Microfinance Methods, Models and Instruments: An analytical Study

Dr. Syed Abrar Hussain Shah
Assistant Professor, COMSATS University Islamabad,Vehari Campus, Punjab, Pakistan:
abrarhussain@cuivehari.edu.pk

Prof. Dr Altaf Hussain Langrial
Professor & Director, Institute of Islamic Studies,Bahauddin Zakariya University, Multan, Punjab,Pakistan.
altaf.langrial@bzu.edu.pk

Dr. Hafiz Muhammad Hassan Mahmood
Lecturer, University of Education Lahore, Vehari Campus, Punjab, Pakistan:
irhasan.mahmood@gmail.com

ABSTRACT:

In this study we attempted to review the models, methods and Instruments of Microfinance,“Village Bank Model, Grameen Bank Model, Credit Union(CU), Self-Help Groups(SHGs)” as a model of Micro Financing. These models are contributing in the development of the micro entrepreneurs in rural Pakistan. This paper will be an input in existing literature on the considered topic as there is a large number of Small Manufacturing Entrepreneurs who are hesitant towards the availability of short-term loans as they avoid financial institutions due to inaccessibility of adequate creditworthiness and collateral. Also, the Small & Medium Sized Enterprises (SMEs) avoid interest-based banking.Microfinance instruments, including micro-loans, savings, insurance, and micro-leasing, provide comprehensive financial solutions that enable clients to manage risks, build assets, and invest in business activities. By examining these instruments, this study highlights how each is tailored to meet specific needs, from smoothing consumption and financing enterprises to providing insurance against life’s uncertainties.Ultimately, this analytical study

underscores the critical role of microfinance in fostering economic resilience and empowering underserved populations, while acknowledging the need for continued innovation and regulation to sustain its positive impact on poverty reduction and financial inclusion.

Keywords: *Microfinance, Objective of Microfinance, Models, Instruments, Methods, Actors in Microfinance*

INTRODUCTION

Microfinance can be broadly defined as: "The provision of small-scale financial services such as savings, credit and other basic financial services to poor and low-income people".[1]

According to United Nation (UN) the term "Microfinance" now, refers to a wide range of organizations dedicated to providing these services and includes non-governmental organizations, credit unions, cooperatives, private commercial banks, non-bank financial institutions and parts of State-owned banks."[2]

How does Microfinance Work?

Microfinance gives the offerings one might anticipate from any monetary organization, consisting of loans, deposits and cash transfers; however, it lends small quantities to customers that traditional financial establishments could not deem creditworthy. As noted, the most common microfinance product is microcredit loans; 'microloans' that are usually much less than $100 and every so often as small as $50. (these figures can be pretty enormous in developing us of a contexts, but in the European context we might assume larger sums to be involved –

[1] Kim, J.C., Watts, C. H., Hargreaves, J. R., Ndhlovu, L. X., Phetla, G., Morison, L. A., et al. (2007). Understanding the impact of a microfinance-based intervention of women's empowerment and the reduction of intimate partner violence in South Africa. American Journal of Public Health, pp.7

[2] ibid

the European figure mentioned above changed into several hundred instances larger, extra than the value of a brand new automobile even though nevertheless beneath the everyday rate of housing.)[3]

Commonly, to accumulate credit score from an MFI, loans are secured towards the 'honour' of a peer group of clients (i.e. social collateral), as opposed to the usage of non-public collateral. If one consumer fails to make payments, others in the lending circle could be denied destiny credit score. Hence, the peer institution takes on joint legal responsibility, and acts as the control institution to ensure mortgage repayment. Peer pressure encourages debtors to be selective about their institution participants and to repay loans completely and on time. High compensation charges are accordingly commonplace here. There is a large social mental literature on the so-referred to as "unstable shift" (by using which organizations of a few kinds take extra risky selections than would be expected if we virtually averaged the options of man or woman members).[4]

The cycles of microfinance loans are generally shorter than conventional business loans: 6-three hundred and sixty-five days of payments, plus interest due weekly. Such cycles and bills assist the borrowers live modern-day, preventing them from being crushed by large payments. But such cycles imply that jogging microfinance schemes may be very costly. This is the purpose given for MFIs to charge interest quotes which might be tremendously excessive.

