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Micro Finance and Economic Development: The Role of Microfinance Institutions Outreach in Pakistan

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Abstract

Microfinance focuses on economic development at a minute level. Microfinance is adopted to reduce the poverty level in the economic system. This study is conducted to investigate the microfinance institutions' outreach, its growth, and challenges faced by the Microfinance Banks (MFBs) and Microfinance Institutions (MFIs). Data is collected from MFBs and MFIs working in Muzaffarabad as well as from interviews and focus group discussions. Findings are based upon lending, headcount ratio, offers, the value of their offer, and the possible growth chances of microfinance in Muzaffarabad. In addition to this, the challenges associated with microfinance outreach have been highlighted during analysis and guidelines have been provided to the MFBs and MFIs to increase their outreach. The sector is financially unstable which is attributable to its reliance on conventional sources of funding. The industry faces several endogenous as well as exogenous challenges from its environment which obstructs its growth. Further, it helps the policymakers to work on the development of the region and provide the base for further future research work.

Keywords: Microfinance, Microfinance Banks, Microfinance Institutions, Outreach, Challenges, Pakistan

JEL Classification Code: E59, M19, M29

1. Introduction

Poverty is the state of not having enough material possessions or income for a person's basic needs. Poverty may include social, economic, and political elements. Since the year 2000, the United Nations (UN), the International Monetary Fund (IMF), and the World Bank have been playing a vital role in the protection of the environment, poverty eradication, and improvements in the health and education sector. The World Social Summit identified poverty eradication as an ethical, social, political, and economic imperative of mankind and called on governments to address the root causes of poverty, provide for basic needs for all, and ensure that the poor have access to productive resources, including credit, education, and training. Poverty eradication must be mainstreamed into the national policies and actions in accordance with the internationally agreed development goals forming part of the broad United Nations Development Agenda, forged at UN conferences and summits in the economic, social, and related fields (United Nations, n.d.).

The primary objective of microfinance is to enhance outreach to disadvantaged sectors of the economy through financial inclusion. It is linked to the empowerment of the poor by the provision of financial emancipation and a simple way to provide loans, and other financial services to impoverished individuals to enhance their income-generating capacity and to foster economic activities in low-income segments. The concept of microfinance can be traced back to the mid-nineteen century when Lysander Spooner documented the benefits of micro-credits to farmers and entrepreneurs as a way through which poor people would and can get out of poverty (Sainz-Fernandez et al., 2018; Shahidullah & Emdad Haque, 2014). The idea of micro-financing came into existence in the mid of 1800. While in German the idea was established by Wilhelm Raiffeisen

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over 40 years ago and the concept has reached over two million rural farmers. In Bangladesh, in 1972 the concept was popularised by professor Yunus who started to provide loans to the people who were unable to access loans services through the formal services, which later evolved and led to the formation of Grameen Bank in 1983 (Yunus, 2008b). The modern Microfinance revolution commenced in the 70s when Dr. Yunus, a Nobel Prize winner economist coined this innovative concept of lending, studied poor individuals in a village named Jobra in Bangladesh and discovered that the poor were unable to change their economic situation because they lacked access to capital due to exclusion from the conventional financial system. In response to their need for capital, Grameen Bank was established with the vision to alleviate poverty and reach those regarded as "Non-bankable" (Desai, 2011; Jalal et al., 2020; Mia, 2016; Tarozzi et al., 2013, 2015).

Today 7000 microfinance institutions are operating in the world with an outreach of about 54 million individuals. Microfinance has a key role in altering issues in the field of agriculture, rural finance, and rural development activities. Microfinance, or financial services for the poor, offers a distinctively crosscutting tool capable of alleviating some of the most challenging issues of our time. These include, but are not limited to, ending extreme poverty and hunger, promoting gender equality, enabling access to healthcare, and promoting inclusive economic growth. With 70% of the world's poor currently relying on agriculture for income and employment, the provision of agricultural financial services offers a critical lifeline to stimulate, stabilize and strengthen millions of farming enterprises.

