COMMERCIALISATION OF MICROFINANCE IN KERALA

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COMMERCIALISATION OF MICROFINANCE IN KERALA

Dissertation submitted in partial fulfillment of the requirements for the Degree of Master of Philosophy in Applied Economics of the Jawaharlal Nehru University

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CENTRE FOR DEVELOPMENT STUDIES

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Certificate

I hereby affirm that the work for this dissertation, **"Commercialisation of Microfinance in Kerala"**, being submitted as part of the requirements for award of the degree of Master of Philosophy in Applied Economics of the Jawaharlal Nehru University, was carried out entirely by myself. I also affirm that it was not part of any other programme of study and has not been submitted to any other University for the award of any Degree.

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To

Amma, Achan and Aniyan

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ABSTRACT OF THE DISSERTATION

THE COMMERCIALISATION OF MICROFINANCE IN KERLA

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This particular study dealt with the most recent development in the microfinance industry, the commercialization of microfinance. The major aim of microfinance institutions is poverty-reduction by providing adequate credit for the rural unbanked people. The major concern raised out of the recent incidents is that whether the microfinance institutions in the country can remain as an institution which helps the rural poor. The experience of Latin America and the incidents in Andhra Pradesh have called for the need to examine the credibility of microfinance institutions in the country. There is evidence of 'mission drift' in microfinance from the places where the commercialization occurred. If commercialization occurs then 'mission drift' follows. So the major objective of the study is to analyse the existence of mission drift. Unlike other states, Kerala has a strong network of state-run microfinance institution known as Kudumbasree which is very successful in poverty reduction. But one can be skeptical about the presence of commercial MFIs in the state. Thus Kerala became the focal point of the study.

In this context the study was conducted to explore the commercialisation of microfinance in Kerala. The objectives of the study are first, to examine the 'mission drift' in microfinance by analysing the development and performance of microfinance industry in Kerala. The study found that there is a strong existence of for-profit microfinance institutions in the state. The for-profit MFIs in the state are drifting from their basic mission of poverty reduction to increase their profit. At the same time the outreach and number of clients are also increasing. But the presence of Kudumabasree made the scenario interesting. The study analysed the factors which led to the co-existence of for-profit and not-for-profit MFIs in the state. The difference in the group lending is the major difference between two types of MFI. The second objective deals with the features of for-profit MFI group lending and how it works despite a well-organised and widespread group lending network of Kudumbasree. The major difference between two groups is the lack of monitoring in the not-for-profit MFI business. The lack information of the clients also paved the way for the 'for profit-MFIs' in the state. The success of a for-profit MFI solely depends on the highly monitored joint liability groups. But the exploitation interms on interest rate demand the need for a strong regulation for the commercial microfinance institutions in the state.

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Chapter 1
Introduction

1.1. Introduction

In developing countries, the poorer sections of the population have little or no access to financial services. Consequently, their participation in economic services is either limited or denied. Many specialized financial institutions created in the 1950s and 1960s proved unable to meet the dual challenge of institutional and financial sustainability on the one hand, and outreach to the large number of poor people on the other hand (Oluyombo, 2012). Usually, the poor have low access to the formal banking system, because they cannot put up the desired collateral or the cost of monitoring loans for poor is high compared to other clients.

The availability of proper financial services has a big role in alleviating the vicious circle of poverty in the developing countries. Rural finance remains very challenging and in developing countries it is generally weak and ineffective, regardless of the efforts of government and donors to improve it. Nevertheless, important approaches (Microfinance, community based lending, co-operative banks and so on) are emerging from these experiences that offer constructive ideas on how to develop and make more effective the provision of rural financial services (Nagarajan and Meyer, 2005). Inadequacies in access to formal finance and the exorbitant terms of informal finance for the poor provide a strong need and ample space for new approaches to serve the financial need of the rural poor In recent debate, microfinance has been emerged as an important tool to control extreme poverty. United Nations Organisation (UNO) declared the year 2005 as 'the international year of microfinance' in support of this view (Aghion and Morduch, 2007: 134).

The Global Financial Index (FINDEX) shows that 75 percent of the world poor (2.5 billion) do not have a bank account or access to formal credit sources (World Bank, 2013). The availability of financial services can play a critical role in the poverty reduction. To overcome poverty, they need to be able to borrow, save, invest and protect their families against risk There are attempts for inclusive financial policies all over the world to meet the financial need of the rural poor. But still financing rural people remains a concern for the policy makers all over the developing world. The pertinent problems in the rural credit market are the major hurdles for the development. If the policies fail to address the problems in the credit market, then those policies do not have much impact on the poor people.

1.1.1. Problems of rural credit

The rural credit markets in developing countries are often described as repressed, imperfect, and fragmented. It is common that segments of borrowers have different levels of access to certain types of loans and certain types of credit institutions (Hoff and Stiglitz 1990). The rural credit markets consist of both formal and informal sectors. In the formal credit market, institutions act as an intermediary between depositors (In some cases the government) and lenders and provide credit at relatively low rates of interest. But in rural informal credit markets, money is lent by legal/illegal moneylenders, traders, landlords, friends, and relatives (*ibid*). The major problem for the lenders in a rural credit market is lack of information (information asymmetries). It prevents the outreach of credit to rural poor and leads to more exploitation.

The major difference between a formal and informal credit market is that the latter lacks availability of information about the market and clients. Historically, those who have the local information, especially, the money lenders have an advantage in the rural credit markets in the developing countries. The formal credit institutions are not able to find space in the rural credit markets due to these inherent problems. There are three major approaches which explain the situation in rural credit markets (Hoff and Stiglitz, 1996).The first theory hypothesizes that the local money lenders in the informal market are monopolists and they charge huge interest rates which fetch them monopoly profits. The second theory distinguishes the rural credit market to be almost perfectly competitive with market clearing equilibrium, where high interest rates indicate high risk of borrowers (Stiglitz and Weiss, 1981). The final theory is the one which got large acceptance. It was put forward by the 'imperfect information school'. They assume that the informal market is characterised by uncertainty, high transaction cost and asymmetric information which finally leads to adverse selection[1] and moral hazard[2] problems in the credit market (Stiglitz, 1990).

The theories in the third school explain the existing problem of informal credit market which prevents the entry of formal institutions and at the same time support the growth of informal institutions. From the existing literature, we can find out three major problems in a rural credit market. The major problems are, screening problem, Incentive problem and enforcement problem (Dacheva and Gotwalt, 2009).

Screening problem in the credit market means the failure of lender to ensure the repayment due to lack of proper monitoring. It leads to default of loans. The information about the agent (borrower) is not perfect in the rural market and it results in adverse selection. Adverse selection occurs when the borrower conceals the information and can use agreements to an extent not foreseen by the lender (Besley, 1994). It is very difficult to screen the activities in such a diverse market. In order to reduce the risk of default, the informal institutions charge high interest rate for their loans.

The problem of incentives is well known as Moral hazard. It means that the borrower has an incentive to change to a more risky project once the contract is done. But the informational constraints prevent the lender from prediction this change in advance. This change to risky projects by borrower may result in default, if the project becomes unsuccessful. So the lender always charges high interest rates to reduce the effect of potential default. The enforcement problem can be defined as a situation when the agent (borrower) is not willing to pay even if he has the money to repay the loan. Stiglitz (1990) called this problem as ex-post moral hazard.

[1] Adverse Selection is the result of information asymmetry in the rural credit market. It means disbursing credit to high risk customers due to lack of information. Refer Stiglitz and Weiss (1981) for a detailed understanding of the concept.

[2] Moral Hazard is a product of lack of information about the clients. It can be divided into two types' ex-ante moral hazard and ex-post moral hazard. Ex-ante moral hazard occurs in different form such as under investment in borrower activity complementary to credit, borrower negligence and partial diversion of a loan from productive investment into present consumption. Moral hazard may also occurs ex-post to project outcome if a borrower simply reneges on a promise to repay. Refer (Aghion and Bolton, 1997; Stiglitz, 1990; Stiglitz and Hoff, 1990) for detailed explanations.

These are the informational constraints which led to charging of high interest rates and default of loans in a rural credit market. It results in further exploitation for the clients whose information is perfect. The answer for these constraints is a new lending methodology. According to Stiglitz and Hoff (1990), these problems can be eradicated by introducing the group lending method. A successful group lending can answer all the information problems in a credit market. The group lending methodology followed by microfinance institutions can solve the inherent problems of rural credit market which deny proper credit access for the poor people in rural areas. Here comes the importance of microfinance in a rural credit market.

1.2. Origin of microfinance

Microfinance originated as an answer to the problems faced by the rural credit markets in the developing world. There has been a growing realization that the credit needs of people in the rural areas cannot be adequately served with the use of large formal financial institutions. The micro information that is required for these operations precludes efficient market coverage on part of these large organizations (Rao and Priyadarshini, 2013).The major feature of microfinance institutions all over the world is 'group lending'. As we will see below group lending can answer the traditional bottlenecks in the rural credit market.

Group Lending means lending to a group of people instead of lending to individuals. The major advantage of group lending is that the entire group members has the responsibility in each loans borrowed by the members. "What joint liability does is to make any single borrower's terms of repayment conditional on the repayment performance of other borrowers in a pre-specified and self-selected group of borrowers" (Ghatak, 1999: p.28).The adverse selection and moral hazard problems can be overcome by the self-selection and peer monitoring techniques in a group.

In a Joint liability group, the borrower who works either independently or as group is self-selected into groups to get the loan. If the group failed to repay the full amount back, then the money lender can stop providing future credit to the entire group. Joint liability induces borrowers, who live in a rural community, to choose partners with perfect information. This is called self-selection of borrowers (Stiglitz, 1990; Varian, 1990). So the chance getting a membership in a group is very less for a risky customer. Although there is risky customer in a group, the entire burden will be on the group than the lender. Thus the self-selection in a group can solve the adverse selection problem.

Another feature of group lending which prevents the moral hazard problem in a credit market is 'peer monitoring'. Peer monitoring by the members within a group can find the free-riders (risky customer, who is not willing to repay). The strong 'peer pressure' forces them to repay the loan. So the lender can ensure proper repayment of the loan by introducing a group lending.

Microcredit paved the way for the group lending revolution in the developing world. The poor people in the developing countries have enjoyed the fruits of microfinance by accessing both formal and informal credits. Microfinance was emerged not merely as a rural credit provision. It was a noble concept to eradicate the poverty in the rural areas of developing countries by satisfying their credit needs. Microfinance helped to generate both formal and informal credit in the rural areas. Microfinance can be defined as "a collection of banking practices built around providing small loans and accepting tiny deposits. It is nothing short of a paradigm shift" (Aghion and Morduch, 2004:1). It is very difficult to name the person who initially came up with the idea of microfinance. The origin of this successful development initiative was linked to few different countries, especially Germany's village bank movement and Chicago's shorebank[3]. The roots of modern microfinance can be found in many places, including different countries in Asia and Latin America. But the best known and most successful story is that of Muhammad Yunus and the founding of Bangladesh's Grameen Bank. Unlike the Latin American Commercial microfinance models[4], Younus model of microfinance 'Grameen solidarity movement'[5] concentrates mainly on the traditional mission of microfinance Although current way of operation has raised questions

[3] Chicago's shorebank was a community development bank founded in Chicago in 1973.It closed down in 2010.At the time of closing it was the oldest and largest institution of that kind.

[4] Latin American Model is a microfinance model with distinct commercial orientation. Refer the book 'An inside view of Latin American microfinance' by Marguerite Burger (2006).

[5] Grameen Solidarity Movement is a path breaking microfinance movement in Bangladesh by the Grameen Bank. Solidarity lending deals with collateral-free loans to group or village organisations created by the Grameen bank. This model of group lending has replicated in many countries.

about its integrity as a poverty reduction programme, the impact made by Grameen bank in the development discourse is commendable (Aghion and Morduch, 2004: 86).

The modern microfinance programme in India was motivated by the success of Grameen bank in Bangladesh. It began as part of a developmental and poverty-reduction project led by some NGOs. They initiated the process of group lending based on Self-Help Groups (SHGs) and act as an intermediary between commercial banks and clients. National Bank for Agriculture and Rural Development (NABARD) [6]officially began the microfinance programme called SHG-Banking Linkage Programme (SBLP) in 1992. SBLP was a pilot programme by NABARD and it provides cheap credit for the SHGs in the country through selected commercial banks. It has slowly captured the rural credit markets in the country, especially in South India. The states like Andhra Pradesh and Kerala have become the hub of microfinance in the country. The Kudumbasree model[7] in Kerala is one of the most celebrated microfinance models in the country. These microfinance institutions have huge impact in the poverty-reduction of the nation. Although they faced competition from other forms of credit agencies, it still remains as one of the world's best microfinance system.

1.3. Commercialization of microfinance

There is a trend visible globally of a "movement of microfinance out of the heavily donor dependent arena of subsidized operations into one in which microfinance institutions manage on a business basis as part of the regulated financial system" (Christen and Drake 2002:4). Commercialisation of microfinance means 'the shift in mission of poverty reduction to excess profit-making. The mission of modern-day microfinance institutions are a) financial sustainability b) alleviating poverty by providing banking service to the unbanked poor. This trend was first visible in the Latin American region. Since the beginning of the 21st century, this commercialization began to spread to other parts of the

[6] NABARD is an apex development bank of India which looks after the development of the cottage industry, small industry and village industry, and other rural industries. NABARD also reaches out to allied economies and supports and promotes integrated development.

[7] Kudumbasree is a poverty reduction mission by the Kerala state government. Kudumabashree has been launched by the State Government of Kerala with the active support of the Central Government of India and the National Bank for Agriculture and Rural Development (NABARD) aiming at removing absolute poverty within ten years with the full co operation of the Local self governments (See section 2.2 in chapter 2)

world. Commercial banks and international private/institutional investors replaced the government/nationalized banks as funding agencies for microfinance operations (Galema and lensik, 2009). This trend was explained as the growing pressure of socially responsible investments from private players by some academicians. However, microfinance may also provide attractive opportunities for portfolio diversification since the risk-adjusted returns exhibit low correlations with other assets (Krauss and Walter, 2008). Normally these microfinance portfolios are considered as flexible to economic shocks and safe.

Those who are against the commercialization focus on the argument that it conflicts with the MFIs traditional mission of poverty eradication, because commercial microfinance focuses on financial efficiency rather than on reaching out to more poor clients. The study (by Hulme and Mosley, 1996) mentions that there exists a trade-off between out-reach and financial sustainability in microfinance, because, the transaction cost of smaller loans are higher than the larger loans. Unlike the traditional microfinance institutions, the commercial MFIs want to lend large loan amount to very few people .The empirical works done by (Christien, 2000; Cull et al. 2007; Hermes et al. 2008)) have given much more evidence for the shift in focus of the microfinance institutions around the world.

The microfinance operations in Latin American countries are best known for their commercial models. They initiated this transformation to commercial model to attract more investment from private players than heavily subsidized government funds which would ensure the sustainability in future. Another feature of the commercial model is that it ensures high profit from the business and attracts so many new players with profit motive. So the business transformed from 'not-for-profit' to 'for-profit'. But the model is heavily criticised for moving away from its traditional poor clients to 'not so poor' clients (Hulme, 2000).The important aspects like women empowerment, community development, poverty reduction are missing from the commercial model.

In Indian scenario, most of the microfinance institutions follow 'The south Asian model'. The south Asian model, largely drawing on the strategic and operational features of the Grameen model, has its spotlight clearly on women and poverty (Nair, 2005). The microfinance sector in India is divided into two. The state owned microfinance programme by NABARD (SHG-Banking Linkage programme) and a parallel microfinance business run by the Non-governmental organisations (NGOs). Since the introduction of SBLP, large chunk of the market has been controlled by the programme and most of the NGO's role has become reduced to intermediary of the SBL programme in the country. In the beginning of the 21st century, the signs of commercialization were visible in India also. The transformation in the country has taken two roots (Nair, 2005).

a) Microfinance- Non-Governmental Organisations (NGOs) become regulated financial institutions like NBFC (Non Banking Financial Company) and banks.

b) Traditional commercial banks in private and public sectors entering the business of microfinance.

The first root is a common way of transformation in India which led to the birth of for-profit MFIs in the country. Industrial Credit and Investment Corporation of India (ICICI) bank was the first commercial bank to enter the microfinance business and many other commercial banks followed them in the business. These days, the for-profit microfinance business has become a major part of the entire microfinance operations in the country. So it is important to understand more about the features and impact of commercialization of microfinance in the country.

1.4. Significance of the study and statement of research problem

There are three different waves in the two decades of MFI presence in India. The first wave developed when the microfinance sector revealed the methodology of distributing micro-loans to the marginalized through a scalable model, which was earlier developed and implemented by the Grameen Bank (Grameen solidarity model). Most of the MFIs have adopted and experimented upon the Grameen solidarity model with the help of NABARD's path breaking initiatives like SHG-Bank Linkage Programme. In this movement, most of the funds are channelized through not-for-profit institutions like NGOs and Societies. The second shift occurred when MFIs in the country achieved scale and have made changes to become commercial entities. In the third phase, major microfinance institutions have taken microfinance as a business (Sriram, 2012).

The second and third phase of the transition happened in the beginning of the 21st century and it gained momentum when many private investors realised the possibility of profit making. So the modern day microfinance in the country has shrunken into two groups. On the one side, the microfinance business run by the for-profit MFIs and on the other side the NABARD's SBL programme run by NGO's and the government missionaries. Although the performance and outreach of MFI business is increasing, the SBL programme still remains as one of the largest and successful microfinance programme in the world.

Most of the microfinance business in the country has concentrated in the southern states. The transformation of microfinance from not-for-profit to for-profit was first visible in the southern states, notably Andhra Pradesh (AP). It is considered as the 'microfinance capital' in the country. In the third face of microfinance transformation most of the successful NGOs in AP has turned to commercial MFIs. But this quick transformation has many negative impacts than positive influences among the clients. The profit motive of those MFIs became lethal in the state. A major crisis broke out in 2006 for the MFIs operating in AP when there was a close down of about 50 branches of two major MFIs (SHARE and Spandana) in Krishna district of Andra Pradesh. The action was the result of 'high interest rate' charged and the 'unfair loan recovery practices' by the MFIs in the state (Shylendra, 2006). The issue got further ignited due to the farmer suicides in the state. This incident has become an eye opener for the central government and the Andhra government has decided to pass a bill for regulating the MFIs in the state. The state government and microfinance industry agreed to modifications including better code of conduct when they deal with the customers. But AP has witnessed yet another crisis in 2010 and this time one of the major player SKS microfinance was the culprit (Sane and Thomas, 2013). At the same time, the rates of growth of those MFIs were very high. This backdrop of rapid growth and high discomfort was the setting of second crisis in 2010. Unlike 2005, AP government responded by passing a strong ordinance (Andhra Pradesh Microfinance Institutions (regulation of money lending) Act) in 2010 which stopped the collection of existing loans and origin of new microcredit institution in the state (Sane and Thomas,2013). Later central government constituted a committee (Malegam Committee, 2011[8]) to revamp the microfinance sector in the country. But the major suggestion by the committee, the new microfinance bill has not yet been passed in the parliament. Reserve Bank of India (RBI) decided to regulate these for-profit MFIs from 2012 onwards. Based on the suggestion by Malegam committee, the legal status of these profit making MFIs has changed to Non Banking Financial Company-MFI (NBFC-MFI). This change was to make the regulation easier. However there is not enough response from the for-profit MFIs in the country and they again started catching up in the business after the slump in 2010-11 (MIXMARKET, 2013)[9]. There is a fear among the academicians that this change in legal status can pave the way to complete commercialization in the Microfinance sector of the country with number of NBFC-MFIs fast increasing day by day.

The major difference in the post AP microfinance business is that the MFIs expand their business to unexplored states in the country, especially Kerala in the south and other northeastern states.

1.4.1. Statement of the problem

Microfinance Institutions (for-profit MFIs) are operating in almost all the states in India except in Jammu and Kashmir and some north eastern states. According to Sa-Dhan[10] there are 184 MFIs operating in the country, out of which 82 are from the four south Indian states. Up to 2010, Andra Pradesh was the center point of the movement, since the state government put regulation on the MFIs in the states; their profit rate has gradually decreased. The 2010 crisis affected the performance the performance of MFIs in the state. It led to closure of more than 30 MFIs in the state (Sa-dhan, 2013).

In case of other south Indian states, both Tamilnadu and Karnataka have a long history of indigenous money lending. The for-profit microfinance business has deep roots in these two states also. There are 34 MFIs operating in Tamil Nadu and 22 in Karnataka (Bharath

[8] Malegam Committee constituted by the reserve bank to study the changes in regulating MFIs in the country. It was headed by Y. H. Malegam and committee submitted its report in 2011. The report is available in the following web address: http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/YHMR190111.pdf

[9] Mixmarket is a data provider of international microfinance institutions (www.mixmarket.org).

[10] Sa-Dhan-An association of community development financial institutions in India It is the largest microfinance group in the country. http://www.sa-dhan.net/

microfinance report, 2013). Although many Andhra-based MFIs were operated in these two states, the crisis in 2010 has not made much of an impact in both Karnataka and Tamil Nadu. In these two states the for-profit MFI business is more popular than the SHG-Banking Linkage programme (SBLP) by NABARD Unlike other states, Kerala has a well developed rural credit market network with the help of SHG-Bank Linkage programme (SBLP). The influence of Kudumbasree mission and rural co-operative societies has made the access to credit much easier for the rural individuals and entrepreneurs in the state. The presence of not for-profit NGOs has also helped to develop a stable credit market in the state. These initiatives have been funded by co-operative societies, NABARD, RRBs (Regional rural Banks) and commercial banks via SBLP. The well developed network of co-operative banks also made the availability of credit easier and cheaper in the state. When compared to other south Indian states, the influence of rural money lender in the rural credit market in the state is less.

