Sa-Dhan

Fostering Inclusive Impact Finance

Strengthening Transparency - Harmonized Information Template

Designed for
Mid and Small Microfinance Institutions

CONTENTS

FOREWORD

Sa-Dhan, as an association of impact finance institution, which mainly include the development financial agencies like Microfinance institutions, is committed to the development of its member institutions. Sa-Dhan has a variety of member institutions, of different legal types and sizes. One of the major challenges faced by the smaller institutions of all legal type is arranging funds for their growth requirements. In this connection Sa-Dhan organised a Lender meet, last year, to bring the lenders and funders face to face and to create a better understanding of each others needs. One of the prominent point which came up in the interactions in the meet is the need for better transparency and governance in microfinance institutions, which all the lenders are looking to. This has been the trigger for us to bring our this manual which mainly talks about how to maintain better transparency and better governance in microfinance institutions.

Microfinance institutions of all legal forms in India are unable to raise savings from the members or public. So, they have to necessarily depend on lenders or investors for raising funds, both debt and equity, as their growth capital. In India, there is an array of financial entities such as Developmental Financial Institutions, Apex Institutions, Multi-lateral agencies, Public & Private Sector banks, Small Finance Banks, and Non-Banking Financial Institutions which provide funding support to Microfinance institutions. The terms and conditions of these vary significantly. To obtain funding support from them is a challenge many MFIs are facing. To smoothen flow of funds this transparency manual is being published. This initiative is meticulously tailored to focus on enhancing both operational and financial transparency within the Microfinance ecosystem, specifically attuned to the unique requisites of different lenders.

The primary thrust of this study was to engage stakeholders from Mid & Small MFIs, Investing/ Lending Institutions, Rating Agencies, and other pertinent entities. The objective was to gain comprehensive insights into the multifaceted risks and challenges impeding funding support within the Microfinance landscape. The study diligently sought to pinpoint prevailing gaps in information and transactions, which contributed to a lack of transparency in the sector.

Guided by the Terms of Reference delineated by Sa-Dhan, the overarching objective aimed to bridge the transparency gap prevalent Some suggestions are made in this manual. In doing so, we have taken the support of Mr. Sudhir Narayan, ,an independent consultant, who has a done good job in compiling the information and putting them in place. I thank him for the services rendered.

I thank all our stakeholders, associate institutions and partners for contributing their insights in preparing this document.

I am also thankful to my colleagues Dr. Saibal Paul, Associate Director and Ms. Sangeeta Naik, Vice President, who have coordinated the work and helped in finalising this document. I compliment them for the same.

I hope this manual will be of use to all MFI in streamlining their process and policies and become adequately transparent for the lenders and investors to associate with them. I also hope lenders and investors will also find it useful.

My best wishes to all

Jiji Mammen
Executive Director & CEO, Sa-Dhan

1. SYNOPSIS

Mid and Small Microfinance Institutions have historically witnessed challenges in raising adequate resources in terms of Capital & Debt from financial institutions like Developmental Financial Institution / Apex Institutions, Multi-lateral agencies, Public & Private Sector banks, Small Finance Banks, Non-Banking Financial Institutions, and the like. The key hinderance faced by the lending institutions is the lack of operational and financial transparencies and availability of structured data from the Microfinance Institutions to ensure better decision making for the lenders.

To mitigate the above challenge faced by Microfinance Institutions, Sa-Dhan, an RBI registered Self- Regulatory Organization (SRO) for Microfinance sector, has engaged an independent consultant to Design, Develop and Streamline the overall credit process with an aim to enhance the transparency within the microfinance ecosystem. This Project is more pertinent towards Mid and Small Microfinance Institutions.

2. OBJECTIVES

The main objective of the study is to engage with all the stakeholders (Mid & Small MFIs, Investing/Lending Institutions & Rating Agencies) and understand the risks and challenges faced by each one of them which hinders funding support. The focus will be to understand the existing gaps in information and other transactions which reduce transparency.

Further as per the Terms of Reference provided by Sa-Dhan, the overall objective is also to bridge the transparency gap between all the stakeholders for easy and quick decision-making on funding process and to create comprehensive standard operating template with he consensus of all the stakeholders to enable the MFIs to approach funding institutions with enhanced transparency mechanisms for funding.

