CHAPTER 2

OVERVIEW OF LITERATURE
Introduction

The concept of microfinance is not new. Savings and credit groups that have operated for centuries include the "susus" of Ghana, "chit funds" in India, "tandas" in Mexico, "arisan" in Indonesia, "cheetu" in Sri Lanka, "tontines" in West Africa, and "pasanaku" in Bolivia, as well as numerous savings clubs and burial societies found all over the world. Formal credit and savings institutions for the poor have also been around for decades, providing customers who were traditionally neglected by commercial banks a way to obtain financial services through cooperatives and development finance institutions. One of the earlier and longer-lived microcredit organizations providing small loans to rural poor with no collateral was the Irish Loan Fund system, initiated in the early 1700s by the author and nationalist Jonathan Swift. Swift’s idea began slowly but by the 1840s had become a widespread institution of about 300 funds all over Ireland. Their principal purpose was making small loans with interest for short periods. At their peak they were making loans to 20% of all Irish households annually. The history of microfinancing can be traced back as long to the middle of the 1800s when the theorist Lysander Spooner was writing over the benefits from small credits to entrepreneurs and farmers as a way getting the people out of poverty. But it was at the end of World War II with the Marshall plan the concept had a big impact.

Today’s use of the expression microfinancing has its roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Mohammad Yunus, started shaping the modern industry of microfinancing. Another pioneer in this sector is Akhtar Hameed Khan. He was a development activists and social scientist credited for pioneering micro-credit and microfinance initiatives, farmers’ cooperatives and rural training programs in the developing world. At that time a new wave of microfinance initiatives introduced many new innovations into the sector. Many pioneering enterprises began experimenting with loaning to the underserved people. The main reason why microfinance is dated to the 1970s is that the programs could show that people can be relied on to repay their loans and that it’s possible to provide financial services to poor people through market based enterprises without subsidy. Shorebank was the first microfinance and community development bank founded 1974 in Chicago.
**Operation of Rural Finance**

The rural finance policy pursued in most developing countries beginning from 1950s was based on providing subsidized credit through state controlled or directed institutions to rural segments of population. Expansion of credit coverage through state interventions was based on various theoretical assumptions. Seibel and Parhusip (1990) mention that this approach was based on the premise that rural micro-entrepreneurs are unable to organize themselves, they need subsidized credit for increasing their income and are too poor to save. Yaron, Benjamin and Piprek (1997) have traced this traditional approach in rural finance leaning heavily towards direct incentives to Keynesian influence. Under this approach, the key problem areas visualized in rural financial markets included a lack of credit in rural areas, absence of modern technology in agriculture, low savings capacity in rural areas and prevalence of usurious moneylenders. These distortions and imperfections in rural credit markets were sought to be addressed through government interventions. The ‘supply led’ approach in rural finance caused various qualitative issues such as concerns about financial viability of institutions on account of high rate of loan delinquency, cornering of subsidy by well-off people in what has been described as ‘rent seeking’ behavior, continued presence of moneylenders, inability to reach the core poor led to a reorientation in thinking around 1980s. United State’s Agency for International Development’s (USAID) spring review of Small Farmer Credit in 1972/73 point the deficiencies of directed and subsidized credit approach. These thoughts got crystallized during the ‘Colloquium on Rural Finance in Low-Income Countries’ by USAID and World Bank in 1981. Hulme and Mosley (1996) credit the counter revolution against Development Financial Institutions (DFIs) in rural credit markets. The initial microcredit innovations in disparate settings of Bangladesh, Bolivia and Indonesia demonstrated the success of micro lending to the poor without collateral requirements. According to Elaine and Barton (1998), social intermediation is a financial intermediation with a capacity building component, aimed at those sectors of society that lack access to credit and savings facilities. The obsession with microfinance in development sector is captured by Remenyi (2000) as ‘every bilateral donor and NGO seems to believe that it too must be involved in microfinance if it is to retain credibility a development agency with an option for the poor. Various scholars like Morduch (2000) have brought out the flaws of Win-Win proposition like belief in congruence between commercial microfinance and poverty outreach. Under the new
approach, institutional viability is of prime concern and instruments of directed credit and interest rate directives have been totally diluted or been done away with. Thus banks are increasingly shying away from rural lending as well as rationalizing their branch network in rural areas. Burgess and Pande, 2005 (ibid) have brought this fact in their study by stating that while between 1977 and 1990 (pre reform period) more bank branches were opened in financially less developed states, the pattern was reversed in post reform period. The philosophy and design of SHG-Bank Linkage programme reflects this new concern vividly by emphasizing on full cost recovery in order to become an attractive proposition for banks. Rhyne (2001) observes that these interventions demonstrated techniques for lending to the poor with better outreach and cost recovery. The innovations like reliance on character or peer pressure rather than collateral as loan security, leveraging social capital, positive incentives for repayment and interest rate that approached or covered costs acted as catalysts and their principles continue to form the bedrock of microfinance interventions till date. Kropp and Suran (2002) state that the design features of the programme emphasize that it does not envisage any subsidy support from the government in the matter of credit and charges market related interest rates based on the premise that sub-market interest rates could spell doom, distort the use and direction of credit. It is claimed that the new paradigm of unsecured small scale financial service provision helps poor people take advantage of economic opportunities, expand their income, smoothen their consumption requirement reduce vulnerability and also empowers them (CGAP, 2003; ADB, 2004). Siebel and Dave, 2002 (ibid) in their study on commercial aspects of SHG programme state the new paradigm with focus on institutional sustainability by saying that as against the long standing tradition of government owned banks undermining rural finance with cheap credit, NABARD belongs to the new world of rural finance, it is profit-making and actively promotes the viability of rural banks under its supervision. The ‘Task Force on Supportive Policy and Regulatory Framework for Micro Finance’ constituted by NABARD has not specified limit for the ‘small’ amount of financial services envisaged.

Problems of Rural Finance

Poor household’s lack of collateral does not mean a complete lack of access to financial intermediation even without microfinance. The lack of banks does not mean that poor individuals
are unable to borrow. They typically have multiple credit sources and informal ways to save and insure. The devices are typically diverse and overlapping. They borrow from informal sources such as moneylenders, neighbours, relatives and local traders. Such lenders often have rich information and effective means of enforcing contracts that banks lack. Their resources, however, are limited. Microfinance can provide a solution to the age-old challenge of finding a way to combine the bank’s resources with the local informational and cost advantages of neighbours and moneylenders. Microfinance institutions can bring in resources from outside the community. In ancient Babylon, Hammurabi’s Code tolerated moneylenders and allowed interest charges, but ancient Greeks and Romans including Plato and Aristotle inveighed against moneylenders and the very act of charging interest on loans (Vermeersch, 1912). Singh (1968) surveys seven moneylenders in a village close to Amritsar and found annualized interest rates from 134 to 159 percent, rates that were far higher than commercial banks’ interest rates. Siamwalla et al. (1990) found typical informal sector annual rates of 60 percent in Thailand. They also report rates that are as high as 120 percent in Thailand’s remote areas. Aleem (1990) found interest rates in market town of Chamber in Pakistan to vary between 18 to 200 percent with an average of just under 70 percent per year whereas local banks in the same region charged 12 percent per year. Mosley (1996) reports from a survey carried out in rural Indonesia in 1990 that as many as 70 percent of the households interviewed borrowed from informal lenders. Steel et al. (1997) found that interest rates charged by moneylenders were at least 50 percentage points higher than formal sector rates in Ghana, Malawi, Nigeria and Tanzania. Ray (1998) reports that at one end of the cost spectrum are loans among family, relatives and friends because these loans often do not carry interest charges and are a part of broader informal insurance relationships. In ancient India, moneylenders were tolerated but the early Hindu scriptures prescribe set interest rates that should be charged according to a borrower’s caste, ranging from 2 percent per year for Brahmins to 60 percent for traders (Reddy 1999). De Soto (2000) has argued that the solution is to tackle the root of the problem by establishing formal title to land and clear property rights over assets that make it easier for the poor to offer collateral. At the other end are moneylenders whose reputations are as loan sharks. Singh’s (1968) study found that in 1 of 45 transactions, a moneylender lost the full principle, but in every other case it was recovered. In 29 of the cases some part of the interest was not recovered. Bottomley (1975) uses a much-cited hypothetical
example to argue that moneylender rates are plausibly competitive. Aleem (1990) similarly found that loans and interest rates are not always paid on time but the cost is typically a matter of several months of delay in retrieving funds rather than a full loss. Steel et al. (1997) showed that 70 to 80 percent of informal lenders had perfect loan recovery rates in Ghana and in Nigeria even though moneylenders had delinquency rates of 14 percent yet all were confident that loans would be fully paid within three months of due date. Basu (1979) gave a comparison of two moneylenders one in the city and the other in the countryside. He concluded that if default rates are high then moneylender interest rates do not look usurious. A broad range of careful case studies show that typical default rates are nowhere close to 50 percent but transactions costs and opportunity costs are high. Singh (1968) argued that the high interest rates are mainly due to high opportunity costs not to monopoly profits. With scarce capital if moneylenders invested their money directly in farm enterprises they would earn net returns that would average 77 percent per year. Monopoly profit averages just 9 percentage points once the costs of loan distributions are added which are 14-31 percentage points. This is far from exploitation but much hinges on how opportunity costs are interpreted. If borrowers invest for farm activities then they are able to earn returns roughly twice as high as moneylenders. One way to avoid the steep costs charged by moneylenders is to borrow from neighbours and friends, but while interest rates may be low or even zero, social costs and obligations can be considerable.

The problem of lack of information for the bank about poor borrowers and the poor borrowers’ lack of collateral to offer as security to banks explain why lenders have a hard time serving the poor. The problem of adverse selection occurs when banks cannot easily determine which customers are likely to be more risky than others. Banks would like to charge riskier customers more than safer customers in order to compensate for the added probability of default. But the bank does not know who is who and thus raises average interest rate for everyone driving safer customers out of the credit market. The problem of moral hazard arises because banks are unable to ensure that customers are making sincere effort for their investment projects to be successful. It also arises when customers try to abscond with the bank’s money. These problems could be eliminated if the banks had cheap means to gather information about their clients and to enforce contracts. But banks typically face high transaction costs when working in poor communities because handling many small transactions is far more expensive than servicing one large
transaction for a rich borrower. Braverman and Guasch (1989) estimate that the administrative costs of handling small loans range from 15 to 40 percent of loan size. Another potential solution would be available if borrowers had marketable assets to offer as collateral because then banks could lend without risk. Microfinance is seen as a way to break the vicious circle by reducing transaction costs and overcoming informational problems. González-Vega et al. (1997) argue that while frequent repayments are critical in keeping the probability of default low, they increase the transaction costs incurred by borrowers and thereby reduce the quality of service to the client.

**Alternatives to the Problems of Rural Finance**

Rotating Savings and Credit Associations (ROSCAs) provide an alternative solution, based on pooling resources with a broad group of neighbours and friends. The basic element of ROSCA is a group of individuals who agree to regularly contribute money to a common “pot” that is allocated to one member of the group each period. ROSCAs thus successfully take the bits of surplus funds that come into households and translate those bits into a large chunk that can be used to fund a major purchase. Like ROSCA credit cooperatives also involve groups. Unlike ROSCAs which are built on informal understandings among friends and acquaintances, credit cooperatives typically have a formal constitution and a degree of legal status. These two microfinance models pave the way for group lending in microfinance like other microfinance models. Group lending can help to reduce costs, mobilize funds, improve monitoring and deploy informal community-based enforcement mechanism. Both ROSCAs and credit cooperatives are commonly seen as ways to compensate for the credit market problems. ROSCAs show a way to formalize and systematize the use of groups to allocate resources in poor communities, but their simplicity can also be a disadvantage. Thus ROSCA transforms into Accumulating Savings and Credit Association (ASCA) which allow some participants to mainly save and others to mainly borrow and for more than one person to borrow at a time (Bouman 1995 and Rutherford 2000). An ASCA is essentially a credit cooperative in its formalized mode. Credit cooperatives are playing an increasing role in today’s microfinance landscape. The roots of credit cooperatives however are much older. Banerjee, Besley and Guinnane (1994) develop a model of credit cooperatives that emphasizes peer monitoring among members and shows ways in which groups
can function to increase lending. Fellow group members act as guarantors and monitors in case of microfinance. The motivation of the group members are fueled by the promise of future access to credit if all group members repay loans. By the early 1990s, nearly one-third of rural households were cooperative members (Adams 1995). Friedrich Raiffeissen had spearheaded a drive in the German countryside to spread new group-based ways to provide financial services to the poor (Guinnane 2002; Ghatak and Guinnane 1999). In Germany, there were over 15,000 institutions operating in 1910, serving 2.5 million people and accounting for 9 percent of the German banking market (Guinnane 2002). The British too were intrigued and they fostered credit cooperatives in India creating a precedent for modern microfinance in South Asia. In 1904 the Cooperative Credit Societies Act established cooperatives along Raiffeisen’s basic model in India. The credit cooperatives function like ROSCAs in that they gather funds from those in a community who are able to save and those funds are allocated to those who want to invest in a lump sum. Key decisions about the prevailing interest rates, the maximum loan size and changes to the constitutional chart of the credit cooperative are taken democratically by all members. In a study of German rural cooperatives during the period 1850-1914, Prinz (2002) analyses the emergence of credit associations on the Raiffeisen model. Although Prinz does not have direct evidence on savings, he argues that such savings by participant members were most-likely long-term savings since interest rates were stable, remaining fairly constant at 4 percent. Prinz emphasizes the importance of trust building ties and “face-to-face” relations among villagers. Members of a cooperative will be keen to invest all their savings in the cooperative when social sanctions are sufficiently high and/or when the opportunity cost of investing elsewhere is high because the incidence of default falls sharply through the combination of social commitment, unlimited liability and interest rate stability. Savings in turn are encouraged by a lower probability of default on loans. Inspite of the optimism generated by the expansion of SHG credit and the high recovery rate there is a gap between actual per capita credit provided to the poor and the demand. The outstandings of the SHG programme in 2003 were around Rs. 10 billion which met only 2.2% to 6.6 % of the projected demand. The share of microcredit in total credit of the Indian banking system was less than 1%. The distribution of microfinance in India was highly skewed, with 65% of SHGs being in Southern India and these SHGs were enjoying 75% of the credit disbursed. Nair (2005) suggested that there is a need to upscale the provision of
microfinance on the strengths of its performance measures primarily in terms of the repayment rates.

