

# The concepts of microfinance and microcredit



## **Chapter 2. 0: Literature Review**

Microfinance is the provision of financial services by certain institutions known as MFI's such as Cooperative Banks, Community Based-Saving Bank, Credit Unions, development bank to the poor, low income earners, self-employed and small businesses. Microfinance has been design to address issues of poverty to help those not having access to formal financial system.. According to MIX in June 2010 there was more than 1800 MFI's in over 100 countries, with 92. 4 millions borrowers and 78. 5 millions savers in the developing world. The concept of microfinance was created by Professor Muhammad Yunus founder of Grameen bank in Bangladesh. Microfinance includes a range of services such as microcredit, saving, insurance and funds transfer. Traditional banks do not provide facilities to low income earners; they provide services to people after assessing the profile of clients according to certain criteria such as pay, credit history and assets of the clients. According to Hernando De Soto (1989) a Peruvian economist poor people have no assets to provide as collateral to bank when taking a loan, therefore they are not liable to receive loans from banks. Since poor people do not have access to traditional banks they have to lend money with high interest rates from others sources such as pawnbroker and local money lender sometimes with 100% interest rate as borrowing from them is fast and flexible.

Over the last 30 years MFIs have developed new methods with less collateral to offer small loans to low income earners and has grown rapidly in Asia, Africa, Eastern Europe and Latin America where there were few bank infrastructures and where in some cases more than 80 % of the population

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did not have a bank account. Grameen Bank and Banco Solidario of Bolivia two popular have provided millions of loans to poor people and microentrepreneurs and and these has caused governments and NGO's to direct their resources to microfinance programmes. According to CGAP (2008), MFI's are funded by 33 donors of 21 investors such as DFI. Microfinance offers permanent financial facilities for education, health, personal emergencies, disasters, investment opportunities to the poor and it is used as a development tool. MFIs begin as non-profit organization increasingly they are now evolving as profit entities because MFIs are required to have a banking license for saving services. Some MFIs offers non-financial facilities such as health services and business development. In this review we will analyze and see how microfinance contributes to the economic development of a country and the review will be focused on creation of employment and the empowerment of women by microfinance.

## **2. 1. 1 Professor Muhammad Yunus**

The concept of microfinance was created by Professor Muhammad Yunus founder of Grameen bank in Bangladesh and noble price winner in 2006. He receives 76 other awards in different countries for his work. Yunus was awarded America's highest civilian honor, the Medal of Freedom by President Barack H Obama for his contribution in poverty alleviation. Professor Yunus obtained a doctorate in Economics from Vanderbilt University found in Nashville, Tennessee in the United States. He stayed in the US for eight years as a student after his study as a professor in economics. In 1972 he came back to Bangladesh During the famine of 1974 in Bangladesh Professor Muhammad Yunus minor loans of USD27 to 42 poor families for them to buy

and sell small articles to allow them to earn a living. The objective behind the loan was to reduce poverty in Bangladesh and poverty alleviation becomes his vision. Grameen bank was an idea generated by Professor Yunus the bank started as a project at the University of Chittagong as a pilot test to find different ways of providing credit to the poor in the rural area

The Grameen bank offered its services to a village named Jobra near the university; the project was successful and had the support of Bangladesh central bank in 1979. The bank extends its services to Tangail district and to other areas of Bangladesh. In 1983 the Bangladesh Government turns the project into an independent bank and Professor Yunus had a grant from the Ford foundation to incorporate Grameen bank with the support of two bankers namely Mary Houghton and Ron Grzywinski from Shore bank of Chicago. The Ford foundation was established in 1936 it is an independent nonprofit and nongovernmental organization which help in social change, the organization help to reduce poverty and help in human advancement worldwide by offering subsidies and loans to certain organizations.

