CHAPTER-II

REVIEW OF LITERATURE

1.1 DEFINING FINANCIAL INCLUSION

Financial inclusion is defined as the timely delivery of financial services to underprivileged sections of society. This simple definition includes two main dimensions (United Nations, 2006). Firstly, financial inclusion refers to a client having access to a variety of formal financial services, from simple credit and saving services to the more complex instruments like insurance and pensions. Secondly, financial inclusion assumes that clients have access to more than one financial services provider, thus ensuring a competitive environment. Taking this definition forward, financial exclusion can be defined as the inability of the disadvantaged to access financial services. As many as twenty-two obstacles has been identified that could lead to financial exclusion. The important ones are listed below:

I. Geography (limiting physical access)
II. Regulations (lack of formal identification proof or of appropriate products for poor households)
III. Psychology
IV. Lack of information on various products and procedures
V. Low financial acumen meaning low income and poor financial discipline

In India, the finance experts define financial inclusion as the process of ensuring access to timely and adequate credit and financial services by vulnerable groups at an affordable cost” (Union Budget, 2007-2008). Some others define it as the process of ensuring access to financial services and timely, adequate credit where needed, to vulnerable groups such as weaker sections and low income groups, at an affordable cost (Report of the Committee for Financial Inclusion, 2008).
In the above two definition’s the term range of financial services’ is more biased towards the credit component. Basu (2005), Dev (2006) and Mohan (2006) stressed this fact that until recently, the discussion on financial inclusion in policy and academic discussions revolved around the offering of institutional credit at the expense of providing savings, in spite of evidence that poor people save. They opined that if this trend continues it will lead to a situation of over-indebtedness and wasteful use of scarce resources (Committee for Financial Sector Reforms, 2008).

1.2 Financial Inclusion- Measurement

Often we come across the idea of breadth of financial services. The breadth of financial services refers to the outreach of financial services in a country’s economy. Breadth particularly measures the number of people having access to financial services. No doubt, that the financial inclusion should signify access to a range of different financial services, but the percentage of people in a given occupancy area with access to a bank account would be the best measuring stick for breadth of financial services, (Beck & De la Torre, 2006).

Mohan (2006) reports that the above measurement approach it can be assumed that a bank account enables poor family to perform important financial functions such as saving money safely outside the house, accessing credit, making loan or premium payments, and transferring money. Littlefield et al, (2006) proposes that a bank account should determine access to and usage of many other financial services. However in developing nations it is difficult to discern access to savings accounts as data on small deposits and borrowings is not easily accessible and in most cases it is not readily available. While in developed nations almost everyone has access to banking services, in less developed countries, access is often limited to small segments of the population.
1.3 Why is Financial Inclusion Important?

One of the most important empirical relationships revealed in the last decade has been the establishment of the causal link between financial depth and growth (Honohan, 2004). Policy-makers would do well to recognise the relationships between well-developed financial systems and economic growth as well as economic growth and poverty reduction.

Studies conducted by Beck and De la Torre (2006) shows that small firms in countries with greater outreach and access face lower financing obstacles and grow at a higher rate. The same is referred as the Schumpeterian process of ‘creative destruction’ which means that a well-developed financial system is able to allocate resources to efficient newcomers. Further it is believed that a strong financial system supports expansion in the market and competition for existing firms. It also ensures that poor households and small are self-dependent and need not depend on intermediaries. In contrast Rajan & Zingales, (2003) reports that an underdeveloped financial system can be collegial, conservative and hostile to poor or small entrepreneurs.

Li et al, (1997) proposes that indirect evidence validates the linkages between financial depth, growth, and poverty improvement. Specifically, financial depth plays a role in depressing inequality and growing the income of the bottom 80% of the population. Dehijia & Gatti, (2002) as cited in Honohan (2004) reveals that child labour, which is positively linked with poverty, has been found to be influenced by the financial depth of a country. The reason for the same could be the poor households in countries that have well-developed financial systems in place, are less susceptible to economic surprises.

It has been theorised that in government-controlled banking systems, formal credit is disposed to exclusive class, discouraging the efforts to progress rural development. In a pivotal study looking at India’s immense banking system, Burgess and Pande (2003) reports that the rural bank expansion programme, authorized by the Indian government
from 1977 – 1990, can explain roughly the decrease in poverty from 61% in 1967 to 31% in 2000. Further, they found that rural bank expansion was linked with non-agricultural growth. These results establish that an increase in bank branches and the resultant improvements in physical access were significant in reaching out to distant areas and decreasing poverty. Although the underlying link between financial depth growth is well-established, the link between the breadth of financial services and growth is less clear reports Beck & de la Torre (2006). The four vital functions of finance are: assembling savings; assigning capital; monitoring the use of credit funds by beneficiaries and transforming risk by pooling and repacking it. These functions need to be strengthened by legal, regulatory, and informational structures that improve the quality of the financial system, which cannot be measured just by looking at the scale or the breadth of the system (Honohan, 2004). Furthermore, as discussed earlier, broad access does not always indicate usage.

1.4 SOCIAL BANKING IN INDIA

In the 1950s, a widespread network of rural cooperative banks was established with the intent of leveraging country-wide deposits and savings towards agriculture and small-scale cottage industries. Nevertheless, this venture failed to become visible as bank credit was directed to big corporations that already had majority stakes in the banks. As a result, banks were nationalised by the RBI in 1969 with the following objectives:

- Check the control of banks by a few corporations;
- Systematize savings from remote and rural regions;
- Use the deposits gathered by banks to achieve impartial growth; and
- Focus on priority sectors like agriculture and small industry (Basu, 2005)

RBI restricted that at least 40% of bank lending should go towards the Priority Sector, out of which 25% had to be drawn-out to the weaker sections within the Priority Sector. Other features included the ‘Service Area Approach’ (SAA) where in a single
bank was allocated 15-20 villages, after which other banks could set up branches upon obtaining the initial bank’s sanction. Similarly, the 1:4 license rule established in 1977 made it mandatory that a bank could open a branch in a banked location only after opening four branches in unbanked locations.

Burgess and Pande (2003), Leeladhar (2006), Basu (2005) reports that the sector liberalisation has headed to changes particularly, with respect to augmented competition and deregulation. Interest rates are no longer regulated, although interest rates on loans under Rs. 2 lakhs are still subject to a cap equal to the prime lending rate, while short term deposits are subject to a floor.

This style, discussed to as ‘social’ or ‘development’ banking, hinged on the hypothesis that small, rural, and poor borrowers were not bankable and would be neglected by banks unless obliged by policy. From this viewpoint formal finance could be provided to the poor only after banks were forced by the government (Burgess and Pande, 2003). As a result, until recent years, over 73% of all commercial banking assets, and 52.4% of the assets of all financial institutions are controlled by the nationalised banks and regional rural banks (RRBs)

1.5 POINTERS OF FINANCIAL DEPTH IN INDIA

The bank nationalisation programme and the government’s efforts to increase bank branches in rural and isolated areas has resulted in extensive national distribution of financial services compared to other developing economies (Basu, 2006). There are over 32,000 rural bank branches (with a total of 68,000 rural and urban branches) including public and private sector banks and RRBs. The post office system comprises around 154,000 post office branches and has about 114 million savings accounts and services 110 million money orders.

During the period between 1973 and 1985, bank branches in rural areas developed at an average yearly rate of 15.2% which is nearly double the growth rate of branches in semi-urban (6.4%), urban (7.8%), and metropolitan (7.5%) areas. Each rural bank attends
an average population of 16,000 and if including rural cooperative banks, this comes to about 12,800 - almost on equivalence with Indonesia and Mexico. India’s huge network of banks is echoed by its low average geographic area per branch, compared to other countries. The level of insurance diffusion, measured as premium as a percentage of GDP, was also a bit higher in India than in Brazil, China, Indonesia, and Mexico.

1.6 INDICATORS OF FINANCIAL INCLUSION IN INDIA

1.6.1 ACCESS TO CREDIT

As discussed above, one of the key objectives of India’s banking system has been the extension of institutional credit to countryside, where the bulk of the poor live. It would appear that while developments have been made since the 1960s towards greater inclusion, an extensive majority of India’s rural poor still lack access to proper finance. We have already discussed that in spite of the vast banking setup; only about 30% of Indians have a savings account. Below, we discuss at some of the concerns related to access to credit.

