

# Microfinance Lending Technologies

Daide Castellani

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# Objectives

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- Distinguish different lending methodologies
- Understand the concept of “Group Lending” and “Individual Lending”
- Understand the differences and similarities between “Microcredit” and “Traditional Lending”

# Content

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## 1. Introduction

- Distinguishing different lending methodologies

## 2. Group Lending

## 3. Individual Lending

## 4. Comparison: Microcredit vs. Traditional Lending

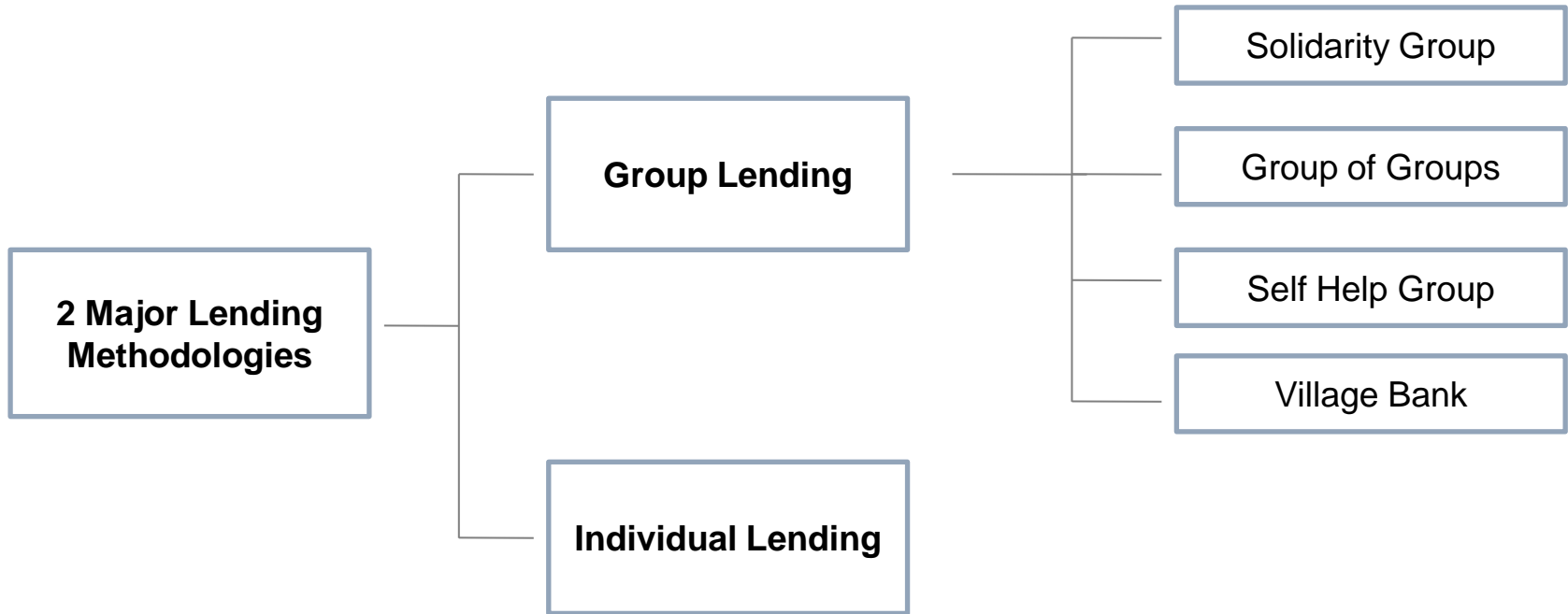


# 1. Introduction: Distinguishing different lending methodologies

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„An extremely small loan given to impoverished people to help them become self employed“  
(Investopedia)





## 2. Group Lending

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## 2.1 Group Lending: Why?

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- **Asymmetric Information** (Adverse Selection, Moral Hazard) leads to **high monitoring costs** in relation to relatively **small loan** sums.
  - Enforcement (for payback of loans) can be difficult due to **legal system** + microfinance clients have **no formal collateral**.
- effective **incentive mechanisms** required in order to insure sustainable microfinance offer.
- + Groups can serve as **platform** for broader development initiatives!

