Study of Transaction Cost-Perspective of SHG and MFI Clients

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Content

List of Tables

List of Figures

List of Charts

Executive Summary

1. Transaction Cost (henceforth TC) has always been the concern of both researchers as well as policy makers in microfinance. A significant reduction in TCs for clients has been advocated as the main mantra of microfinance, and as a result it has been used as a justification for a high interest rates charged to borrowers. TCs, including real and opportunity costs, vary across lending methodologies (individual loan v/s group loan). TC for client can also be dependent upon their location (remote rural area v/s semi-urban area), and occupation (opportunity cost of time vary across different occupation of the clients). The present study estimates the components of transaction cost of the clients across the different microfinance models, and assess the factors responsible for such costs in the state of U.P.

2. The study used the technique of process mapping to understand the methods currently used by Banks/MFIs for providing financial services to people using different microfinance models. Process maps were useful in the study to understand general process adopted by different organizations for lending microcredit, identification of clients' involvement in borrowing loan, identifying the occurrence of transaction cost at various stages, and focuses on stages where transaction cost can be minimized.

3. The study estimated the transaction costs per monetary unit (total transaction costs divided by loan borrowed) incurred by microfinance clients under different business models and across the space. The study computed the following components of transaction cost:

(a) Indirect Transaction Cost (opportunity cost of time)

- Opportunity cost of training time: cost related to the time spent attending group trainings
- Opportunity cost of meeting time: cost related to the time spent attending group meetings
- Opportunity cost of time spent in travelling training place
- Opportunity cost of time spent in MFI/Bank branch

(b) Direct Transaction Cost

- Travel cost to meeting: cost of return journeys to attend training or group meetings

- Travel cost to get the individual photograph
- Travel cost to buy the stamp paper/revenue stamp
- Travel cost for photocopying the documents (resident proof, and ID card)
- Travel expenses incurred in visiting Bank branch for opening the group saving bank account
- Travel expenses incurred in visiting MFI/Bank branch for getting the loan and its repayment
- Cost of photograph, stamp paper, revenue stamp and resident proof

4. In SHG-Bank model, the bank conducts all financial transactions (savings and credit) at group level. Accordingly, group absorbs a lot of transaction cost on behalf of the individual members. The cost incurred at group level consists of opportunity cost of time and travel cost in visiting bank branch for borrowing and repayment, and documents like stamp paper. This cost incurred at group level was distributed equally among all the members to arrive the cost incurred by individual member.

5. Three leading MFIs of U.P., namely, Margdarshak Financial Services Ltd., Sonata Finance Private Ltd., and Cashpor Financial and Technical Service were selected. The study also selected two Self-help Promoting Institutions (SHPIs), namely Khadi Mahila Gramodyog, and Varanasi Medical Society, which have promoted SHGs and got those linked with Commercial Banks and Regional Rural banks (RRBs). A total of 76 groups which were either credit-linked with banks (under SHG-Bank Linkage Model) or where lending was started by MFIs (Under MFI and BC Model) were selected from the three Districts of the State.

6. The clients' transaction cost of borrowing is about 1 percent higher in SHG-bank model (7.18 %) than that in MFI model (6.20 %). Indirect transaction cost (opportunity cost of clients' time in attending group trainings, meetings and visiting MFI/Bank branch) constitutes about 80 percent of total transaction cost; whereas the share of direct transaction cost (travel cost, and documents cost) comes about 19 to 20 percent both in MFI and SHG-Bank model. In SHG-Bank model, duration of clients' training is relatively higher (21.26 hours) as compared to that in MFI model (8.74 hours). A longer duration of training to clients with much wider coverage, as in SHG-Bank model, is extremely important for the long-term sustainability of micro-finance program, but it has its own implications for clients' opportunity cost of time. One has

to keep in mind that in SHG-bank model, the contents of training programs are quite wide as it not only includes the training about group formation and policies and process of microfinance, but it also covers training programs about undertaking income generation activities by the clients. This latter part is absolutely missing in training programs conducted by MFIs.

7. Opportunity cost of clients' time has been computed from the point of joining the group to the point of getting credit from MFI or bank. It can explain the higher transaction cost for clients in SHG-bank model. The incubation period for the clients for borrowing the loan from MFIs is hardly 15 days after forming the groups, as the MFIs are keen to cover more clients within a short period of time, to expand their outreach. The same in SHG-Bank model is minimum 6 months as it is mandatory in SHG-Bank model that group has to save regularly for six months before getting it credit linked with banks. The SHG-bank model rests on the principle of saving first and credit second, as it emphasizes more on promoting savings habit among the clients. On the contrary, MFI on-lending model deals only credit to clients and attaches no role of clients' savings. Due to the fundamental difference in the approach between two models, the opportunity cost of time of the clients increases in SHG-Bank model.

8. The average savings at group level turn out to be Rs. 28,430. It is extremely beneficial for the poor women to save regularly in the groups. The clients also feel the importance of savings in their household economy. The transaction cost of savings turns out to be more than 15 percent and more or less equal in rural and semi-urban areas. The figures look quite high, but when the group is using the clients' savings for internal loaning, it is generating a return of 24 percent. Thus, the individual member is still better off.

9. The average amount of borrowing is about 40 percent less in SHG-Bank model as compared to that in MFI model. Since the clients has to incur transaction cost irrespective of loan amount, a lower amount of lending results in an increased transaction cost as percent of borrowed amount. In case of MFIs, the clients have to visit the MFI branch for borrowing only once. In contrast, the SHG representatives have to visit bank branch for more than two times, resulting the higher amount of travel and time cost for them.

10. The rural clients bear more transaction cost as compared to their counterparts located in semi-urban areas in all the three models of microfinance. However, this difference is not statistically significant in MFI model. On the other hand, in SHG-Bank model, the difference in clients transaction cost across their location is statistically significant at 15 percent. The density of bank branches is less as compared to that of MFI branches, particularly in rural areas of Barabanki and Varansi Districts. As a result, the difference in transaction cost between rural and semi-urban clients is not significant in MFI model. Surprisingly, the difference in the results is sharply distinct and statistically significant in Gorakhpur district, where CFTS is working as BC to bank.

11. Clients' transaction cost of borrowing as per their occupation indicate that the transaction cost differs significantly across occupations of clients. It is quite high for the clients engaged in business and labour work in all the three models. As expected, the transaction cost is least for housewives, for whom the opportunity cost of time is almost negligible as compared to labourers and business women. In MFI model, the transaction cost increases with the loan amount, but the difference in transaction cost across loan categories is not statistically significant. In SHG-Bank and BC models, the transaction cost decreases by and large with an increase in loan amount, and the difference turns out to be statistically significant.

12. The results reveal that by and large, the transaction cost decreases significantly as the clients get mature in group in MFI model. This may be because older clients require less training for microfinance, due to their acquaintance with the MFI for a longer time duration. The results are just opposite in SHG-Bank model, though not statistically significant. This is because, there is no repeat borrower in the sample of SHG-bank model. In BC model, the same trend in the movement of transaction cost has been observed as in case of MFI model.

13. In SHG-Bank model, the bank conducts all financial transactions (savings and credit) at group level. It is evident that group absorbs 39 percent of total transaction cost of borrowing. The bankers and policy makers can leverage this high share of transaction cost at group level by increasing the scale of lending at group level.

14. Given the low level of literacy of MF clients on one hand and limited choices before them to access financial and non-financial services, on the other, the poor are not able to assert themselves with respect to service providers. This difference is not very sharp

between rural and semi-urban areas. The women in semi-urban areas are more aware about different MFIs operating in their areas. They could recall the names of at least 05-06 MFIs operating in Barabanki district. Some of them even have taken loan from more than one MFI. Still majority of the women are at the receiving ends. They expect a lot from the bank and MFIs. The women give lot of emphasis on savings particularly in the SHG model. Among the non-financial services, all the clients are looking forward for business development services to scale their existing business or to start a new enterprise.

15. Based on our interaction with microfinance clients, MFIs and bankers, the followings suggestions are put forward:

(a) The lending to SHGs by banks should be increased. It is disheartening to note that only 40 percent members are borrowing members in the groups. This trend is due to lack of awareness among some of the bankers about SHG methodology and the credit linking process. There is a need for imparting knowledge and training to bank staff about the concept of SHG bank linkage programme so as to encourage bankers to take keen interest in the SHG movement. NABARD has invested a lot of money on training to bankers in the past, particularly during late 90s and early 2000. This process must be continue to keep the momentum for the bankers.

(b) Bankers still perceive lending to SHGs as a risky venture. The SHGs should be part of value chain model, where adequate partnership with marketing agencies (private or Government) should be established. The sale proceed of SHGs products can be routed through banks. Bankers would be more comfortable in financing SHGs which are part of value chain

(c) The MFIs should not insist the members to visit the branch office to repay the loan amount. The MFIs should collect the repayment from the clients at the time of group meeting.

(d) There is tremendous scope of using technology to reduce the transaction cost of the clients as well as of the organizations. Mobile banking technology is already being used to provide saving services in rural areas by many MFIs. The same technology can be used in repayment of loans by the clients so that they can avoid the travel cost to visit MFI/bank branch for repayment of loan.

(e) The banks should promote BC model vigorously for proving loan to SHGs. BCs should be involved in providing number of financial services like credit, savings, insurance and remittances to overcome the problem of financial viability. Banks should also provide training to BC staff to adopt new technology, new products and new systems.

(f) The MFIs may have monthly meeting of groups instead of having the same at weekly level, if all the client in a group desire. It would reduce the time cost of clients in attending the group meetings frequently. Moreover, group meeting should be held in evening so as to minimize the loss of work. The photograph of individual member as well as identity certificates can be digitized electronically at the MFI/Bank so that clients need not to incur the expenses on these items again and again.

(g) Given the difference in the objectives, approach and methodology of SHG-bank model and MFI model, it may not be appropriate to numerically compare the clients' transaction cost across these two models. The comparative analysis of these two models can provide best practices of each model, and more importantly, how those best practices can be incorporated in different models. While comparing the transaction cost across models, one has to keep in the mind that sample of clients is not uniform in terms of their occupation, location and age in the group. All these characteristics of clients affect their transaction cost of borrowing. The SHG-bank model is not as matured in U.P. compared to Southern States of India. In order to get more authenticated results, sample should have included the sample of SHG-bank linkage model from a State, where this model is quite active and mature enough. The results based on the study of U.P. State alone cannot be generalized at country level.

Chapter 1
Introduction

Section 1: Microfinance and Financial Inclusion

1.1.1 It is clear and accepted that poor people want financial services. The benefits of financial services are obvious and increasing evidences suggest that low income households are actively seeking new and better ways to invest in a more secure future (Collins et. al. 2009). The poor require financial services to undertake different expenditures when there is wide mis-match in the inflow of income and outflow of expenditures in their household and business economy. Rural households face broad range of risks and crises such as natural, life cycle related, health related, economic, social, political and environmental. A study conducted at Indian Institute of Management, Lucknow identified variety of risks and crises, which are faced by rural households in U.P. (Kapoor 2006). The study concludes that death, sickness and health problems, agriculture and livestock related shocks are ranked high not only in terms of financial pressure experienced by the poor, but also in terms of their frequency of occurrence. To cope with risk, the poor use diverse strategies. These may include, withdrawal of past savings, borrowing, selling productive and non-productive assets, other forms of self-insurance, informal group-based risk sharing systems, and occasionally, formal insurance.

1.1.2 Given the paramount importance of financial services, the paradox is that millions of people in rural India remain without access to high quality, appropriate financial products from formal financial institutions. Poor people have limited access to formal or semi-formal financial agencies (indeed this is the basic rationale for the development of the microfinance industry). A study conducted by SaDhan reports that aapproximately 87% of the people within the income of Rs.5000/- and less per year approach the money lenders, Financial Institutions such as Microfinance Institutions and friends and relatives for credit. On an average 71.7% of people of this income bracket do not have access to saving avenues with the formal Banking system (Sa-Dhan, 2012). The poor, irrespective of the fact that he or she stays in the vicinity of a bank branch, as a class, gets excluded. 'The Committee on Financial Inclusion headed by Dr C Rangarajan in 2008 points out that the “the poorer the group the greater is the exclusion” (RBI, 2008). In India only 55% of the population has access to formal

bank accounts, a fact that signifies that at least 45% of population is dependent on either the semi-formal or the informal sector.

1.1.3 The considerable amount of financial exclusion has widen the *'Rich-Poor divide'* and thus has resulted to *'Social Exclusion'* of the poor. The absence of access to bank accounts and other financial services results in:

- Lack of savings;
- Low investments;
- Lack of financial planning and security for old age;
- Difficulties in gaining access to credit or being forced to access credit from informal sources at exorbitant rates;
- Increased unemployment due to lack of self – employment opportunities.

1.1.4 The major reasons for financial exclusion are:

- Mismatch between the hierarchy of credit product needs and credit products availability
- High transaction cost for financial agency as well as for rural clients
- High perceived risk to financial agency due to lack of tangible collateral offered by rural clients

1.1.5 Thus, financial inclusion has remained a distant dream for a majority of poor Indians. Financial Inclusion has been defined as the "provision of affordable financial services to those who have been left unattended or under-attended by formal agencies of the financial system. These financial services include payments and remittance facilities, savings, loan and insurance services" (RBI, 2006a). Micro finance has been looked upon as an important means of financial inclusion in India (RBI, 2006b). Microfinance institutions serve as a supplement to banks as they not only offer micro credit but they also provide other financial services like savings, insurance, remittance and non-financial services like individual counselling, literacy programme, training and support to start own business and the most importantly in a convenient way. The borrower receives all these services at door step and in most cases with a repayment schedule of borrower's convenience. Microfinance in India has brought a revolutionary shift in approach for providing financial services to poor since mid-90s. Over the past decade, it has been claimed vigorously that micro-finance has a positive

impact on the poor in terms of increased household income, livelihood improvement and women empowerment.

1.1.6 Microfinance is generally defined as financial services for poor and low-income clients offered by different types of financial service providers. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as "microfinance institutions" (MFIs). In broader way, microfinance refers to a step up that envisions a world in which low-income households have permanent access to a range of high quality and affordable financial services offered by a range of retail providers to finance income-producing activities, build assets, stabilize consumption, social & economic development and protect against risks. These services include savings, credit, insurance, remittances, and payments, and others.

1.1.7 Typical microfinance clients are poor and low-income people that do not have access to other formal financial institutions. Microfinance clients are often self-employed, household-based entrepreneurs which includes small retail shops, street vending, artisanal manufacture, and service provision or labour. In rural areas, micro entrepreneurs often have small income-generating activities such as food processing and trade; some but far from all are farmers. Microcredit works because it is often arranged for a group, which leads to peers pressure on individuals to repay the loans or risk losing microcredit as a financial opportunity for their group.

Section 2: Models of Microfinance Interventions

1.2.1 Microfinance services in India are provided mainly by two distinct models:

(a) Self Help Group - Bank Linkage Program Model (SBLP)
(b) Micro-Finance Institutions Model (MFI).

(a) SHG - Bank Linkage Program

1.2.2 This is the bank-led microfinance channel which was initiated by NABARD in 1992. Under the SHG model, the members in villages are encouraged to form groups of around 10-20 persons belonging to same socio economic background. Main aim of the group formation is to provide mutual understanding, support, help and aid for each other. The members contribute their savings in the group periodically and from

these savings small loans are provided to the members. In the later period these SHGs are provided with bank loans generally for income generation purpose and livelihood betterment.

1.2.3 SHG groups are mainly homogeneous and are voluntarily formed .The group's members meet periodically when the new savings come in, recovery of past loans are made from the members and also when new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular and it has proved helpful in eradicating poverty to some extent. The SHGs are self-sustaining and once the group becomes stable, it starts working on its own with some support from NGOs. This model includes three different approaches that are as follows:-

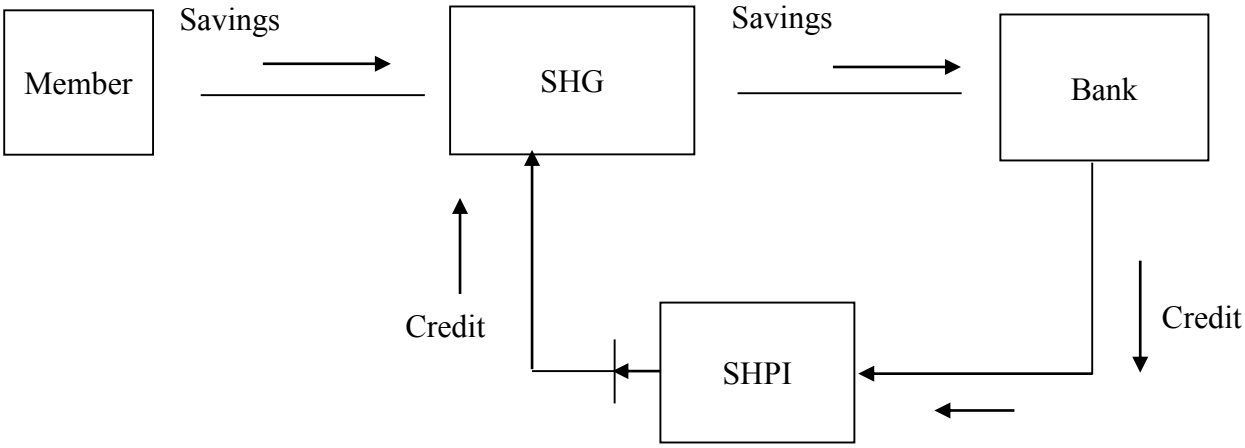
Model I: - SHGs promoted, guided and financed by banks.

Model II: - SHGs promoted by NGOs / government agencies and financed by Banks (Figure 1.1).

Figure 1.1: A Schematic View of SHG-Bank Direct Linkage

Model III: - SHGs promoted by NGOs and financed by banks under NGOs / formal agencies as financial intermediaries (Figure 1.2).

