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# Commercialization and Mission Drift in Microfinance: Implications for Rural India

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## ABSTRACT

The emergence of microfinance has been justified as a measure to occupy the empty space that was created with the retreat of formal banking as part of structural and neoliberal reforms for rural India in post-1990s. Worldwide, although the microfinance institution (MFI) has been flouted to provide credit to unbanked areas with the broader objectives of empowering people and eventually eradicating poverty, there is much disagreement among scholars regarding its actual achievements toward these goals. While some scholars are of the opinion that MFIs are currently in a phase of “mission drift”, based on their increasing commercialization, others argue that these institutions have been always driven by the neoliberal principles of maximizing profit. In view of the globally demonstrated changes in the features and operations of MFIs, this paper uses evidence from secondary data sources to flag the changing trends in credit market with particular reference to MFIs in India. We argue that these changes provide evidence of a mission drift in microfinance that must be critically examined against the backdrop of a chronic and persistent credit crisis in rural India, which may get further exacerbated by the increasing dominance of private credit players. At this juncture, instead of taking lessons and rectifying the existing lapses in enabling rural credit, the reorientation of the MFI's credit-delivery operation toward commercialization must be seen as a perilous step that could close the door of affordable credit to poor and petty borrowers. Chronic bottlenecks in credit delivery must be addressed through more permanent and holistic solutions.

**Keywords:** microfinance, mission drift, India, for-profit microfinance institutions, commercialization

**JEL Classification:** G21, O12, O53

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## INTRODUCTION

In recent decades, there have been continuous changes in the features, practices, and services of microfinance institutions (MFIs).<sup>1</sup> Collectively, these changes are indicators of a shift from the stated objectives that were flagged during its initiation. The modern microcredit industry grew on the objectives of providing collateral free credit to the poor and unbanked population in the rural area at a reasonable rate of interest (Morduch 1999). MFIs are known to have replaced and revamped the concept of microcredit by providing not only credit for income-generating activities but also savings, insurance, money transfer, and other financial services (Hulme 2008 cited in Bateman and Chang 2009; Ramakumar 2012). From an institution envisioned to target the economically disadvantaged and unbanked population, MFIs are exhibiting what is called in microfinance parlance a “mission drift” (Mersland and Strom 2010). Epstein and Yuthas (2010) argue that the MFI mission drift, in the form of increasing interest rates and/or moving away from poor clients, negates the very principles on which the MFI had been conceptualized. Scholars like Kabeer (2005), Duvendack et al. (2011), and Mader (2015), on the other hand, argue that MFIs were never actually “missioned” or structured as a pro-poor mechanism to address the issues of poverty, unemployment, or financial exclusion. These scholars are of the view that the emergence of microfinance has been designed following the neoliberal agenda of filling the gap created by the withdrawal of public banking and financial infrastructure with a private agent-dominated and profit-oriented market. By their logic, ongoing changes were bound to follow as the MFIs were initiated to suit a policy that attempted to enhance entrepreneurial opportunities for individuals

in a framework of free-market and lesser state intervention (Weber 2006).

The case for MFIs being structured to address the small credit needs of women borrowers has also been subject to debate. Pitt and Khandekar (1998) argue that MFIs give women borrowers the opportunity to build self-reliance, whereas, Taylor (2012) argues that lending to women was merely a part of business strategy to reduce transaction costs for the organization since women borrowers were believed to be less likely to default.

There is, therefore, strong disagreement among scholars on the “mission” of MFIs (as its intended purpose) and, therefore, on the existence of a mission drift itself. If we use “mission” here to mean the objectives of MFIs during its inception, then a “drift” would simply mean a reorientation toward new goals. In contemporary times, there is evidence of the entry of large-sized private players in microfinance and the infusion of global capital that is rapidly commercializing these institutions.<sup>2</sup> These deliberate and perceptible changes are restructuring MFIs in ways that do not seem to be taken in the interest of the economically disadvantaged sections of the population. As an MFI is still wielded as a major instrument of credit delivery under the policies of financial inclusion, such transformations in its operations would have broad ramifications and must be examined critically.

This paper is an attempt to flag conspicuous changes in the features and operations of MFIs with particular focus on the trends observed in India. We argue that the path of commercialization and for-profit ventures that MFIs are taking now contrasts with the apparently benevolent face that the goals or mission of microfinance carried during its formative years. Although the mission of microfinance itself has been subject to debate,

<sup>1</sup> The features, characteristics and stated objectives of microfinance (like collateral free loans, of small amounts, for the poor, mainly concentrated in the rural areas and the not-for profit business model) are discussed in detail in the next two sections of this paper.

<sup>2</sup> Market-based business principles are used to make a donor-based subsidy-dependent entity to rely on commercialized debt and equity (Frank 2008). Under commercialization of microfinance, the MFIs manage the business as part of the regulated financial system of the respective country with access to global commercial markets (Christen and Drake 2002; Lennon and Richardson 2002 as cited in Nair 2015).

we use the term “mission drift” to mean the changing characteristics that now openly demonstrate a clearly visible orientation toward commercialization. The terms “commercialization” and “mission drift” are closely linked and we use the former as the means through which mission drift (the end) is happening. In other words, the indications of commercialization are highlighted to argue for the existence of a mission drift.

