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Sa-Dhan
The Association of
Community Development
Finance Institutions

Sa-Dhan: The Association of Community Development Finance Institutions (CDFIs) represents countrywide a total of 252 members across 20 states with loan outstanding of Rs. 18,344 crore (4 billion USD) and client outreach of 2.67 crore (26.7 million).

Need for "India Equity Fund" with Long Term Vision for the Poor

Speech of Smt. Ela R. Bhatt, Chair Emeritus, Sa-Dhan at Sa-Dhan National Workshop on Governance & Risk Management, Ahmedabad, 17th January 2011

There was a time when India was compared with Bangladesh that why India remain far behind in micro-finance movement. Then, we discussed "what is ailing India?" Today, we have to discuss "what is ailing microfinance sector in India". The sector has unbelievably grown in the last 5 years; look at the pace of growth in terms of volume and clients, new players, free flow of



International capital. Diverse ways of microfinance have scope to flourish in this country.

There were handful of providers in India who tried out different forms of Micro Credit –SHGs, Federations, NGO-MFIs, Independent MFIs, NBFCs. In the initial years, SEWA Cooperative Bank started retail credit, FWWB came up supporting MFIs to grow from small to medium. This is my experience overtime.

But as MFIs (not all) grew bigger it became increasingly difficult to remain non-profit, they (may be imperative) operated on commercial format. As they become stabilized, and big, they became acceptable by Banks—the growth continued with ICICI's partnership leverage, SIDBI's aggressive investment in microfinance, the bringing of private equity, charity money turned on to equity—all these factors were events of significance.

Sa-Dhan has been holding deliberations, they are timely. It is time to be more serious, not cynical. I am not. It is time to revisit, search, re-search our common shared goals, our motives deep down our soul. Cynicism we can't afford. It is the poor, particularly poor women who are the ultimate sufferers. We are in serious business with the poor, we can't let them down. We have to regain our lost - whatever little –credibility.

*For internal circulation.



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The Association of
Community Development
Finance Institutions

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All MFIs have not failed in their mission. We have to show the positive work that is being done by MFIs. We should outnumber failures with much more positive work that is being done. Our work will say the positive story. If need be, we MFIs should admit our failings, our mistakes. That is healthy business, healthy public life. We are all responsible to the society to all.

While deliberating the revisit, I have two suggestions that I am keen to share with you.

Let us make a demand for an **Indian Equity Fund**, large in size, say Rs. 5000 Crore to serve 500 MFIs need in India. A fund that is client-centric with a long term vision vis a vis the poor, with our deepened engagement with clients, to produce multiple –diverse products. I would assume slower growth at the bottom line, moderate surplus /profitability and assessment of positive impact on clients' lives. I assume the fund will be a mix of patient capital: which is both risk funding and loan support. An independent, autonomous body professionally mooted it will be. The fund will work closely with public financial institutions to leverage its own investments.

The resources generated will be redeployed into the sector; within country. There will be no risk of flight of capital beyond the borders of India.

Let the fund stay; say for 15 years, moderate returns in the form of declared dividends, not in the form of capital gains.

I am indeed keen on this. I believe that this is time to launch such India equity fund for the Government of India. It will facilitate the progress of the Microfinance movement from poverty to sustainability.

I have a second point. I often think that we are missing a larger picture of the issues of our country? -The issues like hunger, food, water, forest –violence particularly.

We see anger and violence, what is worrisome is rampant unemployment

amongst the young. There is a demography driven upsurge in our country.

In any country, in any culture, when the proportion of 15-29 years olds swells beyond 20 percent, it creates a serious matter of worry. We already see violent eruption all around us. Youth today is in turmoil. Youth needs a purpose to live, to perform his /her abilities.

By 2020 and beyond, as the experts say, the 15-29 age groups will be rising 1.2% annually. This is the early working age population that needs MFIs' attention.

Ofcourse, many of them will find gainful employment, but many more will be building over, frustrated, angry. They will be available as cannon fodder for the wild –eyed politicians and extremist or for any so called 'cause'.

Feeding the young is easy but keeping them productively, meaningfully engaged so that their energies are used constructively is definitely tougher. I see that our MFIs active role, here.

My emphasis is on youth and on strategic lending. Call it 'Livelihood finance 'or 'Youth finance '.

Micro credit –the meaning of credit is trust in Latin. Banking to me is continued relationship of trust. Let us build such relationship with the youth of India.

As the experts say, by 2025, the demographic surge will begin to subside but we won't know what kind of country we will be left with, by then!

Therefore Microfinance cannot miss the macro picture.

Microfinance had emerged out of development paradigm. We succeeded because it was needed by the poor. MFIs were needed, and are still needed by the poor.

Thank you

Ela R Bhatt

MFI body wants national laws to regulate sector

Anita Bhoir

The Financial Express, Dec 21, 2010

The microfinance industry body Sa-Dhan has suggested the Malegam Committee that there should be a single national regulation for the sector rather than state-wise legislation. "We have suggested that there should be a national regulation and tight supervision for the sector. However, the two functions could rest in different entities and the sector also needs to fund self regulation," observed Mathew Titus, executive director Sa-Dhan. The MFI industry believes Nabard could be the regulator for this sector especially since it is owned by the government.

Sa-Dhan, which has about 264 microfinance institutions (MFIs) as its members, conveyed this to the RBI-appointed Malegam Committee last week in Hyderabad. Titus said, "We have also requested that the priority sector status be retained for bank loans given to the MFI sector." The central bank had, in October 2010, set up the YH Malegam committee to study issues and concerns relating to the micro finance sector. Among the terms of reference for the committee is one that it will examine the conditions under which loans to MFIs can be classified as priority sector lending. The MFI sector, particularly in Andhra Pradesh, has assumed a political hue after alleged reports of farmer suicides driven by coercive loan collection methods.

The AP government has passed a Microfinance Bill which

has brought the entire sector to a standstill in the state. The priority sector status, Titus said, "has worked well for the microfinance sector." Financial inclusion is a big agenda for the government and lending to this sector could be one way of achieving this objective." Accordingly, a price matrix could be evolved based on which lending in a particular region for instance North East or Bihar through MFIs would get 2% interest sop under priority sector. This would also bring down the interest rate at which MFIs lend to individuals, he explained. "The pricing matrix for priority sector could be formulated based on the volume and portfolio," added Titus. Currently, loans up to Rs 50,000 are termed as micro credit. Sa-Dhan has suggested that the RBI redefine this amount and make it dynamic by linking it to an index, such as inflation.

