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Micro Finance-Availability and Advantages of Related Products and Services

Dr. Ragini Agrawal

Associate Professor, Department of Commerce

University of Delhi

Abstract

Microfinance is a term for financial services that are offered to individuals or groups, of lower socioeconomic backgrounds or those who lack access to traditional financial services. Microfinance includes a number of services, such as savings accounts, loans, remittances i.e. fund transfers, micro insurance, credit, leasing etc. These services are provided by a variety of institutions which can be broadly divided into micro finance institutions (MFIs), banks, NGOs, credit and savings cooperatives and associations, and non-financial and informal sources. In India, microfinance products and services are provided under two heads i.e. financial services and non-financial services. In financial services, MFIs provide savings account, loan accounts, micro-insurance, micro-leasing, micro-pension, housing loan product etc. In non-financial services MFIs offer business development services, social intermediation services, micro-finance and social services etc. A microfinance institution offers small business loans that are safe to borrower. Therefore, microfinance institutions are becoming one of the best tools for reducing poverty in India. Some microfinance institutions provide financial and business education in order to best position their clients for starting up a small business or to act efficiently as an entrepreneur. In this research paper the availability of different micro-finance products in financial and non-financial categories are discussed. Also, the advantages of each product is also examined.

Keywords: Micro-finance, Financial products, Non-financial products

Introduction

Microfinance is an attempt to provide basic financial services like loans, opening savings accounts and insurance for people with low income. Many professionals or individual businesses often lack access to traditional loan facilities that major institutions offer. A microfinance institution is a provider of credit, like a bank. However, the size of the loans is smaller than those granted by traditional banks. These small loans are known as microcredit. The clients of micro finance institutions (MFIs) are often micro entrepreneurs in need of economic support to launch their business.

The Microfinance pioneer Muhammad Yunus, started Grameen Bank of Bangladesh during 1970's and the use of the present day term 'micro finance' started shaping since then. In India, in 1974, Mrs. Ela Bhatt started the Self-Employed Women's Association ('SEWA') in Gujarat, but the formal starting of microfinance, is done by NABARD, in 1988. Microfinance is a term for financial services that are offered to individuals or groups, of lower socioeconomic backgrounds or those who lack access to traditional financial services. Microfinance includes a number of services, such as savings accounts, loans, remittances i.e. fund transfers, micro insurance, and micro pension, credit, leasing etc. These services are provided by a variety of institutions which can be broadly divided into micro finance institutions (MFIs), banks, NGOs, credit and savings cooperatives and associations, and non-financial and informal sources. A microfinance institution gets the funding from established financial institutions and aid the underprivileged. Microfinance offers small business loans that are safe to borrower. Therefore, microfinance institutions are becoming one of the best tools for reducing poverty in India. Some microfinance institutions provide financial and business education in order to best position their clients for starting up a small business or to act efficiently as an entrepreneur.

Availability and Advantages of Related Products and Services

In India, microfinance products and services are provided under two heads i.e. financial services and non-financial services. They are mainly provided by two models- SHG-Bank Linkage model and MFI-Bank model.

A. Financial Services- Availability

The following are the products and services under financial services which are made available by these models to the clients:

1. Savings Products

Saving means, the remaining amount of income which is left after spending on all the expenditure. Savings are the important financial service. The SHG-Bank linkage model works on the principle "savings first, credit next". Savings in microfinance are basically of two types- compulsory savings and voluntary savings.

- **Compulsory savings-** Some micro finance institutions (MFIs) make it compulsory for borrowers to save fixed amount at regular intervals (weekly or monthly) with MFIs and these savings are called compulsory savings. These regular savings show their motivation as well as the strength of the group. They are generally regular and loan-linked. The client cannot withdraw the savings generally during the term of the loan and thus, act as a form of security for the micro finance institution.

- **Voluntary savings-** The savings that the client decides to make according to his will and availability of funds with him is called voluntary savings. The micro finance institutions may offer different savings products (recurring deposits, fixed deposits, monthly income scheme etc.) with different features to attract the savings of clients. A client can withdraw from voluntary savings and use depending on his needs and convenience. Therefore, managing voluntary savings is very complex issue and require financial skillsets, stability, credibility, liquidity management, strong management systems, supervisory capacity and regulatory requirements.

Savings are a low cost source of funds for both MFIs and SHGs. But, there are number of factors which need to be analyzed to estimate the cost of offering savings correctly. The major costs associated with savings are set-up cost, direct cost, indirect cost and cost of fund. Therefore, at the time of evaluating the viability of saving products, all major costs need to be considered and compared with the cost of raising funds. The viability of the saving products depends on cost factors. If the cost of mobilizing savings is higher than availing external loans, then financially it is better to raise borrowings.