## 2.2 Group Lending: The Grameen Model

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### Grameen Bank in Bangladesh

Founded by Prof. Yunus, 1983 officially  
accredited as a bank

In 2013\*:

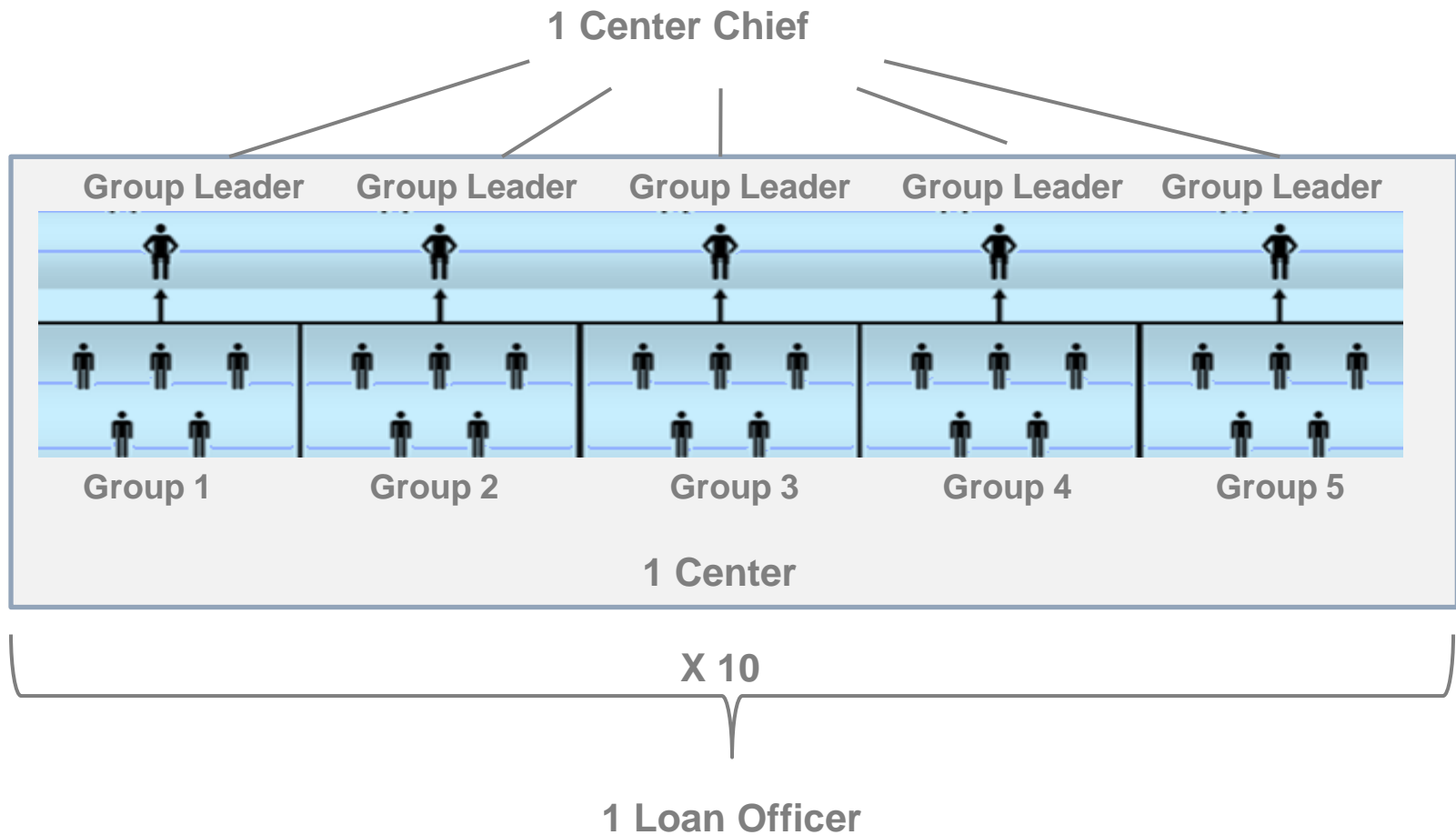
- 8.54 (6.74) millions of clients (borrowers);
- 96% of clients are women;
- Average loan balance: \$ 161;
- Total loan outstanding: \$ 1,085 million
- Portfolio At Risk (PAR): 3.66%

\*Source: Annual Report Grameen Bank 2007;





## 2.2 Group Lending: The Grameen Model



Source: Santos (2002)

## 2.2 Group Lending: The Grameen Model

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### The Lending Mechanism of „classic“ Grameen Model:

- Credit to the first two members of every group
- With prompt payment, credit to two additional members of the group after 4-6 weeks
- After another 4 weeks the group leader receives the credit

### → Incentive Mechanism:

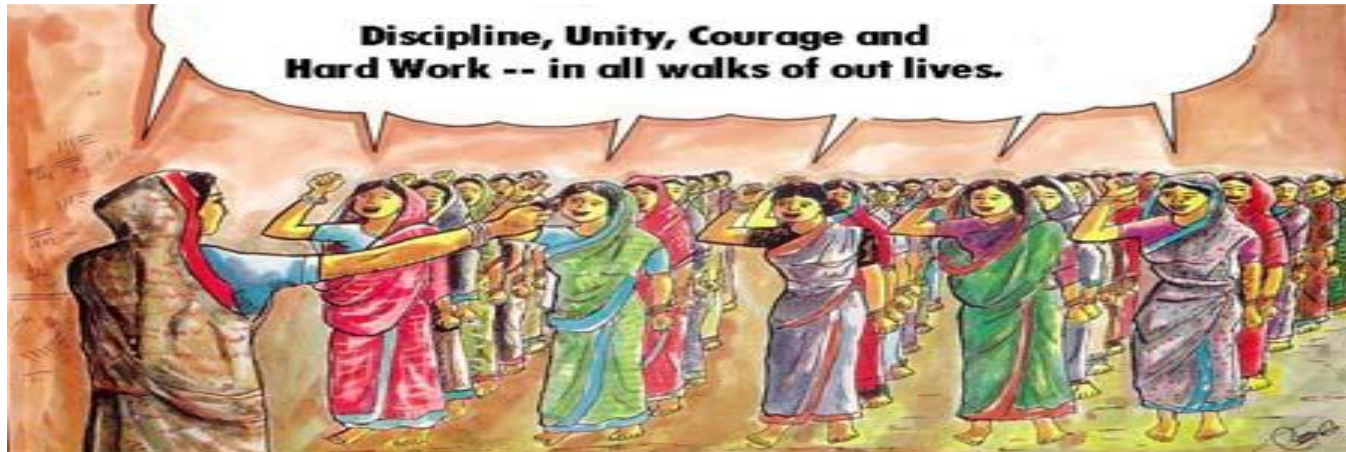
- **Joint Liability** : Every single group serves as guarantor for the group
- **Peer Monitoring**: Group members of same sex and background monitor the usage of credits
- **Peer Pressure**: Access to credit of single group members depend on reimbursement of other group members

## 2.2 Group Lending: The Grameen Model

### Capacity Building and the 16 decisions:

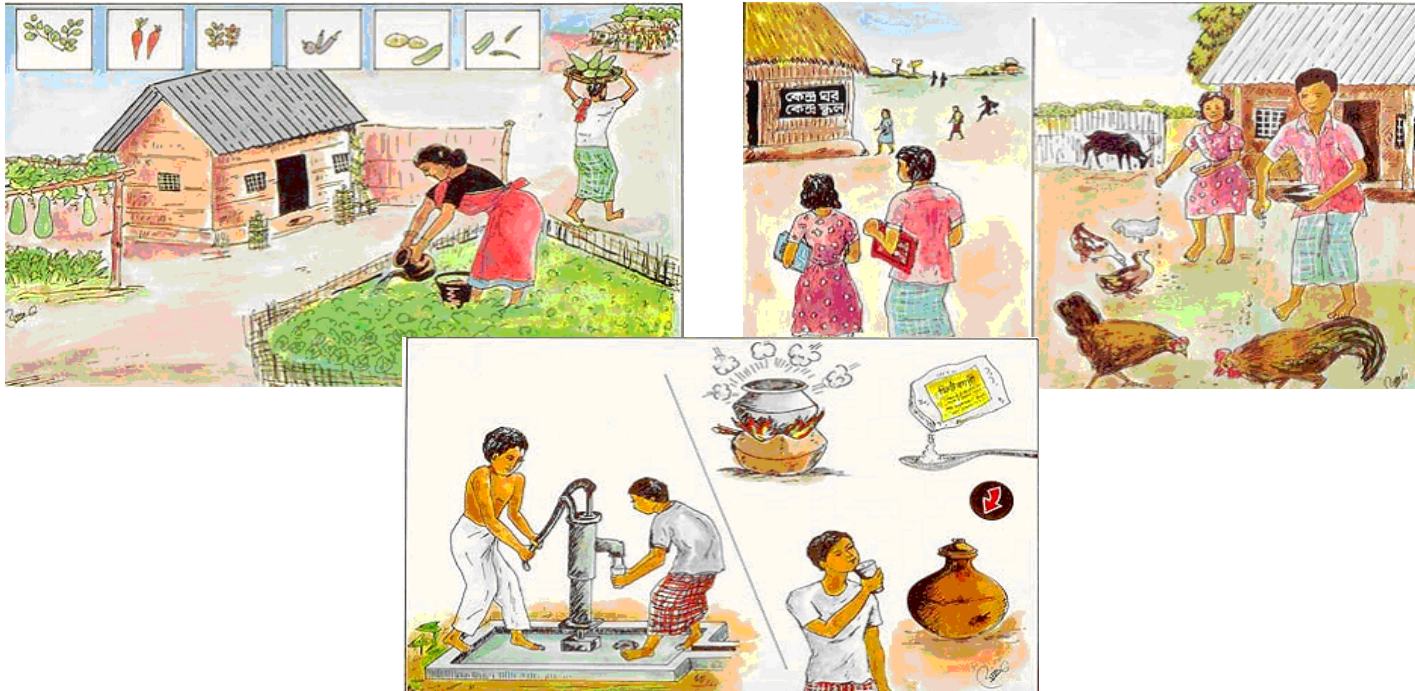
#### Course content:

- Procurement information about credit
- Establishment of personal relationship between lender and borrower
- Exchange of morally and ideologically strong commitments and principals (*the sixteen decisions*) that all group members have to adhere to.



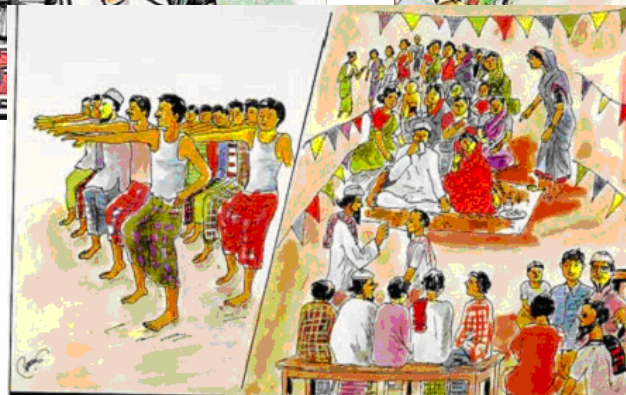
## 2.2 Group Lending: The Grameen Model – 16 decisions

4. We shall **grow vegetables** all the year round. We shall eat plenty of them and sell the surplus.
7. We shall **educate our children** and ensure that they can earn to pay for their education.
10. We shall **drink water from tube wells**. If it is not available, we shall boil water or use alum.



## 2.2 Group Lending: The Grameen Model – 16 decisions

11. We shall not take any dowry at our sons' weddings, neither shall we give **any dowry** at our daughters wedding. We shall keep our centre free from the curse of dowry.
13. We shall **collectively** undertake bigger **investments** for higher incomes.
16. We shall take part in all **social activities** collectively.



## 2.3 Group Lending: Pros and Cons

	Advantages	Disadvantages
Lender	<ul style="list-style-type: none"> <li>• Reduction transaction costs &amp; Information asymmetries</li> <li>• Regular presence in rural areas</li> <li>• <i>Good platform for non-financial services</i></li> </ul>	<ul style="list-style-type: none"> <li>• Limited control on client's base (group decides on who is eligible)</li> <li>• Only feasible with given population-density?</li> <li>• Limited profits as limited loan size?</li> </ul>
Borrower	<ul style="list-style-type: none"> <li>• Access to financial capital</li> <li>• Dynamic group membership could lead to empowerment</li> </ul>	<ul style="list-style-type: none"> <li>• Group membership as pressurizing medium</li> <li>• Interference of privacy?</li> <li>• No flexibility of credits: limited loan amounts, fixed durations etc.</li> </ul>



