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MICRO FINANCE –INSTITUTIONAL OPERATIONS IN INDIA

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Abstract
Micro Finance is generally constituted as a provision of Financial Services, Savings, Credit Insurance and Remittance to mostly low-income people especially the poor and often the very poor (landless labourers, tenant farmers, share croppers, artisans, women) who are in many cases without any tangible assets (that banks intend to secure while providing loans). Well organized and efficiently managed MFI's are expected to create significant impact on poor households in respect of many identified specific areas.
This paper will cover basic issues of Micro-Finance Institutions as an overview along with the various actions associated with the same, it also provide the various measures of competitiveness to perform more efficiently in operation. Finally it ends with a statement of MFI's rating tools for the purpose of rating any institutions.

Introduction

Microfinance is generally construed as provision of financial services [savings, credit, insurance, remittances etc] to mostly low-income people, especially the poor & often the very poor [landless labourers, tenant farmers, share croppers, oral leases, artisans, women] who are in many cases without any tangible assets [that banks intend to secure while providing loans]. Microfinance program in India has been under implementation since 1993 and as on March 31, 2007, over 24.35 lakh SHGs were linked with banks; around 90% of them were women groups; and Rs.113.98 billion had been disbursed to 32.98 million poor households.

The average loan per group was Rs. 50,917 & per household was Rs. 3456. It is, however, disappointing that National Sample Survey 59th Round [2003] estimates, of the total number of cultivator households, only 27 percentage receiving credit from formal sources & 22% receiving from informal sources. The remaining 51 percentage households' mainly comprising small & marginal farmers have virtually no access to credit. It is against this background an attempt is made here to appreciate the role of MFIs, in close collaboration with Government, industrial houses & social organizations, to create expected impact of microfinance on the poor households in respect of poverty-alleviation, generation of employment & income, improvement of health & nutritional status, empowerment of women & their human development. Well organized & efficiently managed MFIs are expected to create significant impact on poor households in respect of following specific areas.

1. Provision of financial inputs & services enable entrepreneurs in informal sector to build & develop their micro enterprises / tiny businesses that can employ family members & others too.
2. Credit along with insurance services enable small- scale farmers to use high-yielding inputs & adopt new technology/practices to increase productivity of land, livestock & labour leading to more food/meat production and farm income. This may broadly promote better nutrition & health. Good nutrition is a major factor in preventing or reducing the severity of much illness & also in the development of healthy, productive adults, both mentally & physically.On the other hand, group-lending methodology of the Credit with Education program made it possible to offer the training in a cost-effective & sustainable way.
3. Provision of affordable /relatively inexpensive credit & convenient savings services to poor families often effectively help them easy access to cash throughout the year to reduce the impact of the annual hungry season; major expenses to meet social, religious & economic obligations such as school fees, or weddings; and/or the devastation of major economic shocks due to family illness, death of a bread winner, loss of livestock or a crop, or a natural disaster.
4. Women's empowerment and more generally, building of social capital, to support self help efforts at the family & community levels and to strengthen the women & other marginalized

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groups to voice their rights & act as agents of local development. Control of the use of loan is considered a major indicator of a woman borrower's empowerment.

5. MFIs, while concentrating on the poverty-alleviation program, may need to seek cooperation of the Governments, industrial houses & social organizations in the area *of human development* of the poor, such as, enrollment of all children in primary school; elimination of gender disparities in primary & secondary education; reducing infant, child & maternal mortality ratios; provision of access for all who need reproductive health services These have been recognized as Millennium Development Goals by the United Nations to be achieved by 2015 Microfinance institutions are not a specific legal institutional form - typically, microfinance is considered a line of business. Among the institutions offering microfinance services, there are non-government organizations (NGOs), foundations, cooperatives, commercial banks, Regional Rural Banks (RRBs), Local Area Banks (LABS) as well as specialized non-bank financial institutions and Sec 25 Companies. Owners can be governmental entities, private individuals, foundations, church organization, other NGOs, holding companies, investment funds or even clients.

There is no doubt that the coming days ahead will be tough days for survival, unless prepared beforehand to face the reality. The Micro Finance Institutions will henceforth have to bear in mind that they will not merely compete with themselves but also with other significant actors in the whole industry like meeting out their potential competitors, interest rate management, win over the competitions and adopting both external and internal marketing practices.

1. The future competition level also depends upon the entry and exit barriers in Micro Finance Industry. In the case of NGOs there are no clear-cut regulations and also no entry/exit barriers for doing the microfinance activities in India. This will attract more NGOs to involve in Micro finance activities.