This in turn offers resilience to communities in the face of changing weather patterns and enables farmers to meet food demand from millions of families worldwide. Microfinance, also called microcredit, is a type of banking service provided to unemployed or low-income individuals or groups who otherwise would have no other access to financial services. Further, banks can also initiate critical business development of small and micro enterprises services in each of the different sectors of the economy. They include both business development services territory of non-financial and financial services at some other point which acts as an essential strategy in poverty reduction and development of rural areas. Women particularly benefit from microfinance as many microfinance institutions (MFIs) target female clients. Microfinance services lead to women's empowerment by positively influencing women's decision-making power and enhancing their overall socio-economic status. Meanwhile, industry plays a significant role in the progress of the country economically. Generally, stock markets and the banking sector are linked with prime economic development (Jalal & Sahar, 2020). Major economies in the world that are facing growth problems can take advantage of loans In this context, loan setup can assist low-income groups and growth of small enterprises which produce income and employment that ultimately benefits their economies and societies (Wright & Mutesasira, 2001).

Okpara (2010) focused on the identification of critical factors that cause poverty in Nigeria and the investigation of the extent to which microfinance institutions have helped in the alleviation of poverty. for analysis. The result of the analysis identified five factors: low profit, prices of commodities are too high, hard economic times, lack of finance to start or expand their business, and business not doing well, as critical factors causing poverty. The analysis also revealed that the impact of microfinance on poverty in Nigeria can be explained in two phases. The first phase, the take-off stage, sees poverty as increasing though at a decreasing rate as microfinance credit increases. In the second phase, precisely starting from the year 2001, a persistent increase in microfinance credit reduced drastically the poverty index in Nigeria. Thus, currently, microfinance credit lowers poverty in Nigeria. The researcher, therefore, calls on the monetary authorities to put in place the financial superstructure necessary for making mandatory the establishment of microfinance banks in every community, if poverty will be aggressively fought. Ehigiamusoe, (2005) opined that since one of the acknowledged 11 principles of microfinance is 'building of institutions which deliver financial services to the poor in an efficient manner and on a sustainable basis, then it is only efficient institutions that can reach a large number of people thereby making a substantial impact on poverty.

In Pakistan, the microfinance era begins in 1970 with the formation of Zarai Taraqiati Bank Ltd formerly known as Agriculture Development Bank of Pakistan and was founded to prolong subsidized loans to the rural population. The initial two MFI's, the Orangi pilot project and Agha khan rural support program (AKRSP) were set up in 1980. AKRSP has been regarded as the most influential of its type since it spawned the Rural Support Program which today accounts for nearly 70% of NGO outreach in microfinance. Pakistan Poverty Alleviation Fund (PPAF) was created through the financial backing of the World Bank and Government of Pakistan in the year 2000, which resulted in the formation of Khushali bank, the first bank in Pakistan which specializes in microfinance. Microfinance was in the limelight when it was made a pillar of poverty alleviation strategy during the regime of Pervaiz Musharraf and it followed a revolution in the past decade by gradually mainstreaming into the formal banking system. This study is carried out with prime objectives to identify the outreach of microfinance institutions and challenges in the least developed areas of Pakistan like Azad Jammu & Kashmir specifically the

Muzaffarabad region. The outcomes of this study will provide literature regarding MFIs outreach in AJ&K as well as it can be used in devising the policies which will ultimately help in the socio-economic development of the people of AJ&K.

2. Literature Review

2.1. What is Microfinance?

Microfinance is a category of financial services targeting individuals and small businesses who lack access to conventional banking and related services. Microfinance increases the income of households, allowing them to increase their savings as well as their investment capacity. Therefore, Microfinance plays an important role at the economic level because it allows people with low income to obtain small loans to participate effectively in the local economy and achieve financial stability which gives them more autonomy. Microfinance is the provision of a 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. It includes a diverse set of financial activities which facilitate the micro-enterprises and help low-income households and the poor to develop themselves as well as raise living standards. It can be called as a special type of banking sector service which addresses financially excluded population, generate employment opportunities and fulfill needs.

