MICRO FINANCE DELIVERY MODELS AND ITS IMPACT ON THE PEOPLE

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Abstract

Micro Finance has become is recent years, a fulcrum for development initiative for the poor, particularly in the third world countries. It has been practiced in varying forms in different countries and has come to be regarded as important tool for poverty alienation through social and economical development of poor, with focus on empowering women. It was observed that Microfinance often gets equated nearly as credit for Micro enterprises while the poor also needs savings, consumption loans, having loans and insurance services.

Key Words: Micro Finance, consumption loans, insurance services

INTRODUCTION

Micro Finance has become is recent years, a fulcrum for development initiative for the poor, particularly in the third world countries. It has been practiced in varying forms in different countries and has come to be regarded as important tool for poverty alienation through social and economical development of poor, with focus on empowering women. It was observed that Microfinance often gets equated nearly as credit for Micro enterprises while the poor also needs savings, consumption loans, having loans and insurance services.

The task force on supportive policy and regulatory frame work for Micro finance has suggested a working definition of Micro finance as ' Provision of thrift' Credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards'. The emphasis of support under Micro finance is on the

poor in ‘Pre – Micro enterprise’ stage for building up their capacities to handle larger resources. No specific limit for ‘small’ amount of financial services in envisaged.

Experience of different anti poverty and other welfare programmes with in as well as outside the country as also by the International organizations have shown that the key to success lies in the evaluation and participation of community based organizations at the Iran root level. Peoples participation in credit delivery and recovery and living of formal credit institutions to borrowers through group approach have been recognized as a supplementary mechanism for providing credit support to rural poor.

Micro Finance services are not new, but have always existed. All the evidence suggests that poor people will continue to need and use these informal services alongside those of eternally supported Micro finance interventions. It is crucial to ensure that externally supported Micro Finance interventions integrate with and complement existing arrangements rather than displaying or undermining them.

It is estimated that 350 million people live below poverty line in India. This translates to approximately 75 Million house holds. Annual credit demand by the poor in the country is estimated to be about Rs. 60,000 Crores. Only about 5% of the rural poor have access to Micro finance. Considerable gaps between demand and supply for all financial services exist. Majority of poor are included from financial services. Bankers feel that it is fraught with risks and uncertainties. Involves high transaction costs and unfavourable policies like caps on interest rates which effectively limits the viability of serving the poor. Micro finance Institutions have show that serving the poor is not an unviable proportion. Micro finance envisages reaching banking services to one third of the very poor of the country i.e., population of about one Million SHGs by the year 2007-08.

MICRO FINANCE DELIVERY MODELS:

MFIs around the world follow a variety of different methodologies for the provision of financial services to low – income families. These methodologies are overwhelmingly based on the Principle of financial services being related to the cash flows of the low-income client groups and thus aim to facilitate relatively frequent and very small or Micro – loan and savings transactions. The focus of such services is on women, based on the observations that in financial matters, they are more responsible than men particularly since their mobility is restricted by family responsibilities.

MFIs use two basis methods in delivering financial services to their clients.

by Abhay, India Microfinance –

MFI’s use two basic methods in delivering financial services to their clients.

These are:

(1) Group Method and

(2) Individual method

Group Method

This is one of the most common methodologies for providing micro-finance. Group method primarily involves a group of individuals, which becomes the basic unit of operation for the MFIs. As we have discussed earlier, MFIs have to provide collateral free loans, group methodologies help in creating social collateral (peer pressure) that can effectively substitute physical collateral. Group becomes a basic unit with which MFIs deal. The advantage of group methodology is that

- Groups are trained to own joint responsibility for loans that are taken by individuals in the group.
- Groups ensure repayments from all individuals in that group and incase of a default.
- Groups functions as the forum where the credit discipline and other related issues are discussed.
- Group may have to jointly own the responsibility of defaults and pay on behalf of defaulting client.
- Group also help credit appraisal and provide opinion on creditworthiness of each individual in the group.
- Groups methodology also helps in controlling cost.

