# Unit 8

## Revolving Credit Mechanisms

### General Objective

After studying this Unit, you should be able to help participants in your training session to build the capacities of trainees to describe revolving credit mechanisms and how they operate.

### Specific Objectives

This Training Unit will help you to enable trainees to:

- describe the meaning of revolving credit;
- discuss how the mechanisms of revolving credit could be applied within self help groups.

### Planning

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| **Time** | : | 3 hours |
| **Training Methodology** | : | Participatory discussions, group exercises, games |
| **Training Materials** | : | Charts, markers, flip charts |
| **Trainer's Preparation** | : | Reading through the background material and other references |
| | | Preparing training aids or identifying existing training aids available |

### Background Material

In any credit programme, savings are the mainstay as these constitute its life blood. This is equally true for NGO-run savings and credit programmes (SCP). Savings are either received by NGOs as part of internal resource mobilization for funding their credit programmes directly or through the self-help groups which keep their funds with the NGO banks. The unique feature of SCP is that the saver and borrower being the same, there is a direct relationship between them. The savings serve a wide range of purposes other than the immediate investments as indicated below:

i) Savings impose discipline on the group members in developing a savings habit;

ii) Savings enhance self-confidence. An individual who is not used to saving, finds it a great source of encouragement to become a habitual saver;

iii) Savings cover normal business risks, seasonal variations in income, natural calamities like flood, famine, cyclone, drought, disease and political disturbances. Members of the group can undertake risk decisions because they find some cushion in the savings;

iv) Group savings of the poor could demonstrate that their number is a great source of strength for themselves and helps them to participate in developmental activities. Small amounts saved each week regularly add up to a large amount;

v) Savings eliminate dependence on money lenders and contribute to the formation of a new team perspective.

## Ground rules for deposits

In a nutshell, some ground rules for deposits are listed here:

- A start can be made with small deposits.
- The size of the deposit may be increased after a few months.
- Pass books should be issued to every member from the beginning.
- Regular savings should be made at every meeting.
- Bank accounts should be opened after a few months.

Now let us explore further details.

**a) Features of efficient deposit management**

i) The deposits should be on a regular basis and be accepted even for small amounts;

ii) Terms and conditions should be clearly spelt out and pass books showing details of deposits received and withdrawn, interest credited etc., should be given to each depositor;

iii) Depositors should have easy access to deposits and should be made to feel assured that their deposits are safe and will be repaid to them even earlier, if so required;

iv) Interest rates should be market rates to compare favourably with the rates given by banks.

**b) Compulsory Deposits/ Thrift**

i) The deposits could be even for the smallest amount in the beginning but in due course it should be related with the amount of loan at a suitable rate, say 1 percent of the loan per year.

ii) The deposits should be collected along with the monthly instalment for repayment of principal and interest. Arrears in this regard should not generally be allowed and amounts should be collected at a later date with penal interest.

iii) Interest could be allowed on such deposits at rates which should normally be less by 6 to 8% over the lending rate adopted by the NGO/Group.

iv) Where no interest is allowed (which is not very desirable), the net surplus of the interest earned on funds could be either proportionately credited to the deposit account of each member or to a common fund. Accretion of surplus may not be allowed to be withdrawn. It will be better if it is used for increasing the common fund.

v) Withdrawals (say 50% of the amount) may be allowed out of deposits only after the beneficiary has repaid the principal and the interest under loan.

vi) Emergency loans could be given out of compulsory deposits at 50% of the deposit at rate of interest applicable to consumption loans.

vii) Refund of deposits and interest could be allowed when the member ceases her membership or asks to leave the Group/NGO for any reason. Such a member, if allowed to rejoin the group, should bring back the total amount of deposit refunded to her. The practice followed by depositors needs to be re-examined.

viii) A one time deposit say Rs. 10 or Rs. 20 per member could be collected for crediting the amount to the account of the Cluster Committee or Federation, if these exist.

