

# **CUSTOMER SATISFACTION SURVEY IN SELECTED MICRO FINANCE INSTITUTIONS**

by

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## INTRODUCTION

*“Micro finance in India is approaching a historic ‘tipping point’ that could lead to a massive poverty reduction in the next five to ten years.”*

– **Grameen Foundation US ( in 2005)**

*“Micro finance is not a charity. It is a way to extend the same rights and services to low-income households that are available to everyone else. It is recognition that poor people are the solution, not the problem.”*

– **Kofi Annan, Secretary General, United Nations (in 2004)**

Micro-finance refers to small savings, credit, insurance and remittance services extended to socially and economically disadvantaged segments of society. In the Indian context terms like “small and marginal farmers”, “rural artisans” and “economically weaker sections” have been used to broadly define micro-finance customers. The recent Task Force on Micro Finance has defined it 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”. At present, a large part of micro finance activity is confined to credit only. Women constitute a vast majority of users of micro-credit and savings services.

During 1990s, micro finance was by and large understood as an activity that was adopting business principles but carried on by an “alternative sector” other than the Government & commercial sector and done exclusively or predominantly with the ‘poor’. While it typically meant lending small amounts to smooth consumption, a similar loan provided by a rural branch of commercial bank or RRB for instance was not necessarily considered micro finance. MFIs & SHGs were, therefore, mainly acknowledged as micro finance providers. This ambiguity of defining the micro finance has been a stumbling block for few years which has been now sorted out with the intervention of the Reserve Bank of India. According to the latest guidelines issued by the Reserve Bank of India, an amount of loan not exceeding Rs.50000.00 (US

\$ 1250) to an individual or a micro entrepreneur would qualify as micro finance

Micro finance is the evolving and impacting theme for the millions of rural and urban poor across the length and breadth of India arousing hope and opportunity to millions for raising their standard of living. Within India the micro finance movements in Western and Southern India have received most attention, both in the media as well as in academic research. Andhra Pradesh, in particular, has witnessed a remarkable growth in micro finance activities and its success stories have been widely reported as well.

Though research on Micro Finance Institutions is plenty, they are restricted mainly to financial performance, outreach and loan repayment aspect. Even their comparisons are also done on these aspects (Besley and Coate, 1995; Sen, 2001). However, micro finance institutions can also be looked upon as service organizations providing financial services to the rural and urban poor section of the society. But there is scant research, as per existing literature, on the aspect of end-users’ satisfaction levels of MFI’s – least research being found on specific analysis of service performance based on satisfaction of the recipients of micro finance i.e. the ‘real poor section’ of the society. This aspect is very important as there is ample evidence in service management and marketing literature that customer satisfaction leads to better performance (Morgan and Rego, 2006). Consequently, it can also be used to compare the performance of different micro finance institutions

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operating in the same geographic area and catering to the beneficiaries with similar demographic profiles.

In the backdrop of these activities, it is imperative to understand the customer perception of a MFI on various parameters namely, service performance, service fairness, customer satisfaction, attitude towards the MFI, behavioral loyalty and word-of-mouth. This is so because there is increasing evidence in the marketing literature that higher customer satisfaction and customer loyalty has a positive impact on the financial performance of firms (Morgan and Rego, 2006; Smith and Wright, 2004). Similarly, customer advocacy (customers' positive word-of-mouth) also has been proved to have a positive correlation with the sales growth rate and profitability of firms (Reichheld, 2003). Further even

service quality has a positive relationship with the financial performance of firms (Nelson et al., 1992; Rust et al. 1995). Thus, it is imperative to examine these relationships in the context of the micro finance institutions.

Therefore, we have conducted a survey of the customer satisfaction of micro finance institutions adopting an existing framework called 'SERVPERF' (Brady, Cronin and Brand, 2002). For the purposes of the study, we have done a comparative analysis of two organizations engaged in the delivery of micro finance services, one in Andhra Pradesh and the other in Orissa. The two organizations used in the study are (i) Bharat integrated Social Welfare Agency (BISWA) based in Orissa and (ii) Krishna Bhima Samruddhi Local Area Bank (KBSLAB) based in Andhra Pradesh.

## CONCEPTUAL MODEL AND HYPOTHESES

The following conceptual model (as shown in figure-1) has been used for the study. The model links the antecedents and consequences of customer satisfaction.

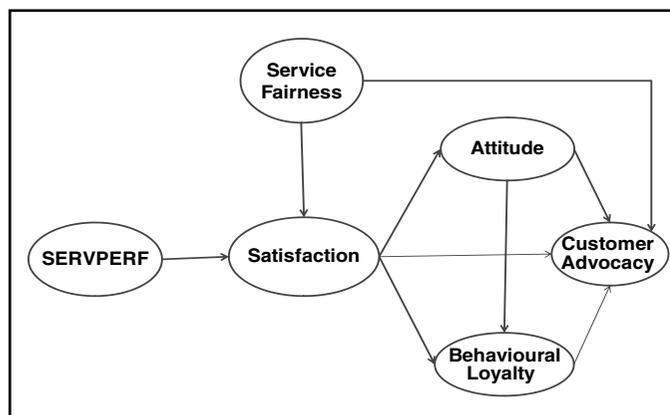


Figure 1: Conceptual Model

### SERVPERF

Performance-only measurement of service quality (SERVPERF) as identified by Cronin and Taylor (1992) among others (Babakus and Boller, 1992), has received significant conceptual and empirical support in services research (e.g. Boulding et al., 1993; Brown et al., 1993; Lee et al., 2000; Teas, 1993, 1994). In a more recent study, Brady et al. (2002) replicated and extended Cronin and Taylor's (1992) work and further confirmed the superiority of SERVPERF as a more appropriate method for measuring service quality. Brady et al. (2002) specifically maintained that SERVPERF outperforms SERVQUAL (a gap-based comparison of the expectations and performance perceptions of consumers) in terms of capturing the variance in consumers' overall perceptions of service quality and validating the conceptualization of service quality as an antecedent of consumer satisfaction.

### Customer Satisfaction

Customer satisfaction has been extensively studied in the field of marketing over the last two decades (Oliver, 1980, 1999; Fornell et al. 1996; Yi, 1989; Johnson et al. 2001; Anderson et al. 2004). It has become an important construct for marketing scholars (McQuitty et al. 2000) and an important goal to achieve for marketing practitioners (Erevelles and Leavitt, 1992). It is by far the most commonly used customer-oriented metric by managers (Gupta and Zeithaml, 2006) because it is generic and can be measured universally for all products and services including nonprofit and public services (Zeithaml et al. 2006; Johnson and Fornell 1991). After an extensive and critical review of the customer satisfaction literature, Yi (1989), conceptualized customer satisfaction as an attitude like judgment following a purchase act or based on a series of consumer-product interactions. This definition highlights that customer satisfaction is essentially customer's judgment about the extent to which a product or service meets or falls short of expectations. The literature has also emphasized the disconfirmation of expectations paradigm to a great extent (Oliver, 1996; Yi, 1989). This implies that the consumer compares the product/service with a pre-consumption expectation. If the expectation confirms with the product/service performance, then customers will be satisfied otherwise they will be dissatisfied. Tse and Wilton (1988) defined customer satisfaction as "the consumer's response to the evaluation of the perceived discrepancy between prior expectations (or some form of performance) and the actual performance of the product as perceived after its consumption."

Customer satisfaction research has developed around two broad types of evaluations: (1) transaction-specific satisfaction (2) cumulative satisfaction or an overall satisfaction concept which is similar to the attitude (Johnson et al. 2001). Traditionally, satisfaction was considered to be transaction-

specific, which is a result of the immediate post purchase judgment or affective reaction (Oliver, 1993). De Ruyter, Bloemer, and Peeters (1997) used the transaction-specific concept and showed the relationship between perceived quality and satisfaction. The authors proposed an integrated model consisting of expectations, perceptions, disconfirmation, quality and satisfaction. The model was tested in a health care setting using two-stage least square analysis in the health care sector. Findings of the study showed that service quality serves as an antecedent of customer satisfaction and satisfaction in turn is a direct function of disconfirmation and perception.

A more economic psychology-based approach to satisfaction has been developed in the literature over the last decade, which is termed as cumulative satisfaction. Cumulative customer satisfaction is defined as customer's overall experience to date with a product or service provider (Johnson et al. 2001). Research conducted by Anderson et al. (1994); Fornell et al. (1996); Johnson et al. (2001) etc. have used the overall customer satisfaction concept. According to these studies, satisfaction is viewed as an "overall evaluation based on the total purchase and consumption experience with a good or service over time (Anderson et al. 1994, p.54)." More and more satisfaction studies are now using the overall evaluation of satisfaction concept which develops over all the experiences a customer has with the firm (Gupta and Zeithaml, 2006). The fact that customer satisfaction is an important predictor of customer loyalty has been widely studied in the marketing literature (Yang and Peterson, 2004; ACSI model; ECSI model; TCSI<sup>1</sup> model; HKSI<sup>2</sup> model etc.). Thus, based on the extant body of literature on customer satisfaction, it is concluded that customer satisfaction is a post-consumption assessment of customers about the product and or service used. The conceptualization of customer satisfaction in this study is consistent with Fornell et al. (1996) and Johnson et al. (2001).

### **Behavioural Loyalty**

Many researchers like Kahn et al. (1986), Ehrenberg et al. (1990), Ehrenberg, 2000, Sharp and Sharp (1997) argue that repeat purchasing captures the true essence of customer loyalty. The authors highlight the importance of the real behavior as the end variable in consumer behavior models. Sharp and Sharp (1997) state that the effectiveness of relationship marketing activities should be evaluated only in terms of behavioral loyalty. These authors argue that a

consumer's purchasing behavior during the customer's stay with the seller is a very important outcome of the relationship. Sharp, Wright, and Goodhardt (2000) suggest that attitude is not relevant to determining customer loyalty. Their contention is that there is no "true" definition of customer loyalty and debating this topic is a waste of time.

According to Back and Parks (2003) brand loyalty is generally perceived as a positive outcome of the behavioral function of repeated relationships between a buyer and seller. Behavioral loyalty is defined as customers' explicit behavior towards a specific brand in terms of repeat purchasing actions. Behavioral loyalty can be measured by determining the actual purchase frequency, the proportion of purchase of a particular brand as compared to the total number of brands purchased and/or the actual amount of purchase made by the customer. Many researchers have used this behavioral approach to measure the customer loyalty (Sharp and Sharp, 1997; Sharp et al. 2002). However, this exclusive emphasis on the behavioral aspect of loyalty highlights certain problems too as evident in the literature. Dick and Basu (1994) points out that this emphasis on the behavioral approach neglects the importance of the customer's decision making process and it does not differentiate between brand loyalty and repeat purchasing behavior. For true loyalty to exist both attitudinal and behavioral components of loyalty needs to be considered. Reinartz and Kumar (2002) also stress that behavioral loyalty alone cannot be the measure of 'true' customer loyalty. So, it is necessary to understand the underlying factors for developing the true customer loyalty. And this can be done with the inclusion of both the behavioral and the attitudinal approach to examine customer loyalty.

In this study, behavioral loyalty is considered as the repeat purchasing behavior of customers. This is consistent with the conceptualization of behavioral loyalty in the existing literature.

### **Customer Advocacy**

Urban (2005) further states that advocacy is a mutual dialogue and a partnership which assumes that if a company advocates for its customers, those customers will reciprocate with trust, purchases and enduring loyalty. It is a partnership between a firm and its customers for the mutual benefit of both. A company advocates for customers' interests and customers advocate for the company by buying its products and helping it design better products and also by telling others about the firm and its products. Companies which advocate for customers enjoy more opportunities for selling a broader range of products to more people. This can lead to growth in sales because consumers and their friends choose the company's

<sup>1</sup>TCSI: Turkey Customer Satisfaction Index Model

<sup>2</sup>HKSI: Hong Kong Customer Satisfaction Index Model

products. It also leads to greater profit margins because customers realize that the company offers an extra value that is reflected in an honest price that is worth paying.

Binney (2006) states that customer advocacy exists where customers are willing to recommend an organization and its services/products to others. The author further adds that customer advocacy measures performance from the customer's perspective of every part of the organization. Companies like GM, Cisco, NEC, McDonald's Japan, eBay; Intel, etc. have successfully applied the customer advocacy strategy which aims to create better customer relationships by providing them expert levels of customer support and protection. The main intent of the organizations with a customer advocacy strategy is customer success.

Lawer and Knox (2006) define customer advocacy as an advanced form of market orientation which responds to the new drivers of customer choice, involvement and knowledge. The authors advocate that customer advocacy aims at building deeper customer relationships by earning new levels of trust and commitment and by developing mutual transparency, dialogue and partnerships with customers. The authors identify four interrelated market mechanisms for leveraging customer advocacy namely,

1. focus on customer success,
2. improving marketing context and consumer involvement,
3. fostering knowledge creating partnerships, and
4. enabling choice transparency.

Hill, Provost and Volinsky (2006) state that customer advocacy is of two types namely,

1. Explicit advocacy and
2. Implicit advocacy.
  1. *Explicit advocacy*: Individuals become vocal advocates for the product/service, recommending them to friends or acquaintances.
  2. *Implicit advocacy*: Even if individuals do not speak about a product, they may advocate implicitly through their actions – especially through their own adoption of the product.

Urban (2004), states that the key to an advocacy strategy of a company is to become trustworthiness in the eyes of its customers. This can be achieved by focusing on the following eight factors namely, transparency, quality of products and services, product comparison, alignment of incentives, partnering, cooperative design, supply chain, and comprehensiveness. The author further highlights different benefits of customer advocacy viz. customer advocacy contributes to the competitive advantage of the company,

brings profit to the company, and generates good profits generally in the long run.

Reichheld (2003) states that customer advocacy can be measured by getting response from customers by asking the following:

*“How likely is it that you would recommend this company – its products and/or services to a friend or a colleague?”*

Another question which measures customer advocacy is proposed by Forrester (2006). Forrester use the following question to measure customer advocacy:

*“My company does what's best for me, not what's best for its profits at my expense”*

### Service Fairness

Customer perceptions of service fairness indicate “rightness” in their evaluation of exchange inputs and outcomes (Oliver 1997). The social nature of services makes fairness significant for customers, with consequent effects on evaluative and relational elements of service loyalty (Huppertz, Arenson, and Evans 1978; Oliver and Swan 1989). We expect fairness to affect satisfaction; if customers feel that service outcomes are commensurate with inputs, they will evaluate their overall satisfaction with the service positively (Oliver 1997).

### Attitude Towards the Service Provider

Ajzen (2001, pp.28) states that in the attitude literature “there is a general agreement that attitude represents a summary evaluation of a psychological object captured in such attribute dimensions as good-bad, harmful-beneficial, pleasant-unpleasant, and likable-dislikable.” This is defined as “a psychological tendency that is expressed by evaluating a particular entity with some degree of favor or disfavor” (Ajzen and Fishbein, 2000). Jacoby and Chestnut (1978) define attitudinal loyalty as “the consumer's predisposition towards a brand as a function of psychological processes. This includes attitudinal preference and commitment towards the brand.” Similarly, Dick and Basu (1994) says that attitudinal loyalty reflects the customer's psychological disposition towards the same brand or brand-set. These authors further argue that attitudinal loyalty reflects customer's favorable attitudes towards the brand or the organization. Rundle-Thiele and Bennet (2001) states that attitudinal loyalty concepts infers consumers' engagement in extensive problem-solving behavior involving brand and attribute comparisons, leading to strong brand preferences. They further state that there is growing evidence in the marketing literature that attitudinal loyalty is a personality trait as well as brand-specific.

## HYPOTHESIS

1.

### **SERVPERF and Customer Satisfaction**

The relationship between customer satisfaction and perceived quality has been studied in the national satisfaction index models (Fornell, 1992; Fornell et al. 1996; Eklof, 2000). But very little emphasis has been given to the dimensions specific analysis of SERVPERF and customer satisfaction. Hence we propose the following hypotheses:

**H1:** *SERVPERF dimensions will have a positive impact on customer satisfaction.*

2. and 3.