The main resources of finance for MFIs are generally charities, governments and worldwide corporations. Donor and subsidy capital aren't always limitless, and the microfinance enterprise may also want to end up extra self-sufficient in financing if it's far to grow enough to

[3]Baron, J. (1993) *The Small Business Technology Transfer (STRR) program: Converting Research into Economic Strength*. Economic Development Review, 11(4), 63-70
[4]Rhyne, E. (1998), *The Yin and Yand of Microfinance*: Reach the poor and sustainability. Micro Banking Bulletin, No. 2.

serve its potential market. These days, dependent financings for microfinance institutions that provide returns to buyers at market rates which are commensurate with chance were developed. Such transactions may be paving the way for microfinance institutions with the intention to get entry to public financing markets which will meet call for.[5]

Who are the Actors in Microfinance?

Helms identify four fashionable categories of microfinance companies ([6]). He argues that a seasoned-energetic strategy of engagement is needed with all of them, so one can assist them reap the goals of the microfinance movement:

I. Informal Financial Provider Carriers

These include moneylenders, pawnbrokers, savings collectors, money-guards, ROSCAs7, and input supply shops. These continue their services because they know each other well and live in the same community; they understand each other's financial circumstances and can offer very flexible, convenient and fast services. These services can also be costly and the choice of financial products limited and very short-term. Informal services that involve savings are also risky; many people lose their money.

II. Member-Owned Organisations

These include self-help groups, Village Savings and Loan Associations (VSLAs), Credit Unions, and a variety of other members owned and governed informal or formal financial institutions. Informal groups, like

---

[5]Naheed, R. (2000), *Social Impact and Constraints of Micro Credit on Poverty Elevation*, A Qualitative Study of Micro Credit Programme Orangi Pilot Project Karachi.
[6] Helms, B. (2006) Access for All: *Building Inclusive Financial Systems*, Washington: CGAP/World Bank. pp35-57.
[7]Rotating Credit and Savings Associations

their more traditional cousins, are generally small and local, which means they have access to good knowledge about each other's financial circumstances and can offer convenience and flexibility. Since they are managed by poor people, their costs of operation are low. Often, they do not need regulation and supervision, unless they grow in scale and formalize themselves by coming together to form II or III tier federations. If not prepared well, they can be 'captured' by a few influential leaders, and run the risk of members losing their savings. Experience suggests though that these informal but highly disciplined groups are very sustainable, and continue to exist even after 20–25 years. Formalization, as a Cooperative of Credit Union, can help create links with the banking system for more sophisticated financial products and additional capital for loans; but requires strong leadership and systems. These models are highly popular in many rural regions of countries across Asia, Africa, and Latin America; and a platform for creating deeper financial inclusion. ([8]).

III. NGOs (Non-Governmental Organizations)

By way of the cease of 2005, there have been 3,133 microcredit NGOs lending to about 113 million clients7. these NGOs have spread across the growing international in the beyond 3 many years and verified innovative in developing banking techniques like unity lending, village banking and mobile banking, which are claimed to have conquer limitations to serving poor populations.

IV. Formal Monetary Establishments

Business banks, state banks, agricultural improvement banks, savings banks, rural banks and nonbank economic institutions. They're regulated and supervised, offer a wider range of economic services, and

[8]Monetary provider associations' and CVECAs, a *self-reliant village savings and credit bank - from the French Caisse Villageoised' Epargne* et de Crédit Autogérée

manage a branch community which could make bigger nationally and across the world.

Common microfinance clients are low-profits individuals, in particular inside the growing global, who do not have get admission to formal economic establishments. Microfinance is regularly used to help or start small scale entrepreneurial or self-employed ventures, regularly household-primarily based.

With appropriate regulation and coverage, MFIs can help in fixing the principle problem of microfinance from the monetary angle of creditors – that is, making sure that customers will repay loans and interest. (Of route, there may be a wider view, which includes the ones concerning the application of the money to the stated social, economic, and/or progressive ends.). as an instance, regulatory and coverage frameworks may be set up to hyperlink self-help agencies to business banks, to network member-owned corporations together to reap economies of scale and scope, and to help efforts with the aid of industrial banks to ‘down-scale’ by using integrating mobile banking and e-price technology into their great department networks.

What is the main objective of Microfinance?