Figure 1.2: A Schematic View of SHG-Bank Indirect Linkage



(b) Financial Intermediation by Micro Finance Institutions (MFls)

1.2.4 MFIs have been promoted in India with the view to provide financial services to the rural or semi-urban people and protect them from risk, improving socio economic conditions, alleviating poverty and providing self-employment opportunity to women. MFIs include NGOs, Trusts, Companies registered under Section 25, Company Act, and Non-banking Financial Companies. MFIs lend small size loans to individuals or groups. They also provide other services like capacity building, training, marketing of products etc. MFIs operate under following models:

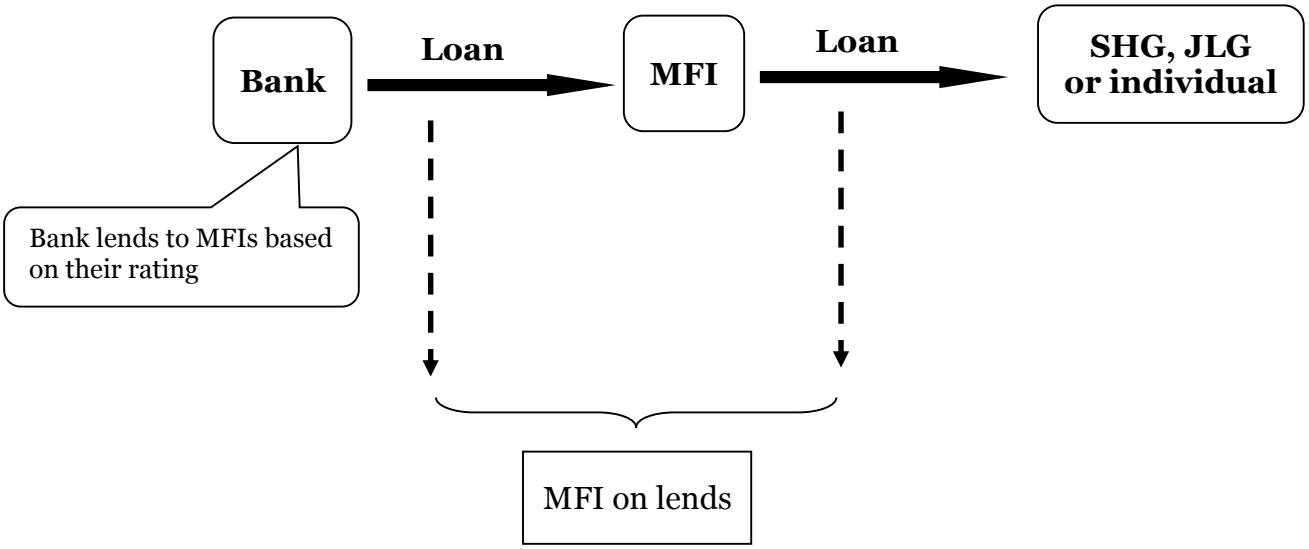
Bank Partnership Model

(i) MFI as Agent: In this model, the MFI acts as an agent and it take care of all relationships with borrower from first contact to final repayment.

(ii) MFI as Holder of Loans: Here MFI holds the individual loans on its books for a while, before securitizing them and selling them to bank.

Banking Facilitators Model: Banking facilitators / correspondents are intermediaries who carry out banking functions in villages or areas where it is not possible to open a branch. In January, 2006, RBI has permitted banks to use services of NGOs, MFIs and other civil society organizations to act as intermediaries in providing financial and banking services to poor (Figure 1.3).

Figure 1.3: A Schematic View of MFIs Lending Model



Section 3: Transaction Cost and Microfinance

1.3.1 One of the key factors which has always been the concern of both researchers as well as policy makers is the issue of Transaction Cost (henceforth TC) in microfinance. TCs can be defined as any costs that arise due to the existence of institutions and the appearance of an economic exchange (Cheung, 1969). Using this definition of transaction cost, there are two party involved in microfinance exchange within an institutional framework of "Group", namely, the poor clients having financial needs on the one hand, and the lender (bank or MFI) on the other. In the absence of institution (group), these two parties face difficulties in conducting the financial exchange due to problem of information asymmetry. Thus, TC is the cost the lender and the borrower incur over and above the direct interest cost in reaching out an agreement between them for financial transaction.

1.3.2 Transaction costs are a measure of the factor in the functioning of financial market. The higher the transaction costs, the higher the cost of intermediation and thus the less efficient the performance of the financial sector (Cuevas, 1988).There are three kinds of costs that a lending institution incurs when it provides loan. First, the cost of the money that it lends, second, the cost of loan defaults and third, the cost of the transaction namely the transaction cost which includes the cost of identifying and screening the client ,processing the loan application, completing the documentation for the loan, disbursing the loan, collecting repayments and following up on non-payments (Savita Shankar,). Unlike the cost of funds and the cost of default, transaction cost, is not proportional to the amount lent since there is invariably a minimum amount of time that each loan require for appraisal of the loan application, processing the loan disbursement and repayments, and follow-up monitoring. The average microfinance loan size being smaller than most other loans, the transaction cost on a percentage basis for a microfinance loan tends to be higher. Some other factors may contribute to higher transaction cost for microfinance loan as compared to other loans: initial training costs for the borrowers (social intermediation), higher degree of supervision, collection of higher frequency of instalment payments (weekly or bimonthly), higher cash handling and distance of group from nearest banking centre.

1.3.3 TCs are part of the total cost of the transaction for the borrowers, in addition to interest rates and fees paid to the institution. A significant reduction in TCs for clients

has been advocated as the main mantra of microfinance, and as a result it has been used as a justification for a high interest rates charged to borrowers. In the measurement of transaction cost in self-help group (SHG) banking ,there are several categories of transaction costs : those incurred by clients in getting loans and making deposits, the transaction cost of SHGs as intermediaries between client members and banks, and the banks transaction cost. SHG are assumed to absorb transaction cost from both bank and poor clients and thereby makes the poor bankable.

1.3.4 The borrower transaction cost consist of the expenditure involved in visiting the bank, documentation procedures in availing the loan and opportunity cost of time spend in getting the loan. The client members have to visit bank branch for negotiating loan, document submission and security submission, so this entire process incurs expenditure in travelling, opportunity cost related to time and travelling , documentation cost. As the time increases by bank in lending loan to the client member and disbursing, more is the transaction cost of the borrower.

1.3.5 There are few other costs related to transaction cost from borrowers point of view is as follows:

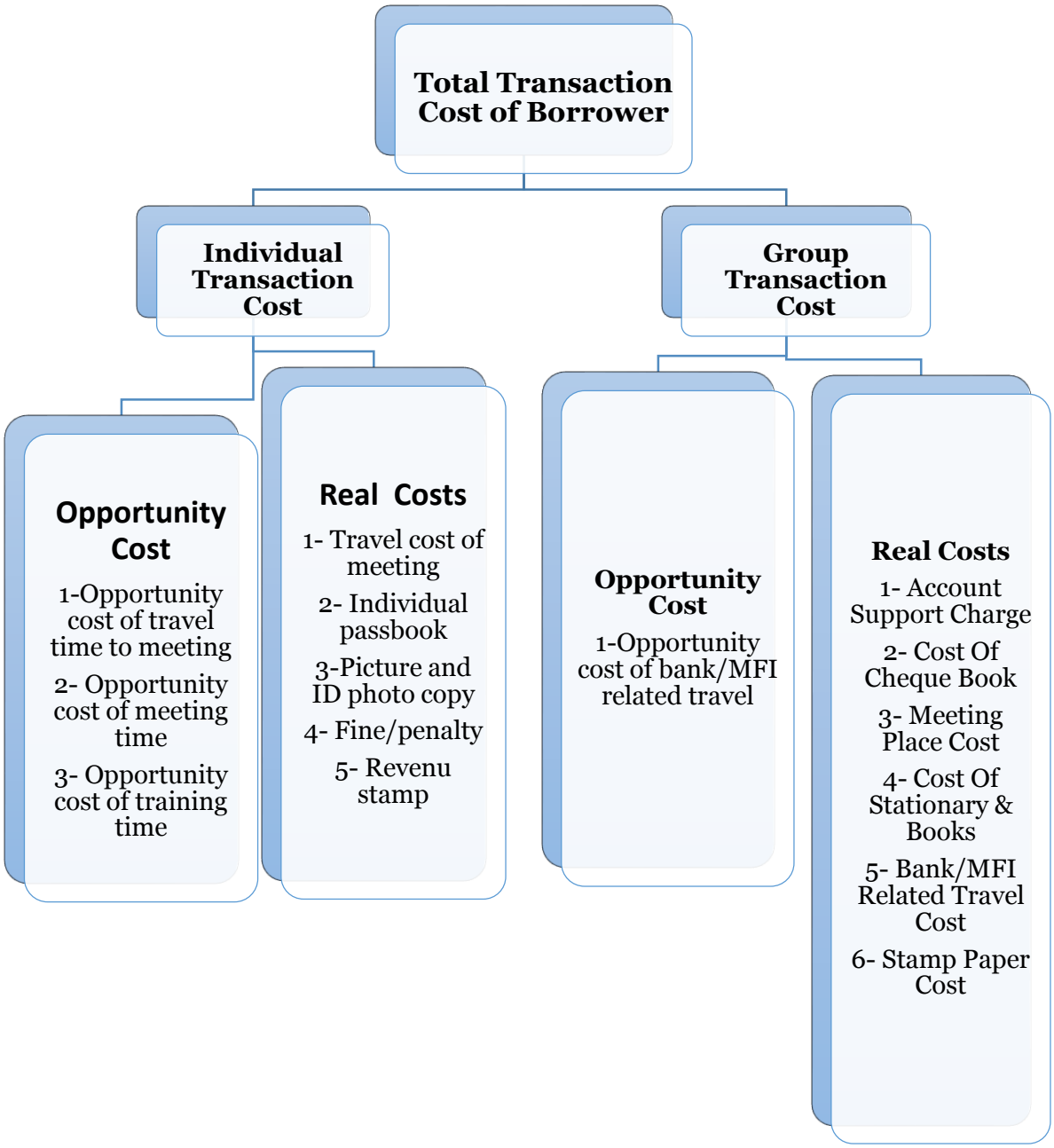
a) **Opportunity cost of travel meeting**: Cost related to the time needed to walk to and from the meeting place.
b) **Opportunity cost of meeting time**: Cost related to the time spent while attending group meetings.
c) **Opportunity cost of training time**: Cost related to the time spent in attending trainings.
d) **Travel cost of meeting**: Cost of return journeys (rickshaws, taxi, and bus) to attend meetings.
e) **Revenue stamp and stamp paper cost**: For disbursement of loan amount revenue stamp and stamp paper is required.
f) **Photograph and copy of ID cost:** MFIs/banks usually ask for photograph and proof of ID.
g) **Fine (cost of missing a meeting):** SHGs usually fine members for not attending a meeting.
h) **Opportunity cost of bank/MFI related travel:** Cost related to the time needed to walk to and from the bank.

i) **Accounting support costs:** SHGs lacking literates pay an auditor or book writer to help.

j) **Cost of stationary and books:** Cost related to the purchase of an attendance register, minute books, loan saving ledger, cash book, general ledger and bank passbook.

k) **Bank/MFI related travel cost:** "Go and return" cost of journeys (bus, rickshaw or taxi) to access banks or MFIs.

Figure 1.4: Schematic representation of transaction cost incurred by a client member while borrowing a loan



Section 4: Need and Objectives of the Study

1.4.1 TCs, including real and opportunity costs, vary across lending methodologies. For instance, loans may be offered individually or in groups, and the size of the loan may increase for each subsequent individual loan. The transaction cost so incurred by the client can also be divided across the services they avail from the institutions. This includes financial activities like savings and credit as well as non-financial activities like training programs. TC for client can also be dependent upon their location (remote rural area v/s semi-urban area). Therefore, the measurement of transaction costs across various models become important to arrive at the most effective model of microfinance. By doing a comparative study of transaction cost estimation across the different models, the policy makers can also come across methods to reduce the transaction costs further by benchmarking best practices across all the models. There is also a need for calculating and comparing TCs for microfinance clients located in remote rural and semi-urban areas of India. It will provide empirical evidence about potential barriers to financial inclusion—in addition to interest rates—for microfinance clients.

1.4.2 The transaction cost to the client is an important component of the total cost. An increase in total costs eventually implies lesser savings, more expenditure and less motivation to avail financial services. Therefore, it was felt extremely necessary by NABARD that a study should be conducted in the present context to analyse the costs to the SHG client when it is linked to bank as well as to a MFI.

1.4.3 The present study was undertaken with the following specific objectives:

- Assess the factors responsible for transaction costs for the client
- Estimate the components of transaction cost of the client and its share in the total cost
- Evaluate the transaction cost occurring to the SHG as the client of a bank as well as an MFI, and compare it with the interest rates charged by the institution and the services availed by the client.
- Identify ways and means to reduce transaction costs for the clients without incurring any additional cost to the suppliers.

Chapter 2
Research Methodology

Section 1: Process of Credit Transaction in Microfinance

2.1.1 The study laid emphasis on understanding the methods currently used by Banks/MFIs for providing financial services to people using different microfinance models. For this purpose, the technique of Process Mapping has been used for this study. Process *mapping* is the first step of process management. It uses tools that enable an organization to document, analyse, improve, streamline, and redesign the way it works. Armed with a thorough understanding of the *inputs*, *outputs,* and interrelationships within each *process*, we can:

- Understand how processes interact in its operational system.
- Locate process flaws that are creating systemic problems.
- Determine which activities add value for the organization and which add value for the *customers*.
- Increase efficiency by streamlining and improving workflows.
- Identify processes that need to be re-engineered.

2.1.2 Process *mapping* is a simple yet powerful method to reveal an organization's core processes and discover how its different parts work together to serve customers. *Process maps* enable to peel away the complexity of an institution's organizational structure to focus on the processes that are truly the heart of a business. Process mapping is thus a valuable communications tool, a strategic business planning tool, and an analytical management tool. A process map enables an organization to compile data about the processes in place so that they can be analysed.

2.1.3 The ultimate objective of process mapping is to understand a *process* as it is currently performed, and how to improve it. Process mapping gathers, organizes, and displays facts about the processes, so that people can study and streamline them. It is also a very useful way for identifying areas of risk in any transaction or process. A process map is a snapshot that shows the specific combination of functions, steps, *inputs*, and *outputs* that an organization uses to provide value to its *customers*.

2.1.4 Each step throughout the process is accompanied by the following issues:

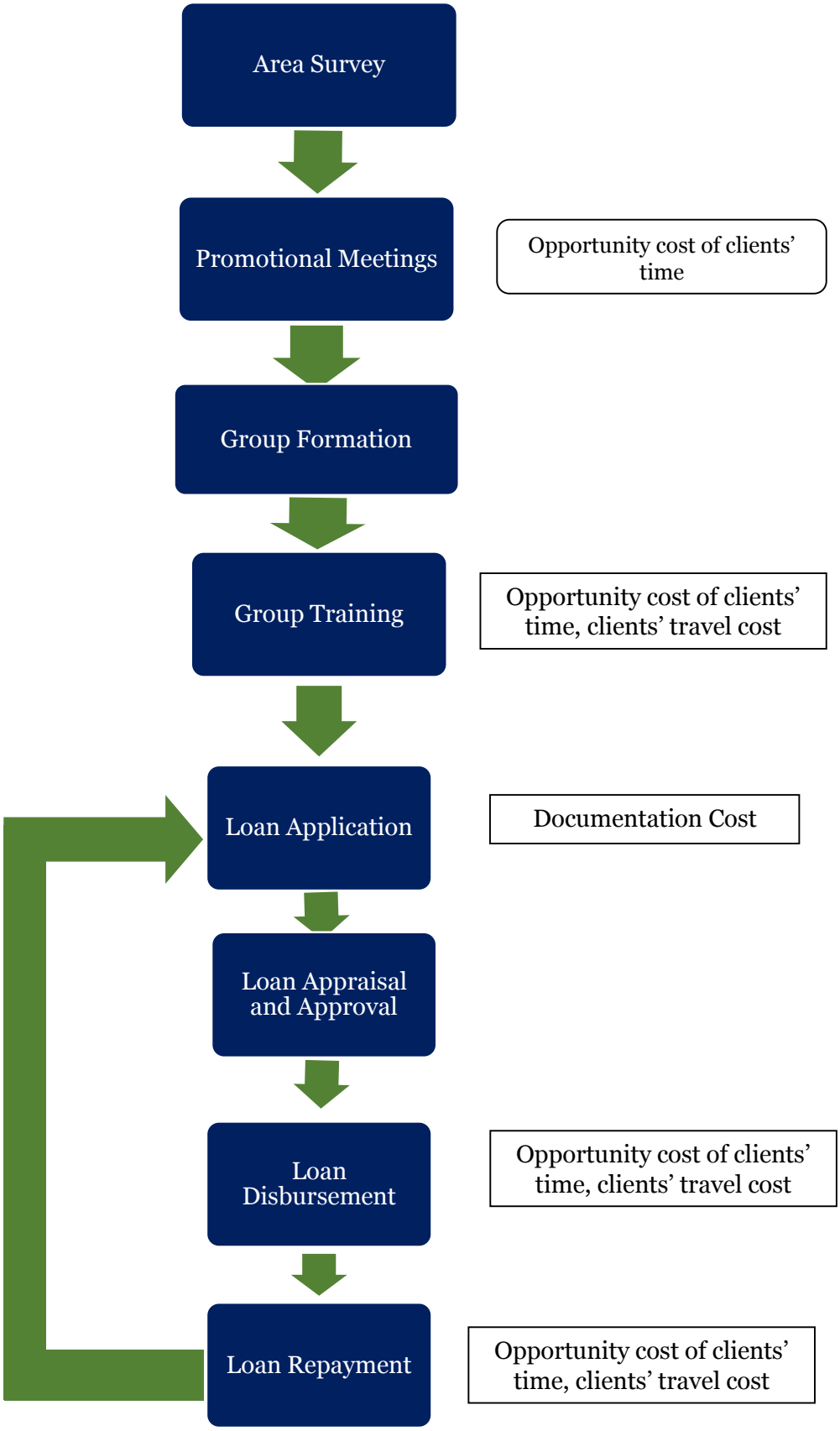
- What is happening?
- When it is happening?
- Who is doing it?
- Where it is happening?
- How long does it take?
- How is it being done?
- Why is it being done?

2.1.5 Process maps for different models proved useful in our research study in designing the questionnaires and focusing on sources of transaction cost in the entire process of borrowing loan. Process maps were useful in:

- Understanding general process adopted by different organizations for lending microcredit,
- Easily identification of borrowers' involvement in borrowing loan,
- Identifying the occurrence of Transaction cost at various stages, and
- Focuses on stages where transaction cost can be minimized.

