A New Perspective on Performance in Indian Microfinance Institutions: An Empirical Study

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ABSTRACT

With the massive growth in microfinance sector, the importance of performance measurement in microfinance institutions (MFIs) has prominent during the last decade. With an objective of commitment to dual mission, the Indian MFIs witnessed a series of rise and fall and subjected to mission drift. Thus redefining the performance is the prime objective of this study. Data gathered from 252 MFIs irrespective of their legal status. Factors for performance were identified through literature and were validated empirically. This research considered both the financial and social dimensions of performance unlike the earlier studies. Financial performance is described by profit margin, return on assets and portfolio at risk whereas social performance consists four factors namely Information disclosure (INFDIS), Mission adequacy (MISADEQ) and Community participation (COMPART). This study can be a useful benchmarking tool for practitioners to monitor and improve the MFI performance. The study has unique value to microfinance literature, both from theoretical and managerial perspectives.

Keywords: Financial Performance, Microfinance, Performance, Social Performance

1. INTRODUCTION

The dual mission of being financially profitable and socially sustainable has put the Microfinance institutions (MFIs) into mission drift. While chasing competition to broadens their client base, many MFIs hired unsuited staff who can deliver expected financial outcomes, however the social issues is being neglected or unseen (Aadhaar Report, 2011). Mission drift happens when MFIs diverge from their original mission of alleviating poverty and serving poor, to more profit centric vision by serving wealthier clients or by charging high-interest rates for their customers. So to cope up with the challenge of mission drift, they need to prioritize both financial and

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social performance. As financial performance is necessary for the self-sustenance and social performance will justify their purpose of existence. Thus balancing these two performances is the prime task before MFI practitioners.

The wide variations in legal status and size of MFIs in India itself possess challenge. As there are different sizes of MFIs, from small, medium to large and so the variations in legal status like Nongovernmental organizations (NGOs), trust, cooperatives, Non-bank financial companies (NBFCs) and section 25 companies. The Many MFIs with smaller credit programs find difficulties in experiencing growth as they lack the technical and financial resources, as well as an obligation to the financial systems approach. Many NGOs in microfinance not only face terrific challenges to balance their client base and financial strength, but also they failed to make an aggregate impact on poverty reduction (Baruah, 2010). Presently, MFIs are moving towards the market and are exposing themselves to a cutthroat competition in the name of lending to the poor. In the process they have started chasing targets and numbers. It seems that the social and developmental concerns, by which the microfinance was being motivated earlier, may have lost their significance as some of the MFIs are become radically commercial (Sriram, 2010). The microfinance sector in India has gone through significant changes since the Andhra Pradesh microfinance crisis of October 2010. The AP Microfinance Ordinance of October 2010 led to a sharp drop in the collection efficiency of AP-based MFIs (from over 99% to almost nil for their AP portfolio), forcing most MFIs based in the southern state to have their debt obligations restructured. The credit profile of AP-focused MFIs weakened significantly during 2010-2013 as they were unable to raise collections from borrowers because of severe state government restrictions. On the other hand, non-AP MFIs also saw fresh funding lines drying up as a result of the general loss of stakeholder confidence. Consequently it impacts the growth pattern across India. This followed by some subsequent regulatory changes with the promulgation of similar legislative act called Malegam Committee in 2011 for Indian MFIs (a special sub-committee appointed by Reserve Bank of India).

There are certain costs and benefits associated when a Microfinance NGO transforms to a NBFC. The charge against these MFIs who are transforming into NBFCs and now want to go for initial public offering (IPO) is that they are supplementing themselves and their shareholders at the cost of their clients. In the case of NBFCs, it is found that their vigorous growth put them into a mission drift. As pointed by Churchill (1997) many MFIs witness cycles of growth followed by periods of condensation where they are compelled to resolve various problems caused by growth, such as a worsening in portfolio quality, client abandonment and management, and staff training, and loan processing and infrastructural challenges. Therefore, this commercial success of microfinance sparks an eyebrow-raising question of whether microfinance actually leads to sustainable development or are the MFIs drifting from the second objective of being socially sustainable in order to fulfil the first objective i.e. being financially viable. A study conducted by Mukhopadhyay and Barpanda (2012) on the ethical issues involved while transforming to profit centric MFIs. In this study, they have taken account of the MFIs that are transforming into NBFCs and considered their mode of operation. The findings suggest that it’s highly demanding to focus on social performance measures of MFIs to lead a sustainable growth. Further, they confirm the critical role of staff to fulfill their mission.

2. LITERATURE REVIEW

The MFIs face unique challenges while fulfilling the objectives of achieving double bottom line of financial profitability and social sustainability. So a proper performance measurement framework can be a better way to judge the performance as compared to a mere objective way
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