

BANKING BY THE POOR - THE INDIAN MODEL

(Extract from the book – “Putting Institutions First – Even in Micro Finance” - 2000)

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With reference to models related to credit provision, which is the focus here, it needs to be stated clearly that MYRADA is not a MFI (Micro Finance Institution); it does not hold the savings of Self Help Affinity Groups in its account nor does it advance loans.

MYRADA's role in micro-finance is restricted to:

- i) **Identifying Affinity Groups**, i. e., Groups whose members are linked together by a network of relationships which enables them to perform certain traditional, support functions. This affinity, which exists prior to any outside intervention, is based on mutual trust, reciprocity or functional support, a degree of homogeneity and voluntarism, and is adequate to cope with traditional needs. It constitutes what could be called - traditional, social and institutional capital.
- ii) **Strengthening the Groups institutional capacity** - building new social and institutional capital (new relationships, skills, systems for functional interaction and networks) to undertake new roles and responsibilities.
- iii) **Training members to develop their confidence, attitudes and skills to manage resources**, in this case credit. Training also goes further to develop their confidence to take the lead as change agents in society.
- iv) **Lobbying for policy change in the official finance system** to recognise the alternate systems of the poor in their own right, and to support them, instead of imposing official rules in the name of mainstreaming people's institutions.
- v) **Training Bankers** to assess whether the Affinity Groups are bankable institutions and to establish a long term link with them through a line of credit
- vi) **Offering opportunities for members to acquire new productive skills.**
- vii) **Linking the Affinity Groups with banks, markets, private sector enterprises and among themselves to form Federations** for on-going support to individual groups.

During 1984-85, MYRADA made several studies related to the structural causes of rural poverty. Dependence on credit was identified as one of the major factors that resulted in the poor losing land, failing to build up capital and increasing their dependence on those who had regular and assured sources of income. The poor had limited access to credit from formal institutions- hardly 20% of credit actually disbursed came for the four official financing institutions, namely the Commercial Banks, Regional Rural Banks,

Co-operatives and LDB. The official institutions dispensing credit were subject to political decisions and pressures, lack of capital and initiative, inappropriate credit policies and norms and a general sense of decay.

This writer was asked in the mid-eighties to start in India a clone of the Grameen Bank of Bangladesh. He pointed out that India had a vast network of Banks. Though in some States, Banks were (and still are) constantly in the red, particularly where they are overly politicised, in general, the banking system functions reasonably well. Priority sector lending is mandatory. The Regional Rural Banks (RRBs) which were instituted in 1975 (together with the Co-operative Societies), were expected to spread the formal credit system in rural areas particularly among the poorer sectors. The RRBs in particular (which incidentally were instituted in 1975, two years before the well known Grameen Bank of Bangladesh), were expected to provide a delivery system with comparatively low transaction costs, which was flexible and "friendly" especially to the poor. These are features which in the popular mind characterise the Grameen Bank of Bangladesh. However, thanks to a combination of aggressive trade unionism and unbalanced socialism, the base of the RRBs was eroded. Yet their network was established and there was hope that a majority of these institutions could be revived.

What India needed was not another Bank; rather it needed a model which used the existing Banking network, but was adequately decentralised (controlled by people), low cost and flexible enough to respond to the complexity of individual needs. This was the basis for the alternative credit system which MYRADA had started promoting a few years earlier and which the Government and the Financial Institutions were invited to assess.¹ MYRADA however insisted that if this alternate system was considered by Government to be adequate and appropriate to achieve the objective of providing credit to the poor, and could therefore be supported officially, it would not be "mainstreamed" by the financial institutions to suit their rules. If the Banks opted to finance these affinity groups, they would have to accept the rules and to work within the framework developed by the groups to manage their affairs.