After the first AP crisis in 2005, the MFI giants like SKS, SHARE began their operation in the state of Kerala to spread the business to unexplored areas. The possibility of a for-profit market in the state was first explored by MFIs in the other states. Gradually, the MFIs and NGOs in Kerala, which worked as intermediaries of SBLP, found the possibility of for-profit microfinance business in the state. In 2005, Evangelical Social Action Forum (ESAF) which was a successful not-for profit NGO had changed their legal status from NGO to NBFC to commence the for-profit microfinance business. Now there are 11 for-profit MFIs in the state (Sa-dhan, 2013) and they have presence in all the 14 districts. Since the for-profit MFIs (NBFC-MFIs) in the state cannot accept deposits, the major means of profit making is interest from lending money. According to MIXMARKET, all for-profit MFIs in Kerala are making profit and their gross loan portfolio is fast increasing. They follow the Joint Liability Model (JLG) methodology in the formation and operation of client groups in the states. It is entirely different from the most successful Kudumbasree and SHG models in Kerala. The major difference between Kudumbasree and the for-profit MFIs is the difference in group lending models. There are difference in the way of operation and interest rate too. The Kudumbasree provides cheaper credit than the for-profit MFIs (interest rate is very high for a for-profit MFI loan) and the repayment methods are also completely different from the strict measure by the for-profit MFIs. But we cannot ignore the fact that the outreach and profit of for-profit MFIs in the state are increasing.

The co-existence of for-profit and not-for profit microfinance institutions in the state is an interesting scenario. The major reason for the entry of for-profit MFI into the state is the commercialisation of microfinance in the country. The extent and impact of commercialisation in India has been analysed by studies like (Sriram, 2010; Nair, 2010 and Shylendra, 2006). But commercialisation of microfinance in Kerala is different from the India scenario due to the existence of wide spread and well developed network of Kudumbasree. So the entry and growth of for-profit MFIs in Kerala is raising some serious doubts among the academicians. The major problem here is the factors which help the for-profit MFIs to establish their business. Now they have branches in all 14 districts of the state. The gross loan portfolio and number of clients are increasing every year (MIXMARKET, 2013). The commercialization of microfinance normally results in the 'mission drift'. In other words, the profit motive of MFIs may lead to a drift from their traditional mission of poverty-reduction to profit making. The possibility of 'mission drift' and the existence of the widespread network of Kudumbasree have made the process of commercialisation of microfinance in Kerala into an interesting research problem. Thus it is worth analyzing the features of for-profit MFI's group lending which helps them to thrive in the state and how they successfully run the microfinance business despite the existence of a well organised and widespread network of Kudumbasree.

1.5. Objectives

The major objectives of the study are the following:

In general,

- To examine the existence of commercialisation of microfinance in Kerala

In Particular,

- To trace out the **performance and development** of the for-profit MFIs in Kerala
- To analyze the **features of for-profit MFI group lending and how it works** despite a well-organised and widespread group lending network of Kudumbasree.

1.6. Data Sources and Methodology

The study has used both primary and secondary data for the analysis. The secondary data has been used to analyse the development and performance of microfinance institutions in India and Kerala. The major data sources used for the analysis is Microfinance Information Exchange (MIX). MIX is a non-profit organisation who provides data for all MFI activities in the world. MIX collects and analyses the financial and social performance data from the MFIs. Other than the financial indicators, the social indicators like Outreach, number of clients etc can be extracted using the MIX data. The study has also used the data from Sa-dhan (www.sa-dhan.net), which provides data about the microfinance institutions in the country. The development and outreach of MFIs in different Indian states has been analysed using the data from the Bharath Microfinance Report by Sa-dhan, 2013[11].

The primary data has used to examine the existence of mission drift in Kerala. The study used the primary data further for analyzing the features of for-profit MFIs group lending in the state. The primary survey has carried out using a questionnaire to examine the socio-economic profile of the clients, credit profile and the group lending mechanism.

1.6.1. Primary Survey-field sites and sampling techniques

The field work was carried out in November-December 2013.The survey was conducted among 149 for-profit MFI clients from 3 major MFIs in Kerala. Those three MFIs were selected based on the performance, outreach and experience in the microfinance business. The selected MFIs are

I. ESAF- Evangelical Social Action Forum, Head Office: Thrissur
II. Muthoot Microfinance, Head Office: Eranakulum
III. HOPE microcredit, Head Office: Palakkad

The selection of MFIs is based on purposive sampling technique. The survey was conducted in three districts, Eranakulum, Thrissur and Palakkad. The districts are selected on the basis

[11] Bharath Microfinance Report is a report published by Sa-dhan. It provided detailed data about the performance and outreach of microfinance business in the country. It is an annual publication.

of the number of loan cycles. The for-profit microfinance business in Kerala began in these three districts and 70 percent of the for-profit MF business in the state is concentrated in these three districts. The selection of districts also based purposive sampling technique. The study limits to clients who at least borrowed thrice from the MFIs. The purposive sampling has used to select the JLGs with minimum three loan cycles in the selected three districts. We have randomly selected 30 different Joint liability Groups (JLGs) from the group of JLGs with more than three loan cycles. A sample size of 149 was drawn randomly from total population of 303 women who are members from 30 different JLGs in the three districts.

The study has used both quantitative and qualitative techniques to analyse the problem. Among the quantitative techniques, the study has used both physical and financial indicators to explain the development and performance of the MFIs in the state. The data has been interpreted using the quantitative methods like cross tabulation of different variables and significance tests like Chi-square and Cramer's V tests. The study has used some qualitative information to strengthen the arguments. Qualitative techniques like Personal interviews and focus group discussions with the group members have helped in understanding the features and dynamics of for-profit MFI group lending in the state. The methodology of each section will be discussed in the respective chapters.

1.7. Chapter Scheme

The chapters are organised on the basis of objectives of the study. Each objective is addressed in each of the following three chapters.

The second chapter deals with the development and performance of MFIs in India and Kerala. It gives more emphasis on development and performance of for-profit MFIs in Kerala. The chapter analyses both social and financial performance with the help of secondary data from various sources.

The third chapter examines the existence of the problem known as 'mission drift' among the for-profit MFIs in the state. The analyses have done by introducing 'average loan size' as the proxy for commercialisation of microfinance. The primary data has used to examine the 'mission drift 'in commercial microfinance business in Kerala.

The fourth chapter deals with the features of for-profit MFI group lending in Kerala which help the MFIs to establish a market. The presence of SBLP network was the major hurdle for the for-profit MFI's entry into state. Those features have been analysed by understanding the dynamics of for-profit Joint Liability Groups in the state. We have used both quantitative and qualitative techniques to examine those features.

The fifth chapter concludes the thesis and it brings out some policy suggestions for regulating the for-profit microfinance business in the state.

Chapter 2

Development and performance of MFIs in India-
An analysis of for-profit MFIs in the State

2.1 Introduction

Ever since India attained independence, the need for providing financial services to the poor and the underprivileged had been recogonised and emphasised both at academics and policy levels. After the nationalization of banks in 1969, the banks are asked to lend money to the priority sector (agriculture and allied rural activities) at a low rate of interest. The major objective of this policy was tó reduce the poverty in rural India by satisfying the credit need of the poor people. The introduction of Integrated Rural Development Programme (IRDP) also fuelled the idea of bringing development by providing credit for the rural poor. The widespread corruption and leakages of funds did not help the supply-side programmes to achieve success in the country. Even though the share of formal sector has increased to 56.6% after the nationalisation (RBI, 1992), the poor people were not able to access the formal financial resources due to lack of collateral and procedural difficulties. The major beneficiaries of these unsuccessful government programmes are the illegal money lenders who charge usurious interest rates (Karmakar, 1999).

In this circumstance, the developing world had witnessed the rise of one of the most successful development initiative known as microfinance. In the initial years, the flag-bearers' of microfinance in India was the Non-governmental organisations (NGOs) in the country. As usual, it began as a poverty-reduction programme. India's first ever microfinance initiative was began in 1974 in Gujarat and that was proposed by the Self employed Women's Association (SEWA) under the leadership of Ms. Ela Bhatt. SEWA's microfinance institution was known as '*Shri Mahila SEWA Sahkari Bank*'. The success of Sahkari bank attracted many other NGO's to the microfinance business in the country in late 1980's. The official efforts to introduce the microfinance in the country had initiated under the National Bank for Agriculture and Rural development (NABARD) in 1992. Before that NABARD partially financed the microcredit programme of Mysore Resettlement and

Development Agency (MYRADA) in 1986-87 (Satish, 2005: 1732). The microfinance programme has introduced in different forms all over the country, especially in southern states. The projects by Professional Assistance for Development Action (PRADAN) and Shreyas in Kerala have introduced different models of microfinance in the late 1980's. The success of these models has indeed forced the central government to begin an official microfinance programme for the poor people in the country. As part of bringing the formal credit resources to the unbanked poor in the country, NABARD initiated a pilot project called SHG Bank Linkage Programme (SBLP) in 1991 (NABARD, 1991).

NABARD's SHG linkage project actually divided the microfinance sector in India into two different groups: institutions funded by NABARD and those funded by other agencies. The pilot project by NABARD included not only the commercial banks but also the regional rural banks and co-operative banks in the country (RBI, 1991). The pilot project pioneered an attempt to bring together the formal banking system and the poor clients through an exclusively microfinance focused programme without subsidy to the poor. This programme has operated through linking up with the ongoing and expanding NGO initiated SHG movement. This initiation becomes famous as SHG-banking linkage programme. During the pilot project period, the Association of Sarva Seva Farms (ASSEFA), Chennai, promoted 214 groups, mobilized Rs 1.4 million of thrift and disbursed credit of Rs 2.3 million; PRADAN, Madurai, promoted 313 groups, mobilized Rs 1.3 million of thrift and disbursed credit of Rs 3.9 million; Community Development Society (CDS), Alappuzha Kerala, promoted 350 groups, mobilized Rs 2 million of thrift and disbursed credit of Rs 4.7 million [RBI 1996].

Since the introduction of SBL Programme in the country, the number of SHGs in the country has increased from 33000 in 1992 to 2.9 million in 2007. But the introduction of commercial model in the beginning of the 21st century has some negative impacts in the industry. The microfinance crisis occurred in Andra Pradesh in 2006 has brought out another face of Indian microfinance (Ghate, 2007 and Shylendra, 2006). The forced repayment methods and usurious interest rates are the major reason for the crisis and those who mainly responsible for these were the commercial microfinance institutions, i.e., the non-NABARD

MFIs. In such scenario, after the large number of farmer's suicides in AP, the central government appointed a committee (Malegam Committee, 2011) for recommending reforms in microfinance sector.

Based on the recommendations of the Malegam Committee, the government of India initiated steps to bring MFIs under a new law and accordingly a bill titled 'The microfinance institutions (development and regulation) bill, 2011, was brought in Parliament with a view to regulate the MFIs in the country. However, the Parliament could not pass the bill yet and it is still debated.

However, the bill motivated the Reserve Bank of India to introduce a separate category of MFIs, known as NBFC-MFIs, to distinguish the for-profit MFIs from others. But surprisingly not a single MFI has registered itself as NBFC-MFI with RBI.

The database maintained by MIXMARKET and the data available with SA-DHAN indicate that there is a continuous increase both in branch networks as well as clientship of MFIs in India though there was a dip in 2011-12 . Therefore, one tends to believe that the microfinance sector in India needs a close examination to see their efficacy as a strong anti-poverty programme, especially after the growth of for-profit MFIs in the country.

When we examine the southern states, Andhra Pradesh and Tamil Nadu, have shown remarkable progress in the growth of microfinance sector in the country. The state of Kerala is always an interesting case even in the global microfinance scenario. An alternative to the commercial model of microfinance is the Kudumbasree program in 1998. Kerala has a cemented place among these south Indian giants mainly because of the success of Kudumbasree programme.

The Kudumbasree program in Kerala comes under the SHG-banking linkage programme (SBPL) and Kudumbasree; a government agency acts as an intermediary in the SBLP. The programme has not followed the traditional SHG model. But they introduced a different group mechanism called Neighbourhood Groups (NHGs). Unlike the SHG models, the NHG models are maintained by the government of Kerala and it brings the activities of various government departments into one umbrella. The Kudumbasree programme is co-sponsored by the Government of Kerala, local self governments and other agencies like UNICEF.

Initially program was implemented in a phased manner across the states. Alappuzha and Eranakulum were the first two districts to experience the fruits of the programme. In the first phase 13 Kudumbasree units were established in those two districts. The second phase has witnessed the presence of the programme in another 16 small towns and the entire Malappuram districts. Gradually Kudumbasree programme was extended all the Panchayats in the state by 2000-01(Ajith et al, 2006). Since then it became one of the most successful development programmes in the state. But the emergence of other MFIs and NGOs in the state has changed the picture. i.e., those NGOs which had financial support from SBLP(SHG-Banking Linkage Programme) and other funding agencies had changed into for-profit MFI (e.g. the former well-established NGO ESAF from Thrissur).This trend is actually the result of the all India shift in mission from poverty reduction to profit making. In recent years the high growth of these MFIs in the state is pointing towards an interesting phenomenon called the commercialization of microfinance through mission drift. The main focus of this chapter is to analyze the development and performance of these newly created MFIs in Kerala and to portray the mission drift of microfinance institutions in Kerala.

2.2. Development of MFIs and different approaches

The concept of microfinance has been identified as a poverty reduction strategy in the developing world. There are large number of successful operational models in Asia and Latin America. But the microfinance sector in the world is largely influenced by the success story of 'Grameen Bank' in Bangladesh. India's pioneer microfinance project, NABARD's SHG-Banking Linkage Programme also inspired from the success stories of NGOs like MYRADA and PRADAN in the country.

Over the years, different operational models have emerged in the microfinance sector which can broadly be classified under:

- **Grameen Bank**: Bangladesh Methodology
- **Joint Liability Groups** (JLGs) : BAAC, Thailand; BASIX

- **Self Help Groups** (SHGs)/Federations-MFIs: Government of India (NRLM-SGSY), NABARD
- **On-lending** through Intermediaries: MFIs, RMK, UN organizations
- **Direct Loans:** BRI, Indonesia, MFIs
- **Loans with Savings and Insurance:** Banks, MFIs, Government of India

Among various models of microfinance, the SHG model by NABARD and Joint Liability Group model introduced by Grameen bank have emerged as the two prominent models in the Indian context. In view of this, only those two models are examined in the present study.

2.2.1 SHG model

There were different forms of group lending methodologies in the country. But SHG model became the first official operational model in the country due to the introduction of SHG-Banking Linkage programme in 1992. Many NGOs and community organisations in the country has shifted to the Self-Help Group (SHG) model lending after the implementation of the NABARD's pilot programme and the linkage with commercial banks further enlarged their scope. (Ghosh, 2013)

SHG group is an affinity group of 10-20 members and having elected leaders from the group members. They hold have weekly meetings and works on the principle of mutual trust. Initially SHG raises small regular savings over a few months until there is enough capital in the group to start lending (Satheesh, 2005).The liability of an external loan is for the whole group and disbursement of those loans to members at the discretion of the group. The path breaking idea in the history of SHG movement in India is the SHG-banking linkage programme (SBLP) by NABARD. In SBLP, the NGO act as an intermediary in between bank and SHG.NGO helps these SHGs to complete all the formalities to get a loan followed by training and after six months SHG members starts working themselves. NABARD estimates that currently around 97 million households have access regular savings through 7.46 million SHGs linked to different banks. About 4.78 million SHGs also have access to direct credit facilities from banks; around 82% of these are women-only SHGs (NABARD 2011. All these suggest that the SHG model is the most successful model in India.

The SHG model was a great success in Kerala also, mainly due to the efficient functioning of Kudumbasree which is largely a state run programme. The Kudumbasree Neighborhood Groups work on the principles of SHGs model with the Kudumbasree Mission acting as the intermediary between NHGs and banks in the banking linkage programme by NABARD (Oommen, 2007). The neighborhood groups created by Kudumbasree helped in creating awareness about the advantage and power of group lending in the state and developed the habit of saving and thrift, especially among women.

During the end of 20th century, several NGOs like SKS, Equitas etc have started adopting another model called JLG model inspired from the success of Grameen bank approach (It is actually a collaboration of Grameen model and JLG model).Later these NGOs turned into MFIs (for-profit MFIs). The change in approach is considered as one of the reasons for the mission drift in Indian microfinance.

2.2.2 Joint Liability Groups

The basic methodology followed in commercial microfinance in India was innovated by Grameen Bank and later improvised by several players. We are generalizing all the models, by calling them as Joint liability group. The Joint liability Group (JLG) comprises preferably of 4 to 10 individuals coming together for the purpose of availing bank loan either singly or through the group mechanism against mutual guarantee (Grameen Bank, 2000). People form groups and borrowed money on the basis of the joint liability contracts. So the entire group members are responsible for repaying each other's loan amount. This operational model was very effective in Bangladesh and known as 'Grameen Solidarity Model'. This model later adopted by microfinance institutions in both Asia and Africa with slight modifications. (Satheesh, 2005).The existing JLG model in India is following the Grameen group lending mechanism. Grameen bank and microfinance institutions in Latin America and Asia are allowed to collect deposit from their clients and outsiders as working capital, however, Indian JLG groups are prohibited from collecting deposits (Ghosh, 2013).

The most important aspect of JLG model is the group monitoring and management of credit. This system has an established methodology for group recognition, client screening and loan

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sanctioning and collections. They ensure repayment through peer monitoring. Since the end of the 20th century, several major NGOs in India have shifted to JLG model. A shift from SHG model to JLG model itself made a huge difference among the attitude of both lender and borrower. Other important feature of these MFIs is that they are availing fund not from the coveted SHG-banking linkage programme, but from other commercial banks and funding agencies. The repayment guarantee attracted several private parties, profit- eyeing investors and NGOs into this model. Once this change in model occurs, the MFIs may shift their mission to profit making and consider it as a business (Sriram, 2010).By 2009, the 233 MFIs that reported to the umbrella organization SA-DHAN apparently served 22.6 million clients independently of SBLP, with nearly two-thirds of this outreach being accounted for by for-profit MFIs.

2.2.3 Andra Pradesh Incident and recent performance of Indian MFIs

The state of Andhra Pradesh (AP) has a unique leadership position in the growth of microfinance sector in India. Even though Andhra state government has failed to implement the central government's SHG programme in a fruitful way, it encouraged the operation of commercial (JLG mode) MFIs in the state. It resulted in a massive microfinance revolution in the state. In 2006 there were more than 50 MFIs operating in Andhra and Hyderabad is the head quarters of four largest MFIs in the country.

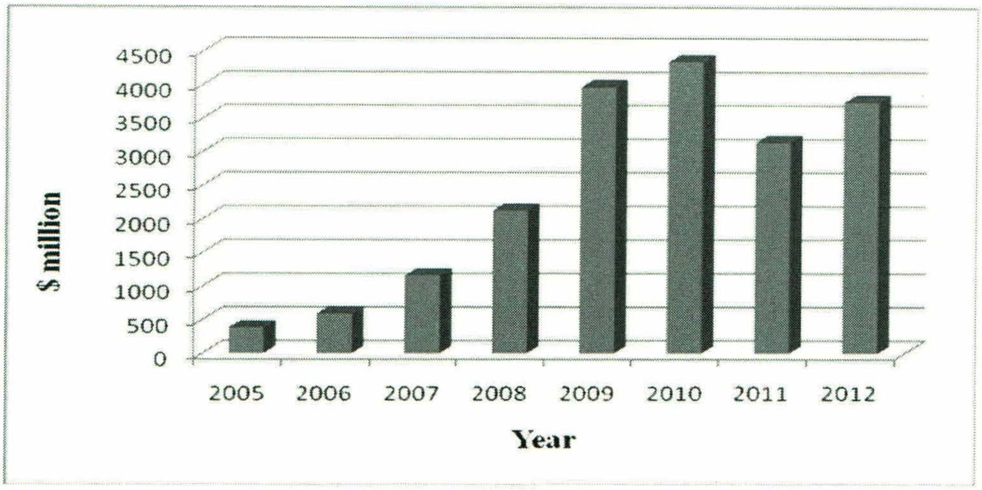
The MFI and government-led SHG programmes coexisted for many years in AP. However, The period 2005-07 has witnessed a major crisis in Andhra Pradesh. The extensive financing of MFIs in the state has resulted in widespread default of microfinance loans. It had further impacts in the form of 'large number of farmer suicides' in the state due to the valiant efforts by the MFIs to collect their money back. This phenomenon was first appeared in Krishna district of Andhra Pradesh. So this crisis is well known as 'Krishna crisis'.

Another important aspect of this crisis is that the academic community in India realized that 'Microfinance becomes an evil' in one way or the other. So the research works done by (Sriram 2005, 2008, 2010; Nair, 2012) were the first to identify the commercialization in Indian microfinance sector. Since this awareness spread across India, both state governments and central government have taken steps to prevent further shocks. The central government appointed a committee to submit reports on the reforms in the microfinance in India, called Malegam Committee in 2011 and Andra Pradesh government has passed Andra Pradesh MFI(regulation of money Lending) ordinance in 2010.Both these moves had checked the growth of MFIs in the country, especially in south India.

Based on the recommendations by the Malegam committee Reserve banks of India and central govt have taken several measures. The committee and academicians in the country have divided the MFI sector in India into three groups other than the state run SHGs, i.e, for-profit MFIs,mutual benefit MFIs and Not-for-profit MFIs (Satish, 2005).According to RBI those who run microfinance business for –profit motive should register in RBI as Non-banking finance company-MFI (NBFC-MFI).So we can largely categorize the MFIs in India into NBFC-MFIs and NGO-MFIs (RBI,2012).This law actually helps us to understand 'how it has turned out to be a business'. That is the all of the prominent MFIs in India have converted their legal status from NGO to NBFC after Reserve bank's order. Out of the top 25 MFIs in the country based on loan portfolio, 22 have registered as NBFC in 2012 and in the bottom 25 MFIs there is no NBFC. These regulations are helpful in understanding the nature of this sector, but hardly done nothing to prevent the negatives effectively.
But when we analyze the growth of MFIs in 21st century, we can easily understand the rising market of these MFI and JLG models in the country over SHG model.

To portray the growth and development of MFIs in India, we can use three major indicators like gross loan amount, number of active borrowers and gross loan per active borrowers. These indicators can be calculated from Mixmarket (microfinance information exchange) data on MFIs in India. A sample of 26 large MFIs for which data are available from the year 2005 to 2012 have been taken (As done by Ghosh ,2013).The major indicator which tell the story of growth is gross loan amount of Indian MFIs from 2005to 2012.

