Chapter – One
Introduction

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1.1 Background

One of the main development tool is Finance, whether for a household or for an economy. It is an undisputed imperative resource for all. This stems a core question that how finance can be obtained as one of the crucial means. Well,for an individualwho act as an agent factor of production, earns it by way of factor payment in terms of wages or in form of profit by entrepreneurs. Asound financial system in an economy not only contributes as backbone for development but it also catalyst in fulfilment of household financial needs. For aneconomy increaseinitsreal income is a resultant effectof itsgreater economic activities generating higher resources.

An alternative question pops up that how an unemployed individual or poor households meets this need of finance whether for survival, for small business etc. The need for finance doesn’t deviate largely between a people dwelling in urban or rural area. But if one sees historically, this need and access to finance is relatively much easier for those in urban or semi urban or for those who are well off compared to poor.

As per census of India in 2011 the total population of India is 121 crores of which50% of population is below 25 years’ and assume 90% of this is below 18 years who cannot have independent bank accounts i.e. 59 crores. Therefore, only 71 crores can haveindependent bank accounts while in reality only 40 crores have bank accounts. As per the report card of Pradhan Mantri Jan Dhan Yojana (PMJDY)during January 2017 claims the higher percentages of bank accounts butstill many are not having privilege for gaining access to financial services still.These are the people belonging to poor and vulnerable section of the society, who since long are been excluded from the formal financial system. So, in the absence of the sufficient formal financial institution the large majority of population even today access to informal sources of finance. Among the many reasons, it was the failures of formal rural credit services, inefficient public sector banks and large existence of informal landings gave rise to inefficient informal finance sources. Access to finance is important as a prerequisite for overall economic growth.

So, if poor household get easy access to informal finance sources why they still not develop? And these informal sources are highly exploitative in nature by charging exorbitant interest rates and takes advantage of illiterate ignorant poor.Thus, the issue of financial inclusion has emerged as a policy concerns primarily to ensure provision of credit to the poor section are normally not given the access to credit. This aim of financial inclusion can also be tackled efficiently and effectively through wide spread of microfinance services.

From the view point of formal financial institutions, the core cause of low financial accessibility to vast majority of poor households is the high transaction costs it owes to banks, absence of lack of information and cohesiveness between lender and borrower and lack of collateral. On the other side, from the view point of poor households the main reasons lay in their lack of awareness and exposure to formal banking system and its workings.

Poor householdalso need finance for various reasons, may it be life cycle needs (such as marriage, festival, old age, social functions etc.) or investment need for commencing small business or buying inputs or it may be emergency needs (such as illness, natural calamity hit etc.). There are various means through which a poor try to fulfil his needs, either the save or borrow or mortgage their assets (house, livestock etc.). The first two represents major and core services of microfinance (MF) that is microcredit and micro saving.

1.2 What is Microfinance (MF)?

MF as a term is not of recent origin and not new. Various savings and credit groups which had operated in different countries since 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. The concept of micro financing and self-employment activities in rural areas has developed considerably and it is not functioning on working charity nor on subsidy. The informal financial institutions distinctively emerged during 15th century in Nigeria who were the first to establish in Europe during the 18th century as a result of increase in poverty due to European wars during 1618 to 1648. The first load advancement aiming poor section was funded in Ireland by Jonathan Swift in 1720. Couple of former studies and discussions have mainly captured only microcredit component and have not captured two core elements micro savings and micro insurance services as utmost primary financial services. Its imperative to understand that microfinance is not a synonym to microcredit, the former is much broader term which represent more than just loaning. Microfinance is much wider concept comprising savings, credit, transfer services and micro insurance to poor. As per the National microfinance Taskforce 1999, defines microfinance as "*provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards".*The aim of microfinance is to mobilize the poor people to act instead of waiting for charity (Consultative Group to Assist the Poor, 2005).

1.2.1 GenesisofMicrofinance (MF)

So how did microfinance evolve? It's not new. Since centuries the savings and credit groups have operated. In Africa, they have Susus and Tontines, in India there are chit funds, while in Indonesian have Arisan, also in Sri Lanka they have Cheetu, all these are examples of traditional models of savings and credit within the communities. Moreover, people's banks, cooperatives, and credit unions among the rural poor expanded throughout the 1800s, and the first rural cooperativecredit society was commenced in Germany in 1864 by F. W. Raiffeisen.

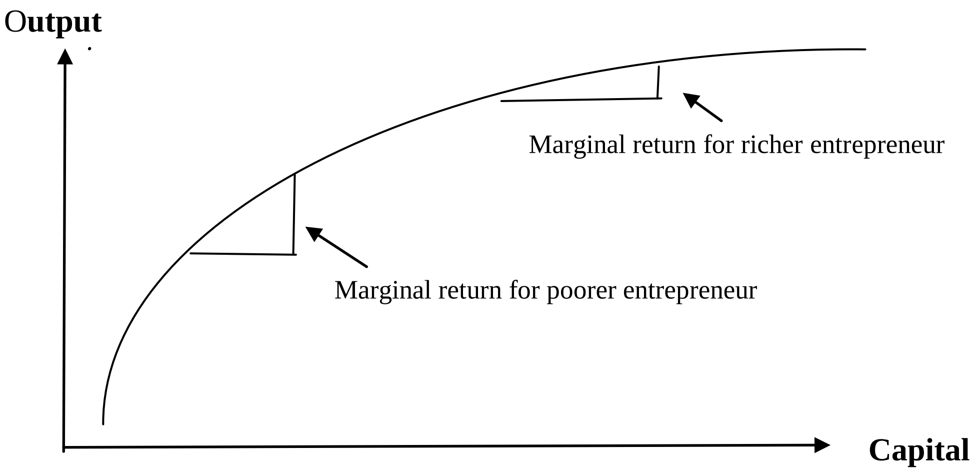
With the wide spread and reach of cooperative societies worldwide continued during 1990s and importantly in Latin America with an aim to improvise the commercialisation in the rural areas. During entire 1950 to 1970 existed a high consideration of primary agricultural credit to poor farmers. As far as India is concerned rural cooperative business model made its debut in 1904, but till late 1990s the overall performance was not satisfactory and these rural cooperatives faced mounting overdues.

