CHAPTER- I

INTRODUCTION

1.1. Microfinance in India

Wide disparities exist in the country in poverty, education, health outcomes and reduction of gender bias across different sections of the population, across different regions, states and within states. India's progress in achieving the MDGs depends crucially on the country's ability to accelerate economic growth, maintain macroeconomic stability and provide appropriate social services to the population, especially the weaker and vulnerable sections. To achieve high growth rates on a sustainable basis, further substantial progress is needed in structural reforms, fiscal condition and improved governance.

India's formal financial sector comprises mainly of commercial banks, regional rural banks (RRBs), as well several cooperative banks and societies. Despite the existence of a deep and diversified infrastructure of financial institutions the majority of India's rural population, especially of poor households and women, do not have appropriate access to financial services offered by the formal banking sector. According to a recent rural financial survey conducted in 2006 with World Bank support, nearly 60 percent of rural households do not have a bank account and only 21 percent have access to credit from a formal source.[1] Below-Poverty Line households often rely on informal sources (money lenders, traders etc. for their consumption credit needs, at exorbitant interest rates. The exclusion of a large section of the people from participation in the financial sector is a dilemma confronting not only the government of this country but most governments, worldwide. Keeping this in mind, in 2003, the then Secretary-General of the United Nations, Dr KofiAnnan, had said:

"The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial

[1] Shukla Rajesh., etal (2011), Assessing the effectiveness of small borrowings in India, NCAER–Centre for Macro Consumer Research, New Delhi.

sector. Together we can and must build inclusive financial sectors that help people improve their lives".

The United Nations (UN), the organisation of all the countries of the world, declared the year 2005 "The UN Year of Microcredit". In the year 2006, Prof. Mohammed Yunus and the Grameen Bank, Bangladesh, were awarded the Nobel Prize for Peace for their efforts to create economic and social development from below.

In recent years, several new approaches have been evolved to provide finance to India's rural poor. Most prominent among them is the "Self-Help Groups (SHGs) - Linkage Banking" model, supported by the National Bank for Agriculture and Rural Development (NABARD). Other microfinance approaches involve partnerships between government, non-governmental organizations (NGOs), and banks. Additionally other institutional structures for microfinance have also emerged: these include mostly independent specialized microfinance institutions (MFIs). These microfinance institutions attempt to address the problem of financial exclusion by providing financial services to the lower income groups who traditionally lacked access to formal financial institutions.

In India, financial inclusion has always been a priority given the socialist beginnings of the Indian state. A policy of directed credit which obliges banks to lend between 32% and 40% of their net time and demand liabilities to 'priority' sectors at a rate lower than their prime lending rates called priority sector lending (PSL) is in place. This policy has met with limited success due to the banks' inability to reach out to the intended beneficiaries; instead, they met their PSL targets by lending to other intermediaries such as Microfinance Institutions (MFI) that emerged due to the inability of banks to promote financial inclusion.

1.2. Banking the Unbanked

From time immemorial banks have not considered poor people as a viable market. Most formal banking institutions are reluctant to serve the poor and microenterprises in the unorganised sector because of perceived high risks, high costs involved in small transactions, perceived low relative profitability, and inability of the poor to provide the physical collateral usually required by such institutions.[2] Due to lack of access to institutional sources of credit, most poor and low-income households are forced to rely on either inadequate self-finance or informal sources. Credit from moneylenders is extremely expensive, and the poor's almost exclusive reliance on informal sources limits their ability to actively participate in and benefit from the development process.

At the same time, it can be argued that the poor need more regular – and not less – access to financial services, including deposits, loans and other services. While they use financial services for the same reasons as anyone else, namely, exploiting business opportunities, smooth consumption, cope with emergencies, and so on, their demand for microfinance is largely inelastic due the fact that the poor value regular access to credit more than the cost of borrowing. To address the small credit needs of poor household, especially those below the poverty line, MFIs have emerged as conspicuous actors in this realm.

