Microfinance In India And Porter’s Five Forces Analysis Of Microfinance Industry

Divya Mehta
Assistant Professor, Dyal Singh College, Lodhi Road, New Delhi - 110003

Monica Aggarwal
Assistant Professor, Ramlal Anand Evening College, Benito Juarez Marg, New Delhi - 110021
Abstract

Microfinance is that wing of providing finance which deals with providing financial services to the poor such as the supply of loans, savings etc. India has witnessed a rapid growth over the last few years in microfinance sector. In this paper, attempt has been made to study the role and growth of microfinance in India with special emphasis on Microfinance crisis in Andhra Pradesh. Attempt has also been made to study Microfinance through Porter’s five forces analysis. This paper focuses on microcredit aspect of as microcredit is still the largest function of microfinance business in India.

Keywords: Microfinance, Michael Porter five forces, Microcredit, MFI, SHG

1. Introduction

Poverty is one of the predominant problems prevailing in the developing and developed part of the world. It is estimated that approximately 2.5 billion people around the world live in poverty. As a result, United Nations Organisation (UNO) has committed itself to its objective of halving extreme poverty by 2015 as part of its Millennium Development Goals. Most of the developing and underdeveloped countries have acknowledged that poverty alleviation is an important step towards achieving sustainable economic development and are directing their policy framework to address the same. Microfinance has gained traction in the policymaking circles as an effective and efficient tool to bring this paradigm change in the rural landscape.

Many credit groups have been operating in many countries for several years. Microfinance can be observed since the beginning of 20th century whereas Muhammad Yunus, a Nobel Laureate is recognized with laying the groundwork of the modern MFIs with establishment of Grameen Bank, in Bangladesh in 1976. This foundation, besides addressing the UN Millennium Development Goal of alleviation of poverty, also serves the multilateral organisation’s other development goals including women literacy and empowerment. Microfinance has now become a most talked about term and has been gaining lot of attention about its growth, innovation and impact. The microfinance industry has mushroomed both in terms of borrowers and type of products and its providers.

This is an evaluation study of micro finance in India using secondary data on SHGs and MFIs. The primary objective of this study is to dig into the meaning and explore the role of Microfinance in India. In the above statement Porter’s Five forces model has been analysed in the view of Microfinance industry in India. In this connection, the study looks at the issues of geographical spread of micro finance institutions and SHGs in India, rise of SHGs in India, Andhra Pradesh and various models of Microfinance in India.
2. Microfinance

According to International Labour Organisaton (ILO), “Microfinance is an economic development approach that involves providing financial services through institutions to low income clients.”

Microfinance means providing financial services to low income clients, including consumers and own employed, who feel lacking behind in having access to banking and related services. Largely, it is a commitment, the objective is to make available to all poor and near poor households a continuous, permanent and cheaper access to a wide assortment of financial services including credit, insurance and fund transfers. Micro finance services includes micro credit, micro pension, micro insurance and thrift services.

Microfinance because of its uniqueness to cater to the rural areas, where the banking sector is not able accessible, is intended to play a very important role in achieving financial inclusion. Today, there are more than 850 players in microfinance industry in India and the top five private sector MFIs reach more than 20 million clients in India.

In Indian context, Microfinance has been defined by The National Microfinance Taskforce, 1999 as “provision of thrift, credit and other financial services and products of very small amounts to the rural, semi urban or urban areas for enabling them to raise their income levels and improve living standards.” The basic principles of micro finance that distinguish it from the earlier modes of credit delivery are small amounts of credit, lack of physical collateral but emphasis on peer monitoring and focus on women borrowers.

The process of microfinance includes the following:

- Recruiting and training of borrowers to establish business.
- Extending help to form groups to provide loans
- Distributing funds for loans
- Meeting with group of borrowers to collect loan repayments and to guide their endeavours

