CHAPTER 4

MICROFINANCE MODELS

The Microfinance is pretty small amount of loan which is being lent to the peer group of friends or neighbors, and the repayment became obligatory because of the relation or the peer group stress. As microfinance loans are of very small amount and to make them commercially practicable with securitization the system may have to take into account thousands of microfinance loans to compensate transaction cost of all the procedure. As far as legal process concerns that would require so many legal, official process as per the law of land where microfinance actions take place. There are some countries having legal support for Microfinance such as in Vietnam. Since 2004, Vietnam has passed a declaration on MFIs for making them more skilled and persuaded with long term planning. But still in all this we were not having any set financing replica to follow microfinance. There are some legal frameworks for current microfinance models and some of the key players in the field of microfinance.

Key Players of Microfinance in India

- National Bank for Agricultural and Rural Development (NABARD)
- Reserve Bank of India
- Self Help Groups
- Micro Finance Institutions (MFIs)
- Non Government Organizations (NGOs)

4.1 LEGAL FRAMEWORK OF MICROFINANCE MODELS PREVAILING

Categories of Providers	**Legal Framework governing their activities**
(a) Domestic Commercial Banks: Public Sector Banks; Private Sector Banks & Local Area Banks	(i) RBI Act 1934/ (ii) BR Act 1949 (iii) SBI Act (iv) SBI Subsidiaries Act (v)Acquisition & Transfer of Undertakings Act 1970 & 1980
(b) Regional Rural Banks	i. RRB Act 1976 ii. RBI Act 1934 iii. BR Act 1949
(c) Co-operative Banks	i. Co-operative Societies Act ii. BR Act 1949 (AACS) iii. RBI Act 1934 (for sch. banks)
(d) Co-operative Societies	(i) State legislation like MACS
(e) Registered NBFCs	(i) RBI Act 1934 (ii) Companies Act 1956
(f) Unregistered NBFCs	(i) NBFCs carrying on the business of a FI prior to the coming into force of RBI Amendment Act 1997 whose application for CoR has not yet been rejected by the Bank (ii) Sec. 25 of Companies Act
(g) Other providers like Societies, Trusts, etc.	(i) Societies Registration Act ’60 (ii) Indian Trusts Act (iii) Chapter IIIC of RBI Act ’34 (iv) State Moneylenders Act

Source : NABARD

4.2 KEY PLAYERS OF MICROFINANCE IN INDIA

4.2.1 National Bank for Agricultural and Rural Development (NABARD):

NABARD is an apex establishment, recognized for all the guiding principle matters concerning scheduling and operations in the fields of credit for agriculture and other financial activities to be carried out in rural India. NABARD was established in 1982 as a Development Bank "for providing and regulating credit and other services for the encouragement and growth of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts which involve linked monetary activities in rural areas with a view to promote and incorporate rural development and securing success for rural areas and for the matters associated therewith or incidental thereto". The commercial mission set by NABARD for making accessible microfinance services to the very poor visualize coverage of one third of the rural poor with the help of one million SHGs by the year.

NABARD acts as a facilitator for rural prosperity by

- Providing refinance to lending institutions in rural areas.
- Bringing about and promoting institutional development.
- Evaluating, monitoring and client inspection through banks.

4.2.2 Reserve Bank of India

The initial reference to micro credit in an official statement of monetary and credit policy of RBI was in former RBI President Dr. Bimal Jalan's Monetary and Credit Policy Statement of April 1999. The policy attached significance to the work of NABARD and public sector banks in the area of micro credit. The banks were pushed to make all efforts for provision of micro credit, especially forging linkages with SHGs, either at their own proposal or by enlisting support of Non-Government Organisation (NGOs). The micro credit given by the banks is reckoned as part of their priority sector lending, and they are free to device appropriation loan and saving products in this regard (Y.V. Reddy, 2005).

Substantial amount of work had been done by RBI in this sector since 1991. In 1991-92 a pilot project for linking up SHGs with banks was launched by NABARD in discussion with the RBI. In 1994, the RBI constituted an operational group on SHGs.

On the suggestions of RBI, SHGs would be reckoned as part of their lending to weaker sections and such lending should be assessed by banks and also at the State Level Bankers' Committee (SLBC) level, at accepted time gap. Banks were also suggested that SHGs, registered or unregistered, who are occupied in promoting the saving among their group members, would be entitled to open savings bank accounts with banks irrespective of the availability of the credit facilities from banks.