- The diminishing share of non-institutional sources of credit, most remarkably the decrease in the share of moneylenders as a source of finance. Disturbingly, this trend overturned between 1991 and 2002, with the share of moneylenders increasing from 17.5% in 1991 to 26.8%. Evidently, the expansion of financial services in rural areas has tumbled short of demand in the last decade (Mohan, 2006).

- The Rural Finance Access Survey (RFAS, 2003) piloted jointly by the NCAER and the World Bank also offers us with some answers as to which sectors of rural borrowers have access to formal credit and why. They maintained that, the most common sources for rural households with access to credit are commercial banks, rather than RRBs (Basu, 2005).
Commercial banks encompass over half the deposits, while RRBs only account for 34%. Cooperatives and post office branches are in fact not a very noteworthy foundation of finance for rural households. Many studies have found that the level of income and occupation are key factors of access to credit and savings (Peachy & Roe, 2006).

The RFAS-2003 approves this by establishing that farmers with bigger landholdings get advantage of greater access to financial services than smaller farmers (Basu, 2005). Statistics show that 44% of large farmers have access to credit, and 66% of them have a savings account. In severe contrast, 87% of marginal farmers do not have access to a savings account, and 71% cannot access credit. Commercial households, that is, households engaged in some form of micro-enterprise, are also wanting for finance.

Thus, the system gives the impression to be tilted in favour of richer rural borrowers; The report also shows that regardless of the overall decrease of moneylenders as a source of credit, in the absence of formal sources of credit, rural borrowers still turn to the casual borrowing. Around 44% of measured households reported having borrowed money casually at least once in the preceding year at an average interest rate of 48% per annum (Basu, 2005).

Informal loaning is most noteworthy for marginal farming households, followed by small and commercial households, which supplements the data that marginal farmers are the most underprivileged of formal credit (Basu, 2005). While evidence specifies that poor households often borrow from both formal and informal sources (United Nations, 2006), in this case, poor households are able to borrow prodigiously from informal sources.
1.6.2 BARRIERS TO ACCESS

A survey in 2007, reveals that 81% of the 63,016 household surveyed save. Yet in spite of this extensive financial behaviour, only 59% of the adult population, or 30% of the total population, has access to a savings account. Why are poor farmers and others incapable to access credit or gain deposit accounts from the formal financial sector?

The survey carried by Invest India Market Solutions (IIMS) in 2007 on one lakh respondents to reveal the characteristics of respondents with bank account had the following findings. There is a strong relation between annual income and ownership of bank accounts by occupation group. The data showed that in both urban and rural areas, banks are able to cover almost all individuals with annual income above Rs. two lakh. It would look that even differences in bank exposure between states can be explained by the differences in income and savings among the numerous states. For example, in comparing Kerala and Bihar, Kerala has one of the highest rates of savings in India and subsequently also one of the highest proportions of bank accounts. Contrariwise, Bihar, where savings are extremely low, also has a much lower proportion of bank accounts (Committee for Financial Sector Reforms, 2008). As mentioned earlier, while this does not establish connectedness, it does show a strong association between low incomes and access to formal finance. A lack of legal documentation is another major obstacle that poor households employed in the informal sector face when trying to open any kind of bank account, be it savings, credit, or current.

- Poor individuals, specifically women and other disregarded groups, rarely have legal proof of identity, address or employment. This concentrates obtaining formal credit even more difficult. Indication from around the world also shows that cultural norms, as well as age and gender, are important factors of access to finance. A survey of bank managers in Madhya Pradesh discovered a perception that women borrowers were more trustworthy and less of a default risk (United Nations, 2006).
However, a larger percentage still thought that women were simply being used by men to gain loans. Socially, poor households may be discouraged from using banks regularly, since banks tend to be structurally and culturally designed to serve a wealthier patrons. Kempson (2006) refers to the psychological and cultural hindrances which prevent people from using banks. Rural households may feel scared by banks and develop a belief that banks are envisioned for more educated and richer individuals. This self-exclusion by low-income households may be as significant a cause for elimination as direct exclusion by banks. Lastly, banks have historically endorsed banking transactions specifically at bank branches. As erstwhile microfinance practice has shown, poor clients, especially in rural areas, may react better to ‘doorstep’ banking that is banking which takes place at a location which is both convenient and comfortable, usually the client’s home. Basu (2005) reveals that currently banks do not have the choice to recruit local staff. This might allow the bank staff to better respond to client needs. Basu (2005, 2006) directs our attention to two additional roadblocks that rural households face when attempting to take a loan from a bank.

Firstly, banks need security to make loans and RFAS (2003) shows that almost 90% of bank and RRB debtors put up collateral. Given that land is the most common form of collateral in rural areas and poor households’ legal/documentation issues, a sizable proportion of the poor is let off (United Nations, 2006).

Excitingly, banks normally do not collect upon default, thus collateralising loans has rare advantages compared to the disadvantage of added costs. Secondly, the survey shows that bribes, ranging from 10% to 20% of the loan, are common in all formal financial institutions including banks, RRBs and credit cooperatives. The average time taken to process a loan application is almost 33 weeks in a commercial bank. Such burdensome and costly processes make it unpleasant for households to depend on on formal finance.
As discussed before, banks have also been unable to open savings accounts for the majority of poor people. A CGAP (2002) donor briefly recognizes the following four crucial features of a savings product viz., security, low transaction costs, appropriate design, and interest rates. A savings account can thus play a significant role in assisting poor people save safely and steadily. However, the design of such products should be matched to the needs of the poor. Even though the poor have need of flexible products and services (United Nations, 2006; Basu 2005), bank savings accounts often have high minimum balances (Peachey & Roe, 2006). Most poor people around the world are simply eyeing for products that integrate the following morals: “security; convenience; liquidity; confidentiality; products fitting for their needs; helpful, friendly, and respectful service; returns; and potential access to loans” (CGAP Interview with Steve Peachy, undated). However, the previous section has recognised the varied and unwieldy barriers which keep the poor excluded. In acknowledgement of these barriers in India, RBI announced several changes to banking operations in 2005-06.

1.7 POLICY CHANGES TO INCREASE FINANCIAL INCLUSION

The RBI’s Annual Policy Statement of April 2005 was widely presented to tackle the topic of financial inclusion, announcing that ‘banking policies inclined to exclude rather than appeal vast sections of the population.’ To counter this truth, three major moves were introduced, sparking a transformed commitment to financial inclusion. The first major step recognized a ‘No Frills’ elementary banking account, which requires a zero or particularly small minimum balance. While the nature and number of transactions through this account can be regulated, banks are required to send these restrictions to customers at the time of account opening. Further, banks were asked to sufficiently publicise these accounts.

The promotion and diffusion of the Kisan Credit Card (KCC), an important means to decrease transaction costs, has also been given due importance. KCC was introduced in 1998-99 with over 30 million cards issued by 2003; however, RFAS 2003 showed that use of the card was sporadic with larger farmers reporting the higher usages. Secondly,
the RBI has condensed some of the transaction costs incurred in opening bank accounts by reducing the strictness of the ‘Know Your Customer’ (KYC) norms for individuals who do not expect having more than Rs. 50,000 in all their shared accounts and whose annual total borrowing not exceed Rs.100,000. The ones lacking proof of identity or residence can be introduced by an account holder of at least six months for whom the full KYC process has already been completed. Finally, the RBI has asked banks to levy reasonable amounts for services offered and to be transparent about these charges from the beginning. In addition to modifications in overall bank policy, the RBI also declared a targeted effort for financial inclusion throughout the country, wherein each family would receive one ‘no frills’ bank account. The first pilot scheme was conducted in Pondicherry district, led by Indian Bank and accomplished in December 2006. Since then, numerous drives, typically lasting one year each, have been accomplished in different parts of India, with the most distinguished of these being the accomplishment of 100% financial inclusion in the state of Himachal Pradesh and in Gulbarga district, one of the most developmentally backward districts in Karnataka.

