JETIR.ORG ISSN: 2349-5162 | ESTD Year : 2014 | Monthly Issue
JOURNAL OF EMERGING TECHNOLOGIES AND INNOVATIVE RESEARCH (JETIR)
An International Scholarly Open Access, Peer-reviewed, Refereed Journal

A study on Risk Management in Micro Finance Institutions in India.

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ABSTRACT:

MFI is an institution that after financial services to low income population micro financing is considered as one of the most effective tools of reducing poverty, this institution are gaining huge in developing countries.

This paper is intended to focus on the risk associated with micro finance businesses and to identity the means to fight against those risks and uncertainty.

Key words: risk, finance, assets, institutions, credit

Introduction:

A Microfinance Institution is an Organization that offers financial services to low income population.

These Institutions provide credit and other type of financial services to the representatives of poor, It is concerned as one of the most effective tool of reducing poverty as it has a significant role in bridging the gap between the big financial institutions and poor.

MFI accesses financial resources from the banks and other financial institutions and provide financial services to the micro entrepreneurs, women, poor and to those who need micro finance.

Various types of institutions offer MF Services and can be broadly classified as

1. Formal Institutions.
2. Semi formal Institutions.
3. Informal sources.

Formal Institutions include rural banks and co-operative society semi formal Institution consist of Institutions such as NGO's and money lenders and shop keepers are the informal source of micro finance.

According to Asian Development Bank "Micro finance is the provision of broad range of financial services such as deposits, loans, payment services, money transfers and insurance to poor and low income households and their micro enterprises".

Micro financial institutions are gaining in developing countries like India because at they easy availability of micro credit facility and its simplified way of operation it is used as an effective tool in eliminating poverty.

Features of Micro financial Institution.

Features:

Distinguished features of micro finance institutions are as follows,

1. Small amount of loans are advanced to the customers.
2. Savings of the customer are very small.
3. The absence of collateral security.
4. Objective of these institution is the social and cultural upliftment of people.

Conceptual framework

Risk is the possibility that the actual return will deviate from that of expected return due to some unfavorable circumstances or conditions, risk is also defined as the chance of loss.

<u>Risk in Micro finance Institutions:</u>

Like any other organization MFI are also exposed to risk factors as these financial institutions provide financial services to poor and low income earners and most of them do not have physical assets and financial assets to pledge as collateral security and such several other such factors as the institutions face several problems

Risk faced by financial institutions can be broadly classified as follows

1. Credit risks
2. Market risk
3. Operational risk
4. Strategic risk

1. Credit risk:- Credit risk is directly associated with the financial position of the organizations whenever an MFI lends money to a client the risk of client turning out to a defaulter will be there these risk is called the Credit risk

   These financial institutions has to deal with low income earners and also provide unsecured loans without any collateral securities in such case MFI does not have any asset to meet its loses, risk of loss arises if a client does not make payment of installment before due date and if any loan has any amount overdue it is termed as a delinquent loan

2. Operational risk:- operational risk relates to the risks emerging from failure of internal system such as technology, human processes or external factors such as natural disasters fires etc.., the Operational risk can be broadly classified into
   a) Human risk: errors, frauds,
   b) Process risk: lack of clear procedure on operations such as repayment, accounting, data recording.
   c) Technology risk: software failure, power failure.
   d) Relationship risk: client dissatisfaction, dropouts, poor products.
   e) Asset loss due to natural disaster

3. Market risk: market risks are risks of financial nature which occur due to fluctuations in the financial market or due to mismatch in asset and liability of an organization Market Risk arises in three ways that is

a) Liquidity Risk.
If on Institutions does not have sufficient; liquid assets to the meet its obligation then there is chance of liquidity risk.

b) Interest rate risk:
Interest rate risk Arises due to fluctuation in the interest rate at which micro finance institution have borrowed loans.

c) Foreign exchange risk.
Foreign exchange risk arises due to fluctuation in exchange rate of currency in which MFI have borrowed loans against local currency.

4. Strategic risk.
Strategic risks are related to weak governance, weak leadership, poor strategic, decision and other risk due to administrative reason these risks can adversely impact organization for a long run noncompliance of legal requirement is also termed as strategic risk.

Risk Management.

Managing risk is complex task for every financial institution as both external and internal factors create impact on this institution. Risk management is an essential element for long term success.

Risk management is the processes of managing the probability are the severity of the advance event within limits set by the MFI's.

The Above discussed risk can be managed in following ways.

1. Setting of clear vision.
   In order to keep credit risk under acceptable limit organization have to frame clear vision and mission for their day to day operation when there is everything clearly said and return there is less possibility of getting confused.
2. Segregation of business function.
   MFI Should be aware that different functions of the organization cannot be mixed with one another for example social welfare activities should be kept separate from that micro finance.
3. Product Design.

Having an appropriate product design is also very essential to make it suitable for target group it is advisable to have frequent repayment in case of loans in order to maintain regular contact with customers.

4. Internal control system

   Credit risk also occurs due to policies not being followed or misappropriation. Therefore a strong internal control system is very essential to avoid fraud or faking.

5. Managing transaction risk.

   Transaction risk is related to loss of loan, all loss of loan due to client's migration, with full difficult business failure etc. is called transaction risk income of household and merit has to been seen before issuing credit and clear verification of application is also important.

6. Maintain better relationship with clients.

   Collecting regular information with the client about their satisfaction will built a good relationship with MFI and its client.

7. Maintain liquidity.

   Their MFI should maintain liquidity i.e. should have sufficient amount of cash to meet any contingency.

8. Maintain transference.

   Transference helps in managing political and administrative risk. MFI Should maintain transference on its interest rates and their policies, maintain Transference with shareholders by disclosing annual report to them and also should disclose relevant information to government local authority and media person.

9. Follow-up actions of organizational policies.

   The actual performances of the organizational policies have to be monitored in order to compare it with estimated result.

10. Adopt process of risk management

    MFI Should have process in its regular operations to identify measure and monitor different types of risk that on MFI is exposed to.

11. Advance preparation.

    Management should consider different risk scenarios and be prepared with some solutions.

Findings:-

1) We found that major problem faced by MFI is recovery of loans
2) Even they are suffering from shortage of funds
3) They are not able to manage several kinds of risks
4) Even they cannot compete with other financial institutions
5) Lack of support from related bodies

Recommendations:

1. Have to manage their credit collection.
2. Need to have proper management.
3. Have to utilize their funds properly and have to concentrate on low income people
4. It is better to gain confidence of self help groups because they can give good business to MFI's
5. Build good team to manage risks both internally and externally

CONCLUSION:

MFI play effective role in the countries in economic development as this institution provide financial service to poor and weaker section of the society. But these institutions are exposed greater risk when compared to other financial institution due to lack of stringent rules and policies will issuing credit and poor management techniques. If this institutions could adopt better risk management techniques like early detection of risk proper analysis of situation better credit policy this institution could be financial strong.

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