International Journal of Advanced Research in Management and Social Sciences
ISSN: 2278-6236
Impact Factor: 6.943

MICRO-FINANCE IN INDIA: STRATEGIES TO OVERCOME OPERATIONAL ISSUES AND CHALLENGES

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Abstract: *Since Independence Indian Government has taken different steps for removing poverty. However, despite of many efforts, still almost one-third of total population in India is below the poverty line. It has been also observed that the majority of the poor lives in rural areas. In spite of this scenario, proper employment has not been generated in the labor market of India. Looking at this, Financial Inclusion is most challenging regarding economically weaker sections of the society. Microfinance refers to the extension of small loans to the poor for self employment and sustenance. Microfinance includes a broad range of services like credit, savings, payment, Insurance, remittance services, transfer services, and others. So Micro-finance is considered to be revolutionary because it aims at servicing the poor who were unfit to get financial services before. However, its growth is obstructed by various regulatory and operational hurdles are threatening the smooth functioning of Microfinance Institutions (MFIs). The main obstructs faced by MFIs (including banks) in financing the poor were the high transaction cost and low profitability while reaching out to the needy in terms of small credit at frequent intervals. An attempt is made to understand the operational difficulties faced by MFIs in providing microfinance as well as to recommend the strategies that can be taken on the indicated challenges and the effective implementation of microfinance delivery modes.*

Keywords: *Microfinance, Challenges, Issues, Delivery, Regulation, Strategies*

INTRODUCTION AND SPREAD OF MF IN INDIA

Microfinance, a financial innovation, originated in Bangladesh, when Prof. Mohd. Yunus changed the lives of millions of Bangladeshis by creating the concept of micro loans. The idea came to his mind by involving himself in fighting poverty during the 1974 famine in Bangladesh. Besides teaching through the traditional methods, he wanted to understand the real life economics also. He gave $27 as the first loan from his pocket to a villager living near his University Campus and discovered that villagers are quickly repaying money by selling their goods in the market; and there evolved the concept of microfinance with the establishment of Grameen Bank in 1976. Prof. Yunus earned a Nobel peace prize in 2006 for his most valuable credit to the financial system for the poor.

Microfinance is a model specially designed for serving the poor. Microfinance programs provide small loans to poor persons for self-employment projects, taking little or no collateral. "Microfinance is a provision of thrift, credit and other financial services and products of very small amounts provided to the poor in rural, semi-urban and urban areas. Anyone availing this facility has to engage in some productive activity that will generate income." It includes financial products like micro-savings, micro-credit, micro-insurance, etc. Besides technical assistance, capacity building, social and cultural programs can also be considered as motivating activities. Thus, microfinance is not limited to micro-credit but includes a broad range of financial services like: deposits, loans, payment services, money transfers, insurance to poor and low-income households and their micro-enterprises. Consultative Group to Assist the Poor (CGAP), which is a consortium of 28 public and private development agencies, developed a set of key principles that govern microfinance. They are:

- Poor people need a variety of financial services, not just loans.
- MF is a powerful tool to fight poverty.
- MF means building financial systems that serve the poor.
- MF can pay for itself, and must do so if it is to reach a very large number of poor people.
- MF is about building permanent local financial institutions.
- Microcredit is not always the answer.
- Interest rate ceilings hurt poor people by making it harder for them to get credit.
- The role of the Govt. is to enable financial services, not to provide them directly.
- Donor funds should complement private capital, not compete with it.
- The key bottleneck is the shortage of strong institutions and managers.

