

## Social Performance of Microfinance Institutions Improving Economic Stability of Low-Income Individuals

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### Abstract:

Right now, a lot of microfinance institutions (MFIs) are straying from their initial goal of reducing poverty. Considering social performance metrics as a means of addressing MFI development, the aim of this study is to identify and update significant social performance (SP) for micro-finance institutions (MFIs). Social performance metrics are more closely aligned with the organization's development and social objectives than regular performance metrics. Therefore, in order to identify critical social performance metrics that MFIs must meet in order to fulfill their social objectives, this study has examined earlier empirical research and consultancy reports pertaining to poverty reduction. This study also examines 125 MFIs that reported social performance in 2018 and 2023 using the Microfinance Information Exchange (MIX) database. According to the research, Therefore, this study offers guidance for future research in performance evaluation that balances social and financial goals in the microfinance sector. In order to support the conceptual literature that is now available, it is also a start toward performing additional research and suggesting regulation of MFIs' social performance. This will need additional empirical study utilizing micro-econometrics approaches in the future.

**Key Words:** Microfinance institutions (MFIs), social performance, non-governmental organisations (NGOs), non-banking financial institutions (NFBIs).

### Introduction:

Although microfinance institutions have made money in India, they have not been helped by rules or populist politicians. These institutions' tiny size suggests that even minor negative events could have an impact on them, leading to unstable finances. A variety of products and an assured deposit structure are typical features of banks. Micro lending institutions, on the other hand, rely heavily on the market for funding. This implies that MFIs may have trouble obtaining funding for even the slightest business-affecting incident. Furthermore, banks are currently involved in micro lending and collaborating with MFIs through strategic stakes. MFIs are likewise having trouble expanding on their own without the assistance of anchor investors. There were 223 MFIs with NGO-run societies and units as of 2017. The Microfinance Institutions Network (MFIN) has registered 47 non-banking finance firms, or microfinance institutions (NBFC-MFIs). The top 10 MFIs consistently have an easier time obtaining bank loans or stock; smaller organizations are typically at a disadvantage in this regard. A number of microfinance companies have changed their name to small finance banks. They may be able to lend money at greater interest rates, based on this. They will be able to acquire inexpensive deposits. According to MFIN data, banks are currently among the biggest providers of microfinance. The main suppliers of microfinance are still MFIs that have converted to banks.

### Danger of Over borrowing in the Microfinance Sector

The largest risk facing the microfinance sector at the moment is borrowers' propensity for taking on excessive debt. Over the past two years, the average size of microfinance loans has increased, according to data from CRIF High Mark. Additionally, a few of borrowers have tried borrowing money from several lenders. A significant portion of this threat came from borrowers who applied for loans from more than four lenders. It was discovered that between March 2017 and March 2019, the amount of these loans rose from Rs. 60,000 to Rs. 81,000. In the same time frame, loan applicants also approached over five banks. In this case, the loan amount increased from Rs. 73,000 to Rs. 1,02,000. The industry-wide over borrowing is to blame for MFIs' current rejection rate of 20% to 30% of loan applications. RBI regulations state that a single loan seeker's total microloan amount cannot be more than Rs. 60,000 during the first cycle. The sum should not exceed one lakh rupees in the ensuing cycles. Additionally, the borrower is not permitted to apply for the same loan at more than two microfinance organizations. Due to the high demand for loans, MFIN raised the lending threshold to Rs.80,000 as part of its self-regulation. Tamil Nadu is one of India's largest microfinance markets as of March 2019.

### Significance of the Study

In order to support their entrepreneurial endeavors and help them escape poverty by meeting their financial needs, microfinance institutions (MFIs) give small loans to low-income and impoverished individuals who do not have access to official banking services. The number of MFIs operating in developing nations has dramatically increased as a result of

the general public's passion for microcredit. Owing to the substantial returns and favorable public image of socially conscious investment in the field, major banks have also ventured into the microfinance sector. Due to the banks' engagement, this industry has expanded economically and is now solely focused on profitability. These days, MFIs are straying from their initial goal of reducing poverty. Evidence suggests that developed financial services lower poverty and economic inequality in a country (Claessens, 2006), but access to these services is not universal, particularly in emerging nations. Financial services are inaccessible to millions of people, and there is a considerably greater need for them than there is supply at the moment. Globally, investments that are socially conscious are growing in popularity. According to Renneboog, Ter Horst, and Zhang (2008), some investors have a preference for making investments that integrate social and ethical considerations and pursue both financial and social objectives. These investors are interested in achieving worthy goals like lowering poverty and achieving the Millennium Development Goals.

