Bharat Microfinance Report 2011: SIDE BY SIDE

Microfinance: Under Scrutiny But Resilient

Sa-Dhan
The Association of
Community Development
Finance Institutions

Citi Foundation

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Mission of Sa-Dhan

"To build the field of community development finance in India, to help its members and associate institutions to better serve low income households, particularly women, in both rural and urban India, in their quest for establishing stable livelihoods and improving their quality of life."

Effective microfinance is to be realized not in terms of the speed of growth, but in the creation of long term relationship between the MFI and client, between communities and communities. Basically, banking is relationship, not mere finance. Relationship continued relationship, relationship of trust. It is through this relationship that the poor women like any other client, gain a sense of security and confidence to plan to take risk in her life and livelihood. And eventually develop a stable livelihood.

Smt. Ela R Bhatt
Founder, Sewa Bank

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Preface

Microfinance sector in India has achieved incredible growth in terms of both client outreach and loan portfolio till October'2010. During the last one year, the growth is in a downward trend because of the microfinance crisis. Now the sector is under the scanner of stakeholders. The microfinance bill and RBI's directives on 3 May 2011 have come as breather to all of us. However, the fund flow from banks, which had slowed down immediately after the crisis, is yet to pick up momentum.

The task before all of us is to build the confidence of the stakeholders to revive their support which we had been enjoying till last year. In this context, I think there are three areas of our domain deserving our special attention. One is the need for articulating the fact that microfinance is a strategic part of financial inclusion agenda of the government and the central bank. The second is the criticality of re-demonstrating our collective intention to help the poor and the unbanked populace by way of right mission, social performance and client protection. The third area is projecting the fact that microfinance institutions are sustainable financial institutions and they continue to be the investable destination for the bankers and the investors.

In order to articulate these positions, we need empirical data. This report has been designed to provide newer perspectives on the above three areas. Primary data received from 172 Sa-Dhan members and other MFIs who represent around 95 percent of the client / the credit portfolio of MFIs in India and analysis thereon are the basis for this report. Chapter 1 and 2 provide insights on microfinance in the context of financial inclusion. Similarly, Chapter 3 and 4 carry inputs on financials of MFIs. Chapter 5 is a futuristic one with reflections for better client protection and sustainable sector.

Sa-Dhan has been publishing Bharat Microfinance Report for the past seven years. This year, in spite of MFIs preoccupation with operational issues as fallout of the crisis, 172 MFIs reported data including 57 non-member of Sa-Dhan. We thank them for reposing confidence in us and valuing transparency through data reporting.

Under my over all supervision, a dedicated team at Sa-Dhan secretariat consisting of Dr.K.Natarajan and Mr. Ardhendu Nandi spearheaded the report work with active support of their colleagues Mr. P.M Kamalesh and Mr.Thomas Mehwald. I appreciate them for their meticulous collection of data through repeated follow up with members, validation of the data through reiteration process, analysis and compilation of the report. I appreciate the data collection support rendered by Mr.Krishna Reddy, Mr. Susanta K.Behera and Mr. Habib Shaik from their respective regions of operation.

We are grateful to Mr. C.S.Ghosh, Mr. Royston Braganza, Mr. R.Prabha, Mr. Aseem Gandhi, Ms. Reena Mittal, Ms. Mona Kachhwaha, Mr. Parasuram Nayak, Ms. Maneesha Chadha, Mr. D.Narendranath and Mr. Atul for their guidance and feedback on the draft report.

Special thanks to Ms. Achla Savyasaachi, Vice President, Mr. K.Balasubramanyam, General Manager for their suggestions and comments for bringing out this report.

We gratefully acknowledge the generous funding support of Citi Foundation which enabled us to collect voluminous data, compile and publish the report.

We acknowledge the institutional support being extended by FORD FOUNDATION. Our work would not have been possible without the patronage of Ministry of Finance and Rural Development, GoI, RBI, SIDBI and NABARD.

We have attempted to provide some new insights in this report in the light of the present crisis. We hope this would be useful to you. We look forward to receiving your comments and suggestions for improvement.

Mathew Titus
Executive Director

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List of Abbreviation

ABCO	Average Borrower per Credit Officer
AP	Andhra Pradesh
BPL	Below Poverty Line
CD Ratio	Credit-Deposit Ratio
CDR	Corporate Debt Restructuring
CEO	Chief Executive Officer
CGAP	Consultative Group to Assist the Poor
CGTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises
CHI	Cashpor House Index
CIB	Credit Information Bureau
CoC	Code of Conduct
CRAR	Capital to Risk (Weighted) Assets Ratio
CRR	Current Repayment Rate
DAS	Data Acquisition Sheet
D-E Ratio	Debt-Equity Ratio
FER	Finance Expense Ratio
FI	Financial Inclusion
FIF	Financial Inclusion Fund
FWWB	Friends of Women World Banking
GDP	Gross Domestic Product
HR	Human Resource
IDF	India Development Foundation
IFMR	Institute for Financial Management and Research
IIMS	Invest India Market Solutions
IRDA	Insurance Regulatory and Development Authority
IT	Information Tecghnology
MD	Managing Director
MFDEF	Microfinance Development and Equity Fund
MFIs	Microfinance Institutions
MIS	Management Informatiom System
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Finance Company
NCD	Non-Convertible Debenture
NGO	Non- Government Organization
NOF	Net Owned Fund
NPA	Non Performing Assets
NSSO	National Sample Survey Organization
OER	Operating Expense Ratio
OSS	Operational Self Sufficiency
PAR	Portfolio at Risk
RBI	Reserve Bank of India
RoA	Return on Asset
RoE	Return on Equity
SC/ST	Schedule Caste/ Schedule Tribe
SHG	Self-Help Group
SIDBI	Small Industries Development Bank of India
SLBC	State Level Bankers Committee
SME	Small and Medium Enterprises

Glossary

ABCO
ABCO is an acronym for Average Borrower per Credit Officer, a measure of client – staff ratio. It is also known as Case Load

AP-based MFIs
Andhra Pradesh (AP)-based MFIs are those MFIs having head quarters in Andhra Pradesh and operation in Andhra Pradesh and other states

Average Loan Size
Average Loan size represents the client-per capita loan amount. It is calculated as: The Loan portfolio divided by the number of clients of an MFI.

Below Poverty Line (BPL)
Below Poverty Line is an economic benchmark and poverty threshold used by the government of India to indicate economic disadvantage and to identify individuals and households in need of government assistance and aid.

Capital Adequacy
Capital Adequacy is the means of measuring the solvency level of MFIs which is an important indicator of risk bearing ability of the entities. It is the proportion of the capital/own fund held by an MFI against its total asset

Capital to Total Assets
Ratio of net worth to total assets

Current Repayment Rate (CRR)
Current Repayment Rate (CRR) is the proportion of client loan and interest amount recovered / repaid out of the total loan and interest amount due as on a particular date.

Debt Dependence
Debt Dependence is the proportion of total assets funded by bank loans and outside debts.

Debt–Equity Ratio
Debt-Equity Ratio is the proportion of total debt borrowed to the total equity held in a given point of time.

Debt Funding
Debt Funding refers to the percentage of loan portfolio funded by outside borrowings

External Cost
External Cost here refers to Finance cost which is determined by the lending rate of banks and hence is beyond the control of MFIs

Finance Cost
Finance Cost here refers to the interest and other expenses incurred on average bank loan outstanding in the books of MFIs. This does not include notional cost of utilizing the equity fund.

Financial Inclusion

Financial Inclusion is the delivery of financial services at affordable costs to sections of disadvantaged and low income segments of society.

Financial Solvency

Financial Solvency here refers to financial strength of an MFI. Solvency among MFIs indicates the financial risk bearing ability of the entities, especially in the event of unforeseen shocks leading to financial loss.

Gross Domestic Product (GDP)

Gross Domestic Product (GDP) refers to the market value of all final goods and services produced within a country in a given period.

Internal Cost

Internal Cost here includes Operation Cost (Operating Expense Ratio- OER) which in turn comprises of Personnel cost, Administrative cost, Depreciation and Miscellaneous Cost.

Interest Rate Cap

Interest Rate Cap refers to the interest rate ceiling of 26 percent fixed by RBI chargeable by MFIs from the loan lent to their clients.

Leverage

Leverage is generally measured as the amount (in multiples of own capital amount) borrowed from outside sources including banks.

Margin

Margin refers to the difference between the finance cost on portfolio and the total yield on portfolio. This term is analogous to the concept of Net Interest Margin (NIM) widely used in banking parlance. Margin Cap refers to the ceiling of Margin of 12 percent fixed by RBI.

Malegam Committee

Malegam Committee is the RBI Board Sub- committee, under the chairmanship of Y.H.Malegam, which investigated the issues affecting the microfinance sector and submitted report to the RBI in 2011

Managed Loan Portfolio

Managed Loan Portfolio is the loan asset originated by MFIs and later sold to banks for getting liquidity. The MFIs continue to manage it - collection of repayment on behalf of the banks which purchased the portfolio.

Operating Expense Ratio

Ratio of staff, travel, administration costs, other overheads and depreciation charges of the MFIs (non-financial costs) to the average loan portfolio during a year

Operating Model

Operating Model of an MFI in this report refers to the model under which majority of the clients are served by the MFI. The same MFI may serve a small portion of clients under other models also.

Operating Self Sufficiency (OSS)
Operating Self Sufficiency (OSS) shows the sufficiency of income (operating income and investment income) earned by MFIs to cover the cost like operating cost, loan loss provision and finance cost, incurred for conducting the operation.

Other State MFIs
Other State MFIs are those MFIs having head quarters in states other than Andhra Pradesh and having main operation in any of the states (mainly outside of Andhra Pradesh)

Portfolio at Risk (PAR)
PAR indicates the proportion of outstanding amounts of all loan accounts having past due/arrears to the total outstanding loan. In general, PAR 60, i.e., the portfolio / part of the portfolio remaining unpaid 60 days and beyond crossing the due date, would be used as a measure to assess the portfolio quality.

Qualifying Assets
Qualifying Assets are loan portfolios created by MFIs adhering to certain conditions to make the MFIs eligible to be called as MFIs and to raise loans from banks under Priority Sector Advances Scheme (as per recent RBI norms).

Return on Asset (RoA)
Return on Asset (RoA) is the universally accepted profitability measure which, in essence, is the percentage net income earned out of total average asset deployed by MFIs during a given period, say a year.

Return on Equity (RoE)
Return on Equity (RoE) is the net income earned out of average equity of MFIs held by MFIs during the given period.

Self Help Groups (SHGs)
SHGs refer to groups of 10-12 women coming together to form a semi formal community based institution to meet their common financial and social needs. SHGs are linked to mainstream banks for depositing surplus savings of the SHGs and to obtain loans (popularly known as SHG Bank Linkage Programme –SBLP)

Yield on Portfolio
Yield represents total income from microcredit operation-Interest income, processing fee/ service charge – earned out of average loan portfolio outstanding. It does not, include investment income. It is a good proxy / surrogate for loan interest rate.

Zero Tolerance Policy
It is generally refers to the tendency of MFIs not to 'tolerate' (entertain) loan repayment default by their borrowers

Executive Summary

The Context

Microfinance has been recognized as one of the potent tools to address the issue of poverty. The positive outcomes of experiments in SEWA bank in Gujarat and initiatives of leading NGOs like MYRADA and PRADAN encouraged the Reserve Bank of India (RBI) and the National Bank for Agriculture and Rural Development (NABARD) to nurture Self Help Group (SHG) movement in India which started with the onset of SHG - Bank Linkage in the year 1992. Also, considering the fact that around 50 percent of working population does not access banking services, the RBI recognized Microfinance Institutions (MFIs) as extended arms of banks to reach out to unbanked populace.

As per the NABARD data (2009-2010), there are over seven million Self Help Groups operating in India. They facilitated small savings / borrowing among the poor women numbering over 5 million. Over 1000 MFIs, most of them operating in southern and eastern India, borrow funds from banks to on-lend to over 30 million clients across the country.

The microfinance sector is undergoing a phase of transition now. The MFIs have started paying more attention to the importance of keeping a balance between financial sustainability of their operations and client level improvements from their credit services. MFIs in Andhra Pradesh State, with maximum concentration of microfinance operation, have been subjected to a well intended but restrictive measures imposed by Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Act 2010. Consequently, the banks, whose funds constitute 85 percent of MFIs resources, have become extra cautions and slowed down release of loans during the past one year. This development brought the sector to a screeching halt. The growth in client outreach and loan volume has retarded during 2010-11.

The RBI is the sole regulator of financial services in India. This being the case, the Andhra Pradesh act, 2010 has inadvertently created a regulatory arbitrage, apart from crippling the functioning of MFIs. The RBI thoughtfully, constituted a Board-subcommittee under the Chairmanship of Y.H.Malegam to study the issues surrounding MFIs. The committee submitted its report suggesting a host of measures to put the MFIs functioning in order. The report provides a much-needed blue print for best practices and standards of operation.

In the meantime, the Government of India brought out a draft bill, Microfinance institutions (Development and Regulation) Bill 2011 with a move to regulate hitherto 'unregulated' MFI-sector.

These two measures of the RBI and the Government have instilled a sense of optimism among MFIs and banks whose loans worth ₹17000 crores is at stake in the sector.

The Target Audience for the Report

The report purports to provide a primary based analytical information to the government, policy makers, the central bank and the apex finance institutions, banks, MFIs, technical service providers for better understanding of the issues for making appropriate interventions.

The Data behind the Report

The report has been compiled out of analysis of primary financial and non financial data filed by 172 MFIs from across India. The reporting MFIs represent over 95 percent of clientele or portfolio in the country. The profile of the reporting MFIs is given in Annexure 1 & 2. In addition secondary data from

NABARD and RBI reports and published literature have been used to widen the perspectives of the coverage.

The report team scrupulously scrutinized the audited financial statements of 110 MFIs to make the financial data and its analysis reliable. All other financial and non-financial data have been used as they were reported by MFIs. The validity of content of report, thus, hinges on the accuracy of the data self-reported by the MFIs. However, suitable desk validation efforts taken by the report team, accompanied by cross checking with the reporting MFIs wherever incongruities were noticed, would make the report dependable.

The Report coverage

This report probes into the role of microfinance in financial inclusion, outreach to different social segments of population, remote geographies, credit dispensation with different products, and a theoretical model on the practical feasibility of financial inclusion through MFIs (Chapter 1).

It also attempts to provide landscape of microfinance services in terms of client outreach and outstanding loan portfolio, loan disbursed, average loan, growth rate including the negative growth experienced during 2010-11 across geographies and types of MFIs (Chapter 2).

It as well seeks to analyze financial performance of MFIs in terms of cost structure, yield and sustainability in the light of Malegam Committee recommendations (Chapter 3).

The financial solvency (strength) of MFIs in terms of Balance sheet composition, liquidity, quality of loan assets, debt structure, fund flow from banks after the microfinance crisis, MFI rating etc is also covered (Chapter 4).

Finally, it explores changes in practices among MFIs, changing role of funding agencies, urgent steps to be taken by the government, the SIDBI and the NABARD, special role of Association and Technical service providers to overcome the present stalemate and build robust system for sustainable microfinance.

The Content Highlights

Chapter 1: Microfinance and Financial Inclusion

- The Government of India and the Reserve Bank of India with measures like microfinance bill, India Microfinance Equity Fund of ₹100 crore, SHG Fund of ₹500 crore and priority sector credit facilities to MFIs etc., have recognized the role of microfinance in Financial Inclusion
- The SHG movement has helped over 8 crore poor women to accumulate savings worth ₹6200 crore and obtain small loans ₹28000 crore as of March 2010.
- The SHG movement has to receive further impetus in North and North- Eastern states.
- MFIs have consistently raising volume of credit made available to the clients located in rural and remote geographies, belonging to different social segments.
- The clientele of MFIs included more than 95 percent women, disabled people, religious minorities, SC /ST communities and Below Poverty Line households.
- MFIs offered products ranging from microcredit, micro insurance, savings, and remittance. Most of the credit availed from MFI are apparently used for income generation purposes.

Chapter 2: Client Outreach, Portfolio Size and Growth Rate of Indian MFIs.

- MFIs operate in 517 districts of India spread across 27 states
- The total MFI -client outreach as of March 2011 was 3.17 crore while the total microcredit outstanding was ₹20276 crore. In addition, MFIs 'manage' estimated loan portfolio of ₹2500 crore which have been securitized to banks.
- During 2010-11, the microfinance through MFI -channel has grown 18.75 percent in 2011 in terms of client outreach and 13.15 percent in terms of credit portfolio.
- This year loan portfolio growth rate has come down heavily to 13.15 percent compared to 56 per the previous year.
- MFIs collectively disbursed ₹33730 crore as loans to clients during 2010-11. The average loan per client stood at ₹5706 which is less than that of last year figure of ₹9766.
- In 2010-11, more than one-third of MFIs displayed negative growth in client and loan portfolio.

Chapter 3 : Financial Performance of MFIs

- The Reserve Bank of India had brought in a condition of Qualifying Asset by which the MFIs should create loan assets that would meet certain conditions like maximum loan amount of ₹50000, at least 75 percent of loan to be given for income generation purpose etc. for availing loan under priority sector credit schemes from the banks.
- The data provides evidence to reasonably conclude that Indian MFIs in general possess Qualifying Asset.
- The cost structure of MFIs showed that the operating cost of MFIs has been, in general, higher than what the Malegam Committee had estimated last year. MFIs, in all likelihood, would find it difficult to contain the Margin (Yield over Borrowing cost) within the cap of 12 percent set by the RBI.
- MFIs may be able to restrict their loan interest rate within the cap of 26 percent.
- The MFIs, in general, are self sustainable meeting their expenses out of their income, leaving, of course, just a marginal surplus to meet their growth needs.

Chapter 4: Financial Solvency of MFIs

- MFIs liquidity position has deteriorated apparently due to the drying up of bank funds to MFIs.
- The liquidity position has further been compounded by increasing Non-Performing Asset (NPA). The NPA (Portfolio at Risk in MFIs parlance) has gone up to 4 percent as of March 2011, while the loan repayment rate comes down significantly. The non-performing assets among Andhra Pradesh-based MFIs is at the all time high of over 96 percent as of September 2011.
- MFIs ere dependent heavily on the bank debt for their operation. Larger MFIs with more than ₹ 500 crore portfolios held 78 percent of total bank debt made available to the sector by banks. The share of small MFIs in the bank debt is very insignificant.
- The larger MFIs appeared to have availed bank loan relatively at lower interest rate (12 percent) compared to their smaller counterparts (13 percent)
- Due to reluctance of banks to release funds after the crisis, bank borrowing by MFIs has come down by > 75 percent during the period April- September 2011 compared to the corresponding period in the previous year.

- Restructuring of sticky bank loans in the books of MFIs, caused by liquidity crunch and spike in NPA, is an urgent step required. At present the facility is available only for very large MFIs.
- The leverage of capital of MFIs (Debt-Equity Ratio) has come down to 4 times. Their capital adequacy ratio is above 15 percent, which is in line with the norm prescribed by the Reserve Bank.
- Around 50 percent of reporting NBFC-MFIs could meet the minimum Net Owned Fund of Rs.15 crore suggested by the central bank.

Chapter 5: New Paradigm for Effective Microfinance Services.

- The microfinance crisis could be viewed as serendipitous development helping to consolidate the sector. The sector can become robust to serve unorganized population better through joint efforts of MFIs, Funding agencies, the Government and the apex institutions and Sa-Dhan.
- MFIs have to undergo reengineering process. They need to revisit their mission and governance structure.
- The growth strategy is critical. Turbo-charged intensive growth in a given geography without adequate systems / trained manpower will compromise client protection. The rate of growth of the sector in any case cannot be more than 50 percent.
- The per capita (staff / client) investment of large MFIs and MFIs with high growth on staff training or MIS was found to be relatively lower compared to their smaller counterparts.
- MFIs need to choose investors who are patient and not profit- seeking.
- The MFI-sector has a work force of 105000 of whom 14000 are women and 63500 are field staff. The employee turnover is high (over 32 percent). This trend needs to be reversed through employee training and right incentive system.
- MFIs products need to be more flexible in terms of repayment schedule and tenor matching the client household cash flows.
- Client protection and transparency deserve top priority of MFIs. MFIs need to do away with Zero Tolerance policy to client loan default. They need to provide consultative solutions to delinquent clients' problems; communicate interest rate to clients in a transparent manner.
- Banks need to support small MFIs as they are starved of adequate liquidity. MFIs may find it difficult to show 99 percent recovery in all circumstances. They are required to accommodate for genuine difficulties of defaulting clients. Banks, on their part, will have to raise the threshold tolerance level of PAR may be to 2-5 percent, while assessing the recovery performance of their client-MFIs.
- The Central Government may pass the microfinance bill early to avoid regulatory arbitrage prevailing at present. It may, with help of RBI, persuade banks and SIDBI for resuming lending to the sector to prevent small MFIs from going out of operation. The Government may, in consultation with SIDBI and NABARD see that the Guarantee fund at the disposal of SIDBI and technology and financial inclusion fund available with NABARD be put to use for the benefit of small MFIs.
- Andhra Pradesh Government may permit MFIs, under the provisions of the microfinance act, to collect the repayment and operate in a way to keep the momentum going. This would avoid the credit culture getting spoilt among the microcredit clients in the state.
- Sa-Dhan, as Community Finance Association, has insights on the sector gained over the past 12 years to extend supervisory support to the central bank, facilitate social investment, capacity building of NGOs/MFIs etc. The stakeholders could tap this potential to build robust sector for financing the poor.

Microfinance and Financial Inclusion

Financial Inclusion (FI)[1] is a very important agenda of the Government of India and the Reserve Bank of India. The Rangarajan Committee defines Financial Inclusion as "...the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost[2]". The committee has detailed out the mammoth credit gap prevailing among the Indian farm households. This herculean task of financial inclusion could be achieved through partnership among different financial service providers. Microfinance Institutions (MFIs) have proved to be credible partners with banks in taking the banking services to the unbanked and vulnerable population. This chapter highlights the stakeholder recognition of MFIs, their outreach to remote areas/different segments of the population, contribution of Self Help Groups and potential role of MFIs as practical partners in financial inclusion.

1. Stakeholder Position on Financial Inclusion and MFIs' Role

1.1 Reserve Bank of India

The Reserve Bank of India looks at core indicators, which place a given population on the continuum of financial access, depending on its usage of formal, semi-formal, and informal financial services and those excluded from the use of financial services[2]. In particular these are:

- the proportion of the population that uses a bank or bank like institution;
- the population which uses service from non-bank 'other formal' financial institutions, but does not use bank services;
- the population which only uses services from informal financial service providers
- the population which uses no financial services.

MFIs belong to non-bank 'other formal' financial institutions, providing services to people at the end of the access continuum.

Reserve Bank of India further clarifies that the degree of financial inclusion can be measured by looking into services offered. The services may be:

- Transactions or payment services
- Savings (deposit) and investment services
- Loan or credit services
- Risk transformation services such as insurance.

MFIs offer loan or credit services through small value, high volume transactions with unbanked or under banked sections of the population, facilitate savings among them by acting as Business Correspondents of banks, among Self Help Groups by linking them with banks, extend insurance services as agents of insurance service providers and offer money transfer services to migrant workers.

[1] Financial Inclusion is the process of ensuring access to appropriate finacial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections of the society in general and vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream institutional players (Dr. K.C.Chakrabarty, Dy. Governor-RBI, Presentation in September 2011

[2] RBI (2008) Report of the Committee on Financial Inclusion

The Reserve Bank of India (RBI) has extended policy support for MFIs, keeping in view the role of MFIs in the financial inclusion agenda. RBI included bank lending to MFIs as priority sector credit which helped MFIs to source resources to on-lend to low end poor clients. Its intervention to prescribe norms, through its board sub-committee (The Malegam Committee) for orderly growth of the sector, further reinforces its commitment to the sector.

1.2 Union Government

The Finance Minister in his 2011 budget speech[3] recognized the crucial role played by microfinance and announced a India Microfinance Equity Fund of ₹ 100 crore.

The finance ministry has proposed the draft Microfinance (Development and Regulation) Bill 2011 to regulate the MF-sector.

The preamble of the draft bill reiterated that microfinance sector is engaged in providing credit and other financial services to the poor households and their microenterprises as an extended arm of the banking system.

2. Self Help Groups and Financial Services

In the last two decade, Self Help Group (SHG) movement has contributed significantly to the expansion of financial services to the otherwise unbanked poor. It has also proved to be the most effective tool for financial inclusion, poverty alleviation, women's empowerment, and social change. Based on the data provided by NABARD annual report, 2009-10, with the coverage of around 90 million households, having savings bank-linkages for over 7 million SHGs, and credit bank-linkages for over 6 million SHGs, the SHG model in India has emerged as the largest microfinance model.

SHGs have made a lasting impact on the lives of the women particularly in the rural areas. Their quality of life has improved a lot. There is an increase in their income, savings and consumption expenditure. This shows an improvement in their standard of living. The women have gained self-confidence. They can speak freely in front of large groups of people. They got recognition in the family and society. SHGs have also given women a greater role in household decision making.

2.1 Savings of SHGs with Banks

The SHG bank linkage data of NABARD shows that there are seven million SHGs in India. The southern region has maximum penetration of SHGs with more than 32 lakh Self Help Groups whereas the North-eastern region lags behind with less than 3 lakh groups. Around 20 percent of the total population is takes part in SHG activities whereas only around 10 percent of the population is covered in Northeast. But the coverage is lowest in the Northern region where less than 2 percent of the entire population gets engaged in group activities.

As on 31 March 2010, a total of 70 lakh SHGs were having saving bank accounts with the banking sector with outstanding savings of ₹ 6198 crore as against 60 lakh SHGs with savings of ₹ 5545.62 crore as on 31 March 2009, thereby showing a growth rate of 13.6 per cent and 11.8 per cent, respectively. Thus, more than 970 lakh poor households were associated with banking agencies under SHG-Bank Linkage Programme.

As per the status of microfinance in India 2009-10, the average savings per SHG with all banks had marginally decreased from ₹ 9060 to ₹ 8915 as on 31 March 2009.

[3] RBI (2009) Report on Currency and Finance 2008

Average savings per SHG is highest in southern region with ₹ 9848 per group and lowest in north-eastern region with ₹ 4164 per group. In terms of states, Goa tops with ₹ 3865 per member followed by Jammu and Kashmir whereas Manipur has lowest savings per member with only ₹ 144 per member.

2.2 Loans to SHGs through Bank Linkage

Except in North-eastern and Central regions, SHGs linked more to the Commercial banks than any other forms of financial institutions. Around two-thirds SHGs are linked to commercial banks in Southern parts whereas a little more than one-third of SHGs are linked to commercial banks in the North-eastern region where regional rural banks are more popular and cater to half of the SHGs. Cooperative banks are more active in western region and show almost no presence in the Central region.

During 2009-10, average bank loan disbursed per SHG was ₹ 91083 as against ₹ 76128 during 2008-09. The average loan per SHG ranged from of ₹ 100050 per SHG by Commercial banks to ₹ 57629 per SHG by Cooperative Banks.

As on 31 March 2010, almost 5 million SHGs were having outstanding bank loans of ₹ 28038.28 crore as against 40 lakh SHGs with bank loans of ₹ 22679.85 crore as on 31 March 2009, representing a growth of 14.8 per cent in number of SHGs and 23.6 per cent in bank loans outstanding against SHGs.

2.3 SHG Federations

The mature SHGs are federated to build community owned financial institutions. Over 200,000 SHG federations emerged and providing many valuable services like sustenance of SHGs after withdrawal of promoting agencies, promoting new SHGs cost effectively, promoting and managing the quality in SHGs, acting as interface between SHGs and mainstream institutions

3. MFIs' Reach to the Unreached

In this section the penetration of MFIs to different geographies and social segment is discussed

3.1 MFIs- Growing in service of the unreached

The Microfinance Institutions have consistently been increasing their outreach and loan outlay to the excluded people over the past one decade (Figure1 & 2). Their coverage remains low compared to the total demand. The current (March 2011) client outreach is 3.17 crore and the total loan amount made available stands at ₹ 20756 crore.

Figure 1 : MFIs Surging to Reach out to the Unreached Every Year

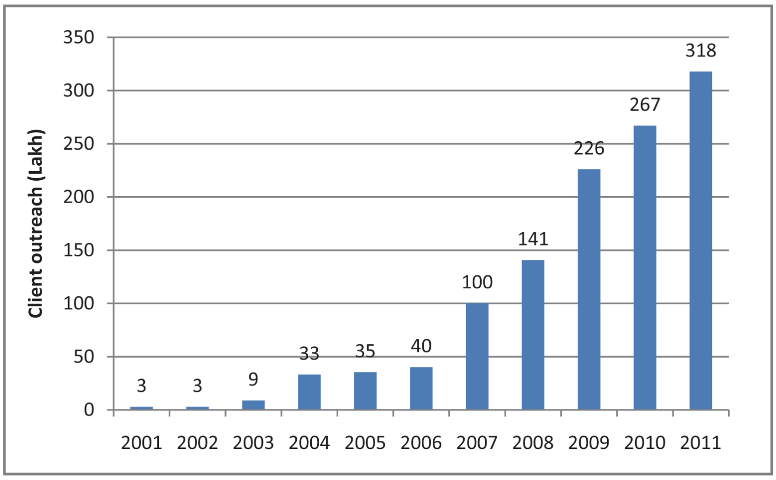
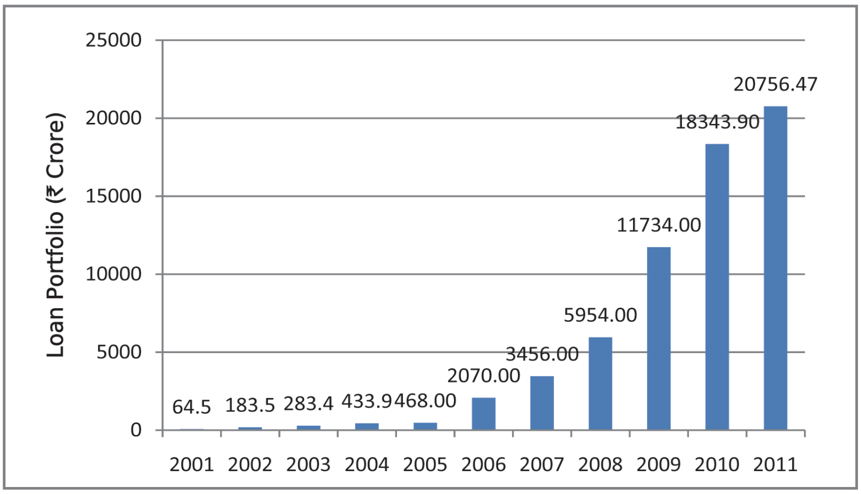


Figure 2 : A Decade Long Microcredit as Factors of Production to the Poor



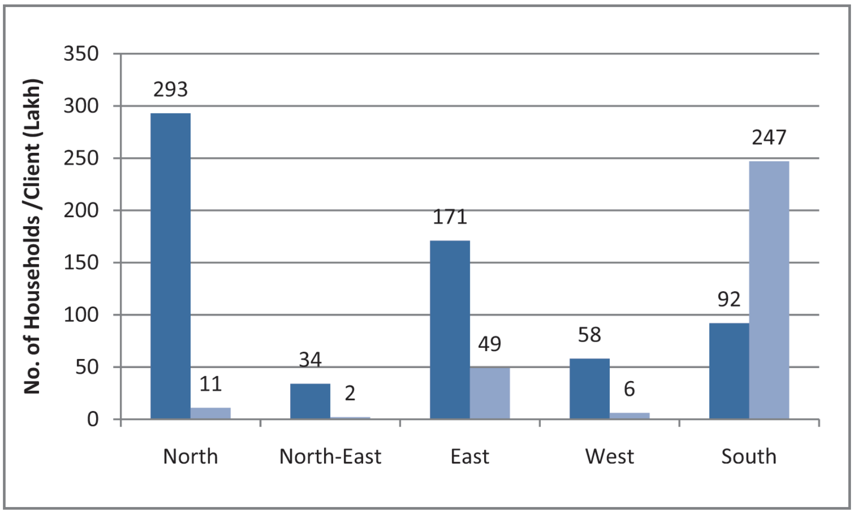
3.2 MFIs in Regions of Non-Indebted Farm Households

Farm households in India are financially excluded to a wider extent. As per NSSO[4] data, 45.9 million farm households in the country (51.4 percent), out of 89.3 million households have no access to credit, either from institutional or non-institutional sources. Only 27 percent of the total farm households are indebted to formal sources. In other words 73 percent of farm households do not have access to formal credit sources.

MFIs do cover clients across different regions where the financially excluded farm households are present. MFIs do not specifically target farm households. However, Sa-Dhan data set for this year indicates that 16 percent of the loan portfolio has been borrowed by clients of the MFIs for agriculture purpose indicating the outreach to farm households. Comparing MFI client outreach in different regions showing figures of excluded farm household could, therefore, be meaningful.

The regional distribution of the excluded farm households and the MFI clients is plotted in Figure 3.

Figure 3 : MFI Clients in the Regions of Excluded Farm Households



The number of MFI clients in all regions is fewer than the excluded farm households except in Southern regions. This is a rough indication of the requirement that MFIs need to focus on regions other than southern region for better complementing the financial inclusion agenda of banks.

[4] National Sample Survey Organization

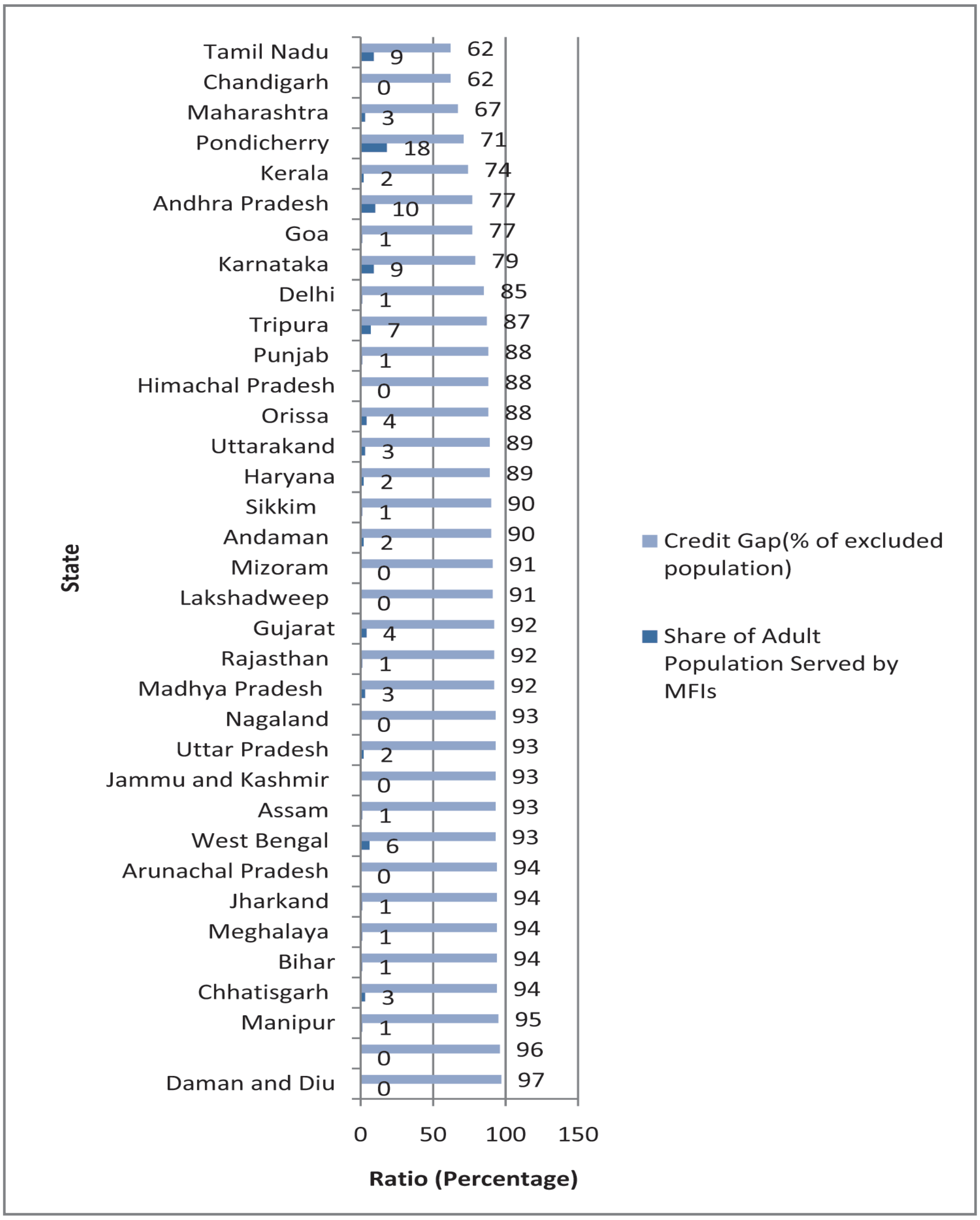
3.3 Client Outreach to Indian States and Districts with Credit Gap

Using 2010 RBI data[5] we calculated simple credit gaps for the states of India. Credit gaps and corresponding share of MFI clients in adult population in each state are shown in Figure 4. The graph shows the outreach of MFIs to states with varying credit gaps. Of the states with high credit gaps, outreach to West Bengal, Chhattisgarh and Madhya Pradesh are worth mentioning.

Similarly, the Rangarajan Committee on Financial Inclusion identified 256 districts where the financial exclusion is severe. According to the committee, a district's exclusion was labelled as 'severe' when the rural & semi-urban per branch population is more than 19,272 and their corresponding credit gap is more than 95 percent as per 2005 data.

MFIs client outreach to these districts serves as an indicator for financial inclusion. The Outreach of MFIs to severely excluded districts is 1.13 crore which amount to 36 percent of MFI clients.

Figure 4: MFI Outreach Versus Credit Gaps in States



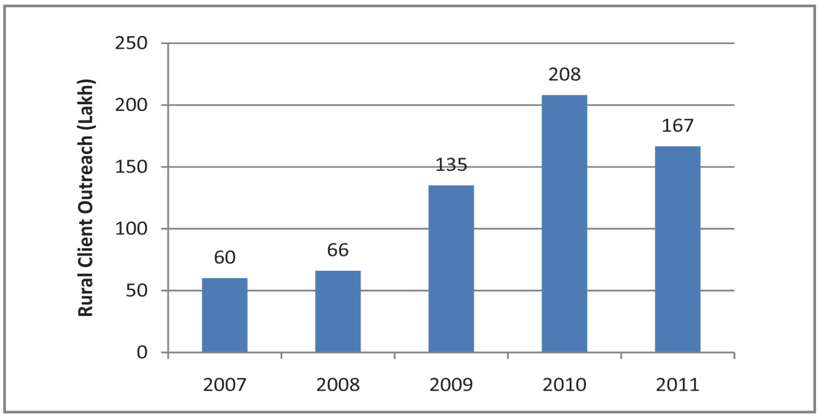
[5] Planning Commission (2008)

3.4 MFIs: Complementing in Rural Finance

Rural development in India is a top priority for the government. Rural finance constitutes important factors of production in villages. Informal sources including money lenders provide a major chunk of funds required by unorganized rural folks. Microfinance is apparently meant for reducing the dependence of the rural households on informal sources, whose services are prohibitively costly.

MFIs focus on rural areas, as evident from the rural client outreach and portfolio. Figure 5 shows rural penetration of MFIs over years. In 2011, MFIs had rural client outreach of 1.67 crore with total loan portfolio of ₹ 13501crore

Figure 5 : MFI -Rural Clients

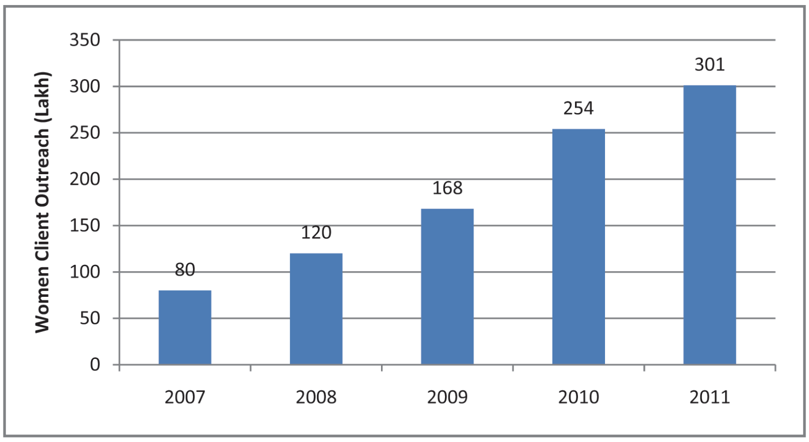


3.5 MFIs for Women Economic Strengthening

Statistics on women show the plight of Indian poor women. In India, women comprise 48 percent of the population but have only 26 percent share in the persons employed[6]. Women face a higher incidence of unemployment than men. Thirty two percent are cultivators, 39 percent are agricultural labourers and 7 percent work in household industry. Most of the women are illiterate and vulnerable while their role in child development and household activities are very critical.