After achieving independence in1947, the Government of India and RBI have made concerted efforts to provide the access of credit to poor. In spite of the increase in the outreach of formal credit institutions in the past several decades the rural poor continue to depend on informal sources of credit. Institutions have also faced difficulties in dealing effectively with a large number of small borrowers, whose credit needs are small and frequent and their ability to offer collateral is limited. Besides, tedious procedures and risk perceptions of the banks have a big gap in serving the credit needs of the rural poor. Experiments of fighting against poverty also included providing subsidized credit to the poor since the last three decades but almost all the time the end result has been the non-performing assets (NPAs). Then it was realized that the real issue was access to credit not the cost of credit that the Govt. has been concentrating on. In India, around 42% of people having lack access to formal banking services, who do not have choice but to resort to local money-lenders who used to exploit the poor with unreasonable interest rates ranging from 30% to 120%. In this context micro-credit has emerged as the most suitable and practical alternative to the traditional banking in reaching the unreached poor population. Micro-credit enables the poor people to be prudent and helps them in getting the credit and other financial services for increasing their income and living standards. Although the concept of MF was introduced in the early 1980s, the Self-help Group (SHG) – Bank Linkage Program was formally launched in the year 1992 as a flagship program by National Bank for Agriculture and Rural Development (NABARD) and capably supported by the RBI through its policy support. The program forecasts organization of the rural poor into SHGs for building their capacities to manage their own finances and then obtain bank credit on commercial terms. Hence, the sector has evolved through two main channels – SHG and Grameen Bank replicator model followed by most MFIs.

Thus, the evolution of MF in India in brief started in 1991-92 with the experimental project by NABARD for linking 500 SHGs with banks. In 1996, RBI decided to include micro-credit as priority sector lending. In 1999, RBI issued guidelines giving banks flexibility to set own terms and to simplify procedures. In 2000, RBI allowed banks to lend to MFIs and treat this as part of priority sector lending. In 2004, the National Common Minimum Program of the UPA Govt. prompts expansion, particularly in backward and economically weak areas. Thus gradually there is an expansion in outreach in different areas of country.

MF DELIVERY MODES

Microfinance in order to achieve its goals should be effectively able to reach the poor entrepreneurs. Following are the identified mechanisms of providing MF classified into 3 categories:

1. Formal Microfinance Institutions (MFIs)

These entities are subject to general laws and regulations by the Central Bank. These include agricultural state banks, commercial banks, community and rural banks, postal banks, etc.

Banks

Banks (Commercial banks, Co-operative banks, Regional Rural banks) have recently walked into the domain of microfinance. The main advantages associated with this mode are that banks bring in self-sufficiency, risk management practices and proper credit appraisal. In some cases, successful MF NGOs have also transformed into for-profit commercial banks. The success would depend on the bank's reach and clarity of objectives. The bank must be able to cater to the rural poor, which has been made possible in India with the setting up of Regional Rural Banks. Clarity of objective refers to the decision whether the MF operation will be completely independent or a part of the existing rural banking framework. For example, ICICI bank's MF operation is completely independent of its commercial banking operation.

Other financial agencies engaged only in the activity of providing MF

The institutions which are engaged only in the activity of providing MF and are formally organized are under this category. The major advantage of such MFIs is focus, since they do not have to cater other services as commercial banks. Also, they can provide a whole range of services ranging from loans to insurance. However, the sustainability of these institutions is doubtful since they depend on external sources of financing. Some Indian MFIs are SKS, Spandana, SHARE, AML, RORES, etc.

2. Semi-Formal MFIs

These entities are either registered or subject to all relevant general laws but not usually subject to oversight by a Banking or Finance authority. These include village banks, NGOs, Cooperatives, credit unions, input suppliers, agribusiness companies, and marketing companies.

Non-Governmental Organizations (NGOs)

NGOs have been popular delivery modes for financial services for a long time since they have indicated concern for the constituencies by developing close relations with the local community that they are working in. NGOs have also gained their trust by providing non-financial services like training and assistance related to literacy, health and other business practices. Also many NGOs have made a significant improvement in the lives of the poor by adopting innovative management and savings/credit delivery practices.

3. Informal MFIs

These are not registered entities. They are monitored only by their members or the community that they serve. These include among others the Self-help groups.

Self-help groups

SHGs have been playing an important role in deploying microfinance for their members, except doing other activities. There are three different models for SHG and Bank linkage. These are:

Model I: SHGs are formed by NGOs and linked to bank. Banks directly provide MF to SHGs with the recommendation of NGOs. Here NGOs work as facilitators.

Model II: NGO forms SHGs. They also perform the role of financial intermediation as on-lender to SHGs after sourcing loans from banks. Here NGOs work as facilitators as well as financial intermediaries. In this case NGO is responsible for repayment of bank loan as well as payment of interest.

Model III: Banks assume to play the role of NGOs and ensure linkage with SHGs.