## Literature Review

### Microfinance and Social Development

Since Schumpeter's "Theory of Economic Development" in 1912, the role of financial development in economic progress has been studied theoretically and experimentally in previous research. These studies look into how financial systems have changed over time and how they contribute to economic growth. They argue over whether financial development has a good effect on actual wealth. Countries that undergo economic development see a sharp increase in their financial assets. Numerous research on this subject have shown a correlation between financial development and economic expansion (Goldsmith, 1969). Economic development is greatly aided by financial activity, which raises and pools capital, encourages the making of riskier investments, and directs resources toward high-productivity industries (Helms, 2006; Tinh Thanh, 2011).

The depth of the financial system and investment, growth, and poverty are all closely related. According to numerous economists and financial professionals, the growth of a nation's financial services industry affects its social, political, and economic environments in addition to playing a major role in economic growth (Calderón & Liu, 2003; Erdal et al., 2011; Houssein & Hassene Ben, 2011; Jeanneney, Hua, & Liang, 2006; King & Levine, 1993). However, in previous decades, attempts to offer formal credit and financial services to the impoverished in developing countries have failed. Because modest loans and savings accounts are thought to carry a high level of risk and come with substantial transaction costs, the mainstream banking industry has historically been hesitant to cater to this market. By employing creative new contracts to help the underprivileged and low-income while still turning a profit, microfinance seeks to improve all of that (Armendáriz de Aghion & Morduch, 2004). Most people hold the view that the primary goal of microfinance was to reduce poverty, and that it created financial markets to cater to the various financial needs of the underprivileged who lack access to the formal financial system (Braut, Hiatt, and Woodworth, 2009; Daley-Harris, 2006; Rock, Otero, & Saltzman, 1998). The Grameen Bank concept was started by Muhammad Yunus, who popularized microcredit. It has been successful in providing financial services to underprivileged women in Bangladesh as a means of reducing poverty in developing nations.

According to Yunus and Weber (2007), the idea has aided in the development of entrepreneurs who strive to raise living standards. MFIs provide services to around 70 million low-income people worldwide (Daley-Harris, 2006). Around 10,000 MFIs are thought to have operated globally in 2007 (Ming-Yee, 2007), providing services to more than 113 million customers. Globally, MFIs are thought to be crucial in helping developing countries end poverty (Caudill, Gropper, & Hartarska, 2009; Zohir & Matin, 2004). The Economist, the New York Times, and the San Francisco Examiner are just a few of the well-known publications that have said that microfinance might be the most crucial instrument for ending poverty.

### Poverty Alleviation Measurements in Social Development Studies

Government leaders stated that any nation might achieve economic growth by embracing the Millennium Development Goals (MDGs), which are recognized as internationally accepted development objectives, at the United Nations Millennium Summit in 2000. The Millennium Development Goals (MDGs) aim to decrease poverty by focusing on different aspects of welfare, including expanding access to basic education, primary healthcare, nutrition, safe water, and women's empowerment (IFAD, 2003). Following the MDG declaration, governments and donor organizations centered their programs on achieving these objectives. According to Littlefield, Morduch, and Hashemi (2003), they used their resources to lower poverty and hunger, end HIV/AIDS and other infectious diseases, empower women and enhance their health, improve children's education, and lower the rate of child mortality.

Any development strategy must focus in large part on achieving a specific set of MDGs. Numerous experts in social development studies have noted that the achievement of these goals depends in particular on things like having a functioning government, physical security, economic development, and basic infrastructure (Littlefield et al., 2003). It appears that achieving the MDGs and having a sound financial system go hand in hand. Some academics working in the field of social development studies have conducted studies to determine how a nation's improved financial system helps its impoverished citizens to become less impoverished. Determining the elements and conditions that support an improvement in the prospects for the impoverished in developing nations is crucial.

While some studies have focused on the importance of income level in assessing the financial system's impact (Cuong, 2008), others have placed more emphasis on the income-generating activities that the impoverished use, such as agriculture, livestock products, and microenterprise (Montgomery & Weiss, 2011). Certain researches take into account the overall monthly/yearly per capita spending on food, non-food products, healthcare, and education (Cuong, 2008; Islam, 2008; Khandker, 2005; Montgomery & Weiss, 2011; Pitt & Khandker, 1998; Tinh Thanh, 2011). Another way to determine how the financial system affects the education of the impoverished is to look at the number of girls and boys between the ages of 5 and 17 who are enrolled in school as well as the rate of absence (Montgomery & Weiss, 2011; Pitt & Khandker, 1998). The degree of borrowing at the village and male/female family levels is another indicator of how the financial system affects poverty (Khandker, 2005; Pitt & Khandker, 1998). Using data from a Bangladeshi village, Nawaz (2010) evaluated the effect of microfinance on poverty using 13 socioeconomic indicators: income, food, clothing, healthcare, housing, furniture, electronics, tube wells, toilets, children's education, social status, voting, and coping vulnerability. The impact of group-based credit on impoverished households in Bangladesh is measured by looking at women's non-land assets and the number of hours per month that these individuals work, ages of 16 and 59 (Pitt & Khandker, 1998).

