

# Comparative Analysis of Conventional and Non-Conventional Microfinance

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## **Abstract**

*This study introduces the concept of interest free microfinance and also compare with conventional microfinance for poverty eradication in India. It briefly dwells on the various forms of microfinance models in which they exist in India and the current status of Microfinance in India. This research proposed to study both the microfinance systems in India and learning from the global experiments arrive at a system or a blending of the two systems which best fits Indian conditions and which is best for the purpose of poverty alleviation, a priority agenda in the country. For this purpose, going first to analyze global microfinance system, then to Indian microfinance system and finally doing the comparative analysis of both to arrive at the best solution for India for poverty alleviation is attempted in this research. The study is to focus the major beneficiaries i.e. the poor Indian for whom the microfinance is to be designed here. This study is based on the demographic, sociocultural and regulatory framework of Indian microfinance. Survey of conventional & non-conventional microfinance beneficiaries reveals the status of women earning, financial literacy, skills development, employment generation, household savings and poverty alleviation. Exploratory and cross section analysis and Independence t-test has used for analysis to identify the significant difference between IFMF and CMF on different aspects are used to understand the satisfaction level among conventional and non-conventional micro-finance arrangements. Therefore, this study is proposed to be 'microfinance customers' study.*

**Key words-** *interest free microfinance, conventional microfinance, poverty alleviation global experiments, Women Empowerment, Capacity Building, Skill Development*

## **Introduction**

Micro Finance is a tool of inclusive growth which provides the financial services and small credit to the poor in rural, semi urban or urban areas, for enabling them to raise their income levels and improve living standards. The emerging issues and challenges in India need a pragmatic framework to empower microfinance arrangements supporting, in turn, the

essential processes of entrepreneurship, capacity building, education, health, and hygiene etc through inclusive growth. The achievement of inclusive growth and overall development of the country is highly dependent on the poverty eradication from the country. However, the poverty eradication is not possible without the development of a community and households. As we know that the indicators of community development are employment generation, education development, women empowerment and equality and prosperity among the communities. Moreover, the development of family or household largely depends upon the women earning potential, financial literacy, skills development, savings, team building, poverty alleviation, rural and semi urban entrepreneur development and community building capabilities.

### **Purpose of Research**

The discussions in the study are mainly concerned with the empirical review of the impacts and influences of conventional and Interest-free microfinance on the life style of microfinance users before loan and after taken loan i.e. their income, expenditure, saving, entrepreneurship, consumption, women participation in earning in the India. This study analyzes factors like problem & procedure of taken loan, effects of the loan on their life style, income, consumption, family financial status, the impact of business and society which compare the potential of interest free microfinance with conventional microfinance system and their role in poverty alleviation. Now there is a need to consolidate, validate and broaden all these contextual and outdated tasks performed in different parts of India (or outside India) for the purpose of arriving at the current state of both the microfinance systems in India and knowing their role in poverty alleviation. It is also desirable to do a comparative study of interest free microfinance clients and conventional microfinance clients and getting the first-hand knowledge of its impact on the eradication of poverty in the Indian context.

