Chapter 3

Models of Microfinance

1. SHG Model

2. JLG (MFI) Model
   2.1 Agency model of MFI
   2.2 MFI Bulk Lending Model
   2.3 Micro Finance and PACS
   2.4 Business Facilitator And Correspondent Models
   2.5 Acceleration Model
   2.6 ICICI Bank’s Partnership Model

3. Micro-Credit Model in Other Countries
   3.1 Rotating Savings and Credit Associations
   3.2 The Grameen Solidarity Group Model
   3.3 Village Banking Model
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“The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector …… Together we can and must build inclusive financial sectors that help people improve their lives.”

- Kofi Annan, United Nations Secretary General, 2003

“Microfinance is a financial service of small quantity provided by financial Institutions to the poor.”

Landlords, local shopkeepers, traders, suppliers and professional money lenders, and relatives are the informal sources of micro-credit for the poor, both in rural and urban areas. Some of the perceived advantages of informal loans are (a) contractual flexibility, (b) lower discrepancies between loan sanctioned and loan received and (c) less reliance on collateral.

Emphasis on collateral security is, however, not totally absent under informal loans as money lenders keep jewellery and kitchen ware as physical security and are known to
mortgage land and house against loans. An overwhelming majority of (landless) agricultural labourers attached to landlords have been borrowing money based on pledging “self-labour” as collateral. This category of borrowers is the most vulnerable as harsh contracts linking labour to loans are imposed. Bonded labour is the extreme form of this collateral.

The interest charged on informal loans is stated to vary between 24 per cent to 48 per cent per annum (or 4 per cent per month). In certain regions, it goes up to 120 per cent per annum (or 10 per cent per month). The Money Lender’s Acts enacted by various states are intended to check the exploitation of the poor by the money lenders. They cannot charge exorbitant rates of interests; in fact, in most cases there is an upper ceiling on interest rates and the total recoveries cannot exceed twice the amount of ‘the principal’. However, such provisions are rarely enforced due to various reasons.

There are two main models of micro credit in the country and they are ‘SHG Model’ (Self Help Group) and the ‘JLG model’ (Joint Liability Group). In the case of the SHG model Self Help Groups are formed and financed by banks. In some cases SHGs are formed by formal agencies/NGOs and financed by banks. These promoting institutions are known as Self Help Promoting Institutions (SHPIs). SHG model can further be bifurcated into two models, SHG- Bank Linkage model and Swarnjayanti Gram Swarojgar Yojana (SGSY). In the ‘JLG model’ JLGs are formed and financed by the MFIs that obtain resource support from various channels (financial institutions). In India, majority of micro-credit activity is under the ‘SHG model’ (NABARD’s Bank-SHG Linkage) and 10-15% of the activity is through ‘JLG Model’. 9 (Nabard Report 2008)
Any discussion on Microfinance Institutions would be incomplete without a proper mention of the various models used by these Institutions. The main models prevalent are discussed here under.

**Various Models:**

1. **Self Help Group Model:**

   The first official interest in group lending in India took shape during 1986-87, when National Bank for Agriculture and Rural Development (NABARD) supported and financed research project on saving and credit management of self help group of Mysore Resettlement And Development Agency (MYRADA). In 1999-92, NABARD launched the SHG-Bank Linkage Programme on a pilot basis to finance SHGs across the country through the formal banking system. High repayment rates by the SHGs encouraged the banks to finance SHGs. In 1996, Reserve Bank of India included financing of SHGs as a main stream activity of banks under the priority sector lending programmes. The SHG Bank linkage programme covered over 24.3 million families by March 2005. Under the Bank-SHG Linkage Programme 2, 24 million SHGs were linked, up to 31st March 2006, of which 90 percent are women’s groups. (NABARD Report 2008)

   The Self-Help-Groups (SHGs) have emerged as a tier below PACS. SHGs comprise a group of 10-20 members. The groups begin by savings that are placed in a common fund. In a way, SHGs are co-operative (credit) societies linked to a commercial bank rather than an apex cooperative bank. Once linked to the bank, the SHGs may access a given multiple of the pooled savings for disbursement to its members. Group selects its
leader and the selection of the leader is based on rotation. The SHGs have, moreover, emerged as a form of “social collateral” substituting other forms of ‘collateral security’ insisted upon by banks. High repayment rate has encouraged banks to institutionalize SHGs under the bank-SHG linkage model. According to RBI Guidelines, banks may give loans to SHGs up to Rs. 5 lakh without insisting on ‘collateral safety’.