### **Service Fairness, Customer Satisfaction and Customer Advocacy**

Customer perceptions of service fairness indicate “rightness” in their evaluation of exchange inputs and outcomes (Oliver 1997). The social nature of services makes fairness salient for customers, with consequent effects on evaluative and relational elements of service loyalty (Huppertz, Arenson, and Evans 1978; Oliver and Swan 1989). Based on the “justice theory” and “dual entitlement” we expect service fairness to affect satisfaction; if customers feel that service outcomes are commensurate with inputs, they will evaluate their overall satisfaction with the service positively (Oliver, 1997). We also expect that if customers perceive fairness in the service they receive they will advocate for the firm in their peer group and others. Hence we propose the following hypotheses:

**H2:** Service fairness will have a positive impact on customer satisfaction.

**H3:** Service fairness will have a positive impact on customer advocacy.

4. and 5.

### **Customer Satisfaction, Attitude, Behavioral Loyalty and Customer Advocacy**

The relationship between customer satisfaction and customer loyalty has been well documented in the literature (Fornell et al. 1996; Eklof, 2000; Aydin and Ozer, 2005). Almost all these studies have considered the behavioral loyalty construct as the outcome of customer satisfaction. There are a very limited number of studies which have considered the impact of customer satisfaction on customers’ attitude towards the

service provider. Lam et al. (2004) identified positive impact of customer satisfaction on attitudinal loyalty as well as behavioral loyalty in a B2B context. Therefore the following hypotheses are proposed:

**H4:** *Customer satisfaction will have a positive impact on customers’ attitude towards the MFI.*

**H5:** *Customer satisfaction will have a positive impact on customers’ behavioral loyalty.*

6.

Anderson (1998) has reported that satisfied customers engage in relatively greater word of mouth behavior. The higher satisfaction level would suggest that the customer is relatively more confident in the ability of the service provider (MFI) to effectively address customers’ needs and, therefore, the customer is quite comfortable in recommending (advocating) the service provider to others. Hence we expect that customer satisfaction will have a positive impact on customer advocacy behavior. Hence the following hypothesis:

**H6:** Customer satisfaction will have a positive impact on customer advocacy behavior.

7.

Glasman and Albarracin (2006), states that past research has shown that attitudes people hold predicts their behavior. The theoretical footing for the effect of attitude on behavior lies in the theory of planned behavior of Ajzen and Fishbein, (2000). Moreover, Dick and Basu (1994) claim that the positive attitude towards the brand ensures that previous purchase behavior will continue. Based on the above argument we propose the following hypothesis:

**H7:** Attitude towards the MFI will have a positive impact on their behavioral loyalty.

8.

Westbrook (1987) pointed out that consumers are more likely to engage in word-of-mouth when they experience positive emotional experiences. The author further adds that cognitive appraisal appears to underlie the specific behavior in the form of word-of-mouth. Dick and Basu (1994) also advocate a positive relationship between relative attitude and word-of-mouth behavior of customers. Similarly in a study done among the customers of grocery stores Reinartz and Kumar (2002) found that the link between customer longevity and the willingness of consumers to engage in word-of-mouth was strong when both attitudinal and behavioral loyalty were considered as compared to when only the behavioral loyalty

was considered. Fullerton (2003) has shown the positive relationship between affective commitment and word-of-mouth behavior of customers. Based on these arguments it is proposed that attitude towards a service provider has a positive relationship with customer advocacy.

**H8:** *Attitude towards a service provider will have a positive impact on customer advocacy.*

**9.**

Gremler and Brown (1996) examined the behavioral outcomes of customer loyalty. According to the author, one

of the outcomes which results from loyalty is positive word-of-mouth, i.e., the extent to which people recommend and talk positive things about the company. Srinivasan et al. (2002) in their study found support for this finding. Hagel and Armstrong (1997) and Dick and Basu (1994), state that loyal customers are more likely to engage in positive word of mouth. According to Dick and Basu (1994) word-of-mouth is one of the consequences of repeat patronage behavior. Thus we propose the following hypothesis:

**H9:** *Behavioral loyalty will have a positive impact on customer advocacy.*

## OBJECTIVES OF THE STUDY

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1. The first objective of the study is to propose and examine an integrated model of service performance for the service providers.
2. The second objective is to perform a dimensions specific analysis of performance-only measurement of service quality and satisfaction in case of the MFIs in India.
3. Next, the study also looks into the factors which may aid the service providers to trigger the positive word-of-mouth (customer advocacy) about them.
4. Finally, the study proposes to compares the aforementioned relationships across two selected MFIs. This will aid the MFIs in understanding their relative performance from the customers' point of view so as to maintain a long-term relationship with the customers and spread positive word-of-mouth.

## HISTORICAL BACKGROUND OF MICRO FINANCE IN INDIA

While technology and finance hold the key to ameliorate poverty, the poor in India do not have adequate access to the formal banking sector. Inaccessibility of the poor to the formal/institutional banking sector is mainly due to the following reasons:

- (a) Lack of good retail outlets offering banking services,
- (b) Lack of assets with the poor that could be used as collaterals and
- (c) Illiteracy of the poor.

The credit requirement of the poor in India has been estimated by the World Bank to be around Rs.75, 000 crore per annum in 2007. Against this requirement, the credit outstanding of the poor with the formal banking sector is stated to be Rs.7500 crores or ten per cent of the total demand.

The poor require finance for both production and consumption purposes. Production loan may be of three types, viz.

- (a) short term (for periods up to 15 months),
- (b) medium term (from 15 months to 5 years) and
- (c) long term (for periods above five years).

Economic activity in rural areas may relate to the various sectors of crop husbandry, animal husbandry, poultry, fishery, cottage & village industries, handicrafts, transportation, repair shops, and trade & services. But the recent strategy is to ensure flexibility in lending and in repayment based on the capacity of the borrower to earn enough to repay – whether it is daily, weekly, monthly or seasonal. Short term loans may be required by the poor for purchasing (HYV) seeds, fertilizer and for irrigating a leased-in land etc. Medium term loans may be required for purchase of bullocks (or a boat) and for purchase of machinery and equipment. Long term loans may be required for repayment of loans, for constructing a shed/shop and for purchase of land etc. What needs to be appreciated is

that all the three kinds of production loans are relevant to the poor.

About two-thirds of the estimated credit requirement of the poor is said to be on account of consumption needs. Nearly three-quarters of this consumption need (Rs.25, 000 crores) is stated to meet emergencies like illness and household expenses during the lean seasons. It is worth mentioning that due to lack of employment, and incomes during the lean seasons, the poor are often not in a position to buy subsidized food grains from the Targeted Public Distribution System (TPDS). If consumption loan could be made available through the formal banking sector, the poor will benefit not only by way of lower interest rate but also in terms of realizing the subsidy on food grains/items of TPDS. Alternatively, food grains credit could be provided directly under TPDS. It is important to note that consumption loans are also as relevant to the poor as production loans.

Availability of finance, moreover, tilts the employment scenario in favour of self-employment vis-à-vis wage employment. An added dimension is the empowerment of women with easier availability of micro-finance to them. Going by the estimates provided earlier, the demand for production credit in the country today is equal to Rs.17000 crores per annum whereas the total credit outstanding under micro-finance is merely Rs.5000 crores. Thus, there is definitely a need to increase the flow of credit, both for consumption and production, to the rural sector.

### DEMAND OF MICRO FINANCE SERVICES IN INDIA

Due to its large size and population of around 1000 million, India's GDP ranks among the top 15 economies of the world.

However, around 300 million people or about 60 million households, are living below the poverty line. It is further estimated that of these households, only about 27 percent have access to credit from the formal sector. Additionally, the segment of the rural population above the poverty line but not rich enough to be of interest to the formal financial institutions, also does not have good access to the formal financial intermediary services, including savings services.

A group of micro-finance practitioners estimated the annualized credit usage of all poor families (rural and urban) at over Rs 65,000 crores, of which some 70 percent is met by informal sources. This figure has been extrapolated using the numbers of rural and urban poor households and their average annual credit usage (Rs 6000 and Rs 9000 pa respectively) assessed through various micro studies.

Credit on reasonable terms to the poor can bring about a significant reduction in poverty. It is with this hypothesis; micro credit assumes significance in the Indian context. With about 60 million households below or just above the austerely defined poverty line and with more than 70 percent unable to access credit at reasonable rates, it is obvious that there are certain issues and problems, which have prevented the reach of micro finance to the needy.

With globalisation and liberalisation of the economy, opportunities for the unskilled and the illiterate are not increasing fast enough, as compared to the rest of the economy. This is leading to a lopsided growth in the economy thus increasing the gap between the haves and have-nots. It is in this context, the institutions involved in micro finance have a significant role to play to reduce this disparity and lead to more equitable growth because of the following reasons.

## MARKET OF MICRO FINANCE

### 1. Demands for Credit

In terms of demand for micro-credit, there are three segments:

- (a) At the very bottom in terms of income and assets, and most numerous, are those who are landless and are engaged in agricultural work on a seasonal basis, and manual labourers in forestry, mining, household industries, construction and transport. This segment requires, first and foremost, consumption credit during those months when they do not get labour work, and for contingencies such as illness. They also need credit for acquiring small productive assets, such as livestock, using which they can generate additional income.
- (b) The next market segment is small and marginal farmers and rural artisans, weavers and those self-employed in the urban informal sector as hawkers, vendors, and workers in household micro-enterprises. This segment mainly needs credit for working capital, a small part of which also serves consumption needs. In rural areas, one of the main uses of working capital is for crop production. This segment also needs term credit for acquiring additional productive assets, such as irrigation pump sets, bore wells and livestock in case of farmers, and equipment (looms, machinery) and work sheds in case of non-farm workers. This market segment also largely comprises the poor but not the poorest.
- (c) The third market segment is of small and medium farmers who have gone in for commercial crops such as (surplus) paddy and wheat, cotton, groundnut, and others engaged in dairying, poultry, fishery, etc. Among non-farm activities, this segment includes those in villages and slums, engaged in processing or manufacturing activity, running provision stores, repair workshops, tea shops, and various service enterprises. These persons are not always poor, though they live barely above the poverty line and also suffer from inadequate access to formal credit.

One market segment, which is of great importance to micro-credit is women. The 2001 Census figures reveal that out of

total 2.81 million marginal workers, 2.54 million were women and their further break-up shows that out of a total of 2.67 million rural marginal workers, 2.44 million were females. Further, many more women were willing to work. This has been corroborated by the results of a survey done by the National Sample Survey Organisation (NSSO), 60<sup>th</sup> round, which has revealed that there is a wide variety of work which rural women combine with household work.

In the NSSO survey it has also been estimated that a large percentage of rural women in the age group of 15 years and above, who are usually engaged in household work, are willing to accept work at household premises (29.3 percent), in activities such as dairy (9.5 percent), poultry (3 percent), cattle rearing, spinning and weaving (3.4 percent), tailoring (6.1 percent) and manufacturing of wood and cane products etc. Amongst the women surveyed, 27.5 percent rural women were seeking regular full-time work, and 65.3 percent were seeking part-time work. To start or to carry on such work, 53.6 percent women wanted initial finance on easy terms, and 22.2 percent wanted working capital facilities, as can be seen from the table below:

**Demand for Micro finance**

<i>Assistance Required (by women marginal workers seeking or available for work at their household premises)</i>	<i>Percent of Women Seeking Assistance</i>
No assistance	2.1
Initial finance on easy terms	53.6
Working capital facilities	22.2
Raw materials availability	4.6
Marketing	1.7
Training	10.5
Accommodation	0.4
Other assistance	4.9
<b>Total</b>	<b>100</b>

## 2. Demands for Savings and Insurance Services

The demand for savings services is ever higher than for credit. Studies of rural households in various states in India show that the poor, particularly women, are looking for a way to save small amounts whenever they can. The irregularity of cash flows and the small amounts available for savings at one time, deter them from using formal channels such as banks. In urban areas also this is true, in spite of better banking facilities, as shown by the experience of the SEWA Bank, Ahmedabad. The poor want to save for various reasons – as a cushion against contingencies like illness, calamities, death in the family, etc; as a source of equity or margin to take loans; and finally, as a liquid asset. The safety of savings is of higher concern than interest rates. The demand for savings services is high in rural areas as well, as can be seen from a recent study of women's savings and credit movement in Andhra Pradesh. Almost all women's groups in their early years begin with regular savings and their savings exceed the loans they give from their funds. Of course, part of this lower demand for credit is the inadequate absorption capacity of women, which comes from long years of exclusion from the economic sphere outside their homes.

The demand for insurance services, though not very well articulated, is also substantial. This comes from the fact that not only incomes of micro finance customers low, but are also highly variable. Insurance by the poor is needed for assets such as livestock and pump sets, for shelter. Crop insurance could be very useful to the rural poor. Finally, insurance against illness, disability and death would also reduce the shocks caused by such contingencies, which lead the poor into taking loans at such times at high interest.

## 3. Supply of Micro-Finance Services

RBI data shows that informal sources provide a significant part of the total credit needs of the rural population. The magnitude of the dependence of the rural poor on informal sources of credit can be observed from the findings of the All India Debt and Investment Survey, 2007, which shows that the share of the non-institutional agencies (informal sector) in the outstanding cash dues of the rural households was 26.9 percent. However, the dependence of rural households on such informal sources had reduced of their total outstanding dues steadily from 83.7 percent in 1961 to 36 percent in 1991 and further reduced to 26.9% in 2007. This is illustrated in the table below.

Outstanding from Informal Sources as a Percentage of Total Dues for Various Occupational Categories of Rural Households

Year	Cultivators	Non-Cultivators	All
1961	81.6	89.5	83.7
1971	60.3	89.2	70.8
1981	36.8	63.3	38.8
1991	33.7	44.7	36.0
2002	31.5	42.3	33.3
2005	28.7	37.2	26.9

Among formal institutional sources, banks and co-operatives provided credit support to almost 61 percent of the rural households, while professional and agricultural money lenders were providing credit to almost one sixth of the rural households. The details by source are given below:

### Sources of Credit for Rural Households, 2007

Credit Agency	% of Rural Households
Government etc	6.9
Cooperative Societies	24.2
Commercial Banks and RRBs	36.7
Insurance	1.7
Provident Fund	0.8
Other institutional Sources	2.8
<b>All Institutional Agencies</b>	<b>73.1</b>
Landlord	4.0
Agricultural Money-lenders	5.0
Professional Money-lenders	8.5
Relatives and Friends	5.5
Others	3.9
<b>All Non-institutional Agencies</b>	<b>26.9</b>
<b>All Agencies</b>	<b>100</b>

Though the overall share of institutional credit for rural households has gone up steadily, households in the lower asset groups were more dependent on the non-institutional credit agencies. The share of debt from the non-institutional credit agencies was 58 percent in the case of lowest asset group of "less than Rs 5,000" as against a low of 19 percent in the highest asset group of "Rs 2.5 lakhs and above".

### Share of Debt from Institutional and Non-institutional Sources, by Asset Holdings of Households

Household Assets (Rs. '000)	Institutional Agency (Share as %)	Non-institutional Agency (Share as %)	All
Less than 5	42	58	100
5-10	47	53	100
10-20	44	56	100
20-30	68	32	100
30-50	55	45	100
50-70	53	47	100
70-100	61	39	100
100-150	61	39	100
150-250	68	32	100
250 and above	81	19	100
<b>All Classes</b>	<b>64</b>	<b>36</b>	<b>100</b>

The demand for micro finance services – savings, credit and insurance – is apparently insatiable in India. In that sense, India is perhaps the largest emerging market for micro finance services. This can be proved from the following facts:

- The National Council for Applied Economic Research (NCAER) reported (2007) that the low income population in rural India has come down from around 65 per cent during the early 1990s to 25 per cent during the recent survey (2007).
- Meanwhile, middle income households in rural India have gone up from 33 per cent to 70 per cent. Almost 50 million households have transcended from low income to the middle income.
- As per the estimates there is an increase in the savings by rural India to the extent of 31 per cent.
- The urban-rural remittances have increased to a great extent as the migrant population began sending their earnings to the villages.
- This reflected in a sudden spurt in demand from India's increasingly assertive and affluent hinterland. Rural India now accounts for around 53 per cent fast moving consumer goods market. Even more telling, close to 59 per cent of demand for consumer durables emanates from rural India.