2. In micro finance industry, the banks charges interest on a declining method, which generates an interest amount, almost half, compared to the flat method applied by the Micro Finance Institutions for their micro clients. Micro Finance Institutions can justify the high interest rates by high costs. But competition will force Micro Finance Institutions to look at their interest rates because competition is the primary incentive to lowering interest rates. The pressure to lower interest rates causes Micro Finance Institutions to look for ways to lower costs via efficiencies, technological innovations, etc. Those successful in lowering costs then are able to lower their interest rates and are thus successful. So interest rate will be a real challenge to the Micro Finance Institutions.

3. Competitiveness is a pre-requisite to remain in business. Competitors can be a resource rather than a threat; a MICRO FINANCE INSTITUTION can adapt and/or improve on a competitor's product. In the competitive environment developing creative means to increase operational efficiency is therefore a must.

4. Microfinance like any other service businesses is more difficult to manage using traditional Marketing approach. Micro Finance Institutions requires not only external marketing but also internal marketing, to motivate the employees and interactive marketing, to create employees skills in the service provider. Micro Finance Institutions that want to professionalize its services must deliver "high touch" as well as "high tech" in their delivery mechanisms.

As the result of the above the Micro Finance Institutions can build an edge against the competition by means of the following measures like: Competitive Differentiation, Product Differentiation, Managing Service Quality, Customer feedback analysis and Marketing audit.

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Competitive Differentiation: Micro Finance Institutions frequently face difficulty of differentiating their services from those of competitors particularly when the market is facing intensive price competition. The solution to price competition is to develop a differentiated offer, delivery and image. The offer can include innovative features to distinguish it from competitor offers. What the customer expects from Micro Finance Institutions or the banks are loans for economic activity or housing or education or for other consumption purposes and these items constitutes primary service package.

For the entire Primary service package the Micro Finance Institutions can add secondary service packages like low cost housing technology training and free housing insurance for Housing customers and entrepreneurial training program, marketing support services, etc to the nonfarm activity customers and setting up agri- clinics along with branch to give inputs like soil testing, pesticides, hybrids, high yield seeds, fertilizers, drip irrigation, crop insurance, monsoon/rainfall insurance etc. to the agri-based customers and also setting up education guidance cell in each branch for the education loan applicants. The Micro Finance Institutions also can differentiate its service delivery in three ways through People, Physical environment and Process, the 3Ps of Service Marketing.

Product Differentiation

The marginal communities who are the customers should be treated well and perceived as customers. By designing products to the evolving needs of clients, an organization can build client loyalty through customer service and thereby increase its profit. This means that the financial services offered by a Micro Finance Institution must be designed in response to the needs and capacities of the clientele. Terms and conditions of loan, savings and other products should respond to the particular needs of the client group. More importantly, products should be tested before launching in the market. Product testing is used to gauge the perception of the customers on the suitability of the new products. This practice is yet to be popular among the financial intermediaries.

Microfinance should operate at ever new frontiers facilitated by research and development leading to new products and services in:

1. Social security such as pension plan, life and health insurance Financial Products (Loan for disaster, consumption, housing, education, micro-enterprise, Marriage etc and various poor-friendly savings products).
2. Managing risk associated with natural calamities and personal/social disasters

Managing Service Quality

One of the major ways to differentiate the Micro Finance Institutions from Banks is to deliver consistently higher quality service. The key factor is to meet or exceed the target customer's service quality expectations. The Micro Finance Institutions must change the attitude of seeing the borrowers as beneficiaries in to customers. The Micro Finance Institutions should serve the customers in order to change the one time borrower in to a lifetime customers by taking into consideration of five determinants of service quality viz. reliability, responsiveness, assurance, empathy and tangibles.

Customers' Feedback and Analysis

Becoming more tuned and responsive to the client needs is the critical part of a Micro Finance Institution's methodological evolution, financial viability, institutional soundness and social impact. For these reasons, marketing research has to be pursued and new product ideas should be explored surveying customer needs, reacting to demands from clients, or actions taken by competitors. This is the basis of drawing a marketing plan and should be the way of serving the customers.

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Marketing Audit

A financial intermediary may find that performance problems recur regularly. In fact, trying to deal with such problems bog down credit managers to the point where they neglect other important responsibilities. Realistically, marketing is one of the major areas, where rapid obsolescence of objectives, policies, strategies and programs is a constant possibility. Because of the rapid changes in the marketing environment, each organization needs to assess periodically its marketing effectiveness through a control instrument called marketing audit. Marketing audit is an in-depth assessment of marketing function. It is essentially an evaluation of where the service provider's marketing function stands at the present time.