The pioneer MFIs operated as nonprofit, nongovernmental organizations (NGO) with a strong social focus. They developed new credit techniques, such as reduction in risk through group guarantees instead of requiring collateral, appraisal of household cash flow, and small initial loans to test clients. Experience, since then, has shown that the poor repay unsecured loans unfailingly and are willing to pay the full cost of borrowing, thus underlining that access is more important to them than cost. Even in India, there has been a noteworthy shift from NGO-MFIs to Non-Banking Financial Institution-MFIs (NBFC-MFIs) in recent years. Also there has been a change in the manner in which MFIs raise finance. From being primarily donor-led, MFIs are now increasingly funded by banks and more recently, by private and shareholder equity.

Every household, irrespective of its rural / urban status or its economic status has a set of consumption and investment needs. Consumption is any spending, eg. For food, for transport, for tips, for school fee, etc, Investment in any spending creates future income eg. a juice machine, produce for trading, land for renting. Nevertheless, the need for fund that typically arises in a poor family for their life cycle, emergency and investment needs. All the

[2]Elizabeth L and R Rosenberg, (2004), Microfinance and the Poor: Breaking down walls between microfinance and formal finance, Finance and Development.

above needs /occasions call for access to fund could be often could be substantial. It is rare that the poor family has enough funds available to it when many of these occasions arise. They are a variety of ways through which the poor try to meet these needs.

- They use their savings,
- They borrow
- They resort / mortgage of assets like land, livestock, valuables.

The first and second mechanism – savings and credit – represent the two major facets / area of financial services that are attend to by financial institutions.

1.3. Definition

Microfinance (mF) is a term of comparatively recent origin. It is reflective of at least two elements which were not captured by earlier debates and concerns on the subject of rural credit. These are i) an emphasis on savings and other financial services apart from loans, and ii) professional management of small loans and savings programmes as part of perceived need for sound accounting, financial portfolio management and decision making for an Micro Finance Institution (MFI). The term microfinance itself is considered inappropriate by some NGOs which prefer the term development finance or alternative finance which can be said to "aim at assisting communities of the economically excluded to achieve greater levels of asset creation and income security at the household and community level".

In India, the Task Force on Supportive Policy and Regulatory Framework for Microfinance has defined microfinance as the "Provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi urban or urban areas for enabling them to raise their income levels and improve living standards"[3]. The task force has not chosen to indicate any specific limit for small amount. However, the report on microcredit of the Reserve Bank of India (RBI) microcredit special cell has proposed a ceiling on microfinance of Rs 25000/- as constituting the limit per borrower outstanding at any time.

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[3] Microfinance: Perspectives and Operations (2009), Indian Institute of Banking and Finance, Mumbai.

Microfinance has made tremendous strides in India over the years and it has become a household name in view of the multi-pronged benefits reaped / receivable from microfinance services by the poor in our country. India is the homeland of Self Help Group movement. Later the movement spread to South East Asian and African countries. Self Help Groups (SHG) have become the common vehicle of development progress, converging all development programmes. The NABARD conducted a series of research studies during the early eighties and found that existing systems and procedures of the banks were not well suited to meet the most immediate credit needs of the poor. It was felt that a new delivery mechanism was required to fulfil the requirements of the poorest, especially the women. During mid 1980s, formation of groups for savings and credit was initiated by MYRADA, an eminent NGO in south India. Around the same time NABARD had some exposure to similar experiences in South Asian countries; they positively responded to the suggestion of MYRADA that SHGs could bring financial services to the poor. This led to the beginning of the linkage of SHGs with the banks by the NABARD and SHGs became intermediaries in linking borrowers with the banks. The combined efforts of the governments at various levels, banks and NGOs have made SHG- Bank linkage programme in India as the largest micro finance programme in the world.

The strategic intent is to provide effective credit delivery system to the poor in order to promote entrepreneurial impulses in them to the effect that their (poor turning into entrepreneurs) value chain contributes to sustainable rural development. Poverty can be reduced by providing credit along with the inputs such as skill development, training and other support facilities to the poor. This will lead to entrepreneurial activities thus paving the way for self-employment. This is likely to generate income base, which in turn would empower the people. The surplus income generated from the self sustaining activities would facilitate the holistic development of the rural poor.

