



State of Microfinance in India

Prepared for



Institute of Microfinance (InM)

As part of the project on
State of Microfinance in SAARC Countries

By

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Disclaimer

Any opinions expressed and policy suggestions proposed in the document are the author's own and do not necessarily reflect the views of Institute of Microfinance (InM). The report also does not represent the official stand of the Government of the countries studied.

List of abbreviations

APMAS	Andhra Pradesh Mahila Abhivruddhi Society
BC	Business Correspondents
BPL	Below Poverty Line
CAR	Capital Adequacy Ratio
CDF	Cooperative Development Foundation
CGAP	Consultative Group to Assist the Poor
CRT	Client Recognition Test
DRDA	District Rural Development Agencies
FI	Financial Institution
FSS	Financial Self Sufficiency
GNI	Gross National Income
GoI	Government of India
GRT	Group Recognition Test
IFC	International Finance Corporation
InM	Institute of Microfinance
INR	Indian Rupee
IRDP	Integrated Rural Development Programme
MACS	Mutually Aided Cooperatives Societies
M-CRIL	Micro Credit Rating International Limited
MFI	Microfinance Institution
MFO	Micro Finance Organisation
MIX	Microfinance Information eXchange
MPI	Microfinance Penetration Index
MPPI	Microfinance Poverty Penetration Index
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non Bank Finance Company
NCAER	National Council of Applied Economic Research
NGO	Non Governmental Organisation
NSS	National Sample Survey
NSSO	National Sample Survey Organisation
OER	Operating Expense Ratio
OSS	Operational Self Sufficiency
PAR	Portfolio at Risk
PKSF	Palli Karma Sahayak Foundation
RBI	Reserve Bank of India
RMK	Rashtriya Mahila Kosh
RNBC	Residuary Non-Banking Companies
RoA	Return on Assets
RRB	Regional Rural Bank
SAARC	South Asian Association for Regional Cooperation
SBLP	SHG-bank Linkage Programme
SCCS	Savings and Credit Cooperative Societies
SC/ST	Scheduled Caste/Scheduled Tribe
SEWA	Self Employed Women's Association
SFMC	SIDBI Foundation for Micro-Credit
SGSY	Swarnjayanti Gram Swarozgar Yojna
SHG	Self Help Group
SHPA	Self Help Group Promoting Agency
SIDBI	Small Industries Development Bank of India
UCB	Urban Cooperative Banks
UN	United Nations
UT	Union Territory
WHH	Women Headed Household

Note

1 lakh = 100,000 (1 million = 10 lakh)

1 crore = 10,000,000 (10 million = 1 crore)

Exchange (31 March 08): USD1 = INR 39.9

Glossary

APR: It represents the income the MFI should earn on the loan. It includes interest, fees, commissions and the calculation method on the loan principal stated in an annualised figure. It does not include forced savings and effects of compounding.

Cost of Funds: Weighted average of interest rates on loans that fund the loan portfolio.

Dropout Rate: This is the proportion of members leaving the SHGs in relation to total existing members

EIR: It represents the financial costs to the borrower. It includes the effects of interest, fees, commissions, calculation method and other loan requirements (forced savings) on the total cost of the loan. It is expressed as declining balance interest calculation – either monthly or annual and includes the effects of compounding.

FER: Total interest expense (incl. interest on savings) for the year divided by the average portfolio.

Loan loss provisioning ratio: Total loan loss provisioning expense for the year divided by the average portfolio.

OER: Ratio of salaries, travel, administrative costs and depreciation expenses to the average loan portfolio

OSS: Ratio of total operating income to total costs for the year.

PAR (60 days): Ratio of unpaid principal balance on all loans with overdues greater or equal to 60 days to the total loan portfolio outstanding

Yield on Portfolio: Ratio of interest income on loans to the average loan portfolio for the year

Portfolio outstanding is the total of all the loans outstanding (total loans disbursed minus total principal repaid by client) that a financial institution holds at a given time

Repayment rate: Ratio of amount received till date to the total amount due this period plus the amount due from previous periods

RoA: Ratio of operational income/loss to average total assets.

TER: Ratio of total financing expenses, loan loss expenses and operating expenses to the average loan portfolio

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Overview

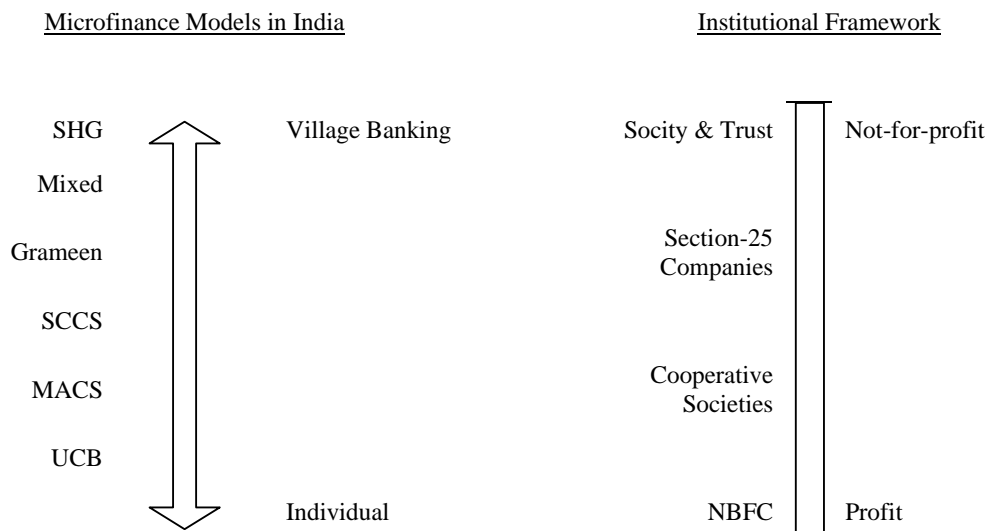
1 Microfinance in India - delivery methodologies

The Indian microfinance sector has two major models for microfinance delivery – the SHG Bank Linkage Programme and the MFI model. While the MFI model is growing rapidly the SBLP is by far the more dominant model in terms of outreach. Both these models are very different from each other in methodologies adopted and legal forms of institution involved in service delivery – SBLP is promoted by the apex agricultural bank (NABARD) through the commercial banks while the MFI model is privately managed with some institutions being regulated by the Reserve Bank of India.

SBLP, initially promoted by MYRADA (in Karnataka) and PRADAN (in Tamil Nadu and in Bihar) and formally launched in 1992 by NABARD began to scale-up in the mid-1990s. Under this programme, NABARD refinances bank loans to SHGs through commercial banks but the credit risk is carried by the banks. This has stimulated the growth of SHGs nationwide making these a dominant model in the delivery of microfinance in India.

