

Analysis of Efficiency of Microfinance Providers in Rural Areas of Maharashtra

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Abstract: In recent years, microfinance has regarded as a vital tool for poverty alleviation as well as to promote microenterprise particularly in the developing countries like India. However, the major challenge that the microfinance industry facing is the sustainability of microfinance providers. The efficiency of microfinance providers is an important parameter for sustainable growth of microfinance providers in rural areas. The present study is an attempt to analyze the efficiency of microfinance providers operating in rural areas. Financial data has been collected from 218 microfinance providers that involved in microfinance activity in Sangli district, state of Maharashtra. Data has been analyzed using descriptive statistics, t-Test and chi square test. The present study shows that there is significant difference in efficiency of microfinance providers as they mature. The paper concludes that as microfinance providers matures; administrative costs usually drop as managers learn from experience, also because competition forces lower pricing and greater efficiency. The present study also shows that provision of non financial services as a complement to credit and saving services leads to enhance reach of microfinance providers towards poor people in rural areas and enhance sustainability of microfinance providers.

Keywords: Microfinance, Efficiency, Sustainability

I. Introduction

Financial institutions and banks are the backbone of any economy. In India banking sector provides financial services to the larger section of population. These financial institutions not keen to provide credit and other financial services to poor people especially in rural areas. As Indian economy is depending on rural segment which still has limited access to financial services because of low literacy rate, high transactional cost. This leads poor people to mainly depend upon the informal providers of finance, such as the village moneylender. It is undisputed that access to finance is critical for enabling individuals and communities to climb out of poverty. Village money lenders are exploiting the rural poor by charging high interest rate. Therefore Government of India has introduced several credit linked poverty alleviation programmes, such as Integrated Rural Development Programme and Prime Minister Rojagar Yojana to alleviate the rural and urban poverty. A huge amount of manpower and money was spent on these programmes. These programmes were failed to achieve the desire targets owing to local political conflicts, lack of co-operation and proper co-ordination between the beneficiaries and Government employees. As a result these schemes became non-viable. Consequently, the Indian economic planner and policy makers turned their attention towards innovative schemes such as microfinance through Self Help Groups (SHGs).

Microfinance refers to the supply of microloans, savings and other basic financial services like insurance without collateral requirements to the poor. The Microfinance industry in India has borrowed largely from Grameen Bank in Bangladesh, in terms of methodology, processes and systems. Most of the leading Indian MFIs started out as NGOs during 1985-1999, adopting the Grameen Bank model of group-based lending to women in rural areas. Over the years, the MFIs have grown significantly and have transformed into for-profit non banking finance companies (NBFCs), thus moving towards a more regulated legal setup.

The International Finance Corporation (IFC), part of the larger World Bank Group, estimates that more than 130 million people have directly benefited from microfinance-related operations as of 2014. However, it is only available to approximately 20% of the 3 billion people who qualify as part of the world's poor. Hence Microfinance can be considered as one of the most effective tools for reducing poverty. Microfinance can play a significant role in bridging the gap between the formal financial institutions and the rural poor. There is need to share experiences and facts, which will help in understanding success of microfinance providers.

II. Literature Review

Morduch (1999) defined Microfinance as the provision of small-scale financial services for the poor. MFIs with poverty-alleviation missions may find rural areas have client bases that better match their visions and goals (Liedholm and Mead 1999; Shaw 2004; De Mel et al. 2008). Poor clients require smaller loans and often are more costly to service Morduch, (1999). Clients with unprofitable or marginally profitable businesses are less likely to meet loan repayment deadlines easily. The characteristics of rural clients that make them more costly also represent significant opportunities to MFIs. Many MFIs would like to reach more poor, uneducated, or female clients to maximize their social impacts Mersland and Strom, (2009). Providing sustained credit services is one of the means to increase income and productivity of the poor. However, the (Indian) formal financial institutions have failed to provide these services (Adams et al. 1984; Hoff and Stiglitz, 1990). The rural poor are often unreached by microfinance because of the high transaction costs, high systemic risk and high vulnerability associated with rural regions Buchenau and Meyer (2007).