3. ANALYSIS

The sample for this analysis was determined by the willingness of various stakeholders including Public Sector Banks, Private Banks, NBFCs, Developmental Finance Institutions, Rating Agency, Microfinance Institutions, Credit Bureaus, and Self-Regulatory Organization in providing the relevant information/ lending criteria with the consultant during their one-on-one interactions. With the support of Sa-Dhan the consultant has obtained sizable information on challenges faced by lenders in terms of information asymmetric. Further, the key challenges faced by lenders are Governance, data capturing / information technology / management information system & data dissemination, asset quality, competition, and capital position. Consultant based on his vast experience in the inclusive finance space has articulated and suggested capturing micro level data on Governance, Operational and financial performance, asset quality.

As part of this process, the consultant was able to conduct discussions with four Private Sector Banks, One Public Sector Bank, Five Non-Banking Finance Companies, one Development

Finance Institution, Seventeen Microfinance institutions with varied legal structure like RBI registered NBFC-MFI, Society, Trust, and Section 8 companies.

4. DETAILED REQUIREMENTS BASED ON CREDIT POLICY OF DFIS

Development Finance Institutions (DFI): Development Financial Institutions like Small Industries Development Bank of India (SIDBI) has always encouraged start-up Microfinance Institutions and assisted many NGO-MFIs to transform into NBFC-MFI and provided both capital and debt to grow their microfinance operations. SIDBI has clearly demonstrated its lending criteria for start-up MFIs and for mature MFIs. Some key criteria are as under:

DFI	MFIs	Other Stakeholders
Two years of full financial year operations	For new / mid and small MFIs registered under RBI	NA
Minimum Net Worth	INR 10 Cr	NA
Net Non-Performing Assets	4% as per latest audited financial	NA
Leverage ratio / Debt to Equity Ratio	05:01	NA
Capital Adequacy Ratio	18%	RBI guidelines is 15%
Net Surplus as per latest audited financials	MFIs also share audited six-month financial statements and BP to showcase their profitability growth	NA
Minimum loan portfolio INR 25 Cr	AUM of INR 25 Cr is minimum requirement	NA
Asset coverage ratio requirement is 1.33 times	MFIS must provide exclusive charge by way of hypothecation of book debts and receivables of the loans provided by MFI	NA
Operational policies on Risk Management	MFI should have detailed risk management policies on tracking normal delinquencies, hidden delinquencies, geographical portfolio, mapping of green, yellow and red operational area	Micro level data assist the lenders to fasten their decision-making process

Microfinance Institutions: Microfinance in India has evolved over the last two decade and many microfinance institutions has transformed due to conducive policies implemented by varied stakeholders. Currently, around 85-90% of the microfinance portfolio in India belongs to large Microfinance Institutions and balance is being held by mid and small microfinance players. Mid and Small Microfinance players have faced many challenges, and they are unable to raise adequate resources, in-spite of sustainable operations, good asset quality and governance.

This study was primarily conducted to understand the challenges mid and small microfinance institutions face in raising resources. Some of the key challenges are Governance, Information asymmetry, management information systems, micro level data on asset quality, geographical diversification, and micro level data on borrowers' profile, livelihood sector, and product bifurcation.

Governance: Mid and small microfinance institutions should avoid conflict of interest, while deciding the governing board. Given the paucity of experienced personnel with knowledge in finance, Information Technology, management processes and developmental sector, limits the mid and small microfinance institutions to adhere to Societies and Trust Laws in India, hence they involve friends and relatives as board members. Relatives, family members and friends have limited experiences in strategic management, hence their involvement is limited to developmental sector and hence limit the transparency process. Governance aspects of Mid and Small Microfinance institutions should have the following best practices to garner fresh capital / additional debts from financial institutions.

