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MFI's Loans: Evaluating Adequacy, Utilization and Repayment Pattern among Urban Poor Households

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ABSTRACT
Microfinance Institutions (MFIs) offer loans to impoverished individuals for small enterprise investments and consumption expenses. Investment-oriented loans can create jobs and income for poor households while ensuring high repayment rates for MFIs. However, studies suggest that microloans are often too small for effective investment, failing to improve living standards significantly in the long term. This study evaluates the sufficiency, utilization patterns, and repayment trends of MFI loans. Using primary data from 104 households in Delhi slums collected in 2016, the descriptive analysis reveals that loans are nearly equally split between consumption and production purposes, sometimes serving multiple uses. Most respondents found the loan amounts insufficient. Repayments are typically punctual, though delays occur in some cases due to inadequate income, loan diversion for household consumption, and giving money to male family members.

Keywords: *microfinance, loan utilization, poverty alleviation, repayment trends, income generation*

I. INTRODUCTION

Microfinance Institutions (MFIs) provide loans to poor people for investment in their small enterprises and also, to some extent, for meeting their consumption expenses such as children's education, house construction, family medical expenses, and other emergencies. Many scholars argue that loans should be allocated solely for investment purposes because they foster income generation, create employment, and help lift impoverished households out of poverty. Loans can open new business opportunities and expand existing enterprises, resulting in increased income and enhanced socio-economic well-being of households (Singh, 2006; Yahaya et al., 2011; Shastri, 2009). Loans, if used only for consumption purposes do not create means for their repayment, and thus, result in a higher financial burden on the poor and the consequent high risk of default for MFIs. When used for production purposes, they generate income and employment for poor households. With the additional income, the poor are enabled to pay back their loan installments in time and thus can maintain financial discipline. This would enhance their creditworthiness for accessing the next loan cycles.

Microcredit, to be more effective should be adequate to meet the minimal business requirements of the production enterprises However, various studies (Attanasio et.al. (2015), Rahman and Khan (2013), Kondo (2007)) have indicated that the microloans provided by MFIs are inadequate and insufficient. They are too small to be used for investment purposes and hence do not manifest in long-term improvement in living standards. Thus, the loan size should be increased to improve the socioeconomic status of its beneficiaries.

MFI loans are characterized by joint liability and group-based credit delivery systems. The physical collateral is replaced by social collateral and social pressure exerted by fellow group members, resulting in timely repayment of loans and very high recovery rates. Various studies have stated that MFI loans have very high and timely recovery rates.

This study aims to assess the adequacy of loans provided by MFIs and how these loans are utilized by the beneficiaries. It also explores general loan repayment trends among the beneficiaries, focusing on whether they are able to repay their loans on time and the reasons behind their repayment behaviors. The descriptive analysis is based on primary data collected from 104 households in Delhi slums in 2016. It is hypothesized that a majority of loans advanced by the MFIs are used for investment purposes to enhance household income levels.

Following the introduction, section 2 provides a brief literature survey on the subject. Section 3 presents the descriptive results relating to the adequacy of MFI's loans, its utilization pattern, and the general loan repayment trends by the beneficiaries. The last section concludes.

II. A BRIEF LITERATURE SURVEY

Microfinance programs are designed to offer small loans to low-income households, primarily to support income-generating activities that can boost their income and overall welfare. However, these programs also provide loans to meet consumption and emergency needs. The Malegam Committee (2011) recommended that Microfinance Institutions (MFIs) should offer loans not just for income-generating activities but also for consumption needs such as education, house construction, medical expenses, and emergencies, in addition to paying off high-interest loans from moneylenders. However, some argue that loans should be restricted to income-generating purposes. The main reason is that the primary goal of MFI loans is to help women escape poverty by supporting income-generating activities. The additional income from these activities helps in repaying the loans and improving the household's overall financial situation. On the other hand, using loans solely for consumption can increase financial strain, as there may be no extra income to cover loan repayments, raising the risk of default. This could lead to higher interest rates and more aggressive loan recovery methods. Hence, it is crucial to strike a balance between providing loans for income generation and for consumption needs. Following the recommendations of the Malegam Committee, the Reserve Bank of India (RBI) established a distinct category of Non-Banking Financial Companies (NBFCs) designated as Microfinance Institutions (MFIs) and implemented specific regulations for them. These regulations require that at least 75% of the total loans disbursed by MFIs must be allocated for production or income-generating activities.

The main objective of microfinance is to provide credit to impoverished households, helping them break free from persistent poverty. However, Buhiya et al. (2016) found that the loans were frequently used to smooth household consumption rather than being channeled into productive activities. This raises concerns about the long-term efficacy of microfinance in alleviating poverty, as using loans for consumption may not lead to sustainable improvements in economic conditions. A study by Kc et al. (2011) in five urban and semi-urban cities in India found that 49% of loans taken by MFI clients were used for current business activities, while the remaining portion was used for consumption purposes, such as repaying old debts, healthcare, and education. Additionally, Microfinance India (2006) reported that the demand for consumption loans among the urban poor was three times higher than that for enterprise loans.