3. Indian origination of Microfinance

Earlier than the first five year plan, i.e. in 1951, maximum of the financial needs of rural sector along with agriculture sector were provided primarily by the moneylenders. At that time, the Reserve Bank of India was very active in taking up cooperative movements through a variety of initiatives. The All India Rural Credit Survey (RBI, 1954) stated in their report that “Cooperation must succeed and recommended a formalized channel for credit delivery. The subsequent formation of ‘Agricultural Refinance Corporation’ in 1963,
nationalisation of major commercial banks in 1969 and then in 1980, setting up of Regional Rural Banks in 1975 and formation of National Bank for Agriculture and Rural Development (NABARD) in 1982 - all these efforts by the Reserve Bank were to institutionalize the credit channel for rural sector. Within a very short span, this experiment of subsidized credit boomeranged and as a result the tangible outcome was the increase in Non Performing Assets (NPA). Then the realization dawned that the core issue for the poor is access to credit and not the cost of credit. Subsequently, in the 1990s and 2000s, the micro-credit connotation with MFI- and SHG-Bank linkage models evolved with the institutional support of the Reserve Bank and NABARD in order to help the poor in providing credit. Microfinance in India can be tracked for its origination back to the early 1970s when the Self Employed Women’s Association (SEWA) of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the purpose of providing banking services to the poor women employed in the unorganized sector in Ahmedabad City, Gujarat. The microfinance sector 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. From modest initial stages, the sector has grown considerably over the years to become a multibillion dollar industry, with bodies such as SIDBI and NABARD devoting significant financial resources to microfinance.

4. Current Picture Of Microfinance In India

4.1 Organization Of Microfinance Institutions

Microfinance Institutions largely function under a broad assortment of legal structures. These microfinance institutions can be categorized as follows:

1. NGO
2. Trust
3. Sec 25 Companies
4. Cooperative Societies
5. Cooperative Banks
6. Regional Rural Banks
7. Local Area Banks
8. Public and Private Sector Banks
9. Business Correspondents
10. Non Banking Finance Company

The microfinance institutions in India can be categorized into 3 forms. These are stated below:

1. Mutual Benefit MFIs
2. Companies
3. NGO-MFIs
Table 1: Type of MFIs

<table>
<thead>
<tr>
<th>Type of MFI</th>
<th>Number</th>
<th>Share</th>
<th>Legal Acts under which registered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual Benefit MFIs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cooperatives</td>
<td>3</td>
<td>0</td>
<td>State Cooperatives Societies Act</td>
</tr>
<tr>
<td>Mutually aided Cooperative Societies</td>
<td>445</td>
<td>57</td>
<td>Mutually aided Cooperative Societies Act enacted by the State Governments</td>
</tr>
<tr>
<td><strong>Sub total</strong></td>
<td>448</td>
<td>57</td>
<td></td>
</tr>
<tr>
<td>Companies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non Banking financial Companies</td>
<td>24</td>
<td>3</td>
<td>Indian Companies Act 1956</td>
</tr>
<tr>
<td>Section 25 Companies</td>
<td>9</td>
<td>1</td>
<td>Reserve Bank of India Act,1934</td>
</tr>
<tr>
<td><strong>Sub Total</strong></td>
<td>33</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>NGO-MFIs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Societies</td>
<td>199</td>
<td>25</td>
<td>Societies Registration Act,1860 or similar Provincial Acts</td>
</tr>
<tr>
<td>Trusts</td>
<td>106</td>
<td>13</td>
<td>Indian Trust Act, 1882</td>
</tr>
<tr>
<td><strong>Sub Total</strong></td>
<td>305</td>
<td>39</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>786</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Source: www.nabard.com

4.2 Models Of Microfinance

Microfinance, in India, functions on two different models viz.

1. SHG-Bank Linkage Programme Model
2. Microfinance Institutions(MFI) Model

<table>
<thead>
<tr>
<th>SBLP Model</th>
<th>MFI(Grameen )Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Groups of 13-20 members</td>
<td>5 member groups, with 5-7 groups forming a center.</td>
</tr>
<tr>
<td>Group formation and monitoring for some time by</td>
<td>Group formation and monitoring throughout by MFI</td>
</tr>
<tr>
<td>NGO, but NGO eventually withdraws</td>
<td></td>
</tr>
<tr>
<td>Loan advanced by Commercial Bank</td>
<td>Loan advanced by MFI</td>
</tr>
<tr>
<td>Group members trained to do record keeping and</td>
<td>MFI staff does record keeping and bank transactions</td>
</tr>
<tr>
<td>bank transactions</td>
<td></td>
</tr>
<tr>
<td>Loans are given to SHGs which on lend to members</td>
<td>Loans are given to members individually though on joint</td>
</tr>
<tr>
<td></td>
<td>liability basis</td>
</tr>
</tbody>
</table>
Savings for 6 to 12 months needs to precede borrowing Loans are given without any prior savings period. In fact savings cannot be collected by MFIs due to regulatory reasons

Delivery of microcredit viewed by some NGOs as secondary to goals of female empowerment and social transformation Micro credit is the main focus

On adhoc basis, government subsidies are given to SHGs by way of grants equivalent to a part of the loan There is no direct subsidy element in MFIs

Average loan size: Rs. 3789 Average loan size: Rs. 6519

The following table explains the loan lended and outstanding amount to MFIs by banks over a span of four years.