The Effect of Social Context on the Implementation of Micro finance Programs
Snow and Buss (2001) argue that the proper design of a micro finance program depends very much on the social context in which the program is implemented. Social relationships play a key role in the viability of micro finance programs in any nation, but the way these relationships are developed and utilized are highly contextual. The social relationships that provide the peer pressure aspect of group lending generally exist prior to the group lending arrangement. In the developing world, the strength and reciprocal nature of these established relationships are utilized in the lending process. Borrowers who belong to a lending group are compelled by the inherent reciprocity of social relations to fulfil their financial responsibilities. The threat of social ostracism within close-knit communities makes this form of peer pressure effective. In the United States, relational elements are still important in micro finance, but the practice of group lending has not been as successful as it has been in other parts of the world. Bhatt and Tang
(2001) argue that the even poor Americans are relatively mobile and that this undercuts the relational pressures that are necessary to make group lending work. They also argue that the bonds of reciprocity that may exist between members of poor communities are not adequate to enforce group lending arrangements. To support this claim, these authors cite examples from programs that have tried the group lending approach in the United States. For the most part, these groups have not been based on existing social relationships, but have been established for express lending purposes. In these U.S. groups, members are often unwilling to take responsibility for payments when other group members fall behind or default on their loans and are unable to pressure errant members into compliance.

Therefore in order for programs to be successful in the United States, program designs cannot blindly follow those applied in the developing world, but must take into account local social relations and cultural mores (Bhatt and Tang 2001, p. 232). Bhatt and Tang (2001) argue that U.S. programs have failed to recognize that programs in the developing worlds are not merely making unsecured loans, but have actually developed alternative forms of collateral based on the social capital of communities.

While group lending is a less successful method of securing loans in the United States, Bhatt and Tang argue that social relationships still play a salient role in the evaluation of applicants. In order to serve clients who cannot participate in the commercial lending system, U.S. micro finance programs must not use the same criteria as commercial banks when assessing the creditworthiness of borrowers. In successful U.S. programs, the relationship between program administrators and potential borrowers become the most important relationships governing program success, rather than the relationships among the borrowers themselves. Program administrators can assess the risk of lending to particular borrowers through their interactions during the application process. These social relationships take the place of traditional sources of collateral, and the facilitation of these relationships plays a critical role in program success (Bhatt and Tang 2001, p.232). Woolcock (1999) supports this appraisal of the importance of social
relationships, arguing that successful programs are those that pay close attention to the specific needs and social organization of their target populations.

1.8 THE EFFECT OF ECONOMIC CONTEXT ON THE IMPLEMENTATION OF MICRO FINANCE PROGRAMS

Scholars also argue that the success of a micro finance program also depends on the dynamics of the particular economic system in which the program is situated. The differences between the highly formal economy of the United States and the more prevalent informal economies in the developing world generate differences in the way micro finance must be pursued and the ease with which people can start micro enterprises.

Cynthia Sanders (2002) describes the advantages of pursuing micro enterprise in developing nations:

In developing countries, the informal sector is relatively easy to enter, unregulated, small scale, competitive, and labour intensive, and it allows the adaptability of resources from one use to another. Programs such as the Grameen Bank have had significant effects on improving the economic well-being of the poor in developing nations. (Sanders 2002, p. 322)

It’s not clear that these same effects can be easily achieved in the United States, where the more formalized nature of the economy makes it difficult to capitalize on such small amounts of money (Sanders 2002, p. 322).

Snow and Buss (2001) also argue that the macroeconomic dynamics of a particular nation will also influence the impact and importance of micro finance within a nation’s economy. Schreiner and Woller (2003) support this claim, asserting that the structural integration of the U.S. economy with global markets diminishes the viability of many small enterprises that are common in the developing world, whether or not they are funded through micro finance programs. Small manufacturers, retailers or farmers must
compete against large corporations that can often provide similar products at lower prices (Schreiner and Woller 2003, p. 1572).

These authors go on to argue that the welfare system in the United States also works against self-employment in a number of ways. Receiving welfare requires less effort than self-employment, and as a recipient's outside income increases, benefits drop.

This decreases the person's return on the investment in self-employment. Assets tests in welfare assessment discourage savings, which some argue is as crucial to business development as credit (Schreiner and Woller 2003, p. 1572). Irene Tinker (2000) also identifies the need to facilitate savings among potential entrepreneurs.

1.9 THE ROLE OF TRAINING IN MICRO FINANCE

In the developing world, formal business training is less essential to the success of a potential entrepreneur than it is in the United States (Servon and Doshna 1999 p. 12). The greater prevalence of the informal economy makes it easier to start a small business in developing nations (Schreiner and Woller 2003). Irene Tinker (2000) suggests that training both provides the skills that potential entrepreneurs need to run a small business in the U.S. economy and provides a measure of the person’s credit-worthiness. The ability to create a viable business plan becomes a measure of the risk involved in lending to a particular person. In fact, she argues, this element of micro finance has become so important that it has led to debate over whether or not access to capital is the primary obstacle to self-employment in the United States (Tinker 2000).

While programs in the United States require more business training, social education is an important component of programs in developing nations. McKernan (2002, p.94) argues that micro finance is a tool of social development as well as business development. In developing nations, the goal of business development is often combined with other social goals, such as proper sanitation, hygiene, prevention of domestic violence, child care, etc. Successful micro finance programs do more than just provide a source of capital, they provide social and economic literacy that help their clients achieve
self-sufficiency and improve their lives in a variety of ways. Servon and Doshna (1999, p.18) argue that this is true of U.S. programs as well. Training programs often provide clients with financial literacy and “life skills”—such as the research and writing skills required to create a business plan—that will serve them in other areas of their lives, even if they do not pursue self-employment in the long-run (p.18).

Bhatt and Tang (2001, p. 232) argue that while training is important and practitioners want to see all their clients succeed, some U.S. programs need to do a better job of helping their clients assess the viability of their business plans. “Often, individuals in the start-up phases of their businesses did not know exactly what they needed the money for. Instead, they made up loan requests and proposals simply to acquire the capital being offered” (p. 232). They go on to suggest that attention must also be paid to the type of training that is offered and whether or not it actually meets clients’ needs. “It appears that human capital is more important than social capital in determining the success of micro-entrepreneurs in the United States” (Bhatt and Tang 2002, p.372). Unspecific training may burden some borrowers without actually providing the skills they need to create successful businesses. Programs need to focus on the feasibility of business plans to ensure their resources will be effectively utilized (Bhatt and Tang 2002, p. 372).

Without appropriate training, uncritical enthusiasm for micro enterprise may lead some people into making inappropriate business choices.

1.10 THE CHALLENGE OF HIGH OVERHEAD COSTS IN MICRO FINANCE

Programs in developing nations have the advantage of lower administrative costs than their counterparts in the United States. The costs and skills required to operate a micro finance program are higher in a formal economy (Servon and Doshna 1999, p.11).

Programs must be able to pay their administrative staff more and the costs of administering small loans also remains high. The effect of reducing cost by shifting some monitoring responsibilities onto borrowers has been successful in developing countries,
but has seldom been successful in the United States (Bhatt and Tang 2001, p. 233). Often times, costs per loan in the United States are much greater than the amount of the loan itself (Bhatt and Tang, p. 233). This is an ongoing struggle for U.S. programs and severely limits their potential for sustainability. Even in South Asia, successful micro finance programs still rely on funding from international agencies (Servon and Doshna 1999, p.12). Micro finance is predicated on the idea that lack of access to capital is the biggest impediment to self-employment, but in the U.S. training is also essential to entrepreneurial success and raises the cost of program administration (Servon and Doshna 1999). Training, loan fund administration, and program outreach are all relatively expensive in the United States compared to the developing world. Many agencies that supply grants for the loan funds of U.S. micro finance programs do not consider the cost of loan administration and training in their view of micro finance. Therefore, it is easy for many U.S. programs to find funding for loans, but much more difficult to find funding for their operating costs (Servon 1998). While donors may wish that capital were the answer in itself, its delivery must be properly administered and monitored to produce success.

1.11 TARGET POPULATIONS AND OUTREACH

Bhatt et al (1999) indicate that many U.S. programs have set out to help the poorest people, but have had difficulty reaching their target populations. Schreiner and Woller support this claim, arguing that micro finance programs are not necessarily suited to the needs and abilities of most poor people in the United States and may best serve a very small subset of the poor—those who have a relatively high level of human capital and already possess many of the needed skills to run a business (Shreiner 1999, p. 512; Schreiner and Woller 2003). Even with training, self-employment is a difficult option for many poor people.