## 3. Individual Lending

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### 3. Individual Lending

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Akquisition	<ul style="list-style-type: none"><li>• Personal Sales</li><li>• MFI decides who is eligible</li></ul>
Disbursement	<ul style="list-style-type: none"><li>• Client comes to MFI</li><li>• Loan size and tenure is personalized (mostly working capital loans of ~1 year duration)</li></ul>
Screening	<ul style="list-style-type: none"><li>• Collaterals and guarantors often required</li><li>• Sometimes „alternative“ and/or liquid collateral</li><li>• Loan officers exercise clients visits</li><li>• Savings first</li></ul>
Incentive Mechanisms	<ul style="list-style-type: none"><li>• Discount of interest rates for on-time repayments</li><li>• Progressive Lending</li><li>• Credit Lines</li></ul>
Repayment	<ul style="list-style-type: none"><li>• Mostly at MFI</li><li>• Often on a monthly base</li><li>• Sometimes in public (Shame factor)</li></ul>





## 4. Comparison: Microcredit vs. Traditional Lending

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## 4. Comparison: Microcredit vs. Traditional Lending

	Traditional Lending	Microcredits
<b>Objective</b>	<ul style="list-style-type: none"> <li>• Profit-maximisation</li> <li>• Shareholder value</li> </ul>	<ul style="list-style-type: none"> <li>• Social goals predominant</li> <li>• Stakeholder value</li> </ul>
<b>Target groups</b>	<ul style="list-style-type: none"> <li>• „Bankable“ clients</li> <li>• Resalable collaterals</li> <li>• High solvency</li> </ul>	<ul style="list-style-type: none"> <li>• Low-income population</li> <li>• Mostly informal self-employed</li> <li>• Low solvency</li> <li>• Socially marginalized</li> </ul>
<b>Provider</b>	<ul style="list-style-type: none"> <li>• Commercial Banks</li> <li>• Savings Banks</li> <li>• Cooperative Banks and Post Banks</li> </ul>	<ul style="list-style-type: none"> <li>• Informal Provider</li> <li>• NGOs</li> <li>• Specialized Microfinance Institutions</li> <li>• Cooperatives</li> </ul>
<b>Credit Characteristics</b>	<ul style="list-style-type: none"> <li>• Individual liability</li> <li>• Unlimited amounts and duration (depending on individual needs and solvency)</li> <li>• Market-based interest rates</li> </ul>	<ul style="list-style-type: none"> <li>• Small sums</li> <li>• Short-term (6 month to 1 year)</li> <li>• Alternative collaterals</li> <li>• Joint liability (group lending)</li> <li>• Regular meetings (group lending)</li> <li>• Obligatory savings</li> </ul>
<b>Business Procedures</b>	<ul style="list-style-type: none"> <li>• Highly standardised (e.g. credit scorings)</li> <li>• Highly decentralized (each step by a special division: sales, disbursement, repayment etc).</li> </ul>	<ul style="list-style-type: none"> <li>• Close personal contact to clients</li> <li>• Loan officer responsible for the whole process</li> </ul>

# Related Literature

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Thank you

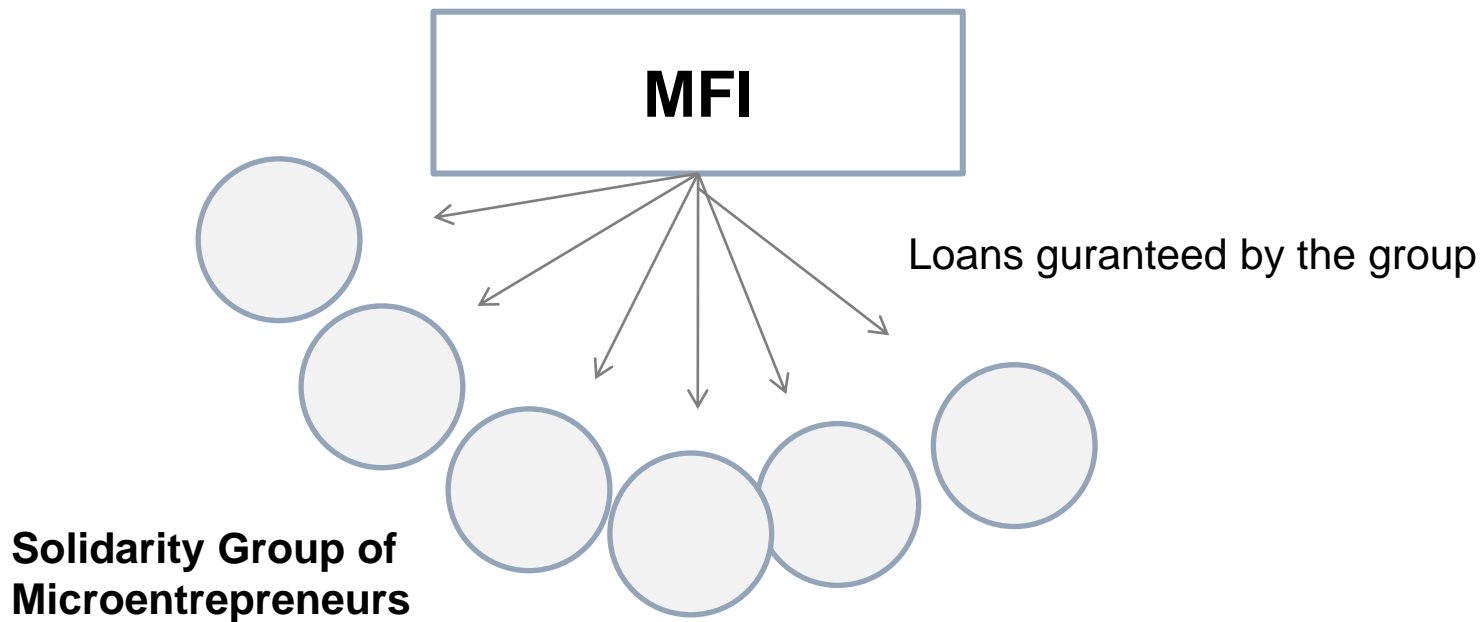
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## Supplementary information

