

Micro-finance: A Brief Review and Comparison of the Grameen and the Self Help Group Models

Dr. Aswini Kumar Dash

Larsen & Toubro Limited, P.O.: Kansbahal - 770 034, District: Sundargarh, Odisha, India

ABSTRACT

This article reviews the interesting concept adopted by the Grameen Bank for poverty alleviation through availability of micro-credit to the rural women of Bangladesh, its operating procedure and the impact it has had on the stature of the rural womenfolk. The methodology of operation of Self Help Groups that form the major micro-finance system in India is discussed and compared with the Grameen system of Bangladesh. Improvements to the micro-finance system prevailing in rural India that would make it more poor-friendly bringing about social benefits on a long term basis, is also deliberated.

Key Words: Grameen Bank, micro credit, rural women, social benefit.

1. INTRODUCTION

Like most developing countries, the majority of Bangladesh lives in rural areas. Fragmented land holdings or landlessness contribute to high poverty levels. Very limited employment opportunities both in agriculture and industry force villagers into small-scale self-employment activities in the rural unorganized sector. Revenue from these activities is low due to productivity issues and disadvantageous contract terms. Lacking sufficient working capital and collateral, those working in the unorganized sector are forced to borrow money from local money lenders at high interest rates since they are not accessible to the banking sector. At those terms, the income earned from even the most productive activities could not support their families, let alone facilitate savings, investment and income growth. High risk, absence of collateral and high transaction costs of banks associated with small loans and savings deposits makes them unbankable; thus indicating that specialized financial institutions were needed that would provide loans to the poor on terms and conditions that were appropriate for them (Bernasek, 2003)[1]. This thought gave birth to the Grameen Bank model.

The importance of micro-finance was also realized in other parts of the world. With the help of non-government organizations and government policies in support of poverty alleviation by making it compulsory for commercial banks to extend micro savings and loan schemes to the poor, Self Help Groups started functioning effectively in India.

2. LITERATURE REVIEW

Poor women in Bangladesh often engage in a variety of small-scale productive activities at home. But without working capital, they rely on credit to carry out these activities. Women lack access to credit from formal lenders not only because they are poor and lack collateral, but also because they are women and formal lenders in Bangladesh do not consider women to be creditworthy (Yunus, 1984)[2]. If women do apply for loans from commercial banks, male relatives must co-sign the loans, and it is the male cosigner and a male loan officer who negotiate the terms of the loan. This discrimination in lending limits women's opportunities to finance income-earning projects at reasonable cost, and limits their opportunities to gain experience and knowledge from those projects.

Cultural norms and expectations in Bangladesh place additional constraints on a woman's access to assets and opportunities to earn. Inheritance rights are also in favour of the men. Thus the rural Bangladeshi woman is poorer than the man and has fewer opportunities for moving out of poverty. (Khan & Hossain, 1989)[3].

The operating method of the Grameen Bank of Bangladesh has become a business model which is also being followed in different parts of the world as an anti-poverty strategy through micro-credit programmes. The Bank recognizes the role of women to be central for the upliftment of the society and is aware of the cultural context which conditions women's willingness and ability to respond to economic opportunities. The Grameen Bank thus primarily focuses on improving the economic status of women (Bernasek, 2003)[4].

The Grameen Bank Model: The central feature of the Grameen Bank is its credit program – providing small loans to the poor to be used for self-employment activities. Strict criteria were established to ensure a focus on the poor, including restrictions on the size of a prospective borrower's landholdings. To provide incentives for repayment, the Bank developed an innovative lending scheme; borrowers are required to form groups of five from among their peers and accept joint responsibility for repayment of loans. Access to credit in the future is conditional on all group members repaying their loans. Although the bank monitors borrowers fairly closely, the organization of borrowers into groups provides incentives for additional peer monitoring (Varian, 1990; Stiglitz, 1990)[5],[6]. The Bank even sequences the granting of loans to

some group members in order to monitor their repayment performance before granting loans to the remaining group members. Only two members are allowed to take a loan at first time. If the performances are reaching at the satisfactory level then next two borrowers can apply for loans. Finally, fifth member can be selected for loan. After approving loan Grameen Bank arranges a training program (Shukran & Rahman, 2011)[7]. The repayment incentives created by this lending scheme thus use the only form of collateral that the poor have access to – social collateral. The members of each lending group experience great peer pressure to meet the terms of their loans, as they know everyone in the group well enough to understand the importance they place on receiving their disbursement. Defaulting will cost a member her reputation in the village because her failure deprives others of needed loans. The combination of support and peer pressure from the group provides borrowers with sufficient motivation to meet the terms of their loans. If the group system represents the first level of regulation, the second level is the assigned center manager, who visits borrowers regularly to monitor loan payments. Center managers are extremely active throughout the process and play a large role in selecting borrowers, approving lending groups and supervising income-generating projects. As an added risk-management measure, branch managers must also approve lending groups during the approval process (Mainshah et al, 2004)[8].