**History of Microfinance**

In the 1800s, various types of larger and more formal savings and credit institutions began to emerge in Europe, organized primarily among the rural and urban poor. These institutions were known as People's Banks, Credit Unions, and Savings and Credit Co-operatives. The concept of the credit union was developed by Friedrich Wilhelm Raiffeisen and his supporters in Germany in 1864. Their altruistic action was motivated to assist the rural population to break out of their dependence on moneylenders and to improve their welfare. From 1870, the unions expanded rapidly over a large sector of the Rhine Province and other regions of the German States. The cooperative movement quickly spread to other countries in Europe and North America, and eventually, supported by the cooperative movement in developed countries and donors, also to developing countries. In Indonesia, the Indonesian People's Credit Banks (BPR) or The Bank Perkreditan Rakyat opened in 1895. The BPR became the largest microfinance system in Indonesia with close to 9,000 units. In the early 1900s, various adaptations of these models began to appear in parts of rural Latin America. While the goal of such rural finance interventions was usually defined in terms of modernizing the agricultural sector, they usually had two specific objectives: increased commercialization of the rural sector, by mobilizing "idle" savings and increasing investment through credit, and reducing oppressive feudal relations that were enforced through indebtedness. In most cases, these new banks for the poor were not owned by the poor themselves, as they had been in Europe, but by government agencies or private banks. Over the years, these institutions became inefficient and at times, abusive. Another organization, The caisse populaire movement grounded by Alphone and Dorimène Desjardins in Quebec, was also concerned about the poverty. Between 1900 and 1906 when they founded the first caisse, they passed a law governing them in the Quebec assembly; they risked their private assets and must have been very sure about the idea about microcredit.

Between the 1950s and 1970s, governments and donors focused on providing agricultural credit to small and marginal farmers, in hopes of raising productivity and incomes. These efforts to expand access to agricultural credit emphasized supply-led government interventions in the form
of targeted credit through state-owned development finance institutions, or farmers' cooperatives in some cases, that received concessional loans and on-lent to customers at below-market interest rates. These subsidized schemes were rarely successful. Rural development banks suffered massive erosion of their capital base due to subsidized lending rates and poor repayment discipline and the funds did not always reach the poor, often ending up concentrated in the hands of better-off farmers. Meanwhile starting in the 1970s, experimental programs in Bangladesh, Brazil, and a few other countries extended tiny loans to groups of poor women to invest in micro-businesses. This type of microenterprise credit was based on solidarity group lending in which every member of a group guaranteed the repayment of all members. These "microenterprise lending" programs had an almost exclusive focus on credit for income generating activities (in some cases accompanied by forced savings schemes) targeting very poor (often women) borrowers.

The beginning of the microfinance movement is most closely associated with the economist Muhammed Yunus, who in the early 1970's was a professor in Bangladesh. In the midst of a country-wide famine, he began making small loans to poor families in neighboring villages in an effort to break their cycle of poverty. The experiment was a surprising success, with Yunus receiving timely repayment and observing significant changes in the quality of life for his loan recipients. Unable to self-finance an expansion of his project, he sought governmental assistance, and the Grameen Bank was born. In order to focus on the very poor, the Bank only lent to households owning less than a half-acre of land. Repayment rates remained high, and the Bank began to spread its operations to other regions of the country. In less than a decade, the Bank was operating independently from its governmental founders and was advertising consistent repayment rates of about 98%. The success of the Grameen Bank did not go unnoticed. The initial success of Grameen Bank also stimulated the establishment of several other giant microfinance institutions like Bangladesh Rural Advancement Committee (BRAC), ASA, Proshika, etc. Institutions replicating its model sprang up in virtually every region of the globe. Between 1997 and 2002, the total number of MFIs grew from 618 to 2,572. Altogether, these institutions claimed about 65 million clients, up from 13.5 million in 1997 and still growing at 35% a year. Alongside the explosion of the microfinance industry in absolute terms, there has been a steady growth in private financing for MFIs. The bulk of microfinance funding is still
provided by development-oriented international financial institutions and NGO's. Yet estimates place demand for unmet financial services at roughly 1.8 billion individuals. Even at its current growth rates, it is clear that microfinance will only be extended to meet this enormous demand by leveraging private capital, flows of which dwarf all other potential sources. Commercial financing has grown most rapidly in Latin America, where regulated financial institutions now serve 54% of the continent's microfinance clients and, importantly, are now responsible for 74% of the region's loans. Overall, 2005 saw private lending to MFIs jump from $513 million to $981 million. This jump in investment is a reflection of an increasing number of sustainable MFIs worldwide. In addition to earning a profit, sustainable microfinance providers are in a better position than their subsidized peers to expand their operations and share of the market.

The history of Microfinance in Pakistan can be traced back to the early 1980s and two projects: the Orangi Pilot Project (OPP) and the Aga Khan Rural Support Program (AKRSP). In 1999, the AKRSP and the National Rural Support Program accounted for 84 percent of total microfinance services; Kashf Foundation was then the only specialized microfinance institution. At present twenty Microfinance institutions provide services in the regulations of State Bank of Pakistan (SBP) and the Microfinance Information eXchange (MIX) Market.

In India, in 1972 the Self Employed Women's Association (SEWA) was registered as a trade union in Gujarat, with the main objective of "strengthening its members' bargaining power to improve income, employment and access to social security." In 1973, to address their lack of access to financial services, the members of SEWA decided to found "a bank of their own". Four thousand women contributed share capital to establish the Mahila SEWA Co-operative Bank. Since then it has been providing banking services to poor, illiterate, self-employed women and has become a viable financial venture with today around 30,000 active clients. The Self Help Group (SHG)-bank linkage programme is the flagship microfinance intervention mechanism of NABARD. The launching of its pilot phase in 1992 is considered as a landmark development in the history of banking with the poor. The informal thrift and credit groups of the rural poor came to be recognized as bank clients under the pilot phase. The pilot phase was followed by setting up of a working group on NGOs and SHGs by the Reserve Bank of India in 1994. SHG concept was considered as a potential intervention tool in the strategy of banking with the poor and thus
RBI advised banks to consider lending to the SHGs as part of their mainstream rural credit operations.

Beginning in the 1980s a new approach came to work on the assumption that more market-based solutions were required still focusing on income expansion and poverty reduction but searching for cost-effective alternatives (Ledgerwood 2000, Yaron et. al. 1998). Through the 1980s, the policy of targeted, subsidized rural credit came under a slow but increasing attack as evidence mounted of the disappointing performance of directed credit programs, especially poor loan recovery, high administrative costs, agricultural development bank insolvency, and accrual of a disproportionate share of the benefits of subsidized credit to larger farmers. The basic tenets underlying the traditional directed credit approach were debunked and supplanted by a new school of thought called the "financial systems approach", which viewed credit not as a productive input necessary for agricultural development but as just one type of financial service that should be freely priced to guarantee its permanent supply and eliminate rationing. The financial systems school held that the emphasis on interest rate ceilings and credit subsidies retarded the development of financial intermediaries, discouraged intermediation between savers and investors, and benefited larger scale producers more than small scale low-income producers. Meanwhile, microcredit programs throughout the world improved upon the original methodologies and defied conventional wisdom about financing the poor. First, they showed that poor people, especially women, had excellent repayment rates among the better programs, rates that were better than the formal financial sectors of most developing countries. Second, the poor were willing and able to pay interest rates that allowed microfinance institutions (MFIs) to cover their costs. These two features - high repayment and cost-recovery interest rates - permitted some MFIs to achieve long-term sustainability and reach large numbers of clients.

Another flagship of the microfinance movement is the village banking unit system of the Bank Rakyat Indonesia (BRI), the largest microfinance institution in developing countries. This state-owned bank serves about 22 million micro savers with autonomously managed micro banks. The micro banks of BRI are the product of a successful transformation by the state of a state-owned agricultural bank during the mid-1980s. The 1990s saw growing enthusiasm for promoting microfinance as a strategy for poverty alleviation. The microfinance sector blossomed in many
countries, leading to multiple financial services firms serving the needs of microentrepreneurs and poor households. These gains, however, tended to concentrate in urban and densely populated rural areas. It was not until the mid-1990s that the term "microcredit" began to be replaced by a new term that included not only credit, but also savings and other financial services. "Microfinance" emerged as the term of choice to refer to a range of financial services to the poor, that included not only credit, but also savings and other services such as insurance and money transfers. ACCION International, an early pioneer, was founded by a law student, Joseph Blatchford, to address poverty in Latin America's cities. Begun as a student-run volunteer effort in the shantytowns of Caracas with $90,000 raised from private companies, ACCION today is one of the premier microfinance organizations in the world, with a network of lending partners that spans Latin America, the United States and Africa. ACCION helped found BancoSol in 1992, the first commercial bank in the world dedicated solely to microfinance.

Concepts of Microcredit, Microfinance and Micro Finance Institutions
Microcredit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to and Robinson (2001). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidized rural credit programmes. These often resulted in high loan defaults, high losses and an inability to reach poor rural households (Robinson, 2001). Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank and Bank Raykat Indonesia (BRI) began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). The difference between microcredit and the subsidized rural credit programmes of the 1950s and 1960s was that microcredit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit (ibid.). It was now clear for the first time that microcredit could provide large-scale outreach profitably. The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale”. Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in
microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these other services (Microfinance Information eXchange, 2005). The importance of microfinance in the field of development was reinforced with the launch of the Microcredit Summit in 1997. The Summit aims to reach 175 million of the world’s poorest families, especially the women of those families, with credit for the self-employed and other financial and business services, by the end of 2015 (Microcredit Summit, 2005). More recently, the UN, as previously stated, declared 2005 as the International Year of Microcredit.

Microfinance is the term that has been used interchangeably with micro-credit. Microfinance is the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services (Christen, Rosenberg and Jayadeva, 2004). Microfinance refers to loans, savings, insurance, transfer services, microcredit loans and other financial products targeted at low-income clients (United Nations. 2005).

According to Menon (2005), microfinance or micro-credit is the extension of small loans to individuals who are too poor to qualify for traditional bank loans, as they have no assets to be offered as guarantee. According to Goodland, Onumah, Amadi and Griffith (1999), the formal sector comprises those institutions which are subjected to government and central bank regulation and include commercial banks and special agricultural financial organisations, savings and credit cooperative unions and finance programmes operated by NGOs. It is also explained by Goodland et al (1999), that the informal sector operates unofficially and escapes regulation and comprises a multitude of different institutions and activities that together play a significant role in Sub Saharan Africa. They include sophisticated but unregulated institutions (credit unions, indigenous banks, and pawn shops), money lenders, merchants, shopkeepers, pawnbrokers, loan brokers, landlords, friends and family, money guard, savings groups, rotating savings and credit associations, accumulated savings and credit associations and employers. Microfinance institution is the term that has been used to mean institutions that provide microfinance services. Microfinance institutions also known as MFIs, offer financial services to undeserved, impoverished communities and these services include savings accounts, insurance, health care and personal development (Brennan 2008). There are basically the formal and informal types of
microfinance services provided by specific institutions. In India, a range of institutions in the public sector as well as the private sector offers microfinance services. These can be broadly categorised as formal and semi-formal institutions. The former category comprises apex development financial institutions, commercial banks, regional rural banks and cooperative banks. These provide microfinance services in addition to their general banking services and thus are referred to as microfinance service providers. On the other hand, semi-formal institutions undertake microfinance services as their main activity and thus are referred to as microfinance institutions. MFIs are mainly in the private sector.