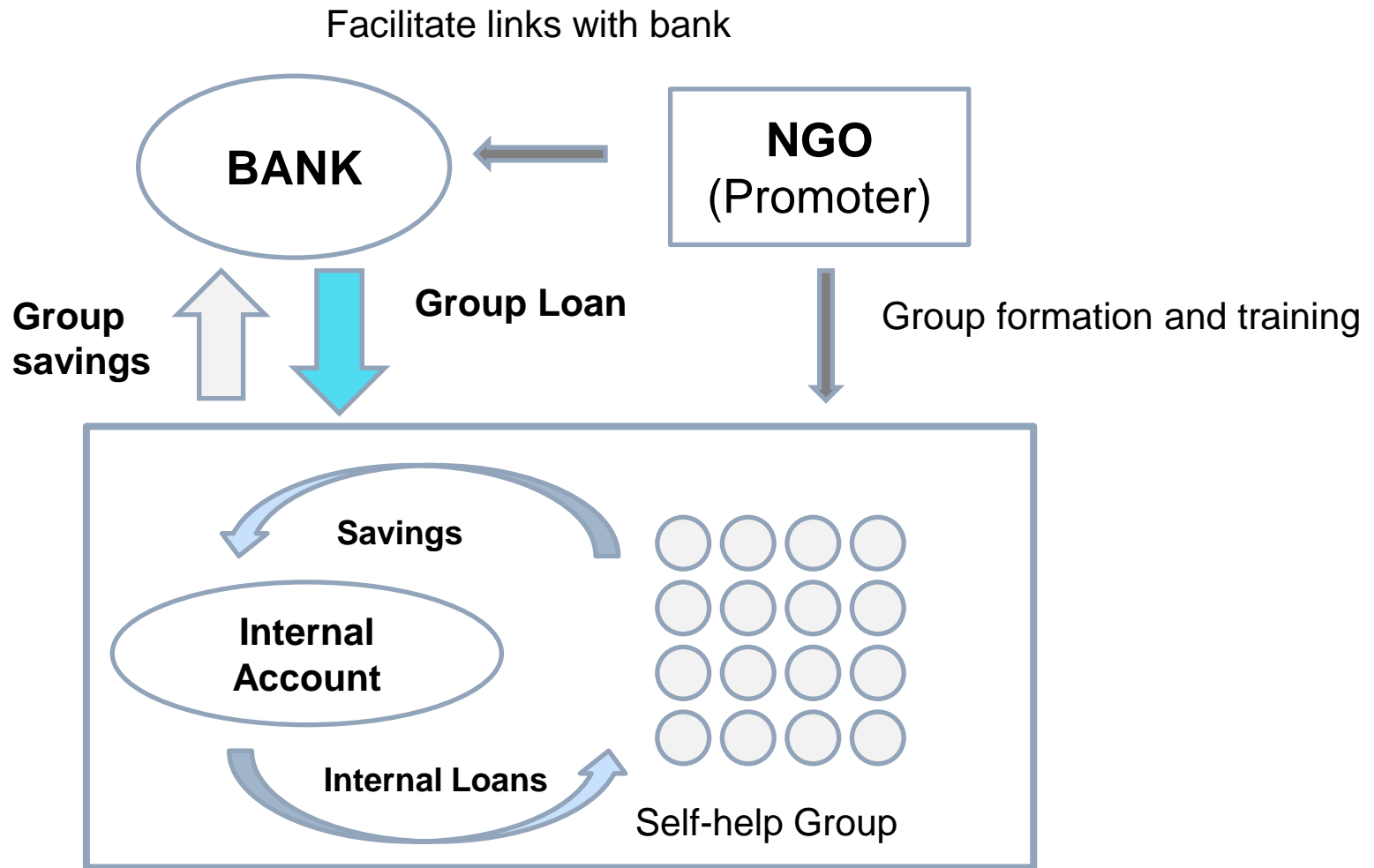
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## 2. Group Lending : Solidarity Groups