Programs need to support the demand for micro finance in addition to just providing capital (Bhatt et al 1999). While programs may aim to reach the very poor and uneducated, in reality borrowers with a fair amount of education run most micro enterprises (Servon 2000). Many already have household incomes well over the poverty
line and own their own homes (Servon and Bates 1998, p.420). This may indicate that gaps in access to credit may extend beyond the poor and that “some college” no longer ensures secure employment (Servon and Bates 1998, p. 423). Programs that have had a problem with outreach consequently have few borrowers and even higher overhead costs. Sometimes available capital even goes un-used (Bhatt and Tang 2001, p. 230). “Layers of cultural and language barriers in these communities [make] it extremely costly to build program awareness and institutional trust among potential borrowers”

(Bhatt and Tang 2001, p. 231). Because of these difficulties, some programs have abandoned their aim of helping only low-income people and have included other income groups in their lending missions.

**1.12 **COMPETITION FOR MICRO FINANCE FROM OTHER CREDIT SERVICES

In the United States, potential micro-entrepreneurs often have access to credit cards and sometimes to family support (Tinker 2000). Though credit cards have high interest rates, the transaction costs associated with using credit cards are much lower than for other types of loans, including micro loans (Irene Tinker 2000). With alternatives like these, the hassle of applying for a small loan through a micro finance program can outweigh the potential benefits from a borrower’s point of view.

**1.12.1 Limitations on Business Growth for Microenterprises**

While one of the aims of micro finance is economic development, few micro enterprises create many jobs or grow substantially. Shreiner and Woller (2003), as well as Servon and Bates (1998), indicate that the small enterprises that do grow are those run by people with skills in high-demand fields. Micro enterprise programs serve low demand, slow-growth fields, which may be more appropriate for low-income people with few skills, but also afford only low returns (Shreiner and Woller 2003, p. 1569). In looking for characteristics of the most successful small businesses, and specifically among
minority entrepreneurs, Servon and Bates (1998) compare microenterprises with other small businesses. They found that the more profitable minority firms are clearly larger-scale enterprises. Owners of these enterprises work fulltime at their businesses, invest substantial capital to launch their ventures, and employ other people. Firms that have been in business less than two years and those that cater only to a minority clientele make less money. These latter firms are significantly less profitable than others (Servon and Bates 1998, p.431). They also found a divergence in the longevity of certain types of businesses run by educated entrepreneurs: Being College educated is strongly, positively associated with firm survival among the emerging business owners, but the opposite pattern typifies traditional forms. All measures of owner education and experience for traditional firms point toward a common pattern: greater education and experience predict firm discontinuance. (Servon and Bates 1998, p. 435)

This means that educated business owners are more likely to succeed in emerging fields than in traditional fields. The authors describe emerging businesses as those that do not cater to only minority clients, and thus draw customers from a broader population. Such fields include construction, business services, and manufacturing. The authors describe “traditional” fields as “small-scale retail and personal service firms” (p. 429). This leads the authors to the conclusion that it is not just human capital that makes small business owners successful; it is human capital coupled with operating a business in an emerging field. Even people with managerial skills and higher education have trouble making it in traditional fields. However, many micro-entrepreneurs fall into this latter, traditional category making it questionable whether these businesses will be able to financially benefit their borrowers or contribute to the economy. The question of which sectors are most appropriate for micro finance development is important to the success of program borrowers and also to the viability of micro finance as an economic development tool.

Another issue that compromises the viability of micro finance in economic development is the fact that many businesses are undercapitalized and cannot grow and
succeed as they might otherwise. Servon and Bates (1998), in the same study, observed that many business owners who received funds from Working Capital (one program in their study) felt that their businesses were under-funded. When customers need larger loans than a micro finance program is prepared to offer, the program’s ability to promote business development is limited (Servon and Bates 1998, p. 435) Bhatt and Tang (2001) also recognize a gap in the provision of financing in the range of $10,000 to $50,000.

They suggest that the people who could handle repayment of these loans generally have somewhat higher income than those typically targeted by micro finance programs, but that they are often unable to acquire such a loan through a commercial institution (p. 237).

1.12.2 The Pros and Cons of Wage Labor Compared with Self-Employment

The benefits of micro finance must also be weighed against those of wage labour. If poor people can’t make more money through self-employment than through wage labour, then the value of micro finance as a poverty reduction strategy is questionable. In many cases in the United States, self-employment does not provide enough income or benefits to be a household’s primary form of support (Servon and Doshna 1999). This leads to what Lisa Servon (1999) refers to as “income packaging.” Many people who participate in micro finance programs, especially women, depend on income from a variety of sources.

Nevertheless Servon (1999) sees this as a positive element of micro finance. In her opinion, it reflects a need for more flexible work arrangements for women and alternative avenues of escape from poverty. Though income from micro enterprise is generally not enough on its own for U.S. entrepreneurs, when combined with other forms of income, it becomes an important economic tool for people who need economic alternatives (Servon 1999). However, Sanders (2002) indicates that in cases where micro enterprises do not make a profit, and there are many, other sources of household income compensate for the lack of business profit. According to Ehlers and Main (1998), 66 percent of businesses in
the Aspen Institute’s national study of micro enterprises were not profitable in 1991, and 48 percent were not profitable in 1992. While start-up businesses generally do take time to become profitable, the fact that many of these businesses are in traditional sectors gives reason to question whether these businesses will ever be truly viable.

In a longitudinal study, Sanders (2002) uses control groups to assess the economic advancement of micro-entrepreneurs. She compares their income growth with that of other low-income self-employed people who did not participate in micro finance programs and with low-income wage labourers. The study showed that compared to the other groups, those who participated in micro enterprise programs did not show greater improvement in their economic conditions. She concludes that micro finance may not be the most effective method of poverty reduction in the United States, but that for some families micro enterprise may be an important aspect of their income-packaging strategy.

She suggests that government resources should be directed at providing support and market access to small businesses (Sanders 2002, p. 336). 2.9 Women Combining Household and Economic Responsibilities through Micro enterprise.

Most authors indicate that the majority of micro-entrepreneurs, in both the developing world and the United States, are women (Ehlers and Main 1998; Sanders 2004; Tinker 2000). Though some authors, like Sanders, believe micro finance offers a valuable economic alternative for women, others question the validity of an economic development tool that does not allow women to fully participate in the mainstream economy. Ehlers and Main (1998) argue that micro-entrepreneurs remain on the periphery of the mainstream economy in a way that perpetuates their marginalization.

These authors argue that the patriarchal logic that governs business development conflicts with the gender-specific limitations and domestic responsibilities that many low-income women face, making success in business a daunting task for which they are not properly prepared. These authors contend that micro finance is popular because it reinforces our
American faith in the free market and a Protestant work ethic, though these may be unrealistic ideals applied in efforts to reduce poverty (Ehlers and Main 1998, p. 425). They question the wisdom of encouraging women to pursue this option, when the chances of establishing a profitable, expanding business are slim.

Servon (1999) counters this by questioning the underlying assumptions of evaluating business success. She argues that while many micro enterprises are criticized because they do not grow to the same extent that other businesses do, this is because women often invest in other areas of their life, such as health care and education for their children, rather than in expanding their businesses. She says that these women confound traditional [i.e. patriarchal] economic logic by using their profits in this way, but the investment in familial and social welfare must be taken into account in the evaluation of micro finance (Servon 1999).

1.13 Objectives of Micro Finance and Dilemmas in Program Evaluation

Micro finance programs are hybrid beasts, straddling the agendas of both economic development and social welfare. They are designed to be instruments of business development as well as of poverty reduction, and this has several implications. First and positively, it means that micro finance has the potential to produce positive results in several areas of social and developmental concern. Secondly, it means that these programs are also saddled with a double set of expectations, some of which may be difficult to meet. These dual goals also pose dilemmas about the way in which these programs should be evaluated. While micro finance may be a viable way to address some problems, it may not be well suited to others. Different problems also require different goals, and these goals sometimes work at cross-purposes with one another. Some authors argue that the goals of micro finance are not always clear at either the organizational level at which they are implemented, or at institutional or governmental levels (Bhatt and Tang 2001). There must be some consensus about the particular goals of a program before we can evaluate its success and decide how the program should be organized:
Program design issues must ultimately flow from program objectives…We cannot determine whether a program is successful if we do not know what it is supposed to achieve in the first place. (Snow and Buss 2001, p.304)

Bhatt and Tang (2001) also observe that donor goals and organization goals sometimes conflict, making it difficult for the organization to evaluate its progress. In the opinion of Snow and Buss (2001), the main tension in setting goals for micro finance comes from fundamental differences in ideas about what micro finance is supposed to achieve—differences between the aim of alleviating poverty and of creating sustainable institutions:

The difference between program designs emphasizing either sustainability or outreach is not unimportant. It gets to the heart of what micro finance is all about. It is not quite as simple as just making small loans available to the poor. If micro finance is about getting capital to the poor quickly, then it begins to look like a kind of social welfare policy. Immediate improvement in livelihoods is the top priority. If micro finance is about building institutions, then it begins to look more like a long-term development policy. Mobilizing local savings and recovering all costs from borrowers forces the micro finance program to become a sustainable enterprise itself. (Snow and Boss 2001, p. 304)

Many authors call for a clarification of the goals of micro finance and for greater empirical work on the actual social and economic impacts of these programs (Snow and Buss 2001; Woolcock 1999). Because micro finance fits somewhere in between social welfare and economic development, it encourages re-evaluation of the nature of development. Tinker (2000) considers how the shift from modernist to grass-roots develop initiatives has been occurring globally over the years, causing some tension and confusion in national agendas: “Some leaders of developing countries were unsettled by this trend to invest in the poor rather than in industrial growth” (Tinker 2000, p. 230). This new emphasis reflects changing ideas of what development priorities should be—a
shift from post WWII mentality of infrastructure and industrial growth to meeting the basic needs of people at the community level (Tinker 2000).

To facilitate the transition to a new development paradigm and help practitioners tackle the divergent goals of microfinance, we need to know more about the outcomes that these programs actually produce. According to Woolcock (1999), one of the key challenges facing the institution of microfinance is the lack of effective, consistent evaluation methods: For all the many positive developmental outcomes that doubtless can be attributed to participation in microfinance programs, there are nonetheless several methodological weaknesses in the literature documenting their impact and replication that should give pause to uncritical, wholesale endorsement. These weaknesses give rise to, among other things, the kinds of projections and expectations generated by the Microfinance Summit, while simultaneously distracting attention from the crucial issue of how the institutional and human resources are to be assembled to meet those projections and expectations. (Woolcock 1999, p.18).

There are several types of methodological flaws that have undercut microfinance evaluation. Snow and Buss (2001) observe that very few studies have measured whether or not microfinance programs actually improve the economic well-being of either the people who take the loans or of the region in which they live. This is true in developing nations as well as in the United States. “A pervasive assumption is that microfinance increases the well-being of the poor. Practitioners only need to get the program design right. All too often appropriate designs are measured in terms of cost recovery and loan repayment rates” (Snow and Buss 2001, p.302). These measures reflect institutional efficiency, but do not represent the actual economic benefit to the poor whom the programs are meant to serve. Proper program development cannot occur on the basis of assumed results.

According to Woolcock (1999), early assessments of microfinance programs included mostly loan repayment rates and qualitative case studies. In the early 1990s,
financial self-sufficiency became a new criterion for evaluation of development initiatives in general: “...the favored approach of the 1960s and ‘70s—i.e. governments heavily subsidizing commercial banks—were declared as an outright failure” (Woolcock 1999, p.20). Most micro finance evaluations have been based on “theoretical perspectives” that do not account for organizational issues, “i.e. the construction of economic institutions to assist the poor” (Woolcock 1999, p. 20). There has also been a tendency for evaluations to focus on success rather than failure. Woolcock (1999) cites a trend in drawing samples from successful clients in well-established programs. One of the most grievous weaknesses in the evaluation of micro finance is the failure to control for other factors that may account for successful outcomes. For example, “does it matter that villages and borrowers are non-randomly selected” (Woolcock 1999, p .19)? Very few studies have used appropriate controls to establish whether or not the observed results would have occurred in the absence of client participation in micro finance programs. As noted earlier in this chapter, Cynthia Sanders (2002) has conducted one of the few control-group studies on the effects of micro finance programs and concluded that participation in the micro finance program did not translate into higher income for participants compared with those of wage-earners and other self-employed people and low-income entrepreneurs (Sanders 2002).

There have also been only a few longitudinal studies on the effects of micro finance programs (Woolcock 1999). This is partly due to the fact that micro finance is a relatively new strategy and programs in the United States are only beginning to mature. Some programs in the United States have now existed long enough for longitudinal studies to reveal more about their actual effects. One of the few studies that have tracked the clients of micro-entrepreneurs over several years is the Self-Employment Learning Project (SELP) conducted by the Aspen Institute. The study catalogs business and social characteristics of over 400 micro entrepreneurs in major domestic micro finance programs (Woolcock 1999). This evaluation is unique because it is longitudinal and because it analyses both program and client data.
To be evaluated as a tool for economic development, micro finance programs must be compared to other development strategies, such as industrial recruitment, business incubation, infrastructure investment, and revolving loan funds. According to a study by Lisa Servon and Jeffery P. Doshna (1999) micro finance fares well on some economic development indicators such as cost per job created, but less well on other traditional economic indicators, such as number of jobs created. They supplement their quantitative work with a qualitative evaluation, and cite the investment that micro entrepreneurs make in their families and in their children’s education as examples of additional measures that need to be included in micro finance evaluation. They also believe that it is inappropriate to compare the ambitions of small entrepreneurs with those of large corporations: Another factor is that most micro entrepreneurs are not looking to create Fortune 500 firms. Their goals tend to be much more modest: exiting welfare, having enough income to support their families, and being able to afford “extras” for the kids were some of the reasons offered… traditional evaluation techniques fail to allow for clients’ definition of success. (Servon and Doshna 1999, p.17) .They argue that micro finance is not a magic solution and has the most potential for success when it is integrated into a broader long-term plan for economic development (Servon and Doshna 1999). However, they do not go into great detail about what this integration should entail, and greater analysis is needed to suggest how this integration should take place. In addition to examining outcomes, we also need to understand how these outcomes are achieved. Woolcock (1999) calls for greater awareness of contextual elements in determining successful program evaluation.

Given the importance of financial services to the poor, and the enormity of the challenge set by the Micro finance Summit, greater attention to the social mechanisms shaping institutional success and failure is needed to complement the more familiar issues of costs, subsidies, interest rates, lending policies, and training that have dominated discussion to this point. (Woolcock 1999) He argues that using cost as a primary measure of success emphasizes outcomes over process, “Whereas a sociological approach focuses
on how the results were attained” (Woolcock 1999). To improve the application of micro finance, we need to examine programs from both these perspectives.

This study of micro lenders and micro borrowers in Erie County approaches micro finance from both perspectives and attempts to draw connections between the two. I focus on how particular outcomes are attained and whether or not these outcomes relate to specific program characteristics. While I cannot address all weaknesses in program evaluation, this project advances our understanding of U.S. micro finance and how best to achieve program success.

1.14 SHG IN INDIA

Pathak (1992) proposed that SHG being encompassed of group of persons, gets authorized to solve most of their problems of non-financial nature like raw materials, inputs supply, marketing, better adoption of technology education and training for comprehending the human potential for development. The SHG’s of Kerala have become centres for introducing social action against dowry system, alcoholism, illiteracy and divorce (NABARD 1997).

Dinakar Rao (1994) stated that networking of SHG’s and Self-help promoting institution are basics of transmitting self-help. And that SHG’s connected with formal credit agencies had advantages of shared enterprises, economic of scale and organisation to relish mistreatment.

Harper (1996) showed that in India, as in other parts of the developing world, the banking community is spreading its services to the poor by lending to SHG’s. This is achieved by extending single larger loans, trusting on the group, on NGOs, to monitor the on lending of micro-loans, the banks transaction charges are reduced, making the operation potential lucrative.
Kumaran (1997) examined SHG’s promoted by a voluntary agency in A.P and their role in encouraging economy and credit activities among the poor. Further he also observed in detail the process of progress of self-help groups, structure and function, resource mobilization and socio-economic, activities. Various elements responsible for active functioning, inactivity and demobilisation of self-help groups are examined.

Ramalakshmi (1998) opined that, scarce working capital, is the most serious problem confining the performance of many DWCRA groups and also the group members need training for skill augmentation specifically for items such as soft made garments, foot wear, woollen blankets etc.

Puhazhendhi and Jayaraman (1999) opined that the SHG members taking up more than one activity amplified from about 30% during pre-group formation situation. They commenced additional activities such as animal husbandry, poultry etc, and non-farm activities like Petty shop, Kirana shop, Flower selling business etc.

Hartwig (1999) reported that SHG of Africa have improved the family income there by safeguarding food security and children education.