The Bank-SHG linkage programme is noticed to have encouraged thrift/savings amongst the poor. According to one case study, while the average savings per member more than tripled, the increase in assets was about 72 per cent. Out of 234 BPL households surveyed under the particular case study, 122 households were noticed to have been lifted up from poverty. There was, furthermore, a decline in the share of consumption and crop loans and increase in loan for allied agricultural activities and small businesses.

Formulation of SHGs is, however, dependent on the intervening agency, who has so far been NGOs/MFIs, RRBs, Banks and DRDAs. SHGs are being promoted primarily under the two separate schemes of NABARD/Ministry of Finance and the Ministry of Rural Development. During some years, the SHGs formed by the Ministry of Rural Development under SGSY scheme have been twice the number of those formed by NABARD under their bank-SHG programme. The total number of SHGs formed is reported to be approximately 2.3 million that covers nearly 30-35 million BPL households (more than 50 per cent of all BPL households). SGSY is financed on 75:25 cost sharing basis between the centre and state. The main objective of SGSY is to raise income of of BPL families to at least Rs. 2000 p. m.

(55)
There is another important difference between the two. While the SHGs promoted by the Ministry of Rural Development enjoys credit-linked subsidy, those promoted by NABARD do not have any such facility. Despite this, the credit disbursed to SHGs under the NABARD programme has been more than under SGSY. The subsidy level, moreover, determines the standard loan size irrespective of what the project needs to be viable.  

2. Joint Liability Group Model (JLG Model):

The specialized MFIs or microfinance movement since the 1990’s is a new avenue of reaching the poor for their micro-credit needs. Some of the MFIs are based on the Grameen Model, which entails formation of a Centre comprising eight solidarity groups of five borrowers. Members of each solidarity group mutually guarantee each other loan. Ten Centres form a Cluster and seven clusters form a (bank) branch and several branches together presumably form the Bank. This is typically based on the model of Grameen Bank of Bangladesh\(^1\). All members save regularly and loan proposals are approved by the Centre; all loans are, moreover, repayable in 50 weekly instalments. \(^2\)

MFIs in India register themselves either as societies (under the Societies Registration Act, 1960), as trusts under the Trust Acts, as Non-Banking Financial Companies (NBFCs), or as Local Area Banks (LABs). All NBFCs requiring registration with the Reserve Bank of India should have a minimum capital of Rs. 2 crore. NBFCs intending

\(^1\) In contrast to the top-down approach of credit cooperatives (banks) formed in India, this is a bottom-up approach of forming a co-operative bank. Credit cooperatives in India, moreover, became credit agencies rather an agent of both thrift and credit.
to accept public deposits have to satisfy stipulated criteria and have to obtain specific
authorisation from the RBI. The issue of covering of NBFCs’ deposits by Deposit
Insurance and Credit Guarantee Corporation (DICGC) was examined several times, and
it was found neither desirable nor feasible to extend such coverage.

Sa-Dhan, an association of MFIs have argued for a new category of NBFCs, namely,
Microfinance Company with a minimum equity capital requirement (capitalization) of
Rs. 25 lakh. Such MFIs are designed to provide credit only; mobilization of savings is
restricted to members and borrowers. The ratio of savings to net owned funds is
recommended to be 1 : 1 initially, which may go up to 5 : 1 subsequently. This may,
however, pose a problem of supervision by the regulator (RBI) if there are a large
number of MFIs. A Microfinance Development Council was therefore proposed for
performing the task of regulating such MFIs. The Government has, however, not
favoured this idea. It is categorized into following models:

2. 1 Agency model of MFI:

The Internal Group on Rural Credit and Micro Finance of RBI (July, 2005), came to the
conclusion that parking of funds with MFIs is faced with two sets of exposures, namely,
once at the MFI/NGO level and thereafter at the level of SHGs/individual borrower level.
The RBI has, nevertheless, favoured the Agency model of MFIs. Under this model, in
addition to the MFIs, CSOs etc., only those NBFCs which are incorporated under
Section 25 of the Companies Act, 1956 are permitted to be appointed as ‘Business
Facilitators’ (BFs) or as ‘Business correspondents’ (BCs). In the former case, the MFIs provide the non-financial services, such as, identification of borrower, processing and submission of applications to banks etc. In the latter case, the MFI provide financial services as “pass through” agents for disbursal of small value credit, recovery of principal / collection of interest or sale of micro insurance / mutual fund products etc. The loan amount, however, remains in the books of the bank. The banks need not obtain prior permission from RBI for appointing BCs and BFs. They are required to conduct thorough due diligence before appointing BFs/BCs, and as principals, are responsible for customer service and control operations. The banks also need to have operational guidelines for the purpose. The MFIs, moreover, provide First Loan Default Guarantee (FLDG) equal to 8 – 15 per cent of the limit sanctioned in the form of security deposit with the bank so as to maintain its stake in the loan portfolio. The banks appear to have positive experience under this model as the MFIs have helped them overcome the problem of outreach in rural areas and have also reduced their transaction cost. In brief, the agency model of MFI is bank driven. 4