Table 1: Governance

Board	Governing Board
	Profile of Board Members
	Relative/ Family Members of Founder / Co-Founder as Board Member
	Profile of Board Members
	Independent Directors
	Profile of Independent Directors
	Clearly defined Mission & Vision
Board Level Committees	✓ Credit Committee ✓ Risk Management Committee ✓ Human Resources Committee ✓ Audit Committee ✓ Asset & Liability Management ✓ Corporate Social Responsibility Committee ✓ Information Technology Committee ✓ Grievances Redressal Management ✓ Strategic Management & Mission Drift
Board Meeting	❖ Conducted at regular intervals ❖ Attendance of board members ❖ Strategic discussion

Policies	❖ Clearly defined and updated credit policy ❖ Operational Policy ❖ Underwriting policy ❖ Cash management mechanism ❖ Asset Quality and write off policy ❖ HR & Remuneration ❖ Compliance & legal ❖ Grievances Redressal ❖ Data Security ❖ Related Party Transaction ❖ Code of Conduct ❖ POSH policy ❖ Whistle Blower policy ❖ Business Continuity Plan ❖ Disaster Management ❖ Accounting & MIS policy
Statutory Auditor	Adherence of Rotation in appointing Statutory Auditor
Internal Audit	❖ Role of Internal Auditore clearly defined ❖ Internal Auditor reporting to the board ❖ Grading mechanism of branches clearly articulated and part of performance management ❖ Incentive Structure are properly verified by the IA team
Information Technology Audit	Periodic audit of IT systems at head office and branches

Transparency: Mid and Small microfinance institutions should enhance their information dissemination process and should share micro level data on area of operations with bifurcation on urban and rural portfolio. Categorization of district on low, medium and high risk will enhance transparency on ground level data with lenders.

Further, the management information system should also capture client-wise data like first, second and third-time borrowers and so on, which will assist the lenders to understand the borrower's profile in detail. Mid and small microfinance institutions should provide data on overdue, on-time and pre-payment collections monthly. Collections / repayment rate should be bifurcated based on product, sector-wise and pre-payments and overdue collections should not be part of on-time collections. This will enhance confidence in lenders and lenders will be able to understand the portfolio at risk at granular level.

Asset Quality: Mid and small microfinance institutions provide data on a quarterly basis on asset quality. However, this data varies largely on a quarterly disbursements' basis. To eliminate this variance, mid and small microfinance institutions should categories their asset quality data on region, district, branch wise, borrower wise like portfolio at risk of first-time borrowers and the like.

Further, mid and small microfinance institutions should also provide portfolio at risk data on sector wise like agriculture, agriculture allied, trading, livestock and the like segments. Moreover, asset quality data should also be provided for each product and hidden delinquencies should also be tracked to strengthen the underwriting process. Mapping of loan portfolio on the basis of green, yellow and red zone needs to be disseminated clearly.

Though banks and large Non-Banking Finance Institutions require certain benchmarks requirements like investment category rating, loan portfolio and geographical diversification. However, if mid and small microfinance institutions were able to improve their management information systems, information technology platform and collate the data as suggested, then lenders may explore opportunities to engage with mid and small microfinance institutions for partnership.

5. INFORMATION TEMPLATE

Tabel 5.1: Synopsis

Legal Status	
Date of Incorporation	
Date of starting MFI business	
Background about MFI business establishment	
Changes in governing board structure (if any)	
Advisors (if any)	
States covered	

Table 5.2: Management & Operations

Management	Latest Organogram ➢ Change in structure (if any)
	Senior Management team Profile of Senior Management team ❖ Operations ❖ Finance & Accounts ❖ Risk Management ❖ Human Resource & Training ❖ Audit Function ❖ Compliance & Legal ❖ Information Technology
Advisors & Consultants	Advisors & Consultants Experience of Advisors & Consultants Relationship of advisors & consultants with respective MFIs

Financial Statements	Audited financial statement for last three years ✓ Notes to accounts ✓ Capital Adequacy calculation (as per RBI guidelines) ✓ Audit Report ✓ Management Letter from auditors ✓ Director's report
	Unaudited or Provisional financial statements with notes to accounts
	Detailed Business Plan
Rating Report	Last three rating report provided by rating agencies
MFI Grading Report	Last three grading report provided by rating agencies
Code of Conduct Grading Report (CoCA)	Last three grading report provided by rating agencies
Market Research Report	Impact Assessment Surveys

Table 5.3: Operational Indicators (Provide data for own and managed portfolio separately)