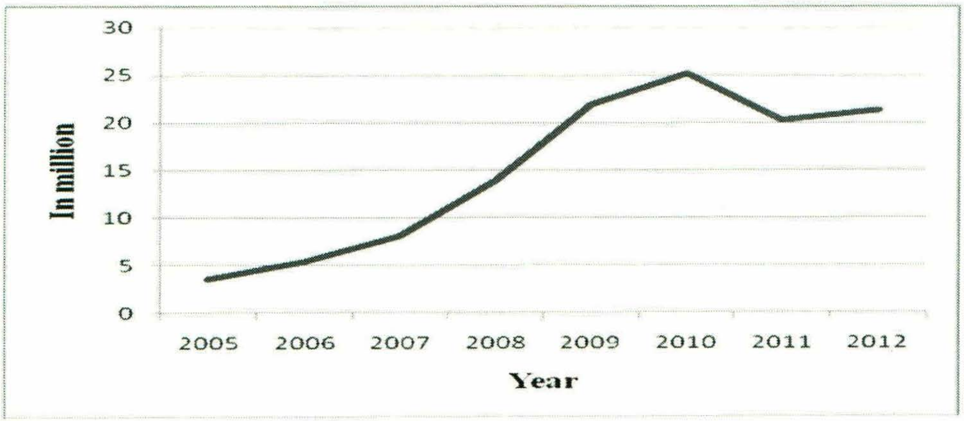
Figure 2.1 Gross loans of 26 large MFIs in India



Source: MIXMARKET[1] (2013)

Figure 2.1 shows that the gross loan amount of initially has shown a gradual increase since 2010, but the incidents followed by AP incident are led to the initiation of Andra money laundering act, poor impression about MFI business and strict regulatory measure by RBI and central government. But in 2012, it slowly started catching up. So we can tell that the MFIs in India recovered from the AP effect and kick started the second generation microfinance campaign in India.

Figure 2.2 Number of Active microfinance borrowers in India(in million)



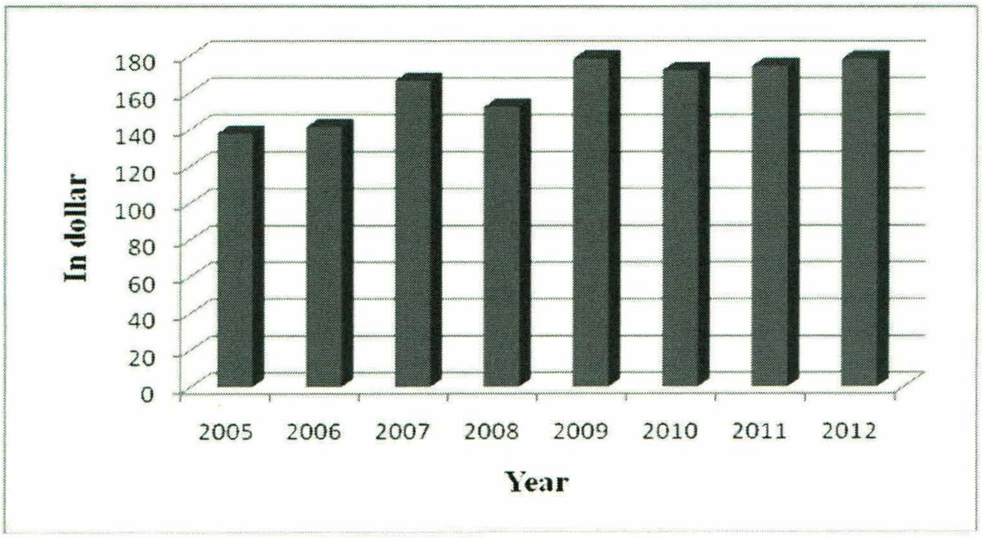
Source: As in fig. 2.1

[1] www.mixmarket.org Accessed on 11 June 2013

Figure 2.2 shows that the number of active borrowers of these 26 MFIs are also showing exactly same trend as the gross loan amount.The important thing is that the second generation MFIs are catching up in the post AP scenario by increasing its outreach by increasing the number of borrowers.

Another variable which shows the growth and outreach of the MFIs in India is the gross loan per active borrowers in the country. Unlike other variables, the figure 2.3 has shown a decline the in the year 2010, but the decline is far less than other two variables. Since 2010, the gross loan per active borrower is showing an increasing trend and it made the researchers to think about a possible move from poverty reduction motive to profit motive. But according to Ghosh (2013), the increase may not be real, since loans that should be written off are also still being kept on the account.

Figure 2.3 Gross Loan per Active Borrower (in dollar)

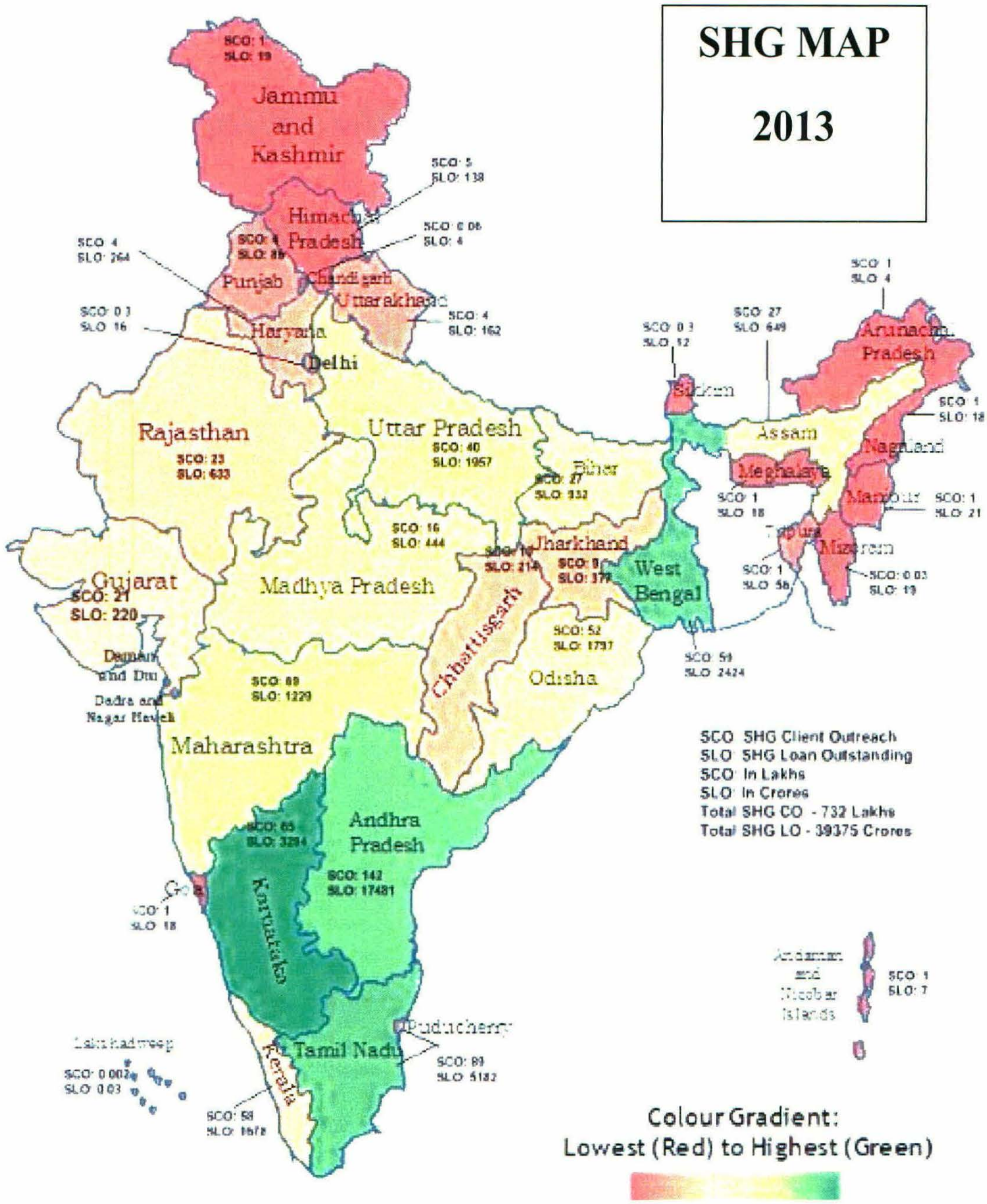


Source: As in fig 2.1

These three indicator have shown a decline in the period 2010-11, since then they recaptured the lost momentom.It is a sign of an emergence of second generation microfinance in India which actually learned lessons from AP incident.

The lionshare of MFIs in India are concentrated in the southern states of the country especially in Andra pradesh,Tamil Nadu and Karnataka.From the maps below (Figure 2.4 and 2.5) the advantage of southern states in the MFI bussiness is very clear.

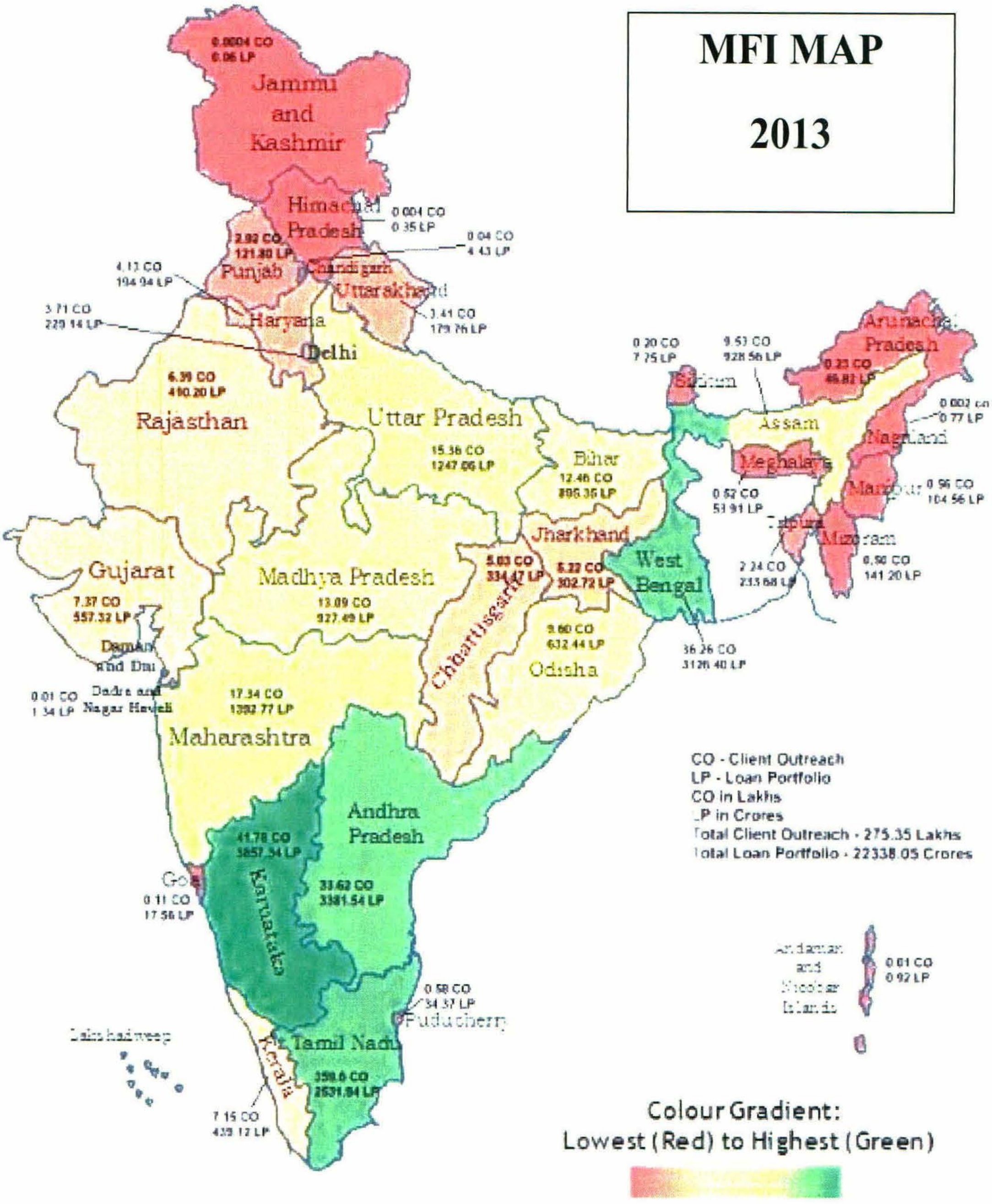
Figure 2.4 Presence of SHG based institutions in Indian states


SHG MAP
2013
SCO: 1
SLO: 19
Jammu and Kashmir
SCO: 5
SLO: 138
Himachal Pradesh
SCO: 0.06
SLO: 4
SCO: 4
SLO: 86
Punjab
Chandigarh
SCO: 4
SLO: 264
Uttarakhand
SCO: 4
SLO: 162
SCO: 0.3
SLO: 16
Haryana
Delhi
Rajasthan
SCO: 23
SLO: 633
Uttar Pradesh
SCO: 40
SLO: 1957
SCO: 0.3
SLO: 12
Sikkim
SCO: 27
SLO: 649
Assam
SCO: 1
SLO: 4
Arunachal Pradesh
SCO: 1
SLO: 18
Nagaland
Bihar
SCO: 27
SLO: 932
Meghalaya
SCO: 1
SLO: 18
Manipur
SCO: 1
SLO: 21
SCO: 16
SLO: 444
Madhya Pradesh
SCO: 10
SLO: 214
Chhattisgarh
Jharkhand
SCO: 8
SLO: 377
West Bengal
Tripura
SCO: 1
SLO: 56
Mizoram
SCO: 0.03
SLO: 19
Gujarat
SCO: 21
SLO: 220
SCO: 52
SLO: 1797
Odisha
SCO: 59
SLO: 2424
Daman and Diu
Dadra and Nagar Haveli
SCO: 89
SLO: 1229
Maharashtra
SCO SHG Client Outreach
SLO SHG Loan Outstanding
SCO In Lakhs
SLO In Crores
Total SHG CO - 732 Lakhs
Total SHG LO - 39375 Crores
SCO: 65
SLO: 3294
Karnataka
Andhra Pradesh
SCO: 142
SLO: 17481
Goa
SCO: 1
SLO: 18
Andaman and Nicobar Islands
SCO: 1
SLO: 7
Lakshadweep
SCO: 0.002
SLO: 0.03
Puducherry
Tamil Nadu
SCO: 89
SLO: 5182
Kerala
SCO: 58
SLO: 1678
Colour Gradient:
Lowest (Red) to Highest (Green)

Source: Sa-Dhan[2] (2013)

[2] www.sa-dhan.net Accessed on 24 July 2013

Figure 2.5 Presence of Microfinance Institutions in Indian States


MFI MAP
2013
0.0004 CO
0.06 LP
Jammu and Kashmir
Himachal Pradesh
0.004 CO
0.35 LP
2.92 CO
121.80 LP
Punjab
0.04 CO
4.43 LP
4.13 CO
194.94 LP
Chandigarh
Uttarakhand
3.71 CO
229.14 LP
Haryana
3.41 CO
179.76 LP
Delhi
6.39 CO
490.20 LP
Rajasthan
Uttar Pradesh
15.36 CO
1247.06 LP
Bihar
12.46 CO
895.36 LP
0.20 CO
7.75 LP
Sikkim
9.53 CO
928.56 LP
Arunachal Pradesh
0.23 CO
46.82 LP
Assam
0.002 CO
0.77 LP
Nagaland
Meghalaya
0.52 CO
53.91 LP
Manipur
0.96 CO
104.56 LP
Tripura
Mizoram
2.24 CO
233.68 LP
0.90 CO
141.20 LP
Jharkhand
Gujarat
7.37 CO
557.32 LP
Madhya Pradesh
13.09 CO
927.49 LP
5.03 CO
334.47 LP
5.22 CO
302.72 LP
West Bengal
Chhattisgarh
9.60 CO
632.44 LP
Odisha
36.26 CO
3126.40 LP
Daman and Diu
0.01 CO
1.34 LP
Dadra and Nagar Haveli
17.34 CO
1382.77 LP
Maharashtra
CO - Client Outreach
LP - Loan Portfolio
CO in Lakhs
LP in Crores
Total Client Outreach - 275.35 Lakhs
Total Loan Portfolio - 22338.05 Crores
Andhra Pradesh
41.78 CO
3857.34 LP
Goa
0.11 CO
17.56 LP
Karnataka
33.62 CO
3381.54 LP
Andaman and Nicobar Islands
0.01 CO
0.92 LP
0.58 CO
34.37 LP
Puducherry
Lakshadweep
Tamil Nadu
Kerala
350.6 CO
2631.84 LP
7.15 CO
439.12 LP
Colour Gradient:
Lowest (Red) to Highest (Green)

Source: As in fig. 2.4

Those three big states in the south have perfect advatage over the other states in both the number of SHG/MFI and the amount of loan outstanding by SHG/MFI. Another important feature is that both SHG model (not-for-profit) and JLG/Grameen model (for-profit) in these states are really high when compared to other Indian states.So the major market for MFI bussiness in the country are southern states and only west bengal has equally good MFI bussiness than these states. This underlines the role of southern state in the Indian microfinance bussiness.

The microfinance sector in Kerala is revolving around the state-run mission Kudumbasree. Before the initiation of Kudumbasree also there are number of NGOs who act as intermediaries to provide microfinance service to the needy was active in the state. Some religious groups also had played an important role in spreading the idea. Most of them are concentrated on thrift oriented approach till 1992. But after the implementation of SBLP in the country, these NGOs understood the importance of rural credit and started intermediating NABARD's loans. In the meantime, they were not reluctant to funds from domestic and foreign agencies. But they are concentrated in some small pockets and hardly able to provide credit on a large basis due to several constraints in the economy.

"The big bang decentralization of Kerala came in two bursts in transfer of powers to local governments. First in October 1995 when the decision to transfer most of the development institutions to local governments was taken and the second in August 1996 when the decision to transfer about a third of State Plan resources to local governments was announced and the People's Plan Campaign launched. Aftermath of these changes, the government decided to universalize the state's own anti-poverty programme called Kudumbasree" (Kudumbasree Annual Report, 2008-09 pp 7). The Kudumbasree of Kerala launched in May 1998 even though it began as a microfinance institution, the operational model of Kudumbasree was entirely different from the existing models of microfinance. Its way of operation is based on a three-tier community development system (CDS) (Oomen, 2007). The women-centered microcredit programme of Kudumbasree has introduced certain indicators to identify the poor women who are eligible for the microcredit programme (Ajith et al, 2006). In this sense Kudumbasree program considered as a successful microfinance programme and it provides number of services like microfinance, education, training, insurance and so on. Kudumbasree has achieved a commendable repayment rate (94.5 percent) within six years (Government of Kerala, 2005).

As a poverty alleviation programme, Kudumbasree has achieved reasonable heights over the years. But as a microfinance programme to alleviate poverty, it faced severe criticism in the academic world due to lack of peer monitoring and poor management skills of authorities. But still the working of NHGs is different from other contemporary models in India. That makes Kudumbasree as a micro finance institution with several unique features. The creation of thrift is the major achievement of the Kudumbasree programme. The Kudumbasree groups in the state were able to pool the thrift amount worth Rs. 700 crore by the end of the year 2006. Today, it is much higher. Other than thrift creation, the programme successfully disbursed Rs.1900 crore worth credit to its members via the SBL programme till 2006. This magnitude of savings and credit managed by KDS, considered as probably the biggest in the world.

The following table 2.1 shows the growth and impact of Kudumbasree programme from 1999-2006; arguably it is the most effective growth period. It has shown tremendous improvement in the outreach, thrift and amount of loans. It actually paved the way for an effective group lending culture in the rural credit markets ok the state.

Table 2.1 Progress of Kudumbasree Program in Kerala: 1999-2006

year	No: Neighbourhood Groups (NHG)	No: of Area Development Societies (ADS)	No: of families covered	Informal amount of thrift (mn Rs.)	Amount of loan (mn Rs.)	Velocity of internal lending
1999-00	7538			883.9	561.4	0.63
2002-03	113675	13423	2210033	1634.9	1695.9	1.04
2003-04	125735	13766	2645369	2528.3	3925	1.55
2004-05	147989	13262	2923425	5330.1	13078.7	2.45
2005-06	167907	14574	3381764	6640	15352	2.30

Source: Various Kudumbasree Annual Reports and Ajith et al. (2006)

Since 2006, the number of commercial MFIs (JLG model) has started spreading out in the state. But Kudumbasree becomes the pioneer poverty alleviation programme in the state with more importance to women empowerment and working in association with local self governments in Kerala. In this period many other state MFIs like SKS, Ujjivan, Share and BSS had opened its branches in kerala. This entry of MFIs has helped the Kerala's own NGOs and money lenders to rethink their strategy of lending. Now in 2013, there are almost 9 major NBFCs operating microfinance business in Kerala and they are increasing their outreach day by day. This shows the spread of commercial microfinance in the state for the past seven to eight years. What makes this really interesting in Kerala is the number of clients and loan size of SHGs (state-led and SBLP) are almost equal to other states. But the number of clients and loan size of JLGs/Grameen model (commercial model) are very less when compared to other states. So In Kerala, the microcredit business run by SHGs (State-led Kudumbasree and SBLP) still dominates when compared to other states.

Table 2.2 Client out-reach and loan portfolio of MFIs in south India-2013

Southern States	Kerala	Karnataka	TN	AP	Total	Kerala's share
Client out-reach(lakh Numbers)	7.15	41.78	35.96	33.62	118.51	6.03
Loan Portfolio(Rs. Crore)	439.12	3857.34	2531.94	3381.54	10209.94	4.3

Source: Sa-dhan (2013)

Table 2.3 Client out-reach and loan portfolio of SHGs in south India-2013

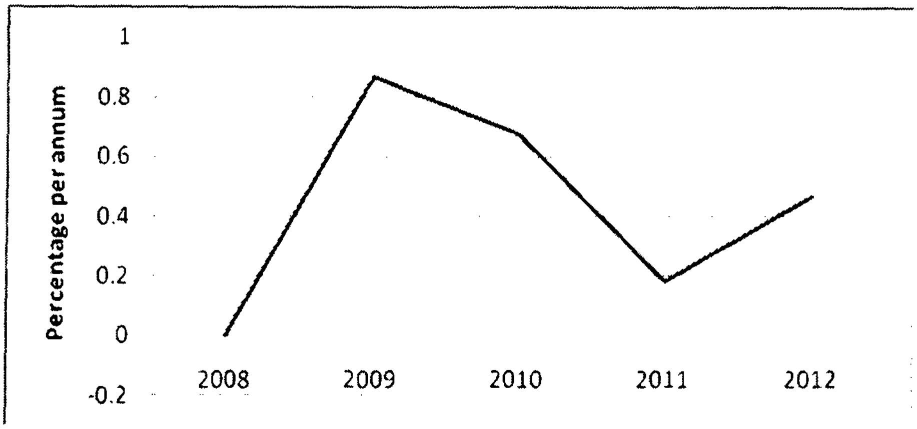
Southern States	Kerala	Karnataka	TN	AP	Total	Kerala's share
Client out-reach (lakh Numbers)	58	65	89	142	354	16.4
Loan Portfolio (Rs Crore)	1678	3294	5182	11181	21335	7.87

Source: Sa-dhan (2013)

From the tables 2.2 and 2.3, we can clearly see the advantage Kerala has in the microfinance activities which follows SHG model. The client out-reach is almost equal to other big brothers like Karnataka.