Overall, one could say that the main idea behind microfinance is poverty alleviation. The main activity is to provide financial services to the poor who have little or no access to commercial bank services. Mr. Muhammed Yunus, founder of the Grameen Bank in Bangladesh and recipient of a Nobel Prize in 2006 are often referred to as the founding father of microfinance. As an economist at the University of Chittagong in Bangladesh, he developed the idea of providing loans to the part of the population that is too poor for the traditional banking system. His belief is that through providing banking services to the poor, microfinance would be able to lift millions out of poverty. Empowerment of the lowest class in society and the involvement of women are key to this theorem. His ideas were refreshing and seemed to propose a sustainable answer to the pressing problem that is poverty. They were received with a lot enthusiasm worldwide.

Microfinance Methods

I. Scientific Method

Scientific method seeks to ensure that effects can be attributed to causes through experimentation.

A particular stimulus to a particular object in a rigorously controlled environment is judged to be the cause of the observed effect. The experimental approach is virtually infeasible in the social sciences, because of the nature of the subject matter, and so the approach has been adapted into Quasi-experiments ([9]). Quasi-experiments seek to compare the outcomes of an intervention with a simulation of what the outcomes would have been, had there been no intervention. One method for this is multiple regression, but this has rarely been used in microfinance IA because of its enormous demands for data on other possible causal factors and its assumptions ([10]). A second approach is the control group method which has been widely used. This requires a before and after comparison of a population that received a specific treatment (i.e. a microfinance programme) and an identical population (or as near as possible) that did not receive the treatment. While this idea is elegantly simple a number of 'elephant-traps' may befall its user. In particular problems of sample selection bias, misspecification of underlying causal relationships and respondent motivation (see later) must be overcome.[11]

Selection bias may occur because of

---

[9] Adams, D., & von Pischke, J. D. (1992). *Microenterprise credit programs*: Deja vu. World Development, 20, 1463±1470

[10] Barnes, C. (1996). *Assets and the impact of microenterprise finance programs*. Washington, DC: Management Systems International.

[11] Buckley, G. (1997). *Microfinance in Africa*: Is it either the problem or the solution? World Development, 25 (7), 1081-1094.

i. Difficulties in finding a location at which the control group's economic, physical and social environment matches that of the treatment group
ii. The treatment group systematically possessing an 'invisible' attribute which the control group lacks (most commonly identified as entrepreneurial drive and ability)
iii. Receiving any form of intervention may result in a short-term positive response from the treatment group (the Hawthorne effect)
iv. The control group becoming contaminated by contact with the treatment group (though this could be a long-term programme goal!), and
v. the fungibility of the treatment (e.g. when a loan is transferred from a borrower to someone else or when the loan is not used in the planned way)

Problems (i) and (iv) can be tackled by more careful selection of the control group. This applies particularly to controlling for access to infrastructure (which has a key influence on input and output prices as well as other variables) and ensuring that the control group is located far away from the treatment group. Problems (ii) and (iii) are more intractable, but in many cases, they can be tackled by using programme-accepted 'clients-to-be', who have not yet received microfinance services, as the control group ([12]). It must be noted, however, that this

[12] Goetz, A. M., & Sen Gupta, R. (1996). *Who takes the credit*? gender, power and control over loan use in rural credit programs in Bangladesh. World Development, 24 (1), 45-64.

approach will not be valid when the take up of microfinance services is based on diffusion through a heterogeneous population.

This leaves the problem of loan fungibility[13]. This can be seen as an intractable problem as '...no study has successfully controlled for the fungibility of resources between the household and the assisted enterprise'. Using case study materials to cross-check actual loan use against intended loan use and thus estimating 'leakage' is one possible approach to controlling for fungibility However, for all studies except those that focus exclusively on 'the enterprise', then a concern about fungibility may be irrelevant. For studies looking at the household, the community or the household economic portfolio (b) fungibility is not a problem for the assessor; rather it is a vital strategy for the client. The best investment returns maybe on 'consumption' (in terms of developing or maintaining human capital through school fees and doctors' bills, or buying food at a time of crisis when the credit terms on 'in-kind' borrowing from traders may be exceptionally high). From this perspective the task of the assessor is not to pretend that microenterprises are 'firms' whose inputs and outputs can be precisely identified and measured but to recognise that the impacts of microfinance must be assessed at a variety of levels. The assessor attempting to control for fungibility (to prove impact) has failed to recognise that fungibility a process to be encouraged (to improve impact)!