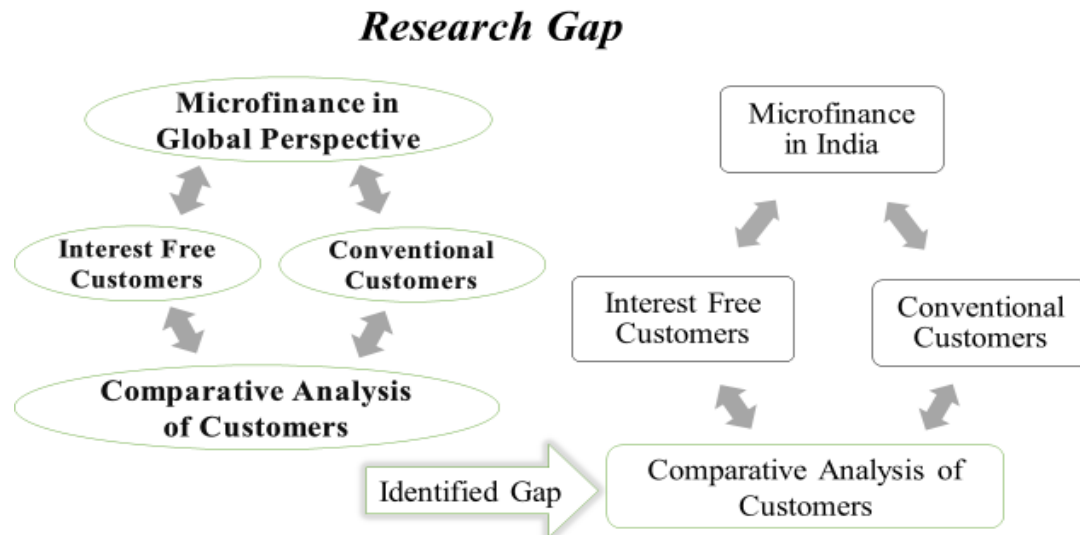
### **Review of literature**

Rogaly, B. (1996) In this study, the author aims to measure the potential of micro-finance institutions to reduce poverty. He suggested that before analyzing how to design anti-poverty financial intermediation the important work was to increase resource allocation in this sector by applying sustainable solutions. Further, he suggests that Micro-finance cannot be assumed to reduce poverty just because it achieves high levels of outreach for very poor people. Harper Malcolm (1998) suggested in his study "Profit for the Poor: Cases in microfinance" that the microfinance must be for every poor people and he also advocated that the ultimate aim for microfinance should be to become as widely available as any other consumer product. Ahmad, A. U. F., & Hassan, M. K. (2007) analyzed the regulatory and legal issues of Islamic banking in Bangladesh. One of the major issues of Bangladesh banking system was found to have the same policy and guidelines for Islamic and conventional banking.

### **Research Gap**

As a matter of fact, multiplicity and variety in the available researches made it difficult to identify the research gap or the comparative analysis of interest free microfinance and conventional microfinance systems. Keeping this in view the literature has been picked up here for review ranging from broad concept to narrow issues.

Fig 1: Research Gap



When we go through the literature on Indian microfinance system we find a number of studies which have analyzed conventional microfinance customers and some have focused on interest free microfinance customers. Microfinance and its role in poverty alleviation are also a subject of study in some researches.

### Specific Objectives

The broad objective of the research, as stated earlier, has been to assess the current status of different kinds of microfinance services in India and measure the impact and potential of its two kinds viz. conventional and interest free systems for the poverty alleviation in India. In the light of this the more specific objectives have been set which are as under:

1. To study the working model of Interest free and conventional microfinance systems
2. To study the products those are used by Interest free and conventional microfinance systems
3. To study the delivery process of Interest free and conventional microfinance systems
4. To measure the economic and social growth of Interest free and conventional microfinance beneficiaries after taking loan
5. To analyse the change in the livelihood of the customers of Interest free and conventional microfinance after taking loan
6. To analyse the performance of interest free and conventional microfinance and their role in poverty eradication
7. To analyse the problems and challenges for implementing interest free microfinance models in India

### Research Design

The conventional and interest free micro-finance are explained in the first phase of study. Thereafter, the supportive diagnostic test will be conducted for understanding the comparative advantage of the conventional and interest free micro-finance customers. The supportive data will be collected through primary as well as secondary sources. After finding the advantageous micro-finance service providers among both of the mention above

the study will further evaluate one of the government welfare scheme with conventional or interest free micro-finance whichever is leading the edge.

### Information Sources

Primary and secondary source of information were used in this study. Information was pooled from different government and non-government agencies within and outside India. Primary data collected through survey of microfinance users was also used. The information drawn from various sources was then analysed quantitatively and qualitatively.

### Survey Design

The primary data was drawn from a survey of microfinance users in the areas of 20 districts in 5 states namely UP, Bihar, Maharashtra, Karnataka and Kerala in India. This study aimed at a cross sectional analysis to identify the sections in which the use of conventional or interest free microfinance works, and also the sections in which the contribution of both the systems exists to explore the optimum combinations. Using stratified convenience sampling method, 2000 respondents were selected, 1000 from each microfinance system and the data. The cross sectional analysis was used to understand the problems, satisfaction level and impact of the government scheme. The stratified convenience sampling method was used to extract the responses of 450 households from the sample districts. A structured questionnaire was administered through the interviews with the respondents to collect the data.