2.1.6 The process involved in microfinance loans starts with screening and identifying area through survey. Next step is formation of groups where potential member come together and form groups. At this stage, transaction costs like opportunity cost of time, meeting place and travel cost incur. Now training and literacy programmes are conducted by organization to impart knowledge about rules and regulations of group based microfinance, group dynamics, savings and MFI/Bank transaction processes. Here borrowers' transaction cost includes stationary cost, travel cost and opportunity cost of time spend in meeting. Once the groups are formed and functional, loan application is made by the members where documents are required (stamp paper, revenue stamp, photograph and other identification documents). It causes not only the cost of different documents but travel and time cost of borrower to get these documents. For the loan disbursement and repayment of loan, client member visits branch office which involves their travel cost and time cost. This general transaction process has been depicted in chart 2.1 below:

Chart 2.1: Process of Credit Transaction in Microfinance



2.1.7 The differences in process of lending under two major models is given in Table 2.1.

Table 2.1: Comparison of MFI and SHG-Bank Model

Sl.	Feature	MFI Model	SHG-Bank Model
1.	Organization responsible for group formation and training	MFI staff Same organization is involved for group formation and training, and lending the money to clients	SHPI There are two distinct identities involved. SHPI for group promotion and training and bank for lending the money
2.	Duration of group training	Less (2-3 days)	More (12 days)
3.	Content of training	Limited to group formation, and MFI lending procedures and policies only	Much wider approach including group formation, literacy, savings, bank procedures and policies, income generating activities
4.	Incubation period before external lending	10-15 days	Minimum 6 months
5.	Frequency of meetings	Weekly/fortnightly	monthly
6.	Mode of loan disbursement	individual	group
7.	Loan disbursement process	Clients and their spouse visit the MFI branch	Group representatives visit the bank branch and borrow the loan amount as per the sanctioned amount on behalf of all the members
8.	Mode of loan repayment	(a)Repayment amount is collected by MFI staff at the group meetings, or (b)individual members visit the MFI branch for loan repayment	Group representatives visit the bank branch and repay the loan amount on behalf of all the members
9.	Savings	Group is not involved in promotion of savings among the members	Mandatory savings by the members of the group
10.	Documents for borrowings	All documents (resident proof, photo and stamp paper) at individual client level	Stamp paper at group level, but resident proof and photo at individual member level

Section 2: Estimation of Clients' Transaction Cost

2.2.1 The study estimated the transaction costs per monetary unit (total transaction costs divided by loan borrowed) incurred by microfinance clients under different business models and across the space. Based on the process maps of credit transaction

in different microfinance models, the study computed the following components of transaction cost:

(a) Indirect Transaction Cost (opportunity cost of time)

- Opportunity cost of training time: cost related to the time spent attending group trainings
- Opportunity cost of meeting time: cost related to the time spent attending group meetings
- Opportunity cost of time spent in travelling training place
- Opportunity cost of time spent in MFI/Bank branch

2.2.2 The opportunity cost of time per hour for labourers and service holders was calculated on the basis of actual wages they receive for a day. For those clients who are involved in pretty businesses, it was based on the loss of income per hour due to absent from their business.

(b) Direct Transaction Cost

- Travel cost to meeting: cost of return journeys to attend training or group meetings
- Travel cost to get the individual photograph
- Travel cost to buy the stamp paper/revenue stamp
- Travel cost for photocopying the documents (resident proof, and ID card)
- Travel expenses incurred in visiting Bank branch for opening the group saving bank account
- Travel expenses incurred in visiting MFI/Bank branch for getting the loan and its repayment
- Cost of photograph, stamp paper, revenue stamp and resident proof

2.2.3 All the components of direct transaction cost were quantified as per the actual expenses incurred by clients on these items. In SHG-Bank model, the bank conducts all financial transactions (savings and credit) at group level. Accordingly, group absorbs a lot of transaction cost on behalf of the individual members. The cost incurred at group level consists of opportunity cost of time and travel cost in visiting bank branch for borrowing and repayment, and documents like stamp paper. This cost incurred at group level was distributed equally among all the members to arrive the cost incurred by individual member.

2.2.4 The share of different components of clients' absolute transaction cost was calculated to find out the relative importance of each component. For the analysis purpose, following categories of components were made among the indirect and direct transaction costs.

1. Indirect transaction cost

(a) Opportunity time cost during group trainings

(b) Opportunity time cost in attending group meeting

(c) Opportunity time cost in visiting MFI/bank branch for borrowing and repayment

2. Direct transaction cost

(a) Travel cost in group training

(b) Travel cost in collecting various documents

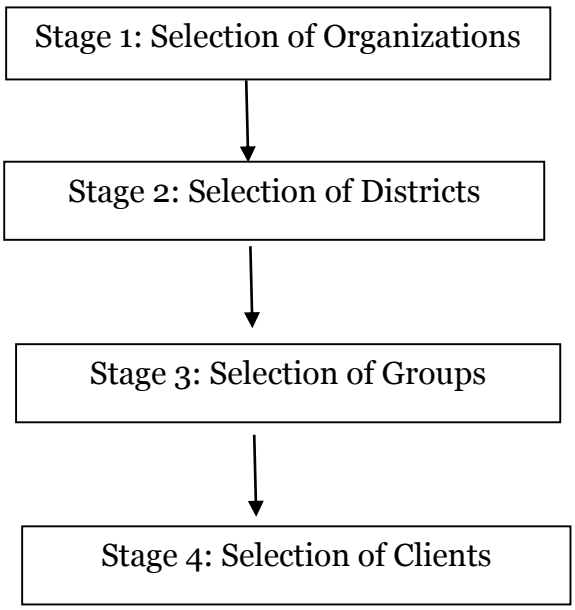
(c) Travel cost in visiting MFI/bank branch

(d) Cost of documents

Section 3: Sample

2.3.1 The study used multi-stage convenient sampling technique to select the sample frame (Chart 2.2).

Chart 2.2: Multi-stage Convenient Sampling Technique



(a) Selection of Organizations:

2.3.2 The study team had a detail discussion with Micro Credit Innovations Department (MCID) of NABARD Lucknow office for selection of organization and Districts. Based on the suggestions of NABARD HO, Mumbai and RO, Lucknow, three MFIs namely, Margdarshak Financial Services Ltd., Sonata Finance Private Ltd., and Cashpor Financial and Technical Service were selected. These are the leading MFIs working in the State of U.P. The study also selected two Self-help Promoting Institutions (SHPIs), namely Khadi Mahila Gramodyog, and Varanasi Medical Society, which have promoted SHGs and got those linked with Commercial Banks and Regional Rural banks (RRBs). A brief description about the nature of these selected organization has been given in Annexure 1.

(b) Selection of Districts:

2.3.3 Based on the operational area of selected organizations, three districts, namely Barabanki, Varanasi and Gorakhpur were selected for the study. These districts were chosen as per the suggestion of the concerned organization.

(c) Selection of Groups:

2.3.4 The groups which were credit-linked with banks (under SHG-Bank Linkage Model) and where lending was started by MFIs (Under MFI Lending Model) were selected from the selected Districts. The number of the selected groups under different microfinance models in the selected Districts are given in Table 2.2. The number of groups selected under different models in different districts were based on availability of the required groups. The sample has been chosen in a way that more than 50 percent of groups must be located in remote rural areas.

Table 2.2: Numbers of the Selected Groups under Different Micro-finance Models

Sl. No.	Districts	MFI Model	SHG-Bank Linkage Model	Banking Correspondent Model
1.	Barabanki	25	11	-
2.	Varanasi	15	15	-
3.	Gorakhpur	-	-	10
4.	Total	40	26	10

(d) Selection of Clients:

2.3.5 From the selected groups, a total of 700 clients were interviewed who had taken loan either from MFI or bank. The number of the selected clients under different microfinance models in the selected Districts are given in Table 2.3. The number of clients selected under different models in different districts were based on availability of the required clients and the size of selected groups.

Table 2.3: Numbers of the Selected Clients under Different Micro-finance Models

Sl. No.	Districts	MFI Model	SHG-Bank Linkage Model	Banking Correspondent Model
1.	Barabanki	172	91	-
2.	Varanasi	163	160	-
3.	Gorakhpur	-	-	113
4.	Total	335	251	113

2.3.6 A summary of total sample frame has been given in Table 2.4 below.

Table 2.4: Summary of Sample frame

Sl. No.	Sampling Unit	Number
1.	Organizations	5
2.	Districts	3
3.	Groups	76
4.	Individual Clients	699
5.	FGDs	76

Section 4: Methods of Data Collection

2.4.1 The required quantitative and qualitative data for the study were collected through conducting primary field survey and Focus Group Discussions (FGDs). Primary field survey included data collection by structured questionnaire and interviews with microfinance clients. The designed questionnaires contained both open ended and closed ended questions covering all the required aspects. Based on interaction with different organizations, and the processes involved in providing financial services to clients, detailed questionnaires were developed separately for clients of SHG Bank linkage model and MFI model. Since group also absorb some of the transaction cost on behalf of members, a separate questionnaire was also developed to elicit the data at the group level. Pretesting of questionnaire was done with the members of 2 SHGs and JLGs. It gave clear idea about factors responsible for

incurrence of transaction cost by individual client. Based on the feedback of clients, questionnaire was modified and improved for further survey. These questionnaires are provided in Annexures 2 to 4.

2.4.2 Questionnaire survey was supplemented by the Focus Group Discussions at group level to encourage client members to come out with their thoughts and provide feedback. It provided useful information that field survey was unable to provide and also gave insight about group activity in qualitative form.

Section 5: Analysis of Data

2.5.1 The collected data were analysed using SPSS software. The required results were generated for different microfinance models, wherever necessary. ANOVA techniques was used to find out the difference among the transaction cost of borrowing across different categories of clients. F statistics were computed to ascertain the statistical difference in the results across categories of clients. For the analysis of transaction cost and its components, the clients were stratified into the following categories:

2.5.2 **Category 1: Location of client**

(a) Rural
(b) Semi-urban

2.5.3 **Category 2: Occupation of client**

(a) Farming
(b) Service
(c) Business
(d) Laborer
(e) Housewife
(f) Others

2.5.4 **Category 3: Borrowed amount**

(a) Less than Rs. 5000
(b) Rs. 5000 to less than Rs. 10,000
(c) Rs. 10,000 to less than Rs. 20,000
(d) Rs. 20,000 and above

2.5.5 Category 4: Age (duration) of client in microfinance group

(a) Less than 6 months

(b) 6 months to less than 12 months

(c) 12 months to less than 24 months

(d) 24 months to less than 48 months

(e) 48 months and above

2.5.6 The stratification of clients in above categories was done to test the following hypotheses:

Hypothesis # 1: The borrowing transaction cost of the clients located in rural areas is significantly more than that for their counterparts in semi-urban areas.

2.5.7 It has been hypothesised that far the client is located from MFI/Bank branch, the travel cost would be more for borrowing and repayment of loan. Being located in remote rural area, a client has to bear more travel cost for getting the required documents.

Hypothesis # 2: There is significant difference in the borrowing transaction cost of clients involved in different occupations.

2.5.8 The opportunity cost of time plays an important role in total transaction cost of the client. It was hypothesised that the opportunity cost of time varies depending upon the nature of clients' occupation (maximum for those clients involved in petty business or labour work, and least for housewives).

Hypothesis # 3: With an increase in borrowing amount, the transaction cost of the clients' would be reduced significantly.

2.5.9 It was assumed that economy of scale would operate in the credit transaction. The fixed cost would be spread thinly for a larger amount, resulting in lower percent transaction cost for the clients.

Hypothesis # 4: The transaction cost of the older clients would be significantly less than that for new clients.

2.5.10 It was presumed that older clients would require less training for microfinance, due to their acquaintance with the MFI or Bank for a longer time duration. Accordingly, the opportunity cost of time incurred in group training would be less for older clients, resulting in lower transaction cost.

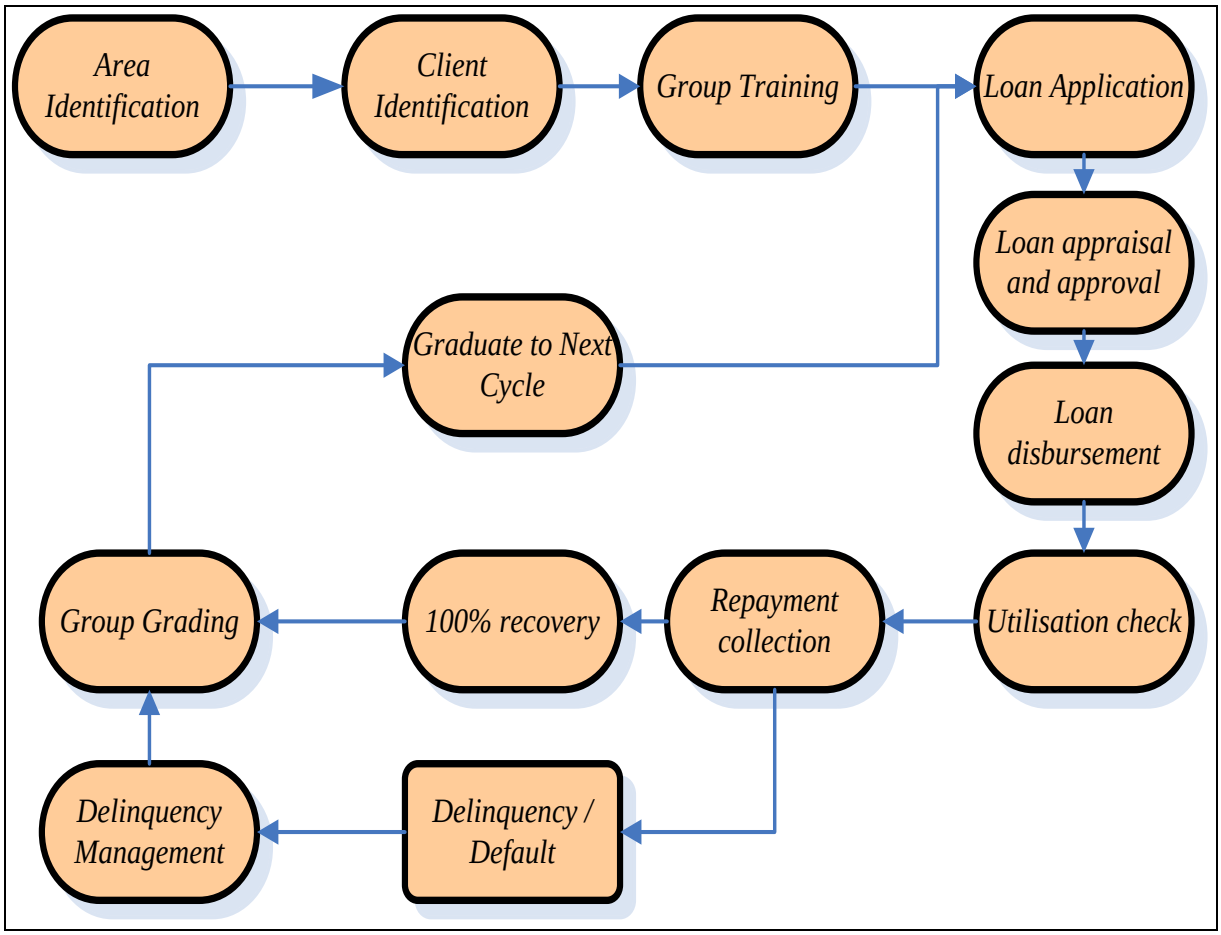
Chapter 3

Results and Discussion

Section 1: Process Map of Lending in MFI Model

3.1.1 Based on the discussion with three MFIs selected in the study, an attempt has been made to map the process involved in lending to clients. The step by step process has been documented to understand the nature of activities undertaken by the MFIs and clients in the entire process of lending. The process map has been depicted in Figure 3.1 below.

Figure 3.1: Process Map of Lending in MFI Model



3.1.2 Area Identification

A new area is identified for operations by the field officer through area survey and screening of target area, households is done. Secondary data is collected and promotional meeting is scheduled for target clients.

3.1.3 Group Formation

Group formation begins with promotional meeting held once or twice in the screened area for 1 hour. This meeting aims to clarify organizations working process, terms & conditions and other related information. Promotional meeting is also conducted for group liability testing so as to form group of 10-20 clients member who are responsible for each other.

3.1.4 Group Training

Training imparted to client is on literacy program and teaching signatures and other information related to MFI transaction process. It is conducted for 3-5 days. Each training session continues for 45 minutes to 1 hour.

3.1.5 GRT and Group Recognition

Branch manager cross check all the documents and verifies on the membership application forms. It is to be ensured that client member understands the organization, the loan, and the repayment process.

3.1.6 Loan Approval

Branch manager reviews the loan proposal section including loan amount, appropriate purpose and given an expected disbursement date of each member. Only, after then membership application form is signed off.

3.1.7 Loan Disbursement

Loan is always disbursed from the branch office. Clients together with their spouse are asked to come to the branch office on a pre-decided date where credit officer, cashier and branch manager checks all the documents and then verifies.

3.1.8 Group Meeting

Meeting is held every weekly or fortnightly at a pre decided meeting place where all group members are present. Meeting is usually held for 30 minutes to 1 hour. Credit officer precedes meeting by conducting pledge ceremony then fills the attendance sheet.

3.1.9 Loan Repayment

In Margdarshak MFI, credit officer collects the amount of loan repayment from the client members and deposit to branch office. In other MFIs, particularly in CFTS and

Sonata, client members themselves visit to branch office to deposit loan instalment amount as credit officer is not allowed to collect from the clients in the group meetings (Box 3.1).

Box 3.1: Trade-off between MFI Risk and Clients' Transaction Cost – Case of CFTS and Sonata MFIs

The members are asked to repay the loan instalment at MFI branch office. This has been undertaken to avoid the risk of internal fraud committed by MFI staff. It has been also designed to minimize the risk of theft of cash from the MFI staff from group meeting place to branch office. Although the MFI has reduced its risk, it has serious implications for transaction cost of the clients as they have to travel to MFI branch for repayment. This decision of MFI has diluted the original concept of microfinance of providing financial services to clients at their doorstep.

3.1.10 Delinquency Management

Members who are unable to pay their repayment instalment are considered as delinquent members. For recovery if it is required, branch manager visits the meeting place and collect instalment. Based on this, group grading is done that help group members in increasing credit limits for the next loan.

Section 2: Process Map of Lending in SHG-Bank Model

3.2.1 Based on the discussion with SHPIs involved in the study, the process map of lending in SHG-bank model has been developed and reproduced in Figure 3.2. The entire process consists of the following activities:

3.2.2 Area Survey and screening

Preliminary survey is conducted to understand the area and member requirement. Assessment is done as per the needs and conditions of target households.

3.2.3 Promotional meetings

Field officer of SHPI introduces about the organization and explains about policies, norms related to bank transaction. Orientation program aims to inform targeted client member about the saving terms, loan conditions, internal and external loaning process, documentation requirement and fees.

3.2.4 Group formation

Group is formed of 8 to 20 members residing within that specified area. Group passes resolution, frame policies and also elects its representative to manage the group.

3.2.5 Training Phase

SHPI staff conducts training for the group at specified location where knowledge about lending policies, guidelines for internal and external saving and loan, literacy programs, techniques to start new employment and develop existing occupation is imparted. Training continues for maximum 12 days where client member spent 2-3 hours daily.

3.2.6 Opening of Bank account

Field officer of SHPI along with group representatives visit bank branch to open a saving account. It requires registered verified documents and signature of all client members. For opening saving account and documentation, client members may be required to visit 2-3 times to bank. Saving collected weekly, fortnightly or monthly is deposited in bank by group representatives.

3.2.7 Loan Application

As per the group requirement, loan application is sent to bank for group loan after minimum of six months saving. Group leader checks the genuine requirement of loan and its utilization. After review of attendance sheet, pass book, cash book, documents, group rating report; branch manager approves the loan.