**c) Optional Deposits**

i) Such deposits could be either in the form of savings bank deposits or term deposits for 1-3 years, depending on the fund requirements of NGOs for term loans. If the NGOs are not issuing loans for more than 2 years, deposits should not be accepted for a term exceeding 3 years. There should be correlation between the collection of a term deposit and the loans portfolio of the NGO for term loans.

ii) Rates of interest on such deposits should normally be equal to about market rates. These could even be ½ % to 1% per cent more than the rate allowed by the banks in the area.

iii) Withdrawal of the optional deposit could be allowed in the case of savings deposits say once in a week as per requirement of the local area and in the case of term deposit, the deposit should be repaid as per tenure of the deposit even if the depositor ceases to be a member of the NGO.

iv) Premature withdrawals of the term deposit could be allowed in very special circumstances but in such cases the interest paid should be 2% less than the rate applicable to the deposit.

v) Loans against term deposit could be allowed at the rate of 75 per cent of the deposit amount and rate of interest could be 2 per cent higher than the rate applicable to the relative deposit. The interest accrued on the deposit should be credited to the loans account in such cases.

vi) Interest on savings bank deposits should be paid on the minimum balance held in the account in the month. Interest may not be allowed if the balance is Rs. 50 or less.

The above are only important broad principles but these could be modified according to the felt needs of the women in the area.

**d) Important points to be noted**

i) It is to be noted that the deposits should be accepted by the NGOs or groups only from members (regular, associate, nominal as per provisions of bye-laws) and not from the public since the latter proposition would require the approval of Reserve Bank of India (RBI). Similarly, withdrawal slips only have to be used for getting payment of the deposits and not cheques, as defined in the Negotiable Instruments Act.

ii) Although there is no requirement to maintain liquid assets to meet the claims of the depositors (under withdrawal deposits) as and when these accrue or earlier on demand, it is always advisable to keep some 25 per cent to 30 per cent of the total amount of deposits in liquid form, i.e., cash, or bank balance in fixed or savings deposit accounts so that these would be available for meeting the demand of depositors.

## Principles of sound lending

**a) The established principles of sound lending are:**

i) The lending must conform to the requirements of the accepted policy of an organization;

ii) There should not be any diversion of finance for anti-social, less productive or unapproved purposes;

iii) The borrowings must be right for the borrower and be of real help in her financial problems. It must not assist her on courses which will lead to further financial embarrassment;

iv) To the extent possible, advances should be production-oriented (barring a few loans for consumption purposes); and

v) Every loan should be for a clearly disclosed and approved purpose to an approved borrower whose character holds out an assurance that the arrangement made will be faithfully and successfully adhered to.

These are some of the sound principles to be acted upon while giving loans. A lender cannot always be a genius but she should use her common sense to reconcile personalities and propositions with principles.

**b) Features of credit delivery for the poor**

A successful Microlending Credit System particularly for the poor run by an NGO should be run on a quasi-informal pattern. It should have the following characteristics:

i) Organization delivering credit and its staff should be involved actively in community outreach through the local organization in the village and the staff should meet borrowers almost daily explaining their requirements, assisting them, etc.

ii) The application form should be simple and procedure should have the minimum paper work;

iii) Loans should be disbursed quickly even for the smallest activities and also for start up business. Initially, loans should be for working capital, which will help test the borrower's conduct and assess whether the loan will help the growth of business or not;

iv) Loans should not generally require collaterals and guarantees. Emphasis should be on the individual's own reputation and preference should be given to groups or borrowers to have the benefit of joint liability and peer pressure;

v) Savings should be compulsory for all as this will help in building up local commitment of the programme whether they ask for a loan or not;

vi) Transaction costs, i.e., cost of administering the credit programme should be minimum both for the borrowers and lenders (for the borrowers in the form of no delay in sanction, simple procedures and flexibility; for the lender, less paper work and hence low cost of operations);

vii) Interest should be charged at market rates with no subsidies and/or subversions, overt or covert;

viii) There should be mutual interaction between borrowers for better use of funds, problem solving, periodical counselling, etc.; and

ix) Links should be developed with the normal sector on selective basis particularly for bigger and profitable projects.