These are not just statistics, rather these culminates into the potentiality and demand for micro banking in the hinterland and the micro finance is the most suitable tool to tap this emerging market.

There is whole lot of research work done on the potential & future market of micro finance. To find out the market, let us first assume the number of people in the Below Poverty Line (BPL) and as per the most conservative estimates, the Average Number of BPL people will be around 579 lakhs to 773 lakhs (UNDP estimates, 2003). To determine the amount of on lending capital requirement for these BPL clients, on annual average loan size of Rs.4000 (US \$ 98.8) to Rs.10000 (US \$ 246.9) has been considered (Average loan size data is from Intelicap's analysis of cumulative MFIs). Applying these loan amount to the BPL population identified above, the annual credit demand could go to Rs.23160 crores (US \$ 5.7 billion) to Rs.57900 crores (US \$ 19.08 billion).

#### Annual micro finance demand (using National Poverty Line Statistics)

Loan Size (US \$)	Potential clients National Poverty line	Financial requirements (National) in US \$	Financial requirements (National) Rs. in crore
98.8	579 lakh	5718518519	23160
123.5	579 lakh	7148148148	28950
148.1	579 lakh	8577777778	34740

172.8	579 lakh	10007407407	40530
197.5	579 lakh	11437037037	46320
222.2	579 lakh	12866666667	52110
246.9	579 lakh	14296296296	57900

Apart from the above estimate, if we calculate the SHG-Bank linkage programme, the market of micro finance will be even bigger and also attractive.

#### Formal/Banking Sector Initiatives

Various programmes were initiated by banks to inculcate savings habit and to provide financial assistance. The initiatives are as follows-

1. *Pigmy deposit scheme* – The Pigmy deposit scheme intended to collect tiny deposits from the depositors from their doorsteps. The scheme was implemented by a few banks by engaging local people. The experience of the banks was not encouraging as there were large scale cash leakages, frauds and reconciliation problems. Most banks found the scheme unattractive.
2. *Mobile banks* – Some of the banks started mobile banks in rural areas. The location and time of operation are usually synchronized with the market days so that the large number of people could transact its business. This programme was dropped because of the man power constraints.
3. Regional Rural Banks (RRBs) were intended to serve the people not covered by co-operatives and commercial banks. But they were not able to serve the purpose as they were more focused on profitability and strong balance-sheets. In spite of this, it was found that the RRBs are better equipped than the commercial and co-operative banks to undertake micro finance operations because of the understanding of the local conditions. As on 2005, there were 196 RRBs, covering 516 districts and a client base of 6.27 crores.
4. Local area banks (LABs) aimed to mobilize rural savings by local institutions and makes them available for investment locally. They were set up in private sector and regulated by RBI. The working of LABs was not very encouraging. One serious drawback was absence of refinancing facility. Krishna Bhima Samrudi, the local area bank in Andhra Pradesh is only one into the business of micro finance on a large scale.

India to-day has an extensive banking infrastructure comprising over 30,000 rural and semi-urban branches of commercial banks, over 14,000 branches of Regional Rural banks (RRBs), around 12,000 branches of District Cooperative Credit Banks (DCCBs) and 1,12,000 Primary

Agricultural Credit Societies (PACS) at the village level (around 66,000 PACS are stated to be functional; the remaining are dormant).

### **SEWA Co-operative Bank (1974)**

The implementation of formal lending programmes towards the poor suffer from the difficulties such as of exact targeting, screening problems of distinguishing good and bad borrowers and usually lending agencies won't be able to ensure the productive usage of loans. Also, the high transaction costs incurred in lending to the poor made the formal lending agencies leave the poor un-banked. The Indian cooperative credit structure meant to empower the poor was not very successful as it was captured by a few powerful and because of excessive governmental interference and regulation. The search for an alternative to the formal banking sector and an effective financial system to cater to the needs of the poor, especially the rural poor, continued. The origin of micro finance can be traced to the establishment of the SEWA cooperative bank in 1974, to provide banking services to the poor women employed in the unorganized sector in Ahmedabad in Gujarat.

### **Self Help Groups (SHGs)**

Government initiatives during seventies and the Fourth Five Year Plan focused on small and marginal farmers and agricultural labourers. Integrated sustainable income generation activity was promoted under Integrated Rural Development Programme. Inadequacies inherent in running programs focused on individual households, called for shift to a group based approach. The first step towards setting up self help groups (SHGs) was taken by MYRADA and it built upon rural chit funds and informal lending networks to evolve a credit management group.

### **National Bank for Agriculture and Rural Development**

In 1991-92, NABARD launched the SHG-Bank Linkage Programme on a pilot basis to finance SHGs across the country through the formal banking system. High repayment rates by the SHGs encouraged the banks to finance SHGs.

### **Rashtriya Mahila Kosh (RMK), 1993**

The success of the concept of micro-credit through self help groups (SHGs) has encouraged the Government of India to establish a National level Micro-Credit organization/Rashtriya Mahila Kosh (RMK) (National Credit Fund for Women) under

the Ministry of Women and Child Development in 1993, with an initial corpus of Rs.31 crores. The objective was to help women organize income generating activities to improve their socio economics status. RMK had disbursed cumulative loan of Rs 151 crores up to July 2006, benefiting 5.50 lakhs women and the recovery rate is above 91%.

### **Small Industries Development Bank of India (SIDBI), 1994**

In 1994, Small Industries Development Bank of India (SIDBI) launched a pilot scheme to provide financial assistance by way of loans to NGOs for providing credit to the poor households, especially women. A small amount of grant also accompanied the loans so as to build capacity of the intermediates and end-users. The programme did not achieve the desired objective. A large number of NGOs were not able to upscale their lending operations because of difficulties like interest rate cap on lending, security stipulations etc. SIDBI reoriented its Micro Finance Programme in 1999 by addressing the weakness of the pilot scheme, with an objective to create a national network of large and viable Micro Finance Institutions from the formal and informal sector. The programme provides need based assistance by way of term loans to partner institutions for meeting their on lending fund requirements. Its programme took off slowly. The bank was able to improve its portfolio by 100% each year for the last three years in a row. It had sanctioned Rs.320 crores financial assistance during 2006 as against Rs 189.73 crores during 2005.

### **SHG-Bank Linkage Programme (1996)**

In 1996, Reserve Bank of India included financing of SHGs as a main stream activity of banks under the priority sector lending programmes. The SHG Bank linkage programme covered over 24.3 million families by March 2005. Under the Bank-SHG Linkage Programme 2.24 million SHGs were linked, up to 31<sup>st</sup> March 2006, of which 90 percent are women's groups.

### **Micro Finance Development and Equity Fund (MD and EF), 2001**

Government of India, in 2001 re-designated the existing Micro Finance Development Fund as Micro Finance Development and Equity Fund with the objective of facilitating and supporting the orderly growth of the micro finance sector, by especially assisting the women and vulnerable sections of the society and also by supporting their capacity building. The size of the fund was also enhanced from the existing

Rs.100 crores to Rs.200 crores. The additional amount was to be contributed by Reserve Bank of India, NABARD and the commercial banks in the proportion 40:20:20.

### Micro Finance Programme (MFC), 2004

In March 2004, the Ministry of Small Scale Industry introduced the Micro Finance Programme through the SIDBI. The Government provides funds for Micro Finance Programme to SIDBI, called "Portfolio Risk Fund (PRF)". This fund is used for security deposit required of the MFIs/ NGOs to get loan. At present SIDBI takes fixed deposit equal to 10% of the loan amount. The share of MFIs/ NGOs is 2.5% of the loan amount (i.e. 25% of security deposit) and balance 7.5 % (i.e. 75% of security deposit) is adjusted from the funds provided by the Government of India. The MFIs/ NGOs avail of loan from SIDBI for further on lending on the support of the deposit. Up to December 2006, 39 MFIs have been disbursed loan to the tune of Rs. 102 crores, thereby utilizing an amount of Rs.7.64 crores from the PRF. This has benefited approximately 3.20 lakhs beneficiaries, mainly women.

### Micro Finance Bill (2006)

The draft Micro Financial Sector (Development & Regulation) Bill, which was put up in the Parliament in March, 2007 had the following salient features:

- (a) Enactment of the bill will give the NABARD explicit powers to regulate the micro finance and so ensure greater transparency, effective management and better governance. This will facilitate the flow of Micro Finance Services in a more efficient way to the un-banked population.
- (b) The Bill defines the Micro Finance services as provision of financial assistance to the eligible clients either directly or through group mechanism for small and tiny enterprise, agriculture, allied activities including

consumption, upto an amount not exceeding Rs. 50,000/- in aggregate and upto Rs. 1, 50,000/- for housing purpose or such other amounts for the above purpose or such other purposes as specified by the NABARD from time to time.

- (c) Micro Finance Organization is defined as an Organization carrying on the business of extending Micro Finance Services and includes Society registered under the Societies Registration Act, 1860 or a Trust created under the Indian Trust Act, 1880 or Public Trust registered under any State enactment or a Cooperative Society engaged in Micro Finance service excluding a Cooperative Bank as defined under the Banking Regulation Act, 1949.
- (d) It differentiates between Organizations accepting thrift and those not accepting thrift. Thrift receiving organizations will be kept under sharp focus. No micro finance Organization would be able to accept thrift unless it obtains a certificate of registration from the NABARD subject to fulfillment of certain conditions. It will require MFOs accepting thrift to create a Reserve Fund.
- (e) It provides for the creation of a Micro Finance Development Council for advising the NABARD on formulation policies.
- (f) It provides to facilitate constitution of a Micro Finance Development and Equity Fund to provide loans, refinance, grant and seed capital to MFOs.
- (g) It will provide a redressal mechanism through a Scheme of Micro Finance Ombudsman.
- (h) It will provide penalties for violation on the provisions of the Act.
- (i) It will authorize the Central Government to make rules and authorise the NABARD to formulate regulations with the previous approval of Central Government.

(Due to certain reasons the above bill lapsed and the term of 14 Lok Sabha expired.)

## MODELS OF MICRO FINANCE IN INDIA

Landlords, local shopkeepers, traders, suppliers and professional money lenders, and relatives are the informal sources of micro-credit for the poor, both in rural and urban areas. Some of the perceived advantages of informal loans are:

- (a) contractual flexibility,
- (b) lower discrepancies between loan sanctioned and loan received and
- (c) less reliance on collateral.

Emphasis on collateral security is, however, not totally absent under informal loans as money lenders keep jewellery and kitchen ware as physical security and are known to mortgage land and house against loans. An overwhelming majority of (landless) agricultural labourers attached to landlords have been borrowing money based on pledging “self-labour” as collateral. This category of borrowers is the most vulnerable as harsh contracts linking labour to loans are imposed. Bonded labour is the extreme form of this collateral.

The interest charged on informal loans is stated to vary between 24 per cent to 48 per cent per annum (or 4 per cent per month). In certain regions, it goes up to 120 per cent per annum (or 10 per cent per month). The Money Lender’s Acts enacted by various states are intended to check the exploitation of the poor by the money lenders. They cannot charge exorbitant rates of interests; in fact, in most cases there is an upper ceiling on interest rates and the total recoveries cannot exceed twice the amount of ‘the principal’. However, such provisions are rarely enforced due to various reasons.

There are two main models of micro credit in the country and they are ‘banking model’ and the ‘MFI model’. In the case of the banking model Self Help Groups are formed and financed by banks. In some cases SHGs are formed by formal agencies/NGOs and financed by banks. In the ‘MFI model’

SHGs are formed and financed by the MFIs that obtain resource support from various channels. In India, majority of micro credit activity is under the ‘Banking model’ (NABARD’s Bank-SHG Linkage) and 10-15% of the activity is through ‘MFI model’.

### 1. “Banking Model”: Bank-SHGs Linkage Programme

The Self-Help-Groups (SHGs) have emerged as a tier below Primary Agricultural Cooperative Societies (PACs). SHGs comprise a group of 15-20 members. The groups begin by savings that are placed in a common fund. In a way, SHGs are co-operative (credit) societies linked to a commercial bank rather than an apex cooperative bank. Once linked to the bank, the SHGs may access a given multiple of the pooled savings for disbursement to its members. Group selects its leader and the selection of the leader is based on rotation. The SHGs have, moreover, emerged as a form of “social collateral” substituting other forms of ‘collateral security’ insisted upon by banks. High repayment rate has encouraged banks to institutionalize SHGs under the bank-SHG linkage model. According to RBI Guidelines, banks may give loans to SHGs up to Rs. 5 lakh without insisting on ‘collateral safety’.

The Bank-SHG linkage programme is noticed to have encouraged thrift/savings amongst the poor. According to one case study, while the average savings per member more than tripled, the increase in assets was about 72 per cent. Out of 234 BPL households surveyed under the particular case study, 122 households were noticed to have been lifted up from poverty. There was, furthermore, a decline in the share of consumption and crop loans and increase in loan for allied agricultural activities and small businesses.

Formulation of SHGs is, however, dependent on the intervening agency, who has so far been NGOs/MFIs, RRBs, Banks and DRDAs. SHGs are being promoted primarily

under the two separate schemes of NABARD/Ministry of Finance and the Ministry of Rural Development. During some years, the SHGs formed by the Ministry of Rural Development under SGSY scheme have been twice the number of those formed by NABARD under their bank-SHG programme. The total number of SHGs formed is reported to be approximately 2.3 million that covers nearly 30-35 million BPL households (more than 50 per cent of all BPL households).

There is another important difference between the two. While the SHGs promoted by the Ministry of Rural Development enjoys credit-linked subsidy, those promoted by NABARD do not have any such facility. Despite this, the credit disbursed to SHGs under the NABARD programme has been more than under SGSY. The subsidy level, moreover, determines the standard loan size irrespective of what the project needs to be viable.

### Problems Associated with “Banking Model” of Micro Finance

To enable the reach of micro finance services to the needy, the problems associated with the legal, regulatory, organizational systems and the attitudes should be addressed to and the desired changes brought in these, to make them more effective.

The mainstream financial institutions are flush with funds and have access to enormous amounts of low cost savings deposits. Indeed, the poorer the region, the lower the credit deposit ratio – most of the eastern UP, Bihar, Orissa and the North-East have Credit Deposit ratios of 25-35 percent. Thus while banks are physically present in rural areas and offer concessional interest rates, rural producers are not able to access, with the result that the rest of the deposits are finding their way into the financial sector. Some of the main reasons for the above are:

(a) **Borrower Unfriendly Products and Procedures**

With a majority of the customers being illiterate, and a majority of them needing consumption loans and a majority of them requiring high documentation and collateral security, the products are not reaching the rural poor.

(b) **Inflexibility and Delay**

The rigid systems and procedures result in lot of time delay for the borrowers and de-motivate them to take further loans.

(c) **High Transaction Costs, both Legitimate and Illegal**

Although the interest rate offered to the borrowers is

regulated, the transaction costs in terms of the number of trips to be made, the documents to be furnished etc. plus the illegal charges to be paid, result in increasing the cost of borrowing. Thus, making it less attractive to the borrowers.

(d) **Social Obligation and not a Business Opportunity**

Micro-finance has historically been seen as a social obligation rather than a potential business opportunity.