The misspecification of underlying causal relationships arises most commonly because of the assumption that causality is a one-way process. This may be a reasonable assumption in the physical sciences (though it does not go unchallenged by contemporary philosophers of science).

[13] In economics, fungibility is the property of a good or a commodity who's individual units are essentially interchangeable.

For human activity it is commonly invalid, as causation may also run from impact back to intervention. Mosley ([14]) illustrates this with the example of a programme whose field staff put pressure on a borrower to repay her loan; this may succeed in the short-term but may induce the borrower to sell assets (machinery, land, trees) which reduce the probability of repayment in the longer-term. Such reverse causation need not necessarily be negative and, from the perspective of more process-oriented analytical frameworks, is essential if programmes are to continually learn from their experience and improve (rather than prove) their impact.

Such problems can be overcome by the adoption of models that conceptualise causation as a two-way process, the use of two-stage least squares technique and regression analysis ([15]). Such an approach is enormously demanding in terms of data requirements, technical expertise and costs. It will only be feasible on very rare occasions ([16]).

For most researchers adopting the scientific method, reverse causality is a problem to be coped with rather than overcome. The main means of dealing with it are

i. tracing dropouts from both the treated and control groups;
ii. only conducting IAs on relatively mature programmes;
iii. interim impact monitoring activities to gather qualitative information about the complexity of causality; and

[14] Mosely, P., & Hulme, D. (1998). *Microenterprise microfinance*: is there a conflict between growth and poverty alleviation. *World Development*, 26 (5), 783-790.
[15]ibid:7
[16]Khandker, S. R. (1998). *Fighting poverty with microcredit*: experience in Bangladesh. Washington, DC: Oxford University Press for the World Bank

iv. Retrospective in-depth interviews with clients ([17]).

II. The Humanities Tradition

The broad sets of approaches that fall under this heading have their roots in the humanities.

Originally geography and rural sociology were the ‘lead’ subjects, but over the last 20 years anthropology has become most important. Its main features are an inductive approach, a focus on key informant, recording by notes or image, and the data analyst is usually directly (and heavily) involved in data collection. This tradition does not try to ‘prove’ impact within statistically definable limits of probability. Rather, it seeks to provide an interpretation of the processes involved in intervention and of the impacts that have a high level of plausibility. It recognises that there are usually different, and often conflicting, accounts of what has happened and what has been achieved by a programme. The validity of specific IAs adopting this approach has to be judged by the reader on the basis of

i. the logical consistency of the arguments and materials presented;
ii. the strength and quality of the evidence provided;
iii. the degree of triangulation used to cross-check evidence;
iv. the quality of the methodology; and
v. The reputation of the researcher(s).

Whether ‘standards’ could be specified for such work - to help its users appreciate how rigorously designed they are - is an important issue that merits attention. Commonly the bulk of data generated by such an approach is ‘qualitative’, although at later stages of analysis such work often quantifies some data.

[17]ibid:6

Although such work has been common in development studies for decades, it is only during the 1980s that its relevance for IA has been recognised. This recognition has arisen partly because of the potential contribution of qualitative approaches (especially in understanding changes in social relations, the nature of programme staff-beneficiary relations and fungibility) and partly because of the widespread recognition that much IA survey work was based on inaccurate information collected by questionnaire from biased samples ([18]). Low budget and low rigour IAs claiming to adopt the scientific method were at best pseudo-science, but more often simply bad science, despite the sophisticated analytical tools that were applied to poor datasets.

However, IAs with their roots in the humanities has considerable difficulties with regard to the attribution of cause and effect. Such studies cannot usually demonstrate the causal link as they are not able to generate a 'without programme' control group (although at times some researchers neglect to mention this to the reader and simply assume causality). Instead, causality is inferred from the information about the causal chain collected from intended beneficiaries and key informants, and by comparisons with data from secondary sources about changes in out-of-programme areas. Problems also arise because not infrequently the labels 'rapid appraisal', 'mini-survey' and 'case study' are applied to work which has been done in an ad hoc manner and does not achieve a minimum professional standard in terms of informant selection and the rigor of data collection and analysis.