4.2.3 Self Help Groups

The origin of SHGs is from Grameen Bank of Bangladesh, which was founded by Mohammed Yunus. SHGs was on the developing track during 1975. The establishment of SHGs can be traced to the survival of one or more difficult areas around which the awareness of rural poor is built and the procedure of group structure or formation initiated. SHGs are measured as a new lease of life for the women in villages for their social and economic empowerment. SHG is an appropriate mean for the empowerment of women. Since SHGs have been able to mobilize savings from persons or groups who were not normally predictable to have any 'saving' and also to reprocess successfully. The shared resources among the members and their activities have fascinated attention of a supportive mechanism for meeting the credit needs of the poor (NABARD, 2004)

4.2.4 Micro Finance Institutions (MFIs)

A series of institutions in public sector as well as private sector proposes the micro finance services in India.

Broadly, MFIs can be divided into three categories:

1) Non Banking Finance Companies (NBFC) are institutions which have fascinated marketable capital and scaled up considerably since last five years. These MFIs includes SKS, SHARE and Grameen Bank style program but after the year 2000, all were

converted into for-profit, synchronized entities mostly Non-Banking Finance Companies (NBFCs).

2) For profit MFIs, around 10-15 institutions with elevated growth rate, including both old and recently formed for-profit MFIs which comprise Grameen Koot , Bandhan and ESAF.

3) Private MFI's, India's 1000 MFIs and NGOs are under pressure to achieve higher growth. Most of these carried on to offer multiple developmental activities in addition to microfinance and had difficulty in achieving higher growth trends.

Private MFIs in India, apart from for a few exceptions, are still in the inception stage and doing efforts and are therefore unregulated. They secure micro finance clients with changeable quality and using different working models.

Regulatory framework should be measured only after the sustainability of MFIs Model as a banking activity for the poor.

4.2.5 Non Government Organizations (NGOs)

The Non Government Organizations occupied in promoting SHGs and linking them with the Formal Financial Agencies (FFAs) executes the following functions:

Organizing the poor people in a group and

- Guiding, training and helping them in the organizational, decision-making and economic matters.
- Serving them access more and more credit availability and linkage with formal financial agencies (FFAs).
- Channelizing the group attempt for various improvement or development activities.
- Helping them in availing available opportunities, widening the options available for financial growth.
- Helping them in supporting the group effort separately even after leaving the NGO.

4.3 MICROFINANCE LENDING MODELS

There are eight working models for microfinance lending in the worldwide.

4.3.1 Model 1: Associations or Self Help Groups

A Self-Help Group (SHG) is a registered or unregistered group of small entrepreneurs having similar social and financial background, approaching in cooperation with each other to save small amounts repeatedly, equally be in agreement to contribute to a common fund and to deal with the crisis with the mutual help basis. The group members use group understanding and peer stress to guarantee proper end-use of credit and well-timed repayment thereof. In fact, peer stress has been known as an effective alternate for collaterals.

Financially poor individuals gain power as part of a group. Besides, financing all the way through SHGs reduces operation costs for both money lenders and money borrowers. While lenders have to deal with only a single SHG account in its place of a big number of small-sized individual accounts, money borrowers as part of a SHG cut down operating expense on travel (to and fro the branch and other places) for carrying out paper work and on the loss of workdays to drum up support for loans.

A group is created with the specific reason to carry out some monetary activity and the group is created as per the gender, religion, caste or culture. Mainly these groups of people belong to weaker sections of society and through the survey this has been observed that more than 90% of the members are women (Lal, 2007). In SHG model every members who is a part of group and start saving a little amount every month and start inter loaning for all the group members. The main characteristics of SHGs are as follows:

- The ideal size 10 to 20 members.
- The group registered is not compulsory.
- In a group only one member from one.
- The group has to be homogeneous group either only men or of only women.

- Women's groups are in general establishing to execute better working.
- Members have the same social and economical background.
- All groups members attendance is compulsory during meetings.

The main functions of SHGs are:

1) 'Savings first – Credit later' be supposed to be the slogan for all the group members. They are put in a practice of saving repeatedly.
2) The sum collected as a saving used for interloaning among the group members and the purpose for loan, amount, rate of interest, etc. to be discussed and decided by the group members themselves.
3) During the meetings, the group will talk about and try to find all the possible solutions to the difficulty faced by any of the group member.

This is the home grown model of microfinance having very less legal formalities, better compatibility and convenient among the group members which in turn gives preferred results. This model is very popular in Punjab and working very efficiently for the rural development.