According to Robinson (2001), microfinance refers to small-scale financial services-primarily credit and savings-provided to people who farm or fish or herd; who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban. Yunus (2008) indicated that microfinance is a way to provide small business owners and entrepreneurs access to capital. Often these small and individual businesses don't have access to traditional financial resources from major institutions. This means it is harder to access loans, insurance, and investments that will help grow their business. By developing the financially excluded population by providing them microfinance overall economy can develop in a better way and will help in attaining stability in the economic setup.

The concept of microfinance can be traced back to the mid-nineteen century when Lysander Spooner documented the benefits of micro-credits to farmers and entrepreneurs as a way through which poor people would and can get out of poverty. The idea of micro-financing came into existence in the mid of 1800. The first cooperative bank for the farmers was founded by Raiffeisen which in the future shaped the present micro-financing. Before Raiffesien, this concept was developed in India as the baniya system, zamindar system, chit fund system, among others. Desai (2011) explored the potential of microfinance in post-conflict economies and specifically examines policy considerations for the case of Iraq. It presents important conditions of the post-conflict economy, and examines three critical requirements for successful microfinance operations, as outlined by the Microenterprises Best Practices Project. Political stability, economic demand, and population stability are evaluated in the case of Iraq. Several other considerations are also addressed, including matters of scale, governance mechanisms and support, and gender and religious contexts.

In 1976, microfinance was introduced by the Grameen Bank of Bangladesh. It has gained acknowledgment and worth in the financial world. Microfinance companies can provide much-need funds to an individual for setting up a healthy business that seeks minimum investment and offers sustainable profit in the long run. Thus, these companies ensure entrepreneurship and self-sufficiency among the lower-income group. Potential entrepreneurs who are not able to provide guarantee/assets to acquire a loan from banks is targeted, in form of a group. This particular group is called as Self Help Group. Self-Help Groups (SHGs) are informal associations of people who choose to come together to find ways to improve their living conditions. It can be defined as a self-governed, peer-controlled information group of people with similar socio-economic backgrounds and having a desire to collectively perform a common purpose.

Improvement was observed in microfinance in terms of targeting the poor as compared to the conventional approach during the 1980s to 1990s. Women and poor people had acknowledgeable repayment rates as compared to the upper class and the financial sector of the developing countries. As the willingness and the paying back behavior of the poor's have flourished, the microfinance sectors also raised the standard of living of the poor population who availed microfinance. Microfinance plays a major part in poverty reduction in access to worldwide growth (Okpara, 2010; Santandreu et al., 2020; Shahidullah & Emdad Haque, 2014; Tarozzi et al., 2015; Wright et al., 2019).

According to Khandker and Samad (2014) if the outreach in terms of numbers of debtors is increasing and the loan repayment is done by debtors then the microfinance sector is successfully performing. The current MFI industry is destined for failure due to poor efficiency. Microcredit was once hailed as "the solution for global poverty. "At the turn of the millennium, the world was full of hope for the latest tool in fighting poverty. Numerous studies have been conducted over the years examining the impact of microcredit. Microcredit is rarely sustainable among the poor at modest interest rates and very rarely reaches the poorest. (Cull et al., 2011; Hermes et al., 2011; Tchakoute-Tchuigoua & Soumaré, 2019). Sander (2003) looked at migrant remittances to and in Africa and the link with the microfinance industry as a provider of money transfer or ancillary financial services to remittance senders and recipients. It explores what transfer services microfinance institutions currently do or could provide and discusses the opportunities and challenges of such services for MFIs in Africa. The findings revealed that a high potential for capturing a market share of an under-serviced market of remittance money transfers; only regulated MFIs to take advantage of this opportunity; product opportunities like domestic money transfers, which can contribute as competitive and profitable service for commercializing MFI. MFIs in Africa are not necessarily the best placed to take advantage of this opportunity due to their legal limitations as financial service providers, their limited institutional and system capacities, limited capital reserves, and limited networks of service outlets and links to international networks. MFIs are not the panacea to lower cost and more accessible transfer services nor the integration of low-income remittance receivers with broader financial services. The high and growing level of remittance flows to Africa suggests that there is an underserviced market for affordable and good money transfer services. Commercial financial providers have various limitations such as limited representation outside the capitals and other access issues, low-quality services, high cost, and in some cases also loss of trust in the banking system due to recent collapses. Understanding the business environment and capacities of microfinance institutions is crucial in considering whether they can capture a market share in money transfers by providing alternative, improved, or lower-cost services.

