

# **TRANSFORMATIONAL LEADERSHIP IN THE INDIAN MICROFINANCE ORGANIZATION**

## **Introduction**

During the last two decades, microfinance has received considerable public and institutional attention – accumulating in the Nobel Peace Prize in 2006 – and is today presented as the “magic bullet” for fighting global poverty. A country with a particularly interesting microfinance sector is India; in 2008, the total outstanding microfinance loans amounted to USD 8 billion, and more than 50% of all low-income households are covered by some form of microfinance product (Srinivasan, 2009). Yet, while Indian MFOs are assumed to help bring the country’s poor out of poverty, and thereby contribute to reaching the Millennium Development Goals, private capital is pouring into the sector and supporters have started to ask for financial returns on their funds. MFOs are hence expected to balance between having a social mission on the one hand, and running a profitable operation on the other.

A first natural question is to ask whether the corporatized MFO manages to stay on track and deliver both on the social and on the financial side, if it is “mission drifting” or not. “Mission drift” is related to the performance of the MFO, mainly measured in how well the organization succeeds in reaching poor borrowers who lack access to formal financial institutions (Copestake, 2007). With an increased pressure from shareholders asking for returns and good financial results, serving the poor without making too many compromises undoubtedly becomes a great challenge.

Although the right policy documents, good governance procedures, and legal frameworks may contribute to ensuring that the social mission is safeguarded, it is here argued that leadership will be decisive in the future performance of MFOs, significantly impacting their “double bottom line”. However, given the complex organizational environment, internal tensions, and rather unique organizational traits, the Indian MFO requires a specific kind of leadership. I here suggest that what has been labelled transformational leadership embodies many of the key features that so desperately are needed in the Indian microfinance sector. Below is an attempt to describe transformational leadership and its potential impacts on follower motivation and performance, as well as explain why this type of leadership is particularly well suited, or even desirable, for the MFO.

## **Transformational leadership**

Burns developed two constructs of leadership: the transactional and the transformational. These two leadership forms are opposing and each represent an extreme. However, when measuring leadership with the Multifactor Leadership Questionnaire, every leader displays a frequency of both the transactional and transformational factors, but each leader’s profile involves more of one and less of the other. Although this specific paper is concerned with the latter construct – transformational leadership – the basic ideas behind the transactional form deserve mentioning. Transactional leadership occurs when the leader and the follower makes an exchange of valued things, e.g. votes, money, goods, or even hospitality for a willingness

to listen to one's troubles. This type of leadership is hence a bargaining process – not more, not less – catering to the followers' immediate self-interests. However, when the transactional leader emphasizes what your country can do for you, the transformational leader asks what you can do for your country (Bass, 1999).

Transformational leadership occurs when leaders and followers engage in a mutual process, raising one another to higher levels of motivation and morality. In doing so, the purposes of the leader and the follower become fused. Burns argued that transforming leaders encourage followers to embrace moral values such as justice, equality, and the interests of the collective (van Knippenberg, De Cremer and van Knippenberg, 2006). Transforming leaders are also suggested to actively develop followers into leaders (Avolio and Gardner, 2005). Transformational leadership presupposes a “self” that is connected to friends, family, and community whose welfare may be more important to the leader than his/her own welfare. The individual is thus seen as a social being situated in a context and guided by social norms and cultural beliefs (Bass and Steidlmeier, 1999).

Transformational leadership incorporates four sub-dimensions: (1) charisma or idealized influence; (2) inspirational motivation; (3) individualized consideration; and (4) intellectual stimulation. Idealized influence, that is, being influential about ideals, involves leadership that is envisioning, confident, sets high standards for emulation, often has a spiritual dimension, and holds high moral values in the influence process. This renders a leader, whose behaviour sets a moral example, and thereby gaining respect and trust among his/her followers.

Inspirational motivation is closely connected to the idealized influence and involves leadership with a clear vision that appears appealing and inspiring to followers. Leaders who have inspirational motivation challenge followers with high standards, are optimistic about the future, and, perhaps most importantly, provide meaning for the everyday work. This in turn results in followers with a strong sense of purpose and meaning. The leader's ability to communicate the common goals and vision in an understandable, precise, powerful, and engaging way is here central (Bass and Steidlmeier, 1999). Compared to other forms of leadership, the transforming leader is also a very charismatic person who is able to dazzle his/her surrounding (Avolio and Gardner, 2005).

Individualized consideration underscores altruism in leadership, in order to separate leadership from authoritarian control. The transforming leader treats the follower as an individual and provides coaching, mentoring and growth opportunities (Bass and Steidlmeier, 1999).

Finally, a leader who is able to intellectually stimulate has an open approach to processes of situation evaluation, vision formulation, and patterns of implementation. This openness has a transcendent and spiritual dimension that helps followers to question underlying assumptions, come up with constructive solution, and think out of the box (Bass and Steidlmeier, 1999).