**Importance of Microfinance and Micro Finance Institutions**

Tesar (1991) find that not only credit, but also savings tends to contribute to economic development. Savings would reduce the vulnerability of the poor to economic shocks and hopefully, enhance their standard of living. Healthy MFIs have a stake in enhancing both social and economic goals. In a global survey, Christen et al. (2004) observe that MFIs, despite their vast outreach, only serve a minority of the unbankable clientele and may suffer significant limitations such as weak loan collection, political domination, subsidy dependency and lack of supply-driven focus on poor clients. Insurance policies including micro insurance can help enhancing the predictability of socio-economic development (Mccord, 2004). Public policy at micro and macro levels has an interest in enhancing local development and investment (Renneboog et al., 2008) and this can be stimulated through microcredit. Credible commitments are important for poor households who have difficulty in saving. Such difficulty can be due to poor self-control, lack of attention to planning or family members asking for money insistently. The proliferations of informal financial devices such as ROSCAs show that the poor feel the need for commitments (Rutherford, 2000; Johnson, 2004; Guerin, 2011). Rigid microcredit contracts with a weekly repayment schedule are popular among people with self-control problems (Bauer et al., 2008). Evidence shows that commitment savings products incorporating enforcement mechanisms effectively help the poor to reach their savings target (Ashraf et al., 2005, 2006; Karlan et al., 2010).

Studies conducted by Choudhari (1972 et al.), Attwood (1984), Baviskar and Attwood (1984) and Attwood and Baviskar (1987) on the effectiveness of cooperatives of agriculture sector show
that it is not only the process of production and distribution which leads to success or failure of cooperatives in different regions of India. Participation of poorer members of cooperatives in decision-making was less. The emphasis of support under microfinance is on the poor in ‘pre-micro-enterprise’ stage for building up their capabilities to handle larger resources. This perception is quite significant, keeping in view the limitations of any approach of micro-enterprise development to help the poorest of the poor for self-employment (Awasthi, 1994, 1996). It was observed by Sriram (2002) that 28% of the funds of MFIs are soft loans provided by development banks and dedicated microfinance wholesalers. Sinha (2003) pointed out that the poorest of the poor are excluded because the effective rates of interest charged by Microfinance Institutions are in the range of 14% to 36% per annum. According to Sinha, even after charging high interest rates the ‘financial spread’ being earned by the average Microfinance Institution in India is barely 11% leaving a 7.5% gap between it and the operating expense level of 18.5% of average portfolio. Goodwin-Groen and Ruth estimated that not even 10% of the MFIs in the Asia-Pacific region had achieved break even, let alone generate surplus. Evidence suggests that 80% of the poor do not have any savings and 91% are without any formal credit (EDA, 2004).

For Micro Finance Institutions (MFIs), clients’ discipline serves to ensure that lenders are more aware of borrowers’ financial situations, reducing the likelihood of clients’ delinquency and default. For MFIs, flexibility is good because it would increase clients’ satisfaction, reduce client dropout and encourage new clients to take up the products. Problems of delinquency and overindebtedness can be reduced by helping the poor to manage their money (Wright, 2001; Chaudhury and Matin, 2002; Meyer, 2002; Karlan and Mullainathan, 2006; Schicks, 2011). Ravi (2006) mention that ad hoc payment schedules permit households to save cash as soon as it is available, avoiding the temptation to spend it on miscellaneous expenses. But flexibility is important for the poor because it helps them to smooth consumption, cope with emergencies and take advantage of business opportunities. Product flexibility refers to the case with which financial transactions are adapted to clients’ cash flow (Collins et al., 2009). The microfinance industry uses certain mechanisms such as joint liability, frequent regular repayment schedule without grace period, progressive lending, intolerant policy towards default and compulsory savings which are rigid and standardized (Armendariz and Morduch, 2010). Field et al. (2011) mentions that allowing for a grace period in loan repayment would expand the range of
investment opportunities that loans could be used to finance. Permitting prepayment of loans or offering passbook savings account with no restriction on deposits would give the poor a means of investing unexpected small financial surpluses (Meyer, 2002; Karlan and Mullainathan, 2006; Collins et al., 2009; Hudon et al., 2009; Shoji, 2010). On the demand side, product flexibility weakens the effectiveness of the commitment and might deteriorate clients’ discipline. On the supply side, product flexibility raises MFIs operational expenses and worsen loan repayment rate (Laureti, 2011).

**Market Structure and Microfinance**

A larger issue concerns the structure of the market. Although there is no evidence of exploitation of a kind stressed by Bhaduri (1977), the market is inefficient and in principle at least, interventions could yield a larger pie. If a microfinance institution could find new ways to lend to those same villagers and charge 25, 50 or 75 percent, efficiency is improved. Adams (1984) argues that markets are competitive since there is relatively free entry by locals. Aleem (1990) suggests that the apparent confusion may derive from a conflation of ‘free entry’ and ‘competition’. In Chambar market of Pakistan, he finds free entry but it better resembles monopolistic competition. He argues if markets are truly competitive then interest rates should be driven down to the marginal cost of lending which is typically below the average cost. Aleem describes a situation in which there are too many moneylenders serving too few clients. As a result, moneylenders have difficulty covering the fixed costs of lending and interest rates stay high because returns to scale cannot be reaped. Floro and Ray (1997) focus on trader moneylenders who are in a monopolistically competitive market. In their model, the moneylenders in a region want to collude to keep interest rates high and collusion is enhanced by the threat of a ‘credit war’. When credit war occurs, lenders rapidly expand credit, which drives down interest rates and undercuts the profitability of the deviating lenders. But with the injection of funds, the possibility of a viable credit war increase which makes collusion easier thus increasing interest rates and making poor borrowers worse off. Thus intervention in the form of a microfinance institution should not only consider reasons such as high interest rates charged by moneylenders but should also see how the efficiency and equity of outcomes will change as a result. Steel et al. (1997) also provide evidence that average costs are much higher than marginal
costs in surveys of moneylenders in Ghana, Malawi, Nigeria and Tanzania. In perfectly competitive markets, interest rates should be driven down to the marginal cost, but clearly this has not happened in these cases. A different way to expand financial services is by increasing supply. Increasing the supply of capital will alleviate credit constraints and reduce interest rates for poor borrowers. Subsidizing the capital infusion should in principle, create even stronger downward pressure on interest rates. Hoff and Stiglitz (1998) conclude that the new entry increases excess capacity among moneylenders and raises unit costs. According to Bose (1998), new entrants must lend to lower-than-average-quality borrowers, since the highest quality borrowers are already in relationships with established moneylenders. Serving lower-quality borrowers increases the average default rate and raises the risk premium that must be charged. Shetty (2002) suggests that it is necessary to encourage different institutions such as commercial banks, Regional Rural Banks (RRBs), Cooperatives, district and block development officers and NGOs to serve SHGs. The practice of achieving a targeted number of SHGs by public institutions should be given up because such a tendency gives rise to unhealthy results associated with forced achievements. Satish (2005) suggested that the growth of microfinance has to necessarily be accompanied by the overall growth in mainstream rural finance. Sriram (2005) argues that emergence of the microfinance movement is often attributed to the failure of cooperatives in providing sustained access to credit to the poor. Basu and Srivastava (2005) suggested that the government should also play an active role to increase efficiency of finance markets such as better laws and regulations governing financial transactions, better credit information and improved price discovery in rural markets. Thingalaya et. al. (2006) made an empirical study of six districts in Karnataka state and suggested that it is necessary to avoid target fixation and credit mapping for microfinance has to be prepared with a long-term perspective. Tripathy (2006) opines that the inherent limitations of the formal and informal financial sectors in providing financial services to the needy and the poor have led to the emergence of microcredit programmes. Raj (2007) suggested that there is an imperative need for avoiding target fixation, subsidy distribution and political intervention. SHGs should be provided with vocational training and organizational support for marketing.
Cost of lending to the Poor

Collateral acts as an ex post way for lenders to recoup losses and to impose a cost on defaulters (Benjamin, 1978; Barro, 1976). Lending to the poor involves high transaction cost and risks associated with information asymmetries and moral hazards (Stiglitz and Weiss, 1981). The willingness and ability to post collateral acts as an ex ante signal of willingness and ability to repay (Bester, 1985; Chan and Thakor, 1987). Lack of collateral increases the costs for lenders to judge risk and to enforce repayment (Nagarajan and Meyer, 1995). Harper (1998) opines that the success of the microfinance institutions is in a large measure due to their adoption of many of the strengths of the traditional forms of financial intermediation. Cost of outreach to user refers to cost of a loan to a borrower. These costs to users might consist of prices like interest rates and various payments that they have to pay which could be revenue to the lender, and other loan related transaction costs like expenses on documents, transport, food, taxes etc. (Navajas et al. 2000). Madeshwaran and Dharmadhikari (2001) stated that due to high transaction costs; the perception of risk in serving the rural population who are unable to provide collateral, articulate their case for or submit proper deposit/loan proposals, the urban orientation of banks, the lack of flexibility in terms of operation, ignorance and the lack of exposure to banking services, etc., banks were finding it difficult to inculcate banking habits and provide access to banking services, which proves to be costly. Robinson (2001) opines that providing credit to people who are too poor to use it effectively helps neither the borrower nor the lender and would only lead to increasing of debt burden and erosion of self-confidence and suggests that this segment should not be the target market for financial sector but of state poverty and welfare programmes. Simanowitz and Walker (2002) observe that microfinance is a compromise between social and financial objectives and most emphasis has been on financial and institutional performance. Vatta (2003) pointed out that MFIs are best suited to reach the rural poor and to address the basic issues of rural development where the formal financial institutions have not been able to make a dent. The ease of obtaining the loan compensates the higher costs. Oladimeji and Ajisafe (2003) studied the role of NGOs engaged in microcredit delivery across the country. The results show that membership and outreach of these institutions have been expanding greatly; however the overall effective cost of credit from these institutions is too high to encourage entrepreneurs. Silwal (2003) notes the correlation between repayment troubles and the frequency of required
installments. He compares repayment performance in nine villages in Nepal and finds that 11 percent of loans were not repaid by the end of the loan period when installments were weekly while twice that rate were delinquent when loans were paid in a single lump-sum payment at the end of the loan’s maturity. Kalpana (2005) argued that the joint liability peer monitoring and peer pressure that are built into the organizational structure are identified as the key features addressing the critical problems of screening, incentive and enforcement at reduced transaction cost to lenders. Ladue, Gloy and Cuykendall (2005) from their study found out that all sizes of agricultural loan relationships can be profitable. Both large and small loan relationships make substantial contributions to lender overhead and profit. The presence of substantial economies of size indicates that on a per unit basis, the cost of extending credit falls considerably as loan volume increases. This contributes to high profit potential for large loans and implies that in the competitive agricultural lending market large borrowers will generally receive favourable rates. Nair (2005) suggested that there is a need to upscale the provision of microfinance on the strength of its performance measures primarily in terms of the repayment rates. The focus on financial sustainability has meant that much of the evaluation criteria for microfinance interventions is based on institutional performance. Weber (2006) says that while the virtuous impact of microfinance is used to justify its expansion, much of the assessment is based on institutional success and avoidance of engaging with impacts. He also argues that such an approach constitutes the ideology and practice of neoliberalism as it is based on the ontological premise that competitive financial institutions provide the foundation for entrepreneurial success and are best suited to reduce poverty. Meissner (2006) stated that the generated effective operating income and the nominal intermediation margin at PACS level are not sufficient to cover the transaction costs and cost of risk of SHG lending at the PACS level. He also stated that trade-off between staff cost and loan loss provision exists. Shankar (2006) reported that in India preferred form of microfinance loan is group lending. According to a study by Sa-Dhan only 7% of microfinance loans in India are given to individuals. The operational cost for lenders can be expected to be lower in the case of individual loans since group loans have certain peculiar costs associated with such as group formation and training. Sundarashyam and Salim (2006) in their study revealed that the contribution of poor and vulnerable households to the economic development of the country is largely affected by their ability to access credit and create wealth.
They suggest that since microfinance programmes differ radically from traditional banking therefore, several strategies can be adopted to reduce the costs. Kereta (2007) in his study identified no evidence of trade-off between outreach and financial sustainability for Ethiopian case, rather positive correlation was observed between them. Yet, correlation test among loan size (which measures poverty level), outreach and profit performance revealed imprecise results.