To address the issue of multiple lending the agency has suggested that MFIs should rely largely on credit officers as the credit bureaus are still evolving. At present, one credit officer handles loan accounts of around 500 to 600 borrowers. This does not give him adequate time to identify a possible distress in the borrower's family. Hence, Sa-Dhan has suggested that the ratio of borrowers to a credit officer be brought down to around 350. To put in place a smooth loan collection system the MFI body has suggested that training be imparted to the employees and a code of conduct be followed. "It should be mandatory for lenders like Nabard and Sidbi to ensure that the funds deployed are used appropriately by the management," said Titus.

Sa-Dhan Interventions: State level meetings with members to highlight key issues confronting the Sector

In the aftermath of the adverse situation for the microfinance sector in Andhra Pradesh, Sa-Dhan had been engaging with the members and other stakeholders in states such as Andhra Pradesh, West Bengal and Orissa. The purpose of these engagements has been to communicate the implications of situation in Andhra Pradesh, and to facilitate collective action from members in other states in terms of responding to the issues and concerns raised by the stakeholders. The focus has been on bringing the confidence back both for the MFIs as well as other stakeholders. The primary agenda in all these interactions has been the implementation of Sa-Dhan Code of Conduct.

Sa-Dhan – SIDBI Meeting with MFIs in Uttar Pradesh

As a pro-active measure, members in Uttar Pradesh had a

meeting in November 2010 to discuss the framework of a possible state level forum to address issues emanating from the Andhra Pradesh crisis in a collective manner. Further, a joint meeting of members with SIDBI was organized on 3rd December 2010 to review the impact of the Andhra Pradesh crisis on the MFIs in Uttar Pradesh and on the way forward in terms of addressing the highlighted issues in the present context of the sector. The meeting was attended by 20 representatives from Sa-Dhan members in Uttar Pradesh, apart from senior officials of SIDBI.

The discussion focused around the issue of multiple lending, staff poaching, interest rate, collection practices and Code of Conduct. While agreeing that the situation in Uttar Pradesh is not like Andhra Pradesh, members emphasized on the need of sharing of client data,

transparency, financial literacy of clients and training of loan officers on “fair practices’ as defined by the Sa-Dhan Code of Conduct.

Members also discussed on the framework of the State Forum in Uttar Pradesh. Members agreed to form a four member Committee comprising of Trust Microfinance Network, Margadarsak Development Services, RISE and Sonata Finance Private Limited.

Formation of Sa-Dhan State Chapter in Tamil Nadu

In order to streamline the Association’s efforts on building transparency and promoting ethical practices, Sa-Dhan had formed State Chapters in the fast growing states of West Bengal and Orissa in the previous months. In this context, a meeting was held with members on 8th December 2010 to formally announce the Sa-Dhan State Chapter in Tamil Nadu and its office bearers. Attended by 45 representatives from 32 Sa-Dhan members, the meeting also had representatives from RBI and SIDBI, apart from former Principal Secretary, Tamil Nadu Government and former Secretary, Rural Development.

While the meeting platform was utilized by Sa-Dhan to reiterate the critical importance of Sa-Dhan Code of Conduct amongst its members in the present context of the sector, members also responded in affirmation on the same. Following a detailed deliberation on the structure of the State Forum a Committee was formed with the following members:

- Mrs CK Gariyali, ChairPerson/Chief Patron.
- President-Mr Joslin Thambi, BWDA
- Vice President-Mr Peter Palanisamy, NDFS
- Mr Stephen, PAT, Executive Committee.
- Mr Vasudevan, Equitas, E.C
- Mr Selvam, READ.
- Mr TamilaRasan, SMILE, E.C
- Mr Devarajan, GramaVidyal. E.C.

The Committee represents all legal forms of MFIs in Tamil Nadu.

Stock Taking with Members in Rajasthan and State Forum

The meeting was primarily called to take stock of the situation in Rajasthan, in the aftermath of Andhra Pradesh crisis, emphasizing on Code of conduct among members through feedback and implementation, and drawing a future road map towards a State Forum/ Chapter. The meeting was attended by 17 participants from 13 Sa-Dhan members.

In terms of stock taking on the practice of MFIs in the State, it was shared that no coercive practices are being followed by MFIs in Rajasthan. In the aftermath of the Andhra Pradesh crisis, the expansion of the MFIs in the State has slowed



down. Many of the members are also engaged in social activities with the clients, apart from providing credit. This way, it is possible to have good rapport with the clients.

On the Code of Conduct implementation process, a presentation focusing on its internalization with the systems of the organizations, implementation and supervision, was made before the members. Members were also informed on the validation exercise on the Code of Conduct in some states and Social performance.

Towards addressing issues collectively through a platform of Sa-Dhan in the State, members decide to form Rajasthan Forum of Sa-Dhan. Further, a four member committee was formed to articulate the scope of work for the Forum. The Committee members are

- i) Mr. P. M. Paul, **Cecoedecon Development Centre**
- ii) Mr. Rajendra Purohit, **Pushtikar Laghu Vyaparik Pratishthan Bachat & Sakh Sahakari Samiti**
- iii) Mr. Sudhir Kumar, **MITR**
- iv) Mr. Prabhu Lal Salvi, **SEVA Mandir**

It was also decided to involve SIDBI, NABARD and other stakeholders in the State Forum meetings to have their views and updating them on the microfinance sector in Rajasthan. Further, it was decided to use the forum to share their data and information so that to avoid multiple lending and other problems. The Forum would also work upon strategies to involve and sensitize the media to avert any un-informed reporting on the sector in the state. With the facilitation of Sa-Dhan the Forum will work to ensure MFIs representation in SLBC and DLBC meetings.