The income generating activity or self employment should not affect the environment; the activity should be a sustainable one even after the slow withdrawal of the facilitative support extended by the intermediaries such as voluntary agencies or financial institutions. The logic is that the guidelines and /or assistance provided by them in the initial phase empower the beneficiaries (poor turned into entrepreneurs) with the capacity to run/continue their income generating project/activity frame.

The Indian microfinance sector presents a robust picture. Its growth was impressive even during the recent financial crisis and it sustained through the second half of 2009. Although the microfinance portfolio represented less than 1% of the total credit outstanding with the Indian banking system as on March, 2010, it constituted as much as 28% of the credit portfolio of RRBs. At current growth rates, microfinance would match RRBs and exceed the total portfolio of micro accounts held by all scheduled commercial banks within next three years.[4]

1.4. Arial view of Microfinance Operations in India.

The below figure 4.1. gives an overall views about the operation & regulation of micro finance lending in India.[5] The Reserve Bank of India, being an apex governing institution, MFIs, Commercial banks and other Govt channels are operating in India.

[4] Microfinance Contributes to Financial Inclusion, M-Cril Microfinance Review, 2010.

[5] Thorat Y.S.P and R S Arunachalam, Regulation and Areas of potential market failure in Microfinance, accessed from ftp://ftp.solutionexchange.net.in/public/mf/cr/res26101001.pdf

1.5. Distribution

At present, MFIs registered as for-profit NBFCs represent 84% of all borrower accounts and manage 88% of the portfolio, although they only account for 45% of the total number of MFIs. Like other parts of the world, in India too, there has been an evolution from unregulated not-for-profit to regulated and for-profit MFIs.

In India, microfinance has so far been synonymous with microcredit, since the latter is the most popular product in demand. Other financial services such as insurance and advice are peripheral, at best, although with potential. MFIs serve the poor in rural, semi-urban and urban areas across the country, but their presence is highest in the southern states. A vast majority of the loans advanced by the MFIs are in the range of Rs 5,000 to Rs 20,000, which are well within the range set up by the Government of India in the "Micro Financial Sector (Development and Regulation) Bill, 2007", where they define the microfinance loans as loans with amounts not exceeding Rs 50,000 in aggregate per individual/small enterprise.

The region wise distribution of leading MFIs in India has not changed drastically. In 2004, almost 59% of MFIs were concentrated in South India, followed by 18.3% MFIs in East and North-East India. In 2010, the percentage for South India was 47%, for East and North East India 28.8%, and a new category of MFI operators across India which captures 8% of the market. In terms of number of borrowers, the top five states are Andhra Pradesh, Tamil Nadu, Karnataka, West Bengal and Orissa. Currently, MFIs operate in 517 district of India across 27 states in rural and remote geographies. The microfinance sector has a client base of 3.17 crores and a portfolio outstanding of Rs 20,276 crores with additional Rs 2500 crores in securitized assets. In recent years, MFIs have diversified remarkably across India, particularly in Central and West India.

1.6. Statement of the problem

Poverty eradication is the major task of the Government. The Government of India, through the Ministry of Rural development, has implemented a number of poverty reduction programmes to bring rapid growth to the economy. These programmes have reduced poverty to a considerable extent.

Millennium Development Goals aim at reducing poverty, improving health and education, empowerment of women, protecting environment and enhancing other aspects of human welfare. In India, the goals of millennium declaration were followed even before the adoption by the United Nations General Assembly, in the form of policy framework and number of schemes for rural development. The movement towards sustainable rural development will lead to the achievement of MDG. Such achievement is possible through the modern tool to combat poverty and ensure rural development, commonly known as micro finance through SHGs. Apart from savings and credit; SHGs were also able to address social issues like health, education, sanitation, drinking water, alcoholism etc.

Extension of micro finance to people, especially women, coupled with supporting activities like training, raw materials supply and marketing of products leads to the establishment of microenterprises in rural areas. These micro enterprises generate income to the family resulting in poverty reduction and set the path for development. Women gain self-confidence to venture on enterprising activities leading to social, economic and political empowerment. With their increased knowledge and awareness, they become partners for developmental activities. When people join together as a group and receive required financial assistance, a mass development takes place with considerable reduction in poverty. The resulting empowerment leads to socio- economic development in a holistic and sustainable manner. Rural development is possible with active participation of people in group activity. The groups should collectively mobilize internal and external resources and invest in entrepreneurial activities which will generate surplus to break the vicious cycle of poverty leading to sustainable rural development.