### **Social Performance Measures in MFI Governance Studies**

MFIs must measure their performance, much like other businesses, in order to assess their continued existence and expansion. But unlike other businesses, MFI performance includes outreach as well as finances. Since the beginning of the microfinance industry, several sectors have proposed different standards for judging MFI performance (Kereta, 2007; Meyer, 2002; Ngehevu & Nembo, 2010). The three crucial factors—financial sustainability, outreach to the underprivileged, and welfare impact—that should be taken into account when assessing MFI success are highlighted by Zeller and Meyer (2002) as the "critical triangle of microfinance." To demonstrate a firm's success, all three sides of the triangle must be assessed for MFI performance. Zeller and Meyer define "impact" as the ability of MFIs to significantly improve clients' quality of life. Additionally, They also emphasize that keeping customers and being able to continue operating without direct funding are the best measures of impact.

One of the crucial goals in the critical triangle that MFIs must accomplish is outreach. Measures of MFIs that are now available show that social performance is less important than the profitability of MFI operations. However, reach is a complex idea that needs to be assessed based on a number of factors (Meyer, 2002; Navajas, Schreiner, Meyer, Gonzalez-vega, & Rodriguez-meza, 2000). Six criteria were identified by Navajas et al. (2000, p. 335) as indicators of MFI outreach. They defined outreach as the social value of an organization's product in terms of depth, worth to users, cost to users, breadth, length, and Scope. Most scholars define reach as the total number of clients or borrowers that MFIs serve (Bassem, 2009; Cull, Demirgüç-Kunt, & Morduch, 2007; Hartarska, 2005, 2009; Hartarska & Mersland, 2009; Hartarska & Nadolnyak, 2007; Kereta, 2007; Mersland & Strøm, 2009; Meyer, 2002; Navajas et al., 2000; Tchakoute-Tchuigoua, 2010). These are some basic definitions of reach. This implies that an MFI now provides services to people who were previously unable to obtain official financial services. These are the impoverished for whom collateral is necessary to secure loans from the official banking system. Rather than focusing on client count, Kyereboah-Coleman and Osei (2008) evaluated outreach using the annual rate of change of active clients.

### **Outreach to the poor and excluded**

This states that MFIs must reach out to the underprivileged who do not have access to traditional banking. MFIs should create their goals and mission with the intention of reaching the impoverished. The extent of the MFIs' outreach can be quantified and assessed.

- a. Targeting by geography: The decision is made by the institution to operate in poor, isolated, and isolated areas without access to financial services;
- b. Individual targeting. The MFI intentionally chooses its clientele based on factors such as financial inaccessibility or poverty levels;
- c. Pro-poor methodology. MFIs create services especially for the underprivileged or marginalized populations.

### **Adaptation of services and products to the target clients**

It is important to determine the target impoverished population's financial needs and then build loan solutions to meet those demands.

- a. A variety of customary services. providing a variety of financial services;
- b. High caliber of work. Providing services of superior quality;
- c. Non-financial and innovative services. Make plans for creative and non-cash services.

### **Improvement in the social and political capital of clients and communities**

Developing a relationship with clients raises the payback rate and reduces operational risk.

- a. A financial advantage for customers. MFIs must provide financial services for the underprivileged in addition to tracking and monitoring changes and putting procedures in place to ensure that customers are receiving benefits;

- b. Client participation. customer participation in governance, which strengthens the social network;
- c. Social capital/client empowerment. Promoting clients' empowerment.

#### **Social responsibility of MFIs:**

The adjustment of MFI corporate culture to the socioeconomic environment, a suitable human resource, policy, etc., is explained by social responsibility.

- a. SR directed at employee. putting into practice suitable HR rules;
- b. providing SR to clients. Ensuring adherence to consumer protection principles;
- c. Social responsibility towards the environment and community. being mindful of the environment, community, and culture in which MFIs operate.

Additionally, in order to gauge the MDGs of financial institutions, CGAP suggested social performance measures. These include the breadth of outreach, the reduction of poverty and hunger (through asset gains and housing structure improvements), the promotion of education (through attendance at primary and secondary schools), the availability of health care services (through use of contemporary medical facilities, immunizations, and clean water), and the empowerment of women and the building of social capital. MIX recently gathered pilot data from 22 social performance measures in 2022 and, with 400 MFI assistance, redefined them in 2020. To measure MFI social performance, MIX and SPTF subsequently whittled these down to 11 metrics (MIX, n.d.). These include the organization's mission and social objectives concerning the impoverished, the management of social performance, the scope of loan products and services, the transparency of interest rates charged, employee incentives, the social responsibility of the company towards the environment, the poverty level of its clients, client outreach through lending methods for ability to create jobs and retain clients.

