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Article · September 2015

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Lingering Challenges of Microfinance Institutions (MFIs) and the Way Forward

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DOI: 10.6007/IJAREMS/v4-i3/1815 URL: <http://dx.doi.org/10.6007/IJAREMS/v4-i3/1815>

Abstract

The microfinance institutions (MFIs) are the agencies that attract global concern due to their importance in ensuring financial inclusion as well as helping poor in addressing poverty. There are parts of specialised financial institutions. Therefore the aim of this paper is to implore the lingering challenges of MFIs and proposed way forward to address them. In order to attain the objectives, review of some related literature were embark upon. Among the findings of the study are the challenges that bedevilling MFIs. The challenges include low outreach, criteria used in granting micro credits, regulatory problems, inappropriate human resources, delay in loan re-payment, high transaction cost, infrastructure etc. Lastly the paper has suggested way forward to address the challenges.

Key terms: Microfinance Institutions, Microfinance, challenges of Microfinance

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Introduction

Microfinance institutions (MFIs) are one of the specialized financial institutions (Mosley and Hulmey, 1998). They are the agencies or institutions which are either established by private individuals, government, donor agencies as well as non-governmental organisations with sole aim of ensuring financial inclusion. The essence of MFIs are to provide microfinance services such as provision of micro loan, micro saving, micro insurance, transfer services and other financial products targeted at poor or low income individuals (Kurfi, 2008). Microfinance can be defined as lending small amount of money for enterprise development and attainment of income above poverty line (Lashley, 2004). It is provision of small units of financial services to low income client which are usually excluded from mainstream financial system (Ehigiamusoe, 2008). Thus the cardinal objective of microfinance is to provide meagre amount of capital in order to allow poor micro entrepreneurs to reap the benefits of their labour (Lashley, 2004). However, because of the economic importance of micro finance the developed and developing countries consider it as a means to alleviate poverty and developed micro enterprises.

There are lots of studies that examined the impact of micro finance on economic growth and social development and the positive effect of micro finance on women empowerment as well as rural development (Cheston and Khun, 2002; Kabeer, 2005; Littlefield, et-al., 2003; Sanyal 2009). Despite the fact that there are many researches regarding the impact of microfinance on economic and social development, one of the major area that still attract attention in microfinance are the lingering challenges bedevilling them. In view of this, the paper is targeted at pinpointing some of pressing challenges of MFIs and proposed possible solutions to address them by review of related literature.

Problem Statement

The central essence of microfinance is to provide loan to micro entrepreneurs to invest in their businesses as well as allowing them to grow out of poverty. It enables women to gain respect from their family members as well as making them to contribute positively to their community (Cheston and Khun, 2002). Microfinance programmes are used for rural economic development and empowering of women and low income individuals (Cheston and Khun, 2002; Moll, 2005). However, microfinance is important mechanism in poverty alleviation and micro enterprise development. In spite of that they face numerous challenges ranging from the criteria used in granting credits, cost of operations, inability to target the appropriate calibre microfinance clients, the interest rate charges, poor repayment records, the goal of the microfinance institutions, legal and regulatory impediments and human resources challenges. These are the key issues to discuss in this paper and proposed possible cause of action to address them.

Literature Review

According to United nation microfinance institutions are organisations that provide small scale financial services which consist of saving, credit and other basic financial services to poor and low-income people (Nasir, 2013). According to the previous research, MFIs are playing role in poverty alleviation, improving the living standard of poor and women, promoting rural development and ensuring financial inclusion. Thus, there is plethora of benefits provided by MFIs, however, certain problems lingering in them. Thus, this aspect would review literatures aimed at imploring the lingering challenges of microfinance institutions.

According to Das et-al (2011) has examined the strategies to address the challenges microfinance. The paper has dual on macro and micro challenges to the delivery of microfinance. They found that challenges encountered by MFIs include the inaccessibility of micro finance services to the poor, the capital inadequacy of MFIs, demand and supply gap in provision of micro credit and micro saving. They also discovered that high transaction cost, the non availability of documentary evidence and problem of re-payment tracking. They have categorised the problems into micro and macro challenges.