Multiple choice answers had the exhaustive and mutually exclusive list of alternatives and dichotomous questions had the choice between yes or no. 'Likert Scale' questions on agreement/ satisfaction (on 5 points scale) were also used to measure the respondents' perceptions/ attitude This was used to measure the perceived impact of microfinance on the living standards or economic parameters. Three-point scale was also used to analyse the bipolar factors like change in expenditure in different heads.

To test the hypotheses in the study, specific statistical tools such as means, standard deviations and t-tests were applied. A cross-sectional view of demographic characteristics of respondents was facilitated by cross analysis with frequency tables. In both category, the respondents were very scattered and hence it was required to take their database the data was taken from the major areas of 20 districts in 5 states namely UP, Bihar, Maharashtra, Karnataka and Kerala in India which is shown in the following table.

### Hypotheses formulation

Tentative assumptions were made in order to test them through logical or empirical evidences. For the primary data analysis the following hypotheses were formulated for testing in research:

Ho1: there is no significant difference between interest free micro finance and conventional micro finance in the process of taking loan further divided into three factors i.e. (a) It is difficult to get micro finance, (b) Procedure is complicated, and (c) Delay in reciting of loan

Ho2: there is no significant difference between interest free micro finance and conventional micro finance economic aspects related to Amount of loan, Interest or processing fees, Easy to repay loan and Customers' need fulfillment.

Ho3: there is no significant difference between interest free micro finance and conventional micro finance in social impact related to Education, Poverty reduction, Employment generation, Women empowerment and Community development.

### Limitations of the Study

The study although covers the analysis of experiments, problems and prospects of different kinds of microfinance throughout the country and around the world but the comparative analysis of the two types of microfinance in terms of its coverage and impact is mainly confined to selected districts of selected states as the primary data was collect only from these 20 district. The investigation through sample survey was restricted to the selected respondents in various areas of 20 districts.

### Analysis and Interpretation

**Table 1: Hypotheses Testing**

|  | t      | P. val | Mean Difference | S.E.D | 95% Confidence Interval of the Difference |        |
|--|--------|--------|-----------------|-------|---|--------|
|  |        |        |                 |       | Lower                                     | Upper  |
| It is difficult to get micro finance               | -16.66 | 0.00   | -1.83           | 0.110 | -2.047                                    | -1.613 |
| Procedure is complicated                           | -15.12 | 0.00   | -1.74           | 0.115 | -1.967                                    | -1.513 |
| Delay in reciting of loan                          | -15.64 | 0.00   | -1.76           | 0.113 | -1.982                                    | -1.538 |
| Amount of loan sanction is low                     | -4.86  | 0.00   | -0.76           | 0.156 | -1.069                                    | -0.451 |
| Problem of high processing fees                    | -15.99 | 0.00   | -1.87           | 0.117 | -2.101                                    | -1.639 |
| It is easy to repay micro finance                  | 9.85   | 0.00   | 1.23            | 0.125 | 0.984                                     | 1.476  |
| Do you think this model fulfill your requirement   | 10.53  | 0.00   | 1.35            | 0.128 | 1.097                                     | 1.603  |
| Do you think it will help in education development | 2.21   | 0.028  | 0.31            | 0.140 | 0.033                                     | 0.587  |
| Do you think it will help to reduce poverty        | 10.08  | 0.00   | 1.26            | 0.125 | 1.013                                     | 1.507  |
| Do you think it will help to employment generation | 7.00   | 0.00   | 0.95            | 0.136 | 0.682                                     | 1.218  |
| Do you think it will help to women empowerment     | 4.75   | 0.00   | 0.65            | 0.137 | 0.380                                     | 0.920  |
| Do you think it will help to community development | 5.62   | 0.00   | 0.76            | 0.135 | 0.493                                     | 1.027  |

Based on the above analysis the formulated hypotheses can test. It is mention below:

Ho1: there is no significant difference in the Process of taking loan between IFMF with CMF.

Independence t-test has used for analysis to identify the significant difference between IFMF and CMF on different aspects. There are three variables taken in the factor process of taking loan i.e. difficult to get micro finance, procedure is complicated and delay in reciting of loan. On the hypothesis that Ho: there is no significant difference in the procedure of getting loan between IFMF and CMF. According to the result that the p value  $p < 0.05$  so we reject the null hypothesis of no difference between the IFMF and CMF in process of taking loan. Hypothesis (Ho1) stands rejected.

