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Microfinance: Contemporary Issues and Challenges A Case Study of J&K State

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Abstract:
Microfinance refers to financial services for poor and low-income clients offered by different types of service providers. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as "microfinance institutions" (MFIs). It is developing as a powerful tool for poverty alleviation in J&K state. This paper makes an attempt to outline the prevailing condition of the Microfinance in J&K in the light of its emergence. The prospect of Micro-Finance is dominated by SHGs (Self Help Groups) - Banks linkage Program. Its main aim is to provide a cost effective mechanism for providing financial services to the poor.This paper discovers the prevailing gap in functioning of MFIs such as practices in credit delivery, lack of product diversification, client consumption and individual loan demand with lack of mitigation measures, less thrust on enterprise loans, collection of loans and highest interest rate existing in micro finance sector. These are conditions, which tell us that the circumstance is moving without any direction. Finally this paper accomplishes with practicable suggestions to overcome the issues and challenges associated with microfinance in J&K.

1. Introduction

Micro Finance refers to the provision of financial services to poor or low-income clients, including consumers and the self-employed. More broadly, it refers to a movement that envisions "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers" (Mohammad, Sulaiman D. 2010). Those who promote Micro Finance generally believe that such access will help poor people out of poverty. Robinson (2001) defines Micro Finance as "small-scale financial services primarily credit and savings provided to people who farm, fish or herd" and adds that it "refers to all types of financial services provided to low-income households and enterprises." (Sriram, M. S. and Upadhyayula, Rajesh S. 2002).Over the past two decades, unrest in Jammu and Kashmir has affected the people, especially the urban poor, either by displacing them from their livelihoods. Their poverty levels are aggravating and seek an urgent but long-term solution. Although some organizations have started working for the development of the area, there is ample scope for microfinance institutions to help the urban poor.The fact was that there are many organizations that are focusing on the rural parts of the state but somehow the urban areas are missing from their developmental plans. While the skilled ones manage to get employed anyhow, it was the large majority of the unskilled people who are forced to work in the unorganized sector. Many of them live in urban areas with low and unsustainable income.

Here, microfinance could play an important role in poverty alleviation. Since majority of the urban population who fall below the poverty line (BPL) have no access to basic financial services, there is always the need to create opportunities for city dwellers to augment their income and to assist them through soft and hassle-free loans. Although some schemes like IndiraAwasYojana — the biggest housing scheme in the country aimed at providing shelter to homeless people living below the poverty line in rural areas. Not many organizations in the valley, either local or international, appear to be keen to focus on the urban poor. There is an existing trend, especially among the NGOs, to view poverty as purely a rural problem. Very often urban regions are sidelined by them as more 'developed' spaces. Over the years, Jammu and Kashmir has seen considerable increase in urban poverty. Majority of the people manage their livelihood solely depending on the fever service sector. But owing to many reasons, the latest of them being the global economic meltdown, the service sector is providing far less opportunities because of infrastructure facility and forcing many to shift to the primary sector (agriculture) for their economic survival. But they don't have the resources either – particularly land – at their disposal. Another visible trend in J&K is the increasing urbanization. With the rural population continuing to arrive in the city, it is putting strain on limited resources available and triggering the urban poverty further. As a result, there are many parts of the J&K where everyone suffers due to unemployment, under-employment and lack of resources. To demonstrate their meager income most of these households have retained their joint family structures. Setting up a microfinance institution, which can focus on the urban poor and would identify the needy persons who have a positive bent of mind to work for themselves and for the society at large, will go a long way in helping alleviate urban poverty.The other issue that needs to be highlighted is the gender aspect. This relates to improving the access and availability of basic amenities, and also addressing such external concerns like shelter space, transport and overall security level of the poor women, so as to enhance their standards of living and to facilitate their participation in the urban market.This should not mean dividing the rural and urban populace, but of locating poverty beyond the conventional notions, in a wider framework. If such steps are not taken, there is a great possibility that this divide will increase and have serious repercussions in near future. To avoid such a situation the issue of urban poverty needs to be tackled seriously.

1.1. Objectives of the Study

In J&K so many micro finance institutions are working. Some are in very good conditions in terms of lending,training to their clients for the effective utilization of resources. Some are bad in conditions struggling for their sustenance. The objectives of the study are:

- To identify the problems prevailing in microfinance in J&K
- To find the solutions of the problems faced by the microfinance institution in J&K.