### 2. “MFI Models”

The specialized MFIs or micro-finance movement since the 1990’s is a new avenue of reaching the poor for their micro-credit needs. Some of the MFIs are based on the Grameen Model, which entails formation of a Centre comprising eight solidarity groups of five borrowers each. Members of such solidarity groups mutually guarantee each other loan. Ten Centres form a Cluster and seven clusters form a (bank) branch [and several branches together presumably form the Bank]. This is typically based on the model of Grameen Bank of Bangladesh. All members save regularly and loan proposals are approved by the Centre; all loans are, moreover, repayable in 50 weekly installments.

MFIs in India register themselves either as societies (under the Societies Registration Act, 1960), as trusts under the Trust Acts, as Non-Banking Financial Companies (NBFCs), or as Local Area Banks (LABs). All NBFCs requiring registration with the Reserve Bank of India should have a minimum capital of Rs.2 crore. NBFCs intending to accept public deposits have to satisfy stipulated criteria and have to obtain specific authorization from the RBI. The issue of covering of NBFCs’ deposits by Deposit Insurance and Credit Guarantee Corporation (DICGC) was examined several times, and it was found neither desirable nor feasible to extend such coverage.

Sa-Dhan, an association of MFIs has argued for a new category of NBFCs, namely, Micro Finance Company with a minimum equity capital requirement (capitalization) of Rs.25 lakh. Such MFIs are designed to provide credit only; mobilization of savings is restricted to members and borrowers. The ratio of savings to net owned funds is recommended to be 1 : 1 initially, which may go up to 5 : 1 subsequently. This may, however, pose a problem of supervision by the regulator (RBI) if there are a large number of MFIs. A Micro – Finance Development Council was therefore proposed for performing the task of regulating such MFIs. The Government has, however, not favoured this idea.

**(a) Agency model of MFI**

The Internal Group on Rural Credit and Micro Finance of RBI (July, 2005), came to the conclusion that parking of funds with MFIs is faced with two sets of exposures, namely, once at the MFI/NGO level and thereafter at the level of SHGs/individual borrower level. The RBI has, nevertheless, favoured the Agency model of MFIs. Under this model, in addition to the MFIs, CSOs etc., only those NBFCs which are incorporated under Section 25 of the Companies Act, 1956 are permitted to be appointed as 'Business Facilitators' (BFs) or as 'Business correspondents' (BCs). In the former case, the MFIs provide the non-financial services, such as, identification of borrower, processing and submission of applications to banks etc. In the latter case, the MFI provide financial services as "pass through" agents for disbursal of small value credit, recovery of principal / collection of interest or sale of micro insurance / mutual fund products etc. The loan amount, however, remains in the books of the bank. The banks need not obtain prior permission from RBI for appointing BCs and BFs. They are required to conduct thorough due diligence before appointing BFs/BCs, and as principals, are responsible for customer service and control operations. The banks also need to have operational guidelines for the purpose. The MFIs, moreover, provide First Loan Default Guarantee (FLDG) equal to 8 – 15 per cent of the limit sanctioned in the form of security deposit with the bank so as to maintain its stake in the loan portfolio. The banks appear to have positive experience under this model as the MFIs have helped them overcome the problem of outreach in rural areas and have also reduced their transaction cost. In brief, the agency model of MFI is bank driven.

**(b) MFI Bulk Lending Model**

While the Agency model may appear more appropriate in the case of small MFIs, the larger MFIs may like to operate independently of banks (e.g. as LABs). This category of MFIs belong to MFI Bulk Lending (Equity Participation) model whereby they can access funds in the form of cheaper loans, subordinated debts, equity or quasi-equity from agencies, such as, the Rashtriya Mahila Kosh, the SIDBI Foundation for Micro-Credit (SFMC), the Micro-Finance Development and Equity Fund (under the chairmanship of NABARD) as well as the FWWB.

**Problems Associated with "MFI Model"**

The main aim with which the alternative MFIs have come up is to bridge the increasing gap between the demand and supply. A vast majority of them set up as NGOs for getting

access to funds as, the existing practices of mainstream financing institutions such as SIDBI and NABARD and even of the institutions specially funding alternatives, such RMK and FWWB, is to fund only NGOs, or NGO promoted SHGs. As a result, the largest incentive to enter such services remains through the non-profit route. The alternative finance institutions also have not been fully successful in reaching the needy. There are many reasons for this:

- Financial problems leading to setting up of inappropriate legal structures
- Lack of commercial orientation
- Lack of proper governance and accountability
- Isolated and scattered

**(a) Inappropriate Legal Forms**

NGOs invented micro-finance but NGOs are not the best type of agencies to carry out micro-finance on a long-term sustainable basis. If an MFI opts to become an NGO, it has the following problems:

- The major source of funds of NGOs are grants, which are very limited.
- If the NGOs earn a substantial part of their income from lending activity, they violate section 11(4) of the Income Tax Act and can lose their charitable status under Section-12.
- Moreover, NGOs do not have the appropriate financial structure for carrying out micro finance activities. NGOs being registered as societies or trusts do not have any equity capital and can never be "capital adequate".

The other alternative for an MFI is to become a cooperative or a company. As in the long run, the primary source of lending funds for MFIs is deposits, till that stage, the MFI has to rely on borrowings. To be able to attract borrowings, the MFI has to have equity capital. Thus, it is only possible to establish a financially sustainable MFI either as a cooperative or as a company.

In most states, with exception of Andhra Pradesh, Maharashtra, and Gujarat, cooperatives are politicized and state controlled and thus not an appropriate form of incorporation for an MFI. That leaves an MFI with the choice to be incorporated as a company and then become an NBFC or a Bank. The latter requires a license and a minimum start up equity of Rs100 crores, which is very difficult for an MFI to mobilize. The concept of Local Area Bank, with a lower startup capital of Rs 5 crores, has not yet been operationalised by the government. If an MFI opts to become an NBFC, it has the following problems:

- The minimum entry-level capital requirements is Rs 2 Crores, w.e.f. April 1999.
- It is difficult to mobilize any borrowings from Indian Financial Institutions due to the negative image of NBFCs in general. Further, even deposit mobilization is not possible at least for the first three years, till a satisfactory credit rating is obtained.
- That leaves the option of borrowing from foreign institutions, which is difficult in the first place, due to RBI's requirement of at least two credit ratings. Further, very few foreign institutions are willing to give rupee denominated loans. Thus the MFI taking foreign currency loans are subject to exchange risks, which they cannot handle.

#### **(b) Lack of Commercial Orientation**

Striving to make the customers' credit available at low cost with subsidies and grants, most of the alternate MFIs achieve a lot of success in their programs in the initial period, but they fail to maintain the same record in the long run because of lack of commercial orientation thus making it unsustainable.

#### **(c) Lack of Proper Governance and Accountability**

Governance and accountability are limited in case of non-profits and need to be improved. Their boards must be made aware of their financial liabilities in case of failure. The lenders should be more stringent and insist on nominating a few directors.

#### **(d) Isolated and Scattered**

The alternate MFIs are isolated and scattered. There is no proper coordination among them and also there is lack of information dissemination.

### **Specialized Micro Finance Models**

#### **A. Micro Finance and PACS**

The share of primary agricultural credit societies (PACS) in rural credit stood at 18.6 per cent in 1991. A good deal of this amount went to people who were relatively better-off, that is, to those who do not belong to the BPL households. Notwithstanding this, a certain percentage of the credit flow has benefited the poor. According to the World Bank NCAER study (2004) the share of PACS in micro-credit is as high as 30 per cent or one-third. PACS are, as such, yet another important channel of micro finance.

In terms of retail outlets, the PACS are ahead of the banks and the MFIs at the all-India level, although they are observed to have greater concentration in Maharashtra and Kerala and very low in North Eastern states. The total membership of PACS is reported to be 120 million. The Scheduled Castes and Scheduled Tribes who generally comprise the weaker sections of the society constitute as high as 36-37 per cent or approximately 45 million PACS members. This is much higher membership than under the SHG-Bank linkage programme, (currently around 30 million BPL households) and under the MFIs/LABs/NBFCs (around 1 million clients).

The co-operative structure is ideally based on the norm of "one man, one vote". The concept of 'social collateral' or 'group guarantee' holds good for the co-operatives as well. Group guarantee is supposed to be stronger in the cooperatives (of the poor) and the guiding principle is "one for all and all for one". What appears to work best under this model is greater proximity of PACS to its members and the credit history that determines the credit worthiness of the clients.

A large number of PACS in rural India have been, however, dominated by the powerful. The prudential norms of banking have also been ignored and loans have been extended to defaulting members. Besides, records are not maintained properly and accounting and book keeping of most PACS are very weak. Political interference of one kind or the other, instead of improving the situation, has only contributed to the decline of PACS. Refinancing facility from apex organisations has consequently declined/stopped and in the absence of emphasis on thrift, the PACS have hardly sufficient funds for credit activity.

Successive Committees constituted to suggest measures for revitalization of PACS have recommended for enactment of the Model Law of Cooperatives. It is an enabling Law that would make the credit cooperatives free from the State's prerogative to override the management (the control of the Registrar of Cooperatives). The recommendations also include diversification of credit portfolio by PACS / Cooperative Banks beyond crop loans. The credit cooperatives may thus also give consumer loan, housing loan and provide finance for services sector as well as distribute insurance products. This would call for capacity and infrastructure building of PACS and observance of prudential banking norms by PACS. The revitalization package proposed is, moreover, restricted only to viable PACS and any new infusion of funds by the apex banks will be linked to signing of a MOU.

### **B. Post Office Network and Banking Services**

The existing extensive formal banking structure is still not sufficient to meet the growing demand of rural credit. Lack of sufficient number of retail outlets of formal banking sector has been a big handicap in reaching the poor. There are approximately 1, 55,000 post-offices in India, which is more in number than the combined outlets of all the banks and the (functional) PACS put together. Post-offices have been already into the business of collecting small deposits from people and have been providing services of transferring money. Post-office network could very well be considered for increasing the outreach of banking services, especially in remote and rural areas.

One of the important principles of micro-finance is to provide door-step and timely delivery of financial service. The scheme of pigmy deposits pioneered by some banks in the past met these criteria. This experiment, however, failed because of unscrupulous agents who indulged in fraud. The post-offices are also known to have experimented with similar schemes and had a greater measure of success. They have a regular and paid staff and with little training and incentives, their services could be utilized very usefully.

### **3. Business Facilitator & Correspondent Models**

The Reserve Bank of India, in January 2006 issued an order to ensure greater financial inclusion and increase the outreach of the banking sector, through Business Facilitator Model and Business Correspondent Model. This enabled the commercial banks, including the RRB to use the services of NGOs, SHGs, MFIs and Civil Society Organization as intermediaries to provide financial and banking services through Business Facilitator and Correspondent Model. Under the Business Facilitator Model the Post Offices can also be used as intermediaries for providing services like:

- (i) Identification of borrowers and fitment of activities
- (ii) Collection and preliminary processing of loan applications including verification of primary information/data;
- (iii) Creating awareness about savings and other products and education and advice on managing money and debt counseling;
- (iv) Processing and submission of applications to banks;
- (v) Promotion and nurturing Self Help Groups/Joint Liability Groups;
- (vi) Post-sanction monitoring;
- (vii) Monitoring and handholding of Self Help Groups/Joint Liability Groups/Credit Groups/others; and
- (viii) Follow-up for recovery.

Under the Business Correspondents Model NGOs/MFIs, Cooperative Societies, section 25 companies, registered NBFCs, not accepting Public Deposit and Post Offices may act as Business/correspondent. In addition to the activities listed under the Business Facilitators Model the scope of activities of the Business Correspondent included:

- (i) Disbursal of small value credit,
- (ii) Recovery of principal/collection interest
- (iii) Collection of small value deposits
- (iv) Sale of micro insurance / mutual fund products/pension products/other third party products and
- (v) Receipt and delivery of small value remittances/other payment instruments.

The banks are expected to act diligently in employing the Business Facilitators and Correspondents. Both the Business Facilitators and Correspondents may be paid reasonable commission/fee by the banks. No fees can be directly charged by them for the services rendered to the customers. The banks are to specify clearly the role of the Business Facilitators and Correspondents and also give wide publicity both in electronic and print media. The banks are also to constitute Grievance Redressal Machinery within the banks for addressing the complaints about services rendered by the Business Correspondents and Facilitators.

However, no major headway has been made in this direction. It was found that the banks have not employed both the Business Facilitators and Correspondents to meet the increasing rural credit requirements.

## **OTHER ASPECTS**

### **Readiness of the Micro Finance Service Providers**

To tap the potential big market for micro finance, the commercial banks are revamping their already existing rural and semi-urban branches which are traditionally poorly run, poorly staffed and were an economic liability to them. Now the commercial banks with their vast network of rural and semi-urban branches are also facing the heat of the competition from the NBFCs, MFIs and NGOs who are now aggressively tapping the rural market and filling up the space left by the commercial banks.

No doubt, rural banking had a pioneering role to play in sowing the seeds of development in the agrarian society, but few of these Public Sector Banks are reaping the rich rewards now. If they do not look smart and innovate the products for catering the rural market with a cadre of dedicated manpower, they could lose the first mover advantage.

The Private sector banking giants like ICICI Bank Ltd & HDFC Bank Ltd. has taken a different route to tap this rural market by financing to the MFIs for on-lending to the individual entrepreneur and supporting the micro finance programme for its success. Out of the Public Sector Banks, the State Bank of India has implemented the Business Facilitator/Business Correspondent model for financial inclusion and taps the rural market by increasing their reach through these outsourced agents. As economic opportunities mushroom across rural India and the commercial banking sector continues to slumber, the non banking financial companies (NBFCs) and MFIs are awakening from the booming demand of the rural households armed with new products and services. There are also disparities in geographic distribution of the bank branches of the commercial banks and the credit extension which is also an important bottleneck for success of micro finance movements in India.

While studying the level of access to the financial service providers it was found that the accessibility of the formal institutional sources of financial services are low compared to the semi-formal sources like MFIs, SHGs, etc. but the most accessible form of financial services are still the informal sources like money lenders, trade creditors, local shop keepers etc.

### Cost of Transaction in Micro Finance

The effective interest rate in the microcredit is ranging between 20-45% per annum which includes various factors such as processing fees, repayment frequency and number of installments etc. This explains how a flat interest rate of 15% per annum, can amount to an effective interest rate of 38% per annum (Shamik Ravi, 2006).

A study made by Yadav & Kumbhare (2008) concludes that the effective cost of borrowing in the SHG-Bank linkage model varied between 10.40 – 18.15 %. This also includes the cost of intermediation (i.e. promotional cost).

### Micro Finance Models in Other Countries

There are, however, two models of bank-post office linkage, namely

- (a) the service model of Brazil's Banco Postal and
- (b) Post Bank model of the Netherlands.

Under the first model, the post offices work as 'business facilitators' and as 'banking correspondents'. In return, they

receive commissions from the banks. The RBI, vide its circular of 25<sup>th</sup> January, 2006 has approved of post office functioning as business facilitators to banks and as bank correspondents.

The second model (Post Bank model of Netherlands) on the other hand, postulates a kind of a merger of the post office with the bank/banks. The post-office network in the Netherlands is jointly owned by TPG Post and Post bank (each of them having a 50 per cent stake). Post Bank is claimed to be one of the most advanced postal banking networks in the world.

### Role of Technology and Micro Finance

Micro-finance is not only about credit. It is as much about thrift (or savings), remittance services and micro-insurance. In a way, even credit may be looked at as one's own savings made available at advance. There is need to put in place a workable system, technologically and managerially, for collecting savings from the poor in small amounts, at regular intervals and at their door step. In the case of the urban poor, in particular, it is observed that they suffer from high income drain on account of many avoidable practices. There is, as such, a great need for plugging this income drain through diverting their resources to savings. The economically active urban poor may be encouraged to own 'debit card' and banks may introduce ATM machines in the residential colonies of the poor. Besides this, the urban wage earners separated from their rural families require to send money home. NBFC-MFI network could devise a mechanism to deliver the money at their doorstep. There are, similarly, many upcoming technologies suitable for the rural poor. 'Gramteller', a rural ATM could be explored for their successful usability in rural areas. Introduction of (bio-metric) smart cards is also expected to revolutionize the micro-finance sector and bring down the transaction costs.

