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# Microfinance institutions in West Bengal: A Performance analysis

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**Abstract**
Microfinance has attracted much attention in the recent years. By resting on market incentives, microcredit is able to promote small scale investment that generates sufficient revenues from otherwise unrealized market activities while yielding a return on the amount lent. Measuring the performance of microfinance institutions (MFIs) is not a trivial task. Indeed, looking at the financial sustainability of an MFI only gives one feature of its performance. As many MFIs primarily exist in order to help the poorest people, one also has to include aspects of outreach in their performance. Hence, MFIs' performance can be termed multidimensional.
This paper illustrates how some statistical tools can offer new insights in the context of MFIs' performance evaluation. The base variables are thus combined to produce different factors, each one representing a distinct dimension of performance.

**Keywords:** Microfinance, Outreach, Chi-Square analysis

## 1. Introduction

Microfinance has attracted much attention in the recent years. Some commentators have brimmed over with enthusiasm and optimism and see microfinance as the panacea to underdevelopment. By resting on market incentives; microcredit is able to promote small scale investment that generates sufficient revenues from otherwise unrealized market activities while yielding a return on the amount lent. This is a powerful lever to provide credits and deposits possibilities to poor individuals who are largely ignored by commercial banks and other lending institutions. The reasons of this neglect are many. Often, such credits are just not profitable enough for banks, because of economies of scale. By focusing on small amounts, and easing collateral requirements, microfinance institutions (MFIs) are better equipped to target poor individuals or groups who need resources to finance small scale investments.

These credits can be sufficient to promote autonomous and profitable economic projects, expand the opportunity set faced by poor individuals and thereby alleviate poverty. Hence, MFIs, once set up and independent should be able to generate "win-win" outcomes, whereby both efficiency and equity are enhanced. Very often, however, and depending on some exogenous factors, like infrastructure or access to markets, microcredit must be subsidized to ensure the survival of the MFIs.

Others have found the evidence to be not so favorable to this argument. Many MFIs seem to have trouble reaching self-sustainability at the financial level, even after the setup period. In this case, microcredit becomes more akin to subsidized credit which has a long record in developing country, but has often failed to achieve lasting positive results (Morduch, 2000) [1].

Still, even if MFIs do not reach financial sustainability and fail therefore to conform to the "win-win" assumption, they can still be considered valuable if they provide credit facilities to poor households who would not be able to find financial resources otherwise. In this perspective, *outreach* has a social value in itself, which may more than offset the cost associated with permanent financial subsidies needed by the MFIs.

In other words, MFIs face a double challenge: not only do they have to provide financial services to the poor (*outreach*), but they also have to cover their costs to avoid bankruptcy (*sustainability*). Both dimensions must therefore be taken into account in order to assess their performance.

There is currently no widely accepted measure for assessing the social performance of MFIs, outreach always being defined in terms of several indicators, like the percentages of female and rural clients or the average loan size (Schreiner, 2002) [2]. Very few attempts have been made to aggregate those numerous indicators into one single measure, although it would be useful since it would give a straight and accurate view of the outreach. Zeller *et al.* (2003) [3] provide some hints for building such a measure, either by assigning arbitrary weights to each of the indicators, or by deriving the weights through principal components analysis. In this paper, we generalize their second method: we apply ANOVA to a set of indicators not only related to social performance but also to financial performance.

The factors determining MFIs' performance are not clearly known either. To the best of our knowledge, Hartarska (2005) [4] was the first to present evidence on the determinants of MFIs' performance in a multidimensional context. However, she estimates different equations for each of the indicators.

## 2. The Data

The sample used is this paper is composed of 8 microfinance institutions. Hamed (2007) [5] provides a complete description of the data set, and we describe here only the variables selected for our analysis.

The majority of these variables are indicators of outreach. One can also expect that an MFI will serve poorer individuals if it lends to groups.

