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# Evolution of Microfinance – A Literature Review

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**ABSTRACT**

*Microfinance as a concept is not new. However, over a period of around 35 years the interpretation, delivery models, stakeholders have changed drastically. The base idea remains the same which is to uplift the poorest of poor. This paper delves into some of the literature which has been done on microfinance. The literature covered is not exhaustive by any means, which is also a limitation of this paper. However, the different models of microfinance and their delivery mechanisms have been covered. This is a conceptual paper and the main aim is to collate the existing literature in microfinance to identify the research gaps for further study. Though there has been extensive study on microfinance there are few research papers which have compared existing microfinance models. This research gap needs to be exploited further and the authors would be working in this direction in future.*

**Keywords:** Microfinance, models, literature review, Self Help Groups, Joint liability groups.

## INTRODUCTION:

Microfinance as the word suggest is a combination of two letters Micro and Finance. Micro means small and finance means capital/money in this context. So, microfinance in literal terms is small amount of money. Even though the term appears to be simple enough the concept has taken some time to develop. It was in the year 1974, when Professor Muhammad Yunus from Chittagong University, Bangladesh took his students on a field trip to a poor village. He came to know from a lady that she had to borrow 15p for purchasing raw material to produce a single stool. After paying off the interest to the money lender which sometimes was as high as 10% a week, she was only left with a profit margin of only a penny. [1] This set-in motion an idea in the mind of the professor that if the lady was able to borrow at better rates, she would be able to earn much more and thus improving her standard of living. Implementing his idea was the next step and the professor lent the equivalent of $27 to 42 basket weavers.

The idea was rejected by established players like banks and the government support was lacking, still Muhammad Yunus continued giving micro loans. (Muhammad Yunus is grameen founder. (n.d.)).[1] This small personal endeavour was institutionalized when Grameen Bank was established in the year 1983. Grameen Bank also means village bank and its brief was to cater to the marginalized section of people in the rural areas of Bangladesh. Today Grameen Bank has 2564 branches, 19,800 staff, 8.29 million borrowers and spread across 81,367 villages. (Muhammad Yunus is grameen founder. (n.d.)). [1] The weekly instalments that the bank collects are to the tune of $1.5 million. (Muhammad Yunus is grameen founder. (n.d.)). [1] The dominant borrowers in terms of gender are women who form 97% of the borrowing collective. (Muhammad Yunus is grameen founder. (n.d.)). [1] Of the total amount lent approximately 97% of the loans are paid back which is way better than other financial institutions. (Muhammad Yunus is grameen founder. (n.d.)). [1] Mr. Muhammad Yunus was awarded the Nobel peace prize jointly with Grameen Bank in 2006 for trying to uplift the lives of the poorest of poor. (The Nobel Peace Prize 2006. (n.d.)).[2]

Microfinance is also known as microcredit. When we are talking about credit, the traditional mechanism involved checking two primary things, 1st is the ability to pay and 2nd is the intention to pay. The target segment in the context of microfinance where primarily people who didn't fulfil the 1st criteria and it was almost impossible to check the 2nd criteria. So, they ended up as the neglected segment, wherein banks did not want to get involved as the average ticket size was miniscule and profits would be hard to come by.

Globally, the number of extremely poor people, i.e. people who live on $1.90 a day or less has reduced from 1.9 billion in 1990 to approximately 736 million in 2015. (Wadhwa, D. (2018, September 18). The number of extremely poor people continues to rise in Sub-Saharan Africa) [(3)]. However, this number is just indicative when we compare it with other basic data points. For example, still over 1 billion people lack access to electricity (Access to electricity (% of population). (n.d.)) [(4)]. Also, 2.4 billion people around the globe also don't have access to toilets (People using safely managed sanitation services (% of population). (n.d.)) [(5)]

The initiative which was started by Prof Yunus was further extended in the form of an action research project which was called the Grameen Bank Project. The objectives (Grameen Bank. (2019, June 12)). [(6)]of the project were:

- To promote financial independence among the poor
- To encourage all borrowers to be savers
- To eliminate the exploitation faced by the poor at the hands of moneylenders
- To encourage the borrowers to set up microenterprises
- To make each Grameen bank branch location free of poverty in terms of providing access to adequate food, drinkable water and sanitation

For the purpose of this paper, we will see the evolution of microfinance from a research project to a mission which gets institutional status. This is a conceptual paper and the scope of the paper is to collate the literature data available.

