The improvement of microfinance institution under inclusive finance: A case of Grameen Bank of China

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Abstract. In the rapid development of modern society, microfinance companies are an inevitable product of the economic market demand, and microfinance companies are bound by the relevant laws of China and enjoy the policy support of the state. As an effective supplement to traditional banking financial institutions, microfinance companies, with their flexible mechanisms and efficient services, are increasingly becoming an important force in achieving the goal of financial inclusion. However, due to the lack of supervision, shortage of capital, and excessive risks, microfinance companies have also been deviating from the original purpose of inclusive financial services, such as "non-farming" and "centralization" of loans. The emergence of the Grameen Bank in the 19th century - a "bank for the poor" - broke the original concept. It will be the case study for analysis in this paper. Using the case of Grameen Bank, this paper aims to explore the characteristics and advantages of small lending institutions, analyze whether they are replicable, sustainable and the social significance their existence brings, and make recommendations and prospects for promoting a greater role of microfinance companies in financial inclusion.

Keywords: Rural bank, microfinance, poverty alleviation, women, financial sustainability, social inclusion.

1. Introduction

People in poverty rarely borrow money from formal lending institutions, such as commercial banks or cooperatives. This is not only because the poor cannot afford to pay high-interest rates, but also because banks are reluctant to engage with the poor. Many low-income countries have implemented credit and savings programs, but their success in helping the poor is still widely debated. From the 1960s through the 1980s, many developing countries had government-sponsored credit programs, often with subsidized interest rates, that were specifically targeted at the rural poor. Burgess, Robin, and Rohini Pande [4] argued that in areas where additional branches have been opened as a result of this policy, people there are becoming increasingly poorer. In the case of social banks in India, they argue that it costs more than Rs. 1 crore to raise the income of the poor by setting up a branch of the bank. Perhaps the establishment of branches does not solve the problem of regional poverty. Mandatory credit schemes are often accompanied by extremely high default rates.

In this case, microfinance becomes a very understandable concept. Anyone who does not aim to raid the poor can enter this market. They charged only a little interest to keep the operation going, or earned a little, but not much. Due to compound interest, a slight downward adjustment in interest rates can change the borrower's life. In this way, the poor do not have to go to the banks, but the banks go to the poor. Thus, microfinance is an effective means of empowering the poor, which is an important step in helping to alleviate poverty. In the inclusive financial system, microfinance institutions (MFIs), as a key component, operate on the concept and principle of lending small amounts of money, making them better able to help the public while also strengthening the development of our innovative financial industry system. The traditional microfinance sector has evolved from a primarily subsidized rural lending program to a sustainable microfinance industry. However, most micro and small enterprises are currently facing financing problems in their development process, and the lack of financing will affect the development of micro and small enterprises, so the credit rationing of microfinance companies is very important. Analyzing the current problems of microfinance companies can help solve the problem of rural lending, which in turn can be further developed to help the poor. The success of the pro-poor bank was not only in lending to the poor at a more reasonable rate and finding a solution to low repayment rates, but also in the financial inclusion, it demonstrated for the community [13].

2. Background Information about MFI and Grameen Bank

DiMaggio and Powell (1983) [5] and Meyer and Rowan (1977) [14] look at the performance and success of microfinance institutions from an institutional theory perspective, arguing that if an organization can effectively demonstrate that all of its policies and procedures are consistent with prevailing local social values and that the results of its overall operations are consistent with social expectations in terms of benefits to the local community then it can ensure its success and long-term viability.