#### 1. Information and Communication Technology (ICTs) and Micro-Finance Activities.

ICTs can be effectively used to provide information about micro finance organisations and their services. Though many web sites provide information on micro financing, there is dearth of information on the terms and conditions, institutions that provides micro finance etc. This information can be provided both in English and also in other Indian languages.

ICTs can be effectively utilised to monitor the various Micro Finance activities. The various schemes implemented by the

Department of Rural Development are monitored physically through various impact assessment studies. RURALSOFT (<http://ruralsoft.nic.in>) is software used to monitor the schemes on a monthly basis. At present assessments are done only up to district or block level because of the consolidated data. Details that truly reflect the success of the schemes are not currently captured because of non-availability of ICT infrastructure in rural areas and the information about individual beneficiaries. The information required to assess the schemes at the grass root level can be outsourced to the self help groups (SHGs). This information can be fed into the Ruralsoft for detailed monitoring of the schemes.

ICTs can be used to provide access to wider markets and better prices. ICTs can be used to enhance the economic returns for the micro finance activities by provide access to global markets at better prices. At present RURALBAZAR (<http://ruralbazar.nic.in>) the application software has been conceptualized to assist market needs of products produced by rural people. It offers internet web to show case their products to the world. It appears, some of the states like Tamil Nadu, Goa and Tripura have successfully adopted the software. However, efforts should be made to ensure quality of the products produced by rural producers and to provide logistic support like appropriate packages and timely delivery of the products.

## 2. Common Service Centres

Department of Information Technology, Government of India has proposed to set up a network of more than 100000 internet enabled Information and Communication Technology (ICT) access points termed as Common Service Centres (CSC). They were meant to provide high quality and cost effective video, voice and data content by the end of 2007. The Goal was to empower the rural community and catalyze social change through modern technologies. It endeavoured to provide economical access to information and services to rural citizens and improve governance at cheaper cost. It envisaged a collaborating model that allows public and private enterprises to integrate their goals of profit and social objective into a sustainable business model for achieving rapid socio-economic change. The scheme proposed a three tier structure where at the first level a Village Level Entrepreneur (VLE- a franchise), at the middle level a Service Centre Agency (SCA- franchiser) and at the third level a State Level Agency (SLA) to facilitate implementation of the scheme within the state. The SLA will be responsible for implementation of the scheme through the franchiser (SCA) and the franchisee (VLE).

## 3. Computer Munshi System

PRADAN evolved the Computer Munshi System to improve the book keeping of the self Help groups (SHGs). So as to improve transparency, equity and longevity of its groups. The model basically aims to improve the accounting and book keeping of the SHGs. A member, acceptable to all the members and capable, of the group is selected and trained in book keeping. He is the Group Accountant (GA). He is supported by a Computer Munshi (CM), who is equipped with a computer and printer in a central location with power connection. A CM is expected to serve about 300 groups. Regular Monthly Transaction Statement (RMST) consisting of the weekly savings and credit transactions and balances, including expenditure and income statement is delivered to the CM. The CM enters these accounts in the computer and sends back the corrected statement to the GA. The system is designed to be self corrective, as the GA is warned each week about the discrepancies, if any. Similarly the CM is also warned of discrepancies every week. Monthly trial balance for the group is prepared by the CM which is discussed in the monthly meetings of the group. The group pays a fee to both the GA and CM. As on March 2005, there were 48 CMs serving about 2000 groups. The model is cost effective, helps in timely preparation of accounts and identifying the discrepancies at the initial stages. PRADAN was provided with grants by NABARD, SIDBI, and DFID.

## A PARTNERSHIP MODEL OF FINANCING MFIS BY THE COMMERCIAL BANKS

Delivery of micro finance by banks under Self Help Group (SHG) Bank linkage model is gaining increased acceptance among Non Government Organizations (NGOs), Banks and rural/urban poor. SHGs, which are ground level organizations, have become very popular as the delivery channel of micro finance to poor, especially women, for their sustained economic development. Many of the NGOs are now playing the roles not only as micro finance facilitator by forming and nurturing SHGs but also entering into financial intermediation as Micro Finance Institutions (MFIs) forging partnership with banks for further retailing of micro finance to SHGs.

The lending to Micro Finance Institutions (MFIs)/Non Government Organizations (NGOs) for on lending to SHGs has been attracting greater importance in the field of micro finance. These loans to MFIs are classified under Priority Sector Lending. The Micro Credit with the SHG model has been fast gaining popularity, thus opening up enormous scope for Banks to go for bulk lending in this model through MFIs. Hence, bulk lending to MFIs has become a good business segment

for the banking sector in view of comparative advantage such as high repayment of loans, reduced transaction cost, reasonable margin and distributed risks. With the enhancement of the capacity and resources of MFIs and fast development of MFI – SHG model during last couple of years, the scheme of financing to MFIs has been a very popular proposition:

### Model scheme for lending to Micro Finance Institutions (MFIs)

**Purpose:** The guidelines envisage credit linkage between the Bank and Micro Finance Institutions, which may be NGOs/ Trust/Non Profit Companies/NBFCs for on lending to SHGs (Self Help Groups)/JLGs (Joint Liability Groups).

**Eligibility:** The MFIs of the following categories, which have undertaken or will commence on-lending to SHGs/JLGs will be eligible under the scheme:

- Non Government Organization (NGOs) registered under Societies Registration Act, 1860 or similar State Acts.
- Public Trust registered under India Trust Act, 1882.
- Non –Profit Companies registered under Section 25 of the Companies Act, 1956.
- Non Banking Financial Companies (NBFCs) registered under Companies Act, 1956 as well as Reserve Bank of India Act, 1934 which have undertaken or will commence the task of financial intermediation, as MFIs are eligible for credit linkage with the bank under this scheme. However, the other existing guidelines/stipulations for financing to NBFCs will be applicable in this case also.
- The MFIs observing the essential features as prescribed by NABARD for credit linking to SHGs should be selected for financing under the Scheme.
- MFIs should not be the defaulter with any other Financial Institutions and their conduct and accounts with the existing bankers should be satisfactory and standard.

- Loans to any single beneficiary to be allowed by the MFI for on-lending shall not exceed Rs.50,000/-

### Selection Criteria of the MFIs

- Significant rural presence with existence/ experience of at least three years.
- Should have elected Board with broad- based membership.
- Should have the borrowing power from the Bank as per Laws/Bye-laws/Deeds/Constitution of the MFI.
- Availability of trained staff with knowledge of the local area.
- Should have a satisfactory track record.
- Should have up-to-date audited accounts with no adverse audit observation.
- Having its own office for rendering services.
- Rating of the MFIs should be acceptable to the Bank.
- Financial soundness and ability to withstand adversities.
- Good business reputation, culture, compliance, security and internal control.

### Selection of Micro Finance Institution

The MFIs intended to take loan from the commercial banks in this partnership model are required to submit their basic information in a model format for consideration by the bank and the verifying official is also required to submit his/her comments on that. After the information received from them, the MFIs will be assigned score based on the following parameters:

- Character
- Capacity
- Core Competence
- Credit Worthiness

Only those MFIs securing a score ranging 65-70% or above marks will be eligible for loan under this partnership model (depends on individual Bank's lending policy).

### Financial Benchmarks for MFIs to be accepted for consideration of loan under this model

Sl. No.	Parameters	Benchmark	
		For lower amount of loans	For higher amount of loans
1	Operational Self Sufficiency (OSS)	More than 1	More than 1
2	Yield on Portfolio	Not below 15%	Not below 15%
3	Operating Cost Ratio	Not to exceed 10%	Not to exceed 5%
4	Operating cost to Total cost Ratio	Not to exceed 60%	Not to exceed 60%
5	Portfolio at Risk (PAR) > =30 days	Not to exceed 2%	Not to exceed 2%
6	Portfolio at Risk (PAR) > = 60 days	Not to exceed 0.5%	Not to exceed 0.5%

### **Rating of MFIs**

For all loans extended to the MFIs, the commercial banks are required to rate the MFI as per the prescribed risk management practice of the concerned bank. They can either rate on their own rating scale or they can take the services of the professional external rating agencies such as CRISIL, ICRA, M-CRIL, CARE and PLANET FINANCE as approved by NABARD in their circular no.73/MCID 1/2006 of 15.05.2006. The MFIs rated as “HIGHEST”, “HIGH”, “ABOVE AVERAGE” and “AVERAGE” will be eligible for loan under this model.

### **Verification of End Use of Funds**

- An end-use certificate along-with the statement of Book Debt is to be submitted by the MFI on monthly basis within 7 days of the next month.

- Random checking of books of MFI/Self Help Groups by Bank Officials.
- MFIs will submit to Bank a Chartered Accountant’s certificate on their Book Debt holding with age-wise break-up on quarterly basis.

**Mode of Repayment:** By equal monthly installment (Principal) for each drawal of the loan through “**Escrow Arrangement**”. The borrower MFI will open an Escrow account with the disbursing branch. Loan recoveries made by the MFIs from the SHGs will be deposited in the said Escrow account. The MFI will also authorize the bank to realize the monthly loan installments from the said Escrow Account. Interest will be paid as and when applied.

## MICRO FINANCE INSTITUTIONS SELECTED FOR THIS STUDY

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### 1. BISWA

Sixteen years ago, in the year 1994 from Sambalpur, Orissa, Bharat Integrated Social Welfare Agency (BISWA), started its journey. BISWA was born with a very well-defined Vision and Mission to eradicate poverty and promote sustainable livelihood thus, making Orissa a poverty-free state. BISWA, within a span of 16 years, provided support and handhold more than 2 lakh families in making their life better with the credit inflow of Rs.64 crores. Thus It is now fully committed towards the sustainable development of the people with special emphasis on women. At present it has decided and planned to create one million employment opportunities by March 2011 and to bring down poverty levels to twenty per cent by that time. In pursuance of its objectives, in later stages it has incorporated various means and methods to achieve desirable results. Promotion of Self Help Groups (SHGs), extending Micro-finance, encouraging Micro-enterprise, ensuring social justice for disabled, socio-economic rehabilitation of leprosy cured persons, creating avenues for alternative livelihood for poor have been adopted since a long time and have proven to be effective tools for poverty alleviation. Micro finance activity is the physical manifestation of this philosophy of BISWA. The target group of BISWA primarily consists of the women, the children, the small and marginal farmers, the grass-root level entrepreneurs, the slum dwellers, the dejected and distressed. The thrust of BISWA being the socio-economic development of these persons, the primary concern was to make finance available to them in a commercially viable but not exploitive in nature, so that they could optimally utilize the available resources with them both human and natural. It is headquartered in Sambalpur, Orissa and has operations all over the State.

BISWA adopted an integrated approach for social development by bringing convergence of Micro finance, Micro enterprise, Micro Marketing and Micro Insurance. Orissa accounted for 3.6% of the population of India as per the 2001 census. 50% of the state's population that live below the poverty line, has lower incomes than the average income of the population below the poverty line nationally (Babu, et al, 2005). According to the Economic Survey for 2007-08, the incidence of poverty in Orissa is still the highest in the country with 40% of the state's population living below the poverty line, and the poverty reduction rate has been very slow. The State could reduce poverty by 1.5% during 2000-05 despite implementation of poverty alleviation schemes. The per capita income of Orissa, as per the 1993-94 price indexes, stood at Rs. 5,747 against the national average of Rs 11,013. The average monthly per capita consumer expenditure was Rs 399 in rural areas and Rs 757 in urban areas, compared with Rs 558 and Rs 1,052 at the national level, respectively.

### 2. KBS LAB

This is an organization which is only one of its kind in India, the only micro finance bank. BASIX, which is the holding company of the bank, contemplated setting up of a few such banks, but only one, the Krishna Bhima Samruddhi Bank actually came up. After the RBI panel report in 2002, the message that the central bank sent to the promoters of the LABs is clear: "you have miles to go before uttering a definitive pronouncement on your success or failure". The KBS Bank is, therefore, pitted against a pervasive and prejudicial notion that it is immaterial to RBI whether the bank survives or not. Even with stronger financial support many organizations, e.g. the village primary cooperative banks

and the Grameen Banks (RRBs) either had to boot their way in the quagmire or wilted without creating any ripple. If this bank, while traveling in the uncertain paths of rural economy, falters, no impact would be felt out. RBI might term it as failed experiment to bridge the credit gap in the rural India. However, if it succeeds, it might create a social banking revolution paving for the others as a model worth emulating -a profitable role model for bankers interested in rural development.

technical assistance in an integrated manner. BASIX will strive to yield a competitive rate of return to its investors so as to be able to access mainstream capital, and human resources on a continuous basis.

The approach of the bank is to leverage the advantages it has in terms of its ability to accept deposits, continuously innovate in order to provide various services to its customers. The bank could look different in the periphery but will not compromise and contribute to the core values of BASIX mission.

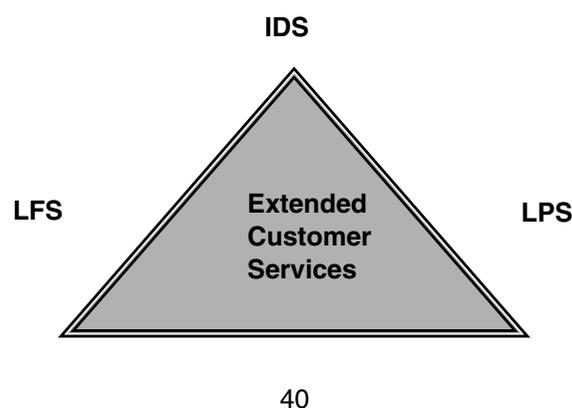
**Mission & Vision of BASIX and KBSLAB**

The mission of KBS Bank is “to be a sustainable local community based institution providing financial services to the underserved, particularly rural poor and woman and to catalyze the provision of technical assistance and support services to the borrowers with the ultimate goal of promoting a large number of sustainable livelihoods in the area”.

The mission of the bank is derived from that of its promoter and owner i.e., BASIX.

The mission of BASIX is to promote a large number of sustainable livelihoods, including for the rural poor and women, through the provision of financial services and

**Livelihood Triad-Philosophy of BASIX**

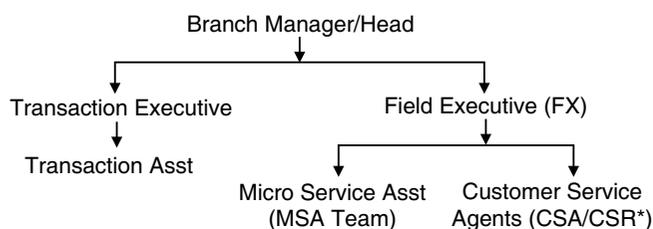


The KBSLAB’s activities include the following services.

<i>Micro Finance Services (MFS)</i>	<i>Livelihood Promotion Services (LPS)</i>	<i>Institutional Development Services (IDS)</i>
Savings, credit, insurance, for lives and livelihoods	Productivity enhancement Risk mitigation (non-insurance) Local value addition Alternate Market Linkages - Input supply, output sales	Formation of groups, federations, cooperatives, mutual benefits, etc. of producers, Capacity Building, Accounting and management information systems and Performance management systems Building collaborations Policy analysis and sector work

**STRUCTURE OF A TYPICAL BRANCH OF KBSLAB**

**Branch Office**



CSRs are those CSAs who have come under the payroll of the bank due to good performance. A field executive typically has 10-12 CSA & /CSR under him. Each CSA/CSR has typically 10-12 villages under him.

**Measurement Instrument**

The measurement items for the constructs were adopted from the existing literature and adapted to the present context. The measurement items for SERVPERF were adopted from Brady et al. (2002); service fairness from Han et al. (2008); customer satisfaction from Gremler and Brown (1996) and Fornell et al. (1996); attitude towards service provider from Srinivasan

et al. (2002); behavioral loyalty from Fornell et al. (1996) and McDougall & Levesque, 2000; and items for customer advocacy have been adopted from Fullerton (2003) and Reichheld (2003).