In the backdrop of globally changing features in the workings of MFIs, this paper focuses on the case of India, which is one of the major emerging markets in microfinance.<sup>3</sup> In a country like India, where 41 percent of households (46% in the rural areas) do not avail themselves of any banking services (RGCC 2011), the signs of wide-scale commercialization of MFIs, which mirror global trends, have significant implications on whether poor borrowers and economically-backward regions will be prioritized for loan assistance.

The rest of the paper is organized as follows. The next section discusses the genesis of microfinance and its unique characteristics and operations. The third section introduces the concept of mission drift in the theoretical domain of microfinance and attempts to evaluate its features and causes. The fourth section discusses the existing organizational framework of microfinance institutes<sup>4</sup> in India and attempts to identify the changing features of MFIs that showcase increasing commercialization. The last section concludes the paper with insights on the wider implications of mission drift.

## MICROFINANCE: GENESIS AND FEATURES

The 1970s is historically marked as a decade that witnessed path-breaking events, which brought about structural changes in the economies of advanced/developed countries. The oil crisis coupled with the dismantling of the Bretton Woods system found the advanced countries reeling under the pressure of a severe recession (Shetty 2012). Faced with surplus funds in the domestic economy due to recessionary conditions, developed countries took keen interest in extending their financial operations to the newer markets of developing nations.<sup>5</sup> The International Monetary Fund (IMF) and the World Bank pushed for a free market and a liberalized capitalist system, lowering of taxes and tariffs, privatization of government functions, and free flow of capital across economies. Most of the developing countries were convinced in restructuring their economies especially with the inflow of foreign capital, reforms in the financial sector, and integration of the domestic economy with the world market.<sup>6</sup> Countries that approached the IMF and World Bank for assistance had to accept certain policy conditionalities that required them to privatize public enterprises, liberalize capital markets, increase domestic interest rates to attract capital, and abolish subsidies on food, energy, and water. These measures have been blamed for massive capital flight, public unrest, and economic decline in developing countries, and seen to have further increased the need for more international loans and foreign capital (Zon 2016).

Structural changes to adopt financial liberalization and adhere to the IMF and World Bank conditionalities set limitations on formal

<sup>3</sup> With a gross loan portfolio of USD 26,769 million and total number of microfinance accounts at 93.3 million as on 31 March 2019, India is one of the major emerging markets in microfinance. This study concentrates on the Indian microfinance sector, given the large size and importance of the market (MFIN 2019).

<sup>4</sup> We restrict our analysis to the private MFIs exclusive of the bank-linked self-help group MFIs. However, it has to be mentioned that self-help group MFIs have significant impact and outreach in terms of clients, savings generated, and loan portfolio as well as contributions to the development of the financial sector in India (Basu and Srivastava 2005).

<sup>5</sup> See Shetty (2012, 102–105) for a detailed discussion of the historical foundations of MFI.

<sup>6</sup> Investment of developed countries' capital in developing financial markets required the financial systems of the latter to open up and simultaneously follow stringent regulatory norms (Shetty 2012, 105). As pointed out, “the funds of the advanced nations cannot be safe in the hands of the banks in developing countries, if the latter do not follow market-oriented conventional policies with vigorous prudential and supervisory norms for their banks.”

sector banks that rendered them less responsive to the financial needs of the poor. A large segment of the population was thus left out from the purview of the so-called “development” discourse. Small, poor, and marginalized populations, especially those engaged in the agrarian economy and the low-end informal sector, found it difficult to access the formal banking system, which was governed by strict regulatory norms. To channel interventions from the outside that would fill the gaps created by the withdrawal of the formal financial sector and to address public outcry, the idea of microfinance emerged. MFIs received wide acknowledgment and favor from international institutions and intellectuals as an intervention for the inclusion of the marginalized population into the “wider capitalist system” (Taylor 2011; Shetty 2012; Loubere 2016). It was expected that the opportunity to access credit (no matter how small) would provide even minor entrepreneurs ample avenues to possibly liberate themselves from the shackles of poverty (Taylor 2011; Bateman 2017). The microcredit needs of the poor were thus recognized globally and several movements were initiated as offshoots of this program (Shetty 2012). Bangladesh, for example, popularized the Grameen Bank<sup>7</sup> spearheaded by Mohammad Yunus, which has been replicated in many countries. Philip Mader (2015) has well summarized the history and emergence of microfinance and argued that the emergence of microfinance must be understood in the larger socio-political-economic context of the post-war period of the 1970s. Credit as a social policy, in the form of cooperative credit, group borrowing and lending (rotating savings

and credit association or ROSCA, chit funds, and occupation-specific group lending/borrowing), had been present in the countries of the global south like India, Bangladesh, Pakistan, Myanmar, Nepal, and Sri Lanka (Shetty 2012), even a century before Grameen Bank and Professor Yunus started the legacy of modern microfinance (Mader 2015).