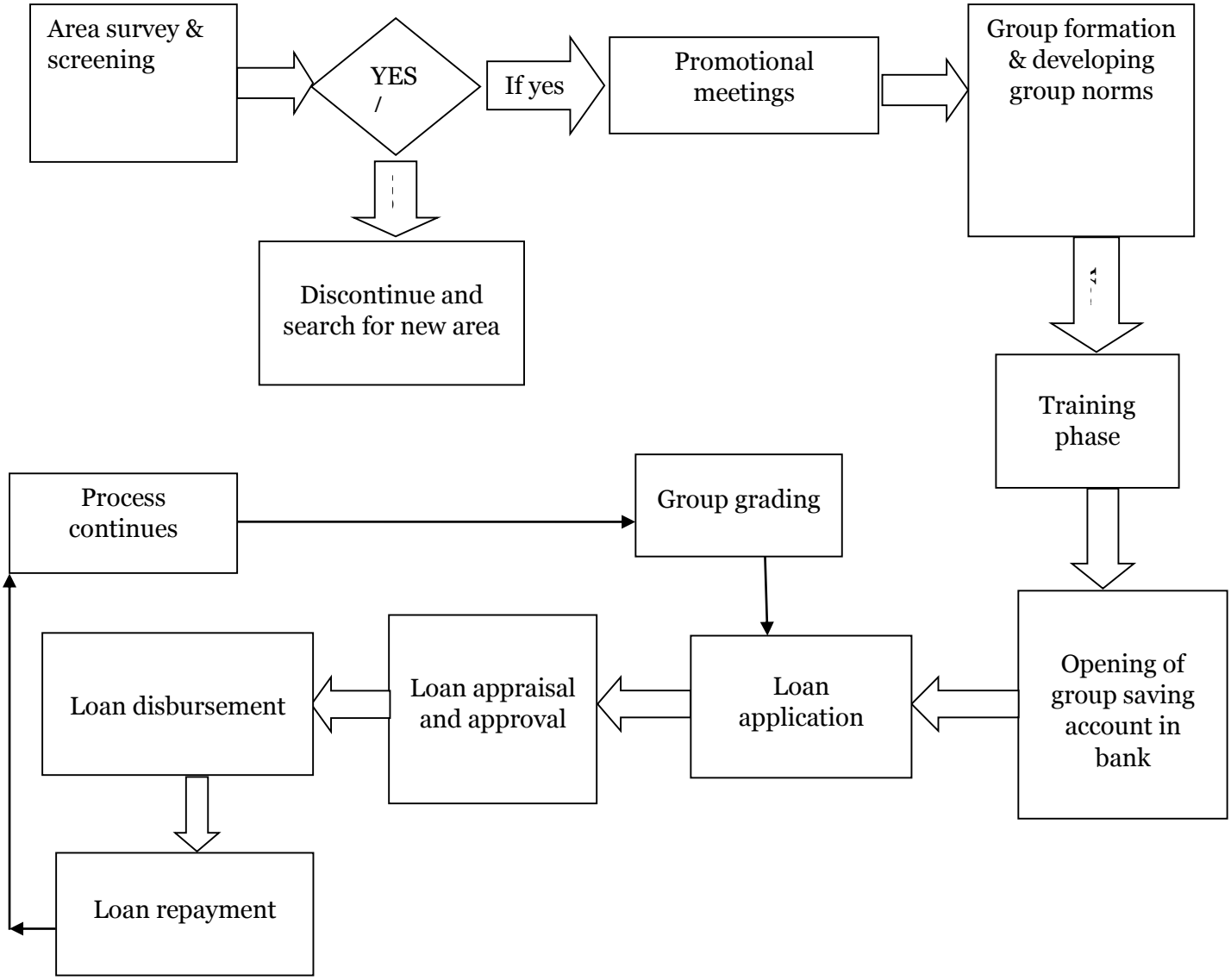
3.2.8 Loan Disbursement

Loan disbursement requires sufficient time for assessing relevant information on groups account. Branch staff forms linkage to bank for disbursing loan with all the receipt for transparency.

3.2.9 Loan Repayment

Loan installments are collected in SHG meetings and group leader deposits collected amount to bank and in turn receives the receipt. Group leader ensures that field officer has updated loan repayment card. After the repayment of all the loan installment, group can apply for next loan.

Figure 3.2: Process Map of Lending in SHG-Bank Model



Section 3: Process Map of Lending in BC Model

3.3.1 The process of lending in BC model is same as that in MFI model. CFTS being registered under Section 25 Company Act, is working as banking correspondent to Indusind Bank in Gorakhpur District of U.P. The bank has adopted the CFTS lending model for disbursement of loan to clients. The loan amount belongs to the bank and therefore, bank also have the final loan approval authority. It takes a little more time for CFTS to disburse the loan to client members. Rest of the activities are undertaken by CFTS.

Section 4: Profile of the Sample Respondents

3.4.1 This section discusses the socio-economic profile of the sample microfinance clients across three microfinance models. The profile has been captured with the following variables:

(a) Location
(b) Occupation
(c) Caste
(d) Gender
(e) Borrowing Amount (Rs.)
(f) Age of membership in Group (months)

3.4.2 The Distribution of sample clients on the basis of these variables has been given in Table 3.1. More than 60 percent clients belong to rural areas across all the models (Chart 3.1). The figure is maximum in case of SHG-Bank Linkage model where the rural clients are as high as 71 percent. This model has penetrated more in rural areas as compared to MFI model as by and large MFIs tend to work more in semi-urban areas to reduce their own transaction cost of lending.

Chart 3.1: Status of Sample Clients based on their Location

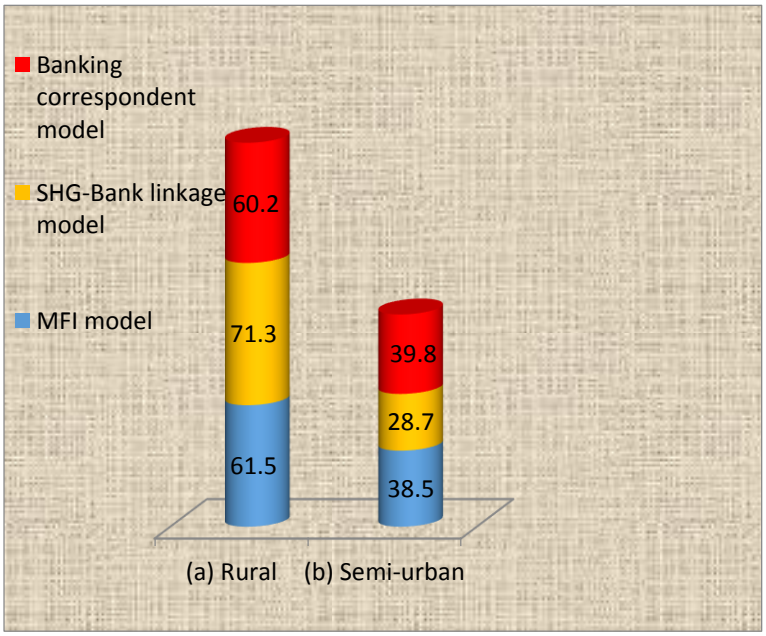
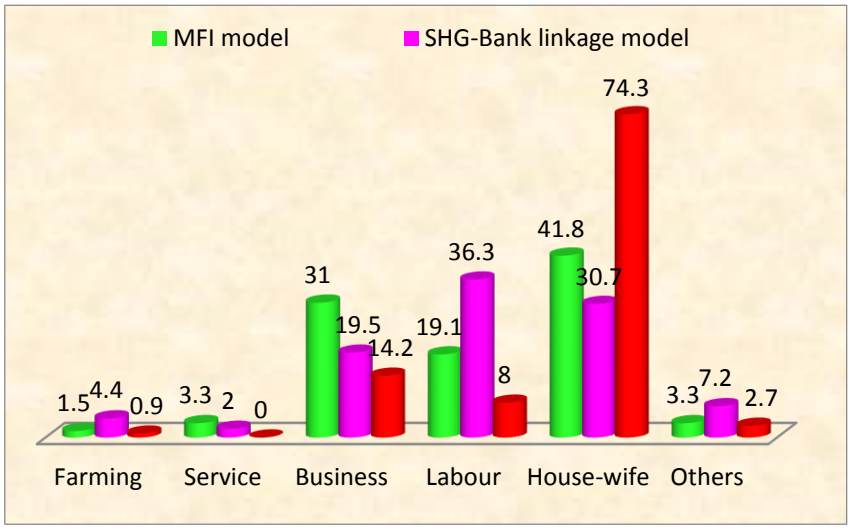
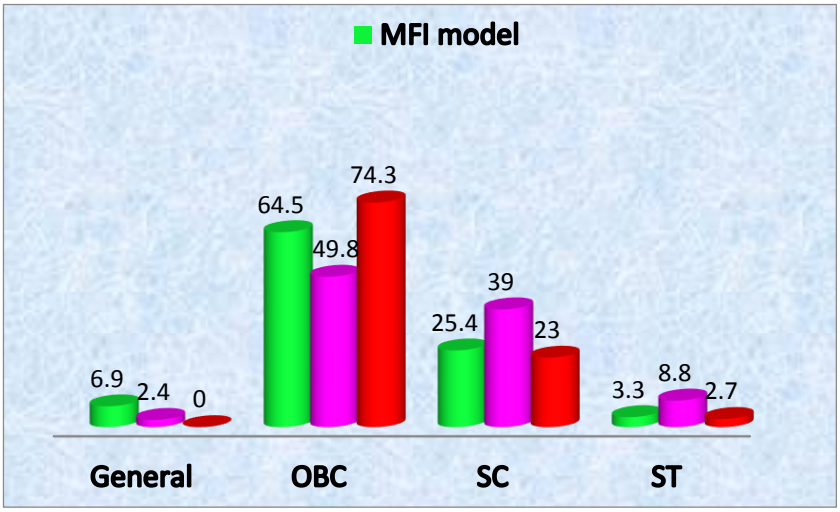


Chart 3.2: Occupation wise Distribution of Sample Clients



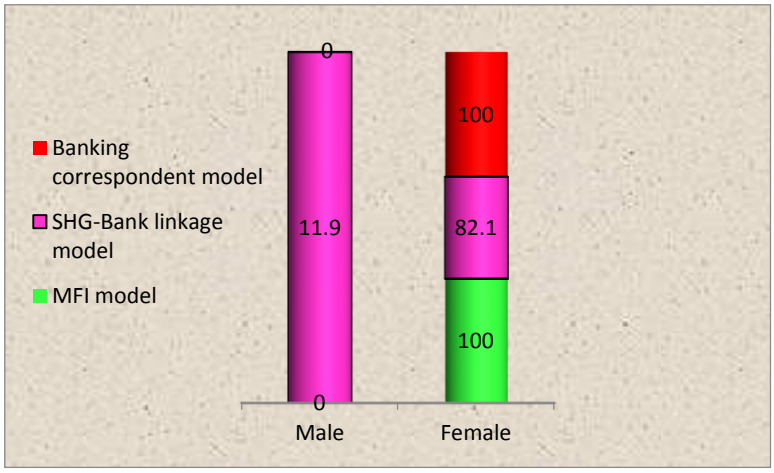
3.4.3 Petty-business and laborers are the two major occupation of the clients in MFI and SHG models (more than 50 percent). All the three models have given a lot of focus to housewives clients (Chart 3.2).

Chart 3.3: Caste-wise Distribution of sample



3.4.4 The distribution of sample across major social classes as given in Table 3.1 indicates the dominance of OBCs in all the three models. The SC clients are also present in significant numbers in the sample (Chart 3.3). It is obvious as microfinance mainly deals with poor and backward caste of clients who are marginalized and been financially excluded since a long time.

Chart 3.4: Gender Distribution of Sample Clients



3.4.5 World-wide microfinance has been proved to be more successful with females. In MFI model and BC model, all the sample clients are women. However, in SHG model, around 12 percent clients are male (Chart 3.4).

3.4.6 If we analyse the data based on borrowing amount by client, there is sharp difference in the distribution of client between MFI model and SHG-bank linkage model. In case of MFI and BC models, about three-fourth of total clients borrow in the range of Rs. 10,000 or more. Contrary, in SHG model, about 2/3rd of sample clients have borrowing amount less than Rs. 5000 (Chart 3.5). Here, only 20 percent client fall in the borrowing limit of Rs. 10,000 or more. As a result, the average borrowing amount in SHG model is only 40 percent of that in case of MFI model (Chart 3.6). SHG-bank model works with small amount of lending.

Chart 3.5: Distribution of Sample according to Borrowing Amount

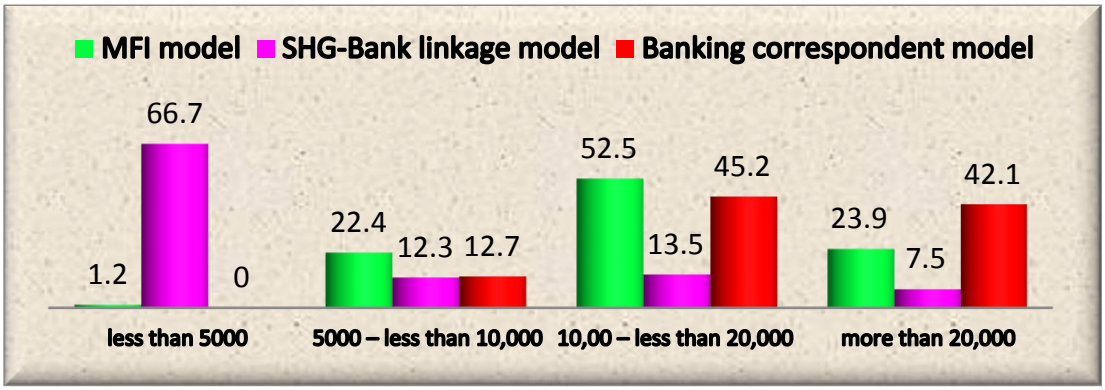
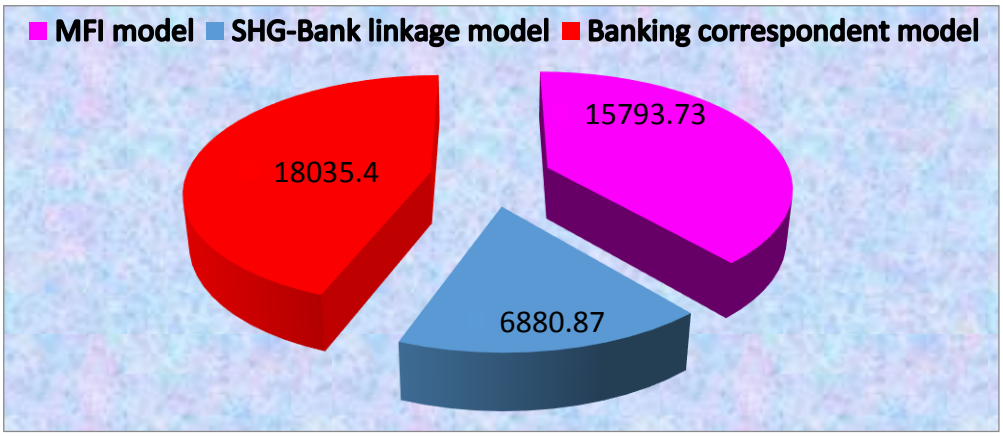


Chart 3.6: Average Amount of Borrowing across Microfinance Models



3.4.7 The distribution of sample clients as per their age in the group membership indicate that clients in MFI model are young as more than 50 percent are less than a year old. In contrast, clients who are more than 2 years old occupy the dominant share (about 75 percent) in SHG-bank model (Chart 3.7). MFIs start lending to clients one week after inducting them in the group, but in SHG-bank model, a client has to be the member for a minimum of 6 month before borrowing from the bank. There is no client in SHG-bank model who is less than 6 months old in group.

Chart 3.7: Distribution of Sample as per the Age in the Group Membership

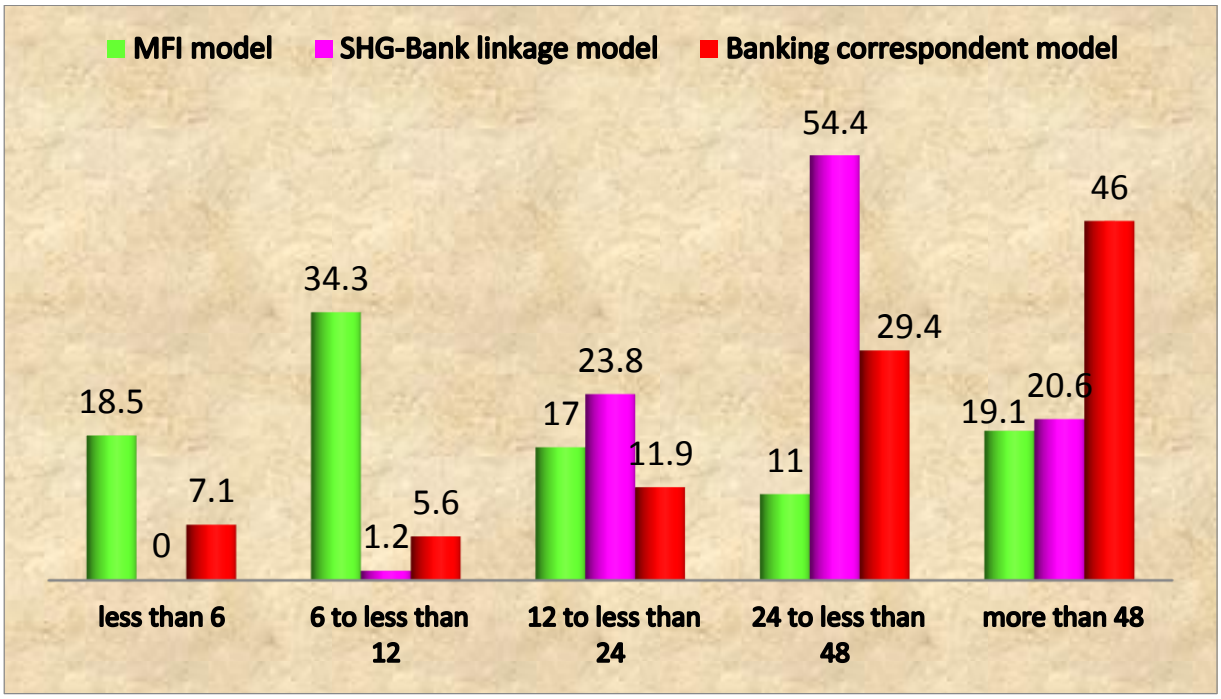


Table 3.1: Distribution of Profile of Sample across Microfinance Models

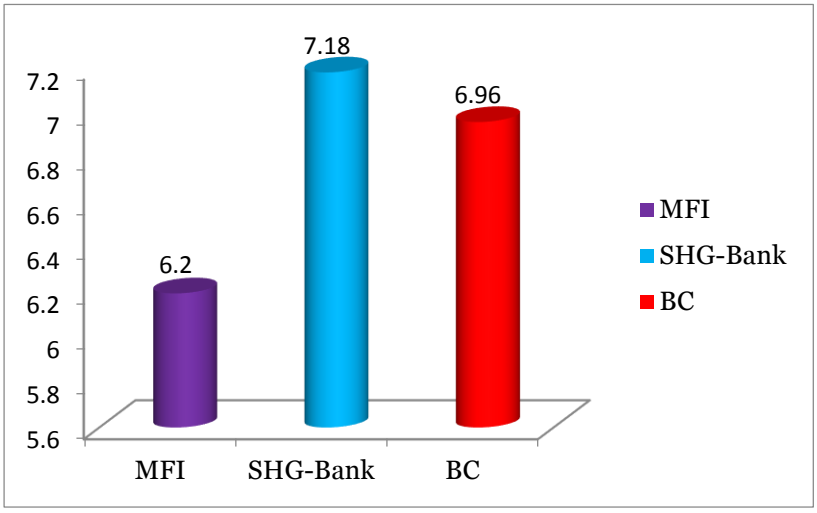
(Figures are in percent)