2. 2 MFI Bulk Lending Model:

While the Agency model may appear more appropriate in the case of small MFIs, the larger MFIs may like to operate independently of banks (e. g. as LABs). This category of MFIs belong to MFI Bulk Lending (Equity Participation) model whereby they can access funds in the form of cheaper loans, subordinated debts, equity or quasi-equity
from agencies, such as, the Rashtriya Mahila Kosh, the SIDBI Foundation for Microcredit (SFMC), the Microfinance Development and Equity Fund (under the chairmanship of NABARD) as well as the FWWB.

2. 3 Micro Finance and PACS:

The share of primary agricultural credit societies (PACS) in rural credit stood at 18.6 per cent in 1991. A good deal of this amount went to people who were relatively better-off, that is, to those who do not belong to the BPL households. Notwithstanding this, a certain percentage of the credit flow has benefited the poor. According to the World Bank NCAER study (2004) the share of PACS in micro-credit is as high as 30 per cent or one-third. PACS are, as such, yet another important channel of microfinance.

In terms of retail outlets, the PACS are ahead of the banks and the MFIs at the all-India level, although they are observed to have greater concentration in Maharashtra and Kerala and very low in North Eastern states. The total membership of PACS is reported to be 120 million. The Scheduled Castes and Scheduled Tribes who generally comprise the weaker sections of the society constitute as high as 36-37 per cent or approximately 45 million PACS members. This is much higher membership than under the SHG-Bank linkage programme, (currently around 30 million BPL households) and under the MFIs/LABs/NBFCs (around 1 million beneficiaries).

The co-operative structure is ideally based on the norm of “one man, one vote”. The concept of ‘social collateral’ or ‘group guarantee’ holds good for the co-operatives as well. Group guarantee is supposed to be stronger in the cooperatives (of the poor) and
the guiding principle is “one for all and all for one”. What appears to work best under this model is greater proximity of PACS to its members and the credit history that determines the credit worthiness of the beneficiaries.

A large number of PACS in rural India have been, however, dominated by the powerful. The prudential norms of banking have also been ignored and loans have been extended to defaulting members. Besides, records are not maintained properly and accounting and book keeping of most PACS are very weak. Political interference of one kind or the other, instead of improving the situation, has only contributed to the decline of PACS. Refinancing facility from apex organizations has consequently declined/stopped and in the absence of emphasis on thrift, the PACS have hardly sufficient funds for credit activity.

Successive Committees constituted to suggest measures for revitalisation of PACS have recommended for enactment of the Model Law of Cooperatives. It is an enabling Law that would make the credit cooperatives free from the State’s prerogative to override the management (the control of the Registrar of Cooperatives). The recommendations also include diversification of credit portfolio by PACS / Cooperative Banks beyond crop loans. The credit cooperatives may thus also give consumer loan, housing loan and provide finance for services sector as well as distribute insurance products. This would call for capacity and infrastructure building of PACS and observance of prudential banking norms by PACS. The revitalisation package proposed is, moreover, restricted only to viable PACS and any new infusion of funds by the apex banks will be linked to signing of a MOU.
2. 4 Business Facilitator and Correspondent Models:

The Reserve Bank of India, in January 2006 issued an order to ensure greater financial inclusion and increase the outreach of the banking sector, through Business Facilitator Model and Business Correspondent Model. This enabled the commercial banks, including the RRB to use the services of NGOs, SHGs, MFIs and Civil Society Organization as intermediaries to provide financial and banking services through Business Facilitator and Correspondent Model. Under the Business Facilitator Model the Post Offices can also be used as intermediaries for providing services like (i) identification of borrowers and fitment of activities (ii) collection and preliminary processing of loan applications including verification of primary information/data ; (iii) creating awareness about savings and other products and education and advice on managing money and debt counseling; (iv) processing and submission of applications to banks; (v) promotion and nurturing Self Help Groups/Joint Liability Groups; (vi) post-sanction monitoring ; (vii) monitoring and handholding of Self Help Groups/Joint Liability Groups/ Credit Groups/ others; and (viii) follow-up for recovery.

Under the Business Correspondents Model NGOs/MFIs, Cooperative Societies, section 25 companies, registered NBFCs, not accepting Public Deposit and Post Offices may act as Business correspondent. In addition to the activities listed under the Business Facilitators Model the scope of activities of the Business Correspondent included (i) disbursement of small value credit, (ii) recovery of principal/collection 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.