Update on Sa-Dhan Code of Conduct Implementation Process & Social Performance Data

In the last few months, Sa-Dhan had focussed on seeking compliance report from members on the Sa-Dhan Code of Conduct and Social performance. Supervision of Code of Conduct compliance consists of offsite and on site surveillance, based on the self reported data. Results from data analysis will support capacity building of members towards enforcement of the Code compliance. In this first step, the self reported data has been validated with 15 organisations in the field.

On site surveillance through validation of received data is done using the Code of Conduct assessment tool. It specifies questions of the self reporting sheet and is comparable to the detailed process of a social audit. These questions are to be asked to the CEO, head of HR, internal audit, branch and centre managers as well as clients. Adding up the answers to the sub questions will provide an understanding of the level of Code compliance of individual organizations. Adding up the level of compliance of individual organizations will provide an overview over the sector's compliance and will point to specific capacity building requirements.

The tool looks at the Code implementation of MFIs from four perspectives:

- ❑ Approval: MFI must be aware of Code of Conduct issues and there should be willingness and express approval from the board that the Code of Conduct will be adhered to.
- ❑ Documentation: Policies and practices confirming to the Code of Conduct would need to be clearly and unambiguously documented in operational manuals, etc.
- ❑ Dissemination: Policies and procedures adopted would need to be clearly disseminated across the organization through trainings, circulars and other communications.
- ❑ Observance: External assessment at client level to ensure that that the prescribed policies are being followed in practice.

The process of onsite surveillance has concluded with a discussion of the gaps between self reported data and facts found in the visits to field, branches and head office. 15 organizations volunteered for the first validation exercise focusing on the growth states of South and East.

Andhra Pradesh: Trident Microfin Private Ltd., SWAWS Credit Corporation India Pvt. Ltd., Saadhana MicroFin Society, CRESA Financial Services Pvt. Ltd, Siri Micro Fin Society, Ashajyothi Mahilabyudaya Society

Orissa: ADHIKAR, Swayamshree Micro Credit Services (SMCS)

Tamil Nadu: SMILE Microfinance Limited, BWDA Finance Ltd (BFL)

Karnataka: Grameen Financial Services Pvt. Ltd., Ujjivan Financial Services Private Limited, RORS Finance Private Limited

West Bengal: AROHAN Financial Services Ltd, Village Financial Services Pvt. Ltd

On data on Social Performance, already 40 member organizations have sent their reports to Sa-Dhan. A tool to analyze the data is being worked upon.

RBI tells banks to resume lending to MFIs

SKS stock rises 8.5%, but analysts say it is too early to expect a major rally in the scrip as uncertainties remain

Pramit Bhattacharya & Dinesh Unnikrishnan

Livemint.com, 23 December 2010

Shares of SKS Microfinance Ltd, the lone listed microfinance entity in India, rose 8.5% on Wednesday to Rs.664 after the Reserve Bank of India (RBI) asked banks to start giving fresh loans to the troubled microfinance industry to help microlenders tide over the current cash crunch. Analysts, however, said it was too early to expect a major rally in the SKS stock as uncertainties on the sector still remain.

In a meeting earlier in the day, RBI deputy governors Shymala Gopinath and K.C. Chakrabarty told heads of leading banks that they should restart lending to microfinance institutions (MFIs) in Andhra Pradesh as long as they don't default. During the meeting, RBI asked bankers to find ways to continue lending to the sector and proposed consortium lending to MFIs, a banker who attended the meeting said.

Bankers are likely to meet at the Indian Banks Association, an industry lobby group, to formalize ways to resume lending. Bankers are not ruling out restructuring of loans. "RBI has asked banks to start giving fresh loans in Andhra Pradesh, at least to the extent of their recovery from the state. The possibility of restructuring of the MFI loan portfolio was also discussed at the meeting," the senior banker said. He did not want to be identified, considering the

sensitivity of the matter. An RBI statement, released late on Wednesday evening, said although MFIs have met the repayment obligations to banks so far, "going forward this may be a matter of concern". "RBI sensitized the banks to the need to maintain funding lines to MFIs on merits to prevent contagion," the release said.

"The Indian Banks Association will shortly come up with concrete proposals for the measures to be taken in the interim, for consideration of Reserve Bank of India." The SKS stock had plunged 19.84% on 18 November to Rs.640.70, after the company said in a statement to the stock exchanges that its collections had fallen sharply in Andhra Pradesh where the microfinance ordinance (since become law) forced MFIs to move from a weekly to a monthly collection cycle. The SKS scrip, which was listed in August, has shed 55% from its peak.

In an unrelated development, SKS Microfinance informed the Bombay Stock Exchange that Sunil Kumar Bansal, vice-president (legal), company secretary and compliance officer, resigned on 20 December. The company did not cite any reasons for the resignation. Some analysts said Wednesday's rise in the SKS Microfinance stock was a correction after investors overreacted earlier, but uncertainties on recovery rates in Andhra Pradesh still cloud the outlook for the

sector. "I believe this (surge in share price) is because the larger message (is) that bank funding to the microfinance sector will be coming now," said Dilli Raj, chief financial officer of SKS Microfinance.

Even if banks start making fresh allocations to the sector, the problem of defaults on loans in Andhra Pradesh remains a key risk, said Pankaj Agarwal, an analyst at Ambit Capital Pvt. Ltd. "Right now, SKS is using repayments from other states to repay its loans to banks and at the same time limiting disbursement in those states," Agarwal said. "I don't think this is sustainable." Even if bank lending resumes, it won't grow at the rate at which it was growing prior to the crisis, limiting the growth prospects of the industry, Agarwal said.

"While existing allocations to the sector will continue, it would be unlikely for any bank to raise allocation to the sector unless there is more clarity on the risks associated with these loans," said Apurva Shah, head of research at Prabhudas Lilladher Pvt. Ltd. Bankers have indicated that MFIs may need to scale down their growth projections, the RBI release said. The central bank has appointed a committee headed by chartered accountant Y.H. Malegam to look into the regulation of the sector. The committee is expected to submit its report by January.

No microfinance, then what?