	MFI model	SHG-Bank linkage model	Banking correspondent model
1. Location			
(a) Rural	61.5	71.3	60.2
(b) Semi-urban	38.5	28.7	39.8
2. Occupation			
(a) Farming	01.5	04.4	00.9
(b) Service	03.3	02.0	00.0
(c) Pretty-business	31.0	19.5	14.2
(d) Labour	19.1	36.3	08.0
(e) House-wife	41.8	30.7	74.3
(f) Others	03.3	07.2	02.7
3. Caste			
(a) General	06.9	02.4	00.0
(b) OBC	64.5	49.8	74.3
(c) SC	25.4	39.0	23.0
(d) ST	03.3	08.8	02.7
4. Gender			
(a) Male	00.0	11.9	00.0
(b) Female	100	82.1	100

	MFI model	SHG-Bank linkage model	Banking correspondent model
5. Borrowing Amount (Rs.)			
(a) less than 5000	01.2	66.7	00.0
(b) 5000 – less than 10,000	22.4	12.3	12.7
(c) 10,00 – less than 20,000	52.5	13.5	45.2
(d) more than 20,000	23.9	07.5	42.1
6. Age of membership in the group (months)			
(a) less than 6	18.5	00.0	07.1
(b) 6 to less than 12	34.3	01.2	05.6
(c) 12 to less than 24	17.0	23.8	11.9
(d) 24 to less than 48	11.0	54.4	29.4
(e) more than 48	19.1	20.6	46.0
7. Average amount of borrowing (Rs.)	15793.73	6880.87	18035.40

Section 5: Transaction Cost of Borrowing

Chart 3.8: Transaction Cost as percent of Borrowed Amount



3.5.1 Using the methodology as outlined in Section 2 of Chapter 2, the estimated transaction cost of clients under different micro-finance model has been presented in Table 3.2 and Chart 3.8. The clients' transaction cost of borrowing is more in case of SHG-Bank model, which is about 1 percent higher than that in MFI model. Indirect transaction cost (opportunity cost of clients' time in attending group trainings, meetings and visiting MFI/Bank branch) constitutes about 80 percent of total transaction cost; whereas the share of direct transaction cost (travel cost, and documents cost) comes about 19 to 20 percent both in MFI and SHG-Bank model.

Table 3.2: Transaction Cost as percent of Borrowed Amount

Sl. No.	Model	Total Transaction Cost	Indirect Transaction Cost	Direct Transaction Cost
1	MFI	6.20	5.07 (81.77)	1.13 (18.23)
2	SHG-Bank	7.18	5.76 (80.22)	1.42 (19.78)
3	BC	6.96	6.55 (94.10)	0.41 (05.90)

Note: Figures in parentheses indicate percent of total transaction cost.

3.5.2 A higher transaction cost in SHG-Bank model turns out due to the following reasons.

Opportunity cost of clients' time

3.5.3 In SHG-Bank model, duration of clients' training is relatively higher (21.26 hours) as compared to that in MFI model (8.74 hours). A longer duration of training to clients with much wider coverage, as in SHG-Bank model, is extremely important for the long-term sustainability of micro-finance program, but it has its own implications for clients' opportunity cost of time. One has to keep in mind that in SHG-bank model, the contents of training programs are quite wide as it not only includes the training about group formation and policies and process of microfinance, but it also covers training programs about undertaking income generation activities by the clients. This latter part is absolutely missing in training programs conducted by MFIs. In SHG-Bank model, sometimes the group representatives attend training program outside of their place of residence and incur travel cost for this purpose.

3.5.4 Opportunity cost of clients' time has been computed from the point of joining the group to the point of getting credit from MFI or bank. It can explain the higher transaction cost for clients in SHG-bank model. The incubation period for the clients for borrowing the loan from MFIs is hardly 15 days after forming the groups, as the MFIs are keen to cover more clients within a short period of time, to expand their outreach. The same in SHG-Bank model is minimum 6 months as it is mandatory in SHG-Bank model that group has to save regularly for six months before getting it credit linked with banks. The SHG-bank model rests on the principle of saving first and credit second, as it emphasizes more on promoting savings habit among the clients. On the contrary, MFI on-lending model deals only credit to clients and attaches no role of clients' savings. Due to the fundamental difference in the approach between two models, the opportunity cost of time of the clients increases in SHG-Bank model.

Scale of lending

3.5.5 The average amount of borrowing is about 40 percent less in SHG-Bank model as compared to that in MFI model. Since the clients has to incur transaction cost irrespective of loan amount, a lower amount of lending results in an increased transaction cost as percent of borrowed amount. During group discussions, many women clients raised their voice about low level of lending by banks to groups.

"Samooh ke liye jitana loan pass hota hai utana bhi nahi dete hai". (Banks do not provide the exact amount which is sanctioned to the group).	"Pichhle loan ka bhugtan samay per karane ke bawjud bank loan ki limit nahi badhate hai". (In spite of timely repayment of the previous loan amount, still the banks don't increase the next loan amount limit).

More visits to bank branches

3.5.6 In case of MFIs, the clients have to visit the MFI branch for borrowing only once. In contrast, the SHG representatives have to visit bank branch for more than two times, resulting the higher amount of travel and time cost for them. In rural areas, these visits are as high as 6 times in some of the groups: whereas in semi-urban areas, some of the group representatives make 4 visits to bank branches (Table 3.3).

Table 3.3: Number of Visits by SHG Representatives to Bank

Sl. No.	Particulars	Average number of visits	
		Rural	Semi-urban
1.	Opening of saving bank account	2.58 (6)	2.28 (6)
2.	Borrowing	2.42 (4)	2.29 (4)

Note: Figures in parentheses indicate the maximum number of visits.

3.5.7 The clients also echoed the similar views with the study team during discussion.

"Khata kholne, loan pass karane aur loan ka bhugtan jama karne ke liye bank mei bahut samaya lag jata hai". (Opening a bank account, loan appraisal and repayment of bank loan is extremely time taking).	"Bank gaon se bahut door hai jiske kaaran hamara kiraya bhada bahut adhik lag jata hai". (Due to far distance of bank branches from the villages, travelling expenses are high).

3.5.8 The clients' transaction cost in relation to interest rate paid by them has been depicted in Table 3.4. The results indicate that the total borrowing cost to the client is more or less similar in both the models. However, transaction cost turns out to be about 19 percent of total cost to the client in MFI model, which is about 23 percent in SHG-Bank model.

Table 3.4: Interest Rate and Transaction Cost

Sl. No.	Particulars	MFI	SHG-Bank
1.	Interest rate paid by client (%)	24.75	24.00*
2.	Loan processing fee paid by client (%)	01.00	nil
3.	Total interest cost (%)	25.75	24.00
4.	Clients' transaction cost (%)	06.20	07.18
5.	Total cost to clients (%)	31.95	31.18
6.	Transaction cost as % to total cost to client	19.41	23.02

* Although clients pay 24 percent interest rate in SHG-Bank model, a substantial part of this interest (13.25 percent) is retained in the group corpus as group pays only 10.75 percent interest to bank. A client can take his/her share of group corpus at the time of leaving the group.

3.5.9 The clients' transaction cost should also be analysed in relation to number of financial products availed by them in the group methodology. In MFI model, clients get only loan, whereas in SHG-Bank model, savings by the clients is inherent part of the process before borrowing from the bank. The average savings at group level turn out to be Rs. 28,430. It is extremely beneficial for the poor women to save regularly in the groups. The clients also feel the importance of savings in their household economy. Moreover, groups' savings is another source of internal lending among the SHG members.

"Samooh me judane se hum logo ko bachat ki adat pad gayi hai. Hum log thoda- thoda paisa samooh me jama karte hai jo hume samay par bahut kam ata hai". (Since we became members of SHG, it became our habit of saving money, which in case of requirement proved very helpful).	"Samooh ki Bachat se loan lena hume bahut assan bhi hai aur samay bhi kam lagta hai". (Internal loaning process is hassle free and it takes less time).

An attempt was made to estimate the transaction cost of savings of those members of SHGs who are engaged in only savings in groups and have not availed loan so far. For this purpose, transaction cost of doing savings by the members in the groups has been calculated equal to opportunity cost of time spent in attending all group meetings so

far and travel expenses in attending such meetings, if any. The results are presented in Table 3.5. The transaction cost of savings turns out to be more than 15 percent and more or less equal in rural and semi-urban areas. The figures look quite high, but when the group is using the clients' savings for internal loaning, it is generating a return of 24 percent. Thus, the individual member is still better off.

Table 3.5: Transaction cost as % of Savings in SHGs

Sl. No.	Location	Transaction Cost
1.	Rural	15.59
2.	Semi-urban	14.95
3.	Total	15.40

3.5.10 Transaction cost of the borrowing across location of the clients has been presented in Table 3.6. The rural clients bear more transaction cost as compared to their counterparts located in semi-urban areas in all the three models of microfinance. However, this difference is not statistically significant in MFI model. On the other hand, in SHG-Bank model, the difference in clients transaction cost across their location is statistically significant at 15 percent. The density of bank branches is less as compared to that of MFI branches, particularly in rural areas of Barabanki and Varansi Districts. As a result, the difference in transaction cost between rural and semi-urban clients is not significant in MFI model. Surprisingly, the difference in the results is sharply distinct and statistically significant in Gorakhpur district, where CFTS is working as BC to bank. The results of our study are inconclusive and we cannot accept our null hypothesis # 1, which states that "the borrowing transaction cost of the clients located in rural areas is significantly more than that for their counterparts in semi-urban areas". We can only conclude that the difference in transaction cost of the clients located between rural and semi-urban areas is specific to particular districts, and cannot be generalized at a larger domain.

Table 3.6: Transaction Cost across Location of Clients

Sl.No	Location	MFI	SHG-Bank	BC
1	Rural	6.23	7.69	7.56
2	Semi urban	6.16	6.00	5.74
	F Statistics	.019	2.23***	3.206**

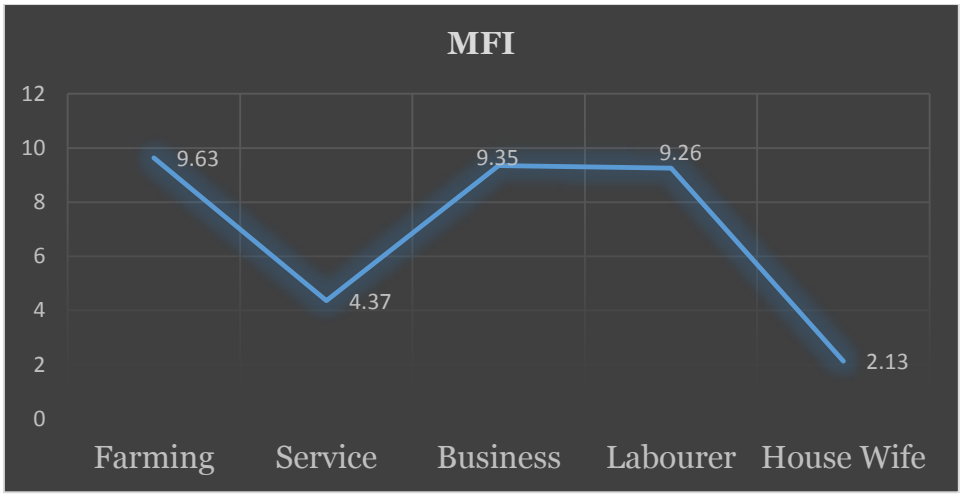
** Significant at 10 percent; *** Significant at 15 percent

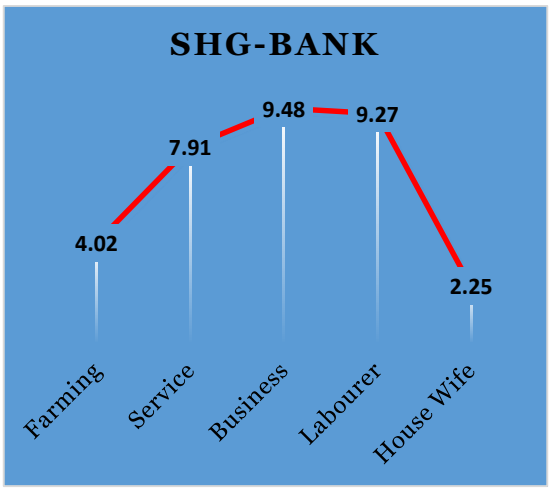
3.5.11 Clients' transaction cost of borrowing as per their occupation has been estimated and the same has been reported in Table 3.7. The results indicate that the transaction cost differs significantly across occupations of clients in all the three models. It is quite high for the clients engaged in business and labour work in all the three models. As expected, the transaction cost is least for housewives, for whom the opportunity cost of time is almost negligible as compared to labourers and business women. The results are in line of our hypothesis # 2 where it was hypothesized that the opportunity cost of time varies depending upon the nature of clients' occupation (maximum for those clients involved in petty business or labour work, and least for housewives). Thus we accept our hypothesis and concludes that there is significant difference in the borrowing transaction cost of clients involved in different occupations.

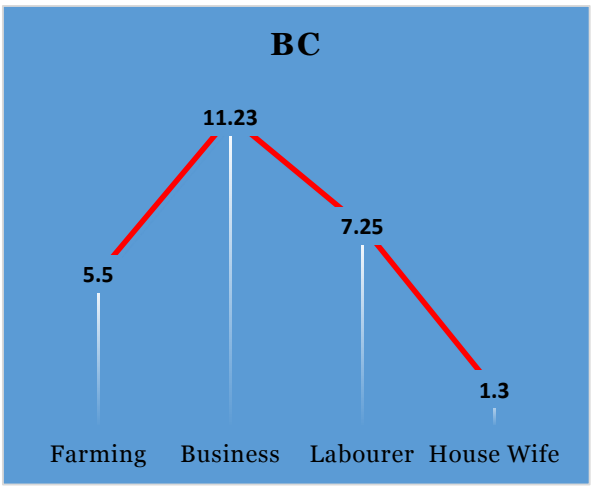
Table 3.7: Transaction Cost across Occupation of Clients

Sl. No	Occupation	MFI	SHG-Bank	BC
1	Farming	9.63	04.02	05.50
2	Service	4.37	07.91	-
3	Business	9.35	09.48	11.23
4	Labourer	9.26	09.27	07.25
5	House Wife	2.13	02.25	01.30
	F Statistics	67.45*	11.61*	31.05*

* Significant at 1 percent.





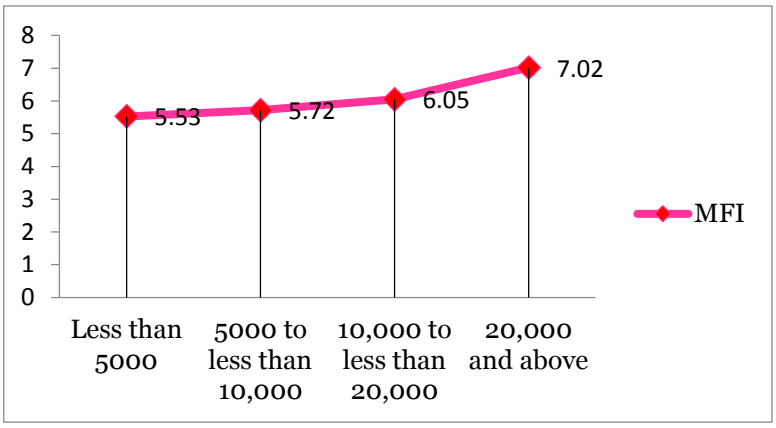


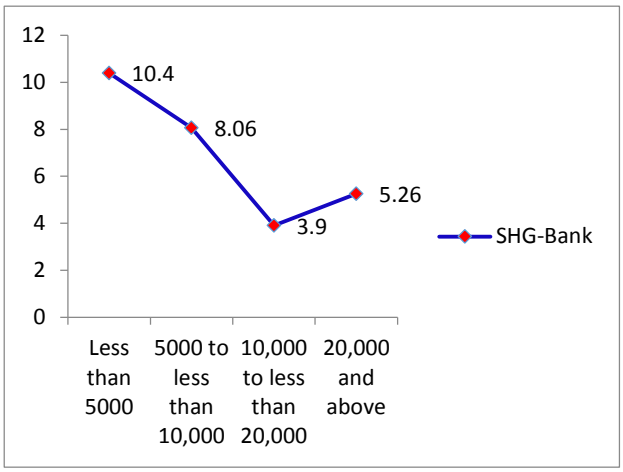
3.5.12 Transaction cost of the clients was analysed as per their borrowing amount. The same has been reproduced in Table 3.8. In MFI model, the transaction cost increases with the loan amount, but the difference in transaction cost across loan categories is not statistically significant. In SHG-Bank and BC models, the transaction cost decreases by and large with an increase in loan amount, and the difference turns out to be statistically significant. The only disturbance in the trend occur in loan amount of Rs. 20,00 and more in case of SHG-bank linkage model, where the transaction cost increases from the previous loan category. It may be due to a very small sample size in this category. It is clear from these results that economy of scale operates in the credit transaction. The transaction cost has been spread thinly for a larger amount, resulting in lower percent transaction cost for the clients. Thus we accept our hypothesis # 3 that with an increase in borrowing amount, the transaction cost of the client would be reduced significantly.