This ensures that even without taking any physical collateral, the MFI is able to manage its credit risk (loan related risk).

MFIs actually deliver the financial service at the client’s location which could be a village in rural areas or a colony/slum in urban area. Having a group helps the MFIs in getting all clients at one spot rather than visiting each individual’s house. This helps the MFI in increasing the efficiency of staff and controlling the cost. Group methodology creates a forum where individuals come and discuss, can provide opinion, and exert social pressure.

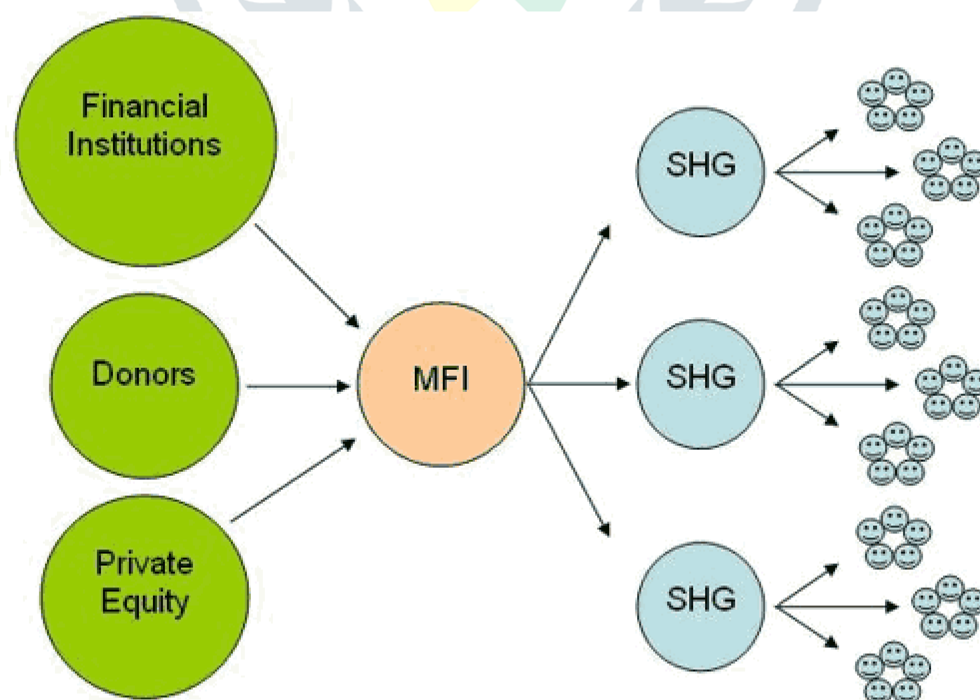
The advantage of Group methodology can easily be appreciated by the fact if a MFI employee has to visit each individual house in isolation, it would be very difficult. Also in the absence of a group, if a client refuses to pay there is no forum where such a case can be discussed or there is no method through which the MFI can expert pressure on the client.

Group methodology is also important because in case of larger loan defaults a financial institutions can take recourse o legal action but in small loans legal recourse is not an economically sound option. An MFI who may have an outstanding or Rs 3,000 at default cannot apply legal pressure as the cost of recovery through that method can be higher than the amount to be recovered itself.

Moreover, the clients that the MFIs are dealing with are generally poor and may face genuine problems at times. Rather than taking an aggressive/legal approach, which such vulnerable clients it is always better to have more constructive and collective approach, which is provided by the Groups.

Due to the various advantages, as indicated above provided by groups, this methodology is widely accepted and used in micro-finance across the world.

Self-help Group and Joint Liability Groups (Grameen model and its variants) are two common credit delivery models in India.



Self –Help Groups (SHGs)

Self-help Group concept has its origin in India. SHGs are now considered to be very important bodies in rural development and are therefore found in almost all parts of the country and their number is still rapidly growing. SHGs are formed by Non-Government Organisations as well as Government agencies and are used as channels for various development programmes.

