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## EXPERIMENTS ON REPAYMENT SCHEDULES IN VWS, WEST BENGAL

**Principal Researchers:** Profs. Rohini Pande and Erica Field (Harvard)

**Partner Organization:** Village Welfare Society, West Bengal

**CMF Research Associates:** Anup Roy and Emmerich Davies

**Timeline:** Baseline survey completed. The first intervention completed in Sept 2007 and the second planned in Aug 2008.



### BACKGROUND

Most of the MFI industry operates on the received wisdom that weekly repayment schedules and the consequent system of weekly centre meetings is critical for ensuring that low levels of default are maintained.

Though fixed, weekly installments have clear benefits – it ensures repayment discipline of borrowers, creates financial literacy among low income clients, ensures that group members know of each other's activity etc. they impose a very high cost structure on the MFI and requires it to maintain a very large staff to client ratio. Instead, if infrequent repayments do not produce an increase in default rates, or if the cost of the increase in default is lower than the savings in terms of transactions costs, it may be worthwhile for the MFI to examine it as an alternative to the weekly model.

In addition, monthly repayment schedules could be more beneficial to households. Indeed, weekly repayment schedules may not suit the income flows of households engaged in certain types of activities. For example, clients are likely to favor less frequent repayment installments if the weekly variance in their income is high or if rates of return on income-generating activities with irregular or infrequent profit streams are sufficiently higher. For instance, existing evidence suggest that many microfinance clients drop-out because of short term fluctuations in income that make it difficult to meet repayment obligations, such as illness in the family. With respect to business investments, high frequency installments could limit clients' ability to invest in high-return activities and thereby discourage them from choosing profit-maximizing investments with regular profit streams. If income-generating activities with less frequent profit streams have higher rates of return, high frequency repayment schemes inhibit economic mobility and business growth. For instance, a vendor might increase profit by investing in inventory with a higher profit margin but lower turn over. On the other hand, collection schemes that mirror clients' income streams are likely to facilitate savings behavior and reduce delinquency. Hence, for clients earning on a weekly basis, weekly repayment requirements have the potential to facilitate repayment but also to hamper business growth. In brief, while increasing payment frequency has the potential to reduce default and increase profitability up to a point, the optimum frequency and correct formula for determining this level remain unclear, and it may depend on clients' activities.

Since it is unclear whether monthly repayment schedules will result or not in increased defaults, and whether they would be more or less beneficial to households and businesses, it is important to study rigorously the impact of introducing monthly repayment schedules, on the organization and on the clients.

### PROGRAM DESCRIPTION

Village Welfare Society (VWS) has been operating in West Bengal since 1982 and has been doing micro-finance activities since 1995. Currently they operate in 5 districts of West Bengal through their 18 branches. Like most

other MFIs VWS also follows weekly repayment installments that begin the week after loan disbursement. They have a client portfolio of around 60,000 and existing loan portfolio of around Rs 22 crores. Their SHG general loan usually starts from Rs 3000 and clients are supposed to repay within 46 weeks after the loan disbursement at the rate of 10%.

For the proposed study, two new repayment schedules were introduced:

- monthly repayments and meetings
- weekly meetings with monthly repayments

The objective of the second scheme is to isolate the effect of the meeting and the effect of the payment.

## RESEARCH DESIGN AND ANALYSIS

### *First phase:*

Three branches of VWS were chosen for the experiment and 100 groups of borrowers were formed with a total of 1027 clients. Recruitment of these groups began on April, 2006. We randomly divided these groups in to three sub-samples.

- Groups in sub-sample A continued with the current practice of weekly meetings and weekly collection.
- Meanwhile sub-sample B groups shifted to system of weekly meeting and monthly repayment system.
- Sub-sample C shifted to a system of loan collection and meetings once per month. Only new client groups recruited by the loan officers at the start of the experiment have been included in the evaluation.

The intervention was implemented by a team of 6 loan officers recruited and trained by VWS for the purpose of the experiment. These loan officers were distributed across bank branches as determined by VWS.

- A baseline survey was conducted before the groups were assigned to one repayment schedule or the other. This survey focused on variables such as households' business, income flows, expenditures and shocks.
- A follow-up survey was conducted when the clients had completed one loan cycle.
- In addition, a daily consumption survey was conducted over a month for a sub-sample of clients in each of these groups, in order to document in details expenditures and incomes flows of these clients. This daily survey helps us find out which repayment schedule seems to fit better households businesses' incomes flows and expenditures.

### *Second phase:*

In a second phase, the study will also compare fortnightly and monthly repayment schedules for third cycle clients, to test the hypothesis that higher delinquency is greater for clients who are in their third or more loan cycle, than for new clients. Thus, repayment quality may decrease among elder clients. The study will focus on the following variables: repayment rates, the organization's transaction costs, and the capacity of households to smooth consumption and to manage their own cash flows.