In the models I and III, the SHG may be considered as MFI since they distribute the loans among the members and are also responsible for repayment of loan.

OBJECTIVES

- To explain the introduction and spread of MF in India
- To narrate the various modes of providing micro-finance in India
- To study the various issues, challenges and problems in effective implementation of various Microfinance programs.
- To explore the strategies to be implemented to overcome issues and challenges

REVIEW OF LITERATURE

Nagaraju and Rameshreddy (2016) in their study states that Microfinance seems to be growing fast with no big hurdles, it has also brought many issues in front. The some issues are investment habits, less education, outreach difficulty, sustainability etc. Rating of MFIs will go high with increasing use of IT by MFIs and development of common software, mobile banking for improving outreach and reducing cost of operations, improving financial literacy amongst microfinance beneficiaries, recording and spreading success stories and innovative methods of financial intermediation and addressing other unfolding issues during the course of microfinance journey.

Kumar S. (2015) in his study suggests that to obtain sustainable development there must be continued growth and diversification of the rural economy, all segments of the population including farmers, rural small entrepreneurs and the poor should have easy access to basic financial services such as savings, credit and insurance. Sustainable rural microfinance requires local initiative and careful donor support for the development of institutions, enabling them to offer both savings and credit services, manage their own resources, have their loans repaid, cover their costs from their operational income. We must not go with the short-term solutions with no chance of long term sustainability.

Rao G. (2014) suggested that micro-finance programs show a much stretched growth in the country. It is important that the microfinance program spread more evenly so that the benefits are available especially in regions where the need is more accurate. The challenge for NGOs and MFIs is to achieve their own financial self-sufficiency without transferring all the overhead costs to their poor clients. They need to ensure sufficient investment to provide different livelihood options and employment creation by utilizing existing resources through timely credit, technical inputs, skill training and knowledge transfer. It is crucial to arrive at the right exchange deal between the needs of the poor and the sustainability of the MFIs. Challenge is to have financial inclusion with an inclusive growth.

Nair T and Tankha A (2013) in their study state that in past couple of years 'Client' has emerged as the main character that revolves around microfinance. "All the self-regulatory initiatives have been mainly around strengthening the process of gathering client-level information. Multiple instruments—code of conduct, client protection principles and fair practices code—are being used to reinforce the idea of responsible microfinance."

Nandal S. (2012) in his study revealed that MFIs need work hard to develop a common culture and reduce the risk posed by loan officers. Yet shutting down an entire industry because of informal evidence of rare problems would be like closing all schools because some teachers fail to provide satisfactory knowledge to their students. With the mutual efforts of the MFI's, self help groups, Govt. and the general public at large the micro finance sector can grow very fast and would be in a position to serve its inherent objectives well.

Sharma M (2011) in his study has stated that one of the major challenges for banks is to establish the network of agents that can provide profitable as well as reliable services to lower income people and such segments who do not have access to other banking services. Banks are developing a wide range of services and are now looking to give lending facilities through agents. But this will depend on the MFIs who actually understand this segment of people.

According to the Microfinance State of the Sector Report (2013), the microfinance is no longer alien to country's financial system as it has acquire a unique method of delivering limited finances. Thus, the microfinance system in India is a combination of diverse organizations that are dependent on the financial institutions so that they can sustain themselves.

KEY ISSUES AND CHALLENGES

1. Repayment Inability

Loan default is an issue that creates a problem in growth and expansion of the organization because around 73% loan default is identified in MFIs. Lack of understanding on the part of the clients, they also cannot correctly manage the loans given to them. At the same time they take multiple loans. As a result, they are not able to pay back the loan

2. Weak Regulatory Framework

Government has not been able to develop and enforce a legal and regulatory framework conducive to rural finance, so that contract design, contract reset, and contract implementation remain weak, making it even more difficult for financiers to provide borrowers with the right incentives for repayment.

3. Higher Interest Rate

MFIs are charging very high interest which the poor find difficult to pay. In India, there is a comprehensive range of such underwrite credit for their lending activities and that is organizations with diverse legal forms, varying why they need to recover their operational costs from significantly in size, outreach, mission and credit delivery borrowers. It is financial institutions for the microfinance disbursement. Important that these NGOs should be willing to operate at Legal Forms of MFIs: The MFIs are an extremely that they can maintain a balance between their dual different group registered as Non-Banking objectives of commercial viability and serving the poor.