According to Mabhungu, et-al. (2011) has studies the factors used by MFIs in granting micro loans to micro and small enterprises. The paper has found that MFIs consider factors such as business formality, value of assets, business sector, operating period and financial performance in granting micro loan. This paper has used micro and small enterprises as the population of the study rather than using MFIs. Therefore, the paper has shown that the method adopted by MFIs may not ensure financial inclusion in Zimbabwe because the first criteria used in granting micro loan is formality while most of micro and small enterprises are informal. This shows that the major challenge of MFIs is the criteria used in granting micro credits which result to low outreach.

In the study conducted by Nasir (2013) “contemporary issues and challenges of microfinance in India”, has discovered that the pressing challenges in MFIs are lack of product diversification, low outreach, high interest rate, late payment or delay in payment by microfinance clients , inadequate funding, neglecting urban poor and high cost of transaction. The paper has dual on the challenges of MFIs without providing any viable solution to address them.

According Nawai, and Shariff, (2013) have found that one of the major obstacles of MFIs is loan re-payment problem. They identified the remote causes for the poor loan repayment in Malaysia. In the paper they implored the reasons why MFIs clients are lackadaisical in loan repayment. The paper shown that among the causes of poor loan re-payment are borrowers` attitude toward their loan, amount received, business experience and family background. Therefore, in the conduct of this research the researchers used qualitative approach while quantitative approach can also be used.

In another study by Acha Ikechukwu, (2012) He has investigated the prospects and problems of Microfinance banks in Nigeria. He has identified the problems of microfinance bank to include lack of infrastructures such as electricity, lack of banking culture among their clients, detestation of interest rate in some part of the country, lack of confidence on the part of prospective clients, limited support for human and institutional capacity. This paper has not used empirical data to implore the challenges of Microfinance banks in Nigeria.

According Bhatt and Tang (2001) have investigated the controversies surrounding the MFIs. Their research look at challenging of MFIs from the perspective of three major controversies,

these are microfinance vehicle, technology and basis for performance assessment. On the microfinance vehicle the paper argue on the appropriate channel for the effective delivery of micro financing. According to microfinance vehicle it has argued that the vehicle through which micro finance can be well delivered should be via profit organisation or non-profit organisation such as NGO. On the second aspect of the controversy, the paper dual on technology that is the key role of MFIs is to provide micro finance not enterprise development or ancillary services that can facilitate development of micro and small scale enterprises. On the same issue (technology) that MFIs is to provide microfinance service at the same time providing ancillary services that can ensure enterprise development. The third controversy is the method of performance assessment in the financial service delivery. They argued that some school of thought as regard to financial performance of MFIs is the changes they impact on micro finance clients while others view the assessment performance from the perspective of the contribution MFIs offer to the financial market. Therefore the controversies addressed in this paper are more of academic discord but may have implication on policies regarding MFIs.

According to Ikeanyibe, (2010) has mentioned that the challenging of MFIs has to do with human resource management. He has study the impact of human resource in sustaining MFIs. In his research, He found that managing human resource efficiently and effectively is prerequisite for the sustained MFIs. The paper has shown that inappropriate human resource may serve as major havoc to the sustenance of MFIs and argued that staff of MFIs is fundamentally relevant toward the success or otherwise of MFIs.

According to Arun (2005) one of the issue that has a significant concerned in MFIs are the regulations that steer the conduct and activities of microfinance. According to his finding on regulating and development the case of microfinance indicate that regulatory framework is one of the issues that need to be addressed in order to have sustained MFIs. The paper argued that MFIs need to be regulated by considering the nature and characteristics of the institutions not using universal regulation of the financial system.

From the review above literature there are lots of challenges bedevilling MFIs such as problem of regulations, high interest rate charge by MFIs, inappropriate human resource, poor attitude of loan re-payment by micro finance clients, inadequate of fund on the part of the MFIs, lack of products diversification and factors that are usually consider in granting micro credits to micro entrepreneurs. It is obvious that the aforementioned challenges are the protracted problems of MFIs that need to be addressed for effective and sustained MFIs to be attained.