There are several questions which arises when discussing about microfinance institutions. Is the concept of microfinance universally applicable, do we need a set of definite conditions or ecosystem for developing an ecosystem for formalization of Microfinance institutions (Cuevas, 1997)? [(7)]

The concept of microfinance and micro credit which essentially means helping the poor comes from the idea of welfare state. Now, majority of world is a free market. However, in the free market private enterprises cater to the class which can pay for their services. So, this has led to people with money getting most of the services or products. As a result, governments take it upon themselves as a moral obligation to help the people who are marginalised. (Pramanik, 2000) [(8)]

(Ahlin et. Al., 2011) has studied about the reasons for the flourishment of microfinance institutions in relation to the country level economics in which they operate. Their study from 373 Microfinance institutions and merging the data with macro- economic parameters prove that MFIs in deeper economies tend to do well, also the costs associated with the operations are also lower. [(9)]

(Mazumder & Lu, 2014) have studied how microfinance impacts the livelihood of people. They have collected data of 300 microfinance beneficiaries along with 200 control respondents in two phases. Their study using descriptive statistics prove that there is a positive impact on the basic right of respondents, also their quality of life tends to improve. It's also showed that the impact was higher in non-governmental microfinance respondents. This study was undertaken in Bangladesh. [(10)]

There is a direct relationship between the amount of time a Microfinance institution has been operating and its cost. Longer the time duration lower would be cost. (Caudil, et al, 2009) using the cost function have identified that MFIs over the ECA region tend to be more cost effective than the time when they started their operations. However, this was not the only finding, the cost effectiveness showed improvement in half the cases, whereas in the remaining half there was no improvement. The improvement was visible in those MFIs who were not dependent on lower subsidies but more on deposits, whereas the institutions which were dependent on higher subsidies tended to underperform. Also, the performances varied in different regions. [(11)]

Microfinance may lead to an increase in informal lending. This was the subject of research of (Barman, et.al 2009) wherein they have studied the role moneylenders play when respondents need the amount of money to be topped up. Using a case study-based approach in the city of Varanasi, they have compared two microfinance models. Their conclusion included the fact that the beneficiaries were more indebted in the case where they lend from Microfinance Institutions. The indebtedness also increased in case where MFIs had not undertaken proper creditworthiness of the clients. The sample size for the purpose of this study were 59 households from 12 villages. The models that were compared for the purpose of study were self-help groups and Microfinance Institutions. [(12)]

(Rathore, 2015) has studied whether social audit is an important factor or not for the purpose of microfinance contract. The author has undertaken a systematic review of theoretical and empirical literature. The important findings from theoretical literature shows that when there is a joint liability it tends to overcome both the informational failure as well enforcement failure in credit markets. In contrast, empirical literature has shown that social capital should not be taken in isolation, but it should be taken in association with other aspects and which may have different effects on the performance. For example, rather than financial incentives the trust between borrowers, cultural and social homogeneity have a higher impact on the repayment performance. Also, it was found that groups which were formed by family members had a lower performance when it came to repayment. The literature review for the purpose of this study was broadly divided in three aspects

(a) Papers which supports that social capital solves the problem of enforcement.
(b) Papers which support that social capital tends to solve the problem of information asymmetry.
(c) Papers which states that social audit plays no role in the group lending process. (13)

(Abrams, J., & von Stauffenberg, D.,2009) in their paper have questioned the role that subsidized capital play in downgrading the development of localized markets. As per data collected by the authors outstanding loans were to the tune of $1 billion in the year 2005. was also found out that development agencies were parking their funds in the successful and aggressive financial microfinance institutions. Data has been taken from Microfinance Information exchange (MIX) for 160 MFIs have been taken for the purpose of this study. (14)

(Muneer Babu, M., & Kulshreshtha, P.,2014) have studied sources of productivity growth and changing trends by using the Malmquist Total Factor Productivity (TFP) index. Panel data for 34 companies during the time period 2005-06 to 2010-11 were used using the Data Envelopment Analysis (DEA). The TFP index was broken down to discover two sources of productivity change which were changes in technical efficiency and technology of sample MFIs. It was found out that the productivity of sample MFIs has declined over time and MFI institutions in India need to upgrade themselves with respect to innovation significantly in order to increase their productivity. However, the technical efficiency of MFIs has improved which shows that the operational as well as managerial effectiveness has improved over time. (15)