Suriakanthi (2000) found that bank transactions are indispensable activities of SHG’s. Credit and subsidy under the (SGSY) Swarna Jayanthi Gram Swarozgar Yojana Scheme can be obtained only through banks.

Dadhich (2001) found that effective execution of micro-finance can be a means not only to lighten poverty and empower woman but also be a sustainable economic and financial proposition.

Raghavendra (2003) found that the average involvement level of SHG members has been quite respectable. Officials of Commercial Banks and RRB’s together account
for 50 per cent of total contribution followed by Co-operative banks at 45 per cent and the balance 5 per cent by NGO’s. Southern region accounts for over 2/3rd of total contribution.

Satya Sundaram (2005) reported that micro-finance in India is making sound and reasonable progress. NABARD has set an aim of covering 10 million poor, i.e. one third of the country’s poor population through one million SHG’s by 2003.

Thorat (2005) opined that micro-financial services provided to the poor in justifiable manner is justifiable with high repayment rates. Which meant that if the services to the poor were provided in a sustainable manner than the beneficiaries would go in for repayments that are quite high in consideration to a staggered manner of provision of services.

1.15 INSTITUTIONAL ASSOCIATIONS OF SHG’S
The impact studies conducted by Nanda (1999) on self-help groups found that the most outstanding influence of the linkage programme could be the socio-economic empowerment of the poor more predominantly the women.

Gurumoorthy (2000) found that the SHG’s are connected with banks for the internal credit under the projects of rural development. The evaluation consists of bank managers, rural development officers, NGOs; project implementation units visit the groups for providing financial assistance to the corresponding entrepreneurial activities.

Barik and Vannan (2001) found that the project of connecting SHG’s with banks has gained impetus in India from 1992. He further reported that three broad models have developed, Model-I: Bank-SHG, member formed 14 per cent, Model-II: bank (facilitating agency) SHG-members formed 70 percent and Model-III: Bank-NGO-MFI-SHG-members formed 16 per cent of SHG’S.
Namboodiri and Shiyanii (2001) found that the SHG’s that are endorsed by the NGOs had a better saving performance related to that of SHPI. However, the repayment performance of the SHG’s promoted by the SHPI was higher to that of NGOs.

Pankaj (2001) found that the SHG-bank linkage programme launched by NABARD in 1992 is a revolutionary in the field of micro financing in India. This programme aims to establish SHG’s 10 to 20 persons from the economically homogeneous layers regularly save the amounts from their earnings.

Satish (2001) reported that the NGOs because of its nearness to the people and flexibility of procedures seem to be better prepared to embark on SHG formation. And connecting SHG’s to bank helps in overcoming the problem of high transaction costs to banks in offering credit to the poor.

Kothal et al (2003) noted that there could be four different models of association between SHG’s and banks. Approval of a particular model depends on the opinion of the bank and the strength of the SHG’s and the NGO. The programme of SHG’s organized by various NGOs and banks in different part of the country is reported to be highly satisfactory.

Kala (2004) noted that the associating the self-help groups (SHG’s) with formal rural banking started after the launching of the pilot scheme by NABARD and that association of SHG’s is possible only if the SHG’s have successfully collected savings, made loans and recovered them for six months.

Selvachandra (2004) found that SHG and its association with banks is an important mode to encourage micro finance in India. This programme helps to encourage financial transactions between formal banking systems with the informal SHG’s as customers.
Asokan (2005) noted that among the three models of linkages introduced earlier, the second model i.e., SHG formed by NGOs and formal agencies but unswervingly financed by bank is the best model. Bhagwati (2006) noted that the micro-credit progressed through the mechanism of self-help groups associated to bank credit is associated with higher level of loan recoveries and that tree linkage project has aided

Joseph and Easwaran (2006) reported that in all parts of the country, SHG’s are organized by governmental and non-governmental organizations (NGOs). The government, banks and non-governmental organizations enable them by providing revolving fund, organizational and training, credit etc socio-economic enablement of weaker sections including women.

1.16 PORT-FOLIO OF LENDING BY THE MICRO FINANCE PROVIDERS

A World Bank study (1995) found that 67 per cent of the credit needs of poor people in India are for feeding needs and of the feeding credit required, 75 per cent was for short periods for up-and-coming needs such as illness and household expenses. They also estimated that 75 per cent of production credit (only 33% of total credit) was met by banks while 100 per cent of feeding credit requirement was to be fulfilled by causal resources at interest rate ranging from 30 per cent to 90 per cent per annum.

Roshan Singh et al. (1978) studied the design of flow of credit in Bichpuri development block of Agra district in Uttar Pradesh. They found that the trend of financing agriculture was similar both at the national and district level. The percentage of bank finance to agricultural showed a firm but slow increase over a period of four years. The overall share of large farmers in total finance to agriculture was much higher as compared to the small and medium farmers in all the years (1972 to 1977). The segment of small farmers showed an increasing trend mainly during the years 1976 and 1977 when thoughtful efforts were made to direct the flow of bank credit in goodwill of small farmers.
Desai (1988) evaluated the institutional credit necessity for agriculture production in 2000 and found that the growth rate of total credit between 1972-73 and 1982-83 was 17 per cent in nominal terms. The commercial bank share has more than doubled from 16.31 per cent in 1972-73 to 35.85 per cent in 1982-83. He projected short term credit necessity by taking the total value of crop output from the cost of cultivation scheme of government of India for the period from 1974-75 to 1984-85 and found that the growth rate in agriculture advance to be 16.28 per cent.

Ramdas (1989) evaluated the institutional credit flow in Pondicherry and witnessed that the short term credit advance by the institutions had grown extremely, while the long term credit wadded. He recommended the need for institution to come forward to provide long term credit and exploit the saving mobilized in rural areas solely for rural investment.

Pradeep kumar (1993) used growth rate analysis to analyse the development in physical and financial performance pointers of horticultural producer’s cooperative marketing society limited, Bangalore. The pointers considered were membership share capital, owned funds, sales, inventories, fixed assets, current assets, total assets, current liabilities and total liabilities.

Pahazhendhi and Jayaraman (1999) anxious about the growth of agriculture advance during 1990-96, pointed out that despite the remarkable growth in absolute terms, the proportion of amount outstanding advance to priority sector showed a deteriorating trend from 16.9 per cent in June 1990 to 14.3 per cent in March 1996. The reversal trend was observed in 1996-97 March when the loans for agriculture constituted 16.3 per cent of net bank advances. The share of priority sector lending at all India level whose share had declined from the peak of 42.9 per cent in 1985 slightly improved to 41.7 per cent in March 1997.
Nair (2000) studied recent trends in rural financial mediators and commercial banks in India specified that the commercial banks credit to rural areas during the late 1980’s and early 1990’s has shown a slowing down in growth. The relative percentage of bank credit flowing to priority sector, specifically agriculture was fallen below the target of 18 per cent at a national level since the mid 1980’s.

Vishwanath (2002) conducted a study in the management appraisal of district central co-operative bank in Uttar Kannada District of Karnataka and found that growth in number of branches, employees and membership was positive and noteworthy. Excluding borrowing (8.17 per cent) all other financial variables presented a positive and substantial growth. The recovery percentage for the selected Karnataka District Central Co-operative bank branches was found to be more than 90 per cent.

Gosh (2005) considered that the share of associated activities in agricultural output, namely dairying, fisheries and poultry has been increasing considerably, the portion of livestock in the gross value of agriculture (crop and livestock production) increased from under 16 per cent in 1970-71 to 26 per cent in 1995-96, that of fisheries went up over the same period from 1.7 per cent to 3.1 per cent. The proportion of non-food crop in the cropped area has increased from 25.7 per cent in the triennium ending 1971-72 to 35.1 per cent by 1999-2000.

Gosh (2005) studied that the short term credit remained nearly unaffected, meaningfully at about 14 per cent, the growth of long term credit slowed down from about 20 per cent in the 1970s to about 14 per cent in the 1990s which is too upsetting. Clearly, this trend is bound to have a crippling impression on the capacity of the agricultural sector to grow and flourish.
Reddy and Gupta (2006) considered the credit management in SHG’s under South Asia Poverty Alleviation Programme (SAPAP) and found that the data on purpose wise distribution of credit showed that sample groups assigned 34 per cent, 22 per cent and 22 per cent of the total credit to small businesses, animal husbandry and agriculture.