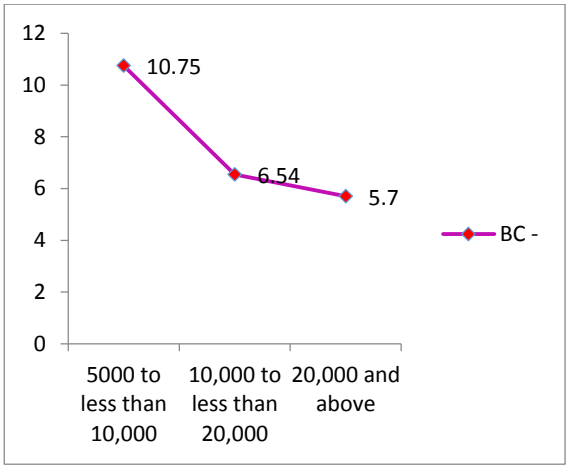
Table 3.8: Transaction Cost across Borrowing Amount

Sl. No	Loan Amount (Rs.)	MFI	SHG-Bank	BC
1	Less than 5000	5.53	10.4	-
2	5000 to less than 10,000	5.72	8.06	10.75
3	10,000 to less than 20,000	6.05	03.9	6.54
4	20,000 and above	7.02	5.26	5.70
	F Statistics	1.52	10.53*	3.89**

** Significant at 5 percent; * Significant at 1 percent;







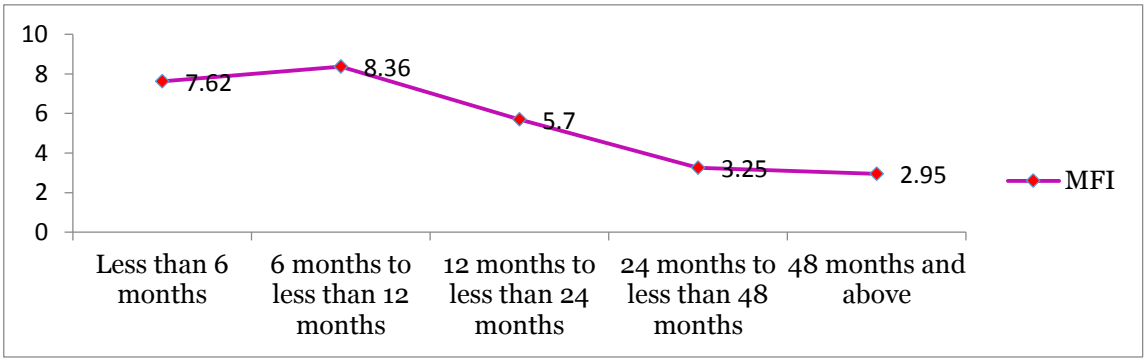
3.5.13 Transaction cost of the clients as per their age in the group was calculated to ascertain the difference in transaction cost of older clients and with that of new clients. The results as given in Table 3.9 reveal that by and large, the transaction cost decreases significantly as the clients get mature in group in MFI model. This may be because older clients require less training for microfinance, due to their acquaintance with the MFI for a longer time duration. Accordingly, the opportunity cost of time incurred in group training would be less for older clients, resulting in lower transaction cost. The results are just opposite in SHG-Bank model, though not statistically significant. This is because, there is no repeat borrower in the sample of SHG-bank model. In BC model, the same trend in the movement of transaction cost has been observed as in case of

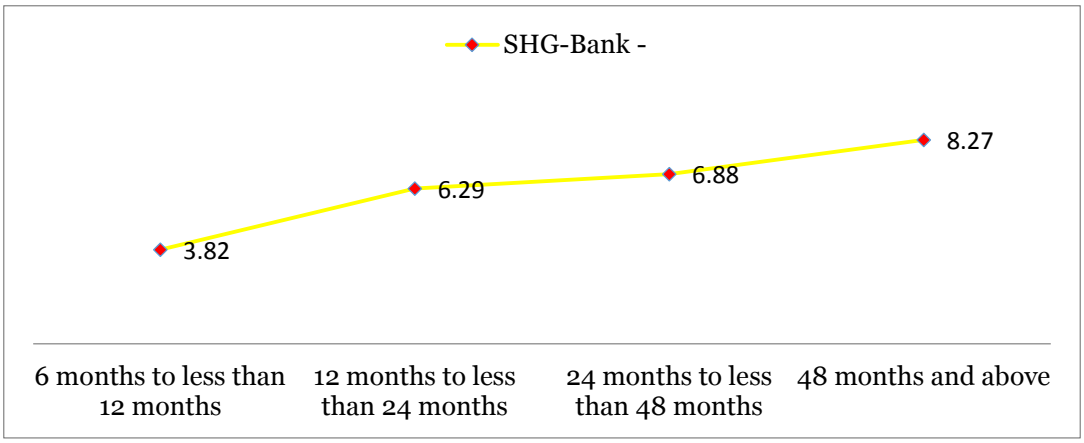
MFI model. Thus, our hypothesis # 4 that the transaction cost of the older clients would be significantly less than that for new clients can be accepted partially.

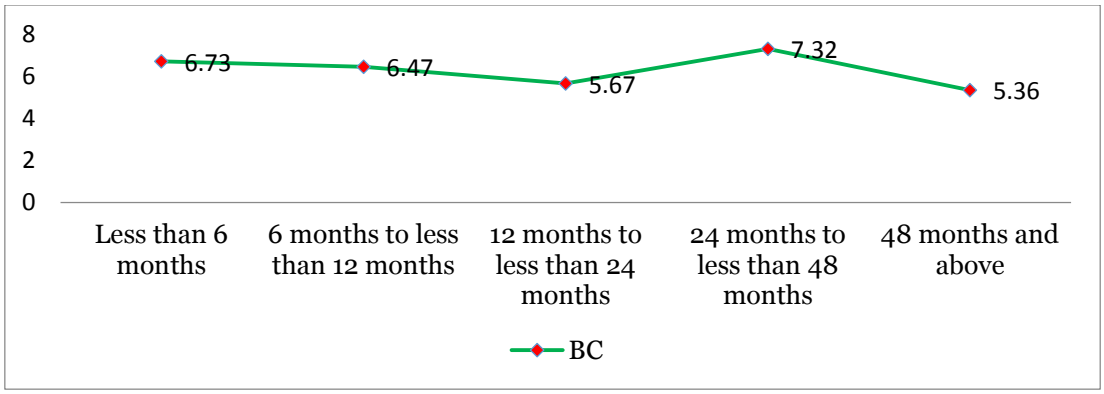
Table 3.9: Transaction Cost across Age of Clients in Group

Sl. No	Age in Group (months)	MFI	SHG-Bank	BC
1	Less than 6 months	7.62	-	6.73
2	6 months to less than 12 months	8.36	3.82	6.47
3	12 months to less than 24 months	05.7	6.29	5.67
4	24 months to less than 48 months	3.25	6.88	7.32
5	48 months and above	2.95	8.27	5.36
	F Statistics	23.52*	0.851	1.66

* Significant at 1 percent;







Section 6: Components of Transaction Cost

3.6.1 The share of different components in the clients' transaction cost was computed to find out the relative importance of each component. The results are given in Table 3.10. Indirect transaction cost comprising the opportunity cost of clients' time occupies about 70 percent of total transaction cost incurred by clients. A major share in this category is taken by opportunity cost of time in visiting MFI/bank branch for borrowing and repayment. Since in SHG-Bank model, the representatives of group visit the bank branch on behalf of the members, there happens economy of pooling. As a result, this component is less in SHG-Bank model as compared to that in MFI or BC models. As discussed earlier, the duration of groups' training is more in SHG-Bank model (para 3.5.2), and consequently, share of opportunity time cost of clients' during group trainings is about 2.5 times more in this model as compared to that in MFI model. Direct transaction cost constitutes about 30 percent of total transaction cost. Because of transaction at group level, the share of travel cost in visiting bank branch is extremely low than that in MFI and BC models.

Table 3.10: Share of different components of clients' transaction cost

Sl. No	Components	MFI	SHG-Bank	BC
1.	Indirect Transaction Cost			
1(a)	Opportunity time cost during group trainings	07.94	21.40	2.68
1(b)	Opportunity time cost in attending group meeting	28.53	22.37	15.23
1(c)	Opportunity time cost in visiting MFI/bank branch for borrowing and repayment	34.58	25.69	40.37
	Sub total	**71.05**	**69.46**	**58.28**
2	Direct Transaction Cost			
2 (a)	Travel cost in group training	-	4.49	-
2(a)	Travel cost in collecting various documents	02.42	0.69	1.21
2(b)	Travel cost in visiting MFI/bank branch	14.93	3.26	25.25
2(c)	Cost of documents	11.60	22.10	15.27
	Sub total	**28.95**	**30.54**	**41.72**

3.6.2 The results of BC model are based on sample households from district Gorakhpur, whereas the samples for MFI and SHG-bank linkage models were drawn from districts of Barabanki and Varanasi. The travel cost in visiting MFI branch is directly proportional to the distance between the group and MFI office. This is not same in different places. In SHG model, the groups have been promoted by NGOs in the areas which are very close to bank branches. In contrast, MFI model and BC model cater to the people even though located at far away from the office of concerned organization. This is reflected in the data about distance of Bank/MFI office from the group place as given in Table 3.11.

Table 3.11: Distance of Bank/MFI branch from the Group

Sl.	Model	Distance (Km.)	
		Rural	Semi-urban
1.	SHG-bank linkage	1.11	0.57
2.	MFI	6.9	1.70
3.	BC	7.9	2.80

3.6.2 In SHG-Bank model, the bank conducts all financial transactions (savings and credit) at group level. Accordingly, group absorbs a lot of transaction cost on behalf of the individual members. The share of transaction cost incurred at individual member level and at group level has been presented in Table 3.12. It is evident that group absorbs 39 percent of total transaction cost of borrowing. The bankers and policy makers can leverage this high share of transaction cost at group level by increasing the scale of lending at group level.

Table 3.12: Transaction cost at member and group level

Sl. No	Components	Individual member	Group
1.	Indirect Transaction Cost		
1(a)	Opportunity time cost during group trainings	21.40	-
1(b)	Opportunity time cost in attending group meeting	22.37	-
1(c)	Opportunity time cost in visiting bank branch for borrowing and repayment	-	25.69
	Sub total	**43.77**	**25.69**

Sl. No	Components	Individual member	Group
2	Direct Transaction Cost		
2 (a)	Travel cost in group training	4.49	
2(a)	Travel cost in collecting various documents	0.69	
2(b)	Travel cost in visiting MFI/bank branch	-	3.26
2(c)	Cost of documents	11.52	10.58
	Sub total	**16.70**	**13.84**
	Total	**60.47**	**39.53**

Section 7: Client Satisfaction among different Models

3.7.1 The three different models are participating in the goal of financial inclusion in its own way. During the focused group discussions, clients of three models were asked to provide their level of satisfaction with the services of the bank branches or MFIs. It was quite disturbing to note the great frustration among the members in SHG-bank linkage model. Their feedback can be explained in the following statements made by the women during FGDs.

1. Jab humlog bank jate hai to bank ke karmchari hamari koi sahayata nahi karte hai.
   (Whenever we go to bank, bank staff do not provide any assistance).
2. Samooh ke liye jitana loan pass hota hai utana nahi dete hai.
   (Bank does not provide the exact amount which is sanctioned).
3. Bank ke karmchari samooh ka khata kholne aur linkej me bhi koi sahayata nahi karte hai.
   (Bank staff do not help us in opening account and bank linkage process).
4. Pichhle loan ka bhugtan samay per karane ke bawjud bank loan ki limit nahi badhate hai.
   (In spite of the timely repayment of the previous loan amount, still they don't increase the next loan amount limit).
5. Bank gaon se bahut door hai jiske kaaran hamara kiraya bhada bahut adhik lag jata hai.
   (Due to far distance of bank from the village, travelling expenses are high).
6. Khata kholne, loan pass karane aur loan ka bhugtan jama karne ke liye bank me bahut samaya lag jata hai.
   (For opening an account, loan appraisal and repayment of loan is time taking in the bank).
7. NGO hum logo ko koi naya vyapar shuru karne ya hume kuchh naya sikhane ke liye kuchh nahi kar rahi hai.

(NGO (Varanasi medical society) is not providing any assistance related to new employment opportunities and growing up the business).

8. Samooh me judane se hum logo ko bachat ki adat pad gayi hai. Hum log thoda-thoda paisa samooh me jama karte hai jo hume samay par bahut kam ata hai.
   (Since we became group member of SHG, it became our habit of saving money, which in case of requirement proved helpful).
9. Samooh ki Bachat se loan lena hume bahut asan bhi hai aur samay bhi kam lagta hai.
   (Internal loaning process is hassle free and in less time).
10. Samooh ki wajah se hum logo ko samooh me kam karna aur apani jimmedari ka ahasas bhi hota hai.
    (Since we became group member, we readily started understanding working as a team and became responsible).
11. NGO ki taraf se ek adami aisa rakha jai jo loan ka paisa ekatra kare aur bank me jama kare jisase humara samaya aur kiraya bhada bhi bache.
    (NGOs should send their staff member for collecting loan, so as to save our time and travelling expense).
12. Baithak sham ko honi chahiye jisase humara dinbhar ka nuksan na ho.
    (Group meeting should be held in evening so as to prevent our loss of whole day).
13. NGO ke log koshish karate hai parantu loan ka paisa samaya per dilane aur loan ki limit nahi badhwa pa rahe hai.
    (NGO staff members are trying to extend the credit limit, but they are not successful).

3.7.2 The members made the following statements with respect to MFI and BC model:

1. Jo gaon bahut adhik dur ke hai wahan MFI ko apani ek shakha kholani chahiye.
   (There should be a regional branch office of MFI where villages are far from main MFI branch).
2. MFI ki shakha gaon se bahut door hai jiske karad hamara kiraya bhada bahut adhik lag jata hai.
   (Due to far distance of MFI branch from the village, travelling expenses are high).
3. Baithak 15 din ya mahine me ek bar honi chahiye.
   (Meeting should be done fortnightly or monthly).
4. Byajdar kam honi chahiye.
   (Interest rate should be low).
5. Baithak sham ko honi chahiye jisase humara dinbhar ke kam nuksan na ho.
   (Group meeting should be held in evening so as to prevent our loss of whole day).
6. MFI ko samooh ke sadasyo ko achha prashikshad aur padhane likhane yogya banana chahiye.
   (Group member should be well trained and literacy programs should be imparted to them).
7. MFI se hum logo ko kafi fayada bhi hai esame kam samaya me hi loan mil jata hai.

(MFI proved very useful as it provides loan in less time).

8. Abhi puri tarah se sabhi samooho me bachat nahi shuru huyi hai atah MFI ke karmchariyo ko humlogo ko bachat ke bare me puri jankari deni chahiye.
   (MFI staff member should provide full information about savings where it is not applicable).
9. Loan ki limit badhani chahiye. abhi humlogo ko zaroorat ke hisab se loan nahi mil pata hai.
   (Credit limit should be increased as per our requirement).
10. Loan gaon me hi batana chahiye jisase humlogo ka kafi samaya aur kiraya bhada bachega.
    (Loan distribution should be done in village, so as to save our time and travelling expenses).
11. Loan humlogo ko kuchh naya karane athawa kiye jarahe kam ko badhane me humari sahayata karata hai.
    (Loan from MFI helps us in providing a zeal to start up new business or to grow the existing business).

Section 8 : Business Correspondent Model and Financial Inclusion

3.8.1 The biggest hiccup in Indian Microfinance industry is that mobilizing savings from the clients is not a permissible activity for MFIs registered under Societies, trust, and NBFC (Section 25 Company) especially in the light of the amendment to Section 45 S of the Reserve Bank of India (RBI) Act. A big step forward for the MFI sector was in January 2006 when RBI carried out the Ministry's request to permit deposit mobilization by MFIs appointed as Business Correspondents by the banks (RBI/2005-06/288, DBOD.No.BL.BC. 58/22.01.001/2005-2006, dated January 25, 2006). The salient features of this circular can be summarized as follows:

- Under the "Business Correspondent" Model, NGOs/ MFIs set up under Societies/ Trust Acts, Societies registered under Mutually Aided Cooperative Societies Acts or the Cooperative Societies Acts of States, section 25 companies, registered NBFCs not accepting public deposits and Post Offices may act as Business Correspondents.
- The scope of activities to be undertaken by the Business Correspondents will include (i) disbursal of small value credit, (ii) recovery of principal / collection of interest (iii) collection of small value deposits (iv)sale of micro insurance/ mutual fund products/ pension products/ other third party products and (v) receipt and delivery of small value remittances/ other payment instruments.

3.8.2 The Business Correspondent model allows the poor to access to the mainstream banking infrastructure using a network of 3 party agents. The BC, as a concept tried to combine the strength of the state and credibility of the banks in conjunction with the closeness of the clients of an NGO, to create a cost effective machinery for serving the financially deprived. The BC model allows banks to do 'cash in - cash out' transactions at a location much closer to the excluded population, thus addressing the last mile problem. Target clients are well known to local NGOs/MFIs and similar local bodies, thus loan facilitation by the NGO/MFI (who are the promoter of the groups) enhances the quality of assets. The concept of Banking Correspondent introduced by RBI in 2006, has undergone modifications and amendments to expand the categories of organizations/individuals who can perform the functions of a BC. The scope of entities eligible to be engaged as Business Correspondents by the banks has been enlarged by RBI from time to time.

3.8.3 Banks have entered in partnership with different organizations as BC offering different banking services through this model. In majority of the cases, the banks are using BC option to open large number of No Frill Accounts as per the directions from the government of India. In some cases, this has been combined with channelizing government payment such as wages for NREGS and other social payments. In few cases, the focus has been extending credit with partnership of MFIs. Thus, the partners chosen, product offered, cost incurred and revenue generated are quite different in various experiments of BC model. Given the relatively small scale of operation of not for profit MFIs, extending credit to rural people through bank linkage has been on the small scale in terms of number of clients reached. This effects the financial viability of the BC as the commission paid by the banks for BC services is not adequate to become a viable business model. Moreover, there is shortage of funds to BC for meeting the group promotion cost and training for their staff. The issue of financial viability of BCs has been documented by various researchers quite extensively.

Section 9 : Perception of Poor about Financial and Non-Financial Services

3.9.1 Given the low level of literacy of MF clients on one hand and limited choices before them to access financial and non-financial services, on the other, the poor are not able to assert themselves with respect to service providers. This difference is not

very sharp between rural and semi-urban areas. The women in semi-urban areas are more aware about different MFIs operating in their areas. They could recall the names of at least 05-06 MFIs operating in Barabanki district. Some of them even have taken loan from more than one MFI. Still majority of the women are at the receiving ends. They expect a lot from the bank and MFIs.

3.9.2 The women give lot of emphasis on savings particularly in the SHG model. Among the non-financial services, all the clients are looking forward for business development services to scale their existing business or to start a new enterprise. Therefore, there is urgent need that microfinance should be linked to value chain concept. Still all the clients perceive microfinance has benefited a lot in their economic life as their dependency on private money lenders has reduced overtime.

> Samooh se judane ke bad hum logo ko seth mahajano se chhutkara mil gaya hai. Pahale hume zaroorat padane par enlogo ke aage hath failana padata tha aur liye gaye loan ka byaj bhi bahut adhik dena padata tha sath me kuchh na kuchh saman bhi girawi rakhana padata tha.
>
> (Due to microcredit process ,we are now free from money lenders who charge high interest cost , mortgage and free from humiliation and embarrassment).