Apparently, it said that Bangladesh has been the birth place of microfinance since 1970s by Muhammad Younus. During 1983 he commenced Grameen Bank as a structure to provide small loans mainly to women clients and this picked a rapid growth. As a concept microfinance gained momentum and was hyped since 2005 when U.N declared it to be ' the International Year of Microfinance' and in 2006 M. Younus was graced with an nobel peace prize. Latetly, with gaining familiarity microfinance isn't only narrowing to disbursement of credit alone but also extending of other primary financial services such as savings and micro insurance.

1.3 Economics of Microfinance

Microfinance is a broad range of financial services including microcredit, micro savings, micro insurance etc., offered and designed especially for poor and socially marginalised people having low level of income. The basic economics theories and concepts affecting the microfinance are discussed here.

Microcreditservices started because of the *failure of formal rural credit services.* Earlier not only in India but across various developing economies especially in rural areas; credit and advances by informal sector was widely popular spread.Moudruch in his book 'Economics of microfinance' throws light on various micro and macroeconomics dimensions.



Source: Adapted from Beatriz Armendariz and Jonathan Morduch, (2010)

Figure 1.1 : **Production function and Diminishing Marginal Returns to Capital**

The ***Figure 1.1*** explains some basic economics principles to understand why capital does not naturally flow to the poor. This principle defines the one of diminishing marginal returns to capital, which was derived from the assumption of concavity of the production function (the assumption is intuitive: the more the firm invest and uses capital K, the more output Y it produces, but each additional unit of capital K will bring smaller and smaller marginal gains).

In other words, it means that businesses with little capital should be able to get greater returns on their investments than richer ones, which use more capital, and thus to be able to pay higher interest rates. As Per this principle, money should move from rich depositors to poor businesses. The marginal gains obviously determine borrowers' ability to pay. So, the poorer the firm, the less the capital used, the higher the marginal returns and the higher the ability to repay loans, even at high interest rates. The Nobel winning economist Robert Lucas Jr. finds surprising results across countries applying this principle: for instance, Indian borrowers, in 1990, should have been willing to pay capital 58 times more than American ones, and money should have been flowing from USA to India.This statement may lead us to following thinking reasons:

- Why the world shows us the opposite money flowing to rich?
- Why money flows to rich countries from poor indeed?
- Why conventional credit markets fail in poor regions?

However, the above arguments fail to consider some important factors like such as risk associated in investing in developing economies, the lack of information about borrowers, their inability to offer collateral, when the bank is considering lending capital (Morduch, 2010). This will be discussed subsequently.

*As per Marguerite Robinson (2001)*there are three main theories explaining microcredit – the vicious circle of poverty theory, the supply leading finance theory and the imperfect information paradigm.

- *The vicious circle of poverty theory*- while relying on the vicious circle of poverty theory, a credit investment framework is constructed and seeks to explain how microcredit can be used as an instrument for poverty reduction. Meanwhile, the proponent of the vicious theory (Nurkse 1967) explains that poverty perpetuates itself in mutually reinforcing vicious circle on both supply and demand sides. Explaining the supply side, it is viewed that due to low level of real income capacity to save isalso less which results in to lack of capital. Regarding the demand side, it is argued that, demand for capital is influenced by incentive to invest.

  However, the lack zeal to invest could be due to low purchasing capacity, small real income and low productivity. Low productivity, however, could be due to small amount of capital used in the production, which may be caused partly by less incentive to invest. Meanwhile, the low level of real income, due to low productivity, is an issue that is common to both supply and demand sides of the circles. Therefore, it could be argued that there are two productive ways to use microcredit,loans can either be used to start a new enterprise or expand an existing one. Provision of credit to people who are not working might serve as a start- up capital for them in doing business (income generating activities), thus, in the process creating jobs for them. Job creation could lead to reduction in unemployment within beneficiaries. As unemployment is reduced, the general poverty level can also be reduced.

- *Credit Rationing and Market Failure problem can be overcome by microcredit services.*Microcredit can be defined as a provision of small scale financial services with emphasis on credit, but also on savings and insurance and other non-financial services, for businesses and families traditionally kept at bay from the financial system. It has appeared to have a potential win-win solution (what economists call Pareto) once institutions as well as poor clients gain.So, when does markets fail, when the hardworking entrepreneurs especially poor who cannot obtain all the capital needed to run their businesses. *There are two main factors responsible for poor section of the society being excluded from the financial system firstly is high operational costs for small operations and secondly lack of collaterals and lack of information.*

  *Experts in favor of Microcredit programs believe that microfinance have made it possible to overcome these obstacles.*Problems related to information asymmetry and contracting in credit markets are believed to be theoretical explanations for credit market failure.Rural credit markets in developing countries have certain characteristic features resulting to *market failures*, such as scarcity of collateral security, information asymmetry and contracting. Lack of collaterals is one of the important causes resulting in increasing risk of bad debts for the lenders. The two main categories of asymmetric information are adverse selection and moral hazard. *Adverse selection occurs* when lenders have incomplete information on the value of investment projects, the risk bearing capacity of borrower and his characteristics. *Moral hazard* is a problem that can arise when the lender is unable to discern the true intentions of the borrower leading to the possibility of adverse selection.

- *How microfinance circumvents high transaction cost, lack of collateral, lack of information and contractual barriers of rural credit markets; Reducing transactions costs and overcoming information problems are the true goals of microfinance*. In the past, low-income countries gave the responsibility to large state agricultural banks to allocate funds and subsidized credit to rural areas, in order to increase their productivity, wages and labor demands. Not only that, states started to compensate entering banks, which otherwise would be discouraged by the perspective of losses due to investing in a risky country with high transaction costs. These subsidies were also used to keep interest rates low, but the policy turned out to be a disaster, because wealth and political favors substituted profit as the measure by which the credit was lent. So, the poorest areas were left behind.

  Microfinance institutions lend to group rather than individual so that there is joint liability for borrowers which can to some extent answer the problems of *collateral security and information asymmetry.* The borrowers in the group are well acquainted with each other and generally they select trust worthy members in to the group thus the lender can pass on the information problem to the group in the context of *adverse selection and Moral hazard.*

- *Regarding enforcement of contract* each borrower has a vested interest in repayment of loan within a given time schedule because of joint liability. Micro finance institutions have adopted the policy of a new loan immediately after repayment of existing loan and denial of loan for all members of the group in case of default to make joint liability contracts more effective. In place of *collateral security***,** the forced savings of the group of borrowers is substituted by some of these institutions. Also, the local presence of these institutions enables them to be in constant touch with the borrowers there by reduces the *transaction costs* of borrowing.