Microfinance is also being criticized for its high interest rate, loan repayment and women exploitation but we cannot criticized whole system if there are drawbacks, the whole system can be reviewed for improvement at the right time and places since no system is perfect

## **2. 1. 2 Grameen bank**

Grameen bank is a Nobel Prize winner corporation founded on 2 October, 1983 and since then has been proliferated in more than 65 countries, its headquarter is situated in Dhaka in Bangladesh and the bank is the largest

MFI's in the country. Grameen is known for its solidarity lending system or banking and is also known as banking to the poor. Solidarity lending is the foundation of microcredit. The word Grameen is derived means "village" in Bangladesh, the bank incorporates the 16 decisions which is recited by bank borrowers and which they shall abide to them. The 16 decisions comprises the four principles of Grameen bank which are Discipline, Courage, Unity, and Hard work, and the other 15 decisions are resumed as to improve their standard of living and there is the element of togetherness to do social activities to improve their way of living. These sixteen decisions have a positive impact on the inhabitants of Bangladesh where more children have joined school. The bank has different sources of funding; initially huge capital was obtained from donor agency at low rates. During the 1990's the bank has its bulk of capital from the Central bank of Bangladesh and recently from the sales of bonds subsidized by its government. In 1998 The bank make loan to poor people in the form of microcredit as a result of flood in Bangladesh, the repayment rate decreases but recovered afterwards, USD4.7 billions has been loaned in 2005 and USD6 billion in 2008.

Nowadays the bank has expand more and offers more loans to the poor and in 2006 it has up to 2100 branches in Bangladesh. Due to Grameen's success more than 40 countries including the United States in 2008 where 12.6% of the population live below the poverty line have been inspired by the bank to make projects with the same perspective, only Africa which has lag behind. The World Bank has financed the projects. The bank is owned by the poor borrowers of the bank of which the majority are women as the borrowers own 94% of the equity and the remaining 6% is owned by the Government of

Bangladesh. The bank has grown to a large extent between 2003-2007 in 2003 the numbers of borrowers have doubled and in October 2007 the number of clients was 7.34 Million of which 97% were women and had a staff of 24703, in 2504 branches over 81574 villages that is the branches have spread in more villages since they were situated in only 43681 villages in 2003 and the repayment rate. Since the bank's started to operate it has USD6.55 billions as loans USD87 billion has been repaid and the bank claim repayment rate of 98.35% up from the 95% of 1998 but again the Wall Street journal in 2001 claim that it doubted the 95% and the accounting standard used by Grameen bank. Grameen started to diversify in the 1980 where it develops into a multi facet group with profit and nonprofit group among which are Grameen fisheries foundation for fisheries project, Grameen Agriculture Foundation for irrigation project, Grameen fund and Grameen Trust. Grameen believe that the concept of giving charity will encourage charity whereas the concept of microcredit will help poor people to exit poverty and the bank invest in children education by providing scholarships and loans for higher education. In 2009 the bank has disbursed total cumulative amount of loans of USD8741.86 and total loans during the year USD 1150.54 millions with a total deposits of USD1200.49 millions with number of groups of 1253160 with 7970616 members. There are organization which has been created all over the world inspired by GB such as Grameen foundation, Grameen Trust, Grameen America, grameen credit agricole among others.

## **2. 1. 3 Microfinance in developed countries**

Poor people who lack access to finance are also found in rich countries such as in America. Grameen started in America in the late 1980's. Southern Bancorp under the tutelage of Grameen give microcredit to entrepreneurs in Arkansas but make 30% losses at the start, afterwards the bank found out that people needed help to develop their working skills. Grameen in the US mostly financed those who already have a job, people selling toys, cleaning houses not those who will start from nothing. The head quarter of Grameen Foundation is situated at Washington D. C in the US; it is a non-profit organization which helps to eradicate poverty. It was inspired by Grameen bank in Bangladesh, but it is an independent organization. Professor Yunus is a member of the board of directors and gave Grameen Foundation its first grant Grameen foundation finance MFI's.

Grameen America has been created to provide microcredit to micro entrepreneurs. It was created in January 2008 and it is found in Manhattan and Professor Yunus is the chairman of the board. The organization is trying to become sustainable to help other people in need, according to the organization anyone with a vision can receive financial services irrespective of their background. The objective of the organization is to reduce poverty to create a better future for families. Grameen America helped the poor communities of the US especially immigrants.