But Oomen (2007) and others have pointed out some of the drawbacks of microfinance programme of Kudumbasree. One of the major threats for the Kudumbasree programme in the state is the dual/multiple memberships in different forms of microfinance institutions like Caste/Politics based NGOs and commercial NGOs. The multiple memberships can be a serious threat to the Kudumbasree programme in the long run (Oomen, 2007). Al though the author misses out the case of commercial MFIs; he pointed out the possible threat and weakness of KDS very clearly. But still Kudumbasree is the largest provider of microfinance through SBLP in Kerala, but the commercial MFIs have been growing fastly and they are no more an infant industry in Kerala. Another interesting factor is that when an all-India dip happened in commercial MFI sector all over the country, Kerala was pretty safe. The Figure 2.6shows that number of clients in the industry has shown an increasing trend even in the years like 2010 and 2011, when the all India level numbers were decreased. The growth rate of number of active borrowers in Kerala has been positive since 2008, but at the same time the all India growth rate is negative. So we can see a gradual increase in the outreach of MFI in the state.

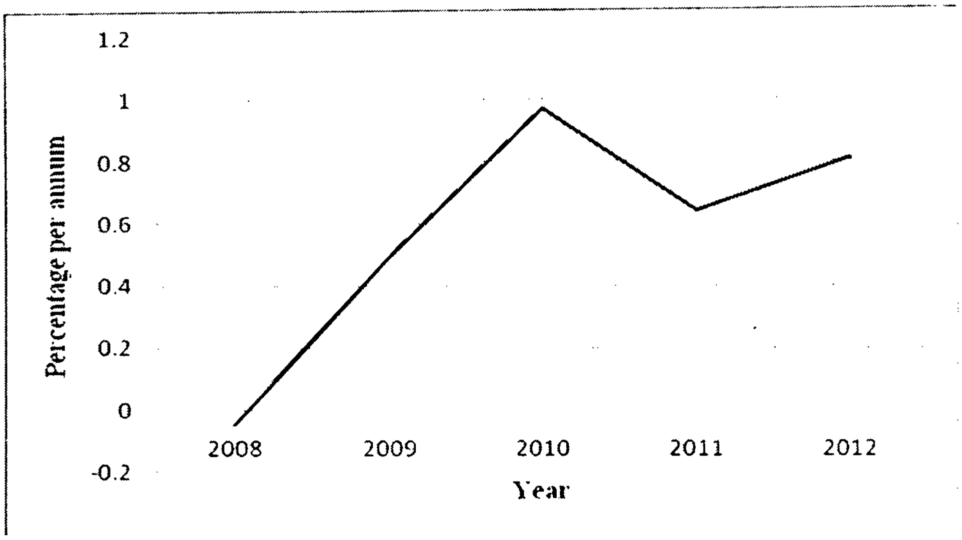
Figure 2.6 Growth rate of number of active MFI borrowers(lakh) in Kerala



Source: Own calculation from MIXMARKET data (2013)

Figure 2.7 confirms that like the number of active borrowers, the growth rate of gross loan portfolio also showed a positive growth rate since 2008 and it didn't affect much from the fall at the national level for the other state MFIs.

Figure 2.7 Growth rate of gross loan amount



Source: Own calculation from mix market data (2013)

So after a dip in the last two years MFIs in the country have started functioning smoothly by slight changes in the existing JLG model. They have learned lessons from the AP incident and are being much careful and stronger than before and they are spreading their operations to states like Kerala and Gujarat were the state run SHG model is stronger than the JLG model. In this regard, the rest of the chapter analysis the curios case of mission drift, especially in Kerala and what are the indicators and behind the 'mission drift' of the for-profit MFIs (NBFC-MFIs)

2.3. Performance of MFIs in Kerala

This section aims at the analysis of financial performance of microfinance institutions in Kerala. The performance of microfinance institutions normally measured interms of non-financial indicators. But there are studies which measured the performance of MFIs interms of financial performance and outreach (Chaves and Gonzales-vega, 1996; Ledgerwood ,1999; Yaron et al,1998 and Arsyad , 2005). We have already discussed the outreach of MFIs in Kerala using certain variables. Here I consider the financial performance of MFIs in the state to show how much developed and sustainable the system. To add more credibility to the development of MFI argument, we can use some variables like number of branches, number of staff and so on. Normally in microfinance research, measuring financial performance is an indicator of financial health of MFI (Meyer, 2012).In this context of the study, the financial performance of MFIs use to show the effectiveness and strength of for-profit MFI business in the state.

The major problem for analyzing the financial performance of MFI is the reliability of data because of the under-reporting of MFIs. By far Mix market is the most reliable database currently available on MFIs. Out of seven NBFC-MFIs operating in Kerala five are regular reporters of financial data to MIX.

To understand the financial performance of the MFIs, I have selected some globally accepted indicators of financial health of MFI. We have almost six years data for analysis.

Table 2.4 Financial indicators of performance of MFIs in Kerala

Indicator/year	2005	2006	2007	2008	2009	2010	2011	2012
Capital/asset ratio	0.0123	0.0266	0.0536	0.1489	0.5874	0.2519	0.2026	0.1215
GLP to Assets Ratio	0.4656	0.8032	0.8579	0.8884	0.8842	0.9182	0.9256	
Debt/Equity Ratio	80.29	36.54	17.67	5.72	4.56	10.02	5.75	
Return on Asset Ratio	0.0057	0.014	0.0069	0.008	0.0025	0.0235	0.047	0.062
Return on Equity Ratio	0.742	0.633	0.163	0.081	0.014	0.061	0.498	0.528
Cost per loan (Rs)	428.48	515.09	557.85	884.59	783.29	805.68	710.11	
Cost per borrower (Rs)	488.49	637.23	675.64	985.01	877.35	944.74	807.86	

Source: Own calculation from MIXMARKET data (2013)

From the table 2.4 it is clear that the overall financial performance of MFIs in Kerala is satisfying over the years. Return on assets and equity have shown an increasing trend from 2005 except 2008-09.When we analyze the financing structure of MFIs, three variables should be taken into account. They are capital/asset ratio, gross loan portfolio to asses and debt/equity. All these variables are showing a decent trend in the recent years and among these three gross loan portfolios to total assets are highly stable since 2008.On the efficiency side, the major variables available here are cost per loan and cost per borrower. Both variables have shown declining trend except in the years 2008 and 2009.

While considering these variables, it is well and clear that the efficiency, performance, revenue and outreach of for-profit microfinance institutions in Kerala are pretty good for the business. If this trend continues for a while, then we can witness some interesting phenomenon in the credit market of the state.

2.4. Summary

This chapter explained the development and performance of microfinance institutions both in India and Kerala. The development of microfinance is evolved by introducing different group lending models. Each change in the group lending models has resulted in the changes in approaches. The Grameen model, SHG model, Kudumbasree model etc have followed a not-for profit approach in the microfinance business over the years. But Latin American model and JLG model have resulted in the commercialization of microfinance. It resulted in a transformation in the microfinance business from not-for profit to for-profit business. India has witnessed the success and failures of both models. The chapter dealt with different group lending model in the country.

When it comes only to the for-profit microfinance business in the country, the story becomes more complicated due to the indifferent performance of the MFIs. The microfinance crisis in the period 2008-2012 affected the performance of for-profit MFIs in the country. Although they have shown some positive signs in the past two years, the overall performance is not convincing enough. Kerala already has a well developed state-run microfinance system. So it was very hard for the for-profit MFIs to enter the state. By comparing the resent status of microfinance institutions in India and Kerala, we are able to tell that the performance and outreach of MFIs in the state are better than the national average. MFIs in Kerala also struggled during the crisis period, but the fall in indicators is not fast as other states. The major players in this industry are expanding both loan portfolio and profit over the last six years in the state. When we consider the widespread network of Kudumbasree in Kerala, the performance of for-profit MFIs in the state is appreciable.

This section also analyses the financial indicators of the MFIs operating in the state. It shows that the business is not only expanding it is profitable also .Cost per loan and borrower has been decreasing since the 2006(except a dip in the crisis period).So the results from this chapter tell a positive growth story of the for-profit MFI in the state, in terms of expansion and profit making. But our major concern is that whether these MFIs drift from their basic mission of 'poverty reduction' to make profit out of the business. Next chapter deals with the question of 'mission drift' in the microfinance industry in Kerala.

Chapter 3

Existence of Mission Drift in Kerala – towards profit making

3.1. Introduction

In the development literature, the word microfinance has played an important role, especially during the past 30 years and what it means to the people is also very clear to everyone. According to Vail (2010: p.14), "micro-credit programmes constitute one vector in the web of de-commodified practices, a 'non-commodified economic circuit' apart from and outside of the profit logic which runs mainstream financial spaces".

According to the UN, microfinance should be a key strategy to achieve the *Millennium Development Goals* (Millennium Summit, 2000). There are large literature supporting this argument where microfinance programmes helped to eradicate poverty, promote children education, improve health for women and children, empowering women and targeting the poorest (Morduch et al. 2003).

Initially, micro-credit was envisioned as an alternative to local loan-sharks, to forceful repayment methods and to usurious interest rates charged. But the chances of income creation, employment creation and empowerment of rural poor women always give an advantage to this noble concept (see Bateman, 2010). For most of the researchers and social scientists microcredit is one tool in order to give *the poor* an alternative to the *informal sector*. This is almost universally accepted as being one of the main objectives of microfinance (Morduch 1999; Gutierrez-Nieto *et al.* 2004; Helms, 2006; Morvant-Roux 2009). So we can lucidly say that the major aim of the microfinance around the world is to alleviate poverty through different methods. Some authors, on the other hand were against the idea that MFI's does not always target *the poor and the poorest* but they often target *less poor customers* (Hulme 2000a; simanowitz, 2002; Scully, 2004). In the beginning of 21st century, poor performance of MFIs all over the world have been criticized on the basis of 'not targeting the poor' argument. Armendariz and Morduch (2010) pointed out that this phenomenon is a worldwide one and mainly affecting the development programmes in the developing and less-developed countries. According to Lensik and Hernans (2007), the major reason for the collapse of MFI system in Latin America was the deviation from the mission. All major MFIs across the world are claiming that their major objective is 'poverty reduction' and they have advertised it and kept that as their major mission.

Table 3.1: Missions of the 8 leading MFIs worldwide (including MFIs from India) and 3 major MFIs in Kerala

Institution	Country	Legal Status	Mission
Grameen Bank	Bangladesh	Regulated bank	Poverty reduction
ASA(Association for social advancement)	Bangladesh	NGO	Income generation
VBSP(Vietnam Bank for Social Policies)	Vietnam	Regulated bank	Poverty reduction
BRAC(Bangladesh Rural Advancement Committee)	Bangladesh	NGO	Poverty reduction
BRI(Bank Rakyat Indonesia)	Indonesia	Regulated bank	Financial services to small entrepreneurs
SKS Microfinance	India	NBFC	Financial services to poor household
SHARE	India	NBFC	Poverty reduction
Compartamos	Mexico	Regulated bank	Create development opportunities for poor
Cajapopular mexicana	Mexico	Regulated cooperative	For Improving quality of life of members
Muthoot	**India**	**NBFC**	**financial services to the needy and the un- served**
ESAF(Evangelical Social Action Forum)	**India**	**NBFC**	**Upliftment of poor**
HOPE	**India**	**NBFC**	**Transforming and empowering the poor**

Source: MIXMARKET (2013) and Armendariz and Szarfas (2011: Table 15.1)

The table 3.1 shows that most of the MFIs either have poverty reduction as their mission or as their long term objective. Most of them have other missions like focus on women, integrate women, develop trust relationship, and offer competitive financial products to its members and so on. But all these are also aiming the long-term upliftment of poor people and poverty reduction. It is same with MFIs all over the world and only the way of operation differs.

In Kerala's context, three major MFIs (Refer the table: 3.1) are aiming at the upliftment of poor and published the same as their long term objective. When compared to other states, it is evident that women empowerment is the major channel which have been used by the MFIs in the state to fulfill their goal of poverty alleviation. The state-owned microfinance programme also tries to alleviate poverty through empowering women (Kudumbasree Mission) and all other for-profit and not-for profit MFIs in the state are claiming that their ultimate aim is poverty eradication.

But as the literature points out, there are several cases of 'mission drift' even in the case of above mentioned MFIs. For example, a study on Banco Comportamos by Ashta and Hudan (2009) discussed about the mission drift in Latin America. A study on commercialization on microfinance in Indian context by Sriram (2010) revealed the change in mission and strategy of four MFIs in India which includes SHARE microfin limited, Asmita, Spandana and SKS microfinance. The mission drift in India has its own features but some of the common features (high interest rate, loan collecting techniques etc) are same everywhere (Nair, 2010).

The reasons behind mission drift are widely studied across the world, even in India after the AP incident. As usual, researchers found too many reasons and named the phenomenon as 'commercialization of microfinance'. Even though there are enormous discussions and studies have done on the issue of commercialisation, nobody had actually looked into the changes happen when a normal MFI becomes a commercial entity. That made the debate about the reasons behind mission drift more vulnerable and complicate.

3.1.1 Conceptual framework and theoretical literature

Mission drift can only appear when there is a mis-match between the announced mission and real practice (maximisation objective). Most of the researchers consider the main objective of microfinance as poverty-reduction and the objectives like women empowerment, providing banking service to entrepreneurs and poor people, income generation and develop "trust relationship" are aimed at poverty reduction. The MFIs want to increase their outreach without compromising their mission of poverty reduction. But the attempts to reach high returns from the business may violate the poverty reduction mission. In other words, they are tempted to provide larger loan to poor clients to achieve higher returns by introducing strict monitoring and repayment methods. Even though the MFIs are able to reduce the cost per loan and to increase sustainability by providing larger loans, there is always a repayment risk. As they increase their outreach, the number of borrower per loan officer (those who are in charge of providing loans) also increases. This increase also ignites the portfolio risk.

In order to solve these negative effects of providing higher loans, the MFIs are forced to deviate from the mission of serving the poor. For example, they may try to lend money to less-risky customers who have the ability to repay the loan amount. However a poor cannot repay larger loans amount on time. So the MFIs lend higher credit only to a certain section of the clientele. It shows that in the long run, there is a clear shift in preference towards the wealthier clients. This shift in preference can be called as 'mission drift 'in the modern day microfinance. "In general, however, the issue of mission drift is seen in terms of change in the poverty level of an MFI's clients. Average loan size of clients is a commonly used indicator, but this has drawbacks" (Armendariz and Szafarz, 2011:351). The major drawbacks are

- The wealthier clients may apply for small loans
- Poor client's interests to take higher loans.
- The MFI may attract towards different markets e.g. SMEs, agricultural loans (Cull et al, 2009).

Other accepted poverty measurement tools which helps to analyse the 'mission drift' include household expenditure/consumption surveys, such as Poverty Assessment Tool by the Consultative Group to Assist Poor (CGAP) and Client Impact Monitoring System (CIMS) by opportunity international. There are some common measures like,

- Housing index surveys.
- Geographical distribution of clients (e.g. poverty is generally more prevalent in rural areas due to access to infrastructure, resources, service and market).

- Sectoral distribution of loans (since some sectors such as agriculture and manufacturing are traditionally considered riskier than others) (Opportunity International, 2007)

The arguments can be divided into two schools of thought. One school believe that the mission drift is the end result of increase in average loan size and other school claimed that mission drift does not have any relationship with average loan sizes, but because of other reasons. The generalization about the mission drift has come from the former. If the firms increase the average loan size of their business, then that will lower the outreach depth. I.e., the aim to target poor people cannot be satisfied. As average loan size increase the amount of loan for a single person will increase drastically but, poor people cannot afford a high loan amount. So they will be excluded from the system fastly and the firms will go for some lower middle class or middle class people.

The major reasons behind increase in average loan size are progressive lending and cross-subsidization (Mosley, 2006; Armendariz and Morduch, 2010; Cull et al. 2008). Progressive lending means lending higher loan amounts to clients with a good repayment record and Cross–subsidization means lending to rich people to finance the poor clients. The implementation of these two methods satisfies the poverty reduction mission also.

Another school of thought argues that the cross-subsidization and progressive lending cannot always be the reason for the mission drift. The cost of lending to poor and wealthier clients forces the MFIs to deviate from their mission. The cost of lending may differ across the regions. There are arguments against considering 'average loan size' as an indicator of 'mission drift'. Christen (2000) pointed out that the average loan size remain high due to the maturity of portfolios. The most important criticism on average loan size theory has come from Armendariz and Szafars (2011). According to them MFIs which operate in a developed region may not find too many poor clients. But those MFIs are considered as for-profit MFI due to less number of poor clients. So the reasons for mission drift may vary across regions, people and MFI around the world. We could also consider the situations where such drift is motivated by profit-oriented donors; this situation has been examined by Ghosh and Van Tassel (2008). So MFIs' interest on unbanked wealthier clients might be motivated by for-profit investors, and drifting from their traditional mission of poverty reduction is the only way out to achieve profit. Another argument is based on sustainability of microfinance institutions. The mission drift can occur if the investor prefers a sustainable microfinance institution than a socially committed (with the objective of poverty reduction) institution (Hermes and Lensink, 2007).The trade-off between reducing poverty and being financially sustainable at the same time is the major challenge for microfinance institution in the world.

From the above arguments we can see that increase in average loan size may lead to mission drift mainly because of more specific reasons. So average loan size, alone cannot be considered as an indicator of mission drift in microfinance. But the variables like interest rate, multiple lending and the rise in average loan size of wealthier client or fall in average loan size of poor clients can be used as indicators to analyze the mission drift.

3.2. Mission drift in Kerala's context – an empirical analysis

From the analysis of performance of MFIs in Kerala, we can see that the growth performance of MFIs in Kerala has been rising since the beginning. Unlike the other Indian MFIs, MFIs in Kerala have not been severely affected by the crisis during 2010-11 period and the variables like number of clients and average loan size are also showing an increasing trend. Therefore it is evident that the business in Kerala is improving over the years. In this context it is important to understand the impact of for-profit MFIs among the poor people in the state. If the MFIs have a positive impact on the poor clients in the state, then they are successful in implementing their mission of poverty reduction. If they fail to do so, it is a drift from their mission. All the three major players in kerala indicate that their mission is to alleviate poverty by providing credit and financial services and empowering rural poor women. As pointed out by Sriram (2010), the performance of MFIs in India has diminished after the AP incident, but the post AP-MFI can be more lethal than the pre AP MFIs. The MFI activities in Kerala can be considered as post AP MFIs (we can call it as second generation microfinance in the country).Therefore we can make an attempt to find whether there is a drift from their mission of poverty alleviation and women empowerment to profit making.

According to the theories of 'mission drift in microfinance', the mission drift from poverty reduction to profit making occurs when *the average loan size of wealthier clients increases and that of poor clients decreases or remains stable.* This section tries to understand the 'mission drift' in microfinance business in Kerala with the help of observations from the primary survey. The primary survey shows that 86 percent of the clients are demanding higher loan amount (more than Rs.30000), 6 percent of the clients are demanding average loan amount and only 8 percent of the clients demand small loans. A rise in average loan size when majority of the clients demand for higher loans is good, but the difference in loan amount for different people can be called as 'mission drift'. If a client gets lesser loan amount than he actually demands, which is discrimination and if it is a poor client (based on income), then that is clearly a drift from their mission of serving poor. From the theoretical literature, we have identified certain variables which are useful to analyse the mission drift without relying on the highly criticized measure of average loan size. Instead of analyzing the average loan size of clients, we can find the average loan size of different income groups. Analysis of average loan size of different income groups can help in answering the question of 'mission drift' when all clients demand higher loan amount.

The next section tries to solve the above mentioned puzzle with the help of the primary survey conducted among the randomly selected clients of selected for-profit MFIs in the state.

3.3 Socio-Economic Profile of the clients- An analysis from the survey

This section tries to portray a picture of the socio-economic profile of the clients. The survey have brought out the status of the workers with respect to their geographical area, caste, religion, land Assets, standard of living, income and occupation of the clients.

149 MFI clients, all of them women, from three districts (Ernakulum, Thrissur and Palakkad) in the state were interviewed. Among 149 clients, 35 percent (51) of them are from urban area and 65 percent (98) are from rural area. Most of the clients are Hindus 64% (96), 17% (25) are Christians and 19 percent of the clients are Muslims .Another important feature is caste where we find that 54 percent (81) of the total clients are Other Backward

Caste (OBCs), 28 percent (42) of the total sample are Scheduled Caste (SCs) and only 18 percent (26) of the clients are forward Caste.

Regarding the poverty level of the clients, 68% (101) of the clients are Above Poverty Line (APL) and 32% (48) of the clients are Below Poverty Line (BPL) (see the Table 3.2). Another vital aspect of MFI lending is about collateral. Among the clients 19% (27) of the clients do not have possession of any form of land and rest of them (81%) possesses less than 10 cents of land. Regarding the occupation of the clients (Table 3.3), 52% (77) of the total 149 women clients engage in household activities and rest of the clients engage in activities like agriculture, services, domestic labour etc.