MYRADA's approach to credit is imbedded in its overall mission to build peoples institutions as instruments of empowerment. MYRADA's Mission goes beyond promoting savings and credit, to empowerment of the poor. To achieve this broader objective, MYRADA assumed -- on the basis of its early experience - that it was necessary to invest in building institutions of the poor whose structure and systems (organisational and financial) are designed by them, appropriate to the resource to be managed, and based on traditional and cultural norms and relationships. The structure of these appropriate institutions and their governance systems developed by the members would in turn foster the attitudes and skills required for sustained management, the ability to mobilise resources, to build linkages and to initiate change. Together, these features form the basis of empowerment. **Participation of the poor, therefore, would not lead**

¹ For a detailed description of this model please refer to, "The MYRADA Experience in Saving and Credit" published in 1991 by this author.

directly to their empowerment; it would lead to building institutions and linkages. The experience gained in building these structures and networks and in maintaining them (which requires coping with vested interests which try to undermine institutions of the poor) in turn would empower the members.

The credit management model that emerged in the late eighties, after several years of trial and error, was one with structural features different from those of the Grameen Bank or the model adopted by major MFIs which are all centralised and controlled by a Financial Institution. It was initially called the "Credit Management Group" approach by MYRADA since the focus was on "management" as an empowering tool. When NABARD started supporting this initiative in 1997-98, the name of the model changed in MYRADA to "Self Help Groups". When the Government of India decided to officially accept this model in 1998-1999, MYRADA decided to change the name to "Self Help Affinity Groups" to highlight the critical importance of "affinity" as a binding force. Incidentally, affinity is not synonymous with 'similar activity'.

The differences between the Grameen Bank and the Self Help Affinity Group Model are several:

To begin with, the model started with identifying affinity groups. There was no fixed number of members; it ranged from 15 to 22. **Secondly**, the groups capital was built on savings. No promise was made that savings would leverage grants; on the other hand the group was informed that if their performance was good, they would be linked to Banks to access loans; they would have to start functioning by meeting members credit needs by disbursing loans from their savings. **Thirdly**, all the decisions were taken within the group. The individual loan applications did not have to be carried to a Bank. The group was free to loan for any purpose. Analysis of data indicated that in the first year a large number of loans were given for health, food, clothing and to release members from moneylenders to whom assets had been mortgaged - yet repayments exceeded 98%. The trend changed over the next two years towards "asset" loans. **Fourthly**, the interest rates were decided by each group and they differed from group to group and from loan to loan. **Fifthly**, the interest earned did not leave the group; it built up the group's capital. **Sixthly**, members were free to leave the Group according to the rules worked out and agreed to by all. **And lastly**, the groups were linked to a Bank leaving MYRADA the freedom to withdraw.

These are some of the features that distinguish this model from that of the Grameen Bank of Bangladesh. MYRADA believes that these organisational features are critical to a credit management model for it to have the potential to be an effective instrument to promote empowerment. Instead of starting a clone of the Grameen Bank, the Government was requested to change the official Banking policy to make it more responsive to the requirements of credit and savings institutions like the self help affinity groups, set up by the people. It is to the credit of NABARD that it took up this challenge and supported the emergence of alternate credit systems both with grants from its R & D fund as well as in the major area of policy change.

When the pilot project initiated by NABARD and MYRADA started in the mid-eighties (1987), the self help group model was adopted - **MYRADA preferred to call it the Indian Model** while NABARD called it the SHG-Bank Linkage Model. It was based on three pillars: the NGO, which identified the affinity group and trained it; NABARD which provided the NGO (MYRADA in this case) with funds under its R&D programme to match the savings of the Credit Management Groups (the precursors of the Self Help Groups), and the Banks which would come into the picture if the pilot project succeeded; their role would be to extend a line of credit to the groups without asking for the purpose of the loan to individual members. NABARD agreed that the official norms which restricted loans to tangible assets and "unit costs" would not be imposed; the groups could lend for any purpose including various types of "consumption", without any ceiling imposed by NABARD on the interest rates; the groups could decide whether to be formally registered or not; in either case, they would have to abide by a set of norms which are required for any organisation to grow and survive. MYRADA assisted each group to develop these norms. The groups started with regular savings, deposited in a group common fund from which they advanced loans and managed repayments for at least 6 months before bank loans were extended. The Banks would lend directly to the group and not through an intermediary.