**c) Need for a policy**

A proper policy of loans criteria and portfolio parameters should be laid down at the beginning of every year by the NGO for itself as also for its affiliated groups taking into account the local factors, needs of the area, human and financial resources available, etc. The policy should lay down the following:

i) Total lending should be done under short-term, medium-term loans, etc., depending on the resources, both existing and expected. The total lending to be done in each month of the year should be estimated; and

ii) Sector-wise allotment of funds would avoid concentration in certain sectors like trade and small business. Sector-wise allotment should be made as per the priorities of the area and experience of previous years and linkages available — both backward and forward—and existence of other government, semi-government programmes. Thus, if a dairy development programme is run by the government in an area where the NGO is working, a lower sectoral allotment for this should be made. The backward linkage in this case means availability of animals, fodder, medicines, etc. while forward linkage will mean arrangements for roads, milk collection, marketing etc., for their successful operation.

**d) Eligibility criteria**

This is an important area where the following should be seen:

i) Prospective borrowers are to be judged very discreetly for their character, capital, capacity, financial position, size of the family, willingness to work with honesty and frankness, health, temperament, life-style, relationship in society, etc. These aspects should be looked into by having some sort of informal survey. The preference of the client for the economic activity should be carefully assessed since this will have an effect on the utilization and recovery of loans. The above criteria should apply to individuals whether they are financed directly by the NGOs or through the SHGs.

ii) While selecting the SHGs as clients for lending, their quality of group activity, image, size and working should be looked into. Only well established, homogeneous and socially viable groups should be made eligible for lending.

iii) SHGs to be selected for lending should have done savings programmes at least for six to twelve months or even more, if considered necessary.

iv) It will be better if some broad ceiling is prescribed in terms of the annual income of a family to be supported by credit by the NGOs.

Cases of defaulters of loans taken from banks under various Government programmes should be carefully examined and decided on merit. Default of the husband and or other family members should not come in the way of advancing fresh loans to member women beneficiaries of the SHGs.

**Tips for Saving and Credit**

Here is a list of useful tips on:

i) savings

ii) loans

iii) common fund management

iv) book-keeping

v) training

Both practices to encourage and discourage are listed.

## Savings Related

### Do's

- The savings habit must be encouraged as a value in itself and not just as a means of increasing the group's fund position. It encourages the thrift habit and controls unnecessary consumption.

- Regular weekly / monthly saving must be insisted upon in the case of all group members.

- There are seasonal variations in the amount saved by a member. Many groups take such seasonal variations into account in fixing the minimum monthly savings expected from members. The practice of fixing a minimum monthly saving expected from members is good.

- Every group needs a policy on how to manage the savings to members who (a) leave the group voluntarily (b) are asked to leave for some reason.

- All groups must maintain individual savings registers and individual pass books given to members.

- Payment of interest to members on savings in the common fund is still not a widespread practice but one that is worth considering and promoting.

- Many groups permit their members to save for a particular purpose, e.g. weekly savings to build up the necessary amount to pay a bank loan instalment when it falls due. Such a practice should be encouraged.

### Don'ts

- The practice in some groups of equal savings by all members each month regardless of the fact that some members may at times be in a position to save more has to be discouraged.

- Several groups don't make a distinction between members. Savings and contributions are non-refundable. The practice of withholding savings of members leaving the group (either voluntary or forcibly) should be discouraged. There are instances where such a decision has resulted in a drop in savings among other members who fear the same consequences.

**Loan Related**

**Do's**

- All loan applications must be addressed to the group or to office bearers of the group.
- All loan applications must be scrutinized and approved, modified or rejected in group meetings only and minuted accordingly.
- Repayment schedules must be finalized and minuted when loans are disbursed
- Service/interest charges on loans must be clearly differentiated from recoveries, should be regularly recovered and entered as such in the books.
- Loans (cash or cheques) must be disbursed only at group meetings.

**Don'ts**

- Few members must not be permitted to repeatedly corner all loans.
- Large loans for a member must not be permitted until the group is financially strong and has a system of administration that is adequate to motivate and guide behaviour; the ability of a member is an important factor in assessing the strength of the group.
- The procedure of first deciding on loans and then assessing how much money there is in the group and, if there is a deficit, asking the NGO to meet it is not credit management. This should be discouraged at all costs.