5.3.1 Outreach

Financial Year	**Mar-24**	**Mar-23**	**Mar-22**	**Mar-21**
Total Active Groups				
Own Portfolio				
Rural				
Urban				
Men				
Women				
First time borrower				
Second time borrower				
Third time borrower				
Fourth time borrower				
Fifth time borrower				
Above fifth time borrower				
Total Members				
Members				
Rural				
Urban				
Men				
Women				
First time borrower				
Second time borrower				
Third time borrower				
Fourth time borrower				
Fifth time borrower				
Above fifth time borrower				
Total Borrowers				

Financial Year	Mar-24	Mar-23	Mar-22	Mar-21
Borrowers				
Rural				
Urban				
Men				
Women				
First time borrower				
Second time borrower				
Third time borrower				
Fourth time borrower				
Fifth time borrower				
Above fifth time borrower				

Financial Year	Mar-24	Mar-23	Mar-22	Mar-21
Active loan accounts				
Rural				
Urban				
Men				
Women				
First time borrower				
Second time borrower				
Third time borrower				
Fourth time borrower				
Fifth time borrower				
Above fifth time borrower				

5.3.2 Operational Performance

Financial Year	Mar-24	Mar-23	Mar-22	Mar-21
Total Disbursements (during the year) - INR				
Rural				
Urban				
First time borrower				
Second time borrower				
Third time borrower				
Fourth time borrower				
Fifth time borrower and above				
In red zone				
Rural				
Urban				
In orange zone				
Rural				
Urban				

Financial Year	Mar-24	Mar-23	Mar-22	Mar-21
In green zone				
Rural				
Urban				
Total Disbursements (during the year) - No of Loans				
Rural				
Urban				
First time borrower				
Second time borrower				
Third time borrower				
Fourth time borrower				
Fifth time borrower				
Above fifth time borrower				
In red zone				
Rural				
Urban				
In orange zone				
Rural				
Urban				
In green zone				
Rural				
Urban				
Assets Under Management (AUM)				
Loan portfolio (Own portfolio)				
Rural				
Urban				
First time borrower				
Second time borrower				
Third time borrower				
Fourth time borrower				
Fifth time borrower				
Above fifth time borrower				
In red zone				
Rural				
Urban				
In orange zone				
Rural				
Urban				
In green zone				
Rural				
Urban				

5.3.2 Portfolio At Risk

Portfolio at Risk				
In red zone				
In orange zone				
In green zone				
Ontime Portfolio				
PAR -30 days				
PAR - 6- days				
PAR - 90 days				
PAR - 180 days				
PAR - 365 days				
PAR - 365 days and above				

6. KEY DISCUSSION POINTS WITH VARIOUS STAKEHOLDERS

Public Sector Banks: Public Sector Banks require an investment category rating ie BBB (Triple B rating) by SEBI registered rating agencies and loan portfolio as of latest financial year should be more than ₹100 Cr. as one of their key criteria for the process of underwriting. Further, Public Sector Banks also emphasize strong asset quality and capital adequacy position. The public sector banks have authenticated that operational and financial performance data are given higher importance during the loan proposal examination. The lending institutions need to understand the overall business operations clearly for decision making.

Private Sector Banks & Small Finance Bank: Private Banks also requires an investment category rating ie BBB (Triple B Rating) by SEBI registered rating agencies and the minimum loan portfolio of ₹250 Cr as of latest financial year. Moreover, a couple of private banks consider rating assigned by top three ratings agencies and increase the lending rate if the rating is assigned by other than top three rating agencies. Further, some private banks don't want to be the first or second lender. They prefer to be third or fourth lender to MFIs. Ability of the microfinance institution to raise timely capital are preferred as partners. Banks suggest that to strengthen the monitoring mechanisms, they need to continuously check the charge creation on Ministry of Corporate Affairs to avoid any major misappropriation of funds by the MFIs.

Non-Banking Finance Companies: NBFC requires the capital adequacy ratio to be higher than stipulated by RBI for NBFC-MFI segment. Further, they also need the loan portfolio to be more than ₹500 Cr with operations spread across multiple Indian States. Furthermore, they require a higher investment category rating to consider as their partners. During the discussion with Microfinance institutions emphasized that these data required presented during the webinar should be in place and a pressing and urgent situation that requires immediate attention.