The MFI model uses a variety of methodologies ranging from the very popular SHG methodology traditionally pursued in the country to Grameen and joint liability groups, as well as individual banking arrangements. Over the years, through an ongoing process of experimentation and innovation Indian MFIs now largely follow a mixed approach customised to their target segment and area of operation. In addition to the microfinance delivery methodologies, MFI management approach, services and performance are influenced by their legal form – ranging from not-for-profit Societies/Trusts and not-for-profit Companies registered under Section 25 of the Companies Act to NBFCs licensed by RBI. The microfinance methodologies and institutional framework adopted by MFIs are illustrated below.

Figure 1

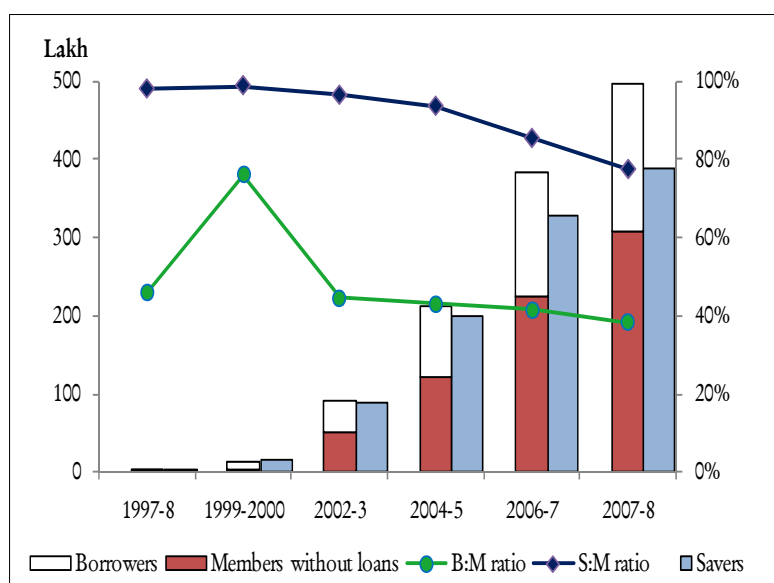


2 Overall outreach of microfinance

The overall outreach of microfinance is estimated at around 50 million people (around 45 million households) by end March 2008. This includes contribution of around 36 million people from SBLP and 14 million from MFIs. It is known that almost all the people linked under SBLP are primarily savers which enable their SHGs to obtain loan from banks. The people linked with MFIs receive mainly credit services for regulatory reasons that limit MFIs from offering deposit services to their clients. However, assuming that about 20% of MFI clients in 2008 also received savings services (a proportion of members of MFIs that adopted the SHG model) the number of microfinance savers in India is estimated at 38.6 million by end March 2008. This shows a predominance of SBLP over the MFIs in providing savings services.

By contrast, in terms of proportion of members who are borrowers, the MFIs are far ahead of SBLP. NABARD data indicates that only 20% of the people linked under SBLP obtained loans in 2008. Overall about 19.1 million people were borrowers of microcredit. Figure 2 below presents the growth of overall outreach (SBLP & MFI) in India in the last ten years in terms of membership, number of borrowers and number of savers.

Figure 2
Growth of overall microfinance outreach in India



While SBLP accounts for around 72% of the total estimated outreach in terms of members covered, the MFI model has a higher coverage of total borrowers at around 62%. One of the reasons for this anomaly is the more aggressive approach of the MFIs in lending in comparison to the banks while there is a greater focus of SBLP on savings. This has resulted in an overall low borrower to member ratio (B:M ratio) of 38% and a much higher savers to members ratio (S:M ratio) of 78% by end March 2008. This is also evident from Table 1 alongside that presents a comparison between average loan size and average savings per client of SBLP and MFIs in 2008. It is clear that SBLP and MFIs have different areas of priority though this is largely because most MFIs are prevented by regulation from offering deposit services.

3 The progress of SBLP

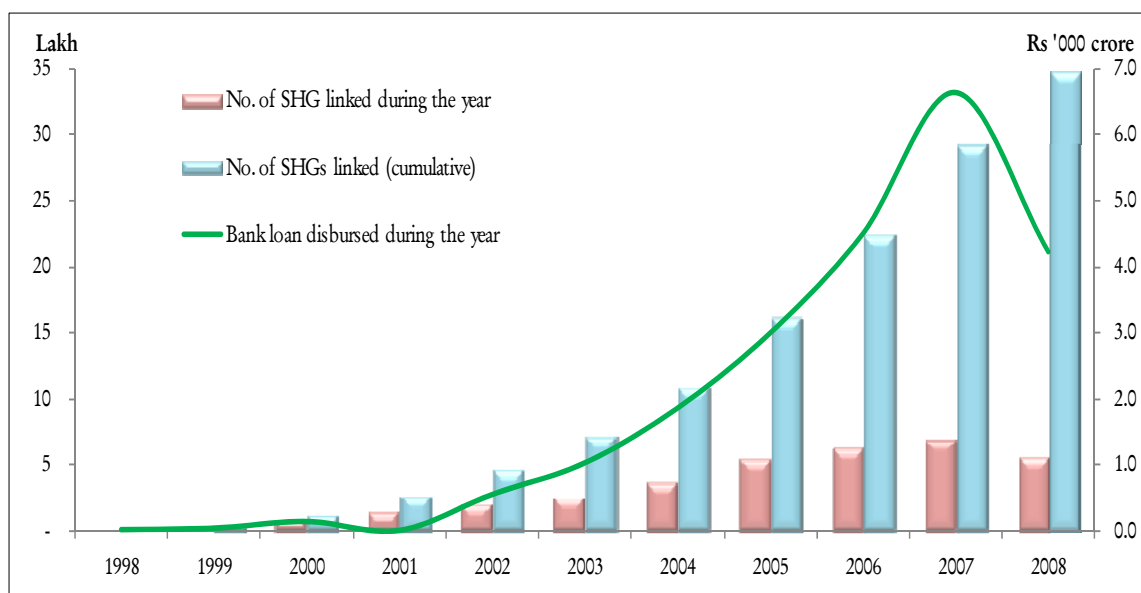
SBLP is the largest microfinance service programme, involving around 5,000 NGOs, and covering about 50 million families through 3.4 million SHGs. Under the SBLP, groups are promoted by self-help group promoting agency (SHPA) and linked to the banks by opening the groups' savings account. The SHPA – an NGO or government agency – promotes the groups, but is not part of its funding chain. The bank lends directly to a group after evaluating the group's operations (particularly the regularity of its savings in the bank, inter-lending of savings among members and its repayment record), maturity, and capacity to absorb credit. The group, in turn, on-lends to its members.

Table 1
Average loan size & savings mobilised

	SBLP	MFI model
Average loan size per borrower (Rs)	3,535	11,480
Average savings per member (Rs)	8,441	191

The overall outreach (cumulative number of bank-linked SHGs) under SBLP reported by NABARD is around 3.48 million SHGs as on 31 March 2008, an increase of 19% from the previous year. However, this figure does not include defunct SHGs and it is estimated that the actual number of SHGs currently linked under SBLP would be around 3.44 million. As discussed above, since all SHGs are required to save to become eligible for bank credit, all SHG members are also savers. About 90% of these SHGs are comprised exclusively of women. Though SBLP has witnessed high growth since its inception (about 174% p.a. in the current decade) there was a decline in 2008 owing to the onset of saturation in the south Indian states and the slow pick-up of momentum in other states of the country. Figure 3 shows the growth trends in SBLP.

