



DEVELOPMENT STAGES AND BASIC PRINCIPLES OF MICROFINANCE ORGANIZATIONS

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Abstract

Keywords: Microfinance organizations, loan percentage, credit history, loan percentage

This article describes the stages of development of microfinance organizations and their activities, specific aspects of their activities, and the reforms implemented in the development of microfinance organizations. Also, practical recommendations have been developed regarding problems in the development of the market of microfinance services in our country and their elimination.

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INTRODUCTION

Microfinance organizations are not considered credit organizations, that is, full-fledged banking institutions, but their activities have aspects similar to those of banks. If we pay attention to the stages of establishment and development of microfinance organizations, the following can be cited as the main reasons that influenced these processes:

- meeting the need to meet the needs of individuals who do not have the opportunity to apply directly to traditional banks for small microloans;
- offering microfinance services to people living in remote areas of the country;
- providing microloans to individuals who do not have a credit history;
- the process of drawing up documents related to borrowing from commercial banks and the limitation of the number of documents;



-increasing competition in the financial services market and increasing the type of services, improving their quality, and shortening the period of processing documents are considered aspects.

If we focus on the history and processes of development of microfinance organizations, we can see that this process does not have a very deep history. To be more specific, microcredit organizations began to be established in the last four stages of the 20th century. During these times, microfinance organizations first appeared in the practice of countries such as India, Bangladesh, Malaysia, Indonesia, and Brazil, which are considered developing countries.¹

LITERATURE REVIEW

As a result of studies and researches, it has been revealed that in almost all the works done on microfinance organizations, their activities and processes related to implementation, Bangladeshi economist and entrepreneur Muhammad Yunus is recognized as the founder of the microfinance organization. Muhammad Yunus's contribution to the development of microfinance organizations is that he provides small financial funds to the financially disadvantaged population for business development, where one of the main conditions for granting this amount is that the given amount is prohibited from being spent on consumption, and this amount must be used for business development had to be directed.

As a result of the successful development of Muhammad Yunus' program that supported the financially poor segment of the population on the basis of microfinance in Bangladesh, "Grameen Bank" (Grameen Bank of Bangladesh) was established in the future. This bank is the first bank in the world to provide microfinance services, and it is still successfully operating today.²

However, the fact that microcredit organizations were initially opened by Muhammad Yunus is not without some considerations. For example, the creation of these financial institutions is due to the fact that when poor

¹ Shahriar AZM, Schwarz S., Newman A. Profit orientation of microfinance institutions and provision of financial capital to business start-ups. *International Small Business Journal*. 2016;34(4):532–552. DOI: 10.1177/0266242615570401

²Zakhkin A.A. Mikrofinansirovanie na rynki finansovykh uslug: istoriya voprosa i mirovoy opyt. *Bankovskieservice* _ 2013; (4): 91-95.



entrepreneurs turn to the bank to start production, the loan percentage offered by the bank is almost half of the profit. Then he decides to finance this production process from familiar entrepreneurs and his own capital, after receiving a refusal from the local banks to reduce the loan percentage. In the future, this woman entrepreneur will give a loan (loan) to several women entrepreneurs for a short period of time and cause them to develop their activities as well. Female entrepreneurs who have taken a loan will repay the loan amount in full in a short period of time. Thus, the Gramin bank, whose name we mentioned above, was established, and in a short period of time, it began to serve more than 3.5 million customers. However, this is not a reason to say that the microfinance organization was originally opened in Bangladesh. Because financial institutions operating on the basis of the same principles were established in Europe much earlier, in the 16th century. In particular, the Bank of the Poor, which serves the poor in Holland, was founded in 1618. In the 18th century, some charities were established in Ireland, which later specialized in lending. Such credit unions also operated on the basis of the principle of collective repayment in cases where the borrower was unable to repay the loan.

ANALYSIS AND RESULTS

These associations, which were opened in Europe in the 19th century, were later called Loan Funds, which collected interest for loans and attracted funds in deposits. Their number was more than 300 in the 1840s, and more than 20 percent of them were founded and operated by Irish families. These funds later closed due to excessive interest rates.

Historical sources indicate that the first savings banks appeared in Hamburg in 1801 under the influence of the Irish. From 245 to 15,000 agricultural corporations founded on the principle of microcredit organizations in Germany between 1885 and 1914, they worked as agricultural prototypes without changing their operating principles. According to some sources, 50% of bank assets in Germany now belong to microfinance organizations.

Analyzes and studies show that microfinance organizations established in most European countries are founded by women (female entrepreneurs), and in most cases there are views that this business is specific to women ³.

³Anthony Saunders/Marcia Millon . Financial markets and institutions. 7th edition. Published by McGraw-Hill Publishing . 2 Penn Plaza, New York, NY 10121. 2019.