Table 3.2: Socio-Economic features of the client

	Socio-economic features											
	Religion			Caste			Place of residence		Economic status		Land ownership	
	H	C	M	SC	OBC	FC	U	R	APL	BPL	Landless	Land owned
No. of clients	96	25	28	42	81	26	51	98	101	48	27	122
Percentage	64	17	19	28	54	18	35	65	68	32	19	81

Note: H- Hindu, C- Christian, M-Muslim, SC- Scheduled Caste, OBC- Other Backward Caste, FC- Forward Caste, U-Urban, R-Rural, APL- Above Poverty Line, BPL- Below Poverty Line
Source: Primary Survey (2013)

Table 3.3: Occupation of the clients

Occupation	**Number of Clients**	**Percentage**
Household duty	77	51.7
Agriculture	3	2.0
Petty trade	8	5.4
Household industry	15	10.1
Domestic labour	6	4.0
Service	16	10.7
Any other casual labour	7	4.7
Public sector	9	6.0
Others	8	5.4
Total	149	100.0

Source: Primary Survey (2013)

Based on all these features it is evident that the MFIs target the jobless-landless-poor people in the lower strata of the society regardless of their caste and religion.

For a more detailed classification of the standard of living of the surveyed clients, the clients are divided based on their income and standard of living. Based on the monthly income of the household of the respondents, the clients have divided into four quartiles.

Table 3.4: Household Income quartiles of MFI clients

Income Group of the household	Number	Percentage
Low	38	25.5
Below Average	43	28.9
Average	35	23.5
High	33	22.1
Total	149	100.0

Source: Primary Survey (2013)

Table 3.4 shows the data of households in different income groups. Out of 149 clients 53 percent of the clients have monthly income less than Rs.12000 and 47 percent of the clients have monthly income between Rs.12000-21000.The minimum value is Rs.4500 and maximum value is Rs.21000. So MFIs in Kerala are not interested to lend money only to a particular income group and income of the household may not be a determinant of repayment ability of the client. But the high income clients may get high loan amount compared to low income clients. One thing is very evident that they are successful in accommodating all income groups in their lending activities even when the group is really heterogeneous based on income. However income matters most in the MFI activities in the state only when the client demands for a higher loan. The coming sections will discuss and evaluate these statements in detail.

Another classification of MFI clients based on the Standard of Living of the clients is given below. A Standard of Living Index has been created to divide the clients into different income groups.

3.4. Standard of Living Index

Standard of living Index can help us to understand the nature of every client in detail. This study follows the NFHS (IIPS, 2000) methodology for creating a standard of living Index. In the primary survey, we have collected some socio-economic indicators of the clients like access to water, access to sanitation, electricity connection, nature of house and assets like land, livestock and poultry of the households. Each component was assigned weights zero and one, depending on its availability.

The components and the weights given are the following:

1. Access to water: No= 0; Yes= 1
2. Electricity connection: No= 0; Yes= 1
3. Access to sanitation: No= 0; Yes= 1
4. Roof: Thatched or tiled= 0; Concrete= 1
5. Wall: Tin sheets or Mud= 0; Bricks= 1
6. Livestock: No= 0; Yes= 1
7. Poultry: No= 0; Yes= 1
8. Land ownership: No= 0; Yes= 1

Instead of prioritizing each component, the study has given same weights for all the nine components.

The index is calculated by dividing the sum of the weights with number of components.

$$SLI = \frac{Sum\ of\ weights}{Number\ of\ components}$$

Note that this index lies between 0 and 1; closer the index of a household to unity, higher is the standard of living of the household and vice-versa.

Table 3.5: Summary statistics

Statistics	Values
N	149
Mean	0.6928
Median	0.6667
Std. Deviation	0.14289
Range	0.67
Minimum	0.33
Maximum	1.00

Source: Own calculation using primary survey data (2013)

The summary statistics in Table 3.5 shows that the mean value is 0.69 (maximum value is one) and the clients may have an average standard of living. The minimum value is 0.33 and maximum is one, it shows the variation in Standard of Living of the clients. But a clear picture of the standard of living can be portrayed when the frequencies are grouped into quartiles.

For the purpose of comparison, the index was grouped into quartiles based on a reference population consisting of the All India NFHS-2(1999) data set. Table 3.6 shows that the first quintile (bottom 25 percent) represents the poorest group of the population and the fourth quintile (upper 25%) represents the wealthiest.

Table 3.6: Standard of Living Index of clients

Standard of Living	Frequency	Percentage
Poor	45	30.2
Lower Middle	31	20.8
Upper Middle	54	36.2
High	19	12.8
Total	149	100.0

Source: Primary Survey Data, 2013

Among the 149 clients, only 12.8 percent can be considered wealthiest and 36% of the total clients fell in the 3rd quartile. But the notable thing is that 56% of the clients are people with average and moderate standard of living. Thus in the surveyed sample most of the clients have a moderate/adequate living condition. Even though most of the clients have average living standards, 30% of the clients are in the first quartile. The table 3.6 makes it clear that most of the surveyed MFI clients have either poor or moderate living standards and the clients with high living standards are less in number.

The socio-economic profile of the clients gives an idea about the surveyed MFI clients across the state. The major objective of this chapter is to check the existence of mission drift, therefore, the division of clients based on income and standard of living can help in analyzing it by checking the average loan size of different groups (based on income and standard of living).In addition to this analysis, we can check the existence of multiple borrowing as a proxy of 'mission drift'. In the next section the existence of mission drift is analysed using the variable average loan size. In spite of criticism, it still remains as a major tool for the analysis.

3.5. Average Loan size

A mere increase in the average loan size cannot be considered as a reason for the mission drift from not-for profit microfinance to for-profit microfinance. But if we consider the average loan size of APL and BPL household separately, then the shift in mission can be shown clearly. Another variable which can explain the mission drift is average loan size in terms of standard of living of the people. Based on the survey data, the clients are separated into two categories as seen in the above section.

- APL/BPL
- Standard of living (Based on a standard of living Index)

Here Average Loan Size of a client means the total MFI loan amount in his life divided by the number of loans.

Average Loan Size of a client = Total MF Loan Amount / Number of Loans

In this study we have clients who in general availed more than three MFI loans in their life time. The chance of discrimination arises when their average loan size is low compared to other clients when all clients demand for higher loan. If a client who faces this kind of discrimination is a poor client (based on both income and standard of living) then we can clearly says that the MFI has drifted from their main mission (Cull et al, 2007). Therefore this study also has followed the same theoretical background by analyzing the average loan size of the clients.

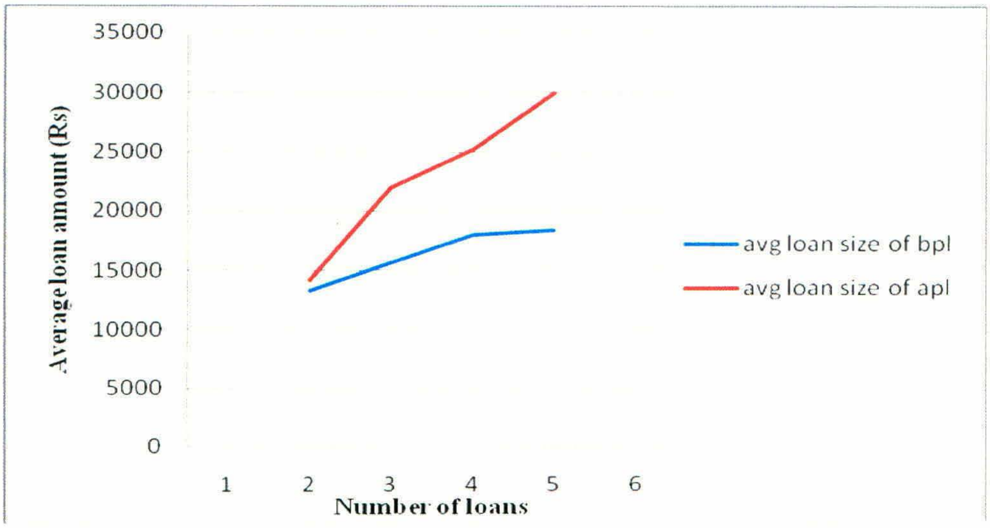
3.5.1. Average loan size of APL and BPL customers

The major aim of all three leading MFIs in the state is the upliftment of poor households in the state. If they want to succeed in their mission they should be able to provide adequate financial support for the poor people and if they fail to do so, then we can consider it as a drift from their original mission. In order to analyze the financial support provided for the poor people, the study has used the average loan size of poor people as the indicator. As mentioned earlier, it is difficult to get correct information about the earnings of the household; we decide to divide clients based on poverty. The most commonly used tool to separate poor and non-poor in the country is poverty line. The information about the clients' poverty line status has been collected from the survey. By distinguishing the average loan size of poor and non-poor, we can separate out the financial support provided by the MFIs in Kerala over the years.

In our sample of 149 clients, 101 were people above poverty line and 48 were below poverty line. Most of our customers were 4th generation customers. So we can calculate the average loan size of APL and BPL customers, who have taken at least four microfinance loans. The major problem with this kind of separation is the drawbacks in the Poverty line estimation.

The Figure 3.1 shows the average loan size of clients in different loan cycles. It means the 'average loan size' of clients in the first loan cycle followed by second, third and fourth. The data shows that the average loan size of the poor people is way behind that of others .The first set of loan amount looks same for both APL and BPL and after the first cycle the average loan size of APL people shoots up. Even though the average loan size of BPL is increasing, the rate of increase in the case of APL clients is very high. In case of fourth generation loans, the average loan size of BPL people stay constant.

Figure 3.1: Average Loan Size of APL and BPL clients



Source: Primary Survey (2013)

The figure 3.1 confirms that as the number of loans increases average loan size of non-poor is increasing at a much faster rate than that of poor. So there is a clear preference for the APL clients in the microfinance loan market in the state although 90% of the clients demands higher loan amount as the number of loan increases. This result shows a clear case of discrimination by the MFIs in the state as the business expands and more evidence can be shown by dividing the average loan size of each client into different quartiles.

A cross tabulation[1] between the average loan amount in different quartiles to the poverty line will help to explain the discrimination more clearly.

Table 3.7: Average Loan Amount Quartile

Quartile	Average Loan Amount (Rs)
1	7500-10000
2	10000-12500
3	12500-15000
4	Equal to or above 15000

Table: 3.7 shows the different average loan amount quartiles. The average loan size of each client vary from 7500 to 20000.To check the mission drift, we can find the percentage of APL and BPL clients in the different quartiles.

Table 3.8: Poverty Status Vs Average loan amount

			Average Loan Size (Quartiles)				Total
			Q_1	Q_2	Q_3	Q_4	
PL	APL	Number	21	19	29	32	101
		Percentage	20.80	18.80	**28.70**	**31.70**	100
	BPL	Number	20	14	7	7	48
		Percentage	41.70	29.20	**14.60**	**14.60**	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided)
Pearson Chi-square	13.051	3	0.005
Cramer's V^2	0.296	3	0.005

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- ≥Rs.15000

Source: Own calculation from Primary Survey Data (2013)

[1] Cross tabulation is a statistical process that summerises categorical data to create a contingency table. It provides a basic picture of the interrelation between two variables and can help in finding the interaction between them.

The table 3.8 reveals the percentage of APL/BPL clients in different quartiles. Among 101 APL clients, 31.7 percent of clients are in the fourth quartile and 28.7% in the third quartile. It implies that 60.4% of APL clients among the total APL clients have high average loan size. But 70.9% of the BPL clients among 48 clients are in the first and second quartile, that means average loan size of 70.9% customers are low (below 12500). All 149 clients have taken four or more loans from MFIs over the years. So a low average loan size for the Below Poverty Line clients means that MFIs in the state do not want to give higher loan amount for them in the long run. But the average loan size of clients above poverty line remains high even after four loan cycles.

The statistical test used here to check the relationship between two variables is Chi-square test. The chi-square test measures the discrepancy between the observed cell counts and what would be expected if the rows and columns were unrelated. If two-sided asymptotic significance of the chi-square statistic is much lesser than 0.05, then we can say that the poverty status and average loan size are not independent and there is a relationship exists between two variables.

From the above, it is clear that MFIs show discrimination towards the poor clients and that is a clear shift from the basic mission of 'poverty eradication'. This result shown above indicates that MFIs in the State are drifting from their basic mission. Now an analysis based on another indicator called 'standard of living of the people' (SLI) will help us to understand more about the 'mission drift' phenomenon in the state.

3.5.2. Average loan size based on SLI

This indicator is used to analyse whether MFIs in the state discriminate the clients based on their standard of living. Standard of living of the people includes the factors such as income, quality and availability of employment, class disparity and poverty and so on. Here standard of living can be used as a proxy of poverty. It implies that people with high standard of living can be considered as well off people/non-poor/credit worthy and vice versa.

A standard of living index has already been constructed and the clients have been divided into four quartiles based on the standard of living of the clients (refer table 3.5).The average loan size of the people can be divided based on the SLI of the households. If households with poor/moderate SLI have low average loan size when compared to the households with high SLI, then there is a possibility of mission drift. At the same time, if we fail to find sufficient difference between the average loan sizes of two groups, then we have to give up the assumption of 'mission drift' in microfinance based on standard of living of the people.

We can check the possibility of mission drift based on standard of living from the cross tabulated table below. The cross tabulation has been done from the survey data of 149 samples across the state.

Table 3.9: Average Loan Size of each customer Vs Standard of Living Index

SLI (Quartiles)			Average Loan Size (Quartiles)				Total
			Q_1	Q_2	Q_3	Q_4	
SLI (Quartiles)	1	Number	26	8	6	5	45
		Percentage	57.80	17.80	**13.30**	**11.10**	100
	2	Number	5	13	6	7	31
		Percentage	16.10	41.90	**19.40**	**22.60**	100
	3	Number	8	10	18	18	54
		Percentage	14.80	18.50	**33.30**	**33.30**	100
	4	Number	2	2	6	9	19
		Percentage	10.50	10.50	**31.60**	**47.40**	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided
Pearson Chi-square	42.109	9	0
Cramer's V	0.307	9	0

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- ≥Rs. 15000

Source: Own calculation from Primary Survey Data (2013)

The Table 3.9 presents the cross tabulation between SLI and average loan size of clients and it shows that 75.6% of clients with poor standard of living lie in the first and second quartile and 58% of the clients with moderate standard of living lie in the first and second quartile of average loan size quartiles. Another interesting result is that 66.6% of clients with average standard of living lie in the third and fourth quartiles and 79% of the clients with high standard of living lie in the third and forth quartiles. So it is understandable that clients with lower standard of living is not getting higher amount of loan as the loan cycle increases and the loan amount of those clients with high standard of living are increasing as the loan size increases.

The chi-square test result shows that the two variables are not independent and the null of 'no relationship' can be rejected here. It tells us that SLI and average loan size of the clients are not independent.

Even though all the clients demand higher loans, the MFIs discriminate their clients based on different criteria and standard of living is one among them. However most of the people with poor standard of living are able to access only a small amount of microfinance loan in the state and MFI prefers to give higher loans to people with better standard of living. I.e., disbursing higher loans to rich people will ensure the repayment more than poor people and higher loans will reduce their transaction cost also. So in long-run, these MFIs will drift their mission of poverty reduction to profit making.

These are the two methods of measuring 'mission drift' other than the highly criticized method of direct average loan size calculation. Another indicator which we can rely upon is multiple borrowing.

3.6. Multiple Borrowing as an Indicator of 'Mission Drift'

Multiple borrowing/lending (otherwise known as 'ponzi financing') is considered to be a major feature of for-profit MFIs in India (Sriram, 2010)[3]. It means lending from more than one MFI at same time. Some studies indicate that multiple borrowing has a positive effect on loan repayment and sustainability of MFIs while others show that it leads to over indebtedness and consequently default on loan (Mpogole et al, 2012). Empirical evidences on the effect of multiple borrowing on clients and the MFIs are contradictory. Some studies find that multiple borrowing has a positive effect on loan repayment and sustainability of MFIs (Krishnaswamy, 2007) while others, for example, Chaudhury et al. (2001), Rhyne (2001), Johnson (2004), and Wisniwski (2010) show the opposite. Krishnaswamy (2007)

[3] Refer Malegam Committee report (2011)

reports that multiple borrowers have been found to have equal or better repayment records than their single borrowing peers in the same villages. Contrary to Krishnaswamy (2007), a number of incidences of failure to repay because of multiple borrowing have been reported. For example, Chaudhury et al. (2001) find that there have been an increasing number of households in Bangladesh that took multiple loans from different MFIs and that their repayment rate was declining. It was found that multiple borrowers had increasingly high debt levels and repayment obligations, which they frequently could not fulfill because of over-indebtedness. For instance, Wisniwski (2010) finds a correlation between over-indebtedness as measured by number of credit contracts and risk of default as measured by over 30 day unpaid loans. Individuals with more credit contracts were at a higher risk of defaulting.

Johnson (2004) mentioned that encouraging borrowers for multiple borrowing is the result of commercialization of microfinance all over the world. After the AP incident, the RBI has actually prevented the multiple lending in microfinance activities in India (RBI, 2012) and the proposed microfinance bill of 2011[4] also made a clause against the multiple borrowing. Since it will increase the indebtedness of clients, especially poor people in the long run (Ghosh, 2013).But the MFIs are still deliberately encouraging multiple lending to ensure the repayment of their loans. In the long run, the amount of loan will increase, then they may not be able to repay the loans properly and that will increase the indebtedness.

In Kerala the MFI system is fast growing, but still in an infant stage. So the existence of multiple borrowing will become an evil in the long-run. A study by Oommen (2007) has mentioned about the threat of multiple lending in the state. According to him, there is a mushrooming of microfinance outfits organised by communal outfits, NGOs, and individuals which provide micro credit, mobilise savings and provide linkage banking. Such fragmentations of the poor and parallel organisations can pose serious threat to the healthy

[4] The microfinance institutions (development and regulation) Bill 2011, proposed by Malegam Committee, is a bill to provide access to financial services for the rural and urban poor and certain disadvantaged sections of the people by promoting the growth and development of microfinance institutions as extended arms of the banks and financial institutions and for the regulation of microfinance institutions and for matters connected therewith and incidental thereto. The bill has tabled in 2011 and yet to be passed in the parliament

progress of state-run microfinance institution (Kudumbasree).This threat is still valid in case of Kerala and rather than disturbing the growth of Kudumbasree it can pose serious threat to the poor people by pushing them into huge indebtedness in the long-run.

This deliberate action by MFIs to increase their profit by ensuring repayment can be considered as a shift from their original mission of poverty reduction and upliftment of poor. We can analyze the intensity of multiple borrowing in Kerala with the help of survey data. The survey revealed that the MFI clients are simultaneously borrowing from maximum three MFIs in Kerala and most of them have other kind of debts like gold loan, bank loan etc.

Table 3.10: Multiple lending

Number of MFIs	Number of clients	Percentage
1	75	50.3
2	59	39.6
3	15	10.1
Total	149	100

Source: Own calculation from Primary survey data (2013)

The result from frequency table 3.10 tells that almost half of the respondents are single borrowers, but on the other hand 39.6% of the borrowers have borrowed from two MFIs and 10.1% clients from three MFIs. Almost half of the respondents are actively participating in multiple borrowing from MFIs in the state. Among the multiple borrowers 10.1% clients currently borrow from three sources. If they go on like this for another three years, then they will be in severe indebtedness[5]. The impact of multiple borrowing on mission drift can be explained with more clearly by understanding the standard of living of those clients. The following cross tabulation with multiple borrowing and the already calculated Standard of living will make the story clearer.

[5] Refer Wisniwski (2010), Johnson(2004)

Table 3.11: Cross tabulation between SLI and Multiple Borrowing

			Multiple borrowing			Total
			1	2	3	
SLI (Quartiles)	Q_1	Number	17	22	6	45
		Percentage	**37.80**	**48.90**	13.30	100
	Q_2	Number	11	16	4	31
		Percentage	35.50	51.60	12.90	100
	Q_3	Number	37	14	3	54
		Percentage	68.50	25.90	5.60	100
	Q_4	Number	10	7	2	19
		Percentage	52.60	36.90	10.50	100
Total		Number	75	59	15	149
		Percentage	50.30	39.60	10.10	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided)
Pearson Chi-square	11.88	6	0.065
Cramer's V	0.2	6	0.065

Note: Q_1- Poor, Q_2- Lower middle, Q_3- Upper middle, Q_4- High
Source: Own calculation from primary survey data (2013)

The Table 3.11 tells us that poor people are borrowing from multiple MFIs more than the rich people, i.e., 62.2% clients with poor SLI borrow from more than MFI, but only 47.4% clients with high SLI borrow from more than one MFI at a time. When we check the case of clients with moderate and average SLI, the picture becomes clearer. Among the clients with moderate SLI, 64.5% of them are active in multiple borrowing. But among clients with average SLI, only 31.5% of the clients are active in borrowing from different sources. It is evident from the table that people with low standard of living (poor clients) are more active in multiple borrowing compared to people with middle standard of living and that can surely pull them to high indebtedness in the long run. In other words, allowing poor people to do multiple borrowing is a strategy by the MFIs to make profit by ensuring repayment. When they fail to repay an MFI loan on time, they would go for another loan from a different MFI to repay the loan. So allowing poor people to borrow from multiple MFIs is clear drift from the mission of poverty reduction. Instead of reducing poverty this can make the poor more vulnerable to credit in the long run.

The last chapter has concluded that the development of for-profit MFI sector in the state is fast and widespread. The major objective of this section of the thesis is to find evidence of mission drift in Kerala MFI sector from the primary survey. From the literature, we have identified three variables to analyze the mission drift of MFIs in Kerala. They are average loan size of APL and BPL clients, average loan size based a standard of living index and existence of multiple borrowing. These three variables have confirmed a change from the basic mission of poverty reduction to profit making and the change in target group from poorest section of the society to people with an average or above average standard of living or income.

3.7 Summary

The major point of discussion in this chapter is 'mission drift' of for-profit MFIs in a state like Kerala where the formal financial system and state run microfinance institutions are strong. With the help of available literature on mission drift, we are able to portray the major indicators of mission drift and its flows. However, we have identified three main variables with help of literature to explain the existence of mission drift in the state. From the survey data, the existence of mission drift and the reasons for the drift were found out. All three variables have showed that the target population of MFIs have changed from poor to rich (average and above average clients based on income and standard of living) and they are making profit by exploiting the poorest section of the society.