However, commercial banks are able to offer loans at lower costs, which results in lower interest rates. MFIs' interest rates are traditionally higher than the interest rates asked by commercial banks due to the high transaction costs MFIs bear Rosenberg et al. (2009). This could lead to a crowding-out effect where the MFI clientele substitutes its MFI loans with commercial bank loans at lower interest rates. Hermes et al. (2009) find that MFI efficiency is positively correlated with overall financial sector development and overall, the relationship seems unclear. According to Morduch (1999) Efficiency and profitability among MFIs largely depends partly on their ability to procure and effectively utilize cheap funds and channel them to users with minimal recovery risks, among others and partly on the ability to identify and remove operational constraints.

Otero et al. (2006) shown in their work that Cost reductions can be achieved through simplified and decentralized loan application, approval and collection processes. Also group loans which give borrowers responsibilities for much of the loan application process, allow the loan officers to handle many more clients and hence reduce costs. Thus number of studies on MFIs have emphasized on the assessment of their performance and sustainability by assessing their financial indicators (such as loan recovery rate and profitability) resulting self-sufficiency, (Chaves and Gonzalez-Vega 1996; Woolcock 1999; Yaron 1994; Yaron et al.1997). Thus MFI self-sufficiency and sustainability data needs to be generated under more realistic operating conditions. Furthermore to Hollis and Sweetman (1998) studied six cases to identify the institutional designs which facilitated success and sustainability. Similarly, Bennett and Cuevas (1996) suggested three important areas such as financial sector development, poverty reduction and enterprise formation and growth, for the self sufficient MFI.

It is clear from the review presented in this section that the financial sustainability is important for MFIs overall sustainability. So to capture financial sustainability, economies of and efficiency in recovering the cost is very vital for microfinance provides. To the best of author's knowledge, a through scan of open literature survey related to efficiency of microfinance providers in rural areas, it is found that very few studies dealing with efficiency of microfinance providers in rural areas have been reported in literature. Therefore, more research work is required in this area to provide the needful information for understanding growth of microfinance providers in rural areas.

III. Research Methodology

Objectives

The objectives of the present research study are as follows

- To study the efficiency of microfinance providers in rural areas
- To analyze impact of non financial services on efficiency of microfinance providers in
- rural areas

Methodology

The present study involves 218 microfinance providers including MFIs and commercial banks and cooperative bank, NGOs that providing microfinance in Sangli district, Maharashtra state of India. The sample size has been taken by stratified sampling method. Data has been collected in the form of questionnaire and datasheet filled by managerial level staff of microfinance providers. The secondary sources of data were taken from the various websites, books, journals reports, articles etc. Microfinance providers efficiency shows, how proficient the organization and management is in operating its financial activities, particularly its use of assets and human resources. In this regards we have used Cost per Active Client (CPA) as a measure of efficiency of microfinance providers. The t- Test has been used to study efficiency of young and mature microfinance providers in rural areas. Further Chi square test is used to analyze impact of non financial services on efficiency of microfinance providers in rural areas.

Hypothesis

H01: There is no significant difference in mean of efficiency for young and mature microfinance providers in rural areas

H11: There is significant difference in mean of efficiency for young and mature microfinance providers in rural areas

H0 2: Efficiency is independent of non financial services provided by microfinance providers.

H1 2: Efficiency is dependent of non financial services provided by microfinance providers.

IV. Data Analysis

Data analysis has been divided in two parts as follows

Efficiency of microfinance providers in rural areas – The t- test has been used to study whether there is significant difference in the mean for efficiency of young and mature microfinance providers as follows

Table no. 1: Test of equality of variance for CPA

Parameter	Hypothesis	P-value	Decision	Interpretation
CPA 2012	$H_0: \sigma_y^2 = \sigma_m^2$ $H_1: \sigma_y^2 \neq \sigma_m^2$	0.000	$P < \alpha$ Accept H_1	Variances are assumed to be not same for productivity and efficiency management of young and mature microfinance providers
CPA 2013	$H_0: \sigma_y^2 = \sigma_m^2$ $H_1: \sigma_y^2 \neq \sigma_m^2$	0.000	$P < \alpha$ Accept H_1	Variances are assumed to be not same for productivity and efficiency management of young and mature microfinance providers
CPA 2014	$H_0: \sigma_y^2 = \sigma_m^2$ $H_1: \sigma_y^2 \neq \sigma_m^2$	0.000	$P < \alpha$ Accept H_1	Variances are assumed to be not same for productivity and efficiency management of young and mature microfinance providers

The results of Table no1 we can conclude that variances are assumed to be not same for productivity and efficiency management of young and mature microfinance providers for year 2012, 2013 and 2014.

