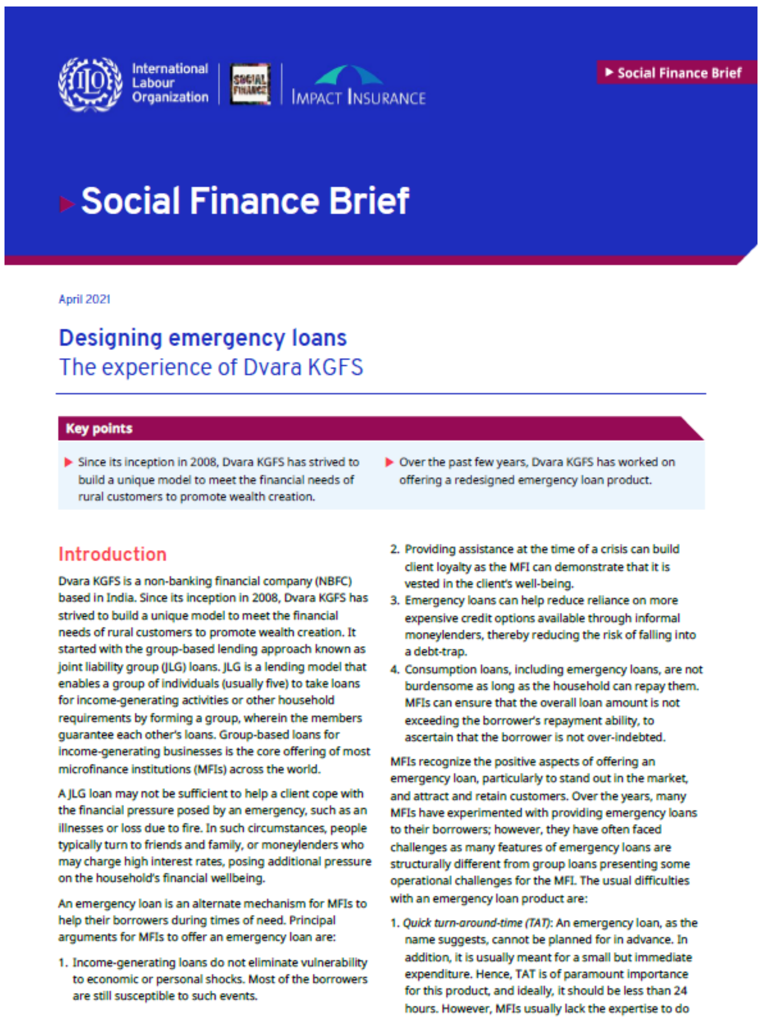

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Social Finance Brief

Social Finance Brief

April 2021

Designing emergency loans
The experience of Dvara KGFS

Key points

- Since its inception in 2008, Dvara KGFS has strived to build a unique model to meet the financial needs of rural customers to promote wealth creation.
- Over the past few years, Dvara KGFS has worked on offering a redesigned emergency loan product.

Introduction

Dvara KGFS is a non-banking financial company (NBFC) based in India. Since its inception in 2008, Dvara KGFS has strived to build a unique model to meet the financial needs of rural customers to promote wealth creation. It started with the group-based lending approach known as joint liability group (JLG) loans. JLG is a lending model that enables a group of individuals (usually five) to take loans for income-generating activities or other household requirements by forming a group, wherein the members guarantee each other's loans. Group-based loans for income-generating businesses is the core offering of most microfinance institutions (MFIs) across the world.

A JLG loan may not be sufficient to help a client cope with the financial pressure posed by an emergency, such as an illnesses or loss due to fire. In such circumstances, people typically turn to friends and family, or moneylenders who may charge high interest rates, posing additional pressure on the household's financial wellbeing.

An emergency loan is an alternate mechanism for MFIs to help their borrowers during times of need. Principal arguments for MFIs to offer an emergency loan are:

1. Income-generating loans do not eliminate vulnerability to economic or personal shocks. Most of the borrowers are still susceptible to such events.
2. Providing assistance at the time of a crisis can build client loyalty as the MFI can demonstrate that it is vested in the client's well-being.
3. Emergency loans can help reduce reliance on more expensive credit options available through informal moneylenders, thereby reducing the risk of falling into a debt-trap.
4. Consumption loans, including emergency loans, are not burdensome as long as the household can repay them. MFIs can ensure that the overall loan amount is not exceeding the borrower's repayment ability, to ascertain that the borrower is not over-indebted.

MFIs recognize the positive aspects of offering an emergency loan, particularly to stand out in the market, and attract and retain customers. Over the years, many MFIs have experimented with providing emergency loans to their borrowers; however, they have often faced challenges as many features of emergency loans are structurally different from group loans presenting some operational challenges for the MFI. The usual difficulties with an emergency loan product are:

1. *Quick turn-around-time (TAT)*: An emergency loan, as the name suggests, cannot be planned for in advance. In addition, it is usually meant for a small but immediate expenditure. Hence, TAT is of paramount importance for this product, and ideally, it should be less than 24 hours. However, MFIs usually lack the expertise to do

[1]

Case Brief #: 31

Title: Case Brief: Dvara KGFS

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Date of Publication: April 2021

Summary:

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