Figure 3
Growth trends in SBLP



The cumulative bank loan disbursed rose to Rs222.68 crore (\$55.8 million) in 2008 from Rs180.4 million (\$45.2 million) in 2007. But loans disbursed to new groups declined in 2008 to \$105 million from \$165

million) a year earlier. The average loan size per SHG member remains low at Rs3,535 (\$88.5). Savings is also one of the important services that are being provided under SBLP. During financial year 2007-08, about 4.16 million SHGs saved around Rs3,512 crore (\$880million); Rs8,441 (\$212) per SHG.

In recent years, the recovery performance of banks lending under SBLP has dipped. Data reported to NABARD shows that several banks have a recovery of less than 90%. Studies (APMAS) have shown that the intra-group loans are likely to face even higher default rates as the groups always work towards keeping a default free record on the bank loan. A study by NCAER also reveals that only 69.2% of the SHGs had an excellent repayment record. An EDA study points out the need to reform the recovery practices through capacity building with the group to improve the repayment performance of SHGs. Good recovery (and therefore portfolio quality) has an important correlation to the long-term sustainability of the group.

The programme continues to be concentrated in the southern region with a share of 48.2%. However, with coverage in the south approaching saturation, regional shares have undergone a gradual change over the years and the south is losing its share to other regions of the country. In the current decade the eastern region has grown comparatively faster than other regions. The coverage of priority states by SBLP has shown a mixed picture. While the coverage has increased (8 out of the 13 priority states registered higher growth rates than the national average), a closer analysis shows wide disparities between states in terms of SHG linkages.

4 The progress of the MFI model

The overall outreach of the MFI model in March 2008 (**Table 2**) was about 14 million members including about 12 million borrowers, having a portfolio of Rs5.9 billion (US\$1,490 million) and savings of Rs2.4 billion (US\$61.0 million).

Table 2
Overall outreach of MFIs

Year	No. of MFIs	Number of (million)			Portfolio O/s	Savings balance
		Members	Borrowers	Savers	Rs Million	Rs Million
1999-00	44	0.52	0.20	0.36	710	310
2002-03	94	0.92	0.78	0.59	2,488	1,457
2004-05	122	2.58	2.19	1.21	8,747	950
2006-07	169	8.20	6.97	2.62	26,750	2,121
2007-08	223	14.10	11.87	2.79	59,540	2,434

Sa-Dhan 2008, The MiX 2008, M-CRIL

For consistent and in-depth analysis of outreach, financial performance and sustainability, this study uses data of rated MFIs that is validated and representative of the major proportion of the MFI sector (clients and portfolio outstanding – as shown in Annex 1). This data shows the following:

- In terms of model and legal forms, Grameen organisations accounted for about 78% of membership (in terms of methodology) while (organisationally) NBFCs covered 65% of outreach. This proportion has been growing over the years, which is evident from the fact that in 2003 the SHGs and NGOs accounted for the majority of microfinance coverage. The main reason has been the transformation of MFIs into commercial entities and adopting the Grameen model to meet their growth requirements.
- Like SBLP, the outreach of MFIs is also concentrated in the traditional southern region, with about a 75% share. However, in the last couple of years many south based MFIs have started to operate in other regions as well and the share of the south is expected to decline in the years to come.
- The ratio of borrowers (members with loans) to members is largely dependent on the extent of dormancy accepted within a methodology. The Grameen model has a high average of >90% while for the SHG model this lies around 50% because of a longer gestation period after which the member becomes eligible for loans.
- NBFCs comprise a substantial proportion of the portfolio outstanding. The share of NBFCs in portfolio outstanding has grown from 50.5% (2005) & 71.3% (2007) to 76.0% currently. The NBFCs also have about a 70% share of the borrowers. In this context, the proposal to bring societies, trusts and cooperative MFIs under a separate regulatory framework from that of NBFCs would mean regulatory exclusion of a major proportion of microfinance clients.
- There is a high degree of concentration in the microfinance portfolio. The Top 10 MFIs account for over 64% of the total portfolio. The reasons for this are related to the efficiency, financial performance and microfinance methodology and legal forms of the MFIs. Most of the Top 10 MFIs are NBFCs adopting the Grameen model for operations.
- The size of the average loan balance held by borrowers of Indian MFIs as a proportion of GNI per capita (a quick indicator of depth of outreach) has increased to 13.0% in 2008 from 9.9% in 2007. The Top 10 MFIs record a slightly lower loan size-GNI ratio of 11.7%, and has consistently dropped over the years. NBFCs have the highest loan size-GNI ratio of 14.1%. This shows their emphasis on having large loan sizes than other models right from the first loan cycle.
- The magnitude of thrift deposit services, in India is limited by the fact that not all MFIs are able to offer such services. Most NBFCs, which cover more than 70% of the MFI sector, are not allowed by RBI to mobilise deposits. However, NBFCs do collect security deposits (usually interest free) from their clients up to a certain proportion, (10-15%) of the loan disbursed. which are refunded at the end of the loan term. Overall, deposits mobilisation has seen a downward trend mainly as a result of regulatory pressure even though many of the MFIs are not directly regulated by the RBI.

Analysis of the financial performance of MFIs (based on select rated MFIs) shows an improving long term trend on various parameters including staff and operational efficiency, profitability and sustainability of operations. It is also apparent that debt has become the dominant source of finance for Indian MFIs. The allocation of funds has also been fairly productive with a high proportion being deployed in loans. Table 3 presents a summary of key operational and financial ratios indicating the progress of MFIs.

The overall picture of sustainability is quite encouraging. Analysis of OSS and FSS indicates that Indian MFIs have become more sustainable. The weighted average OSS and FSS of the Indian MFIs in 2008 has increased significantly to 122.4% and 115.4% respectively as compared to 92% and 87% respectively during 2007. This is mainly attributed to better management of operating and other expenses by some of the large and relatively new organizations. Also with the decline in grant funding of Indian microfinance there are no longer substantial differences between the OSS and FSS of Indian MFIs.