Micro Finance Institution Rating Process

MFI rating is based on the GOOHAP *(Governance, Outreach, Operations, Human resources, Asset quality & disclosure and Profitability & Efficiency)* parameters with qualitative measures by using various parameter, sub-parameters / indicators have been evolved and used in the rating tool evolved by MICROSOP foundation. The rating process involves with using the top management at the initial discussion and finally reaches the operational side of the management. At the outset, SWOT analyses need to be drawn based on selected GOOHAP parameters.

1. Discussion with the Board & Senior Management personnel,
2. Visits to branch units to understand the operations practiced,
3. Interaction with the field staff,
4. Village visits & getting feedback from SHG member - clients,
5. Participatory SWOT analysis (Framework as shown below),
6. Analysis of financial statements.
7.

Based on Major parameters identified for MFI performance measurement, Micro credit practitioners' foundation has evolved a statement of' Micro Finance Intuitions rating tool' for the rating usage. The model of the rating tool has given below.

Table -1,A Statement Of Micro Finance Institution Rating Tool (Source: Micro Credit Practitioners' Foundations)

S. No	**Parameter / Sub- Parameter / Indicator**	**Maximum Points**	**Awarded Points.**
1	Governance		
1. 1	Board composition i. Board member with grass root experience / from Self Help Group, ii. Specialists from Legal, Finance, Human resources Management, iii. More than 50% are women	3	
1.2	Conduct of Board meetings once in a quarter	1	
1.3	Vision & strategic plan evolved	2	
1.4	Integrity & commitment of promoter directors. (If promoter name or their group concern is not found in defaulter list of Reserve Bank of India / Credit Information Bureau of India Limited).	3	

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1.5	Institutional association with other development agencies / departments (If link is established with more than 5 institutions)	1	
	Sub-total	10	

2	**Outreach**		
2. 1	Proximity of Micro Finance Institution to people i. If MFI's Head office is based & functioning in local area (3 ii. If MFI's HO is based elsewhere & already functioning in the area (2) iii. If MFI is a New organization - (1)	3	
2.2	Number of villages covered i. Above 100 villages (3) ii. 76-100 (2) iii. 50-75 (1) iv Below 50 villages (0)	3	
2.3	No. of Self Help Groups (SHGs) formed i. Above 600 SHGs (3) ii. 200 to 600 SHGs (2) iii Below 200 SHGs (1)	3	
2.4	No. of members enrolled i. above 10,000 members (3) ii. 3001 to 10,000 (2) iii. Upto 3000 (1)	3	
2.5	Targeting the poorest (Enrolment of people from Scheduled caste , Scheduled tribe, Deserted, Widows, Handicapped & women headed households) i. If above 50% (3) ii. 30 to 50% (2) iii. 10 to 30% CD iv. If less than 10% (0)	3	
2. 6	Commitment for pro-poor approach i. Focus on empowering women ii. Thrust on participatory processes iii. Integrated approach	1 1 1	
2.7	Geographical distribution of SHGs i .Targeting in backward & remote areas ii. Geographical distribution of SHGs -If operating in more than one state	1 1	
	Sub-total	20	

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3	**Operations**		
3.1	More than two years of experience in micro credit lending operations (2) If less than 2 years of experience - (0)	2	
3.2	Provision of promotional support services (e.g. EDP training, skill training, SHG management & book keeping training, Marketing support) i. If users pays the cost of services (2) ii If the services are offered free of cost (1)	2	
3.3	% of SHGs, which are more than 3 years of age i. Above 75% (3) ii. 50% to 75% (2) iii Less than 50% (1)	3	
3.4	Resources mobilization i.Mobilizing Equity /Quasi equity from social investors or financial institutions or banks. Diversification of commercial borrowing sources, (if more than from one source of borrowing)	1 1	
3.5	Credit History - Size of borrowings of MFI i. More than Rs 500 lakh/year(3) ii. Between Rs l00 lakh and 500 lakh/yr(2) iii. Less than Rs 100 lakh /year (1)	3	
3.6	Track record- Repayment of loan by MFI i.If 100% repayment paid on due date (3) ii. If 100% repayment with some delays (2) iii. If principal or interest arrears remain (0) or repayment not yet commenced.	3	
3.7	Systems and Procedures in credit administration i .Full-fledged Operation Manual in place (3) ii. Written circulars in place (2) iii. Inadequate systems and procedures (1)	3	
3.8	Management Information System i. Fully computerized systems (3) ii. Adequate manual system (2) iii. Moderate manual system (1) iv. Inadequate manual system (0)	3	
3.9	Liquidity management i. Availability of standby credit lines / Cash budget / Investments (2) ii. Cash disbursement planning (1)	2	
3.10	Range of products offered by MFI i.If two loan products + Insurance/Savings(3) ii. If two loan products or 1 loan + Insurance or Savings(2) iii. If only one loan product (1)	3	
3. 11	Innovative Products / Processes that resulted in cost saving to MFI or increased the outreach	1	
3.12	Amount lent to Branches (Suya Seva trusts) i. More than Rs5 00 lakh /year (3) ii. Between Rs 100 lakh and 500 lakh /yr (2) iii. Less than Rs 100 lakh / year (1)	3	
	Sub-total	**30**	