Anupama Chandrasekaran
Livemint.com, 29 December 2010
HYDERABAD/CHENNAI:

Encouraged by a stringent law to regulate the activities of the microfinance industry in their state and egged on by local politicians, poor borrowers in Andhra Pradesh have stopped repayments. Repayments fell below 20% from a much-trumpeted 99% before Andhra Pradesh issued the ordinance that preceded the legislation, according to a November report by **Credit Rating and Information Services of India Ltd.**

Such strategic defaults will undoubtedly ease the fiscal stress of overstretched borrowers in the southern state, some of whom are reported to have taken their lives because they couldn't meet payments. But this could drive poor families back to those who lend money at usurious rates. "If politicians start telling local people to not repay, quite a few microfinance institutions (MFIs) will shut down and the poor will be forced to seek credit with money lenders," said Justin Oliver, executive director of the Centre for Micro Finance, a think tank in Chennai.

Even as the national debate on microfinance continues to hover around issues such as the validity of the Andhra Pradesh regulations, the financial viability of microlenders in the state and the potential problems of banks that have lent to these MFIs, a visit to the areas where the repayment problem is rife tells a story of aggressive lending, immediate relief for borrowers and the revival of money lenders. About 110km from Hyderabad past paddy fields, the village of Domakonda branches off from a national highway.

Here, five lenders--Bhartiya Samruddhi Finance Ltd (part of the Basix group), L&T Finance Ltd, SHARE Microfin Ltd, Spandana Sphoorty Financial Ltd and SKS Microfinance Ltd parcelled out loans, processed in a few days, to village women at their doorstep. In 2007, 24-year-old Domakonda resident Hafeeza Sheikh borrowed up to ₹1.2 lakh from a local moneylender to finance her



policeman husband's Dubai voyage to become a construction worker. Soon after, the fast-talking seamstress and mother of two children enrolled with all five MFIs in the village to service various debts.

"All of these guys want money at any cost and it is a very fluid system," said Vijay Chidambaram of consultancy Centre of Gravity that in 2008 studied the financial pulse of 1,200 poor households in six slums in Bangalore. "So they will take money out of self-help groups (SHGs) to pay off microfinance debts and vice versa. The requirements of money and the way they handle it is haphazard."

An October report published by Centre for Micro Finance shows that multiple borrowing exists among 83.7% of the 1,920 rural Andhra Pradesh households surveyed, largely due to loans from informal sources. The study signalled 11.4% of the sample group borrowed from MFIs, 17% from moneylenders

and 53.5% had an outstanding loan from an SHG. A few women in Domakonda acknowledged they would even borrow from MFIs to lend to a friend who would pay the processing fees and shell out weekly or monthly payments. In return, the legal borrower would get a ₹1,000 cut.

With an income that barely helped her scrape through the month, Sheikh was obviously relieved when television news channels splashed news of the ordinance. She promptly stopped juggling ₹1,200 in average weekly payments against a monthly income of ₹5,500 after combining remittances from her husband. "I used to get tense paying off defaults of group members," said Sheikh in Hindi, pointing to the widely used joint liability or group guarantee system. Under this, MFIs offer a loan to groups of five women who have to pay up for defaulting or absconding team-mates. "Now, the kids go to school on time and we are also

eating better," said Sheikh, referring to the increased time and money available in the absence of weekly MFI meetings for payment collections.

The temporary relief hasn't completely unshackled her fiscal duress. She still has to repay the ₹1.2 lakh that she borrowed from a moneylender at 36%. And recently, when her mother was prescribed medical tests as her blood pressure shot up, the family borrowed ₹4,000 from a pawn broker against a gold chain, a ring and a pair of silver anklets. It also hurt her chances to make some extra money by trading sarees, for which the MFI loans provided working capital within days as against SHG loans that took at least a month or two to be processed.

"The current conflict between MFIs and the government has become intense because of the nature of regulation," said Narasimhan Srinivasan, a former development banker and the author of State of the Sector Microfinance India Report. "It does little for customer protection and more for business restriction." P. Jayamma, a 35-year-old mother of four children and a cleaner in a neighbouring college, lives in the

redeveloped slum of LB Nagar in south Hyderabad. A few years ago, Jayamma borrowed from India's largest MFI, SKS Microfinance, to help her husband buy a ₹65,000 autorickshaw. Her family graduated to an attached toilet in their home using several cycles of MFI loans, more recently from **Chennai-based Equitas Micro Finance India Pvt. Ltd.**

Like Sheikh, Jayamma finds the nonpayment wave a relief. But she's uncomfortable with monthly instalments of interest and principal loan amount and worries that her husband's daily income of ₹300-400 from driving the autorickshaw that easily supported weekly repayments will be frittered away. "I'm illiterate, but I do know that a monthly payment will make things tough and so we've requested MFIs to consider fortnightly payments," said Jayamma in Hindi. "The new system also increases our liability when someone defaults."

In a situation where there's multiple lending, a non-paying borrower pinches fellow members across several MFI groups. Taking on multiple loans of

others hurts the financial health of the remaining group members, who get pushed into a debt trap to meet ends. The current credit drought, as fresh MFI loans dry up, has already brought out the loan sharks. Jayamma said moneylenders have approached slum dwellers with loans at 60-100% interest. Still, Domakonda's Sheikh claims she is done with MFI borrowings and is waiting get a share of an SHG loan that is likely to be sanctioned by a bank in January. At an 11 December meeting with government officials, she chimed in with other women for better access to SHG loans at interest rates as low as 3%.

"The microfinance institutions' idea was to minimize contact with clients and maximize business," said M.S. Sriram, a former professor at the Indian Institute of Management, Ahmedabad who has been on the board of several MFIs. "There was no engagement with the clients to provide a suite of financial services. Naturally, public support slipped. "This is the first of a three-part series. Next: MFIs are discarding the model that seeks to sign up as many customers as possible and trying to focus instead on a smaller crop of clients.

Form consortium for MFI lending, RBI tells banks

The Financial Express, 23 December 2010
Mumbai:

The Reserve Bank of India (RBI) on Wednesday asked banks to follow a consortium-based lending approach to finance the micro finance sector. **RBI deputy governor Shyamala Gopinath and KC Chakravarty** met the chiefs of commercial banks to review their exposure to the microfinance sector. "In keeping with bankers suggestions, RBI has asked banks to form a consortium to lend to MFIs," said a senior State Bank of India (SBI) official, adding that it was decided that bankers would monitor the portfolio and jointly take a decision on release of additional funding to MFIs.