The major reason for this 'drift from mission is the profit motive of the private MFI business in the state. Although all the clients demand for higher loan amount as the loan cycle increases, the MFI prefers to disburse higher loan amount only based on credit-worthiness. From the result it is clear that other than collateral, the standard of living, poverty line etc are the major indicators of credit-worthiness. They do not encourage loan default from any kind of clients. Hence they allow clients to borrow from multiple sources and most of the high-risky customers (especially poor or collateral less people) are into multiple borrowing in the state. We do not have any right to prevent MFIs doing business in the state/country, but what worries us most is the exploitation and huge profit making of MFIs. The MFIs are receiving large amount of foreign aid and low-interest loans from the commercial bank only because of their 'poverty reduction mission'. But their mission and the result from the survey are highly contradictory .i.e. the MFIs are not able to serve the poor in the long run, but they claim as 'an institution which helps the state in poverty eradication'. So it would be really difficult for a for-profit microfinance institution to meet their major objective of poverty reduction and profit making together. In other words we can say that the cost of avoiding any credit risk is the 'mission drift'.

In Kerala, the client's awareness about the group lending system helps the MFI to approach the clients faster compared to other regions. The factors behind the growth and the role of group lending in for–profit MFI business in the state shall be discussed in detail in the next chapter.

The exploitation by MFIs may pull down the poor in the state to more trouble in the future. But as a relatively new business, the drift from 'poverty-reduction' to 'profit-oriented business' has not received much attention in the state. It is the duty of state and central governments to regulate and monitor the activities of for-profit microfinance business in the state.

Chapter 4

Features of Group Lending in Kerala: A case of for-profit MFIs in the state

4.1. Introduction

Microfinance is typically associated with group lending. Group liability is often mentioned as a key innovation responsible for the expansion of access to credit for the poor in developing countries (Morduch 1999; Armendariz de Aghion and Morduch 2005). The role of group lending in transforming microfinance from a poverty reduction policy to a profitable business is very important. When clients create groups and are held liable for each other, lending to the poor can be profitable even if borrowers lack a credit history and do not possess any collateral (Lehner, 2009). A good, well monitored group has been the feature of commercial MFI's all over the world. There are different group lending models practiced all over the world. But creation and successful operation of group is the most difficult job for the microfinance institutions in the world.

There are numerous theoretical papers which addressed the positive effects of group lending in microfinance and how the microfinance business overcame the hurdles like 'information asymmetry' and 'adverse selection' in a rural credit market. However the most important thing in microfinance is the 'Group'. As mentioned in the earlier chapters, most of the leading microfinance firms in the world are following Joint Liability Group (JLG) Models[1]. In this business, the investor's major worry is default of the microfinance loans and it can happen mainly because of the presence of some group members who always default their loans. In microfinance literature the presence of defaulters in an MFI group is the result of Adverse Selection[2] (Stiglitz, 1990; Armendariz and Gollier, 2000). The adverse selection of

[1] Refer The Economic Journal vol.117 Issue 517 (2007) for more information about joint lending and related aspects.

[2] The adverse selection problem occurs when lenders cannot distinguish inherently risky borrowers from safer borrowers. If lenders could distinguish by risk type, they could charge different interest rates to different types of borrowers. But with poor information, options are limited. See Chapter four ' Economics of microfinance', MIT press

clients can lead to moral hazard[3] which will further worsen the repayment of loans. (Van Tassel, 1999) argued that the adverse selection problem in microfinance group lending can be reduced by introducing the self-selection of clients based on local knowledge. It shows that the formation of group in microfinance is the most important thing and the dynamics inside a group determines the repayment of loan.

Ghatak and Guinnane (1990) and Ghatak (2000) confirm that joint liability group lending activities accomplish self-selection of clients and operate as a screening mechanism. So the microfinance institution can easily ensure repayment of their loans. Self-selection means institutions allow the clients to select their own group members and they will only select less-risky and trustworthy fellow members. In other words self-selection allows for risk diversification between group members (Sadoulet, 2000). It benefits both lender and the borrower. This will enhance the repayment and avoid the threat of moral hazard. Self-selection only cannot avoid the threat of defaulting, but it is only an initial step to an ideal group situation. A proper peer monitoring will help self-selected clients to ensure repayment among them. A strong peer monitoring mechanism helps in solving the enforcement problem through peer monitoring. Stiglitz (1990) and Varian (1990) indicated the role of peer monitoring in group lending activities, which transfers the role of monitoring from the financial institution to the clients and work as an effective incentive system. The methods used to monitor the members in a group differ in different MFIs and region. Armendariz (1991) pointed out that if the credit risks are positively correlated among the joint liability group members, then the benefits from peer monitoring would be very high. The MFIs use different methods like weekly or daily meetings, classes, personal training etc to ensure the trust and proper repayment.

The advantages of group lending attracted the commercial MFIs also. They have used the group lending by entertaining the self-selection and peer monitoring in ensuring full repayment. But the collapse of commercial microfinance business in some part of the world made MFIs to change or modify their strategy. The major reason for the collapse of MFI

[3] Moral Hazard is a situation in which one party gets involved in a risky event knowing that it is protected against the risk and the other party will incur the cost. Important papers on group lending with moral hazard include those by Stiglitz (1990) Besley and Coate (1995) and Armendariz de Aghion (1999)

business in the end of the 20th century is 'high default' even among trustworthy clients and it is generally regarded as the failure of group lending mechanism, especially self-selection mechanism. However the 21st century MFIs realized the importance of client selection in the microfinance after the widespread default by clients in the early phase of microfinance. Although the MFIs follow the group lending methodology these days, they do not follow a complete self-selection of group members. Instead, they strictly monitor the group formation and client selection. The selection of client depends upon certain factors which ensure the repayment of loan rather than the identity of being 'poor'.

In India, the group lending methodology in microfinance became prominent in the late 1990's. Even before National Bank for Agriculture and Rural Development (NABARD) implemented its pilot programme SHG Banking linkage programme (SBLP)[4] in 1992; there were few practical models available in the country, like the Myrada, Pradan[5] models in south India which actually followed the group lending methodology in the 1980s with good effect. Then the NABARD'S SHG-bank Linkage Programme has expanded at a fast pace in India to evolve into the largest microfinance programme in the world. By far it is the major microfinance programme in India. However, there are also microfinance institutions (MFIs) operating in the country following a variety of saving and credit technologies (Satheesh, 2005).These different microfinance groups are differentiated on the basis of the different group lending models. Most of the Non- Governmental Organisation's (NGO), NABARD's SHG-banking linkage programme and other state run projects follow the traditional SHG model. But the modern day commercial microfinance institutions in the country are following the Joint Liability group model (JLG) model. It is actually a mix of SHG model and Grameen model. The major difference with the SHG model is that there is a strong monitoring mechanism compared to other model, which would ensure complete repayment of loans. However the MFIs in the country have even made some changes in the JLG model according to different regions of the country.

[4] Self Help Group- Banking Linkage Programme- See section 2.1 of chapter 2.

[5] Pradan and Myrada are group lending models introduced in India even before the SBL programme launched. Refer Satheesh (2005),Mainstreaming Indian Microfinance, EPW

One of the major success stories in Indian microfinance is from Kerala. The state sponsored poverty alleviation programme called Kudumbasree is the major force behind the spread of group lending in Kerala (Ajith et al, 2006). "The *Kudumbasree* of Kerala launched in May 1998 but effectively implemented from early 2000 does not seem to follow any of the existing models though its economic base is patterned on the SHG-based micro finance system" (Oomen, 2007: 4). Kudumbasree began the activities in the state by making Self help group among the poor women to make them empower enough to save their family from threat of poverty. The idea of group lending was less known to most of the people in Kerala. As many NGOs did in other state Kudumbasree acted as an intermediary in the NABARD's SBL programme and almost all the Kudumbasree NHG/SHGs has high repayments rates for the microfinance loans (Ajith et al. 2006).A Kudumbasree group is a slightly modified version of the SHG system in the country (See section 2.2.1). But the lack of monitoring and high default rate the in the recent period remain as a major concern.

As we have seen all over the country, the private microfinance institutions started its operation in Kerala in 2006.They have not followed the SHG model of microfinance lending, instead of that they followed the Joint Liability group model (refer 2.2.2).The other chapters show that the performance and repayment of commercial MFIs in the state is improving over the years. It is clear that the MFIs in the state achieved this success by managing the Joint liability groups by avoiding the adverse selection and moral hazard issues. So it is interesting to know the method and features of for-profit MFI's group lending in the state. There are enormous literature on the operations and success of Kudumbasree groups in the state. But there is no such study which explores the features and dynamics of group lending by the commercial MFIs in the state. Next section explains the features of MFI group lending in the state.

4.2. Mitigating Adverse Selection and Moral Hazard in a Joint Liability Group

There are several methodologies to solve the adverse selection and moral hazard problems in a Joint Liability Group. These problems are arise due to the persisting 'information asymmetry' in the rural informal credit market. Microfinance has considered as an answer to these imperfect information in the rural credit market. The prime concern for a lender in rural credit market is the 'risk' associated with the lending. According to the promoters of microfinance, group lending is an answer to these questions.

The typical argument on risk in borrowing involves asymmetric information including adverse selection, moral hazard and difficulties in monitoring (Dacheva and Gotwalt, 2009).Adverse selection problem in a group setting arises when the borrower does not have an idea about the quality (good or bad) of his project. This lack of understanding of borrower about his own project has led to ex-ante moral hazard problem. Even if the borrower has an understanding about his project and that helps him to succeed, there is a chance of not repaying the loan amount. This dilemma is known as ex-post moral hazard problem (Armendariz and Morduch, 2005). Regular monitoring is the only solution to these problems, but this is expensive and not practical for the small scale loans.

Although the group lending activities are very much diversified across the developing world, the most important aspect of any group lending is the careful management of group pressure to ensure repayment of groups. The MFI's do not give loan to a group until they pay back all their debt. If a member in a group failed to repay the debt, then the entire group has to bear the burden. This strategy by MFIs always creates a 'peer pressure' among the members in a group. In other words, the potential borrowers can use their information to find their best match. This would help the borrower to separate risky and safe borrowers and the safe borrowers form a 'safe group' and risky borrowers identify themselves and form a 'risky group'[6]. Thus, the adverse selection problem is alleviated without the financial institution getting information.

Regarding moral hazard, Stiglitz (1990) set out an ex ante moral hazard approach to group lending. According to him, the group lending contracts circumvents ex-ante moral hazard by inducing borrowers to monitor each others' choice of projects and inflict penalties upon borrowers who have chooses excessively risky projects. In other words, MFI just needs to exploit the local information available with the clients. The members in a joint liability group should directly or indirectly participate in implementing the projects in a group to

[6] Formation of risky and safe groups by borrowers called in labour economics as 'positive assortative matching'. Refer Ghatak(1999)

ensure the repayment. The ex ante moral hazard can be removed by using these measures (Ashta, 2007). Moreover, these group activities can act as a moral pressure on the borrower to repay the loan amount. All these group dynamics ensure that the asymmetric information problem is alleviated.

The ex- post moral hazard issue which occurs after the production is over. The borrowers may now be tempted to get away with the revenue without repaying the loan. The traditional individual lending cannot solve this problem[7]. But a strong peer monitoring in a group can solve ex-post moral hazard. Another advantage of group lending which solves the 'ex post moral hazard problem' is the frequent repayment. The frequent repayment mechanism by MFIs (normally once in a week) prevents the clients from using their income for other purposes. This method also contributes to alleviate the ex-post moral hazard problem.

So it is evident that the group lending can successfully answer the adverse selection and moral hazard in a rural informal credit market. Next section explains the features of for-profit group lending in Kerala based on this theoretical background.

4.3. Features of MFI Group Lending in Kerala

This section talks more specific about the successful group lending practice by the for-profit MFIs in the state with the help of the primary survey conducted. There are eleven major for-profit MFIs operating in Kerala [8](Sadhan, 2014). Among them ten are following Joint Liability Group(JLG) model and the only exception is Evangelical Social Action Forum (ESAF).They follow SHG model group lending, but MIX MARKET data shows that the cost per loan in ESAF is increasing over the years. So they cannot stay away from strong monitoring measures and their model no longer can be called a pure SHG model. Most of the features of the for-profit group lending in Kerala is exactly similar to a Joint Liability Group Lending. They have modified the activities in the group to ensure the repayment of loans by completely wiping out the 'problem of Asymmetric Information'.

[7] Refer Besley and Coate (1995) and Armendariz De Aghion(1999).These studies talks about the optimal lending contracts in the case of moral hazard.

[8] See www.sa-dhan.net

In each group the number of clients varies from ten to fifteen and *all the clients are women*. The post-AP MFIs realized the repayment ability of the women and they have completely withdrawn from providing group loans for men (Sriram, 2010). Kudumbasree also focuses on women only and we can generally say that the microfinance in the state is mainly aiming the women in the state.

The lending mechanism of MFI groups in Kerala is completely different from the SBLP model. Unlike SBLP, the JL groups run by MFIs are seeking weekly repayment of their loans. But the SBLP and other commercial bank's microfinance loans seek monthly repayment from clients. The minimum gestation period for repaying a loan is one year, which is much lower than SBLP and higher than the indigenous money lenders. In 2006, the minimum microfinance loan amount in JLG was Rs.5000. Now the minimum amount is Rs.10000 and the maximum amount is Rs.50000 (Muthoot, 2013). The interest rates for these loans vary according to the loan amount. They charge high interest rate for large amounts and low interest rate for small amounts.

The major feature of SHG group lending is 'thrift creation' or 'savings generation'. But for-profit MFI cannot collect money from clients as saving or deposits (RBI, 2012).So any kind of official thrift creation is absent in this group lending. But there exists several informal savings programme run by the clients themselves to enhance the repayment of their loan.

As we discussed in the last chapter, the MFIs in the state allow multiple borrowing among the clients. The clients can apply for loan from more than one MFI (it can be a commercial MFI, SBLP or caste/politics based MFIs) at a time to meet their credit needs, even though RBI prevents it by law, the MFIs encourage multiple borrowing to ensure the repayment of loans.

Unlike the pre-AP incident MFIs in the country, the MFIs in the state hardly use any forceful repayment methods and they completely rely on the peer group pressure in repaying the loan. To enhance repayment MFIs introduced methods like 'door step delivery', collection of loan amount, fast loan sanctioning, less paper works etc. Moreover they are depending very much on the joint liability aspect in repaying the loan amount. According to

MIXMARKET data the MFIs in the state are enjoying 100 percent repayment of microfinance loans since 2010.It can be considered as the success of managing the joint liability groups in the state.

Another method to ensure the repayment of loans is selection of clients and group formation. As we discussed earlier in this chapter the MFIs use the group advantage as an effective way to tackle the information asymmetry and adverse selection. Due to the failure of AP-MFIs, the MFIs operating in Kerala have taken some other steps to tackle the adverse selection. Instead of allowing self selection of clients, the MFIs themselves select the clients based on certain factors. Earlier and in other SHG systems, the major criterions to satisfy are the unemployment, landlessness, income, poverty and so on. The clients in a group are selected mainly by the group members themselves. But the MFIs in the state strictly monitor the situation and do not allow complete self-selection of group members. The major criteria for the MFIs in the state is creditworthiness (concluded from last chapter).So they strictly monitor the client selection and group formation in the JL groups in the state and that is how they have achieved 100% repayment in the business. But an enquiry into the nature and factors of client selection and group formation has to be done. The next section talks about the client selection for the JLGs in Kerala and the factors which influence the MFIs in selecting a client.

4.4. Client Selection in a Joint Liability Group

As we discussed in the earlier chapters, there is a drift in mission of microfinance institutions in the state by serving more non-poor instead of the poor in the long run. Among the features of MFI lending in Kerala, the most notable one is high repayment and MFI's selection of clients completely depends upon the credit worthiness of the client. The advantages of group lending are mainly useful to collect information about the repayment capacity of the client. It will even reduce the 'information asymmetry' in a typical rural credit market. Once these MFIs become for-profit MFIs they quit the strategy of self-selecting the clients and they begin to initiate a strict monitoring mechanism within the group. So client-selection becomes an integral part of ensuring the repayment of MFI loans.

The selection of clients can be influenced by factors like standard of living of the clients, Income of the household, occupation, caste/religion, purpose of loan and collateral (Armendariz and Szafarz 2011; Christian 2000; Armendariz and Morduch 2010). This section analyses the influence of these factors in client selection with the help of primary. Average Loan size of each client can again be taken as a proxy for the selection of clients.i.e, a for-profit MFI aims at high profit and full repayment of loans. As we already saw the existence of mission drift in the state, those clients with high average loan size are considered as premium clients and most of them are not poor. Here high average loan size means high preference and low average loan size means less preference (Average loan size = preference, see section 3.5). So a cross tabulation between average loan size of each client and the variables mentioned above would give a clear picture about the factors which determines the selection of clients in this successful microfinance business in the state.

Among the variables, standard of living of clients is already discussed in detail. The other four factors, caste/religion, purpose of loan and collateral, occupation and household income can be analyzed here.

Table: 4.1 show the influence of caste in the client selection. It confirms that there is no clear influence of caste in the client selection. In detail, the MFIs preference to SC (Scheduled Caste), OBC (Other Backward Caste) and FC (Forward Caste) is almost same and all three social groups have almost equal representation in all four average loan size classes.

Table 4.1: Caste Vs Average Loan Size

			Average Loan Size (Quartiles)				Total
			Q_1	Q_2	Q_3	Q_4	
Caste	SC	Number	9	14	6	13	42
		Percentage	21.40	33.30	14.30	31.00	100
	OBC	Number	21	15	25	20	81
		Percentage	25.90	18.50	30.90	24.70	100
	FC	Number	11	4	5	6	26
		Percentage	42.30	15.40	19.20	23.10	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided
Pearson Chi-square	10.092	6	0.121
Cramer's V	0.184	6	0.121

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- ≥Rs.15000

Source: Own calculation from primary survey data (2013)

It is clear from the table that all three social groups have good representation in the high and average loan size classes. The chi-square test also has not shown a significant relationship between the two variables (P value is greater than 0.05).

A client Usha reported that *"We never felt a cast based discrimination from these MFIs and all they want is some people who are ready to repay their loan properly"*. So 'caste-based' discrimination and client selection are almost absent in the for-profit MF business in the state. Another interesting observation from the interview is that people are not that interested in borrowing from the caste based/political based MFIs in the state. We will discuss the reasons for that in the coming sections.

Table: 4.2 capture the influence of religion in the client selection with average loan size as the proxy. Like caste, religion also does not have an impact in the client selection. The chi-square and Cramer's V tests do not show any significant relationship.

Table 4.2: Religion Vs Average Loan Size

			Average loan (Quartiles)				Total
			Q_1	Q_2	Q_3	Q_4	
Religion	Christian	Number	7	10	2	6	25
		Percentage	28.00	40.00	8.00	24.00	100
	Hindu	Number	29	19	23	25	96
		Percentage	30.20	19.80	24.00	26.00	100
	Muslim	Number	5	4	11	8	28
		Percentage	17.90	14.30	39.30	28.60	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided)
Pearson Chi-square	11.286	6	0.181
Cramer's V	0.195	6	0.181

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- ≥Rs. 15000

Source: Own calculation from primary survey data (2013)

According to a top for-profit MFI official (he did not want to reveal his real name), *"most of the MFIs in Kerala began either as a cast or religion based organization and they* *concentrated on specific people in the initial period. Once the business spread and more players entered the frame, those MFIs also came out of their cast cover".*

That is the real picture of group lending in the state. It becomes a purely profit-oriented business and neither caste nor religion is a hindrance to avail microcredit. Now we can discuss the role of household income and collateral in the client selection in a group. Even though microfinance is for poor people who do not have collateral to access the formal banking system, clients with collateral have a huge advantage in the business (Aitken, 2013).The for-profit MFI business also follows that general conscience. Table 4.3 shows that MFIs give higher loan amount mostly to people who posses land.

Table 4.3: Land Vs Average loan Size

			Average loan				**Total**
			Q_1	**Q_2**	**Q_3**	**Q_4**	
Land	< 10 cents	Number	29	25	33	36	123
		Percentage	23.60	20.30	26.80	29.30	100
	No Land	Number	12	8	3	3	26
		Percentage	46.20	30.80	11.50	11.50	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided
Pearson Chi-square	9.687	3	0.021
Cramer's V	0.255	3	0.021

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- ≥Rs. 15000

Source: Own calculation from primary survey data (2013)

In the sample most of them are either landless or with land less than 10 cents. Those clients with less than 10 cents of land have an advantage over the clients with no land. About 56.1% of clients with land have either average or high average loan size. In case of landless clients only 23 percent of the total clients have average/high loan size. Therefore it is clear that availability of collateral is an important factor in the client selection. The two-sided asymptotic significance of the chi-square statistic is much lesser than 0.05.thus there is a significant relationship and both variables are not independent.

Table 4.4 explains the influence of another variable, i.e. household income in the selection of clients. The traditional and not-for profit MFIs target poor people (based on income and standard of living) as their major client. But the for-profit institutions are criticised widely for making it as a business for middle income people (or not so poor) (Hulme, 2000).The major reason for that is the credit-worthiness. They consider information about income is of much value to avoid the adverse selection problem in the joint liability groups. So people with better income always gets higher credit as the loan cycle goes up. An active client Radha from Palakkad reported that "*the client was very active in the business from 2005 to 2010. In 2010 her husband passed away in an accident since then the MFI officials was skeptical about her repayment and they reduced the loan amount from Rs.25000 to RS.10000 in 2011. She lost her membership in the group in 2012 when the MFI rearranged the group*". In her case, when income halved due to the death of her husband, the MFI avoided any case of moral hazard or default by cutting down her loan amount initially and then by removing her from the group. Hence household income has a major role to play in the client selection.

Table 4.4: Income Class Vs Average loan Size

			Average loan Size (Quartiles)				**Total**
			Q1	**Q2**	**Q3**	**Q4**	
Income Class	1	Number	17	10	4	7	38
		Percentage	44.70	26.30	10.50	18.40	100
	2	Number	17	11	7	8	43
		Percentage	39.50	25.60	16.30	18.60	100
	3	Number	4	7	14	10	35
		Percentage	11.40	20.00	40.00	28.60	100
	4	Number	3	5	11	14	33
		Percentage	9.10	15.20	33.30	42.40	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided
Pearson Chi-square	29.078	9	0.001
Cramer's V	0.255	9	0.001

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- ≥Rs. 15000

Source: Own calculation from primary survey data (2013)

Table 4.4 also tells the same story. The average loan size of clients in the lower income level is very less compared to clients in the upper income level. Among the client with low household income, only 28.90 percent are having a high average loan size. But 75.70% of the clients with high household income have high average loan size. The difference is clear and the chi-square test also shows the existence of a relationship between the two variables. So the primary data also confirms a role of household income in deciding the membership in joint liability group run by for-profit MFIs in the state.