Examples of this include:

i) basing data collection only in programme areas that are performing well, and surveying best clients, and ii) inferring that the data collected in one area applies to all clients without explaining this assumption. While such

[18] Chambers, R. (1997). *Whose reality counts*? Putting the first last. London: IT Publications.

studies cannot provide the degree of confidence in their conclusions that a fully resourced scientific method approach can yield, my personal judgement is that in many cases their conclusions are more valid than survey-based work that masquerades as science but has not collected data with scientific rigor. Whatever, it is becoming increasingly common to combine 'scientific' and 'humanities' approaches so as to check the validity of information and provide added confidence in the findings ([19]). In the future dealing with attribution by multi-method approaches seems the way forward.

III. Participatory Learning and Action (PLA)

In the last five years participatory approaches to development planning and management have moved from being a fringe activity to centre stage. While many donor agencies, have simply added a bit of PLA to their existing procedures, it can be argued that this is inappropriate as conceptually participatory approaches challenge the validity and utility of the scientific method as applied to developmental problems ([20]). According to this line of argument the scientific method fails as: it ignores the complexity, diversity and contingency of winning a livelihood; it reduces causality to simple unidirectional chains, rather than complex webs; it measures the irrelevant or pretends to measure the immeasurable; and, it empowers professionals, policymakers and elites, thus reinforcing the status quo and directly retarding the achievement of development goals. At heart, PLA theorists do not believe that ultimately there is one objective reality that must be understood. Rather, there are multiple realities and before any analysis or action is taken the individuals concerned must ask themselves, 'whose reality counts?' ([21]). Their answer is that the perceived reality of

[19]Hulme and Mosley, 1996; *Schuler and Hashemi*, 1994; Hashemi et al, 1995

[20] Chambers, R. (1993). *Challenging the professions: frontiers for rural development*, London: IT Publications.

[21]ibid

the poor must take pride of place as, if development is about 'empowering the poor' or 'empowering women' (as virtually all development agencies now say), then the first step towards empowerment is ensuring that 'the poor' or 'women' take the lead in problem identification and analysis and knowledge creation.

For impact assessment the purist PLA line is damning - '...conventional baseline surveys are virtually useless for impact assessments... The question now is how widely local people can be enabled to identify their own indicators, establish their own participatory baselines, monitor change, and evaluates causality...' ([22]). By this means two objectives may be achieved (i) better impact assessments, and (ii) intended beneficiaries will be '...empower[ed] through the research process itself' ([23]). In practice, the art of participatory impact assessment (PIA) is in its infancy and a pragmatic rather than a purist approach has been common. Agencies such as Proshika in Bangladesh have begun to use PLA methods extensively for their assessment and planning exercises.

The reliability of participatory methods varies enormously, as with 'scientific' surveys, depending

'...largely on the motivation and skills of facilitators and those investigated and the ways in which informants' perceptions of the consequences of research are addressed' ([24]).

Nevertheless, it is argued that '...a number of rigorous comparative studies have shown that, when well-conducted, participatory methods can be more reliable than conventional surveys' ([25]).

---

[22]ibid:123
[23]Mayeux, L. (1997). *Impact assessment and women on empowerment in microfinance programmes: issues for a participatory action and learning approach mimeo*. Washington, DC: Consultative Group to Assist the Poorest (CGAP). pp.2
[24]Ibid: p.12-13
[25]ibid and Chambers, 1997:141-146

To date the literature on PLA and PIA has only partially addressed the issue of attribution. From a scientific perspective PIA has grave problems because of the subjectivity of its conceptualisations of impact; the subjectivity of the data used to assess impact; the variables and measures used vary from case to case and do not permit comparison; its pluralist approach may lead to a number of mutually conflicting accounts being generated about causality; and, the assumption that because lots of people are taking part in an exercise means that all are able to 'voice' their concerns (so that opinions are representative) is naive about the nature of local power relations. From the perspective of a 'new professional' then such a set of accounts is unproblematic, as it reflects the complexity and contingency of causality in the real world. In addition, it can be argued that PIA contributes to programme goals (perhaps particularly in terms of empowering women ([26]) and the poor) by not facilitating the continued dominance of target groups by powerful outsiders.

Why dwell on issues of attribution when efforts to overcome such problems require the adoption of IA methods that actively undermine the attainment of programme goals?