**Common Fund Management Related**

**Do's**

- Frequent rotation of the common fund for loans is indicative of an active group.
- Since the group becomes responsible when it has to handle the members' own hard earned savings, the project contribution should take care that the balance between the members' saving and project funds facilitates rather than destroys responsible behaviour.

**Don'ts**

- Large sums of money lying unutilized for long periods represent 'process blocks'. The reasons have to be analyzed and addressed.
- Large amounts of money for infrastructure, community programmes, or even credit management should not be routed through the group since this can distort the working of the group to fund-monitor rather than fund management. (There are examples where project contributions have made members take careless decisions which they would not take with their own money. Members have rotated only the project money keeping their own savings intact.)

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| – All accounts should be in the name of the group and not in the name of one or more members. | – No money transaction should be conducted outside the meetings, whether it relates to loan disbursals, collection of savings and repayments or decisions with regard to using funds for community programmes. NGO staff should not handle group money. They should not function as group office bearers; neither should they accept (even informally) to perform those functions that are expected to be performed by the group members themselves (e.g. depositing money, making withdrawals, purchases etc.) |
| – Signatories to the group bank account must be rotated periodically. | |
| – Fund management tends to improve if groups display charts showing lists of members' loans, recoveries, overdue balances and other activities. | – No group member or office bearer should hold cash balances at any time. |
| – All decisions regarding fund management and fund utilization should be verifiable through the minutes of the group. | – Interest/service charges which are unrealistically low should be avoided as experience shows that very low interest rates discourage recoveries; further the members may re-lend loans to others at higher rates of interest. |
| – Group purchases should be handled by an appropriately appointed Purchase Committee | – A group should preferably have only one account for the common fund. The practices in a few groups of placing savings in one account and recoveries in another needs to be discontinued. |

**Book-keeping Related**

| **Do's** | **Don'ts** |
|---|---|
| – All groups require training to keep basic books and documents. | – The practice of keeping books with the NGO staff or in the NGO office should be discouraged. |
| – All books must be kept upto date with transactions being recorded as soon as they occur. | – Initially NGO staff may have to assist the group in maintaining their books and documents but not on a permanent basis. |

- All groups must close the books by the end of each calendar year.
- Groups must be helped to maintain their own (appropriate) systems and records for book-keeping.
- Accounts must be audited at least twice a year.
- Auditors must ensure that concerned staff and group representatives are present at the time of audit.
- Audit reports must be presented to the group in a language in which it can be understood by all members.
- Audit reports should be taken note of for immediate and appropriate follow-up action. A regular record system should be established to follow up audit remarks.

- If a group retains a person on an honorarium / wage basis to keep accounts, the money will have to be generated by the group.
- Disposal of group-owned assets cannot be undertaken without the approval of members and appropriate documentation.
- Members who have purchased assets with group assistance cannot dispose off the same while loan instalments are still due, without adequate reasons that have the approval of other members.

**Training-Related**

**Do's**

- Training needs of groups should be periodically assessed and the project staff should be provided appropriate training.
- Priority should be given to training group members in maintaining their own books and documents.

**Don'ts**

- The practice of paying compensatory wages for group members attending training programmes should be firmly discouraged. Instead, if necessary, a contribution can be made to the group common fund to which the member belongs.

## Work Plan for Your Training Session

### Activity 1

Ask participants to write and stage a short play about revolving credit in a rural SHG illustrating do's and don'ts regarding:

- savings
- lending.

After the short play is staged by the participants give your feedback and suggestions about the main points to be recalled. You can facilitate the process by helping participants with props and other necessary requirements for staging the play.

### Activity 2

Divide the participants into two groups. Ask each group to discuss for 10-15 minutes on important aspects of:

- ground rules for deposits; and
- principles of lending.

Allow each group to present their findings to the larger group. Allow the participants to add more points. At the end you could summarize the main points emerging from the discussion.