

P E R S P E C T I V E

## Group Lending – The “Trusted” Lending Model for the Microfinance Industry



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There is a sea change in the way people perceive microfinance today than from a decade ago. The industry has grown to USD 300 billion, coming a long way since the first micro loan of USD 27 was given in 1976 by the generous Dr Mohammed Yunus to the needy women of Bangladesh. The microfinance industry is typically defined by its underlying Group Lending model, which is quite different from traditional forms of lending. Microfinance Institutions (MFI) the world over use variants of group lending, achieving repayment rates between 95 percent and 98 percent, results that traditional lending aspires to. This paper delves into the proven group lending model, which is the hallmark of the microfinance industry. Worldwide, IT service providers, regulators, banks, NGOs and academia are closely tracking this sector with a clear motive to leverage any upswing.

### Group Lending – The Concept

By definition, group lending revolves around providing financial assistance to a group, wherein members act as guarantors for availing the loan, for one another. To illustrate, in a group of five, four members stand guarantee for a loan taken by the fifth. Should the borrower default, the guarantors contribute equally towards clearing the outstanding installments.

### Types of Group Lending

The two important methods of group lending practiced globally are as follows:

- Self Help Group [SHG] – An informal group of 15 to 20 people is formed under the guidance of an NGO or bank. Loan funding may be provided directly by the bank or through the NGO. An SHG is a self-regulated group with little outside monitoring.
- Grameen Model – Propagated by Dr. Mohammed Yunus in Bangladesh, under this model a microfinance institution forms, monitors and services a group of five members.

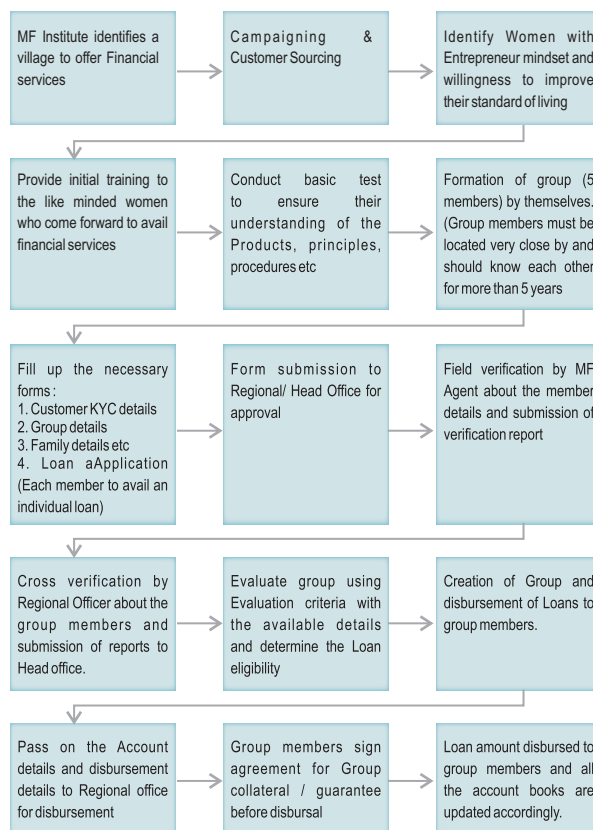
*It is observed that many of the urban and semi-urban MFIs issue individual loans once the group proves through consistent repayment that its members are worthy of a higher credit rating.*

FEATURES	SHG LENDING	GRAMEEN LENDING
Number of people in the group	15 to 20	5
Originator of the group	The members themselves	MFI
Serviced by	Bank	MFI
Monitoring of the group	Group leader	MFI agent
Collection of repayment	Group leader	MFI agent
Current involvement of systems	Less automation, more paper	Higher
Flexibility of loan products	Less	More

**SHG Lending and Grameen Model Lending**

### Demystifying Group Lending – The Process Flow

Better repayment rate and an improved Social Performance Index have promoted microfinance group lending considerably. The group lending process flow is depicted below:



### Models of Group Lending and Repayment

While group lending is the preferred and most trusted model in microfinance, there are

variations depending upon the prevalent banking regulations and guiding principles in different geographies, some of which are listed below:

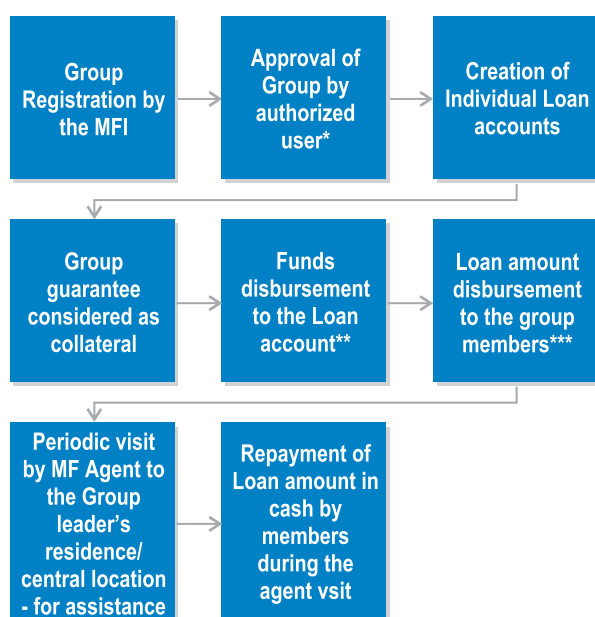
- a. Group registration and individual lending – Individual loan accounts are registered under group disbursement and repayment is made to the loan account directly or from an individual savings account.
- b. Group registration and group lending – A group loan account is created for lending money to the individuals in a group. Repayment is made to the group loan account directly or from the individual savings accounts.

### Group registration and individual lending

#### Individual loan account and repayment

In this mode, group members are served with individual loan accounts based on their requirement and payment is made into these on a periodic basis.

The process flow for the above is depicted below:



\* On-field verification is carried out by agents and other 3rd party agencies before the group is approved

\*\* Group evaluation is carried out to take a decision on approval of loan amounts requested by the members. The primary data for this evaluation is taken from physical verification done during the initial stages.

\*\*\* Group members need to sign some legal documentation pertaining to the group collateral for the loan amount disbursed and are briefed about the repayment schedule and associated penalties, if any.

In case of default by any group member, the others shall pay off the installments to the MFI agent on his/ her behalf, until the closure of the account. [For example, if each member of a group of 5 is paying an EMI of Rs. 500 per month, should one member default, the remaining four shall pay Rs. 125 per month (125\*4 = 500) on his/her behalf.]

#### Savings linked individual loan account

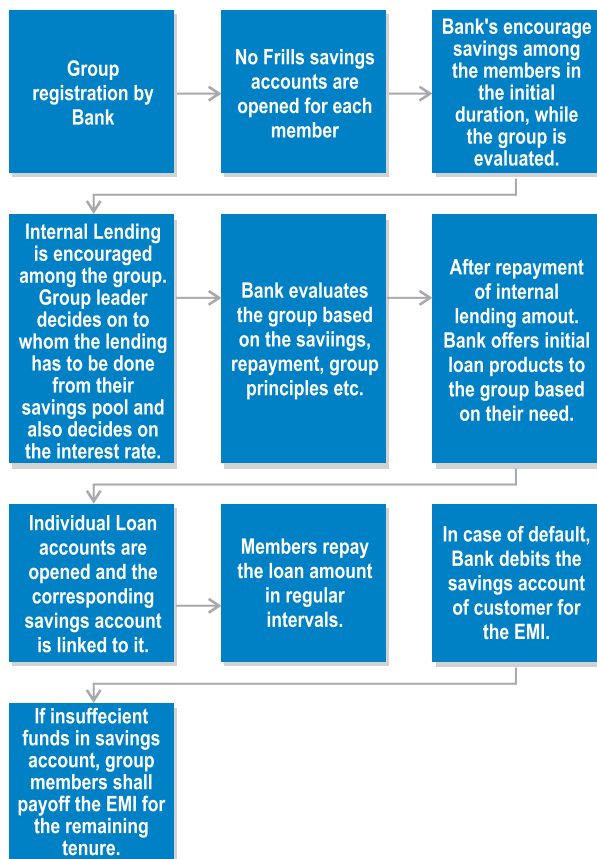
This model prevails when a bank offers financial services to groups. Groups are primarily evaluated on the living conditions, aspirations and basic skill sets of their members. Once done, individual members are offered No Frills accounts with the bank. Initially, members are encouraged to save at least for a period of around 6 months, during which the bank evaluates the group's capability to save.