4.3.2 Microfinance Lending Model

Credit Guarantee Facility

For directing of funds towards Microfinance Sector, SBP has considered a Microfinance Credit Guarantee Facility, hereafter referred to as the "facility" which will be managed by the State Bank of Pakistan (SBP), Banking Services Corporation (BSC). The ability is expected to smooth the progress of banks/DFIs (Development Financial Institute) to play a leading responsibility for facilitating credit constraints of MFBs (Micro finance Borrowers) / MFls in their way to take full advantage of outreach by extending loan facilities to them. The capability is expected to attain the following objectives:

i) The guarantees are anticipated to help in building relations between micro borrowers and traditional financial institutions.

Becoming accustomed to the banks with the client should sooner or later lead to the "graduation" of the borrower.

ii) Under the competence of SBP, the BSC provides partial guarantees to wrap the principal sum in default or first loss Default Guarantees covers the first loss and this is limited to a assured percentage on the principal amount, to banks/DFIs for minimising the perceived risk by covering the part of the losses carried on funds borrowed or made available to MFBs/MFIs for the benefit of leveraging the guarantee fund for a number of times.

iii) Banks/DFIs will assess the potential loan recipient MFBs/MFIs according to their internal criteria. This way the credit development facility will serve the banks/DFIs to expand their own sense of the risks concerned in microfinance.

iv) The guarantee will make possible resolution of regulatory issues that limit in secured lending by banks/DFIs and would bring the loans to MFBs/MFIs for fulfillment with banking regulations. This is a model which is working very efficiently with different names at different locations AfriCap Microfinance Fund (Mauritius), Bellwether Microfinance Fund (India), Latin America Bridge Fund, Microfinance Credit Guarantee Facility (Pakistan)

4.3.3 Microfinance Lending Model 3:

4.3.3.1 Community Banking/ Grameen Bank/ Village Banking

Grameen Bank of Bangladesh which transformed micro-finance and generated millions of small entrepreneurs, for the same lobbying is done between bank and government of Bangladesh by Yunus. The Grameen bank has obtained authoritarian permission to open a link or liason office in Mumbai (India). The Indian functions for Grameen Trust of India expanded working of different grameen type of micro-finance to work on build, operate and transfer (BOT) basis, mostly in the North-East region of India and among tea estate workers in Assam. It will also monitor and evaluate all the twenty replicas of Grameen model, which are already in operation in various parts of India. The original seed capital was provided by the Grameen Trust to various NGOs working efficiently and micro-finance supporting institutions. Collateral-free loans provided to those farmers owning less than half acre of land or generate equivalent amount of income with labour or routine working that the land would generate for them. Besides, this training is required for the access of the grassroots personnel and for conducting workshops to equip them with the working knowledge. Subsequently, it is considering independent financial support.

4.3.3.2 Grameen model

As per Yunus, (1998) For this model a bank unit is set up with a manager working in that particular field and a number of bank workers, covering an area of about 15 to 22 villages maximum. The manager and workers starts by visiting all the villages to familiarise themselves with the local environment in which they will be working and recognize potential clientele, as well as explain the reason, function, and mode of process with which the bank will work for the local population. A group of five prospective borrowers constituted in the initial stage, and only two of them are made eligible for receiving loan amount. The group observed for a month to see if the members are working as per the rules of the bank, only if the first two borrowers repay the principal plus interest over a period of fifty weeks then other members of the group also become entitled for a loan. Because of the limitations, there is a comprehensive group stress that keeps individual records very clearly. In tune to this, collective responsibility of the group that serves as collateral for the loan.

4.3.3.3 The Grameen Peer-Lending Model

America uses the Grameen group lending and savings model that has been developed and refined over thirty years by the Grameen Bank. The basis of the system is a peer group model in which borrowers encourage, support, and learn from each other. The group model requires prospective borrowers to form or join 5-member “Groups.” Groups are then organized into Centers that have up to 8 Groups. Centre meetings take place on a weekly basis and are facilitated by

Centre Managers who are employed by Grameen. Group meetings that happen weekly or monthly(as per group) and Grameen Bank's lending principles give confidence for successful repayment and also provide a valuable opportunity for best-practice sharing and training on economic issues such as credit scores, savings, and related needs like health and insurance.