### Table 2: MFI Bank Linkage Programme

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of MFIs</td>
<td>Amount</td>
<td>No. of MFIs</td>
<td>Amount</td>
</tr>
<tr>
<td>Loans disbursed by banks to MFIs</td>
<td>779 (34%)</td>
<td>10728.50</td>
<td>471</td>
<td>8448.96</td>
</tr>
<tr>
<td></td>
<td>(187.4%)</td>
<td>(6-21.3%)</td>
<td>(39.5%)</td>
<td>(-1.3%)</td>
</tr>
<tr>
<td>Loans outstanding against MFIs as on</td>
<td>465</td>
<td>5205.29</td>
<td>426</td>
<td>7839.51</td>
</tr>
<tr>
<td>31 March</td>
<td>2315</td>
<td>(13955.75)</td>
<td>(13730.62)</td>
<td>(2042)</td>
</tr>
<tr>
<td></td>
<td>(-1.3%)</td>
<td>(178.6%)</td>
<td>(39.5%)</td>
<td>(4.2%)</td>
</tr>
<tr>
<td>Fresh Loans as %age to Loans Outstanding</td>
<td>76.9</td>
<td>61.5</td>
<td>45.5</td>
<td>54.3</td>
</tr>
</tbody>
</table>

(figures in the paranthesis indicates growth/decline over the previous year)

Note: Actual number of MFIs availing loans from Banks would be less than the figures shown as most of MFIs avail loans from more than one Bank/more than one loan account.

Source: NABARD

From the above table it is observed that the disbursement of loans from the banks to MFIs has decreased by nearly 25% in the year 2012-2013 as compared to 2009-2010 however the loans outstanding against MFIs has marginally increased during the same span. To throw light to the above statement we can say that the MFIs default rate is high may be due to mismatch between demand and supply

---

1 However both models receive an implicit subsidy as bank loans to them are considered as part of priority sector lending requirements which banks are mandated to meet
2 The “Side by Side” report on microfinance in India published by Sa-dhan
3 The “Side by Side” report on microfinance in India published by Sa-dhan
Table 3: SHG BANK LINKAGE

| Source: www.nabard.com |

The above graph shows the linkage between SHG and banks in terms of loans disbursed by banks and loans outstanding on the part of SHGs for three years. It is quite evident that the loans given to SHGs has increased manyfold in just three years. With this we can conclude that SHGs are preferred as a source of Microfinance primarily because it may lead to upliftment of society. In this respect the following table gives a comparison of SHGs bank linkage and MFIs bank linkage trend.

Table 4: Loan outstanding vs NPAs (Rs crore) - bank loans to SHG & MFIs - Trends (MFIs (NPA) figures reported at bank level, doesn't include restructured assets)

The outstanding amount of loan of SHGs over MFIs is very predominant from the above graph. Loans outstanding to both MFIs and SHGs has shown an increasing trend from 2009 to 2013. In 2010-2011 the
NPAs have increased drastically for SHGs. This is mainly due to Microfinance crisis that happened in the year 2010.

4.3 Policy Initiatives For Microfinance In India

The RBI has been entrusted with the responsibility of the regulator for the microfinance sector in the draft manuscript of Microfinance Bill, 2011 and therefore, is shouldered with the accountability of strengthening the sector and of protecting the concern of the clients of MFIs. RBI, in the capacity of a regulator of the microfinance sector and as the central bank of India, is expected to perform the following functions:

- Framing policy and guidelines for rural financial institutions
- Making available the credit facilities to issuing organizations
- Preparing potential-linked credit plans annually for all districts for identification of credit potential
- Monitoring the flow of ground level rural credit
- sustaining financial liberalization and generate conditions sustainable for the sector
- Prudent regulations and supervision
- Supporting the pilot projects of microfinance
- data collection and its publication
- Training and advocacy

Following are the various types of microfinance institutions which are primarily functioning in India:

<table>
<thead>
<tr>
<th>Type</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Niche market MFIs</td>
<td>Such as Spandan, SKS Microfinance, SHARE Microfin Ltd have scaled-up their micro credit outreach dramatically in recent years</td>
</tr>
<tr>
<td>Private Banks</td>
<td>Extention of financial services by ICICI Bank to the poor through a multi-prolonged approach- Directly providing credit to Self Help Groups (SHGs), and providing whole sale credit facilities to microfinance NGOs and NBFCs</td>
</tr>
<tr>
<td>Public Sector Banks</td>
<td>Syndicate Bank, Andhra Bank, Canara Bank, and Indian Bank have entered the sector</td>
</tr>
<tr>
<td>ADB</td>
<td>ADB, through its Microfinance Development Strategy, aims to ensure permanent access to institutional financial services for the poor</td>
</tr>
<tr>
<td>PE Firms</td>
<td>Started to eye low profile MFIs as they foresee huge potential in terms of returns from this sector. E.g. JM Financial has investments from Old Lane Partners</td>
</tr>
<tr>
<td>NABARD and SIDBI</td>
<td>They have been performing regulatory and promotional role providing financial resources as credit and equity and enhancing technology knowhow of MFIs</td>
</tr>
</tbody>
</table>
4.3.1 Microfinance Institutions Bill, 2011

The Ministry of Finance, Government of India, had placed the draft of Microfinance Institutions Bill 2011 online on July 6, 2011 whereby clarifying the doubts on the decision of a separate regulation for the microfinance industry, and thereby inculcating a probability that a promotional outline for microfinance as an instrument of financial Inclusion can now be put in place, the following table contains a concise arrangement of vital key provisions of the bill:

<table>
<thead>
<tr>
<th>Areas of Microfinance</th>
<th>Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulator</td>
<td>Reserve Bank of India</td>
</tr>
<tr>
<td>Institutions covered</td>
<td>All those offering Microfinance services including NBFCs but not cooperatives</td>
</tr>
<tr>
<td>Jurisdiction over Institutions covered</td>
<td>Limited to RBI-registered MFIs not to be treated as money lenders under state level enactments</td>
</tr>
<tr>
<td>Minimum capital (net own funds)</td>
<td>Rs. 500000 (11000$) initially</td>
</tr>
<tr>
<td>Systematically important MFIs currently defined for NBFCs as those with assets in excess of Rs. 100 crore (22.7 million$)</td>
<td>If not already a company, must transform to NBFC (or Section 25 Company)</td>
</tr>
<tr>
<td>Services offered</td>
<td>Micro-credit, thrift, remittance, pension and Insurance services</td>
</tr>
<tr>
<td>Thrift Services</td>
<td>“money collected other than in the form of current account or demand deposits” from micro clients</td>
</tr>
<tr>
<td>Security of Thrift</td>
<td>Creation of free reserves in unencumbered securities + first charge over assets in favour of clients/members</td>
</tr>
</tbody>
</table>
| Prudential Norms                       | • Covering  
|                                        | • Income Recognition  
|                                        | • Accounting standards,  
|                                        | • Provisioning for bad debts  
|                                        | • Capital adequacy based on risk weights of assets  
|                                        | • Credit conversion factors for off Balance Sheet items  
|                                        | • Disclosure of assignments or securitizations  
|                                        | • Specified norms of Corporate Governance                                                                                                  |
| Business Conduction Rules              | • Maximum amount of loan  
|                                        | • Term/tenure of loan  
|                                        | • Periodicity of installments  
|                                        | • Location of transactions                                                                                                                   |
| Pricing and Profitability              | • Maximum Annual Percentage Rate (APR)  
|                                        | • Fees, levies, insurance premiums  
|                                        | • Margin cap                                                                                                                                  |
## Client Protection

Mandatory membership of credit information bureaus, adherence to codes of conduct and transparency to clients; establishment of advisory councils at the central and state levels.

## Reporting/Information Requirements

The usual reporting and information requirements that facilitate benchmarking and marking.

## Development Resources

Establishment of Microfinance Development Fund to enable lending, equity investment, capacity building and research.

Some of the special features of the bill are as follows:

- Though RBI has been appointed as a regulator of the sector as a whole, it can delegate any of its powers to NABARD anytime.
- As jurisdiction of all MFIs is limited to RBI, the state governments will have no control over the functioning of MFIs and any law, suo moto enacted by them, cannot be enforced upon them.
- The bill allows MFIs to offer thrift services as taking recurring and term deposits only declining clients the flexibility of frequent withdrawals. This way, the bill make sure that MFIs can accept deposits and thereby, has tried to bring down the cost of funds for MFIs. A provision has to be made against the deposits that MFIs take and the rate is to be defined by the regulator.