After this duration, internal lending is encouraged within the group which decides how much is to be lent to its members based on need and urgency. These payments, which reflect in the bank's books, are closely tracked in order to understand the repayment capability and willingness of the group members to save and improve their living standards.

Once the internal lending is completed, the bank may offer credit products to the group members based on their needs. While the loans are disbursed to the individual loan accounts of the members, the bank links the savings account of the customer to the loan account. This allows the bank to debit the savings account in case the member fails to repay the loan installments. If the account does not have sufficient funds, the remaining group members have to pay off the installments to the MFI agent on the defaulting member's behalf, until the closure of the account.

*Regulators in different countries have varied views on microfinance institutions accepting deposits from or offering savings accounts to their clientele. There is no uniformity of law or practices among countries when it comes to deciding the eligibility of microfinance institutions to offer savings products.*

The process flow for the above is depicted below:



## Group registration and group lending

### Group loan account and individual repayment

After group members are registered, the loan is made out in the names of the five members of the group and only one loan account is maintained for tracking repayment. The MFI agent periodically visits the group members to collect repayment.

While disbursing the loan, the following measures are taken:

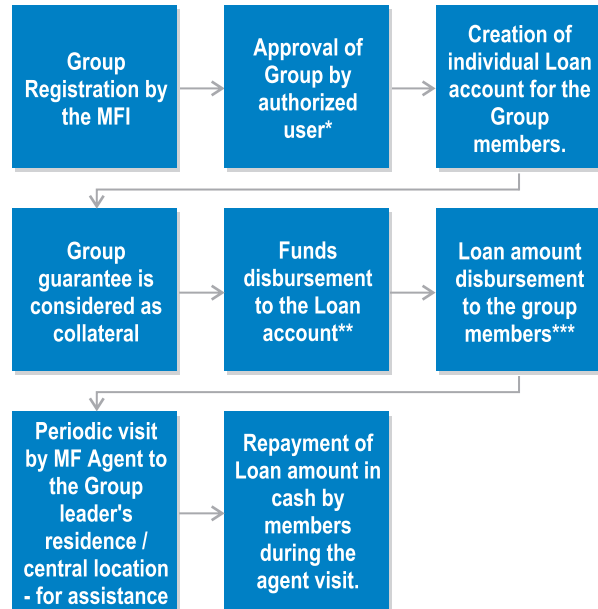
- The loan amount is the cumulative value of individual loan requests raised by group members.
- Members are informed about the quantum and frequency of repayment at the time the loan is disbursed to them on the field.

If any group member defaults on repayment, the others have to pay off the balance loan amount within the tenure.

This model prevails in most of the MFIs which are operating on hosted basis for the usage of

their loan module/ core banking Services. The serving logic is that they need not maintain hardware or software which would increase their capex and opex

The process flow for the above is depicted below:



\* On- field verification is carried out by agents and other 3rd party agencies before approval of the group.

\*\* The loan amount is the cumulative value of loan requests made by group members.

\*\*\* During disbursement, the MFI agent shall specify the amount to be repaid towards the loan by each group member.

### Individual savings linked to group loan account

Some banks adopt this model when group members hold savings accounts with them. In such cases, a single loan account is opened for all the group members. Currently, only Commercial Banks are permitted to open savings accounts for group members.