Micro Insurance services like micro credit services can be catalyst to break the *poverty trap*, by ensuring households and low-income earners, businesses and farmer's means of livelihoods is retained post disaster. *Imperfect information* paradigm exits in the insurance market as well.Imperfect information give rise to the problem moral hazard and adverse selection. *Moral hazard* occurs when people engage in riskier behaviour with insurance than they would if they did not have insurance.If an insurance company had perfect information on risk, it could simply raise its premiums every time an insured party engages in riskier behaviour. Nevertheless, it is not practical for an insurance provider to keep close check on all the risk insured might take all time, hence despite of several checks and cost sharing, the problem of moral hazard still persists. The challenge of *Adverse selection* refers to situation in which the buyers of insurance are more aware of their own high or low risk than the insurance company does. This creates the problem of information asymmetric. Rather than face such a situation of adverse selection, the insurance organisations at times are reluctant to sell insurance in such markets. However, microcredit compared to micro insurance is more likely to overcome both the challenges arising from market imperfection.

Micro Savings servicesis yet another branch of microfinance. As per Keynesian economics savings are residual of one's disposable income after consumption in given period. It is interestingly put forward by Harvard economist S. Mullainathan that saving is generally 'what didn't happen' i.e. accumulation of not to consume, while consumption is a conscious decision to purchase. There exists a difference between a person's willingness to save and what they end up saving. An individual savings is affected by their choice of preference for postponement of present consumption, confidence regarding future income and on the rate of interest to some extent.

On an individual level, it enhances financially security and provide a safety net in case of an emergency. But one disadvantage to savings accounts is that they offer low interest rates. In fact, the returns may be so low that a person can risk inflation eating away at the value of one's deposit.*On an economy level* savings are undoubtedly at the heart of the economic growth that raises people's living standards. Also,it has a strong positive correlation to investment. Nevertheless, increased savings alone cannot push economy's progress, there is an equal need to invest and thereby increase productive capacity. This can be fulfilled by increasing micro credit service and encouraging small entrepreneurs.

Lastly its vital to understand that formal financial facilitates are obtained for broadly two reasons firstly income generation and secondly income and consumption smoothing. Investment credit along with long term savings deposits falls in former (production credit promote income generation) while insurance, consumption credit and short-term savings deposits falls in later (consumption smoothing). Furthermore, consumption borrowing is generally ex-post to an event while insurance and saving deposits are ex-ante planned for easy in consumption spending as pointed out by Zeller (2011).

1.4 Worldwide Organizations Promoting Microfinance Development & Database

Few internationally notable microfinances organisations viz. Grameen Foundation,MIX, ACCION International, FINCA,CGAP have played a vital role in promoting and developing microfinance services world over. Brief description of these notable organisations is below.

Microfinance Information Exchange (MIX) is a non-profit organization incorporated in 2002 with headquarters in Washington, DC and regional offices in Azerbaijan, India, Senegal, and Peru. It is the premier source for objective, qualified and relevant microfinance performance data and analysis. It also provides performance information on microfinance institutions (MFIs), funders, networks and service providers dedicated to serving the financial sector needs for low-income borrowers. MIX fulfils its mission through a variety of platforms and one of the platform being the MIX Market.

Consultative Group to Assist Poor (CGAP)is an independent research and policy organization dedicated to expanding access to finance for poor people around the world. Housed at the World Bank, CGAP was created in 1995 by a group of leading donors and practitioners with the mandate to develop and share best practices, set standards, and develop technical tools to support the development of the field. It is supported by more than 30 development agencies and private foundations that share a common vision to foster development and alleviate poverty by advancing access to financial services.

Foundation for International Community Assistance (FINCA) is based in Washington DC and it provides financial services to the world's lowest-income entrepreneurs so that they can create jobs, build assets and improve their standard of living. It is an anti-poverty organization founded by Dr. John Hatch in 1984 whose work is aimed at creating employment, raising family incomes, and reducing poverty worldwide. The organization offers small loans and other products to those turned down by traditional banks, believing that even the poor have a right to financial services. FINCA pioneered the “Village Banking Model” of credit delivery, now used by hundreds of organizations worldwide.

Americans for Community Cooperation in Other Nations(ACCION)is a global non-profit organization dedicated to creating economic opportunity by connecting people to the financial tools they need to improve their lives. A world pioneer in microfinance, it was established in 1961 in 22 shanty towns in Venezuela and issued their first microloan in 1973. ACCION over the years has helped build 63 microfinance institutions in 32 countries on four continents – Africa, Asia, Latin America and the U.S. These institutions are currently reaching millions of clients.

Grameen Foundation was founded in 1997 with an aim to curb poverty and enhance food security and global health. They provide access to essential financial services and information on agriculture and health, assistance that addresses the specific needs of poor households and communities. Its headquarters in Washington, D.C., with offices in the U.S., Africa, Asia, and Latin America and the Caribbean. They also work in the Middle East and North Africa through Grameen-Jameel Microfinance Limited, a joint venture, and in India through Grameen Foundation India, a wholly-owned subsidiary.

1.5 Presence of Microfinance in Asia and India's Standing

In Asia microfinance, specifically in India has witnessed high volatility ups and down in the sector. Certain Asian countries like Bangladesh, India, Philippines and Indonesia the industry is mature, whereas in other Asian countries such as China, Myanmar, and Laos, the microfinance sector is still establishing itself.For most of the developing nations microfinance is one of the measures leading to financial inclusion in a country through its macro policy support. It has contributed immensely to the improvement of financial inclusion in most of the Asian countries such as Philippines, Vietnam, Sri Lanka, Nepal and Bangladesh. There are mushrooming Microfinance Institutions (MFIs) in mature markets and huge for the growth in under penetrated markets. An indicator of the huge growth in the sector is the comparison of the ratio of microfinance loans to the Gross Domestic Product (GDP), which is low even in mature markets such as India, Philippines and Indonesia. However, going by only the size in microfinance loans, India ranks number one in the charts with gross loan portfolio of 12.3 billion (USD) for MFIs.