Why do you as a Peace Corps Volunteer (PCV) need to know about financial services for the poor? Because you decided to spend two years of your life as a development worker helping people help themselves, including the "poorest of the poor." The experience of development agencies shows that when the poor have cash to purchase productive assets, they can increase their incomes and break the poverty cycle. By the time you complete this module you should have the knowledge, skills, and attitudes to:

[26]Mayeux, L. (1997). *Impact assessment and women empowerment in microfinance programmes:* issues for a participatory action and learning approach mimeo. Washington, DC: Consultative Group to Assist the Poorest (CGAP). pp.2

- Explain why the lives of the poor would improve if they had access to non-exploitative credit and savings services.
- Describe three non-formal traditional methods used by the poor to acquire financial services and why none of these adequately satisfy the families' needs for financial services.
- Identify the lessons learned from non-formal traditional financing methods, which led to the development of today's microfinance institutions (MFIs). State how these lessons were incorporated into MFIs.
- Describe for someone unfamiliar with financial institutions the different MFIs offering financial services to the poor: commercial banks, Latin American solidarity groups, Grameen Bank, village banks, savings and loan associations, and credit unions.
- Express an opinion as to how Volunteers can best contribute to the development of your host country in the area of microfinance.

Microfinance Models:

Microfinance institutions thus have distinct features that make them specialized components of the formal financial system. The basic point identified for departure of microfinance from mainstream financial systems is its alternative approach to collateral that comes from the concept of joint liability. In this concept individuals together form small groups and apply for financing. Members of these small groups are trained in the basic elements of the financing and the requirements they need to comply with in order to continue to have access to funding. Funds are disbursed to individuals within the group after they are approved by other members in the group. Repayment of the financing is a shared responsibility of all of the group members. In other words, they share the risk. If one member is a defaulter, the entire group members bear the risk. In most cases, microfinance programmes are structured to give credit in small amounts and require repayment at weekly intervals and within a short time period– usually a month or a few months. The beneficiary looks forward to repetitive financing in a graduated manner and this also helps them mitigate risk of default.

Grameen Bank Model: This model requires careful targeting of the poor through means of tests comprising mostly of women group. The model works on intensive fieldwork by staff to motivate and supervise the borrower groups. Groups normally consist of five members, who guarantee each other's loans. A number of variants of the model exist; but the key feature of the model is group-based and graduated financing that substitute's collateral as a tool to mitigate default and delinquency risk.

Village Bank Model: A second model that has been widely replicated mainly in Latin America and Africa, but with substantially less total outreach than the many Grameen Bank replications is the Village Bank model. This model involves an implementing agency that establishes individual village banks with about thirty to fifty members and provides "external" capital for onward financing to individual members. Individual loans are repaid at weekly intervals over four months, at which time the village bank returns the principal with interest/ profits to the implementing agency. A bank repaying in full is eligible for subsequent loans, with loan sizes linked to the performance of village bank members in accumulating savings. Peer pressure operates to maintain full repayment, thus assuring further injections of capital, and also encourages savings. Savings accumulated in a village bank is also be used for financing. As a village bank accumulates sufficient capital internally, it graduates to become an autonomous and self-sustaining institution (typically over a three-year time period).

Credit Union (CU): The third type of MF model is a Credit Union (CU). A CU is based on the concept of mutuality. It is in the nature of non-profit financial cooperative owned and controlled by its members. CUs, mobilize savings, provide loans for productive and provident purposes and have memberships which are generally based on some common bond. CUs generally relate to an apex body that promotes primary credit unions and provides training while monitoring their financial performance. CUs are quite popular in Asia, mostly in Sri Lanka.

Self-Help Groups (SHGs): A fourth model originated in India is based on Self-Help Groups (SHGs). Each SHG is formed with about ten-fifteen members who are relatively homogeneous in terms of income. An SHG essentially pools together its members' savings and uses it for lending. SHGs also seek external funding to supplement internal resources. The terms and conditions of loans differ among SHGs, depending on the democratic decisions of members. Typical SHGs are promoted and supported by NGOs, but the objective for them is for to become self-sustaining institutions. Some NGOs act as financial intermediaries for SHGs, while others act solely as 'social' intermediaries seeking to facilitate linkages of SHGs with either licensed financial institutions or other funding agencies. The SHG model is a good platform for combining microfinance with other developmental activities.