**Table 1:** Characteristics of Variable

| VARIABLE | DATA TYPE |
|---|---|
| Retention of Clients | Continuous Variable |
| Service for Clients | Continuous Variable |
| Clients are not educated about financial services | Continuous Variable |
| Not having relevant information about clients | Continuous Variable |
| Education level of client is low | Continuous Variable |
| Language Barrier | Continuous Variable |
| Late Payments | Continuous Variable |
| Clients are not informed about consumer protection | Continuous Variable |
| Clients are not informed about debt management | Continuous Variable |

***Source:*** *Own Survey*

## 3. The multiple dimensions of MFIs' performance

In order to assess the performance of the micro insurance providers in West Bengal, the researcher interviewed, with the help of a structured questionnaire, 8 microfinance institutions (MFIs) in West Bengal in terms of a number of factors that are expected to play a major role in helping their organisation grow.

**Table 2:** Period of Operation of MFIs

| Period | Frequency | % |
|---|---|---|
| Less than 1 year | - | 0.00 |
| 1-3 years | 1 | 12.50 |
| 3-5years | 4 | 50.00 |
| 5 years or more | 3 | 37.50 |
| Total | 8 | 100 |

**Source**: Field Survey

It can be said that majority of the MFIs have been operating for more than 3 years.

**Table 3:** Target Customers of MFIs

| Target Customers | Frequency | % |
|---|---|---|
| Service-employed (men/women/both) | - | 0.00 |
| Self-employed (men/women/both) | 3 | 37.50 |
| Unemployed (men/women/both) | 2 | 25.00 |
| All of the above | 3 | 37.50 |
| **Total** | **8** | **100** |

**Source**: Field Survey

It can be observed that the MFIs work for all classes of people whether they are unemployed, self-employed or in service. Different insurance products are designed for different classes. This is actually a challenging task for the MFIs.

**Table 4:** Frequency of Promotional Campaigns

| Promotional Campaigns | Frequency | % |
|---|---|---|
| less than 3 months | 1 | 14.29 |
| 3- 6 months | 4 | 57.14 |
| 6 months to less than one year | 2 | 28.57 |
| more than 1 year | - | 0.00 |
| Total | 7 | 100 |

**Source:** Field Survey

Majority of the MFIs engage in promotional campaigns, indicating increasing competition among them in recent times. Their clients are not highly educated and therefore they have to be continuously educated about the new products and their features.

**Table 5:** Income (p.m.) Group of Clients

| Income (p.m.)Group | Frequency | % |
|---|---|---|
| Rs.4000 or more per household | 4 | 57.14 |
| Rs.3000 to Rs.3999 per household | 1 | 14.29 |
| Rs.2000 to Rs.2999 per household | 2 | 28.57 |
| Rs.1000 to Rs.1999 per household | - | 0.00 |
| Below 1000 per household | - | 0.00 |
| Total | 7 | 100 |

**Source**: Field Survey

It is observed that majority of the clients of the MFIs fall in the highest income group. During the interviews with the concerned MFI officials, they pointed out that income of their clients has increased considerably due to microfinance activities.

During the interviews with them, it was also found that their customer awareness strategies are mainly references and repeat clients, and their product marketing strategies are door to door campaign, distribution of leaflets/brochures, and word of mouth.

Apart from the above analyses, primary data relating to few selected factors, which are expected to helpthe MFIs grow, have also been analysed.