Economic empowerment of women is one of the objectives of microfinance. Money put in the hands of women is put to use more productively and for household welfare. More than Ninety-five percent of MFIs clients are women. Figure 6 shows the trend in women clientele. MFI–client outreach, in effect, is synonymous to women client outreach.

Figure 6 : MFI- Women Clients



[6] van Klaveren, M, Tijdens, K., Hughie-Williams, M., Ramos Martin, N., (2010)

3.6 MFI Support to Scheduled Caste and Scheduled Tribe (SC /ST)

Poverty is common among SC/ST communities. Available data suggests that 36.8 per cent rural SCs and 39.9 per cent urban SCs live below the poverty line (in 2004–05) in contrast to the 16.1 per cent rural non-SC/ST and 16 per cent urban non-SC/ST population

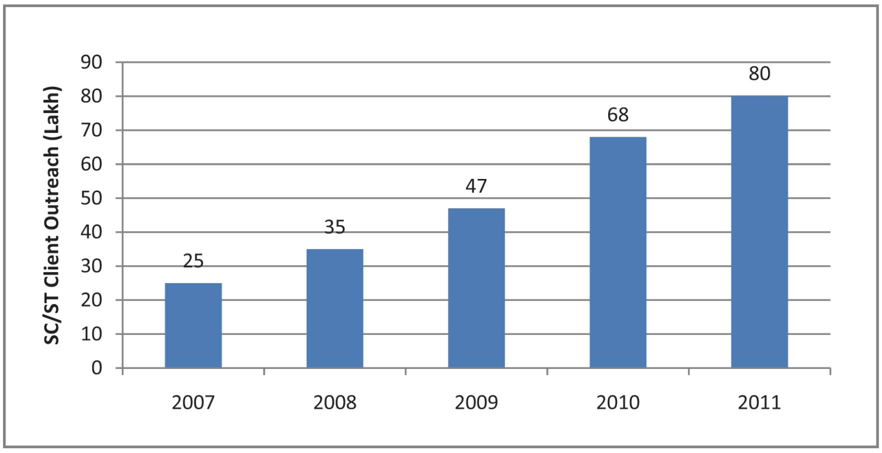
Government of India has been implementing many social projects for uplifting SC/ST Community[7].

The Rangarajan Committee on financial inclusion quoted that out of the total SC farm households of 119.24 lakhs, 75.94 lakhs (63.69 per cent) were non-indebted (excluded) from financial services. Similarly, of 155.93 total ST farm households, 77.60 lakhs (49.77 percent) farm households were excluded.

Loans to SC/ST clients also is one of the sub components of Priority Sector target set by the Reserve Bank of India to scheduled commercial banks. Thus, SC/ST client outreach is an indicator of inclusive finance.

MFIs exposure to SC/ST community is meant towards making credit available for their betterment. Sa-Dhan has been collecting disaggregated data from its members on their outreach and portfolio to SC/ST clients. Figure 7 indicates that the MFIs have consistently been increasing the coverage of SC/ST clients over the years.

Figure 7 : Increasing No. of SC/ST Clients with MFIs



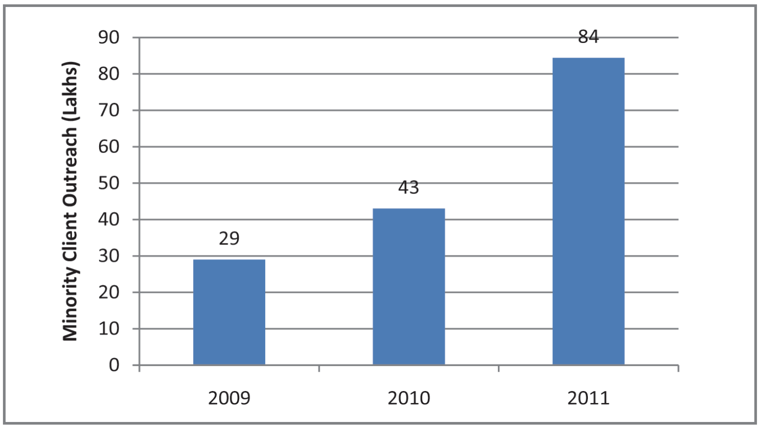
At the end of March 2011, MFIs collectively offered loan to SC/ST clients with outstanding of ₹ 5041 crore.

3.7 The Religious Minority – Among the MFI Target Segment

Loans to minority clients again constitute a sub target under priority sector lending set for banks. Religious minority like Muslims, Parsees, Sikhs, Buddhist and Christians are important segments of MFI clients. The coverage of this segment is growing (Figure 8)

[7] Planning Commission (2011)

Figure 8 : Growing Outreach to Minority Clients



MFIs have loan assistance made available to the minority clients with outstanding of ₹ 5389 crore as of March 2011.

3.8 Below Poverty Line (BPL) Households as Microfinance Beneficiaries

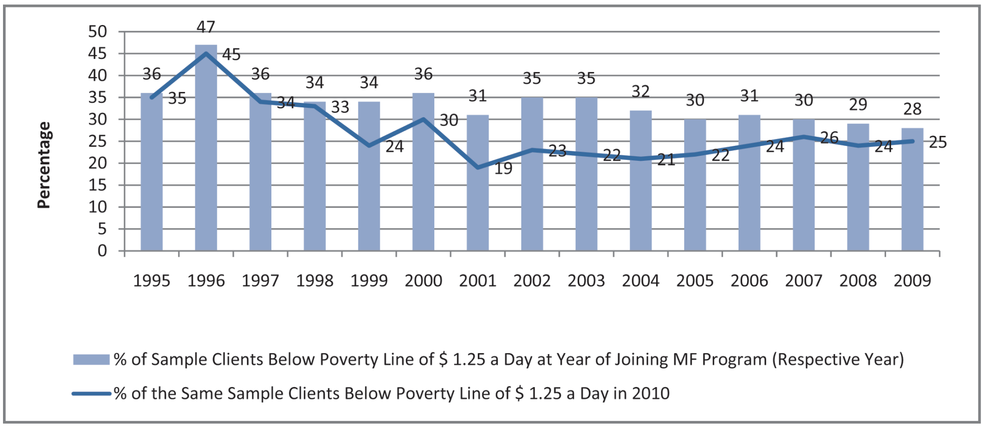
Poverty is widespread in India. The Tendulkar committee estimated that 40.74 percent of the population live below poverty line[8].

MFIs have, as part of their clientele, BPL households. Cashpor India, a Sa-Dhan member, for example, extends credit only to women from households living below the official poverty line income (BPL), as identified by their field staff. They use the Cashpor House Index (CHI), adapted to conditions in eastern UP and Bihar to identify likely BPL families. Bandhan Financial Services, another Sa-Dhan member, has special program for hard- core poor.

Sa-Dhan, for the first time collected data from its member – MFIs on the outreach to the Below Poverty line clients. BPL[9] card issued by the Government has been taken as the yardstick by the reporting MFIs. In 2011, total BPL clients reached out by MFIs are 36 lakhs. The BPL clients had outstanding loan of ₹ 2706 crores.

Grameen Keota, the member based in Karnataka, has tracked the position of their clients poverty level over a period and found that 22 percent of their clients ,who were below the 1.25 USD per day income earlier, moved above that threshold level. Many other members like Ujjivan and others are tracking the poverty level of their clientele.

Figure 9: Microfinance Households Below $1.25 a Day Consumption



[8] Planning Commission (2009)

[9] Poverty definition of the Tendulkar Committee and the criteria used by reporting MFIs are different.

Sa-Dhan facilitated a study on microfinance and poverty conducted by India Development Foundation (IDF) among Sa-Dhan members[10]. The household sample size for the study was 14746 availing services from MFIs. The study measured poverty levels of microfinance clients. The results of the study, as extracted from the IDF study report, are presented in Figure 9. The study compared the percentage of sample households having consumption threshold expenditure of below $ 1.25 a day at the time of study (2010) and at the time of joining the microfinance programme in different years.

The study result indicated that, all in all, at all India level, approximately a net of 12 percent (9 million) of all MFI clients (74 million) have crossed the $ 1.25 a consumption threshold from below.

As can be seen from the graph, the largest drop in poverty rates was found among the clients who joined the microfinance program in 2003 (13 percent). This indicates that the clients can reap optimum benefit through associating themselves with the MFIs for about seven years.

3.9 Microfinance for 'Differently- Abled' People

Disabled people are among the most important segment for social targeting by the government. Planning commission in its eleventh Fiveyear-plan[11] has announced host of programmes / schemes to be implemented by various government departments: They are, among others

- Each ministry/department reserves not less than three percent of the annual outlay for the benefit of disabled persons as enjoined in the Persons with Disabilities Act,1995
- Income ceiling for availing assistance to be raised to ₹ 10000 per person per month.
- Loans for disabled people through commercial banks, Regional Rural Banks, and cooperatives on concessional terms for undertaking self-employment ventures.

Though reporting MFIs had been extending loan assistance to this segment for quite some time, Sa-Dhan, for the first time, captured data on disabled clients assisted by MFIs. As of March 2011, 42780 disabled clients have been covered with loan assistance outstanding of ₹ 28 crore.

3.10 Loan Products Suitable for Excluded People.

Financially excluded population is excluded not only because banks do not entertain them, but also because they do not find banks' products being convenient to them. They prefer products that are, for example, collateral free; carry less transaction cost; are delivered at their doorsteps; provide freedom on end utilization, etc. Bank products have constraints in having most of these features. Microfinance products encompass most of these missing features.

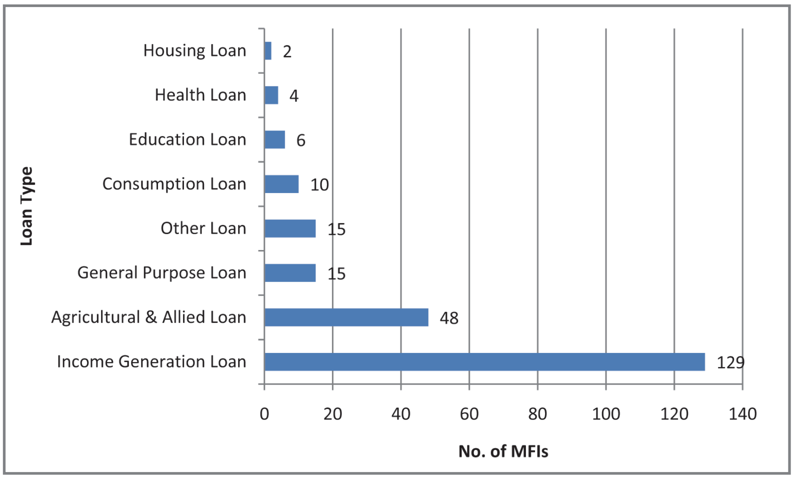
Interestingly, the freedom offered by MFI products is not misused by the poor women clients, as found from Centre for Microfinance study[12]. The study confirms that the clients put the loan into use mostly for productive purposes.

Among other things, the study found that 15 percent of the loan used for repaying old debts, 22 percent for home improvement, 11 percent for health services, 13 percent for purchase of agriculture inputs and such other purposes.

[10] India Development Foundation (2010)
[11] Planning Comission (2011)
[12] Centre For Microfinance (2010)

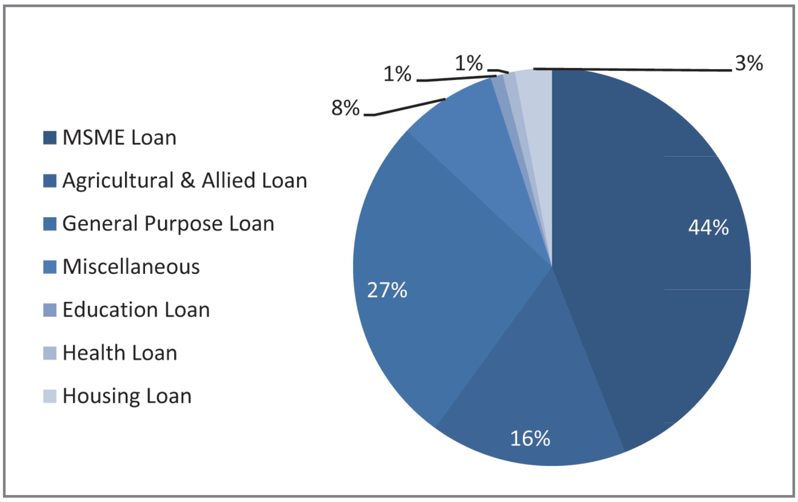
Sa-Dhan data analyzed in 2010 showed that many MFIs provided variety of loan products for the clients (Figure 10). Most of the MFIs provide income generation loan and agriculture loan.

Figure 10 : MFIs Providing Loans to Different purposes



Similarly, 2011 data showed the loan portfolio held by MFIs under different sub sector / utilized for various purposes. Figure 11indicates that major loan portfolio of MFIs is under Micro Small Medium Enterprises, Agriculture and General purpose. Incidentally, mainstream banks do not normally lend to the unorganized clients without collateral for these sub-sectors.

Figure 11 : Share of MFI Credit Portfolio under Different End Use



3.11 Micro Insurance – A critical Component of Inclusive Finance.

The Rangarajan Committee observed that poverty is not just a state of deprivation but has latent vulnerability. Micro insurance provides economic and psychological security to the poor. It is a key element in the financial services package for people at the bottom of the pyramid. The poor face more risks than the well off, but more importantly, they are vulnerable to the same risk. Usually, the poor face two types of risks – idiosyncratic (specific to the households) and covariate (common, e.g., drought, epidemic, etc).

Insurance Regulatory and Development Authority (IRDA) permitted NGOs, MFIs, and SHGs as micro insurance agents. MFIs have been extending micro insurance to their clients during the past few years.

Sa-Dhan member MFIs have been providing micro insurance to their clients by acting as corporate agents of insurance companies.

Sa-Dhan gathered data on beneficiaries and claim compensation facilitated by MFIs as of March 2011 (Figure 12 &13).The data showed that total clients covered under MFIs micro insurance program stood at 92 lakhs as of March 2011. The data from IRDA indicated that during 2010-11, micro insurance clients of 23.76 lakhs constituted insurance companies' new business[14].

Figure 12 : Micro Insurance Clients Served by MFIs

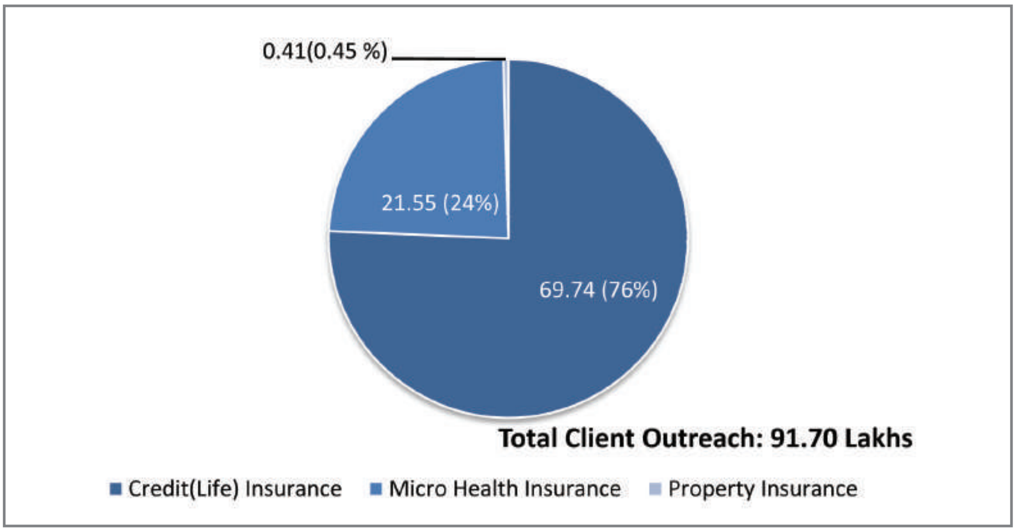
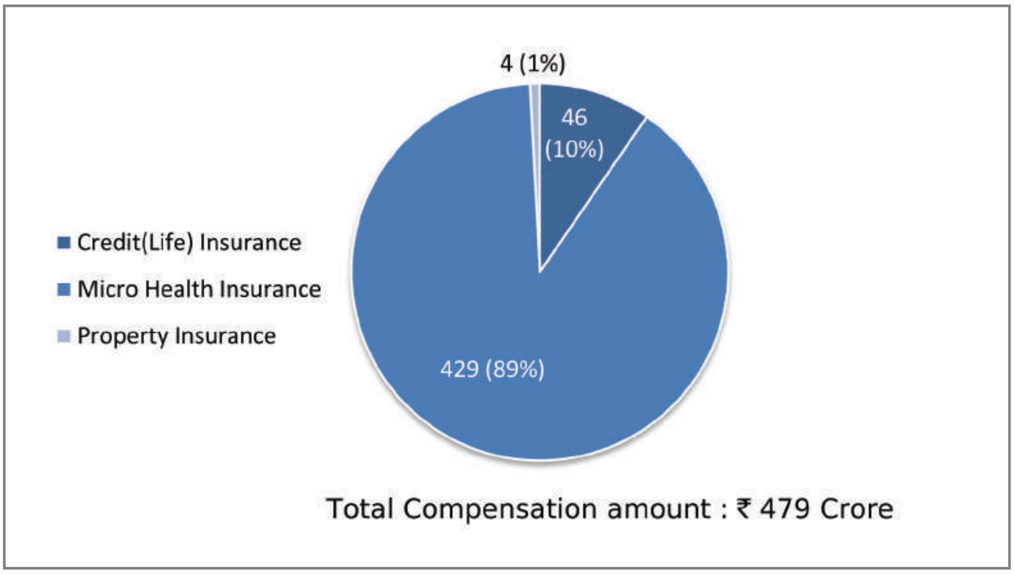


Figure 13 : Micro Insurance Compensation Obtained by MFIs (cumulative during the past three years)



Similarly, Sa-Dhan members facilitated cumulative insurance claim compensation of nearly ₹ 500 crore to their clients (₹ 54 crore during 2010-11 as per IRDA data).

Sa-Dhan does not have any benchmark to compare the micro insurance performance of its members. Yet, sheer fact that MFIs facilitated mortality/ morbidity / property loss-related financial compensation indicates the level of risk mitigation done to the livelihoods of the poor.

[14] Insurance Regulatory and Development Authority (2011)

3.12 MFIs: As Money Transfer Agents of Migrant Workers

Micro Money Transfer is a much-needed service required by migrant workers across India.

GIZ[15] estimated through a systematic study that there are up to 100 million circular migrant workers in India, who contribute as much as 10 percent to the national Gross Domestic Product (GDP). Circular migration has become a crucial livelihood strategy.

Remittances, as per the study, make up 80 percent of the cash income of the sample households in Uttar Pradesh for example. Within Maharashtra and from Gujarat to Rajasthan around 90 percent of the respondents carry cash themselves or send money back home through others. The average annual remittance per capita is about ₹ 20,000, and even the poorest of the migrants are sending money home.

Although access to banking services in urban areas is generally good, most migrants do not have a bank account at the urban destination point where they are working. Many migrant workers do not have adequate information about formal financial services, and many of those who have accounts with banks do not use them effectively.

Sa-Dhan members have been facilitating remittance among the migrant workers during the past few years. The remittance services rendered by Sa-Dhan members like Adhikar and BASIX are noteworthy. During the year 2011, 25 Sa-Dhan members collectively have undertaken 1675651 transactions involving remittance amount of ₹365 crore.

4. MFIs as Pragmatic Partners in Financial Inclusion: A Theoretical Construct

Banks as principal agencies of financial inclusion endeavour to bring all the excluded population under their ambit. The ideal financial inclusion agenda would be to wean away the high proportion of those borrowing from moneylenders, for example, and bring them under the fold of banks. This is a noble and lofty ideal. This saves a lot of borrowing cost on the part of the excluded population, but it involves enormous practical difficulties. This ideal agenda of financial inclusion is compared with a MFI-based and more practical agenda of financial inclusion as illustrated in Table 1.

As illustrated in the table, MFIs can act as stepping stones for full-fledged financial inclusion in the long run. The table uses the findings of IIMS (Invest India Market Solutions) household survey 2007 on the indebtedness of different income groups to different finance service providers[16]. As per the findings, 13 percent of the earners earning up to ₹ 50000 (a typical Microfinance client) a year avail services from banks, while 35 percent of them use services of money lenders. Only 1.1 percent of them obtain loans from MFIs.

The table shows savings of borrowing cost attainable by the borrowers under two different options of financial inclusion. It compares the concept of bringing clients of moneylenders directly to banks and the concept of using MFIs as intermediaries. As illustrated in the table, bringing the clients of moneylenders first to MFIs and then to banks will be an easier option rather than attempting to bring them under the fold of banks directly.

[15] GIZ (2011)
[16] Reserve Bank of India (2009)

Table 1: MFIs as Stepping-Stone for Financial Inclusion – A Theoretical Construct **

Parameter/ Proposition	Financially included	Financially Excluded	
	Borrowing from bank (Lender A)	Borrowing from MFIs (Lender B)	Borrowing from Moneylenders Lender C)
Percentage[18] of Indebted earners upto ₹50000 annual income (borrowing from)	13%	1.1%	35%
Estimated total number of borrowers [assuming all 40 crore BPL Population (40% of pop) belonging to less than of ₹ 50000 earners category and are intending to borrow.	5 crore (40x13%)	0.44 crore (40x1.1%)	14 crore (40 x 35%)
Borrowing rate (Interest rate) - Approx.	12% per annum	26% per annum	60% per annum
Borrowing eligibility assumed - maximum @ 40% of annual income (₹ 50000)	₹ 20000	₹ 20000	₹ 20000
Borrowing cost per annum of all potential borrowers	₹12000 cr [5 cr x20000x 12 %]	₹2288 cr [0.44 cr x 20000x 26%]	₹168000 cr [14 cr x 20000 x 60%]
Financial Inclusion Option 1 Bringing all the excluded to the banking system (All the excluded end up incurring borrowing cost @ 12% p.a)	Saving in Total Borrowing cost: ₹ 135632 cr [16000 + 2288 - 33600-1056]	₹ 1056 cr (20000x12%x0.44)	₹ 33600 cr (20000x12%x14)
Option 2 Bringing MFI clients to Banks & Money lenders clients to MFIs. Hitherto-moneylender clients start incurring borrower cost @ 26 %, first.	Savings in Total Borrowing cost: ₹ 96432 cr. [168000 + 2288 - 72800 -1056]	₹ 1056 cr (20000x12%x0.44)	₹ 72800 cr (20000x26%x14)
Feasibility of Option 1	*Very difficult option as the major chunk of borrowers of Lender C does not have KYC documents and repayment track records. Lender A is not geared to entertain that class without collateral.*		
Feasibility of Option 2	*Feasible option as Lender B covers such clients through alternative collaterals. Moving the MFI clients with some track record later to Lender A would be feasible.*		

[18] Invest India Market Solution (IIMS) finding

**Note: Sa-Dhan Illustration based on the IIMS survey of percentage of indebted to diff. loan agencies

Key Takeaways

- *MFIs and SHGs have successfully reached out to contribute to the financial inclusion agenda of the government.*
- *They have been able to evolve a first generation suite of products that provide basic financial services to the poor. It is important that, as we progress forward, look at refining the products and services that will be more relevant to the poverty requirements of the country.*
- *More specifically, in some of the poorer states and districts, their proportion as a percentage of the outstanding is significantly higher.*
- *In addition, for special groups, such as minorities the growth has been more than 90 percent. Further support for the efficiency of the MFIs to work with these special groups is evident in the work they are doing with specially abled and disabled clients.*
- *Secondly, training and knowledge has to be built of the existing services, so that reductions in cost can be effected.*
- *We need to examine where and how technology can be used to leverage this vast outreach to both supervise and make it more efficient.*
- *Thus, MFIs and SHGs target the poor, illiterate women, SC/ST clients, religious minority clients, BPL clients, disabled clients located in rural and underserved areas, providing appropriate products at their door steps.*

Client Outreach, Portfolio Size and Growth Rate of Indian MFIs

1 Client Outreach

1.1 Geographical Spread of Microfinance Clients

Total client base of MFIs has crossed 30 million in 2011. For the total 172 MFIs that reported to Sa-Dhan this year, the total client outreach stands at 31,782155 (31.78 million) as on 31 March 2011. The figure, however, is not adjusted for overlap of clients among the MFIs, which has become a common phenomenon in those geographical pockets (especially in southern and eastern regions), where there is intense competition and multiple lending among MFIs. Historical trends of client outreach has already been presented in Chapter 1 (Figure 1)

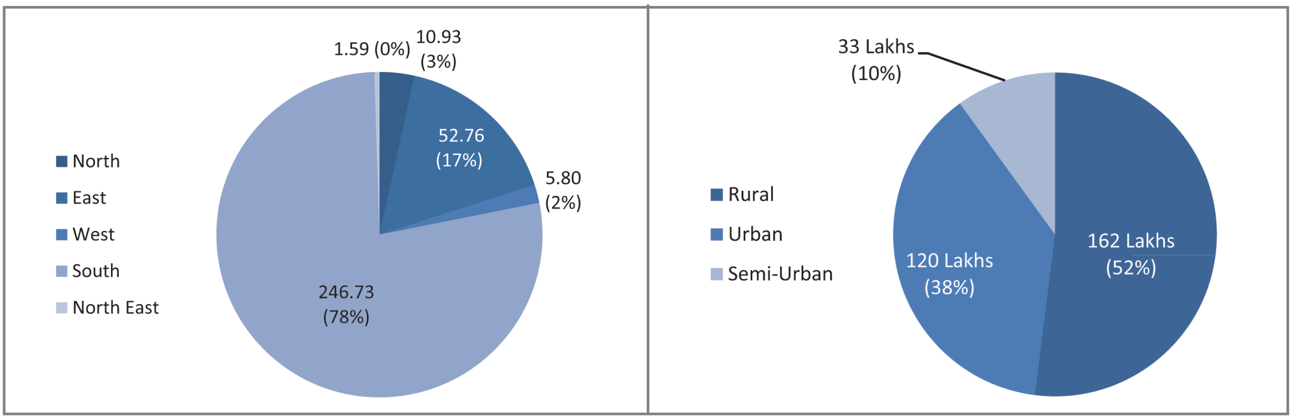
Of the total clients of 3.17 crore, rural clients constitute 52 percent (Figure 14). Rural client outreach is critical as financial exclusion in rural areas is a formidable challenge for mainstream banks in the context of their financial inclusion agenda. The decline in the share of rural outreach is a matter of concern. MFIs have increasingly been concentrating in urban and semi urban areas. Reaching out to geographically dispersed population in rural areas is difficult and hence critical. MFIs complement the efforts of banks in the financial inclusion agenda.

The southern region continues to dominate in terms of client outreach. Nearly 80 percent of the clients belong to this region. The eastern region stands second and the rest of regions have lower outreach. This skewed outreach pattern delineates the importance of MFIs to focus in the northern and north-eastern regions of the country to bring about a balanced growth.

MFIs collectively reached out to 3.17 crore clients, as of March 2011.

Nearly 80 percent of the outreach is in the southern region.

Figure 14: Share of Client Outreach across Geographies



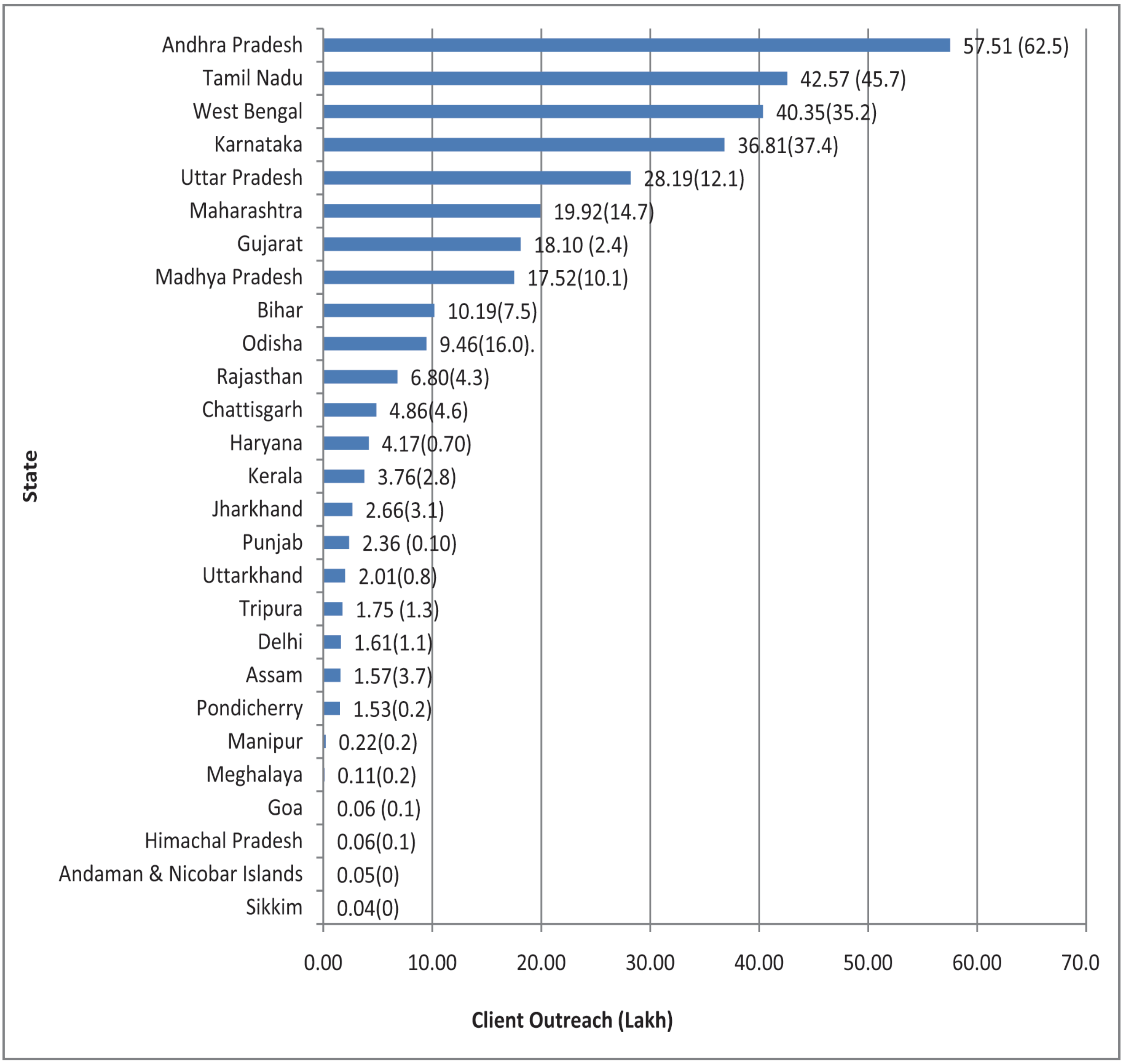
The state wise client outreach figures show that Andhra Pradesh, Tamilnadu, West Bengal and Karnataka take the lead, in that order, in terms of client outreach (Figure 15)

A closer look at the outreach figures for 2011 vis-a- vis 2010 shows that many states viz, Andhra Pradesh, Tamilnadu, Karnataka, Odisha, Jharkhand, Assam, Meghalaya, Himachal Pradesh and

Goa have negative growth in the client base during 2011 over 2010. The states showing significant growth include Uttar Pradesh, Maharashtra, Gujarat, Madhya Pradesh, Bihar, Rajasthan and Kerala.

The recent microfinance crisis could have prompted some of the south - based MFIs to spread their operation in northern and western regions resulting in growth in these states. This is an encouraging trend as it would help reaching out to the unreached areas.

Figure 15: State-wise Distribution of Client Outreach as of March 2011 (March 2010)*



*Figures in the parentheses indicate outreach as of March 2010.

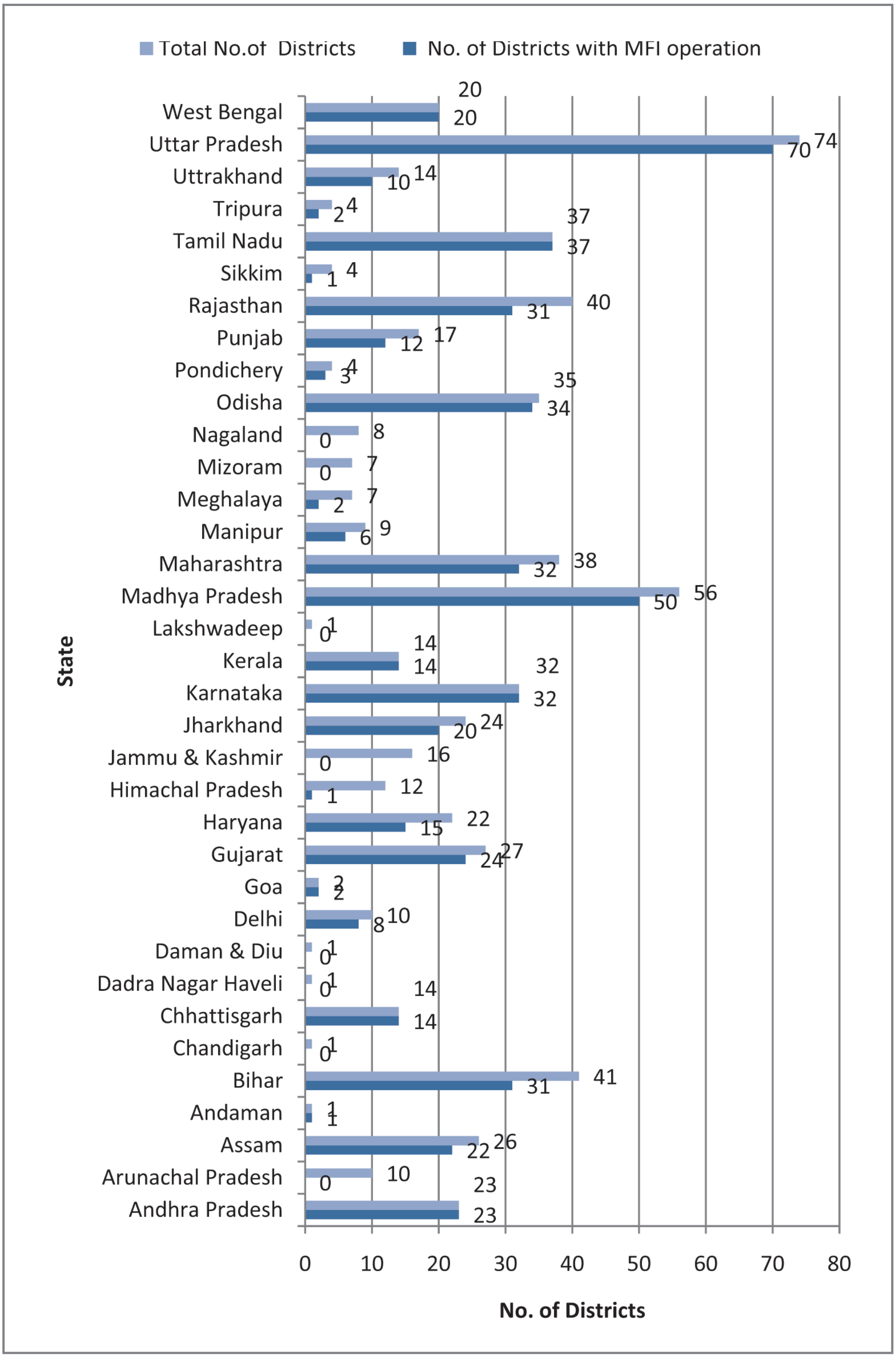
Numerically, MFIs are operating in 517 of the total 652 districts in India (Figure 16). MFI- coverage in districts is very wide, though their spread in districts of north-eastern states needs to improve[1]. Given that the topography of the north-eastern states present operational challenges for the provision

[1] Earlier, Sa-Dhan had been tracking outreach to poorest districts. Since the Government has announced most of Indian districts as poorest districts, such tracking no longer provides meaningful information. Sa-Dhan has now captured operations of MFIs in the districts, in general.

of financial services, support from the Government as well as some concessions and privileges from the Reserve Bank of India may help in improving the outreach of MFIs in these states.

MFIs operate in 517 of total 652 districts in India, spread across 27 states

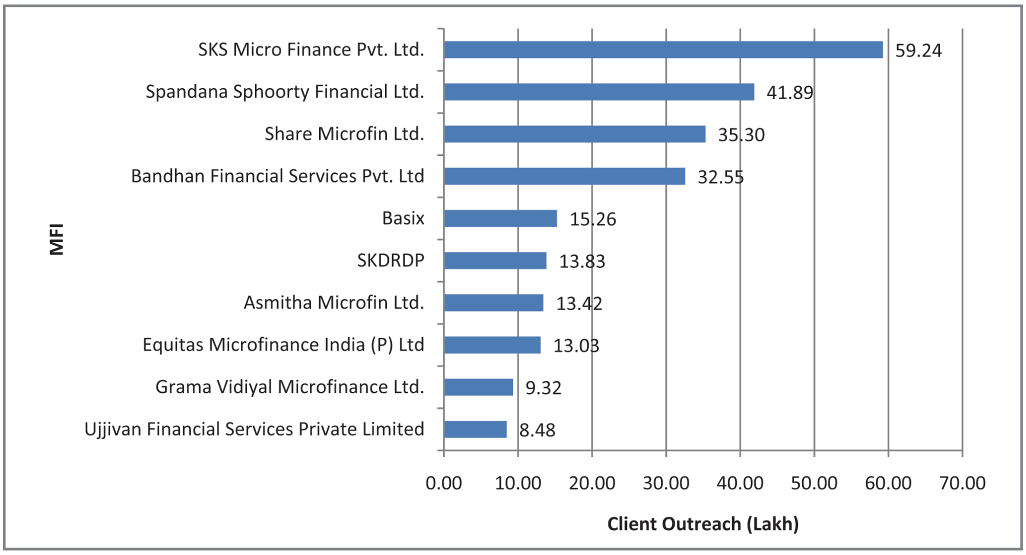
Figure 16: MFIs in Indian States & Districts



1.2 Client Outreach across Categories of MFIs

Indian microfinance sector is dominated by a few large MFIs in terms of clients and portfolio size. There are also many smaller MFIs with portfolio size less than ₹ 10 crore who cumulatively provide services to 14 percent of the total MFI clientele. As can be seen in Figure 17, top 10 MFIs have the client base of around 2.36 crore as of March 2011, representing nearly 75 percent of the total clientele. It is notable that five of these MFIs have headquarters in Andhra Pradesh.

Figure 17: No. of Clients Served by Top 10 MFIs in 2011



Most of these MFIs (except Grama Vidiyal) have a portfolio of more than Rs.500 crore . Similarly, the pattern of client outreach of MFIs across different size (Figure 18) is skewed in favor of large MFIs. The distribution pattern in 2011 is similar to that in 2010, confirming the fact that larger MFIs continue to be dominant in the sector.