Conventional microfinance over the years has witnessed a paradigm shift – from the traditional donor-based approach to a for-profits approach in building inclusive financial systems. The basic assumption is that the demand for these services is simply too high to be fulfilled by government and donor funds on a sustained basis. The excess demand will, need to be met by commercial capital available at a "fair" market price. The focus therefore, has sharply shifted from charity to profits. Of all the models discussed above, the Grameen model and the village bank model are the more structured than the rest. Indeed, the Grameen model has now become the text-book model of microfinance.

a. Instruments of Microfinance

Most important forms of MFI[27] can be understood from the institutional innovation perspective. With microfinance, institutional innovation does no longer continually imply growing a brand-new institutional kind, but may be the edition of a present institutional kind to the restrictions and potentials of a sure purchaser group, in particular nearby surroundings.[28]

Essential kinds of MFI are:

i. The Cooperative Version

Stimulated with the aid of the fulfilment in Europe and North America on the stop of the nineteenth century, this becomes the primary model to introduce microfinance in growing international locations. The cooperative individuals are the owners, contributing to the fairness capital through stocks. Loans are only granted to the members. Cooperative MFIs are solely consciousness at the provision of economic services.

ii. The Grameen Solidarity Group Model

This model is based on group peer pressure whereby loans are made to individuals in groups of four to seven (Berenbach and Guzman, 1994). Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members. Payments are usually made weekly (Ledgerwood, 1999). According to

[27] Microfinance Institutions

[28]Kyereboah-Coleman, A. (2007) *The impact of capital structure on the performance of microfinance institutions.* The Journal of Risk Finance Incorporating Balance Sheet, 8(1), 56-71.

Berenbach and Guzman (1994), solidarity groups have proved effective in deterring defaults as evidenced by loan repayment rates attained by organisations such as the Grameen Bank, who use this type of microfinance model7. They also highlight the fact that this model has contributed to broader social benefits because of the mutual trust arrangement at the heart of the group guarantee system. The group itself often becomes the building block to a broader social network (1994, p.121).

iii. Solidarity Credit Organizations

Here, 3 to ten clients be part of a group to get hold of get entry to monetary offerings (usually credit), previous to them saving earlier than receiving a mortgage. Further, non-financial offerings are offered to institution individuals, consisting of education or get entry to marketplace statistics. Group members collectively assure loan repayment, and get right of entry to next loans is given handiest once previous loans are paid in complete.

iv. Rotating Savings and Credit Associations

These are formed when a group of people come together to make regular cyclical contributions to a common fund, which is then given as a lump sum to one member of the group in each cycle (Grameen Bank, 2000a). According to Harper (2002), this model is a very common form of savings and credit. He states that the members of the group are usually neighbours and friends, and the group provides an opportunity for social interaction and are very popular with women. They are also called merry-go rounds or Self-Help Groups (Fisher and Sriram, 2002).

v. Village Banks

The village financial institution is efficaciously a mixture between the cooperative and solidarity group fashions, searching for to capitalise at the benefits of every. The village financial institution typically has fewer participants than a cooperative, and is less formalised and complex in structure. Some worldwide NGOs sell the status quo of village banks. Their primary form of credit assures is predicated on peer stress amongst contributors, as is the case in team spirit credit groups.

Village banks are community-managed credit and savings associations established by NGOs to provide access to financial services, build community self-help groups, and help members accumulate savings (Holt, 1994). They have been in existence since the mid-1980s. They usually have 25 to 50 members who are low-income individuals seeking to improve their lives through self-employment activities. These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect payments and services (Grameen Bank, 2000a). The loans are backed by moral collateral; the promise that the group stands behind each loan (Global Development Research Centre, 2005).

The sponsoring MFI lends loan capital to the village bank, who in turn lend to the members. All members sign a loan agreement with the village bank to offer a collective guarantee. Members are usually requested to save twenty percent of the loan amount per cycle (Ledgerwood, 1999). Members' savings are tied to loan amounts and are used to finance new loans or collective income generating activities and so they stay within the village bank. No interest is paid on savings but members receive a share of profits from the village bank's re-lending activities. Many village banks target women predominantly, as according to Holt (1994, p.158) "the model anticipates that female participation in village banks will enhance social status and intra household bargaining power".

vi. The Linkage Version

This version builds on existing casual self-help organizations, which includes rotating credit score and financial savings associations ([29]). It seeks to combine the strengths of current casual systems (patron proximity, flexibility, social capital and attaining poorer clients) with the strengths of the formal system (e.g. threat pooling, term transformation, provision of lengthy-time period investment loans and monetary intermediation throughout regions and sectors).