The microfinance Institutions Bill has come at the right time when the entire microfinance sector was reeling under the pressure from the government of Andhra Pradesh and will rescue the industry.

### 4.4 Self Help Groups (SHGs)

The microfinance sector has grown over the past century in India into enormous operating sizez and colour and to a diversified degree of success. One such variation of microfinance has been the development of the self help groups (SHG). Developed on the belief of “self help”, small groups of women was formed in groups of fifteen to thirty members and operate on a savings-first business model whereby the member”s savings are used to fund loans. These small groups are called Self Help Groups (SHGs). The appraisal of outcome of cooperatives by All India Rural Credit Survey Committee in 1954 bought the fact that volume of credit supplied by the cooperative movement was insignificant, accounting only 3% of the total borrowing of cultivators. It expressed that the proportion of institutional agencies, comprising the Government, the cooperative and commercial banks in financing the borrowings of rural household was only 7.3% in 1951-52 corresponding to the share of private money lenders was high as 68.6%.

4 LALITHA (1998) Rural Women Empowerment and Development Banking
sector. The following table throws light on the loans disbursed to SHGs by different categories of banks. It also segregates the loan disbursement to exclusive women SHGs.

Table 5: Bank Loans disbursed to SHGs during 2012-13

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the Agency</th>
<th>Loans disbursed to SHGs by banks during the year</th>
<th>Out of Total- under SGSY</th>
<th>Out of Total- Exclusive Women SHG</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>No of SHG</td>
<td>Loans disbursed</td>
<td>No of SHG</td>
</tr>
<tr>
<td>1</td>
<td>Commercial Banks</td>
<td>735577</td>
<td>1338500.7</td>
<td>88594</td>
</tr>
<tr>
<td>2</td>
<td>Regional Rural Banks</td>
<td>312010</td>
<td>562652.22</td>
<td>58890</td>
</tr>
<tr>
<td>3</td>
<td>Cooperative Banks</td>
<td>172234</td>
<td>157383.52</td>
<td>33688</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1219821</td>
<td>2058536.44</td>
<td>181172</td>
</tr>
</tbody>
</table>

Source: NABARD

From the above table it is evident that commercial banks gives the highest amount of loan to the SHGs. Within SHGs, exclusive women SHG are ten times more in number than SHGs under SGSY. Similarly loans disbursed to exclusive women SHGs is very high as compared to the loan given to SGSY.

The role and importance of SHGs have widened very speedily primarily due to the reason that there is a large degree of comfort of replication and construction. SHG Bank Linkage has provided the capacity for SHGs to increase their capital base to fund more members and bigger projects. In the current status, it is configured that there are at least over 2 million SHGs in India. In many Indian states, SHGs are networking themselves into federations to achieve institutional and financial sustainability. Cumulatively, 1.6 million SHGs have been bank linked with cumulative loans of Rs. 69 billion. In 2004-05 alone, almost 800000 SHGs were bank linked. The success of few nongovernmental Organisations (NGOs) like Mysore Resettlement and Development Agency (MYRADA) in group lending, made the government in shifting the strategy of women development and empowerment under Development of Women and Children in Rural Areas (DWCRA) programme through group based approach. The first interest in informal group lending in India took shape during 1986-87 on the initiative of NABARD. It took a research project on SHGs as a channel for delivery of microfinance in the late 1980s. Amongst the MYRADA sponsored research project on ‘Savings and Credit Management” on SHGs was partly funded by NABARD in 1986-87. In the very next year, in association with Asia Pacific Rural and Agricultural Credit Association (APRACA), NABARD undertook a survey of 43 NGOs on 11 states to study the functioning of microfinance Self Help Groups and their collaboration possibilities with the formal banking system. Both these research projects threw up the encouraging
possibilities and NABARD initiated a pilot project called SHG-bank linkage project. The spread of SHGs also led to the formation of SHG Federations which are a more sophisticated form of organization that involve several SHGs forming into Village Organisations (VO) / Cluster Federations and then ultimately into higher level federations (called as Mandal Samakhyas (MS) in AP or SHG Federation generally). SHG Federations are formal institutions while SHGs are Informal. Many of these federations are registered as societies, mutual benefit trusts and mutually aided cooperative societies.