Based on the endogeneity associated with MFI lending, a country with a higher total loan portfolio per capita of MFIs tends to have a lower level of poverty index [9]. In a way, this is an affirmation of microlending. Poor banks are not unusual, but banks willing to practice in-kind unsecured lending and rely on peer monitoring and peer pressure to enforce loan contracts are rare. Barua's research [2] shows that the Grameen Bank is creating self-employment opportunities for the large pool of unused and underutilized human resources in rural Bangladesh through a microfinance model. Its philosophy is that providing financial services to the poor will help the poor to become self-employed and will generate income, thus not only lifting them out of poverty but also enabling them to learn to take responsibility both personally and socially. In addition, providing social intermediary inputs will help them to be financially and socially disciplined. Information on Grameen Capital's website [8] shows that since its inception in 1994, over 2 million members and $306 million from the underprivileged have been mobilized by Grameen Bank. When compared to the pitiful recovery rate of roughly 25% for the nation's commercial and agricultural development banks, it has maintained a loan recovery record of over 90%, a remarkable accomplishment for a rural financial institution. Additionally, Grameen Bank has concentrated on creating neighborhood organizations. This grassroots organization is focused on the group and has a stronger sense of camaraderie than the typical credit institution. Most surprisingly, women made up 94% of the members of Grameen Bank. At the time, it was uncommon to find a rural bank that welcomed women. In conclusion, the Grameen model is being imitated both in Bangladesh and overseas as a result of its success, which garnered international attention.

Because of Grameen bank's innovative program design, women's services, and poverty reduction potential, development practitioners are increasingly interested in learning more about its potential and replicability. It has been well studied in terms of its program design and sources of success as a rural financial intermediary. In 1990, Hume examined the replicability of the Grameen Bank outside of Bangladesh [7]. And its impact on the poor and women has also been studied [18]. However, there ave been several microfinance bank failures around the time of the Grameen Bank's inception. To date, no study has been comprehensive enough to examine the benefits and costs of the program or to determine the causal impact of the Grameen Bank to determine whether the program has truly produced the desired social inclusion.

Many researchers continue to contest the legitimacy of microfinance institutions' existence. Khandker and Pitt's study [18] data analysis revealed that despite higher cumulative lending returns, program participants' property losses were less in 1998–1999 (2 percentage points) than they were in 1991–1992. (5 percentage points). The diminishing rewards from more borrowing are the cause of this. As a result, despite the fact that the number of female members who borrow has increased, the increase in consumption that resulted did not sufficiently lower poverty as anticipated, and the effectiveness of micro-borrowing was not as great as one could have anticipated.Therefore, this paper analyzes previous research and summarizes several problems that microfinance institutions face today.

3. Analysis

3.1. The unsustainability of institutions

To begin with, the sustainability of microfinance institutions has been controversial. for one, researcher Khandker and Shahidur used a panel household survey in Bangladesh to examine whether the impact of microfinance will be saturated or replaced over time [19]. The findings suggested that saturation may occur in microfinance villages. At the same time, the strategy of microfinance institutions to consistently adhere to a zero default rate seemed to contradict their sustainability. On many levels, the success of microfinance stems from setting repayment as a fixed social contract. It is up to the community as a whole to ensure repayment, and the MFIs will continue to provide loan services. But Xavier Gine and Dean Karlan's research [20] shows that if clients do not meet weekly, but monthly, the group's social relationships are built more slowly and its default rate eventually rises. If high-frequency meetings are necessary to maintain relationships and ensure repayment rates, this would seem to be the opposite of the sustainability of the Grameen model demonstrated earlier; after all, there are many uncontrollable factors that prevent members from meeting regularly, such as a member's parent being sick, a member being unwell, or inclement weather.

3.2. The high risk of borrowing

For another, there is no doubt that the target audience of MFIs determines their high-risk nature. Microfinance is supposed to be a more flexible and lower-threshold way to alleviate poverty. They are less complicated and do not require as much collateral as ordinary financial institutions. However, this is precisely where the problem of high riskiness comes from. Take farmers, for example. Farmers are a large part of the population served by rural banks. The property they often use as collateral is their crops or farmland. However, whether it is objective factors such as weather or human factors such as crop cultivation, these are problems that are difficult to avoid from time to time in the agricultural economy. This is when agricultural economic development is limited and microfinance institutions are inevitably exposed to significant risks. This is because farmers are likely to be unable to deliver sufficient collateral and give guarantees for continued borrowing. At this point, the MFI not only has to cover the shortfall of the borrower who fails to repay the loan promptly but also continues to incur costs to keep the institution going. It is easy to imagine that in the long run, small lenders will not be sustainable.