The measurement items for all the constructs are shown in Table 1.

**Table 1:** Measurement Items

<p><b>SERVPERF Items</b></p> <ol style="list-style-type: none"> <li>1. BISWA has up-to-date equipment.</li> <li>2. BISWA's physical facilities are visually appealing.</li> <li>3. BISWA's employees are well dressed and appear neat.</li> <li>4. The appearance of the physical facilities of BISWA is in keeping with the type of service provided.</li> <li>5. When BISWA promises to do something by a certain time, it does so.</li> <li>6. When you have problems, BISWA is sympathetic and reassuring.</li> <li>7. BISWA is dependable.</li> <li>8. BISWA provides its services at the time it promises to do so.</li> <li>9. BISWA keeps its records accurately.</li> <li>10. BISWA does not tell its customers exactly when services will be performed.</li> <li>11. You do not receive prompt service from BISWA employees.</li> <li>12. Employees of BISWA are always willing to help customers.</li> <li>13. Employees of BISWA are never too busy to respond to customers' requests.</li> <li>14. You can trust employees of BISWA.</li> <li>15. You can feel safe in your transactions with BISWA's employees.</li> <li>16. Employees of BISWA are polite.</li> <li>17. Employees get adequate support from BISWA to do their jobs well.</li> <li>18. Employees of BISWA give customers personal attention.</li> <li>19. Employees of BISWA give customers individualized attention.</li> <li>20. Employees understand the specific needs of customers.</li> <li>21. BISWA has customers' best interests at heart.</li> <li>22. BISWA's operating hours are convenient to all their customers.</li> </ol> <p><b>Overall Customer Satisfaction</b></p> <ol style="list-style-type: none"> <li>1. Overall I am satisfied with BISWA.</li> <li>2. I am happy with BISWA's services.</li> <li>3. Using BISWA's services is a satisfying experience.</li> </ol> <p><b>Service Fairness</b></p> <ol style="list-style-type: none"> <li>1. I was treated with courtesy and respect.</li> <li>2. The interest and fees charged are reasonable for the services I received.</li> <li>3. BISWA treats all its customers equally.</li> </ol>	<p><b>Attitude</b></p> <ol style="list-style-type: none"> <li>1. I like BISWA.</li> <li>2. I will prefer BISWA over other MFIs in future.</li> <li>3. I feel a strong sense of identification with BISWA.</li> </ol> <p><b>Behavioral Loyalty</b></p> <ol style="list-style-type: none"> <li>1. I will use the services of BISWA in future.</li> <li>2. I would do more business with BISWA in future.</li> <li>3. Compared to other MFIs I have used the services of BISWA more.</li> </ol> <p><b>Customer Advocacy</b></p> <ol style="list-style-type: none"> <li>1. I would recommend BISWA to anyone who seeks my advice.</li> <li>2. I encourage friends and relatives to take the service of BISWA.</li> <li>3. I say positive things about BISWA to other people.</li> </ol>
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#### Attitude

1. I like BISWA.
2. I will prefer BISWA over other MFIs in future.
3. I feel a strong sense of identification with BISWA.

#### Behavioral Loyalty

1. I will use the services of BISWA in future.
2. I would do more business with BISWA in future.
3. Compared to other MFIs I have used the services of BISWA more.

#### Customer Advocacy

1. I would recommend BISWA to anyone who seeks my advice.
2. I encourage friends and relatives to take the service of BISWA.
3. I say positive things about BISWA to other people.

With these items a questionnaire was constructed. The questionnaire consisted of a mix of positively and reversed coded statements. The scale used is a five point Likert scale from "1 meaning "strongly disagree" to "5 meaning strongly agree."

We followed Churchill's (1979) well defined steps to come up with own instrument. The questionnaire was translated to Oriya and Telugu languages so that the micro finance end users can easily fill the questionnaire in their own language. Both the versions of the questionnaire were shown to two judges each who could read and write Oriya and Telugu. This was done to check for the correct wordings and order of the questionnaire items. Finally, we pretested both the questionnaires among the Oriya speaking and Telugu speaking end users of a small micro finance institution operating from Hyderabad. Pretest resulted in a 15-item scale for the SERVPERF and other items were sufficient to measure the other constructs used in the research framework.

The final questionnaire had two parts viz. the first part had the items measuring the constructs in the research model and the second part had the questions regarding the demographic details of the respondents.

### Sampling

Depending upon the penetration of BISWA and KBSLAB in the respective States, the convenience method of sampling was adopted to select and identify the respondents from the population of end users of these micro finance institutions. Researchers personally went to the end users of BISWA and KBSLAB to conduct the personal interviews. Both these organizations provided some volunteers to accompany us.

Since the total number of measurement variables included in the survey was thirty so the sample size  $30 \times 10 = 300$  to maintain a ratio of 10 to 1 as per the suggestions of Hair et al. (2006). In case of BISWAS the final usable sample size is 350 which are sufficient for the analysis ahead in the study.

## DATA ANALYSIS AND RESULTS FOR BISWA

### A. Demographic Profile of BISWA Customers

Understanding the customers profile can be a valuable tool for the management of MFI's. Demographic analysis can highlight trends as well as factors attracting or discouraging individuals from accessing the micro finance facilities. This type of information can be incorporated into a management information system (MIS) to display demographic patterns spatially, linking accessing micro finance and human characteristics within a landscape.

Demographic analysis can also be used to establish the percentage of the total population involved in a particular type of usages of the micro finance loans thus leading to a typical satisfaction response. By delineating this information by age, sex, or education level, MFI managements can develop targeted outreach and training activities for local communities.

We have administered the questionnaire on 555 individuals surveying in three (3) adjacent district viz. Khurda, Puri, Cuttack. We had 350 usable questionnaires.

We have collected the information on each individual regarding the following variables:

Age, Sex, Social Category, Educational Qualification, Household Size, Household Income (Per Month), Number of Children, Sources of Livelihood, Duration of Relationship With Biswa etc.

We present here some selected demographic details from our collected data;

#### 1. Preliminary Analysis of Demographic Data

We first classify the respondents according to some important categorical variables for the purpose of profiling the customers.

**Exhibit 1.** Classification of the Respondents based on SEX

	<i>Frequency</i>	<i>Percent</i>
Female	328	93.8
Male	22	6.2
<b>Total</b>	350	100.0

We observe that more than 93% of our respondents are female. This is of no surprise since most of the clientele of the MFI's are women. However 22 (6%) of our respondents are male.

**Exhibit 2.** Classification of the Respondents Based on LEVEL of EDUCATION

	<i>Frequency</i>	<i>Percent</i>
No Schooling	5	1.5
Upto Standard 5	93	26.2
Upto 10th Standard	188	53.8
Upto 12th Standard	41	11.8
Graduate	18	5.1
Others	5	1.5
<b>Total</b>	350	100.0

We see that more than 80 % of the respondents are educated up to 10<sup>th</sup> standard or less whereas the number of graduates is only 10 which amounts to 5% of the total 350 customers.

**Exhibit 3.** Classification of the Respondents Based on SOCIAL CATEGORY

	<i>Frequency</i>	<i>Percent</i>
GEN	206	59.0
OBC	59	16.9
SC	83	23.6
ST	2	0.5
<b>Total</b>	350	100.0

We classified them according the social category to which they belong. Interestingly we find that general category customers of BISWA are prevalent in our sample (almost 60%), followed by SC (24%) and OBC (17%). Representation of ST is almost nill (0.5%).

**Exhibit 4.** Classification of the Respondents Based on LIVELIHOOD

	Frequency	Percent
Auto Driver	9	2.6
Book Store	11	3.1
Fish Business	34	9.7
Kirana Shop	23	6.7
Labourer	16	4.6
Milk Business	122	34.9
Others <sup>3</sup>	79	22.6
Pan Shop	20	5.6
Service	16	4.5
Vegetable Shop	20	5.6
<b>Total</b>	<b>350</b>	<b>100.0</b>

We may notice from the above exhibit that according to the sources of LIVELIHOOD we have collected a well diversified sample of respondents. However, we find that milking cattle's is the predominantly prevalent Livelihood among them.

**Exhibit 5.** Classification of the Respondents Based on Duration of Relationships

	Frequency	Percent
Less than 1Year	90	25.6
1to3 years	220	63.1
More than 3 years	40	11.3
<b>Total</b>	<b>350</b>	<b>100.0</b>

And last but not the least we classify the respondents according to the duration of their relationship with BISWA and found that almost 90% of the customers that we have surveyed are having a relationship with BISWA whose length is not more than 3 years. Almost 1/4<sup>th</sup> (25.6%) are having less than 1year of relationship.

We have also collected data on some continuous variables. We now present their brief characteristics in the following table.

<sup>3</sup>Others' category comprises of Cycle Repairing shop owner, Canteen Owner etc several employment whose count is less

**Exhibit 6.** Descriptive Statistics

	Mean	SD	Max	Min
Age	35.54	7.82	70	20
Household Size	4.21	1.12	9	2
Income(per Month)	7105.13	3218.89	20000	2000
Number of Children	2.06	0.89	5	0
Duration	1.71	1.56	7	0

It can be observed from Exhibit 6 that average age of the respondents included in the sample is around 35 years with minimum and maximum being 20 years and 70 years respectively. The average house hold<sup>4</sup> size to which they belong is 4 with maximum being as high as 9 and minimum being 2. The average monthly income is around Rs.7000 with a standard deviation of Rs.3218 which clearly shows that the maximum income of Rs.20000 is an outlier. The average number of children of the respondents is 2 with minimum and maximum being 5 years and 0 respectively. And the duration for which they are with some kind of customer relationship with BISWA is close to 2 years on the average.

## B. Data analysis

There are two common statistical approaches for estimating structural models. The most prominent structural equation modeling (SEM) technique is the maximum likelihood (ML) based covariance structure analysis method (Byrne, 2001). The second approach is the partial least squares (PLS)-based variance analysis method developed by Wold (1985). PLS supports both types of relationships, formative and reflective, whereas, ML-based method supports only reflective indicators.

PLS is suggested as a powerful estimation method for CSI (Customer Satisfaction Index) studies by Fornell (1992). But covariance based structural equation modeling approach can handle both non-recursive and recursive structural models. The proposed conceptual model is non-recursive. Therefore, the proposed structural model will be estimated using the covariance based SEM method.

<sup>4</sup>Number of persons sharing a common kitchen.

**Table 2.** Exploratory Factor Analysis of SERVPERF Items

SERVPERF Items	Factors		
	Tangibility	Reliability/Assurance	Empathy/Responsiveness
X1. BISWA has upto date equipment	0.825		
X2. ISWA's physical facilities are visually appealing.	0.525		
X3. BISWA's employees are well dressed.	0.650		
X4. Appearance of BISWA's physical facilities is in keeping with the service provided.	0.670		
X5. When BISWA promises to do something it does so.		0.760	
X6. BISWA is dependable		0.550	
X7. BISWA provides its services in time it promises to do so		0.658	
X8. BISWA keeps its records accurately		0.679	
X9. You can feel safe in your transactions		0.632	
X10. Employees are polite		0.563	
X11. When you have problems, BISWA is sympathetic and reassuring			0.792
X12. You can trust employees of BISWA			0.753
X13. Employees of BISWA give customers personal attention			0.795
X14. Employees understand the specific needs of customers			0.785
X15. BISWA's operating hours are convenient to all their customers			0.621
<b>Cronbach's alpha</b>	0.801	0.820	0.720

Data analysis in this study has followed a four step approach. First, the exploratory factor analysis was performed on the SERVPERF items to obtain the dimensions of service performance of the MFIs. Second, a confirmatory factor analysis was performed to confirm the factor structure of service performance. Next, the unidimensionality of the other constructs used in the study was examined. Thereafter, the measurement properties (reliability and validity) of the measurement model were examined. Finally, the hypotheses were tested using the structural equation modeling.

### Exploratory Factor Analysis of SERVPERF Items

An exploratory factor analysis was performed on the fifteen items of SERVPERF using principal component analysis with varimax rotation for BISWA. Three factors with even values greater than one were extracted. Results of the factor analysis are shown in Table-2 above.

We retained the factor loadings greater than 0.50 for further analysis. All the fifteen items loaded on the three factors obtained. The three factors that were retained represented the following dimensions of the service quality, viz., Empathy/responsiveness (of employees); Reliability/assurance and Tangibility. Construct reliability of the factors was calculated

using the Cronbach's alpha. The Cronbach's alpha value of greater than or equal to 0.7 is considered acceptable for the factor to be reliable (Hair et al. 2006). The Cronbach's alpha for the service quality dimensions ranged between 0.72 and 0.82 as shown in Table 2 above.

### Confirmatory Factor Analysis of Quality Attributes

The three factors obtained in the preceding stage and their indicators were subjected to first-order confirmatory factor analysis (CFA) through a measurement model using AMOS 7.0. The measurement model indicated an acceptable model fit with data ( $\chi^2 = 363.93$ ,  $df = 125$ ,  $p < 0.001$ ; CFI = 0.94; TLI = 0.931; IFI = 0.937; NFI = 0.912; and RMSEA = 0.06). In addition all the indicators loaded significantly on the respective latent constructs providing unidimensionality. Cronbach's alpha values of all the quality factors ranged from 0.767 to 0.882 providing internal consistency. Factor loadings for SERVPERF quality items were in the range from 0.50 to 0.80 respectively (significant at  $p < 0.001$ ) and AVE values for all the quality factors were greater than or equal to 0.50 which reflected the convergent validity (Fornell and Larcker, 1981). The discriminant validity of the quality factors was assessed by comparing the average variance extracted (AVE)

with the corresponding inter-quality factors' squared correlation estimates (Fornell and Larcker, 1981). Thus the quality dimensions were found to have adequate psychometric properties.

### Measurement Model Estimation

**Reliability:** Reliability of the constructs was examined by calculating the Cronbach's alpha values. These ranged from 0.76 to 0.89 which is acceptable Hair et al. (2006). We also report the composite reliability of the constructs because it is generally acknowledged that composite reliability is a better measure of scale reliability than Cronbach's alpha coefficient (Bagozzi and Yi 1988; Homburg et al. 2003). Table-3 shows that the composite reliability values of all the constructs range from 0.6 to 0.75 which further strengthens our assessment of reliability of the constructs (Hair et al. 2006).

**Construct validity:** The analysis followed the two-step approach of Anderson and Gerbing (1988) whereby the

estimation of a confirmatory measurement model precedes the simultaneous estimation of the measurement and structural models. Therefore, the analysis evaluated the convergent and discriminant validities of the eight constructs in. The latent constructs were allowed to correlate with each other and the measurement items and their error terms were allowed to be uncorrelated. The measurement model indicated an adequate model fit with data ( $\chi^2 = 518.14$ ,  $df = 172$ ,  $p < 0.001$ ; CFI = 0.956; TLI = 0.947; IFI = 0.957; NFI = 0.936; RFI = 0.922; and RMSEA = 0.06). The reliability of the constructs is shown in Table 3 below.

Convergent validity was assessed by examining the factor loadings and average variance extracted of the constructs (Fornell and Larcker 1981). All the indicators had significant loadings onto the respective latent constructs ( $p < 0.001$ ) with values varying between 0.696 and 0.959. In addition the average variance extracted (AVE) for each construct is equal to or greater than 0.50, which further supports the convergent validity of the constructs.