It is argued that financial sustainability is necessary as an opportunity cost during the nonexistence of microfinance institutions may be high. Studies express that microfinance is a very constructive tool for poverty eradication (Mazhar Siraj, 2012; Khandker & Samad, 2014; Sainz-Fernandez et al., 2018; Santandreu et al., 2020; Xu et al., 2019). Microfinance help to generate income as well as assist to improve the standard of poor people.

2.2. MFIs and MFBs in Pakistan

The impact of microfinance is far beyond the single customer. Past research studies depicted that a large number of loans are provided to women because women are more likely to reinvest the earned amount in the enterprise as well as in their families also. Microfinance also generates employment opportunities, knowledge delivery, and community development. Microfinance Institutions provide financial services to the poor population at a micro-level (Okpara, 2010; Sainz-Fernandez et al., 2018). Most of the MFIs are non-governmental organizations committed to the development of humans. These organizations gather resources with the help of government agencies or from formal or Informal NGOs.

The history of microfinance in Pakistan begins in 1970 with the establishment of the Agriculture Development Bank of Pakistan later named Zarai Taraqiati Bank Ltd. which was founded to extend subsidized loans to the rural population. In 1980, two MFI's, the Agha Khan Rural Support Program and Orangi Pilot project were set up. AKRSP has been regarded as the most influential of its type since it spawned the Rural Support Program which today accounts for nearly 70% of NGO outreach in microfinance. Microfinance was in the limelight when it was made a pillar of poverty alleviation strategy during the regime of Pervaiz Musharraf and it followed a revolution in the past decade by gradually mainstreaming into the formal banking system. Pakistan Poverty Alleviation (PPAF) is also working on the same track to reduce the poverty in the country through micro-lending. To foster the process of economic development at the micro-level, the Government of Pakistan, in 2000, established the first specialized Khushali bank to carry out the microfinance activities under the 'Khushhali Bank Ordinance, 2000'. The bank focused on microfinance activities and played a major role in strengthening the economy through microlending and creating employment opportunities. To formalize these activities, the Government of Pakistan passed an ordinance in 2001, "Microfinance Institutions Ordinance, 2001". And timely upgrading of this ordinance has increased the efficiency of MFBs.

The evidence shows that the microfinance sector in Pakistan is a new thing and most initial studies were done on the impact of microfinancing on poverty minimization. Historical records express that a major portion of studies on microfinancing and its impacts on various factors was undertaken in the decade of 2000 by the MFIs and government agencies. Regulatory bodies, Academic & research institutions like Applied Economic Research Centre, Pakistan Institute of Development Economics (PIDE), State Bank of Pakistan (SBP) also conducted few studies on microfinancing.

Role Regulatory body in Micro Finance

In Pakistan, the regulatory action on the activities going on in the financial system is taken by the State Bank of Pakistan (SBP). SBP has taken a liberal approach towards effective policymaking for promoting and encouraging the growth of the industry.

Service Centers

SBP has taken innovative decisions to allow the establishment of service centers at third-party premises. It is expected that this initiative will allow micro-financing institutions to conduct operations within third-party premises which will ultimately lead to the decline of operational costs which pose a big challenge to the microfinance industry and it is considered the main factor that is responsible for the financial unsustainability of this sector.

Access to local and foreign funding

In response to the issue of financial unsustainability, SBP has come forward by facilitating access to diverse sources of funding. First SBP has facilitated the provision of wholesale loans from commercial banks to micro-financing institutions. SBP has permitted microfinance institutions to access foreign currency debt from foreign mortgagees as well as access debts in local currency. SBP is also coordinating with foreign donors to strengthen apex fund to ensure long-term fund supply for microfinance institutions.