For- profit-MFIs and MFIs with Grameen model serve around 2.5 crore clients. MFIs with Individual model appear to gain prominence. SHG Model, with the lowest share, needs further impetus

Figure18: Share of Clients across Portfolio Size (March 2011)

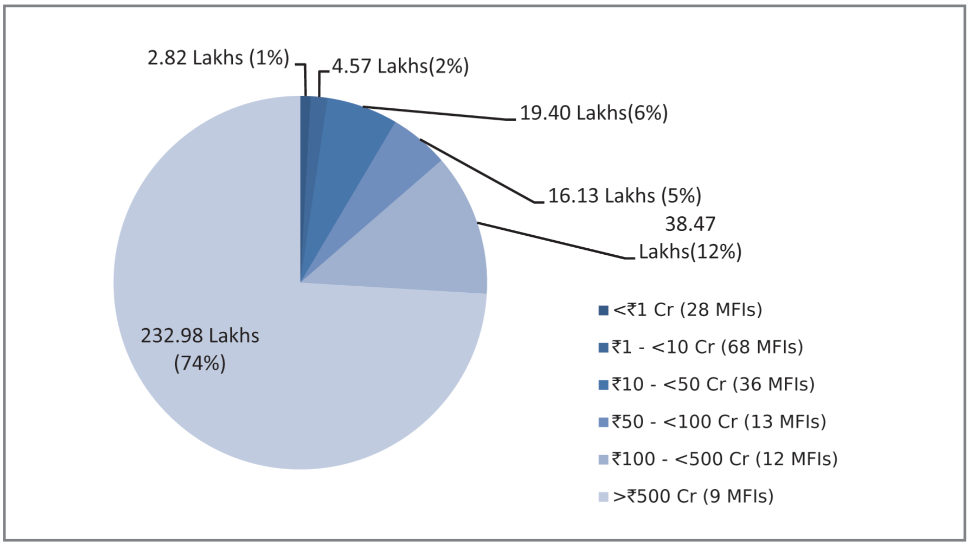
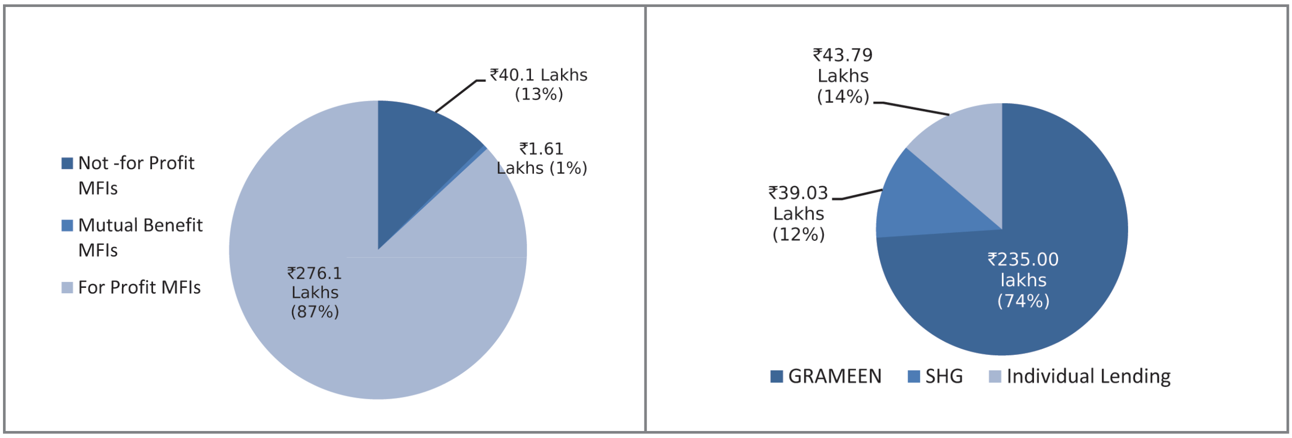


Figure19: Share of Clients across Legal Forms and Operating Models[2] (March 2011)



The For- profit MFIs account for 87 percent of the clients. Also, MFIs that follow the Grameen model account for nearly three-fourths of the total (Figure 19). The pattern in 2011 is similar to that of the previous year.

It is also interesting to note that client share of MFIs with mainly individual lending model is increasing. The emergence of Individual model, as an alternative to Grameen model, might be due to the perceived weakening of group guarantee mechanism that had been working well in the initial phase.

2 Loan Portfolio

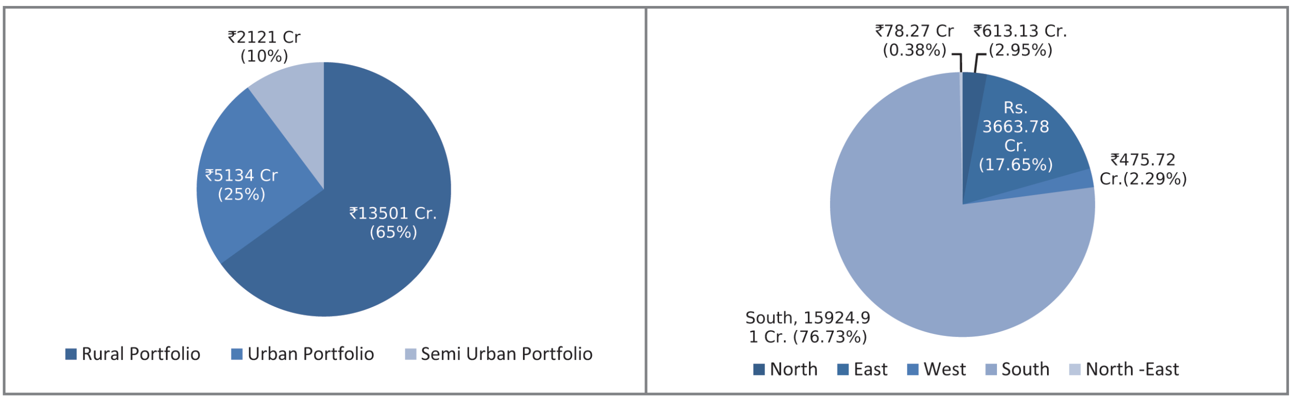
Microcredit is an important service provided by MFIs in India, and they have become an important source of provision of institutional credit to the underprivileged sections of the society.

The historical trend of microcredit outstanding portfolio of MFIs over the years has already been presented in Chapter 1 (Figure 2). MFIs total loan portfolio as of March 2011 stood at ₹ 20276 crore. In addition MFIs had an estimated managed loan portfolio[3] of around ₹ 2500 crore.

2.1 Geographical Spread of Portfolio

The portfolio distribution among different geographies is presented and discussed in the succeeding paragraphs (Figure 20 & 21).

Figure 20: Loan Portfolio across Different Geographies



[2] The Operating Model of an MFI in this report refers to the model under which majority of the clients are served by the MFI. The same MFI may serve a small portion of clients under other models also.

[3] Managed Loan Portfolio is originally originated by MFIs and later sold to banks for getting the liquidity. The MFIs continue to manage it-collection of repayment on behalf of the banks which purchased the portfolio.

The poor residing in rural areas have little access to credit from formal sources. In this background, it is interesting to note that rural portfolio occupies nearly two-thirds of the total microcredit portfolio. This share is more or less proportionate to the rural share of population.

The regional distribution of portfolio shows the dominance of south-based MFIs. MFIs already operating in north and north-eastern regions need to deepen their penetration. , and may require capacity building support in order to successfully meet the growth challenges.

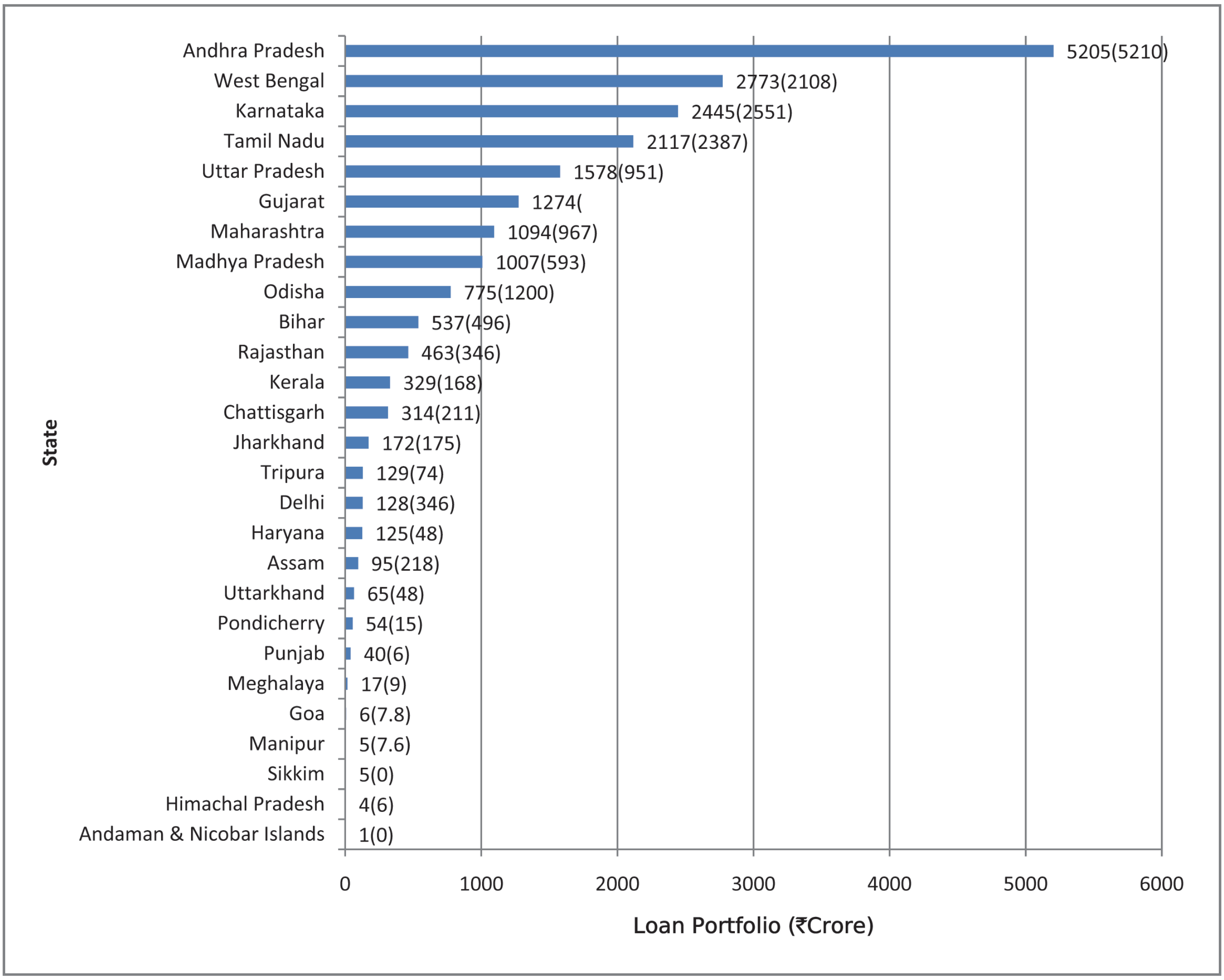
MFIs total loan portfolio as of March 2011 stood at ₹ 20276 crore.

In addition, MFIs had an estimated managed loan portfolio of around ₹ 2500 crore.

State-wise distribution of portfolio shows that Andhra Pradesh, West Bengal, Karnataka and Tamil Nadu are toppers, in that order. Some states, as depicted in Figure 21 exhibited a decrease in portfolio outstanding in 2011 compared to 2010. They include Andhra Pradesh, Karnataka, Tamilnadu, Odisha, Delhi and Assam.

Also some states increased their loan portfolios. They were: Haryana, Uttar Pradesh, Gujarat, Bihar, Rajasthan, Kerala, Chhattisgarh and Punjab.

Figure 21: State -wise Loan Portfolio Outstanding as of March 2011 (March 2010)*



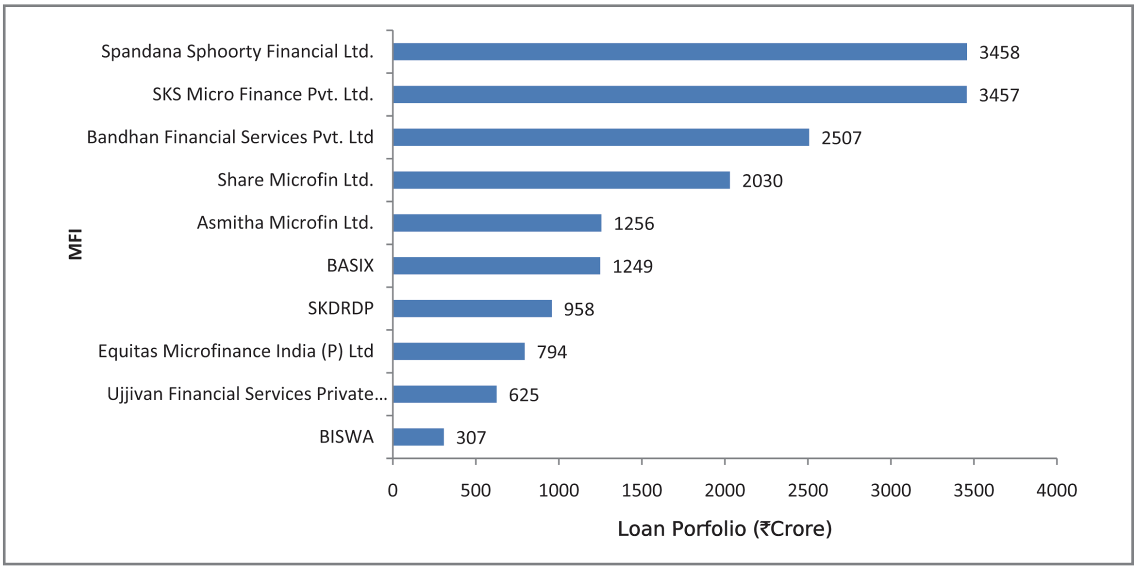
* Figures in the parentheses indicate portfolio as of March 2010

2.2. Portfolio among Different Categories of MFIs

As in the case of client outreach, the share of top 10 MFIs in loan portfolio has also been analyzed. Figure 22 displays the absolute loan amount held in the books of top 10 MFIs. They collectively hold over ₹ 16640 crore portfolio out of the total portfolio of ₹ 20276 crore.

All these MFIs, except Bharat Integrated Social Welfare Agency (BISWA), have portfolio worth more than Rs.500 crore. The dominance of these MFIs is also reflected in portfolio size wise analysis (Figure 23)

Figure 22: Loan Portfolio held by Top 10 MFIs as of March 2011



The share of loan portfolio among different MFI-size (Figure 23) confirms that top nine MFIs having portfolio of >₹ 500 crore possess nearly 80 percent of portfolio in the sector. Similar distribution pattern prevailed in 2010 also, indicating the continued dominance of the larger MFIs.

Figure 23: Share of Loan Portfolio across Portfolio-Size (March 2011)

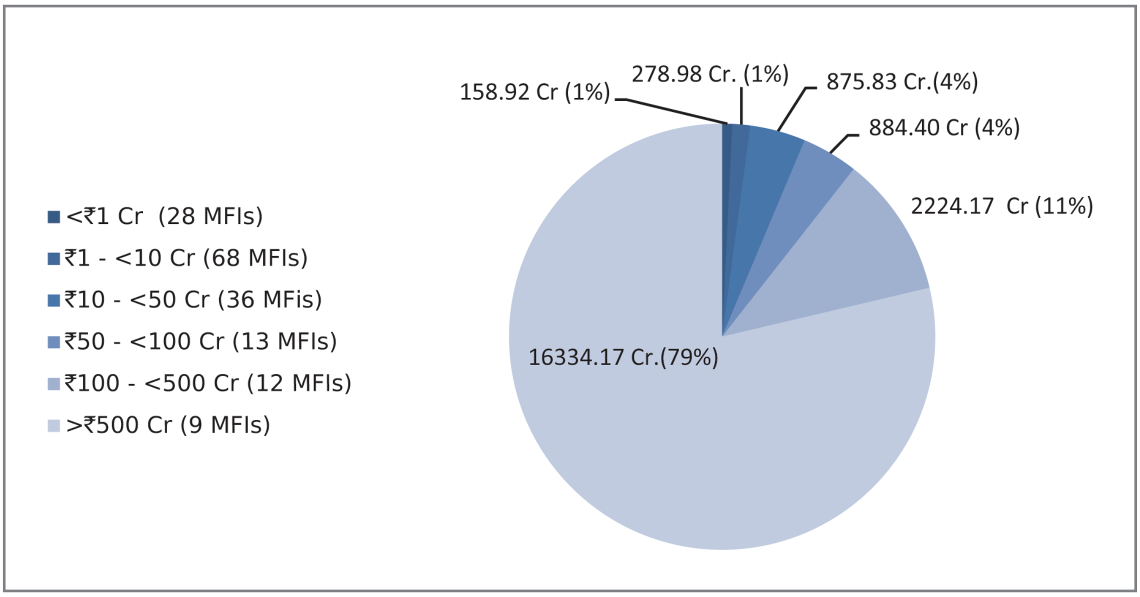
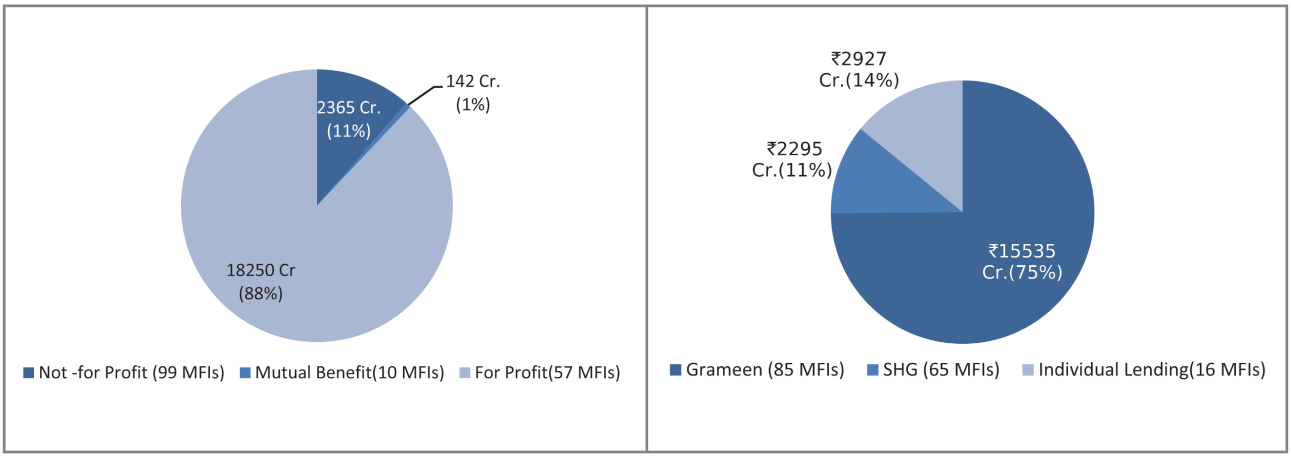


Figure 24: Share of Loan Portfolio across Legal Forms & Operating Models (March 2011)



As shown in Figure 24, the distribution pattern of loan portfolio among different legal forms and operating models in 2011 remains similar to the previous year. For - Profit MFIs had 88 percent of the loan portfolio. MFIs with Grameen operating model had 75 percent of the total portfolio. These distribution patterns are similar to the pattern on client share among MFIs.

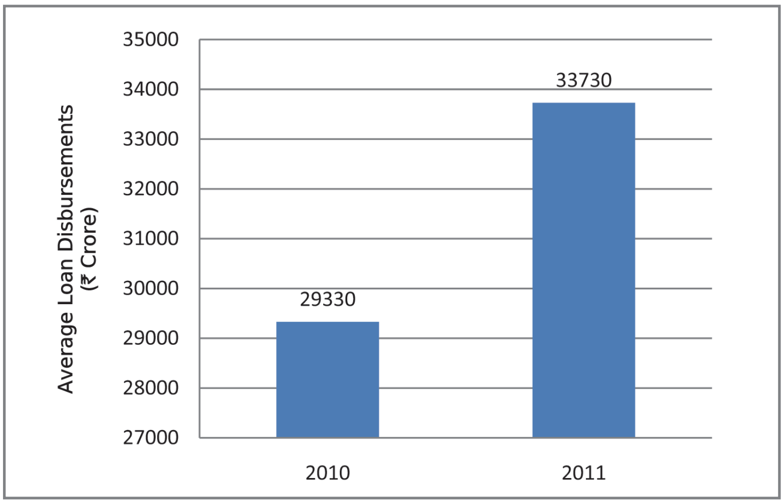
States like Uttar Pradesh, Haryana, Madhya Pradesh, Gujarat, Rajasthan, Kerala, Chhattisgarh, Tripura and Punjab started gaining prominence through considerable loan portfolio growth in 2011

3 Loan Disbursement

Microfinance Institutions have been facing a very critical time in sustaining the growth of their loan portfolios in the aftermath of the microfinance crisis, as banks stopped releasing sanctioned loans/ sanctioning fresh loans. MFI data was analyzed to find out the level of loan disbursements made by MFIs during 2010-11. Figure 25 shows that loan disbursement for the period during April 2010– March 2011 exceeded the disbursement during the corresponding period of last year by ₹ 4400 crore.

Similarly, MFIs have collectively disbursed a loan amount of ₹ 33730 crore to clients and collected principal repayment of ₹ 27323 crore from the clients during 2010-11.

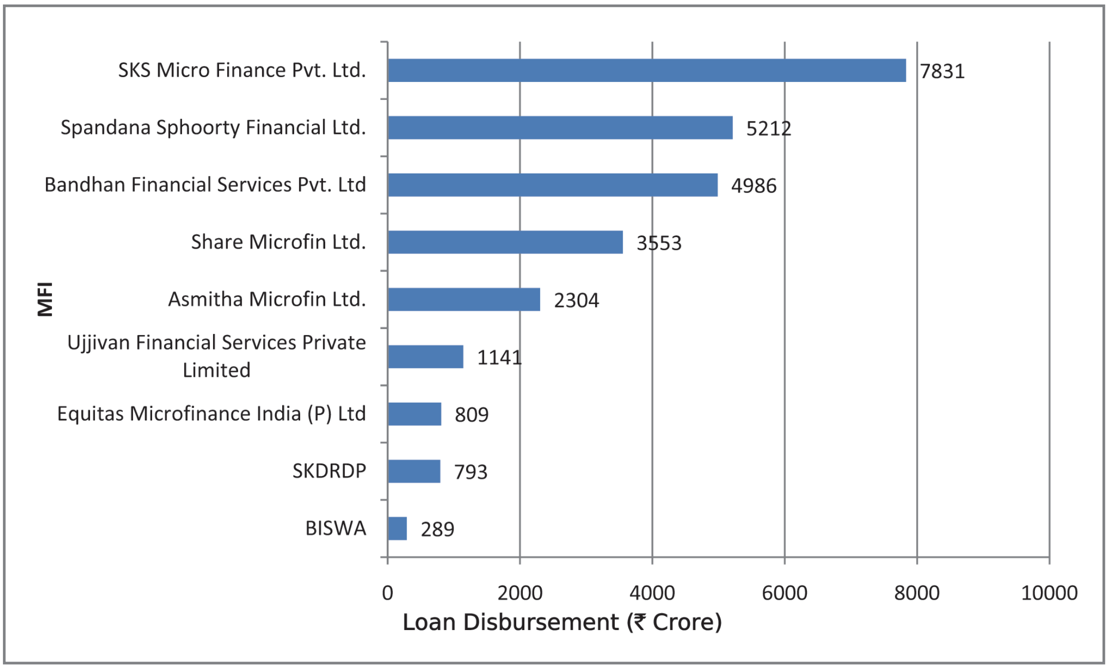
Figure 25: Total Loan Disbursement to Clients Made by MFIs in Financial Year 2010 & 2011



Major portion of this disbursement, of course, would have happened during the first half of the year, i.e., April – September 2010, prior to the onset of the crisis.

When the data was further analyzed to see the disbursement by the large players, it was found that the top nine players (BASIX – data was unavailable) had disbursed ₹ 26918 crore (Figure 26).

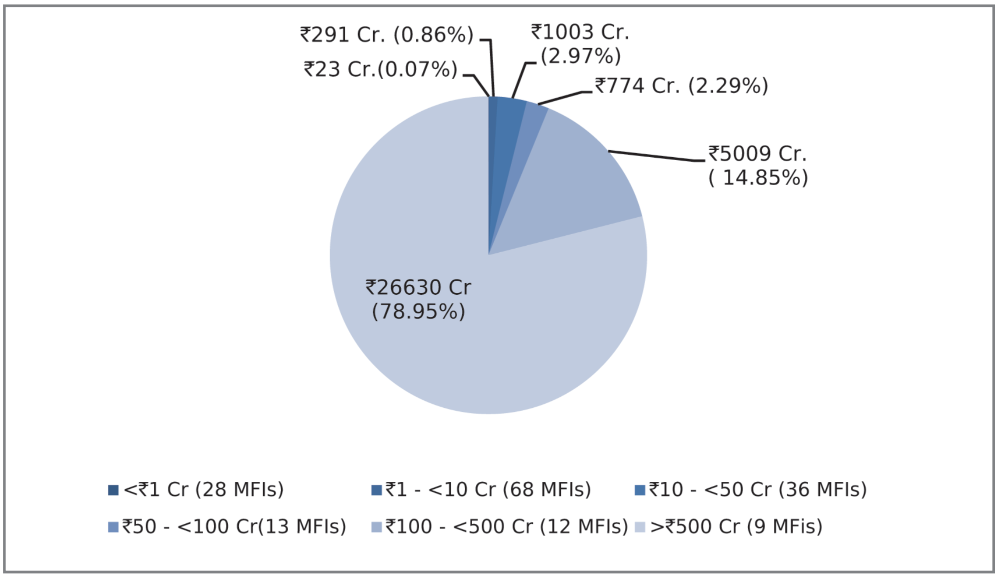
Figure 26: Loan Disbursement Made by Top 9 MFIs (April 2010 - March 2011)



The data further showed (Figure 27) nearly 80 percent of disbursement was made by the large MFIs which had > ₹ 500 crore portfolios. The small MFIs had a small share of the disbursements as the crisis had affected them the most.

MFIs have collectively disbursed a loan amount of ₹ 33730 crore to clients and collected principal repayment of ₹ 27323 crore from the clients during 2010-11

Figure 27: Loan Disbursement Made by MFIs of Different Size (April 2010 - March 2011)

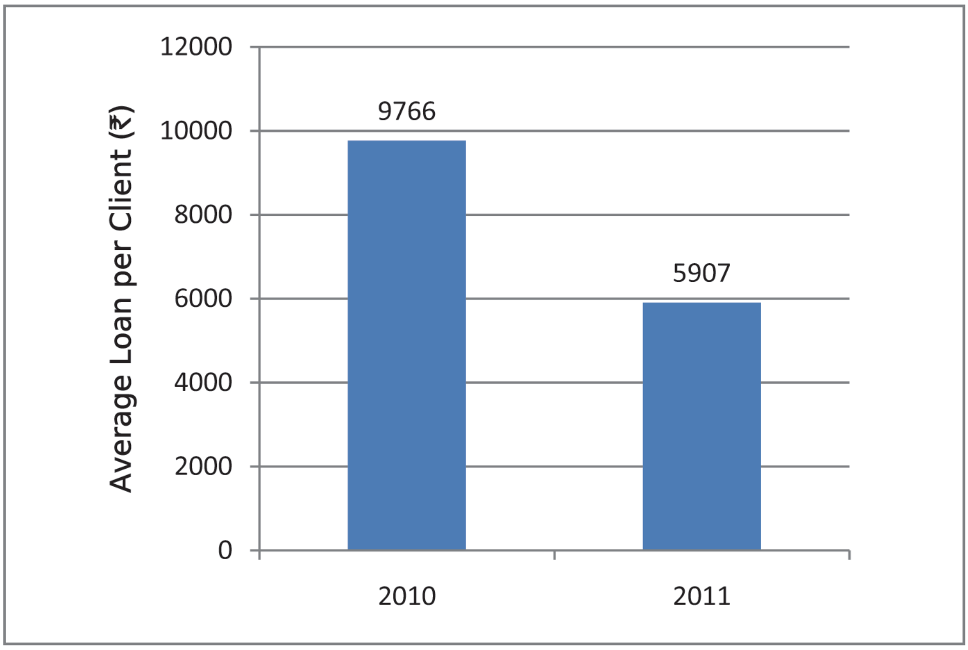


4. Average Loan Size

Average Loan amount per client has been an important criterion to understand the general profile of clients borrowing from the MFIs (a surrogate for depth of outreach) as well as its implications on operating cost, as average loan size influences the operating cost.

The median loan size has come down during 2011 compared to the previous year-2010 (Figure 28). This fall in the loan size could perhaps due to the present crisis and consequent shortage of fund at the disposal of MFIs. The MFI clients in the advanced borrowing cycles could not get further loans resulting in reduced average loan size.

Figure 28: Dwindling Average Loan Size per Client

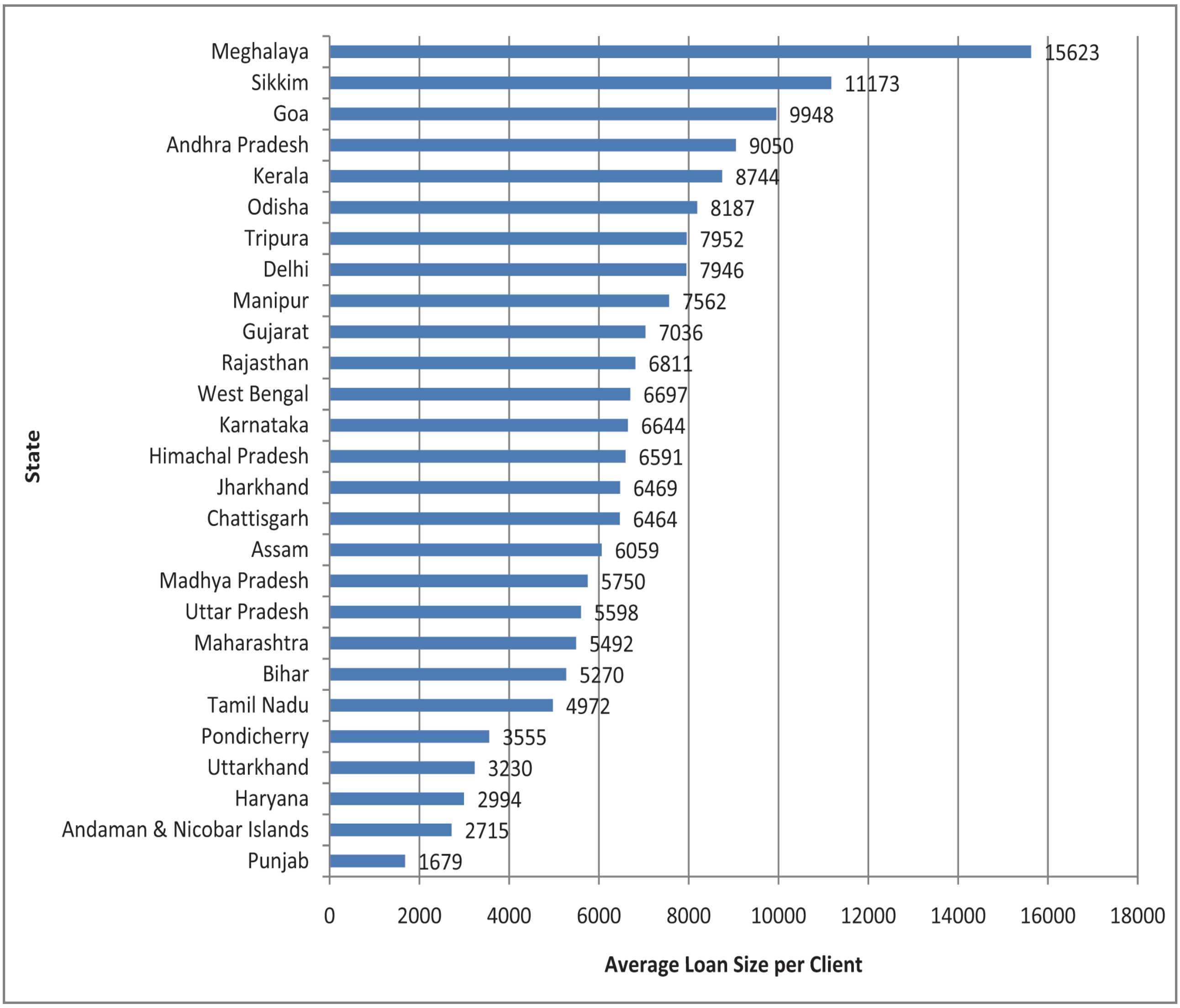


The average loan size in different states, among top nine MFIs and across portfolio size showed a significant variation (Figure 29,30 & 31).

Among the states with significant microfinance penetration, such as Andhra Pradesh, Tamil Nadu and Odisha had a higher average loan size. Uttar Pradesh and West Bengal, for example, had small loan size.

Similarly, the top nine MFIs had average loan size which is higher than that of the sample / all India average. The same pattern is seen in the average loan size across different portfolio size, wherein the large MFIs had larger average loan size.

Figure 29: Average Loan Size per Client across Indian States



The average loan size came down by 42 percent in 2011. In most states the average loan ranged from ₹ 5000 to 10000. It increased with increase in portfolio size of MFIs.

Figure 30: Average Loan Size per Client among Top 10 MFIs

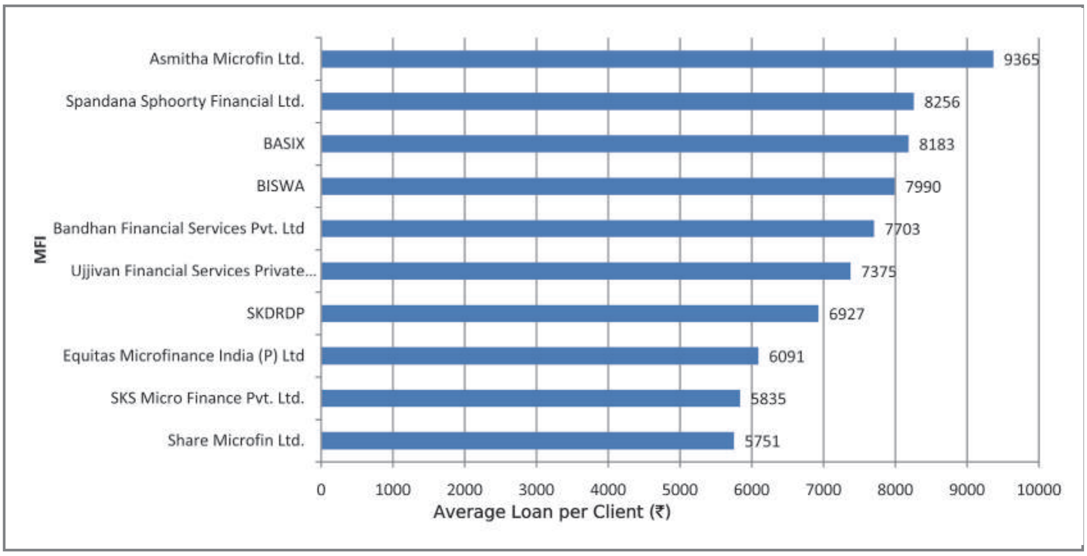
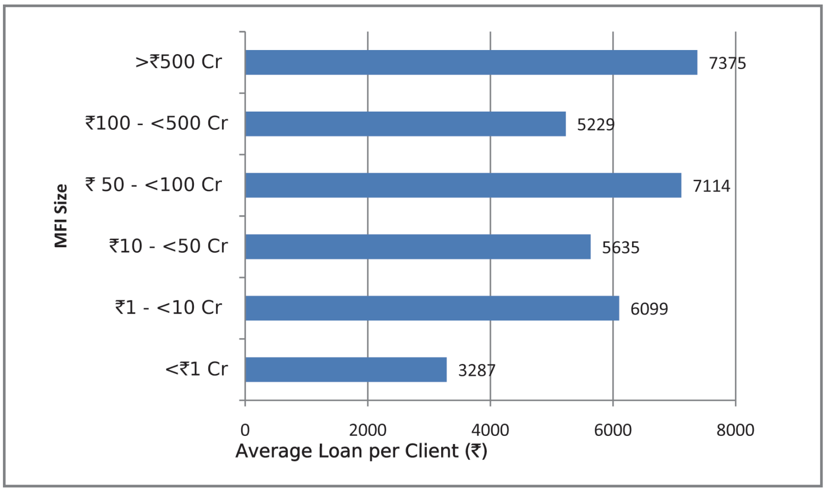


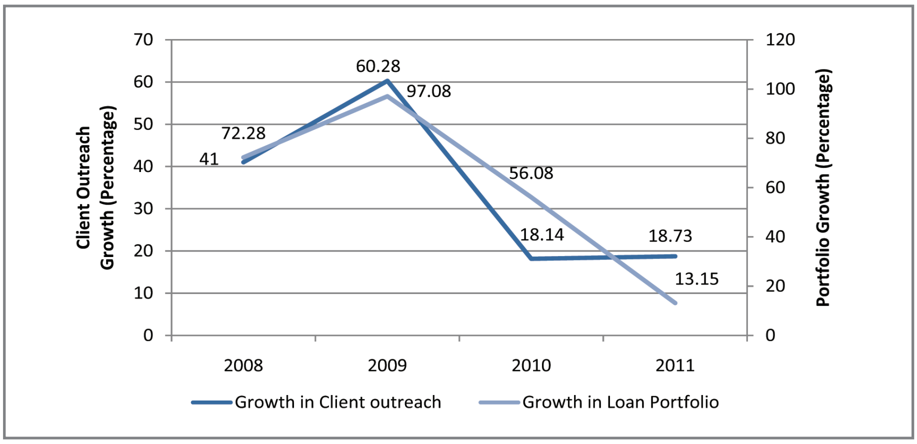
Figure 31: Average Loan Size per Client across MFI -Size



5. Growth of MFIs

The growth of MFIs had been phenomenal, both in terms of client outreach and loan portfolio, until 2010. The year 2010-11 has been different because of the Andhra Pradesh crisis that impacted the other states also. The historical growth, as depicted in Figure 32, shows that the client growth rate over the past two years has been the same (around 18 percent). However, the portfolio growth rate has drastically got reduced to 13.15 percent compared to the previous two years. This is obviously due to the crisis which has made bankers extra cautious while providing loan funds to the sector.

Figure 32: Year-on-Year Growth Rate of MFIs.



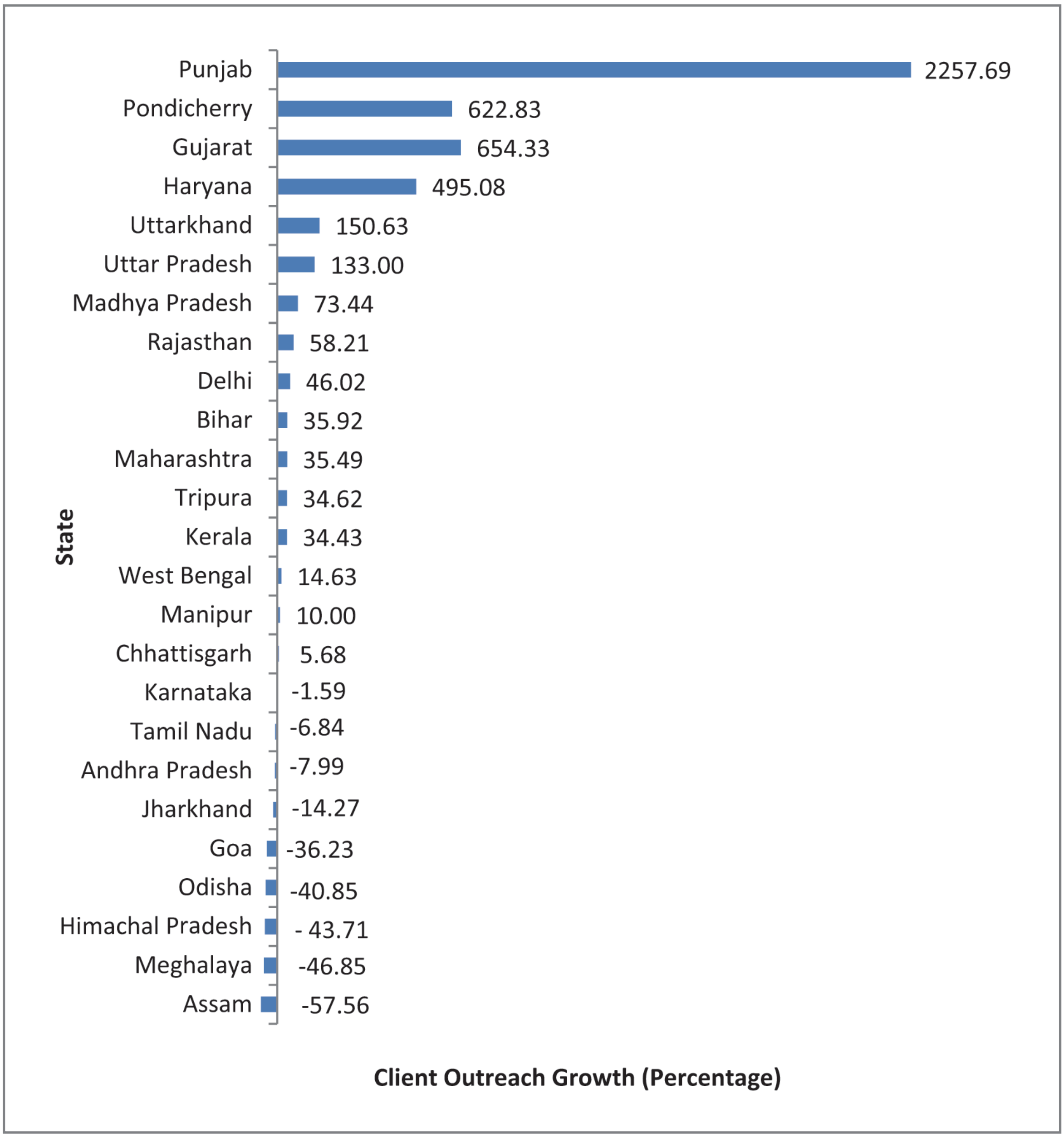
The growth rate in different states in the country has been interestingly different as many of emerging states in the microfinance horizon have shown positive growth, while some of the hitherto-leading states have experienced negative growth. (Figure 33 & 34)

Year-on-year growth in loan portfolio has plummeted in 2011, while the growth rate in clientele has remained the same as that in 2010.