4. Low Outreach

In India, MFI outreach is very low. It is a problem in growing the MFIs. There is about 28% client only 8% as compared to 65% in Bangladesh. Data show retention in the MFIs. This happens because people are not the great potential of MFIs in improving their outreach properly informed and educated about services and scale of operations. It has been observed that MF products provided by the institutions more over the programs focus a great deal of attention on women. It has been argued that women are better clients as they in forming and developing self sustainable co-operatives are more inclined to save than men, they borrow small and also take education and training than men and their repayment performance is better than men. So rather to consider only women as clients, MFIs should focus on male clients in equal way.

5. 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 because its percentage is around 70% in MFIs. 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.

6. Language Difficulty

Language barrier makes communication with the clients (verbal and written) is an issue that creates a problem in growth and expansion of the organization because around 54% language barrier has been identified in MFIs. 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.

7. Negligence of Urban poor

It has been noted that MFIs pay more attention to rural thinking that they are only needy poor and thus neglect the urban poor. Out of more than 800 MFIs across India, only six are currently focusing their attention on the urban poor. However, the population of the urban poor is very large, amounting to more than 100 million. With increasing urbanization, this number is expected to rise rapidly in the coming years. In this situation, MFIs need to pay equal attention to the urban poor because they too need financial assistance for various activities.

8. Lack of access to funding

Another factor contributing to the lack of growth in MFIs is that requisite financial support has not been provided to MFIs by concerned agencies. Around 68% of MFIs response was in favor of that government and SBP don't support them to meet the funds requirement as MFIs cannot alone remove the poverty from the country.

9. High Operational Cost

High transaction cost is a big challenge for microfinance institution. The volume of transactions is very small, whereas the fixed cost of those transactions is very high. It cannot vary with the size of the loan.

STRATEGIES TO OVERCOME ISSUES AND CHALLENGES

Microfinance provides the optimal platform for the fragile sections of society. Taking into consideration the issues and challenges, we can make some recommendations.

- Microfinance programs and formation of group must be handled by trained personnel in a proficient manner.
- Leading banks and industry developments should be taken into consideration district-wise and block-wise and then economic opportunities and resource mapping can give the idea about future scope.
- The skills should be disseminated through various training programs to poor for capacity building.
- New help groups should be formed and quality standard should be focused for new as well as reorganized groups.
- Co-ordination committees should be formed for better association amongst various groups working in different areas.
- The microfinance programs should not be restricted only for meeting the financial needs of women but also promotes the economic and socio-cultural status of women.
- Considerable financial investments are required for the promotion of different self-help groups. These financial resources must be planned as per a concrete, long-term action plan.
- For control of interest rates of microcredit institutions, regulatory framework should be established, based on transparency and avoiding hidden cost.

- Special federations must be established to fulfill the equity needs of MFIs.
- There should be awareness building programs amongst poor through various media programs.
- Ensure the uniform distribution of micro financing in both rural and urban areas of each states of India.
- Micro insurance services should be provided to protect the poor from financial shocks.
- Information and Communication Technology should be adopted for implementation of various credit programs.
- Use of e-commerce to reduce the high transaction cost.

CONCLUSION

Microfinance is very necessary thing in India where most people are poor, less educated and in the position of requiring basic financial services. Lending to the poor, if handled in an proper manner it can be a wonder for the development of the country and Removal of Poverty. If government and MFIs act together then microcredit can play a great role in poverty alleviation as well as the most sensing issue Women empowerment. MFIs are the pilot institutions offering financial services to low income people. They have been proactive in the process of complete growth in India by their hardback approaches. They are varying for the better. With the provision of financial and social services and helping the members put into practice repayment ethics and social unity they can be solution for rural poverty and backwardness. They have huge potential not only as a system of peer-to peer lending but also as an opportunity of social bonding. The Micro Finance Institutions will subsequently have to sustain in mind that they will not only compete with themselves but also with other significant actors in the whole industry. Their actual success will depend on the potential, reach and transparency, both from the financial side and from the social side. Accessibility, accountability and sustainability in all their operations will help the MFIs to lift themselves as social architectures, effectively.

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