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4	**HUMAN RESOURCES**		
4.1	Knowledge of staff on Micro finance operations / SHG promotion i. Knowledge level is more than 75% (3) ii. If it is between 50% & 75% (2) iii. If it is less than 50% (1)	3	
4.3	Skill sets of Staff (Communication, Training, SHG rating, Book Keeping, Two Wheeler Driving.		
4.4	Computer Operating Skills i. If Skill level is more than 75% (3) ii. If it is between 50% & 75% (2) iii. If it is less than 50%		
4.5	Attitude of Staff towards work i. If attitude level is high ii. if it is Medium iii. If it is Low		
4.6	Scope for Up-gradation of Skills i. Staff sent to external training often (2) ii. Internal training offered every quarter (1) iii. If trainings are not offered regularly (0)		
4.7	Performance linked incentives schemes to staff		
4.8	Staff representing various development committees set up by government or development agencies in the district		
4.9	Professional Management capacity among staff i. High (3) ii. Medium (2) iii. Low (1)		
4.10	Recruitment Policy & Labour Laws (PF, Gratuity & so on) as per government norms i. Well laid out policy & norms (2) ii. Policies and no20rms to some extent (1)		
4.11	Staff turnover (More staff drop out within 6 months to one year, which affects the continuity of the service delivery) i. If turnover is not more (1) ii. If turnover is not more		
	Sub Total	**20**	
5	**Asset Qulaity & Disclosure**		
5.1	Portfolio at Risk* (PAR_{30}) (*notes at the end) i. If Less than 2% (2) ii. If between 2% & 5% (1) iii If more than 5% (0)		
5.2	Asset Allocation – Loan Portfolio as % of Total Assets i. If more than 80% (2) ii. If between 60% and 80% (1) iii. If less than 60%		
5.3	Capital Adequacy Ratio i. If more than 20% ii. If between 8% & 20% iii. If less than 8%		
5.4	Availability of financial statements i. Latest audited financial statements (2)	2	
5.5	Rating by professionals & info for public view i. Professional Rating info put on websites (2) ii. Professional rating done & not put on web (1)	2	

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6	**PROFITABILITY (P) & EFFICIENCY)**		
6.1	P - Operational Self Sufficiency (OSS) i. If more than 135% (2) ii. If between 100 and 135% (1) iii. If less than 100% (1)	2	
6.2	P - Financial Self Sufficiency (FSS) i. If more than 100% (2) ii. If between 80 and 100% (1) iii. If less than 80% (0)	2	
6.3	P - Return on Assets (ROA) i. If above 3.5% (2) ii. If between 2 & 3.5% (1) iii. If less than 2% (0)	2	
6.4	E - Operational Efficiency Ratio (OER) i. If less than 20% (2) ii. If between 20 & 30% (1) iii. If above 30% (0)	2	
6.5	E - Total Cost Ratio (TCR) i. If less than 30% (2) ii. If between 30 & 40% (1) iii. If above 40% (0)	2	
	Sub - total	**10**	
	GRAND TOTAL MSR - Grade	**100 Grade.**	

Based on scores obtained, the MSR grades will be evolved as ['A', 'B', 'C and 'D'] mentioned below and necessary recommendations will be given for to the bank / financial institutions/ donor/ development agency for their follow-up.

Table 2 Recommendations to the Bank / Financial Institution / Donor / Development agencies

MSR- Grade Comments

'A' & 'B'	Finance can be extended
'C'	Finance cannot be extended but can be considered later, when the MFI improves certain basic requirements
'D'	Finance cannot be extended

Conclusion

In the development paradigm, micro-finance has evolved as a need-based policy and programme to cater to the so far neglected target groups (women, poor, rural, deprived, etc.). Its evolution is based on the concern of all developing countries for empowerment of the poor and the alleviation of poverty. Development organizations and policy makers have included access to credit for poor people as a major aspect of many poverty alleviation programmes. Thus, Micro-finance institutional programmes have become one of the more promising ways to develop the objectives of overall development including poverty alleviation.