

Effective Credit Lending and Portfolio Risk Mitigation Methodologies in MFI

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Abstract

Clean loans having possibilities to face major challenges in choosing correct set of borrowers. Mr. Dan Norell in his passage (How to reduce arrears in Micro finance Institutions)discussed various recovery techniques based on customer mindset .

In order to mitigate risks in pre and post loan process,we are going to apply his concept by classifying the behavior of borrowers mindset for effective credit lending and risk mitigation in MFI. we have applied this in selection process of customer and obtained good set of borrowers in pre-loan process and in recovery methodologies too.

Keywords: Self Help Group, Micro Finance, Joint Liability Group, Risk Mitigation.

Introduction

The main challenge in successful lending to choose the correct set of borrowers, since the attitude of customer may be influenced by various factors. Especially, it comes to clean loans like MFI loans SHG(Self Help Group), JLG(Joint Liability Group)etc.,where the customer credit discipline plays a vital role. Recently borrowers mindset has changed and are focused on, whether the loan institutions are serious in collecting repayments. So,fixing the credit discipline methodology and recovery methodology in pre and post loan disbursement process decides the level of portfolio risk.

The main theme is to classifying and analyze the borrowers based on overall behavior in credit evaluation process. This passage enumerates the clear methodology of lending process for effective lending to build strong credit discipline. We have applied this concept in pre and post loan process and gained good outcome in Effective credit lending and in recovery procedures.

Applications in Effective Credit Lending

Now, in our study we are going to implement the concept of classifying the borrowers by analyzing their behavior 'PRIOR' lending process. So, that the chance of default/NPA is reduced by selecting the correct set of borrowers.

CGT (Center Group Training): Training given by field officer about the MFI rules, regulations and to build strong credit discipline.

GRT (Group Recognition Test): On completion of training, GRT is held. The members are tested by supervising officials on MFI principles taught during the previous training(CGT).

Usually the primary process of MFI lending is initiated by Field Staff, who actually finds out whereabouts of the customer. Streamlining a common tool will greatly help in analyzing the customers mindset. During CGT and GRT, field staff and supervising official should analyze and classify the customer in to one of the four following categories.

Now, let us see how the customers are classified in this concept in to four different types.

TYPE A : Willing and able to repay

TYPE B : Willing but unable to repay

TYPE C : Unwilling but able to repay

TYPE D : Unwilling and unable to repay

By identifying,observing and analyzing these components in customer, we may easily choose the correct set of borrower.

TYPE A (Willing and able to repay): To find out this type of group or Individual, we should analyze through 3 following parameters and sub categories.

1.Individual/Group members residential status

2.Character & Integrity

3.Repayment Capacity Analysis

1.Individual/Group members residential status: All members in group are residing in same locality, 4 essential ID and address proof should indicate the same locality (no frequent migration from area to area), should have residential proof for staying more than 3 years in same house.

2.Character & Integrity: All individuals are ready to accept group guarantee concept, All members in group are paying full attention during CGT, Confirm no individual found suspicious in group, if yes note for inquiry /rejection.

3.Repayment Capacity: Analysis: Calculate fixed obligation for income, Analyze the individual who having total debt above 80k in MFIs' and to analyze the expenditure & Income.

Credit Lending decision: By analyzing above said parameters with the customer during CGT and GRT, Field and supervising official comes under the conclusion as TYPE A individuals/Group. This type of customers are those who are rated from 35 to 40 in rating chart (annexure1)and can undoubtedly yield 100% repayment.

TYPE B (Willing but unable to repay): To find out this type,we should analyze through 2 parameters

1. Knowledge and awareness
2. Locality observations.

Knowledge and awareness: All the individual in group having the sufficient knowledge about their group member residence, background, source of income, character etc., if any suspicious or negative feedback's please note that individual for deep inquiry /rejection.

Locality observations: Analyze the location whether Economically active area, over dependent on seasonal demand business and under the process to recover from natural calamities.

Credit lending decisions : We may decide to lend by fixing additional responsibility to MFI, to convert inefficient borrowers in to efficient borrowers (entrepreneurs)through counseling, workshops, Proper CGT, Savings practice. This type having low risk but leads to healthy portfolio development.

TYPE C (Unwilling but able to pay): Back ground verification is the process during CGT and GRT, Any individuals/group having finance as main business, unethical political background, unethical advocate and unethical police,Ghost borrowers.(If yes, need more attention to read the mindset of borrowers to take decision before credit lending).

Credit Lending decision: By separating/removing the unethical individuals in group by proper CGT and GRT, also explaining the litigation process when attempted to cheat the company will take necessary legal actions against them (creating psychological /legal threat). This type having medium risk but during the course of CGT and GRT by officials has to decide whether counseling works out for changing their mindset from 'unwilling' to 'willing to pay'.

TYPE D (Unwilling and unable to pay): Ghost borrowers(one person borrowing on behalf of the other) can be identified by conversing, the family members of the applicant during house visit and making them aware of the consecutive. This is the important area to detach the unethical borrowers in credit lending process. Below said qualities of customer are noted as TYPE D.