Savings institutions, credit unions, and finance companies that reflect the characteristics of commercial banks and provide financial services began to be established in the United States in the 1800s. Savings institutions, as a financial institution competing with commercial banks, are institutions that provide retail financial services to individuals, in particular, mortgage loans for the purchase of a house, on simple, short and easy terms.

The table below provides information about US savings institutions.

Assets and Liabilities of US Savings Institutions⁴

(January 1, 2016, as a percentage of the total in million US dollars)

No	Billions of Dollars		Per cent
1	Cash and due from (Накд money and fees)	84.75	7.65%
2	US Treasury and federal agency obligations (USA Treasury and a federal agency obligations)	40.77	3.68
3	Federal funds oath repos	1.21	0.11
4	Bonds, corporate stock, and other securities	36.5	3.29
5	Mortgage loans	461.55	41.64
6	MBS (includes CMOs,POs,IOs ,)	232	20.93
7	Commercial loans	64.16	5.79
8	Credit card loans	82.29	7.43
9	Other consumer loans	45.34	4.09
10	Other loans and financing leases	20.61	1.86
11	Less: Allowances for loan losses and unearned income	9.76	0.88
12	Other assets	48.92	4.41
13	Total assets	\$1,108.34	100%
14	Total deposits	\$867.85	78.3%
15	Federal funds oath repos	8.95	0.81
16	Other borrowed money	91.99	8.3
17	Other liabilities	16.52	1.49
18	Total liabilities	985.31	88.9%
19	Net worth	123.03	11.1
20	Total liabilities and net worth	\$1,108.34	100%
21	Number of institutions	820	

Today, these institutions perform a number of operations of commercial banks. It is engaged in providing mortgage loans to the population and

⁴Anthony Saunders/Marcia Millon . Financial markets and institutions. 7th edition. Published by McGraw-Hill Publishing . 2 Penn Plaza, New York, NY 10121. 2019.458 p.



providing other financial services to households. In the United States, credit unions are non-profit depository institutions established by depositors and operating on the basis of mutual agreement. Historically, they have focused on placing funds formed by depositors in consumer loans. Savings institutions and credit unions are commonly referred to collectively as THRIFFS (thrifts). The main function of financial companies is to provide microloans to citizens and entrepreneurs. Financial companies provide these services in the form of consumer credit, production credit and mortgage financing. Funding institutions, in turn, are divided into two groups. The first group includes savings associations and the second group includes savings banks.

In the United States, microfinance organizations have been developing since 1800, and their number was more than 750 in the 1880s. In 1986-1992, due to the bankruptcy of most of them, about 100 remained, meanwhile, they joined with each other and started new activities.

It can be seen from the table that the main share of the assets of the US savings institutions corresponds to the share of mortgages and microloans (these assets are 41.64 and 20.93 percent, respectively).

In the part of liabilities, deposits attracted from customers and depositors (88.90%) made up the main share. It can be concluded that savings deposits in the USA almost completely perform the most important functions of commercial banks, such as attracting deposits and issuing loans, the main difference between them and commercial banks is that the country is not connected to the electronic payment system.

If we pay attention to the processes of establishing microfinance organizations, they are established in different countries under the influence of different goals and factors. However, in scientific and economic works, it is recognized that the organization of these financial institutions mainly fulfills two, namely social and economic functions.

It is manifested in the process of reducing poverty in the performance of social function, mainly in developing countries. Its economic function is to attract financial funds for the purpose of profiting by certain groups in developed countries and provide these funds to small business representatives on a commercial basis. At the same time, microfinance organizations in



developing countries are distinguished by their activities in strengthening the stability of the financial system and creating additional jobs.

Based on the above-mentioned circumstances, we would like to summarize the reasons and factors that motivated the establishment of microfinance organizations in the countries of the world:

- in economically weak countries (Latin America, Africa and Asia), the main goal of microfinance organizations is to eliminate poverty, and the main part of the loans given by them consisted of very small amounts;

- microfinance organizations in developed countries (Western Europe and the USA) are important because the main goal of their founders is not to provide financial support to the financially vulnerable population, but to earn additional profit. The amount of loans given by microfinance organizations in these countries is several times higher than the amount of loans given by microfinance organizations in economically poor countries;

- in the process of economic transition and in developing countries, the main emphasis in the establishment of microfinance organizations is aimed at providing employment to the population and providing financial resources to those who do not have the opportunity to receive loans from commercial banks.

The results of researches and studies show that the main focus in the establishment of microfinance organizations is on lending to private entrepreneurs and low-income people who do not have a credit history and the ability to get loans from commercial banks, while microfinance organizations did not pay much attention to the level of risk associated with returning the given loan.

It should be noted that the level of risk of loans given by microfinance organizations, even if they are small, is high, and in most cases, this risk is covered by high interest rates.

The analysis of the international practice shows that the amount of outstanding debts on microloans issued by microfinance institutions is not very high and the chances of obtaining microloans are generally high.

