ISSN NO.2395-0692

International Journal of Arts, Humanities and Management Studies

A Study of Economic Effects of Loan Repayments to the Microfinance Institutions on Household Economy: An Analysis of Evidence in Lucknow, Uttar Pradesh

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ABSTRACT

Microfinance means the provision of financial services to low-income clients, including consumers and the self employed, who traditionally lack access to banking and related services. The microfinance sector in India went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. The beginning of the microfinance movement is most closely associated with the economist ***Muhammad Yunus,*** *who in the early 1970's was a Professor in Bangladesh. In the midst of a countrywide famine, he began making small loans to poor families in neighbouring villages in an effort to break their cycle of poverty. He started micro credit by giving a loan of $ 27. In India, the concept of microfinance has existed since the year 1904, when the Cooperative Societies Act was passed for ensuring production credit loans for farmers through primary credit societies. In this research, the researcher has used the regression analysis to study the effects of Age, Gender, Number of Dependent and Education level due to multiple loan contracts. Further, the relationship between variables taken in this research has been analyzed such as income of the respondents and the amount of the Loans. Finally we can conclude that from this research report that, 40% of the Clients admit that High Operating Cost is main reason for High interest rate of Microfinance while 30% microfinance companies admit that Due to loan Losses there is High rate of interest.*

Keywords: *Microfinance, interest rates, economic effects*

I. INTRODUCTION:

The Canadian International Development Agency (CIDA) defines microfinance as, "The provision of a broad range of financial services to poor, low income households and micro-enterprises usually lacking access to formal financial institutions".

Microfinance means the provision of financial services to low-income clients, including consumers and the self employed, who traditionally lack access to banking and related services. The microfinance sector in India went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. The beginning of the microfinance movement is most closely associated with the economist **Muhammad Yunus,** who in the early 1970's was a Professor in Bangladesh. In the midst of a countrywide famine, he began making small loans to poor families in neighbouring villages in an effort to break their cycle of poverty. He started micro credit by giving a loan of $ 27. In India,

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the concept of microfinance has existed since the year 1904, when the Cooperative Societies Act was passed for ensuring production credit loans for farmers through primary credit societies. The Syndicate Bank, established in the year 1921, concentrated on raising micro deposits in the form of daily/ weekly savings and sanctioned under social banking in the year 1967. After bank nationalization in the year 1969, microfinance concepts in banking institutions once again came to the fore, when the **Self Employed Women's Association** ("SEWA") of the state of Gujarat formed an Urban Cooperative Bank, called the Shri Mahila Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganized sector in Ahmedabad city, Gujarat. The microfinance sector went on to evolve in the year 1980s around the concept of **SHGs** (Self Help Groups) and **JLGs** (Joint Liability Groups), informal bodies that would provide their clients with much – needed savings and credit services.

1.1 The goals for Microfinance Institutions should be:

- To improve the quality of life of the poor by providing access to financial and support services;
- To be a viable financial institution developing sustainable communities;
- To mobilize resources in order to provide financial and support services to the poor, particularly women, for viable productive income generation enterprises enabling them to reduce their poverty.
- Learn and evaluate what helps people to move out of poverty faster.
- To create opportunities for self-employment for the underprivileged
- To train rural poor in simple skills and enable them to utilize the available resources and contribute to employment and income generation in rural areas.