As opposed to the formal banking sector, a distinctive feature of MFIs is that credit is given without the need to produce collateral. This is premised on the innovative idea that the borrowing group would serve as collateral for credit distributed to individual members (Ghatak and Guinnane 1999; Gine and Karlan 2007; Swaminathan 2007). Group lending, which is the backbone of microfinance models, is argued to eradicate the problems of moral hazard and adverse selection in the credit market.<sup>8</sup> The tenure of loans in microfinance is essentially short; the frequency of repayment is usually weekly or monthly. Although designed to distribute small loans, there is actually no specific limit on the amount of loans that can be disbursed. The credit disbursing design of MFIs has appeared to be suitable for collateral-lacking poor households (primarily engaged in the informal sector) who are in desperate need of small loans for income generation and self-employment purposes. These features are considered to make MFI a panacea for the poor who have been excluded from the formal banking system (Zeller and Sharma 1998; Imai, Arun, and Annim 2008).

<sup>7</sup> Professor Yunus started the initiative in a few remote villages in Bangladesh to lend tiny credit to rural poor under a research project. The initiative, which became a full-fledged bank (Grameen Bank) in 1983, was started by lending exclusively without collateral to groups of five members each in rural and poverty-ridden areas in Bangladesh. The focus of the bank was to provide collateral-free tiny loans to poor customers with similar potential risk profile so that peer monitoring of the group members work smoothly (Nair 2015). In 2005, major changes were made in the operations and business model of the bank towards more profit orientation.

<sup>8</sup> Microfinance is considered to be the answer to an imperfect credit market. It is viewed as an alternative to the formal credit delivery mechanism, which has been observed to suffer from high transaction cost and poor recovery. The problem of moral hazard (inability to make sure that borrowers utilize the loan properly and later repay) and adverse selection (inability to ascertain what kind of a risk the potential borrower is) takes place because of lack of information (Ghatak and Guinnane 1999; Armendariz de Aghion and Morduch 2010).



## COMMERCIALIZATION IN MICROFINANCE: INDICATIONS OF MISSION DRIFT?

Since the late 1990s and early 2000s, there has been a change in the business model of MFIs, which have diverted their focus toward goals for their own sustainability and profitability by taking the commercial approach (Mader and Sabrow 2015). Increasing commercialization has led to the dominance of a few big players who now provide credit at a high rate of interest. This has increased their profitability at the cost of bypassing the credit needs of the poor (Bateman and Chang 2012; Bateman 2010 as cited in Ghosh 2013).

In the initial days of microfinance, the sector primarily relied on donor funding and subsidies. However, multilateral international organizations had reservations in financing the microfinance model due to the latter's reliance on subsidies (Bateman 2017). It was observed that most of the newly-formed MFIs depended on subsidized capital from the government, the international development community, and/or donor agencies. To reduce the volume of subsidies in the microfinance sector, there has been a strong push to move the sector toward a profit-oriented commercial model.

In the process of transformation toward a commercialized entity, MFIs attempted to increase their capacity for raising funds by issuing stocks in the share market. In 2003, Bank Rakyat Indonesia was listed in the Indonesian stock exchange, and the Bangladesh Rural Advancement Committee or BRAC bank floated shares on the Dhaka and Chittagong stock exchanges in 2006 (Liberman et al. 2008). It was after Banco Compartamos (Mexico's largest microfinance bank) issued the initial public offering or IPO of its shares in 2007 that most MFIs in other countries also began issuing stocks in the share market on a significant scale (Bateman 2017). Many MFIs in India (discussed in the third section), Indonesia, Bolivia, Mexico, and Bangladesh began transforming themselves from a not-for-profit (mainly NGO-based MFIs) into for-profit organizations like non-bank financial companies (NBFC) (Shetty 2012; Nair 2015). Others have even converted

into full-fledged banks/financial institutions<sup>9</sup> in several countries. What is pertinent might be to question why MFIs transform from a not-for-profit to a for-profit institution or to a regulated financial institute/bank. Some suggest that easy access to funds (Frank 2008; Fernando 2004 as cited in D'espallier et al. 2016) could bring financial stability and help MFIs offer a wide range of services like savings,<sup>10</sup> insurance products, and also sustain itself in the long-run for more growth and momentum (Frank 2008).

However, transforming to a for-profit institute has not been the only change that is observed in the MFI sector in recent times. Several other changes can be flagged in the structure and workings of MFIs globally, including in India. A few of them are outlined here.

First, it is known that poorer borrowers, in general, demand smaller loan amounts compared to wealthier clients (Mersland and Strom 2009). MFI's movement toward commercialization, however, can cause the average loan size to increase (Forkusam 2014). Although permissible loan size is not specified for most MFIs, contrary to the fundamental objective of lending tiny loans to the poor, there has been a growing tendency to offer larger loans (Schreiner 2002). An increase in loan size can potentially enable MFIs to divert funds needed by small borrowers toward those seeking larger loans. The spread of the volume of credit to a few large borrowers can benefit an MFI by reducing transaction costs and by monitoring responsibility, which is high if there are multiple clients. This practice can divert funds away from

<sup>9</sup> PRODEM in Bolivia was transformed into a regulated bank named Bancosol in 1992; the Kenyan microfinance institution, K-Rep, was converted into a regulated financial institution in 1994; Banco Compartamos in Mexico, Banco FIE in Brazil, and SKS in India, a few big NGO-MFIs, have transformed into regulated NBFCs.