Thanarathnam (2006) studied the working of primary agriculture co-operative banks and analysed the loan distributed by the bank. He used the annual average growth rate of various types of loans given by banks. He found that the average annual growth rate for the period 1996-97 to 2001-02 with regard to short term loan was 2.07 per cent, for jewel loan it was 1.35 per cent deposit loan has 3.44 per cent of growth rate. It was really noticeable and showed the performance of the bank. According to the amount of loan disseminated by the bank, a large percentage share was taken by the jewel loan in all the six years and the amount was small with respect to deposit loan.

Ramappa and Sivasankaraiah (2007) considered that the share of agriculture loan in the total priority sector advances was noticeably large and varied from 73.02 per cent in 1993-94 to 76.79 per cent in 2004-05. It was also evident that of the total agriculture loan in 2004-05, crop loan alone contributed for 93.31 per cent. Among non-agriculture activities retail trade/business enterprise received large share of loan followed by SHG’s. The percentage share of non-priority sector in total unresolved advances showed increasing trend from 15.16 in 1993-94 to 34.2 in 2004-05. It indicates the change in the lending pattern of the Rayalseema Grameena bank in Andhra Pradesh.

Rangi et al. (2002) stated that about 59 per cent of the borrowings were for feeding purposes in the household. However, about 32 per cent of the respondents reported those feeding loans were completely for routine family expenditure because employment was not recurrently available to the respondents’ households. About 18 per cent of them took credit for repair of their houses and about five per cent each used it for the study of their children and fixing of hand pumps. It was found that about 71 per cent of these bank
loans were for industrious purposes. Among the industrious purpose, dairy farming was the most prevailing (about 32%) followed by tailor shop (about 19%), cloth shop (about 10%), grocery shop (about 6%) and electrical shop (about 3%). The loans for feeding purposes accounted for about 29 per cent of the cases. The routine family spending was principal reason for taking loans. The other drives were social functions, medical treatment and house repairs (Rangi et al., 2002).

Vasudeva Rao (2003) in his study piloted at Andhra Pradesh pointed out that a bulk of the people have taken loans for their own work-related growth, while, only a few have taken for health, education and marriage purposes. The amounts taken are also fluctuating with the purpose. About 75.60 per cent availed loan for dairy activities, while 4.00 and 3.60 per cent of the respondents’ availed loan from the group for daughter’s marriage and poultry (Ritu Jain et al, 2003).

1.17 PERFORMANCE OF SELF HELP GROUPS

Ramlingam et al (1987) showed that the social status of the defendants had increased significantly from low status to higher status. Mahabub Hussain (1988) while evaluating the performance of the Garmeena Bank in Bangladesh placed the proposition that “ If the poor are provided with the working capital, they can produce productive self-employment without additional exterior support”, and the results showed that the Garmeena bank has reached 6 percent of villages and 4 percent target households (1987).

Molly (1990) found that there is huge share of NGOs programmes in the selected organizations associated to the factory type employment such as readymade garments, Khadi and Village industry, candle making etc. The major productions programmes especially on household basis, which occupied 24 percent of total schemes, animal husbandry, poultry, sericulture, fodder cultivation, kitchen garden and others.
Girija (1995) stated that the group offers the women a base for self-employment and enablement through group undercurrents. The peer pressure on group members has warranted proper deployment of credit and repayment of loans, savings provided self-insurance and self-assurance to the group members.

McGuire and Conroy (1997) study compared the transaction costs experienced by banks while lending to the poor through various channels, and found that the transaction costs were much lower where banks used NGOs and self Help Groups as mediators. Transaction costs facing borrowers were also meaningfully lower. This suggests an important role for NGOs in the intermediation process. Another study observed at the question from the prospective of NGOs. It found that NGOs could conduit credit to the poor with lower transaction cost, as a percentage of loans granted, than most other institution. But the small loans and short maturities essential in lending to the poor inevitably led to transaction costs being relatively high compared to the value of loans outstanding at any one point of time.

Kumaran (1997) in his study on 21 SHG’s found that 19 were active groups and one each was inactive and softened group. He found that the individual monthly contribution for savings varied from group to group (Rs.10-Rs.30) and the total savings for 18 groups in a year was Rs.33, 013/- while the total credit produced during the same period was Rs.2, 18,223/-, of which business took a large share of 29 per cent followed by others at 28 per cent, cumulative loan at 23 per cent, clearance of old debit at 12 per cent and health expense at 6 per cent. The interest rate on the loan varied from 5 percent to 3 percent between the groups on monthly basis.

Prasad (2000) reported that in many villages, community issues like drinking water, roads, and power and health services were addressed by the women’s groups. The women involved themselves in various activities like desalting of tanks and working towards child development in addition to income generating undertakings.
Arun Kumar (2004) reported that (53.33%) of the groups studied belong to medium level of performance class followed by high level of performance class (33.30%) of groups and remaining 13.33 per cent of groups belonged to low performance class.

Selvi and Rathna Krishnan (2004) observed that the bulk of the SHG leaders (88.30%) performed the specified leadership roles to the medium level followed by 11.7 percent of them in lowland.

Asian productivity organization (2005) restated that on the way to improve the measurement of performance in productivity measurement, the total factor productivity should measure the collaboration and competence of utilizing both labour and capital inputs. Further it stated that an suitable productivity performance measurement system should cover financial, internal business process customers and learning and growing.

The first randomized impact assessment of expanding admission to credit in a new urban market occurred in Hyderabad, India, in partnership with Spandana, one of the largest and fastest growing MFIs in India (Banerjee, Duflo, Glennerster, and Kinnan, 2010). The findings showed that:

- People with access to micro finance were more likely to have started a business.
- Beyond the influence on new business formation, there was no substantial effect on average business profits, monthly revenues, inputs spending, or number of employees.
- Those with an existing business and access to credit bought more hard-wearing goods for their home and business.
• Those who started a new business cut back on temptation goods (tobacco, alcohol, tea, betel leaves, gambling, and food consumed outside the home) and invested—compression their belts to make the most of the new opportunity
• No increase in consumption and no visible welfare improvements
• Did not help captivate income shocks
• Those with an existing business at the start of the study abridged consumption
• Consumption augmented for those without prior business activity

In this study 52 of 104 groups were arbitrarily selected for the opening of a new MFI branch offering loans to self-formed groups of six to ten women. The typical loan averaged 10,000 (US$200), for families where the normal monthly expenditure was 5,000 (US$100) for a family of five. Twelve to 18 months after the introduction of an MFI branch, a complete household survey was conducted in a random sample of eligible households in both treatment and comparison areas.

This change from temptation goods to investment and durable consumption in the groups with businesses is an inspiring finding. No sign was found to suggest that microfinance was empowering women, at least along measured factors, such as exercising greater control over how the household spent its money. They also found no evidence of improved pointers for the use of healthcare services or education.

Similar findings are seen in an evaluation of microfinance in a rural setting (Crépon, Devoto, Duflo, and Pariente, 2011). Findings from this study showed that:
Number of new businesses did not increase for individuals with existing farming activities, access to credit increased the volume of activity
• More employees were hired from outside the household
• Sales, expenses, and profits increased
• Animal husbandry increased, and loans were used to diversify the types of animals raised, increasing the asset value of the livestock.

The findings from this study suggest that micro finance is an chance that different people will take advantage of in different ways—whether because of temperament or circumstances. More evidence could help us understand the factors that affect a person’s capability to make good use of loans.

The first randomized impression study to evaluate access to individual micro finance loans took place in the Philippines (Karlan and Zinman, 2011). This study sought further explanation of how micro finance affects businesses and business activity. Findings showed the following:

• Those given access to credit did not increase investment in their business
• Those given access to credit reduced their overall number of business activities and employees
• Access to credit helped borrowers cope with risk, strengthened community ties, and increased their access to informal credit.

The researchers of this study determine that micro finance may work, but perhaps the focus should be on a household rather than a business. The concept of a focus on consumer household credit, rather than orienting lending around a business, was examined through a study that measured the effects of expanding consumer credit to low-income workers in South Africa (Karlan and Zinman 2010).

The results are as follows:
• Expanding access to credit increased borrower well-being 6-12 months after receiving the loan
• Incomes were higher for applicants in the treatment group
• Applicants in the treatment group were more likely to have kept their jobs
• 26% of treated households reported an improvement in food consumption.
• Subjective measures of decision-making within the household, community status, and overall optimism were higher.
• Creation of a credit history increased the probability of future loan approval in the sample by 19 percent over a 15 to 27 month horizon.