Table 3
Summary of key financial performance ratios

Parameters	All India			
	2003	2005	2007	2008
Outreach (averages)				
Members/MFI	21,235	34,265	96,347	215,406
Borrowers/MFI	7,770	20,908	74,086	183,243
Loan size (Rs)	6,562	11,509	8,117	11,480
Loan balance (Rs)	3,336	4,257	3,381	4,944
Savings per member (Rs)	762	300	211	191
Savings to portfolio ratio	62.4%	11.5%	8.1%	4.5%
Credit performance				
Portfolio at risk (>60 days overdue)	12.2%	4.7%	6.4%	2.9% [^]
Efficiency and productivity				
Members per staff	335	359	296	276
Borrowers per staff	122	219	228	234
Portfolio per MFI (Rs Million)	26	89	251	906
Portfolio per staff (Rs lakh)	4.1	9.3	7.7	11.6
Borrower/member ratio	36.6%	61.0%	76.9%	85.1%
Earnings/expenses				
Portfolio yield (weighted)	18.8%	25.2%	24.8%	24.6%
Financial cost ratio		10.3%	9.1%	9.8%
Operating expense ratio (weighted)	19.9%	15.6%	15.9%	11.1%
Loan loss provision		1.8%	5.2%	0.9%
Total expense ratio		27.7%	36.0%	21.9%
Operating cost per borrower (Rs)	548	581	504	457
Profitability and sustainability				
Return on assets (weighted)	-1.5%	2.1%	0.0%	3.0%
Operational self sufficiency (weighted)	88.2%	108.0%	92.0%	122.4%
Financial self sufficiency (weighted)	76.8%	102.0%	87.0%	115.4%
Leverage				
Capital adequacy ratio (weighted)	33.1%	20.6%	12.7%	17.1%
Debt : Equity ratio			14.2	5.2
Asset allocation				
Loans to total assets	62.1%	73.6%	75.0%	77.4%
Cash	5.6%	6.1%	10.0%	12.5%

*Detailed table in Annex 6; ** ^ PAR 30 for 2008.

5 Impact of microfinance

There has been a significant growth in per capita GNI in India of around 6% p.a. in this decade. Poverty rates have also decreased though it remains significant. The start of growth of microfinance in the country in the mid-1990s coincided with the beginning of economic liberalization when 36% of the population was estimated to be below the national poverty line. This declined to around 27% of the population in 2006.

Poverty outreach of microfinance

As discussed above, the southern states have a higher concentration for both the SBLP and MFI models of microfinance service delivery. The southern states have historically been the hub of microfinance activities although, in recent times, there has been substantial growth in microfinance in the eastern and northern regions. Yet, data for the southern states shows a lower proportion below the poverty line as compared to other regions. It is apparent, therefore, that the focus of microfinance has been in the states with lower poverty rates. The states in the northern and central regions with relatively high poverty rates in the 35%-40% range have very low microfinance penetration, accounting for no more than 10% of the overall portfolio outstanding, despite higher growth in recent years.

Social data is not so systematically reported as financial data. For key data – to profile clients, as well as to assess change – we have to rely on data and studies with varying scope and coverage.

In the context of overall declining poverty rates in India and the relatively small (micro) size of micro-credit the data indicates the following:

- Primarily rural outreach, though MFIs are beginning to expand into urban/city areas.
- Depth of outreach (% new microfinance clients below the poverty line) at an estimated 58% below the national poverty line for SBLP (compared to the All India figure of 17% households below the national poverty line). Lower poverty outreach for MFIs, with data benchmarked to the international poverty lines (20% of new clients below the \$1.08 poverty line, 62% below the \$2/day line, compared to All India household poverty levels of 25% below the \$1.08 line, and 75% below the \$2/day line).
- Moderate coverage of marginal communities – Scheduled Castes and Scheduled Tribes – at around 30% compared to 27% in the population
- An estimated 62-63% of micro-credit is used for direct productive investment; 37-38% is used for other household needs. Poorer clients are more likely to use credit for consumption smoothening
- Annual dropout rates of 8-11 % on average
- Some evidence for poverty reduction for those who stay with microfinance: 58% to 33% poor based on recall for the SBLP, 38%-30% comparing longitudinal wealth rank data for MFI clients. Continuing poverty for one-third of clients, after 5 years with microfinance.
- More evidence for poverty alleviation – in terms of reported increase in incomes, and in assets
- With women accounting for 94-95% of microfinance clients, a high proportion of women (around two thirds on average) report positively on qualitative indicators of empowerment. Quantitative data indicates variation in women's engagement in financed enterprises, with some evidence for 'loan-pass' (38% of financed enterprises are managed by a husband or son) and not much change over time. Women's ownership of assets in terms of perceived joint ownership with men in the households has increased.

- There are some interesting examples of women’s agency and empowerment at the community level, especially through the SBLP.
- Education of children does not follow automatically with microfinance, and continues to be a gap.

Competition between MFIs, and overlap between MFIs and SBLP, is emerging in some areas of the country. Whilst overlapping membership limits the extent of financial inclusion that is being achieved at the household level, qualitative data signals the risk of over-indebtedness.

6 Microfinance regulations

To reach large numbers of people, microfinance must eventually move into institutions that are licensed and supervised by a country’s financial authorities. A licensed institution can offer deposit services to its clients (to enable them to save) and thereby also have additional funds for on-lending at a generally lower cost than an unlicensed MFI would need to incur. Because microfinance is different from conventional banking, the banking laws and regulations of most countries are gradually being adjusted to accommodate licensed microfinance.

Microfinance Regulation refers to the set of legal rules that apply to microfinance. Supervision is the process of enforcing compliance with those rules. Financial service providers that take deposits need prudential regulation. This type of regulation protects their financial soundness and reduces the chances of their losing small depositors’ money. Prudential regulation – which mandates, for instance, capital-adequacy requirements and rules for provisioning for loan losses – is relatively difficult, intrusive, and expensive because it involves understanding and protecting the core health of an institution.

Non-prudential rules – such as the screening out of unsuitable owners/managers or requiring transparent reporting and disclosure – tend to be easier to administer because governments do not have to take responsibility for the financial soundness of the organization.

Microfinance needs different treatment from normal banking primarily because microfinance assets consist of many small, uncollateralized (that is, unguaranteed) loans. Areas of regulation that typically require adjustment include the relaxation of unsecured lending limits, tightening (if necessary) of capital-adequacy ratios, stricter rules for provisioning for loan losses and lower minimum capital requirements since MFIs are generally smaller institutions than banks or non-microfinance NBFCs.

India is a relatively unique case when it comes to microfinance regulation and supervision. It is not only its size that makes it very different from other countries. The involvement of the commercial banks in the financing of the MFIs is much stronger in India than anywhere else. This was facilitated by the advent of microfinance rating and the central bank’s circular recognising wholesale lending by banks to MFIs as part of their priority sector lending requirement (40% of all loans). This has stimulated and accelerated the transformation of NGO MFIs to non-bank finance companies (NBFCs) since banks are more comfortable with the latter institutional form. The result is that there is *de facto* regulation of microfinance institutions through the central bank. However, since the RBI has not recognised microfinance NBFCs as a separate category, it cannot create the separate prudential and non-prudential regulations that would facilitate the provision of microfinance services and safeguard micro-clients. Thus, unrated NBFCs are not allowed to offer deposit services limiting the financial inclusion of microfinance clients to the single dimension of credit.