Ho2: there is no significant difference between IFMF and CMF in Economic Aspects of loan. We reject the null hypothesis because ( $p < 0.05$ ) of no difference between the IFMF and CMF in economic aspects. This hypothesis (Ho2) also stands rejected.

Ho3: there is no significant difference between IFMF and CMF in Social Impact.

As a result ( $p < 0.05$ ) then we reject the null hypothesis of no difference between the IFMF and CMF in social aspects. Therefore, this hypothesis (Ho3) has also rejected.

The examination of these three aspects from the concerned tables are showing results through statistical tools like mean and standard deviation and t test from the respondents. It indicates that the interest free micro finance customers are more satisfied than conventional micro finance customers

### Findings

Indian microfinance system largely works to facilitate the women. Many microfinance institutions were found during the course of data collection, which are exclusively working for women. The existence of female dominance was much higher in CMF setup in comparison to that of IFMF. Majority of male respondents under the study were representing women beneficiaries. The family size of most of the respondents was found to be large. Its justification is given by Sampson and Laud (1994) as large family size meant more expenditure and fewer saving which could cause poverty. Large part of the respondents belonged to the mature age group in both the microfinance setups. About 80% of the respondents were literate but less than graduate. According to Solga and Heike (2002) less educated people had decreasing employment opportunities. More than 90% families were dependent on the employment of one or two individuals in the family under both of the microfinance arrangements. The borrowers were largely either self-employed or engaged in private jobs. The dependency on additional finance was higher among families of less income or irregular income generation capacity. Nuclear families were more likely to face problem of financial crunch than joint families. Around 85% of respondents were APL in both of the microfinance setups. It was a technical issue arising due to political decisions in the past; MFIs wanted to ignore any chances of loan waiver because of BPL category. The penetration of interest free microfinance was lesser in rural areas. There were majority of borrowers in the CMF living in kaccha or semi-kachcha houses while presence of interest free respondents was comparatively high in urban locations. The absence of rate of interest on borrowed amount and lesser processing charges were making IFMF more attractive than CMF. IFMF facilitated 1-2 years loan period on the higher side while the spread of loan period in different categories was well balanced under CMF. In general, the respondents were taking loans for situational or occasional reasons. The purpose of taking loan for business support was not impressive under both the microfinance arrangements.

### Implications of the study

India like many of the developing countries is facing the problem of extreme poverty particularly in the rural or semi urban areas where almost 80% of our population lives.(Government of India, 2013) According to the data of planning commission government of India, while the percentage of people below poverty line in India fell gradually the number of the poor barely changed over the last four decades (321.3 million in 1973,322.9 million in 1983, 320.3 million in 1993–94 to 301.7 million in 2003–04 and 2013, 269.3 million). Thus, even after 60 years of independence, over a quarter of our population still remains poor. A large section of Indian population is still in existence which is surviving well below the standard of living who can subsequently become active participants in the larger economy. It has been suggested that interest free microfinance could be a powerful model that contribute to the success of poverty alleviation programs. Therefore, commercial banks along with conventional microfinance should also start interest free microfinance model as they have expert human resource and proper infrastructure, this can assist in the development of this industry as a mass tool for poverty alleviation. The irony is that with interest free microfinance, its target group is most ignorant part of the society. Therefore, a massive campaign of advertisement and consultancy is required for it. Indian Government should also take some concrete steps for the establishment of interest free microfinance by establishing some banks for the application of interest free microfinance in different part of the country. Innovations of interest free



microfinance model should be firmly based on Islamic (sharia) system so it creates to explore the specific market opportunities, providing medium or small amounts of credit at reasonable fees by simple interest method thereby providing people with the readiness and know-how an opportunity to set up a small business and stable inflow of cash, security to financial agencies for prompt recovery.

### Recommendations

There is a need to develop a collaborative structure where these different functions could be catered by one single co-ordinating department or ministry. The target of such department or ministry should be to alleviate poverty by empowering rural or urban poor. Microfinance Institutions should work with such co-coordinating agency. Government should start an index to rate the performance of MFIs. The criteria to get maximum rating should be based on basic factors such as borrowers' productivity, loan productivity, penetration of scheme, quality service, women empowerment, healthy life, nutrition intake, employment generation, innovation, poverty alleviation etc. It is easy to get the data on such parameters as most of the borrowers may be attached with the government schemes.

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