<sup>10</sup> Savings are a good source of capital and can be used for lending easily by the MFIs (D'espallier et al. 2016). In most countries, NGO-MFIs are not permitted to accept saving deposits from clients. Before 2011, only NBFC-based MFIs were permitted to mobilize savings in India under certain restrictions. After the Malegam Committee recommendations in 2011, NBFC-MFIs are no longer permitted to accept deposits or savings.

the poor and discriminate small borrowers, such as marginal farmers, artisans, and micro-entrepreneurs who seek small loans due to low repayment and low risk-taking capacity. Using a cross-country dataset for 1,558 MFIs in 102 countries, a study by [Wagenaar \(2012\)](#) shows that for-profit MFIs have a higher average loan size compared to not-for-profit MFIs. He concluded that the transformation of an MFI from an NGO to an NBFC reduced the outreach of the MFI and was also seen to bring a change in the clientele by lowering the proportion of female borrowers.

Second, it was observed that commercialization also brings a shift from group lending to individual lending in the MFI industry ([Hermes and Lensink 2007](#)). This change is of profound significance as the cornerstone of microfinance has been group lending, which has been supported by rigorous theoretical models and literature. Attributed as an advantage to lending institutions, group lending can increase the chances of timely recovery of loans and shift the task of monitoring to the borrowers themselves. As MFIs offer uncollateralized loans, its attempt to move away from group lending toward individual lending can lead to a rigorous credit assessment of clients. Stringent screening of individual borrowers puts poor households at a disadvantage when it comes to eligibility for loans. Using a cross-section dataset for 800 villages in Bangladesh, [Berg, Emran, and Shilpi \(2013\)](#) found that an increase in MFI penetration was accompanied by an increase in interest rates charged by informal moneylenders. The authors attribute such a tendency as a possible fallout of MFIs cream-skimming (or attracting the more credit-worthy borrowers), while risky borrowers (to the MFIs) are left to depend on moneylenders. Once eligible, a single borrower also shoulders the full burden of repayment. Studies in India have found that MFIs are promoting unfair business practices by using coercive methods of recovering loans ([Chavan and Ramakumar 2005](#); [Chandrasekhar 2010](#)). [Mallick \(2012\)](#) found that in order to repay the loans taken from MFIs, borrowers were seen to resort to moneylenders for additional funds. The high demand for funds from moneylenders, in turn, pushed up the rates

of interest to usurious levels. This is an interesting case of increasing dependency on moneylenders by MFI borrowers. Nevertheless, the shift to individual loans coupled with the implications of an increase in loan size can reinvent the wheel of poverty and exclusion that microfinance claimed to address and correct at the time of its inception.

Third, MFIs are expected to concentrate in areas that are poorly covered by formal banking and financial institutions. In this respect, rural areas are undoubtedly less developed and less banked compared to their urban counterparts. Contrary to this principle, in recent times, MFIs have been found to be drifting from rural to urban areas at the cost of the former ([Mersland and Strom 2010](#)). This is happening because MFIs are choosing their destinations based on rigorous profit-oriented objectives by evaluating existing and potential borrowers on the basis of their creditworthiness, repayment capacity, entrepreneurial skills, and economic vulnerability to unforeseen shocks. Rural areas clearly offer fewer business opportunities due to the small size of borrowings and the underdeveloped states of the market and infrastructure that increase the cost of providing loans ([Basu and Srivastava 2005](#)). Destinations are also evaluated based on the costs of doing business and competition from other players active in the market ([Monne, Louche, and Villa 2016](#)). Choosing an area of operation that will guarantee good financial returns is fraught with uncertainty, so that MFIs have also been following the location choices of earlier institutions. Such practices of risk-lowering strategies have resulted in the clustering of MFIs in well-developed areas instead of expanding their outreach in neglected and credit-needy areas. This places the rural populace at a credit disadvantage and deprives them of opportunities for exploring avenues of economic self-enhancement through small investments. By clustering to better-off areas, MFIs are actually found to be accentuating inequality and economic disparities between regions and districts ([Vanroose 2016](#)).

The Indian microfinance sector also exhibits a similar pattern in terms of its location and is heavily skewed in the southern states where the

number of bank-linked self-help groups (SHGs) and degree of banking penetration are higher vis-à-vis most of the other states (Ram Mohan 2010). The southern region also has the highest shares of both outreach and loans outstanding in the MFI sector. Out of the total client base of 35 million, it alone contributes 34 percent, followed by 29 percent in the eastern region, and 19 percent in the central region. The western and northern regions contribute 7 percent and 9 percent of total outreach, respectively. In terms of overall outstanding loan portfolio, MFIs in the southern region dominate (37%) followed by MFIs in the east (26%), central (18%), and lastly, west (9%). MFIs in the north and in the northeast have the lowest portfolio shares of 7 percent and 3 percent, respectively (Sa-Dhan 2018).

