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FACTORS AFFECTING THE SUSTAINABILITY OF MICROFINANCE INSTITUTIONS- AN EMPIRICAL ANALYSIS

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Central and State governments in collaboration with foreign agencies, implemented various programs for alleviation of poverty in India. These programs did not succeed in the long-run due to the sustainability of the implementing organization. Microfinance is one such program and is implemented through the various forms of microfinance institutions. Therefore, the success of the poverty alleviation programs depends on the sustainability of the implementing agencies. Present study is designed to analyze the impact of such programs implemented through the microfinance institutions. The study assessed the respondents from Karnataka, Kerala and Tamilnadu by applying statistical tools and observed that the respondents are loyal to their organization in Karnataka but not in Kerala and Tamilnadu. The services of the MFIs did not satisfy a few clients due to irrational behavior of the microfinance institutions' in the process of recovery of credit. Disappointed clients accessing the services from more than one microfinance institution without discontinuation of membership in existing microfinance institution, is a peril to the sustainability of the institution and clients as well. The findings and recommendations of the study provide the factual impact of microfinance and evidences for further regulation of MFIs in the Indian economy.

Key words: *Sustainability, Economic Impact, Social Impact, Financial Inclusion, Loyalty*.

1. Introduction

Microfinance had been in practice in the developing countries for the past three decades. It has achieved major success in a few nations and has provided the access for financial infrastructure

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to the poor. Micro finance is provided by different types of organizations like non-profit organizations (both regional and international), financial institutions, some commercial banks and also state and local governments and independent rating agencies in different parts of the world. The high growth rate of microfinance has been fueled by commercial banks funding which inherently gravitates towards for-profit institutional structures. In India, at the regional level, the south continues to dominate the sector in concentration of numbers of MFIs (RBI, 2011). However, there are some MFIs, which have multistate operations and cannot be clearly categorized as working in a particular region. The rush to be regulated (as NBFCs) along with the push for growth has become the dominant characteristic of Indian microfinance. The balanced growth, superior recovery of loan portfolio with assured returns to the investors transformed the microfinance sector as one of the profitable investment avenues. World over, various research studies highlighted the outcome of microfinance and the performance of microfinance market. In India, RBI, NABARD published the growth of microfinance in their annual reports, microfinance research institute (Sa-Dhan) and credit rating institutions (MCRIL, CARE) analyzed the microfinance market performances by comparing to other sectors of Indian economy. The conclusions reflected the enhanced financial performance and growth, which captivated the attentions of investors. As a result, financial institutions entered to rural and urban markets to serve the microfinance customers. NGOs transformed themselves into NBFIs to enhance their services and profitability. Private and public sector banks too entered the rural to capture the market.

Precipitous growth of MFIs has led to the progress of rural financial market and competition among the rural microfinance institutes. Recently, however, there seems to be a shift from subsidizing MFIs to a focus on its financial sustainability and efficiency (Hermes, 2011). Around the world, many commercial banks are attempting to enter the microfinance sector and a few unregulated NGOs up-scaling to become a regulated MFIs (SOS Faim, 2008), mostly, because

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regulated MFIs are allowed to collect deposits and increase their loanable funds (Campion & White, 1999, Hartarska & Nadolnyak, 2007). Consequently, microfinance sector is growing dynamically. In the absence of a license to collect deposits, MFIs leverage donated resources by borrowing from formal financial institutions, large institutional or individual investors and, in some special circumstances, by collecting limited savings (Dowla & Alamgir, 2003, Hartarska & Nadolnyak, 2007). Previously donor driven, subsidy-reliant institutions are advancing into for-profit, publicly listed organization that necessitates an analysis of outreach and financial sustainability of MFIs (Kailthya, 2008). The sustainability of MFIs is measured through assessing the outreach and financial performance. However, the sustainability of the MFIs depends on the effectiveness of the credit plus programs of the financing institution. MFIs need to measure the impact of such programs on the borrowers to assess the effectiveness of credit programs (Ghalib, 2009). Number of studies debate that micro financing has two dimensions - economic and social (Holcombe, 1995; Khandker, 1998; Hulme, 2000). The economic impact is acknowledged through economic indicators such as income, employment and changes in lifestyle and standard of living etc. However, the information on social impact indicators is generally limited and descriptive, which cannot be used as a basis for numerical reasoning, quantification, forecasting and making predictions of how micro credit programs transform livelihoods of the particular MFI (Ghalib, 2009). Due to lack of information, controversy persists about the true impacts of micro finance on poverty and on the objective of social change (Oliver, 2010).