Table1.1:Microfinance Penetration in Asia (Loan to GDP ratio in %)	
Country	**Value of Microfinance Loan**
China	0.01
Indonesia	0.02
Russia	0.10
Myanmar	0.40
Philippines	0.40
India	0.59
Laos	1.00
Vietnam	3.80
Cambodia	16.00
Source: PwC, Microfinance in Asia, a mosaic outlook (2018)	

1.6 Rural Credit, Saving, Insurance and Seeds of Microfinance in India

In India, the birth of MF is mainly due to inefficiency and failure of conventional models,Regional Rural Banks (RRBs), others government schemes and Cooperatives.Starting late 1960s, India was home to one of largest state intervention in rural credit market. During 1969 we saw nationalization of existing private commercial banks, massive expansion of branch network in rural areas, mandatory directed credit to priority sectors of the economy, subsidized rates of interest. It was in 1982, Apex bank for Agriculture and Rural Development (NABARD) at national level was created. In India Microfinance Revolution began in the 1980s with the formation of pockets of informal Self Help Groups (SHG) engaging in micro activities financed by Microfinance. India’s first microfinance institution was SEWA i.e. self-employed women association as urban cooperative society by Ela Bhatt in order to bring together underprivileged woman of society to enable them for better standard of living. Moreover, today financial institutionsin India like Small Industries Development Bank of India (SIDBI), the National Bank for Agriculture and Rural Development (NABARD) and the Rashtriya Mahila Kosh (RMK) and few *NGOs like*Self Employed Women Association (SEWA),Professional Assistance for Development Action (PRADAN), International Centre for Entrepreneurship and Career Development (ICECD), and Maysore Resettlement and Development Agency (MYRADA)*have played a significant role in promoting microfinance in India.*

Since the past few years, the microfinance industry has seen strong growth with the introduction of institutional provisions like revision of RBI guidelines for NBFC-MFI operations, launch of MUDRA bank and small bank licenses. (PwC November 2016 'Shifting trends in the microfinance ecosystem'). Nevertheless, the microcredit services are growing and micro saving thrift habits are been inculcated among the poor households in rural areas but still the presence of micro insurance services is highly underserved.

1.6.1 Legal Structure of Microfinance Institutions (MFIs) in India

A microfinance institution under the Microfinance Institutions (Development and Regulation) Bill, 2012 includes the following five entities (a) a society registered under the Societies Registration Act, 1860 (b) a company registered under section 3 of the Companies Act, 1956 (c) a trust established under any law for the time being in force (d) a body corporate or (e) any other organisation, which may be specified by the RBI if the object of the institution is the provision of microfinance services.

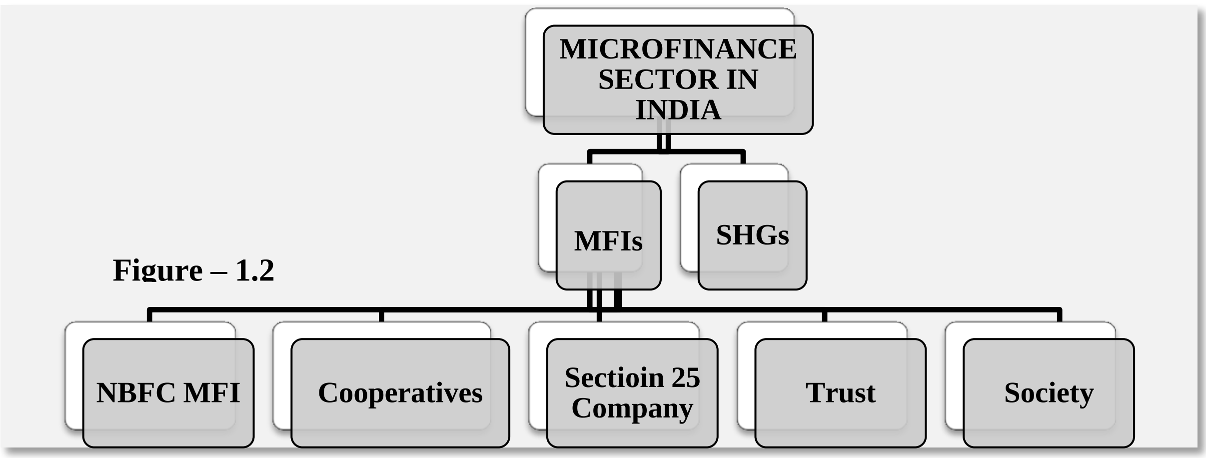


Figure – 1.2

Source: Sa-Dhan, MFIN, ICRA, CRISIL, CARE, India Ratings, PwC analysis

The Reserve Bank of India (RBI) raised the micro credit collateral free loans limits for lending by MFIs. The Reserve Bank in its monetary policy of April 2015, increased the total indebtedness of a borrower to Rs.1 lakh, doubling it from the previous limit of Rs. 50,000 and this doesn't take in to consideration educational and medical expenditure. Furthermore, MFIs can disburse loans with a rural household annual income of Rs. 1 lack as compared to earlier limit of Rs. 60,000 and in case of customers in the urban or semi-urban areas this limit has been increased to Rs. 160,000 which was earlier 120,000.

1.6.2 Micro Insurance Regulations in India

The coverage of micro insurance in India has been increasing but not in the explosive manner of as micro credit. The journey of micro insurance started in India from the year 2002. The first nominative provision for micro insurance has made in the Insurance Regulatory Development Authority of India (Micro Insurance) Regulation 2002. It was just a starting in this sector. It set a quota system for the insurers to promote the micro insurance. The complete regulation issued by IRDA in the year 2005.