Amendments to Prudential Regulations

The recent amendments to prudential regulations have led to an increase in the ceiling in loans and relaxed borrower criteria. To avoid credit risk, SBP has also made the condition of CIB necessary during loan borrowing. SBP is also working to bring microfinance institutions under the minimum regulatory framework.

3. Methodology

The research is based on the literature study, the secondary data. The secondary data is collected from Khushali Bank of AJK and AJKRSP (2012–2016), also to analyze the outreach of microfinance in Muzaffarabad region Schreiner (Schreiner, 2002) six-dimensional model is used. The model determines the length, breadth, scope, depth, worth, and cost of outreach. Further, this model is redesigned by eliminating the length and cost due to the unavailability of financial data regarding the outreach. The redesigned model analyses the outreach of MFB's and MFIs as shown in figure 1:

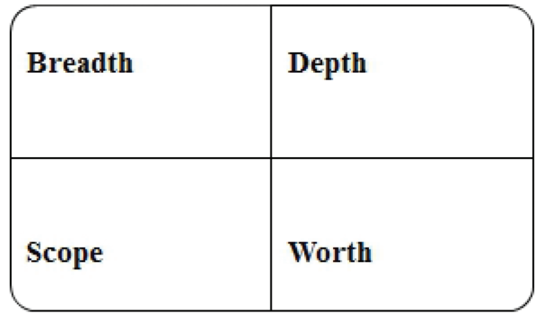

Figure 1: Four Dimensions of Studying MFBs' & MFIs' Outreach (Generated by Authors after Literature Analysis)

- **(i) The breadth of outreach:** "It covers up the number of poor people reached by MFBs and MFIs. The breadth of outreach is the calculated total number of active borrowers" (Schreiner, 2002).
- **(ii) The depth of outreach:** "It shows those who are excluded from financial sector covered by an MFB or MFI. Depth is calculated as the ratio of active women borrowers to total borrowers" (Schreiner, 2002).
- **(iii) The scope of outreach:** "Scope involves the diversity of financial services offering by an MFB or MFI" (Schreiner, 2002; Tchakoute-Tchuigoua & Soumaré, 2019).
- **(iv) Worth of financial service:** "The terms and conditions of microfinance affect both the borrowers and the sustainability of an MFI. The worth of microfinance loans will increase if the terms and conditions in terms of, size, time period, loan installment payments, collateral requirements, interest rate, fees, etc. are suitable according to the needs of the borrowers. The worth of outreach is measured as average loan size" (Hermes & Lensink, 2011; Hermes et al., 2011; Schreiner, 2002; Tchakoute-Tchuigoua & Soumaré, 2019). The data has been collected from Khushali Bank of AJK and AJKRSP specifically for the time period 2012–2016. Moreover, focus group discussions have been used to highlight the challenges faced by involving the borrowers and MFBs and MFIs.

4. Results and Discussion

4.1. Outreach of Sector

4.1.1. Breadth of Sector

The breadth of the sector is measured overall as the number of debtors increased from 8820 to 10797 in 5 years. The group-wise comparison indicates that MFBs lead over MFIs. As in 2012, MFBs' borrowers were 7938, and MFIs' borrowers were 822. An increase in MFBs' borrowers is observed by the addition of new 496 borrowers and a decrease of 180 borrowers occurred in 2013, in comparison to 2012 records. Similarly, from 2014 to 2016 an annual increase of 609, 522, 196 respectively is observed in the number of borrowers of MFBs.

Table 1: Outreach in Terms of Breadth (No. of Borrowers)

Year	AJKRSP	BAJK	KHUSHALI BANK	TOTAL
2012	882	2600	5338	8820
2013	702	5500	2934	9136
2014	826	5700	3523	10049
2015	802	6500	3245	10547
2016	856	6700	3241	10797

Source: BAJK, AJKRSP, KHUSHALI BANK.

Table 2: Outreach in Terms of Depth (No. of Female Borrowers)

Year	AJKRSP	BAJK	KHUSHALI BANK	TOTAL
2012	882	130	4270	5282
2013	990	275	2347	3612
2014	1015	305	2400	3720
2015	1075	310	2467	3852
2016	1125	345	3000	4470

Source: BAJK, AJKRSP, KHUSHALI BANK.