1.7. Need for the study

The review of extant literature on micro-finance reveals that the existing studies highlight the impact of SHG and microfinance on economic improvements in households, capacity building, empowerment and problems and constraints of microfinance. Integrated studies highlighting the harmonious impact of Microfinance Institutions (MFIs) and Micro Finance on the economic, financial, cultural, social and political aspects of rural households and urban households are, however, rare to come across. So, there is a need to study how micro finance through microfinance institutions plays a pivotal role in sustainable rural development. In other words, there is a need to study the impact of micro finance institution (MFI) lending in an integrated manner on income, savings, living standard, social status and cultural changes of the borrowers from rural and urban areas.

South India was pioneer in microfinance activities in country especially Tamilnadu state was one of the most active contributors in the microfinance industry. Among the quick penetrated districts in the state, Kanchipuram district had more number of active borrowers and presence of majority of Microfinance Institutions. With these issues, the main focus of this study is to determine whether micro finance through microfinance institutions in Kanchipuram district is an effective instrument in bringing out sustainable rural development and if so, whether any difference between rural and urban borrowers. To investigate the above issues, the following research questions are raised in the study. Unlike the previous studies, the present integrated study addresses the issues relating to the effectiveness of MFI lending and the role of MFIs in sustainable rural development.

1. *Is there any multiple lending to the MFI borrowers?*
2. *Is there any positive effect of MFI lending on income and savings of the borrowers?*
3. *Do the borrowers use the loan amount effectively?*
4. *Does husband of the women borrowers influence them in terms of usage of loan, asset purchase and their entrepreneurship?*
5. *What is the impact of asset purchase and housing of the MFI borrowers?*
6. *Are there any changes in their food, medical treatment of the family and schooling of their (grand)child(ren)?*
7. *How does microfinance impact on women' self confidence?*
8. *What are the effects of microfinance on social awareness and social status of women?*
9. *How many of the MFI borrowers are aware about availability of loan from banks at lower rate of interest?*
10. *Whether micro finance has positive effect on borrowers' husband's drinking and smoking habits?*

1.8. Objectives of the study

The present study is undertaken with the following specific objectives:

1. To study the special features and significance of microfinance.
2. To study the profile of Kanchipuram district
3. To study the various microfinance models operating in the selected district, and
4. To study the impact of microfinance on the beneficiaries in the selected district.

1.9. Research Methodology

This study is both descriptive and diagnostic one. The research questions are crystallized very clearly and the variables were identified from the earlier research studies, and hence fall in the classification of descriptive as well as diagnostic designs.

1.9.1. Data:

Both primary and secondary data were used in the study.

1.9.2. Primary data

The primary data were collected on scientific approach as briefed below.

1.9.3. Sample Design

The sample design took a three step process adopting multi-stage sampling design. It involves selection of district, area and respondents.

1.9.3.1. Selection of District

There are 32 revenue districts in Tamil Nadu as on 31.3.2012. Kanchipuram district is one of the vibrant districts in the state in terms of microfinance. Also, most of the MFIs have their presence in Kanchipuram district only next to Villupuram district in Tamilnadu[6]. No studies are available on the district with the chosen objectives. The researcher was working in the chosen district and very well known about socio-economic condition of the people in the district. Hence Kanchipuram district was selected for the study.

1.9.3.2. Selection of area

The selected district has 13 blocks, of which two falls in Chennai corporation limit. In order to cover all the blocks and covering both rural and urban area, from each block, urban centre and nearby rural pockets are identified and chosen for study. Distribution of the samples is depicted below in table 1.1. Kattankulathur block had a least coverage of less than 1% of respondents and Thirukkazhukundran had maximum coverage with 11.8% of respondents. More than two third (68%) of the respondents were chosen from rural area of the district for the study.