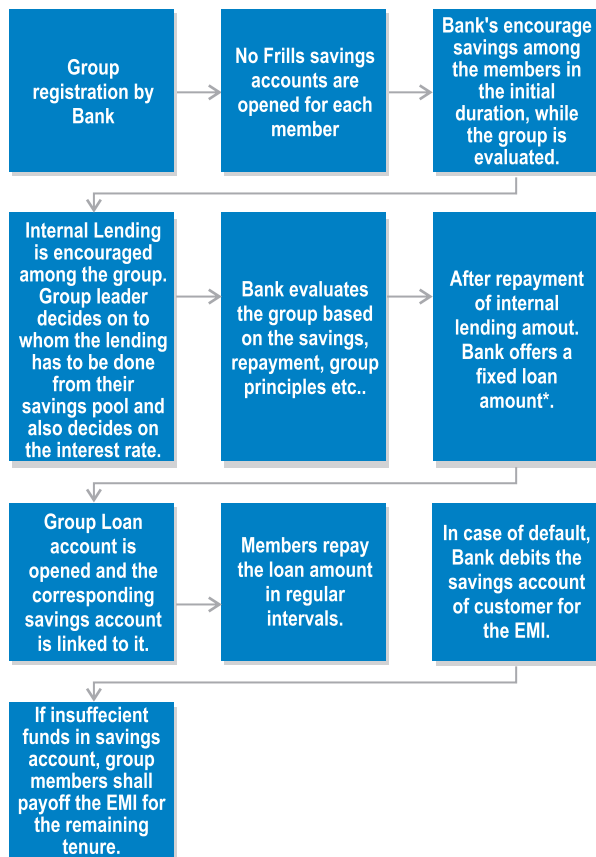
In the above model, the bank aims to understand the group's commitment to the bank and to the loan availed. In this case, the bank opens one loan account for the group which is linked to its members' savings accounts.

In the initial stages, the bank disburses a fixed loan amount and evaluates the group based on its loan requirement, promptness of repayment, attendance at meetings etc.

Any lapse in repayment results in a negative evaluation, and the corresponding defaulting

member's savings account is debited towards repayment. In case of insufficient funds, other group members have to pay off the balance within the tenure of the loan.

The process flow for the above is depicted below:



\* The bank may choose to lend a certain amount to the group, say Rs.10000, for a duration of 1 year and evaluate the group based on its repayment pattern.

### Inference

Group lending is the heart of the microfinance business. Any MFI, IT solution provider or intermediary foraying into this space needs to understand the concept of group lending and its variants being practiced by the industry.

Particularly, banks and technology solution providers must know how group lending differs from the typical individual lending of mainstream banking. This involves additional data capturing, creation of groups during account origination, scheduling and tracking of individual repayments

within a group and monitoring individual performance as a function of group performance. Group Assessment, a socio-economic indicator of lifestyle betterment used by MFIs also takes inputs from group lending data. New products rollout, up-selling, cross-selling and customer credit ratings are other areas which revolve around microfinance group lending.

Currently, only commercial banks are allowed to accept savings deposits from clients in a majority of countries including India, Bangladesh etc. However, ROSCA (Rotating Savings and Credit Association) in Kenya may accept savings deposits from member clients. Uniformity in the definition of microfinance practices and clear rules and compliance guidelines are the need of the hour. These will go a long way in reinforcing the confidence of all stakeholders and bridging the gap between the haves and have-nots of the world. The core objective of each microfinance model is to create peer pressure among team members to ensure proper loan repayment, since no collateral is involved. With the surging interest displayed by investors, clients and IT system vendors, it is reasonably hoped that regulators will acknowledge the importance of this industry and institute laws to support and develop it in the coming years.

### Glossary of Terms

1. SHG – Self Help Group
2. MFI – Micro Finance Institution
3. EMI – Equated Monthly installments

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