The banks are expected to act diligently in employing the Business Facilitators and Correspondents. Both the Business Facilitators and Correspondents may be paid reasonable commission/fee by the banks. No fees can be directly charged by them for the services rendered to the customers. The banks are to specify clearly the role of the Business Facilitators and Correspondents and also give wide publicity both in electronic and print media. The banks are also to constitute Grievance Redressal Machinery within the banks for addressing the complaints about services rendered by the Business Correspondents and Facilitators.

However, no major headway has been made in this direction. It was found that the banks have not employed both the Business Facilitators and Correspondents to meet the increasing rural credit requirements.  

**Acceleration Model:**

This model was proposed by SKS. This model applies principals from Starbucks, Coca-Cola and McDonald’s to reduce transactional costs and replicate rapidity.

**ICICI Partnership Model:**

This is based on an analysis of traditional financing model and ICICI Bank’s experience in India. This is basically a model for financing Microfinance Institutions (MFIs) and its
potential for rapidly increasing outreach and unlocking large amounts of wholesale funds available in India’s commercial banking sector. 8

3. Micro Credit Model in Other Countries

Many models of microfinance are popular all over the world, few important of them are discussed here. The Grameen Bank (2000) had identified fourteen different microfinance models, of which three models have been discussed: Rotating Savings and Credit Association (ROSCAs), Grameen Bank and the Village Banking model.

3. 1 Rotating Savings and Credit Associations (ROSCAs):

These are formed when a group of people come together to make regular cyclical contributions to a common fund, which is then given as a lump sum to one member of the group in each cycle. This model is a very common form of savings and credit. The members of the group are usually neighbours and friends, and the group provides an opportunity for social interaction and are very popular with women, these are also called merry-go-rounds or Self-Help Groups. 5

3. 2 The Grameen Solidarity Group Model:

This model is based on group peer pressure whereby loan are made to individuals in groups of four to seven. Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members. Payments are usually made weekly. Solidarity groups have proved effective in deterring
defaults as evidenced by loan repayment rates attained by organisations such as the Grameen Bank, who use this type of microfinance model. This model has contributed to broader social benefits because of the mutual trust arrangement at the heart of the group guarantee system. The group itself often becomes the building to a broader social network. 6

3. 3 Village Banking Model:

Village banks are community-managed credit and savings associations established by NGOs to provide access to financial services, build community self-help groups, and help members accumulate savings. They have been in existence since the mid-1980s. They usually have 25 to 50 members who are low-income individuals seeking to improve their lives through self-employment activities. These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect payments and services. The loans are backed by moral collateral; the promise that the group stands behind each loan.

The sponsoring MFI lends loan capital to the village bank, who, in turn, lend to the members. All members sign a loan agreement with the village bank to offer a collective guarantee. Members are usually requested to save twenty percent of the loan amount per cycle.

Members savings are tied to loan amount and are used to finance new loans or collective income generating activities and so they stay within the village bank. No interest is paid on savings but members receive a share of profits from the village bank's re-lending
activities. Many village banks target women predominantly. The model anticipates that female participation in village banks will enhance social status and intra-household bargaining power.

There are two models of bank-post office linkage, namely (a) the service model of Brazil’s Banco Postal and (b) Post Bank model of the Netherlands. Under the first model, the post offices work as ‘business facilitators’ and as ‘banking correspondents’. In return, they receive commissions from the banks. The RBI, vide its circular of 25th January, 2006 has approved of post office functioning as business facilitators to banks and as bank correspondents.

The second model (Post- Bank model of Netherlands) on the other hand, postulates a kind of a merger of the post office with the bank/banks. The post-office network in the Netherlands is jointly owned by TPG Post and Post bank (each of them having a 50 per cent stake). Post Bank is claimed to be one of the most advanced postal banking networks in the world.

**Conclusion:**

This chapter covers basic structure of microfinance prevailing in the country and abroad. There are two major models under microfinance: Self –Help Group bank linkage (SHG-BL) and Microfinance Institutions Bank Linkage (MFI-BL). Self –help group bank linkage (SHG-BL), it was launched by NABARD as a pilot project in the year 1992. MFIs are basically NBFCs, sec. 25 company etc. There are basically two models under it. One is Agency model of MFI and the other is Bulk lending model of MFI. Among the models
from other countries Rotating Savings and Credit Associations, The Grameen Solidarity Group Model and Village Banking Model are included. Currently around 75% of the credit supply is via SHG-Bank linkage route largely financed by NABARD and the rest coming from MFIs increasingly backed by commercial banks.
References:


Websites:


(67)