Advantages-Savings

- Saving account help rural poor people in streamlining the cash flows and they can use their funds whenever need arises.
- The economically weaker section customers have flexible, erratic, small amount of savings apart from the inaccessibility of banks. Micro finance institutions can provide them the scope for keeping their savings. Hence, there is a great significance of savings in lessening the risk and vulnerability of rural borrowers. The saving accounts of clients are important not only for them but also for micro finance institutions.
- Savings account can even out the cash flow fluctuations of poor people. It helps the poor clients to use it in times of lean periods or out of season time. Therefore, past savings can be used as an investment in the business when need comes.
- The livestock or business assets can be purchased with the help of savings, which can help in creating new source of income or increasing the volume of existing income.
- Savings can be spent for non-productive but necessary activities like education, housing, social ceremonies. Hence, it lessens the risk and supports the poor borrower in emergent times.
- Savings work as a good source of money even for micro finance institutions. The cost of borrowings is costlier than the cost of funds generally. So, savings help in decreasing the financial cost overall and therefore supports in developing the micro finance institutions.

- The collection of funds by micro finance institutions from external sources needs specialization as it is a complex process, on the other side, savings is a definite and regular source of money for MFIs.
- Micro finance institutions (MFIs) receive regularly some amount of savings also from the members particularly, in case of compulsory savings where a fixed amount of savings received by MFIs regularly.

2. Loan Products

Loan / Credit means providing loans to the clients, which is collected back with the principal amount and interest in a fixed number of instalments, spread over a period of time. This is the most common financial product provided by micro finance institutions. They provide loans for productive purposes (business, working capital etc.) and consumption purposes as well. The rural poor people need finance for income generation activities and also for consumption purposes like, education, medical and social functions etc. There are many products which are offered by MFIs for meeting different types of requirements of the borrowers. The MFIs use innovative and new product designs and delivery channels to overcome the challenges of serving the low income sector. MFIs provide a range of micro enterprise loans including individual products and group products for fixed assets and working capital needs.

There are certain credit principles of MFIs, while delivering microfinance loan products, like timeliness of credit, collateral free loans, credit at door steps and simple loan procedures etc. There are two different approaches in offering loan products and services to the borrowers. One is Income Generating Loan Approach and another is Consumption Loans Approach.

- **Income Generating Loan Approach**

  Many micro finance institutions (MFIs) provide loans only for income generating purposes i.e. micro enterprise loans, which can help in income generation like business expansion, working capital etc. They intend to give loans primarily for increasing the income of the clients. It means money given as loan for investment in income generating activities like business, livestock etc.

  Another reason for providing micro enterprise loans is that income generation activities reduce the risk of giving credit for MFIs. A loan invested in business activities will get repaid, as it will increase the income returns of the client and he would be in a better position to pay back the loan amount.

- **Consumption Loan Approach**

  A poor client may have the market but he may not have funds to expand the business. Also, he may have seasonal demands of his produce but due to lack of working capital, he may loss opportunities. In such cases if he gets a loan, he can increase his business and make more volume of sales and so profits. Therefore, to overcome this situation, some micro finance institutions offer small and quickly available loans to help the borrowers to meet the unexpected contingencies. The clients may need credit for many types of non- productive purposes, like education, health, house, social functions etc. Also, if the loans are not given for consumption purposes, the poor people turn to the money lenders who charge high rate of interests. As such even if the loans are given for productive purposes, the loans may turn bad, if the other needs are not met. So in any case, they will not be free from the hands of money lenders. MFIs believe as long as they are able to recover the loans, the client should have the freedom to decide the utilization. MFIs secure the loan by the process of assessment and appraising the creditworthiness of the borrower and also through group guarantees.

Advantages-Loan Products

Loan products offered by MFIs help small rural businesses and poor individuals financially and also socially by creating self-dependency and sustainability in their businesses. Micro enterprise loans encourage the micro entrepreneurs to start a small business. Therefore, it gives security, economic growth and business opportunities. The following are the advantages of loan products offered by MFIs:

- Loans offered by some micro finance institutions make it easier for poor rural individuals or groups to have access to funds. Gradually, they can become financially empowered and repay their loans in future, on easy repayment terms offered by MFIs.
- Micro finance institutions offer small and immediate consumption loans to help the borrowers to meet the non-productive needs and contingencies, like education, health, house, social functions etc.
- Getting credit helps small businesses to meet the basic financial requirements of their business and help them further in future investments and progress.
- Income generating loans support in managing productive activities and increasing the income of the borrowers.

3. Insurance Product

Insurance is a promise of compensation for particular potential future losses in exchange for a periodic payment. It is designed to protect the financial wellbeing of an individual, company or any other entity in case of unexpected losses. There are many types of uncertainties that could cause risk to any individual. So insurance proves to be a good help. In the microfinance context, insurance is a financial service that gives security or control risks in case of any mishap with the client. A client has to pay a fixed amount every year called premium and the insurance company in turn, indemnifies and assures a fixed sum of money that will be paid if that event occurs for which the insurance has been taken.