3.3. Limitations led by different perceptions

Precisely because of the different service groups mentioned above, people's different perceptions of microfinance institutions will limit the development of microfinance institutions. From the analysis of the current situation of the operation of public microfinance companies, microfinance companies, whether from the perspective of lender or borrower, have problems of trust because of the perception of each different perspective. From the perspective of the rich, they can lend on a large scale and do not need to consider small institutions. What’s more, because of their long-standing choice of large institutions, they inevitably question the professionalism and trustworthiness of micro and small institutions. From the perspective of the poor, they lack understanding of the concept of microfinance or even lending, and therefore may not anticipate the existence of small institutions and lending from them. Therefore, the difference in perception can make them all likely to not choose a microfinance institution.

While microfinance programs have improved loan repayment rates to some extent, they inevitably have a high cost. This cost can be stated in two ways. The first is the transaction cost. khandker's study is consistent with the argument of this paper [11]. In other words, even while many microfinance programs are able to serve the poor and recover loans better than traditional credit institutions, many of them are unable to fully recoup their operational expenses. MFIs that depend on donated or subsidized resources for lending and development are still unable to break even when such resources are priced at the market. Microfinance programs will need to charge interest rates that are too high for borrowers to afford if they wish to achieve complete financial independence and preserve long-term profits over losses. This would go against the stated goal of "helping the needy." In actuality, the government offers subsidies and takes into account the current state of microcredit. But in the past, affluent regulators removed a lot of subsidies instead of using them to support underprivileged families and communities [15]. This has certainly increased the cost of microfinance institutions. The second point is the cost of time. As mentioned earlier, frequent maintenance of contact and meetings at very short intervals have a high time cost. The borrower could have gone on to discover more potential clients. And the lender could have continued to work on his or her business. Giving up this to maintain such a strict meeting system over time would limit the size of the loan and raise the time cost.

4. Suggestion

4.1. Unique pattern for sustainability

Grameen Bank has relatively addressed the issue of sustainability. The bank's regular meeting training and regular repayment policy succeed in getting these poor people to understand how to save, getting them to make commitments at a central monthly meeting, and getting them to sustainably improve their situation. Long-term input and output help the poor become familiar with the model and convert it into a habit. At the same time, the Grameen model combines the differences between East and West, while being a market-based approach to solving social problems and winning the support of local governments and markets. This reflects the sustainability of Grameen Bank compared to some other small lenders.

According to the Grameen Bank's operating model, microfinance programs should provide a proper platform for work for those who come in for loans, especially the poor who need help. The most powerful way to break the cycle of poverty is to match them with the right resources so that they can start their own businesses after receiving a loan, rather than relying on small lending enterprises like Grameen for long periods of time. Doing so helps balance the economic development of the community and contributes to the success of poverty alleviation. Along with the program, many microfinance programs have leadership training programs. Identifying and developing good community leaders helps to strengthen the community and feeds the community and society at large with them. By developing a cohort of leaders, the leaders in turn develop a cohort of talent, which acts as a cycle to ensure the sustainability of the entire process.

As mentioned earlier, microfinance institutions do have high costs, however, Grameen Bank has cleverly leveraged the unique nature of social enterprises to make a profit. The high costs of Grameen Bank, like most social enterprises, come not only from the failure of clients to repay on time, but also from the commitment to meet the interests of all other stakeholders such as donors, managers, investors, and society at large. But if microfinance can be managed as effectively as Grameen Bank, then private capital becomes available and can flourish without relying on private donors. The Grameen Bank's five-member team, regular meetings, timely updates and interviews with members, and other strategies epitomize effective management. The strong ties with managers and members have helped to increase social welfare significantly and social costs have decreased as a result. Therefore, this study argues that MFIs meeting the minimum needs of all stakeholders is the key to ensuring that MFIs have a long-term viable future, that is, sustainability [6]. This study has always believed that microfinance needs to set up a flexible system to adapt to various changes in the business environment. And setting up loans with different interest rates and different manpower allocations according to the policies of different regions is one option to consider. From the point of view of time cost, Grameen Bank also made weekly repayments but did not have very serious problems. Perhaps in the future, this is a point that could be adjusted. But for now, the issue of transaction costs is more imminent.