**Table 3:** Confirmatory Factor Analysis

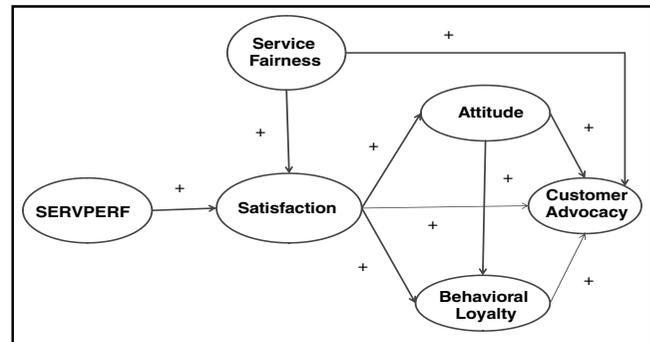
Constructs	Measurement items	Loadings	p-value	AVE	Cronbach alpha	Composite reliability
SERVPERF	X1	0.833	***	0.55	0.88	0.620
	X2	0.799	***			
	X3	0.700	***			
	X4	0.784	***			
	X5	0.713	***			
	X6	0.744	***			
	X7	0.829	***			
	X8	0.783	***	0.58	0.76	0.600
	X9	0.696	***			
	X10	0.700	***			
	X11	0.845	***			
	X12	0.829	***			
	X13	0.942	***			
	X14	0.954	***			
	X15	0.808	***			
Satisfaction	S1	0.867	***	0.74	0.87	0.630
	S2	0.959	***			
	S3	0.964	***			
Attitude towards the MFI	A1	0.850	***	0.62	0.84	0.740
	A2	0.777	***			
	A3	0.881	***			
Behavioral Loyalty	St1	0.678	***	0.50	0.9	0.660
	St2	0.779	***			
	St3	0.779	***			
Customer Advocacy	W1	0.656	***	0.65	0.86	0.76
	W2	0.595	***			
	W3	0.665	***			
Service Fairness	SF1	0.565	***	0.62	0.71	0.67
	SF2	0.501	***			
	SF3	0.522	***			

As proposed by Fornell and Larcker (1981), discriminant validity was assessed by comparing the average variance extracted (AVE) with the corresponding inter-construct squared correlation estimates. All the AVE values are greater than the inter-construct correlations which supports the discriminant validity of the constructs. Thus, the measurement model reflects good construct validity and desirable psychometric properties.

**Structural model and hypotheses testing for BISWA**

The structural model with inter-relationships amongst the different customer metrics as discussed in the literature review section is shown in Figure 2 below. Structural equation modeling (SEM) was conducted using AMOS 16.0 to test hypotheses H1 to H9 for BISWA. The results indicated an adequate fit between the data and the mode.

Results in Table 4 below indicate that all the three dimensions of SERVPERF i.e. tangibility, reliability and responsiveness had significant relationships with customer satisfaction. Results showed that tangibility has a direct and positive impact on customer satisfaction (coefficient = 0.240,  $p < 0.001$ ); reliability has a direct and positive effect on customer satisfaction (coefficient = 0.272,  $p < 0.001$ ) and empathy has a positive and significant impact on customer satisfaction



**Figure 2:** Structural model

(coefficient = 0.181,  $p < 0.001$ ) supporting H1. Similarly, customer satisfaction had significant effects on attitude towards the MFI (coefficient = 0.452,  $p < 0.001$ ); on behavioral loyalty (coefficient = 0.493,  $p < 0.001$ ); and on customer advocacy (coefficient = 0.199,  $p < 0.001$ ) which supports H4, H5 and H6. Next, attitude towards the MFI had direct and positive effects on behavioral loyalty (coefficient = 0.20,  $p < 0.001$ ) and customer advocacy (coefficient = 0.54,  $p < 0.001$ ) supporting H7 and H8. Behavioral loyalty was significantly associated with customer advocacy (coefficient = 0.268,  $p < 0.001$ ) which supports H9. Results did not indicate a significant relationship between service fairness and customer satisfaction and customer advocacy.

**Table 4** Standardized Parameter Estimates of the Hypothesized Paths

Hypothesized Paths	Path Coefficients	Results
Tangibility → Satisfaction	0.240*	H1 (accepted)
Reliability → Satisfaction	0.272*	H1 (accepted)
Empathy → Satisfaction	0.181*	H1 (accepted)
Service Fairness → Satisfaction	0.181 (NS)	H2 (rejected)
Service Fairness → Customer Advocacy	0.202 (NS)	H3 (rejected)
Satisfaction → Attitude	0.452*	H4 (accepted)
Satisfaction → Behavioral Loyalty	0.493*	H5 (accepted)
Satisfaction → Customer Advocacy	0.199*	H6 (accepted)
Attitude → Behavioral Loyalty	0.440*	H7 (accepted)
Attitude → Customer Advocacy	0.540*	H8 (accepted)
Behavioral Loyalty → Customer Advocacy	0.268*	H9 (accepted)

## DATA ANALYSIS FOR KBSLAB

### Demographic Profile of KBSLAB Customers

Understanding the customers profile can be a valuable tool for the management of MFI's. Demographic analysis can highlight trends as well as factors attracting or discouraging individuals from accessing the micro finance facilities. This type of information can be incorporated into a management information system (MIS) to display demographic patterns spatially, linking accessing micro finance and human characteristics within a landscape. Demographic analysis can also be used to establish the percentage of the total population involved in a particular type of usages of the micro finance loans thus leading to a typical satisfaction response. By delineating this information by age, sex, or education level, MFI managements can develop targeted outreach and training activities for local communities.

We administered the questionnaire to 420 individuals surveying in three (3) adjacent districts viz., Mahboobnagar, Gulbarga and Raichur. Out of 420, we found 3 as having incomplete/inconsistent information. So, after removing them we had 417 usable questionnaires.

We have collected the information on each respondent regarding the following variables:

Age, Sex, Social Category, Educational Qualification, Household Size, Household Income(per month), Number of Children, Sources of Livelihood, Duration of the Relationship with KBSLAB etc.<sup>5</sup>

### I - Preliminary Analysis of Demographic Data

We first classify the respondents according to some important categorical variables for the purpose of profiling the customers.

<sup>5</sup>We have also collected information regarding several other variables, like number of school going children and number of dropouts. However, we have not used them in the present analysis.

**Exhibit 7.** Classification of the Respondents Based on SEX

	<i>Frequency</i>	<i>Percent</i>
Female	266	64
Male	151	36
Total	417	100

We observe that 64 %of our respondents are female. This is of no surprise since most of the clientele of the MFI's are women. In fact compared to a typical MFI clientele this is less. However 36% of our respondents are male.

**Exhibit 8.** Classification of the Respondents Based on LEVEL of EDUCATION

	<i>Frequency</i>	<i>Percent</i>
No Schooling	178	42
Upto Standard 5	36	9
Upto 10 <sup>th</sup> Standard	107	26
Upto 12 <sup>th</sup> Standard	84	20
Graduate	12	3
Total	417	100

We see that more than 50% and 77 % (42+9+26) of the respondents are educated up to 5<sup>th</sup> standard or less and 10<sup>th</sup> standard or less respectively whereas the number of graduates is only 12 which amounts to 3% of the total 417 customers.

**Exhibit 9.** Classification of the Respondents Based on SOCIAL CATEGORY

	<i>Frequency</i>	<i>Percent</i>
GEN	48	11
GEN-Others	80	19
OBC	225	54
SC	49	12
ST	15	4
Total	417	100

We have classified them according to the social category to which they belong. We find that Other Backward Classes (OBC) customers of KBSLAB are predominant in our sample (54%), followed by general category (30%)<sup>6</sup>. Representation of SC and ST categories are about 12% and 4% respectively.

**Exhibit 10.** Classification of the Respondents Based on LIVELIHOOD

	Frequency	Percent
Agri Allied & Dairy	120	29
Bangle Shop	27	6
Contract Labourer	30	6
Kirana Shop	47	12
Carpentry	17	4
Fruit Vendor	15	4
Tailoring Shop	39	9
Tea stall	21	5
Others <sup>7</sup>	101	24
Total	417	100

We may notice from the above exhibit that according to the sources of LIVELIHOOD we have collected a well diversified sample of respondents.

**Exhibit 11.** Classification of the Respondents Based on Duration of Relationships

	Frequency	Percent
Up to 1Year	24	6
1to3 years	286	70
More than 3 years	107	24
Total	417	100

And last but not the least, we have classified the respondents according to the duration of their relationship with KBSLAB and found that almost 70% of the customers that we have surveyed are having a relationship with KBSLAB whose duration is between 1 to 3 years. Almost 1/4<sup>th</sup> (24%) are having more than 3 years of relationships but the proportions of new customers are much less (only 6%).

We have also collected data on some other demographic variables which are continuous in nature. We now present their salient statistical features in the following table.

<sup>6</sup>This includes Gen\_Others category which is mainly the minority community.

<sup>7</sup>Others' category comprises of Cycle Repairing shop owner, Auto parts owner, Leth Factory owner, Tye Tube Repairing Shop owner etc several employment whose count is less

**Table 5.** Descriptive Statistics

	Mean	SD	Minimum	Maximum
Age (In Years)	37	9	24	54
Household Size	6	1.7	3	11
Income (Rs. Per Month)	8121	4928	1500	30000
Number of Children	3.19	2.11	2	7
Overdue Amount (In Rs.)	536	4541	1	87147

Over and above, we have collected response on an item called Overall Satisfaction Score (OSS) measured in a five point Likert scale, with 1 being least and 5 being the highest score. The purpose of this was to enable us to examine the relationship of some of the demographic variables with the overall satisfaction level of the customers of these MFIs. (e.g. 'whether overall satisfaction level is more or less uniform across social categories'? etc.) The basic statistical features of the Overall Satisfaction Score (OSS) are given below:

**Table 6.** Overall Satisfaction

	Mean	SD	Min	Max
OSS	4.02	0.67	2.5	5.0

In the next section we provide the results of our analysis whether OSS has any significant relationship with any of the demographic variables like Social Category or gender etc. We have applied the following methodology: depending on whether the demographic variable is categorical/discrete or continuous (or discrete with more than, say, 5 different values) either cross tabulation done with OSS or correlation is calculated with OSS. Thereafter, a test of association (or independence) is conducted using Frequency Chi-square or an ANOVA is performed.

Based on above statistical analysis we arrive at the following conclusions:

- I. Overall satisfaction level does not vary significantly over different levels of social category.
- II. Overall satisfaction level does not vary significantly across genders.
- III. Overall satisfaction level does not vary significantly over different levels of household size (small, medium or big).
- IV. Overall satisfaction level does not vary significantly over different levels of educational qualifications.
- V. Overall satisfaction level does not vary significantly over different categories of Purpose of the Loans (firm or non firm loans).

VI. Overall satisfaction level does not vary significantly over different levels of duration of the relationship.

However, overall satisfaction level does have a significant and positive correlation with different levels of house hold income as well as house hold size. This is supported by ANOVA analysis.

The corresponding analysis along with Cross tabulation, Frequency Chi-square tables and ANOVA tables have been given in the appendix

## II - Data analysis

Data analysis in this study has followed a four step approach. First, the exploratory factor analysis was performed on the SERVPERF items (shown in Table 7) to obtain the dimensions of service performance of the MFIs. Second, a confirmatory factor analysis was performed to confirm the factor structure of service performance. Next, the unidimensionality of the other constructs used in the study was examined. Thereafter, the measurement properties (reliability and validity) of the measurement model were examined. Finally, the hypotheses were tested using the structural equation modeling.

**Table 7.** Measurement Instrument for KBSLAB

### SERVPERF Items

1. KBSLAB has up-to-date equipment.
2. KBSLAB's physical facilities are visually appealing.
3. KBSLAB's employees are well dressed and appear neat.
4. The appearance of the physical facilities of KBSLAB is in keeping with the type of service provided.
5. When KBSLAB promises to do something by a certain time, it does so.
6. When you have problems, KBSLAB is sympathetic and reassuring.
7. KBSLAB is dependable.
8. KBSLAB provides its services at the time it promises to do so.
9. KBSLAB keeps its records accurately.
10. KBSLAB does not tell its customers exactly when services will be performed.
11. You do not receive prompt service from KBSLAB employees.
12. Employees of KBSLAB are always willing to help customers.
13. Employees of KBSLAB are never too busy to respond to customers' requests.
14. You can trust employees of KBSLAB.
15. You can feel safe in your transactions with KBSLAB's employees.
16. Employees of KBSLAB are polite.
17. Employees get adequate support from KBSLAB to do their jobs well.

18. Employees of KBSLAB give customers personal attention.
19. Employees of KBSLAB give customers individualized attention.
20. Employees understand the specific needs of customers.
21. KBSLAB has customers' best interests at heart.
22. KBSLAB's operating hours are convenient to all their customers.

### Overall Customer Satisfaction

1. Overall I am satisfied with KBSLAB.
2. I am happy with KBSLAB's services.
3. Using KBSLAB's services is a satisfying experience.

### Service Fairness

1. I was treated with courtesy and respect.
2. The interest and fees charged are reasonable for the services I received.
3. KBSLAB treats all its customers equally.

### Attitude

1. I like KBSLAB.
2. I will prefer KBSLAB over other MFIs in future.
3. I feel a strong sense of identification with KBSLAB.

### Behavioral Loyalty

1. I will use the services of KBSLAB in future.
2. I would do more business with KBSLAB in future.
3. Compared to other MFIs I have used the services of KBSLAB more.

### Customer Advocacy

1. I would recommend KBSLAB to anyone who seeks my advice.
2. I encourage friends and relatives to take the service of KBSLAB.
3. I say positive things about KBSLAB to other people.

## Exploratory Factor Analysis of SERVPERF Items

An exploratory factor analysis was performed on the fifteen items of SERVPERF using principal component analysis with varimax rotation for KBSLAB. Three factors with eigenvalues greater than one were extracted. Results of the factor analysis are shown in Table-8.

We retained the factor loadings greater than 0.50 for further analysis. All the fifteen items loaded on the three factors obtained. The three factors that were retained represented the following dimensions of the service quality, viz., Empathy/responsiveness (of employees); Reliability/assurance and Tangibility. Construct reliability of the factors was calculated using the Cronbach's alpha. The Cronbach's alpha value of greater than or equal to 0.7 is considered acceptable for the factor to be reliable (Hair et al. 2006). The Cronbach's alpha for the service quality dimensions ranged between 0.72 and 0.82 as shown in Table 8 below.

**Table 8.** Exploratory Factor Analysis for KBALAB

SERVPERF Items	Factors		
	Tangibility	Reliability/Assurance	Empathy/Responsiveness
X1. KBSLAB has up to date equipment	0.725		
X2. KBSLAB 's physical facilities are visually appealing.	0.500		
X3. KBSLAB 's employees are well dressed.	0.625		
X4. Appearance of KBSLAB 's physical facilities is in keeping with the service provided.	0.630		
X5. When KBSLAB promises to do something it does so.		0.740	
X6. KBSLAB is dependable		0.520	
X7. KBSLAB provides its services in time it promises to do so		0.618	
X8. KBSLAB keeps its records accurately		0.649	
X9. You can feel safe in your transactions		0.622	
X10. Employees are polite		0.543	
X11. When you have problems, KBSLAB is sympathetic and reassuring			0.762
X12. You can trust employees of KBSLAB			0.733
X13. Employees of KBSLAB give customers personal attention			0.775
X14. Employees understand the specific needs of customers			0.765
X15. KBSLAB 's operating hours are convenient to all their customers			0.611
<b>Cronbach's alpha</b>	0.789	0.801	0.701

### Confirmatory Factor analysis of Quality Attributes

The three factors obtained in the preceding stage and their indicators were subjected to first-order confirmatory factor analysis (CFA) through a measurement model using AMOS 7.0. The measurement model indicated an acceptable model fit with data ( $c^2 = 353.83$ ,  $df = 125$ ,  $p < 0.001$ ; CFI = 0.936; TLI = 0.923; IFI = 0.936; NFI = 0.911; and RMSEA = 0.06). In addition all the indicators loaded significantly on the respective latent constructs providing unidimensionality. Cronbach's alpha values of all the quality factors were in the range from 0.72 to 0.82 providing internal consistency. Factor loadings for SERVPERF quality items were in the range from 0.50 to 0.80 respectively (significant at  $p < 0.001$ ) and AVE values for all the quality factors were greater than or equal to 0.50 which reflected the convergent validity (Fornell and Larcker, 1981). The discriminant validity of the quality factors was assessed by comparing the average variance extracted (AVE) with the corresponding inter-quality factors' squared correlation estimates (Fornell and Larcker, 1981). Thus the quality dimensions were found to have adequate psychometric properties.

