Information Technology and Microfinance Institutions: Challenges and Lessons Learned

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ABSTRACT

Microfinance Institutions have the potential to alleviate poverty across the world. However, they face many challenges before they can grow to meet set objectives. The use of information technology holds promise to enable such growth. There are some key challenges that must be addressed by microfinance institutions before the full potential of IT can be realized. This paper articulates five key challenges that microfinance institutions face, particularly those operating in rural undeveloped areas in the developing world. This paper also discusses how some of these challenges are being overcome by these institutions. Finally, the authors lay out a framework for building and operating effective information systems.

Keywords: Challenges, Information Systems, Information Technology, Microfinance, Sustainability

INTRODUCTION

Microfinance Institutions (MFIs) have been at the forefront of poverty alleviation efforts around the world. These institutions are based on the simple concept of promoting entrepreneurship among the poor, by making financial resources available (Attali, 2000). MFIs, such as Grameen Bank in Bangladesh, lend small amounts of credit to the poor, which provides the crucial start-up capital for job creation and sustainable development. By most accounts, MFIs have been very successful in promoting a market solution to poverty across the world. Positive outcomes include creation of social capital, alleviation of poverty, empowerment of women, and the financial performance of the MFIs themselves (Arsyad, 2005; Britta Augsburg, 2009; Hiatt & Woodworth, 2006; Kanak & Iiguni, 2007; Marr, 2002; Swain & Wallentin, 2009). MFIs have grown tremendously due to their success. This success has changed microfinance from a predominantly non-profit socially oriented effort, to a for-profit industry (Bhattacharya, 2009; Cull, Demirguc-Kunt, & Morduch, 2009).

The last decade has been marked by the increasing influence of Information and Com-
munications Technology in all walks of life. Its impact on developing countries, particularly in Africa and Asia, has been tremendous (Dias & Brewer, 2009; Heeks, 2009). The microfinance industry is no exception to this trend. Indeed, it has often been opined that the true potential of microfinance may only be realized by combining it with technology (Attali, 2000). While MFIs have been tremendously successful (Dichter, 1996; Robinson, 1996), the social dimension of their success is quite often limited because of their reach. MFIs still fail to reach a big proportion of the rural poor (Kota, 2007). In order to meet set goals (such as the UN millennium development goals), MFIs will have to increase their outreach exponentially (Hartarska & Nadolnyak, 2007).

With current practices, nonstandard data and the lack of infrastructure, microfinance institutions seeking growth will have difficulty in even doubling their operations. As a result, new business practices and innovative solutions by harnessing the benefits of technology are preeminent to achieve the breakthrough in scale. MFIs will succeed only by reducing transaction costs dramatically (Bhatt & Tang, 1998). The solution to this is integrating MFI with IT based management information systems (MIS). While some have rejected the silver bullet hypotheses that IT can be used in all contexts to achieve efficiencies, IT based systems do have the potential to have a positive impact in MFIs (De & Ratan, 2009).

In this paper, we will discuss five main challenges that arise in implementing IT within MFIs. While these challenges are not exhaustive, they are key fundamental issues, and thus, need to be addressed. We will also articulate with the help of real world examples, on how these challenges were overcome by MFIs that operate in various locations around the world.

CHALLENGES IN SUSTAINING MIS IN MFIS

Information and communication technologies (ICTs) have a tremendous potential for increasing the efficiency of MFIs. IT based systems have fundamentally changed the way businesses function. However, certain challenges need to be addressed, for the complete potential of IT to be realized (Parikh, 2006). While some of these challenges are due to the unique nature of MFIs, others are infrastructural and environmental in nature.

MFIs Are Different from Commercial Banks

Microfinance is significantly different from Commercial and Retail banking in its approach and operational structure. Since Microfinance is a relatively new concept, as compared to commercial financing, very little attention has been given to its organization and structure. Furthermore, account officers working in MFIs are not that well trained in their realm, as compared to their counterparts in the banking sector.

One of the reasons for the less organized nature of MFIs is that the industry is still in its inception phase. MFIs typically struggle to sustain themselves within the first few years. Therefore, up until recently, MFIs have eluded the attention of commercial bankers, who may be more capable to improve on the structure and processes of MFIs. The entry of commercial banks into MFIs is already underway with some banks entering the microfinance market because they see sustainable profit and growth opportunities. Furthermore, commercial banks are facing increasing competition in their markets, leading to shrinking margins. This pressure is leading forward-thinking banks to explore new potential markets. To many commercial banks, microfinance is a potential market with the capacity to generate growth in clients at acceptable profit margins.

The kind of information that MIS need to capture is another factor that makes Microfinance different from regular banking. In regular banking, banks obtain proof of the client’s identity and certain relevant information like KYC (Know Your Client) before doing any financial business with the client. Also, in regular banking there is a concept of keeping financial history
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