Another feature designed to meet the needs of the poor is small loans that are repaid in weekly installments over a period of one year. The Bank is organized in concentric circles from bottom to top. The Grameen Bank finance project works with a strong chain. Each group consists of five members and there are eight groups in each Centre. The Branch office controls fifty Centers, comprising of 2000 members. The Area office looks after five Branch offices while the Zonal office handles five Area offices (Shukran & Rahman, 2011)[9]. The highest level of management is the Bank's Head Office located in Dhaka. One of the unconventional ways the Bank conducts its business is to have the bank workers from a branch travel to the borrowers in their villages rather than requiring the borrowers to travel to the bank branch. A bank worker meets with the members of each center once a week. Loan payments are made at those meetings, which helps to facilitate transparency in the lending process. The interest rate is set to the rate charged by other commercial lenders in Bangladesh. The Bank leaves the decision of what activities to undertake to the borrowers. The decision-making process includes a discussion among group and center members, who consider each individual's existing skills as well as current market conditions and the profitability of proposed activities (Bernasek, 2003)[10].

Initially, the bank made loans to women and men equally, a lending policy that was considered radical at the time. But as it gained experience and insights, the Bank has focused its new loans on women and now makes more than 95 percent of its loans to women due to the observation that income earned by female borrowers had more beneficial effects on the well-being of children and household members generally, than income earned by male borrowers. The management had the opinion that women were more determined than men to pull their families out of poverty and, as such, Grameen Bank lending would be more effective in alleviating poverty if it focused on increasing women's income earning opportunities. The majority of women receive loans for activities that are considered traditionally female activities like raising poultry, raising cattle, weaving, and food processing. These activities are generally less productive than men's income-earning activities. For this reason, over time women have borrowed for joint undertakings with their husbands to take advantage of higher profitability. These activities often involve home-based processing work, with men buying raw materials and selling the final product. Increasingly, they involve lease of land for cultivation. In addition to providing credit, the Bank has promoted specific social development goals. The Bank's "Sixteen Decisions" is a list of goals for borrowers and their families to aspire to, and work toward. The decisions include commitment to better sanitation, education, family planning practices, housing, and better nutrition, among others. Women are seen as key to success in alleviating poverty and thus many of the social development goals are aimed at empowering women (Bernasek, 2003)[11].

The Self Help Group (SHG) methodology has evolved as the most effective and popular micro-finance system in India. In this system, the members form a group of up to 20 members. The group formation process may be facilitated by a non-governmental organization or by the micro-finance organization or bank itself, or it may evolve from a traditional rotating savings and credit group or other locally initiated grouping. The process of formal linkage to a micro-finance institution (MFI) or bank usually goes through the following stages: (a) The SHG members decide to make regular savings contributions. These may be kept by their elected head, in cash, or in kind, or they may be banked. (b) The members start to borrow individually from the SHG, for purposes, on terms and at interest rates decided by the group themselves. (c) The SHG opens a savings account, in the group's name, with the bank or MFI, for such funds as may not be needed by members, or in order to qualify for a loan from the bank. (d) The bank or MFI makes a loan to the SHG, in the name of the Group, which is then used by the Group to supplement its own funds for on-lending to its members (Harper, 2000)[12].

The SHG carries out all the same functions as those required by the Grameen system, but they do this on their own behalf, since the SHG is effectively a micro-bank, carrying out all the familiar intermediation tasks of savings mobilization and lending. The MFI or bank may assist the SHG in record keeping, and they may also demand to know who are the members and impose certain conditions as to the uses of the loan which they make to the SHG, but the SHG is an autonomous financial institution in its own right. The members have their accounts with the SHG, not with the MFI or bank, and the MFI or bank does not have any direct dealings with the members. The banker or NGO field worker may visit the SHG members frequently during the initial group promotion stage, but the aim is to help the group keep their

own records and run their own meetings. Once this has been achieved, there is no further need for weekly or even monthly visits (Harper, 2000)[13].

