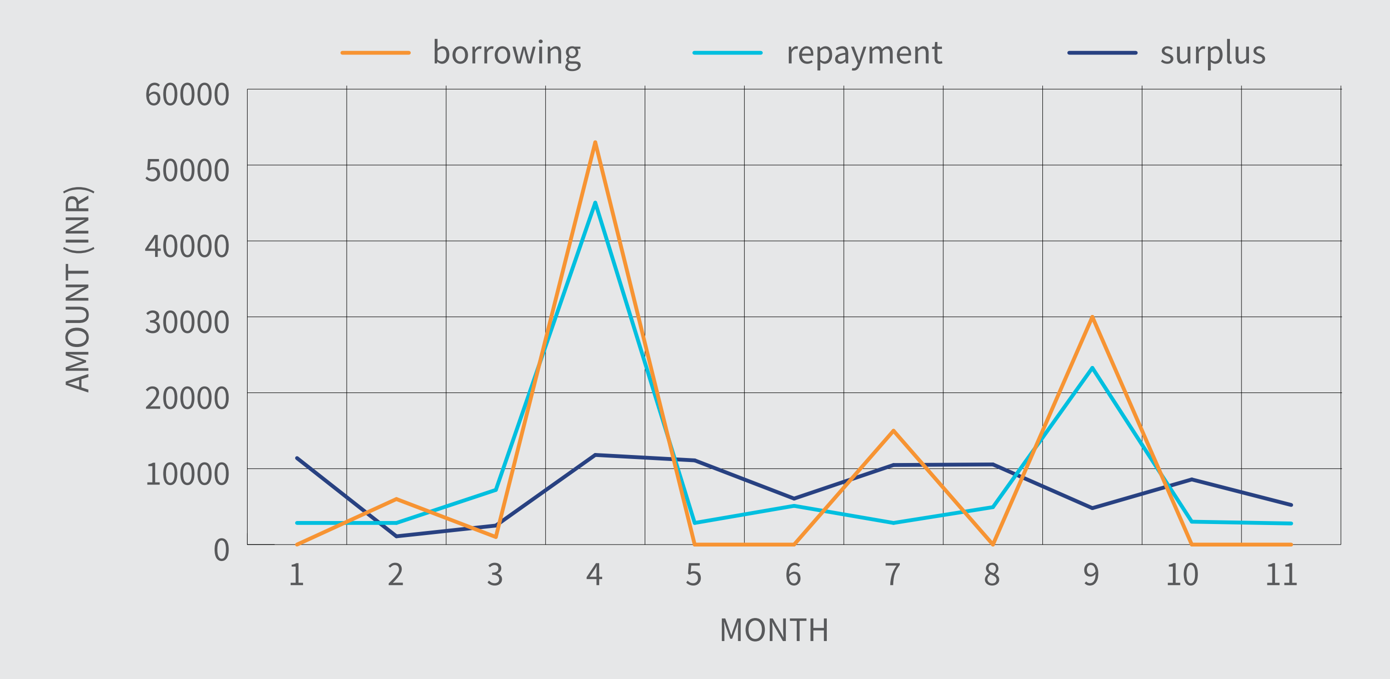
Similarly, Household B had five outstanding loans when we met them. In our last month of interaction, the household had seven different outstanding loans. In a given month, it managed between four and as many as 11 outstanding loans.

The main breadwinner of Household B, 28-year old Sakhtivel, earned a variable income by working as a food caterer to feed his wife and two children, aged 7 and 9. Naturally, the surplus cash flows of household B tended to be much more volatile, with a mean of INR 3,293 (USD 50) and standard deviation of INR 7,303 (USD 111). Interestingly, its monthly consumption also tended to be more volatile than Household A. As a result, there are a few months during the year when the household finds itself in a surplus negative (or deficit) state.

Over the course of the year, the household opened 15 new loans and closed 12 outstanding loans. Like Household A, it too used its access to credit substantially, although borrowing even more frequently (borrowing 9 out of 11 months) and for much higher amounts (between INR 2,000 (USD 31) and INR 40,000 (USD 610) adding up to INR 170,500 (USD 2,601)). It also used many more of its new borrowings to make outstanding repayments and close outstanding loans. Its most significant borrowings are described as follows and illustrated by the "peaks" in the "borrowing" line in the chart[6] for Household B.

6. The chart illustrates the interaction of its monthly household surplus cash-flows (income net of consumption) with its monthly borrowing and monthly repayment.

HOUSEHOLD B



- In month 2, the household borrowed INR 15,000 (USD 229) in two loans from friends, using about 70% of it to make outstanding repayments.
- In month 5, the household borrowed INR 20,000 (USD 305) in one loan from a self-help group, using about 150% of it (supplemented with savings) to close seven outstanding loans.
- In month 6, the household borrowed INR 17,000 (USD 259) in two loans from a commercial bank and from one of Sakhtivel's brothers, using 85% of it to make repayments and close one outstanding loan.
- In month 9, the household borrowed INR 30,000 (USD 458) in one loan from a microfinance institution, using 90% of it to make repayments and close three outstanding loans.
- In month 10, the household borrowed INR 20,000 (USD 305) in one loan from a friend, using about 25% of it to make repayments and close one outstanding loan.