Individual/Animator/Representative having main business as Finance, Group/Individuals are referred by Ring Leader, FIR /Litigation in the name of applicant/family members in the group, black list members in black list area.

Credit Lending decision: It is high risk and not advisable for credit lending. If it is identified, the details of group study in CGT and GRT should be updated in black list customer register for future reference to upcoming managers as and when Field officer and Manager get transferred.

This type of customers are there with least score in scoring sheet (refer annexure 1).

Risk Mitigation process for Portfolio Risks

Below said table classifies the customer behavior in repayment based on qualities & category of customer, Reasons for causes of arrears & probable defaults and mitigation tool to overcome the risk in portfolio (refer table A).

POST LOAN VERIFICATION PROCESS

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Credit Risk(Portfolio risk) and Mitigation Tool

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Controlling measures for Probable default, Overdue and NPA

Table A

<i>classification of customer</i>	<i>qualities & category</i>	<i>reasons</i>	<i>mitigation Tool</i>
Type A Willing to pay, able to pay	Good repayment capacity&good family background	1.Deviation in follow up of field staff,Manager 2.Poor CGT&GRT	1.Provide Special Center Meeting. 2.Prior reminder call 3.Allow staff for Spot Collection.
Type B Willing to pay, unable to pay	1. Customer voluntarily visit the branch trying to explain their inability. 2. Previous repayment history found good but delayed for present EMI	1. Affected by natural calamities, 2. Sudden negative changes in family	1.Credit discipline caring letter 2.Restructure the Loan
Type C Unwilling to pay, able to pay	1. Unethical Political, legal, police family background 2. Animator & Representative misappropriation 3.influenced by ring leader 4. Ghost Borrowers	1.Poor attitude 2.Poor CGT&GRT 3.Doing Finance as occupation	1.Provide Special Center Meeting. 2.Prior reminder call 3.Frequent field visit 4.Bring awareness about litigation process 5.Fix staff Accountability 6.Interactive with family members.
Type D Unwilling to pay, Unable to pay	1. Ghost Borrowers 2. Commission based mindset of A&R,Staff	1.Internal&External fraud 2. Poor CGT&GRT 3. Loan disbursed without the knowledge of family members	1.Fix staff accountability 2.Litigation process 3.Interactive with their family members

Conclusion

We have applied the above tool to selective respondents and attained a remarkable result. Applying the concept in identifying prospective can take MFI to the next level on the other hand greatly supporting the needy people.

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Encl

1. Pre Loan Disbursement Process Rating Sheet (annexure 1)

Pre Loan verification Process Group /Individual Rating Sheet

NAME OF SHG/INDIVIDUAL :

SCORES

	YES	NO	Maxm
<i>TYPE A : (WILLING TO PAY,ABLE TO PAY)</i> 1.Individual/Group members residential status: a. Is there all members in group are residing in same locality? b. Voter ID,Ration Card & aadhar card having the proof of same locality ? c. Having Residential proof for staying more than 3 years in same house? d. Is 70% of group members having own house ? e. Is there any blood relatives are in same group ?	5	0	5
2.Character & Integrity: a. Unwillingness to accept group guarantee Concept ? b. Is group members /Individual not paying attention during CGT ?if yes Brief observation note about individual/group. c. No suspicious individual grouped together ?	0	3	3
3.Repayment Capacity Analysis: a. Is there any individual having below income Rs.10000 Per month (calculate Fixed obligation for income). b. Is there any individual having equal to or more than 1 lac debt in MFIs ? c. Is any group members having other debts and expenditure over income ? d. If individual whose total outstanding under JLG /SHG will below 60K?	0	4	4
<i>TYPE B(WILLING TO PAY UNABLE TO PAY)</i> 4.Knowledge&Awareness : a. If all the individual, are well known about the group members about their residence b. Source of income c. Family background ,character etc...(observations through questionnaire) d. Is Individual have family?	4	0	4
5.Locality observations : a. whether the area is economically active and not overly dependent on seasonal demands or monsoons,etc.,	0	1	1
<i>TYPE C(UNWILLING TO PAY,ABLE TO PAY)</i> 6. Back Ground Verification : a. Is there any individual in group under/ having financial background,political postings,advocate & police influence ?(if yes read the mindset of borrowers).	0	3	3

b. Is Animator & Representative are relative? c. whether loan application submitted by customer with the knowledge of family member's?			
<i>TYPE D (UNWILLING TO PAY, UNABLE TO PAY)</i> 7. Attitude / Location reading : a. Is there any individual / Animator / representative doing finance as business? b. Is group referral made by Ring leader (Seeking for commission from bank & Group members ? c. Is any FIR history / Court Case for their debt (Participated in agitation against MFIs)? d. Is area under black list ?	-20	20	20
Total			40
CGT observations Field Staff Note : If any Brief explanation on negative marks : Correction required : Customer category :			
GRT observations Field staff report review : Score accepted : Possibilities for Internal & External fraud by field staff or by individual: Y/N Bring Awareness about whistle blower : Y / N If rejection made please brief the review note			
Common Note about the SHG			