Doshi, K. (2010) has studied how sustainable value is created by Microfinance institutions. For the purpose of this paper author has undertaken a case study-based approach Accion San Diego. The development of Accion was studied with the help of Appreciative Intelligence framework. Accion SD has emerged as an organization which has got a lot of potential as it is continuously learning from its experiences and continuously expanding by following its positive initiatives. This has helped the organization to become sustainable. (16)

Lahkar, R., & Pingali, V. (2016) in their research paper have studied the growth of microfinance and what are the policy implications which are affecting the borrowers. They have used a screening model and have been able to prove that microfinance expansion may lead to higher interest as well as default rates but the welfare of the borrower will also increase due to the fact the borrowers were previously denied credit and as the database of pre-existing borrowers will increase the screening costs are bound to come down. They have concluded through this paper that policies if any that seek to regulate interest rates as well as screening levels would be counterproductive. The paper tends to work on improving the understanding with regards to microfinance sector as well the implications of microfinance on the welfare of borrowers. They have for the purpose of the study have considered two situations, the first, where in there is fund constrained benevolent mutual fund and the second is competitive microfinance sector where the participants are for profit MFIs who don't have any restrictions on lending abilities.(17)

Hudon, M. (2008) in his paper "Norms and Values of Microfinance institutions" studies the role of norms and values in microfinance sector. The author has proposed classification of the sector on the lines of two axes. The first is using profit motive, i.e. for profit vs. not for profit and second is based on decision-making style i.e. centralized vs. non centralized. The institutions studied, in their interactions followed rules to the tee or they would base their interactions on values. The author has argued that microfinance institutions which are for profit would follow the rules while MFIs on the not for profit spectrum would follow an inclusive decision-making process which are more ethical in nature. The author has however pointed out that the cases of South India also paint a different picture in the sense that interest rates can be politically as well as emotionally motivated. (18)

Olsen, W., & Morgan, J. (2010). The authors have studied the issues which come to the fore when the aspirations of microfinance borrowers increase. The paper was written within the geographical constraint of South India. There are two problems which arise when aspirations increase. Firstly, there is a tendency to borrow more than one's ability to repay. Secondly, female borrowers who are the major chunk of microfinance borrowing tend to find their individualistic aspirations clashing with the traditional power centre of male dominance in the family. A total sample size of 187 families were taken for the purpose this study. The main question which has been tried to address is what people want in life, what is the extent that they will go to get it and what are the repercussions which arise from these aspirations. There were two main findings from this study. First, there is a wide acceptance among the locals of taking debt and it was considered a normal activity. In many cases, rather than considering