Table 4.5: occupation Vs Average loan Cross size

			Average loan				**Total**
			Q_1	**Q_2**	**Q_3**	**Q_4**	
occupation	Household duty	Number	25	14	18	20	77
		Percentage	32.50	18.20	23.40	26.00	100
	agriculture	Number	1	0	1	1	3
		Percentage	33.30	0.00	33.30	33.30	100
	petty trade	Number	1	3	1	3	8
		Percentage	12.50	37.50	12.50	37.50	100
	Household industry	Number	6	1	6	2	15
		Percentage	40.00	6.70	40.00	13.30	100
	domestic labour	Number	2	1	0	3	6
		Percentage	33.30	16.70	0.00	50.00	100
	service	Number	0	8	2	6	16
		Percentage	0.00	50.00	12.50	37.50	100
	any other casual labour	Number	2	1	0	4	7
		Percentage	28.60	14.30	0.00	57.10	100
	public sector	Number	3	3	3	0	9
		Percentage	33.30	33.30	33.30	0.00	100
	others	Number	1	2	5	0	8
		Percentage	12.50	25.00	62.50	0.00	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided
Pearson Chi-square	10.579	24	0.134
Cramer's V	0.156	24	0.134

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- ≥Rs. 15000

Source: Own calculation from primary survey data (2013)

The other important variable mentioned in the literature is occupation of the client (see table 4.5). The nature of occupation of a client considered as one most important variable in deciding the credit worthiness of the client. It is similar in both formal and informal credit markets. Here we examine whether the nature of occupation of the client does have any influence on his membership in a joint liability group.

A collection agent Vishnu (not the real name) reported that "*the senior officials insisted the loan officers to make clear idea about client's income (income sources) .If a client earns 600 rupees from casual labour, and then give her more preference than a nurse who earns 250 rupees per month from a private hospital*".

The table 4.5 shows that there is no clear relationship between the variables and the clients with different occupations have similar distribution of average loan size. So MFIs in the state do not consider the nature of occupation in giving membership in a joint liability group. The two-sided asymptotic significance of chi-square statistic is greater than 0.05.

Table 4.6: Purpose of MFI loans Vs Average loan Size

			Average loan Size (Quartiles)				Total
			Q_1	Q_2	Q_3	Q_4	
purpose of MFI loans	domestic	Number	30	28	25	31	114
		Percentage	26.30	24.60	21.90	27.20	100
	marriage	Number	2	1	1	3	7
		Percentage	28.60	14.30	14.30	42.90	100
	agriculture and animal husbandry	Number	0	0	1	2	3
		percentage	0.00	0.00	33.30	66.70	100
	business	Number	6	3	6	1	16
		Percentage	37.50	18.80	37.50	6.20	100
	business of spouse	Number	3	1	3	2	9
		Percentage	33.30	11.10	33.30	22.20	100
Total		Number	41	33	36	39	149
		Percentage	27.50	22.10	24.20	26.20	100

	Value	Degrees of Freedom	Asymp. Sig. (2-sided
Pearson Chi-square	10.579	12	0.565
Cramer's V	0.154	12	0.565

Note: Q_1- Rs.7500-10000, Q_2- Rs. 10000-12500, Q_3- Rs. 12500-15000, Q_4- >= Rs. 15000

Source: Own calculation from primary survey data (2013)

The purpose of an MFI loan is the most discussed topic among academicians and policy makers. There are successful MFI model which lend money for productive purposes (See section 2.1).But after the commercialization for microfinance the purpose of taking an MFI loan remains a concern. In kerala, Kudumbasree can claim success in lending money for productive activities and lot of poor women became self employed with the help of the SBLP-SHG (Kudumbasree) initiative in Kerala. But the for-profit MFI cannot claim a success like that till date. They encourage mostly credit for consumption purposes. Table:4.6 enquire the influence of 'purpose of loan' in the selection of clients in a for-profit MFI. Most of them have borrowed money for domestic/consumption purposes. But MFIs do not show any preference based on the intention of client. They spent money for consumption, marriage, agriculture and business of spouse. But the average loan size does not show any specific inclination for a group of clients. The chi-square statistic also tells that both variables are independent. Thus it is clear from the data that the MFIs do not worry about the purpose of loan and that will not affect the selection of client in a joint liability group.
RBI (2012) strictly pointed out that the MFIs should have an idea about the purpose of borrowing to reduce the default.

But Sunil, an MFI official, said *that "we know all of them are borrowing money for buying things, marriage, repay debt etc, but we are told to look only into the credit-worthiness of the client"*. Another client, Sulochana from Ernakulum reported *that "they brought a form every time when we apply for loan. There is a space to write the purpose of loan. We all write either to start animal husbandry, agriculture, tailoring etc. Both the officials and clients know that the information is wrong"*.

These statements tell us the real nature of lending and the selection of clients has nothing to do with the purpose of loan borrowed. Among the variables analysed only two variables have shown a significant relationship with the client selection. They are 'income of household' and 'availability of collateral'. Rest of the variables including cast, religion, occupation and purpose of loan do not influence the client selection for a for-profit MFI in the state. Both the variables which have an influence on the client's selection are the indicators of credit-worthiness. As a result the client selection of for-profit MFIs is completely depending upon the repayment ability. The MFI avoided self-selection of clients in JL group to carefully escape from adverse selection problems and they select only credit-worthy customers as long run clients.

Another important methodology adopted by the MFIs all over the world to reduce the 'information asymmetry' is careful group formation and peer monitoring. That has been the feature of Joint liability lending all over the world and this strong monitoring separates the operation of SHG and JLG model in India. It is same with the MFIs in Kerala also. Next section talks in detail about the group formation and peer monitoring techniques in for-profit lending in the state.

4.5. Group Formation and Peer Monitoring

A good, properly working Joint Liability Group is an important feature of for-profit microfinance business. Joint liability allows lenders to extract high repayment rates even when households are not able to offer any traditional form of collateral. So far, this thesis establishes that there is 'mission drift' in microfinance business in Kerala. At the same time there is 100 percent repayment of microfinance loans. They achieved this by efficient use of joint liability groups and to avoid adverse selection, they selected clients instead of self-selection by group members. From the survey and literature it is clear that only selecting a safe group of clients will not always help to develop a smooth repayment culture. Therefore the MFIs have begun to influence the group formation also. According to Thorp et al (2005), other than the social-economic features of the individual borrowers, the structure of groups also has an important role in ensuring the repayment of microfinance loans.

In literature, it is evident that the MFIs in different regions would adopt different methods to avoid adverse selection and moral hazard issues and finally the 'asymmetric information' will be vanished. Morduch (1999) and Armendariz de Aghion and Morduch (2005) point out in their microfinance reviews that the performance and operation of group liability contracts in developing countries indeed has been very diverse. The post-AP MFI activities are concentrating on ensuring repayment without any forceful repayment methods. But when they adopted traditional self-selection and peer monitoring techniques in Andra, the clients were failed to repay the loans and finally that led to forceful repayment and other causalities.

Thus as an extra care to ensure the repayment, the MFIs either monitor the formation of group or they themselves create a JL group.

The MFIs in Kerala have been adopting both the techniques to form a joint liability group. In most of the cases they only monitor the group formation and allocate the clients into different groups based on their repayment capacity. But creation of a JL group by themselves has practical difficulties like collecting deeper information about their assets, credit histories etc. Another important problem is the cost of creating a group. They have to spend some money to create a new group which suits their ambitions. The MFIs in Kerala have an advantage in the formation of JL groups. The people in Kerala are well aware about the advantages of group lending due to the widespread network of Kudumbasree-SBLP lending programme. So it is much easier for the private MFIs in the state to magnetize more clients to the business. Another specific strategy used by these MFIs is that they target the inactive Kudumbasree groups to form a new joint liability group. A client, Noorjahan from Mannarkkad pointed out that *"initially the MFI officials came to our colony and asked the details of the Kudumbasree groups in that area and tried to convince the Kudumbasree members that their organisation is better than Kudumbasree"*. This shows that they used the existing state-run system to reduce the information asymmetry in the MFI sector.

The most common strategy is to monitor the formation of the joint liability group. A JL group consists of people with different repayment capacity. MFIs try to allocate people with different repayment capacity in a group to achieve two things. One is regular repayment of their loans and another is the 'poverty reduction mission' by accommodating poor people.

To investigate the strategies in the group formation, we can analyze the standard of living of 100 clients from ten different groups in the state. Here, the standard of living is considered as the proxy for repayment. Table 4.7 show the percentage of clients in different SLI categories of ten JL groups. It is clear that in each group 50 percentage of the clients have poor repayment capacity (i.e. they are the clients with poor/below average standard of living) and the other 50 percent of clients have average/high repayment capacity (clients with average/high standard of living index).It shows that the MFI deliberately includes both poor and non-poor to satisfy the above mentioned objectives.

Table 4.7: Percentage of clients in different groups in different Living standards

Group	Number of respondents	Percentage of clients in different SLI categories				Total
		Q_1	Q_2	Q_3	Q_4	
1	10	40	10	20	30	100
2	10	40	10	40	10	100
3	10	40	10	30	20	100
4	10	40	10	40	10	100
5	10	30	20	40	10	100
6	10	30	20	40	10	100
7	10	30	20	40	10	100
8	10	30	20	40	10	100
9	10	30	20	40	10	100
10	10	30	20	40	10	100

Note: Q_1- Poor, Q_2- Lower Middle, Q_3- Upper Middle, Q_4- High

Source: Own calculation from Primary Survey Data (2013)

Even though the poor people in a group fail to repay an installment, the MFI includes those clients who can easily bear the debt of other client's also. It will clearly balance the repayment mechanism in joint liability group. If all members of a group are poor people, then they may fail to bear the loan of rest of the clients and if all members of a group are rich people, then the aim of poverty reduction is violated. Hence their best strategy to ensure repayment is by creating a group which consists of both rich and poor.

Other than the involvement in group formation, the most important mechanism in a joint liability group is peer monitoring. Normally peer monitoring is done by clients themselves in closed group and the MFI has not have much role in the peer monitoring. But they can introduce certain new strategies to enhance the peer monitoring. The next section discusses the new peer monitoring strategies followed by the for-profit MFIs in the state.

4.5.1. Peer monitoring strategies

Joint liability group lending "stimulates screening, monitoring and enforcement of contracts among borrowers, reducing or erasing the agency costs of the lender" (Hermes and Lensink, 2007: 21).A proper peer monitoring mechanism is the final stage of ensuring the repayment of loans in a joint liability group. . If one of the members of a group fails to pay back, the rest of the members have to contribute in order to ensure the full repayment. It helps the lender in reducing the cost and information asymmetry. Stiglitz (2000: 1454) pointed out that the problem of moral hazard can be overcome with monitoring or screening and with the use of incentives.

Normally the MFIs prevent default with the help of 'peer pressure'[9]. But there are examples which failed to prevent 'moral hazard' even if the peer monitoring is strong among the members. So the MFIs in Kerala (most of the Indian MFIs in post AP period) have come up with different strategies to further strengthen the peer monitoring with in a group. The strong monitoring by MFIs in the client selection and group formation process already paved the way for repayment. However the MFIs are risk averters and they want to prevent any time of default to ensure 100 percent repayment and profit.

The strategies would be different for each MFI. The major strategy is 'regular daily/weekly group meetings'. Some MFIs make sure that the group members should meet once in a week and some other MFIs conduct daily meetings either in the branch office or in a permanent meeting place. They make sure that all the meeting should begin only in the presence of an MFI official. During the field survey, I have attended some weekly meetings of the JL groups. The official himself ask the name of the people who failed to pay the installment for a week or more than that and at the same time he finds time to appreciate those who are regular in repayment. This strategy itself put huge pressure on the regular defaulters.

Another interesting strategy by the MFIs to improve co-ordination among group members is to keep a programme chart for each weekly meeting. It starts with a prayer and the prayer song belongs to the dominant community in that particular area. The MFI officials strictly check the accounts and defaulters are warned by them. These strategies only help in igniting further repayment pressure in a joint liability group member. The MFIs have their own method to recollect their money. Most of the MFI officials are women and they do not go back from a group without the weekly collection. At the same time, they do not use violent method in repayment.

[9] Peer Pressure in microfinance means the pressure/influence that a group exerts to encourage proper repayment of loans.

According to a client Mary from Ernakulum "*Sir (the MFI official) will not leave house without that week's collection and the officials do not make any noise. They secretly call the officials 'Gandhi"*.

It confirms that the MFIs in the state are very careful about the dynamics in a joint liability group. They monitor each and every step in a joint liability group since its formation. They are very successful in satisfying the twin objectives of 'targeting poor' and '100 percent repayment'. Unlike the traditional liability groups, the modern day MFIs monitor the activities very deeply to overcome the adverse selection and moral hazard issues in an informal credit market.

But still there are concerns about the growth of for-profit MFIs in a place where the Kudumbasree led SBL programme is very strong. Although they have used their own survival strategies to encroach into the mainstream microfinance market, the problems/defects of other MFI programmes paved the way for them. The next section analyses the problems of SBLP network in the state.

4.6. Problems of SBLP Lending in Kerala

The entire microfinance sector was revolving around a government aided programme in Kerala over a decade and a half. Kudumbasree acts as an intermediary in availing SBLP loans for the Kudumbasree groups in the state. We have already discussed the success story of Kudumbasree in the second chapter of the thesis. Kudumbasree cannot be called a pure microfinance institution/an NGO. *It strives to develop the model of a micro finance led financial security process into a more comprehensive model of local economic development under the aegis of local governments* (Kudumbasree mission). But in the initial years of Kudumbasree, it concentrated more on creating Self Help Groups and linked the groups with SHG-banking linkage programme by NABARD. This activity had a huge impact in the rural informal credit market in the state. The SHG model was accepted by the world as one of the successful model of group lending. As discussed earlier, Kudumbasree NHGs (Neighbourhood groups) have some unique features and it encouraged self-selection of clients (but based on a nine point programme to identify the poor people) and peer monitoring within the group to encourage the repayment of loan.

But the major difference with JLG system is that they do not monitor deep into these process to ensure repayment. But Still Kudumbasree has reached the heights which no other 'poverty reduction programme' could reach in the recent past. This section analyses why the for-profit MFIs were able to create market in the state and what were the possible reasons behind shift from Kudumbasree to for-profit MFIs.

The SBL programme with Kudumbasree was growing on a high rate till 2007. Since then the growth started declining (Ajith et al. 2006). But still Kudumbasree is the largest provider of microcredit in the state. After 2008, there was a change in the approach of Kudumbasree in its operations. Oommen (2007) pointed out some pitfalls in the Kudumbasree operations in Kerala, like identification of poor and non-poor, dual membership, higher indebtedness of Kudumbasree families (NSSO 59^{th} round) etc. But the 'thrift and credit' operations of Kudumbasree were indeed a success over the years and it has reached the poor clients all over the state.

The Kudumbasree has followed a multi-pronged strategy, which include: (a) convergence of various government programmes and resources at the community-based organisation level; (b) efforts to involve the CDS structure in local level anti-poverty planning; and (c) development of women's micro-enterprises, and thrift and credit societies (Devika and Thampi,2007).While the micro-credit is one among the many strategies, it has been gained importance and publicity since the beginning of the programme. But after 2005, the first objective of converging government programmes and resources became a major agenda for the Kudumbasree mission. The major reasons for this shift were the policy changes by the new left government and the introduction of Mahatma Gandhi National Rural Employment guarantee Scheme (MNREGS) by the central government. The NHGs under Kudumbasree has become an important player to help the government in spreading the government projects to its beneficiaries. This shift in priority has also reaped benefits for the poor, but the status of Kudumbasree as micro-credit institution has slowly faded away. Now

Kudumbasree has a much deeper role and reach out in the state, but not through the SBLP lending (credit programmes).

In the same period, the state witnessed entry of many for-profit microfinance institutions to the state. Even though Kudumbasree still hold a major chunk of the microcredit market, the repayment rate of SBLP loans in Kerala decreased from 94.5% in 2005 to 76% in 2011(NABARD 2012). So it is clear that Kudumbasree is losing its grip in the state microfinance sector. This actually helped the for-profit MFIs in state to gather momentum. They have used the available information to build an equally competitive group lending mechanism in the state. But there are other factors (the dynamics within both Kudumbasree groups and for-profit MFI groups) which led to this particular state of affairs in the State. The reasons for this quick growth and market capturing of for-profit MFIs (other than the shift in objective of Kudumbasree) can be analysed with the help of the inferences from the primary survey.

Among the 149 surveyed MFI clients, 125 clients are Kudumbasree members. I.e., 84% of clients have membership in both Kudumbasree and for-profit MFIs.

Table 4.8: Active and Inactive Kudumbasree borrowers among the surveyed clients.

Number of Kudumbasree members	125
Number of clients who have a SBLP loan.	12
Number of clients who borrowed from SBLP at least once	110
Number of inactive borrowers	98
Percentage of inactive Kudumbasree borrowers	78.40%

Source: Own calculation from Primary Survey Data (2013)

From Table 4.8, we can see that among the Kudumbasree members only 9.6% (12) clients are still indebted to the SBL programme. But 88% (110) of clients have at least borrowed once from the SBL programme. Thus it is clear that 78.4% of the clients are inactive borrowers from the Kudumbasree led SBL programme. Although 84% of the total clients are Kudumbasree members, only 9.6% of people are active borrowers. It means rest of them is only members in paper and they are not part of the lending process. But the shocking fact is that out of 125 Kudumbasree members 98 people were part of the lending process and they stopped borrowing from SBL programme after some time. So it is evident that most of the members in the Kudumbasree group remain as mere members (not borrowers).

The major question that arises here is why they still remain as Kudumbasree members? The answer was given by a client called Fathima from Aluva and she told that *'Membership in Kudumbasree helps us to get benefits from panchayath and MFIs give us credit'*.

The clients of for-profit MFI use the Kudumbasree membership to get benefits from various government programmes and to be a part of government-funded development projects like MNREGA. But one concern remains unanswered. What are the advantages of MFI lending which tempt the clients from borrowing SBLP loans?

Some observations identified from the survey to answer these concerns are the following;

a) **Monthly Repayment, time lag and papers works**

The clients found that monthly repayment of SLBP loan is very difficult for them. But the for-profit MFIs collect the loan amount in a weekly basis and the installment is very less compared to a SBLP's monthly repayment. As most of them are daily wage-earners it was easy for them to save money for one week's installment.

Another thing is the time lag for getting the loan sanctioned. In a for-profit MFI the maximum time for getting a micro loan is one week. But in SBLP system it may take one to two months and they have to run around panchayath/corporation for getting sanctions from various departments. Thus the time lag and paper works are also a hindrance for getting a quick SBLP loan.

b) **Lack of co-ordination among members in Kudumbasree groups**

It is the result of poor monitoring in the self help groups. In the initial stages of Kudumbasree activities, there were officials and panchayath members to co-ordinate, to clear doubts and to monitor the activities within the group. But the lack of co-ordination led to widespread loan default due to moral hazard.

c) **Other Operational bottlenecks and lack of idea about the interest rates**

Another major drawback of SBLP lending which discourage the clients is the restriction that rental households cannot apply for SBLP loan. This has a huge negative impact in urban areas. Another clause is that one self help group would be eligible for SBLP loan only after one year of formation or after reaching a thrift target. These kinds of strict policies will not help to compete in the existing microfinance market when all groups are in need of quick credit to satisfy their needs.

Another problem is the interest rate. The SBLP loans have been provided by several commercial banks in the state. They charge different interest rates. The clients feel it as high compared to MFI interest rate because the MFIs convince people that they charge very less interest rate compared to others. In a weekly repayment system, the weekly installment will be very less even though the interest rate is high. Therefore the clients do not feel it as high or unbearable. In other words, the clients are very much misinformed about the interest rate charged and that is also a reason in the shift from SBLP lending to MFI lending.

So the lack of clear information about the interest rate and other cheap credit facilities in the market and operational inefficiencies remain as an important reason for the shift in interest from SBLP to for-profit MFIs.

4.6.1. Borrower's information problem in Kerala's MFI market

According to the theory of group lending, peer monitoring will resolve issues like moral hazard and adverse selection by reducing the 'information asymmetry' among lender and borrower.(Ghosh, 2013; Stiglitz, 1990; Arnott and Stiglitz 1990). So far we have seen that the lenders (MFIs) successfully used the available information to avoid the adverse selection and moral hazard issues. But the borrowers still lack some information about the existing microfinance market in the state. Arnott and Stiglitz (1990) pointed out that both the parties in group lending will benefit only when the information is perfect. Here peer monitoring helps the borrowers to operate a low-risk group which ensures the repayment of loans, but the lack of information about the interest rate and other microfinance options leads to exploitation.

Interest rates information means the information about the interest rate charged for a microfinance loan. According to RBI (2012) the maximum interest rate for a loan is 26 percentages (RBI recently removed that cap also). But from the survey, it is clear that they charged interest rates from 13% to 30% for a microfinance loan. The interest rate increases as the loan amount increases. The minimum loan amount provided by an MFI in the state is Rs.10000 and the rate of interest for that amount is 13%, but as the amount increases the rate of interest also increases. But the MFIs used certain repayment strategies which helps the borrower to repay effortlessly. For example the repayment periods for small loans are one year. As the loan amount increases both interest rate and repayment period would increase. So there will not be much increase in the amount which is to be paid in every week. During the survey some clients said that "the interest rate is very low, it is only 13% which is even less than banks". The problem is that the interest rate written in the pass book is only 13% and most of them do not spend time to calculate the interest rate of their loan. This is a clear case of exploitation by capitalising on the ignorance of the borrower.

At the same time the maximum interest for an SBLP loan is only 13% up to Rs.20000, which is much less than the interest rate charged by the MFI. However they think that the interest rate is still high in the SBLP lending.

Table: 4.9 show the clients opinion about the interest rates in different micro-lending group in the state.

