Financing micro Enterprices - Issues and Challenges in Microfinance

"If you are uplifting the poor you are uplifting the nation"

(***Mahatma Gandhi)***

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Abstract

Micro-credit movement was started by Mohammed Yunus - Managing Director of Grameen Bank. Micro finance refers to banking the unbankables. It is a financial service extended to poor and low income people (including women) of rural areas to raise their standard of living and make them economically sound. It is the supply of loans, savings and other financial services to poor to help them engage in productive activities or grow their tiny business.

Problems such as illiteracy, poverty, unemployment etc in India are rampant. Around 350 million people live Below Poverty Line and 95% of them have no access to microfinance. There is a considerable gap between demand and supply for all financial services. Majority of poor are excluded from financial services. If this segment is addressed by the provision of finance it will lead to a healthier nation. Indian banks should focus on rural upliftment and progress which will empower people to augment their standard of living. This paper is a modest effort to identify the issues and challenges of micro financing in India and the strategies to address the issues.

Origin of Microfinance

Microfinance is a financial innovation developed by Prof. Mohd. Yunus. In the year 1974, Bangladeshis struggled a lot to survive due to famine. To help the poor to fight against poverty during famine he lent $ 27 as the first loan from his pocket to a villager and discovered that the villagers are quickly repaying the money by selling their goods in the market. This led to the establishment of Grameen Bank in 1976.

Meaning of Microfinance

Micro finance is the provision of financial services to low income level clients mainly the self-employed & women with little or no collateral with a view to eradicate poverty.

Keywords

Microcredit, neoliberalism, rural development, farms, poverty, Micro entrepreneur etc..,

Why Microfinance?

The importance of microfinance lies in the fact that the formal/institutional banking sector has not lived up to its social responsibilities of meeting the financial needs of the poor due to various reasons such as lack of adequate branch network in the rural areas, inability of the poor to offer collateral securities for the loans and lack of education and awareness among the poor people. Despite having an extensive banking infrastructure, credit to the poor from formal sector remain inaccessible in India. In Andhra Pradesh and Uttar Pradesh around 87% of the marginal and land less farmers don’t have access to credit from the formal banking sector.

The requirement of the poor in India has been estimated to be around Rs.50000 crore per annum. Against this requirement, the credit outstanding of the poor with the formal banking sector is stated to be Rs.5000 crore which is 10% of total demand.

The Role of Microfinance in the Development of economy

- Mobilize deposits in order to expand outreach;
- Be grounded on market principles;
- Contribute to solving the problem of inadequate housing and urban services;
- Provide multi-purpose loans for income generation, housing improvement and consumption support;
- Conduct research on demand for finance and savings behavior of borrowers to determine the mix of multipurpose loans;
- Enhance creditworthiness of the poor and enable them to qualify for long-term credit from the formal sector;
- Build financial discipline among borrowers and educate them about repayment requirements.

Segments of Microfinance

Segments of micro finance are Dairy, Poultry, Fishery, Sheep, Goat rearing, bee-keeping, Sericulture, Artificial flower maker, Band player, Basket maker, Broom maker, Canewalla, Cobbler, Doll maker, Plumber, Rope maker, Rubber stamp maker, Beauty parlour, Book-binder, Fish vender, hair dressing saloons, Papad maker, Pickle maker, photo-frame maker etc.

Features of Microfinance

Empowerment of the poorest

It is a tool for empowerment of the poorest. The main motive of micro finance is to empower poor socio-economically and improve their livelihood pattern.

Delivery through Self Help Groups (SHGs)

Delivery is normally through Self Help Groups (SHGs). SHGs are small and informal groups (strength of members: - 10 to 20). Group members are socio-economically homogenous. The group mobilizes savings among the members and issues need based loans to the members out of the common funds created.

Self-employment

The opportunities of wage employment are limited in developing countries. Micro finance essentially aims at promoting self-employment.

Women empowerment

It is not just a financing system, but a tool for social change, especially for women. It does not spring from market forces alone. It is potentially welfare enhancing. There is a public interest in promoting the growth of micro finance. This is what makes it acceptable as a valid goal for public policy.

Not recognized as a formal sector

Because micro credit is aimed at the poorest, micro-finance lending technology needs to mimic the informal lenders rather than the formal sector lending. It has to: a) provide for seasonality (b) allow repayment flexibility (c) eschew bureaucratic and legal formalities (d) fix a ceiling on loan sizes.