Table1.2:Micro Insurance Products as per IRDA

Type	Sum insured (Rs. 000)	Term (in years)	Age (in years)
Term life	5-50	5-15	18-60
Endowment	5-30	5-15	18-60
Health (individual)	5-30	1-7	Insurer's discretion
Health (family)	10-30	1-7	
Accident rider	10-50	5-15	18-60
Livestock/assets	5-30	1	NA
Accident(non-life)	10-30	1	5-70

Source: IRDA, www.irda.gov.in

Highlights of Micro Insurance Regulations (2005)

- Product guidelines for distribution, design and issuance of policy contracts
- Guidelines for appointment of agents, compensation, code of conduct, capacity Building etc.
- Guidelines for life & non-life tie-ups - A life insurer may offer general micro insurance products & vice versa
- Directive on covering rural and social sectors

Highlights of Changes in Micro Insurance Regulations (2015)

- Capacity building exercises to be expanded by putting in 25 hours of training for micro agents licensed to distribute general insurance MSME policies with compulsory refresher training in every 3 years. Appointment of Micro agents is expanded through tie ups with AIC and other health insurers now permitted.
- Minimum five person from earlier cap of twentywill be allowed for group policies
- Microagent'sdefinition expanded with inclusion of RRBs, Primary agricultural and other co-operative Societies, Bank correspondents of scheduled commercial banks etc.

- Rural and Social Sector Obligation - Life Insurers are required to cover a certain % of the total policies in rural areas and to insure a given number of lives in the social sector.

Micro Insurance Intermediaries

The regulation provides autonomy to fix micro insurance agent for disbursement of the micro insurance policies. Micro insurance agent may be NGO's, SHG's, MFI's, RBI regulated NFBC. Also, district cooperative banks, RRB act 1976 subject to brief eligible as per norms of RBI, primaryagriculture cooperative societies and Business correspondent appointed as per reserve bank guidelines with any of the scheduled commercial Bank.

1.7 Statement of the Problem

In today's time also, rural finance is an issue of great concern in a developing countrylike India where still nearly 60% of the population is earning their livelihood from primary activities. Also, not less than 40% of the GDP is generated from rural sector. Many learned experts said India will prosper if its villages prosper. Adequate and timely disbursement of any financial needis imperative to improve quality of life, for investment or any emergency calling. This will enable speedy economic development especially in rural areas. A broader role for rural finance is the need of the day. *Rural finance should not only encompass credit but also savings and insurance to improve allocation of assets and income generation.* And microfinance promise for the same and aims to better the living standards of the poor households.

Despite rich literature there are growing concerns and debate over the impact of microfinance. The six internationally notable microfinance practitioners Grameen Foundation, ACCION International, FINCA, Women's World Banking Opportunity International and Units recently came up with a common statement where they claim that many research studies and media reports have failed to portray the real impact of microfinance in reducing poverty, providing financial services to the poor and empowering them. They claim they have witnessed the positive impact of microfinance. Loans enable a beneficiary to buy tools and materials to start an income generating business and/or to increase the productivity of an existing business. Increased income generated from these businesses allows them to pay school fees to educate their children, stabilize food sources, and pay for other expenses that lead to the improvement of the health and well-being of their families" (ACCICON 2010). At the other end there are few writers who caution against such optimism and points out to the negative impacts that MFIs have on socio-economic empowerment i.e. MFIs are not silver bullets (Adams and von Pischke, 2009 and Buckley, 2007).

Scholars have divergent views whether and how much is impact of Microfinance and no conclusive evidence as such represents that microfinance services have positive effects on socio-economic well-being of beneficiaries. Also, a large majority of microfinance impact studies are only microcredit centred in the name of microfinance**.** Available evidence from micro insurance implementations is much scarcer than for microcredit (Young et al. 2006, Dercon and Kirchberger 2008).

Hence the researcher believes that the outreach and impact of microfinance services in majority of leaves out part (savings and insurance) of the story if it only looks at one of the three components (credit) of the so-called finance *triad*. In the knowledge of researcher choices for credit, savings and insurance are interconnected and an investigation of the outreach and impact of determinants of formal savings, loans, and insurance service on household's welfare has not been undertaken. Apparently, the outreach of recent government insurance scheme Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) and Pradhan Mantri Suraksha Bima Yojana (PMSBY) which are among the micro insurance products has not been empirically investigated until now. To what extent the desired impact of microfinance on the poor is achieved is difficult to measure in absence of any information regarding savings and micro insurance habit of the poor household. Savings and micro insurance product are not substitute but rather complementary services to micro credit. Knowledge regarding these is a crucial step for better appreciation of the financial development.

In last few years Gujarathave seen extraordinary in leaps and bounds in the microfinance industry. Gujarat is one of the rapidly developing state in India. As per the last*census study report of year 2011, Dang in Gujarat is the most backward district in the country.* This drew the researcher's attention here that, how one of the most developed state of the country has the most backward district in the economy? And to what extent microfinance programs are contributing in development households of Dang district?

An important question how does microfinance services impact on the target group of borrowers? has been raised but never been fully answered. To give the best possible answer to this question, it is needed to measure the extent to which microcredit along with micro savings and micro insurance services has affected the outcomes of the targeted households. This is referred as impact evaluation. *Hence, this study revisits the evidence of microfinance services which comprises not only Microcredit but also savings and Micro Insurance, with a focus to analyses its impact on socio-economic improvement and on evaluations of the challenges in its implementation from the viewpoint of beneficiaries. There is no significant study so far is conductedin Dang district whichcomprehensively measure the performance of the MF services on the socio-economic improvement of household.*

With this scenario, it is relevant to examine following ***Research Questions -***

1. Do microfinance interventions have really result in improving socio-economic improvement among poor households of Dang District?
2. Does microfinance contribute in growth and income of the individual / family?
3. To what extent savings habits are inculcated among thehouseholds in Dang district?
4. To what extent there is use of life micro insurance product by the households in Dang.
5. What different components (factors) are responsible for socio-economic impact on beneficiaries by microfinance intervention in Dang district.
6. Are there any challenges faced by the household in availing microfinance services such as micro credit, savings and micro insurancein Dang district?
7. Is there any inter relationship between credit, savings, insurance and socio-economic factors or are they independent.

Thus, the present study is an attempt to examine the extent to which microfinance interventions through formal sources especially microcredit, micro savings and microinsurance services have been successful in delivering their promises?