Table 4.9: Interest Rate Information

Interest rate	Frequency	Percentage
High	24	16.1
Lower than banks	104	69.8
No idea	13	8.7
Higher than bank's	8	5.4
Total	149	100

Source: Own calculation from Primary survey data, 2013

From the table 4.9 we found that 69.8 percent of the surveyed clients believe that the interest rate charged by MFIs are lower than banks and only 5.4 percent of clients believed that the interest rate are higher compared to banks. Among the clients, 8.7 percent have no idea about the interest rate. It shows that the MFI clients lack clear information about the interest rate of their loan and most of them believe that the interest rate charged by the for-profit MFIS is lower than that of SBLP. Most of the clients are highly mis-informed and that leads to further exploitation. Other than information on interest rate, the lack of idea about the overall market and other cheaper options is the major issue which led to exploitation of the clients.

In the primary survey data, none of the clients have heard about the unfair practice of microfinance in other states and countries. Some clients even call the MFI as 'Kudumbasree'. It shows that they could not recognise the difference between a MFI and Kudumbasree. At the same time the MFIs in the state do not want the people to get information about their business. It may affect their smooth conduct of business in the state. Most of the clients always complain about the SBL programme and they do not recognize the importance of the state run microfinance institution. Another issue is that there are private/commercial banks which lend microloans for the Self help groups in the state. They charge high interest rates, which is even higher than MFI loans and put some unfair repayment pressure on the clients in the state. They misinterpreted it as the old SBL programme and stop borrowing from SBL programme also.

The MFIs in the state used the group lending advantages to earn profit and 100 percent repayment out of the microfinance business. They are able to collect full information about the borrower and succeeded in not providing full information about the lender to the clients. Some inherent defects of the SBLP and operational inefficiencies put them into trouble and they completely failed to prevent the competition from commercial MFI by providing full information regarding the entire microfinance business to the clients. Here the government and private MFIs remain happy because they get their money back and repayment is occurring without any harsh repayment methods. But this business is surviving by exploiting the poor clients without providing them information (mis-informed also).The lack of information may have huge impact in the long run.

4.7. Summary

This chapter dealt with the activities within a for-profit MFI group. It was an attempt to find out the methods used by for-profit MFIs in the state to ensure 100 percent repayment. The major hurdle for an MFI to ensure repayment is 'information asymmetry' in the rural credit markets. Unlike the traditional models which prefer self-selection of group members to avoid moral hazard and adverse selection, the MFIs in the state select the clients in a group or monitor the client selection very keenly. The major strategy by the MFIs is to increase monitoring in the client selection and group formation activities. There are several factors identified from the survey which influence the client selection of the MFIs. Among the variables only 'income of the household' and 'purpose of loan' have an influence in the client selection of the MFIs. Rest of the variables like caste, standard of living, occupation etc has no role in deciding the membership in a for-profit MFI. Thus it is evident that they look for credit worthiness only. They have reaped success out of that by achieving 100 percent repayments for their MF loans. So as we found out from the last chapter the MFIs are drifting from their mission of poverty reduction and using the 'group lending advantages' to make profit.

Another reason for the success of for-profit MFI is the shift in approach by the SBLP lending system in the state. Kudumbasree has opted for other poverty reduction methods to reach out to the poor people and it helped the for-profit MFIs to develop a market .The strategies used by for-profit MFIs help them in overtaking other players in the business. Even though both lender and borrower are satisfied with the for-profit lending due to the 100 percent repayment, the borrower is highly exploited by the lender. The lack of information about interest rates and alternative sources of credit leads to exploitation of clients. Thus the for-profit MFIs are so far successful in exploiting the lack of information of the microfinance clients in the State.

Chapter 5
Conclusion

5.1. Major findings and Conclusion

The microfinance industry in the country became more diverse and complex in the 21st century. But nobody can deny the importance of microfinance in the development process. So it is important to understand and analyse the developments in microfinance industry. This particular study dealt with the most recent development in the microfinance industry, the commercialization of microfinance. The major aim of microfinance institutions is poverty-reduction by providing adequate credit for the rural unbanked people. The major concern raised out of the recent incidents is that whether the microfinance institutions in the country can remain as an institution which helps the rural poor. The experience of Latin America and the incidents in Andhra Pradesh have called for the need to examine the credibility of microfinance institutions in the country. There is evidence of 'mission drift' in microfinance from the places where the commercialization occurred. If commercialization occurs then 'mission drift' follows. So the major objective of the study is to analyse the existence of mission drift. Unlike other states, Kerala has a strong network of state-run microfinance institution known as Kudumbasree which is very successful in poverty reduction. But one can be skeptical about the presence of commercial MFIs in the state. Thus Kerala became the focal point of the study and the study analysed the extent of commercialisation by analysing the performance and outreach of MFIs in the state. In general, the aim of this study is to examine whether a mission drift in microfinance is happening in Kerala and the factors which led to the transformation.

To examine the existence of mission drift, the study had analysed two major aspects. One is the performance and outreach of for-profit MFIs in the state. As the first objective, the study analysed the physical and financial performance of top three MFIs in the state, who control almost 85% of the microfinance business in the state. The secondary data sources include MIXMARKET, Sa-Dhan and The Bharath Microfinance Reports have used to analyse the performance and outreach of for-profit MFIs in the state. The study has used both physical and financial indicators to explain the development and performance of the MFIs in the state. Unlike the all India status, the outreach and financial performance of MFIs in the state are higher than national average. Although the MFIs in Kerala also struggled during the crisis periods in Andhra Pradesh, the fall in indicators is not as fast as other states. Except HOPE microcredit, which faced some operational problems in the last two years, two other major players (ESAF and Muthoot) are expanding their business to all fourteen districts in the state. The financial performance of them also is fast improving, especially the cost per loan, cost per borrower and return on asset and equity. It shows that their profit is increasing over the years. It is a clear indication that the for-profit microfinance business in Kerala is improving over the years. Thus these results tell us a positive growth story of the for-profit MFIs in the state, in terms of expansion and profit making. Once the occurrence of commercialization of microfinance confirmed, the next concern is about the mission of those microfinance institutions.

Third chapter dealt with the question of 'mission drift' among the for-profit MFIs in the state. The best way to examine 'mission drift' is to understand the poverty status of MFI clients. If the clients are poor, then we can say that the MFIs have not drifted from the original mission. But the modern day MFIs lend money not only to poor people, but also to average/middle income people to increase their profit. The theories on 'mission drift' (See section 3.1.1 in chapter 3) redefined the definition of mission drift in microfinance. According to those theories, a MFI with poverty-reduction mission always has a preference for the poor clients. Their premium clients will be the poor people who do not have access to formal credit sources. If the preference for MFIs changes from poor to non-poor over the years, then we can call that as 'mission drift' for profit–making. The average loan size of each client (with minimum 3 loan cycles) has taken as the proxy for preference (mission drift). The study has analysed the clients in two ways, based on their standard of living and poverty. The analysis has shown that the MFIs have more preference for the people with high standard of living and low poverty level as the loan cycle increases. Another crucial variable used to explain the mission drift is multiple borrowing. The study confirms that there is existence of multiple borrowing among the poorest section of for-profit MFI clients. Allowing poor clients to borrow from multiple sources is a strategy by MFIs to make profit by ensuring repayment. It is a clear drift from the mission of poverty reduction. Instead of reducing poverty, multiple borrowing can make the poor clients more vulnerable to credit in the long run.

Although every client demands for higher loan amount as the loan cycle increases, the MFI prefers clients purely based on credit-worthiness. MFIs decide the credit-worthiness by analyzing the variables like standard of living, poverty status and collateral. Finally they encourage poor clients to borrow from multiple sources to ensure their profit. Here what worries us most is the exploitation and misuse of a noble concept for profit making. The MFIs have full right to act as a financial institution which is purely profit oriented. But they receive large amount of foreign aid and low-interest rate loans from the commercial banks by claiming that they do business for the upliftment of poor. But the result from this study contradicts their claims. It would be really difficult for a for-profit microfinance institution to meet their twin objective of poverty reduction and profit-making together.

The results from the second and third chapters confirm the existence of 'mission drift' among the commercial microfinance institutions in the state. The final chapter examined the factors which help the MFIs to survive in a market where the Kudumbasree network is strong. The date from primary survey has used to analyse these factors. The quantitative techniques like cross tabulation and chi-square tests are exercised to examine the primary data. Like the third chapter, the survey results are strengthened with the help of information from qualitative techniques like focus group discussions and personal interviews. The major difference between these two is the difference in group lending. So the chapter analysed the features of for-profit MFI group lending also. The for-profit MFIs in the state ensure 100 percent repayment from the business by overcoming the hurdle of 'information asymmetry' in the rural credit market. They have applied some changes in the traditional joint liability group (JLG) lending model to survive in the business. They select or monitor the client selection in the Joint liability group instead of self selection. The traditional JLGs and SHGs allow group members to select the other members of group. But the for-profit MFIs in the state allow self selection with strong monitoring. In some cases the MFIs denied credit for some self selected members. Like client selection, the MFIs keenly monitor the formation of groups. There are some factors identified from the survey which influence the client selection. Among the analysed variables, only 'income of the household' and 'availability of land' have an impact in case of client selection. The variables like social group, religion, purpose of loan and occupation are found to have no role in deciding the membership in a for-profit MFI. So it is evident that they made strong monitoring mechanism to ensure repayment. Thus the MFIs use these group lending advantages to make profit.

Another reason for the growth of for-profit MFIs in the state found from the survey results is the shift in approach by SBLP lending system in the state. Kudumbasree is well known as a microfinance institution for some time and it was successful in reaching the poor through the SHG banking linkage programme. They have taught the advantages of group lending to the poor women in the state. But after 2006, Kudumbasree has opted for deeper role in poverty reduction in the state. Kudumbasree has joined hands with the local self government sin implementing the government's poverty reduction programmes. The SHGs in the state lack proper support and monitoring from the authorities. The survey results show that among 149 clients, 125 clients have membership in Kudumbasree also. But 79% (98) of the Kudumbasree members are inactive borrowers. They revealed that the repayment of Kudumbasree loan is very difficult due to lack of support and monitoring from the government authorities. The panchayath member/co-coordinator approaches them only to explain about the government programmes, especially NREGS. It led to high default of SBLP loans by the Kudumbasree members. The clients added that even though Kudumbasree membership helps them to earn lot of benefits from the panchayath/municipalities, the clients fail to meet their credit needs with a Kudumbasree membership. This helped the for-profit MFIs to develop and build a microfinance market of their own and their job became easier due to the better awareness of clients about group lending and its advantages.

The strict repayment strategy by for-profit MFIs helps them in getting more clients in the state. They feel that if they are able to repay the loans properly, then for-profit MFI is a better option compared to the SBLP, because, they are able to repay the loan amount in time. But in the SBL programme, there is high chance of defaulting. The for-profit MFIs introduced other attractive offers like door step loan delivery and collection, quick disbursement of loans and less-paper works to attract more customers. All these operational advantages help the for-profit MFIs to establish a market in the state. But the major concern with the for-profit MFIs in the state is the exploitation. Even though both lender and borrower are satisfied with the for-profit lending due to 100 percent repayment, the borrower is highly exploited by the lender. The lack of information about interest rate and other credit sources leads to exploitation of clients. They do not have information about the real advantages of SBLP lending like women empowerment, low interest rate and so on. The survey results show that some clients do not know about the rate of interest charged for their loans and some on them are forced to borrow even if they are aware that the interest rate is high. So we cannot deny the fact that for-profit MFIs are meeting the credit needs of the rural poor in the state. But to avoid the exploitation on the poor clients, strong regulation measures are needed. Kerala government has not come up with a law to regulate the for-profit MFI business in the state.

5.2. Limitations of the study

The major limitation of the study is that of data. The secondary data from MIXMARKET is widely criticised due to its reliability. MIX is an NGO and the data on MFIs performance are submitted by the respective MFIs. So the chance of manipulation is very high. Most of the time they manipulate data in order to evade tax. But it is the only available data source on the performance of MFIs in the world. Another problem is the lack of data on MFIs in Kerala. The primary survey has its own limitations. The lending behaviour of people would be different in different geographical regions. So it will be really difficult to generalize the finding from the primary survey. Other than the data problems, the study has not discussed much about the empowerment issues in for-profit microfinance. It is beyond the scope of our thesis.

5.3. Need for regulation and suggestions

After the second AP crisis in 2010, the Andhra Pradesh government has come up with a strong law to prevent the usurious activities of MFIs in the state. The law has huge impact in the state. The central government has appointed Malegam committee to suggest reforms in the microfinance sector. The government has brought a new Bill to regulate the microfinance business in the country in 2011 following by the Malegam committee report in 2011. Both policy responses suggest strong measures to regulate the MFI business. But the microfinance bill still remains as a bill. Recently RBI removed the interest rate cap of 26%

to help the MFIs which suffer due to high cost per loan. But this decision to remove the interest cap leads to more exploitation of clients.

All over the world, there is an appreciation that unregulated finance will lead to suboptimal outcomes. Consumer protection should be the main priority in the financial regulation (Campbell et al. 2011). In India, the strategies of for-profit MFIs differ in different states to ensure more profit. Thus each state government should introduce a new law to regulate the microfinance activities in their state. The microfinance regulation bill in Andhra Pradesh can be considered as a successful example.

As the number of for-profit MFIs is increasing in the state for the last six years, the government should come up with a law to regulate them. From this study, I have listed some suggestions for the proposed Microfinance regulation Bill for the state of Kerala. The major considerations in law can be the following:

A. Identify the for-profit MFIs in the state by creating a category.
B. Regulate the fund for microfinance institutions in the state.
C. Monitor the repayment mechanism of the for-profit MFIs.
D. The provisions of Money laundering act (PMLA, 2002) can be introduced for those MFIs which charge high interest rates and unethical repayment practices.
E. Prevent multiple borrowing by law.
F. Introduce an income limit for the borrowers from for-profit MFIs.

These are the major suggestions for the proposed microfinance regulation Bill for the state. The government should take measures to revamp the SBL programme and the inactive SHGs to reduce exploitation by the for-profit MFIs. A proper mechanism for the repayment of SBLP loans can answer most of the problem and accept the positives from the joint liability group lending in Kerala. The need for credit will remain as the major concern in a developing economy forever. Thus government should try to ensure ample credit for the needy without allowing any exploitation.

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APPENDIX 1

Questionnaire No:

CENTER FOR DEVELOPMENT STUDIES

Commercialization of Microfinance in Kerala

Section 1: Location details

1.2 State ______________________________

1.3 District ______________________________

1.4 Taluk ______________________________

1.5 Panchayat/Municipality/Corporation ______________________________

1.6 Ward ______________________________

1.7 Area ______________________________

1.8 Type of area: [Observation only]

1 Urban

2 Rural

3 Tribal □

4 Border

5. Coastal Area

2. Household Particulars

2.1. Religion □

Codes: 1-Christian, 2-Hindu, 3-Muslim, 4-Others

2.2. Caste □

Codes: 1-SC, 2-OBC, 3-FC, 4-ST

2.3. APL/BPL (TICK)

3. Personal details of the household members

3.1Name	3.2Sex	3.3Marital status(see code 1)	3.4Age	3.5Educational Status(see code 2)	3.6Activity Status(see code 3)	3.7.Main Source of Income(see code 4)	3.8Single/multiple borrower

4. Basic Amenities and household characteristics

	Before Borrowing	After Borrowing
4.1Access to water at home(well or tap)		
4.2Electricity Connection		
4.3Access to sanitation		
4.4Roof		
4.5Wall		
4.6Ownership of house		

4.1-4.3: 1-Yes, 0-No. 4.4: 1- Thatched, 2-Tiled, 3-Concrete,4-Others. 4.5: 1-Tin sheets, 2-Mud, 3-Bricks, 4-others. 4.6: 1-In own name, 2-Partly Owned with spouse, 3-Owned by spouse, 4-Owned by in-laws/spouse

5. Asset holdings

5.1Land	Before Borrowing	After Borrowing
5.1.1 Area		
5.1.2 Ownership		
5.2 Livestock		
5.3 Poultry		
5.4 Other Assets		

(5.1.1: 1-No land, 2- < 50 cents, 51-100 cents, 3-1 to 2 acres, 4->2 acres. 5.1.2: 1-In own name, 2-Jointly owned with spouse, 3-Owned by spouse, 4-Owned by in laws/parents. 5.2: 0-No livestock, 1-Cow, 2-Ox, 3-buffalo, 4-Goat. 5.3: 0-no poultry, 1-Hen, 2-duck, 3-others.)

6. Expenditure on Education, health and entertainment

	Before Borrowing	After Borrowing
6.1 Expenditure per month for education		
6.2 Type of Educational institution		
6.3 Expenditure for entertainment per month.		
6.4 Expenditure for Health		

(6.1: 1- <1000, 2- 1001-2000, 3-2001-5000, 4- >5000, 0-NA. 6.2: 1- Govt, 2-Aided, 3-Unaided, 0-NA. 6.3: 1- <500, 2- 501-1000, 3- 1001-2000, 4- >2000. 6.4: 1- <500, 2- 501-1000, 3- 1001-2000, 4- >2000.)

7. Occupational distribution

	Before Borrowing	After Borrowing
Occupation(see the codes 5)		

8. Credit Profile

8.1. How much do you earn daily? Rs □

8.2.

	Before Borrowing	After borrowing
8.2.1 Income(monthly)	Rs.	
8.2.2 Debt Profile		
8.2.3 Purpose-wise Debt profile		
8.2.4 Savings Profile		
8.2.5 Amount of savings	Rs.	

8.3.2: 1-Banks, 2- Relative/friends, 3-Money lenders, 4- Pledge jewelry. 8.3.3: 1-Domestic, 2-marriage, 3- Medical, 4-Education, 5-Agriculture and animal husbandry, 6-Land purchase, 7-Bussiness. 8.3.4: 0-no savings, 1-Banks, 2-insurance, 3-Mfls, 4-others

8.3. What is the reason for preferring MFI instead of other formal financial institutions?

8.5. What is the purpose of taking MFI loans? □

Coeds: 1-Domestic, 2-marriage, 3- Medical, 4-Education, 5-Agriculture and animal husbandry, 6-Bussiness

If it is income generating, then □

8.6. The income generated from the activity? Rs □

8.7. What kind of loan do you prefer?

Codes: 0-small, 1-medium, 1-large

8.8. The number of loan you have taken till date? □

Codes: 0-one, 1- two, 2- three, 3- four, 4- > four

8.9. The current loan amount---------------- Rs □

8.10. What is the normal rate of interest? □

8.11. Have you ever failed to repay the money? □

Codes: 0- No, 1- Yes

8.12. If yes, how did u manage the situation?

8.13 How long are you getting microfinance through MFIs – no of years.

8.14. How many MFIs she is dealing with.

8.15. Approx. credit / year taken from all MFI sources(last 2 years). And other sources (moneylenders)

8.16. Any non-financial services received in --- years (through MFI) ie., financial literacy, skill development, business development, health education, basic medical services etc?

9. Group lending (only for those respondents involved in group lending)

9.1. Do you prefer group lending or individual lending? □

Codes: 0-Group Lending, 1-Individual Lending

9.2. If yes, why?

9.3. What is the major income generating activity in your SHG? □

Codes: 0-No activity, 1-Agriculture, 2-Small scale enterprises, 3-Animal husbandry, 4- Others (specify)

9.4. Income generated from those activities Rs □

10. Perception about the MFI

10.1. Are you happy with the present MFI? □

Codes: 0-No, 1-Yes

10.2. If no, what is the reason?

10.3. How do they collect the money? And please explain the role of intermediaries?

10.4. What will be the action taken by MFIs, if you fail to repay the money on time?

10.5. If you have an urgent need for money, which agency/person do you prefer? □

Codes: 1-Banks, 2-Money lender, 3-MFI, 4-Relatives, 4-Others

10.6. Do you think that the interest rate is higher in this MFI? □

Codes: 0-No, 1-Yes

10.7. If so, why have you taken loan from there?

10.8. Do you think your MFI is more professional/efficient/polite in their dealings, compared with others?

10.9. Have you read/heard about the unfair practices of some MFIs in some other states?

10.10. According to you, what is the difference between the local money lender and the MFI?

10.11. Do you have membership in any other groups? □

Codes: 0-No, 1-Yes

10.12. If yes, type of that group □

Codes: 1- Private MFI, 2- Kudumbasree, 3- Caste or religious based MFIs, 4- Political party based MFIs

10.13. Have you ever worked in Kudumbasree/Ayalkootam before? □

Codes: 0- No, 1- Yes

10.14. If yes, why do you choose to stop borrowing from Kudumbasree?

10.15. If no, what is the reason for not choosing Kudumbasree?

11. Interest Rate Mechanism

11.1. What is the duration of your current loan?

11.2. How do you repay (Daily/weekly/monthly)

11.3. How much do you pay in one installment?

12. Intra-household decision making

Who makes the decision in the following

	Before borrowing	After borrowing
Routine consumption		
Children's Education		
Use of own earnings		
Buying jewelry, clothes		
Asset purchase		
Savings and loans		

Codes: 0- Wife, 1- Husband, 3- Both, 4-Others

Code 1

Unmarried-1
Married-2
Widow/widower-3
Divorced-4
Seperated-5
Unwed mother-6

Code 2

Illiterates-1
Newly literate-2
Primary-3
Up to SSLC-4
SSLC-5
Pre-degree/plus two-6

Graduation-7
Post Graduation-8
Professional degree-9
Informal training-10
Others (specify)-11
Not applicable

Code 3
Employed-1
Unemployed-2
Inactive-3
Students-4
Sick-5
Too old to work-6
Disabled-7
Others(specify)-8

Code 4

1 Household Duty
2 Agriculture (Farming, Laborer)
3 Fisherperson
4 Petty Trade (Buying and Selling)
5 Household Industry (Weaving, Handicrafts, etc)
6 Domestic Labor
7 Construction Worker
8 Service – plumbing, electrical, computer, canteen, etc. [Specify]
9 Any Other Casual Laborer
10 Tuition Teachers
11 Non-household manufacturing
12 Public sector
13 Others _

Code 5
1 Household Duty
2 Agriculture (Farming, Laborer)
3 Fisherperson
4 Petty Trade (Buying and Selling)
5 Household Industry (Weaving, Handicrafts, etc)
6 Domestic Labor
7 Construction Worker
8 Service – plumbing, electrical, computer, canteen, etc. [Specify]
9 Any Other Casual Laborer
10 Tuition Teachers
11 Non-household manufacturing
12 Public sector
13 Others _