SBI has an exposure of about Rs 853 crore to the MFI sector. **Bandhan Financial Services (Bandhan), SKS Microfinance and Share Microfin are the major borrowers of State Bank of India.** "The consortium of lenders would vary for each MFI," explained another senior banker present at the meeting. "Each consortium will take a decision on the rescheduling of the loan as requested by the MFI," he added.

Mathew Titus, executive director Sa-Dhan had told FE, recently that the industry body had requested banks for a three month moratorium on repayment of loans. "It would take three months for full scale repayments to pick up," he had said. **Sa-Dhan has about 264 micro finance institutions (MFIs)** as its members. Titus also added that the MFI sector would need emergency funding of Rs 2,000 crore. The for-profit MFIs would require Rs 1,200 crore and not-for-profit MFIs would require funding to the tune of Rs 800 crore.

The central bank is concerned about banks' exposure to the sector after the AP government passed a Microfinance Bill last week bringing lending by the sector to a standstill and badly hurting collections. Banks have an exposure of about Rs 15,000 crore to the sector of which 30 to 35% is in AP. Small Industries Development Bank of India has an exposure of about Rs 5,000 crore by way of equity and debt to the MFI sector. The RBI has formed a committee under YH Malegam to look into the functioning of the MFIs and their regulation. This committee will submit its report in three months.

Small loans can end global poverty

Dilip Mookherjee

Financial Express, December 14 2010

In the name of protecting India's poor, the state government of **Andhra Pradesh has caused deep turmoil** in microfinance. A new law clearly signals that borrowers need not repay their small-scale loans. Not surprisingly this has led to large-scale default, throwing the industry in India into a crisis it may not survive. This is having repercussions for microfinance worldwide.

As a result, **the sense is growing that microfinance itself is a flawed idea.** Some have even drawn parallels between this crisis and the sub-prime disaster. But this is badly misguided. Microfinance institutions are highly focused on avoiding default. The historic default rates in India have been close to zero, reflecting trust built over many years. If borrowers are encouraged to default en masse the system will fall apart, and a valuable financial product will disappear. This, in short, is a crisis born of government intervention, not flaws in microfinance itself.

If this sector collapses Indian banks will suffer losses, while commercially viable efforts to lend to the poor at reasonable rates will be thwarted for years to come. Clients will have found out that it is possible not to repay. Banks will learn that doing business with the poor is riskier than it need be. India's poor will, once again, have to rely either on failed public-sector efforts for financial inclusion, or on money lenders. It is even possible that this crisis could scare capital away in other countries too, threatening a sector that currently serves more than 200m poor borrowers across the world.

Microfinance fills a vital need in developing countries: the provision of financial services to those on low-incomes who lack access to formal banking. It is not a silver bullet that ends poverty, as is sometimes claimed. But studies have shown sound evidence that it allows many of the world's poorest people to develop businesses, insure against bad weather and illness, maintain employment, and smooth consumption. Its main innovation is not lending to the poor – but doing so at lower cost, and with lower interest rates, than informal moneylenders. Microcredit can be profitable, but its

profits, at least in South Asia, come mainly from large volumes rather than large mark-ups.

To be sure, India's microfinance industry is not without its problems. Microfinance institutions charge rates ranging from 18 to 35 per cent. This looks higher than regular banks, creating the impression that microfinance is inequitable. But this impression needs to be tempered by the fact that credit card rates are quite similar. The costs of lending small amounts to vast numbers of poor people who lack collateral or credit records are high anyway, which is why they are often excluded altogether from formal credit channels. Microfinance manages to provide some credit access at rates substantially below the informal market, which ranges from 30 to 120 per cent.

Other problems in microfinance relate to its rapid growth. Loan officers are given financial incentives to recruit more clients, and may not screen them adequately. Anecdotal evidence suggests over-indebtedness of clients is a problem, while there are also rumours of debt-related suicide. Yet tragic though these problems are, we must remember that rural indebtedness is mostly a problem caused by loans from non-microfinance sources, and, in particular, from old fashioned money lending.

The priority now should be to stop the current crisis. Andhra Pradesh should withdraw its ordinance. Microfinance also does need better regulation, but the primary focus should not limit interest rates or profits. Instead, it should reform rules to help microfinance institutions better screen borrowers, thereby lowering costs. Other initiatives can help too, such as new ways to investigate client grievances and better enforcement of the code of conduct for credit officers.

When it works well microfinance really can be a win-win. Institutions need to be more diligent in their lending – but politicians also need to be wary. In taking aim at the occasional overstep, they may inadvertently destroy microfinance itself. That would be a disservice to the world's poor, and their hopes of climbing out of poverty.

Abandoning scale for closer ties

Microfinance institutions are discarding the model that seeks to sign up as many customers as possible and trying instead to focus on a smaller crop of clients

Anupama Chandrasekaran
Livemint.com, 30 December 2010
Hyderabad/Chennai:

There couldn't have been a more inopportune moment to trumpet the growth story of India's largest and only publicly listed microfinance company SKS Microfinance Ltd. The Andhra Pradesh government's strict law on microfinance institutions (MFIs) was not the only reason the October launch of **SKS founder Vikram Akula's autobiography looked ill-timed**. It was also because the world described in his *A Fistful of Rice*, quite simply, had changed.

Through his narrative, the former McKinsey and Co. consultant paints a picture of a fast-growing microcredit business mimicking the time-crunching processes followed by the world's largest hamburger chain, McDonald's Corp. But some micro creditors are discarding the mass-scale, fixed-price, fast-credit menu offered by Indian MFIs.

"We get five people according to a **Grameen Bank** model, offer them a single non-collateralized loan requiring periodic payment," said Ramesh Ramanathan of **Janalakshmi Financial Services**, which focuses on the urban poor in several Indian states, referring to the Bangladeshi pioneer of microfinance. "We've somehow defined this plain vanilla product as the end-game rather than an intermediary point," Ramanathan said. "None of us who are in microfinance, whether we are promoters or field officers, access our financial needs through a group loan."