4.1.2. Depth of Sector

The outreach of the sector in terms of depth indicates to what extent the social objective of including deprived population is fulfilled by micro-financing activities. The overall depth of the sector declined from 5282 in 2012 to 4470 in 2016. Female borrowers remained the main target of MFIs and MFBs. Collectively MFBs' female borrowers decreased after 2012. Whereas, an MFI working in the Muzaffarabad region observed a continuous increase in female borrowers.

4.1.3. Worth and Scope of the Sector

In the AJK region, the outreach in terms of MFBs and MFIs vary in terms of capacity to offer diverse products which favor borrowers. The financial services that are offered by MFBs or by MFIs under microfinance should have the potential to cover up the needs of the customers. The Bank of Azad Jammu and Kashmir (BAJK) established by the Government of Azad Jammu and Kashmir provides microfinance loans to microenterprises and agriculture activities under a micro-financing scheme to promote economic activities to reduce poverty and raise the standard of living. The financial services which are offered under the scheme of micro-financing of BAJK are not considered as diverse because a single loaning policy is used for a different purpose which shows that this product is not properly designed by keeping in view the nature and needs of the potential market for micro-financing. Hence, a better and diverse product should be designed to cover all flaws in present financial services.

BAJK's target population is poor people who are living in the Muzaffarabad region. This MFB opposes the restriction that skilled people in activities like grocery shops or other small retail shops etc. cannot avail of this service. It provides microfinance to microenterprises and to agriculture activities that can be held to a limit of Rs 25000 to Rs 200000. The main benefits that BAJK gives to its borrowers are minimum documentation and loan at a low rate of return i.e. 15%.

Whereas the most active specialized bank (in AJK) in the field of micro-financing i.e. Khushali bank carrying its operations in Muzaffarabad offers multiple and diverse financial services to its customers having different needs under their loan scheme for micro-financing. For this purpose, Khushali Bank offers Agricultural loans, livestock loans, enterprise loans, and a specific loan named as Sarsabaz Karobar loan having a maturity period of three months to twelve months that may extend. For loan services, the bank has established its eligibility criteria which focus on Age limit i.e. 18 years – 58 years, Annual Income must be less than Rs.300000 and the experience needed in the field is 2 years, and cross guarantees to assure that loan will be efficiently and effectively used and recovered. The basic flaw considered in the loaning technique of this MFB is that it imposes too many legal requirements. The rate of return is high which is not beneficial to low-income borrowers who are already experiencing high inflation.

Azad Jammu and Kashmir Rural Support Program (AJKRSP), the MFI working in Azad Kashmir, provides a loan that obstructs the poor from improving their activities in the manufacturing and social development sector. It focuses on Agri/livestock financing, small enterprises financing. The basic difference between AJRSP (MFI) and MFB (BAJK, Khushali Bank) is that AJKRSP primarily focuses on creating a sense of awareness than serving in the targeted area. AJKRSP offers about 90% of loans to women and about 10% loans to enterprises, males, etc. but imposes a basic restriction of loaning, which is, loans will be given in form of groups with a cross-guarantee rule to minimize the default risk. The credit plans are diverse but given for the period of 12 months to 18 months.

4.2. Challenges Faced in the Outreach of Microfinance

Focus group discussion was arranged and questions were asked from borrowers and institution representatives. These questions covered the breadth, depth, scope, worth of MFB's and MFI's along with other macro-environment factors, directly and indirectly, affecting the outreach. It was found that microfinance outreach is affected by the following factors.

Market hold

Microfinancing is a new product in this region. MFBs and MFIs are working on it, while there are few which have made their hold in the market. They charge a higher interest rate, difficult terms and conditions that make their product line rigid, ultimately few borrowers acquire the loan. This issue has slowed down the growth of this sector as well as affected the outreach in terms of breadth and depth.