Overall credit for the poor is found to be important and useful, but not the silver bullet for the alleviation of poverty. However, there are strong reasons to believe that clients around the world value credit services as coping tools (CGAP 2011). The evidence comes mainly from the observed behaviour of hundreds of millions of clients who demonstrate how important microfinance is to them by “voting with their feet.” Similarly a study in partnership with the Bumala village bank in Kenya randomly provided small business owners with access to savings accounts (Dupas and Robinson 2011). Data from the bank displayed that many women used the accounts pretty intensively. For example, 25 percent of women saved more than 1,000 KSh (US$14.28) in the accounts, a significant amount given daily income of about $2 per day. Some women saved much more. These savings transformed into other positive outcomes that included:

• Four to six months after account opening, women in the behaviour group had 45 percent higher daily investment in their trades.
• Food spending was 10–20 percent higher for the treatment group.
• Daily private expenditures was 27–40 percent higher for the behaviour group.

Savings accounts also seemed to make women slightly less susceptible to health shocks, which were predominantly common in this sample. The logbooks showed that women without savings accounts were forced to draw down their working capital in response to illness. In disparity, female savers did not have to reduce their business outlay levels when dealing with a health shock, and were better able to afford medical expenses for more serious illness incidents.
The study suggests that the bank accounts offered were operative in increasing savings by overcoming gravity on market women to share their cash with others. Placing money into formal accounts seemed to reduce the risk of appropriation by relatives, friends, and neighbours.

The accounts presented no interest on deposits and included considerable withdrawal fees. There was nonetheless high demand for these costly savings approaches, which suggests that the available substitutes were inferior. The possible savers were market vendors, bicycle taxi drivers, and self-employed artisans who did not already have a savings account, but were attracted in opening one. The researchers had them keep daily logbooks with detailed evidence on business investments, expenditures, and health shocks.

A second study (Ashraf and Karlan, 2005) scrutinized the effect of offering a savings account to women. After twelve months, average savings balances increased by 81 percentage points for customers presented a savings account relative to the group not offered a savings account. The study also established that the product offered a long-term change in savings as opposed to a momentary change.

In spite of the lack of evidence for positive effects on well-being from credit, the studies so far offer tempting evidence that there could be important potential paybacks for some poor households to be gained by helping the poor reprioritize their outlays. Remarkably, the impact study for savings showed positive outcomes for female savers. The next generation of savings related studies is exploratory product design to see how small changes can develop outcomes for poor client.
1.18 INSURANCE

In addition to savings, a key effort is currently in progress to expand access to insurance products that improve upon old-style risk-sharing arrangements and informal insurance setups to help poor households deal with weather shocks and irregular income from agriculture. In theory, micro-insurance—insurance targeted to the poor through low premiums and/or low coverage restrictions—should be in strong demand to act as a safety net for poor families whose crops may fail, whose livestock may decease, and who may suffer from the effects of bad climate and health tremors. Latest findings suggest that micro-insurance has positive influences on poor households, but determined low rates of take-up, even for effective products, show that product design matters enormously.

Gine, Menand, Townsend, and Vickery (2010) measured two different types of possible influences of rainfall micro-insurance in Andhra Pradesh, India. How well does having insurance help farmers deal with an agricultural shock and how does having access to insurance disturb household decision making, even in the absence of a claim? The study findings indicated the following:

- Insurance does not escalate the use of inputs or change the allocation of land
- Access to rainfall insurance does cause farmers to change toward more perilous, rain-sensitive crops, which typically offer higher profit.

1.19 REMITTANCES

Anzoategui and Demirgut-Kunt, (2011) investigated the influence of remittances on financial inclusion using records from a four-wave rural household survey from El Salvador. The study examined the impact of remittances on the probability that households use financial services such as deposit accounts and loans.
The results suggest that remittances have a positive influence on financial inclusion by encouraging the use of deposit accounts. Also remittances do not have a noteworthy effect on credit from formal financing institutions. Thus the study determines that remittances might reduce the need for external financing by financial institutions, while at the same time increasing the demand for savings instruments.

1.20 The effect of rural banks in India

During 1977 and 1990, to be eligible for a license to open a branch in a location which previously had one or more bank branches, an Indian bank had to open four branches in locations with no bank branches. This policy triggered banks to open reasonably more rural branches in Indian states with lower initial financial development between 1977 and 1990. The converse was true outside this period. A recent study uses these policy-induced trend reversals in the relationship between a state’s initial financial development and rural branch growth as instruments for rural branch expansion and found that rural branch expansion in India considerably reduced rural poverty (Pande and Burgess, 2004).

This study further summarises that this effect was, at least partly, mediated through increased deposit mobilization and credit distribution by banks in rural areas. In distinction, the rural branch expansion program left urban poverty consequences unaffected.

1.21 Other Studies in India

In India, the results from the existing stimulus assessments have been largely varied. Most of the findings come from quasi-experiments, which have been piloted all across India. One of the most significant studies was completed by Chen and Snodgrass (2001). In their study of SEWA Bank compared participants that had taken at least one loan from SEWA to customers who just participated in SEWA’s savings program without taking any loans. Both groups were then compared to non-customers. Other studies
include those accomplished by EDA (2005) and Deininger and Lin (2009). EDA published a study for Small Industries Development Bank of India (SIDBI) that compared 4000 existing micro finance customers and 1400 non-customers across eight states. The other study compared existing and entering micro finance customers, in addition to non-customers.

Sriram (2010) conducted a study on Kalanjiam groups in Karnataka and Tamil Naidu. Since the study lacked benchmark data the researchers compared groups of different age levels with the forecast that more mature groups would have experienced greater measured impact.

1.22 PORTFOLIOS OF THE POOR:

Collins, Morduch, Rutherford, and Ruthven (2009) presents the results of financial journals composed about twice a month from hundreds of rural and urban households in India, Bangladesh, and South Africa. These journals disclose that financial instruments are critical survival tools for poor households—undeniably, that these tools are even more significant for the poor than for richer people. The study finds that a great difficulty encountered by the poor is not only the extent of their income, but also the irregularity of that income. To meet basic feeding needs, poor households must save and borrow persistently. Whether or not financial services lift people out of poverty, these services are vigorous tools in helping the poor to manage with their state of affairs. The poor use credit and savings not only to level consumption, but also to deal with difficult times like health problems and to gather the larger sums they need to grab opportunities and pay for big-ticket expenditures like education, marriages, or funerals.
For the journal households, movements into and out of financial instruments ranged from 75 to 500 percent of annual income. The poorer the household, the higher that percentage tended to be. On reflection, this is not amazing; the closer a household is to the edge of existence, the more it will have to challenge to keep basic consumption steady and to accumulate larger amounts when it needs them. Over the year, the average journal household used 8 to 10 different types of financial instruments, and most forms were used multiple times.

1.23 PROBLEMS FACED BY MICRO FINANCE PROVIDERS

Kumaran (1997) concluded that passivity in self-help group is mainly on account of irregularity in payment of savings and employment of loans, non-adherence to norms set by the group and lack of mutual trust and confidence among members. Regular defaulting by some members resulted in dissolution of some SHG’s.

Prita (2001) studied the performance of Self Help Groups in Dharwad district found that the major constraints faced by the members were difficulties in diversification/starting of activities (41.67%), misunderstanding among SHG’s members (38.17%), lack of space for storage of materials (28.24%) and inadequate availability of raw material at the right time (16.03%).

Sentil and Sekar (2004) stated that political interference in selection of beneficiaries under peoples plan, lack of timely credit facilities, lack of adequate credit, lack of adequate farm women oriented schemes and delay in operation of development programmes were the major constraints perceived by the SHG members.

Darlingselvi (2005) reported that from the study conducted in Kanyakumari district that the members came across certain difficulties in marketing their products in time.
Rao (2005) reported that though problems varied across activities, social taboos as also lack of communication skills came out to be major factors. Lack of transportation, competition from established brands and lack of capital were voiced by women.

Joseph and Easwaran (2006) identified the perceived constraints in the functioning of SHG’s and found that lack of government attention was first and foremost problem i.e. 39 percent. High rate of interest was felt by 33.43 percent of members, followed by insufficiency of loan for income generation, inability to repay the loan etc.