Micro financiers such as Janalakshmi, **Kshetriya Gramin Financial Services** (KGFS) and **Equitas Micro Finance** are giving up on the push to get as many customers as possible, through a variety of loan and even savings or related products, to a small crop of customers. Following the Andhra government's October directive that enforced interest rate restrictions and longer repayment schedules, putting at risk Rs. 9,000 crore of outstanding microloans in the state, the MFI sector seems ripe for reinvention. "It is complicated to offer multiple financial products and micro creditors may not be able to afford it on a large scale," said

Vijayalakshmi Das, a director at Ananya Finance for Inclusive Growth that has Rs. 460 crore in outstanding loans to 130 MFIs across a dozen Indian states.

"But it is what the poor need and, finally, that approach is profitable too. Even two to five lakh (200,000-500,000) members offer a fantastic base." Two-year-old KGFS—one of the first micro creditors to borrow from Ananya—has **125,000 customers** with just three operations across Tamil Nadu's Thanjavur, Orissa's Ganjam and Uttarakhand's Tehri Garhwal districts. Just 40% of its customers borrow at an 18% all-inclusive interest rate on a reducing balance. The majority are non-borrowers who invest in money market mutual funds and insurance products.

As credit and non-credit services are sold unbundled, KGFS claims to cover 60% of households in its target geographies as against an average 10% of a village that a microfinance company usually reaches. "We set up branches in small geographies and justify its cost by serving more people," said Anil Kumar, chief executive of **IFMR Rural Finance**, the parent company of KGFS. Each branch, costing Rs. 3.5 lakh, covers 2,000 rural households and breaks even in 14 months. "You've got to decide whether the process is key or is it the customer." Over a decade, India's top 10 MFIs focused on processes to shrink a loan officer's time on field while creating a widely distributable loan product.

As a result, costs per borrower in India halved from Rs. 620 in 2000 to one of the lowest in the world at Rs. 298 in 2010, according to rating agency **Micro Credit Rating International Ltd, or M-CRIL**. The quick, low-cost service garnering 99% repayments saw average loan sizes double over a decade to Rs. 7,783 in 2010 shows M-CRIL's November report. But this led to looser ties with increasingly debt-ridden customers who, under the joint liability system and in an environment of multiple lending, had to foot several debts of a defaulting group member. "Today, most microfinance companies have a brittle relationship with their customers," said Janalakshmi's Ramanathan, who doesn't have a stake in Janalakshmi Micro Finance and, therefore, no share in its profits as part of a corporate governance measure.

Ramanathan has interests in related **not-for-profit Janalakshmi Social Services, or JSS**. "A multi-product offering makes customer relationships stick as it offers more value to the users." With about 200,000 customers across eight states, Janalakshmi is hoping to turn profitable next year through loan and savings offerings. In November 2009, the non-banking financial company (NBFC) started offering a pension product that requires borrowers to pay Rs. 100-300 a month up to the age of 58 with a choice to get a lumpsum or monthly amount at the end of it. Two months ago, JSS, which largely offered financial advice to borrowers, turned business correspondent for **Axis Bank**. In September, the **Reserve Bank of India (RBI) said companies, non-government organizations, cooperatives and post offices could collect deposits and disburse loans for banks**.

NBFCs, including for-profit MFIs, were not allowed to take on this role. While this was a blow to MFIs, Ramanathan legally leveraged the non-profit JSS to log 35,000 savings accounts for Axis Bank through a 150-strong sales force, which currently targets non-borrowers. It will spread to five more cities over the next three months. Despite the legislative barrier to collecting deposits—a nominal source of funds when compared to 12-18-month bank loans at 10-12% that MFIs take—some new-age, for-profit MFIs are balancing cost pressures through technological efficiencies.

"Having a low-cost position is becoming important as interest rates are coming down hard and to achieve it you need to have good efficient lean processes or be large scale," said **Sumir Chadha, managing director of Sequoia Capital India**, a US venture investor with investments in SKS and Equitas. Floated in 2007 by former banker **P.N. Vasudevan, Equitas, an NBFC** lauded in the industry as being technologically progressive, kicked off operations with a Rs. 50 lakh centralized core banking software that can accommodate deposits in case the MFI wins a banking licence in the future. Currently, MFIs are prohibited from collecting customer savings like a bank. Within three years and despite being relatively small scale, Equitas' operating

expenses stand at 8.9% of assets or outstanding loans, close to that of industry leader SKS and much lower than peers such as **Ujjivan Financial Services Pvt. Ltd.**, logging 17%.

“We are dealing with a large number of people carrying out tiny transactions and if you don't have processes and systems in place, you cannot control operating risks or frauds,” said Vasudevan. He chose a central model over a branch-based data

unit with 100 people to key in and double-checks customer information shipped from 163 branches across five states.

As part of its ecosystem to serve low-income customers, Equitas has an allied for-profit arm that supplies vegetables to loan customers keen to earn a living selling produce. There's also a non-profit company, **Equitas Dhanyakosha** that provides groceries at cost to members on

a monthly Rs. 1,000 credit. These services will continue if they are accessed by at least 25% of its currently 1.3 million borrowers having Rs. 956 crore in loans outstanding. “The moment you have food security it cuts down on health expenses with indirect impact on income,” said Ananya's Das. “MFIs have to choose if they want to grow faster through a single product or think of the household and gradually link up with (a) basket of services.”

Microfinance, Macro Effects

Vishal Mehta

The Indian Express, 3 December 2010

Recently there has been a lot of debate on the Andhra Pradesh government's ordinance effectively preventing microfinance companies from operating in that state, as well as its alleged causes, including multiple lending and coercive collection practices by MFIs that have supposedly forgotten their social mission. However, the widespread criticism of microfinance and the Centre's and the RBI's unwillingness, so far, to step in decisively risks making an already bad situation even worse. Indeed, we risk throwing out the financial inclusion baby along with the supposedly muddy microfinance bathwater.

One should first recognise that over the last decade, MFIs have been able to provide credit to over 25 million poor households, eclipsing five decades of government efforts. And they were able to do this despite charging higher interest rates than banks or government programmes — so clearly there has to be something right about the customer-centricity of their model. Indeed, MFIs in India emerged largely out of social-driven enterprises, for most of whom profiteering was not the sole objective.