A Self-Help Group is an association of generally up to 20 members (not exceeding 20 members), preferably from the same socio-economic background. SHGs are facilitated by Government agencies or NGOs for members to come together for discussing and solving their common problems either financial or social through mutual help. An SHG can be all-women group, all-men group, or even a mixed Group. However, it has been the experience that women's groups perform better in all the important activities of SHGs. Mixed group is not preferred in many of the places, due to the presence of conflicting interests.

Some of the distinct features of SHGs are;

(i) Recognized by government: SHGs are well recognized and accepted by government, SHGs can open bank accounts in the name of SHG. They can also receive government grants and funds for development activities.

(ii) SHGs are social intermediaries: SHGs do not restrict their functions only to financial transactions. SHGs are often involved in many social activities. There are example where SHGs have taken up social issues and fought against social evils like alcoholism, violence, against women, dowry, getting into village politics and being elected as Sarpanch.

(iii) Books of accounts: SHGs maintain their own books of accounts. These are simple books to keep records of their savings, loans income and expenditures. Strong SHGs also make their Balance sheets and Income statements.

(iv) Have office bearers: SHGs gave a structure where there is a Group President, Secretary and Treasure. They are elected by the group.

(v) SHGs are more autonomous as they decide their own rules and regulations.

(vi) SHGs mobilize thrift and rotate it internally.

(vii) SHGs can hold bank account and can also borrow from banks and other financial institutions.

We see that SHGs are groups, which are more autonomous. While they are involved in financial transactions, their role is not just restricted to it. SHGs are also involved in various social issues.

As more SHGs are formed they have started federating themselves into clusters and clusters in turn as SHG Federations. The Federations are able to channelise funds to the SHGs and also help in improving the managing and financial skills of SHGs.

Joint Liability Group – Grameen Model

Grameen model is based on the concept of joint liability. It is the brainchild of Prof.. Muhammad Yunus, founder of Grameen Bank in Bangladesh. Grameen model is the most accepted and prevalent micro-finance delivery model in the world today. Many MFIs have accepted the model as it has high focus on standardization and discipline

Grameen model, as mentioned, is a joint liability group model. Here five-member groups are formed and eight such groups form a Center. Hence, in a full-capacity Center there are 40 members (8 x 5). However, over the years people have experimented with Centers of different sizes and now there are variations of 5-8 groups within a Center. Center is the operational unit for the MFI, which means that MFI deals with a Center as a whole.

Meetings also take place only at the Central level and individual groups do not meet. Group meetings take place only in front of the Field staff of the MFI. A Grameen model is focused on financial transactions and other social issues are generally not discussed. The Group and Center are Joint liability

Groups, which means that all members are jointly responsible ('liable') for the repayment. MFI recovers full money from Center, if any member has defaulted: the group members have to pool in money to repay to the MFI. If Group members are unable to do it, Center as whole has to contribute and share the responsibility.

Some other features of Grammen Model are:

(i) The group meeting take place every week

(ii) Interest rate are charged on flat basis

(iii) MFI staff conducts the meeting

(iv) All transactions take place only in Center meetings.

Grameen model is focused on providing financial services to the clients and hence there is an emphasis on standardization and discipline. The model suggests weekly meeting for frequent interaction with the clients to reduce credit risk. The meetings are conducted for carrying out the financial transactions only. The meetings are conducted systematically in a short-time and other social issues are not discussed. Flat interest is charged again for making the system standardized. In flat rate system installment size of repayment remains small for all weeks and hence is convenient and easier to explain. Also, it is easy to break the loan installment into the principal and interest component. We see that the SHG and Grameen model have originated with two different approaches. SHG model has been developed with holistic view of development and empowerment of society where financial transactions are only one part of it. While Grameen model is specifically focused on providing financial services to the low-income clients. A broad comparison of the two models is presented in the Table 1.

Joint Liability Groups (JLG)

Grameen model is a particular form of joint liability Group but in India there are other forms of Joint liability Groups as well. MFIs, particularly in urban areas, form JLGs of five-members. These are group of individuals coming together to borrow from the financial institution. They share responsibility ("liability") and stand as guarantee for each other. There is a Group Leader in such JLGs, many MFIs prefer such group in urban business areas. Such JLGs do not hold periodic meetings.