4.2. Reducing risk through increasing participation

Grameen Bank also helps its participants to move from being passive recipients of credit to being an active agents of economic and social processes, and more generally, it helps women's empowerment. The small lenders in today's market, mentioned earlier in this paper, do not pay special attention to this point of gender. Central meetings can satisfy women's sense of talking. It not only helps women find a sense of belonging in a group, where people It not only helps women find a sense of belonging in a group, where people are all equal and respected, but also provides a relaxed environment where there is mutual understanding and trust and this is very important in a large Basher's research shows that rural women learn how to cope and use existing information and communication systems efficiently by attending group meetings, visiting branches, and communicating financially with field workers [3]. This has greatly increased their self-confidence. Microfinance institutions should not only aim to help the poor out of poverty, but also provide them with a platform to connect with society and help them develop a sense of independence, and self-reliance. This is the ultimate goal of sustainability.

This paper suggests that Grameen Bank's application of the concept of "peer pressure" may be a good solution to the high-risk nature of microfinance institutions mentioned above. When a group of five is surrounded by partners who make payments on time, this creates pressure for the remaining members to make payments on time. This extrinsic peer drive combined with the intrinsic drive of the self leads to high repayment rates at Grameen Bank. The paper also argues that a response to high riskiness could also be a solution to the unsustainability of small lending institutions today. Repayment together is not only stressful, but on the other hand, it can help strengthen friendships among women, which in turn can bring women and society closer together because of the Grameen Bank model. Five women form a support group, and while communication becomes more frequent, they share the high risk of repayment. This is a common choice in society. Microfinance institutions can learn not only to make the borrower and the community more connected, gradually forming a mutual help whole and thus becoming inseparable. This way, uncontrollable factors will not affect the final repayment of the loan. The growing connection between the borrower and the community shows the replicability of the Grameen model and the future of small-scale lending institutions.

4.3. Financial and social inclusion

Finally, Small lenders like Grameen Bank are socially inclusive. At the most basic level, Grameen Bank cares more about the disadvantaged at the macro level. This paper argues that Grameen Bank is like using the "angel investment" strategy in finance, caring for the poor who cannot afford collateral as much as possible without considering profitability. Although many banks in society are reluctant to lend to the poor because of immediate profits, through the Grameen Bank, the poor have the opportunity to get their first loan and take the first step in their business. If we look at society, the social responsibility of small lenders will be felt even more. For example, it is written on the website of Grameen Bank that by doing small loans in Bangladesh, people learned that many villages are not connected to electricity and people have to light kerosene lamps. So Grameen set up a new company clled Grameen Energy. Various social enterprises followed Grameen Bank and started working to bring electricity to the villages. Such cooperation and linkage improved social life and helped people. Such a sense of social responsibility is in contrast to some of today's microfinance institutions that only think of profit as their goal. Grameen bank’s social significance is well worth it and should be encouraged to be replicated by microfinance institutions.

5. Conclusion

With its open strategy, Grameen Bank has solved the current problems of cost and unsustainability of microfinance institutions, fully absorbed the advantages of social enterprises, brought into play its social responsibility and a high degree of inclusiveness, and promoted the empowerment of women in villages and the exploration of self-awareness of the poor. Such help is different from direct financial support, but through a more effective way to make the borrower more independent, and thus truly achieve the goal of combining both profit and charity.

In this regard, the future findings of microfinance require more future research. This study concludes that, despite the hardships, loans from microfinance institutions have changed the lives of some of the poor to some extent. Microfinance has earned a place of its own, bringing meaning to society and becoming one of the effective tools in the fight against poverty. Replication of the Grameen Finance model is possible with the necessary modifications and adaptations to different regional situations. In conclusion, the microfinance bank shows itself to society as a bank that is oriented to the people and not waiting for them to go to the bank.

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