International Journal of Research in Economics and Social Sciences (IJRESS)

Available online at : http://euroasiapub.org/current.php?title=IJRESS

Vol. 6 Issue 7, July 2016, pp. 48~57

ISSN(o): 2249-7382 | Impact Factor: 6.225 ,| Thomson Reuters ID: L-5236-2015

The Strategic Role of Micro Finance Institutions in India

Dr. Balaji Bhovi*

Article history:

Received July 14th, 2016;
Approved July 22th , 2016;
Available online: Aug 12st, 2016.

Keywords:

Financial Services,
Micro-Entrepreneurs,
Poverty Alleviation,
Self Help-Groups.

Abstract

Microfinance has evolved as an economic development approach intended to benefit the low-income part of a given society. It is emerging as a powerful tool for poverty alleviation in India. Microfinance Institutions can be non-governmental organizations, self help groups, saving and loan cooperatives, credit unions, government banks, commercial banks, or non-bank financial institutions. Microfinance gives access to financial and non-financial services to low-income people, who wish to access finance for starting or developing an income generation activity. Micro finance institutions are established to provide financial services to the micro-entrepreneurs and some poorer to improved their economic status and social conditions after receiving the financial services.

The purpose of this paper is to study the role of microfinance institutions in poverty eradication in India and to observe the issues and challenges facing microfinance institutions. Impact of micro finance is appreciable in bringing skill development and empowerment among the disadvantaged segments in the society. Micro finance has emerged as a catalyst of rural development, social and economical empowerment.

Author Correspondence

First Author
Asst. Professor, Dept. of P. G. Studies in Commerce,

Besant Women's College

Mangalore, Karnataka-575003

Introduction

Microfinance is the financial assistance to low-income people and the self-employed people, who are lack to access for banking and related services. The basic idea of micro-finance services is to provide the financial assistance to the poor at the time they need it at a very convenient condition. Generally, it is a movement whose object is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate level of high quality financial services, including not just credit but also savings, insurance, and fund transfers." Those who promote microfinance generally believe that such access will help poor people out of poverty. The vision of microfinance is quite simple to create systemic change in financial systems worldwide. Microfinance intends that they serve the majorities of disadvantaged people and lift them out of poverty and make them full participants in their country's social and economic development. A microfinance program creates employment through microfinance initiatives which is the most important factor to eradicate the poverty through employment. NABARD has been extending various supports to various stakeholders to facilitate sustained access to financial services for the unreached poor in rural areas through various microfinance innovations in a sustainable manner. The Government has also announced hundred billion to NABARD (National Bank for Agriculture and Rural Development) for refinancing rural banks and help better for free flow funding. Much has been concentrated towards rural development where interest subsidy for women Self-help Groups in 2012-13. Microfinance has emerged as a growing industry to provide financial services to poor people. Until recently, microfinance focused primarily on providing microcredit for microenterprises. However, there is recognition that poor people need a variety of financial services, not just credit. Current microfinance has therefore moved towards providing a range of financial services, including credit, savings and insurance, to poor enterprises and households.

Statement of Research Problem

In the environment of micro finance business to eradicate the poverty in rural areas there is a lack of awareness among the poor people specially women about micro finance institutions and its services to poor people. Even some of them who are having awareness though they are not in a position to get benefit because they are not awareness of executive operating system of micro finance business and they are scared to fulfill the requirement conditions of micro finance institutions after taking a credit due to lack of confidence among the clients. In the village areas poor people are not skilled or in a status to prepare a proposal for their venture business and submit to get the finance and also lack of knowledge of convincing to the micro finance institutions about their idea of business to get the credit loan and services from micro finance institutions. Due to all these problems may be still poverty is not eradicated completely even though the well established of micro finance institutions in India.

Objectives of the study

- To know whether the clients are aware or not about micro finance institutions and its services in India
- To study the whether the clients are educated to prepare a proposal to acquire the benefit from micro finance institutions
- To evaluate the role of the micro finance institutions for mounting the scenario of entrepreneurship culture

Methodology

This study is based on descriptive and secondary data. The researcher referred the research articles and reports which were published in professional journals and micro finance institutional websites. He prepared the conceptual paper on this micro finance topic.