Ineffective human resource management

Along with many operating issues that remain with MFBs, one notable issue is the lack of appropriate staff to deal with the potential borrowers. The major focus of microfinance remains the financially excluded part of the society that is women. The culture of the area under discussion doesn't allow socialization of both genders that becomes a barrier when it comes to dealing with them because like any other male dominant society the workforce consists of mostly men. Moreover, when it comes to marketing the microcredit products, the staff greatly lacks the appropriate and useful skills. They are unable to convince people to consider the advantages & usefulness of microcredit facilities. The specialized banks like Khushali bank have managed a better staff which is working effectively for pursuing outlined goals of the institution, while commercial banks such as Bank of AJK in this case faced with an issue of non-availability of suitable staff.

Lack of knowledge and awareness

In this age of heavy marketing and well-informed customers, knowledge, and awareness remain a critical issue when it comes to microfinance in rural areas of Muzaffarabad. The terms and conditions of the microfinance facility offered by Khushali Bank are though well-articulated and known to benefit people, the potential and usefulness of the facility are not being optimally capitalized. There remains a dire need for awareness programs and the spreading of financial literacy in the people of Muzaffarabad especially the population residing in the rural areas. They are mostly unaware of their potentials and resources that if employed in a particular sector can be profitable. The people of Muzaffarabad are unaware of the great potential of their area in particular sectors like tourism, agriculture, and hydropower. The microfinance facility is largely seen as a mere tactic of banks to earn a profit. The ever-increasing interest rate and rigid rather harsh repayment pattern add up to their existing financial miseries.

Funding

Researching about the Microfinance institutions and banks, we found that the major source of income for them is funding from either government or local and international non-governmental organizations. The major player in the field of microfinance in the area Khushali Bank, which was initiated with the funding of the Asian Development Bank. AJKRSP is also funded by NGOs and the government that impedes the effective functioning of the institute. Many MFIs are often initiated but they exit the market even before starting their operations due to a lack of funds and resources. In this regard, commercial banks have the advantage of being self-sufficient because of a great number of deposits, but other than the Bank of AJK there is no other player in the field of microfinance in this area. However, these sources of funding cannot be permanent hence it initiates the need to fulfill their cost by increasing the interest rates which in turn makes the micro-financing facility inaccessible to the deserving.

Risk Aversion

Almost all banks are risk-averse, but when it comes to micro-financing their tactics for avoiding risk are a hurdle in the desired outcomes of micro-financing. The most common practice that microfinance banks use is group lending. Main players including Khushali bank and AJKRSP uses this practice and their lending is only in the form of a group of 3 to 5 people with the same business interests so that the recovery is easy. This practice is not as harmful as modifying their offerings such that the investment goes into the sector with minimum risk. Khushali bank lends only around 20–80 thousand that is mostly insufficient for either a small enterprise or agriculture practices hence serving only livestock. Their loaning is also concentrated in urban areas, to avoid risk and hence not serving a huge deserving population. Due to this Khushali bank strongly discourages lending in a new business. There are only 2 cases of new business beneficiaries, in the past 10 years.

High Operational Cost

Higher operational cost remains a barrier to expand the outreach of the microfinance sector. The operational cost includes administrative and personal expenses. The administrative cost incurred during transportation and time taken to conduct microfinance operations, delivery of products and services in areas with poor telecommunication facilities, and delivery of products through unusual distribution channels in contrast to the commercial banking sector in areas that lack properly developed physical infrastructure, contribute to significant elevation in operating costs. These higher operating costs are responsible for lower outreach in terms of depth and breadth of this sector in economically challenged rural areas. Also, clients are accessed directly for loan offering and recovery by microfinance agents who visit personally which makes microfinancing a labor-intensive operation. All these factors form bases of high operating cost which is formidable to recover in a very small loan size. High operating costs incurred during staff hiring also hinder MFIs to recruit new employees.