Related to the above is also the issue of fairness. Transformational leadership is seen among the followers as more procedurally fair compared to other leadership forms, contributing to creating trust in the leader and strong organizational commitment (van Knippenberg, De Cremer and van Knippenberg, 2006). Further, in order to get followers to accept changes in the organization, leaders can exercise their authority via fair procedures. This relationship is

especially strong among those followers whose identification with the organization is high (Tyler and De Cremer, 2005).

Since leadership occurs in a dynamic and complex context, this must also be incorporated in the analysis of leadership development and effectiveness:

“leadership style is a dependent variable which depends on ‘something else’. That ‘something else’ is the historic context in which they [leaders] arise, the setting in which they function. . . They are an integral part of the system, subject to the forces that affect the system” (Avolio and Gardner, 2005, p. 327).

As suggested by Avolio and Gardner (2005), transformational leadership is particularly suited for organizational environments characterized by uncertainty, inclusion, and an ethics.

Transforming leaders produce in their followers a higher: salience of the collective identity in their self-concept; sense of consistency between their self-concept and their actions on behalf of the leader and the collective; level of self-esteem; and similarity between their self-concept and their perception of the leader. This has strong and enduring behavioural consequences, resulting in increased engagement of the self, self-monitoring, self-evaluation, and motivation. Ultimately, this leads to increased commitment to the vision and mission of the leader (Bass, 1999).

### **Indian microfinance**

In broad, microfinance can be defined as the provision of financial services such as credits, savings, and insurances to low-income people in developing nations who lack traditional collateral and who do not have access to the formal financial system. A vast majority of Indian microfinance clients are women, and many microfinance providers have an outspoken strategy to target women only. Microfinance loans are often given to different group constellations, e.g. self help groups, joint liability groups, or solidarity groups, as opposed to individuals, and the group is responsible for repaying the loan. The development and existence of social capital is deemed critical to the success of microfinance (Leigh Anderson and Locker, 2002). Social capital is maintained as making microcredit lending feasible by functioning as an individual collateral substitute where peer pressure, also referred to as “social collateral”, is accepted in lieu of the physical collateral normally required in traditional banking (Reinke, 1998).

Indian microfinance is undergoing rapid change transformation. Most early MFOs were non-profit nongovernmental organisations, offering subsidised interest rates covered by soft loans and donations. However, because of the commercialization trend, there are signs of a mounting number of commercially oriented MFOs being established (Mehta, 2004). MFOs have started to move away from a dependency on donors and subsidies, to an arena where they manage on a business basis as part of the regulated financial system (Drake and Rhyne, 2002, p. 4). Profits are viewed as not only acceptable, but essential, because profits are presumed to attract private investment to the sector (Conning, 1999). However, critics to this trend describe the current developments more bluntly:

“Many of the [nongovernmental organizations] have completely changed their strategy of social intermediation – from issue-based activism to financial delivery (...) Some of them are on the way

to achieving the ultimate goal of becoming formally established, self-sustaining, commercial banks, the most “exciting” indication that their [microfinance] programmes have come to stay” (Nair, 2001, p. 402).

With commercialization also follows more business-like characteristics, demonstrated in, for instance, an emphasis on financial reports and figures. New recruits to senior levels are today likely to come from business schools rather than from the field of social work, compensation levels for professionals are increasing, and reward systems tied to loan-output is common. The rhetoric has also changed into a more corporate one, where “client”, “joint liability group”, and “an untapped customer segment” have replaced concepts such as “target group”, “self help group”, and “beneficiaries unable to access formal markets”. In addition, many MFOs are today promoted by entrepreneurs with mainstream banking, consulting, or corporate experience, rather than by the traditional development workers (George, Maheswari, and Pandian, 2007; Nair, 2001).

## Discussion

In light of the above, what are the potential consequences of introducing transformational leadership in the Indian MFO, struggling to combine profitability with a social agenda, and, further, why is this leadership construct so suitable for MFOs? First, as described above, Indian microfinance is undergoing rapid change transformation from a non-profit domain and into a semi-profit, more corporate one. The organizational environment is marked by uncertainty and complexity. Such changes may give rise to much internal tension and dispute

As MFOs engage in substantial organizational and strategic changes to accommodate the transformation to a more corporate form, it is not unlikely that conflicts arise regarding the appropriate course of action. At times, conflicting views and positions may rest on different beliefs and aspirations about what the organization is and should be. For instance, people in different organizational sections and levels may develop diverging views and aspirations, which may give rise to internal tensions. Hence, in order to motivate and get all followers onboard the change train, there is evident need of a transforming leader.

As already noted, MFOs are partly mission driven organizations expected to have a positive impact on poverty and women empowerment. Some MFOs, especially those working with clear social issues such as women empowerment may even be categorized as value-based organizations. A value can be defined as “an enduring belief that a specific mode of conduct or end-state of existence is personally or socially preferable to an opposite or converse mode of conduct or end-state of existence” (Rokeach, 1973, p. 5). Transformational leadership emphasizes the importance of having a clear mission and vision in order to create meaning and purpose.