[6] www.tnrd.gov.in/schemes/st_mahalithittam.html

Table 1.1. Distribution of the Samples

Name of the Block	Location Type		Total	Percent
	Rural	Urban		
Acharapakkam	36	7	43	7.6
Lathur	55	0	55	9.7
Chittamur	51	0	51	9.0
Kanchipuram	34	25	59	10.4
Kattankolathur	5	0	5	0.9
Kundrathur	0	7	7	1.2
Madhuranthakam	32	15	47	8.3
Sriperumbudur	30	32	62	10.9
St Thomas Mount	4	48	52	9.1
Thirukazhukundram	37	30	67	11.8
Thiruporur	33	11	44	7.7
Uthiramerur	27	7	34	6.0
Walajabad	43	0	43	7.6
Total	**387**	**182**	**569**	**100.0**

Source: Primary Data

1.9.4. Population

Unlike, registered self help groups having reported with District Mahalir Thittam, there is no agency, which publishes consolidated and authenticated figures of borrowers of microfinance institutions at district level. There are 282.5 million active MFI borrowers who had borrowed a total Loans of 43.4 billion USD and had Deposits base of 1.5 billion USD by 28.9 million Depositors in India as of 2011. There are 1249 MFIs operating in India[7]. The total number of MFI borrowers as on March 2012 was 152500 in the district[8]. Predominantly MFI lending focuses on women population in the district and the total number of men beneficiaries are very meager. Hence the population is confined to only women beneficiaries.

1.9.5. Sample size

Many researchers (and research texts) suggest that the first column within the table should suffice (Confidence Level = 95%, Margin of Error = 5%). To use these values, simply determine the size of the population down the left most column (use the next highest value if your exact population size is not listed). The value in the next column is the sample size that is required to generate a Margin of Error of 5% for any population proportion. The sample size required for the study was determined using the below formula, and it was found to be of minimum of 383 respondents. Since there is an inverse relationship between sample size and the Margin of Error, larger sample size will yield lesser Margin of Error. A total of 600 respondents were interviewed. Due to incomplete details, 31 responses were rejected out of 600 samples, and finally 569 responses were taken for study.

$$\text{Sample Size} = \frac{Z^2 * (p) * (1-p)}{c^2}$$

Where: Z = Z value (e.g. 1.96 for 95% confidence level); p = percentage picking a choice, expressed as decimal (0.5 used for sample size needed); c = confidence interval, expressed as decimal (e.g., .04 = ±4).

1.9.6. Sampling Technique

[7] www.mixmarket.org/mfi/country/India

[8] General Manager-State Coordinator, Microfinance Network (MFIN), a self regulatory organisation of the Indian Microfinance sector

The main goal of purposive sampling is to focus on particular characteristics of a population that are of interest, which will best enable the researcher to answer the research questions. The sample being studied is not representative of the population, but for researchers pursuing qualitative or mixed methods research designs, this is not considered to be a weakness. Rather, it is a choice, the purpose of which varies depending on the type of purposing sampling technique that is used. In order to choose samples from diversified democratic profiles such as type of area (Rural & Urban), age, occupation, literacy, family size etc, with such a purpose, Purposive sampling method was adopted for the study.

1.9.7. Pilot study

Interview Schedule was prepared based on the issues and gaps in the studies carried out by the earlier researchers in India relating to Micro finance, Self Help Groups, their impact. Pilot studies were conducted to ensure the reliability and validity of the research instruments**.** The Interview Schedule comprised questions relating to demographic aspects, MFI details, income and saving pattern, entrepreneurial details, food & cultural habits, social actions, decision making, attitudinal change etc.

The draft Interview Schedule was referred to experts in the fields of management, economics, commerce, rural development, banking and micro finance and their comments on the draft Interview Schedule were incorporated and the contents and quality of Interview Schedule were tuned up. The draft Interview Schedule was pre-tested with 30 respondents in a pilot study. The respondents were explained about the objectives and importance of the study. A few respondents suggested some changes in the Interview Schedule for the sake of simplicity and clarity and the pilot study was useful to restructure the Interview Schedule by way of additions, deletions and modification to original questions. The final version of the Interview Schedule was developed for administration in the main study which has been enclosed as an annexure in the report.

1.9.8. Mode of data collection

Pretested interview schedule was used to the borrowers to collect the data. Field visits to the respondents' house were made during morning hours so as to meet the respondents directly.