The central (federal) government of India initiated the Microfinance Bill and it was presented to the previous Parliament in 2007. The provisions of the bill include Societies and Trusts and provide them with the legal sanction to accept deposits from their borrowers. The Bill, however, excludes NBFCs and not-for-profit companies (Section 25 companies) since these are regulated by the central bank. Yet, such companies form the bulk (75%) of the microfinance sector in terms of outreach and loan outstanding. As a result, a large proportion of microfinance clients will continue to be denied the deposit service even if the microfinance bill is passed.

7 Challenges facing the Indian microfinance sector

The Indian microfinance sector has seen unprecedented growth in this decade. Increased outreach, large investments and the growing role of private equity coupled with greater demand are some of the characteristics that could be marked with the recent development of the sector. The growing scale has brought with it its own set of challenges. Some of the key challenges discussed in the report are

Requirement of deposit services – There are limited deposit services available for the poor in India. Under the SBLP, group savings accounts are opened in local banks, but these are used primarily for internal group lending, though with access to savings on exit. MFIs find it difficult to offer this service due to regulatory restraints. NBFCs hold a major chunk of the outreach and portfolio but are not permitted to accept member savings as deposits thereby leaving a large proportion of their clients (virtually all low income families around or below the poverty threshold) without access to this service.

Deepening of outreach – Unless SHPAs and MFIs know the depth of their outreach to clients below the poverty line (and different poverty lines) it will be difficult for them to address any issues related to the poor. In the fast paced growth of the sector it is particularly important to analyse if microfinance services providers are reaching down to those most in need and those not serviced by formal financial institutions. This is the common mandate (by and large) of most microfinance service providers and as tools have become available to measure poverty levels, the challenge is for institutions to define their target outreach more clearly, effectively segment their market and respond with appropriate products.

Social performance management and reporting – Whilst financial performance management and reporting has developed across the sector, with consensus on key indicators and ratios, the development of social performance management is just beginning. This is seen at the international level to be increasingly important, to ensure that microfinance meets its social goals as a double (or triple) bottom line sector. It will require some reorientation and skill building, to encourage SHPAs and MFIs to go beyond the numbers to ensure quality services with consistent management and reporting.

Sector slow down due to global economic crisis – The global economic crisis has affected all sectors across countries and continents. Smaller MFIs face problems in obtaining debt funds from banks and find it difficult

to maintain liquidity. The liquidity risk has the potential to hamper refinancing of existing clients, leading to the risk of a rise in the current default rate.

Capacity building – Capacity building and improving understanding of techniques for improving microfinance management is the key to effective microfinance operations and eventually for achieving the objective of financial inclusion with social value. The effective bridging of capacity building gaps requires regular intervention in a number of areas like keeping pace with the fast growth of the sector, geographical spread and diversity and local language constraints. The high attrition rate of MFI staff is also a challenge often inhibiting MFI managements from investing in staff capacity.

Micro-credit plus – Building capacities and skill level of borrowers for better utilisation of credit are considered as some of the biggest challenges. There is a need to combine micro-credit with appropriate improvements in infrastructure, technology transfers, skill development and strengthening of market linkages to enable BPL producers to earn a higher return on their efforts. This is the best way of facilitating and enabling poverty reduction.

The problem of multiple lending – With an increasing number of MFIs and expansion of operations, the issue of overlapping membership and potential over-indebtedness is beginning to emerge, particularly in certain areas of the country. This is an area that needs more research, and clearer guidelines for the sector on appropriate practice.

Regulation – Regulatory movement with regard to microfinance has been slow and debates are still underway – as to which institution should be entrusted with regulatory supervision of the sector, and how to regulate the new NBFCs which serve a substantial majority of MFI clients.

8 Conclusion

The Indian microfinance sector has grown by leaps and bounds during the first decade of the twenty first century. A lot of changes have been seen during the last ten years on how the microfinance institutions function. Many transformed to for-profit legal forms and MFIs overall continue their efforts to become more efficient and productive. SBLP has also grown exponentially and is considered as the single largest microfinance programme globally. However, in this quest for growth and expansion the essence of microfinance as a programme for reaching the poor and excluded has lost its focus. There are other challenges as well, as discussed above (including savings services, social reporting, capacity building, tackling funding requirements and over-indebtedness, micro-credit plus and an enabling regulatory environment) that need to be addressed and would go a long way in making the Indian microfinance sector more inclusive, vibrant and sustainable.

Chapter 1: Introduction

This report is part of the series on the State of Microfinance in SAARC Countries sponsored by the Institute of Microfinance based in Dhaka. The objective of this assignment is to document the progress of microfinance initiatives in the SAARC countries and present the current status in terms of

- Types of institutions providing microfinance
- Models adopted for microfinance delivery to target clients
- Outreach – numbers and types of target communities served
- Impact of microfinance at the household level
- Sustainability of microfinance programmes
- Regulatory regime for microfinance
- Challenges facing the microfinance sector

This chapter presents the evolution of microfinance in India, starting from the launch of the cooperative movement in early 20th century to the present SHG bank linkage initiative and microfinance services provided by microfinance institutions (MFIs). The range of financial service providers has also been described which includes microfinance service providers. The methodology for analysing the status of the microfinance sector in India is also presented.

1.1 The evolution of microfinance in India

While financial services in India can be traced to the era of Kautilya in the fourth century BC the age of organized sector finance in India is generally acknowledged to have started with the Cooperative Credit Societies Act of 1904. The cooperative credit societies were based on the models of the German cooperative movement, in particular the Raiffeisen and the Schulze-Delitsch cooperatives. The objective of the Act was “to facilitate promotion of cooperative societies, for the promotion of thrift and self-help among agriculturists, artisans and persons of limited means.” To the extent that the wording of this objective could be applied to the objects of many MFIs today, this Act is a true precursor to modern microfinance in the country.¹

The true expansion of financial services in India started with the nationalization of all banks in the country during the late 1960s. This was reinforced with the establishment of Regional Rural Banks (RRBs) in 1976, and directed credit became the *mantra* of the Indian financial sector. In the meantime, the cooperative sector infrastructure had developed through the creation of an apex banking structure at the district and state levels to ensure the smooth flow of capital in the cooperative system. Yet, the entire network of primary cooperatives in the country and the RRBs, established to meet the needs of the rural sector in general and the poor in particular, has not proved to be successful. The cooperatives suffered from mismanagement, leadership by the privileged, and corruption, and were gradually smothered by state patronage and protection, in many cases

¹ Rangarajan, LN (ed), 1987. The discussion in this section is derived largely from Sinha, Sanjay & Ramussen, Stephen *et al*, 2006. *Microfinance in South Asia: Towards financial inclusion for the poor*. Washington DC: The World Bank.

including management by ill-motivated government-appointed persons. Meanwhile, saddled with the burden of directed credit and a restrictive interest rate regime, the financial position of the RRBs deteriorated.²

For many years, bankers and senior government officers in India described the Government of India's main poverty alleviation programme, the Integrated Rural Development Programme (IRDP), as "the world's largest microfinance programme." Started in the early 1980s, the IRDP, involved the commercial banks in giving loans of less than Rs15,000 (US\$330) to poor people and, over twenty years, this resulted in financial assistance of around \$5,600 million to roughly 55 million families.³ The problem with IRDP was that its design incorporated a substantial element of subsidy amounting to 25-50% of each family's proposed investment cost in an income generating activity, prompting extensive misappropriation and mis-utilisation of funds. This situation led bankers to regard the IRDP loan as a politically motivated hand-out and they largely failed to follow up on repayments due from borrowers. The net result was that estimates of the repayment rates in the IRDP ranged from 25-33%. Not surprisingly, the two decades of IRDP experience in the 1980s and 1990s affected the credibility of micro-borrowers in the view of bankers and ultimately hindered the access of low income clients to banking services.