### Measurement Model Estimation

*Reliability:* Reliability of the constructs was examined by calculating the Cronbach's alpha values. These ranged from 0.76 to 0.89 which is acceptable Hair et al. (2006). We also report the composite reliability of the constructs because it is generally acknowledged that composite reliability is a better measure of scale reliability than Cronbach's alpha coefficient (Bagozzi and Yi 1988; Homburg et al. 2003). Table-9 shows that the composite reliability values of all the constructs range from 0.6 to 0.75 which further strengthens our assessment of reliability of the constructs (Hair et al. 2006).

*Construct validity:* The analysis followed the two-step approach of Anderson and Gerbing (1988) whereby the estimation of a confirmatory measurement model precedes the simultaneous estimation of the measurement and structural models. Therefore, the analysis evaluated the convergent and discriminant validities of the eight constructs in. The latent constructs were allowed to correlate with each other and the measurement items and their error terms were allowed to be uncorrelated. The measurement model indicated an adequate model fit with data ( $c^2 = 518.14$ ,  $df = 172$ ,  $p < 0.001$ ; CFI = 0.956; TLI = 0.947; IFI = 0.957; NFI = 0.936; RFI = 0.922;

and RMSEA = 0.06). The reliability of the constructs is shown in Table 9 below.

Convergent validity was assessed by examining the factor loadings and average variance extracted of the constructs (Fornell and Larcker 1981). All the indicators had significant

loadings onto the respective latent constructs ( $p < 0.001$ ) with values varying between 0.69 and 0.95. In addition, the average variance extracted (AVE) for each construct is equal to or greater than 0.50, which further supports the convergent validity of the constructs.

**Table 9.** Confirmatory Factor Analysis

Constructs	Measurement items	Loadings	p-value	AVE	Cronbach alpha	Composite reliability
SERVPERF	X1	0.813	***	0.55	0.78	0.620
	X2	0.789	***			
	X3	0.690	***			
	X4	0.684	***			
	X5	0.702	***			
	X6	0.724	***			
	X7	0.809	***			
	X8	0.772	***	0.58	0.80	0.600
	X9	0.686	***			
	X10	0.690	***			
	X11	0.835	***			
	X12	0.819	***			
	X13	0.924	***			
	X14	0.950	***			
	X15	0.800	***			
Satisfaction	S1	0.837	***	0.74	0.86	0.630
	S2	0.948	***			
	S3	0.934	***			
Attitude towards the MFI	A1	0.829	***	0.62	0.83	0.740
	A2	0.766	***			
	A3	0.871	***			
Behavioral Loyalty	St1	0.740	***	0.50	0.88	0.660
	St2	0.660	***			
	St3	0.749	***			
Customer Advocacy	W1	0.656	***	0.65	0.85	0.76
	W2	0.559	***			
	W3	0.649	***			
Service Fairness	SF1	0.556	***	0.62	0.70	0.67
	SF2	0.500	***			
	SF3	0.511	***			

As proposed by Fornell and Larcker (1981), discriminant validity was assessed by comparing the average variance extracted (AVE) with the corresponding inter-construct squared correlation estimates. All the AVE values are greater

than the inter-construct correlations which supports the discriminant validity of the constructs. Thus, the measurement model reflects good construct validity and desirable psychometric properties.

### Structural Model and Hypotheses Testing for KBSLAB

The structural model with interrelationships amongst the different customer metrics as discussed in the literature review section is shown in Figure 2. Structural equation modeling (SEM) was conducted using AMOS 7.0 to test hypotheses H1 to H9 for KBSLAB. The results indicated an adequate fit between the data and the model.

Results in Table 10 below indicate that all the three dimensions of SERVPERF i.e. tangibility, reliability and responsiveness had significant relationships with customer satisfaction. Results showed that tangibility has a direct and positive impact on customer satisfaction (coefficient = 0.240,  $p < 0.001$ ); reliability has a direct and positive effect on customer satisfaction (coefficient = 0.272,  $p < 0.001$ ) and empathy

has a positive and significant impact on customer satisfaction (coefficient = 0.181,  $p < 0.001$ ) supporting H1. Customer satisfaction had no significant effects on attitude towards the MFI; has significant impact on behavioral loyalty (coefficient = 0.393,  $p < 0.001$ ); and on customer advocacy (coefficient = 0.199,  $p < 0.001$ ) which rejects H4, and supports H5 and H6. Next, attitude towards the MFI had no positive effect on behavioral loyalty and whereas a significant impact on customer advocacy (coefficient = 0.340,  $p < 0.001$ ). Hence hypothesis H7 is rejected and hypothesis H8 is accepted. Behavioral loyalty was significantly associated with customer advocacy (coefficient = 0.208,  $p < 0.001$ ) which supports H9. Results did not indicate a significant relationship between service fairness and customer satisfaction and customer advocacy.

**Table 10** Standardized parameter estimates of the hypothesized paths

<i>Hypothesized Paths</i>	<i>Path Coefficients</i>	<i>Results</i>
Tangibility → Satisfaction	0.210*	H1 (accepted)
Reliability → Satisfaction	0.172*	H1 (accepted)
Empathy → Satisfaction	0.181*	H1 (accepted)
Service Fairness → Satisfaction	0.181 (NS)	H2 (rejected)
Service Fairness → Customer Advocacy	0.202 (NS)	H3 (rejected)
Satisfaction → Attitude	0.002 (NS)	H4 (accepted)
Satisfaction → Behavioral Loyalty	0.393*	H5 (accepted)
Satisfaction → Customer Advocacy	0.199*	H6 (accepted)
Attitude → Behavioral Loyalty	0.040 (NSS)	H7 (accepted)
Attitude → Customer Advocacy	0.340*	H8 (accepted)
Behavioral Loyalty → Customer Advocacy	0.208*	H9 (accepted)

### COMPARISON OF BISWA AND KBSLAB HYPOTHESIS TESTING RESULTS

Table 11 compares the hypothesis testing results of BISWA and KBSLAB.

**Table 11.** Comparison of BISWA and KBSLAB

<i>Hypothesized Paths</i>	<i>Path Coefficients for KBSLAB</i>	<i>Path Coefficients for BISWA</i>
Tangibility → Satisfaction	0.210*	0.240*
Reliability → Satisfaction	0.172*	0.272*
Empathy → Satisfaction	0.181*	0.181*
Service Fairness → Satisfaction	0.181 (NS)	0.181 (NS)
Service Fairness → Customer Advocacy	0.202 (NS)	0.202 (NS)
Satisfaction → Attitude	0.002 (NS)	0.452*
Satisfaction → Behavioral Loyalty	0.393*	0.493*
Satisfaction → Customer Advocacy	0.199*	0.199*
Attitude → Behavioral Loyalty	0.040 (NS)	0.440*
Attitude → Customer Advocacy	0.340*	0.540*
Behavioral Loyalty → Customer Advocacy	0.208*	0.268*

\*indicates significant at  $p < 0.001$ ; NS indicates non-significant

## CONCLUSIONS

Micro Finance institutions can act as a silent catalyst in improving the economic scenario of rural India and in embracing the marginalized section unto the banking fold. Though the concept may be new and unsteady, MFIs have already made its small footstep and it is felt as a pioneering sign of social revolution as micro-credit became drops for bringing a sea change in our poverty stricken world. MFIs have also made their presence felt in India over the last decade or so. This study attempts to examine the end-users' satisfaction levels of MFI's - least research being found on specific analysis of service performance based on satisfaction of the recipients of micro finance i.e. the 'real poor section' of the society. We examined the customer perception of two MFI on various parameters namely, service performance, service fairness, customer satisfaction, attitude towards the MFI, behavioral loyalty and word-of-mouth.

Two organizations namely, BISWA and KBSLAB, were chosen for the study because both are reputed MFI. The questionnaire was prepared from the existing literature. Data was analyzed using exploratory factor analysis and structural equation modeling.

### Observations

1. Results indicate that the three dimensions of service performance i.e. tangibility, reliability and empathy have positive and significant impacts on satisfaction judgments of the end users of the MFIs. This highlights that MFIs need to focus on projecting a reliable image and make their services tangible enough so that the end users know about the services offered by the MFIs. Also the MFIs need to show empathy towards the end users in terms of loan repayment periods and loan collection from the defaulters.
2. Another striking finding of the study is that in case of both the organizations studied:
  - (a) service fairness does not have a significant impact on satisfaction judgments of end users.
  - (b) This highlights the fact that MFIs need to treat their customers fairly in terms relaxed loan rates and loan repayment periods.
3. Another important finding of the study is the positive impact of end-user satisfaction on their loyalty and advocacy behaviors. This is very important for MFIs as if they treat their customers fairly customers will be happy and they will spread the positive word-of-mouth for the MFI which helps them to acquire more and more customers. But to retain them the MFIs need to treat the customers fairly and cater the basic service to the end-user in a satisfactory way.
4. However differences and indifferences do exist blatantly as though micro finance has entered the banking lexicon, the governmental support and infrastructural support required to come at par with conventional banks, is by far lacking.
5. Financial inclusion the noble mantra of MFIs that has recently been recognized as a corporate responsibility by business houses, hardly gets the much needed through research.
6. The recent policy of the MFIs by the government of A.P. following a tragic bout of suicides by the debt ridden loanies of MFIs created a furor nationwide. Apart from the conventional wisdom of repayment rate and rate of interest charged, there are other several dimensions of assessing the activity of an MFI and "consumer satisfaction" is one such aspect.

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# ANNEXURE-I

## QUESTIONNAIRE

1. Why you are a customer of BISWA?
2. Are you satisfied with their services? If yes/no, why?
3. Other MFIs that operate in your region—are you also a customer of them? If yes/no, why?
4. In case of default (loan or anything worth mentioning).How you are being treated? Are you happy with their conduct/behaviour the way in which they handle default?

(Five point Likert scale from “strongly disagree” to “strongly agree”.

## SERVPERF Items

1. BISWA has up-to-date equipment.  
0P      25P      50P      75P      100P
2. BISWA’s physical facilities are visually appealing.  
0P      25P      50P      75P      100P
3. BISWA’s employees are well dressed and appear neat.  
0P      25P      50P      75P      100P
4. The appearance of the physical facilities of BISWA is in keeping with the type of service provided.  
0P      25P      50P      75P      100P
5. When BISWA promises to do something by a certain time, it does so.
6. When you have problems, BISWA is sympathetic and reassuring.
7. BISWA is dependable.
8. BISWA provides its services at the time it promises to do so.
9. BISWA keeps its records accurately.
10. BISWA does not tell its customers exactly when services will be performed.
11. You do not receive prompt service from BISWA employees.
12. Employees of BISWA are always willing to help customers.
13. Employees of BISWA are never too busy to respond to customers’ requests.
14. You can trust employees of BISWA.
15. You can feel safe in your transactions with BISWA’s employees.
16. Employees of BISWA are polite.

17. Employees get adequate support from BISWA to do their jobs well.
18. Employees of BISWA give customers personal attention.
19. Employees of BISWA give customers individualized attention.
20. Employees understand the specific needs of customers.
21. BISWA has customers’ best interests at heart.
22. BISWA’s operating hours are convenient to all their customers.

## Overall Customer Satisfaction

1. Overall I am satisfied with BISWA.
2. I am happy with BISWA’s services.
3. Using BISWA’s services is a satisfying experience.

## Service Fairness

1. I was treated with courtesy and respect.
2. The interest and fees charged are reasonable for the services I received.
3. BISWA treats all its customers equally.

## Attitude

1. I like BISWA.
2. I will prefer BISWA over other MFIs in future.
3. I feel a strong sense of identification with BISWA.

## Behavioral Loyalty

1. I will use the services of BISWA in future.
2. I would do more business with BISWA in future.
3. Compared to other MFIs I have used the services of BISWA more.

## Customer Advocacy

1. I would recommend BISWA to anyone who seeks my advice.
2. I encourage friends and relatives to take the service of BISWA.
3. I say positive things about BISWA to other people.

## Demographic Data to be Collected

(Regarding Respondent)

Name .....

Age .....

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Sex .....

Village .....

Dist .....

Social Category: SC, ST, OBC, Gen

**Occupational Category: Salaried, Self-employed  
(Agriculture, non agriculture) etc.**

Educational Background

(Regarding the Household<sup>8</sup> of the respondent)

Household size

Household income (per month or week)

Number of children

How many of them going to school or dropouts

Sources of livelihoods of the household

(Regarding Nature of relationships with the MFI)

What kind of product/services he/she has availed of

Duration of relationship:

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<sup>8</sup>Number of persons sharing a common kitchen.

# ANNEXURE-II

## QUESTIONNAIRE – KBSLAB

(Five point Likert scale from “strongly disagree” to “strongly agree”. Note: We need to devise scale in local language.)

### SERVPERF Items

1. KBSLAB has up-to-date equipment.
2. KBSLAB’s physical facilities are visually appealing.
3. KBSLAB’s employees are well dressed and appear neat.
4. The appearance of the physical facilities of KBSLAB is in keeping with the type of service provided.
5. When KBSLAB promises to do something by a certain time, it does so.
6. When you have problems, KBSLAB is sympathetic and reassuring.
7. KBSLAB is dependable.
8. KBSLAB provides its services at the time it promises to do so.
9. KBSLAB keeps its records accurately.
10. KBSLAB does not tell its customers exactly when services will be performed.
11. You do not receive prompt service from KBSLAB employees.
12. Employees of KBSLAB are always willing to help customers.
13. Employees of KBSLAB are never too busy to respond to customers’ requests.
14. You can trust employees of KBSLAB.
15. You can feel safe in your transactions with KBSLAB’s employees.
16. Employees of KBSLAB are polite.
17. Employees get adequate support from KBSLAB to do their jobs well.
18. Employees of KBSLAB give customers personal attention.
19. Employees of KBSLAB give customers individualized attention.
20. Employees understand the specific needs of customers.
21. KBSLAB has customers’ best interests at heart.
22. KBSLAB’s operating hours are convenient to all their customers.

### Overall Customer Satisfaction

1. Overall I am satisfied with KBSLAB.
2. I am happy with KBSLAB’s services.
3. Using KBSLAB’s services is a satisfying experience.

### Service Fairness

1. I was treated with courtesy and respect.
2. The interest and fees charged are reasonable for the services I received.
3. KBSLAB treats all its customers equally.

### Attitude

1. I like KBSLAB.
2. I will prefer KBSLAB over other MFIs in future.
3. I feel a strong sense of identification with KBSLAB.

### Behavioral Loyalty

1. I will use the services of KBSLAB in future.
2. I would do more business with KBSLAB in future.
3. Compared to other MFIs I have used the services of KBSLAB more.

### Customer Advocacy

1. I would recommend KBSLAB to anyone who seeks my advice.
2. I encourage friends and relatives to take the service of KBSLAB.
3. I say positive things about KBSLAB to other people.

### Demographic data to be collected:

(Regarding Respondent)

Name: .....

Age: .....

Sex: .....

Village: .....

Dist.: .....

Social Category: SC, ST, OBC, Gen

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**Occupational Category: Salaried, Self employed  
(Agriculture, non agriculture) etc.**

Educational Background: .....

(Regarding the Household<sup>9</sup> of the respondent)

Household size: .....

Household income (per month or week): .....

Number of children : .....

How many of them going to school....or dropouts .....

Sources of livelihoods of the household: .....

(regarding Nature of relationships with the MFI)

What kind of product/services he/she has availed of: .....

Duration of relationship:

<sup>9</sup>Number of persons sharing a common kitchen.