Discussions

According to Das et-al (2011) have found that the challenges of MFIs include the inaccessibility of micro finance services to the poor, the capital inadequacy of MFIs, demand and supply gap in provision of micro credit and micro saving, high transaction cost, non availability of documentary evidence as well as problem of re-payment tracking. Therefore these challenges can be tackled by creating more awareness to the poor and low income individuals on the essence of micro credit, business angel participation in the area of capital adequacy, provision of needed facilities by every relevant stakeholders, training of micro entrepreneurs on the significance of business documentation and assessment of integrity of clients before granting the micro credits.

Nasir (2013) like Das et-al (2011) have investigated the challenges that face MFIs. Among the challenges are lack of products diversification, low outreach, high interest rate, late payment or delay in payment, inadequate funding, and neglecting urban poor and high cost of transaction. Therefore these problems can be tackled well by ensuring product diversification by MFIs, charging of moderate interest rate, participation of business angels, considering client with high sense of integrity, and involvement of every form of poor without discrimination of any location be it from rural or urban city.

According to Mabhungu, et-al. (2011) they researched on the criteria that usually follow by MFIs in granting microfinance credits even though they used micro and small enterprises as the population of the study. Therefore among the criteria usually used by microfinance includes business formality, value of assets, business sector, operating period and financial performance. The paper has shown the primary criteria used by MFIs in granting loan is business formality whereas most of micro enterprises are operating at informal level this has cause havoc to the micro enterprises to have access to microfinance. In this issue government need to participate in training of micro and small entrepreneurs on the formalization of their businesses.

According Nawai and Shariff, (2013) have identified that the major challenge as regard to the activities of MFIs is loan re-payment. They went ahead to pinpoint the remote causes of loan re-payment problem. The paper shown that among the causes of poor loan re-payment are borrowers` attitude toward their loan, amount received, business experience and family background. Indeed the paper indicates that delay or late payment is the major havoc in the operation of MFIs. However, client with high sense of integrity should be considered when granting micro credits.

Acha Ikechukwu, (2012) has examined the problems of microfinance bank to include lack of infrastructures such as electricity, lack of banking culture among their clients, detestation of interest rate, lack of confidence on the part of prospective clients, limited support for human and institutional capacity. Therefore, the aforementioned problems can be handled through government participation particular in the area of infrastructure, building confidence of microfinance clients by NGOs, inculcating the banking culture to the poor and low income persons. Other measures to ensure effectiveness of MFIs include recruitment of right calibre of staff and strengthening the institutions by avoiding any sort of corrupt practice.

According to Ikeanyibe, (2010) the problems of MFIs have to do with human resources while Arun (2005) stated that the major problem of MFIs is related to regulations of the institutions (MFIs). Therefore employment of appropriate staff and setting regulatory framework that can suite the operations of MFIs are the solutions to their problems.

The above discussion has showcases the lingering challenges of MFIs as well as some of the proposed possible course of actions to address them. The paper has pinpointed the major problems of MFIs which consist of high transaction cost, lack of confidence by microfinance clients, criteria used by MFIs in granting micro loans, lack of products diversification, regulatory framework, loan re-payment problems, financial inadequacy, high interest rate, human resource problem, accessibility and low outreach. However, the paper has provides some of the measures to address the challenges such as government participation in the area of infrastructure, employment of right calibre of staff, ensuring products diversification, coming up with appropriate regulations, associating with right clients particularly those with high sense of integrity etc.

Conclusion and Implication

The essence of MFIs are to provide microfinance services such as provision of micro loan, micro saving, micro insurance, transfer services and other financial products targeted at poor or low income individuals (Kurfi, 2008). Many studies have reported that MFIs play important roles in economic and social development. One of the issues that still need attention is the challenges that surrounded the MFIs. This paper has identified the challenges as well as proposed some of the way forward to tackle them. The paper has not empirically implored the lingering challenges but rather studies some past literature to explore them. In view of this the paper suggested that the future research should use empirical approach to implore the lingering challenges so that the reliable solutions can be obtained.

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