2. Literature Review

Microfinance, efforts to reduce povertyand provide "microfinance services, specifically credit for self-employment and savings capabilities" and shall focus on the world's poorest people. Women's access should be prioritized, as they are "very adept at saving, highly creative entrepreneurs, and consistent in ensuring that earnings go directly to meeting family needs." Microfinance is an important tool for sustainable social and economic progress, and a key strategy in ending poverty ("Declaration", 1997) (Yunus, 1997). Microfinance appeared as a fresh solution to an old problem. It appeared to be a "win-win" situation, where both financial institutions and poor clients profit. The "win-win" appearance of microfinance created unparalleled excitement in the world of economic development. The first microenterprise program began in the developing world in the early 1960s and emerged in the United States in the early 1980s. The U.S. microfinance movement was influenced by the women's movement and is an integral part of the community economic development movement (U.S. GAO report, 2003). As governor of Arkansas, Bill Clinton supported the Good Faith Fund, one of the early U.S. microenterprise programs. As president, he emphasized the reform of welfare laws and economic self-sufficiency and created a new branch of the U.S. Department of Treasury called the Community Development Financial Institution Fund, which funds microenterprise development and other community banking efforts. Microbusiness development markets for capital growth. Today, more than 750 organizations in the United States are providing microloans or related business training. Many of the early microloans programs in the United States, such as Women's Imitative for
Self- Employment, focused on women, who still remain the primary borrower (Susan R. Jones, 2004.) Gender equality advocates have also recognized the importance of the microfinance industry. In 1994, Women's World Banking, and Organization dedicated to helping low income women entrepreneurship by expanding their access to financial services, invited income women leaders to form the United Nation (UN) Expert Group on Women and Finances. It is reported that this meeting contributed to the UN's 1996 Women's Conference in Beijing, the UN Capital Development Fund, and the UN Department of Economics and Social Affairs. Contributions from the UN Expert group on Women and Finances have been used by many reactionaries and policy makers in many countries"to build policies, system and services that work for microfinance (J.D. Sachs, 2005). Microfinance services are provided by banks, credit unions, and microfinance organizations, which are also known as microenterprise development organization (MDSs). These are generally for-profit and nonprofit or nongovernmental organizations (NGOs), private voluntary organizations legally chartered, where necessary, to lend money to poor people. MDOs such as ACCION International were started in the early 1960s; other, such as the Grameen Bank, began in the 1970s when its founder, Mohammad Yunus, an economics professor in Bangladesh, began lending small amounts of money to poor people, mostly. These small loans were used to start or expand small enterprises, such as vegetables farming, weaving, and livestock holding (Stephen C. Smith, 2005). The world attention was focused on microfinance when Yunus and the Grameen Bank won the Nobel Peace Prize in 2006 (Muhammad Yunus, 2003). Funding for MFIs is provided by international finance institutions such as the World Bank, UN agencies, and the international Fund for Agricultural Development. Today, a number of MFIs – including the Grameen Bank, the Bangladesh Rural Advanced committee, the Vietnam Bank of Agriculture, and Cajalos Social in Columbia-are serving ,more than 1 million clients. Seventy percent of all foreign investment in microfinance is with regulated financial institutions, and 60 percent of this among goes to only 10 MFIs, including Bancosol and Cajalos Andes in Bolivia, Comparators in Mexico, Banco de Solidario in Eduador, and Confinaza in Peru. These MFIs tend to serve what is called "upper layer of the pyramid" as opposed to the poorest of the poor. Microfinance, now clearly a worldwide movement, is embraced by governments, corporations, banks, development agencies, business communities and civil societies.

3. Statement of the Problem

Although microfinance institutions are playing important role in the alleviation of poverty, upliftment of living stranded of poor people. But what are the problems faced by the microfinance institution? The paper focuses on the issues and challenges prevailing in J&K regarding the micro financing. An attempt is made through the paper to look out these problems.

4. Significance of Study

The paper will through light on the conditions of microfinance institutions in J&K. The research paper also tells why the microfinance institutions charges high interest to the borrowers. Here, in this research article, the attempt has been made to focus the problems of microfinance at political level, social and cultural level, educational level etc. The author presents some suggestions and recommendations to overcome from these problems of microfinance institutions.

5. Materials And Methods

The data for the present study is collected from the primary and secondary sources. Various magazines, newspapers, research articles, referred journals and books have been studied and used for the collection of data.