**Problems of Repayment and Indebtedness**

Behavioural economics highlighted that continued demand for a product does not automatically prove it beneficial. Micro borrowers are over-indebted when they continuously struggle to meet their repayment deadlines and structurally have to make unacceptably high sacrifices to repay. When heavily indebted borrowers still manage to keep their repayments up, they already suffer from the cost of repayment. Brett (2006) finds micro borrowers in Bolivia to rely on cash support from their families and social network, take on additional debt, sell assets, reduce the quantity and quality of their food and to take on additional paid labour to be able to repay on time. Typical human challenges such as temptation and an inconsistent evaluation of benefits over time can lead to unreasonable spending, under-saving and over-borrowing (Ashraf et al., 2006; Banerjee and Duflo, 2007; Banerjee and Mullainathan, 2009; Schicks, 2010). The risk of over-indebtedness gave rise to an argument against the right to credit that is often encouraged by promoters of the microfinance industry (Hudon, 2009). With a higher burden of debt expenses in relation to income, over-indebted borrowers live on a lower consumption level than their peers (Betti et al., 2007) and have lower buffer shocks (Burton, 2008). In addition to sacrificing current income, Gonzalez (2008) identifies similar repayment sacrifices in Bolivia and adds reductions in human capital investments, pointing out that over-indebtedness lead to lower education levels, lower income-generating capacity and lower household welfare in the long-run. Schicks (2011) finds that borrowers are likely to experience impoverishment due to over-indebtedness. They may also experience sociological consequences such as social stigma, peer pressure, domination in the household, shame and coercion and the loss of their social networks. They can also experience potential psychological effects of over-indebtedness causing depression or deterioration in physical health. Canner and Luckett (1991) and Drentea and Lavrakas (2000) identified similar kinds of sacrifices in microfinance in developed countries.
Inspite of sacrifices, when an over-indebted borrower is no longer able to repay his loan on time and delays, it triggers new consequences- the costs of delinquency and default (Stearns, 1991; De Vancy and Lytton, 1995). Canner and Luckett (1991) points out that being in debt represents a sociological cost thus leading to the burden of asking others for help. Rahman (1999) points out that being in debt bears the pain of peer pressure in solidarity groups, marital tensions, domination and violence towards women borrowers in the households and detaining borrowers at group meetings beyond schedule. In case of microfinance markets, there are reports of coercive collection practices and even imprisonment from microfinance markets (Montgomery, 1996; Hulme, 2007). The social pressure in group lending represents a high sociological cost for borrowers (Besley and Coate, 1995). Over-indebtedness can lead to a loss of business opportunity if business partners withdraw when their reputation deteriorates (Besley and Coate, 1995; Smets and Bahre, 2004). Due to over-indebtedness, borrowers may experience a loss of income due to reduced workplace performance (Bagwell, 2001) and higher workplace absenteeism (Jacobson et al., 1996; Kim et al., 2008). Peer pressure tends to start with gossiping about delinquent group members, insulting and humiliating and sometimes threatening them as applying physical violence and destroying the defaulter’s belongings (Montgomery, 1996; Smets and Bahre, 2004; Hulme, 2007). The most important cost of default is the seizure of collateral or other assets (Hulme, 2007). A seizure usually represents a serious loss to the household and in some cases reduces the borrower’s future income-generating capacity. Indebtedness can harmful effects on reputation and represents a principle of social differentiation and source of shame for borrowers. Roesch and Helies (2007) find that in Southern India, even in a microfinance environment, people consider debt as bad and try hard to avoid it. Dichter (2007) claims that the fact of being in debt is charged with strong negative symbolism and implies an emotional burden for the debtor as well as social stigma in the eyes of others. Similarly, Guerin et al. (2011) explain that in Tamil Nadu, to be involved in debt implies surrender, dependence and even servility.

According to empirical research by Brown (1952) with data from Canada, the existence of household debt is correlated with lower psychological well-being of the household head. There are financial consequences of over-indebtedness related to higher screening expenses, collection costs and other operating costs of dealing with over-indebted customers (Canner and Luckett,
In the case of default, write-offs permanently reduce the size of the income earning portfolio (Stearns, 1991). Over-indebtedness not only affects the delinquent borrower but also leads to an erosion of social trust and mutual support in the community, disturbing informal credit relationships and social networks (Montgomery, 1996; Smets and Bahre, 2004; Banerjee and Mullainathan, 2009; Morvant-Roux, 2009). Sen (1999) points out that if poverty equals capability deprivation, then depriving the borrower of respect, self-dependence and freedom of choice are also mechanisms of impoverishment. Drentea and Lavrakas (2000) and Webley and Nyhus (2001) show that debt is positively associated with behaviours of low self-control. The stigma of over-indebtedness can lead to a loss of self-confidence and of one’s social network and safety nets (Smets and Bahre, 2004; Guerin et al., 2011). Bridges and Disney (2005) find a relationship of debt to psychological stress to the extent of depression. In developed and developing countries, over-indebtedness has pushed defaulters into crime and suicide (Fouillet, 2006; Dichter, 2007; Dossey, 2007; Hulme, 2007; Burton, 2008). According to Gloukoviezoff (2008), the effect of debt varies between borrowers, some managing to rationalize and mitigate the shame and others suffering from guilt and shame leading to mental health deterioration. In the Bolivian over-indebtedness crisis, debtors even formed associations aiming to release borrowers from their repayment obligation (Gonzalez, 2008).

The adverse selection problem occurs when lenders cannot distinguish inherently risky borrowers from safe borrowers. If lenders could distinguish by risk type, they could charge different interest rates to different types of borrowers. Adverse selection may lead to credit rationing because it induces lenders to charge everyone high interest rates to compensate for the possibility of having very risky borrowers. The trouble arises when safe borrowers are thus deterred from applying for loans. Group lending with joint responsibility can mitigate this inefficiency. The fact that groups are encouraged to form on their own is the key to the solution. Potential borrowers can use their information to find the best partners. Faced with the prospect of joint responsibility for loans safe types group with safe ones and thus the risky borrowers have no alternative but to form groups with the risky types leading to a segregated outcome known as assortative matching. Risky borrowers have to repay for their defaulting peers more often under group lending with joint responsibility otherwise they will be denied future access to credit.
Profitability and Sustainability of MFIs

Standard enforcement mechanisms used in microfinance serve MFIs to deal cost effectively with information asymmetries, assuring that loans are repaid on time without incurring in excessively high transaction costs. But standard enforcement mechanisms do not allow financial transactions to be adapted to clients’ cash needs. Sadoulet (2002) shows that repayment insurance should be provided only after the first loan cycle and only to those clients who achieve a good reputation for loan repayment but with the increase in number of loan cycles, the lender must impose additional sanctions to deter defaults and insurance claims. Tedeschi (2006) proves that the punishment for defaulting clients need not be a lifetime without credit if the client has much to gain from borrowing. Mcintosh (2008) found that a monthly repayment schedule enhanced both clients’ repayment of loans and their satisfaction with the product, measured by a decrease in the dropout rate compared with a weekly repayment schedule. Recent evidence showed a higher productivity of rural MFIs with respect to urban, as a result of a less disperse target client population (Gonzalez, 2008). Targeting poor is more expensive and worsens operating efficiency by limiting the scope of diversification and the possibility of disbursing loans with respect to more relaxed forms of targeting (Gonzalez, 2010). Recent research efforts explored potential relationships between social and financial performance by suggesting the existence of related synergies rather than trade-offs between the two (Gonzalez, 2010; Bedecarrats et al., 2009; Dewez and Neisa, 2009; Microfinanza Rating, 2010). Fisher and Ghatak (2010) explain that high frequency repayment schedule increases the size of loan clients will take on a given set of enforcement mechanisms. But Field et al. (2011) found that the introduction of a two-month grace period into loan contracts increased delinquency and default. Some authors use theoretical models to explain the trade-off and find ways to overcome asymmetric information with flexible loan contracts. Hamp and Laureti (2011) suggests two potential trade-offs when balancing flexibility and discipline, mainly for the credit market. First, flexibility may result in higher costs for enforcing loan contracts, especially for acquiring information on clients to evaluate their preferences, repayment capacity etc. Second, MFIs tend to offer flexibility to households with diversified cash flows, households with collateral, and households with large savings thus excluding poorer and more vulnerable households that may benefit from access to credit.
Flexibility increases MFIs’ costs but does not seem to bring with it a broadening of their client base.

Hermes et al. (2007) suggest that there is empirical evidence on a negative correlation between social and economic performance of MFIs. The ‘welfarists’ promote the social performance and outreach goal (Woller, 2002) while the ‘institutionalists’ stress the importance of sustainability and efficiency (Isen and Porteous, 2006). A third group promotes a more balance view, claiming that both approaches go hand in hand (Morduch, 2006; Helms, 2006). Research claim that combined microfinance (CMF) can be good for the sustainability of MFIs (Ahlin and Yang, 2008). Galema et al. (2010) suggests that commercialization is the driving factor of CMF. MFIs can lose focus from the social mission if too much focus on economic performance is given (McIntosh and Wydick, 2005; Labie, 2004). MFIs would increase efficiency by enlarging the average loan size in the process of scaling up (Mersland and Storm, 2010; Armendariz and Szafarz, 2009). The continued pressure for commercialization may also involve increased profit making and the setting of high interest rates (Ashta and Hudon, 2009). Policy makers could develop various mechanisms to enhance the sustainability and economic performance of new products being developed by MFIs (Armendariz and Morduch, 2010).

**Choice between Individual and Joint Liability Loan Contract Systems**

Empirical research on group versus individual liability lending has not provided policymakers and institutions the clear evidence required determining the relative merits of the two microfinance systems. Instead the focus has been on which group characteristics lead to higher repayment or which program design do individuals choose. Huppi and Feder (1990) observed that the most successful group lending programs have been those where loans were made to self-selected groups of homogeneous individuals belonging to the same village and with similar economic standing. Fuglesgang et.al. (1993) state that even micro lenders who have become world famous for their group loan methodology such as Grameen Bank of Bangladesh do in fact also rely heavily upon highly motivated and locally recruited loan staff officers as monitors and organizers. Besley and Coate (1995) point out that borrower who would repay under individual liability may not do so under group liability. This situation may arise if members realize that they cannot repay as a group. Social collateral can help make joint liability work better than
individual liability. Microfinance practitioners are themselves in no way in agreement about the relative merits of group loans. Critics contend that the purported benefits of group loans have been exaggerated and that the methodology is often overly rigid and poorly adapted to borrower’s needs. They argue instead for simpler individual liability loans monitored by locally recruited loan officers, which they claim achieve results that are every bit good or better than group loans. Khandker, Khalily and Khan (1995) taking evidence from Grameen Bank and replications elsewhere in Asia find that 15.3 percent of male borrowers were struggling in 1991 while only 1.3 percent of women were having difficulties. Kevane and Wydick (2001) find that at a group lending institution in Guatemala, female borrowing groups misused funds least often, and as a result, outperformed male borrowing groups. Conning (1999) and Morduch (2000) summarize some of the main policy disagreements in the field. One camp, the so called ‘institutionalists’ tends to favour individual liability loans and financially sustainable lending, while ‘welfarists’ are more likely to support group loans and targeted outreach over financial sustainability. Conning (2000) has shown that an advantage to joint liability loans exist even under the more realistic assumption that borrowers cannot side-contract and monitoring is costly and subject to moral hazard. Ghatak (2000) in his theoretical study explained how joint liability can achieve high repayment rates even when borrowers have no conventional collateral to offer. Ahlin and Townsend (2002) raised a question – which type of loan contract has a higher repayment. They observed that social structures that enable penalties can be helpful for repayment while those which discourage them can lower repayment. Ahlin and Townsend (2003) in their study found that a wealth level further away from the village average makes choice of a group loan over an individual loan more likely. Anderson and Baland’s (2002) article on ROSCAs reports on a survey of hundreds of women in Kenya and concludes that an important motive for women joining ROSCAs is to keep money away from their husbands. Other studies, not necessarily confined to ROSCAs suggest that savings considerations apply as well to women’s involvement in microfinance institutions. Laffont and Rey (2003) in their investigation of moral hazard and group lending state that close ties and information sharing among borrowers open the way for contracts that improve on traditional individual lending contracts. But on the other hand, the scope for collusion against the lender increases when borrowers share knowledge and social ties. If borrowers do not collude, Laffont and Rey show
that group lending contracts are superior to individual lending contracts because the contracts take advantage of borrower’s knowledge and social ties. But if borrowers collude, then they show that group lending is superior to these alternative mechanisms. The contract delivers outcomes that are not as good as could be obtained if the lender had full information on borrowers, but it beats any alternatives. Their bottom line is that having more information leads to contracts that improve on standard individual lending contracts, even when borrowers collude against the lender. Madajewicz (2004) established that lenders who use individual liability loans look no different than do group lenders when judged by repayment rates and they tend to be more profitable. She also stated that the poorest borrowers served by group lending programmes are often poorer than the poorest clients of individual lenders. Even if group liability does not jeopardize repayment, theory also suggests it may do no better than individual liability. Rai and Sjostrom (2004) show that both individual and group liability alone can be dominated by a contract that elicits truthful revelation about the success of the peers’ project. Weiss and Montgomery (2004) observe that high recovery rates may be due to intense group pressure and do not reflect the capacity to repay. Armendariz and Murdoch (2005) argued that group lending contract provides a way to achieve efficient outcomes even when the lender remains ignorant or unable to effectively enforce contracts. Group lending does better than traditional individual lending and makes lending sustainable by inducing peer monitoring and overcoming enforcement problems. Roy Chowdhury (2005) in his study showed that in the presence of joint liability, the rate of monitoring is higher thus leading to a greater rate of repayment. An institution with perfect repayment may be more profitable with lower repayment but a larger client base. Sinha (2005) observed that microfinance is making significant contributions to both savings and borrowing of the poor in the country. The study concluded that SHG model is exceptional in providing a saving based mechanism for internal group credit to meet household needs. This mechanism also serves to facilitate access to credit by poor clients, who are more likely to need small amounts of credit for immediate household purposes. Simtowe and Zeller (2006) have shown in their study that micro finance institutions offering both joint and individual liability loan contracts must relax their rule on joint liability by allowing borrowers with dynamic and growing investments who make use of group loans at the beginning to switch individual credit offers when they are in need of higher loans to reduce mismatching problems and enhance
dynamic incentive. Shankar (2006) reported that in India preferred form of microfinance loan is
group lending. Rajeev, Ranade and Deb (2006) have obtained during the survey that the poorest
of the poor are the most prompt repayer of loans because farmers who have no other source of
funds like own fund or relatives to borrow from, need to depend on reputation. Therefore in the
face of imperfect information, for them to build credibility prompt repayment is of utmost
importance. On the other hand, the comparatively richer farmers have automatically attained
some trust from the lenders as their paying capabilities are higher and they often have alternative
source of financing. Gine and Karlan (2007) observed that individual liability compared to group
liability leads to no change in repayment but did lead to more individual borrowing. They also
found statistically significant evidence of screening and monitoring but did not find that it adds
to economically meaningful way to higher default. Lightfoot from Bank for Agriculture and
Agriculture Cooperatives (BAAC) stated that farmers involved in joint liability borrowing are
relatively small scale farmers who borrow relatively small amounts. Sarangi (2007) in his study
indicates the exclusion of very poor households from participation in group-based credit
programs. Madajewicz (2004) established in her theoretical model that group liability loan is
only desirable for the poor borrowers. In her model, below a certain level of wealth, group
liability dominates individual liability. But above a certain wealth individual liability will be
preferred by rural households. Gangopadhyay, Ghatak and Lensink (2005) argued that by
exploiting local information, joint liability lending can improve efficiency compared to standard
debt contracts in the presence of asymmetric information about borrow types. When other
potential screening instruments such as collateral, are not available, joint liability lending
becomes a particularly attractive method of lending. Fedele (2005) showed that the repayment
rate and welfare improve under joint liability contracts with respect to conventional individual
liability contracts because the former is able to exploit the information borrowers have about
each other. Kritikos and Vigenina (2005) in their empirical study found that joint liability
induces a group formation of low risk borrowers. After the loan disbursement, the incentive
system leads to peer monitoring, peer support and peer pressure between the borrowers, thus
helping the lending institutions to address the moral hazard and enforcement problem. Gine and
Karlan (2007) found less willingness among bank officers to open groups despite no increase in
default. According to Lehner (2008), micro finance institutions offer group loans when size of