## **2. 1. 4 Microcredit**

### **Theoretical review**

According to Boudreaux and Cowen (2008) microcredit is a micro magic and makes the life of the poor becomes easier, it is an alternative to traditional

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lending of banks. Instead of giving charity to the poor, microcredit is a human way of providing finance to poor people as according to the Chinese proverb " Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime", it is an investment in human capital. Microcredit is an innovation in the world of finance it is at the heart of microfinance, the concept did not exist before the seventies, and it is a small loan rarely exceeding USD200 and usually below USD50 made to the poor or people with low income with little or no collateral. Microcredit clients are those that are considered as near the poverty line, the loans allow micro entrepreneurs to generate an income for a better standard of living. Grameen bank based itself on three C's namely Character that is the reliability of the people the Capacity to handle funds and the Capital which is the assets of the borrower such as savings. Microcredit is gaining more credibility in the finance industry and many large organizations are developing microfinance programs for future growth although at the start many were pessimistic about the future of microcredit in the financial system. 50% of the population in many developing countries is self employed and these loans of three months to three years with small interest rates and no collateral help poor people to become financially independent and help to reduce poverty. The microcredit programs helps people to achieve high repayment rate even sometimes more than that of traditional banking because of the system of peer support. In the case of the Grameen bank where there are solidarity groups and it is also known as social capital and is composed of 5 members and each member is responsible for each other success and repayment, but are not guarantees or liable if members default. Nevertheless the members make sure that each one is taking its



responsibility to make repayment this act as a motivating factor for the members. Sometimes in real life when a member of the group defaults the other four collaborates together and contribute to pay on behalf of the defaulting member.

The microcredit system of Grameen bank is based on Trust and there is no conventional contract between the bank and the borrowers, but the borrowers must have a small account with the bank known as group fund which acts as an insurance in case of an emergency. Women account for 97% of the microcredit client of Grameen bank and this help to empower women as they get access to resources and have a say in decision making since they become micro entrepreneurs. Grameen bank has records of 98% repayment rate from women which is in contradiction with Wall street Journal which says that there is one fifth of the total loan of the bank is overdue but Grameen bank claims in turn that the standard of living of the poor has increased that is they are respecting the 16 decisions of the bank and are able to make a repayment of around 4USD per week.

## **Empirical review of microcredit**

Grameen bank develop several program for the poor of which one of them is the struggling members program in 2003 which is different from the 5 group member borrowing it consists of distributing interest free loans to beggars in Bangladesh where the banking rules do not apply and where the repayment period is arbitrary for USD1. 5 about 3. 4 US cents and if they borrower default they are already covered under an insurance paid by the bank itself. This type of loan encouraged the beggars to generate an income by the sales of cheap items, there is a record shown in the microfinance summit <https://assignbuster.com/the-concepts-of-microfinance-and-microcredit/>

2006 that loans taken by beggars are about USD 833, 150 and the repayment is USD 496, 900 that is 59. 64% repayment rate which according to me is quite encouraging since it is more half of the money loaned.

Certain developed countries such as in Canada have try to used the Grameen model but the project has failed due to certain factors such as the risk profile of clients, no taste for joint liability that is the no solidarity between the borrowers, high overhead costs therefore the project does not stand without subsidies in Canada which is contrary to the USA where microcredit has been successful. Sometimes microcredit is subjected to problem such as opportunism and asymmetric information. The first Grameen branch has made a loan of \$1. 5 million in the USA among which was 600 women and the repayment was very high up to 99%. People took the loan to sell items such as flowers, jewelry clothes and Grameen bank remains unshaken while others collapsed during crisis. Despite the global recession, The President Barack Obama announced the creation of \$100 million funds to lend as microcredit to the western hemisphere. Microcredit programmes should be well designed according to the characteristics of a country, other factors such as the background of the country, the stability of the banking sector, the poverty level, the opportunities and the challenges.

## **2. 1. 5 Micro Saving**

Apart from microcredit the need of financial users is increasing, there is demand from 19 million potential savers to have access to micro saving services. They need services that are flexible and adapted to them.