In some villages, respondents from the same group and neighbouring borrowers were gathered and individual interview were undertaken.

1.9.9. Secondary data

The secondary data were collected from a number of Reports, journals, books and websites-published and unpublished by the microfinance institutions, MFI coordinators, rural development agencies, state and central government departments, agencies and local bodies.

1.9.10. Tools of Analysis

The primary data collected was tabulated and various analyses were carried out to test the hypotheses and models specified in the study. Analysis of variance (ANOVA) and Chi square test were adopted besides frequency distribution, weighted average and percentage analysis.

1.9.11. Impact Evaluation

The researcher was cautious to provide unbiased results on the impact, and undertaken few steps i.e., personal discussion with selected field experts including senior officials of two MFIs, personal observation to the respondents' households, and strategic questions in the interview schedule measuring the improvements on the beneficiaries after availing the loan. The researcher being a banker by profession visited some of the household in the selected areas during pre & post disbursement of loan amount and noted the changes among the borrowers. Changes were observed in terms of new asset purchased, new enterprise started, self confidence and social status of the borrowers etc.

1.9.12. Operating Definitions:

a. **Young Age Group:** The respondents who are in the age group between 21 and 30 years.

b. ***Middle Age Group*:** The respondents who are in the age group between 31 and 40 years are considered as middle age group.

c. ***Middle Income Group*:** The respondents whose total family income is between Rs 6000 and Rs 8000 per month are considered as middle income group.

1.10. Experts views:

Personal interview with experts in the field of Microfinance and related field were carried out and their feedbacks were incorporated in the study.

1.11. Hypotheses

Following hypotheses were tested.

1. There is no significant positive economic impact on MFI borrowers
2. There is no significant positive financial impact on MFI borrowers
3. There is no significant positive cultural impact on MFI borrowers
4. There is no significant positive social impact on MFI borrowers
5. There is no significant positive political impact on MFI borrowers

1.12. Scope of the study

Maximum number of studies has been conducted in the state of Andhra Pradesh. The socio-economic conditions of Kanchipuram district are similar to those of the neighbouring districts such as Thiruvallur, Vellore, Thiruvannamalai and Villupuram. So the outcome of study in the chosen Kanchipuram district might be useful for policy implications to other districts in the zone also. This study will be useful to policy makers, MFIs, bankers and planners in revamping the micro finance delivery system. This study will be useful to rural development practitioners, NGOs, government departments and all other stakeholders in sustainable rural development. The present study will be a value addition to the updated literature in the field of micro finance. It opens up avenues for further research in the areas of empowerment of women, multiple lending and impact on various aspects in MFI lending, role of MFIs, capacity building, regularisation and liberalisation on various issues relating to MFI lending, managerial aspects of micro enterprises, sustainable livelihood practices through micro finance etc.

1.13. Limitations of the study

1. As there was no published record on MFI borrowers' population at district level, the population was defined with the information obtained from the General Manager (State Coordinator), Microfinance Information Network (MFIN), Chennai.
2. Since, the information on men beneficiaries were not available at district level and considered to be very meagre, the population was confined and considered with women population only.
3. Due to time constraint, the study was restricted only with the MFI beneficiaries, could not extend with MFIs.
4. Validation of the impact of the study was carried out with personal discussions with field experts which are incorporated in the Chapter V.

1.14. Chapter Scheme

The thesis consists of six chapters in line with the objectives of the study. The chapter I gives an overall view about micro finance and explains the objectives and the methodology of the study. The chapter II briefly describes about the profile of the study area Kanchipuram district. The chapter III discusses about the review of literatures on the selected topic both in global and local context. The chapter IV describes on various microfinance models that exists in the country and in the selected district. It also briefs about allied services offered by the MFIs. The chapter V analyses the data collected from the respondents and interprets their attitude on various dimension of impact of MFI borrowing. Also illustrates the views and inputs obtained from the experts in the subject. Success stories of MFI lending are also highlighted in the same chapter. The chapter VI narrates the summary, conclusions and suggests suitable recommendations for MFIs, policy makers and regulators. Appendices consist of acronyms used, bibliography and the Interview Schedule employed.