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credit is quite large. With a rather small loan size, all micro finance institutions offer individual loans Kundu (2009) in his primary data based study observed that wealthier among the less affluent rural households prefer to join microfinance system operating on the basis of individual liability loan contract through a micro finance institution and comparatively less wealthy households prefer to join micro finance system operating on the basis of joint liability loan contract. But households with no asset or little valued asset are less possible to join in any micro finance system.

**Economic Impact of Microfinance through Individual Liability Loan Contract System**

The main argument raised against the individual contract is that the collateral requirement makes it impossible to reach the target group of poor people since it is in particular them who have nothing to pledge as collateral (Khandker 1998). Todd (1996) found that many borrowers were using loans to purchase land, rather than to complete their proposed projects. Her anecdotal evidence is consistent with the evidence of relatively frequent and larger land purchases. The fruit of those investments are not apt to show up immediately, and it is possible that stronger impacts of the microfinance programmes would show up in time. Hulme and Mosley (1996) concluded that growth in incomes of borrowers always exceeds that of control group. They also found that positive impacts on income are larger for better-off borrowers. Morduch (1998) argued that access to the microfinance programmes is associated with substantially lower variation in labour supply and consumption across seasons- a benefit that may be considerable for poor agriculture-based households. At the same time, no evidence was found to support claims that the programmes increase consumption levels or increase educational enrolments for children relative to levels in control villages. Khandker (2001) confirm that programmes make a difference to poor participants by raising per capita income and consumption as well as household net worth, thereby increasing the probability that the programme participants lift themselves out of poverty. The welfare impact of microfinance is also positive for participating and non-participating households, indicating that microfinance programmes help the poor beyond income redistribution and income growth. Zeller et. al. (2001) found different impact estimates depending on the season. They noted that substantial difference between their estimate and that of Pitt and Khandker (1998) and explained that their measures were not only the effect
of actual borrowing, but also the effect of access to credit, that is, the ability to borrow sometime in the future even if the household in the current period chooses not to borrow. Coleman (1999) found no significant impact of access to microcredit on improving household wealth. Coleman (2006) found that the insignificance was limited to general beneficiaries and that a positive impact was found among committee members who received access to financing. Puhazhendhi and Satyasai (2000) in their study commissioned by NABARD spread over 11 states across India found that 58.6% of sample households registered an increase in assets from pre to post SHG situation, an additional 200 economic activities taken up by sample households from 73.9% to 57%. Another study commissioned by NABARD in 2002 in eastern India also corroborate the findings of earlier evaluation with 23% rise in annual income and 30% increase in asset ownership among 52% of sample households. Meyer (2002) concluded that while access to micro credit seems to have an overall positive effect on income and education, results differ substantially across countries and programmes both in magnitude and statistical significance and robustness. Maldonado, Gonzalez-Vega and Romero (2003) state that greater access to land and therefore to opportunities for farming appear to increase the household’s demand for child labour, as participants in the household’s own productive activities. Land tenure policies, therefore, while increasing income opportunities for the household may, at the same time, increase the opportunity cost of keeping children at school. Similar effects might be created with the encouragement of household microenterprises. Agricultural intensification policies, rather than land intensification substantially increase the productivity of available household labour and other resources and improve the returns on human capital. Estimates in Montogomery (2005) using data from Pakistan found a mild significant impact on per capita food expenditure in the months after the beneficiary first borrowed. However, access to microcredit did not have a significant impact on non-food expenditure. Menon (2005) demonstrate that although membership has beneficial impacts on a household’s consumption smoothing ability, members may become less dependent on programmes after a few years of participation. Greelay (2005) rightly notes that in absence of specific poverty targeting and mainstreaming of impact assessment, the claims about the impact of microfinance on the achievement of Millenium Development Goals lacks credibility. World Bank policy research paper (ibid) 2005 details the findings of Rural Finance Access Survey (RFAS) and indicate 72% average increase in real
terms in household assets, shift in borrowing pattern from consumption loans to productive activities and 33% increase in income levels. Reliance on credit off take and recovery as a proxy for positive economic development ignores the critical issue of impact assessment at client level. Dichter (ibid) feels that the use of proxies like repayment rate to justify impact is not tenable as it does not examine the source of repayment. Deubel (2006) citing (Buckley, 1997) states that loan repayment rate as an indicator may show participant’s ability to repay but does not take into account the impact of loan on enterprise. Bebezuk and Haimovich (2007) found that credit increased labour income in a statistically and economically significant manner. Asian Development Bank (2007) concluded that there was no significant difference between those who received microcredit loans and those who did not. Jamal (2008) suggest that microfinance intervention possibly helps in smoothing consumption, especially in urban areas and in generating income. No significant differences between borrowers and non-borrowers are evident regarding the expenditure on education and health also girls’ schooling.

**Economic Impact of Group Lending Scheme**

Group lending contract can help lenders reduce interest rates even when neither the bank nor the clients have information about who is safe or risky. In the process adverse selection can be mitigates and a greater number of worthy borrowers can get access to credit. Group lending with joint responsibility may circumvent moral hazard problems in lending thereby relaxing credit constraints. Stiglitz (1990) argues that the group lending contract circumvents ex ante moral hazard by inducing borrowers to monitor each others’ choice of projects and to inflict penalties upon borrowers who have chosen excessively risky projects. Montgomery (1996) argues that BRAC’s implementation of group lending can lead to forms of borrower discipline which are unnecessarily exclusionary and which can contradict the broader aims of solidarity group lending. He contends, loan officers put sharp pressure on borrowers to repay, even when the borrowers faced difficulties beyond their control. Matin (1997) has written that the staggered disbursement of loans helps to ensure that there is often someone in the larger group that is close to qualifying for a next loan and thus particularly open to suasion. Ghatak (1999) hinges on the functioning of multiple groups within a village so that borrowers can freely sort themselves into groups on the basis of risk. Indeed larger groups may be better able to deal with risks and less vulnerable to collusion. The finding that groups of strangers do as well as groups of friends
conflicts with arguments about the role of social capital and social sanctions in microfinance. Wydick (1999) studied group lending in Guatemala and concluded that social ties per se have little impact on repayment rates. He studied that participants are sometimes softer on their friends, worsening average repayment rates. Laffont and Rey (2003) argue that group members are affected by the actions and inactions of other members- means that they will take steps to punish anyone who puts in little effort and thus burdens the group with excessive risk. Ahlin and Townsend (2003) also find that proxies for strong social ties are associated with weaker repayment performance in evidence on group lending in Thailand. Karlan (2003) argues that social capital helps in Peru. He finds that default leads to dropout from the programme, the effect is accentuated for clients with more social capital. The finding suggest the possibility of beneficial risk sharing i.e., clients who are forced to default due to circumstances beyond their control are less likely to be forced to leave the programme when the clients have strong social ties to the rest of the group. Karlan’s results thus show that group contract can harness local ties in ways that traditional lending contracts cannot.