Traditionally savings is done by people at home or by normal banks at a high cost which was not encouraging to the poor. Microfinance has brought

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services such as savings to poor people. Savings help people to feel safer and more stable, and help poor people to manage their money conveniently. Micro saving consists of small deposits, terms and interest rate that is flexible to clients at the same time banks used the money to make loans to poor people. In some cases micro saving is better than taking small loans since taking a loan is a debt and it becomes a responsibility or a burden if the interest rate of the loan is too high, therefore microcredit is more risky than saving. Saving is an asset for people whereas a loan is a liability; clients will prefer to have assets than liabilities. Saving is a sacrifice for poor people but it is flexible and they earn interest instead of paying interest which is a source of income. Saving is a must and can help people in times of need of illness, fire, flood and unexpected events

## **2. 1. 6 Credit Insurance**

In 2002 opportunity organization started to give micro insurance services. Its' subsidiary MicroEnsure was the first institution offering micro insurance services and provide protection against many risks for the poor.

Stakeholders and local insurance worked in collaboration with MicroEnsure to develop and match the needs of the poor. The insurance provided were affordable, they offered agricultural, medical, property and life policy providing a safety net in case of disasters with average premium of USD 1. 5 for family with 5members. Medical policies covered even people already suffering from diseases and even those suffering from HIV viruses. Actually MicroEnsure is offering insurance in 5 countries to over 1million poor people and was one of the runner-ups of financial times in June 5 for sustainability award and receives a grant from The Bill and Melinda Gates Foundation to

expand itself in other countries. MicroEnsure operates in 9 countries and serve millions of people with credit life, funeral, Health, Political violence, property , typhoon and weather index crop

## **2. 1. 7 Microcredit Summit**

The first microcredit summit was held at Washington D. C. on the 24 February 1997, 137 countries were present at the summit with 2900 participants. In the summit they launch a campaign to reach 100 million poorest families that is those people living below the poverty line, with those living with less than USD1. 25 a day adjusted to the purchasing power parity (based on 2005 prices) all around the world within nine years especially to empower women as micro entrepreneurs. The objective was nearly achieved in 2005 and in November 2006 the campaign re-launched to 2015 with two new objectives was ensured that 175 millions poorest families especially women are obtaining credit for self employment and for business and financial services. The second objective is to ensure that 100 millions poorest family's worldwide increase to USD1 a day adjusted to the purchasing power parity from 1990 to 2015.

The microcredit campaign is the project of the Educational fund from the USA an organization committed to end hunger and poverty around the world. The campaign group together people such as microcredit practitioners, donor agencies, international financial institutions, non -governmental organizations, advocates, and other people involved with microcredit for effective and efficient practices. In August 2008 the World Bank claim that approximately 280 million families live below the poverty line with less than USD1. 25 daily. The four core themes of the summit are reaching the

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poorest, empowering women, building self sufficient and sustainable MFIs, ensuring that microfinance has a positive impact on the lives of the poor

The forthcoming Microfinance Summit 2011 will be held in Valladolid, Spain, the summit is believed to improve the microfinance sector and to achieve the Millennium Development Goals. A hundred countries and over 2000 participants are expected in the summit. In the agenda there will be the presentation of new products, job creation with microfinance and best practices among other issues will addressed.

## **2. 1. 8 Poverty**

It has been proved that microfinance is the tool to help poor family moved out of poverty and to contribute to the economy of a country by increasing their income generating capacity. Studies have shown with the microcredit provided by Grameen bank in Bangladesh 48% of the families below the poverty line have exit from poverty. According to some studies with microcredit 5% of the poor could exit the poverty line each year as it is an investment in human capital and improve people's life. Microcredit is an opportunity for the poor to realize their dreams. Microfinance is a strategic tool to trim down poverty and help the poor to participate in the social and economic life of a country.

## **2. 1. 8 Employment Generation**

Microcredit helps in the generation of employment; therefore it helps in economic development and in a sustainable means of income. With the microcredit poor people are able to earn a living by selling low priced items or to even expand their businesses at the same time they become

sustainable and create employment for other people . Microfinance is a mean of creating employment and improving the life of poor people.