The most substantial benefits of microcredit are realized when there is a long-term relationship between the borrower and the microfinance institution (MFI), the loan amounts are sufficient, and the funds are utilized for productive purposes. According to Awan & Juiya (2015), larger loan amounts are correlated with enhanced household welfare and economic well-being. They suggest that more substantial loans enable households to invest in business expansion and gain access to better opportunities, which can significantly improve their economic status and reduce poverty levels. Coleman's (1999) study on village banking in Thailand found that the impact of microfinance on household income and assets was minimal. This limited effect was primarily because the loans were used for consumption rather than generating income. Additionally, the loan amounts were often too small to support meaningful investments that could lead to significant economic gains.

Attanasio et al. (2015) observed that MFI loans are seldom used for investment purposes. They identified two main reasons: the loans are typically too small and inadequate, and they often end up being shared with family and friends due to tightly-knit family structures. This situation leads to increased consumption rather than investment, which fails to result in a long-term improvement in living standards. Similarly, Rahman and Khan (2013) found that the ASA microcredit program in Bangladesh was not as effective as intended. They noted that the loan amounts provided by ASA were insufficient and recommended increasing the loan sizes to enhance the socioeconomic status of the beneficiaries. Kondo (2007) studied the impact of the Rural Microenterprise Finance Project (RMFP) on the well-being of impoverished rural populations in the Philippines. The study revealed that, for poorer borrowers, the cost and availability of loans are insufficient to encourage them to choose more productive activities that would cover the borrowing costs and generate additional revenue. Linn & Charoenloet (2009) found comparable findings when examining the influence of Chin-MFI membership in Myanmar on household welfare. Their research suggested that microfinance loans did not enhance borrowers' welfare through income-generating activities, primarily because the loans provided were insufficient for this purpose. This indicates that merely providing access to credit is not enough; the size and intended use of the loans are crucial factors in determining the effectiveness of microfinance as a tool for poverty reduction.

Research indicates that offering credit to women is a sound business strategy, as they generally exhibit better saving and repayment behaviors. Consequently, Microfinance Institutions (MFIs) often extend micro-loans to women borrowers to maintain high repayment rates. When it comes to debt repayment, women are usually more dependable than men (Das and Patnaik, 2016). The concept of joint liability in microfinance promotes self-confidence and ensures disciplined repayment practices (Tarozzi et al., 2015). However, it's important to note that prompt loan repayment does not always equate to improved welfare, as it may also be the result of fines and penalties imposed to enforce repayment (Ahlin & Townsend, 2007).

Some researchers argue that loans given to women are typically controlled by men in the household, leading women to rely completely on their husbands to make loan repayments. This can frequently lead to domestic violence and the exploitation of women (Goetz and Gupta, 1996; Leach and Sitaram, 2002; Rahman, 1999). Swain and Wallentin (2009) observed that women

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borrowers frequently encounter difficult circumstances because they are held accountable for repaying the loans despite not having a specific source of income. This situation can be disempowering for them and highlights the exploitation women endure from male members of their households, as noted in numerous other studies (Goetz and Gupta, 1996; Rahman, 1999; Leach and Sitaram, 2002; Hunt & Kasynathan, 2002).

III. DATABASE AND METHODOLOGY

This study focuses on a primary survey conducted with clients of Microfinance Institutions (MFIs) operating in the slums of Delhi. It includes two specific MFIs: Janalakshmi Financial Services Ltd, an NBFC-MFI, and Sanchay Cooperative Urban Thrift and Credit Society, a Mutual Benefit MFI. The MFIs work in different urban slums in Delhi, selected using the convenience sampling method. The participants from each MFI were chosen based on their willingness and availability to participate in the survey, provided they had been clients for at least three years and had taken out loans from these MFIs.
From the list of clients, a total of 104 participants were selected for the study, with 58 respondents from Janalakshmi and 46 from Sanchay. The survey was conducted using a structured questionnaire during the last quarter of 2016. The questionnaire covered topics such as the purposes for which MFI loans were used, the adequacy of the loans, and trends in loan repayment.

IV. RESULTS

Usage Pattern of MFI's Loans
To evaluate how the loans provided by MFIs are being used, all respondents who had taken loans were asked about their usage patterns during the current loan cycle. The findings are as follows.

Table 1: Loan usage by the MFI's clients

	Frequency	Percentage
Production purposes	51	49.04
Consumption purposes	46	44.23
Production and Consumption purposes	07	6.73
Total	104	100

Source: Author's calculation (primary data).