1.2 Models of Delivery in Microfinance Industry:

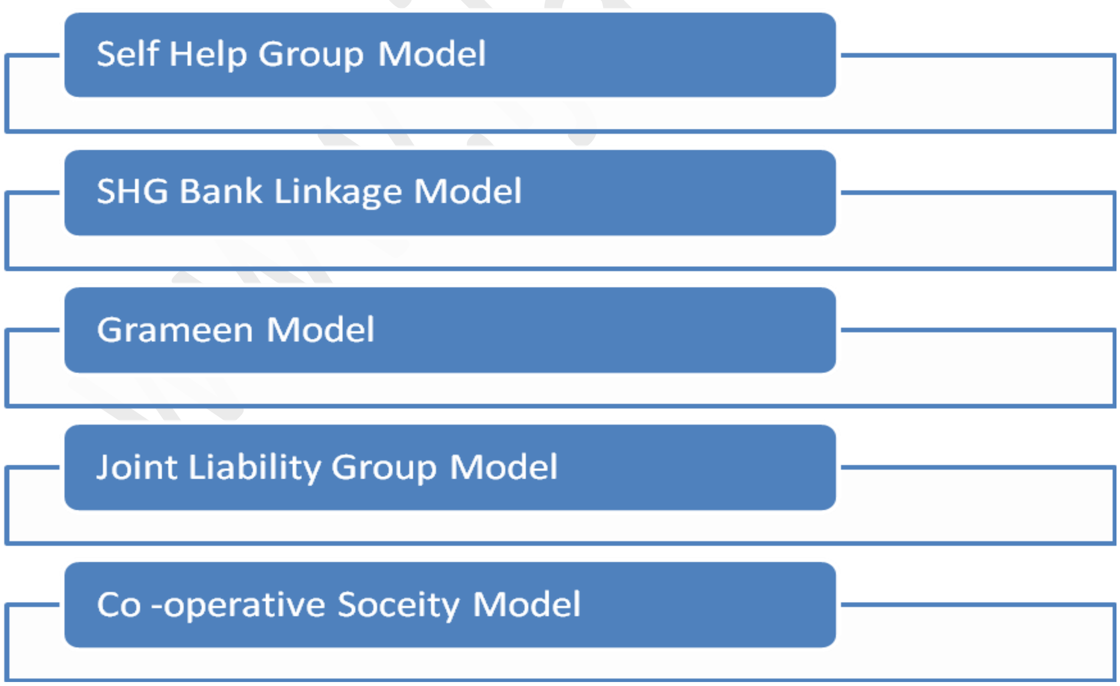

Figure No. 1.1: Models of Delivery in MFIs
Source: Author

ISSN NO.2395-0692

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II. REVIEW OF LITERATURE

(Morduch 1999) One of the key determinants of the observed success of microfinance lies in the existence of high repayment rates. Most microfinance programmes usually report loan repayment rates of above 95%, often even as high as 100% – not least since this is what is nowadays expected from them and can serve as a door-opener to donor funding. To reach the objective of near to perfect loan recovery, organizations working in the microfinance sector have been using various techniques – most of which do not relate to the special features of microfinance services outlined above (i.e. group lending, joint liability, small and frequent installments, doorstep policies and dynamic incentives). In case a customer is not able to repay an installment, one of the first measures (especially practiced with SHGs) is to charge a fine. The amount of this fine is often decided by the groups themselves and can range from Rs. 1 to 80. In case of continued delay, pressure is exerted. This can take several forms but usually starts with the group's leader or MFI staff visiting the defaulting borrower. Such a visit can already have the desired effect since other village members become aware of the borrower's inability to repay, which strongly influences his or her socio-economic status as well as other credit opportunities in society.

Tripathy and Jain (2008) studied Self Help Groups in Haryana and Orissa and concluded that micro finance has a negligible income impact on asset less rural poor, the deprived and disadvantaged.

Sinha (2006) studied 214 SHGs in Andhra Pradesh, Karnataka, Orissa and Rajasthan and concluded that

- SHG members contribute to women's election in Panchayat Raj but do not appear to inform what they can achieve if elected.
- 26 SHGs have taken up issues on social justice (i.e.12 percent of 214 SHGs) such as drunken husband, violence, dealing with dowry, prevention of child marriage, bigamy.
- Leaders obtained more loans to the tune of 25 to 30 per cent – both in terms of frequency and amount borrowed.
- Default rate was 28 per cent (high in A.P.); 38 per cent of very poor members have more over due, in Andhra Pradesh defunct groups emerging as an indicator of loan default.

Tadele Haileslasie Rao P. Madhu Sudana (2014) he has analyzed that Ethical behavior in business practices determines success or failure of an organization and it is not an exception to MFIs.it was unique and significant in terms of the severity of the crisis. The industry hasn't taken any lesson from Microfinance crisis happened in other countries in previous years. Finally, this paper offers concluding comments regarding effective finally; this paper offers concluding comments regarding effective Microfinance crisis practices that have emerged in the literature.