## **2. 1. 9 Women Empowerment**

Microfinance more specifically microcredit is an instrument used for the empowerment of women it increase social welfare and enhances gender equity. Microcredit helps women to become economic actors in power that is becoming self reliance and economically independent. We have heard a lot about the role of women in microfinance, 94% of the borrowers of Grameen bank are women and 97% of the borrowers are owners in the equity of the bank, according to Rankin (2002) the reason behind this is because women invest more in the family than men because of their nurturing instincts and are more devoted towards their families. Women play a crucial role in the economic growth of a country by first improving their family life, their communities and countries. In the microfinance summit provisions are made for the poorest families around but especially for women as they form an important part of microfinance. Women are targeted because they are the one in the family to up bring the children and poverty of the women results in illiteracy of their children and other social problems. Mohhamud Yunus (1999) explains that women are more willing to work harder to raise their children and to move their families out of poverty, whereas when a destitute father earns an income his priorities will more around himself than for his family. In 2005 Kofi Anan promote the year as the UN microfinance year for empowerment of women. Studies have shown that women are good income earner and that women have a high repayment rate this is because solidarity group or social capital replaces securities required by traditional banks thus

creating better credit worthiness. In Nepal with the Women empowerment program 68 % of the women are able to cater for the needs of the family by sending their children to school, buying and selling properties which normally was the duty of the husband. Access to microcredit has increase from 7. 6 million in 1997 to 26. 8 million in 2001 among which are 21 million women the access to loans enabled them to make economic decisions , to buy assets and resources and to become more independent. Social capital forms an integral part of empowerment of women and they work collectively for mutual welfare. According to Coleman (1988) social capital is an asset in the form of human relationship by the sharing of knowledge and resources within a group and World Bank (2009) define social work as a model of collective actions that create quality and quantity social interactions. Social capital helps women to feel united build trust, motivates them to work together to achieve in life. Women empowerment leads to self esteem, motivation, self empowerment, higher knowledge, good leadership, higher collective action, better decision making and ultimately better social position. Women empowerment also helps to fight violence against women. Although violence against women occurred in all social class but women living in poverty are more prone to domestic IPV and domestic violence, but can at the same time increase the risks since in some cases empowering women is challenging the gender norms

Benefits cannot be assumed in all contexts since empowerment is complex and depends on situation. There is also the problem of moral hazard since when women have access to the credit for a given purpose and they are using the money for other purposes.

We will look at two among many microcredit stories of women the first one is that of Janet Deval from Haiti who was an illiterate women with a hearing problem she had five children, her husband refused to pay the school fees but she knew that education was important for the children. Janet sold goods in Hinche and pay for her children schools on her own. She started to take literacy classes at Fonkoze a microcredit institution in Haiti. Afterwards Janet knew how to write her name and could things that she couldn't do before since she was never sent to school. Later she took a loan from Fonkoze to be able to expand her business at the market to be able to continue to send her children to school, without the microfinance institution Janet would have been unable to read and write and to even expand her business therefore she would have been able to educate her children.

The second case is that of Anastacia Abella from the Philippines, she lived as a squatter in Manila, she lived with her four children in a shelter made from scrap, the village have frequent blackout therefore she decided to search for jar in the garbage to make lamps, after decorating the lamps, she sell 150 of them each day and make a small profit. She took a loan at Opportunity international and she was to make 300 lamps a day, the loan allows her to make greater profit and be able to improve her standard of living.

## **Empirical review**

Social capital is an important component of microcredit it is used as a tool in development programmes. Social A study was carried out by Forbes Marshall Co . Ltd a well known company in Pune, India as an initiative of CSR about the impact of social capital on social empowerment carried using primary data from 217 women all members of SHG by using random sampling from <https://assignbuster.com/the-concepts-of-microfinance-and-microcredit/>



60 SHG among which 34% came from lower social class and the rest middle lower class with average family members of 5 and the average age of the women was 30 years old. The number of years of association is 1-7 years. Data reveals that most of them entered a group for the first time and that most of them were aware of the SHG by existing members. The SHG met frequently for interactions. 15 variables such as “ Access for awareness building and capacity building” which was further divided into “ Access to education and training”, access to loan and girl’s education” were used using Likert scale to know the perceptions of women about the microfinance programs. To see the effectiveness of the microfinance programmes by the indicators more, sensitivity was used as the SHG were divided into 3 categories of less than 1year, 1-3 years and more than 3years. The conclusion of the study was that the social capital created help in women empowerment the older the association the higher the social empowerment and the higher the awareness, the unity and decision making process, but the organization must give appropriate support and policies to the social capital such as capacity building programmes to help decision making. Microfinance programmes make use of physical resources and social capital for sustainable development and economic growth.