vii. Micro Banks with Individual Economic Contracts

Other MFIs are member-based (i.e. individuals contribute within the management, possession and manipulate of the MFI). Micro banks (e.g. BancoSol in Bolivia), depend on person contracts among the organization and its patron. Despite the fact that this sort of MFI is closest to the conventional banks, the mortgage collateral approaches are generally non-traditional.[30]

viii. Capital Shap

Maximum MFIs appoint high leverage, and finance their operations with long-term (in preference to short-term) debt. Enormously leveraged microfinance institutions carry out higher with the aid of accomplishing out too much broader customers, enjoying economies of scale, and accordingly being better

[29] Sika, J.M. &B. Strasser (2000) Tontines in Kamerun: *Verknüp fung traditioneller und semi-formeller Finanzierungssysteme.* E+Z Entwicklung und Zusamenarbeit, 41(11), 316-318

[30]Ledgerwood, J. (2000) Microfinance Handbook: *An Institutional and Financial Perspective,* Washington DC: The World Bank.

capable of cope with moral danger and adverse choice, enhancing their potential to cope with threat ([31]).

Various factors, other than level within the existence cycle, seem to be related to the performance of MFIs. Recent studies via Bogan ([32]), for example, show that the dimensions of belongings and capital structure of MFIs are related to overall performance. In phrases of sustainability and outreach, asset length is vital: a measure of presents received by way of MFIs (from donors inclusive of charities, governments and worldwide companies) as a percentage of belongings is extensively and negatively associated with sustainability and is undoubtedly associated with MFI fee according to borrower. Bogan also finds proof to aid the announcement that the usage of offers drives down MFI's operational self-sufficiency. She shows that long term use of presents can be associated with inefficient operations because of lack of the aggressive pressures that could be related to attracting marketplace investment. Significantly, the outcomes do no longer imply that offers are related to more or extra highly-priced outreach. Consequently, offers should avoid the development of MFIs into aggressive, efficient, sustainable operations ([33]).

In short, in this chapter, it has been endeavoured to discuss all aspects of microfinance which are necessary to understand, the nature, functions and possible results of Microfinance in Pakistani context.

---

[31]Kyereboah-Coleman, A. (2007) *The impact of capital structure on the performance of microfinance institutions*. The Journal of Risk Finance Incorporating Balance Sheet, 8(1), 56-71.
[32]Bogan, V. (2008) *Microfinance Institutions*: Does Capital Structure Matter? Available at SSRN: http://ssrn.com/abstract=1144762.
[33]Bogan, V. (2008) *Microfinance Institutions*: Does Capital Structure Matter? Available at SSRN: http://ssrn.com/abstract=1144762.

Conclusion

Microfinance has emerged as a critical tool for financial inclusion, targeting the underprivileged and underserved populations who lack access to traditional banking services. The various **methods** used in microfinance, such as group lending, individual lending, and community-based models, illustrate the flexibility of microfinance institutions (MFIs) to cater to different client needs and community contexts.

Models like Grameen, Self-Help Groups (SHGs), and Village Savings and Loan Associations (VSLAs) each offer unique approaches to mitigate risks, enhance repayment rates, and build community support. These models have been instrumental in uplifting poor communities by empowering women, increasing income-generating activities, and fostering entrepreneurship.

Instruments within microfinance, including loans, savings accounts, insurance, and micro-leasing, provide a range of financial tools that help clients smooth consumption, invest in business ventures, and cope with unexpected life events. Each instrument is tailored to address specific financial needs, with micro-loans supporting enterprise development, micro-insurance offering security against risks, and micro-savings helping in capital formation and risk mitigation.

While microfinance has proven successful in many areas, challenges persist, such as ensuring sustainability, managing credit risk, and preventing over-indebtedness among borrowers. Additionally, technology is playing an increasingly pivotal role, transforming microfinance delivery through mobile banking, digital platforms, and fintech innovations.

In summary, microfinance has made significant strides in reducing poverty and fostering economic development, yet it requires a careful balance of social and financial goals. Ongoing innovation, improved regulatory frameworks, and a commitment to ethical practices will be essential to ensure that microfinance continues to provide effective and sustainable financial services to those in need.