debt as a liability, it was considered as a positive thing. It added to the status of the beneficiary and socially he was on the higher rung of the ladder. The second finding was that SHGs have played an important role in fanning the aspirations of women as well as cross sectional classes so they should also be part of the transmission process.
Watkins, T. A. (2009) has suggest a framework of key innovations which would help in developing a management information system (MIS) for microfinance. Many industry stalwarts have been working successfully in the field of microfinance like Grameen Bank, Banco Sol, FINCA etc. but the learning need to be adapted at the local level. The need of the hour is reaching a vast client base within limited costing. There are many aspects of the industry which have still not been disseminated like client acquisition methodologies, performance management and control, human resource management etc. Microfinance loans typically are small ticket loans whose value range from \$50 to \$500 but that does not reduce the amount of backend work is required with regards to account management, serviceability and labour required for the activities. The main issue arising out of this problem is that financial inclusion for all becomes difficult due to the high transactions costs and inability to reach populace which are far flung and sparsely populated. MFIs are traditionally required to have a higher interest rates to be sustainable, but now they are also looking towards technology to reduce their costs and improve efficiency simultaneously. Innovations have started but it is largely at an organisation level rather than being on an industry level. Industry level collaborations would help in reaching a higher target base more efficiently. The author has suggested using the roadmap approach so that innovations are properly mapped, and it helps in developing a common understanding among the homogeneous organisations. It also would help in identifying the key barriers or bottle necks and steps to overcome them. (21)
Trujillo-Tejada, V., Muriel-Patino, V., & Rodríguez-López, F. (2015). The authors have tried to create a framework for regulating microfinance. They have used guidelines of the Association of Supervisors of Banks of America, Consultative group for the poor and the Basel committee of Banking supervision. They have used 63 core criteria which have been provided by the above for the purpose of developing the framework. This study is however limited to Latin American and Caribbean countries as they are culturally similar, and the legal environment is also more or less on the same lines. This homogeneity helps in identifying the main points of similarity as well as points of divergence. This homogeneous group consists of 17 countries from the region. The main purpose of developing regulation is it will result in efficient utilization of resources as well as capital accumulation. Regulation will also help the microfinance institutions to better manage themselves and attain sustainability in the long run. While developing the policy for microfinance one should ensure that it should balance both economic efficiency as well as financial inclusion (22)
Toindepi, J. (2016) has focussed on the best practice models in microfinance for the purpose of poverty alleviation. There is the double bottom approach which focusses on the economic impact of microfinance and social impact of microfinance. Also, there is tripe bottom approach which has added one additional tier of environmental impact of microfinance. The author has critically analysed the different practices and tried to address the issue of best practices in the sector. The different approaches to microfinance are influenced by the underlying motivations and philosophies of the participants. The best practices of microfinance should be of international standards and based on the good performance, transparency, good corporate governance and proper reporting. Sustainability is also very important for microfinance and this issue came to the fore in the 90s when it was evident that donor contribution was not reliable in the long run and sustainability based on donor funding was questionable. MFI sustainability has now become a cornerstone for microfinance programmes so that private investors as well as donors are attracted to the programmes. One of the ways in which sustainability can be achieved is through new product development and innovation. Non-financial services like trainings and marketing play an important role in developing the skillset of the beneficiaries which in turn would result in better productivity. In addition, the fees and charges for the services should be reasonable and acceptable to the beneficiaries. (23)
Togba, E. L. (2012) has studied microfinance products with reference to Côte d'Ivoire which is classified 164th out of 177 countries in the human development index as per World Bank, 2009 data. The country is having a predominantly poor population and hence they have made poverty alleviation one of the primary objectives of its social welfare programmes. One such initiative was development of MFIs in the country. Low income groups in the country have the option of borrowing from formal sector or informal sector. Formal sector is one which is governed by rules and regulations, must do regular reporting and ensure transparency. Informal sector on the other hand is less inclined to follow the formal guidelines but its presence is attributed to the fact that there is a large demography which is unable to meet the stringent standards of formal financial sector. In the informal sector, the most relevant factor is having in possession any object which can be used to secure a loan. The selection of informal sector by the beneficiaries suggest that they follow a rational methodology when the requirement for loan arises. The author has considered various alternatives which are available to households which include Banks,

framing companies, credit unions, social funds, moneylenders, cooperatives, ROSCAs and others. A total of 10800 households were surveyed for the purpose of the loan of which 1392 households have demanded a loan. Due to information asymmetries existing in the market there might be credit rationing in the markets. Three variables were studied for the purpose of the study which included household income, loan ticket size and social capital. Low income households were found to be levitating to the informal sources of credit. (24)

Waweru, N. & Spraakman, G. (2012) in their paper have studied three Kenyan MFIs and their use of performance measures. These MFIs are classified as formal and client based and there are assumed to take rational measures. Self Help Group Members of these MFIs have essentially two main responsibilities of mutual support, advice and there is a group guarantee that the loans will be paid. Data was collected based on research questions and interview guide. It was found that the MFIs used both performance as well as non-performance measures to get the best results. Performance measurement is an important parameter in these institutions as the results indicate the performance of the group as well as the management. Performance measurement also ensure sustainability of the MFIs. The study also uncovered the performance of the three MFIs in Kenya. Groups are generally formed by the MFIs in a heterogeneous manner irrespective of gender, ethnicity and affluence. Prospective entrepreneurs who have shown interest in microfinance are invited to the meetings and efforts are made to bring them into the microfinance fold. In Kenya, the interest charged by MFIs are in the range of 25% to 35% in 2008, which is higher than the interest charged by formal banking institutions which is generally in the range of 13% to 18% in 2008.(25)

Reeves, M., & Sabharwal, N. (2013) in their paper have studied the features which are necessary for developing a mobile microfinance platform. They have identified the key parameters required for a positive relationship between the mobile network service provider and the MFIs. The main implications of this is that it would act as a bridge to most of the population which is unbanked as well as without mobile connectivity. The authors have used mobile penetration data and banked data of different countries to prove that developing a mobile application while improve the penetration level of the countries. In the BOP segment, the mobile phone is used primarily for voice and SMS related services. However, if banking applications are also provided it would help improving the penetration levels. This can only happen if there is a proper drive to improve the financial literacy among the BOP clients and technology should be simple to use. M-banking would also help in bringing down the transaction costs which would help in making MFIs sustainable. It would also have a cascading effect on the interest rates which can be brought down as the transactions cost reduce. (26)