Typically members are shopkeepers from same locality. These forms of JLGs are somewhere between Group and Individual lending methods. While lending in such JLGs is to individual members small JLGs still provide some sort of comfort to the MFIs. Also collection can be done from a single point, generally from the Group leader rather than going to each individual. As in urban areas shopkeepers do not have time to hold meeting, these JLGs do not meet.

Individual Method

So far we have discussed the Group based lending method. However MFIs are also increasingly providing loans to individuals. In Individual lending method, MFIs provide loans to an individual based on his/her own personal credit worthiness. Individual lending is more prevalent with clients who generally need bigger size loans and have the capacity to produce guarantee and generate enough comfort to the MFI. MFIs generally base their decision on personal knowledge of the client, his/her reputation among peers and society, client's income sources and business position. MFIs also ask for individual guarantors or take post-dated cheques from clients.

Individual guarantors come from friends or relatives well known to the borrower and who are ready to take liability of repaying the loan.

Characteristics of Microfinance Delivery Models in India

Financial Service	Characteristic	Description
Credit	Loan amount	Determined by the longevity of the client's association with the MFI. Not often directly related to the credit needs of the borrower.
	Loan term	Usually 12 months, occasionally less, sometimes greater
	Repayment installments	Monthly or weekly – usually fixed, equal amounts.
	Interest charges	Range: 24-36%, usually levied as a flat charge, partly to simplify calculations for

		both the MFI and the client. Some MFIs charge lower rates but suffer from poor sustainability as a result.
	Collateral	No physical collateral but often linked to some compulsory savings component which acts as financial collateral. Reinforced by joint liability (Grameen) with other clients or peer pressure arising from membership of a community group revolving its own as well as borrowed funds (SHGs, cooperatives). Some MFIs also create reserve funds to cover the risk of default.
Savings	Amount deposited	Grameen: Compulsory – usually a fixed proportion of the repayment Installment. SHG: Compulsory – fixed amounts per (weekly or monthly) meeting to be deposited as part of the group fund; occasionally also voluntary Some MFIs now offer long term fixed deposits.
	Withdrawals	Compulsory savings cannot be withdrawn except when the client leaves the group. Voluntary savings often require some notice of withdrawal.
	Interest paid	Most programmes pay 4-6% interest (not consistent)
Insurance	Life	Some MFIs are starting to offer life

		insurance covering client loan repayments plus a small payment to the family in case of the death of the client. A reserve fund is created for the purpose or insurance is bought from the organised sector on behalf of the client.
	Animal	Usually linked with a formal insurance company which obtains bulk business from the MFI while the latter provides the service of premium collection; assists in the verification of claims

Common Characteristics of Microfinance Models

The common characteristics across the current approaches to the provision of microfinance services are summarised in Exhibit 1. In practice, the average microfinance client's relationship with an MFI can be defined by a fairly standard *set of obligations*.

- Attendance of regular weekly (fortnightly or monthly) meetings of her group.
- Training in 'loan utilisation' or participation in discussions of developmentally relevant issues such as social discrimination, gender awareness, health, sanitation and education.
- Contribution of fixed amounts, termed 'savings', to a fund managed.
- Either by her group or by the MFI with direct access of the member.
- Limited or even barred.
- Repayment of fixed amounts as installments on any loan she obtains from the MFI or from her group.
- What she actually *receives* in return for fulfilling these obligations are:
- Fixed amounts of loan apparently 'for productive activities' – with the size of the loan usually determined by the longevity of her relationship with the MFI rather than by her financial needs.

- Emergency loans for 'consumption' – in the case of some MFIs – but relatively small amounts and subject to the approval of her group.
- Insurance – provided by a risk fund or insurance fund created by a few MFIs, or by an insurance company in collaboration with the MFI.
- Other development services, in the case of multi-service NGO/MFIs.

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