Chapter 4
Summary and Conclusions

Section 1: Study Objectives and Coverage

4.1.1 It is clear and accepted that poor people want financial services. The poor require financial services to undertake different expenditures when there is wide mis-match in the inflow of income and outflow of expenditures in their household and business economy. Rural households face broad range of risks and crises such as natural, life cycle related, health related, economic, social, political and environmental. To cope with risk, the poor use diverse strategies. These may include, withdrawal of past savings, borrowing, selling productive and non-productive assets, other forms of self-insurance, informal group-based risk sharing systems, and occasionally, formal insurance.

4.1.2 Given the paramount importance of financial services, the paradox is that millions of people in rural India remain without access to high quality, appropriate financial products from formal financial institutions. Poor people have limited access to formal or semi-formal financial agencies (indeed this is the basic rationale for the development of the microfinance industry).

4.1.3 The major reasons for financial exclusion are:

- Mismatch between the hierarchy of credit product needs and credit products availability
- High transaction cost for financial agency as well as for rural clients
- High perceived risk to financial agency due to lack of tangible collateral offered by rural clients

4.1.4 Micro finance has been looked upon as an important means of financial inclusion in India. Microfinance institutions serve as a supplement to banks as they not only offer micro credit but they also provide other financial services like savings, insurance, remittance and non-financial services like individual counselling, literacy programme, training and support to start own business and the most importantly in a convenient way. The borrower receives all these services at door step and in most cases with a repayment schedule of borrower's convenience. Microfinance in India has brought a revolutionary shift in approach for providing financial services to poor since

mid-90s. Over the past decade, it has been claimed vigorously that micro-finance has a positive impact on the poor in terms of increased household income, livelihood improvement and women empowerment.

4.1.5 Typical microfinance clients are poor and low-income people that do not have access to other formal financial institutions. Microfinance clients are often self-employed, household-based entrepreneurs which includes small retail shops, street vending, artisanal manufacture, and service provision or labour. In rural areas, micro entrepreneurs often have small income-generating activities such as food processing and trade; some but far from all are farmers. Microcredit works because it is often arranged for a group, which leads to peers pressure on individuals to repay the loans or risk losing microcredit as a financial opportunity for their group.

4.1.6 One of the key factors which has always been the concern of both researchers as well as policy makers is the issue of Transaction Cost (TC) in microfinance. TCs can be defined as any costs that arise due to the existence of institutions and the appearance of an economic exchange. Using this definition of transaction cost, there are two party involved in microfinance exchange within an institutional framework of "Group", namely, the poor clients having financial needs on the one hand, and the lender (bank or MFI) on the other. In the absence of institution (group), these two parties face difficulties in conducting the financial exchange due to problem of information asymmetry. Thus, TC is the cost the lender and the borrower incur over and above the direct interest cost in reaching out an agreement between them for financial transaction.

4.1.7 Transaction costs are a measure of the factor in the functioning of financial market. The higher the transaction costs the higher the cost of intermediation and thus the less efficient the performance of the financial sector. TCs are part of the total cost of the transaction for the borrowers, in addition to interest rates and fees paid to the institution. A significant reduction in TCs for clients has been advocated as the main mantra of microfinance, and as a result it has been used as a justification for a high interest rates charged to borrowers. In the measurement of transaction cost in self-help group (SHG) banking ,there are several categories of transaction costs : those incurred by clients in getting loans and making deposits, the transaction cost of SHGs as intermediaries between client members and banks, and the banks transaction cost.

SHG are assumed to absorb transaction cost from both bank and poor clients and thereby makes the poor bankable.

4.1.8 TCs, including real and opportunity costs, vary across lending methodologies. For instance, loans may be offered individually or in groups, and the size of the loan may increase for each subsequent individual loan. The transaction cost so incurred by the client can also be divided across the services they avail from the institutions. This includes financial activities like savings and credit as well as non-financial activities like training programs. TC for client can also be dependent upon their location (remote rural area v/s semi-urban area). Therefore, the measurement of transaction costs across various models become important to arrive at the most effective model of microfinance. By doing a comparative study of transaction cost estimation across the different models, the policy makers can also come across methods to reduce the transaction costs further by benchmarking best practices across all the models. There is also a need for calculating and comparing TCs for microfinance clients located in remote rural and semi-urban areas of India. It will provide empirical evidence about potential barriers to financial inclusion—in addition to interest rates—for microfinance clients.

4.1.9 The transaction cost to the client is an important component of the total cost. An increase in total costs eventually implies lesser savings, more expenditure and less motivation to avail financial services. Therefore, it was felt extremely necessary by NABARD that a study should be conducted in the present context to analyse the costs to the SHG client when it is linked to bank as well as to a MFI. The present study was undertaken with the following specific objectives:

- Assess the factors responsible for transaction costs for the client
- Estimate the components of transaction cost of the client and its share in the total cost
- Evaluate the transaction cost occurring to the SHG as the client of a bank as well as an MFI, and compare it with the interest rates charged by the institution and the services availed by the client.
- Identify ways and means to reduce transaction costs for the client without incurring any additional cost to the supplier.

Section 2: Sample and Methodology

4.2.1 The study laid emphasis on understanding the process currently used by Banks/MFIs for providing financial services to people using different microfinance models. For this purpose, the technique of Process Mapping has been used for this study. Process *mapping* is a simple yet powerful method to reveal an organization's core processes and discover how its different parts work together to serve customers. The ultimate objective of process mapping is to understand a *process* as it is currently performed, and how to improve it. Process maps for different models proved useful in our research study in designing the questionnaires and focusing on sources of transaction cost in the entire process of borrowing loan.

4.2.2 The study estimated the transaction costs per monetary unit (total transaction costs divided by loan borrowed) incurred by microfinance clients under different business models and across the space. Based on the process maps of credit transaction in different microfinance models, the study computed the indirect transaction cost (opportunity cost of time) and direct transaction cost (travel cost and documents cost).

4.2.3 All the components of direct transaction cost were quantified as per the actual expenses incurred by clients on these items. In SHG-Bank model, the bank conducts all financial transactions (savings and credit) at group level. Accordingly, group absorbs a lot of transaction cost on behalf of the individual members. The cost incurred at group level consists of opportunity cost of time and travel cost in visiting bank branch for borrowing and repayment, and documents like stamp paper. This cost incurred at group level was distributed equally among all the members to arrive the cost incurred by individual member.

4.2.4 The study used multi-stage convenient sampling technique to select the sample frame. Three leading MFIs working in the State of U.P., namely, Margdarshak Financial Services Ltd., Sonata Finance Private Ltd., and Cashpor Financial and Technical Service were selected. The study also selected two Self-help Promoting Institutions (SHPIs), namely Mahila Khadi Gramya Sewa Sansthan, and Varanasi Medical Society, which have promoted SHGs and got those linked with Commercial Banks and Regional Rural banks (RRBs). Based on the operational area of selected organizations, three districts, namely Barabanki, Varanasi and Gorakhpur were selected for the study.

4.2.5 The groups which were credit-linked with banks (under SHG-Bank Linkage Model) and where lending was started by MFIs (Under MFI Lending Model) were selected from the selected Districts. A total of 76 groups were selected under different microfinance models in the selected Districts. The sample has been chosen in a way that more than 50 percent of groups must be located in remote rural areas. From the selected groups, a total of 700 clients were interviewed who had taken loan either from MFI or bank.

4.2.6 The required quantitative and qualitative data for the study were collected through conducting primary field survey and Focus Group Discussions (FGDs). The required results were generated for different microfinance models, using SPSS software. ANOVA techniques was used to find out the difference among the transaction cost of borrowing across different categories of clients. F statistics were computed to ascertain the statistical difference in the results across categories of clients. For the analysis of transaction cost and its components, the clients were stratified into the following categories:

Category 1: Location of client

- **a)** Rural
- **b)** Semi-urban

Category 2: Occupation of client

- **a)** Farming
- **b)** Service
- **c)** Business
- **d)** Laborer
- **e)** Housewife
- **f)** Others

Category 3: Borrowed amount

- **a)** Less than Rs. 5000
- **b)** Rs. 5000 to less than Rs. 10,000
- **c)** Rs. 10,000 to less than Rs. 20,000
- **d)** Rs. 20,000 and above

Category 4: Age (duration) of client in microfinance group

- **a)** Less than 6 months
- **b)** 6 months to less than 12 months
- **c)** 12 months to less than 24 months
- **d)** 24 months to less than 48 months
- **e)** 48 months and above

Section 3: Transaction Cost of Borrowing

4.3.1 The estimated transaction cost of clients under different micro-finance model indicates that it is maximum in case of SHG-Bank model (7.18 percent), which is about 1 percent higher than that in MFI model (6.20 percent). Indirect transaction cost (opportunity cost of clients' time in attending group trainings, meetings and visiting MFI/Bank branch) constitutes about 80 percent of total transaction cost; whereas the share of direct transaction cost (travel cost, and documents cost) comes about 19 to 20 percent both in MFI and SHG-Bank model.

4.3.2 A higher transaction cost in SHG-Bank model turns out due to the following reasons. In SHG-Bank model, duration of clients' training is relatively higher (21.26 hours) as compared to that in MFI model (8.74 hours). A longer duration of training to clients with much wider coverage, as in SHG-Bank model, is extremely important for the long-term sustainability of micro-finance program, but it has its own implications for clients' opportunity cost of time. One has to keep in mind that in SHG-bank model, the contents of training programs are quite wide as it not only includes the training about group formation and policies and process of microfinance, but it also covers training programs about undertaking income generation activities by the clients. This latter part is absolutely missing in training programs conducted by MFIs. In SHG-Bank model, sometimes the group representatives attend training program outside of their place of residence and incur travel cost for this purpose.

4.3.3 Opportunity cost of clients' time has been computed from the point of joining the group to the point of getting credit from MFI or bank. It can explain the higher transaction cost for clients in SHG-bank model. The incubation period for the clients for borrowing the loan from MFIs is hardly 15 days after forming the groups as the MFIs are keen to cover more clients within a short period of time, to expand their outreach. The same in SHG-Bank model is minimum 6 months as it is mandatory in

SHG-Bank model that that group has to save regularly for six months before getting it credit linked with banks. The SHG-bank model rests on the principle of saving first and credit second, as it emphasizes more on promoting savings habit among the clients. On the contrary, MFI on-lending model deals only credit to clients and attaches no role of clients' savings. Due to the fundamental difference in the approach between two models, the opportunity cost of time of the clients increases in SHG-Bank model.

4.3.4 The average amount of borrowing is about 40 percent less in SHG-Bank model as compared to that in MFI model. Since the clients has to incur transaction cost irrespective of loan amount, a lower of amount of lending results in an increased transaction cost as percent of borrowed amount.

4.3.5 In case of MFIs, the clients have to visit the MFI branch for borrowing only once. In contrast, the SHG representatives have to visit bank branch for more than two times, resulting the higher amount of travel and time cost for them. In rural areas, these visits are as high as 6 times in some of the groups: whereas in semi-urban areas, some of the group representatives make 4 visits to bank branches.

4.3.6 The clients' transaction cost in relation to interest rate paid by indicates that the total borrowing cost to the client is more or less similar (about 31 percent) in both the models. However, transaction cost turns out to be about 19 percent of total cost to the client in MFI model, which is about 23 percent in SHG-Bank model. Although clients pay 24 percent interest rate in SHG-Bank model, a substantial part of this interest (13.25 percent) is retained in the group corpus as group pays only 10.75 percent interest to bank.

4.3.7 The clients' transaction cost should also be analysed in relation to number of financial products availed by them in the group methodology. In MFI model, clients get only loan, whereas in SHG-Bank model, savings by the clients is inherent part of the process before borrowing from the bank. The average savings at group level turn out to be Rs. 28,430. It is extremely beneficial for the poor women to save regularly in the groups. The clients also feel the importance of savings in their household economy. Moreover, groups' savings is another source of internal lending among the SHG members.

4.3.8 Transaction cost of the borrowing across location of the clients shows that the rural clients bear more transaction cost as compared to their counterparts located in semi-urban areas in all the three models of microfinance. However, this difference is not statistically significant in MFI model. On the other hand, in SHG-Bank model, the difference in clients transaction cost across their location is statistically significant at 15 percent. Surprisingly, the difference in the results is sharply distinct and statistically significant in Gorakhpur district, where CFTS is working as BC to bank. The results of our study are inconclusive and we cannot accept our null hypothesis # 1, which states that "the borrowing transaction cost of the clients located in rural areas is significantly more than that for their counterparts in semi-urban areas". We can only conclude that the difference in transaction cost of the clients located between rural and semi-urban areas is specific to particular districts, and cannot be generalized at a larger domain.

4.3.9 Clients' transaction cost of borrowing as per their occupation indicates that the transaction cost differs significantly across occupations of clients in all the three models. It is quite high for the clients engaged in business and labour work in all the three models. As expected, the transaction cost is least for housewives, for whom the opportunity cost of time is almost negligible as compared to labourers and business women. The results are in line of our hypothesis # 2 where it was hypothesized that the opportunity cost of time varies depending upon the nature of clients' occupation (maximum for those clients involved in pretty business or labour work, and least for housewives). Thus we accept our hypothesis and concludes that there is significant difference in the borrowing transaction cost of clients involved in different occupations.

4.3.10 Transaction cost of the clients as per their borrowing amount reveals that in MFI model, the transaction cost increases with the loan amount, but the difference in transaction cost across loan categories is not statistically significant. In SHG-Bank and BC models, the transaction cost decreases with an increase in loan amount, and the difference turns out to be statistically significant. It is clear from these results that economy of scale operates in the credit transaction. The transaction cost has been spread thinly for a larger amount, resulting in lower percent transaction cost for the clients. Thus we accept our hypothesis # 3 that with an increase in borrowing amount, the transaction cost of the client would be reduced significantly.

4.3.11 Transaction cost of the clients as per their age in the group was calculated to ascertain the difference in transaction cost of older clients and with that of new clients. The results reveal that by and large, the transaction cost decreases significantly as the clients get mature in group in MFI model. This may be because older clients require less training for microfinance, due to their acquaintance with the MFI for a longer time duration. Accordingly, the opportunity cost of time incurred in group training would be less for older clients, resulting in lower transaction cost. The results are just opposite in SHG-Bank model, though not statistically significant. In BC model, the same trend in the movement of transaction cost has been observed as in case of MFI model. Thus, our hypothesis # 4 that the transaction cost of the older clients would be significantly less than that for new clients can be accepted partially.

4.3.12 The share of different components in the clients' transaction cost was computed to find out the relative importance of each component. Indirect transaction cost comprising the opportunity cost of clients' time occupies about 70 percent of total transaction cost incurred by clients. A major share in this category is taken by opportunity cost of time in visiting MFI/bank branch for borrowing and repayment. Since in SHG-Bank model, the representatives of group visit the bank branch on behalf of the members, there happens economy of pooling. As a result, this component is less in SHG-Bank model as compared to that in MFI or BC models. As discussed earlier, the duration of groups' training is more in SHG-Bank model, and consequently, share of opportunity time cost of clients' during group trainings is about 2.5 times more in this model as compared to that in MFI model. Direct transaction cost constitutes about 30 percent of total transaction cost. Because of transaction at group level, the share of travel cost in visiting bank branch is extremely low than that in MFI and BC models.

4.3.13 In SHG-Bank model, the bank conducts all financial transactions (savings and credit) at group level. Accordingly, group absorbs a lot of transaction cost on behalf of the individual members. The share of transaction cost incurred at individual member level and at group shows that the group absorbs 39 percent of total transaction cost of borrowing. The bankers and policy makers can leverage this high share of transaction cost at group level by increasing the scale of borrowings at group level.

Chapter 5

Policy Brief to Reduce the Clients' Transaction Cost

5.1 Microfinance has been used as an important instrument to achieve the goal of financial inclusion in India and other developing countries. It has grown leap and bound over the years. There is no doubt that microfinance has brought revolutionary impact on the lives of poor women (box 5.1), yet efforts need to be made to minimize the transaction cost of the borrowers.

Box 5.1: Varanasi medical society helped Tulsa business take off.

Tulsa a 58 year old resident of Ghamahapur in Barabanki district is widower. She had a setback in life when her alcoholic husband died after 16 years of marriage. For surviving and providing living to her 3 children she started working in field as a labourer but earning was insufficient to run the family. When Tulsa became a member of Varanasi medical society and started contributing small amount in saving account. She availed first loan of amount 4000 and utilized in setting up of new business involving beads and pearl work. After two consecutive loans, she with the help of her daughters, is involved in bead business and making variety of products namely; bead necklace, bead bangles, pearl rings etc., earning 8000 monthly. Her standard of living has grown and she has developed confidence of expanding this business to higher scale and planning to employee few interested ladies in her existing business. Her efforts reaped fruits. Organization supported her to move away from poverty crunch.

5.2 Although the clients' transaction cost is less in microfinance as compared to that in traditional banking model, there is always scope to further minimize it to increase the efficiency of the microfinance model. Based on our interaction with microfinance clients, MFIs and bankers, the followings suggestions are put forward:

(a) The lending to SHGs by banks should be increased. It is disheartening to note that only 40 percent members are borrowing members in the groups. The low figure for borrowing members is due to both internal capital rationing (in minor cases) as well as lack of loanable funds with the SHGs (in majority of cases). Non-lending or insufficient lending to groups create frustration among the members.

(b) There is lack of awareness among some of the bankers about SHG methodology and the credit linking process. There is a need for imparting knowledge and training to bank staff about the concept of SHG bank linkage programme so as to encourage bankers to take keen interest in the SHG movement. NABARD has invested a lot of

money on training to bankers in the past, particularly during late 90s and early 2000. This process must be continue to keep the momentum for the bankers.

(c) Bankers perceive lending to SHGs as a risky venture. The SHGs should be part of value chain model, where adequate partnership with marketing agencies (private or Government) should be established. The sale proceed of SHGs products can be routed through banks. Bankers would be more comfortable in financing SHGs which are part of value chain. The case of BASIX, given in Box 5.2, is a live example, which can be replicated in SHGs or federation of SHGs (registered under Producers' Company Act).

(d) Lending to SHGs should be a part and parcel of strategic business plan at bank corporate level. Employees should be motivated to accomplish the target and performance based incentive linked to number of SHGs linked with banks should be adopted.

(e) The MFIs should not insist the members to visit the branch office to repay the loan amount. The MFIs should collect the repayment from the clients at the time of group meeting.

(f) There is tremendous scope of using technology to reduce the transaction cost of the clients as well as of the organizations. Mobile banking technology is already being used to provide saving services in rural areas by many MFIs. The same technology can be used in repayment of loans by the clients so that they can avoid the travel cost to visit MFI/bank branch for repayment of loan. A suitable partnership with telecom companies need to be established.