The Consultant has described key challenges faced by lenders during the underwriting process. These challenges are captured in a tabular format in two sections viz: Public, Private Banks, Small Finance Banks, and Non-Banking Finance Companies:

Banks & NBFCs	MFIs	Other Stakeholders
NBFC registered with RBI preferred	Forms of MFIs are NBFC, NBFC-MFI, Society, Trust, Mutual Benefit Trusts	Strong legal structure provides business continuity
Net worth above RBI threshold of 15%	Most of the MFIs have been following the regulatory framework	More than 15% stipulated by RBI. Rating Agencies requires higher Capital adequacy ratio and commitment to maintain high Capital adequacy ratio, to support the rating/grading assigned
Banks need three years profitability	MFIs with three years profitability or with monthly breakeven apply for credit	Third party evaluators will not consider the grant income and will consider the expenses arise out of grant income as operational expenses
Banks need AUM of INR 100 Cr and above	MFIs with good governing board could reach AUM of ₹100 Cr with the assistance of Banks as Banking correspondent partners	NA
External Credit Rating should be BBB- and above	MFIs with less than BBB- credit rating, should provide personal guarantee/s of board members or directors	NA
Certain NBFCs does not consider the external rating of Mid-sized rating firm.	The rating assigned by mid-size rating firm will be notched down and there is an increase in lending rate by 25-75 bps	NA
MFIs should demonstrate sourcing funding from minimum two or three lenders	Banks are not comfortable lending to MFIs if they don't have minimum two or three lenders as Banks.	NBFCs cannot be the largest lender in terms of ticket size for MFIs.
Bank Internal Rating system	MFIs should be aware about the cut-off of internal rating of banks/lenders internal system	NA
Private Banks requires external credit rating of BBB-	Not applicable to Mid and Small MFIs	NA

Banks & NBFCs	MFIs	Other Stakeholders
Private Banks requires MFIs book size has to be more than INR 500 Cr.	Not applicable to Mid and Small MFIs	NA
Repayment Rate / Collections	MFIs to provide MIS data on collections with details of pre-payment, overdue collections and on time collections. Real-time monitoring access of the Loan Monitoring System to lenders will be an added advantage for MFI in establishing trust with prospective lenders. The MFI can provide access to either the portfolio hypothecated to the lender or the entire portfolio and mask the KYC documents / information	Third party evaluators will also need this data
Conflict of Interest	MFIs to be careful that they are adhering to and avoiding any conflict of interest. For example, same board member	NA
Profile of board members	Friends, relatives, or members with Social Development background will have limit ed weightage	NA
Background with Social Development	Knowledge of business operations and MIS is limited. Therefore, they are unable to provide strategic direction to the organization	NA
Micro level operational data	MFIs should provide micro level operational data like portfolio in green, yellow and red zone, districts and branches in green, yellow and red zone and the like for last 8 quarters.	Third party evaluators will also need this data
Micro level Aging analysis	MFIs should provide micro level aging data like overdue portfolio in green, yellow and red zone, product wise and sector wise aging analysis for last 8 quarters.	Third party evaluators will also need this data
Portfolio evergreening	MFIs should provide the charge created on MCA website for each credit sourced by MFIs.	NA
Independent Director	Mandatory to have Independent Director/s to an extent of 40%. The Independent Director should be pard of board level committees mainly Risk Management, Audit and Information Technology.	

Banks & NBFCs	MFIs	Other Stakeholders
Rescheduled Portfolio	Past 2 years performance of rescheduled portfolio to be mandatorily part of management information system. District and branch wise information also to be provided.	
Internal Audit Mechanisms	Detailed organogram of internal audit mechanism to be shared along with Internal audit report of vintage branch and new branch.	

Credit Rating Agencies: Credit Rating Agencies monitor the performance of Microfinance Institution at regular intervals as stipulated by SEBI. The credit rating upgrade and downgrade are subject to the overall operational and financial performance of the financial institutions. To improve the credit rating, the Microfinance Institutions need to strengthen their governance practices, risk management mechanisms, underwriting process and operational indicators. A higher capital adequacy ratio with the Governing board's approval to maintain a high capital position will be seen as positive for the institution. Similarly, diversified operations with a strong second line of management will help the institution in attaining a higher credit rating.

Maintaining strong asset quality levels with improvement in net margins will be key rating drivers for any credit rating movement. Rating Agencies also consider diversified resource profile as one of their key indicators during their rating process.

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