During 2010 -11, more than one-third of MFIs displayed negative growth in client outreach and loan portfolio.

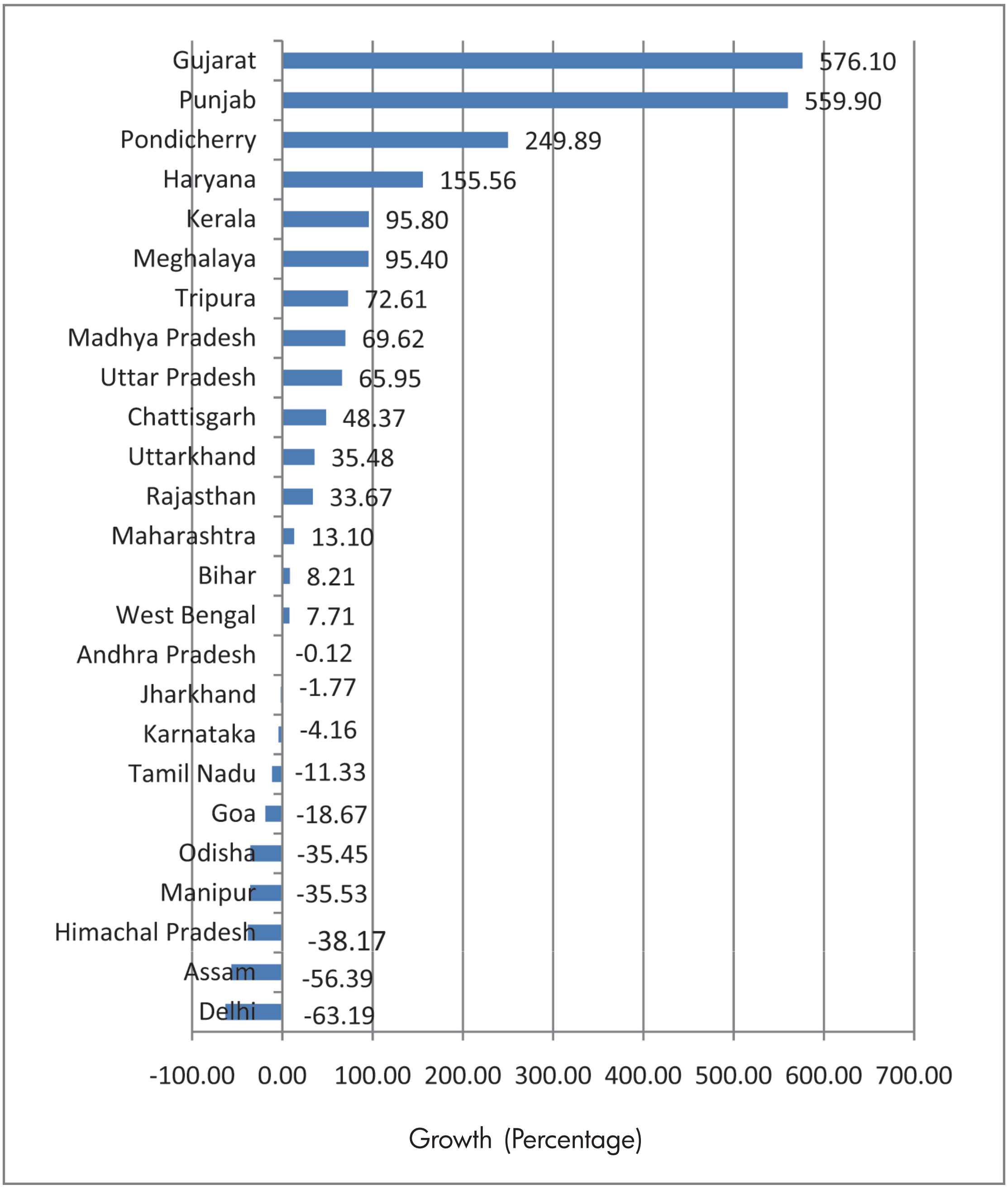
As of September 2011, the MFIs have shown negative growth of over 10 percent due to liquidity crunch

Figure 33: Client Growth Rate among Indian States in 2011 over 2010



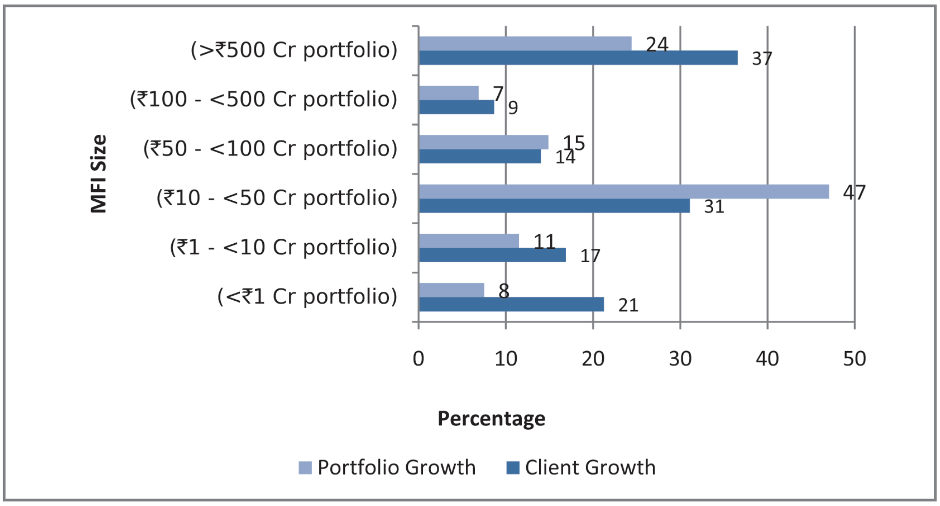
The very high growth figure for certain states like Punjab, Pondicherry; Gujarat etc are due to their lower base figure for the previous year. However, their fast emergence in the microfinance landscape is a positive sign as the penetration there had earlier been consistently low.

Figure 34: Loan Portfolio Growth Rate among Indian States in 2011 over 2010



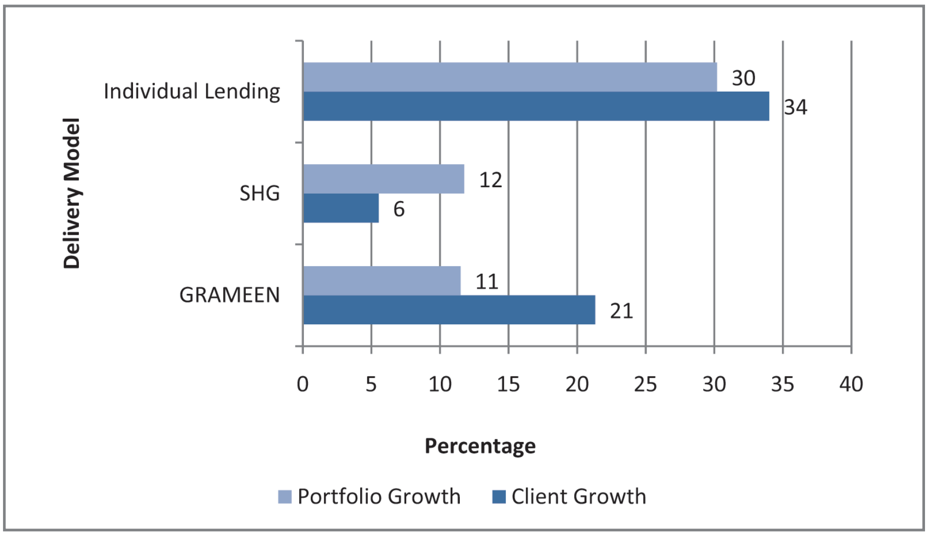
The MFI-size wise growth rate of both client base and portfolio has not shown any distinct variation (Figure 35). However, the portfolio growth rate of ₹ 10-50 crore category has been distinctly high for the second consecutive year (2010 : 75.4 percent and 2011 : 47 percent) compared to the other lower portfolio categories. This might be due to the fact that they are at the peak growth phase in their institutional life cycles.

Figure 35: Growth Rate in Client & Portfolio across MFI-Size during 2010-11



The growth rate studied across lending methodologies show that MFIs having substantial individual–client-based transactions have grown much higher than those of SHG/Grameen models (Figure 36). This might be due to the tendency among the MFI-managements to focus on individual clients rather than on group clients, apparently after wide criticism/ seeming failure of group guarantee system.

Figure 36: Growth Rate across Operating Models during 2010-11



The data also revealed that 38 percent, 36 percent and 24 percent of MFIs posted negative growth respectively in client outreach, loan portfolio and both (client and portfolio) during 2010 -11 (Table 2)

Similarly Figure 38 indicates the number of MFIs getting shifted to different portfolio size due to the change in portfolio. Box 1 confirms the continuing negative growth in clients/portfolio till September 2011.

Table 2: No. of MFIs with Negative and Positive Growth

	Client Outreach	Loan Portfolio	Both Client & Portfolio
No. of MFIs with Negative Growth -2010-11	53 (38%)	51 (36%)	34 (24%)
No. of MFIs with Positive Growth-2010-11	88 (62%)	90 (64%)	

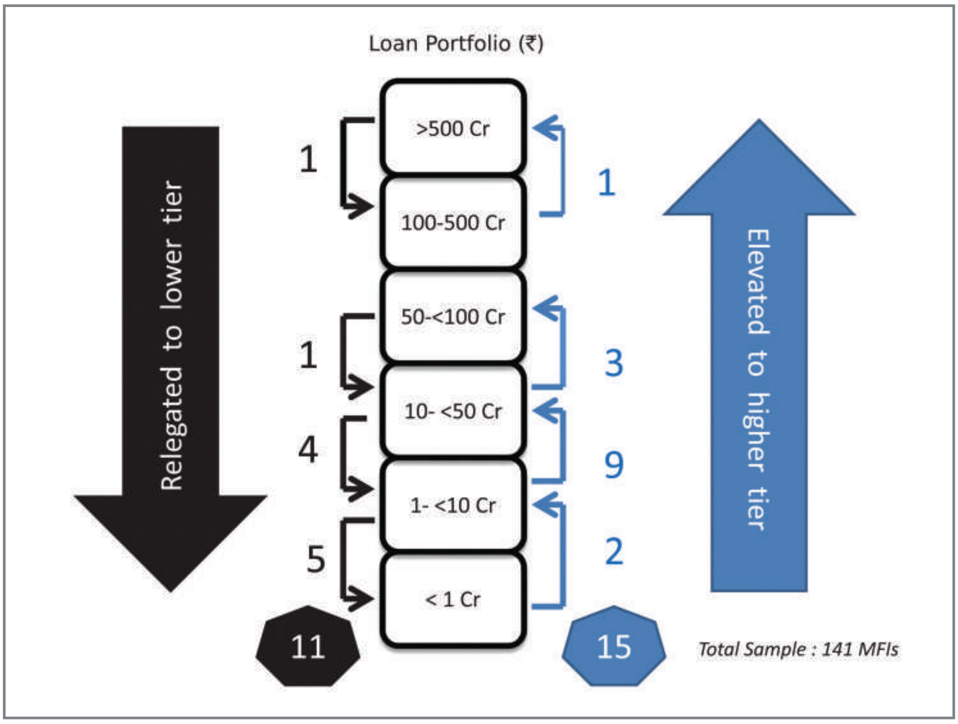
Box 1: MFI Growth- Current Scenario (October 2011)

Sa-Dhan conducted a quick survey of MFIs during October 2011 to ascertain the growth situation for the sake of this report. Data from 58 MFIs were gathered and analyzed. Their growth rate during 1 April 2011 to 30 September 2011 is shown in the following figure.

Figure 37: Median Negative Growth recorded during April-Sept.2011

During the same period, of 58 MFIs, 42 MFIs posted negative growth in client outreach (the range of negative growth being -1 percent to -40 percent) , 38 MFIs posted negative growth on loan portfolio (the range of negative growth being -1 percent to -150 percent) and 33 MFIs experienced negative growth in both client outreach and loan portfolio.

Figure 38: No. of MFIs Transitioned during 2010-11 through Change in Portfolio Size



Key Takeaways

- *Over all, microfinance sector has grown during 2010-11 in absolute terms, while the rate of growth has come down heavily. Similarly, retarded growth is witnessed in loan disbursement and average loan size. Microfinance crisis prevailing at present, with accompanying shortage of bank fund, has slowed down the growth rate.*

- *MFIs will have to target northern and north-eastern states, where microfinance penetration is low, for their future expansion. This will avoid concentration in a few states, inviting operational and political risk.*

Financial Performance of MFIs

The Reserve Bank of India suggested a host of measures to regulate and strengthen microfinance institutions. The RBI-appointed Malegam Committee[1] expressed certain concerns on the way of functioning of the microfinance institutions. The MFIs and the professionals in the sector have already been speculating upon the impact of the RBI measures. This chapter analyses the financial performance of MFIs in the light of these measures with the help of latest MFI financial data collected by Sa-Dhan during 2011.

This chapter particularly looks at six financial performance aspects of MFIs being impacted by the new measures. They are:

1. Qualifying Assets of MFIs
2. Cost Analysis
3. Yield on Loan Portfolio
4. Margin Analysis
5. Surplus, Sustainability and Profitability of MFIs
6. Productivity of MFIs

1. Qualifying Asset[2] - *'The Condition that MFIs Could Meet'*

The loan assets created by MFIs should be, as per the Malegam committee recommendation, in the form of Qualifying Assets. The committee stipulated that, not less than 85 percent of the total assets (other than bank balances and money market instruments) should be in the nature of qualifying assets. This has also been confirmed by the Reserve Bank of India in its circular, issued on 3rd May 2011, on bank loans to microfinance institutions. This is necessary for the MFIs for getting classified as NBFC-MFIs and to become eligible for benefits including bank credit under Priority Sector Advances category. Though this measure is proposed for NBFC-MFIs now, the RBI being proposed as the potential regulator of the whole sector in the current microfinance bill, these recommendations, in all likelihood, will become the norm for all MFIs in the future.

1.1 Loan Amount: *'Preponderant Amount Under ₹15000'*

The RBI circular of May 3rd 2011 which draws on the recommendations of the Malegam committee prescribes two different loan size depending on the loan cycle of the borrower as one of the qualifying asset criteria. The quantum of loan given to individual borrowers should not exceed ₹ 35000 in the first cycle and ₹ 50000/- on the subsequent cycles. Similarly, the total indebtedness of the borrower should not exceed ₹ 50000/- on any given point of time. The analysis of data presented in the following paragraphs has been performed in a way to indirectly ascertain if this condition is fulfilled by the reporting MFIs. The average balance and the loan portfolio (and clientele) falling under different loan slabs are the two parameters analyzed.

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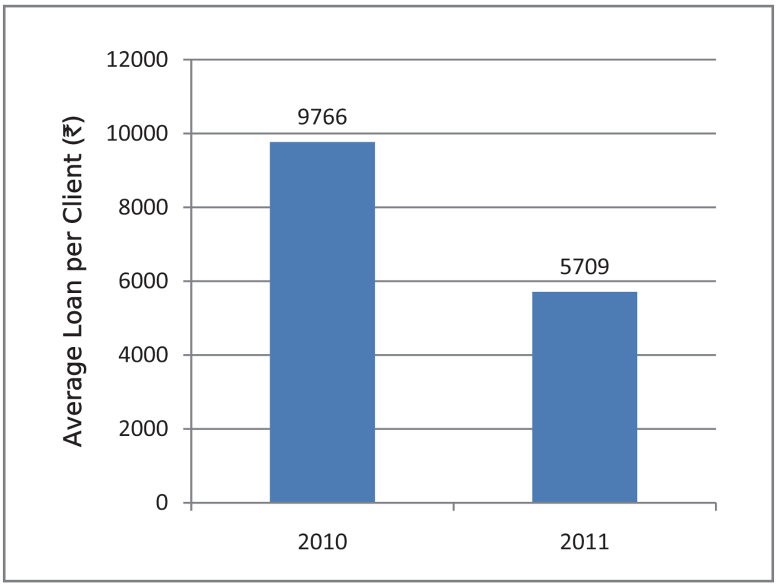
[1] Malegam Committee is the RBI Board Sub- committee, under the chairmanship of Y.H.Malegam, which investigated the issues affecting the microfinance sector and submitted report to the RBI in 2011

[2] Qualifying Assets are loan portfolios created by MFIs adhering to certain conditions to make the MFIs eligible to be called as MFIs and to raise loans from banks under Priority Sector Advances scheme.

The average outstanding loan per borrower is ₹ 5709 for 2011 which is far below the limit prescribed of ₹ 25000. Figure 39 shows that reporting MFIs had average loan sizes of less than ₹ 10000 in two consecutive years in 2010 and 2011.

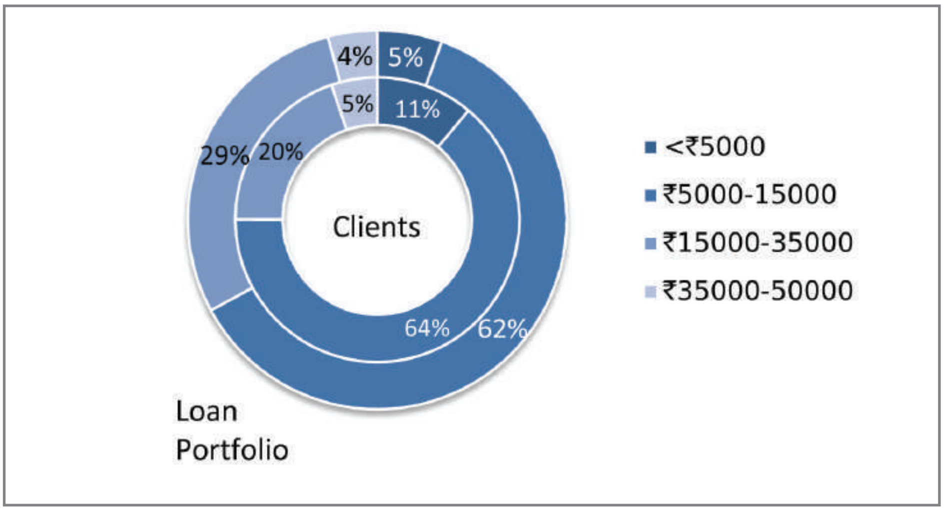
Figure 39: Average Loan Size per Client



Similarly Figure 40 shows that more than 60 percent of loan portfolio and clientele fall under the loan slab of ₹ 5000-15000. This is very much in conformity with the stipulation of Malegam Committee for Qualifying Asset.

The loan size has consistently been below ₹ 10000. More than 60 percent of loan portfolio and clientele fall under the loan slab of ₹ 5000 - 15000

Figure 40: Share of Clients & Loan Portfolio under Different Loan Slabs

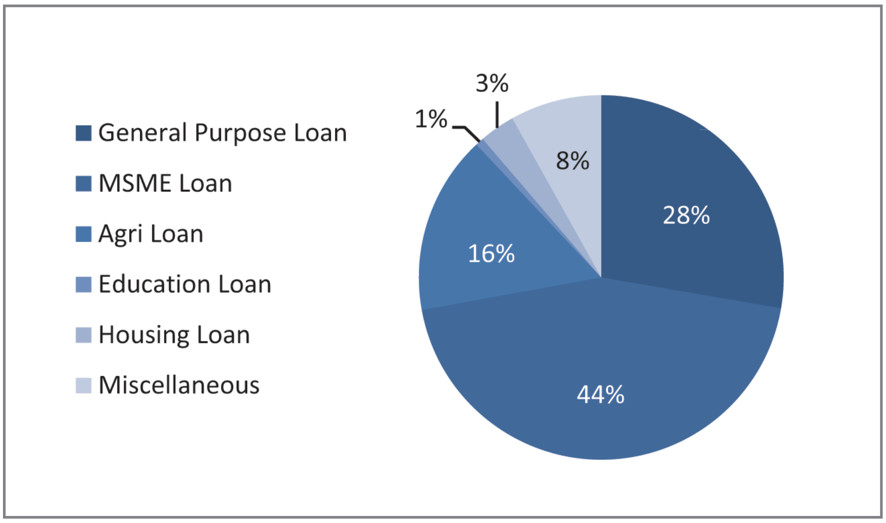


Thus, reporting MFIs, in general, could meet one of the conditions of Qualifying Asset, that is, the loan amount.

1.2 Loan Purpose: *'Two-Thirds of Portfolio Meant for Productive Purpose'*

The Malegam committee stated that the aggregate amount of loans given for income generation purposes should not be less than 75 percent of the total loans given by the MFIs. This is apparently to ensure that the loans given by MFIs are utilized for livelihood enhancement, rather than for meeting consumption expenses like purchase of consumer durables etc.

Figure 41: Purpose-wise Share of MFI Loan Portfolio



Loans to agriculture and Micro, Small and Medium Enterprises (MSME) together constitute more than 60 percent of the portfolio of the reporting MFIs

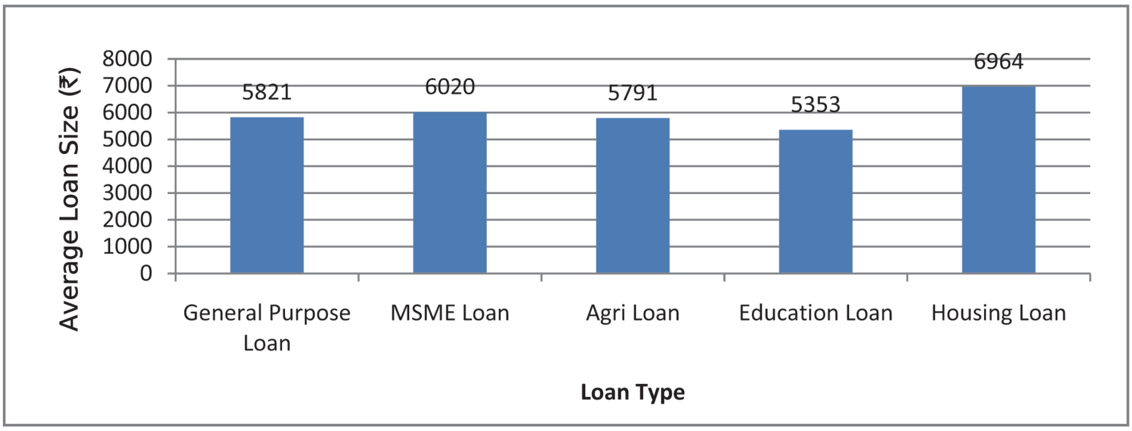
The purpose -wise disaggregated data on loan portfolio (Figure 41) shows that this condition of the committee seems to be met by Indian MFIs. As shown in the figure, the loans are given for subsectors like micro, small and medium enterprises (MSME), agriculture, education, housing and health. It also shows the median percentage of the portfolio held by reporting MFIs under different purposes. The MSME loans and agriculture loans are direct income generation loans. They constitute 60 percent of the outstanding. Also, we could assume that a part of general purpose loan would be utilized for productive purpose.

Indian poor households use their homesteads not only for living but also for undertaking their livelihood-related chores like running microenterprises which include storing of raw materials and finished products. Thus, housing loans directly contribute to the livelihood improvement of the borrowers. In the same way, loans given out for education and health purposes indirectly contribute to the human development and thereby to the earning capacities of the households. Studies have shown that investments in education and health can significantly improve lifetime earnings of people[3].

The median loan size for the above purpose is shown in Figure 42. Though the median loan size does not seem to differ significantly among purposes, the average (mean) figures calculated separately indicated higher size of loan under MSME and housing categories. This is on the expected lines.

[3] Banerjee, A., Duflo, E. (2011)

Figure 42: Purpose-wise Average Loan Amount

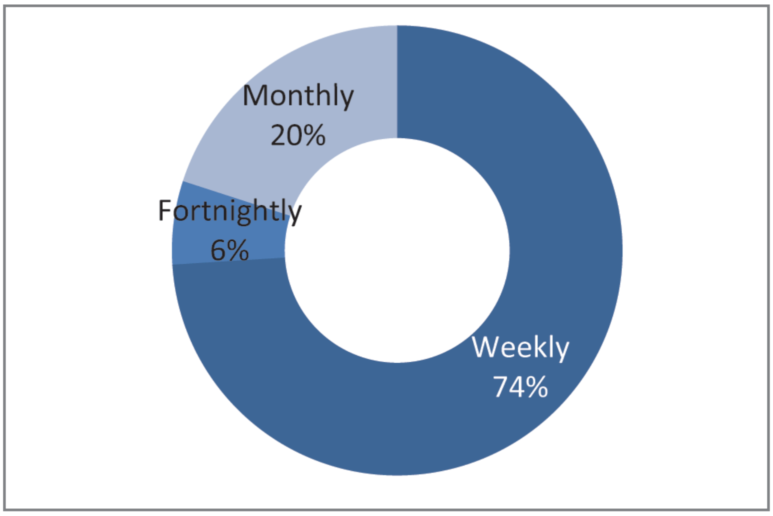


However, the loan size is small in general. This could force the clients to resort to multiple borrowing to meet their financial needs. MFIs require additional resource-capacity to enhance the quantum of loan to the poor households to satisfy their borrowing needs fully.

1.3 Loan Repayment Frequency: *"'Weekly' is the Common Practice"*

One of the conditions for Qualifying Asset, as per the committee report, is that the loan repayment frequency may be weekly, fortnightly or monthly depending on the choice of the borrowers. The analysis of data of reporting MFIs involving total portfolio of ₹ 16,889 crore showed that the weekly repayment method covers 74 percent of the portfolio of the sample MFIs. (Figure 43).

Figure 43: Share of Portfolio under Different Repayment Mode



Weekly repayment mode forms the major repayment frequency adopted by MFIs, with three-fourths of loan portfolio getting repaid weekly

It may be recalled that the Andhra Pradesh microfinance act, purporting to regulate MFIs, stipulates that the MFIs migrate to monthly repayment mode. Given the fact that the majority of portfolio falls under weekly mode and the loan size is small, it could be enervating to convert the frequency of huge portfolios from weekly to monthly mode. Therefore the decision on repayment mode is better left to clients, as suggested by the Malegam committee.

The findings therefore provide evidence to corroborate that MFIs could meet the stipulation of the committee (> 75 percent for productive purpose) and hence meet one of the conditions of Qualifying Asset. Indian MFIs have products and practices that are in line with the conditions of Qualifying Asset.

> *The reporting MFIs, as found out from their 2011 data, could potentially fulfil Qualifying Asset criterion proposed by the Reserve Bank of India*

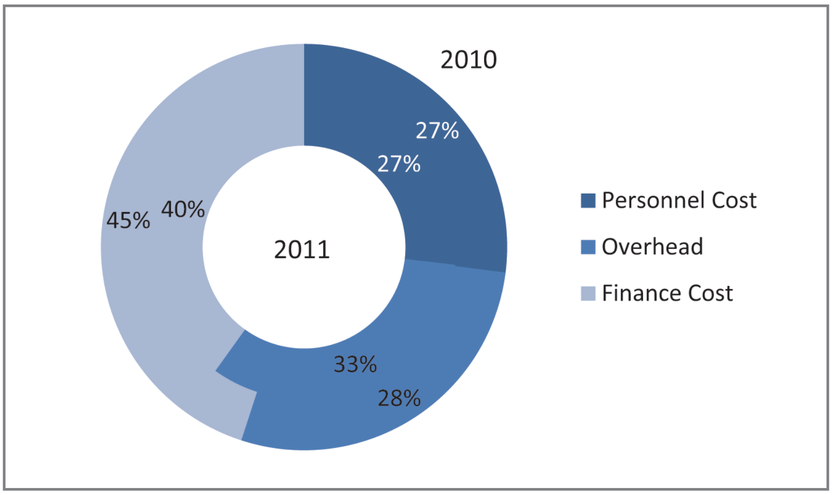
2. Cost Analysis: *'Sa-Dhan Members Conform to Interest Rate Cap'*

One of the concerns expressed by the Malegam committee is the perceived high interest rate. The committee studied the microcredit cost structure of select MFIs and came out with prescription on Margin Cap and Interest Rate Cap. This section analyses the cost and the interest rate structure of the reporting MFIs and compares the findings with that of Malegam Committee.

2.1 Cost Composition: *'Hike in Share of Overheads'*

The cost composition has changed a little in 2011 compared to the previous year. The total cost for the operation have been divided into three categories, viz. Personnel Cost or Staff Cost, Overhead or Administrative Cost and Finance Cost or Funding Cost. As shown in Figure 44, the share of average Finance Cost has come down from 45 to 40 percent of the total cost while the overhead cost has gone up from 28 percent to 33 percent. This might be due to soaring inflation, and consequent increase in expenses under transport and other administrative items.

Figure 44: Changing Composition of Cost - 2010 vs 2011



MFIs need to pay attention to the higher share of overhead cost to bring down the overall cost and improve efficiency. Operating Cost is subject to further analysis in the succeeding sections unravelling other perspectives.

2.2 Internal[4] & External Cost[5]: *'Which one to Tame to Conform to Malegam Norm'*

Personnel Cost and Overhead Cost are within the control of the MFIs while the Finance Cost is determined by the bank lending rate. As it is discussed elsewhere in this report, 70-80 percent of

[4] Internal cost here includes Operation Cost (Operating Expense Ratio- OER) which in turn comprises of Personnel cost, Administrative cost, Depreciation and Miscellaneous Cost.

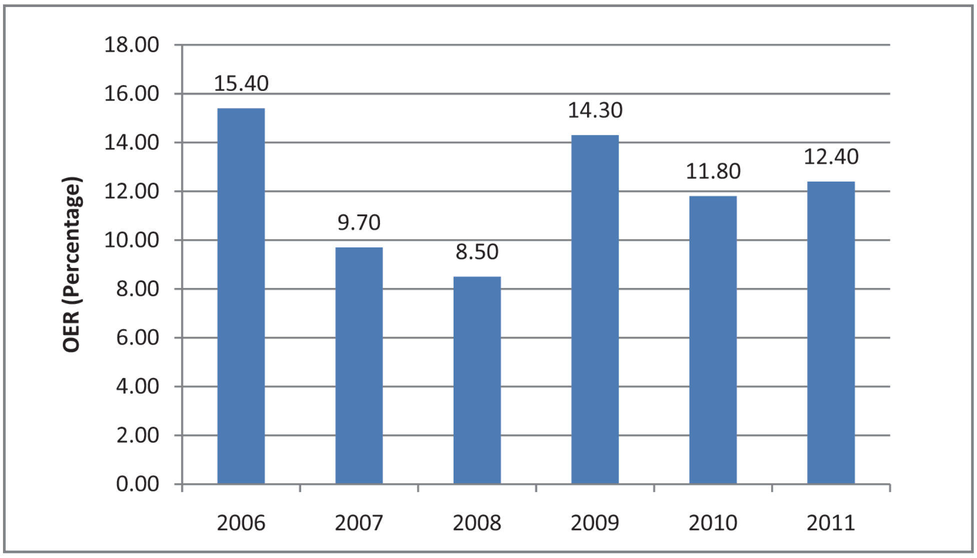
[5] External Cost here refers to Finance cost which is determined by the lending rate of banks and hence is beyond the control of MFIs

the lending resources of MFIs are sourced from mainstream banks. The internal cost and the finance cost collectively determine the interest rate to be charged on loans given to microcredit borrowers. As the interest rate on loans has been now become a bone of contention among the stakeholders, it is important to analyze the cost structure, both internal and external, with fresh data to gain newer perspective on the issue.

2.2.1 Internal Cost: 'Soaring Operation Cost Compels MFIs to Exceed Margin Cap'

First, let us examine how the Operating Expense Ratio (OER) has been moving over years. In tune with the expectation that OER for the sector would come down as the sector matures, the Indian microfinance sector has managed to bring down the cost from 15.4 percent during 2006 to the present 12.4 percent. However the median OER has been on the rise during the past two years as can be seen from Figure 45. The inter-year variation could be attributable to several factors of cost including inflation, salary cost etc.

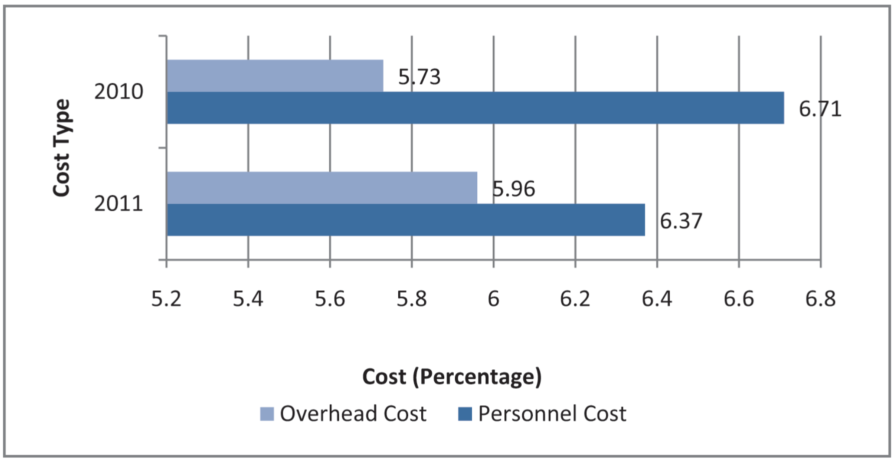
Figure 45: Operating Expenses Ratio (OER) over Years



The OER comprises of two sub cost components, Personnel Cost Ratio and Overhead Cost Ratio. They are probed a little further to know what drives operating cost. Their ratios are shown in Figure 46. It is found that personnel cost has come down a little, the overhead cost has gone up in the last two years. Thus, bulging overheads like administrative cost escalate the operating cost in the recent past.

The sector has managed to bring down operating cost ratio over the past five years. Controlling operating cost would be a challenge in future as evident from 2011 data showing a spike in the operating cost

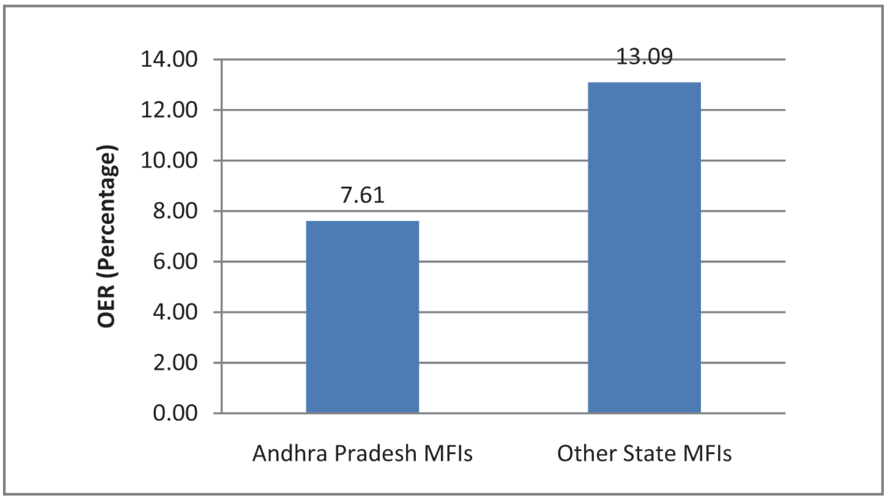
Figure 46: Median OER % (Overhead Cost Ratio + Personnel Cost) 2011



2.2.1.1 AP-based MFIs[6] and Larger MFIs: 'More Cost Efficient'

The present microfinance crisis originates from Andhra Pradesh (AP) state of India. It might be of interest to know the cost structure of AP-based MFIs. The 2011 data set was disaggregated to know the OER of AP- based MFIs vis-à-vis other state MFIs in India and the results are displayed in Figure 47. The OER of AP- based MFIs is much lower perhaps because of the higher scale achieved by the AP-MFIs. The MFI-size wise data presented in Figure 48 further corroborates to this conclusion. These results confirm the general understanding that higher scale would bring down the operating cost.

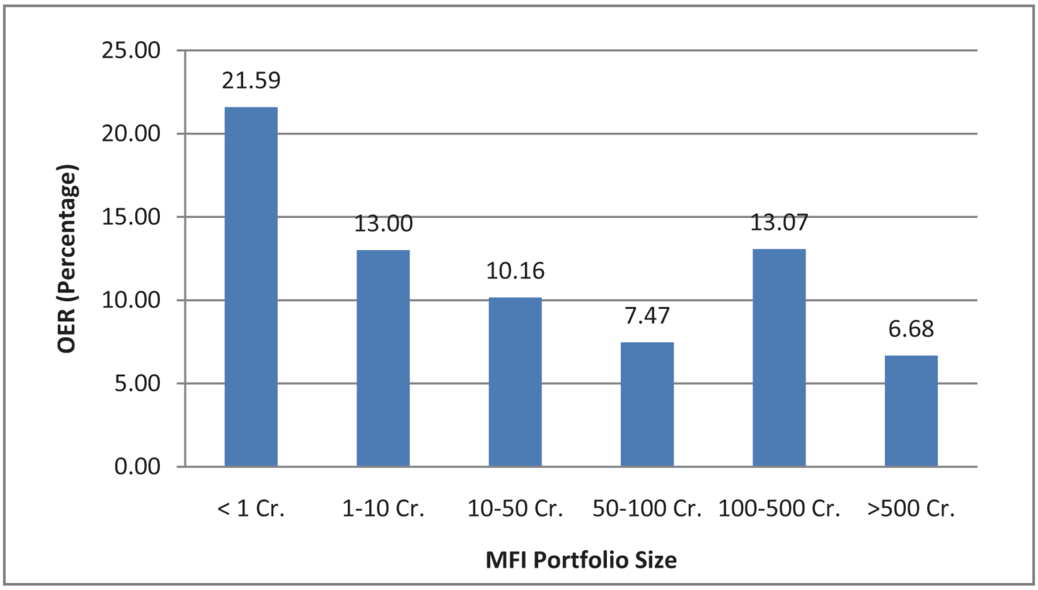
Figure 47: Median OER of AP-based MFIs Vs Other State MFIs



AP- based MFIs, apparently due to the their higher scale, had only one- half of the Operating Expense Ratio of their counterparts in other states in 2010-11 indicating their higher cost efficiency

[6] Andhra Pradesh (AP)-based MFIs are those MFIs having head quarters in Andhra Pradesh and operation in Andhra Pradesh and other states

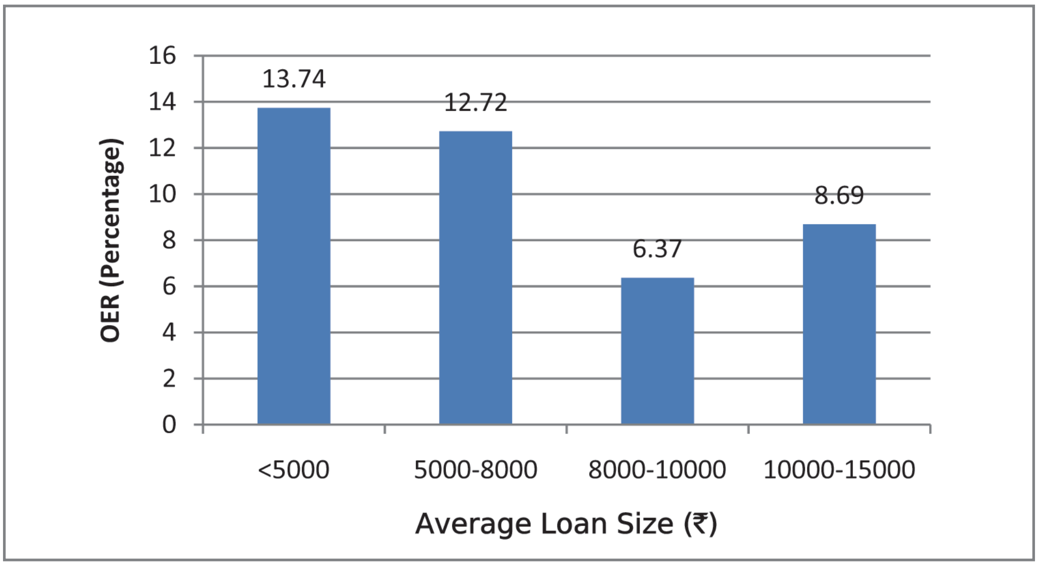
Figure 48: OER across Portfolio Size



2.2.1.2 Average Loan Size & Cost: 'Higher the Loan Size – Lower the Unit Cost '

The operating expense (OER) decreases with increase in average loan size as shown in Figure 49 Sa-Dhan's last year data also revealed the same relationship.