Insurance provided to low income clients is commonly known as micro insurance. It is a financial service that can complement and enhance the loan services and saving services, as explained above. These services together can reduce the vulnerability and risks of the poor people, which is the major objective of micro finance. Most micro insurance provides coverage to individuals who do not have retirement savings or to low-income households. Micro insurance products are made specifically for compensation for illness, injury, or death, and lower valued possessions or assets.

Micro insurance is different from general insurance as it is a low value product involving modest premium and benefit package. Therefore, there are the requirements of different design and distribution strategies such as premium based on community risk rating, active involvement of an intermediate agency representing the target community etc. Micro insurance has gained a lot of momentum and holds a good future. It is fast emerging as an important safety strategy for the low income people engaged in a variety of income generating activities and who remain exposed to a variety of risks mainly, because of absence of cost effective hedging instruments. The poor people are vulnerable to the risk due to their economic circumstances. There are four models for delivering insurance to the poor people. Partner-Agent Model, Community based Insurance Model, Full service based Insurance Model and Provider Model.

Advantages-Insurance

- The biggest advantage of micro insurance is that it offers the opportunity for the economically vulnerable section of the population to buy insurance at a low cost. Therefore, they can receive financial assistance during challenging times.
- The households may lose critical assets to risks in the absence of micro insurance.
- Micro insurance protects the low -income people, with affordable insurance products to help them cope with and recover from financial losses.
- It has a low value product involving modest premium and benefit package.
- It is an important safety strategy for the low income people, who remain exposed to a variety of risks mainly, because of absence of cost effective hedging instruments and due to their economic circumstances.

The micro insurance market is still in its infancy stage. Insurers need to establish them to get the advantage in the long run. Eventually, they'll also be able to gain the trust of the people they are insuring.

4. Micro pension Product

It can be regarded as a risk management mechanism for the poor people to use it as a protection in their old age. Alternatively, it can be viewed as an opportunity to provide financial services to the low income market. Small amounts of money can be saved individually and invested collectively to grow benefits. Benefits are dependent on investment returns. Micro pensions are individual based long term products where trust in the pension trustee is important. In India, most individuals are not part of the organized sector. The unorganized sector change jobs or opt for self-employment, move from one location to another and at times temporary unemployment also. The sub economic sector population has certain unique features like they live in remote areas, requiring a different distribution channel to pension products. Generally, they are illiterate and unfamiliar with the concept of pension, so they require unique approaches for marketing and contracting therefore, it leads to high transaction cost, apart from that they have little experience of dealing with financial institutions. A typical micro pension scheme is based on voluntary savings accumulated and these savings are intermediated through capital and financial markets by a professional fund manager. Total amount accumulated depends on contributions and net investment returns of administrative, investment management and other expenses. At an agreed age to withdraw (usually 58 to 60 years), the accumulated balances can be withdrawn.

Advantages-Micro Pension

- It helps to build up assets as old age income for poor people.
- It helps in long term savings by low income, informal sector workers with the objective of obtaining income security during old age.
- The poor people can become financially independent in old age.
- The poor people have flexible contribution remittances.
- They have the opportunity to make withdrawal prior to retirement (40% of contribution).

5. Remittance Product

Remittance is a financial service that deals with transfer of money from one place to another including payments made in case of commercial transactions. Although provision of this financial service by MFIs is still at its infancy stage, but there is a lot of need of this service due to the following reasons:

- **I**n India, rural labor keeps on moving in search of work. These migrants need convenient low cost and safe means to transfer their savings back to their families.

- The formal money transfer facilities offered by banks and post offices are inadequate and inconvenient for them. Also, the charges payable on postal money order is a significant sum of money for them.
- The rural people do not have access to banks, they find difficult to use bank drafts etc. as these formal channels are not suited to cater to low income clients.

Therefore, in these circumstances, micro-finance institutions are well suited to provide remittance services due to their outreach to remote locations. MFIs play an important role in transferring their money from one place to another, provided they have some minimum number of migrants in the place of destination from a particular place of origin in the rural areas. Although, remittance appears to have high potential ahead, in our country on account of seasonal employment and high number of poor migrants, but MFIs are not fully prepared for this financial services so far. One of the constraints for MFIs is to have presence at the two locations, origin location and destination location simultaneously.

Advantages-Remittance

- Remittances or the money transfer activity has a significant positive impact on savings collection. MFIs involved in the remittances market thus attract more savings than MFIs that are not involved in it.
- Remittances help to improve financial inclusion, especially, for people who are unbanked. Remittances are an important source of assistance for families and communities.
- Remittances can greatly improve livelihoods of people, promotes education, health, and capital investments.