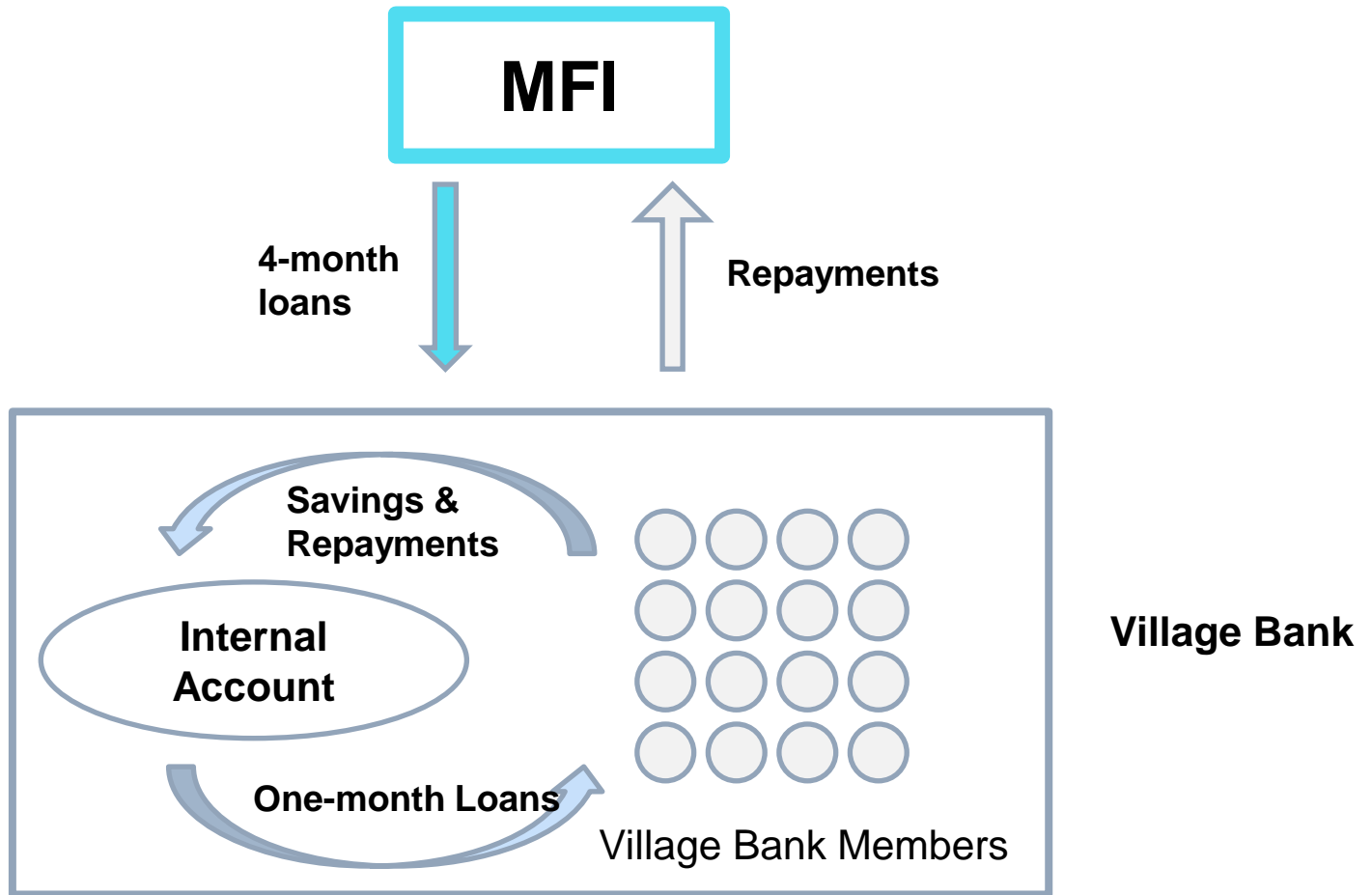
Source: unpublished Ppt. by Cheryl Frnakiewicz and Craig Chrchill  
2008