Lack of Innovation in Products

Microfinance serves poor individuals with complex and highly diverse financial needs which require this sector to be innovative during product development and introduce differentiated products to serve the needs of borrowers. The main objective of microfinance is the social empowerment of financially excluded individuals i.e. women but the sector does not offer any special products for female borrowers to fulfill their specific needs. To grow intensively in the presence of intense competition from the commercial banking sector, MFIs needed to innovate constantly keeping in view the demands of the target market. Currently, microfinance institutions are offering a limited product range insufficient to cater needs of the highly diversified market in turn which is responsible for the lower outreach of this sector in terms of breadth and depth. Lack of awareness due to deprivation from educational facilities in target customers of this region is also a challenge in conducting effective market research. Hiring specialized marketing staff for market analysis would result in high operating costs aggravating problems for already financially troubled MFIs and RSPs.

Macro Environment Factors: Fraud

When talking about the impact of microfinance on the growth of any region, there are not only banks and microfinance institutes that are to be blamed but some beneficiaries play an equal role in making microfinance ineffective to generate a healthy economic activity. In any case, they would return the principal amount along with the interest on time so the bank is in a win situation, but it does not generate any economic activity and hence the purpose of microfinance is not served. The practice of fraud is very common. Sometimes the beneficiaries would take up a loan for the cause of consumption and show another reason to just fulfill the requirements of the lender. They even sometimes fake business setups just to pass the inspection.

Topographical makeup

Most of the financially excluded population in this region dwell in rural areas. This population should be the real target of MFBs and MFIs. Most of the rural areas of this region are inaccessible. After the area has been struck by a massive earthquake, the issue of land sliding has become very common. Moreover, due to mountainous terrain and its altitude, even a minor rain causes a huge landslide blocking and destroying the already poor infrastructure of the area. This ends up making rural areas inaccessible and may well increase the cost of operations, discouraging the expansion and penetration of the microfinance market.

Physical infrastructure

According to Planning and Development Department, Muzaffarabad is the capital of the Azad Jammu Kashmir covering 1642 sq. km area, having 1932.42km roads which in comparison to District Poonch and Kotli is less i.e. 2264.7 km, 3023 km, causing problems to MFB and MFI to raise their operations in this area and also serving as a barrier for new entrants because the operational cost is higher in this region. The Internet (ICT) in Muzaffarabad is not good and the systems used in the MFB and MFI are not working well due to which MFB and MFI are using manual ways to process their data which in result slow down the speed of data collection that these institutions can use for the studying the market to improve their performance. And in some areas, power supply facility is not available and due to power shortfall, MFBs and MFIs use alternative power sources which increase their expenses, and indirectly the cost of their services is increased to cover these expenses.

Cultural Barrier

The majority of the female population lag in economic activities as they are less motivated to pursue entrepreneurial spirit and women are unable to access microfinance which is attributable to regional norms and values. They hardly take part in financial decision-making due to their social role. These cultural barriers contribute to lower outreach of the sector in terms of depth. The low depth of the sector is also attributable to a lower proportion of the female workforce in this sector that could deal with female clients in remote areas.

4.3. Limitations

The limitation of this research is data availability constraints due to poor disclosure of required information. Organizations are reluctant to disseminate exact information regarding clients. Statistical data was improperly managed as there is no proper department for data recording neither in government nor in the private sector. Time constraint was another challenge during the research process. The researchers were unable to visit clients to collect information regarding products & services offered, customer satisfaction, and information needed to find out challenges faced by borrowers. The unavailability of resources is another obstacle in conducting effective research.

5. Conclusion

Despite its growth, microfinance has still a long way to go and emerge as a fully sustainable industry. The microfinance industry since its inception is still struggling to grow and expand its outreach to financially challenged segments of society. The outreach of this sector in terms of breadth and depth is unsatisfactory as it is still unable to serve a huge portion of the economically excluded target population. MFIs and MFBs are doing well to attain the objective of women empowerment but commercial banks have still a long to go due to the diversification of their operations. The sector is still financially unstable which is attributable to its reliance on conventional sources of funding. The industry faces several endogenous as well as exogenous challenges from its environment which obstructs its growth. The sector is not focusing on developing an effective policy framework for market penetration. Microfinance activities are largely concentrated in urban areas. The reluctance of this sector to adopt innovation to reach end-users presents an obstacle to the growth of this sector and it is responsible for operational unsustainably.

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