Table no. 2: Independent t-test for CPA

Parameter	Hypothesis	P-value	Decision	Interpretation
CPA 2012	$H_0: \mu_y = \mu_m$ $H_1: \mu_y \neq \mu_m$	0.000	$P < \alpha$ Accept H_1	There is significant difference in the mean for efficiency of young and mature microfinance providers
CPA 2013	$H_0: \mu_y = \mu_m$ $H_1: \mu_y \neq \mu_m$	0.000	$P < \alpha$ Accept H_1	There is significant difference in the mean for efficiency of young and mature microfinance providers
CPA 2014	$H_0: \mu_y = \mu_m$ $H_1: \mu_y \neq \mu_m$	0.000	$P < \alpha$ Accept H_1	There is significant difference in the mean for efficiency of young and mature microfinance providers

The results of Table no.2, shows that there is significant difference in the mean for productivity and efficiency management of young and mature microfinance provider’s year 2012, 2013 and 2014. It shows that from descriptive statistics, CPA is higher for the young microfinance providers (96.00) compared to mature microfinance providers (22.42) for year 2012, young microfinance providers (183.26) compared to mature microfinance providers (29.80) for year 2013, young microfinance providers (103.50) compared to mature microfinance providers (36.29) for year 2014.

Impact of non-financial services on productivity of microfinance providers – The Chi square test is used to study impact of non-financial services on efficiency of microfinance providers in rural areas.

Table no. 3: chi-square for efficiency

Hypothesis	P-value	Statistic related with chi-square	Decision	Interpretation
H_{0a} : Efficiency is independent on business training provided by microfinance providers H_{1a} : Efficiency is dependent on business training provided by microfinance providers	0.000	0.724	$P < \alpha$ Accept H_1	Efficiency is dependent on business training provided by microfinance providers.
H_{0b} : Efficiency is independent on literacy training provided by microfinance providers	0.000	0.581	$P < \alpha$ Accept H_1	Efficiency is dependent on literacy training provided

H _{1b} : Efficiency is dependent on literacy training provided by microfinance providers				by microfinance providers.
H _{04c} : Efficiency is independent on social awareness provided by microfinance providers H _{1c} : Efficiency is dependent on social awareness provided by microfinance providers	0.267	0.775	P> α Accept H ₀	Efficiency is independent on social awareness provided by microfinance providers.
H _{0d} : Efficiency is independent on legal counsel provided by microfinance providers H _{14d} : Efficiency is dependent on legal counsel provided by microfinance providers	0.000	0.646	P< α Accept H ₁	Efficiency is dependent on legal counsel provided by microfinance provider.
H _{0e} : Efficiency is independent on market information provided by microfinance providers H _{1e} : Efficiency is dependent on market information provided by microfinance providers	0.000	0.657	P< α Accept H ₁	Efficiency is dependent on market information provided by microfinance providers.

The results of Table no.3, shows that, productivity is dependent on non-financial service provided by microfinance providers such as business training, literacy training, legal counsel and market information. From the statistics also found that the association is strong because the Cramer ‘V’ value is 72.4 %, 58.1%, 64.56% and 65.7 % which is greater than 50%.

V. Conclusion

The efficiency of microfinance providers is an important parameter for sustainable growth of microfinance providers in rural areas. Present study shows that efficiency has improved as microfinance providers matures as cost per active borrowers goes down as the microfinance providers matures, administrative costs usually drop as managers learn from experience. Also competition forces microfinance providers to lower pricing and enhance the efficiency. A major issue that most of microfinance providers facing that after selection of customers with a clear target, microfinance providers don’t have clarity about the right products and appropriate processes which fulfill their clients’ needs.

Microfinance providers should apply product development and marketing strategies. The present study also shows that provision of non financial services as a complement to credit and saving services leads to enhance reach of microfinance providers towards poor people in rural areas and enhance sustainability of microfinance providers. Microfinance providers should train rural poor in simple skills and enable them to utilize the available resources and contribute to income generation in rural areas. Efforts towards use of IT for operations will steadily improve efficiency in turn helps accelerate the growth rate of the microfinance sector.

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