Figure 49: OER for Different Range of Loan Size



It may be interesting to compare the observation of Malegam Committee with this finding. The committee observed that the cost of credit delivery is relatively flat, that is, the delivery cost per loan remains more or less the same, irrespective of the size of the loan. In fact, the difference is between "per loan' cost and cost 'per unit loan amount". OER measures the cost in terms of loan amount which comes down with increase in loan size, while the Malegam -point is on 'cost per loan' which would be flat, irrespective of the loan size.

By and large, increasing loan size serves two purposes. The higher unit cost that accompanies the smaller loan size may be reversed by enhancing the loan size. Similarly, earlier we found that the average loan size is too low to support major investment needs of the borrowers. Thus, higher loan would perhaps resolve this issue as well.

Increasing average loan size serves twin purposes. It reduces the operating cost for MFIs. It also helps clients to meet their borrowing needs, obviating the need for multiple borrowing.

2.2.2 External Cost: 'Finance Cost does not matter for Margin Cap, matters for Interest Rate Cap'

Finance Cost[7] (Finance Expense Ratio-FER) is the only external cost, which comprises mainly of interest charges and other charges incurred by MFIs on the bank borrowing. The median FER for 2011 works out to 10.77 percent for the entire sample.

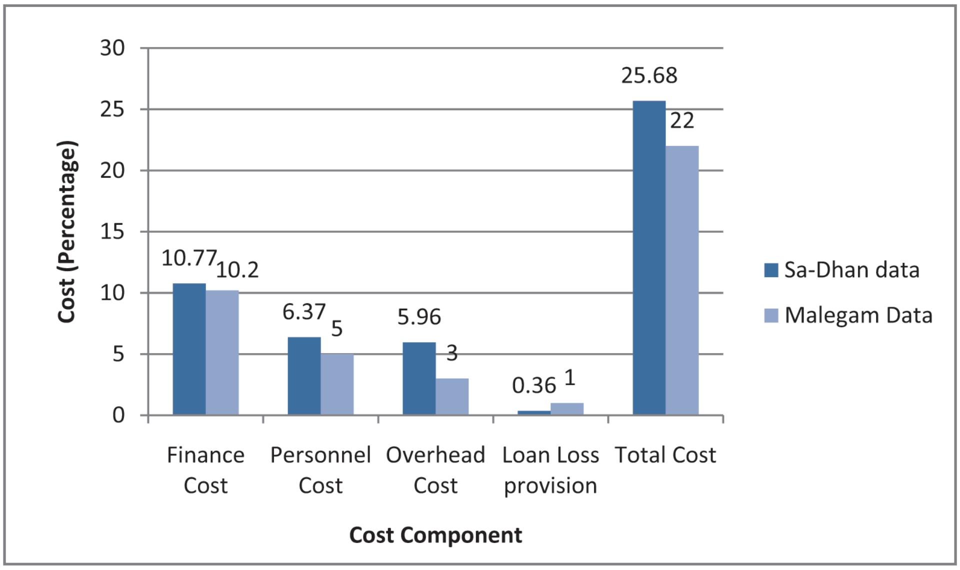
Any steady increase in Finance Cost would invariably constrain MFIs from containing the loan interest rate within the Interest Rate Cap.

2.2.3 The Cost Estimate: 'Sa-Dhan Estimate Vs Malegam Estimate'

The cost structure of select MFIs analyzed by the Malegam committee for 2010 data formed the basis for its prescription on the Margin Cap and the Interest Rate Cap. The cost structure is compared with those of MFIs reporting data for 2011 and the result presented in Figure 50

The median cost percentage for all cost components (except Loan Loss Provision) for Sa-Dhan data is higher than the Malegam estimates. Keeping in view the margin realized by MFIs for this year, apparently exceeding the cap, fresh margin cap raising it from the present 12 percent may be considered by the Reserve Bank of India. This is also necessitated in the light of the negligible / negative surplus realized by MFIs at large (Figure 57) discussed in the succeeding section.

Figure 50: Cost - Sa-Dhan Estimate Vs Malegam Estimate



2011 data show higher cost involved in MFIs operation compared to the cost estimated by the Malegam Committee in 2010

7 Finance Cost here refers to the interest and other expenses incurred on average bank loan outstanding in the books of MFIs. This does not include notional cost of utilizing the equity fund.

3 Yield[8] on Loan Portfolio *'Below The Interest Rate Cap'*

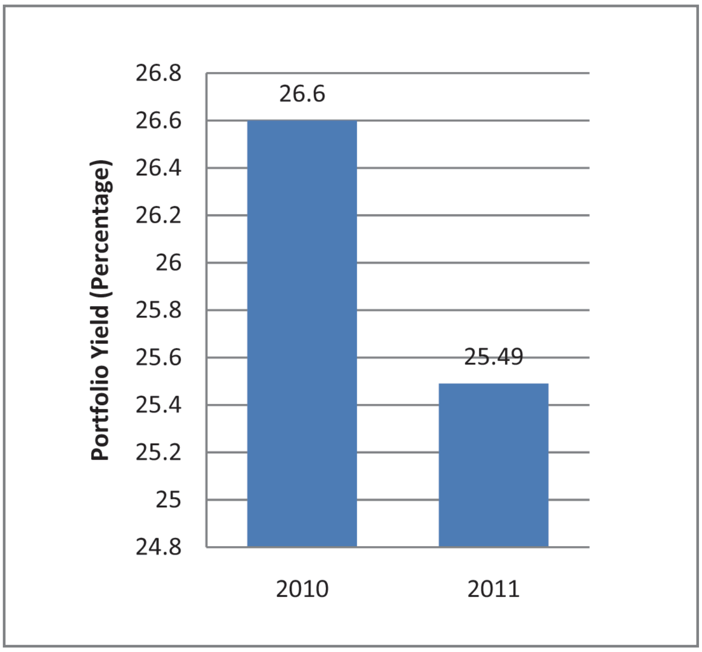
Yield helps us to compare return against cost in the microcredit transaction. It also helps us to estimate interest rate charged on microloans given to borrowers. Interest rate, being a bone of contention in the recent past, estimating yield on portfolio assumes importance. In this section, an attempt has been made to analyze the yield level of MFIs.

3.1 Yield in 2011: *'Sliding Down!'*

Yield on portfolio has been on the decreasing trend as understood from the Sa-Dhan data analyzed for consecutive years (Figure 51). This could be the pointer to the general interest rate reduction and the possible deterioration of portfolio quality.

Given the fact that 2011 results in general have been influenced by the microfinance crisis, probable contributing factor for the yield reduction in 2011 would be deterioration of portfolio quality.

Figure 51: Portfolio Yield over Years



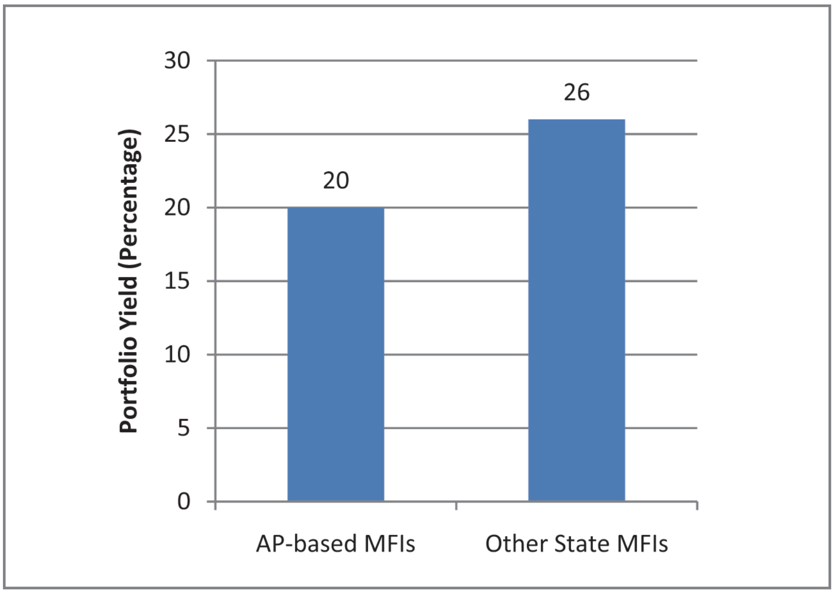
3.2 Yield among AP-based MFIs Vs Other State MFIs: *Lower among AP-MFIs*

Andhra Pradesh based MFIs are estimated to have loan portfolio exposure in the state to the tune of 25-30 percent. They have seen reduction in their yield (Figure 52)obviously because of the crisis in the state where The Andhra Pradesh Microfinance Institutions Act had been imposed resulting in stoppage of further lending to clients and drastic reduction in loan repayments from the clients.

Yield on loan portfolio decreased in 2011. It was only 20 percent among AP-based MFIs

[8] Yield represents total income from microcredit operation-Interest income, processing fee/ service charge – earned out of average loan portfolio outstanding. It does not, include investment income. It is a good proxy / surrogate for loan interest rate.

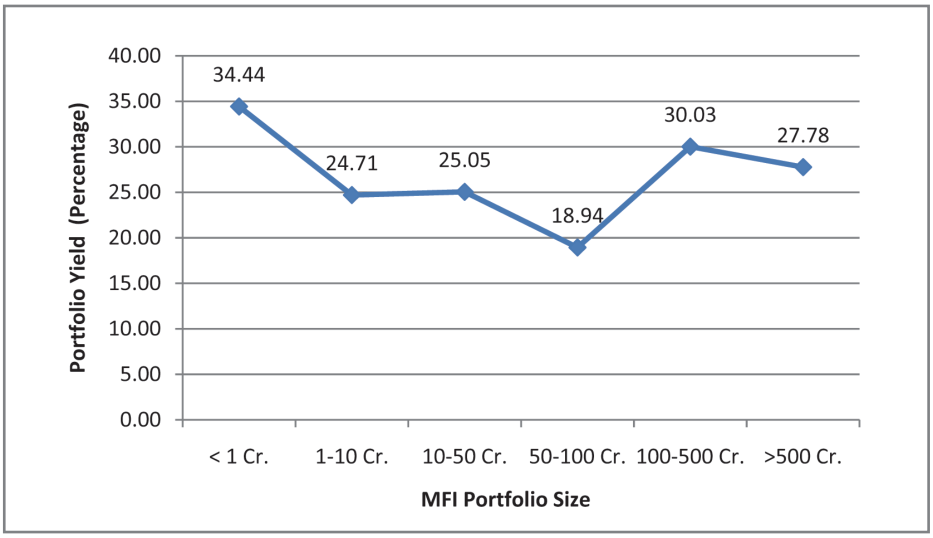
Figure 52: Portfolio Yield among AP-based MFIs Vs Other State MFIs



3.3 Yield and MFI Size: *'Distorted Relationship in 2011?'*

There has been a general understanding that economy of scale will improve yield on the loan portfolio.

Figure 53: Portfolio Yield across Portfolio Size



However as could be seen from Figure 53, portfolio size, as an indicator of scale of operation, does not seem to have any relationship with yield on portfolio. This is probably because of the microfinance crisis which has affected the sector, systemically affecting the repayment and thus distorting the relationship between yield and size of MFIs.

4 Margin[9] Analysis - *Compliance to RBI Norm?*

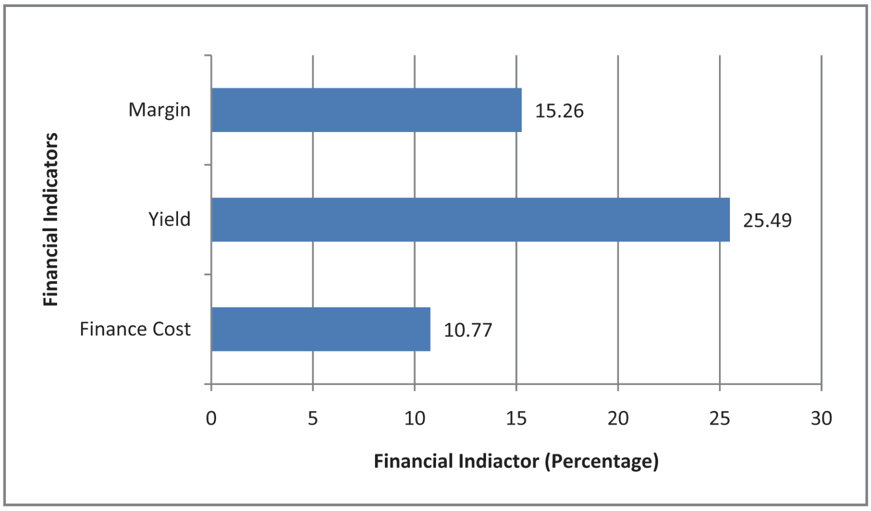
Very important apprehension among MFIs and others over Malegam Committee recommendation has been that the margin cap of 12 percent and the interest rate cap[10] of 26 percent would seriously affect the financial sustainability of MFIs. Understandably, the logic behind margin cap is that the major cost variation in microfinance operation happens in operating cost, which the MFIs are supposed to have control over to enhance operating efficiency and thereby reduce interest cost to the borrower. The margin over finance cost (the latter being beyond the control of MFIs as the funding cost is determined by banks) will have to cover the cost of delivery and at least a little surplus that is necessary to sustain the MFIs as financial institutions. In this section, cost, yield and margin relationship is analyzed briefly.

4.1 Cost, Yield and Margin

Indian MFIs may find it, at least now, difficult to conform to margin cap norm of Malegam committee that is 12 percent over the finance cost. Figure 54 provides evidence to the fact that the MFIs have exceeded margin cap so prescribed by the committee. The median margin is 15.6 percent for the sample. And at the same time, the sample MFIs are very well within the interest rate cap (26 percent Interest Rate +1 percent Processing Fee) as the overall median yield is 25.49 percent .

There would be a constraint for Indian MFIs to adhere to Margin Cap norm at least under the present cost structure.

Figure 54: Finance Cost, Yield and Margin for 2011



The escalating operating cost constrains MFIs from controlling the cost within the Margin Cap of 12 percent. RBI may consider upward revision of the cap.

[9] Margin refers to the difference between the finance cost on portfolio and the total yield on portfolio. This term is analogous to the concept of Net Interest Margin (NIM) widely used in banking parlance. Margin Cap refers to the ceiling of Margin of 12 percent fixed by RBI.

[10] Interest Rate Cap refers to the interest rate ceiling of 26 percent fixed by RBI chargeable by MFIs from the loan lent to their clients.

4.2 Margin - Performance Across MFI-Size

Figure 55: Margin Performance across MFI Size

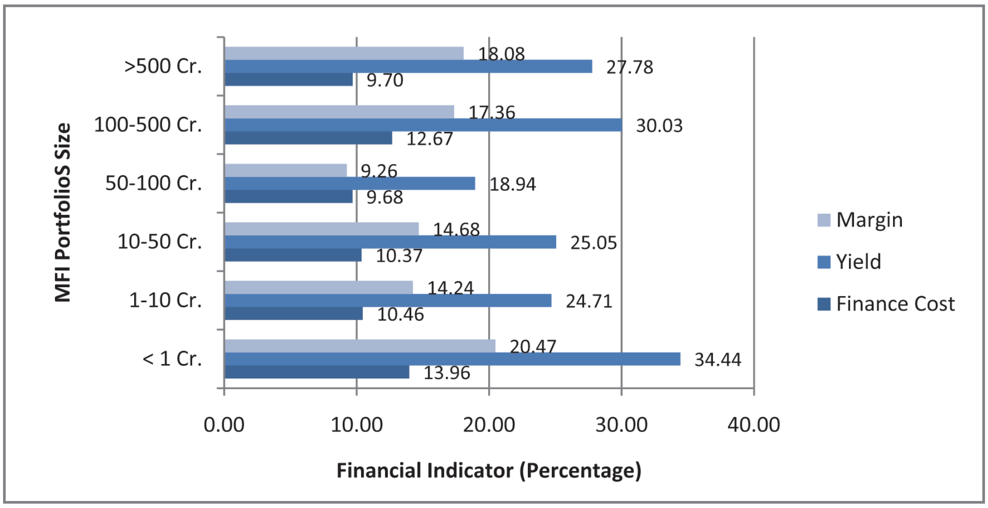


Figure 55 depicts the yield and margin realized by MFIs having different portfolio size. The MFIs, irrespective of portfolio size, exceed margin cap except the 50-100 crore portfolio categories.

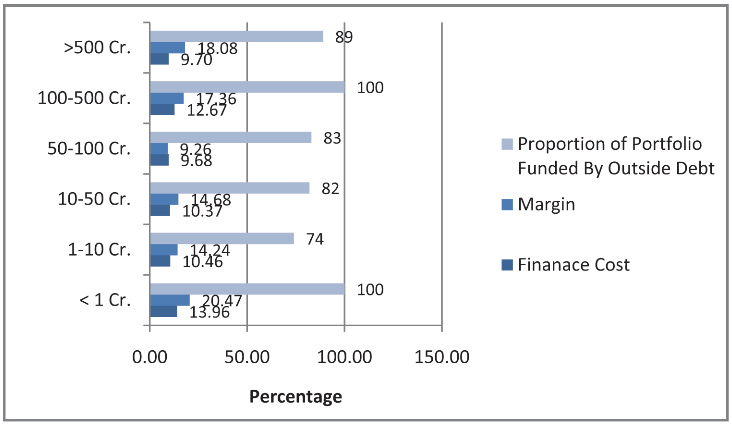
Similarly, yield level of very small MFIs (< 1 core) and that of the large MFIs (100-500 crore) appear to be beyond the prescribed interest rate plus processing fee cap of 27 percent. However, when their total cost is taken into account, they post either negative or moderate surplus (Figure 57). In addition, their Return on Asset analyzed in the subsequent sections show that they do not enjoy disproportionate profit. (Figure 60)

4.3 Size of Debt Funding[11] & Margin Performance

An MFI which has most of its portfolio funded from equity will have very low Finance Cost. In the extreme case, if there is an MFI which has funded its entire portfolio from equity its Finance Cost will be zero.

For the year 2010-11, the average proportion of borrowed fund used for funding the loan portfolios of the reporting MFIs stood at 85 percent. Figure 56 shows the relationship between the outside funding, the finance cost and the margin across different portfolio size.

Figure 56: Relationship Between Borrowed Fund, Finance Cost & Margin



[11] Refers to the Percentage of loan portfolio funded by outside borrowings

The figure shows that higher the borrowed fund for funding the portfolio higher is the finance cost. Within a peer group having similar / same yield level, the MFIs having higher proportion of borrowed fund will have higher finance cost and hence consequently lower margin. This is true between the portfolio categories >₹ 500 crore and ₹ 100-500 crore, both have narrow range of yield between them compared to the rest of the groups. The 100-500 crore category displays lower margin since it has got higher proportion of borrowed fund.

Strategically, maintaining an optimum proportion of borrowed fund is important in the margin cap scenario. Any attempt to reduce the borrowed fund / raise the equity fund for funding the loan portfolio may prove to be counterproductive as the reduced finance cost will artificially inflate the margin to be hit by the restriction of margin cap. However, this analysis has to be repeated with a larger set of data for gaining right perspective on the issue.

5 Surplus, Sustainability and Profitability- *'MFIs do not make Huge Profit Anyway'*

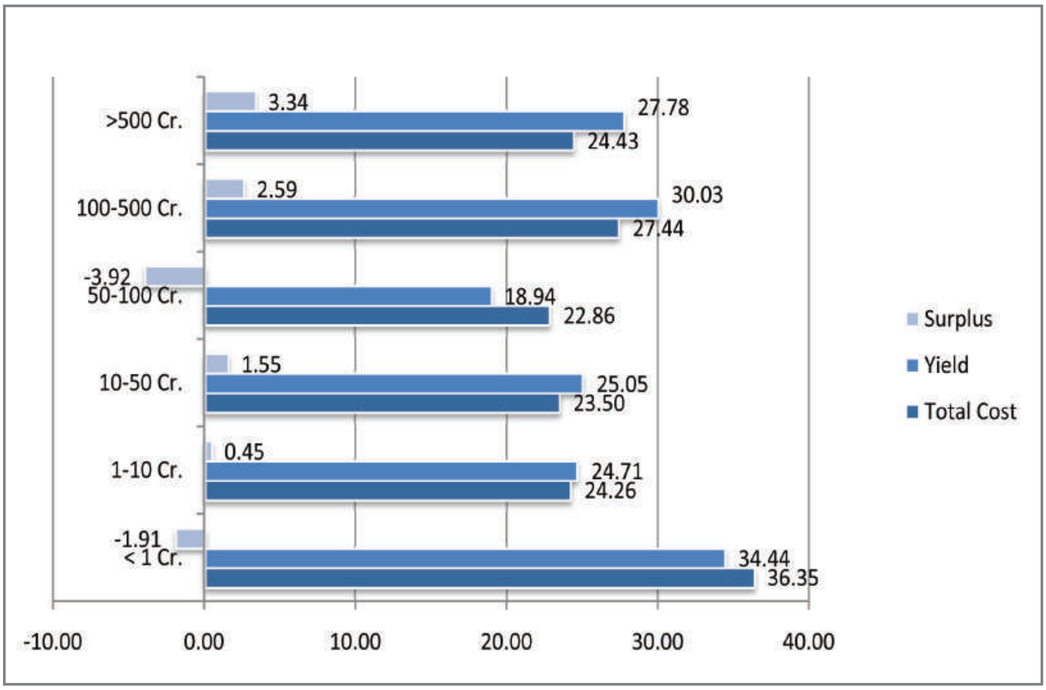
5.1 Surplus:

We observed in the previous section that the majority of MFIs are unable to meet the margin cap norm. Some of the MFIs are not conforming to the yield cap. It would therefore be worthwhile to compare their total yield with total cost to find out as to whether the MFIs make net surplus (Yield net of total cost).

It would be important to remember that operating cost analyzed earlier does not take into account the Loan Loss Provision which is inherent part of MFI cost structure. The surplus is studied here comparing yield vis-à-vis Total Cost (Finance Cost plus Operating Cost plus Loan Loss Provision)

Figure 57 shows that the surplus enjoyed by MFIs across the categories is negligible. The MFI category that seemed to have got higher yield as per Figure 53 viz., < 1 crore portfolio posts negative surplus. Similarly, the category with 50-100 crore portfolios, posting lowest margin that too well below the margin cap, has got negative surplus.

Figure 57: Surplus (Total Yield minus Total cost) across MFI Size



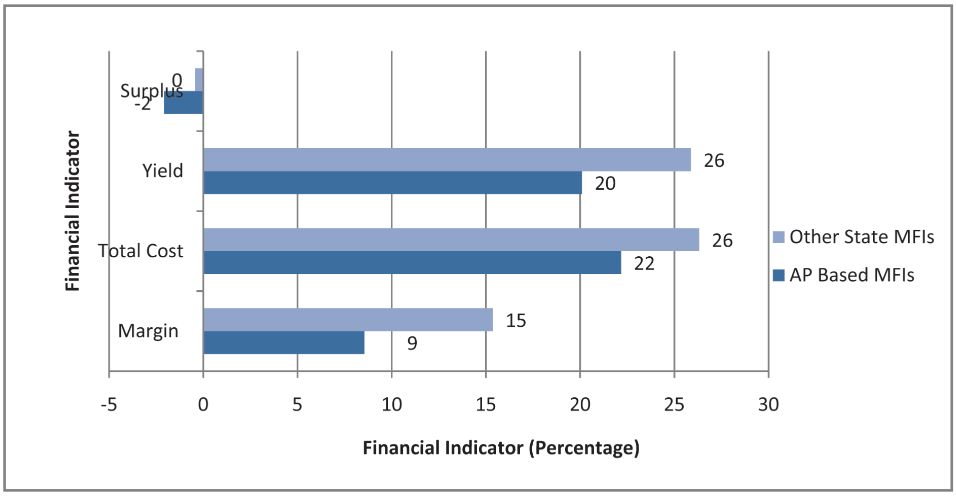
The MFI-categories, apparently showing higher yield, post either negative or moderate surplus, when their total cost is taken into consideration

It is however suggested that this surplus results will have to be interpreted in the light of results of Return on Asset (RoA) and Return on Equity (RoE) arrived at in the subsequent sections for holistic view on the issue.

5.1.1 Surplus among AP – based MFIs: 'AP-MFIs show Negative Surplus'

The MFIs based in Andhra Pradesh are found to conform very well to the Malegam recommendation, both with respect to Margin Cap and Interest Rate Cap. However, they are posting negative surplus this year, apparently due to their portfolio deterioration and negative growth in Andhra Pradesh after the stringent microfinance act in the state. (Figure 58)

Figure 58: AP-based MFIs - Margin & Negative Surplus



AP- based MFIs showed negative surplus in 2011

5.2 Self Sufficiency and Profitability – *'Self sufficient but not Profitable, in General'*

The obvious reason behind prescribing the financial return - related caps like the margin cap and the interest rate cap, would be the apprehension that MFIs take home unjustifiable amount of profit at the cost of the poor clients.

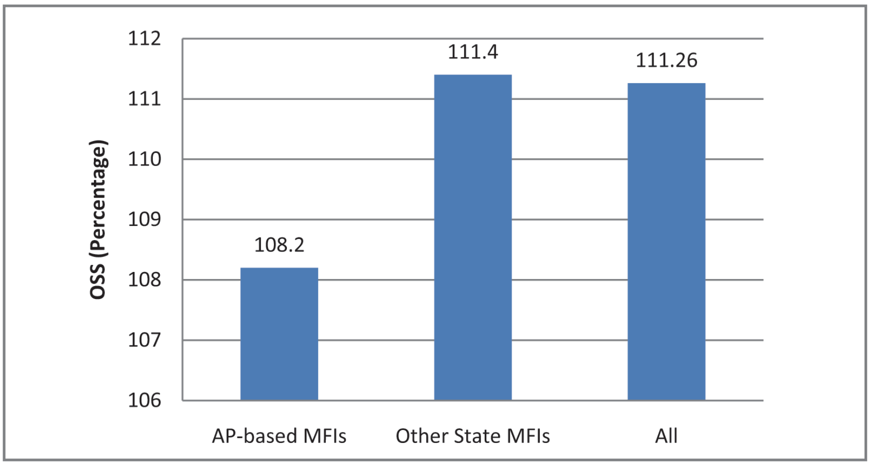
In this section, self sufficiency measure, Operational Self Sufficiency (OSS)[12] and profitability measures viz., Return on Asset (RoA)[13] and Return on Equity (RoE)[14] are assessed and compared.

[12] OSS shows the sufficiency of income (operating income and investment income) earned by MFIs to cover the cost like operating cost, loan loss provision and finance cost, incurred for conducting the operation.

[13] Return on Asset (RoA) is the universally accepted profitability measure which, in essence, is the percentage net income earned out of total average asset deployed by MFIs during a given period, say a year.

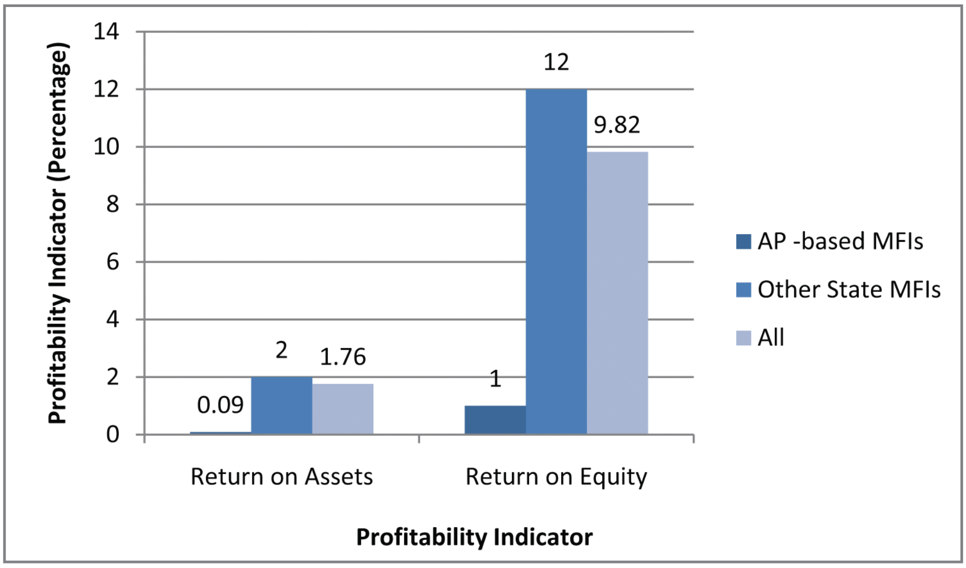
[14] Return on Equity (RoE) is the net income earned out of average equity of MFIs held by MFIs during the given period.

Figure 59: Operational Self Sufficiency Ratio (OSS) of Different Categories of MFIs



MFIs are just financially self-sufficient when all the income, including investment income, is taken into account. This leaves however negligible surplus for funding expansion of their operation to newer territory/clientele

Figure 60: RoA and RoE of Different Categories of MFIs



In 2010-11, the surplus realized by MFIs and their Return on Asset (RoA) show that MFIs do not enjoy disproportionate profit . The profitability level is just comparable to that of banks

Figure 59 shows that the median Operational Self Sufficiency - is more than 100 percent -indicating the self sufficiency of income to cover the cost. OSS is a little lower for AP MFIs for obvious reasons.

Similarly, median Return on Asset for the entire sample is 1.76 percent while it is near zero for AP-based MFIs. ROE for the entire sample is 9.82 percent while the same is one percent for AP-based MFIs(Figure 60).

These results show that MFIs have profitability levels which are only comparable with those of the banking sector. Thus, MFIs in general have reached a stage when their profitability is just sufficient to meet the growth needs.

6 Productivity of MFIs – *'Warranting Redefinition?'*

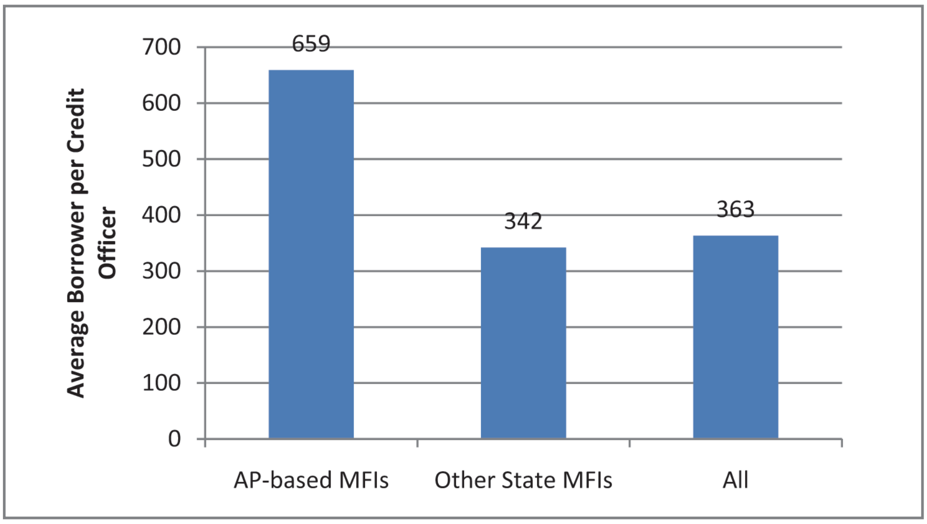
One of the concerns of Malegam Committee has been on MFI's efficiency of operation and management effectiveness. Staff Productivity determines the cost effectiveness of services for client level improvement.

6.1 Staff Productivity of MFIs: *'Optimum in General – high among AP MFIs'*

Higher staff productivity is one of the many ways of enhancing cost efficiency, better portfolio quality and yield. Number of clients handled by a staff / credit officer has been one of the staff productivity measures tracked widely. Sa-Dhan, as part of its standards initiative, had prescribed Average Borrower per Credit Officer (ABCO)[15] of 250 -350 as optimum level of client-staff ratio.

Figure 61 shows the ABCO level for this year, comparing the measure for AP- based and other - state MFIs. ABCO for the entire sample (363) and Other- state- based-MFIs (342) is conforming to the Sa-Dhan standards. ABCO for AP-State based MFIs (659) is found to be high compared to the standard.

Figure 61: Average Borrower per Credit Officer (ABCO) among MFI Categories



Sa-Dhan standard norm of staff productivity - Average Borrower per Credit Officer (ABCO) - is 250 – 350. This ensures cost efficiency and optimum portfolio quality, as corroborated again through 2011 data set.

Very high ABCO level, however, heralds client protection related issues as high number of borrowers handled by an officer leaves less scope for better interaction with clients , individual attention, need based service delivery etc. The AP crisis is not only a useful lesson for the sector but also a pointer to optimum client-staff ratio as well.

6.2 ABCO as a Determinant of Efficiency and Yield

ABCO, presumably, influences the cost, the portfolio quality and therefore the yield. An attempt has been made to plot a graph (Figure 62) displaying this relationship using the sample data.

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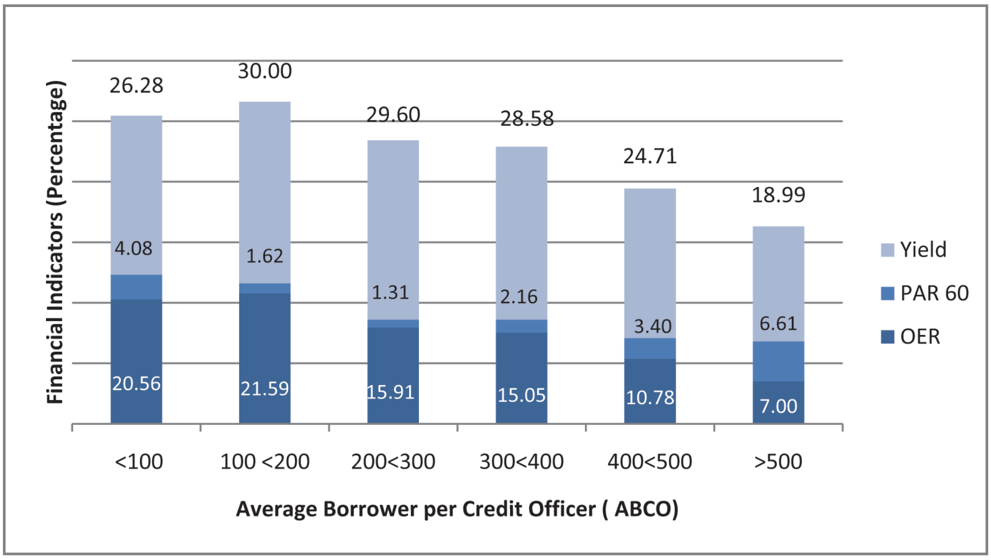
15 ABCO is an acronym for Average Borrower per Credit Officer, a measure of client – staff ratio. It is also known as Case Load

ABCO has got direct correlation with Portfolio at Risk (PAR 60)[16], a measure used to rate the portfolio quality. Similarly, ABCO has negative relationship with cost and yield.

Figure 62: Relationship among ABCO, PAR, Yield & OER



Higher ABCO affects loan portfolio quality. Incidentally, AP-based MFIs have the highest ABCO.

Higher ABCO indicates lower OER. It takes a toll on yield if it exceeds 300 as seen in the graph. This is due to deterioration of portfolio quality that accompanies higher ABCO. Similarly, PAR gets inflated as ABCO getting higher. This result confirms Sa-Dhan's earlier finding that ABCO is directly correlated with Loan Write off, an end product of deteriorating portfolio quality.

The ABCO –results in the light of the Andhra Pradesh crisis (higher ABCO among AP MFIs is a case in point) indicates that the sector needs to redefine, find new metrics to measure staff productivity. Sa-Dhan Standard on ABCO level is, in all likelihood, to be the constant benchmark for the sector to follow to avoid AP-like crisis. The fact however remains that the sector needs to identify alternative productive measures for optimizing cost, portfolio quality and yield.

[16] PAR60 denotes the percentage of aggregate loan outstanding of all loan accounts having overdue (past due) beyond 60 days to the total portfolio (To be dealt with in detail in Chapter 4).

Key Takeaways

- *Indian MFIs are very much geared to meet the Qualifying Asset criterion set by the RBI.*
- *The escalating operating cost prevents them from meeting Margin Cap of 12 per cent set by the RBI. This necessitates that the RBI to consider upward revision of Margin Cap at least to 15 per cent over the Finance Cost. All in All, yield level indicates that MFIs meet the interest rate cap set by the central bank.*
- *MFIs average loan, irrespective of the purpose for which it is lent, is very low. This lower amount could force the clients to resort to multiple borrowing to meet their borrowing needs. MFIs need higher resource support to enhance the loan size.*
- *MFIs need to optimize the staff –productivity level. Any move to raise the number of clients served by a loan officer, beyond Sa-Dhan standard of 350 in a bid to cut cost, will have a toll on yield.*
- *The financial results of AP-based MFIs are matters of greater concern. The government will have to take appropriate but urgent steps to ease the stalemate prevailing in the state.*

Financial Solvency of MFIs

The central bank and the government are keen to ensure that MFIs function as stable financial institutions to render sustainable service to the low income households. It is important to explore what conditions or what features are optimal to the business model of microfinance. Sa-Dhan has chosen to address this issue, as it is of primary concern to the future of what will determine the state of the sector.

One common approach adopted by regulators and policy makers is to recommended corporate size and capital adequacy, minimum provision for bad debts, acceptable funding pattern, etc to ensure financial soundness of MFIs. Government of India, in its draft MFI bill, introduced stipulations including reserve fund to be created by MFIs.

This chapter probes into different aspects affecting the financial strength of MFIs with particular reference to:

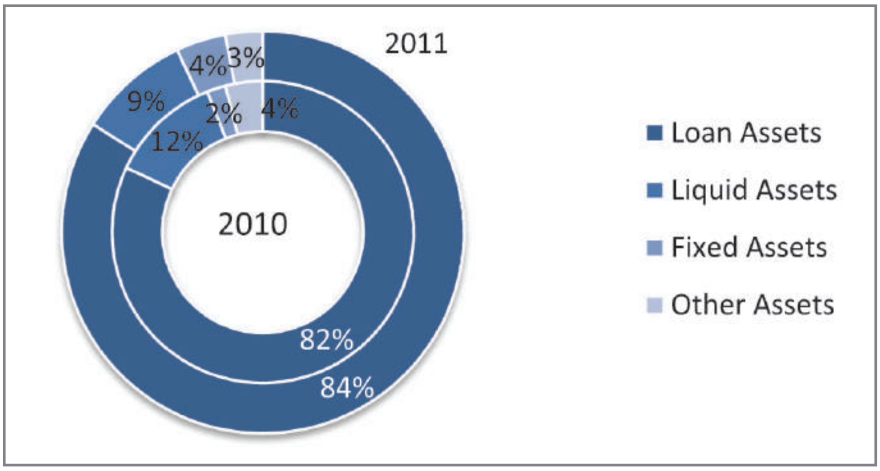
1. Asset Composition
2. Portfolio Quality and Provisioning
3. Bank Funding
4. Leverage, Capital Adequacy and Net Owned Fund.
5. Rating of MFIs

1. Asset Composition: *'Shrinking Liquid Asset'*

Asset composition is analyzed in terms of pattern of allocation of key assets of an MFI, namely, loan portfolio, liquid assets (cash and other investments), and fixed assets, among the Indian MFIs. The pattern of allocation of assets within an MFI has a direct bearing on its earning level. In general, MFIs are expected to deploy a major portion of their assets into loan portfolio, while keeping a healthy mix of liquid assets and fixed assets that are essential for running the microfinance business.