The microfinance sector in India gained real impetus with the establishment of the National Bank for Agriculture and Rural Development (NABARD)⁴ in 1982. NABARD's well known SHG Bank Linkage Programme (SBLP) was initiated through a pilot in Karnataka and, from the mid 1990s, has now expanded throughout the country. It is increasingly adopted by Government agencies as a vehicle for their programmes. In this model, NABARD refinances commercial bank loans to self help groups (SHGs) in order to facilitate relationships between the banks and poor borrowers. SBLP has made significant progress since 1998. The bank-SHG linkage programme has greatly increased the outreach of the banking system to otherwise unreached households – especially to women as SHG members and initiated a change in the outlook of banks towards low income families from beneficiaries to customers.

Over the past 30 to 35 years, microfinance was also initiated through the efforts of influential development organizations such as the SEWA Bank (Ahmedabad), Annapurna Mahila Mandal (Mumbai) and Working Women's Forum (Chennai)⁵. This movement began to gain momentum in the 1990s with the entrance of a number of NGOs into microfinance. And since 1995, attempts to reform the cooperative system have also resulted in the creation of a new generation of cooperatives, the "mutually aided cooperatives societies" (MACS) that lie outside the purview of state control. So far, five states have enacted MACS Acts. The new legal system for cooperatives has guarantees of independent management and has resulted in the creation of hundreds of MACS in Andhra Pradesh, for example, many of them directly engaged in microfinance through SHGs of women members.

Starting with a few pilot programmes in the mid-1970s, the MFI sector in India has now grown to over 500 NGO-MFIs, several hundred independent cooperative societies focussing on financial services and around two dozen finance companies providing microfinance services. Current estimates of the number of NGOs and

² For a more detailed discussion, see Sinha, S 2000. India Country Study in Asian Development Bank, 2000. The Role of Central Banks in Microfinance in Asia and the Pacific. ADB: Manila.

³ This could suggest that virtually all the 60 million or so families 'officially below the poverty line' could have been covered by the IRDP. This was not the case as the numbers included many cases of repeat assistance (deliberate) as well as even more cases of selection of 'non-poor' beneficiaries.

⁴ NABARD is a government-owned apex refinance (wholesale loan) institution with a combination of promotional, supervisory, and refinance functions for retail institutions – rural branches of commercial banks, regional rural banks, and cooperative banks

⁵ SEWA Bank was established in 1974; Mahila Mandal in 1975 and Working Women's Forum in 1978

MACS engaged in mobilizing savings and providing microcredit services to the poor exceed 1,000 organizations.⁶

The MFI model received a boost with support from the Small Industries Development Bank of India (SIDBI) through the SIDBI Foundation for Micro-Credit (SFMC)⁷ in 1999. Since its establishment SIDBI/SFMC has played a crucial role in the promotion of the MFI model in India by providing credit for on-lending and capacity building support to NGO-MFIs. Initially, many NGO MFIs were funded by donor support in the form of revolving funds and operating grants. In recent years,⁸ apex development finance institutions such as SIDBI, NABARD and microfinance promotion organizations such as the Rashtriya Mahila Kosh (RMK) have provided wholesale loans to MFIs. This has resulted in the MFIs becoming intermediaries between the largely public sector development finance institutions and retail borrowers consisting of groups of poor people or individual borrowers living in rural areas/urban slums.

1.2 Financial service providers in India

The Indian financial sector includes a range of institutions as shown in Exhibit 1.1. Many of these are involved in providing microfinance services with a varying degree of focus. Typically the banks (including RRBs and cooperative banks) are involved under the government initiated SBLP while some of them also support Microfinance Institutions (MFIs) by providing them credit for on-lending. The Non-Bank Finance Companies (NBFCs), Cooperative Societies, not-for-profit companies (registered under Section-25 of Companies Act) and NGO-MFIs (registered as Societies or Trusts) are part of the MFI model.

1.3 Methodology

This report presents the overall status of the microfinance sector on the basis of the progress and experiences of the SBLP and the MFI sector. It is based on secondary research, drawing on reports and data from the past ten years. For information on models of microfinance and outreach, it draws on data compiled by NABARD for the SBLP, and data reported for MFIs to Micro-Credit Ratings International Ltd (M-CRIL)⁹ and its parent company EDA Rural Systems Pvt Ltd (EDA), the Microfinance Information eXchange (the MIX)¹⁰, and to Sa-Dhan (the network of community based financial institutions in India)¹¹. For documenting the impact of microfinance, the study has drawn on data gathered by major studies of both the SBLP (sponsored by

⁶ This number includes all registered societies, trusts, a few NBFCs and “new generation” cooperatives acting as financial intermediaries. It specifically excludes unregistered self help groups that are usually established and facilitated by the NGOs; and it also excludes conventional cooperatives.

⁷ SFMC is the apex wholesaler for microfinance in India providing a complete range of financial and non-financial services such as loan funds, grant support, equity and institution building support to the retailing MFIs so as to facilitate their development into financially sustainable entities, besides developing a network of service providers for the sector. SFMC is also playing significant role in advocating appropriate policies and regulations and to act as a platform for exchange of information across the sector. Source: www.sidbi.in

⁸ Roughly since 1994

⁹ M-CRIL is a specialized credit rating agency covering MFIs in 27 countries across Asia, Europe, Russia and Africa

¹⁰ The MIX is a global provider of business information and data services for the microfinance industry. www.themix.org.

¹¹ Sa-Dhan (www.sa-dhan.net) has since 2007 published annual data sets as reported by its members.

NABARD, GTZ and other donors) and the MFI sector (sponsored by DFID and SIDBI). We have also drawn on social rating data of Indian MFIs (by M-CRIL) to profile depth of outreach and client feedback. For sustainability analysis, data available for the SBLP comes from study¹² which was a joint initiative of CARE, Catholic Relief Services (CRS), United States Agency for International Development (USAID) and GTZ. For the MFI sector, the study draws on M-CRIL data for MFIs rated during 2003 to 2008. Data preference for MFIs reporting to all three agencies mentioned above was given to M-CRIL as the data is validated through a rigorous rating process. The 2008 MFIs also include some non-rated MFIs reporting to MIX. These MFIs represent 77% of All India MFI clients, 81% of All India MFI portfolio and 85% of All India savings mobilised – as discussed in Chapter 2 (and Annex 1).