The role of microcredit spearheaded by the SHG movement in women empowerment is by now a well-established fact. Liberating rural women from their traditional confinements to homesteads, participation in microfinance programs contributes to social change as well as empowering women by strengthening their economic roles. In many MFIs, women have become preferred clients as their income benefits their families through improved nutrition, health, education and well-being; because they have higher repayment rates; and because women work better in the group lending programs that makes reaching the poor efficient. Access to the basic financial products such as savings and loans enable women to set up new economic activities or expand the existing ones for higher income. The control over this increased income and assets can be used directly for her own well-being and that of her children/family. Moreover, the control over income and assets strengthens women's ability to negotiate change in gender relations within the household and wider community. Thus, besides a popular poverty alleviation strategy, the empowerment of women has become a key rationale for SHG expansion and replication. Indian microfinance has also been showing mild signs of recovery on account of improving regulatory environment and improvement in governance.

Micro Venture investment model, which is a dramatic departure from traditional microcredit lending promoted by Micro Graam aims to bring an array of diverse financial tools for India's underprivileged rural poor. In Micro Ventures, a micro-entrepreneur and a micro venture capitalist enter into a revenue sharing agreement, which enables the two partners to create a micro to small enterprise (MSE). Although traditional microcredit provides the essential service of access to credit, entrepreneurs who are willing and able to undertake larger business ventures are unable to do so under the current paradigm. Micro- Graam has created Micro Ventures to address this underserved niche market of entrepreneurs who require a larger loan size but cannot obtain them from commercial financing. Micro Ventures provide flexibility and cost savings, which can only arise from long term financing. In this model, the micro venture capitalist provides the full upfront cost to starting the business, and the two parties agree to share a percentage of the profits or losses. The two parties agree upon how to share the profits or losses and the number of years the micro venture capitalist will be involved. Micro Graam acts as the facilitator in the transaction and helps the entrepreneur with their business model. The partner organizations currently provide clients most of whom are women with three types of loans: agricultural loans, educational loans, and microenterprise loans.

Micro Financial Institutions are divided in to three categories:

- Non Profit making: Section 25 of Companies Act 1956
- Mutual Benefit making: Registered under state co-operative societies Act,
- Profit making: Companies Act 1956 and registered with RBI

Values of Microfinance are stated as follows:

- To provide low-income clients women, men and their families, with access to financial services that are client focused and designed to enhance their well-being, and are delivered in a manner that is ethical, dignified, transparent, equitable and cost effective.

- To ensure quality services to clients, appropriate to their needs, and delivered efficiently in a convenient and timely manner.
- To provide complete and accurate information to clients regarding all products and services offered.
- To create awareness and enable clients and all other stakeholders to understand the information provided with respect to financial services offered and availed.
- To ensure that clients are protected against fraud and misrepresentation, deception or unethical practices.
- To ensure that all practices related to lending and recovery of loans are fair and maintain respect for client's dignity and with an understanding of client's vulnerable situation.
- To safeguard personal information of clients, allowing disclosures and exchange of relevant information with authorized personnel only, and with the knowledge and consent of clients.

Principles of Microfinance are stated as follows:

- Promote and strengthen the Microfinance movement in the country by bringing low-income clients to the mainstream financial sector.
- Build progressive, sustainable, and client-centric systems and practices to provide a range of financial services (consistent with regulation) to clients.
- Promote cooperation and coordination among themselves and other agencies in order to achieve higher operating standards and avoid unethical competition in order to serve clients better.

Ethics of Microfinance are stated as follows:

- MFIs must design appropriate policies and operating guidelines to treat clients and employees with dignity.
- MFIs must incorporate transparent and professional governance system to ensure that staff and persons acting on their behalf are oriented and trained to put this Code into practice.
- MFIs must educate clients on the Code of Conduct and its implementation.

Objective of Micro Financial Institutions:

- To play vital role in reducing poverty
- To supply of loans, savings and other basic financial services to the poor people
- To provide financial services to the active poor
- To provide diversified, dependable and timely financial services to the economically active poor
- To create employment opportunities
- To provide benefits to the poor people both an economic and socio well-being
- To help existing business grow or diversify their activities
- To encourage the development of a new business
- To empower women or other disadvantaged population groups

Innovative products and services by Indian microfinance institutions:

Details of different categories of innovative products of the practices by Micro Finance Institutions and most MFIs have fine-tuned their product features to the requirements of their clients and their institutional priorities and constraints as an indication of the variety of options available for developing a meaningful association with clients.

Loans to Educated Clients:

This product is offered only to clients with a perfect repayment record. Group clients have an aspiration target to reach, which acts as a good repayment incentive. The practices of administered by a separate set of staff; detailed appraisal of client businesses to ensure that business volume can support repayments; Ensures that client has a savings route also by disbursing the loan only in a savings bank account.