## B. Group Lending : Self Help Groups



Source: unpublished Ppt. by Cheryl Frnakiewicz and Craig Chrchill 2008; own adaption

## B. Group Lending : Village Banking



Source: unpublished Ppt. by Cheryl Frnakiewicz and Craig Chrchill 2008; own adaption



## B. Group Lending : Comparison

	Roots	Members	Characteristics
Solidarity Groups	Latin America	5 to 8	<ul style="list-style-type: none"> <li>Historically one loan per group</li> <li>Begins with 3-4 hour training/information session</li> <li>Targets existing business with regular cash flow</li> <li>Loan amounts somewhat larger than other group methodologies</li> </ul>
Group of Groups (Grameen)	Bangladesh	5 X 5	<ul style="list-style-type: none"> <li>Individual contract with group as co-signer</li> <li>Begins with several weeks of meetings and savings</li> <li>Supports new income generating activities</li> <li>Platform for non-financial services</li> </ul>
Self-Help Group	India	20 to 25	<ul style="list-style-type: none"> <li>Typically involves 2 institutions (NGO &amp; FI)</li> <li>Bank/MFI lends to SHG (not to members)</li> <li>Begins with 6 month of savings and internal lending</li> <li>Platform for non-financial services</li> </ul>
Village Bank	Latin America	30 to 50	<ul style="list-style-type: none"> <li>MFI organizes and trains groups</li> <li>May use internal account</li> <li>Platform for non-financial services</li> </ul>

## 2. Group credit - Sixteen decisions (Grameen)

1.0 We shall follow and advance the **four principles** of Grameen Bank --- Discipline, Unity, Courage and Hard work – in all walks of our lives

2.0 **Prosperity** we shall bring to our **families**

3.0 We shall not live in dilapidated houses. We shall **repair our houses** and work towards constructing new houses at the earliest

4.0 We shall **grow vegetables** all the year round. We shall eat plenty of them and sell the surplus

5.0 During the plantation seasons, we shall plant as many **seedlings** as possible

6.0 We shall plan to keep our **families small**. We shall minimize our expenditures. We shall look after our health

7.0 We shall **educate** our children and ensure that they can earn to pay for their education

8.0 We shall always keep our children and the environment **clean**.

## 2. Group credit - Sixteen decisions (Grameen)

9.0 We shall build and use **pit-latrines**

10.0 We shall drink **water** from tubewells. If it is not available, we shall boil water or use aluminium

11.0 We shall not take any dowry at our sons' weddings, neither shall we give any dowry at our daughters wedding. We shall keep our centre free from the curse of **dowry**. We shall not practice child marriage

12.0 We shall not inflict any **injustice** on anyone, neither shall we allow anyone to do so

13.0 We shall **collectively** undertake bigger investments for higher incomes

14.0 We shall always be ready to **help** each other. If anyone is in difficulty, we shall all help him or her

15.0 If we come to know of any breach of discipline in any centre, we shall all go there and help **restore** discipline

16.0 We shall take part in all **social activities** collectively.

### 3. Individual Credit

#### **Microlenders focusing on individuals tend to:**

(a) Be smaller and serve better-off clients, as reflected by average loan size

(b) Be more self-reliant as proxied by the percentage of their financial costs covered – 102 percent relative to just 89 for group lending microentrepreneurs

(c) Serve a smaller population of women clients on average 46% of the clients of individual microlenders are women vs. 73% for group lenders and 89% for village banks

(d) Charge low interest rates and fees as reflected in the real portfolio yield: 49% for village banks, 30% for group lenders and 21% for individual lenders