Wenner (1995) finds that social cohesion is a positive force in groups in Costa Rica. Wenner’s investigation of repayment rates shows that delinquency rates are higher in wealthier towns where, presumably, clients have more abundant outside options. The result is echoed by Sharma and Zeller (1996) in their study of three programmes in Bangladesh but not Grameen. But Khandker, Khalily and Kahn (1995) while investigating the Grameen Bank and other Bangladesh banks find that both dropout rates and repayment rates increase in better-developed villages. Gomez and Santor (2003) find that default is less likely if there is greater trust and social capital and is members have known each other before joining the groups. Another empirical issue involves the role of diversity in groups. The theories that stress the positive role of social capital and social sanctions suggest that less diverse groups will do better. Sadoulet (2003) states that diversity can help because greater diversity means those group members’ incomes are less likely to vary together and thus group members’ ability to insure each other increases. If diversity helps then borrowers should try to form groups that are broad. Sadoulet and Carpenter (2001) find a similar result while studying groups in Guatemala.
There is a huge network of institutions of development in India to alleviate poverty and generate employment. But anti-poverty programmes could not be implemented properly. Studies conducted by Ansari (1980), Jain (1984), Chaturvedi and Mitra (1987) and Ray (1992) show that the rural development programmes were centrally invented (lacking participations of local level institutions), politically motivated, having leakage and misappropriation and heavy administrative expenses. Consequently, poor quality assets were provided to the beneficiaries for productive purposes. Studies conducted by Basu (1979), Chippa (1987), Netherlands Development Cooperation (1992) and Rayadu (1992) show that rural credit schemes were politicized. There was lack of mobilizing local savings. Regional distribution of agricultural credit was inequitable. The findings by Hulme and Mosley (1996) stated that poor households do not benefit from microfinance; it is only non-poor borrowers (with income above poverty lines) who can do well with microfinance and enjoy sizeable positive impacts. Hashemi (1997) finds important underlying differences between borrowers and non-borrowers in villages served by Grameen Bank and BRAC. Over half of those who chose not to participate did so because they felt that they could not generate adequate profits to reliably repay loans. Another quarter opted out due to religious and social sanctions that restricted the ability to participate in meetings outside the house with non-family males. Khandker (1998) is of the opinion that the appropriateness of microcredit as a tool, for reducing poverty depends on local environment. Many microcredit programmes have attained the outreach objective of reaching the larger number of clients with small amounts of resources. Some eligible poor do not join microfinance programmes because they lack their ability to use loans productively or the land needed to bear the risk of self-employment. Morduch (1998) in his study established that the households served by the microfinance programmes do substantially better than control households. At the same time, no evidence was found to support claims that the programmes increase consumption levels or increase educational enrolments for children relative to levels in control villages. He concluded that membership does little to reduce poverty, it may however reduce vulnerability. Pitt and Khandker (1998) investigated credit received by men separately from credit received by women and stated that household consumption increases by eighteen taka for every one hundred taka lent to a woman. For lending to men, the increase is just eleven taka for every one hundred taka lent. Men, according to the estimates, take more leisure when given the chance. Non-land
assets increase substantially when borrowing is by women, but not by men. Morduch (1998) finds no sharp evidence for strong impacts of microfinance on household consumption, but he finds some evidence that microfinance helps households diversify income streams so that consumption is less variable across seasons. Coleman (1999) found no significant impact of access to microcredit on improving household wealth. He finds that average programme impact was not significantly different from zero after controlling for endogenous member selection and programme placement. He argues that one reason that wealthier borrowers may have experienced larger impacts was because they could commandeer larger loans. Khandker (2001) in his study confirmed that programmes make a difference to poor participants by raising per capita income and consumption as well as household net worth, thereby increasing the probability that the programme participants lift themselves out of poverty. The welfare impact of microfinance programmes helps the poor beyond income redistribution and income growth. The programmes have spillover effects on the local economy, but the impacts are very small. The study revealed empowerment of women through microfinance and easy access of finance to poor clients to whom formal financial institutions are inaccessible. McKernan (2002) finds that not controlling for selection bias can lead to overestimation of the effect of participation on profits by as much as 100 percent. She also finds that being a member of the Grameen Bank is associated with a 126 percent in self-employment profits after accounting for the direct benefit of access to capital. The increase, she believes is due to increased social and human capital derived from group meetings. Smith (2002) finds that the health interventions did improve health care for the participants relative to the health care received by those in credit-only programmes, and the health interventions did not diminish the bank’s financial performance in rural Equador and urban Honduras. Khandker (2003) compiles data from Bangladesh and states that in programme villages, microfinance participants saw important declines in poverty rates. He finds that lending 100 taka to a woman leads to an increase in household consumption by as much as eight taka annually. This is less than the 18-taka increase that he found in the earlier cross-section but is still meaningful. Loans obtained from MFIs are utilized in agriculture and small business. Independent incomes and modest savings have made women self-confident and helped them to fight poverty and exploitation. Ohri (2004) stated that microfinance is now established as an important poverty alleviation tool, although most MFIs exclusively focus on income generation
for poor people. This is only a partial solution. Singh (2004) highlighted the role of microfinance in poverty alleviation and income generating activities by explaining the microfinance delivery approaches. Microfinance has made impact on the life of people and strengthened the capabilities of poor people to start income-generating activities or micro enterprises. Sa-Dhan (2004) reported that sustainable microfinance is an effective tool for poverty reduction. It has encouraged the flow of credit to the poor by substituting physical collateral with social collateral. Jayasheela and Palanna (2005) focused mainly on how a NGO facilitated in improving the capabilities of individuals and the quality of life of vulnerable rural communities living in degraded and drought prone regions of Karnataka. The study showed that the standard of living of these households has improved considerably. Anbalagan et.al. (2005) made an attempt to highlight the importance of NGOs in SHG formation. They estimated that nearly three-fourths of the loans and advances to the SHGs were provided directly by the banks, which are promoted by NGOs. They suggested that the impact of microfinance to micro enterprises owned by SHGs is quite significant in terms of socio-economic transformation. The need of the hour is not only to make them better bankable with financial institutions but also to increase the level of flexibility in credit instruments that would match their multiple credit requirements. Goldberg (2005) with an overview of different studies and literature has confirmed that microfinance programmes can increase incomes and lift families out of poverty. Access to microfinance can improve children’s nutrition and increase their school enrolment rates among other outcomes. Mahajan (2005) stated that microcredit is a necessary but not a sufficient condition for micro-enterprise promotion. Coleman (2006) found that the insignificance was limited to general beneficiaries and that a positive impact was found among committee members who received access to financing. Vandenberg (2006) stated that increased enterprise income (profits) can help to reduce poverty but the connection is not always assured. The only thing that can be said for certain is that increased enterprise profit increases the income available to the owner/enterprise. Raghavan (2006) opines that with significant growth in microfinance activities, the effective benefit would spread to various aspects such as literacy, empowerment, entrepreneurship, employment, improvement in living standards, development of rural economy and finally poverty elimination. Tripathy (2006) suggested that the battle for total eradication of poverty requires combining microcredit programmes with parallel complementary programmes at the regional, national and
international levels. Pollin (2007) stated that micro enterprises run by poor people cannot be broadly successful simply because they have increased opportunities to borrow money. For large number of micro enterprises to be successful, they also need access to decent roads and affordable means of moving their products to markets. They need marketing support to reach customers. Sometimes poor rural people do not have the skills, vision, creativity and persistence to be entrepreneurial. Sarangi (2007) clearly proved that there is positive and significant effect of programme participation on increase in the income of the household. His findings suggest that on the one hand, many of the very poor households are excluded from the programme and on the other hand, the gains from participation of the programme are mostly observed for the better off section of households. Asian Development Bank (2007) in their study of three countries indicated that the microfinance projects had positive effects on the status of women particularly in the household like greater role in household generation of cash, greater involvement in making major expenditure decisions and generating cash savings, ability to generate more income on their own and greater role in business decision making, acquisition of more skills and expanding their network of friends and support system and increased acquisition of assets. Bebezuk and Haimovich (2007) found that credit increased labour income in a statistically and economically significant manner. The impact was sensitive to the size of the loan. Ghalib (2007) in his model discussed four variables-livelihoods, literacy, community and health to understand the social impact assessment. He established in his study that each variable is not a stand-alone entity and therefore works in coordination as system. Literacy for instance, raises awareness about HIV/AIDS prevention and educates people how to take preventive measures, so it affects health-related issues, which in turn keeps them at work and enables them to provide for their families, thus keeping them away from poverty, and thereby improving livelihoods. Duquet (2008) stated that if at an individual level the impact of microfinance activities is obvious, the impact at an economic level of microcredit has not been established by the study: level of new employment, start of new activities remain quite low. Kondo, Orbeta, Dingiong and Infantado (2008) found out that the impact of microfinance programme on per capita income, total expenditures and food expenditure is only slightly significant but with regressive features. They argued that a majority of the existing clients, new clients and non-participating households deemed qualified for the programme are not poor according to the official definition. This is in sharp contrast to the other
studies which indicated that the majority of microfinance programme clients are poor. Roodman and Morduch (2009) established that microcredit is effective in reducing poverty generally and the extremely poor benefit. Rafiq, Rahman and Momen (2009) in their findings suggest that microcredit programmes are effective in generating higher income and assets for borrowers. They also suggest that age of female and male has a significant and positive impact on income and assets; education of female as well as male is an important factor in affecting income and assets positively. They have also found that as number of earners increase in a household, the amount of borrowing increases and microcredit programmes help yield better outcomes for high income compared to medium and low income group borrowers. They argue that micro credit is more effective for relatively wealthier borrowers compared to non-wealthy borrowers. The reasons for ineffectiveness of microfinance programme through joint liability loan contract system to reduce poverty have been identified by many researchers through their findings. The MIT study by Banerjee, Duflo, Glennerster and Kinnan (2009) found no impact on measures of health, education, or women’s decision-making among the slum dwellers in the city of Hyderabad, India. Similarly, the study by Dean and Zinman (2009), which measured the probability of being below the poverty line and quality of food that people ate, found no discernible effects. Shastri (2009) state that scheme of microfinance has been found as an effective instrument for lifting the poor above the level of poverty by providing them increased self-employment opportunities and making them credit worthy.