Figure 63 depicts the asset allocation pattern of the reporting MFIs for two consecutive years -2010 and 2011.

Figure 63: Changing Composition of MFI Assets



* Financial Solvency here refers to Financial Strength

Share of liquid assets in the total assets in 2011 has decreased considerably due to the liquidity crunch

The composition of asset pattern between the two consecutive years shows that the proportion of loan assets and fixed assets has increased during 2011 compared to 2010, shrinking the portion of liquid asset and other assets.

The shrinkage of liquid asset could be due to slow down and in some cases drying up of bank fund to MFIs after the Andhra Pradesh crisis. The consequent repayment default from the clients hindered the loan outstanding from dwindling further, though the quality of the outstanding has inevitably taken a beating.

2. Portfolio Quality and Provisioning: *'Matching the Benchmark of Banks'*

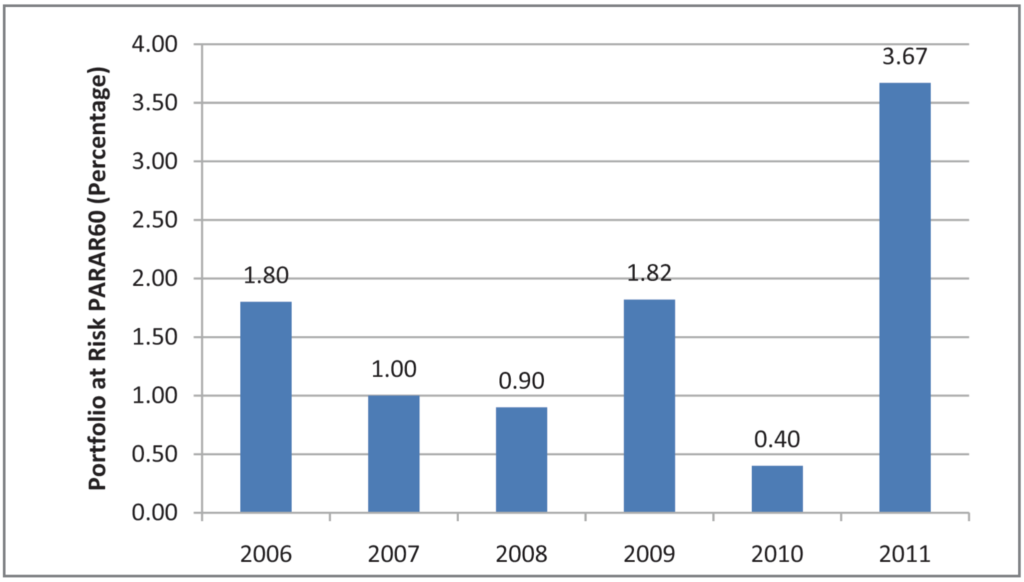
The loan portfolio is the key income generating asset in MFIs. In any financial institution lending is fraught with inherent risk of repayment default. Maintaining healthy loan portfolio with minimum client default therefore ensures financial soundness of MFIs.

The portfolio quality is analyzed using two parameters widely adopted in the sector. One is Portfolio at Risk (PAR) and another is Current Repayment Rate (CRR).

2.1 Portfolio at Risk (PAR 60)[1]: *'Unprecedented PAR in 2011'*

The historical PAR 60 is captured over years in Figure 64. PAR 60 has gone up during 2011 compared to earlier years, due to the present crisis.

Figure 64: PAR 60 over years



The non-performing assets (PAR) in 2011 are the highest during the past six years. It is alarmingly high among AP– based MFIs as of September 2011.

[1] PAR indicates the proportion of outstanding amounts of all loan accounts having past due/arrears to the total outstanding loan. In general, PAR 60, i.e., the portfolio / part of the portfolio remaining unpaid 60 days and beyond crossing the due date, would be used as a measure to assess the portfolio quality.

Figure 65: PAR 60 in AP- based MFIs –March 2011

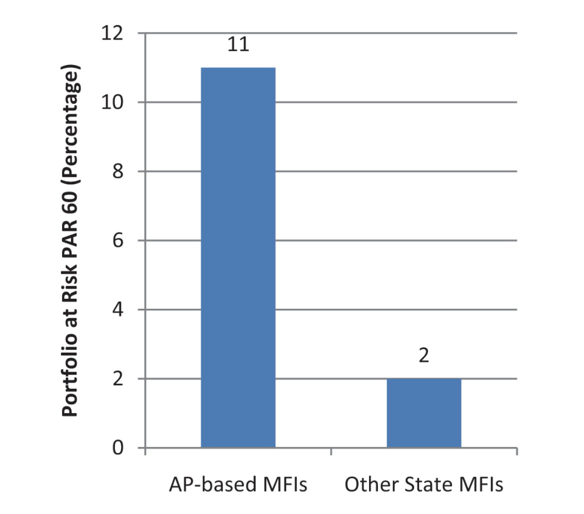
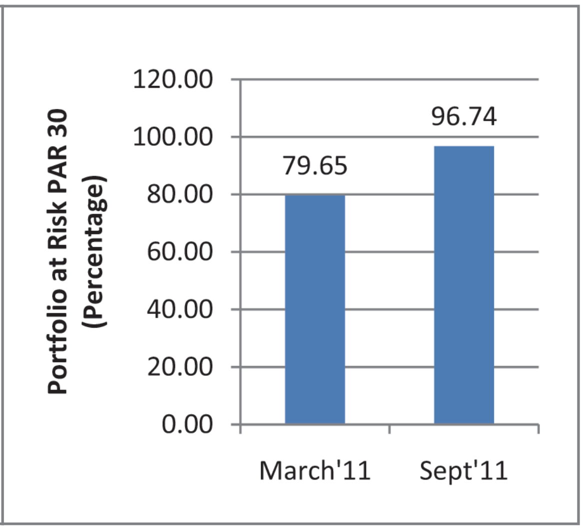


Figure 66: PAR 30 in AP (April & Sept.2011)



Similarly, a comparison has been made between PAR 60 of AP–Based MFIs with that of Other State MFIs (Figure 65). In addition, PAR 30 of AP based MFIs specifically collected for this report shows the current portfolio quality of AP-based MFIs (>96 percent) indicating the precarious situation of the MFIs based in AP (Figure 66). Such a widespread default is not only hence a function of management challenges of MFIs, but rather a result of the problems that exist within the political economy of each state.

If this loan default rate continues unbridled, the credit repayment culture among the clientele will deteriorate and reach a point of no return causing widespread pessimism among any type of lender to the poor.

Similarly, the default tract record of the microcredit borrowers will also be reflected in credit information bureaus making them ineligible for loan from any organized lender in future. The unorganized segment then will have to be at the mercy of the moneylenders.

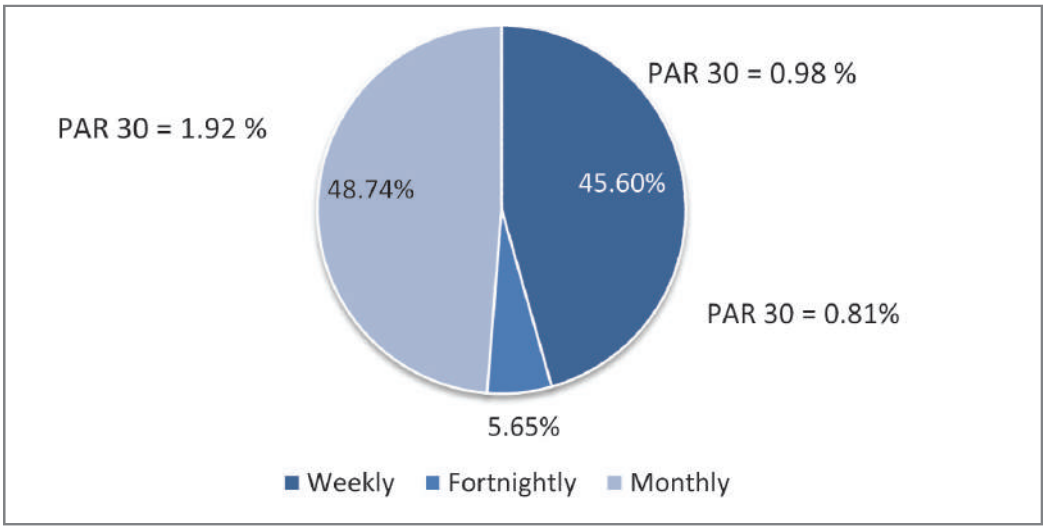
2.2 Repayment Periodicity & PAR: *'Lowest PAR in Fortnightly Mode'*

Microfinance practitioners hold the view that loan repayment periodicity influences the portfolio quality and weekly mode helps contain PAR. Disappointingly, the Andhra Pradesh microfinance act stipulates that the loan repayment frequency among AP MFIs to migrate to monthly mode, perhaps under the presumption that weekly mode is burdensome to clients.

In order to test this assumption, Sa-Dhan data on loan portfolio falling under different repayment periodicity was collated along with the corresponding PAR 30 values. The results of the analysis is presented in Figure 67.

The result reveals that fortnightly mode facilitates better portfolio quality. Of the three modes studied, portfolio falling under monthly mode has got the highest median PAR30 of 1.92 percent. The weekly mode is preferred by MFIs because of the assumption that it minimizes default risk. Monthly mode is suggested by the AP government because of the assumption that it is convenient to the clients.

Figure 67: Portfolio Held under Different Repayment Mode & Their PAR 30



The portfolio quality is healthier in fortnightly repayment mode compared to weekly repayment mode

This finding, on contrary, suggests that fortnightly mode, which is via-media between weekly and monthly mode, may be adopted by MFIs at large. This would improve the portfolio quality and also enhance customer convenience.

Incidentally, a major chunk of portfolio is found to be falling under monthly mode, perhaps due to AP portfolio which recently got transitioned into that mode after the new act.

The data suggests that clients under fortnightly repayments are more prompt and this might be because fortnightly repayment schedule allows clients to better plan their cash flows. Also, as compared to the weekly repayment model, fortnightly model may prove more economical for MFIs as their operational staff will then need to attend collection meeting only once in two weeks. However, MFIs will need to modify their Management Information System (MIS) and their operating procedures if they desire to transition to a fortnightly repayment model.

2.3 Current Repayment Rate[2] (CRR)

Higher CRR indicates better portfolio quality. The CRR studied for 2011 MFI sample is presented along with the historical data.

The loan repayment rate has dipped in all years of crisis in India: 2006 (Krishna Crisis), 2009 (Kolar Crisis) and 2011 (AP crisis). Management of political risk forms part of the process of evolving robust sector.

[2] CRR is the proportion of client loan and interest amount recovered / repaid out of the total loan and interest amount due as on a particular date.

Figure 68: Current Repayment Rate (CRR) over Years

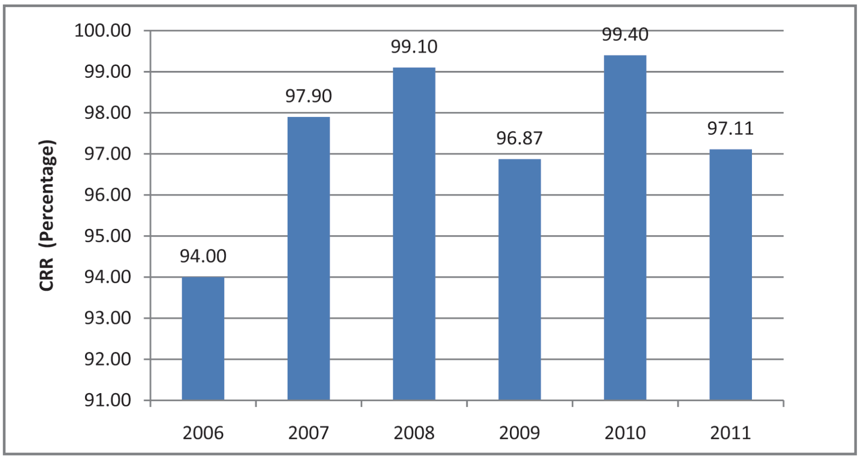
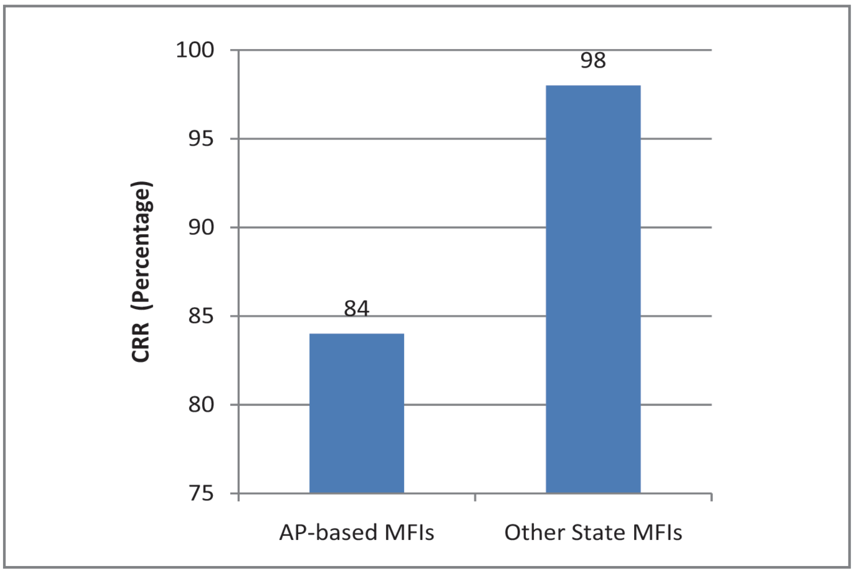


Figure 68 portrays the trend in CRR over years. Palpable slump in CRR is noticed in year 2006, 2009 and 2011. These years, if recollected, coincided with the microfinance crises that affected the sector during the corresponding years. They are Krishna crisis in 2006, Kolar crisis in 2009 and AP crisis this year. This once again demonstrates how important the management of the political risk is for the industry.

Figure 69 further disaggregates the 2011 data and provides comparison of CRR among AP based MFIs vis-à-vis other state MFIs. The AP-based MFIs have lower CRR for obvious reasons.

Figure 69: CRR in AP - based MFIs Vs Other - State MFIs



All major AP-Based MFIs have nearly 60-70 percent of their portfolio in other states which has helped them show a passable repayment rate.

By and large, the portfolio quality of MFIs has suffered due to the microfinance crisis in 2010-11. However, the quality is still comparable in terms of benchmark Non Performing Assets (NPA) of mainstream banks, where NPA (Non-Performing Assets) would be in the vicinity of 2.5 percent of gross advances, that too calculated based on 180 /90 days past due.

MFI portfolio is fragile and its quality is often subject to public perception and political interference.

2.4 Solvency[3] Against PAR: *'MFIs Prudent Enough to Meet RBI Norm'*

Indian MFIs meet solvency requirement recommended by the Malegam committee. The committee has suggested to MFIs, making provision for an amount highest of the following:

i. 1% of the gross loan portfolio

ii. 50% of all aggregate installments which are overdue for more than 90 days

iii. 100% of all aggregate installments which are overdue for more than 180 days

The data for the item i and ii are not readily available. 2011 data shows that the collective provision of all 110 MFIs calculated against their total loan portfolio exceeds the 1 percent norm recommended by the committee. The provision (reserve) outstanding constituted 2.69 percent of the gross loan portfolio as of 31 March 2011.

MFIs have made Loan Loss Provision in their balance sheets in line with the Malegam Committee recommendation

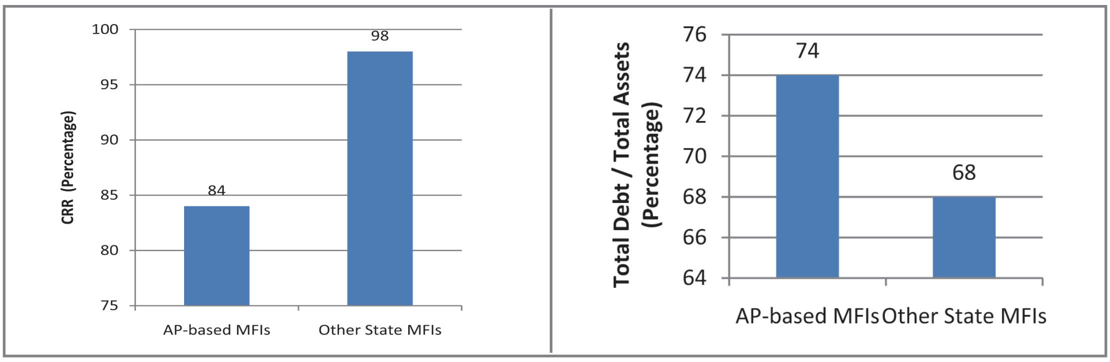
3. Bank Funding : *'Reduced Flow to Select MFIs'*

MFIs depend majorly on bank funds for their lending resources. The present microfinance crisis has become a systemic one, unlike the earlier ones, because of stoppage of bank fund across India. In this section, the debt structure of sample MFIs is analyzed and the results used to contextualize the bank fund problem facing the sector. Accordingly, two aspects viz., Debt Dependence and Debt Composition are briefly discussed before moving on to discuss the core issue of MFI funding.

3.1 Debt Dependence[4]

The bank debt dependence of the sector seems to have come down while AP based MFIs depended more on bank fund compared to other MFIs (Figure 70)

Figure 70: Debt Dependence (Total Debt / Total Asset - %) of MFIs



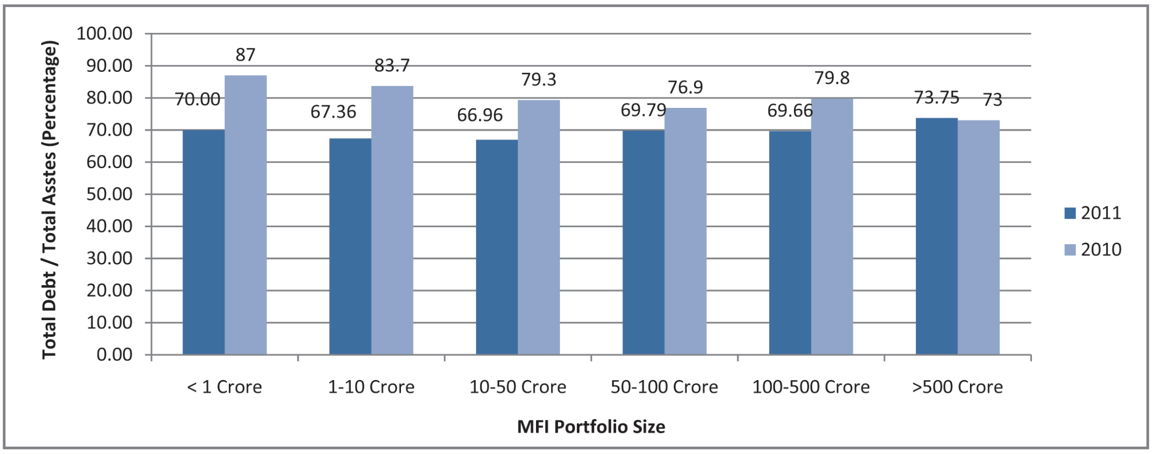
Bank Debt continues to be the major means of funding MFI-assets. Debt dependence has come down slightly in 2011. This is due to shortage of fund coming from banks.

[3] Solvency among MFIs indicates the risk bearing ability of the entities, especially in the event of unforeseen shocks or financial loss. Net owned fund and other reserves are the common instruments to meet the solvency requirement.

[4] Debt Dependence can be understood by studying the proportion of total assets funded by bank loans and outside debts.

The analysis also has revealed that the MFIs size does not provide any variation for this year. This scenario is a little different from the last year, as displayed in Figure 71

Figure 71 : Debt Dependence (Total Debt / Total Asset)-percentage across Portfolio Size



The analysis has further revealed that the debt dependence does not vary with MFI size in 2011. The scenario in 2011 is a little different from that in 2010 when variation with MFI size was witnessed. The disrupted bank fund flow this year would have distorted the relationship between the MFI size and debt dependence this year.

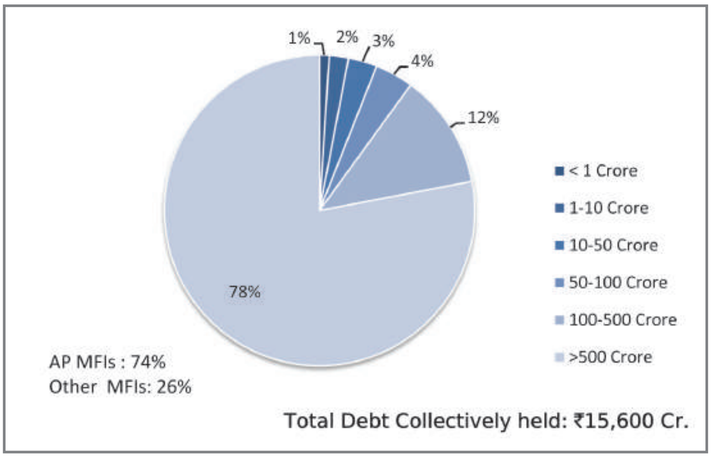
3.2 Debt Distribution in the Sector – *'Skewed Towards Bigger MFIs'*

An analysis of the debt (bank borrowings) held at the books of MFIs, would provide clues as to how the borrowings have been distributed among MFIs. The total debt held by 110 MFIs as on 31 March 2011 was ₹ 15600 crores.

The total debt figure extracted from balance sheets of the above MFIs is distributed variedly among the MFIs having different scale of operation. Figure 72 bears out that a preponderant share (78 percent) of outside debt is held with MFIs with > 500 crore portfolios. As expected, the AP –based MFIs have a lion's share in the debt held.

Potentially, the distribution of the debt among the MFIs could serve as a surrogate indicator of the degree of risk for the debt provider – banks (who is normally not expected to 'put all his eggs in one basket'). On the bank risk point of view as well as on the view of small MFIs being desperate to get banks' patronage, the bank fund flow needs to be redirected towards small MFIs in the months to come.

Figure 72: Debt Distribution among MFIs



Bank loan constitutes the preponderant component of debt of MFIs. Highest share of bank debt by larger MFIs indicates skewed flow of fund from banks. Banks need to redirect fund flow benefitting small MFIs for better risk management and uniform growth of the sector.

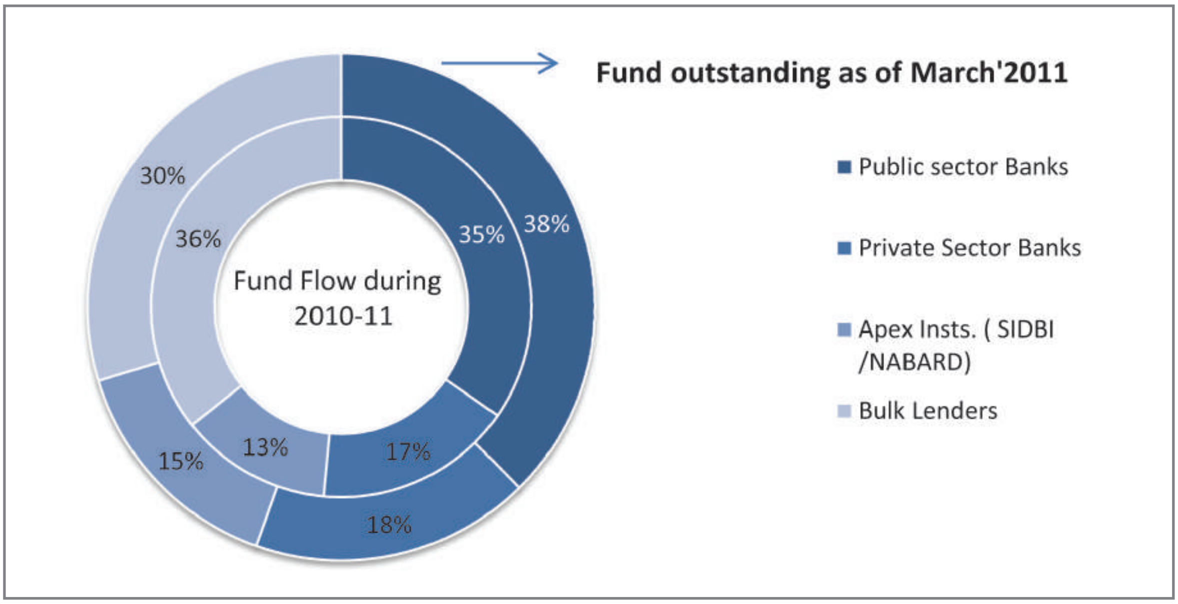
3.3 Bank Funding to MFIs (April 2010 – March 2011)

MFIs source funds from banks and other bulk lenders to on-lend to their clients. Indian microfinance operation has slowed down because of the slowdown in the bank funding ever since the AP crisis inflicted the sector. The client growth rate came down to 18.73 percent and the portfolio growth plummeted to 13.5 percent during 2010-11. (Figure 32 in chapter 2)

The MFI-sector received ₹ 11300 crore of funds during 2010-11 from banks, apex bodies and private bulk lenders leaving a bank credit outstanding of ₹ 16400 crore as of March 2011 in the sector.

Public sector banks and bulk lenders were the major lenders to MFIs during 2010-2011. Seventy one percent of the total loan made available to MFIs during the year came from public sector banks (35 percent) and bulk lenders (36 percent) (Figure 73). The outstanding figure at the end of the year also shows the similar (68 percent) contribution from these entities. The absolute amount of fund flow and fund stock from these entities as reported by MFIs is shown in Figure 74.

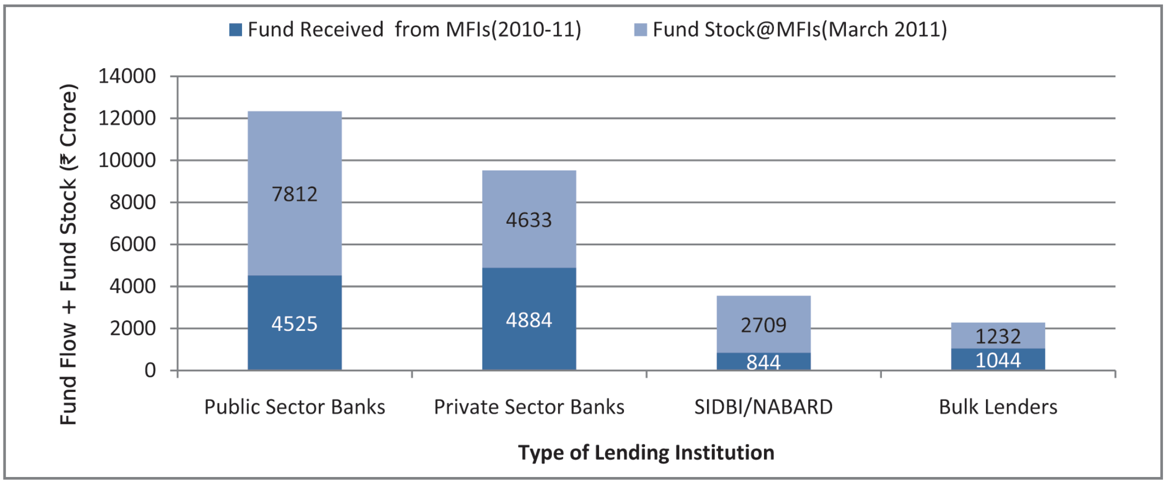
Figure 73: Lender-wise Share of Flow & Stock of Bank Credit to MFIs (2010-11)



These facts underline the importance of bulk lenders (Ananya Finance, Oiko Credit, RGVN and others) in funding the sector during the crisis period. The proportion, of course, appears to be higher especially during this year perhaps due to the fact that banks in general shied away from disbursing loans to MFIs after the AP crisis. Besides, the bulk lenders also are understood to have resorted to alternative mechanism of funding to MFIs like portfolio securitization which helped them to show up higher share in this year MFI funding. In any case, as they play a crucial complementary role, they deserve refinance support from NABARD, SIDBI and banks in a large and significant manner.

The banks, SIDBI and bulk lenders collectively lent ₹11300 crore to MFIs during 2010-11. 170 MFIs had ₹16400 crore outstanding loans from the above lenders as of March 2011

Figure 74: Lender- wise Flow & Stock of Bank Credit (Absolute Amount) to MFIs -2010-11

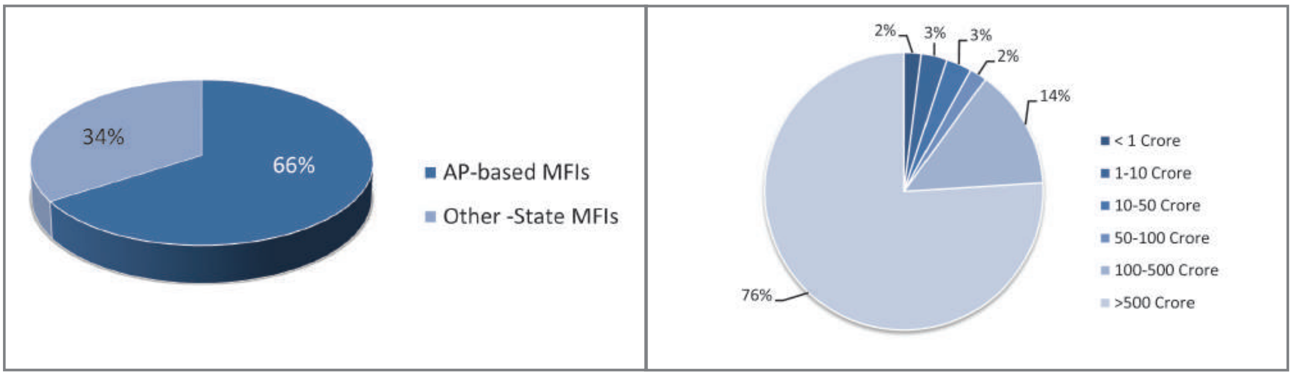


3.3.1 Bank Credit –' Large Amount to Largest MFIs'

AP–based MFIs and MFIs with loan portfolio of more than ₹ 500 crore have secured the lion's share of the loan obtained from the lenders during the year (Figure 75).

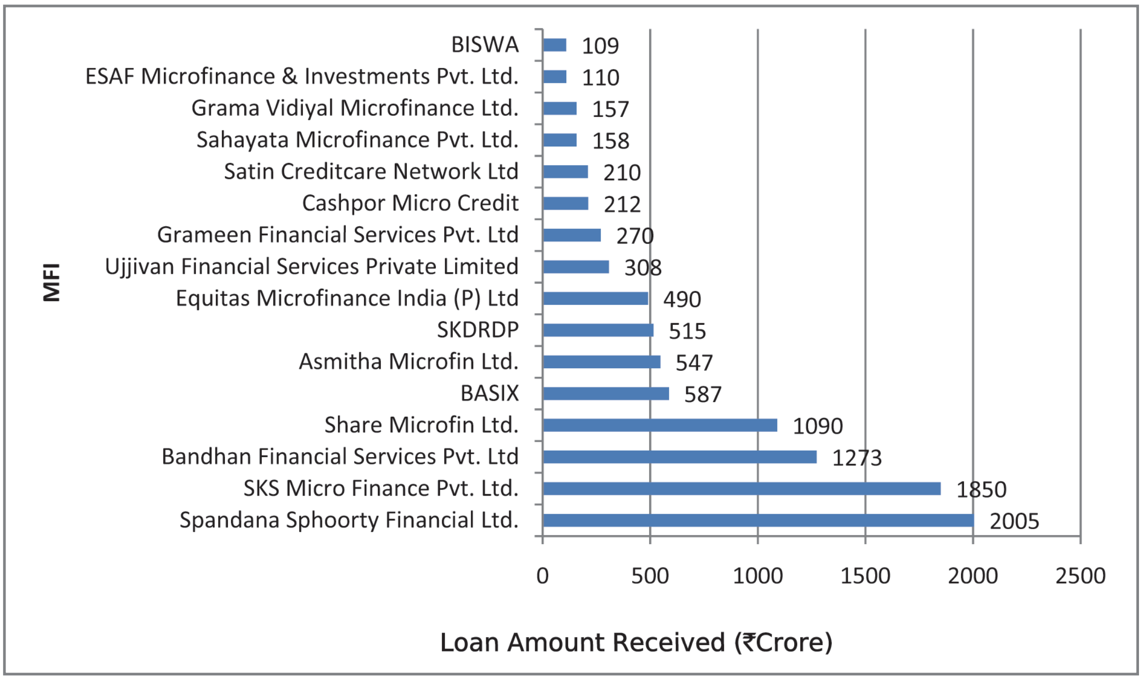
Banks need to focus on small MFIs to reduce their concentration risk as well as to help nurture small MFIs who are rendering yeoman service to clients in specific pockets.

Figure 75: Share of Different Categories of MFIs Receiving Fund during 2010-11



The list of MFIs who got loans more than 100 crore during the year is given in (Figure 76)

Figure 76: Major MFIs Receiving Bank Credit over ₹ 100 Crore during 2010-11

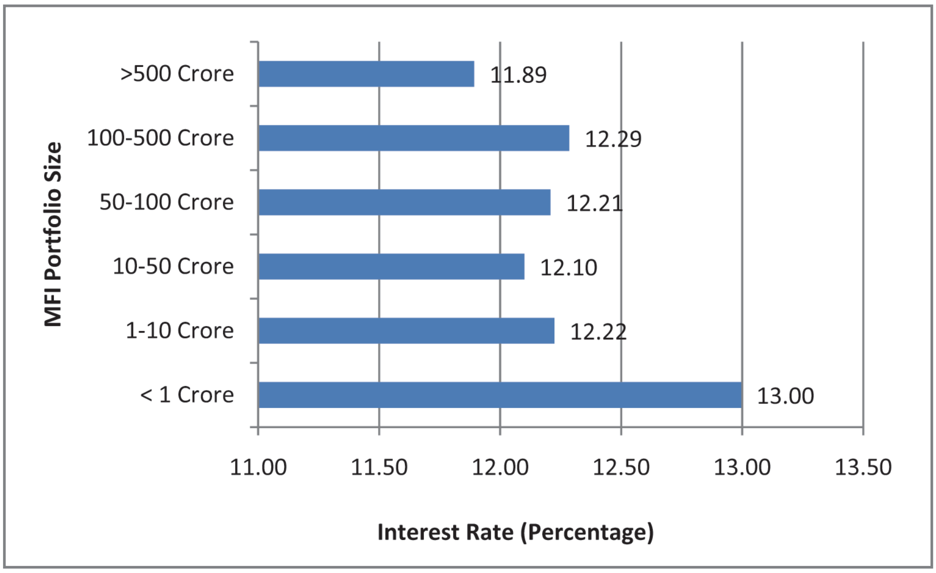


3.3.2 Bank Interest Rate: 'Favoring Larger MFIs?'

Large MFIs appear to have higher negotiation power to get cheaper credit as well. The interest rate on bank loan determines the financial cost of MFIs. The interest rate on loans availed by the sector ranged from 12 to 13 percent, also providing evidence, to a certain extent, to the hypothesis that '*larger the MFI the lower would be the interest rate*' (Figure 77).

> *Larger MFIs manage to get bank loan at relatively lower rate of interest compared to their smaller counterparts. This again delineates the need for banks to extend support to smaller MFIs to enable them reduce their overall cost*

Figure 77: Average Interest Rate on Bank Loan Availed by MFIs of Different Portfolio Size (2010-11)



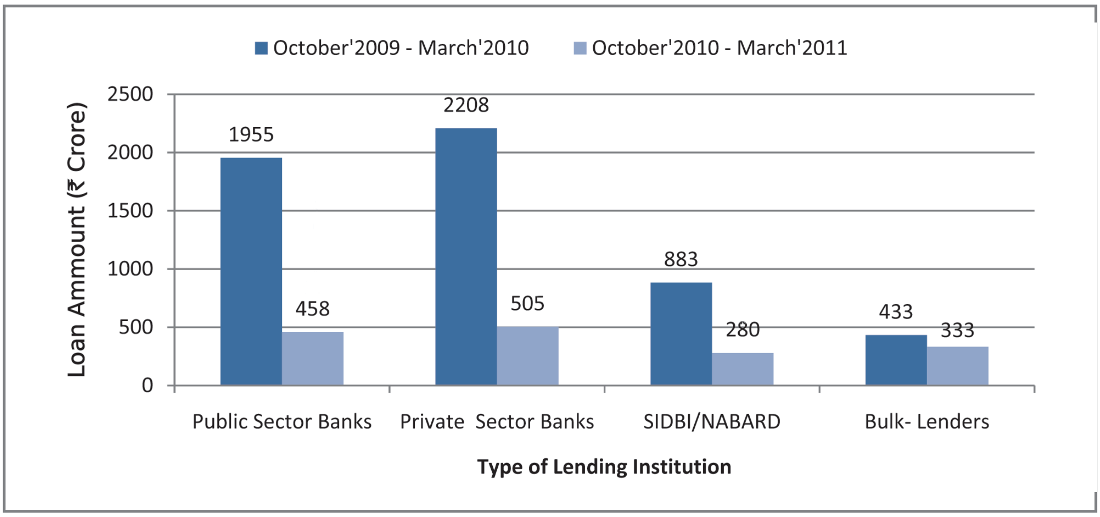
3.4 Bank Funding to MFIs (October 2010 to March 2011)

Bank fund flow to MFIs had come down significantly after October 2010, the month during which the AP ordinance to regulate MFIs was promulgated. Sa-Dhan conducted a rapid survey during April 2011 to find out the fund flow situation. Fifty four MFIs reported data in response to the survey. The results of the survey are presented in Figure 78.

Bank fund flow to MFIs dwindled by 70-90 percent during October 2010 to March 2011 compared to the corresponding period of the previous year (October 2009 – March 2010)

The fund flow from different categories of lenders during the crisis period (half year from October 2010 to March 2011) was compared with that of corresponding period of the previous year (October 2009 to March 2010) to ascertain the extent of impact of the crisis. The drop in fund flow ranged roughly from 70 to 90 percent depending on the lender category.

Figure 78: Impact of Crisis on Bank Fund Flow (October 2010- March 2011)



The slowdown in fund flow disabled the MFIs across India from further lending to clients, which ultimately encouraged withholding of repayment amounts by clients and thus accelerated the default rate.

3.5 Bank Funding to MFIs (April 2011 to September 2011)

In order to record up to date funding situation for the sake of this report, Sa-Dhan conducted second Rapid Survey during October 2011 among member MFIs and the results of data reported by 58 of them are presented in Figure 79.

Here again, the fund flow has been studied between the corresponding periods of two consecutive years to ascertain the impact of the crisis. MFI funding has dropped by 43 - 85 percent during April-Sept 2011 compared to that of the previous year (April –Sept 2010).

The RBI, in its recent communiqué[5] , has revealed that during April to September 2011, bank loan growth to MFIs has declined 16.4 percent compared to a 7.5 percent growth during the corresponding period last year.