Exhibit 1.1
Financial service providers in India

Type of service provider	No. of institutions ¹	Type of lending
Banks		
Commercial Banks	189 including public, private and foreign	In addition to general commercial activities, public- and private-sector banks are supposed to lend at least 40% of net bank credit to the "priority sector" (see note)
Local Area Banks	4	Including small value borrowers though constrained by the unsecured lending limit of 15% of total advances.
Regional Rural Banks	89	Traditionally, small-value borrowers are those with loans less than Rs200,000 (\$4,500)
Non-Bank Finance Institutions		
National Financial Institutions	4 (NABARD, SIDBI, NHB & EXIM Bank)	Development-oriented term-lending, refinance, and investment institutions.
Non-Bank Finance Companies	~7,000 (including ~700 that are allowed to accept public deposits)	Equipment leasing, hire-purchase, loan companies, and investment companies. A few focus on deposit services. About two dozen are focused on microfinance.
Primary Dealers	17	Government securities and other interest rate products.
Cooperatives/Credit Unions		
Primary (Urban) Cooperative Banks	1,854	Lending to members only
State and Central Cooperative Banks	14 & 73 respectively	Short-term lending to rural areas.
SCARDBs/PCARDBs	20 SCARDBs and 727 PCARDBs	Long-term lending to rural areas.
Primary Agriculture Coop. Societies	98,000	Micro/rural credit delivery and technical assistance.
Mutually Aided Cooperative Societies	Approx. 200-250 focusing on financial service	Micro/rural credit delivery

¹² EDA, APMAS 2006. "SHGs in India – A study of the lights and shades"

Non-Profit Institutions		
NGOs-MFIs	400-500	Microfinance lending and other charitable activities
Non-profit companies	10 (as of mid 2004)	Microfinance lending for business and household purposes

Source: Summarised and updated from India profile on CGAP website (2006)
 RBI December 2006, “Quarterly Statistics on Deposit and Credit”. Reserve Bank of India
 RBI 2004-2005, “Progress of Banking in India”. Reserve Bank of India
 Bhattacharjee & Staschen, 2004
 State Cooperative Agriculture and Rural Dev. Banks (SCARDBs); Primary Cooperative Agriculture & Rural Dev. Banks
 Rao, “Microfinance Institutions in India”; 2006, Sa-Dhan

Note: According to the Reserve Bank of India the Micro-credit provided by banks either directly or through any intermediary; Loans to self help groups (SHGs)/Non Governmental Organisations (NGOs) for on-lending to SHGs forms part of the Priority sector. Other Priority sector areas include: agriculture, small scale industries, small road and water transport operators, small business, retail trade, professional and self-employed persons, education, housing, software industry and Investment by banks in venture capital with specified limit of credit for each

1.4 Limitations

As indicated above, this study has relied on data reported by NABARD to analyse the progress of SBLP. NABARD data reflects cumulative numbers of SHGs and also presents new SHGs formed every year. However, it does not account for SHGs that have become defunct and, therefore, it does not give an entirely accurate picture of SBLP outreach. Also numbers are affected by the emerging overlap in microfinance, both between different MFIs in some areas, and between MFI and SBLP, affect the outreach numbers. Therefore, the overall outreach (all India) of microfinance (SBLP and MFI model) is an approximate indication of the progress of the sector as a whole.

It can be estimated from Exhibit 1.1 that there are about 800 institutions (including non-profit institutions, mutually aided cooperative societies and non-bank finance institutions; excluding primary agriculture cooperatives) involved in providing microcredit services under the MFI model. However, there are only about 200-250 MFIs that have a high degree of focus on microfinance and these provide financial and operational information to different institutions (like M-CRIL, miX and Sa-Dhan) for various purposes. Even for institutions that report their information there are issues of uniformity and regularity in sharing data. Therefore for in-depth analysis of the financial sustainability of the MFI sector this study has mainly used rated data (from M-CRIL) which is consistent and validated.

The evidence for impact (in terms of attributing change to microfinance) is technically limited – although large scale studies for both SBLP and the MFI model have been undertaken. Competition within the sector is an emerging issue, but there has been limited research on this as yet.

Chapter 2: Microfinance in India – the macro context

This chapter presents the models and methodologies adopted by various microfinance service providers in India. These include the most dominant SHG models which figure commonly under SBLP as well as the MFI model. The other models include the Grameen model that originated in Bangladesh and the individual banking model. This chapter discusses the variations of these models across the legal forms of MFIs.

An overall picture of the growth experienced by the sector, based on data reported by NABARD for SBLP and by MFIs to M-CRIL, MIX and Sa-Dhan is also provided. However, for in-depth analysis of operational and financial performance, impact and sustainability of SBLP and the MFIs this study has used select institutions and data that provides an indicative picture of the microfinance sector in India.

2.1 Microfinance delivery methodologies

The Indian microfinance sector has two major models for microfinance delivery – the SHG Bank Linkage Programme and the MFI model, as mentioned in the previous section. While the MFI model is growing rapidly the SBLP is by far the more dominant model in terms of outreach. Both these models are very different from each other in methodologies adopted and legal forms of institutions involved in service delivery – SBLP is run by the government while the MFI model is privately managed with some institutions being regulated by the Reserve Bank of India. In SBLP, NGOs are involved in promoting SHGs and linking them to local banks for savings and credit. The NGOs provide development inputs to the groups they work with, but do not directly mediate – or report on – the financial transactions. On the other hand, the MFIs may have started as NGOs but they have, in their work, developed a focus on financial intermediation as a key part of their operations. For them, financial transactions and reporting are a routine part of their systems.

2.2.1 The SBLP

Under the SBLP, NGOs usually act not as MFIs but as SHG Promotion Agencies (SHPAs) – a different model of microfinance in which the NGO role is to provide developmental support to the SHGs, that open group deposit accounts in a Bank and then can borrow directly from the Bank. This model was initially promoted by NGOs such as MYRADA (in Karnataka) and PRADAN (in Tamil Nadu and in Bihar). Since the mid-1990s, when the model began to be scaled up, promotional work has been undertaken by specialized government agencies, such as the District Poverty Initiatives or the Velugu project in Andhra Pradesh and the Kudumbashree project in Kerala, the Women’s Development Corporations in the states of Tamil Nadu and Maharashtra, the Women and Child Development departments, and the District Rural Development Agencies (DRDAs) in most others states.

The scaling-up of the SHG model is mainly attributed to the SBLP, launched in 1992 by NABARD. NABARD’s programme is designed to integrate informal savings and credit groups with the mainstream banking system. Under this programme, NABARD refinances bank loans to SHGs: it provides financing to banks at below-market interest rates (currently 6%), though banks continue to carry the risk for their loans.

This has stimulated the growth of SHGs nationwide. Characteristics of SHGs under the SBLP are described in Box 2.1.