The Grameen model incorporates all the necessary savings that are mandatory for loan dealings so that borrowers can build economic resources for future. Savings are mandatory in several ways for an SHG and are promoted all the way through the borrowers relationship because Grameen model works on a belief that savings are an essential component for future financial security and stability of our borrowers through performing responsibilities such as:

- holding regular and weekly meetings, which are supervised in turn coordinated by the MFI worker and as a coordinator MFI worker maintains all the records of savings and collected repayments and kept,
- organizing financial assistance to one or a number of group savings funds, which can be used by the group for different purposes an MFI coordinator who maintains group accounts and is in agreement with group,
- assuring loans to group members by acknowledging joint liability and understanding group emergency funds utilisation and by accepting that no members of a group will be offered any loan in case of arrear of any member,
- appraising fellow-members' credit applications in the light of above rules and ensuring that their fellow-members will continue their periodic savings and repayment of loans .

Prospective clients are asked by the MFI to systematize themselves into 'Groups' of five members who are then organised as a 'one Centre' of around five to seven such Groups of five members each. All the members make recurring savings and loan raising with the MFI, according to fixed schedule. Each member of the group has individual savings and loan account with the MFI, groups and centres are to facilitate the financial process intermediation.

4.3.4 MICROFINANCE LENDING MODEL 4: COOPERATIVES

Co-operative Societies work on the belief or the principal of mutual help. Cooperative societies are the organisations of economically weaker sections of society. These societies change the weakness of members into power by adopting the belief of self-help all the way through joint co-operation. It is to work jointly on the rule of "Each for all and all for each", the members struggle, exploit and secure a place in society. In the cooperative societies model earnings are not made at the cost of members. The profit earned is distributed between group members. In a co-operative society, principal amount is pooled by all the group members. However, with no trouble to raise loans and protect grants from government after its registration as a society. The membership of a Co-operative Society can be availed with common interest. To form a cooperative society a group of ten members are required. The Co–operative societies Act do not have any limit for maximum number of members but member of the society can specify or limit the maximum number of members.

A co-operative society is a charitable association of individuals with common needs or interest who join hands for the accomplishment of common financial interest. Its aim is to serve the poorer sections of society all the way through mutual help.

- Membership of co-operative societies is voluntary and open to all those who have common interest. It is democratically managed and it has a legal existence. It works on the principle of self help through common support of all the members of the society.
- A co-operative society can be formed under the act of Co-operative Societies Act, 1912, with a minimum number of ten members and maximum unlimited. For registration, an application along with rules of the society to be followed i.e. by laws of the society has to be submitted to the Registrar of Co-operative Societies.

Co-operative societies may be classified as follows:

1) Consumers' co-operative society - created to eradicate the function of middlemen and to supply better quality goods and services at practically price for the consumers.
2) Producers' co-operative society - created to facilitate producers to get hold of raw material, tools, equipment etc.
3) Co-operative marketing society - created to ensure an encouraging market for small producers to sell the final product and get a good value or return on sale.
4) Co-operative credit society - created to provide economic help to society members.
5) Co-operative farming society - created to attain economies of high scale farming and maximization of agricultural output received.
6) Housing co-operative society- created to provide residential houses to society members by constructing houses for them or providing loans to society members to construct their own houses.

Cooperative system is like a community banking. In this working model a group of people belong to middle /upper middle class, they forms a cooperative society to offer micro finance services to the poor, In this model the borrower along with his choice group shares a joint liability for the loan amount, that if in future either of the member is not paying, the accountability lies with the peer group members as they will not be having access to the loan/finance in the future. These are the models working very efficiently for the homogeneous products as Amul india,Verka, Milk Plant, Lijjat Papad.

4.3.5 MICROFINANCE LENDING MODEL 5: CREDIT UNIONS

A credit union is a exclusive member-driven, self-help financial institution. It consists of members of a particular group or an organization, who agree to loan to the peer members at a rational price and ready to save their money together. The members of the credit union are the people having common bond i.e. they are working for the same company or employer; Social society, labour union, etc. or working in the similar community. A credit union's membership is open for all group members, regardless of religion/ race/colour or creed. A credit union is a self-governing, not-for-profit monetary firm. Each member can vote in the elections for the post of director or committee representatives.

In a credit union, all the members of a selected community put their money together and make loans to one another at very economically priced interest rates percentage. This model of microfinance is known as Unión Progresista Amatitlaneca in Guatemala and Vancity Credit Union in Canada.

4.3.6 MICROFINANCE LENDING MODEL 6

Non-Governmental Organizations (NGOs)

NGOs are 'external organizations' and their actions range from offering microfinance services like loans, insurance, savings and to improving credit rating of poor NGO works on training, education and research. NGOs may also act as intermediaries between the poor and supporter agencies like UN, ADB and World Bank to operate locally and through online or physical presence.