[5] Mint News

Figure 79: Impact of Crisis on Bank Funds Flow (April 2011 to Sept.2011)

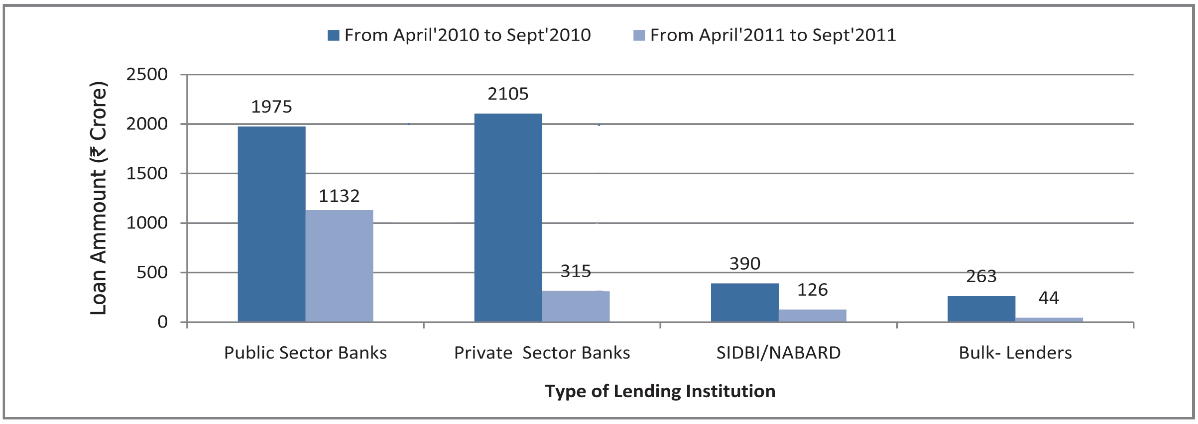
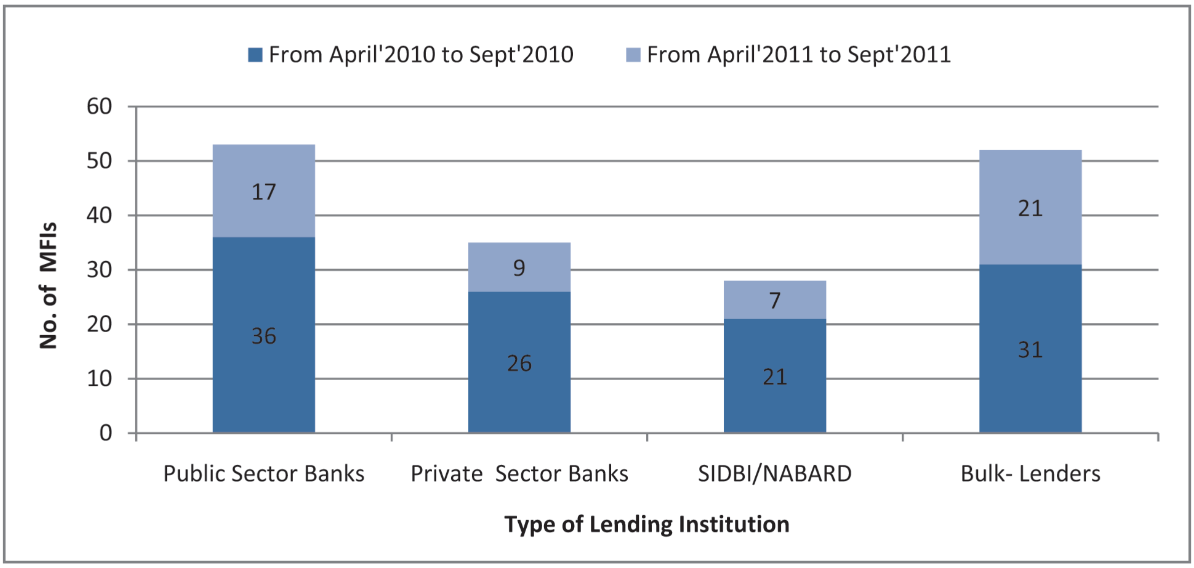


Figure 80 : Bank Funds-Impact of Crisis on No. of Beneficiary MFIs (April 2011 - Sept.2011)



The Rapid Survey also brought out the reduction in the number of beneficiary MFIs who obtained funds between the study periods(Figure 80).

The banks need to resume funding to the sector to regain its lost share of investment in the sector. This will complement the efforts of banks in their financial inclusion agenda.

Bank fund flow came down by 50-85 percent during April – September 2011 compared to the corresponding period of the previous year (April - September 2010)

BOX 2: MFI CDR Debt Restructuring Program*

Banks, to avoid their portfolio going bad after the microfinance crisis, extended debt restructuring facility under Corporate Debt Restructuring (CDR) to some large MFIs. The debt composition of major MFIs participated in the program is tabulated below:

(₹ in Crore)

Microfinance Institution	Total CDR Exposure	Non-CDR Exposure	Total Debt
Asmitha Microfinance	1106.32	88.12	1194.44
Future Financial Services	98.95	60.59	159.54
Share Microfinance	1887.75	110.37	1998.12
Spandana Sphoorty Financial	2115.68	256.61	2372.29
Trident Microfinance	140.00	8.07	148.07
Total	**5348.70**	**523.76**	**5872.46**

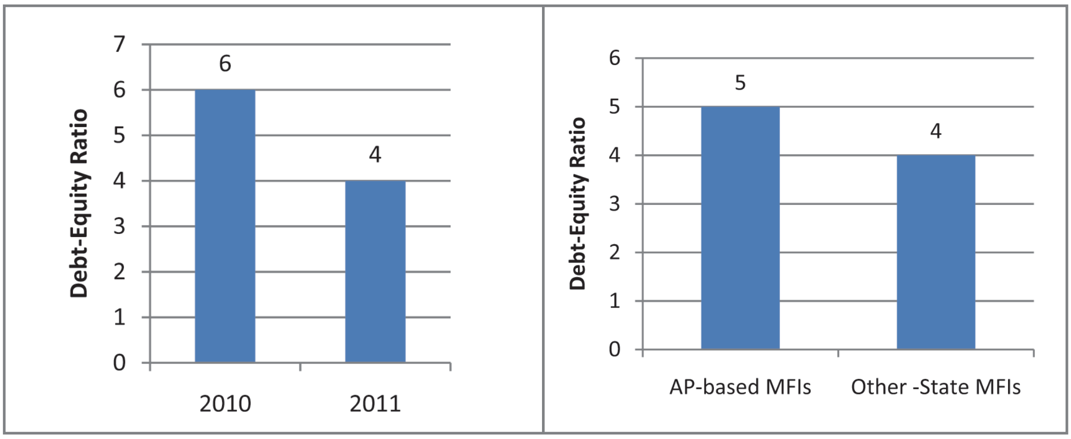
The figures have been confirmed from the MFIs concerned

4 Leverage, Capital Adequacy and Net Owned Fund

4.1 Leverage[6] of MFIs: *'Gearing down'*

MFIs, like any other business institutions, use own fund as a base for borrowing from banks. Their borrowing capacity depends on their capital. Debt-Equity Ratio[7] is the parameter considered for the measurement. The leverage needs to be optimum to balance between profitability and stability of MFIs.

Figure 81: Debt-Equity ratio (D-E ratio) of MFIs



The Debt–Equity Ratio (leverage) of MFIs has come down from six times in 2010 to four times in 2011.

MFIs, in general, meet the 15 per cent criterion of capital adequacy

[6] Leverage is generally measured as the amount (in multiples of own capital amount) borrowed from outside sources including banks.

[7] Debt-Equity Ratio is the proportion of total debt borrowed to the total equity held in a given point of time.

* The original idea on this chart and data offered by N. Srinivasan, author-sos, is gratefully acknowledged.

D-E ratio indicates that Indian MFIs are less leveraged in 2011 compared to 2010. However, those based in AP were more leveraged compared to the rest of the MFIs (Figure 81).

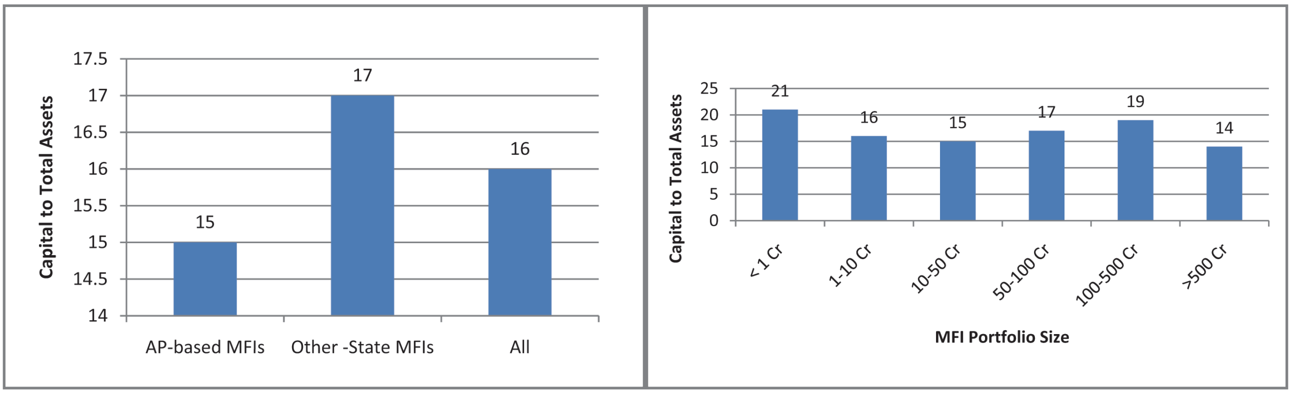
4.2 Capital Adequacy[8] - *'Adequate now'*

The Malegam Committee has prescribed minimum reserve requirement against past due portfolio, minimum capital adequacy for NBFC–MFIs, etc. The provision against bad debt has already been discussed briefly in the previous chapter. In this section, Capital to Total Asset and Minimum Capital (Net worth) of MFIs are analysed based on the MFI data for the current year.

4.2.1Capital to Total Asset

Capital to Total Asset is an important measure to gauge the adequacy of capital of an MFI to finance its assets. This is measured not only to find out the status of leverage of capital by an MFI but also to check as to whether the equity holders (owners) of an MFI have significant stake in the business. This concept is analogous to Capital to Risk weighted Asset (CRAR) being used in analysis of banks' capital base. Here, unlike CRAR, no risk weight is assigned to the assets.

Figure82: Capital to Total Asset among MFI Categories



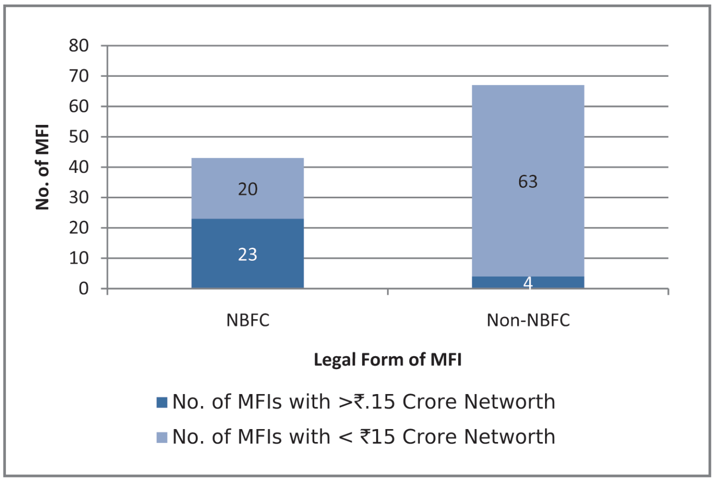
In general, capital adequacy of Indian MFIs is conforming to the Malegam committee standards (Figure 82). The Malegam committee prescribes 15 percent as capital adequacy ratio for Non Banking Finance Companies (NBFCs).

4.2.2Minimum Capital/ Net Worth:

The Malegam Committee suggested minimum corporate size, in the form of Net Owned Fund (NOF) for NBFC- MFIs, as ₹15 crore. Sa-Dhan analyzed the reporting MFIs data to find out the number of MFIs meeting this criterion (Figure 83. Only 47 percent of the reporting NBFC-MFIs are compliant under the suggested norm. Majority of MFIs need to bolster their capital base in the medium term to adhere to the standard.

[8] Capital Adequacy measures the solvency level of MFIs which is an important indicator of risk bearing ability of the entities. It is the proportion of the capital/own fund held by an MFI against its total asset.

Figure 83: No. of MFIs Meeting Corporate Size Norm (₹ 15 Crore NOF) of Malegam Committee



Only 47 per cent of the reporting NBFC –MFIs meet the suggested minimum capital requirement of ₹15 crore. Negligible proportion of non-NBFC MFIs meets this condition.

5 Rating of MFIs: *'MFIs : Safe!'*

Assessment of MFIs by rating agencies is becoming increasingly popular to showcase the financial strength of the MFIs for enabling potential investors for taking informed decision. Sa-Dhan data collected on MFIs' ratings during 2011 helped to project the financial health of MFIs in general.

Of total 170 MFIs data studied, only 53 MFIs had undergone rating by at least one of the popular rating agencies in the market, Viz, M-CRIL, CRISIL, CARE, SMERA and ICRA. The rating scores given by the rating agencies, have been juxtaposed and MFIs falling under different common safety buckets been sifted out and enumerated. The results of the analysis (Figure 84) showed that majority of MFIs rated had been adjudged as 'safe' by the rating agencies. The result however is worth re-interpreting in the light of the present crisis to suggest any changes that are required in the rating metrics adopted hitherto by the rating agencies.

Figure 84: Number of MFIs falling under Different Safety Buckets of Rating Agencies

Less than one-third of reporting MFIs has undergone rating by rating agencies. Of them, more than one-half have been adjudged as 'Safe'

Key Takeaways

- *RBI, in its recent communiqué, has revealed that during April to September 2011 bank loan growth to MFIs has declined 16.4 percent compared to a 7.5 per cent growth the corresponding period last year. It further added that on year -on- year basis, that is between October 2010 and September 2011 , credit growth to MFI segment declined 4 percent compared to 27 percent growth in the previous year.*
- *The deteriorating loan quality due to shortage of bank fund and increasing loan repayment default on the part of clients threatens the solvency of MFIs.*
- *Banks not only slowed down lending to MFIs but also exert pressure on MFIs to recover the loan. With debt restructuring available only to a very few large MFIs, they have hard time. Nearly 20 small MFIs in Andhra Pradesh have already closed down operation due to solvency issue.*
- *The key now is with banks. They need to restructure loans and resume lending to resuscitate the sector. Banks need to focus equally on all categories of MFIs to avoid concentration risk. Their patronage to small MFIs is a very critical requirement for building healthy sector in the year to come.*

New Paradigm for Effective Microfinance Services?

Microfinance in India is undergoing a testing time. The current situation in India demands that all concerned look at hard options for stabilizing the microfinance sector. A quick review of the following key takeaways from the analysis of data presented in the first four chapters would help strategise the future agenda.

- *Microfinance institutions (MFIs) can be the potential partners to banks in their financial inclusion agenda. They reach out to underserved and un-served people in remote locations which are difficult to be reached by the mainstream banks. Their financial inclusion role can be bolstered through improving the support system and infrastructure.*
- *The microfinance growth has come down during 2011. More than one-third of MFIs posted negative growth in terms of client outreach and loan portfolio apparently owing to the present microfinance crisis. MFIs need to undergo a re-engineering process to grow horizontally to reach out to poorer and underserved regions of the country.*
- *The operating cost structure of MFIs would constrain MFIs from meeting the Margin Cap set by the Reserve Bank of India. This further necessitates MFIs to embrace systems which are more cost efficient and focus on long-term investments in improving their service.*
- *The non-performing assets and liquidity crunch are matters of great concern especially during the past one year. This is primarily due to slowdown of bank fund to the MFIs. Many MFIs would face the risk of closure if the liquidity shortage prolongs for some more months. There is also an urgent necessity to reverse the situation by putting in place necessary systems and control among MFIs.*

The present stalemate in the sector could be resolved by joint efforts of different stakeholders in the sector. This chapter, therefore, highlights the changes that are warranted in different aspects of MFI operation and role of different stakeholders. The discussion calls attention to modification that is required in the practices /roles of the following categories of key players in the sector.

1. Microfinance Institutions
2. Funding Agencies
3. Government and Apex Bodies
4. Association
5. Technical Service Providers

1. Reengineering **Microfinance Institutions**

MFIs are important players, next only to the poor borrowers of the sector. There has been allegation by certain stakeholders, such as regional governments and the media, that there are excesses committed on the part of MFIs, especially in areas of client protection. This section endeavours to highlight important changes in MFI-practice that are required to avoid such criticism. The MFIs may have to revisit their strategy and operational system, Product and Services, Processes, Human Resource and Incentive system.

1.1 Strategy and System

1.1.1 Revisiting the Mission

The mission of MFIs needs to refocus in the current situation. Commercialization and mission drift are the critiques which MFIs need to handle and learn lessons from. The Sa-Dhan survey, this year, has revealed that as much as 67 percent of respondent MFIs have 'poverty outreach' as their principal mission[1]. The other missions of MFIs reported were poverty reduction, community development, women empowerment and access to finance. Despite these objectives, the industry faced a strident criticism of mission drift.

At this juncture, it may not be an irrelevant proposition to get the leaders of the sector, who built microfinance in India during the past two to three decades, together to deliberate on the appropriate mission for sector in the changed situation. In this context, it would be worth taking cognizance of the Chair Emeritus of Sa-Dhan, Ela R Bhatt, who enunciated new direction for the sector in one of the Sa-Dhan events. Her speech is reproduced in Annexure 3. Realignment of MFI-mission in the line of this broader direction would help mitigate reputation risk facing the sector in the coming years.

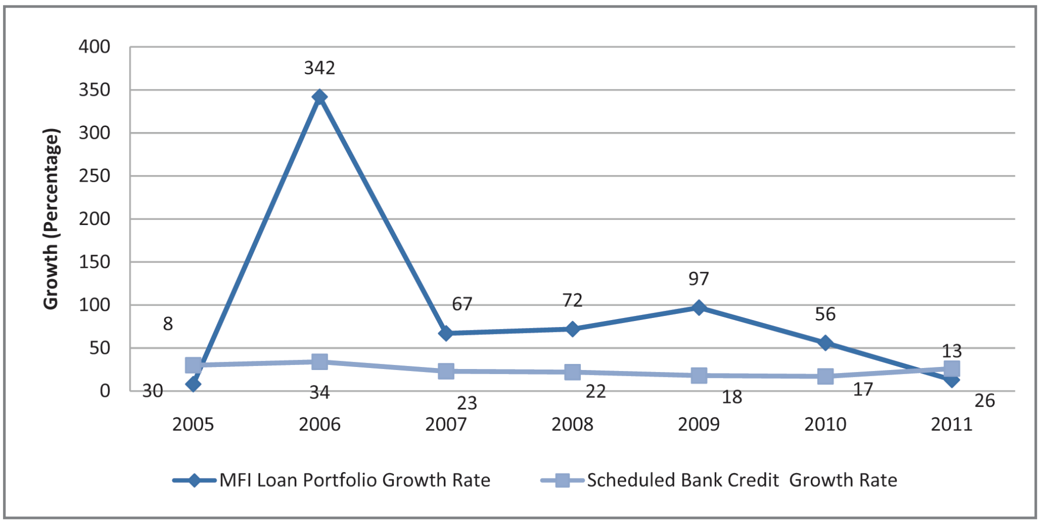
1.1.2. Growth Strategy

Excessive growth has engendered aberrations in areas having bearing on client protection. The specific areas of concern, included, *inter alia*, coercive recovery, over indebtedness etc. Henceforth, growth will have to focus on ensuring the staff paying attention to the demands of the poor clients as well as any problems which might emerge from a challenge of being poor. Growth strategy, as a governance function, has to be consciously decided by MFI boards, keeping the mission and the clients' requirement in view.

1.1.2.2 Lessons from Banking Sector

Microcredit of MFIs has been consistently growing and its growth rate has been higher than that of loan portfolio of scheduled commercial banks (Figure 85). Banking operation in India is fairly stabilized in the range of 15 to 30 percent.

Figure 85: MFI- Loan Portfolio Growth Rate Vs Scheduled Bank Credit Growth Rate[2]



[1] Sa-Dhan (2011)

[2] Source RBI Data

Playing the complementary role in financial intermediation, MFIs could draw cues from trends in the banking sector to define their own acceptable growth rate. Going by the growth trajectory of bank credit which at peak has been 34 percent, MFIs could moderate their portfolio growth rate.

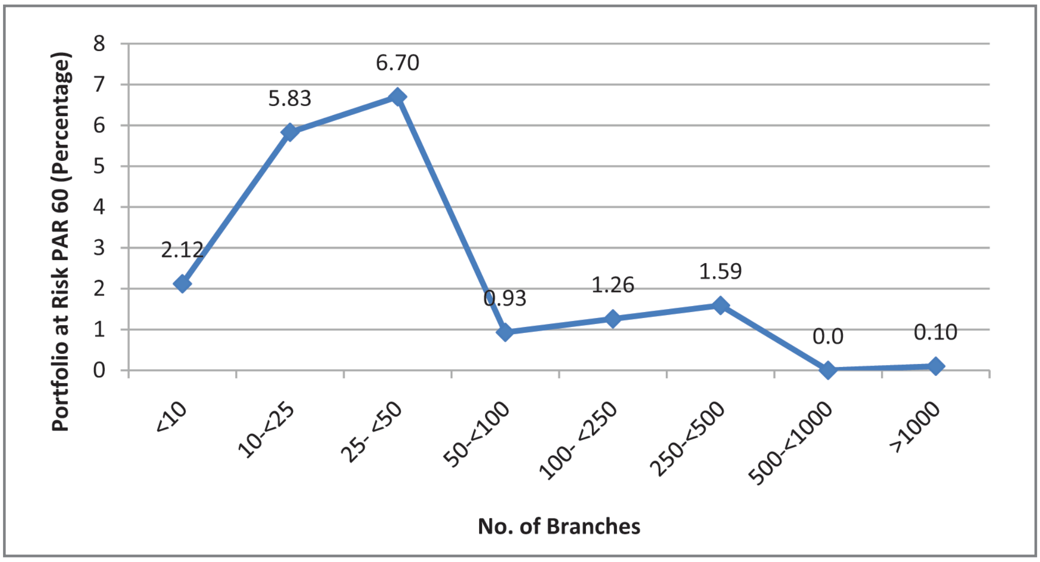
1.1.2.3 Acceptable Growth Pattern and Rate

The growth rate during 2007-2010 has been phenomenal, perhaps, fuelled by growth in inflow of private equity in to the sector. The growth rate of the portfolio during this period far exceeded the growth rate of clients implying that the higher loan amount was provided to existing clients.

Intensive growth in a given geography might help in portfolio /client deepening. Such growth, together with a higher concentration of staff is found to cause growth related issues like portfolio deterioration, over indebtedness etc., compared to extensive growth over wider geographies.

This notion is further corroborated through analysis of 2011 Sa-dhan data set on range of MFI branch network juxtaposed with corresponding PAR values. The finding was that the higher the number of branches in which the MFIs operated, lower was the PAR value (Figure 86).

Figure 86: Variation of PAR -60 Values with MFI-Branch Network Size

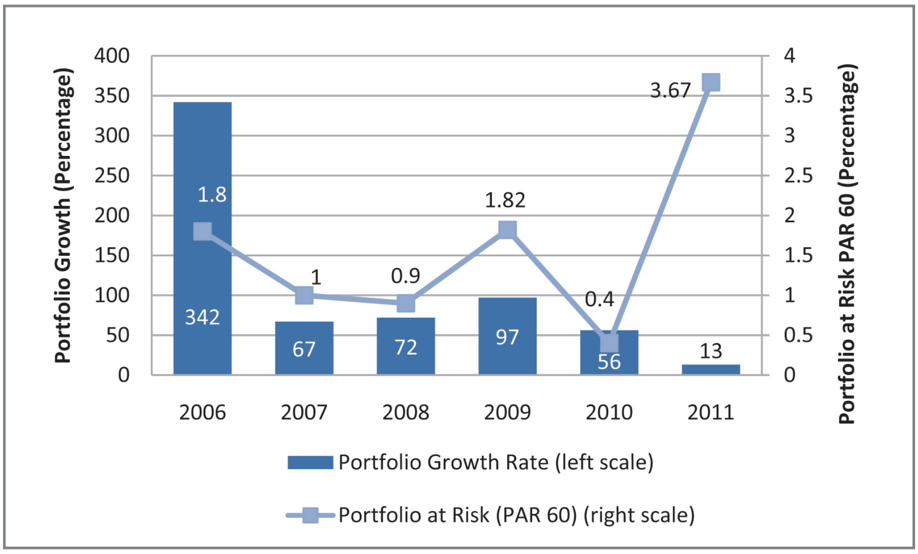


As of March 2011, 170 MFIs had collective branch network of 12756 spread across 517 districts of the country. It would be therefore good for the sector that MFIs are spread across more number of districts rather than operating through a dense branch network.

As of March 2011, 170 MFIs had branch network of 12756 branches spread across 517 districts of the country. Higher the number of branches in which the MFIs operated, lower was the non-performing asset (PAR)

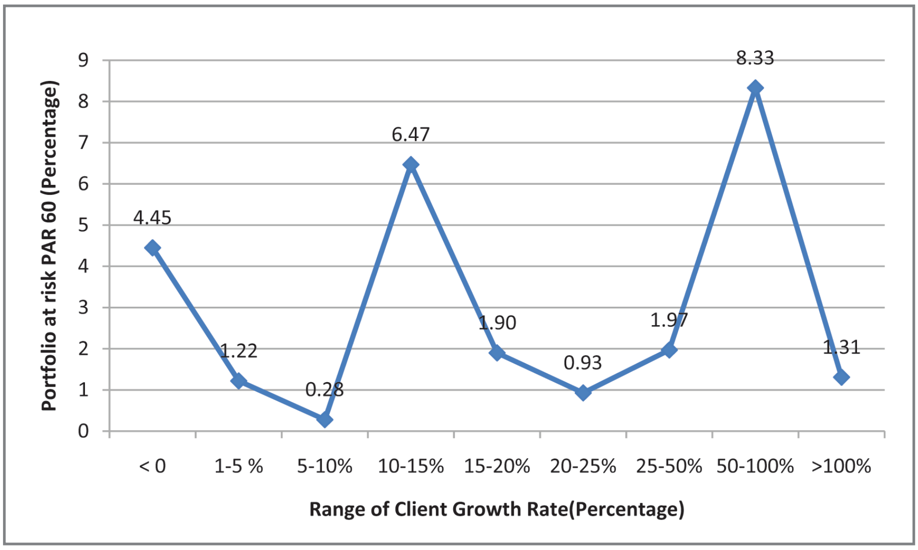
Sa-Dhan's six-year time series analysis on portfolio growth rate and PAR value has not indicated any obvious relationship between the parameters (Figure 87). Similar was the finding when different ranges of client growth rate for 2011 and their corresponding PAR values were compared. (Figure 88).

Figure 87: Six- Year- Trend in Portfolio Growth Rate Vs Portfolio at Risk (PAR 60)



In India, annual portfolio/client growth rate of more than 50 per cent may not be desirable in the changed situation

Figure 88: Variation in PAR 60 Values with Client Growth Rate (2011)



It may be important to reconfirm the impact of growth rates on the operational parameters of MFIs with the help of larger sets of data. Nevertheless, it is necessary that MFI-governing boards agree on acceptable growth rates. In India, for example, annual portfolio/client growth rate of more than 50 per cent may not be desirable in the present changed situation.

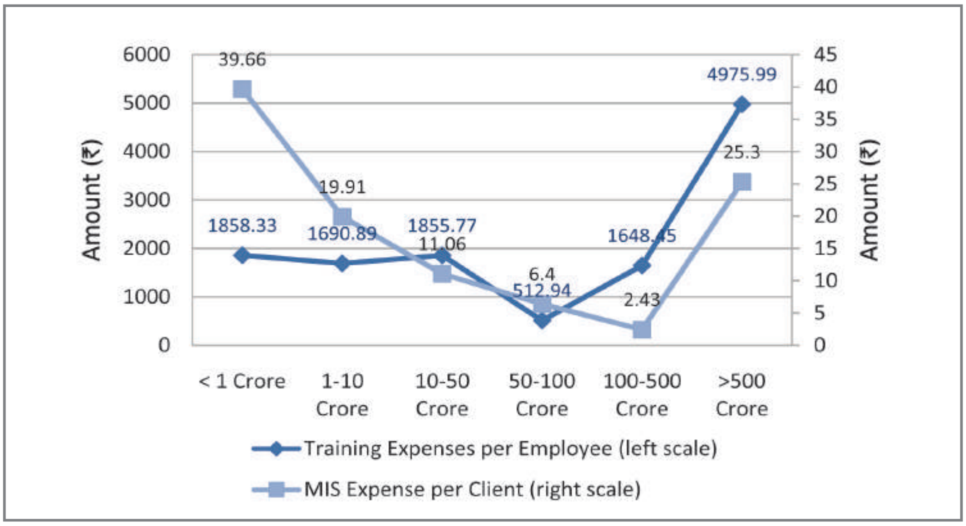
1.1.3 Growth with a Robust System

CRISIL[3], in its rating reports, established a link between growth pressure and loosing credit standards such as reduced waiting period for loans and fewer post disbursement borrower checks. Rapid and burgeoning growth and not backed by appropriate growth in MIS systems as well as staff and administrative capacity to manage growth would destabilize the sector.

[3] CRISIL

Going by the above insight, training of staff and investment in technology / MIS for managing growth are supposed to form the top priorities of MFIs. Money spent by MFIs on these important areas has been analyzed by Sa-Dhan during 2010-11. The median amount spent on training per employee is found to be ₹ 1500, while the amount spent /invested on MIS *per client* (assuming that no. of client could be the proxy for no. of accounts or transactions having bearing on the MIS investment) is ₹ 14.

Figure 89: Staff Training and MIS Expenses of Different MFI Size during 2010-11

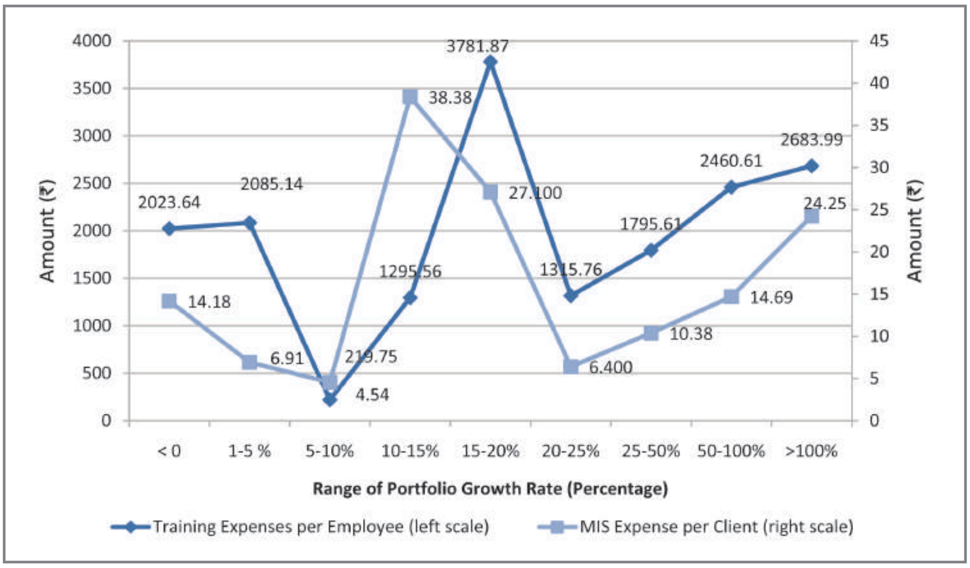


When the amount spent by MFIs of different size and growth rate was analyzed, the general observation was that the MFIs with higher scale or growth rate invested relatively less (Figure 89 & 90). The complexity of operation tends to be higher among bigger MFIs or MFIs with rapid growth needing higher investment in staff and MIS. Underinvestment on these critical aspects is likely to spur field level operational aberrations.

Similarly the quality of staff training deserves equal attention. The staff needs to be trained on social intermediation, Code of conduct and behaviour with clients to enhance profitability and reduce risk.

> *MFIs with larger portfolio and higher growth rate need to invest more on staff training and MIS investment. Staff training on social intermediation, code of conduct and behaviour with clients is bound to enhance profitability and reduce risk.*

Figure 90: Staff Training and MIS Expense of MFIs with Different Portfolio Growth Rate during 2010-11



The investment in employee training should naturally be higher when higher employee turnover is the reality. Sa-Dhan data revealed that as many as 51000 new employees joined 170 MFIs while 34300 left them during 2010-11(Figure 92), underlining the significance of the investment needed.

High employee turnover necessitates higher investment in staff training. Staff recruitment process will have to involve verification check with previous employer of candidates

Employees leaving one MFI and joining another MFI, as it normally happens, could be a matter of concern. Anecdotal evidence suggests that field staff in new MFIs have followed 'poaching' of the clients of the first MFI by offering products of their new employer-MFI. This unhealthy phenomenon in the sector has prompted Sa-Dhan members to bring in norms, such as getting No objection Certificate from the previous employer for employee recruitment, as part of their Code of Conduct.

1.1.4. Recovery Strategy

Loan recovery methods adopted by MFIs have been questionable. The Andhra Pradesh Government has described the methods in general as strong arm tactics. Zero tolerance by MFIs towards default has been the other criticism advanced by the stakeholders.

The other charges are that MFIs are not considerate to the delinquent clients' household problems. There is a necessity to analyze the causes of delinquency and offer them consultative solution. Restructuring of delinquent loans has to be looked at seriously by MFIs. Even the Grameen Bank of Bangladesh has embraced the Grameen[4] – II model which has more flexibility in terms of loan repayment and restructuring of client loan etc.

MFIs need to shed Zero Tolerance policy to Default.
They need to offer Consultative solution to delinquent clients' problems.
They shall guard themselves and clients against abuse of the position of Centre leaders

Staff code of conduct on the acceptable behaviour becomes all the more critical. Training staff on appropriate behaviour with clients, designing right incentives for ensuring acceptable recovery practice on the field, monitoring and controlling their performance, etc have been part of challenges faced by MFIs. The analysis of field level adoption of client protection code by Sa-Dhan members reveals these challenges. As found from the data analysis, higher case load (ABCO) impairs the portfolio quality and causes staff behaviour related issues.

The position of Centre Leaders[5], of late dubbed as "ring leaders", among the clients has been abused to the extent that they become centres of power, misleading the borrowers. The centre leaders' recovery behaviour with clients directly affects the relationship between the MFIs and the clients. The MFIs need to guard themselves and clients against abuse of such position.

Putting in policy and system for ensuring acceptable staff behaviour is, thus, an important step on the part of the board and top management to manage reputation risk haunting the sector.

1.1.5. Acceptable Profit

The Malegam committee has recommended caps on the interest rate and the margin under the assumption that interest rate charged by MFIs is high. The Sa-Dhan data for 2011 has shown that MFIs have, in

[4] Grameen Bank in Bangladesh is founded by Prof Mohammad Yunus, the Nobel laureate

[5] Centre Leaders are key customer elected by clients to moderate group meetings & dynamics.

general, exceeded the margin cap owing to higher operational cost. Sa-Dhan will advocate for revision of margin cap and interest rate cap based on these findings.

The bank funding under priority sector advances is linked to adherence to norms including the margin and interest rate cap of RBI. MFIs, therefore, need to analyze their cost drivers very closely and initiate cost cutting measures to bring down the overall cost under the margin cap, so as to contain the interest rate within the overall limit prescribed.

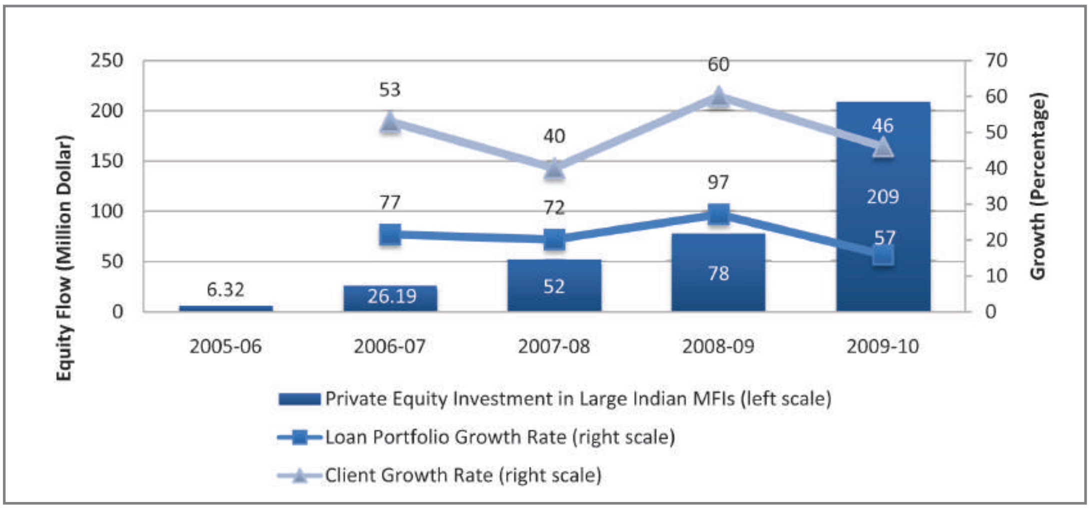
1.1.6 Choice of Investors

There has been a theory shared among the industry observers that private equity money flowing into the sector has caused stupendous growth in the portfolio of MFIs. Figure 91 is drawn plotting the trend in equity flow with that in portfolio and client growth rate.

Growth fuelled by profit-seeking equity investors will destroy the sector.

The graph does not seem to subscribe entirely to that theory. Overall, as the sector, the situation was not bad, as most investors did not force the extra-ordinary high growth rates. There were, however, a few exceptions forcing the governments to impose prohibitive laws. These were large enough to spoil the context for all the agencies.

Figure 91: Long Term Trend in Equity Inflow[6] and MFI Loan Portfolio Growth Rate



Notwithstanding the theory behind drivers of the growth, the fact remains that the growth fuelled by profit - seeking equity investors is not sustainable and would destroy the sector. The investors need to be patient to see organic growth of the investee-MFIs to create social impact on the clientele.

Clearly, there is difficulty in managing investors. Some investors possess a commercial outlook. Some represent social values. MFIs need to attract both categories of investors for ensuring steady but responsible growth.

While deciding the choice of investors, the MFI boards and their senior management will have to consider relevant questions[7]. Some of the questions might include: What is the appropriate mechanism to get funds? Should we seek funds from private investors or should we rely on government agencies?

[6] N. Srinivasan (2010)

[7] Reena Mittal (2011)

What partnerships should be established between investors and MFIs to ensure adequate communication and continuous evaluation? How can the MFI protect its client base while maintaining profitability? Sa-Dhan has a plan to deliberate these questions/considerations among member-MFIs and propose a new model subsequently.

1.1.7. Client Protection and Transparency

Client Protection and Transparency have been the overarching ethical norms prescribed to financial service providers in general. The Reserve Bank of India advocates a Fair Practices Code and Lenders Liability etc for banks. . Microfinance clients, being vulnerable and mostly illiterate women, require MFI-client protection and transparency measures of high order. MFIs, intermediating public funds, need to be transparent with external stakeholders. It is just ethical to be transparent to the primary stakeholder-especially poor clients-on the terms of contract including interest rate and such other material information through the language understandable by them. These two issues have been highlighted by the Andhra Pradesh Government and the Malegam Committee also in their respective policy documents on the sector.

> *The clients, being vulnerable and mostly illiterate women, require MFIs client protection and transparency measures of tall order.*
>
> *MFIs intermediating with public funds need to be transparent to external stakeholders.*

Client Protection and Transparency are important components of the code of conduct of Sa-Dhan advocated for the past five years. Sa-Dhan has been verifying the adoption of these two critical components of the code by its members. The results of such verification have been published in a separate publication, "Client Protection and Social Performance of Indian MFIs" 2011.

As per the findings, client protection measures like Fair Practices adopted, avoiding over Indebtedness, Appropriate Interaction and collection practices and Privacy of Client Information have immense scope for improvement. The findings on the practice of transparency also are on the similar line. These practices obviously need to undergo change for the better. We need to invest resources: time, money, man power to earn clients' goodwill and loyalty, especially in this changed situation where profit margins are curtailed to prop up sustainability of MFIs.

The MFIs rapport with the broader political economy is very much important. Local staff needs to have a cordial relationship with local leaders, administrators and the common man to display positive outlook of MFIs and their services.

Sa-Dhan code also dwells on financial literacy programmes to enable clients to take informed decision on the borrowing. MFIs will have little choice but to initiate programmes on financial literacy now.

MFIs also need to equip their MIS system to capture and track data on the client protection and transparency protection practices.