5.1. Microfinance in J&K

The main focus of Micro-finance is to help poorest families with very small loans (Micro-credit) either to engage them in productive activities or grow their small businesses. With the passage of time it has been realized that the poor and very poor who lack access to customary formal financial institutions require a verity of financial products.Poverty is an age old and worldwide phenomenon. It affects the quality of life of the people in the society inone form or other. J&K is having a huge percentage of population living below poverty line. The unemploymentunderemployment, underdeveloped agricultural and horticultural sectors, unbalanced development with hugeregional imbalances, illiteracy, shortage of capital, lack of entrepreneurships etc. are some of the major causes ofpoverty in the J&K state.Relief and subsidies cannot eradicate poverty. It needs to be removed through creation of productiveemployment opportunities, development of basic infrastructure and other social conditions. Productiveemployment generates growth, creates assets and thus improves the economic condition of the poor who can getengaged in such pursuit. At the same time, growth through productive employment creates a multiplier effectfor bringing about a change in the economic scene.

- **Delivery Models of Microfinance:** Many delivery models have been developed over a period of time. Each delivery model has its share of problem and success. In J&K, various delivery models have been adopted by microfinance institutions and they can be categorized in to following broad categories, discussed one by one.
- **Grameen Bank:** the prime focus of theGrameen Bank is based on the principle of providing loans and to interrupt poverty, they offer people the opportunity to take initiatives in business or agriculture, which provide earnings and enable them to pay off the debt. The bank is established on the belief that people have endless potential, and unleashing their creativity and initiative helps them to end poverty. Grameen has offered credit to classes of people formerly underserved: the poor, women, illiterate, and unemployed people. Access to credit is based on reasonable terms, such as the group lending system and weekly-installment payments, with reasonably long terms of loans, enabling the poor to build on their existing skills to earn better income in each cycle of loans. Grameen's objective has been to promote financial independence among the poor. Yunus encourages all borrowers to become savers, so that their local capital can be converted into new loans to others. Since 1995, Grameen has funded 90 percent of its loans with interest income and deposits collected, aligning the interests of its new borrowers and depositor-shareholders. Grameen converts deposits made in villages into loans for the more needy in the villages (Yunus and Jolis 1998).It targets the poorest of the poor, with a particular emphasis on women, who receive 95 percent of the bank's loans.
- **Self Help Group:**A self-help group (SHG) is a village-based financial intermediary usually composed of 10–20 local women or men. A mixed group is generally not preferred. Most self-help groups are located in J&K, though SHGs can also be found in other part of country. Members make small regular savings contributions over a few months until there is enough capital in the group to begin lending. Funds may then be lent back to the members or to others in the village for any purpose. In J&K, many SHG's are 'linked' to banks for the delivery of micro-credit.Self-help groups are started by non-governmental organizations (NGOs) that generally have broad anti-poverty agendas. Self-help groups are seen as instruments for a variety of goals including empowering women, developing leadership abilities among poor people, increasing school enrollments, and improving nutrition and the use of birth control. Financial intermediation is generally seen more as an entry point to these other goals, rather than as a primary objective.This can hinder their development as sources of village capital, as well as their efforts to aggregate locally controlled pools of capital through federation, as was historically accomplished by credit unions.
- **Co-Operative:** A co-operative is an organizationowned by the members who use its services. This model works on the principle that every community has enough human and financial resources to manage their own financial institutions. The members who own it are the members who use its services and can come from different sections of same community like agriculture, retail, wholesale etc. By proper networking small scale local institutions scale up and become sustainable while locals maintain ownership and control over their institution. The organization which has been vastly successful in co-operative form in J&K is Sahavikasa or Co-operative Development Foundation (CDF). CDF's approach relies on the well-known Credit Union model involving a savings first strategy.
- **Microfinance Institutions:** Microfinance institutions(MFIs) are the organisations or associations of individuals that provide financial services to the poor. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee.
- **Legal Forms of MFIs:** This document discusses how the regulatory framework for MFIs in J&K influences the choice of their legal form. It discusses the structural evolution of MFIs. The vacuum in financial services for the poor;the formation of the non-government organization (NGO) MFI sector;This delivery of microfinance through a variety of legal forms. The document then presents a review of the legal text and framework for various institutional forms. It discusses societies, trusts, not-for-profit companies, non-banking finance companies (NBFCs), Nidhi companies,

cooperatives, mutually aided cooperative societies and producer companies. There are regulatory limitations to the legal framework for the microfinance sector in J&K.