3. DISCUSSIONS AND CONCLUSION

The village communities of Bangladesh are generally more socially and economically homogeneous and less divided by caste than their counterparts in most Indian villages. Hence, it is easier to form groups that would follow a standardized procedure. This makes it easier to operate with the Grameen system in Bangladesh than in India.

It is observed that the Grameen system is better suited for more densely populated areas. There are parts of India which are as densely populated as Bangladesh, and some of the Northern hill tracts, and some part of the Sundarbans, are fairly thinly populated. The population density in India is a little higher than 1/3rd that of Bangladesh.

In the Grameen system, the groups avail micro-financial services from the Bank, while the SHGs are effectively a micro-bank carrying out their own savings mobilization and lending.

The basic difference in the approaches of the Grameen system and the SHG model is that the former starts with micro-credit and then graduates to micro-savings, while the SHG model is based on the concept of micro-savings leading to micro-credit. Thus, the SHG model is more sustainable from viability point of view. Though both the models are for the poor, yet Grameen system is more suited to the very poor category of people who may not have sufficient fund to generate the initial savings required in the SHG system.

Unlike Bangladesh, India has a good network of commercial banks with almost 70% of the 80,000-odd bank branches located in the rural and semi-urban areas. Policies of the Government to make it mandatory for the banks to extend credit to the priority sector and also support the cause by providing funds to these commercial banks at a reduced rate of interest have helped in the development and support of the SHG model in India.

In addition to the banks, India has the advantage of having more than 1,39,000 post offices in the rural areas. Since the post offices are part of the Central Government network, there is the opportunity of utilizing these post offices for micro-financial services for the poor through the SHGs. This would not only increase the reach of the Government system to the poor, but would also improve the utilization of the post offices.

REFERENCES

- [1.] Bernasek, A., 2003. Banking on Social Change: Grameen Bank Lending to Women. *International Journal of Politics, Culture, and Society*, Vol. 16, No. 3, pp. 369-385.
- [2.] Yunus, M., 1984. *Credit is a Human Right*. Dhaka: Grameen Bank.
- [3.] Khan, A. R. & M. Hossain, 1989. *The Strategy of Development in Bangladesh*. London: Macmillan.
- [4.] Op. cit. Bernasek, A., 2003. pp. 369-385.
- [5.] Varian, H. R., 1990. Monitoring Agents with other Agents. *Journal of Institutional and Theoretical Economics*, Vol 146, Issue 1, pp 153-174.
- [6.] Stiglitz, J., 1990. Peer Monitoring and Credit Markets. *World Bank Economic Review*, Vol 4, Issue 3, pp 351-366.
- [7.] Shukran, M. K., Rahman, F., 2011. A Grameen Bank Concept: Micro-credit and Poverty Alleviation Program in Bangladesh. *International Conference on Emerging Trends in Computer and Image Processing (ICETCIP'2011)*, Bangkok.
- [8.] Mainshah, E., Heuer, S. R., Kalra, A., Zhang, Q., 2004. *Grameen Bank: Taking Capitalism to the Poor*. Chazen Web Journal of International Business, Columbia University.
- [9.] Op. cit. Shukran, M. K., Rahman, F., 2011.
- [10.] Op. cit. Bernasek, A., 2003. pp. 369-385.
- [11.] *Ibid*.
- [12.] Harper, M., 2000. *Co-operative Success, what makes group enterprise succeed?* Oxford and IBH Publishers, London, ITDG Publications, pp 39-42.
- [13.] *Ibid*.

AUTHOR



Aswini Kumar Dash joined M/s Larsen & Toubro Limited in 1992 after completing B.E. in Metallurgical Engineering from REC (now NIT), Rourkela, Odisha, India. While working in L&T, he completed M.E. in Metallurgical Engineering from REC (now NIT), Rourkela in 1998, Post Graduate Diploma in Business Management in the year 2005 from XIM, Bhubaneswar, Odisha, India, and Doctorate in Management from KIIT School of Management, Bhubaneswar, Odisha, India in 2013. He is heading the Foundry business at Larsen & Toubro Limited, Kansbahal Works, Odisha, India since October 2011.