Issues of micro finance in India

Lack of capital

There is lack of adequate quantities of risk capital. Many of the Micro Finance Institutions are socially oriented institutions and do not have adequate access to financial capital. As a result they have high debt equity ratios. Presently, there is no reliable mechanism in the country for meeting the equity requirements of Micro Finance Institutions. Lack of long-term finance to pay for creation of the necessary infrastructure and pre-operative expense is also an issue.

Lack of transparency

Lack of transparency of financial performance and disclosure of accounting information in Balance sheet. Little data have been compiled concerning demand for services across these sectors. Likewise, data on financial performance or outreach are scarce for microfinance banks, SME finance providers, and branchless banking providers.

Human Resource

There is lack of efficient and well trained staff in adequate numbers at all levels. Many mainstream commercial banks are now entering microfinance, who are poaching staff from MFIs and MFIs are unable to retain them for other job opportunities. Attracting the right talent proves difficult because candidates must have, as a prerequisite, a mindset that fits with the organization's mission. There is lack of committed staff/ personnel to work in rural and remote areas.

Usage of Loan

The lender cannot keep a vigil on what client is doing with the borrowed funds. The result could be strategic unwillingness to repay and bad usage of usage.

High transaction costs

Microfinance is no collateral, low value and cash intensive nature of the business. It involves high administrative and monitoring cost relating to size of the loan.

Poor diversification of products

The products offered by Microfinance institutions are micro credit, deposits, micro insurance and micro pensions. It does not include the other financial products such as housing loan, educational loan, health insurance, business development services etc.

Training to SHGs

Training provided by NABARD and SBI occasionally to SHGs is inadequate. Even a village level fair is not organized regularly.

Key Challenges for MFIs today

Despite considerable achievements, MFIs are now facing new challenges to sustain their operations and meet the expectations of the double bottom line.

Gap in demand and supply

Considerable gap between demand and supply for all financial services Majority of poor are excluded from financial services. This is due the following reasons: Bankers feel that it is fraught with **risks and uncertainties** and it involves **high transaction costs.** The requirement of the poor in India has been estimated to be around Rs.50000 crore per annum. Against this requirement, the credit outstanding of the poor with the formal banking sector is stated to be Rs.5000 crore which is 10% of total demand. This poses a biggest problem.

Geographical coverage

Outreach of the programme to rural people is still challenge for the microfinance industry. It has a much skewed growth pattern in the country. The programme is largely concentrated in the southern region of the country. It is important that the microfinance programmes spread more evenly, so that the benefits are available uniformly. (outreach of the programme)

Investment in green technology

Investing in green technologies and inputs are not considered to be income generating by most of the people. (Investment in green technology)

Committed and professional human resource

The ability to attract and retain professional and committed human resource is still a challenge for MFIs.

Monitoring and supervision

There is lack of institutions doing monitoring and supervision of financial institutions and guide them for appropriate linkages and supports.

Strategies

Issues and challenges if left unattended will make India remain as a developing economy. The following strategies will help overcome the problems and make microfinance a fully developed area.

- MFIs for their growth and development need to have sound governance, good management practices and demand-driven products to cater to their clientele.
- MFIs have to design the outreach of the programme in such a way that the benefit/facility is passed on to those mostly in need of such services.
- Government should impart training to SHGs. Economic activities such as dairy, fishery, duck rearing etc can be explained from the stage of planning to implementation.
- Credit is the only financial service required by the poor. Poor need a range of services such as a) risk mitigation mechanisms, for example insurance, to protect against exogenous shocks; b) savings facilities to smooth consumption and get reasonable returns even on small amounts; and c) investment/risk management mechanisms that allow for wealth creation and diversification of risk. Attending these basic needs should be the primary concern of MFIs.
- Poor households cannot afford to borrow at high interest rates. Thus interest rates should be reduced.
- MFIs to offer variety of financial products such as housing loan, education loan, business development services etc.
- Mitigation of risk from the view point of lender. This can be achieved with joint liability within a group of borrowers.
- There should be high reach of this facility. It should be evenly distributed.
- Capital markets for mobilizing funds for microfinance should be encouraged.

Conclusion

To conclude I would say Micro Finance has grown from a Child to Adult in India. Let us allow it to grow further and contribute to the Society particularly for strengthening livelihoods of underprivileged in India. To achieve this government and SHGs should play an active role in funding and monitoring minor projects/businesses to alleviate poverty.

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