1.8 Objectives of the Study

The **primary objective** of this study was to determine whether and up to what extent the formal source microfinance intervention has improved socio-economic condition of the households in Dang District Gujarat. Subsequently the **secondary objectives** could be defined as

- **i.** To know the respondent's preference for the formal and the informal sources of finance.
- **ii.** To examine the source and utilization of credit by household.
- **iii.** To assess the contribution of microcredit in growth and income of the household.
- **iv.** To study the benefits of savings on household.
- **v.** To study the extent of use of micro insurance by the households.
- **vi.** To know the perception of beneficiary on benefits from micro insurance.
- **vii.** To assess problems faced by the household in availing microfinance services.
- **viii.** To know problems faced by Banks in extending microfinance services.
- **ix.** To find out the different components (factors) responsible for socio economic impact on beneficiaries by microfinance intervention in Dang District.

These objectives are segregated as follows for this study:

Ob1: To study the influence of microfinance on households with defined family structure (gender, family type and socio-economic status) of Dang district of Gujarat State.

- To study the difference between genders (male and female) regarding the influence of microfinance services on Socio-economic improvement of the household of Dang district of Gujarat State.
- To study the difference between family types (joint and nuclear) regarding the influence of microfinance on Socio-economic improvement of the household of Dang district of Gujarat State.
- To study the difference between borrowers and non-borrowers regarding the influence of microfinance on Socio-economic improvement of the household of Dang district of Gujarat State.

Ob2: To find out the factors which could responsible for micro savingsservices from formal financial sources?

Ob3: To find out the factors which could responsible for micro insurance services?

Ob4: To find out the factors which could responsible for impact on socio economic status of households in Dang due to microfinance services?

Ob5: To analyse the problems faced by the beneficiaries in availing Microcredit, Savings and Micro Insurance services.

Ob6: To find out inter relationship between credit, savings, insurance and socio-economic factors.

Ob7: To analyse that Microfinance intervention has discriminated between beneficiaries of Dang District of Gujarat State.

Main Hypothesis

With reference to above defined objectives the main hypothesis for the study is designed as follows: (*Sub Hypothesis is elaborated in chapter 3, 3.5*)

H_O = Microfinance intervention by formal sources have not made socio-economic improvement in living standards of beneficiaries in the Dang district of Gujarat State.

Ha = Microfinance intervention by formal sources have made socio-economic improvement in living standards of beneficiaries in the Dang district of Gujarat State.

1.9 Limitations of the Study

All possible efforts were made by researcher to make study precise, but certain limitations like any other social science research did remain in present study too. Some limitation related to the present study could be cited here as follows:

- The study is confined only to the microfinance services comprising microcredit, savings and micro insurance in Dang district (majorly rural area) and the findings of this study may not be generalized directly to all other areas. However, the study is useful for an area specific investigation and the possibility of comparing results with other area specific studies.
- Only Life Micro Insurance products of LIC, SBI and Governments are been considered for the study.
- The present research study is carried out to analyze the impact of microfinance on socio-economic improvement of rural households, however it is limited only to variables mentioned in subsequent chapters 3 and 4.
- As the study is based on primary data collected through questioner and interview schedule the reliability depends in the true responses of the respondents and at times it

is difficult to persuade the respondents to provide complete detail of their households. Also, statistical methods used with 95% confidence limits two sided.

1.10 Profile of the Study Area Dang District

Overview

Gujarat is India's one of the most rapidly growing state in recent times. The state has witnessedlofty growth in both infrastructure and revenues from different fields like agriculture and technology. On contrary to this, one of the districts of the State known as Dang is regarded as the most backward and economically distressed district. The Dang district (in ancient times known as Danda-Karanya) is the only district of the Gujarat State with dense forest having 311 villages divided in 3 talukas (i.e. blocks) named Ahwa (100 villages), Vaghai (106 villages) and Subir (105 villages). This is most backward district in India having district head quarter at Ahwa. In 2006 the Ministry of Panchayati Raj named Dang district as an economically distressed district, one of 250 out of 640 districts. It is one of the six districts in Gujarat currently receiving funds from the Backward Region Grant Fund Programme (BRGF).

Geography and Climate

It is in the southern part of the state, to the north and west lie Surat and Navsari districts whereas to its east and south are the districts of Maharashtra. It lies between 20.39 degree to 21.5 degree North latitudes and 72.29 degree to 73.51 degree East longitudes. The terrain is hilly. The administrative headquarter/ Taluka of the district is in Ahwa. It is comprised of 311 villages and has an area of 1764 sq. Km. the climate is dry in winter till March and thereafter humidity increases. The monsoon lasts till October. The soil quality is very poor and unsuitable for agriculture.

Demographics

The population data as per Census 2011 published by Government of India for Gujarat state reveal that population of Gujarat has increased by 19.17% in the during 2001-2011 compared to 1991-2001 (20.66%). The population density is 129 inhabitants per square kilometre. It ranks 587th in India among all 640 districts in term of population. Decadal population of this district is growing with a rate of 21.44 %. Despite being termed as one of the most backward district, the literacy level is 76.8%, which is quite high. Dang has sex ratio of 1006 females for every 1000 males as compared to country's 940. *Until 2001 census, Dang had no urban areas but as per 2011census the district comprise nearly 11 % of urban area along with 3 main town Ahwa, Subir and Vaghai*. The population density here is the lowest in Gujarat i.e. 129 people per square kilometre.

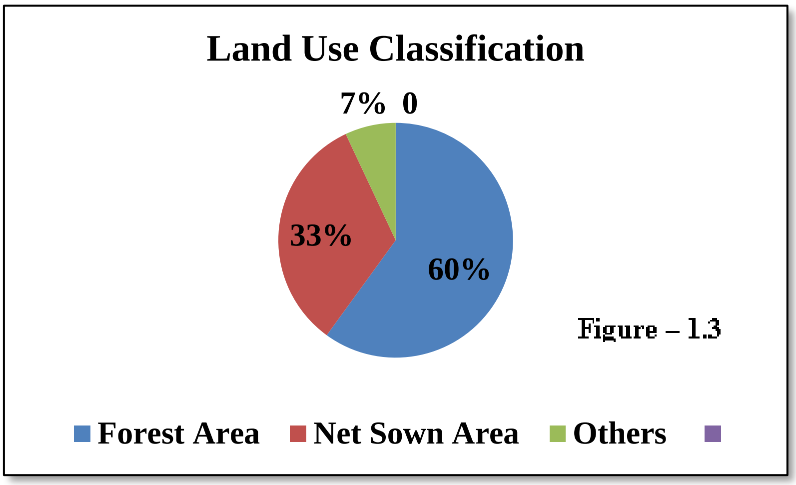
Table –1.3: Population of Gujarat and Dang District (in Million)