5.2. Key Issues in Microfinance in J&K

- **Less Outreach:** In J&K, MFI outreach is very low. It has been observed that MF programmes focus a great deal of attention on women It has been argued that women are better clients as they are more inclined to save than men, they borrow smaller amounts than men and their repayment performance is better than men. These characteristics of women clients constitute evidence in support of the inclination of MFIs to cater to the needs of women. Women may be better and more reliable clients, but in order to increase their outreach MFIs cannot ignore men as clients.
- **Higher Interest Rate:** MFIs are charging very high interestrates, which the poor find difficult to pay. It has been argued that MFIs are private entities and hence need to be financially sustainable. They do not receive any subsidized credit for their lending activities and that is why they need to recover their operational costs from borrowers. In the process, the basic reason for their existence-and their primary objective-is being lost. 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.
- **Urban Poor Negligence:**It has been noted that MFIspay more attention to rural areas and largely neglect the urban poor. Only few are currently focusing their attention on the urban poor. However, the population of the urban poor is quite large. 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.
- **Retention of Client:** Client retention is an issue that createsa problem in growing the MFIs. There is less client retention in the MFIs. This occurs because people are not properly informed and educated about services and products provided by the institutions more over the current client has higher default rate.
- **Loan Default:** Loan default is an issue that creates aproblem in growth and expansion of the organization because majority of 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. As a result, they are not able to pay back the loan.
- **Education Level:** The level of education of the clientsis 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.
- **Challenges Before the MFIs:** No doubt, microfinanceprogramme has shown impressive achievements, but a number of challenges are there: Did this programme reach the underprivileged? Whether everyone in need of microfinance intervention had been reached by any of the agencies? Even if everyone had been reached, did they get the required quantum of assistance to have sustainability? These questions are still very inconvenient to be answered because there are certain challenges associated with this programme. Some of the main challenges have been discussed in the following paragraphs.
- **Regional Disparity:** It has been observed that themicrofinance programme is mainly run by formal financial institutions with the help of SHGs. As a result, microfinance programme is progressing in those areas of the state where there is tremendous growth of formal financial institutions. Microfinance institutions were expected to reach those areas where the formal banking system failed to reach and the poor people have to depend on the money-lenders in order to meet their financial requirements. But actually, many big MFIs are activating in those states where the banking network is very strong.
- **Deserving Poor are Still not Reached:** The microfinancedelivery models are not exclusively focused on those who are below the poverty line or very poor. Though the programme is spreading rapidly but with a slow progress in targeting the bottom poor households. About 50 per cent of SHG members and only 30 per cent of MFI members are estimated to be below the poverty line. According to Ghate (2008), approximately 75 million households in India are poor and about 22 per cent of these poor households are currently receiving microfinance services. In order to run the groups successively and to achieve higher repayment rates, they generally select the non-poor people as programme beneficiaries. The study finds that the core poor are often not accepted in group lending programmes by other group members because they are seen as a bad credit risk.
- **Low Depth of Outreach:** Another problem faced by themicrofinance programme is the depth of services provided. Though the outreach of the programme is expanding, large number of people is provided with microfinance services but the amount of loans is very small. The average loans per member in both MFIs and SHGs are between Rs. 3,500 his amount is not sufficient to fulfill the financial needs of the poor people. The duration of the loans is also short. The small loan size and short duration do not enable most borrowers to invest it for productive purposes. They, generally, utilize these small loans to ease their liquidity problems.
- **Unregulated Microfinance Institutions:** In J&K, microfinance is provided by a variety of institutions. These include banks (including commercial banks, RRBs and co-operative banks), primary agricultural credit societies and MFIs that include NBFCs, Section-25 companies, trusts and societies. But only the banks and NBFCs fall under the regulatory purview of the Reserve Bank of India. Other entities, e.g., MFIs are covered in varying degrees of regulation under their respective State legislations. There is no single regulator for this sector. As a result, MFIs are not required to follow some standard rules and are not subject to minimum capital requirements and prudential norms. This has weakened their management and governance, as they do not feel it mandatory to adopt some specific systems, procedures and standards.

Therefore, there is a need for regulating the varied number of microfinance providers which are influencing the lives of millions of poor people. The regulation would, therefore, help in improving the growth of MFIs in an orderly approach.