NGOs have mushroomed as a key player in the field of microcredit. They have played the role of mediator in various proportions. NGOs have been energetic in opening and participating in microcredit programmes. This takes into account for creating awareness and importance of microcredit within the community, as well as various international and national patron agencies. They have urbanized resources and tools for microcredit organizations to supervise progress and to spot better practices. They have also generated opportunities to become skilled and practice of microcredit. This includes publications, workshops and seminars, and training programmes. This model is successfully working all over the world

ACCION International (headquarters in USA), KIVA (Headquarters in USA), Kashf Foundation (Pakistan) and in Punjab(India), this has been observed that NGO are acting as a facilitator by joining hand with NABARD for giving training on different small scale businesses to be carried out for economical independence.

4.3.7 MICROFINANCE LENDING MODEL 7: FOR-PROFIT BANKS

Commercial Banks, as well as focused Microfinance Banks offer a variety of financial services to the poor but the main reason may be to protect high return on investment. Unlike other models, the aim is of this model is also social development as well as financial improvement beyond institutional sustainability.

The function of banks in microfinance for profit banks encourage microfinance in many different ways, direct lending, lending to MFI or partnership with MFI.

4.3.7.1 Direct lending

Banks can straight away lend to micro entrepreneurs. This way the payment is observed in banks working with the of solely serving in the microfinance sector. The Grameen Bank was founded by Muhammad Yunus in 1976, which works with the sole goal of helping the poor through the condition of small loans to a group of borrowers. Group loaning is done on the recognition and identification of each person in the group but in case loans are not paid back completely, loan is not renewed to anyone in the group.

As a result of peer pressure, the group lending method prerequisite is to be financially disciplined and to repay their loans.

4.3.7.2 Microfinance Subsidiary

Banks may select to separate their microfinance operations through the creation of a new or separate subsidiary. Such subdivisions help banks to moderate the levels of risks associated with lending to the poor. This is a necessary step for banks on condition that both consumer finance and microfinance requires a different move toward the business and a different training of the employees to deal with any kind of unusual working required for different market.

In addition a borrow gets more consideration and a trust is formed that improves working just by making separate human resources under the same premises.

4.3.7.3 Partnership with a Microfinance Institution

Banks can build partnerships with microfinance supporting institutions. Banks can lend to microfinance institutions in the form of wholesale banking, and in turn, MFIs can employ the capital to lend to the poor.

In this process, the bank frequently provides the loan funds and the knowledge assesses the pricing and the levels of risk involved with the loans. On the other hand, the MFIs embark on the organisation monitoring and collection of the loan funds. Indeed, there are a lot of rewards for MFIs engaging in partnerships with banks. With the greater amount of capital comes that increases the loan size and more branches of the bank has, the better the outreach achieved all the way through geographical expansion.

In Punjab so many MFIs are having tie ups with commercial banks having separate branches for microfinance e.g. HDFC bank, ICICI bank and SBOP bank.

4.3.8 MICROFINANCE LENDING MODEL 8: ROTATING SAVINGS AND CREDIT ASSOCIATIONS (ROSCAS)

ROSCAs are small groups, formed by women, where each member makes ‘regular cyclical donations into a common fund’, which is given completely to one member at the start of each cycle either weekly, monthly or quarterly. The benefit of this model is the identical to client’s cash flows with the loan amount, the capability to makeup the deal without interest rates in the absence of over-head costs.

Rotating Savings and Credit Associations (ROSCAs) are basically a group of individuals who come as one and make regular cyclical contributions to the common fund, which is then given as a lump sum to one member in each cycle. Thus, a member will 'lend' money to other members through their regular contributions. After receiving the lump sum amount when it is his turn, he then pays back the amount in regular monthly installments. Deciding who receives the lump sum is decided by consensus, lottery, and bidding with agreement.

The study concluded that different models are working in different parts of the world and as the case of Punjab, A Self-Help Group (SHG) as a registered or unregistered group of micro entrepreneurs having homogenous social and economic background voluntarily, coming together to save small amounts regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis. Economically poor individuals gain strength as part of a group. Rotating Savings and Credit Associations (ROSCAs). ROSCAs are small groups, typically composed of women, where each member makes 'regular cyclical contributions into a common fund', which is given entirely to one member at the start of each cycle (weekly, monthly, quarterly). The benefit of this model is the matching of a client's cash flows with the loan, the ability to structure the deal without interest rates, and the absence of over-head costs.