> *Now MFIs will have little choice but to initiate financial literacy programme*

Box 3: The Crisis and the Small MFIs

- In the present microfinance crisis, small MFIs have been hit hard. Nearly twenty small MFIs in Andhrapradesh have been forced to close their operation. Net owned fund of small MFIs are relatively very small. Hence in any crisis situation, they tend to disappear quickly.
- Small MFIs of a reasonable size might not have problem as long as they are efficient. With the existing interest and margin caps, institutions (whether NGO or otherwise) that cannot bring down operating costs below nine percent will have to look for alternatives.
- Capitalization of smaller MFIs should be an agenda of development banks. The capitalization can match the client outreach of MFIs as this would ensure proportionate support to the livelihoods of clients which are at stake.
- Small MFIs may explore options like private placement in NCD (Non-convertible Debenture) to raise funds.
- Scaling down of ROE and ROA expectations with full understanding of the investors is another non-negotiable strategy.
- They may plan to become Banking Correspondents and Facilitators of banks. The option of aggregator from Pension Fund Regulatory and Development Authority and agency from insurance companies for distributing their products is very much available for the small MFIs.
- The Financial institutions shall be assured that customer protection code and a credible grievance handling mechanism are in place. Greater use of credit bureau and keeping banks appraised of the developments is important to make them know multiple loans are being tracked and avoided.
- On the governance side, number of independent directors on boards (regardless of whether MFI is in for-profit or non-profit form) may be increased to provide comfort to all stakeholders that all interests will be protected.

1.2 Products & Services

The microfinance programme has just been microcredit programme with disproportionate emphasis on credit. The much needed savings services could not be offered because of legal constraints in India. The penetration of micro insurance has been shallow and is, by and large, limited to loan protection insurance.

Under the credit service, the present product offerings have got lacunae in them in terms of flexibility and relevance to client needs. In majority of cases the loan repayment commitment begins from the very next week of disbursement of the loan. The Malegam Committee suggested MFIs to consider moratorium period for the repayment. The standardized 52-week loan helps MFIs to scale up but it takes them away from the client who require customized product. Besides, it could lead to client abuse.

Client - household - cash - flow based innovative products for productive purposes and with flexible repayment schedule will have to be developed.

Besides, the loan size offered has not been appropriate either to the requirement of the client enabling them to make meaningful investment in livelihood activities or proportionate to their debt servicing capacity. The loan product and its repayment schedule need to be attuned to the household cash flow and financial plans of the clients. Clearly, the fortnightly shift in repayment suggested in this report would be a good way to potentially go forward, with some positive benefits.

Similarly, what prompted the Malegam committee to stipulate that at least 75 percent of loan should to be offered for income generating purposes may not be difficult to understand. Sa-Dhan data 2011 (Figure 41) indicate that this condition seems to be fulfilled. Yet, MFIs need to put systems to monitor the end utilization to continue to comply with this norm.

There have been new products being rolled out by MFIs during the past one year by MFIs. Tractor loan, truck finance, cycle loan, etc are some of the products. These would definitely help MFIs in mitigating their risk and diversifying income stream. These may be brought in taking advantage of the cushion available for NBFC-MFIs to raise non-microfinance based assets up to 15 percent. In any case, product innovation is warranted for mitigating the risk of the clients making the product relevant to them.

1.3 Alternative Collateral

Lack of collateral on the part of clients belonging to unorganized sector has been the key reason for the mainstream banks' reluctance to lend to the segment. Microfinance institutions have overcome the limitation by harnessing peer pressure based group collateral. Excessive reliance on this for supporting turbo-charged portfolio growth has been taking a toll now in terms of group disintegration, allegation of driving group members towards extreme steps etc. There is, thus, an urgent need to look for alternate collaterals for uninterrupted lending to the clients.

Some of the MFIs have already started exploring the personal guarantee of spouse of the clients for offering loans. This would be a move on the right direction, as the loan transaction then will become an affair between a household and an MFI and the social pressure will not come into play inviting reputation and political risk. MFIs need to explore other alternative collaterals in the months to come.

1.4 MFI Process

The lending technology adopted by MFIs needs certain readjustment in the light of emerging issues. The necessity to revisit group collateral has been mentioned in the previous paragraph. The other processes including customer acquisition, following Know Your Customer norm, training groups / clients through Compulsory Group Training, screening clients through Group Recognition test, ascertaining the existing debt level, loan collection periodicity, etc need to undergo reengineering process.

> *Process improvement is warranted in areas of customer acquisition, training groups through Compulsory Group Training, screening of groups through Group Recognition Tests, ascertaining client debt, loan collection frequency, etc*

The customer acquisition process, particularly, has been quite controversial in the sector. Concentrated lending among shared clients, poaching of clients of fellow MFIs with promise of higher loan amount are among the critiques. There has to be a fair play in acquiring clients. The process demands significant investment in terms of money and time. The investment would mainly be for identifying clients hitherto un-served, training /orienting them for matured financial transaction with MFIs.

Assessment of existing debt of and no. of creditors to the clients demands a lot of focus for avoiding over indebtedness and multiple lending. Subscribing to an approved credit bureau would help share the clients' antecedents among MFIs to take informed decision.

Healthy competition among MFIs is very important. Sharing of information among MFIs not only in their head office level, but also in the field and village level avoids problems like multiple lending and over indebtedness. Sa-Dhan state chapters, for example, have set up district level coordination committees for exchange of information among loan officers and branches.

Sa-Dhan invited responses from its member-MFIs on the coping mechanism/adaption that they are contemplating / already initiated in their strategy, operation, products targeting etc after the crisis. Their responses are captured in Table 3

Table 3: Adaption of MFIs to Crisis

S.No	MFIs Coping Strategy	MFI- Response (%)
1	Reduction in the rate of interest	22
2	Reduction in loan amount	6
3	Incorporated the Sa-Dhan Code of Conduct and RBI guidelines as part of organizational strategy and operation	13
4	Stopped all branch expansion plans, stopped new customer acquisition and restricted loan disbursement.	6
5	Avoiding multiple lending and reduction in disbursements	14
6	Reduction in processing fee	4
7	Staff and client motivational training in regular interval	10
8	Strengthening the existing SHGs / federations through training on responsibilities, financial discipline, etc	11
9	Sharing client data to credit bureaus	11
10	Risk monitoring	4

The responses of MFIs are encouraging. These adaptations, obviously, would better stabilize the growth and enhance client protection and institutional stability.

1.5 Human Resource & Incentive System

Human resource requirement to the microfinance sector is quite different and unique. Microfinance involves low volume, large number of transactions mostly in cash. This demands a different kind of skill set on the part of employees. They need to be good at not only on the financial dealings but also at social intermediation with low income clients. Middle and field staff is important segments. Field staff constitutes the interface with clients dispensing the products and services of MFs. Trained middle management is critical in leading the sector in the years to come.

Employee turnover makes the HR matter more complex. During 2010-11, more than 51000 new staff joined MFIs while 34300 left them. The staff compliments in the sector is captured in Figure 92.

There are over one lakh staff employed in MFIs.
High staff turnover (32.5%) is the reality.
High investment on staff training for staff retention should be the priority for the MFIs.
Good quality Staff training will ensure client retention and cost efficiency.

Figure 92 : Staff Compliments in Indian MFIs -2011

Indian MFIs Staff Position as of March 2011

Total 51051
Male 45891
Female 5160
Staff Newly Recruited During 2010-11

	Male	Female	Total
Top Mgt. staff	1076	266	**1342**
Middle Mgt. Staff	25049	1628	**26677**
Field Staff	55828	7659	**63487**
Contractual Staff	10025	4037	**14062**
Total	**91978**	**13590**	**105568**

Total 34295
Male 31294
Female 3001
Staff Left MFIs During 2010-11

The figure indicates large number of employee turnover (32.5 percent) happening in the sector. Turnaround of up to 10-15 percent may be a normal phenomenon. This high turnover has implications on recruitment, training, incentive system, client acquisition, client retention etc. We have already mentioned inadequacy of investment on staff training by MFIs (Figure 89 & 90). Higher investment has to be set apart for training existing employees to enhance the quality of service with clients. Since high turnover is the reality, the existing training investment ought to be diverted for basic training on the new employees joining throughout the year.

Similarly, an employee leaving an MFI, in all likelihood, joins another MFI mostly operating in the same geographical locality. The clients of the previous MFI loyal to the employee will tend to defect to new MFI, if the employee approaches them for offering services of the new MFI. This phenomenon has been identified as an important cause for client poaching and consequent over indebtedness leading to a host of reputation related issues in the sector. Thus, staff retention becomes imperative for MFIs in general.

The number of clients serviced by a credit officer (ABCO / Case Load) has also been an important issue pointed out by sector observers. It affects portfolio quality as clearly proved through Sa-Dhan data (Figure 62). This higher caseload has ethical staff treatment dimension as well.

Quality of service and client level improvements, inter alia, should become part of parameters determining the staff incentive structure.

Designing the right incentive system to make the workforce to do what is desirable to do is critical now. There has been criticism on faulty staff incentive system leading to undesirable practices. Incentives based on loan disbursements, recovery of loan, etc. will have obvious adverse impact. The quality of service rendered and / or client level improvement, for example, might form part of preferred incentive structure.

Thus, MFIs are up against the task of evolving system which would ensure high level of employee retention, client retention and quality service.

2. Changing Role of **Funding Agencies**

Funding agencies form an important force driving the microfinance sector in India. Given the fact that MFIs in India are not permitted to mobilize savings from the public, financial intermediation actually happens between the MFI clients and the banks. Nearly eighty percent of the lending resources of MFIs are bank funds. Size of bank funding is directly linked with equity held by MFIs. Equity participants obviously play a crucial role in funding and functioning of MFIs.

> *Banks may realign their credit policy towards higher threshold limit for PAR, say 2-5 percent. This will substantially improve client protection practices among MFIs.*

Funding agencies, in general, have significant influence over the operation of MFIs. The eligibility criteria set by banks for extending loans, for example, have bearing on the performance of MFIs. One palpable example is the threshold level of Portfolio at Risk (PAR) expected by banks. MFIs lament that PAR value of less than one percent consistently expected by banks puts them under tremendous pressure to show high recovery rate. This has got implications on client protection at large. This vicious cycle of plausible lowest PAR expectation drives the MFIs to embrace Zero Default Tolerance Policy causing untold miseries on the part of the clients whose household economy is not always amenable for near 100 percent repayments. At best, very high repayment rate could happen either because of multiple loans or ever greening of existing loans, both defeat the very purpose of microcredit.

Sa-Dhan had earlier set a standard norm of “less than 10 per cent PAR 60” which could be followed for realistic repayment performance by MFIs. Banks may realign their internal policy to engender a change of practice on the part of MFIs, potentially having larger impact on the client protection.

The role of equity participants is equally critical. Their expectation of profitability of MFIs and financial return has had a negative impact on the operation. While this has not withstood scrutiny in Sa-Dhan data, the minimum return expectation is stated to be so high that it has adverse implication on client protection in terms of over lending, zero tolerance to default, etc. This is also alleged to set vicious cycle of practice aimed at high valuation.

> *Equity investors may expect Economic and Social Return from MFIs in place of financial return.*

The potential equity participants in MFIs may, alternatively, look for economic return coupled with social return[8]. They may consider some important questions for taking appropriate funding decisions. Some of the questions might be; how to measure valuation for organizations that has both an economic and social purpose? Are standard metrics like ROE sufficient or do they understate the 'effective return'? How extensively should credit ratings be used to compare MFIs? Are ratings provided by rating agencies

[8] Reena Mittal (2011)

used consistently? Should social returns be used in conjunction with credit ratings? The answers for these questions need to be found out collectively by funding agencies and MFIs. The idea of Economic Return and Social Return will be taken forward by Sa-Dhan for deliberation among MFIs and reported subsequently.

3. Succour from the **Government and the Apex Bodies**

Box 4: Key Intervention Sought From Government to Resuscitate the Sector

Ministry of Finance:

- The MFI Bill to be introduced in the Parliament at the earliest and the regulatory structure are put in place.
- Initiating dialogue with the Andhra Pradesh Government to resolve the crisis and bring back normalcy for MFIs. This would reinstate confidence among the banks to resume lending to MFIs.
- The Government can suitably direct SIDBI and banks to start lending. In addition, the Government need to direct banks to restructure debts of small and not-for-profit MFIs, even outside of AP, without treating their portfolio as NPAs. The Government may further facilitate for putting these MFIs on rejuvenation path through further lending.
- The Government, joining hands with SIDBI/NABARD, need to help establishing public infrastructure like Credit Information Bureau and Credit Guarantee.
- The Government need to initiate pilot projects for livelihoods cluster development in underserved regions with the help of NGOs/MFIs

Govt. of Andhra Pradesh:

- Stalemate is prevailing in the Andhra Pradesh state during the past one year. It is a matter of great concern that nearly 20 smaller MFIs, mostly NGOs who had been operating in the interiors of A.P. for decades, have closed down their operation. The stalemate could be broken only if the Andhra Pradesh Government allows the MFIs to collect and disburse loans as per the provisions of law.
- Stoppage of bank fund to MFIs has disabled the MFIs from releasing to and collecting loan repayment from clients leading to mass default. This has disrupted cash flow of MFIs forcing them to default payment to banks. Some banks have already served legal notices for recovering the dues. The state government can persuade banks to extend restructuring of loans of smaller MFIs. Re-structuring facility has so far been extended only to larger MFIs (Box 2).
- It shall urge the State Level Bankers Committee (SLBC) to persuade banks to start lending to MFIs.
- Sa-Dhan has submitted a proposal to the Principal Secretary, Rural Development of A.P. to bring back normalcy in the state. As per the proposal , we may kick start the MFI operation in select three blocks in Andhra Pradesh, wherein the MFIs can aggregate the loan dues, appoint a lead MFI, start collecting the dues and disburse fresh loans duly following the provisions of the law.

Box5: Initiatives Sought from the Apex Bodies

SIDBI:

- SIDBI, as the leader of Lender's Forum and the torch-bearer of microfinance movement, is in the best position to take the lead to lend to the MFIs. This has to start with small and medium MFIs working in difficult areas followed by the large MFIs. The banks would definitely get a positive signal from it and follow suit.
- SIDBI lending rate can be limited to 14 percent per annum, all inclusive as the MFI lending rate is capped at 26 percent. It is also better not to insist on personal guarantee of the promoters by SIDBI as the current crisis is a result of external factors.
- SIDBI can also extend repayment holiday for principal for one year to all the MFIs. MFIs may service the interest due during this period.
- The 100 Crore SIDBI Liquidity Fund as proposed under the Budget 2011 by the Finance Minister should start extending equity support to the small and medium not–for–profit institutions at the earliest. Sa-Dhan has proposed that 80 percent of the funds go to MFIs having good practices on the ground as well as outreach. Sa-Dhan data and knowledge base on MFIs may be utilized for identifying such MFIs.
- Being the sponsor of CGTMSE[9], SIDBI should extend credit guarantee for loans sought by small and medium MFIs from banks..
- SIDBI could recognize the sector Code of Conduct (CoC), making it as a mandatory requirement for extending loan to MFIs and promote the code with training, capacity building, monitoring & reporting. Sa-Dhan, having prior experience in taking SIDBI resources for CoC–related awareness programmes can extend operational support to SIDBI initiatives.
- SIDBI can support MFI-projects on microenterprise financing under the cluster development program, as already piloted through GIZ.

NABARD:

- NABARD has an opportunity to spell out the future of the SHG movement with the help of national consultations, surveys and research. It has been 20 years since the SHG movement began in the country and there is a felt need for rebuilding the movement with renewed vigour.
- In order to make the Credit Information Bureaus (CIBs) function effectively and avoid multiple lending, the initial investments may be made by the FITF (Financial Inclusion Technology Fund) housed under NABARD.
- NABARD need to ensure that the CIBs accommodate SHG data also and suitable IT software must be developed to source data from and exchange the same among banks/MFIs/SHPIs and others.
- NABARD should invest in projects on data sharing among MFIs, training and capacity building of MFIs and SHPIs.
- Funds under the FIF (Financial Inclusion Fund) and MFDEF (Microfinance Development and Equity Fund) shall be released to MFIs/Self Help Promoting Institutions working in backward and underserved regions, promoting the cause of financial inclusion.

[9] Credit Guarantee Fund Trust for Micro and Small Enterprises

4. Critical Role for **MFI - Association**

Sa-Dhan, as the sector association, has a very vital role to play in moulding the sector. It is involved in policy advocacy, capacity building, evolving standards and best practices at the national and regional level.

The knowledge and inputs available at its disposal has to be reckoned with for any policy related and strategic intervention of the stakeholders. Sa-Dhan, for example, has been doing primary data based analysis on the sector and bringing out reports consistently during the past seven years. It has got the capability to do data warehousing of the MFIs performance with the help of data base maintained at the Data Centre in Hyderabad.

Sa-Dhan also could act as certifying agency providing comfort to social investors. Certificates could be issued after completing due diligence on MFIs using social and financial metrics specially identified for this purpose. Potential social investors, using the certificate, could take informed investment decision. Sa-Dhan, going beyond such certification, could act as monitoring agency for the investors after their investment in MFIs.

> *The insights available with Sa-Dhan can better be harnessed for building the sector. Sa-Dhan could facilitate social investors to invest in the sector.*

As rightly indicated by Malegam Committee the infrastructure and the network Sa-Dhan could be utilized by the central bank for hiving off / complementing its supervisory function.

5. New approach by **Technical Service Providers**

There are several national and international agencies that extend support to the microfinance sector. They are, among others, CGAP at the global level, rating agencies and capacity building institutes at the local level.

Given the fact that certain metrics / practices promoted by CGAP (Consultative Group to Assist the Poor) like Zero Tolerance to default have encouraged inappropriate practices, they deserve de-emphasis now. Similarly, the poor households across continents need affordable and sustainable livelihood financial service to escape out of poverty. The agency may engage itself in evolving robust livelihood finance practices among MFIs.

Rating agencies too need to review the metrics that they use to rate MFIs. There are evidences that the MFIs which have been rated high are found to have indulged in practices that invited reputation risk to the sector prompting government intervention. The Andhra Pradesh crisis is a case in point. Sa-Dhan stakeholder study held recently has revealed the role of large MFIs in putting the sector's reputation in jeopardy. These large MFIs had consistently been enjoying high rating assigned from the rating agencies.

The capacity building institutions have very crucial role in revitalizing the human resource of the sector. As discussed in the previous section, the employee turnover is high in the sector. The staff efficiency needs to be improved to reduce cost of operation and their attitude towards the development work requires change to enhance client protection. These fall under the domain of the capacity building institutions.

Key Takeaways

The microfinance sector has demonstrated the feasibility of client outreach to remote locations and of delivering small value, high volume financial transactions in the door steps of clients in a cost-effective manner.

Access to finance for the low income households has been the concern of many governments across the globe. MFIs have shown the way. Microfinance is going to be an important service for the decades to come.

The approach of MFIs, at least in India, deserves critical review for making the MFIs service more effective. Sa-Dhan, as the network, has been providing platforms for the stakeholders for discussing several developmental issues. It will continue to organize events and forums for introspection of MFIs to review and refine the approaches in line with the suggestions made in this chapter.

The Government, the RBI, the banks, the SIDBI and the NABARD have always been supportive of the sector. Their concerns have been reckoned in their right perspectives. This understanding will reinforce the new paradigm of microfinance enunciated in this report.

All in all, microfinance is ***under scrutiny*** *now but will become* ***resilient*** *soon with the active patronage of the Government, the RBI, the apex bodies, the banks and others.*

Annexure -1
Distribution of Data Contributing MFIs for this Report

(a) Sa-Dhan Membership of MFIs

Membership	No. of MFIs
Sa-Dhan Member	115
Non- Member	57
Total	172

(b) Legal Form wise MFIs:

Legal Form	No. of MFIs
NBFC	57
LAB	1
Section 25 Company	17
Society	70
Trust	16
Cooperative	11
Total	172

(c) Model wise MFIs

Operating Model	No. of MFIs
Grameen	87
SHG	69
Individual	16
Total	172

(d) Region and state wise MFIs

Region	State	No. of MFIs
North	Uttar Pradesh: 12, Uttrakhand: 1, Madhya Pradesh: 5, Haryana:1, Delhi: 5	24
East	West Bengal:33, Odisha:16, Jharkhand:6, Bihar:12	67
West	Gujarat:5, Maharashtra:7, Rajasthan:10	22
South	Andhra Pradesh:15, Tamil Nadu:19, Karnataka:11, Kerala:6	51
North East	Assam:7, Manipur:1	8
Total		172

States Coming under Different Regions in this Report

Region	State/Union Territories under the region
North	Utter Pradesh, Uttrakhand, Punjab, Himachal Pradesh, J&K, Haryana, Madhya Pradesh, Delhi
East	Bihar, Odisha,West Bengal, Jharkhand, Chattishgarh
West	Gujarat, Maharashtra, Goa, Rajasthan
South	Andhra Pradesh, Tamil Nadu, Karnataka, Kerala, Pondicherry, Andaman and Nicobar
North-East	Assam, Tripura, Manipur, Nagalad, Sikkim, Arunachal Pradesh, Meghalaya, Mizoram

Annexure -2
Profile of MFIs which Contributed Data for this Report

(A) List of MFIs with Loan Portfolio Less than ₹1 Crore

S.No.	Name of the MFI	Region	Legal Form	Rated by	Rating Score
1	Samarthan Weakling Development Foundation	E	Section 25 Co.		
2	Arasan Rural Devlopment Society	S	Society		
3	Trust Microfin Services	E	Trust	M-CRIL	ß+
4	Barasat Anweshan	E	Society	CRISIL	MFI-6
5	PAHEL Livelihood	N	Section 25 Co.	SME	MF6
6	Srijan Foundation	E	Trust		
7	Vivekananda Sevakendra -O-Sishu Uddyan(VSSU)	E	Society		
8	Barasat Unnayan Prostuti	E	Society	CRISIL	mfR6
9	Yukti Samaj Sewa Society	N	Society		
10	Anupama Education Society	N	Section 25 Co.		
11	Mass Care International	E	Society		
12	Banki Anchalika Adibasi Harijan kalyan Parisad	E	Society		
13	BOARD	E	Trust		
14	Balajee Sewa Sansthan	N	Society		
15	Matashree Gomati Devi Jan Seva Nidhi	w	Society		
16	Prerna Microfinance	E	Trust		
17	National Rural Development Trust	E	Trust		
18	Gramyasheel	E	Society		
19	Dmatrix Development Foundation	W	Section 25 Co.		
20	Uttarakhand Microfinance and Livlihood Promotion Cooperative	N	Cooperative		
21	Batika	E	Society		
22	Center for Promoting Sustainable Livelihood	E	Society		
23	Pragati	E	Cooperative		
24	Prayas Juvenile Aid Centre	N	Society		
25	Prasad Foundation	E	Society		
26	Orissa Rural Infrastructure Development Association	E	Society		
27	Suraje	E	Society		
28	Jan Sewa Parisad	E	Society		
29	Center For Action And Rural Reconstruction	E	Society		
30	Surbhi Women Multipurpose Cooperative Society	W	Cooperative		
31	DISHA,Pune	W	Society		
32	Youth Council for Development Alternatives (YCDA)	E	Society		
33	Micro Enterprises & Sustainable Projects	E	Section 25 Co.		

(B) List of MFIs with Loan Portfolio Between ₹1 and <10 Crore

S.No.	Name of the MFI	Region	Legal Form	Rated by	Rating Score
1	Seva Rahara	E	Society	M-CRIL	B+
2	Nav Bharat Jagriti Kendra	E	Society	CRISIL	Mfr-5
3	Coochbehar Khagrabari Relief Service	E	Society	M-CRIL	B
4	WSDS- Institute of Innovative Technology Transfer and Environment	NE	Society		
5	Development Organization for Village Environment	S	Society	CARE	MFI3
6	Rural Education and Action Development	S	Society	CRISIL	
7	Destiny Finco Pvt. Ltd	E	NBFC	CRISIL	MFR5
8	Belghoria Janakalyan Samiti	E	Society	CRISIL	MFR6
9	CDC Microfinance Pvt. Ltd.	S	NBFC	SMERA	MF4
10	Global Welfare Society	NE	Society		
11	Nirantara Community Services	S	Society	M-CRIL	ß+ "Neutral"
12	Ajagar Social Circle	NE	Society		
13	Dibakar	E	Society		
14	Swayanshree Mahila Samabaya Ltd.	E	Cooperative	CRISIL	
15	Guidance Society For Labour Orphans & Woman	S	Society	CARE	MFR3
16	Human Development Centre	E	Society	CRISIL	mfR5
17	Social Action for Rural Community	E	Society		A
18	Sanginee Secondary Co-op Ltd.	E	Cooperative	CRISIL	mfR5
19	Humana People to People India	W	Section 25 Co.	M-CRIL	Beta plus
20	Dar Credit & Capital Ltd	W	NBFC		
21	Institute of Rural Credit & Entrepreneurship Development	W,S	Society	SMERA	MF4
22	Virutcham Microfinance Ltd	S	NBFC	SMERA	MFR5
23	Oazoane- The Society for Development of Human Abilities and Environment	S	Society	CRISIL	MF6
24	Barasat Sampark	E	Society		BB
25	Saija Fianance Pvt. Ltd	E	NBFC	CRISIL	MFR-5
26	Kelkar Leasing Company Pvt. Ltd.	W	NBFC		
27	Priyasakhi Mahila Sangh	N	Society	care	4+
28	Agradut Polly Unnayan Samity	E	Society		
29	Aprajita Mahila Sakh Sahakarita Maryadit	N	Cooperative		
30	Sanchetna Financial Services Pvt. Ltd.	N	NBFC	M-CRIL	B+
31	FREED	S	Society		
32	Ulkunda Tarun Seva Sangha	E	Society		
33	Bhartiya Micro Credit	N	Trust	CRISIL	mFR5
34	Ajiwika Society	E	Society	M-CRIL	ß+
35	Chaitanya India Fin Credit Pvt. Ltd.	S	NBFC	CRISIL	mfR5
36	SATRA	NE	Society		

S.No.	Name of the MFI	Region	Legal Form	Rated by	Rating Score
37	Sambandh Finserve Pvt.Ltd.	E	NBFC		
38	Anjali Microfin Pvt. Ltd.	E, NE	NBFC	CRISIL	mFR5
39	Parama Mahila Samitee	E	Society		
40	Ullon Social Welfare Society	E	Society		
41	Sambhav Social Welfare Organization	N	Society		
42	Disha India Micro Credit	N	Section 25 Co.	CRISIL	mfR5
43	IMPACT	S, W	Section 25 Co.		
44	Bal Mahila Vikas Samiti	N	Society	SMERA	mf 4
45	Bihar Development	E	Trust	M-CRIL	ß+
46	Shikhar Microfinance Pvt. Ltd.	N	NBFC	SMERA	MFI 4 Average
47	Dakshin Budhakhali Improvement Society	E	Society	CRISIL	Mfr5
48	Ishara Finance & Rural Development Pvt. Ltd.	N	NBFC		
49	Sripur Swami Vivekananda Welfare Society	E	Society		
50	Dora Microfinance	S	Society		
51	The Saath Savings and Credit Cooperative Society Ltd.	W	Trust		
52	Rural And Urban Innovative Social Enterpreneurship	N	Section 25 Co.		
53	Prayas Organization for Sustainable Development	W, N	Trust		
54	Sakhi Samudaya Kosh	W	Section 25 Co.	SMERA	MF4 Average
55	Hope Intrgrated Rural Development Society	S	Society	SMERA	MFI-4
56	Reedmas	S	Society	CRISIL	MfR6
57	Sambandh Finserve Pvt.Ltd.	E	NBFC		
58	Swayamsampurna	E	Society		
59	Bengal Women Welfare Association	E	Section 25 Co.		
60	Kalighat Society for Development Facilitation	E	Society		
61	Planned Social Concern	W	Section 25 Co.		
62	Dhosa Chandaneswar Bratyajana Samity	E	Society	CRISIL	Mfr5
63	MITR	W	Society	CRISIL	mFR5
64	Khandagiri Madhyamika Mahila Samabay Sangha Ltd.	E, NE	Cooperative		
65	Community Services Trust	S	Trust		
66	Seva Mandir	W	Trust		
67	Jagaran	E	NBFC		

(C) List of MFIs with Loan Portfolio Between ₹10 and <50 Crore

S.No.	Name of the MFI	Region	Legal Form	Rated by	Rating Score
1	The Payakaraopta Women's Mutually Aided Co-operative Thrift and Credit Society Ltd. (PWMACTCS)	S	Cooperative	CRISIL	mfR5
2	Navachetna Microfin Services Pvt Ltd.	S	NBFC	CARE	mfR5
3	Society for Model Gram Bikash Kendra	E	Society	CRISIL	mfR5
4	People's Forum	E	Society	CARE	MFI-3
5	Indur Indtideepam Macs Federation Ltd.	S	Cooperative	M-CRIL	Beta +
6	Centre For Development Orientation And Training	E	Society	CRISIL	Avg-MF4
7	Unacco Financial Services Pvt. Ltd	NE, E	NBFC	M-CRIL	
8	Pragathi Mutually Aided Cooperative Credit & Marketing Federation Ltd.	S	Cooperative	Crisil	
9	Guardian	S	Section 25 Co.	CRISIL	MF3
10	Sarala Women Welfare Society	E	Section 25 Co.	M-CRIL	Beta positive
11	Network of Entrepreneurship & Economic Development	N,E	Society	CRISIL	mfR5
12	Uttrayan Financial Services Pvt. Ltd.	E	NBFC	CRISIL	
13	Sahara Uttrayan	E	Society	CRISIL	MFI 3+
14	Margdarshak Financial Services Ltd.	N	NBFC	SMERA	mfR6
15	Arman Financial Services Ltd.	W	NBFC	CRISIL	mFR5
16	Sarva Jana Seva Kosh Ltd.	S	NBFC		MFI3'
17	Capital Trust Limited	N	NBFC	CRISIL	mfR5
18	Sreema Mahila Samity	E	Society	CRISIL	mfR5
19	Welfare Services Ernakulam	S	Society	CRISIL	
20	Asomi Finance Pvt Ltd	NE	NBFC	M-CRIL	ß+
21	Swayamshree Micro Credit Services	E	Section 25 Co.	CRISIL	MFR5
22	SV Creditline (P) Ltd	N, W	NBFC	CRISIL	mfR5
23	Credible Microfinance Ltd.	E	NBFC		NFR5
24	Anupurna Mahila Co-op. Credit Society Ltd.	W	Cooperative	SMERA	MfR4
25	Growing Opportunity Finance(India) Pvt. Ltd.	S,E	NBFC	CRISIL	mfR5
26	Sarvodaya Nano Finance Ltd	S,N,W,E	NBFC	M-CRIL	mfR5
27	Suryoday Microfinance Pvt. Ltd.	W,S, E	NBFC	CRISIL	Mf(R) 4
28	Arth Micro Finance Pvt. Ltd.	W	NBFC		B+ Stable
29	Hope Microcredit Finance (India) Pvt. Ltd.	S,E	NBFC	CRISIL	ß+
30	Kaveri Credit India Pvt. Ltd.	S	NBFC	CARE	mFR5
31	Vedika Credit Capital Ltd	E	NBFC	CRISIL	
32	Grameen Sahara	NE	Society	CRISIL	BB/Stable
33	Rors Finance Pvt. Ltd.	S	NBFC	M-CRIL	
34	CReSA Financial Services Pvt. Ltd.	N, NE	NBFC		B+
35	Gram Utthan	E	Society	CRISIL	ß+
36	People's Action for Transformation (PAT)	S	Trust	M-CRIL	mfR4

(D) List of MFIs with Loan Portfolio Between ₹50 and <100 Crore

S.No.	Name of the MFI	Region	Legal Form	Rated by	Rating Score
1	Sahara Utsarga	E	Society	CRISIL	MfR4
2	Sanghamithra Rural Financial Services	S	Section 25 Co.	CRISIL	BB Stable
3	Arohan Financial Services Ltd.	E, NE	NBFC	M-CRIL	μ-
4	Rashtriya Seva Samithi	S	Society		
5	Mahasemam	S	Trust	ICRA	M4+
6	IDF Financial Services Pvt. Ltd.	S	NBFC	CRISIL	mfR4
7	Swadhaar FinServe Pvt. Ltd.	w	NBFC	CRISIL	mfR5
8	Shalom Microfinance Ltd.	S	NBFC	CRISIL	mfR4
9	Saadhana Microfin Society	S	Society	CRISIL	MFR 4
10	Pustikar.L.V.P.B.&.S.S.S.LTD.	W, S	Society	SMERA	
11	Sonata Finanace Pvt. Ltd.	N	NBFC	CRISIL	mfR4
12	Krishna Bhima Samruddhi Finance Ltd.	S	LAB	SMERA	MF3
13	Sewa Bank	W	Cooperative		
14	RGVN (North East) Microfinance Ltd.	NE	NBFC	CRISIL	MfR4

(E) List of MFIs with Loan Portfolio Between ₹100 and <500 Crore

S.No.	Name of the MFI	Region	Legal Form	Rated by	Rating Score
1	Village Financial Services Pvt. Ltd.	E	NBFC	CRISL	mFR-4
2	Grameen Financial Services Pvt. Ltd	S,W, N	NBFC	CRISIL	mfR3
3	BWDA Finance Ltd.	S	NBFC	Crisil	MFR4
4	SMILE Microfinance Ltd.	S	NBFC	ICRA	M3
5	Sahayata Microfinance Pvt. Ltd.	W,N, E	NBFC	CARE	MFI 3+
6	BSS Microfin Pvt. Ltd	S,W	NBFC	CRISIL	mfr4
7	Satin Creditcare Network Ltd	N,W, E	NBFC	CARE	MFI2
8	Cashpor Micro Credit	N,E	Section 25 Co.	CRISIL	mfR3
9	Bharat Integrated Social Welfare Agency	E, S, N,S	Society	M-CRIL	μ-
10	Grama Vidiyal Microfinance Ltd.	S,N,W	NBFC	Social	75/100
11	ASA International India Microfinance Pvt. Ltd.	E, NE	NBFC	CRISIL	mfR3
12	ESAF Microfinance & Investments Pvt. Ltd.	S, W, N	NBFC	CRISIL	Mf R4
13	Trident Microfin Pvt. Ltd	S, W, N	NBFC	CRISIL	mfR4

(F) List of MFIs with Loan Portfolio above ₹500 Crore

S.No.	Name of the MFI	Region	Legal Form	Rated by	Rating Score
1	Bandhan Financial Services Pvt. Ltd	E,NE,W,N,	NBFC	Care	mfr2+
2	Ujjivan Financial Services Private Limited	S,W,N,E, NE	NBFC	CRISIL	mfR3
3	Bharatiya Samruddhi Finance Ltd.	S,N,W,E,NE	NBFC	CRISIL	BB+ *-ve
4	Spandana Sphoorty Financial Ltd.	S,E,N,W	NBFC	Crisil	mfR1
5	Shree Kshethra Dharmasthala Rural Development Project	S	Trust	Mcril	μ-
6	Share Microfin Ltd.	S,W,N,E, NE	NBFC	CARE	
7	SKS Micro Finance Pvt. Ltd.	S,W,E,N	NBFC	CARE	PRI+(SO)
8	Asmitha Microfin Ltd.	S, W, N,E	NBFC	CRISIL	mfR2
9	Equitas Microfinance India (P) Ltd	S,W	NBFC	CRISIL	mfR2

ANNEXURE - 3

MFI-MISSION AND GOVERNANCE IN THE NEW DECADE

A Speech by Smt. Ela R Bhatt[1]

There was a time when India was compared with Bangladesh that is why India remained 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 the growth in terms of loan volume and clients, new players, free flow of international capital etc. Diverse ways of micro finance 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 initial years,1974 SEWA Cooperative Bank for 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) to operate on commercial format. As they become stabilized, and big, they became acceptable by Banks – the growth accompanied with ICICI's partnership leverage, SIDBI's 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. It is time to revisit, search, re-search our common shared goals, over motives deep down our soul. Cynicism… we can't afford. It is the poor, poor women who are the ultimate sufferers. We do serious business with the poor, we can't let them down. We have to regain our lost whatever little–credibility.

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 many more positive work that is being done. Our work will say the positive story …….we, MFIs, should admit our failure, our mistakes. That is a healthy public life. We are all responsible to the society at large.

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 ₹ 5000 Crore to serve 500 MFIs need in India. A fund that is client-centered with a long term vision vis a vis the poor, with our deeper engagement with clients, to produce multiple–diverse products. I would assume slower growth at bottom line, moderate surplus/profitability and assess positive impact on clients live. I assume the fund will be a mix of patient capital: which is both risk funding and loan suppor. An independent, autonomous body professionally *mooted* it will be. The fund will closely work with public financial institution to leverage its own investments.

[1] An extempore speech delivered in Sa-Dhan's Governance Conference held in Ahmedabad (2011)

The resources generated will be redeployed into the sector; within the 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 the time to launch such India Equity Fund for the Government of India. 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….

We see anger and violence, what is worrisome is rampant unemployment amongst the youth. 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 creates a serious matter of worry. We already see eruption of violence 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 group will be rising 1.2% annually. This is the early working age population that needs MFIs attention.

Of course, 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… 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 is 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.

We 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

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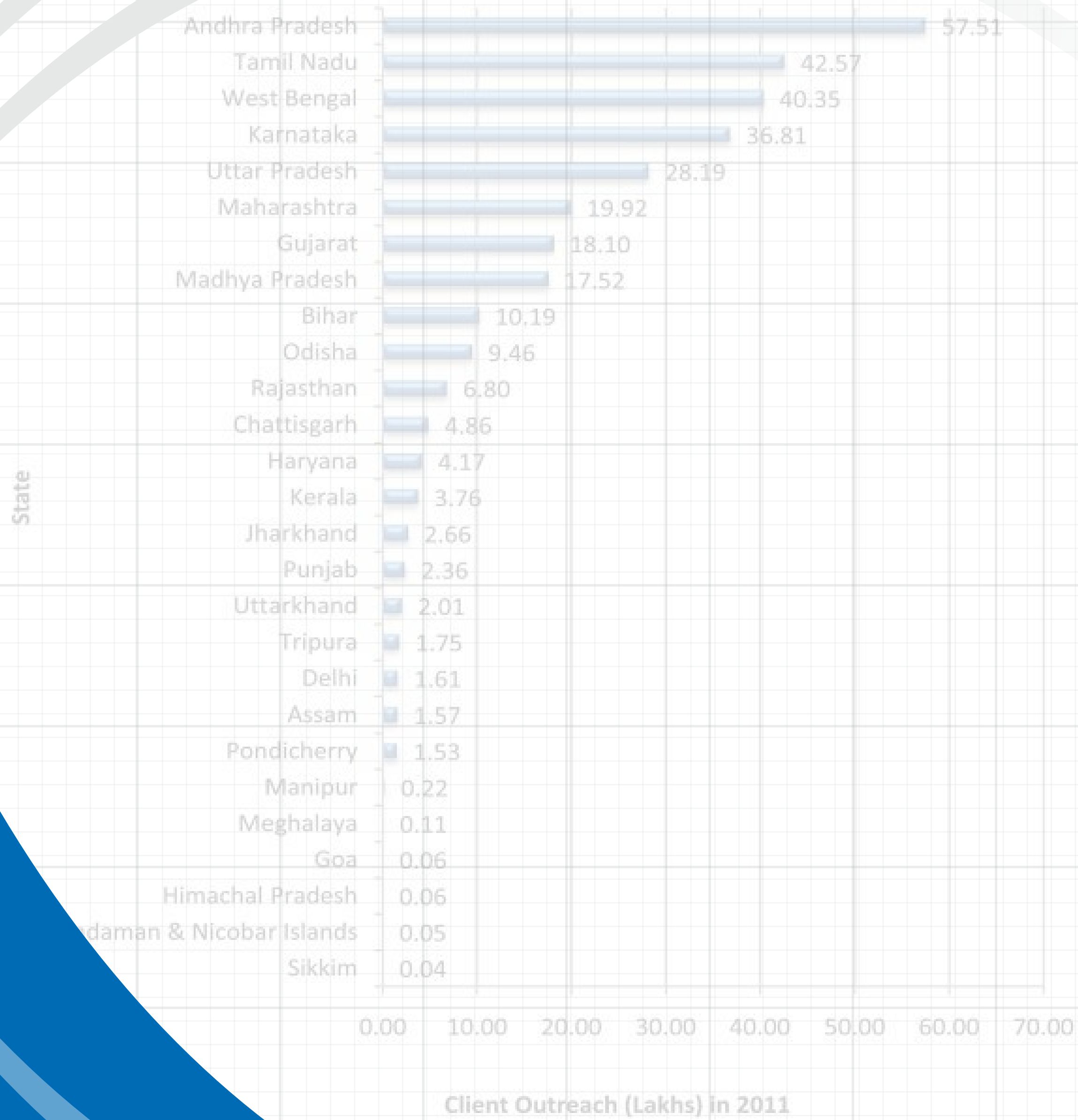

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