The household borrowed to meet lumpy expenditure, such as for their children's education, to contribute to dowry for their relatives, and to fund a cardiac operation and subsequent check-ups. Their first resort was formal financial institutions, including banks, bank-linked self-help groups, and microfinance institutions, but frequently supplemented with borrowing from friends and relatives. They frequently "rotated" repayments on their outstanding loans, prioritising loans based on the severity of consequences and the likelihood of renewing their loan.

DISCUSSION

These cases serve to demonstrate that while ubiquitous access to credit is an effective way to smooth consumption in the face of lumpy expenditure, its market-prevalent form may be fuelling imminent distress. Where volatile household cash flows require smoothing, meeting timely repayment obligations mismatched with cash flows, may require itself require smoothing. It is easy to see why the use of easily available credit as a go-to coping mechanism seems like the most convenient "in-the-moment" solution for a household that is already stretching its resources to the limit.

With increasing access to credit and deepening of rural Indian credit markets, it is imperative for providers to have in place more responsible measures to assess borrower ability to repay but also manage debt and delinquency. As markets for credit, savings, and insurance gain vibrancy catalysed by new technology and regulatory reform, providers may have to offer stressed borrowers more optimal amounts of credit, more comprehensive financial services, and more sophisticated ways to manage repayments to suit their unique financial situations.

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Rachit Khaitan is an independent researcher interested in household finance. Previously, he worked with Dvara Research on research and policy initiatives with the Reserve Bank of India, CGAP, and the National Stock Exchange. He also worked with financial services providers KGFS and Svasti Microfinance. He is currently a graduate student in Economics at Johns Hopkins SAIS, based in Washington, DC.

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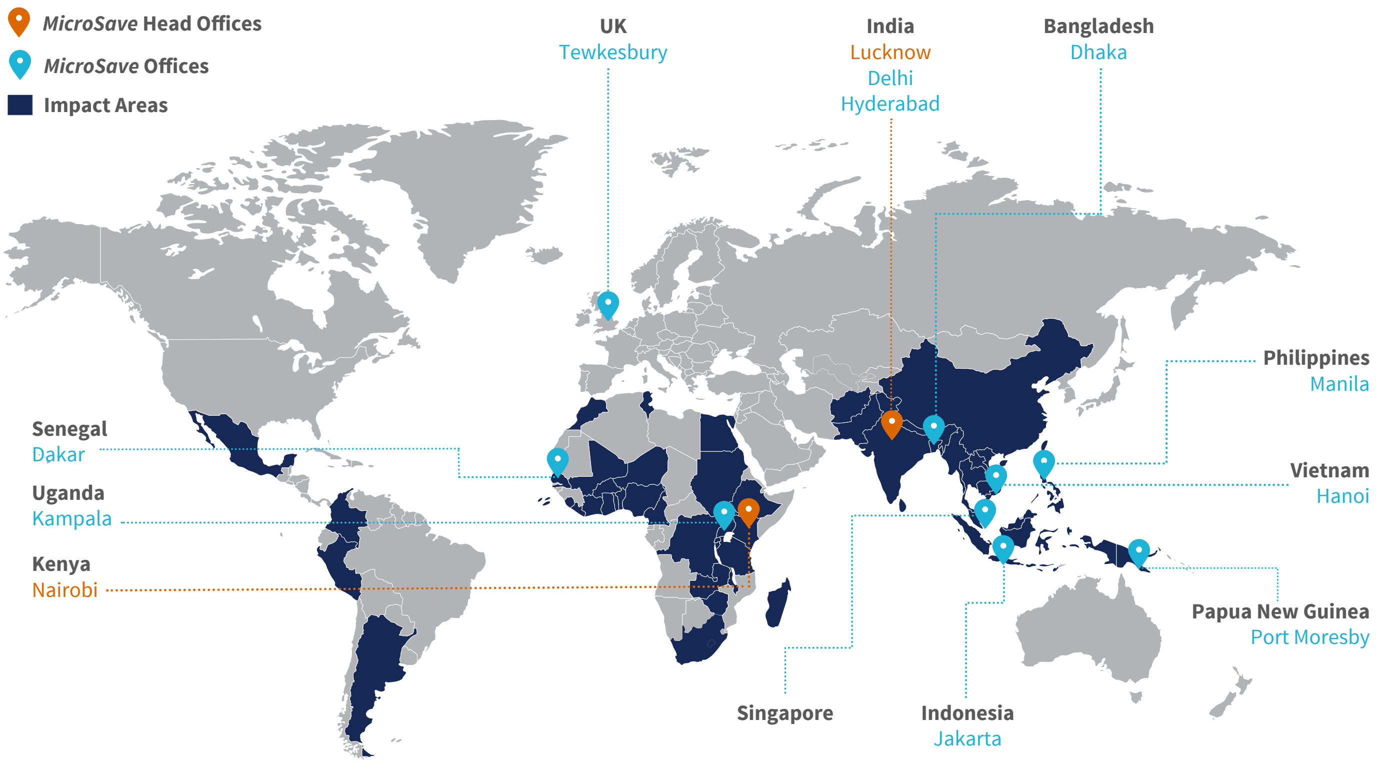

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