III. Research Methodology

This chapter develops the research framework and research objectives; and explains the methodology adopted to address the research problem and gain some useful finding from it.

ISSN NO.2395-0692
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3.1 Research Problem:

According to the **Stanford Social Innovation Review (2007)** "Research showing that microfinance clients have been known to **scrimp on food**, **sell their furniture, borrow from loan sharks, and take second jobs to pay off their loans; that husbands, sons, and fathers-in-law often take control of women's loans**; and that, overall, microfinance fails to find its way to the world's poorest people."

In this research, the above problem is further elaborated by analyzing the impact of multiple borrowing of the microcredit among the clients of Microfinance Institutions in central Uttar Pradesh region of India. A lot of literature has been done in this area of microfinance but not in respect of this context and with reference to the region of Central Uttar Pradesh, India.

3.2 Research Design:

In this research, the researcher has used the regression analysis to study the effects of Age, Gender, Number of Dependent and Education level due to multiple loan contracts. Further, the relationship between variables taken in this research has been analyzed such as income of the respondents and the amount of the Loans.

3.3 Research Objectives:

The study has been undertaken with the following objectives:

(i) To find out the causes of high interest rates of Loans of Microfinance Institutions.
(ii) To find out the economic effects of Loan repayments on households to the Microfinance Institutions.
(iii) To find out whether Microfinance Institutions are satisfying the needs of clients or not

3.4 Sampling Design:

It is a definite plan for obtaining a sample from a given population. It refers to the technique or the procedure the researcher would adopt in selecting items for the sample. In this research, the researcher has focused on Central Uttar Pradesh region as a population (Universe) size in which 2 districts i.e. **Lucknow & Sitapur** were taken under **Sampling Frame**. There are two major reasons for specific selection in this study. First, Central Uttar Pradesh has both characteristics of rural and semi-urban features where like other parts of the country, microfinance services have been growing rapidly with increasing cases of outstanding Loans. Second, the location was within the reach of the researchers especially in terms of associated travel and data collection costs since there was no external funding for this research.

3.5 Sample Size:

The sample size of **50** respondents who are the clients of the selected Microfinance Institutions were included in this research. In order to make it feasible, this sample size has been selected from the people belonging to rural areas and semi urban areas of the selected 4 districts of Central Uttar Pradesh region.

3.6 Sampling Technique:

Simple Random Sampling is the purest and the most straightforward type of probability sampling strategy. It is also the most popular method for choosing a sample among population for a wide range of purposes. In this research, the researcher has used this technique to collect the data by approaching the clients of Microfinance Institutions randomly.

3.7 Collection of Data:

There are two method used for collecting the data, which are as follows:

Primary Data:

Primary data is original research that is obtained through first-hand investigation, while secondary data is research that is widely available and obtained from another party. Primary data includes information collected from interviews, experiments, surveys, questionnaires, focus groups and measurements. For the collection of the data, the close-ended schedule has been designed to consist of two parts- basic information related to the respondents and the information related to the loans and repayments. The schedule contains a series of 32 questions out of which 8 questions are related to basic information of the respondents, 20 questions are related to information of loans and repayments and 4 questions were related to level of satisfaction of the respondent and the product knowledge on five point Likert Scale.

Secondary Data:

Secondary data refers to data that was collected by someone other than the user. Common sources of secondary data for social science include censuses, information collected by government departments, organizational records and data that was originally collected for other research purposes.

In this research, the sources of data are the websites of the microfinance institutions, research paper journals, publications of the various government agencies, books, etc. related to this area of research. The secondary sources were extremely helpful in this research because they bring out the actual research done in the area of microfinance and provide clear vision of this research.

3.8 Data Analysis Technique

Once the data was collected, the researcher did the processing and classification of the data including editing, coding, tabulation of data and construction of charts. Further, for the analysis of the data, the researcher has used the different research techniques as per the requirement of the justification of the objectives. **For the first objective - the multiple regression analysis has been done in order to bring the relevant findings, for the second & third – the Bar Graph and the Pie Chart method has been used.** The researcher has used MS and SPSS 14 (Statistical Package for the Social Sciences) for quantitative calculations in this research.