Even if one does not agree with that, the fact that MFIs have played a role in starting a real, more scalable financial inclusion movement in India, especially compared to the public sector, means it is important to step back and analyse the positives and negatives of the model rather than getting carried away by the venal campaign of a particular group of state politicians.

Let's start with scale as a non-negotiable objective. Clearly the microfinance sector has done well on this metric, for instance by successfully scaling up the human resources required for their high-touch, low-tech business model. And this scaling up was achieved in a high-growth scenario, as MFIs increased their clients by 60 per cent every year since 2007; and in a fairly competitive landscape, with hundreds of MFIs competing in India with several other informal (moneylenders) and formal (banks, large NBFCs) lending sources. So we cannot ignore the efforts behind this scale-up, and the business model that achieved it efficiently.

The delivery of most public goods in India still suffers from the “last mile” servicing problem. Government efforts have been based on mandates rather than an incentive-based approach. If cracking the last mile is a consistent and vital piece of the inclusion challenge, any potential solution, like the Indian microfinance model, deserves a good look. MFIs have demonstrated that a viable last mile solution exists in

delivering basic services that the BOP (base or bottom of the pyramid) segment badly needs. A closer look at the business elements of the MFI model could help us learn how to develop better last mile channels elsewhere.

If these are their key positives, where have MFIs failed? They have successfully created a business model that serves the BOP, thereby creating value for themselves and their shareholders in a sustained manner. But they have not figured out how to share with customers the value that is being created. And we are back to the same old conventional business models where, most of the time, the value distribution is skewed towards the top and largely limited to shareholders and management.

And for the BOP segment this sharing is a “must-have” factor — even if from a pure business strategy approach — because this segment will always be close to the political class, for both the right and wrong reasons. Right, because they ought to be the focus given the lack of access to even the most basic services. Wrong, because any politician will get nervous when other channels are also able to provide critical services to a segment she thinks of as “my constituents”. So any private business model that wants to target this politically-active customer segment needs an adjustment to its business approach. And one clear way of doing so is to keep the customers at the very centre of the business. This will make the politicians less anxious and keep most shareholders happy at the same time.

It will be a pity if we let the MFI model go to waste — and the AP government's ordinance is a surefire way to kill this sector. The Centre needs to curtail the Andhra crisis, and urgently, given the liquidity situation: banks have heavily reduced financing to MFIs. Any solution should discourage other state governments from Andhra-type knee-jerk reactions.

It is clear that MFI customers will be at the losing end if the microfinance model takes a hit. Customers are bound to lose out on availability of credit, as well as through increased credit costs — especially in unbanked geographies which are reached mainly by smaller, regional MFIs that are most at risk with liquidity in the sector running thin. If we agree that customers' interest should get prioritised over other stakeholders, the AP crisis begs immediate banking and political support to the microfinance sector. Otherwise, this could potentially undermine India's financial inclusion success story in the name of protecting the poor, which would be very unfortunate.

SBI likely to seek restructuring of MFIs loan

The Economic Time, 24 Dec, 2010,
MUMBAI:

Country's largest lender State Bank of India (SBI) today said it could seek restructuring of loans given to **Micro Finance Institutions (MFIs)** if they turn non-performing. "Wherever (MFI loans) are likely to fall sick restructuring will have to take place," SBI Chairman O P Bhatt told reporters after bestowed with best banker of the year award by the Business world here.

Restructuring of loans involves deferment of loan repayment by the borrowers in case of problems. MFIs are facing tough time following crisis that erupted in Andhra Pradesh. The problems in the microfinance sector

erupted after the Andhra Government imposed restrictions on activities of the MFIs following spate of suicide by harried borrowers. Yesterday, the RBI asked the banks to maintain funding lines to MFIs to prevent the problem from fanning out of Andhra Pradesh. The concern stems from the fact that there has been cases of default.

The bankers had informed the RBI that collections by MFIs in Andhra Pradesh have deteriorated considerably and there were some incipient signs of the problem spreading to other states. Although there has been no default in repayment obligations to the banks by

the MFIs till November 2010, RBI had said, "going forward this (repayment) may be a matter of concern."

The banks urged the RBI to work out interim arrangement to deal with the problem. They suggested that the banks be allowed to reschedule exposures to MFIs subject to the condition that such institutions reduce exposure and scale down growth projections. Besides, the lenders also demanded regulatory concessions for averting any crisis and preventing contagion spreading to other states. Meanwhile, SBI was also given most socially responsible bank of the year award.

SHGs to function as bank 'business correspondents'

The Hindu Business line, 9 December 2010
Kolkata

The West Bengal government is planning to introduce the concept of "business correspondents" through self-help groups (SHG), who will act as representatives on behalf of the banks in rural areas. The proposal was discussed here at a meeting between the **West Bengal Finance Minister, Dr Asim Dasgupta, and the RBI Governor, Dr D. Subbarao.**

"The idea is to ensure greater financial inclusion and widen the reach of the banks in different rural areas," Dr Dasgupta said. Under the scheme, the banks will identify self-help groups who will act as "business correspondents" and lend money on behalf of the banks. A six-month training programme will be conducted by the National Bank for Agriculture and Rural Development (Nabard) after which these people will be appointed as business correspondents.

The State government has also proposed to pay 50 per cent of the remuneration that will be given to such business correspondents. According to the Finance Minister, the banks have so far identified 252 business correspondents. The matter is likely to be taken up for discussion at a meeting with all the bankers on December 10. The decision comes at a time when the State government has time and again complained that lending by the banks in the rural areas and reach of banks in different villages are very poor.

According to statistics available with the State Finance Department, there are around 39,000 villages in the State. Of these, 7,486 do not have any bank branches. While targets set by the Union Finance Ministry point out that 2,581 of the villages should have at least one bank branch by March 31, only 324 of these 2,581 villages have bank branches at the moment.

The RBI Governor pointed out that the State government has been asked to identify places where bank branches could be set up. SHGs have been chosen keeping in mind their track record and performance over the years, Dr Dasgupta said. SHGs have a 93 per cent loan repayment track records while they have an NPA of 2.19 per cent. The loan to savings ratio of SHGs in Bengal is 2.6 per cent.