**Table 6:** Crosstab of the Factors and the Responses of the 8 MFIs

| | | FACTORS | | | | | | | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | RETENTION OF CLIENTS | SERVICE FOR CLIENTS | CLIENTS ARE NOT EDUCATED ABOUT FINANCIAL SERVICES | NOT HAVING RELEVANT INFORMATION ABOUT CLIENTS | EDUCATION LEVEL OF CLIENT IS LOW | LANGUAGE BARRIER | LATE PAYMENTS | CLIENTS ARE NOT INFORMED ABOUT CONSUMER PROTECTION | CLIENTS ARE NOT INFORMED ABOUT BASICS OF DEBT MANAGEMENT | |
| RESPONSE | FULLY DISAGREE | 0 | 0 | 0 | 1 | 0 | 2 | 2 | 2 | 3 | 10 |
| | | 0.00% | 0.00% | 0.00% | 14.30% | 0.00% | 25.00% | 25.00% | 25.00% | 42.90% | 14.50% |
| | DISAGREE | 0 | 0 | 1 | 2 | 1 | 6 | 2 | 3 | 0 | 15 |
| | | 0.00% | 0.00% | 12.50% | 28.60% | 12.50% | 75.00% | 25.00% | 37.50% | 0.00% | 21.70% |
| | NEITHER AGREE NOR DISAGREE | 0 | 0 | 3 | 4 | 1 | 0 | 3 | 1 | 1 | 13 |
| | | 0.00% | 0.00% | 37.50% | 57.10% | 12.50% | 0.00% | 37.50% | 12.50% | 14.30% | 18.80% |
| | FULLY AGREE | 1 | 0 | 3 | 0 | 4 | 0 | 1 | 0 | 2 | 11 |
| | | 14.30% | 0.00% | 37.50% | 0.00% | 50.00% | 0.00% | 12.50% | 0.00% | 28.60% | 15.90% |
| | AGREE | 6 | 8 | 1 | 0 | 2 | 0 | 0 | 2 | 1 | 20 |
| | | 85.70% | 100.00% | 12.50% | 0.00% | 25.00% | 0.00% | 0.00% | 25.00% | 14.30% | 29.00% |
| Total | | 7 | 8 | 8 | 7 | 8 | 8 | 8 | 8 | 7 | 69 |
| | | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |

**Source**: Field Survey

*Null Hypothesis ($H_0$)* –there is no significant difference in responses on the factors that are expected to help the MFIs grow

*Alternative Hypothesis ($H_1$)* – there is significant difference in response on the factors that are expected to help the MFIs grow

If P value < 0.05, the *Null Hypothesis* is rejected.

| Chi-Square Tests | | | |
|---|---|---|---|
| | Value | df | P Value |
| Pearson Chi-Square | 83.904 | 32 | <0.001 |

**Source**: worked out by the researcher

Based on the above Chi-Square value, the *Null Hypothesis* is rejected (as P<0.05) and the *Alternative Hypothesis* is accepted, indicating that there is significant difference in responses on the factors that are expected to help the MFIs grow.

Difference in opinion is mostly noted with respect to the following factors:

- Late payments
- Clients are not informed about consumer protection
- Not having relevant information about clients
- Clients are not informed about basics of debt management.

While these factors are major challenges before some MFIs, these can also be seen as opportunities.

The researcher has also conducted one-way ANOVA.

## 4. Conclusion

Microcredit is often promoted as an efficient tool to help the poor, since it is based on sound economic principles. Rates of return of small scale investments can be very high and explain why some people are ready to pay high interest rates in order to finance them. However, market failures and relatively high transaction costs can prevent a substantial part of these investments to be realized through private financial intermediaries, especially in remote rural areas. MFIs' ambition is to fill the gap. As discussed earlier, they can do so either by focusing on the poor and expanding their outreach, or they may prioritize their financial viability.

The goal of this paper was to provide some new empirical and methodological insights on this important subject. It is quite similar in spirit to Flückiger & Vassiliev (2007) [6], where MFIs' "outputs" are measured and evaluated with respect to resources used in an efficient frontier context, but with different data and an alternative model. Our approach attempts to shed some light on the way the performance of MFIs can be evaluated in a multi-dimensional context. The same is true, though to a lesser extent, for the financial performance. Clearly, some ambiguity can arise as to the choice of variables that should be used to define these indices. Most results were plausible, although we stress that the paucity of the data made it clear that their statistical reliability is rather limited and that they should, for this reason, be considered more for their heuristic value.

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