**Empowerment of Women using Social Capital**

World Bank in its World Development Report (1990) state that women are lagging behind in many key indicators of economic development. Moreover, the report finds that, relative to men, women in low-income countries face greater social, legal and economic obstacles. Microfinance is seen as a road to gender empowerment. Rosenzweig and Schultz (1982) find that survival probabilities for female infants in rural India are higher in areas where opportunities for female employment are greater. Their argument is that asymmetric mortality patterns result because parents are forced to invest in children with the greatest earning potential. It is argued that such strategic decision-making results from the need to sometimes make tragic, brutal choices in the struggle for basic survival. But microfinance advocates repudiate the helplessness that is implied.
First, by helping to raise incomes, advocates argue that microfinance can lift the constraints that force households to make such life and death choices. Advocates argue that microfinance can also change the nature of basic trade-offs. They aim to improve opportunities and economic returns to women’s work and thus to change the economic values of women within the house. Raising these returns reduce discrimination of the sort documented by Rosenzweig and Schultz (1982). Both the World Bank Report 1991 and the Fourth World Conference on Women held at Beijing in 1995 declared that women are central to the success of the poverty alleviation effort; hence the importance of women’s empowerment and their full participation on the basis of equality in all spheres of society is crucial. According to Sen and Grown (1987) the origin of the concept of women’s empowerment, can be traced to the latter half of 1970. The concept was initially developed when many feminist scholars were engaged in the project of constructing a coherent framework to understand the subordination of women and feminism. Schultz (1990) finds that in Thailand non-labour income in the hands of women tends to reduce the fertility more than non-labour income possessed by men. He also finds that impact of non-labour income has different effects on labour supply depending on which household member actually controls that income. Thomas (1990) reports that child health in Brazil along with household nutrient intakes tend to rise more if additional non—labour income is in the hands of women rather than men. Thomas (1994) reports that increased bargaining power of women is associated with increases in the share of household budget spent on health, education and housing as well as improvements in child health. Engle (1993) similarly studies the relationship between a mother’s and father’s income on child’s nutritional status for hundreds of households in Guatemala and reports that children’s welfare improves as women’s earning power increases relative to their husband’s. Batilwala (1994) stated that the process of empowerment liberate the men also because they will be empowered too by being free from burdens of male responsibility. The UNDP report of 1995 introduced two main complementary indices – Gender-Related Development Index (GDI) and Gender Empowerment Measure (GEM). Some authors have tried to construct alternative indices of empowerment more specifically related to microfinance activity. Ackerly (1995) constructed an accounting knowledge indicator. Goetz and Sen Gupta (1996) built an index of managerial control on the use of loans, contributions in terms of labour to the financed activity and the control over the entire production process. They report that 40
percent of women in their survey have little or no control over their own investment activities. Gulati (1995) point out that the productivity gap of poor women is much wider than that of economically better off. Therefore, women will gain proportionately more, if the investment allocation is shifted in their favours. Marilyn et al. (1996) reported that the best way of achieving women’s empowerment is to organize them under a common group or forum with income-generation programme support. The study showed that participation in women organizations has changed the lives of women economically and socially. Women are now contributing to the household income and investing in productive activities. The economic successes in turn have resulted in women’s increase in the capacity to negotiate at household level and in village level in decision-making. Women’s involvement with the cooperative has also increased their ability to speak in meetings and to authority figures. Hashemi et al. (1996) suggest that women’s access to credit contributes significantly to the magnitude of the economic contributions reported by women, to the likelihood of an increase in asset holdings in their own names to an increase in their exercise of purchasing power, and in their political and legal awareness. They also found that access to credit is also associated with higher levels of mobility, political participation and involvement in ‘major decision making’ for particular credit organizations. Udry (1996) using data from Burkina Faso finds that controlling for soil quality and other variables; agricultural productivity is higher in plots that are cultivated by men. He concluded that productivity differentials are attributed to the intensity of production between plots cultivated by men and women and not to inherent skill differentials. He suggests that input reallocation towards plot cultivated by women can thus increase efficiency. Another solution is to provide women with credit sufficient to purchase additional inputs and have adequate access to inputs and marketing facilities using microfinance. This could be done through demonstration effect or from pressure created by the micro lender to ensure high returns to borrowers’ investments. Schuler, Hashemi and Riley (1996) and Rahman and Da Vanzo (1998) report that in Bangladesh, microfinance has been promoted as a way to limit the number of children, and positive impacts have been found on contraceptive use. This is due to the fact that microfinance increases the opportunity cost of women’s time. This effect may be reinforced by peer pressure as women are urged to reduce family size in order to increase education and health expenditure, and to better manage the ability to repay. On the other hand, Pitt et al. (1999) confirming evidence from a cross-sectional survey
in Bangladesh argue that microfinance could be positively associated with higher fertility as access to microfinance raises income thus increasing the demand for children keeping all else constant but may also increase the opportunity cost slightly through self-employment activities from home while simultaneously caring for children. Khandker (1998) indicates that inclusion of drop-outs and villages away from the ‘key success areas’ would substantially increase estimates of negative impact and reveal more cases of serious disempowerment. Harper (1998) demonstrates that women’s economic and social position is improved through access to microfinance. Khandker (1998) is of the opinion that although microfinance generates benefit for women and the poor, it seems to benefit only that portion of the poor (and women folk) which is able to use loans productively. Browning and Chiappori (1998) derive implications of a model in which bargaining power is driven by the ability of women to credibly threaten to leave the household. The credibility of such threats will depend on factors like earning power. They show that in bargaining contexts, preferences tend to shift with income. Microfinance may thus affect household choices through a variety of channels like changing bargaining power, raising overall resources, affecting the returns to investments in human capital and influencing attitudes and norms. Berhman (1998) shows that household nutrient intakes and health outcomes in his sample from India are positively correlated with earning profiles. He also shows that pro-male bias is more severe during lean seasons when resources are tight. Households tend to allocate food to members who receive the greatest returns in the labour market, resulting in greater intrahousehold inequality in the lean seasons, but they are more egalitarian in surplus seasons. Lalitha (1998) pointed out that 30-35 percent of Indian rural households are headed by women and thus in most cases households depend exclusively on female’s income. Even where there are male earnings women’s earnings constitute a major part of the income of the poor household. Kabeer (1999) stress that women’s empowerment is about the process by which those who have been denied the ability to make strategic life choices acquire such ability. Rahman (1999), using an anthropological approach with in-depth interviews, finds that between 40% and 70% of the loans disbursed to the women are used by the spouse and that tensions within the household increase because men feel increasingly threatened in their role as primary income earners in traditional societies. As a result violence increased in those households which were involved with microfinance. On the other hand, Kabeer (2001) report that microfinance in Bangladesh has
indeed reduced violence against women. He argues that the rationales for targeting women, over and above the desire to empower, include the following observations that – men are less likely to share their loans to women than women are likely to share loans with men, loans to women are more likely to benefit the whole family than loans to men, and loans to men have little impact on intra household gender inequalities- in fact, they can reinforce them by providing men with a base to prevent wives from engaging in income-generating self-employment. Mayoux (1999) reports on a survey of fifteen different programmes in Africa, finding that the degree of women’s empowerment is household and region specific which depends on inflexible social norms and traditions. Impacts on empowerment also depend on how well the programmes are designed. Puhezhendhi and Jayaraman (1999) noticed that till recently, women were not able to actively participate in income generating economic activities mainly due to historical and socio-cultural reasons, including gender bias. The low social status of women stem from the insignificant economic status ascribed to them in the rural society which is due to the continuous dependence on the male members of the household. Thus, there is need for empowerment of women economically. Ledgerwood (2000) is of the view that microfinance has evolved as an economic development approach intended to benefit low-income women. Evidence suggests that microenterprise credit does not result in significant net gains in employment but it can and does lead to increased use of family labour. Rajasekhar (2000) made an attempt to analyze the contribution made by microfinance programmes in Kerala. The analysis revealed that the better participation of members in microfinance programmes resulted in savings and credit operations that were conducive to women’s needs truly contributing to poverty alleviation and empowerment of women. Hulme and Mosley( 1997) and Kabeer (2001),citing evidence from South Asian Studies suggests that within the family, the purchase of food and other items of household consumption and decisions related to children’s health appear to fall within the women’s arena. It has been well documented that an increase in women’s resources results in increased well-being of the family, especially children. Suguna (2001) argues that the process of women’s empowerment must challenge patriarchal relation. This leads to the changes in men’s traditional control over women, particularly over the women of the household. According to Zaman (2001) self-help groups intermediated by microcredit have been shown to have positive effects on women, with some of these impacts being ripple effects. They have played valuable
roles in reducing the vulnerability of the poor through asset creation, income and consumption smoothing, provision of emergency assistance and empowering and emboldening women by giving them control over assets and increased self-esteem and knowledge. Manimekalai and Rajeshwari (2001) in their study highlight the provision of microfinance by the NGOs to women. The study shows that SHGs have helped the groups to achieve both economic and social empowerment and that the income of SHG women almost doubled after taking to micro enterprise. SHGs have also developed the qualities of leadership, organizational and skill management of various activities of business, marketing and modernization. Kevane and Wydick (2001), though, find that gender differences in economic responses to credit access are small in the Guatemalan group lending programme they investigate. While they find that young male entrepreneurs tend to be more aggressive in generating employment than older male entrepreneurs, older women tend to be more aggressive in generating employment than younger women to older men. Holding all else constant, they thus find no statistically significant overall difference in the way credit affects the ability of female and male entrepreneurs to generate increases in gross sales within an enterprise. Skoufias (2001) reports that Oportunidades in rural Mexico indeed led to sharp social improvements poverty decreased by 10 percent, school enrolment increased by 4 percent, food expenditures increased by 11 percent and adult’s health improved considerably as well. Thingalaya (2002) reveals that encouragement given to thrift has resulted in the women members saving some small amounts thus finding their way to the banks. Synghal (2002) argues that women are small borrowers and tend to be easily excluded from participating in programmes that require a minimum size of loan, which is beyond their capacity to absorb usefully. As a result, landless poor and women were sidelined. Several recent assessment studies have also generally reported positive impacts (Simanowitz and Walker, 2002). Lalitha and Nagarajan (2002) pointed out that in India, microcredit studies done on groups dealing with dairy farming have noted positive profit levels and short payback periods for loans ESCAP (2002) showed that studies in several countries point out that loans are sometimes used for consumption smoothing, not production. A proportion of the funds made available for self-help microcredit schemes were utilized by women, enabling them to meet the subsistence needs of their families during those difficult economic times. Krishnaraj and Kay (2002) stated that in Bangladesh, women showed a great deal of empowerment in their capacity to articulate
their needs and in their receptivity to new ideas. More impressive was the emergence of women’s group as a dynamic, articulate constituency. These first hand observations and in-depth interviews appear to validate the findings of other studies (Cheston and Kuhn, 2002). The perception that microcredit is an empowering tool for women has in recent years come under close and in some instances negative scrutiny. Critics have charged that microcredit accessed by women has often been appropriated by other household members, leaving women burdened with the responsibility of repayment and the sanctions of default (Goetz and Sen Gupta, 1996). Rankin (2002) argues that microfinance may entrench rather than challenge traditional gender roles. According to Rankin women are often encouraged to take up enterprises such as sweater knitting that do not disrupt practices of isolation and seclusion within their households. But according to Gibbons (1995), Goetz and Sen Gupta (1996) and Dawkins-Scully (1997), such increased specialization within the household reinforces women’s reliance on male family members due to women’s limited access to inputs, supplies and marketing facilities. Dreze and Sen (2002) stated that economic independence and education has strong impact on the fertility rate. Grootaert (2003) points out that building social capital and empowerment are multi-level concepts and facilitate the link to poverty reduction whereas Community Driven Development (CDD) is a manifestation of social capital and empowerment. In order to study the impact of microfinance on women empowerment, there is a need for appropriate indicators that can measure it. Khandker’s (2003) evidence suggests that lending to women yields greater social and economic impacts than lending to men. Sinha (2003) emphasized the need for “Empowerment Strategy”. She suggested that a judicious mix of microcredit along with other activities with emphasis on development and empowerment strategies and processes would certainly make microcredit an effective instrument of social and economic development particularly of the women section in a holistic and integrated manner. Purohit (2003) opines that availability of timely and adequate credit is essential for women to undertake any income generating activity rather than credit subsidy and there is a positive correlation between credit availability and women empowerment through employment, not just self-employment but also wage employment. Another study by Rajasekhar (2004) reveals that microfinance leading to income generating activities contributes to women empowerment. Regular savings enable the people to develop confidence and introduce them to local banks thus contributing to improved credit
worthiness of the poor. It has been argued that the ability of microfinance programmes to provide credit to the poorest was limited for both structural and technical reasons. Sa-Dhan (2004) reported that microfinance encouraged women to be more mobile within and outside their villages. It improves their access to information and has a positive impact on their self worth. Rajasekhar (2004) reveals that microfinance leading to income generating activities contributes to women empowerment. The linking of savings to credit, collateral requirements and the emphasis on the short-term credit prevented the poorest from accessing credit and enabled the less poor with assets to access more credit. Todaro (2004) revealed that more educated mothers have important impact on breaking the vicious cycle of poverty. Holvoet (2005) finds that in direct bank-borrower minimal credit, women do not gain much in terms of decision making patterns. However, when loans are channeled through women’s groups and are combined with more investment in social intermediation substantial shifts in decision-making patterns are observed. She finds that the effects are even more striking when women have been members of a group for a longer period and especially when greater emphasis has been laid on genuine social intermediation. Tankha et. al. (2005) estimated that nearly 75 million poor households in India need financial access to meet various consumption, emergency and production related needs. Microfinance had made significant contributions towards improving their visibility and awareness levels, developing their sense of confidence and integration in economic and political spheres. Mishra (2005) said that microfinance through SHGs is essentially an effective medium for social, economic, political and psychological empowerment. Sultana (2005) reported that involvement of women groups not only empowers them but also enables them to shape themselves as social activists by trying to check the malpractices and injustice in the implementation of different schemes. He suggests that women self-help groups should be encouraged to avail the concession offered by Rashtriya Mahila Kosh (RMK), Development of Women and Children in rural areas (DWCRA) and Training for Rural Youth for Self-Employment (TRYSEM). Chandrakavate (2006) opines that among the various measures targeted towards women’s empowerment the provision of microfinance or small credit assumes crucial importance. The SHGs in India have proved beyond doubt that if the women, how so ever poor, illiterate and ignorant are organized guided and made, them to realize their problems will make wonders in their own lives and lots to their families. Vigneshwara (2006) opines that one
of the most essential factors contributing to success in micro entrepreneurship is access to capital and financial services. Based on context specific and gendered studies it is essential that, periodically, policies, workshops are held at all levels to encourage microfinance. These kinds of workshops involving all the stakeholders of the programmes of women development go a long way in centrifuging the mixed efforts towards empowerment of women. Guerin (2006) examines the complexity and diversity of women’s informal financial practices using data from surveys conducted in Senegal. She suggests that microfinance practices are at the centre of a constant dialectic between short-run and long-run horizons, between the requirements of daily survival and the demands of the community solidarity and between personal aspirations and collective constraints. Raghavan (2006) opines that with significant growth in microfinance activities, the effective benefit would spread to various aspects such as literacy, empowerment, employment, improvement in living standards, development of rural economy and poverty elimination. He points out that cohesive group discipline and peer pressure is the intrinsic strength of the micro-financing activities. Misra (2006) found that the microfinance programme had definite impact on building of social capital; it had marginal impact on income level. Raj (2007) observed that additional income in the hands of women and the opportunities created for participation in gainful economic activities has resulted in their becoming more confidants and assertive. Chakrabarti and Biswas (2008) concluded that inspite of all government effort by adopting developmental programme since first five year plan and a multi-disciplinary approach with a special thrust on health, education and employment level of women since sixth five year plan, empowerment level of women did not increase to the expected level till 1998-99. A review of various studies conducted abroad, India and regional level have brought out diversified findings and conclusions on methods of study and ability of SHG microfinance in empowering women. While analyzing the socio-economic benefit and empowerment of women through SHGs, most of the studies have focused on the women population in general and come out with a general conclusion and hence given uniform policy measures irrespective of social groups or level of poverty in a given region. The studies also show that microfinance through SHGs succeeded in empowering women but it totally failed in including or uplifting the extreme poor. The studies also reveal that without economic empowerment we cannot think of social empowerment. Therefore, for overcoming the problems of inequality, harassment, exclusion etc. economic
empowerment of women is necessary and microfinance through self-help groups is one of the ways in this process.

Micro finance and Micro insurance

Risk is uncertainty that affects an individual’s welfare. It is often associated with adversity and loss. There are numerous sources of risk in agriculture. They range from price and yield risk to the personal risks connected with injury or poor health. The price and yield risks along with a farmer’s attitude toward risk have a major impact on the choice of risk management strategies and tools. Binswanger (1980), after studying the risk in agricultural investments, risk averting tendencies of the farmers and available strategies for shifting risk, concludes that farmers’ own mechanisms for loss management or risk diffusion are very expensive in arid and semi-arid regions. Availability and effectiveness of these risk management strategies or insurance surrogates depend on public policies and demand for crop insurance (Walker and Jodha 1986). At a higher level of income and staying power, the farmer would opt for higher average yields or profits over a period of time even if it is achieved at the cost of high annual variability on output (Rao et al., 1988). For an individual farmer, risk management involves finding the ideal combination of activities with uncertain outcomes and varying levels of expected return. Thus, risk management involves choosing among alternatives for reducing the effects of risk on a farm (Hazell 1991). Risk management typically requires the evaluation of tradeoffs between changes in risk, expected returns, entrepreneurial freedom, and other variables (Harwood et al. 1999). To provide risk cover to farmers, weather index insurance is better placed. Advocates of index based insurance argue that it is transparent, inexpensive to administer, enables quick payouts, and minimizes moral hazard and adverse selection problems associated with other risk-coping mechanisms and insurance programmes (Gine, Townsend and Vickery 2007).