Government asks banks to submit MFI loan, NPA data

Manojit Saha
Business Standard, December 3, 2010,
Mumbai:

Two months after the crisis in the microfinance industry broke out, resulting in the possibility of bank loans to the sector becoming non-performing, the government now wants to do a reality check.



Last evening, the finance ministry dashed off a letter to public sector banks, S m a l l

Industries Development Bank of India and National Bank for Agriculture and Rural Development, asking them to furnish data on how much exposure they have to the MFI industry, how much is re-paid and what is the amount of non-performing loans. Banks have to submit data till November 30 on all the

microfinance institutions (MFIs) they lend to. The state-level bankers' committees have also been asked to furnish loan details.

Following the problems in MFIs, which broke out in October, banks had stopped lending to MFIs, especially those having bulk of the business in Andhra Pradesh, fearing building up of non-performing assets (NPAs). MFIs' collection of debt dropped below 10 per cent in Andhra Pradesh due to an ordinance issued by the state government. **The Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Ordinance, 2010**, which came into effect on October 15, stipulates that MFIs should register with the project director of the district rural development agency. MFIs are also banned from weekly collection in the state.

MFIs raise 75-80 per cent borrowings from banks, 15 per cent from equity,

and another 10 per cent from other cash flows like cash securities. Interest rates charged by MFIs could be as high as 32 per cent, bankers said. Earlier, the government had asked banks to ensure that the interest rates charged by MFIs were capped at 24 per cent. Following the crisis, the Reserve Bank of India (RBI) set up a committee under Y H Malegam, a senior member on its board of directors, to study the issues in the sector and come out with suggestions for making interest rates charged by MFIs reasonable.

RBI regulates only those MFIs, which are registered as non-banking finance companies. The RBI-regulated MFIs cover more than 80 per cent of the microfinance business. But in terms of number of companies, they constitute a small percentage of the total number of MFIs in the country. The central bank, however, does not prescribe lending rates for MFIs.

Microfinance aiding farmers

The Assam Tribune, 21 December 2010
Guwahati,

“To make democracy function effectively, we must have inclusive growth. Microfinance has given a choice to those who were earlier excluded from the traditional institutional mode of finance. Since more than 80 per cent of Indian farmers do not get loans from such institutions, emergence of micro-finance has been beneficial to the rural poor.”

Dr Amiya Sharma, executive director of the Rastriya Gramin Vikash Nidhi (RGVN) opined this at the fourth Bhabananda Deka memorial lecture held at the Pragjyotish College on Saturday. The annual lecture was organised under the aegis of the Economic Planning Forum, Department of Economics, Pragjyotish College.

Dr Sharma, in his lecture, sounded a note of caution against the unscrupulous elements that are entering into the field of microfinance. “There is a need for

regulating microfinance so that the poor are no longer exploited in new ways. Educational institutions like the Pragjyotish College should come forward for networking so that the actual beneficiaries get the right message timely. This will further ensure right type of action for those who have been excluded from the country's growth process for a long time,” he added.

Earlier, Dr Dayananda Pathak, principal, Pragjyotish College paid homage to the late Bhabananda Deka, former principal and HoD, Economics of Pragjyotish College. Dr Pathak said that late Deka was not only a scholar in economics but also a prominent writer who wrote books on economics in Assamese, making the subject intelligible to one and all in Assam. The function was presided over by Atanu Kr Chowdhury, HoD, Economics, of the college.

Margins of MFIs should be capped: Rangarajan

Business standard, December 20, 2010,
Hyderabad;

'Margin should be adequate to cover the transaction cost and the risk element'. After suggesting that microfinance institutions (MFIs) change their 'flawed' business model, **C Rangarajan, Chairman of the Prime Minister's Economic Advisory Council**, today said MFIs' interest rate margins should be capped.

"I suppose one approach is to fix the margins of MFIs so that the margin they enjoy is not really too high. The margin should be adequate to cover the transaction cost and the risk element," he told media persons on the sidelines of the foundation day fete of skill-development firm, TalentSprint.



While refusing to specify the figure for such a cap, he said "that (number) depends on the rate at which they borrow and the rate at which they lend." Further, to a query on the interest range suggested by the Andhra Pradesh Government in its report to the **Malegam Committee, appointed by the Reserve Bank of India** to study the microfinance sector, he said the report needs to be examined by the committee. Earlier, he had asserted that the business model adopted by MFIs that are facing rough weather in Andhra Pradesh, should undergo a change.

"The whole idea of encouraging microfinance is to encourage credit for income generating activities," Rangarajan had said. "One of the problems that have surfaced recently is that they (MFIs) have been indulging in multiple lending and a large parts of the loans are given for consumption purposes. This is the model that will land them in trouble," he had said.

On the issue of a need for a separate regulator for MFIs, Rangarajan said the report of the Malegam committee needs to be taken into consideration before a decision is taken in this regard. "We need to wait for the report. **The Non-Banking Finance Companies (NBFCs)** are theoretically under the regulation of RBI. So far, they looked at the liability side of the NBFCs. Now they should look at the assets side also and think what kind of regulation can be thought out," Rangarajan said. On inflation, he said that by the end of December it (inflation) could come down to 6.5 per cent and will further come down to 5.5 per cent by March 2011.

Important Upcoming Events

- Programme on “Development of microfinance Facilitators in Banks acting as SHPI” , 7-11th Feb 2011, Lucknow, conducted by BIRD
- Programmes on “Formation & Financing of JLGs”, 14 – 17th Feb 2011, Lucknow, conducted by BIRD
- Training Programme on “Regulation of Microcredit Institutions and the Implications of Basel 3” , 23-25th Feb 2011, Kent, United Kingdom, conducted by Microfinance Association
- “Enabling SHG members to Graduate to Micro Enterprises”, 28th Feb – 4th Mar 2011, Lucknow, conducted by BIRD
- Programme on Micro Insurance, 28th Feb – 2nd Mar 2011 , Lucknow, conducted by BIRD
- National Microfinance Conference 2011 on “Re-engineering Microfinance: Need for New Products and Policies”, 15 – 16th Mar 2011, New Delhi, organized by Sa-Dhan & FICCI
- Financial Analysis for Microfinance Practitioners, 21-25th Mar 2011, Kent, United Kingdom, conducted by Microfinance Association