#### **Methodology**

In order to give a general understanding of the MFIs that reported social performance and to emphasize the significance of social performance for the microfinance sector, this research collected data about 125 MFIs from the MIX database. Descriptive data analysis approaches were employed in this study to evaluate the features of MFIs that provided social performance measures in 2018 and 2023. Consequently, there are 458 observations in the sample.

#### **Descriptive Results and Discussion:**

The number of MFIs reporting social performance climbed by 72% between 2018 and 2023, according to statistics from the MIX social performance database. Of the individuals that disclosed their social performance, 34% are non-banking financial institutions (NBFIs) and 34% are non-governmental organizations (NGOs). Banks, credit unions, and rural banks make up the remaining institutions (8 percent, 6%, and 4%, respectively). According to this study, 78% of MFIs with social performance reports prefer to work with low-income clients over the poor (62%), especially the very poor (32%), and middle-class consumers. Almost all of the 125 MFIs that reported social performance target female rowers (85%), clients residing in rural areas (76%) and clients residing in urban or semi-urban areas (82%). For these institutions, this is a positive beginning that demonstrates their role in societal advancement.

Additional analysis reveals that, as opposed to medium and large organizations, 98 percent and 65 percent of observations, respectively, support microenterprises and small businesses. This result encourages the growth of entrepreneurial activity inside a nation. Approximately 85% of the sample aims to reduce poverty when offering clients financial and non-financial goods and services. It should be highlighted that 78% of the sample aims to help create jobs, and 82% of the sample offers facilities to support the expansion of current enterprises. It's interesting to note that between 31 and 35 percent of MFIs offer financial and non-financial goods and services for enhancing adult education, kids' education, and health. Table 1 lists the various loan kinds that the chosen sample offered. Based on the provided information, half of the MFIs in the sample offer goods and services for consumer use, lending money for housing and other household necessities like buying a television or paying a bill. Theoretically, MFIs are required to lend money to their customers so they can use it for profitable business ventures. The findings, however, suggest that not every recipient of a microloan is a potential business owner.

**Table 1. Range of products and services.**

Loan	%	Savings	%
Microcredit loans for microenterprises	98	Voluntary savings	31
SME loans	52	Compulsory savings (cash collateral)	17
Loans for agriculture	47	Fixed term deposits	25
Housing loans	50	Special purpose savings accounts	13
Microcredit for other household needs/ consumption	48	Checking accounts	8



## Conclusion and Policy Implications:

As MFIs must assess the social impact of sponsored operations, this study provides important social performance metrics that they should take into account when gauging their performance. Currently, many MFIs only take into account improvements in their output, such as the quantity of borrowers they serve, the number of jobs created, the average loan outstanding, and the breadth of their outreach, but they do not take into account improvements in their outcomes, such as calculating the impact on client income or the influence on the social and educational standing of clients and their families. Scholars have not previously paid much thought to the mapping of social outcomes associated with MFI activities. Since social performance improves overall performance, microfinance, being a social enterprise, must carefully address social performance.

Only social performance is essential to continuing to provide clients with service can be complemented by financial performance. In order to attain it, MFIs must present proof of accomplishments in areas including housing, health, and client empowerment.

Theoretically, MFIs are required to lend money to clients so they can use it for profitable business ventures. But not every recipient of a microloan qualifies as a potential business owner. A lot of customers take out microloans for consumption—for example, to pay for a bill or purchase a television. Merely five percent of all microfinance loans are taken out for useful purposes. Generally speaking, MFIs do not disclose their consumption loans, and a large number of fund providers do not seem to verify the information in their customer portfolios. But in the future, practically all stakeholders and investors in the microfinance sector will pay special attention to the social development that their investments support. One example of a link that influences donors' choices is the one between funding and social performance. MFIs should take into account both the soft and hard level outputs, such as consulting services for borrowers on business planning, inventory control, and budgeting, in addition to the credit facilities.

Policymakers at the national level who are curious about the social effects of MFIs in their own nations can learn from this study. Stricter reporting guidelines and public release of the data are two important ways regulators can help lessen the harm MFIs are causing. People will withdraw their money if they no longer have faith in financial institutions, which might lead to the collapse of the banking and financial systems as a whole. The industry is currently trying to reinvent itself. If the microfinance industry is to become the panacea for poverty, it must become more efficient. By identifying several forms of social performance, this study advances our understanding of MFI social performance. MFIs will be able to operate in accordance with societal goals thanks to this. This paper makes the case for the necessity of thorough empirical research on the microfinance sector, utilizing econometric techniques to bolster the conceptual literature..

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