Each of these pillars had their respective comparative advantages. MYRADA had experience in identifying affinity groups and in training them, NABARD had the funds to experiment and, above all, could influence policy throughout the rural banking sector; the Banks had the potential to provide credit in an on-going manner and the potential to acquire the expertise to assess whether each group was an institution which could be considered as a sound investment opportunity. The affinity groups that are functioning well are those that have benefited from the comparative advantages of these pillars.

A study by NABARD conducted in the early 90s compared the transaction costs of three models namely: direct lending to individuals (e. g. in the IRDP programme), lending to intermediary organisations which in turn lend to Groups and the MYRADA model where Banks lend directly to Groups. This NABARD study concludes that the overhead costs of the MYRADA model both to the borrower and lender are far less than in the others.² On its part MYRADA divides the interventions required to set up functioning and bankable groups into three categories: In the first category falls those activities required to identify "AFFINITY" groups. This category of activities cannot sustain itself and needs to be subsidised fully. MYRADA therefore decided that this set of activities would be led by an NGO. In the second category fall those activities required for training the group. The details of the modules required are described in Chapter 5. Once again this category of activities is not self-supporting. It has to be subsidised; but the degree of subsidy depends on each situation. Finally in the third category fall

² Refer to the study in "Transaction Costs of Lending to the Rural Poor" by Dr V. Pugazhendhi published by the Foundation for Development Cooperation, Brisbane, Australia

Donation	127,225. 50
Interest Collected from Loans	24,241,982. 62
Bank Interest	825,514. 23
Capital Mobilised from Government	1,706,899. 00
Capital Mobilised from NABARD	20,000. 00
Community Contribution	574,293. 00
Refund (-)	177,268. 00
Total	59,143,599. 35

NOTE: This fund is not held in a consolidated manner; each Group's common fund remains in its control and in its own dedicated Bank account.

The number of women's Groups is much larger than others since this project primarily focused on women.

The largest component of this fund (53%) has been mobilised from savings of each member. Next in size is the amount of interest that the groups earned on loans and which remained in their own accounts; it comprises (41%) percent of the common fund. Fines indicate that the Groups are willing and able to impose sanctions, and that members are ready to accept them for dysfunctional behaviour. Members are fined for failure to repay loans in time, being late or absent for meetings without prior intimation, smoking in a group, disturbing meetings, not sending children to school after the group has decided that this is a duty of every member, etc. The ability to "fine" indicates a healthy institution. It is based on a realisation of the fact that rules are of no use unless they are enforced and that sanctions, particularly where the members have themselves elected to introduce them, are a major instrument of promoting self-discipline.

Table 1.2 Patterns In Lending for the 682 Groups in Dharmapuri Project

ACTIVITY	NO. OF LOANS	AMOUNT LOANED (RS.)
Clothing	1,016	2,177,393
Education	1,184	2,834,028
Food	5,422	6,499,510
Health	3,348	5,276,899
Household Expenses	24,361	36,603,059
Socio-Religious	2,987	11,083,840
Repaid To Money Lenders	5,131	17,560,204
Crop Loan	24,445	65,935,205
Equipment (Agriculture)	23	348,300
Irrigation	137	213,356
Land Development	187	979,553
Bullocks	19	58,490
Seeds	12	3599
Cow/Buffalo	8,100	30,228,745
Poultry	24	11,575
Piggery	22	7,084

ACTIVITY	NO. OF LOANS	AMOUNT LOANED (RS.)
Sheep/Goat	205	365,882
Cottage Industry	477	3,163,080
Tailoring Machine	4	10,000
Petty Business	1,937	8,289,201
Sericulture	140	211,545
House Construction	4,419	14,358,580
House Electrification	43	51,731
House Repairs	760	2,740,322
House Purchase	13	18,700
Rent	7	4,950
TOTAL	84,411	209,031,232

If the groups are free to decide on the purpose of loans, the diversity that emerges is amazing. General trends of loans in MYRADA indicate that in the first year the average number of loans for consumption is large (around 40% to 50% of total loans), while the total amount is comparatively small (around 20%-25%). In the following years the number of loans for trading, release from moneylenders and for small assets tends to increase. The number of loans for larger asset rises in the third year.