Emergency Loans:

Usually available to clients in the second loan cycle onwards; the amount equivalent to four to ten installments of the regular loan sometimes this is also called a seasonal/festival loan and can be used for seasonal expenditure incurred on unavoidable religious and social practices. Enables the client to meet their pressure without approaching a moneylender and allows the MFI to fulfill the client's need and strengthen its relationship. The practices of the client should have a record of perfect repayment for at least a year; For festival/seasonal loans; May require special guarantee by a group member or leader to substitute detailed appraisal; For health emergencies, disbursements should be made within twenty four hours of demand; Some MFIs offer such loans free of interest; some offers a wedding loan of fifteen thousand which has a very short tenure.

Other Consumption Loans:

Available to clients after they have completed at least one-two loan cycles with the MFI, with perfect repayment. Given for purposes, which would improve quality of life for customers—water connection, water purifying equipment, toilet construction, solar lighting, payment for institutional delivery (pregnancy loan), and children's' school fees. Sometimes these are given for purchase of small assets, which would indirectly enhance productivity, such as bicycle or mobile phone. Such products give a competitive advantage and ensure client retention even if competitors offer lower interest rates on regular loans. These products also enable MFIs to meet the actual needs of their clients and to track utilization effectively. The practices of MFIs which leverage on in-house or external technical expertise in water, sanitation, health, etc., may perform better in ensuring proper utilization of such loans, by ensuring purchase of good material and good construction quality.

Non-Financial Services:

Some MFIs provide non-financial services to existing clients and their families or community in the operational area at large (health camps, financial education). Others provide these services to the best borrowers as an incentive to the others (business development training, sustainable farming practices). Some non-financial services are undertaken for ultra poor beneficiaries who are not yet eligible for loans, but require grants and other support (ultra-poor programs, vocational training, income-generating asset distribution, schools for poorest children).

- Health program creates health awareness amongst mothers and girls and improves accessibility to health services through community volunteers.
- Education program supports 'out of school' children and dropouts for enrolment in secondary schools.
- Employment programs trains, guides and links youth to decent job opportunities

Loans for Specific Enterprises or Business Segments:

Usually available to a segment, which is completely distinct from the group lending target segment comprises middle-level businesses with high working capital requirements but may lack documentation and awareness to approach banks. These loans require extensive appraisal of customer credentials as well as business performance and its future prospects.

Other Financial Services:

These include savings through banking correspondent arrangements; Pensions and Insurance through tie-ups; and Remittances. MFIs have to bargain with the best service providers for the most beneficial deals for their clients. MFIs which have extensive outreach will be able to bargain hard on product pricing. Providing such tie-ups builds several links between the clients and MFI, forging a deep relationship and ensuring client retention.

Issues of Micro Finance Institutions:

Low outreach

It has been observed that Micro Finance programs focusing on women than men. These characteristics of women clients constitute evidence in support of the inclination of Micro Financial Institutions to cater to the needs of women. Women may be better and more reliable clients, but in order to increase their outreach MFIs cannot be ignored men as clients

High interest rate

MFIs are charging very high interest rates, which the poor find difficult to pay. It has been argued that MFIs are private entities and hence need to be financially sustainable. It is important that these NGOs should be willing to operate at narrow margins and to bear a low effective interest rate so that they can maintain a balance between their dual objectives of commercial viability and serving the poor.

Negligence of urban poor

It has been noted that MFIs pay more attention to rural areas and largely neglect the urban poor. However, the population of the urban poor is quite large. MFIs need to pay equal attention to the urban poor because they too need financial assistance for various activities.

Client retention

Client retention is an issue that creates a problem in growing the MFIs. This occurs because people are not properly informed and educated about services and products provided by the institutions.

Loan default

Loan default is an issue that creates a problem in growth and expansion of the organization Lack of understanding on the part of the clients, they also cannot correctly manage the loans given to them. As a result, they are not able to pay back the loan.

Low education level

The level of education of the clients is low. So it creates a problem in the growth and expansion of the organization. Target population of MFIs is people of rural areas and they have no or less education level. As the percentage of people who have very less education.

Language barriers

Language barrier makes communication with the clients (verbal and written) is an issue that creates a problem in growth and expansion of the organization. As the education level of clients is low so it is difficult to communicate with them. For this reason it is also difficult for the MFIs employees to make the clients to understand the policy and related details.

Late payments

Late payments are an issue that creates a problem in growth and expansion of the organization. This usually occurs because clients are uneducated and they don't know how to manage their debt. They are unaware of the fact that late payment increases their loan payments.