4.5 The Andhra Pradesh (AP) Microfinance Crisis

Compared to the other states in India, the growth and development of the microfinance sector followed a unique course in AP. Although all the states in the country experienced initiation and the growth of SHG Movement, the mainstay of Indian Microfinance, the state government of AP systematically nurtured and deepened the institution of SHG through the use of public resources due to number of political motives. The AP government constituted an autonomous body named Society for Elimination of Rural Poverty (SERP), which is implementing the Indira Kranthi Patham (IKP) project in all the 22 rural districts of AP. The project methodology involves mobilizing and organizing rural women in the SHGs consisting of ten to fifteen members. Activities of the SHGs revolve around regular savings by their members, credit (from both external and internal sources) and regular meetings (weekly, except in case of newly formed SHG). The SHGs have been federated at village level are called Village Organisations (VO). The VO’s have been further federated as Mandal Samakhyas or Mandal Organisations (MOs) at manda (sub districts) level. All SHGs in a village contribute two members to their VO (one member in case of twenty SHGs in a village), while every VO in a manda sends two of its members to the concerned MO. All MOs have organized themselves in to Zila Samakhyas or District Organisations (DOs) at the district levels (Government of Andhra Pradesh, 2009). The SHGs, VO’s, MOs and the 5 DOs are being increasingly involved in implementing and monitoring various government development programmes through IKP.

The presence of such, existing organized groups of the poor resulted in the largest concentration of the MFIs in AP among all the states in India. Thus, while AP households had much better access to microfinance than all the other Indian states through the state sponsored microfinance programme, private MFIs flocked in to AP to leverage on the SHG network already existing in the state. It was much easier for private MFIs to start their business in AP than in any other state of India, which led to an oversupply of microfinance, more specifically of microcredit, to AP households.

4.5.1 The origin of the crisis
As stated above, microcredit in AP was supplied to an extent of saturation. This oversupply could sustain due to a phenomenon called ‘aspiration paradox’. The aspiration paradox in western life is said to occur when a family invests in holidays, a fancy car, housing or consumer goods - often using a credit card – without realizing that the debts piling up are going to cause them to go bankrupt. The paradox is also observed in the case of poor households as they very often fail to accurately assess and quantify their repayment capabilities due to aspiration paradox. Thus, many poor households in AP took advantage of the easy availability of credit and borrowed far beyond their repayment capabilities from various microfinance sources. The MFIs, for their part, offered multiple loans to the same borrower household without following due diligence, as it served their business interest. Worse still, some MFIs collaborated with consumer goods companies to supply consumer goods such as televisions as part of their credit programmes. As the poor aspired to own such goods, they were happy to receive them. Possession of such goods exacerbated their already worsening indebtedness as such investments did not generate any income. The poor borrowers therefore started defaulting in repayment and the MFIs resorted to coercive methods of loan recovery. Many borrowers were forced to approach money lender to borrow at exorbitant rates of interest to repay to MFIs. When the situation became impossible, some of these borrowers committed suicide and the matter caught the attention of media. The issue became political. A minister in the government of AP admitted on 3rd December 2010 that 75 suicide cases had come to the notice of the government by that date (fullhyd.com). In some cases, even the employees of microfinance institutions have been allegedly involved in forcing borrowers to commit suicide. After such the government of India passed an ordinance.The Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Ordinance, 2010 in order to harness the situation of oversupply of microcredit and coercive practices to recover loans which was implemented with effect from 15 October 2010. The ordinance mandates all the MFIs to register themselves with the government authority while specifying the area of their operations, the rate of interest and their system of operation and recovery. The ordinance also specify stiff penalties for ‘coercive action’ by MFIs while recovering their loans. In addition, it prohibits them from extending multiple loans to the same borrower and limits the total interest charged to the extent of the principal amount.

5. Porter’s Five Forces Analyses Of Microfinance Industry

Michael Porter provided a framework that models an industry as being influenced by five forces. The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates. Porter’s Five Factor analysis is a framework for industry analysis

---

5 Aspiration Paradox is a concept that originated from the writings of Thorstein Veblen and was subsequently expanded and elaborated by Pierre Bourdieu (Bourdieu, 2005).
and business strategy development innovated by Michael E. Porter in 1979 of Harvard Business School. He uses the concepts developed in industrial organization economics to derive Five Forces that determines the competitive intensity and therefore attractiveness of a market. It consists of those forces close to a company that affect its ability to serve its customers.