### MICROFINANCE IN INDIA—FEATURES AND EMERGING TRENDS

In India, microfinance can be grouped into three categories—the SHG microfinance, bank-NGO-SHG microfinance, and MFIs operated by private entities. The bank-linked SHG model has been the dominant program in terms of outreach, activities, and ability to reach women borrowers (RBI 2017).

In India, MFIs and their evolution, from the perspective of business practices and expansion strategies, fit into three phases. The first phase was marked by the rapid spread of the bank-linked SHG movement, which extended across the length and breadth of a large section of society, including women. This mainly started during the late 1980s and early 1990s with the involvement of institutions like the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), Reserve Bank of India (RBI), Self Employed Women's Association or SEWA, and other banking/financial institutions. Numerous NGOs were also made a part of the program during that time.

The second phase was distinguished by the expanding business and scale of operations of

MFIs through the significantly high participation of private players. The sector eventually started following the commercial mode of operations early in the 2000s (Sriram 2010).

In the third and current phase, MFIs are in a distinct drive toward commercialization through conversion from NGO-based to NBFC mode of operations. MFIs are also raising funds by issuing stocks in the share market and are getting incorporated into the banking business or formal financial institutions through licenses for banking under the broad aegis of financial inclusion. Thus, in 2014, Bandhan Financial Services Private Ltd. and the Infrastructure Development Finance Company Ltd. were given the nod to start a banking business in the private sector (RBI 2014). Bandhan is one of the leading MFIs in terms of client outreach, number of branches, and gross loan portfolio (Sa-Dhan 2015). Ten more financial institutions (among which, eight were MFIs) were recently given permission to set up small finance banks (RBI 2015). Interestingly, as already discussed in the previous section (in the case of Mexico, Indonesia, and Bangladesh) all the phases in the trajectory of microfinance (converting from a not-for profit institute into a for-profit corporate/NBFC/banks) in India match those of its' counterpart countries.

Studies on the macro trends and performances of MFIs over time are limited due to data scarcity<sup>11</sup> in India. The decennial All India Debt and Investment Survey (AIDIS) conducted by the National Sample Survey Organization (NSSO) since 1971–1972, is a comprehensive source of information on the rural and urban credit markets in India. However, modifications in the NSSO questionnaire over different survey rounds render data on sources of credit rather complicated to compare. The latest 2012–2013 survey has produced three reports so far, and bank- and NBFC-linked SHGs are considered as a separate category under the institutional sources of

<sup>11</sup> Macro-level information are available mainly on self-help groups and their businesses across the states in the RBI's database on Indian Economy and NABARD's annual report.



credit for the first time. In the earlier surveys and corresponding reports, information was available only on SHGs, which referred only to bank- or NGO-linked MFIs.

Every three years since 2011, the World Bank has been conducting a nationally-representative survey on the aspects of financial inclusion in different countries across the world. It is known as the Global Findex Database, which provides information on indicators of financial inclusion, such as sources of banking, account ownership, sources of credit, types of savings, and modes of payment, among others. Although the data can be useful in examining financial inclusion and digital finance in India, it lacks a database and sets of information on the activities of MFIs. An alternative source for data at the macro level in India is Sa-Dhan's report on microfinance.<sup>12</sup> Sa-Dhan publishes a report, *Bharat Microfinance in India*, on private MFIs that are listed in their membership rolls. Non-members can also allow Sa-Dhan to use their data for the report. Although Sa-Dhan claims to cover around 95 percent of the industry, membership in Sa-Dhan is voluntary, and the data is self-reported. This makes it problematic to treat the report either as a comprehensive or a representative data source.

## Emerging Trends in Indian Microfinance

From the available and relevant secondary sources of data, we discuss below three main trends that are emerging in the world of Indian microfinance.

First, an increasing number of MFIs in India have changed their legal forms into for-profit MFIs. Though not-for-profit MFIs (society, trust, section 8 companies, and cooperatives) are still the major players in terms of number, for-profit MFIs (NBFC-MFIs) now account for a significant share of the loan portfolio and client outreach (Sa-Dhan 2016). In 2018, there were 200 MFIs

in India who reported to Sa-Dhan, out of which 89 were NBFC-MFI/NBFC. In 2007 there were only 17 NBFC-MFI/NBFC out of 129 MFIs (Table 1).