Farmers have their own ways to mitigate risk. There are certain risks that are exclusive to agriculture. For instance, the risk of bad weather considerably reduces yields within a given year (Singh and Jogi 2008). Then there are risks associated with price or institutions that reflect an added economic cost to the farmer. If the farmer’s benefit-cost trade-off favours mitigation, then he will attempt to lower the possibility of adverse effects (Hardaker, Huirne and Anderson 1997; World Bank 2005). Indian agriculture has throughout been affected by vagaries of nature. The
diversity of Indian agriculture compounds it. The country has been witnessing suicides by Indian farmers over the last couple of years. Around 70 percent Indian agriculture is at the mercy of vagaries of the monsoon and other factors beyond the control of the farmer (Singh 2009), the importance of crop insurance is not in doubt and needs no emphasis. Climate change would further demand such risk management interventions (Singh 2009).

There is little evidence to show that crop insurance has had any positive impacts on agricultural lending, agricultural production or farm income. For example, social cost-benefit analyses of the Mexican and Japanese schemes show negligible social returns in relation to their high costs (Bassoco et al, 1986 and Tsujii, 1986). Pomareda (1986) found that a small increase in interest rates would have been just as beneficial to the ADB in Panama as the compulsory crop insurance program for its borrowers. Crop insurance, when heavily subsidized, can even have important negative social impacts. Subsidies for risk management have similar effects as subsidies on any other farm input; it encourages over use. And since the reduction in production costs is partly paid for by the subsidy, the dead weight loss of the subsidy is always greater than the combined benefits to producers and consumers (Siamwalla and Valdes, 1986). Subsidies not only create dependence on future drought assistance from the government, but also lower social welfare. Kunreuther (1973) and Kaplow (1991) demonstrate how such assistance sends the wrong signals for hurricanes and earthquakes. The multi-peril crop insurance is very expensive and has to be heavily subsidized (Hazell 1992).

Insurance markets for natural disaster risk are largely missing in developing countries. In developing countries, spatially correlated risk exposure creates a significant challenge since participants in consumption-smoothing mechanisms often come from the same region or even the same village (Anderson, 1976). Jodha (1981) finds that the riskiness of farming impinges upon the investment in agriculture leading to suboptimal allocation of resources. He also finds that official credit institutions are ill equipped to reduce the exposure of Indian farmers to risks because they cannot or do not provide consumption loans to drought-affected farmers. The major role played by insurance programmes is the indemnification of risk-averse individuals who might be adversely affected by natural probabilistic phenomenon. Insurance, by offering the possibility of shifting risks, enables individuals to engage in risky activities which they would not undertake otherwise (Ahsan et al., 1982). It is argued that farmers' own measures to reduce the risk in
farming in semi-arid tropical India were costly and relatively ineffective in reducing risk in farming and to adjust to drought and scarcity conditions. Crop credit insurance also reduces the risk of becoming defaulter of institutional credit. The reimbursement of indemnities in the case of crop failure enables the farmer to repay his debts and thus, his credit line with the formal financial institutions is maintained intact (Hazell et al., 1986; Pomareda 1986; Mishra 1996). The farmers do not have to seek loans from private moneylenders. The farmer does not have to go for distress sale of his produce to repay private debts. A farmer may grow more profitable crops even though they are risky. Similarly, farmer may adopt improved but uncertain technology when he is assured of compensation in case of failure (Hazell 1992). This will increase value added from agriculture, and income of the farm family. Even in developed countries, such insurance for crop failure due to natural disasters exist primarily due to large government subsidies. Such subsidies are expensive, inefficient, and have detrimental implications that make the consequences of future catastrophes worse (Barnett, 1999). A properly designed and implemented crop insurance programme will protect the numerous vulnerable small and marginal farmers from hardship, bring in stability in the farm incomes and increase the farm production (Bhende 2002). The farmer is likely to allocate resources in profit maximizing way if he is sure that he will be compensated when his income is catastrophically low for reasons beyond his control. Bhende (2005) found that income of the farm households from semi-arid tropics engaged predominantly in rain-fed farming was positively associated with the level of risk. Hence, the availability of formal instrument for diffusion of risk like crop insurance will facilitate farmers to adopt risky but remunerative technology and farm activities, resulting in increased income.

Some of the studies confirm the conventional view that moral hazard incentive lead insured farmers to use fewer chemical inputs (Smith and Goodwin 1996). Babcock and Hennessy (1996), find that at reasonable levels of risk aversion, nitrogen fertilizer and insurance are substitutes, suggesting that those who purchase insurance are likely to decrease nitrogen fertilizer applications. A study by Horowitz and Lichtenberg (1993) find that in the US Midwest, crop insurance exerts considerable influence on maize farmers' chemical use decisions. An analysis of data from US agriculture indicates that the producer's first response to risk is to restrict the use of debt. Price support programmes and crop insurance are substitutes in reducing producer risk. The
availability of crop insurance in a setting with price supports allows producers to service higher levels of debt with no increase in risk (Atwood et al., 1996). Mishra (1994) analyzed the impact of a credit-linked Comprehensive Crop Insurance Scheme (CCIS) on crop loans, especially to small farmers in Gujarat. He observed that CCIS had a collateral effect as reflected through the increased loan amount per borrower and reduction in the proportion of non-borrowers among small farmers. It is observed that insured households invest more on agricultural inputs leading to higher output and income per unit of land. Interestingly, percentage increase in output and income is more for small farms. Many of the risks insured under public insurance programme are essentially un-insurable risks. Moreover, they occur frequently and hence are expensive to insure. The financial performance of most of the public crop insurance has been ruinous in both developed and developing countries.

In a study of program crops, O'Donoghue et al. (2009) find that the expansion of crop insurance associated the 1994 FCIRA led to modest increases in on-farm specialization, either because producers substituted toward crops whose expected returns increased with the introduction of subsidized insurance, or because insurance reduced demand for crop-diversification for risk-management reasons. Climatic risks present major problems for poor farmers around the world. Not only do they retard growth by discouraging investment, but they can also trap individuals in poverty as a major weather shock can disrupt progress being made by individual households just beginning to escape the grips of poverty. The literature that describes the link between risk, adverse shocks, and poverty traps is growing (e.g., Dercon, 2005). Studies increasingly find that many of the poor in developing countries are transitory, moving in and out of poverty on a regular basis. Shocks from a wide range of risk-related events send households who are making progress back to the poverty ranks. High transaction costs are often identified as the factor that severely limits the poor’s access to financial services. Many cropping strategies and farming practices have been adopted in the absence of crop insurance for stabilizing crop revenue.

The role of governments towards microfinance and private sector development has been subject to much public debate. Rosengard (2010) suggest that microfinance pose unique oversight challenges linked to its client base, lending methodology, transaction costs, portfolio composition and governance. On the other hand, Arun (2005) argue for little regulation and refer to small size operations of microfinance and the assumption that cost of developing and
implementing regulations exceed the benefits accrued from it. Public policy should be designed to facilitate the entry of new private actors without abandoning the markets that could not work without some public support (Hudon, 2006). It should ensure that an environment is created where product diversification, business development and sound competition go hand in hand with the protection of the clients (Labie, 2007). Governments have a role to play in terms of regulation and supervision. In many countries, the microcredit institutions are not included under financial regulations which legally restrict them to engage in providing savings services. Arun (2005) argues for sector specific regulation which allows MFIs to access deposits and refers to complementary regulation to mitigate the possible risks involved. Governments can also play a role in providing financial protection for savings or loans. Ioannidou and Penas (2010) find evidence in Bolivia that the introduction of deposit insurance can lead to a higher risk-taking behavior of financial institutions. Hatarska et al. (2010) highlight that public policies designed to improve MFIs’ performance to expand their services should take into account regional, organizational and contextual characteristics. The design of products influences adoption and usage and ultimately economic and social results (Karlan and Morduch, 2010).

Overview of literature gives an insight into the area of research. Review of literature is essential to understand the different aspects on which the research is to be carried out. It helps to develop analytical power of reasoning and critical judgment. Research questions are framed on the basis of different scholar’s views in that particular area. Research questions are framed to achieve certain objectives. The questions framed are either to verify whether the arguments stated by different scholars fall in line with the current research work or to challenge the different scholars’ arguments.

Empirical research provides arguments against lending to the poor due to high transaction cost and risks associated with information asymmetries and moral hazard. The literature also provides evidence of high profit potential for large loans. On the contrary, there are also evidences of positive correlation between outreach and financial sustainability. There is no evidence in terms of cost of lending by PACS which acts as a MFI and SHPI for both individual and joint liability. This research compares cost of lending for both the microfinance systems to understand which system is more profitable from the point of view of PACS as PACS lend for both the systems
even though the main function of PACS is to lend for agriculture and allied activities. Financial performance is also analyzed through a comparative study of the microfinance systems in this research.

Empirical research carried out by different scholars indicate wealth/asset as the determining factor to identify a rural household’s preference to join either individual liability or joint liability loan contract system but it ignores the other factors that can contribute to a rural household’s decision. But wealth or asset cannot be the only measuring rod to judge an individual’s decision regarding joining a particular loan contract system. This study tries to identify the different factors that can influence a rural household’s decision –making regarding which contract system to join. The literature provides evidence that the poorest borrowers of group lending scheme are often poorer than the poorest clients of individual lenders. But no evidence has been provided as to why some of the poorest individuals who are of the same economic condition as that of group lending scheme prefer to stay away from such a microfinance system even though the parameter i.e., economic condition which is determined by wealth /asset (land particularly for rural households) is the same for both members and non-members. There is a difference of opinion in the literature regarding who joins the group lending scheme. One study indicates exclusion of very poor households and another model establishes the fact that group lending is only desirable for the poor borrowers. This difference of opinion is confusing because the main objective of group lending scheme is to include the poor households in the formal financial system to protect them from the clutches of the money lenders.

The literature provides differences of opinion while evaluating the impact of microfinance programme under individual liability loan contract system. Some studies point out positive impacts on income consumption levels while some studies found no significant impact. The literature also provides evidence about members becoming less dependent on such programmes after a few years of participation. This study highlights the importance of ‘scale of finance’ which determines the credit limit, change in the rates of interest for agricultural loans over years and different repayment periods for different crops for analyzing the impact. This study also identifies the reasons behind the importance of PACS in case of individual liability even though agricultural credit is provided by commercial banks that charge the same interest rate and are
situated within the close proximity of rural households. No such evidence is found in the literature. This research also provides policy prescriptions for policy makers and institutions which might be economically beneficial for the rural participants.

There are different findings by different scholars regarding effectiveness of microfinance programme for the members of joint liability loan contract system. Some evidences show positive impacts whereas others claim that membership does little to reduce poverty. It has also been argued that micro credit is more effective for relatively wealthier borrowers compared to non-wealthy borrowers. There is also clear evidence of the fact that impact is sensitive to the size of loan. This study while analyzing the impact of microfinance programme for members of joint liability loan contract system demarcates between credit taken for income generating activity and non-income generating activity because the essence of joint liability against individual liability lies in the fact that loans can be taken purely for consumption purposes as well without any collateral. It is interesting to note that loans taken for health purposes have been categorized under income generating activity. There is no clear evidence of this aspect in the literature. The literature also has no clear evidence of the impact being sensitive to ‘adult equivalent dependency ratio’ but this research gives importance to this variable to study the impact. The reasons for effectiveness of microfinance programme have been identified by many scholars in their findings. But this research is important because the impact is studied considering PACs as MFI and Self-help Promoting Institution (SHPI) which charges much lesser rate of interest as compared to MFIs and where repayment rates are very high.

The literature provides clear evidence of women empowerment through microfinance programme though critics point out that women are often burdened with the responsibility of repayment and the sanction of default if the micro credit is appropriated by other household members. There is also evidence of positive and significant relationship between people’s propensity to trust others and their attitude to behave trustworthy. Concepts of social capital are also available in the literature. But no paper has ever tried to investigate whether social capital plays any significant role to estimate ‘Women Empowerment Index’ among the microfinance participants. This research will try to do that on the basis of primary data.
The literature provides evidence that crop insurance is dependent on vagaries of monsoon. It has been pointed out that insurance markets for natural disaster risk are largely missing in developing countries but are prevalent in developed countries. There is evidence that credit institutions fail to minimize risk of Indian farmers. It is also stated that there is lesser risk of becoming defaulters of institutional credit due to crop insurance. There is also clear evidence of increase in income of the farmer family which is brought about by compensation during crop failure due to adoption of uncertain technology. This study tries to establish a relation between crop insurance scheme and farm income thus proving that crop insurance is prevalent in India, a developing country. It also studies the role of credit institutions, here PACS, in minimizing the risk by examining the financial performance of PACS.

The following chapter defines the different research questions in order to achieve certain objectives. The interlinkages between the different research questions and the sequence in which the research questions are arranged is also justified and mentioned.