The next step is then to be able to articulate the same mission and vision to the followers. The mission statements of many non-profit organization may sometimes be vague and difficult to translate into practical actions; hence, communicating the message and turning into strategy and practice may here be a challenge. Also, if the leader is unable to create meaning around the MFO’s mission and vision and thereafter communicate how these general ideas will be transformed into practice, there is an evident risk of the followers drowning in big world problems.

Like most non-profit organizations, MFOs are unable to pay salaries that compete with traditional banking. At the same time, MFOs want to attract experienced and committed professionals, since they have to implement similar functions and systems as formal banks. A transforming leader may be able to attract and retain the right kind of people without offering the same reward system as the corporate sector and thereafter unleash tremendous energy from the followers. Within the organization, there is likely to be a conflict between social workers on the one hand and business people on the other in how to plan, execute and talk about things. By creating common goals and purposes, the transforming leader may however be able to solve such differences. In doing so, it is, however, central that the leader sets a good example and work long and hard days, and that the compensation for the leader himself/herself is moderate and considered reasonable or even modest among the followers.

Working in an MFO means meeting and dealing with poor, often illiterate, rural women. In addition, MFOs are by nature rather decentralized and each loan-officer typically has a lot of power. The loan-officer should thus have a responsible and mature way since he/she will be looked upon with much respect and esteem and since there is a risk of misusing power. In an organization where the leader fosters the followers to become leaders, this will be easier to attain.

Further, as discussed above, building social capital is critical to the success of microfinance. When individuals engage in networks they develop a framework for common values and beliefs, which in turn can generate trust and norms of reciprocity – labelled social capital – and in thereafter result in collective action (Rankin, 2002). It thus becomes the loan-officer's task to contribute to building bonds between the group members. This underpins the central idea in transformational leadership that the leader transforms the follower into a leader. This shows the importance of the leader conveying how you can make an impact in circles beyond your direct action area by, e.g. being a good model for other MFOs.

A commonly cited example of a transforming leader is Gandhi, who transformed the lives of millions of Indians (Burns, 1978). In the Indian context, Gandhi is of course an especially important role model; however, in the non-profit sector, he is close to God. This further reinforces the idea of the leader as an altruistic, community-oriented person who gives up himself/herself for others. Spirituality also plays a role here as many spiritual leaders represent true leadership and closeness with the followers while business leaders and politicians represent corruption and nepotism. In such context, it becomes even more central to “walk the talk”.

Finally, a challenge for the leader is to contribute to creating a united organizational identity to which the followers can subscribe. A cornerstone of such identity must be the altruistic dimension of the MFO. In their interactions with poor communities, MFO employees must show justice, equality, and the interests of the collective.

## REFERENCES

- Avolio, Bruce J. and Gardner, William L. 2005, Authentic leadership development: Getting to the root of positive forms of leadership. *Leadership Quarterly*, 16:315-338.
- Bass, Bernard M. and Steidlmeier, Paul 1999, Ethics, Character, and Authentic Transformational Leadership Behaviour. *Leadership Quarterly*, 10(2):181–217.
- Bass, Bernard M. 1999, Two Decades of Research and Development in Transformational Leadership. *European Journal of Work and Organizational Psychology*, 8(1):9-32.
- Burns, James 1978, Transactional and transforming leadership. In Robinson Hickman, Gill (ed.) 1998, *Leading organizations: Perspectives for a new era*. Thousand Oaks, Calif.: Sage Publications.
- Conning, Jonathan 1999, Outreach, sustainability and leverage in monitored and peer-monitored lending. *Journal of Development Economics*, 60:51-77.
- Copestake, James 2007, Mainstreaming microfinance: Social performance management or mission drift?. *World Development*, 35(10):1721-1738.
- Drake, Deborah and Rhyne, Elisabeth (eds.) 2002, *The commercialisation of microfinance: Balancing business and development*. Bloomfield, CT: Kumarian Press Inc.
- George, M.; Maheswari, A. and Pandian, N. 2007, *Inverting the pyramid: The changing face of Indian microfinance*. Sponsored by IFC and published by Intellect.
- Leigh Anderson, C. and Locker, L. 2002, Microcredit, social capital, and common pool resources. *World Development*, 30(1):95-105.
- Mehta, Nina 2004, The loan rangers eye the capital markets. *Financial Engineering News*, 40.
- Nair, Tara S. 2001, Institutionalising microfinance in India: An overview of strategic issues. *Economic and Political Weekly*, 36(4):399-404.
- Rankin, K.N. 2002, Social capital, microfinance, and the politics of development. *Feminist Economics*, 8(1):1-24.
- Reinke, J. 1998, How to lend like mad and make a profit. *Journal of Development Studies*, 34(3):44-58.
- Rokeach, Milton 1973, *The nature of human values*. New York: Free Press.
- Srinivasan, N. 2009, *Microfinance India: State of the Sector Report 2008*.
- Tyler, T.R. and De Cremer, D. 2005, Process-based leadership: Fair procedures and reactions to organizational change. *Leadership Quarterly*, 16:529-545.

van Knippenberg, D.; De Cremer, D. and van Knippenberg, B. 2007, Leadership and fairness: The state of the art. *European Journal of Work and Organizational Psychology*, 16:113-140.