Table 1 indicates that 49 percent of the loans are utilized for production purposes, while 44 percent are directed towards consumption purposes. Production purposes refer to using loans for income-generating activities or acquiring productive assets that will generate future income. Consumption purposes encompass spending on smoothing consumption, education, health care, acquiring household assets, housing, emergencies, and similar needs. Additionally, some respondents (6.7 percent) reported using their loans for both consumption and production purposes. This finding aligns with previous studies, such as Microfinance India (2006) and research by Kc et al. (2011), which also highlighted a significant demand for loans for consumption purposes. Specifically, Kc et al. (2011) found that 49 percent of loans taken by MFI clients were used for current business activities, with the remainder allocated to consumption needs like paying off old debts, medical expenses, and education.
Upon further analysis of how MFI clients utilize loans based on the type of MFI, the following results were obtained.

Table 2: Loan usage by the MFI's clients as per the type of MFIs

	Sanchay	Janalakshmi
Production purposes	50 (23)	48.27 (28)
Consumption purposes	45.65 (21)	43.1 (25)
Production and Consumption purposes	4.34 (02)	8.6 (5)
Total number of observations	46	58

Source: Author's calculation (primary data). Note: Figures in parentheses show the frequencies of the variables.

The findings presented in Table 2 indicate that most loans from Sanchay are used for production purposes (50 percent of respondents), followed by consumption purposes (46 percent), and multiple uses (4 percent). For Janalakshmi, 48 percent of the loans are utilized for production purposes, 43 percent for consumption purposes, and 8.6 percent for both consumption and production. This distribution does not align with the RBI regulation that requires at least 75 percent of the total loans provided by NBFC MFIs to be used for production purposes. The data shows that Sanchay has a higher proportion of clients using loans for both production and consumption purposes compared to Janalakshmi. These results reject the postulated hypothesis that a majority of loans advanced by the MFIs are used for investment purposes to enhance household income levels.

Respondents were also questioned about whether the loans met their requirements adequately. Their responses are summarized in Table 3 below.

Table 3: Adequacy of MFI's Loans

	Frequency	Percentage
Loan size is adequate	39	37.5
Loan size is not adequate	65	62.5
Total	104	

Only 37.5 percent of respondents were fully satisfied with the loan amount, while nearly 65.5 percent felt that the loans were insufficient. This finding is consistent with studies by Attanasio et al. (2015) and Rahman and Khan (2013), which also reported that loan sizes were inadequate and insufficient.

Loan Repayment Trends

To evaluate the overall loan repayment trends, all the women respondents were asked if they were able to make their loan installments on time. If they were not, they were asked to explain the reasons for the delays. Their responses are summarized in Table 4.

Table 4: Loan repayment trends

	Percentage
Repay on time	71.15
Could not repay on time	28.88

Source: Author's calculation (primary data).

The results indicate that 71 percent of beneficiaries are able to repay their loan installments on time. Among the 29 percent who faced delays, the majority (14 percent) reported that they had given the loan amount to male family members, who then failed to repay it on time. This finding is consistent with various studies (Swain and Wallentin, 2009; Goetz and Gupta, 1996; Rahman, 1999; Leach and Sitaram, 2002; Hunt & Kasynathan, 2002) that have highlighted how loans can sometimes lead to the exploitation of women by male household members.

Additionally, some women cited insufficient income (8.6 percent) and diversion of loans for household consumption (3.8 percent) as reasons for delayed repayments. A small percentage of beneficiaries (2 percent) mentioned other reasons, such as delayed wages and family emergencies like illness.

V. CONCLUSION

This paper aimed to assess the adequacy of microfinance institutions (MFI) loans and how beneficiaries utilized them. It also analyzed the trends in loan repayment among beneficiaries to determine if they could repay their loans on time and explored the reasons behind any repayment issues. The analysis was based on primary data from a 2016 survey of 104 households in Delhi slums.

The findings revealed that 49% of respondents utilized their loans for income-generating activities, while 44% used them to cover consumption needs. Additionally, a small percentage (6.7%) of loans were used for both consumption and income generation. Thus the loans are nearly equally split between consumption and production purposes, sometimes serving multiple uses. When examining loan utilization by specific MFIs, it was observed that Sanchay had a higher percentage of clients using loans for both production and consumption purposes compared to Janalakshmi. Our results reject the postulated hypothesis that a majority of loans advanced by the MFIs are used for investment purposes to enhance household income levels.

Regarding the adequacy of loans, only 37.5% of respondents felt the loan amounts were fully sufficient, while 62.5% believed they were inadequate. This indicates a need for increasing loan sizes to better support investment and improve household welfare.

The findings on loan repayment trends indicate that 71 percent of beneficiaries successfully made their loan payments on time. However, 29 percent faced difficulties with timely repayment. Among these, a significant portion (14 percent of the respondents) reported that they handed over the loan money to male household members, who then failed to repay on time.

Overall, most repayments were made as scheduled, but some delays occurred due to inadequate income and the use of loans for household expenses or transferring the funds to male members.

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