2. Review of Literature

To assess the effectiveness of credit programs, Micro Finance Institutions (MFIs) need to measure the impact of development programs on the borrowers (Ghalib, 2009). Microfinance Institutions ultimately measure their success by the impact they have on their clients, on client's families and on the communities in which they dwell (Woller & Parsons, 2002). However, the

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impact varies from region to region and country to country depending on the form of programs and implementing agencies. Impact measuring indicators too varies according to the regions. Therefore, only a few studies (Gupta & Kumar 2011) used region specific variables to measure the impact. Measuring impact on clients of financial services provided by MFIs is the most difficult and controversial aspect of performance evaluation (Meyer, 2002). Many studies debate that micro financing has two dimensions - economic and social (Holcombe, 1995; Khandker, 1998; Hulme, 2000; Hartarska and Nadolnyak, 2008). The economic impact acknowledged through economic indicators such as income, employment and changes in lifestyle and standard of living. However, the information on social impact indicators is generally limited and descriptive, which cannot be used as a basis for numerical reasoning, quantification, forecasting and making predictions of how micro credit programs transform livelihoods of the particular MFI (Ghalib, 2009). Due to absence of widely available information on social aspects, methodological difficulties and high cost involved in conducting in-depth survey centered studies, Meyer (2002), argues that important evidence of impact should be whether MFI clients continue to use the services or not. If so, then they must value the benefits received from MFI.

Owing to lack of information, controversy persists about the true impacts of micro finance on poverty and on the objective of social change (Oliver, 2010). Therefore, the present study is an attempt to assess the impact of micro finance interventions on the financial activities of the rural poor.Research studies on Impact Evaluation (IE) or Impact Assessment (IA) started in some of the developing countries in the early eighties. Two important approaches were applied to quantify the impact, i.e. quasi-experimental approach and the experimental approach. These analyses were similar to counterfactual analysis, where both the approaches analyzed what would be the state of affairs of the beneficiary, if he / she does not have an access for micro finance, to one where he / she uses it (Benerjee & Duflo, 2009; Armendariz & Morduch, 2010; Kamaha, 2013). The approach involved the process, where the data and analysis were derived on comparing the Treatment group (Individuals who get microfinance access-client) with Control

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group (Individuals who never get microfinance access – Non-client) which was considered to be too difficult and cumbersome in late nineties (Kamaha, 2013). Using World Bank data, Pitt and Khandker (1998) analyzed the beneficiaries of Grameen Bank, Bangladesh Rural Advancement Committee (BARC) and Bangladesh Rural Development Board's (BARD) Rural Development RD-12 Program and concluded a larger positive impact on consumption, household assets, education of the children and the behaviour among the women participants. However, the outcomes of Pitt and Khandker were re-investigated by many researchers (Morduch, 1998, Chemin, 2008; Roodman & Morduch, 2009; Duvendack & Palmer Jones, 2011) and the results were contradictory to the findings of Pitt and Khandker. No significant impact was found in the study of Morduch and the findings of Chemin, Roodman & Morduch pointed out less significant impact than the outcomes of Pitt and Khandker. However, Duvendack & Palmer Jones concluded that the findings of Pitt and Khandker are exaggerated. Therefore, the quasi-experimental approach suffers from numerous biases (Kamaha, 2013). The experimental approach was applied by Benerjee et al. (2010) on Indian MFIs and had a positive impact on employment and other development activities. The approach adopts ex ante and ex post analysis of members to quantify the impact.