Loan collection method

Loan Collection Method is found an issue that creates a problem in growing the organization. Most of the MFIs are not able to make their loan collection system as effective as they want to do so.

Challenges of Micro Finance Institutions:

- Inadequate donor funding or lack of accessing fund
- Insufficient support from governments
- Limited management capacity of micro finance institutions
- Less attention on financial sustainability of MFIS
- Lack of adequate loan or equity capital to increase loan-able funds
- Lack of standardize reporting and performance monitoring system for microfinance institutions
- Lack of understanding of the definition and concept of microfinance by the clients.
- Major challenges of microfinance institutions are communication gaps and inadequate awareness
- There is a danger of systemic credit risk in which default borrowers worsen the whole system
- Educating clients about channels and formats for information

Suggestions to cope up the constraints to access finance in India

Banks Are Reluctant to Lend to Rural Clients

From the perspective of the rural banks, serving the rural poor is a high-risk, high-cost proposition. Uncertainty and default risk. Lending to some segments, especially to the very poor, is surrounded by uncertainty about repayment. The rural poor tend to have irregular/volatile income streams and expenditure patterns and they also tend to be highly exposed to systemic risks such as crop failures or a fall in commodity prices, and therefore, may face real difficulties servicing loans. So banks have legitimate concerns while dealing with the rural poor, and tend to perceive such loans as risky.

Lack of Credit Information

Problems caused by uncertainty are exacerbated by the lack of reliable information on the past credit history of borrowers. There are a number of sources of credit information in India, but none of these focuses on small, rural borrowers. Credit information on such borrowers is difficult to obtain because the majority of the rural poor rely on moneylenders and other informal lenders, and it is not in the interest of such lenders to pass on a borrower's good credit repayment record to

other providers of finance. The unavailability of credit information has reduced the volume of lending in India; because performance risk measures are unavailable, the current risk management practice of banks is to control loan amounts. Better credit information could directly increase the amount of financing available to rural borrowers.

The autocracy of collateral

Most of India's rural poor, for instance, have no fixed collateral or only small plots of land that most often cannot be mortgaged. Identification of alternative collateral is costly and cumbersome. So only those with assets can borrow! Another problem is that collateral can only provide security to lenders in an environment where households have proper titles to their assets, and where the legal system makes it relatively straightforward for lenders to enforce contracts and repossess collateral; the legal system in India makes collateral registration, and its repossession by the financier, a long and arduous process.

Transactions costs

The transactions costs of rural lending in India are high, mainly due to the small loan size, high frequency of transactions in rural finance, large geographical spread and heterogeneity of borrowers, and widespread illiteracy. The geographical spread of customers in rural India, and widespread illiteracy, further drive-up the administrative costs, after the loan is granted.

Absence of flexible products and services

Rural banks do not provide flexible products and services to meet the income and expenditure patterns of small rural borrowers. Small rural borrowers have irregular income streams and expenditure needs, and therefore, prefer to borrow frequently, and repay in small installments, but most banks do not offer such products. Also, while small rural borrowers seek savings and lending products, they also seek insurance (life, health, crop), which banks do not generally offer.

Weak legal framework and enforcement issues

Government has not been able to develop and enforce a legal and regulatory framework conducive to rural finance, so that contract design, contract renegotiation, and contract enforcement remain weak, making it even more difficult for financiers to provide borrowers with the right incentives for repayment. While the recent enactment of the securitization and asset reconstruction law (2002) has helped improve the legal framework for recovering bad loans, by facilitating out-of-court settlements on non-performing loans and instituting alternate methods of dispute resolution between creditors and debtors, the law does not cover small loans.

Government policy

Government policy has created a "financial climate" that is not conducive to lending in general, and to rural banking, in particular. High fiscal deficits, the government's domination of rural finance institutions, persisting weaknesses in the regulatory and legal framework, and a set of policies towards the sector that have been designed to gain political patronage, have resulted in the distortion of risk/return signals and inefficiencies in the delivery of rural finance services. An outcome of these realities has been a dilution of the credit creating role of rural banks.