- **Lack of Insurance Services:** Poor people are helplessto financial shocks. A small change in their earning patterns due to natural calamities, health problems, and death of earning member can push them to destitute. So, a provision of insurance under the microfinance programme is very essential to help the poor to cross the poverty line. But, in reality, the current microfinance programme in J&K is just focused on regular saving and micro-credit. SHG-BLP developed by NABARD is also providingsaving and credit services mainly and the provision of insurance is very less. However, some of the MFIs have started providing insurance services but the efforts are still at an experimental stage.

6. Conclusion

On the above findings researcher observe so many problems are associated with the MFIs. The Microfinance institutions are lagging behind in terms of loan and credit the real needy, regional imbalance, a proper regulation etc. Internal, external and client based challenges are prevailing from starting of the MFIs in J&K state. Researcherviews MFIs in J&K state have so many lacunas in their running, though the MFIs paid an important role in the poverty alleviation and enhancing the living standards of the poor. If the above shortcoming will be eliminate from the MFIs, it would have positive results on the economy of the J&K state, lead to greater efficiency and improvement of living standards of the thousands of poor.

7. Suggestions

- **Proper Regulation**: The regulation was not a major concern when the microfinance was in its emerging stage and individual institutions were free to bring in innovative operational models. However, as the sector completes almost two decades of age with a high growth trajectory, an enabling regulatory environment that protects interest of stakeholders as well as promotes growth, is needed.
- **Field Supervision**: field visits can be adopted as a medium for monitoring the conditions on ground and initiating corrective action if needed. This will keep a check on the performance of ground staff of various MFIs and their recovery practices. This will also encourage MFIs to abide by proper code of conduct and work more efficiently. However, the problem of feasibility and cost involved in physical monitoring of this vast sector remains an issue in this regard.
- **Encourage rural penetration:** It has been seen that in lieu of reducing the initial cost, MFIs are opening their branches in places which already have a few MFIs operating. Encouraging MFIs for opening new branches in areas of low microfinance penetration by providing financial assistance will increase the outreach of the microfinance in the state and check multiple lending. This will also increase rural penetration of microfinance in the state.
- **Complete range of Products:** MFIs should provide complete range of products including credit, savings, remittance, financial advice and also non-financial services like training and support. As MFIs are acting as a substitute to banks in areas where people don’t have access to banks, providing a complete range of products will enable the poor to avail all services.
- **Transparency of Interest rates:** As it has been observed that, MFIs are employing different patterns of charging interest rates and a few are also charging additional charges and interest free deposits (a part of the loan amount is kept as deposit on which no interest is paid). All this make the pricing very confusing and hence the borrower feels incompetent in terms of bargaining power. So a common practice for charging interest should be followed by all MFIs so that it makes the sector more competitive and the beneficiary gets the freedom to compare different financial products before buying.
- **Alternative sources of Fund**
  In absence of suitable funds growth and the reach of MFIs become limited and to overwhelm this problem MFIs should look for other sources for funding their loan portfolio. Without investment by outside investors, MFIs are limited to what they can borrow to a multiple of total profits and equity investment. To increase their borrowings further, MFIs need to raise their Equity through outside investors. The most crucial step to receive equity investment are getting converted to for-profit NBFC. Along with the change in status the MFI should also develop strong board, a quality management information system (MIS) and obtain a credit rating to attract potential investors.Portfolio Buyout; It is when banks or other institutions purchase the rights to future payment stream from a set of outstanding loans granted by MFIs. In such transactions MFIs are responsible for making up any loss in repayment up to a certain percentage of the portfolio and this clause is known as “first loss default guarantee”. The above clause ensures that the MFI retains the correct incentive to collect these loans. To ensure security to the buying institution, MFIs are allowed to sell off as much of the outstanding portfolio as is financed by accumulated earnings or equity.Securitization of Loans: This refers to a transaction in which the repayments from a set of microloans from one or more MFIs are packaged into a special purpose vehicle, from which tradable securities are issued. As the loans from multiple MFIs can be pooled together the risk gets diversified. Though securitization of loans and portfolio buyout are similar in many ways like first loss default guarantee clause, limit to the amount of loans that can be sold off etc. The major difference between the two is that securitizations require a rating from a credit rating agency and that it can be re-sold, which makes securitized loans attract more potential buyers. Through securitization, MFIs can tap new sources of investments because fund of certain types like mutual funds, which are barred from directly investing in MFIs, can invest through securitized loans.

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