Second, the average loan size disbursed to borrowers has been increasing. The rising trend in the gross loan per client is shown in Figure 1, which graphs the average loan per client since 2005. The average loan per client for MFI in India, which was a little less than INR 2,000 (around USD 25–30) in 2005, increased to more than INR 19,500 (USD 270–280) in 2018.<sup>13</sup>

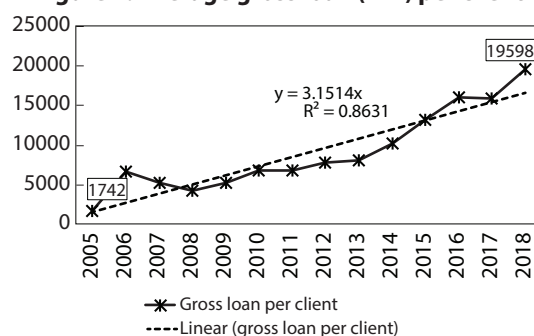
**Table 1. Number of MFIs in terms of legal form**

Legal Form	2007	2012	2016	2018
Society	73	85	62	68
Trust				
Section 8 company*	13	20	24	32
Mutually aided				
cooperative societies	25	15	7	11
(Macs)/cooperatives				
Local area bank	1	1	2	–
NBFC				
NBFC-MFI	17	63	71	89
<b>Total</b>	<b>129</b>	<b>184</b>	<b>166</b>	<b>200</b>

Source: Sa-Dhan (various years)

Note: \* Section 25 under the previous Companies Act of 1956; in 2016, all 71 were NBFC-MFI.

**Figure 1. Average gross loan (INR) per client**



Source: The Bharat Microfinance Report (Sa-Dhan various years)

<sup>12</sup> Sa-Dhan is a community development finance institution in India that was established in 1999. It has been publishing the *The Bharat Microfinance Report* since 2004. Recently the Reserve Bank of India identified Sa-Dhan as one of the self-regulatory organizations for MFIs.

<sup>13</sup> This increase far outstrips the nominal increase that would have been explained by inflation, which was 4.25 percent in 2005 and remained almost at the same level of 4.86 percent in 2018. Thus the nominal increase explained by inflation alone would have been less than a factor of 2, while average loan size grew nearly tenfold.

Closely related to this trend in increasing loan sizes is the evidence of loan portfolio growth at a higher rate compared to the growth rate in the number of clients.<sup>14</sup> Barring the initial years of 2004 and 2007, MFI loan portfolios grew at a higher rate than the growth rate in number of clients. In 2018, the growth rates of loan portfolio and number of clients stood at 47 and 19 percent, respectively (Figure 2). Those growth rates can be flagged as two of the critical attributes of the unsustainability of the sector as the net outstanding loan amount has been growing at a much higher rate compared to the number of clients. There is also a misbalanced spread of loan shares over a relatively smaller number of clients, which is suggestive of the recent practices of increasing the loan size relative to the number of borrowers to reduce costs and risks, as well as cream-skimming.

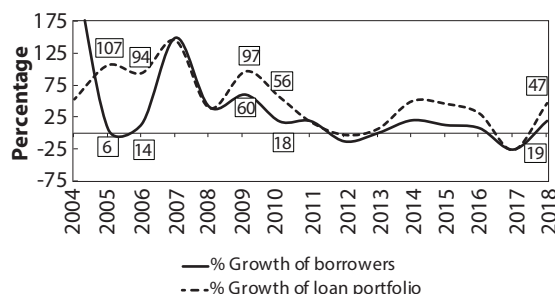
A closer look at the graph reveals that in 2005–2006, the loan portfolio grew at a much

higher rate compared to the number of borrowers (107% versus 6% in 2005). This period coincides with the time when the Krishna District in Andhra Pradesh had a severe crisis as many borrowers committed suicide because they were not able to repay borrowed loans and could not withstand coercive recovery of instalments by MFI officials (Arunachalam 2010). A similar crisis in the sector returned in 2009–2010, but it was more widespread and prolonged in its impact and not confined to Andhra Pradesh alone. Interestingly, in 2009 and 2010, the loan portfolio grew at 97 percent and 56 percent (60% and 18% in terms of the number of MFI borrowers), respectively, at a much higher rate than the increase in the number of MFI borrowers.

Third, of late, there is a declining trend in the share of MFI borrowers in rural areas as compared to its share in urban areas. The predominance of MFIs in the rural areas compared to the urban areas can be credited to the RBI's priority sector norm, which has encouraged banks to lend primarily to the agriculture sector, marginalized groups, and the unbanked (Care India, MSDF, and ICICI Bank 2006). The creation of the NABARD and SIDBI also contributed to a vibrant rural microfinance sector. While NABARD (with its promotion-linking of SHGs) and banks (through the SHG-Bank Linked Programme or SBLP) explored a huge potential for the rural poor, SIDBI played an important role in promoting the Bangladesh Grameen<sup>15</sup> model in India's MFI sector. Contrary to convention, there is now a declining trend in the share of MFI borrowers in rural areas from 69 percent in 2012 to 55 percent in 2018 (Figure 3). During 2015–2016, this share had plunged to around 33–38 percent.

The falling share of rural borrowers in microfinance, if examined against the backdrop of a high share of non-institutional credit sources in total outstanding debt in rural areas, suggests an alarming trend toward declining use of institutional credit. It also indicates that microfinance has not been able to drive moneylenders out of business.