(g) The banks should promote BC model vigorously for proving loan to SHGs. Given the scarcity of staff at rural bank branches, partnership with MFIs under BC model would be an effective methodology. BCs should be involved in providing number of financial services like credit, savings, insurance and remittances to overcome the problem of financial viability. Banks should also provide training to BC staff to adopt new technology, new products and new systems.

(h) Banks should promote branchless banking (rural ATMs with franchising system) to cater the financial transaction with SHGs. It would save a lot of time and travel cost of clients in visiting bank branch again and again.

(i) The MFIs may have monthly meeting of groups instead of having the same at weekly level, if all the client in a group desire. It would reduce the time cost of clients in attending the group meetings frequently. Moreover, group meeting should be held in evening so as to minimize the loss of work.

(j) The photograph of individual member as well as identity certificates can be digitized electronically at the MFI/Bank so that clients need not to incur the expenses on these items again and again.

(k) Microfinance should be promoted with a credit plus approach. Credit cannot stand on alone itself. The technical and marketing aspects of various livelihoods should be included in the training programs conducted by MFIs. The SHPIs promoting SHGs take care these aspects up to some extent. The clients of microfinance should be developed as micro-entrepreneurs. Microfinance can make a real difference in the lives of those served, but microfinance is neither a panacea nor a magic bullet against poverty, and it cannot be expected to work everywhere and for everyone.

5.3 Given the difference in the objectives, approach and methodology of SHG-bank model and MFI model, it may not be appropriate to numerically compare the clients' transaction cost across these two models. The comparative analysis of these two models can provide best practices of each model, and more importantly, how those best practices can be incorporated in different models.

5.4 While comparing the transaction cost across models, one has to keep in the mind that sample of clients is not uniform in terms of their occupation, location and age in the group, across different models. All these characteristics of clients affect their transaction cost of borrowing.

5.5 In our study, the same organization (CFTS) is acting as MFI and BC in providing credit to clients. Ideally, in order to bring out the role of BC model as distinct from MFI model, BC should have been studied as separate organization from MFI. This is the limitation of the study.

5.6 The SHG-bank model is not as matured in U.P. compared to Southern States of India. In order to get more authenticated results, sample should have included the sample of SHG-bank linkage model from a State, where this model is quite active and mature enough. The results based on the study of U.P. State alone cannot be generalized at country level.

Box 5.2: BASIX – Promoting Value Chain of Potatoes

BASIX started as a microfinance institution, has grown to become a livelihood promoting agency for poor people. It promoted a contract farming model for chip grade potatoes to link a number of small-scale farmers in Jharkhand with Frito-Lays, a subsidiary of PepsiCo. Potato is considered to be a valuable cash crop in the State. The market however, is highly volatile in terms of price, demand and supply.

A number of meetings took place between PepsiCo, BASIX and the farmers. The negotiations went on for almost a year before the farmers and PepsiCo agreed to enter into a contract. BASIX was the facilitator and was also to provide financial and technical services. The company entered into a procurement and input contract with the Potato Growers Association which BASIX had developed the farmers to start. The company agreed to provide the specialized Atlanta variety potato seeds to the Growers' Association under supervision from BASIX. The Association bought the seed at previously agreed price, and delivered it to its members, at their own cost, and BASIX provided credit to the farmers for this purpose. The company agreed to purchase the growers' potato crops, provided they satisfy certain conditions, at a predetermined price.

BASIX was to pay 75 percent of the seed value in advance on signing the agreement, on behalf of the Growers' Association, and the balance would be adjusted against the amount payable to the Growers' Association after the harvest. BASIX was responsible for ensuring that the members of the Growers' Association followed all of PepsiCo's advice, from planting to harvest. The farmers had to grade, sort, and pack and load the potatoes, again through Growers' Association and under the supervision of BASIX.

Farmers who could not afford to pay for potato seeds or other inputs received loans from BASIX through Joint Liability Groups (JLG). BASIX designed a combined cash and kind loan product, with the potato seed supplied in kind and the balance paid in cash for the purchase of other inputs. All the loans were compulsory linked with the life and health insurance, which was offered in collaboration with Aviva and Royal Sundram.

BASIX provides credit and extension services to the farmers through self-employed agents who are known as Livelihood Service Advisors (LSAs). They work on commission basis. The farmers pay BASIX an annual service charge of Rs. 300 for receiving specific technical services.

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Appendix 1

Brief Profile of MFIs and SHPIs selected for the Study

1. Margdarshak Financial Services Limited

Margdarshak Financial Services Limited is a non-deposit taking NBFC-MFI. Part of the Margdarshak Group, the company is engaged in the business of financial inclusion and microfinance in the state of Uttar Pradesh. Promoted by a group of development professionals in 2004, the Margdarshak group is engaged in providing financial and income enhancing services to the community. The microfinance intervention of the Margdarshak group was initiated in 2007, under the aegis of Margdarshak Development Services (a not for profit group company) and promoters of Margdarshak acquired an NBFC in 2010.The company provides a range of credit products like Pragati loan , Unnati loan, Livestock loan, Samriddhi loan ;using the group based individual lending methodology. The company has over 26,639 loan clients which are being served through a network of 25 branch offices in 16 districts of Uttar Pradesh. Loan Lending Model is joint Liability Group (JLG) type.

2. SONATA Finance (P) Limited

SONATA Finance (P) Ltd is a micro-finance company registered as a non-banking finance company (NBFC) under Reserve Bank of India Section 45 IA. SONATA started its operations in January 2006 in Central East Uttar Pradesh where the potential for micro finance operations is huge. This densely populated region is one of the poorest in India in terms of density and depth of poverty. In U.P., starting its operation from Allahabad district, SONATA later expanded to other adjacent districts of Kaushambi, Raibareli, Pratapgarh, Varanasi, Sultanpur, Kanpur and Fatehpur. Current latest sonata finance has operations in 165 branches across 6 states of India- Uttar Pradesh, Madhya Pradesh, Uttaranchal, Rajasthan, Bihar and Haryana with a portfolio size of Rs 270 crore.SONATA finance has set itself a mission to "identify and motivate poor women in a cost-effective way and deliver them micro finance services in an honest, timely and efficient manner."

3. Cashpor Financial and Technical Service (CFTS)

CFTS is a poverty focused, not for profit Company that provides microfinance exclusively to Below Poverty Line women in eastern U.P. and Bihar. CFTS is not registered with RBI as an NBFC-MFI, it is not required to follow RBI guidelines applicable to NBFC-MFI. However company voluntarily follows RBIs guidelines applicable to NBFC-MFI. CFTS was founded as a Trust in 1997. In order to comply with new regulations in 2003, Cashpor's microfinance operations were transferred to a not-for-profit company under Section 25 of the Companies Act 1956. Cashpor has reasonable track record of microfinance operations and currently serving over 500,000 women through 264 branches spread over 22 districts of Uttar Pradesh and Bihar. Cashpor mainly focuses on joint liability groups (JLGs); lending only to women.

4. Mahila Khadi Gramya Sewa Sansthan

Mahila Khadi Gramya Sewa Sansthan is an NGO registered under society registration act 21, 1860. It started operating in 2008, established its head office in Barabanki district, branch office in Faizabad & registered office in Barabanki. Funding agencies like NABARD Lucknow, Rural self-employment training institute bank of India, Sohratgarh Environmental Society, Gramin Bank of Aryavart, Social Security Wage Base Lucknow have supported Mahila Khadi Gramya Sewa Sansthan in providing training & skill development programmes. Currently serving 252 numbers of SHGs, 250 saving bank account, 217 credit linked SHG in Barabanki district. The organization conducts various leader training programmes related to bank transaction, organizes holding camp on women empowerment, rehabilitation of the migrant child with support AHSHAS Lucknow, SHG training programme associated with income generating activities for sustainable livelihood, group leader training programme under Jayanti Gram Swarojgar yojna, vocational training for women under TRISEM/DWCRA programme supported by DRDA.

5. Varanasi Medical Society

A registered Society known as Varanasi Medical Society, is a pioneers in working for the social development of 50 villages in Kashi vidyapeeth block and Araziline block of Varanasi district of Uttar Pradesh. Varanasi Medical Society is having a full-fledged hospital, a community development centre for the social development, and a

community care centre for the AIDS patients, is a pioneer in socio-health development work in the district of Varanasi. Varanasi Medical Society is working for health awareness program for mother and child, adolescent girls and the family all together. Total self-help groups' client members are 2500 and financial supporters are Manos Unidas, Spain, NABARD India and WDF through CHAI India.

Appendix 2

Indian Institute of Management, Lucknow

Study of Transaction Cost-Perspective of SHG and MFI Clients

SHG-Checklist For Individual Clients

A. Basic Profile:

1. Name of respondent.....

1.1 (a) Village..... (b) Block.....

(c) Tehsil ..... (d) District.....

1.2 Location..... *(rural-1,semi urban-2)*

1.3 Gender: ..... *(male-1, female-2)*

1.4 Marital status: ..... *(married-1, unmarried-2, Widower-3, Separate-4)*

1.5 Age: ..... *(years)*

1.6 Education..... *(Illiterate-1, Literate-2, JHS and below-3, Secondary/HS-4, Grad./PG-5, Diploma-6)*

1.7 Social category: ..... *(Gen-1, OBC-2, SC-3, ST-4)*

1.8 Occupation: .....*(Farming-1, Service-2, Business-3, Labourer-4, HW-5, Retired-6, Others-7)*

a. If involved in service, then how much monthly salary.....
b. If involved in business, then how much daily selling .....and expenditure .....
c. If involved in farming/Labour work, then how much daily wage .....

1.9 Name of organization.....

1.10 Nam e of the group you belong .....

1.11 Date of joining this group.....

1.12 Amount of loan borrowed.....

1.13 Repayment period for the amount of loan borrowed .....

1.14 Interest rate .....

1.15 Rate of processing the loan.....

1.16 What are the other charges included in processing fee (insurance/service tax)

.....

1.17 What do you know about financial institution?

.....

1.18 What do you know about non-banking financial institutions?

.....

B. Nature of Transaction Cost-

B 1. <u>Promotional Phase</u>:

a. Promotional meeting is conducted for how many days?
   .....

b. How much total time spent in attending all promotional meetings conducted by organization (Hours)
   .....

c. What is the total opportunity cost of time spent in attending all the promotional meeting conducted by organization?
   .....

d. What are the total expenses incurred in travelling for attending all the promotional meeting?
   .....

e. What are the expenses incurred in arranging the promotional meeting at a public place?
   .....

B 2. <u>Group Training phase:</u>

a. Training is conducted for how many days?
   .....
b. How much total time is spent in attending all trainings?
   .....
c. What is the total opportunity cost of time spent in attending the group meetings?
   .....
d. What is the distance of training place from the house?
   .....
e. What is the mode of transportation used for visiting the training place?
   .....
f. How much total travelling expense incurred while visiting the training place?
   .....
g. How much total time is spent in travelling to the training place?
   .....

h. What is the total opportunity cost of time spent in travelling training place?
.....

i. What are the extra expenses incurred in visiting training place?
.....

j. What are the stationary expenses required during training period?
.....

B.3. <u>Borrowing Phase</u>:

a. How much time is spent in attending group meeting (hours)?
.....

b. What is the opportunity cost of time spent in attending group meeting?
.....

c. How many times is it required to visit the bank for opening an account?
.....

d. What is the distance of bank from the house?
.....

e. What is the mode of transportation used for visiting the bank?
.....

f. How much total travelling expense incurred in visiting the bank?
.....

g. How much time is spent in travelling from house to bank?
.....

h. What is the opportunity cost of time spent in travelling to the bank?
.....

i. What is the-
   1. Cost of photograph.....
   2 Cost of travelling.....

j. What is the -
1. Cost of revenue stamp.....
2. Cost of travelling.....

k. What is the-
1. Cost of stamp paper.....
2. Cost of travelling.....

l. What is the-
   1. Cost of voter i.d., ration card, and other documents .....
   2. Cost of travelling.....

m. How many times is it required to visit the bank for borrowing loan?

.....

n. How much time is spent in visiting the bank for borrowing loan (hours)?

.....

o. What is the opportunity cost of time spent in travelling to the bank for borrowing loan?

.....

p. What is the mode of transportation used for visiting the bank?

.....

q. How much travelling expense incurred while visiting bank?

.....

r. How much total time is spent in travelling bank for borrowing loan?

.....

s. What is the total opportunity cost of travelling time spent in visiting bank for borrowing loan?

.....
.....

t. What are the expenses incurred can be minimized in borrowing loan?

.....
.....

B.4. <u>Repayment Phase</u>:

a. How much total time is spent in attending all group meetings (hours)?

.....

b. What is the total opportunity cost of time spent in attending group meetings?

.....

c. How many times is it required to visit the bank for repayment of loan?

.....

d. How much total time is spent in visiting bank for repayment of loan?

.....

e. How much total travelling expense incurred in visiting bank?

.....

f. What is the total travelling time spent in visiting bank for repayment of loan?

.....

g. What is the total opportunity cost of time spent in repayment of loan?

.....

h. How much fine is paid for non -payment of loan installment on time?

.....

i. How much fine is paid for not attending the meeting?

.....

Total Group cost

What are the Total expenses incurring in entire group?

.....

.....

.....

Name of investigator .....

Appendix 3

Indian Institute of Management, Lucknow

Study of Transaction Cost-Perspective of SHG and MFI Clients

MFI Checklist for Individual Clients

A. Basic Profile:

1. Name of respondent.....

1.1 (a) Village..... (b) Block.....

(c) Tehsil ..... (d) District.....

1.2 Location..... *(rural-1,semi urban-2)*

1.3 Gender: ..... *(male-1, female-2)*

1.4 Marital status: ..... *(married-1, unmarried-2, Widower-3, Separate-4)*

1.5 Age: ..... *(years)*

1.6 Education..... *(Illiterate-1, Literate-2, JHS and below-3, Secondary/HS-4, Grad./PG-5, Diploma-6)*

1.7 Social category: ..... *(Gen-1, OBC-2, SC-3, ST-4)*

1.8 Occupation: .....*(Farming-1, Service-2, Business-3, Labourer-4, HW-5, Retired-6, Others-7)*

d. If involved in service, then how much monthly salary.....
e. If involved in business, then how much daily selling .....and expenditure .....
f. If involved in farming/Labour work, then how much daily wage .....

1.9 Name of organization.....

1.10 Nam e of the group you belong .....

1.11 Date of joining this group.....

1.12 Amount of loan borrowed.....

1.13 Repayment period for the amount of loan borrowed .....

1.14 Interest rate .....

1.15 Rate of processing the loan.....

1.16 What are the other charges included in processing fee (insurance/service tax)

.....

1.17 What do you know about financial institution?
.....

1.18 What do you know about non-banking financial institutions?

.....

B. Nature of Transaction Cost-

B 1. <u>Promotional Phase</u>:

f. Promotional meeting is conducted for how many days?

.....

g. How much total time spent in attending all promotional meetings conducted by organization (Hours)

.....

h. What is the total opportunity cost of time spent in attending all the promotional meeting conducted by organization?

.....

i. What are the total expenses incurred in travelling for attending all the promotional meeting?

.....

j. What are the expenses incurred in arranging the promotional meeting at a public place?

.....

B 2. <u>Group Training phase:</u>

k. Training is conducted for how many days?

.....

l. How much total time is spent in attending all trainings?

.....

m. What is the total opportunity cost of time spent in attending the group meetings?

.....

n. What is the distance of training place from the house?

.....

o. What is the mode of transportation used for visiting the training place?

.....

p. How much total travelling expense incurred while visiting the training place?

.....

q. How much total time is spent in travelling to the training place?

.....

r. What is the total opportunity cost of time spent in travelling training place?

.....

s. What are the extra expenses incurred in visiting training place?

.....

t. What are the stationary expenses required during training period?

.....

B.3. <u>Borrowing Phase</u>:

a. How much total time spent in attending all the group meetings (hours)?

.....

b. What is the total opportunity cost of time spent in attending group meeting?
.....

c. What is the-
1) Cost of photograph.....
2) Cost of travelling.....
d. What is the -
1) Cost of revenue stamp.....
2) Cost of travelling.....
e. What is the-
1) Cost of stamp paper.....
2) Cost of travelling.....
f. What is the-
1) Cost of voter i.d., ration card and other documents .....
2) Cost of travelling.....
g. How many times is it required to visit the MFI branch for borrowing loan?
.....
h. How much total time is spent in MFI branch for borrowing loan?
.....
i. What is the total opportunity cost of time spent in MFI branch for borrowing loan?
.....
j. What is the distance of MFI branch from house?
.....
k. What is the mode of transportation used for visiting the MFI branch?
.....
l. How much total travelling expense incurred in visiting MFI branch?
.....
m. How much total time is spent in travelling MFI branch for borrowing loan?
.....
n. What is the total opportunity cost of travelling time spent in visiting branch for borrowing loan?
.....
o. What are the expenses incurred can be minimized in borrowing loan?
.....

B.4. <u>Repayment Phase</u>:

a. How many meetings are conducted for repayment of loan?
.....
j. How much total time is spent in attending all group meetings (hours)?
.....
k. What is the total opportunity cost of time spent in attending meetings?
.....
l. How many times is it required to visit the MFI branch for repayment of loan?
.....

m. How much total time is spent in visiting MFI branch for repayment of loan?
.....

n. How much total travelling expense incurred in visiting MFI branch?
.....
o. What is the total travelling time spent in visiting MFI branch for repayment of loan?
.....
p. What is the total opportunity cost of time spent in repayment of loan?
.....
q. How much fine is paid for non -payment of loan installment on time?
.....
r. How much fine is paid for not attending the meeting?
.....

Total Group cost

What are the Total expenses incurring in entire group?

.....
.....
.....

Name of Investigator .....

Appendix 4

Indian Institute of Management, Lucknow

Study of Transaction Cost-Perspective of SHG and MFI Clients

Focus Group Discussion

Village ..... Block .....

Tehsil ..... District .....

Location ..... (Rural/semi urban)

Group name .....

Total number of member in a group .....

Total amount of loan borrowed by group .....

Date of group formation.....

How many meetings are conducted in a month?

.....

.....

What is the process of saving the contribution done in a group?

.....

.....

What are the group expenses incurred in a meeting place?

.....

.....

What are the norm and by laws related to attendance?

.....

.....

What are the norm and by laws related to non-repayment of loan?

.....

What are the criteria of internal loaning?

.....

.....

What are the expenses incurred in ledger and register maintenance?

.....

.....

What are the expenses incurred on documentation, photograph, stamp paper, revenue stamp and other items?

.....

.....

What are the expenses incurred in stationary items?

.....

.....

What are the total travelling expenses incurred in group while visiting to organization?

.....

.....

What are the indirect expenses for availing loan like?

(Commission, bribes, loss of wages)

.....

.....

Does this process of getting loan is profitable in your point of view?

.....

.....

Name of investigator .....