3.9 Research Objective wise Analysis:

1. **To find out the causes of high interest rates of Loans of Microfinance Institutions**

   Graph No. 3.1: Bar graph showing the causes of high interest rates

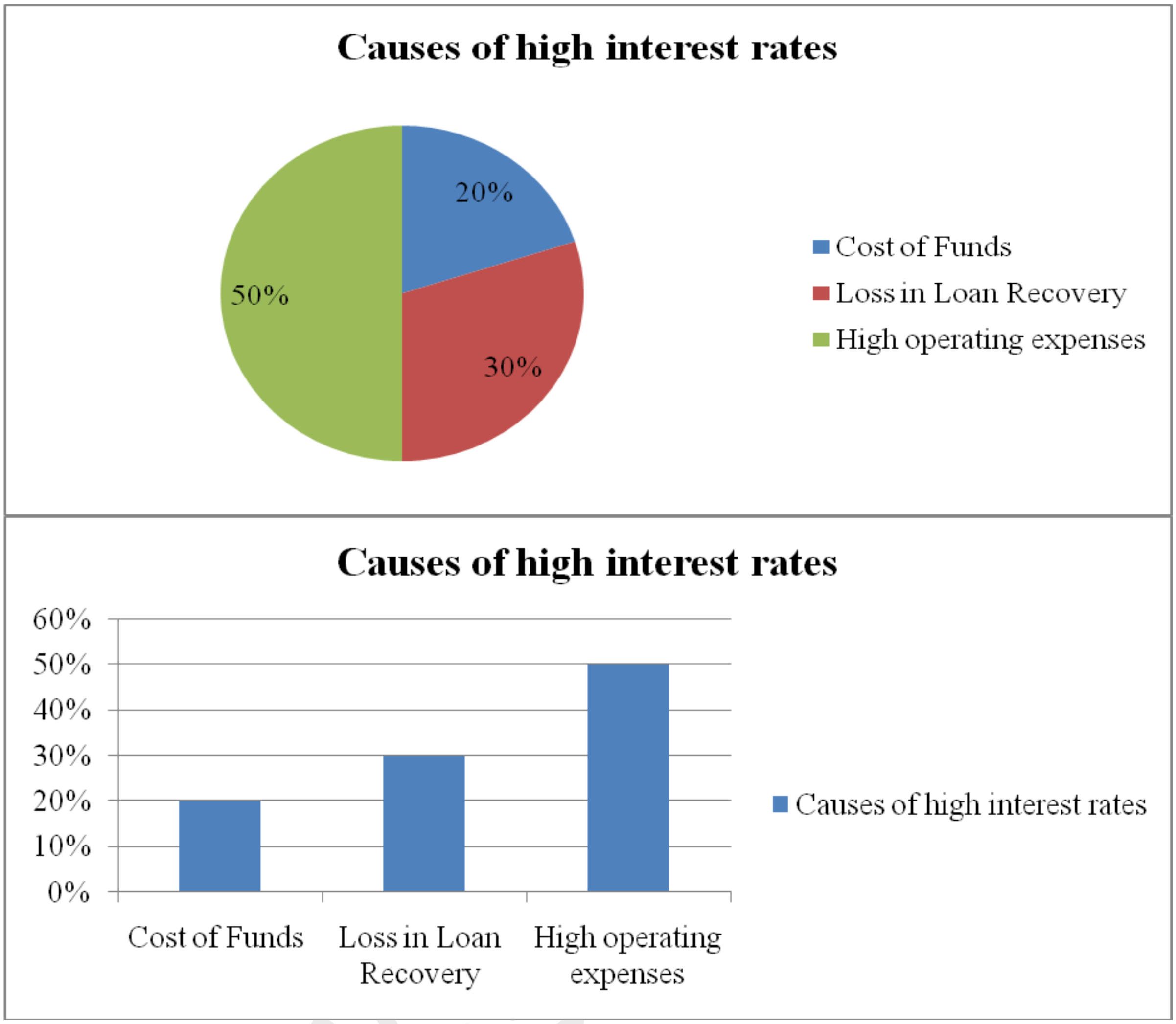

Figure No. 3.1: Chart showing the causes of high interest rates

Interpretation:

From the above pie chart and Bar Graph its clearly shows that out of 10 microfinance, 4 of them i.e. 40% of them admit that High Operating Cost is main reason for High interest rate of Microfinance while 30% microfinance companies admit that Due to loan Losses there is High interest rate. 20% of microfinance Companies says that these interest rate Reasonable, while 10 % says that microfinance companies are more accessible than banks

Inference: From the above table and pie chart, it can be inferred that the different causes of high interest rates are considered.