Few studies assessed the financial and non-financial services offered by the MFIs to upgrade the members' socio-economic status. These studies assessed the status before and after financing the individual or the family. The independent research studies of the MFI and/or on be-half of MFIs like – Proximity Finance Foundation, Belgium (2007), Adie, France (2010), Banco de la Mujer Munidal Espana (2008), National Federation of Caisse d'Epargne, France (2010),Kamaha (2013) in France applied the methodology of comparison of beneficiaries situation during the investigation to the one before obtaining any services from the MFI. In present study, an attempt is made to analyze the status of beneficiaries before and after procurement of MFI services.

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3. Objectives of the Study

Present study is designed to assess the factors that are affecting the sustainability of microfinance institutions in the long-run.

4. Research Methodology

4.1 Data and Sample

A list of the members who had completed five years as a member in an MFI and accessed for credit at least three times were collected from the head offices of the respective MFI. The members were categorized according to their taluk's / Mandal / paragana (a sub-division of a district or a group of several villages organized for revenue purposes) and randomly selected for interview.

4.2 Sampling Method and Size:

To analyze the impact of microfinance intervention, primary data on the socio-economic status of the members was collected through a self-administered structured questionnaire. The questionnaire was designed based on the constructs derived from the literature. Judgmental sampling or Purposive sampling under Non-probability sampling technique is where the researcher chooses the sample based on who they think would be appropriate for the study. This is used primarily when there are a limited number of people who have expertise in the area being researched. The total sample of the study is 939 collected from three South Indian states. The total sample consists of 382, 362 and 195 respondents from Karnataka Tamilnadu and Kerala respectively.

4.3 Statistical Tool

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Karl Pearson's Coefficient of Correlations is used to analyze the impact of microfinance intervention, primary data on the socio-economic status.

5. Analysis and Interpretation

5.1 Correlation between Loyalty and Economic Impact, Social Impact and Financial Inclusion

Loyalty, which results from satisfaction, primary behavior and secondary behavior of the clients, that would result from long-term benefits received from an MFI.

Table 1: Correlation between Loyalty and Economic Impact, Social Impact & Financial Inclusion

MFI			Economic Impact	Social Impact	Financial Inclusion
Karnataka	Loyalty	r	0.140	0.151	0.557
		p	0.006	0.003	0.000
Kerala		r	0.197	0.042	0.246
		p	0.006	0.556	0.001
Tamilnadu		r	0.237	0.032	0.451
		p	0.000	0.538	0.000

*Correlation is significant @0.05 level (2 tailed), N=939
**Correlation is significant @0.01
level (2 tailed), Karl Pearson's Correlation (r)

Table 1, illustrates the relationship between loyalty and economic impact, social impact & financial inclusion. Economic impact ($r = 0.140$, $p = 0.006$) and social impact ($r = 0.151$, $p = 0.003$) has a low correlation with loyalty. Socio-economic impact of the MFI is increasing extensively but it does not contribute towards enhancing the loyalty of the clients. Financial inclusion has significant ($p = 0.000$) correlation with loyalty. The correlation is moderate (r =

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0.557) at significance level of 0.01, which indicates that the loyalty towards the institute is moderately increasing with the benefits received due to financial inclusion.

There is a low correlation between economic impact (r = 0.197, p = 0.006), financial inclusion (r = 0.246, p = 0.001) and loyalty in microfinance institutions in Kerala. However, there is no correlation between social impact and loyalty ($p > 0.05$), which indicates that social impact due to intervention of microfinance is insignificant and its contribution in increasing the loyalty among the clients is very low. Economic impact and benefits of financial inclusion are fairly influencing the loyalty of the customer.

Economic impact (p = 0.000) and financial inclusion (p = 0.000) has significant correlation with loyalty. The strength of the correlation is low (r = 0.237, r = 0.451) at significance level of 0.01. Loyalty of customer towards MFI is slightly inclined due to economic impact and financial inclusion. The social impact has no correlation with loyalty ($p >0.05$).