Most micro-credit models, which have been propagated by International and National Finance Institutions start by forming Groups, but continue to decide on the purpose of loans, on the rate of interest and schedule of repayments. They continue to keep records in the name of individuals, demand to know the ultimate purpose of the loan before they release the money and restrict loans only to asset creation or income generation. All critical decisions are taken outside the group. Briefly, they tend to use the group as a "tool" to implement their micro credit programmes and to ensure repayment. MYRADA's experience indicates that these micro-credit models are structurally vulnerable to some of the common criticisms related to marginalisation of the weakest members of the Groups. The organisational demand of the Micro Finance Institution is to cover all its risks and administrative costs which are comparatively much higher than in the MYRADA model, where the Banks lend directly to the Affinity Groups.

MYRADA is concerned about the credit flow in the rural areas. It therefore seeks to ensure that at least 20%-25% of the credit demand from the poorer sectors in its project areas is met through the Affinity Groups, which have emerged as appropriate institutions to manage savings and credit with a potential for stability. It attempts to encourage this credit flow, both through its own efforts as well as by networking at the District level with other NGOs, Commercial and Regional Rural Banks, and recently with District Co-operative Banks. It is conscious of the fact that private credit sources will continue to be required, as the formal institutions cannot cope with the credit demand, especially from the poor. Several surveys indicate that if about 20% to 25% of the credit can be provided by the affinity group network through direct

linkages with formal credit institutions, the interest rates levied in the informal sector by private sources operating in the area decline, at times by over fifty percent.

MYRADA does not project the Affinity Groups as institutions that will continue to be the only instrument that meets the credit needs of their members. The members are free to decide whether or not the roles and functions which the groups have promoted and supported are relevant at each stage of their personal growth. They are competent and free to change them or to leave the group or to disband the group if they decide that their investment in maintaining the group is no longer worthwhile. Several Groups, after 6 to 8 years have dissolved after clearing their dues to the Banks and deciding on how to disburse their savings and other group income. Individuals from these Groups have approached the Banks directly for larger loans or joined other private associations providing credit, to which, according to their own feedback during studies conducted by outside evaluators, they had no access prior to the credibility they acquired through their experience and progress as members in the affinity group.

The MYRADA model, which seeks to use the official Banking network, was referred to in the World Development Report (1998-99) brought out by the World Bank.

Excerpt from World Development Report (1998-99) - pg. 125

"In rural Southern India an NGO called MYRADA wants to put itself out of business in five years by forging links between bankers and the poor. To integrate its credit management Groups (*sanghas*) into the commercial banking system, it requires '*sangha*' members to assume responsibility for maintaining their own financial records, for forming and enforcing their own lending rules, and for participating in regional organisations (called apex bodies) run by elected '*Sangha*' representatives.

The apex bodies teach members how to resolve disputes, select and train new members, and negotiate with commercial bankers for progressively larger loans. Most important, the apex bodies take on long-term management of the '*sanghas*' when MYRADA staff leave. MYRADA is thus a temporary broker for bankers and the poor. Its objective is to help the poor become "bank-friendly", and the banks become more "poor friendly".

MYRADA's most mature project, in Holalkere, involves 214 '*sanghas*' and about 4400 people. By mid 1996, three years after the apex bodies were granted full managerial oversight of the '*sanghas*', 81 '*sanghas*' were meeting without MYRADA's supervision and were receiving loans directly from commercial banks. Perhaps more important, the '*sanghas*' are now role models for neighbouring villages, with at least three new ones having formed without any assistance from MYRADA".

The Report adds: "In Grameen Bank's Group Lending model, would-be borrowers first form Groups of five. Although the loans go to individuals, all group members understand that if any member defaults, none will receive subsequent loans. MYRADA, a rural Indian NGO, employs a similar strategy **but goes a step further in seeking to establish self-sustaining links between Banks and the rural poor**".

Note: At the end of August 2002, lending by Banks and Financial Institutions to SAGs in India has reached Rs.1170 crores (USD 230 million). This translates into over 8 million families brought within the fold of the formal banking services. The SAG-Bank Linkage has also become the largest micro financing instrument for the poor in the world.