Social capital should not be the only factor that helps in the empowerment of women; there must be a good policy and objectives behind the social group. Other tools such as experiments, interviews and other types of surveys or a combination can be used to assess the impact of social capital in microfinance programmes for the empowerment of women. In the study

above 15 indicators have used to assess social capital but there be other indicators that can be assessed such as communication, trust among others.

IMAGE studied the impact on women's empowerment on IPV in South Africa by using random cluster and qualitative data. A microfinance program and training were provided on gender norms, sexuality, HIV and domestic violence. 9 indicators of which self confidence, financial confidence, and power to make decisions were used to measure women empowerment. Results about changes in the loan groups were collected and the results were that after 2 years women's empowerment reduced sexual violence by more than half. With adjusted risk ratio= 0. 45; 95% confidence interval = 0. 23, 0. 91 It was observed that the 9 indicators improved and the study showed that women empowerment reduce IPV.

### **2. 2. 0 Sustainability of Microfinance**

Sustainability of MFI does refer to the profit making or the institution being able to sustain itself without the donors or funders. Sometimes to become sustainable MFI's lower their cost and increase their interest rate. According to Rahman (1999) the IR of loan from Grameen has been higher than that of traditional bank rate in Bangladesh. The increase in interest rate may sometimes hinder repayment, the increase should not be too high so that microfinance may serve its purpose. According to UNDP (2003) among the 147 MFI's reporting in the microfinance bulletin 62 are sustainable financially.

## **Chapter 3. 0 Microfinance in Mauritius**

Mauritius is a bank-based economy, there are 19 banks serving the country among which 5 are offshore banks, these commercial banks do not provide microfinance services but the banking sector is stable in Mauritius and therefore important since microfinance is the by-product of the banking system. Microfinance has emerged recently in the country and actually there is only DBM established in 1964, a state-owned bank which operates in the microfinance sector and other sectors of the economy. The head office is found in Port-Louis and 5 other branches among which one in Rodrigues. The DBM serves as a catalyst in the socio-development in Mauritius, the supply of microfinance in Mauritius is quite limited in terms of range of services and the number of people served as DBM provides only Microcredit to its clients since December 2006.

Microfinance is used as a tool to fight against poverty, in Mauritius the poverty line is for a household income not exceeding Rs6000 monthly that is those in the vulnerable group.

There are 3 types of microcredit loan scheme that are offered to clients the first one is the

Booster microcredit loan for women entrepreneur in sectors such as finance, manufacturing sectors, agricultural, agri business, handicraft, Tourism, ICT and the services sector . Women entrepreneurs loaned by DBM must be registered with NVEC, SEHDA, AREU, IVTB or the Tourism Authority. The loan amount is Rs 100, 000 with 9% IR with repayment rates of 5 years and moratorium period of up to 1 year. Normally when taking microcredit no

collateral are needed but in this case promissory notes are required as security. Women which are eligible are laid off women workers in EPZ and sugar industry, those in existing business, small women entrepreneurs.

Microcredit financing scheme offered to vulnerable groups and are microentrepreneurs with a maximum loan of Rs50000 and 5% IR/per annum and repayment period of 4years and 6 months moratorium and as security floating charge.

Booster scheme for small entrepreneur for entrepreneurs to finance a category of activities such as kindergartens, e-commerce, ICT among others, with a maximum of Rs1500000 with a repayment period of 5years, moratorium of 1 year and 9% IR p. a and a limited number of clients are served.

Microfinance in Mauritius is in an infancy stage since the financial facility offered is only limited to microcredit and only 3 types of loan are provided to clients and many people may not be aware of these services since they are new in the financial sectors.