5.2 Correlation between Economic impact and Social Impact, FinancialInclusion, Satisfaction, Primary Behaviour, Secondary Behaviour

Table 2 indicates that, there is significant correlation between economic impact & social impact (p = 0.000) and economic impact & financial inclusion (p = 0.000) in microfinance institution in Karnataka. Social impact has a moderate correlation (r = 0. 780) and financial inclusion has low correlation (r = 0.198) with economic impact, at significant level of 0.01. Social transformation results from economic reforms.).

Table 2: Correlation between Economic Impact and Social Impact, Financial Inclusion, Satisfaction, Primary Behaviour, Secondary Behaviour

MFI		Social Impact	Financial Inclusion	Satisfaction	Primary Behaviour	Secondary Behaviour
Karnataka	r	0.780	0.198	0.033	0.005	0.011

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	p	0.000	0.000	0.522	0.143	0.834
Kerala	r	0.505	0.211	0.037	0.190	0.104
	p	0.000	0.003	0.607	0.008	0.117
Tamilnadu	r	0.337	0.042	0.240	0.172	0.224
	p	0.000	0.430	0.000	0.001	0.000

*Correlation is significant @0.05 level (2 tailed), N=939 *Source: Survey data*
**Correlation is significant @0.01 level (2 tailed), Karl Pearson's Correlation (r)

Economic impact has a correlation with primary behaviour (p = 0.005) of the clients and which has a low correlation (r = 0.143) at significance level of 0.001. No correlation exists between economic impact & satisfaction (r = 0.033, p = 0.522) and economic impact & secondary behaviour (r = 0.011, p = 0.834.

In Kerala, economic impact and social impact has significant correlation (p = 0.000). However, the strength of the correlation is moderate (r = 0.505) at 0.01 significance level. There is correlation between economic impact & financial inclusion (p = 0.003). The strength of the correlation is low (r = 0.211) at significance level of 0.001. There is correlation between economic impact & primary behaviour (p = 0.008) of the clients. The strength of the correlation is weak (r = 0.190) at significance level of 0.001. There is no correlation between economic impact & satisfaction (p = 0.607, r = 0.037) and economic impact & secondary behaviour (p = 0.104, r = 0.117).

In Tamilnadu, economic impact has significant correlation with social impact, satisfaction, secondary behaviour (p = 0.000). However the strength of the correlation is weak (r = 0.337, r = 0.240, r = 0.224) at a significance level of 0.001. The primary behaviour (p = 0.001) of the clients has a correlation with economic impact but the strength of the correlation is weak (r = 0.172) at significance level of 0.001. There is no correlation between economic impact & financial inclusion (p = 0.430, r = 0.042).

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6. Implications of the Study

The socio-economic impact quantifies the long -term effect of microfinance on its clients. Change in the socio-economic impact was observed among the members in the present study but the range of impact varied among the selected institutions. Since, creating social awareness among the rural people and enhancing the standard of living through employment and income are the major aim of microfinance, the low performing microfinance institutions should advance their impact range to bring out the rural people from the vicious circle of poverty. By extending the nature of the study through the region-specific variables, the present study considered financial inclusion and loyalty indicators as a part of impact measurement. The spillover effects of consistency in employment, enhanced income and imparting knowledge through training had increased the need for accessing the financial services. Financial inclusion among the rural poor is one of the long-term objectives of the Government of India to provide financial services which is also useful to access the subsidized government promoted development programs without the intervention of intermediaries.

7. Conclusion

Retaining existing customers and increasing the outreach is a challenge for the microfinance institutions due to increased competition between the microfinance institutions. The loyalty of the members is the spillover effect of financial and non-financial services offered by the microfinance institution. Therefore, providing satisfactory services to the members is essential to sustain in the competitive market. The outcome of the statistical tests revealed that there is a highly significant difference in the loyalty of the members towards the microfinance institution. Further, the members of microfinance institution from Karnataka were found highly satisfied and others (Kerala&Tamilnadu) satisfaction level was medium and low. As highly satisfied customers are the assets of a financial institution, application of customer retention strategies is essential for the sustainability of the institution. Ever since poverty and microfinance became the

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international issues, many international players are entering the Indian financial market to provide micro financing.

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