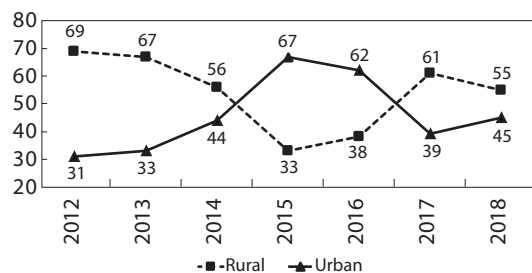
**Figure 2. Growth rate of the number of borrowers and loan portfolio**



Source: Calculated from data reported in *The Bharat Microfinance Report* (Sa-Dhan various years)

<sup>14</sup> According to the Sa-Dhan *The Bharat Microfinance Report*, the number of clients/borrowers of MFIs has gone up from 0.3 million in 2001 to 39.9 million in 2016. Within the same period, the total net outstanding loans of MFIs have increased to INR 390.28 billion from INR 0.65 billion. The period 2006 to 2009 appears to have been very conducive and favorable for the MFIs as both the number of clients and loan portfolio grew at very high rates. From 2010 onwards, the growth rates declined substantially, but since recovered in 2014. In 2015, around 88 percent of the loan amount was shared by NBFC-MFIs, followed by societies and trusts at 9 percent. This has been, by and large, the general trend with the largest share of loan amount or number of clients belonging to NBFC-MFIs.

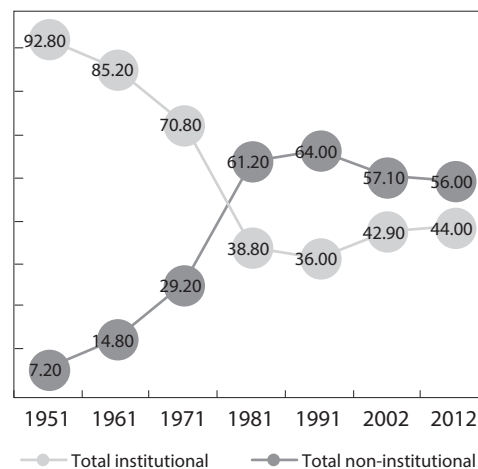
<sup>15</sup> The word *grameen* means "village", reflecting Bangladesh's focus of microfinance in the countryside.

**Figure 3. Share (%) of MFI borrowers, rural and urban**

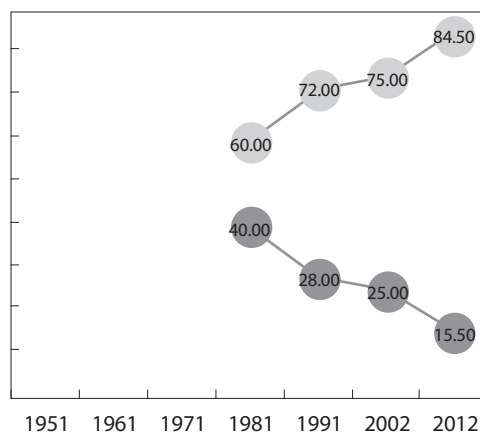
Source: Sa-Dhan (various years)

We used data from the AIDIS 70th round (2012–2013) to compare the overall indebtedness in rural and urban sectors and the changing coverage and outreach of institutional and non-institutional sources of credit. It was reported that there had been a slow but steady increase, especially since 1991, in the non-institutional sources of outstanding cash debts in rural India (Figure 4). The share of non-institutional sources in total cash loan outstanding in rural India has gone up from 36 percent in 1991 to 44 percent in 2012 (Pradhan 2013; NSSO 2014).

The share of moneylenders, in particular, has increased consistently and even doubled in rural areas from around 16 percent in 1991 to 33 percent in 2012.<sup>16</sup> The NSSO report (2014; 2016) based on AIDIS (Table 2) found that in 2012, the combined percentage shares of both bank and NBFC-linked SHGs accounted for only 2.20 percent of the total cash dues outstanding compared to the more than 33 percent share of moneylenders in rural areas.<sup>17</sup>

**Figure 4. Share of institutional and non-institutional sources in total outstanding cash debts, rural (top), and urban (bottom)**

— Total institutional — Total non-institutional



— Total institutional — Total non-institutional

Sources: Pradhan (2013); NSSO Reports (various issues)

Note: Data for urban areas before 1981 were not available

**Table 2. Share of different credit agencies to total cash dues of households as of June 2012, all India (in percent)**

Credit Agency	Percentage Share of Cash Dues in Credit Agencies	
	Rural	Urban
Self-help group-bank linked	1.90	0.60
Self-help group-NBFC	0.30	0.20
All institutional agencies	56.00	84.50
Agricultural moneylender	5.00	0.10
Professional moneylender	28.20	10.50
All non-institutional agencies	44.00	15.50

Source: NSSO (2014)

<sup>16</sup> Studies in other countries have also found that contrary to popular expectations, microfinance has failed to dampen the significance of coercive non-institutional credit sources (see Mallick 2012 and Berg, Emran, and Shilpi 2013).

<sup>17</sup> It is possible that non-institutional sources have a higher share of outstanding loans due to non-repayment and higher debt accumulations, such as in the case of loans taken from moneylenders. The SHGs, on the other hand, have a regular and systematic structure for repayment of loans. This argument needs to be factually verified.