Shylendra, H. S. (2012) studies the microfinance intervention models and the issues associated with them. The paper tries to capture the effect of community-based models on the delivery of microfinance. The problems associated with these types of modes are identified and reason behind non achievement of the microfinance objectives are highlighted. The paper also tries to improve the delivery mechanism by bringing in policy changes and establishing a robust legal system. (27)

Women empowerment is an important aspect of microfinance. Bali Swain, R., & Wallentin, F. Y. (2017) have studied the impact on women empowerment with respect to location and the group linkages associated with the respondent. Women empowerment is very difficult to measure as it is a latent variable, however, the authors have used structural equation modelling (SEM) for the purpose. It has been found out that there is significant correlation between women empowerment and the decision-making autonomy. The variables which were used to measure women empowerment through the participation level and autonomy of women in decisions like buying and selling land, family planning and contraception usage, decision to education a girl child or marry an offspring. These decisions were traditionally taken by men and the same if taken by women would suggest women empowerment.(28)

Nurmakhanova, M., Kretzschmar, G., & Fedhila, H. (2015) in their paper have tried to develop a model linking financial sustainability and outreach of MFIs. They have based their study on previous literature which have used both the variables but haven't identified a link between them. For the purpose of this study they have used financial sustainability and outreach as variables and identified the linkages. Their study has concluded that focussing of financial sustainability does not affect the outreach of the microfinance institution.(29)

Batra, V. (2012) has explored the role as well as the performance of various microfinance models in India. The paper explores various factors related to microfinance like outreach, impact, efficiency, sustainability and financial inclusions. The models studied are Group-based model, NBFC model, wholesale banking model, individual banking-based model, Cooperative model. The author has concluded that though microfinance has grown in India there are still issues plaguing it efficiency and effectiveness like there is still a huge demand and supply gap. The three strategies that haven identified in this paper for inclusive financial services are scaling up of quality financial services, reaching the poorest of poor, and bringing down the overall cost to the people and the service provider.

Ault, J. K., & Spicer, A. (2014) have studied the impact of state fragility on the growth of microfinance institution over the period 1998-2009. State fragility has been defined as the degree to which 'state power is unable and/or unwilling to deliver core functions to the majority of its people: security, protection of property, basic public services and essential infrastructure' (Engberg-Pedersen, et al., 2008: 22)[32]. The authors have applied the concept of state fragility on commercial microfinance of 106 developing countries. The paper concludes that the growth of the microfinance institution in terms of increasing its client base, bringing down the cost and attract investment depends on the fragility of the state. [31]

Lerpold, L. (2012) have studied the microfinance models in India and South Africa. The model which has been successful in India when applied to South Africa did not attain the same levels of success. In this exploratory paper, the authors have used the literature on social capital and contextualisation to state the social capital is an important factor for the varying degree of success. The author has used Hand in Hand (HIH) model for social capital study. The success of HIH depends on the number of women members who have join the group, formation of new SHGs, the number of micro enterprises which have been supported and the repayment track records. The HIH model suggested that the group members were happier and trusting of the SHGs in India as compared to South Africa. The turnover ratio in South Africa was estimated to be at 60%. [33]

Kamaluddin, A., Hadi, N. A., Alam, M. M., & Adil, M. A. M. (2015) have studied microfinance in the context of social collateral using focus group discussions and interviews. The authors have found out five components which need to be included in the social collateral which are social capital, group pressure, entrepreneurship skills, culture and religiosity. Social capital has another two sub parts, trust and networking. Group pressure also has two parts ex-ante and ex-post. This study is limited to Islamic populace in Malaysia. [34]

## CONCLUSION:

The literature suggests that microfinance is still an evolving field. A model which is successful in one region is not sure to succeed at another place. The above research papers are not exhaustive in nature which is a limitation of this paper. However, we need to understand microfinance is a tricky game for the stakeholders. Models like self-help groups are successful in certain regions whereas in other locations it has not attained the same level of success. Also, when the motive behind microfinance shifts from non-profit to profit the rules of the game tend to change. Microfinance can succeed if there is an element of trust among all the stakeholders and that takes time.

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