Place	Description	Overall			Urban			Rural		
		Total	Male	Female	Total	Male	Female	Total	Male	Female
Gujarat	**Population**	6.04	3.15	2.89	2.57	1.37	1.20	3.47	1.78	1.69
	Literate	4.11	2.35	1.76	1.97	1.06	0.91	2.14	1.12	1.02
	SC	0.41	0.21	0.20						
	ST	0.89	0.45	0.44						
Dang District (2011)	**Population**	0.23	0.12	0.11	0.03	0.01	0.01	0.20	0.11	0.10
	Literate	0.14	0.08	0.06	0.02	0.01	0.01	0.12	0.07	0.05
	SC	0.02	0.01	0.01						
	ST	0.21	0.11	0.10						

Source: Census 2011

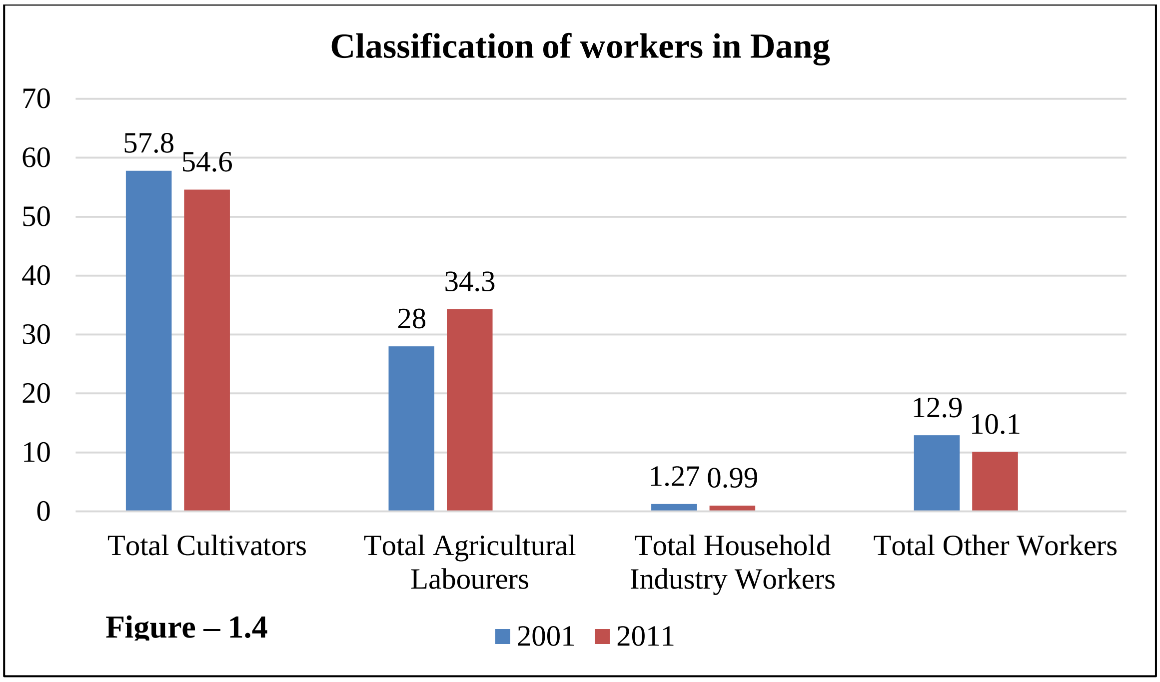
Economic Resource Base

As per the District Human Development Report of the Dang 2015, its total land area of is 176400 hectares, of which 60% is forestland and 33% is cultivable land to support agriculture as shown the Figure- 1.3 below. The quality of land here is poor and major proportion of the agricultural land is situated on slopes making irrigation quite challenging for the locals. Moreover, green houses are being propagated in the district and apart from this animal husbandry also has huge scope as allied activity alongside agriculture.



Source: District Human Development Report of the Dang (2015)

The classification of workers in Dang is highlighted in the Figure – 1.4 below which showed that the total numbers of cultivators are higher than the other types of workers.



Source: District Human Development Report of the Dang (2015)

The extent of Banking indicates economic activity in a region. As per the District Human Development Report of the Dang, during 2015 it possesses 6 centers of Scheduled Commercial Bank which have 11 offices with 34,170 lakhs as deposits, while credit extended was7358 lakhs. Out of 11 offices, 4 are comprised of State Bank and 7 offices were of other

Scheduled Commercial Banks including Nationalized, Foreign and RRBsin 2013. The *poor telecommunication services* only contribute to a few jobs created for local people. This is because telecommunication is predominantly dependent on government owned BSNL and its penetration is at a very low level in the district. Insurance services are extremely negligible with no data availability.

The SHG's in Gujarat are vastly backed by the **SGSY** (Swarna jayanti Gram Swarozgar Yojna), the **Sakhi Mandal scheme (SHGs)** of the state government and now the **NRLM** (National Rural Livelihood Mission) / Mission Mangalam.Also, the launch of the *Kisan Credit Card Green*can contributebeneficiaries in comprehensive ways.During 2015 Dang has 2,996 SHGs. The Dang District Micro Finance campaign progress report as on February 2015 is presented below.

Table -1.4: Taluka wise Status of Credit Linkage (as on February, 2015)

Sr. No	Taluka	Total Number of					Total amount of credit sanctioned (in lakhs)	Average amount of cash credit sanctioned
		Bank Branches	SHGs having SB A/cs	Applications submitted	Applications sanctioned	Applications pending		
1	AHWA	12	2996	1410	909	313	795.41	0.87504

Source: Dist. Rural Development Agency Dang-Ahwa

Table -1.5: Bank Wise Microfinance Campaign Credit Linkage details (as on February,2015)

Sr. No	Bank Name	Total Number of				Total amount of Credit sanctioned (in lakhs)
		Branches having SHG Accounts	Groups having SB Accounts	Applications submitted	Applications sanctioned	
1	Baroda Gujarat Grameen Bank	3	1309	512	333	299.45
2	State Bank of India	4	940	466	263	242.63
3	Bank of Baroda	2	546	306	232	183.33
4	Union Bank	1	49	27	26	18.5
5	Punjab National Bank	1	134	91	51	47.5
6	Central Bank of India	1	18	8	4	4
Total		**12**	**2996**	**1410**	**909**	**795.41**