Porter’s Five Forces analysis of the microfinance industry will help understand the new dynamics of the industry completely. Following are the forces given by Michael Porter.

- The threat of substitute products
- The threat of existing Rivals
- The threat of new entrants
- The bargaining power of customers
- The bargaining power of suppliers

This analysis helps to assess and manage the long term attractiveness of an industry. It is designed to explain the relationship between the five dynamic forces that effect an industry’s performance. It includes three forces from ‘horizontal’ competition, which can be referred as 3 Ts. These are:

- The threat of substitute products
- The threat of existing Rivals
- The threat of new entrants

And the two forces from ‘vertical’ competition, which can be referred as to be 2 Bs. These are:

- The bargaining power of customers
- The bargaining power of suppliers

### 5.1 The Threat Of Substitute Products

The government, in the draft Microfinance Bill, have mentioned that the life insurance products have to be provided under microfinance category. The insurance industry already has a lot of players. In addition some private and nationalized banks were providing insurance products. They are popularly known as bancassurance. These substitute products may pose a threat to the insurance products of the microfinance
entities because of their expertise in the insurance domain and of the fact that microfinance institutions have negligible experience in providing insurance services.

To overcome this threat, the microfinance industry has to develop expertise in the insurance field and redesign its strategy for developing new products, based on the needs of the poor for e.g.,

- As most of the borrowers of the microfinance Institutions are women, the financial services can be designed to cope up their widowhood
- As a women depends totally on the man of her family for her survival and sudden unexpected demise of the man puts the women in the perils of social evils.
- The products have to be developed to suit the abandon old age couples and singles survival.

Moreover, the cooperative banks are already extending credit, as a substitute product, at a very low interest as compared to many private and PSU Banks.

5.2 The Threat Of Existing Rivals

In general, intensity of competition depends upon the size of the firms in the game. As far as microfinance industry is concerned the major operators are SHGs directly or through MFIs/NGOs. Apart from them there are moneylenders, which, with negligible administrative cost and enormous wealth, may pose a threat to microfinance entities. With more than thousand entities(850 registered and other non registered with NABARD), concentrated in selected states like Andhra Pradesh, Odisha, Karnataka, Chhattisgarh, there will a pressure to reduce the margin to be in the business.

More and more organizations are taking up corporate social Responsibility (CSR) activities. Companies like Oracle Corporations, IBM, PepsiCo, ITC and Infosys have a very detailed agenda on corporate social responsibility, which doesn’t directly involve in money lending but provide all support, both technically and financially, for the development programmes in association with the local organizations. This makes them virtual competitors in the microfinance arena.

In rural areas people have the mindset that co-operative bank and regional rural banks(RRS) are their only source of money and for which they need collateral. As MFIs are a part of formal financial system, people still perceive MFIs as banks which provide money without security leading to these co-operative banks becoming the competitors of Microfinance Institutions. In this scenario, first of all MFIs and the government have to educate the public, particularly the illiterate and ignorant, about this new social phenomenon. They should conduct literacy campaign that can give basic verbal knowledge to adults.
5.3 The Threat Of New Entrants
Currently in India the suppliers of micro finance may be classified into three categories as follows

- Formal sector which includes banks
- Semi formal group which comprises of MFIs and SHGs
- Informal providers which are not legal entities and includes money lenders, chit funds, pawn brokers, employers, relatives and friends.

As per NABARD, there were more than thousand (850 registered and rest unregistered with NABARD) entities providing microfinance services in India. With so much competition, the firms are already finding it difficult to maintain their margins. After implementing Business Correspondent (BC) Model\(^6\), and providing the facilities of No-Frills account, some banks have also forayed into microfinance. Banks with a large capital base and less cost of funds may turn out to be a major threat to the microfinance entities.

After the RBI Guidelines have been issued and passing of Microfinance Bill in the Parliament, there may be a rush to acquire the license of providing microfinance services as the minimum capital base required for applying a license just Rs. 5 lac. This possibility cannot be ruled out in the current scenario when the microfinance industry is becoming more formal with a central regulator and a set of concrete policies in place. The flood of more and more companies in the industry will put more pressure on margins of the microfinance institutions.

Microfinance entities should innovate themselves with specialized products for the target population, try to reduce administrative costs by improving operational efficiency to meet the challenge posed by potential new-entrants in the industry.