Conclusion:

However, the concept and inception of modern Micro Finance was introduced in Bangladesh in 1970 by the economist Dr. Mohammad Yonus. In India the SHG Bank linkage program implemented during the last two decades has significantly contributed in terms of outreach of financial services to unreached people. The review of the performance of the program

reveals that there has been a significant improvement in terms of socioeconomic empowerment of rural poor, particularly of women, across states in India. Microfinance services for the poor are now widely promoted as a key strategy for poverty reduction. Many microfinance programs have increasingly targeted women in response to experience of excellent repayment rates. The impact of microfinance on poverty, studies has shown that microfinance has been successful. However, certain challenges/issues remained. Some of these are: Outreach challenges whether all very poor identified and included financially under SBLP? Quality and sustainability of Self-help Groups as a grassroots level institutions for financial inclusion? Inadequate donor funding or lack of accessing fund and in the event that some institutions do not adhere to reporting requirements, what types of sanctions are appropriate? Even in a market where all institutions are capable of adhering to reporting requirements, there will inevitably be those that choose not to and violate the requirement. What is the right approach to educating clients about channels and formats for information? Client financial education is an essential component to healthy microfinance markets, Clients are difficult to reach, financial education is expensive and general education levels tend to be very low among microfinance clients.

Considering financial inclusion as a major agenda, the need for redesigning the long tested strategies of the SHG movement need not be over emphasized. Scope for active participation of community oriented organizations in the institutional arrangement for financial products' delivery to the poor seems to be bright. The experiences and lessons learnt during the last two decades are very valuable based on which future road map of the SHG movement may be drawn. Let the coordinated efforts by all the stakeholders with genuine focus on the poor and their active participation contribute for the livelihood development of the poor in the country.

References:

Aden. A. (2011), Microfinance Institutions activities and entrepreneurship development of selected SMEs in Mogadishu, Somalia.

African Microfinance Pricing Transparency Leadership Forum Discussion Insights: Challenges and Solutions, for more details http://www.mftransparency.org/

Barr, Michael S. (2005), "Microfinance and Financial Development", the John M. Olin Centre for Law & Economics Working Paper Series, University of Michigan Law School

Code of Conduct for Microfinance Institutions in India, Micro Finance Institutions Network, the Association of Community Development Finance Institutions for more details http://mfinindia.org/

Dahir Ahmed Mohamed, (2015) the Challenges Facing Microfinance Institutions in Poverty Eradication: A Case Study in Mogadishu, International Journal of Humanities Social Sciences and Education, Vol. 2, 2, PP 56-62

Edited by Bedson Jamie, Microfinance in Asia, Trends, Challenges and Opportunities, the Banking the Poor Network with the SEEP Network, the Foundation for Development Cooperation.

Edited by Kelly Hattel and Sahra S. Halpern (2002), Challenges to Microfinance Commercialization, Summary of "Challenges to Microfinance Commercialization" Conference Convened at The World Bank June 4-6, 2001 by MicroFinance Network and ACCION International.

Fink A. (2009), How to Conduct surveys A step-by-step guide.(4th ed). Sage publications, California

Karen Doyle the SEEP Network (1998), Microfinance in the Wake of Conflict: Challenges and Opportunities, Microenterprise Best Practices,This work was supported by the U.S. Agency for International Development, Global Bureau, Economic Growth Section, Microenterprise Development Office,.

Kumar, R. (2005), Research Methodology-A Step-by-Step Guide for Beginners, (2nd.ed.), Pearson Education, Singapore

Matovu, Dan (2006) "Microfinance and Poverty Alleviation, a case study of Uganda finance trust." Göteborg University. Microfinance from Argentina, Development Policy Review, 19(3), pp 339–354.
Micro Finance India-State of the sector Report 2012, An Access Publication,
Morduch, J. (1998). Does Mocrofinance Really Help the Poor? New Evidence from Flagship Programs in Bangladesh, Mimeo Stanford: Hoover Institution, Stanford University.
Provident J. & Zacharia S (2008), a critical look at the role of micro finance banks in poverty reduction in Tanzania: A case of Akiba Commercial Bank Limited.
Regulation of Microfinance Institutions in India, Briefing Paper, and Centre for Competition, Investment and Economic Regulation (2013) is available in http://www.microfinanceindia.org/
Robinsons S. (2001) The Microfinance Revolution: Sustainable Finance for the Poor. Vol. I the World Bank: Washington D.C.
Tiwari Piyush and Fahad S.M., Concept Paper Microfinance Institutions in India, Housing Development Finance Corporation is available in http://www.gdrc.org/icm/conceptpaper-india.html
Wilson, T, (2003) lesson from microfinance pilot project in Rwanda. Field exchange issue 20,
Y.S.P. Thorat and Graham A.N. Wright, MicroSave India Focus Note 2, Microfinance – Meeting the Challenges to Realise the Potential for more details http://www.microsave.net