It became clear that it is very necessary to support the state with various financial instruments (taxes, cheap financial resources, etc.) for the



establishment of microcredit organizations in the countries of the Commonwealth of Independent States (CIS) and their effective operation.

Microfinance organizations are also highly developed in the countries of Central and Western Europe, their development accelerated after the end of the former socialist regime. In particular, the "Fundush Mikro" fund has developed quite widely in Poland, its branches are established in 28 regions of the country, this microcredit organization mainly provides financial services to ⁵small business entities with less than five employees . In Poland, microfinance organizations not only attract funds and provide microloans, but also provide advice on financial literacy to the relevant segment of the population. At the same time, the activities of microfinance organizations in this country are supported and encouraged by the government through various financial and economic mechanisms.

The results of the research show that microfinance organizations were formed and developed in the continents and countries of the world under the influence of specific characteristics and various factors.

CONCLUSIONS

At the end of our article, based on the researches and studies, we will try to express the process of establishment and development of microfinance organizations in the following basic principles.

Microcredits reduce poverty in poor countries, increase profits and create additional jobs in developed and developing countries . In fact, in the majority of the world's population, the demand for financial resources and the opportunity to freely use financial services were not enough, and this very process was a strong impetus for the establishment and development of microfinance organizations. In developed countries, it can be recognized that they are organized for the purpose of efficient use of financial resources, creation of additional jobs and profit.

Saving the country's population from poverty and increasing their solvency. It should be noted that the economic helplessness and weak solvency of the country's population cause a number of problematic situations to arise. In

⁵Ovchijan MP, Malafej Ju . V. The concept of microfinance development in Belarus for 2010–2015 [Concept development microphone nansirovaniya v Respublika Belarus 2010–2015 gody] . _ Minsk , 2009.



particular, there are social problems in the country, such as the development of crime, robbery, vandalism, and the stable growth of the country's economy at the macro-economic level . In addition, the low solvency of the population causes a problem related to the decrease in general demand and scarcity. This, in turn, leads to the balanced development of the country's production and, ultimately, problems with the state of the infrastructure in the regions.

Microfinance organizations are an important financial mechanism for poverty reduction in the country. The important convenience and advantage of microfinance organizations is that they increase the population's ability to obtain financial resources, which in itself provides an opportunity to completely eliminate their financial problems. Individuals who have taken a loan from a microfinance organization in the form of a microloan will first think about repaying it, and secondly, their opportunity to improve their lifestyle and financial responsibility will increase.

To increase and strengthen the stability of the local financial and credit system and to ensure the stability of the national currency . Of course, microfinance organizations serve as an important financial link in increasing the stability of the country's financial and credit system by attracting temporarily unused funds in the economy on appropriate terms and providing them to those who need them. In addition, the placement of the population in production based on the redistribution of temporary funds, firstly, increases the circulation of the national currency and the volume of local production, and secondly, the increase in the confidence of the population in the country's financial and credit system will have a positive effect on the strength of the national currency.

Microfinance organizations do not have the opportunity to solve large and multifaceted issues . In fact, if we take a closer look at the purpose of establishing microfinance organizations and their activities, they do not have the capacity to provide large amounts of loans for all purposes and large-scale production. Therefore, these financial institutions take an active part in solving relevant socio-economic issues at the micro level.

Microfinance organizations offer relatively expensive microloans to clients. The interest rates of microloans provided by microfinance organizations for a short period of time are high compared to the interest rates of large loans provided by commercial banks, and if they do not provide microloans at high



rates, they will not be able to receive the expected profit, and at the same time, in order not to suffer losses even if the microloans and accrued payments are not returned. and their interest rates are relatively high.

Microcredit organizations are not directly supported by the state, but indirectly. Since microfinance organizations are mostly private in terms of ownership, they are not supported by cheap and long-term government financial resources. In cases where the state is interested in supporting and developing their activities, microfinance organizations can relax the requirements for authorized capital and authorization of their activities. It should be noted that in international practice, local (municipal) authorities are interested in the establishment and development of microfinance organizations, and in most cases they support them by allocating buildings, creating optimal infrastructure, and improving the business environment. Because microfinance organizations established in remote areas of the country are a very important financial link in business development, creation of additional jobs, offering local products to the consumer goods market.

Limited establishment of microfinance organizations. In practice, it can be observed that microfinance organizations have not developed in a balanced way in all regions of the country, there are certainly a number of objective and subjective reasons for this. First, there is insufficient infrastructure for establishment, insufficient support from local authorities, and secondly, there is insufficient knowledge, skills, and experience of specialists who form microfinance organizations.

Transparency of activities of microfinance organizations and availability of information. The transparent organization of these financial organizations' activities on the market is of great importance in attracting investors and depositors to them, as well as in the future decisions of the founders of these organizations.

In conclusion, the stages of development and the main principles of the activity of microfinance organizations have their own characteristics, and a number of objective and subjective factors influenced their organization and operation, while these financial institutions are an important financial link of the market economy.



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