5.4 The Bargaining Power Of Customers
In any industry, the bargaining power of the customer depends upon

- Concentration of buyers,
- Number of suppliers providing similar services

In microfinance industry, most of the buyers are in groups or in clusters like SHGs. A group of buyers have more bargaining power than an individual has. These groups can exercise their power through the MFIs/Banks that they are affiliated to. The presence of lots of options for them also make them influential. As an institution, they can influence the decisions of the supplier.

---

\(^6\) In BC Model an executive is assigned the responsibility of a particular area and he/she is responsible for visiting the area with a pre-decided frequency to provide banking services. This model has help banks provide services in the remote areas at a low cost.
Microfinance institutions are already facing tough competition within the industry as there are large number of players, including local money lenders providing microfinance services. The presence of large number of options for the customers gives them the bargaining power.

Another factor is availability of the substitute products and various sources for the same. In remote villages, people prefer taking loans from the local money lenders as they are accessible more easily. Hence, availing a loan from MFIs automatically, become a second priority for the people, giving them an upper hand on the pricing of the credit.

A matter of concern for the people, and the government is that not many people are aware of the range of options available for them for availing loans. Moreover, most of the people in the rural areas are financially illiterate, which give the MFIs the opportunity to advantage of the situation.

5.5 The Bargaining Power Of Supplier
Barring a few states, most of the rural areas are still untouched and the concentration of MFIs in some areas is very high. Hence, the MFIs, ideally, should have negligible power in dictating terms in the business. But, due to widely prevailing financial illiteracy in the rural areas of India, most of the MFIs charge the poor very high interest rates, ranging from 20-30%.

The government has acknowledged the fact that the microfinance institutions are taking advantage of the financial illiteracy of the rural population. Hence, the issue of charging high interest rates has been addressed in the recently introduced RBI guidelines. The cap of 12% on the margin of the MFIs will, eventually, lead to lower rate of interest on the loans disbursed to the poor.

6. Conclusion
Microfinance, since its inception, has received over-whelming response by the poor as they see it as a ray of hope for availing the financial services like microcredit. But, unfortunately, Microfinance has not received much attention from the government of various states and the government of India, despite the fact that microfinance is expected to play a vital role in realization of financial inclusion.

From the Andhra Pradesh Microfinance crisis, we have learnt that all the states should take policy initiatives so as to avert the crisis like this in the future. The microfinance bill which is to be tabled in the parliament soon, addresses this issue, providing the industry a much needed priority sector status. Issue of many MFIs charging high interest rate has been successfully addressed by the RBI Guidelines and the microfinance bill.
Coercive recovery methods and non-transparency in informing the borrower about the interest rates by various MFIs in Andhra Pradesh got attention of all the sections of society. This has dented the image of MFIs and the microfinance sector. This may play a spoilsport for the industry. Industry bodies like Sa-Dhan and MFIN should work to cleanse the image.

Microfinance can achieve its objective of financial coverage, financial independence and poverty eradication of the borrowers only if microfinance institutions and if the government, NGOs and the other organizations, and microfinance institutions work in tandem helping one another to address the prevailing issues in the industry like policy inaction by governments, non-uniformity of the rural outreach by the MFIs, more specifically, selecting the target population wisely and help them get the required skills to take up an economic activity that may help them lift them out of poverty. The role of government and of NGOs is of utmost importance here as they can help the poor acquire the skill-sets.

It is important to note that providing financial services means providing services like micro-pension, micro-insurance, thrift services too. Thrift services may prove beneficial for the entities that can accept deposits. The money collected from thrift services should reduce the cost of funds for the MFIs, and as they have to meet the regulation of a cap of 12% in margin enjoyed by them, the borrowers will be the beneficiary ultimately. MFIs need to innovate themselves to customize the insurance products as per the need of the poor.

7. References
5. Microfinance and its delivery Models. StudyMode.com
11. NABARD, Progress of SHG-Bank Linkage in India, various issues
13. Pradhan N C (2013), Persistence of Informal Credit in Rural India: Evidence from ‘All-India Debt and Investment Survey’ and Beyond, RBI Working Paper


16. www.microfinance india.org

17. www.scribd.com

18. www.snvworld.org

19. www.fijitimes.com

20. www.slideshare.net


22. www.ukessays.com

23. Raavi Radhika, “Self Help Groups in India”


25. Chaudhuri, “Demand and Supply Factors in the Regional Disparity of Micro Credit in India”, ijimt