6. Leasing Product

The financial lease is a micro finance product that allows client to purchase assets without a major down payment and without additional collateral. The financial institutions retain the ownership of the asset until the end of the lease term and therefore, the assessment process can become simple. It is less common micro finance product.

Advantages- Leasing

- Under micro leasing, MFIs can finance fixed assets for a broad range of microenterprises through innovative products, services, and delivery channels. Some of the benefits offered by leasing include: availability and demand, efficient capital use, collateralized financing, lower transaction costs, and fixed rate financing.

7. Housing Loan Product

It is a new micro finance product which assists to make improvements in dwellings of the poor people. Micro Housing Finance focuses on offering housing financial aid to lower-income households, in the informal sector generally. The borrowers usually take one to three years' loan to build additional room or upgrade the roof etc. and then once the loan is repaid, they may borrow again to build another part of the house.

Advantages-Housing Loan

- The main advantage of housing loan is that the loan is offered at a low-interest rate to the borrowers.
- It is easy to pay back loan due to short span relatively.

These are some of the important financial services, the MFIs have already been providing but these are not the only financial services that they can deliver. In future, MFIs may add more financial services if the regulatory environment is conducive.

B. Non-Financial Services

Some micro-finance institutions also provide non-financial services like business development services and other social services. They provide non -financial services to vulnerable people and low income households. MFIs may combine financial or non-financial services to have a greater impact and to reduce the lending risks. The following are the products under Non- Financial Services category of micro-finance institutions to their clients:

1. Social intermediation Service

It means service of non-financial nature which is based on social pressure and social intermediation. Social (peer) pressure acts as the security of the loans for MFIs. MFIs use group guarantee schemes, where all group members take guarantee for one another and it creates the social pressure. MFIs find it more convenient and cost effective. The strength of the group is the most crucial parameter. Mobilizing community, forming groups, training groups on leadership issues, record keeping, owning responsibility, communication etc., all such activities are in the nature of social intermediation and are carried out by MFIs to build the capacity of the community. These services are non-financial in nature.

Advantages

- Social intermediation has the role in building of social capital within groups. Social ties and trust created amongst group members will promote a lending relationship between financial organizations and clients in the credit industry.

2. Business Development Service (BDS)

Some micro-finance institutions (MFIs) believe that giving financial services may not be enough and can be best utilized by their clients only if they have entrepreneurial skills and linkage to market. Therefore, these MFIs get involved in providing business development services to their clients, apart from providing financial services. They offer skill building training to their members to carry on the particular activity which is helpful in setting up production units, designing of products and arranging market linkages to ensure marketability and good price for the produce of their client.

Many micro-finance institutions adopt integrated approach and get involved in offering services beyond microfinance. Business Development Service (BDS) is one such non-financial service provided by many MFIs. They help the entrepreneurs in their business activities by helping in building their capacity and creating, enabling environment for them to establish businesses and so reap benefits. MFIs help in arranging producers, doing market surveys, designing latest products, training of producers, spreading awareness about government schemes, helping entrepreneurs in availing such schemes and linking them to markets. They also help in arranging common facility centers, exhibitions and publicity. BDS is a step further by MFIs to see that the clients get organized and gradually become successful entrepreneurs.

These microfinance products and services assist the poor rural to get four main socio-economic improvements like job creation, asset building, poverty reduction and empowerment.

3. Microfinance and Social Service

There are MFIs which are involved in financial as well as non-financial services also, like working on issues of health, education, women development, child labor, human rights, sanitation or natural resource management etc. In India, many MFIs generally following SHG model, are very active and managing social intermediation and other social services. Such MFIs not only form SHGs but also create even larger structures of SHG clusters and federations. These community structures can be used by the government agencies also as channels for delivering their own developmental projects and programs. MFIs try to create empowerment at the community level so that community structures may become independent finally and can act as MFIs on their own. They can avail loans from the banks directly and can rotate the money. There are some MFIs also that have microfinance as a major activity but they still allocate a certain percentage of surplus for other social purposes, like, education, social awareness, water management etc. But, sometimes, the performance of their social programs may affect their microfinance related operations.

Conclusion

The clients of micro finance institutions (MFIs) are often micro entrepreneurs in need of economic support to launch their business. Although, there are important financial services that the micro-finance institutions (MFIs) have already been providing but these are not the only financial services that they can deliver. In future, MFIs should add some more financial services if the regulatory environment is conducive. The micro-finance institutions also provide non-financial services like business development services and other social services. They provide non -financial services to vulnerable people and low income households. Micro-finance institutions should combine financial or non-financial services to have a greater impact and to reduce the lending risks in future.

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