The trends in the features of microfinance in India are identical to some of the stark transformations that have been taking place globally. Given the distinct prevalence of non-institutional credit agencies, especially in the rural sector, we believe that the commercialization-profit orientation of MFIs may not be suitable for the following three reasons. First, it may lead to the continuation of the formal credit vacuum and undermines the possibilities, if present, of realizing micro strategies for livelihood support. Microfinance, even after commercialization, has not been able to fill up the vacuum created after structural reforms in the sources of credit agencies accessible to the poor. The increasing shift toward urban locations is further distancing credit-needy rural borrowers. Second, commercialization allows the permeation of “capital-market-centric investors” that seek to make commercial profits and could run counter to the social commitment with which the microfinance movement began (Shetty 2012). Studies in Ghana, Malawi, Zambia, and Nicaragua also show that commercialization might actually increase the “pressure to instill more financial discipline” that can shift the focus of the organizations away from their original mission (Datar, Epstein, and Yuthas 2008). Third, as a consequence of the above two, power dynamics in the market are reinforced, and borrowers are exposed to the money lenders’ market as the last resort where interest rates are usurious and unregulated.

## CONCLUDING REMARKS

Microfinance is one of those major neoliberal initiatives anchored on the belief that underdevelopment, poverty, destitution, disempowerment, and marginalization could be eradicated through inclusion of the people into the fold of finance. Pieces of existing literature on microfinance in India take varied positions on the role of these institutions. Notwithstanding the debate on the efficacy of an institutional approach to poverty and its limitations subject to the neoliberal context in which it was conceived,

our paper only makes a nascent attempt to identify trends in microfinance that are suggestive of a mission drift, which needs to be scrutinized much more closely. As India is taking giant strides toward financial inclusion, indicators suggesting digression of MFIs from their main role as key credit agencies for the rural poor must be brought under sharp scrutiny and subsequently corrected, if warranted. With regard to the indicators of a mission drift, we would like to conclude by opening up a platform for further discussion on three issues that we think are relevant in this front.

First, although microfinance aims to bridge the gap between lenders and marginal borrowers, there is a trend toward commercialization and participation of profit-oriented private players catering to a select clientele to reduce risks and costs. It is an opportune time now to examine whether and how commercialization (as a part of mission drift) affects the efficacy of MFIs in serving the unbanked and credit-needy populations. If microfinance increasingly relies on for-profit MFIs for credit disbursement, it is pertinent to invite micro-studies that will throw light on whether this move will ameliorate or exacerbate credit deprivation among the marginalized populations.

Second, and closely related to the first issue, is that at a juncture where substantial macroeconomic factors have brought about irrevocable changes in the viability of agriculture in India, the impact of commercialization and inclusion of giant private players in its operations must be closely studied. Existing studies in India show that the viability of agriculture has been declining on account of several factors such as shortage of formal sources of credit, reduction of input subsidies, integration of the domestic agrarian economy with the international markets, and also due to climate change. Banerjee (2012, 192) argued that the trimming in public expenditure in the agrarian sectors of the global south, including India, has serious negative ramifications for households dependent on agriculture. The study further adds that “the continued exclusion of small-scale rural producers from the institutional credit coverage as a fallout of banks’ response to the financial crisis has tightened the grip of private moneylenders on the

rural credit market.” Bhattacharyya, Abraham, and D’ Costa (2013) also found that farmers in India in the post-1990 era have faced reduced access to formal credit and lack of proper/useful extension services. The insufficiency of bank loans in meeting farm input costs and the desperation to repay the bank in order to remain eligible for future loans from the formal sector has been found to compel farmers to take multiple credits and depend on private and non-institutional sources. There is dominance of non-institutional sources of credit, particularly money lenders, despite the expansion of microfinance drive that has been conspicuously mushrooming. Since MFIs have been recognized as key agencies designed to meet the credit demand of small borrowers, it is important to assess in future studies whether a mission drift makes MFIs overlook existing bottlenecks in credit delivery and crowd out small borrowers seeking capital to invest in agricultural inputs.

Lastly, our views concur with those of scholars who argue that chronic problems in credit delivery must be addressed through a combination of long-term sustainable measures in finance, as well as non-credit interventions. This means that MFIs alone might not be sufficiently equipped to permanently address financial exclusion and substitute for social and development banking services. Ghosh (2013) pointed out that alternative financial institutions like local development banks, financial cooperatives and community banks that cater to the credit needs of the poor to a considerable extent (as is being done in Brazil) deserve more attention than the excessive support given to MFIs. Taylor (2012) has also rightly argued for the simultaneous need of non-credit interventions, such as land reform, public investment in infrastructure, and securing of farmers’ rights over resources and labor protection measures.

As the MFI is still wielded as a major instrument of credit disbursement under the policies of financial inclusion, there is need of both macro data and primary field-based surveys to gauge the impact of commercialization of microfinance especially in the rural areas. It is therefore important to more closely examine

whether its conversion to for-profit MFIs and the entry of large private players in its operations might have defeated its original avowed global mission of serving the micro-credit needs of the poor. It remains to be explored whether this paradigm shift in the characteristic features of MFI has resulted in the erosion in its social commitment to its original target clientele.

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