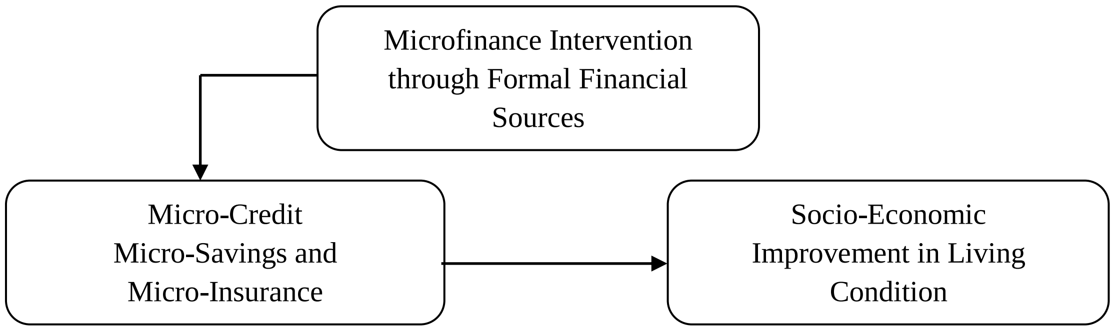
Source: Dist. Rural Development Agency Dang-Ahwa

1.11 Conceptual Framework

This describes some important definitions and explanation adopted in the study.

Microfinance Intervention

This study conceptualized Microfinance Interventions comprising micro credit, micro savings and micro insurance through formal financial sources (2011 Ruth Stewart et al.)



Independent Variable (s) **Dependent Variable (s)**

Figure1.5: Conceptual Framework on the Effect of Microfinance Intervention on Socio-Economic welfare of Households

Socio-Economic Welfare

The socio-economic welfare is for the present study is considered as improvement in socio-economic status of the household. Improvement in the standard of living is majority considered as an improvement in wellbeing and welfare of the poor households. Several studies have elaborated on crucial factors for socio-economic status aspects such as own income, qualification (literacy), job, family, family income, movable property and housing respectively. *Socio Economic Status (SES)* is established determinant which is known as *Kuppuswamy's socio-economic status tool* originally proposed in 1976. The Kuppuswamy's socioeconomic status scale as mentioned in **Code List** (see **Appendix–II** and **Appendix -III**) used to determine the socioeconomic status of every participant in which data related their educations, occupations and their monthly income etc.

Microcredit

Microcredit is the extension of very small loans to borrowers who is not able to provide collateral. Microcredit is part of microfinance which provides wider range of financial services. Reserve Bank of India (RBI) raised the micro credit collateral free loans limits for lending by MFIs. In its monetary policy, April 2015, the central bank raised the total indebtedness of a borrower to Rs.1 lakh, doubling it from the previous limit of Rs. 50,000. This excludes educational and medical expenses. It also clarified that MFIs can disburse loans to a borrower with a rural household annual income of Rs. 100,000 as compared with the earlier limit of Rs. 60,000 and in case of customers in the urban or semi-urban regions, the annual income limit has been raised to Rs. 160,000 from Rs. 120,000 earlier.

Micro Savings

The term Savings i.e. deposit refers to money kept aside for future use. Savings generally represent only one part of an individual’s disposable income. Micro Savings is branch a Microfinance comprising small deposit account recommended as an incentive to those with lower incomes. It operates similar like normal saving account, but designed for lower income group with small deposits.

Micro Insurance

Insurance is a contract known as *policy*, in which an individual or entity receives financial protection or reimbursement against losses from an insurance company. The company pools client’srisk to make payments more affordable for the insured. Insurance policies are used as hedge against the risk of financial losses for an unwanted event.

The *micro insurance*can be understood as the defence of poor income people mainlythose living on Below Poverty line (BPL), as resistant to specific hazards in consideration for premium proportionate to itsprospect and cost of the risks involved.Thus, it is the provision of insurance to low-income households, including insurance for life, health, property, disability, and agriculture that is involving a risk pooling element, which allows big groups of insured entities to share the losses resulting from the occurrence of an unwanted event. This risk pooling function makes insurance more complicated than savings or credit services. Poor families are especially vulnerable to risk, both in the form of natural disasters, and more regular incidences of accidents and illness.

As Per International Association of Insurance Supervisors (2007) "Micro Insurance is insurance that is accessed by low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices. Importantly, this means that the risk insured under a micro insurance policy is managed based on insurance principles and funded by premiums". As per *The World Bank* "Micro Insurance is an insurance product to improve a low-income person's quality of life by allowing the person to better manage potential problems while empowering that person to be more proactive as to the future". *Asian Development Bank* "Micro Insurance refers to the insurance products that are designed to be beneficial and affordable to low-income individuals or groups".*IRDA(2005)* defines a micro-insurance policy is "A general or life insurance policy with a sum assured of Rs 50,000 or less' to promote insurance coverage among economically vulnerable sections of society".

However, the present study only adopts the following Micro Insurance schemes:

Table – 1.6: Various Micro Insurance Schemes

Sr. No.	**Source or Organization**	**Micro Insurance Scheme Considered for the Study**	**Year of Commencement**
1	LIC Micro insurance schemes	a. Jeevan Madhur	2006
		b. Jeevan Mangal	2006
		c. Bhagya Laxmi	2006
2	Government's Micro insurance schemes	a. Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY)	2015
		b. Pradhan Mantri Suraksha Bima Yojana (PMSBY)	2015
3	SBI Micro Insurance schemes	a. Grameen Shakti	2008
		b. Grameen Super Suraksha	2007
		c. Grameen Bima	2007

Beneficiary is a personor group of persons who benefited from microfinance services are referred to as beneficiary. Thus, for this study beneficiaries of microfinance are an individual and/or group of persons who benefited from microfinance services in Dang district.

Vulnerability refers to the external environment in which people pursue their livelihoods and their exposure/risk to the negative effects of the external environment, as well as external shocks and trends of seasonality.

Household Respondent will be thosewho are natives of Dang district at least forat least not less than10 years.