2. **To find out the economic effects on household of Loan repayments to the Microfinance Institutions.**

The following Hypothesis has been taken for this objective-
Ho: Loan Repayment and Monthly Income of Client are independent.

H1: Loan Repayment and Monthly Income of Client are Dependent.

	Loan repayment		
Monthly Income	**Yes**	**No**	**Total**
Below 5000	8	10	18
5000-10000	10	19	29
above 10000	1	2	3
Total	19	31	50

Observed(O)	**Expected(E)**	**(O-E)**	**(O-E)^2**	**(O-E)^2/E**
8	6.572	8.428	71.03118	1.066983
10	11.428	-8.428	71.03118	0.637463
10	10.712	-6.712	45.05094	0.418254
19	18.288	6.712	45.05094	0.249883
1	1.716	-1.716	2.944656	0.231571
2	2.684	1.716	2.944656	0.138351
	50		**238.0536**	**2.742504**

Table No. 3.1: Calculation of Chi Square test

Df = (Number of Row – 1)*(Number of Column – 1)= (3-1)*(2-1)=2

So Chi Square test Statistics Value= 2.742504
While Chi Square Critical value for Degree of Freedom 2 and level of significance 0.05
P value = The P-Value is 0.25379.
The result is *not* significant at $p < 0.05$.

Interpretation: That shows that Monthly income is independent of Loan repayment, it means monthly income is not one of the Key factor for late repayment.

Inference: From the test, it can be inferred that the factors of late repayments of the microcredit are considered.

ISSN NO.2395-0692

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3. To find out whether Microfinance Institutions are satisfying the needs of clients or not

The following Hypothesis has been taken for this objective-
Ho: Utilization of Loan and Impact on Business is Independent of each other
Ha: Utilization of Loan and Impact on Business is dependent of each other

Observed (O)	Expected(E)	(O-E)	(O-E)^2	(O-E)^2 /E
24	12.744	113.256	12826.92154	106.2324
2	13.256	-113.256	12826.92154	93.45254
0	11.256	-113.256	12826.92154	113.256
24	12.744	113.256	12826.92154	99.63122
50	**50**			**412.5721**

	Impact on Business		Total
Utilisation of Loan	**Yes**	**No**	
Yes	23	2	25
No	0	24	24
Total	23	27	50

Table No. 3.2: Calculation of Chi Square Test

Chi squared equals 412.5721 with 1 degrees of freedom. The P- Value is < 0.00001. The result is significant at $p < 0.05$.

Interpretation: The association between Utilization of Loans and Positive Impact of Business is considered extremely significant statistically. That means Utilization of Loans and impact on Business are dependent on each other .There is sufficient evidence to show that Microfinance Institutions are fulfilling the needs of clients.

Inference: From the above test, it can be inferred that in order to check whether the Microfinance Institutions are fulfilling the needs, the hypothesis is considered.

3.10 Conclusion

- Finally we can conclude that from this research report that, 40% of the Clients admit that High Operating Cost is main reason for High interest rate of Microfinance while 30% microfinance companies admit that Due to loan Losses there is High rate of interest.

- While checking the economic effects on households related to Loan repayments to the Microfinance Institutions, we find out that Monthly income of Clients do not have effect on Loan Repayments of Microfinance Institutions. When we find out the effectiveness of Microcredit's for the Clients we find that 69% of the Clients are not satisfied with the services of MFIs.
- When we check the main cause of dissatisfaction, we come to conclusion that 67% of the Clients are worried due to the High interest Charges.
- When we go to check that whether Microfinance Institutions are satisfying the needs of clients or not, we observe that the association between Utilization of Loans and Positive Impact of Business is considered to be extremely significant statistically in our analysis of the data which shows a positive indication for MFIs. That means Utilization of Loan and impact on Business are dependent of each other.

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