Under the SBLP, a bank lends directly to a group after evaluating the group's operations, maturity, and capacity to absorb credit. The group, in turn, on-lends to its members. A self-help group promoting agency (SHPA) – an NGO or government agency – promotes the groups, but is not part of its funding chain.

Box 2.1

SHGs in the SBLP

Self Help Groups (SHGs) are autonomous collectives that deliver small loans to their members. SHGs are run by members who themselves choose their leaders and bank signatories. Most SHGs are part of federations that help them with the governance and financial monitoring and promote new groups where needed.

SHGs collect periodic savings and make loans to their members. Loans to members are funded through savings, revenues, loans from banks and other sources. These loans range from Rs100-2,000 (\$2.5-45) with a maximum loan period of six months and with bullet repayment systems. Over time, SHGs mobilize more savings, retain earnings and often borrow external funds, enabling larger loans for consumption and business purposes. These loan range from Rs1,000-20,000 (\$23-\$450) and are paid in monthly instalments over one to three years.

NABARD defines the SHG as a group of 20 or less people from a homogenous class who are willing to come together for addressing their common problems. They make regular savings and use the pooled savings to give interest-bearing loans to their members. The process helps them imbibe the essentials of financial intermediation including prioritisation of needs, setting self-determined terms for repayment, and keeping books and records. The SHG norms help to build financial discipline and a credit history that then encourages banks to lend to them in multiples of (3-10 times) their own savings and without any demand for collateral security.

To this definition can be added the affinity dimension and the need to acquire the 6 organisational characteristics of Vision/Mission, Organisational Management Systems, Organisational Accountability Norms, Financial Management Systems, Learning and Evaluation Systems and Networks and Linkages with other institutions.

Under a variant of this main model, a Bank may be both promoter and lender: The bank acts as a SHPA – with bank staff forming SHGs, training them, and then lending to them. (Available data shows 21% of bank linked SHGs in March 2008 were promoted by banks).

A third variant is for the NGO-SHPA to perform the funding role (like an MFI). A bank lends to the SHPA which then on-lends the funds to its SHGs. (As of March 2008, 7% of bank linked SHGs had been financed using this approach).

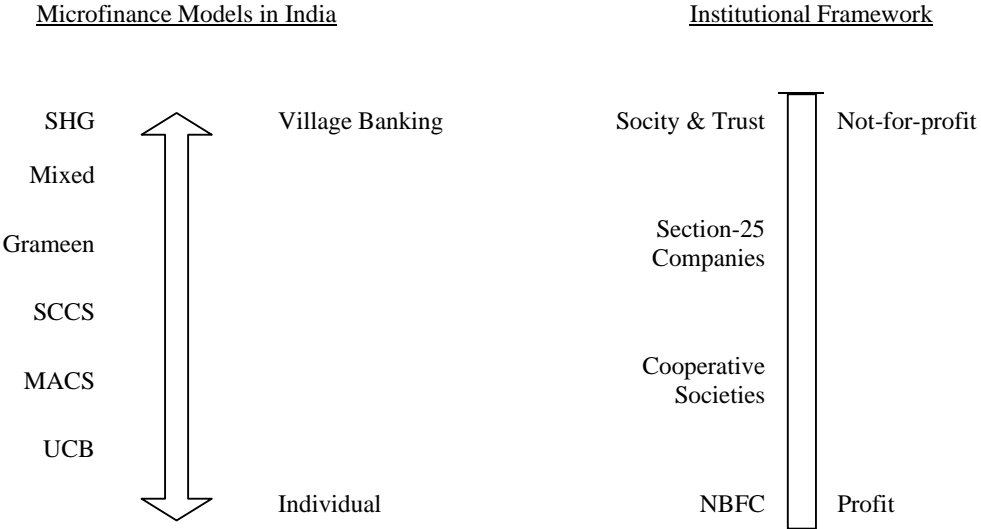
Cumulatively, the programme had resulted in lending by all the major commercial banks, regional rural banks and cooperative banks to some 3.5 million SHGs by March 2008. Other than the bank-SHG linkage programme, the involvement of commercial banks in microfinance continues to be negligible both in relation

to the current volume of microfinance and to their broader engagement in rural areas. The total credit from the scheduled commercial banks to the “weaker sections”¹³ was estimated at Rs82300 crore (\$18,300 million) at the end of March 2006 compared to total rural deposits of over Rs400000 crore (\$89,000 million). Further, the amount outstanding to SHGs (Rs8,000 crore at this time) was just over 0.5% of the total outstanding loans of scheduled commercial banks.

2.1.2 The MFI model

The MFI model refers to microfinance delivery by microfinance institutions (MFIs) using variety of methodologies ranging from the very popular Self Help Group (SHG) methodology traditionally pursued in the country to Grameen and joint liability groups, as well as the individual banking arrangements of the Savings and Credit Cooperative Societies (SCCS). Over the years, through an ongoing process of experimentation and innovation undertaken by Indian MFIs the MFIs now largely follow a mixed approach customised to their target segment and area of operation. In addition to the microfinance delivery methodologies, MFI management approach, services and performance are influenced by their legal form – the institutional framework ranges from not-for-profit Societies/Trusts and Companies registered under Section 25 of the Companies Act to Non Banking Finance Companies (NBFCs) licensed by the Reserve Bank of India. The microfinance methodologies and institutional framework adopted by MFIs are illustrated in Exhibit 2.1.

Exhibit 2.1



¹³ “Weaker sections” is official parlance for the poor and under-privileged sections of society. This includes all families officially classified as poor but also some non-poor who belong to the lower castes or to specified groups of religious minorities.

A detailed description of institutional types is provided in Annex 2 to this report. The main microfinance methodologies can be described as follows

Self-Help Group (SHG)

The resources of SHGs are often augmented by funds borrowed from MFIs or banks. Savings thus precede borrowing by the members. Some non-government organisations (NGOs) operate microfinance programmes by organizing federations of SHGs to act as the MFI.

Grameen methodology (G)

Grameen MFIs undertake individual lending but all borrowers are members of 5-member joint liability groups which, in turn, get together with 6-9 other such groups from the same village or neighbourhood to form a centre. Savings are linked to the size of the loan and are a compulsory component of the loan repayment schedule but do not determine the magnitude or timing of the loan.

Joint liability is basically a group lending methodology in which the members of the groups are jointly liable for each other's borrowings. Such groups are commonly seen with MFIs practising the Grameen model.

Individual Banking methodology (IB)

Entailing the provision by MFIs of financial services to individual clients – though they may sometimes be organised into joint liability groups, cooperatives or even SHGs. In the case of cooperatives, all borrowers are members of the organisation either directly or indirectly by being members of primary cooperatives or associations which are members of the apex society. Creditworthiness and loan security are a function of cooperative membership.

Mixed methodologies

Some of the MFIs started with the Grameen model, then embraced the SHG model at a later stage but did not completely do away with the Grameen model and smaller groups. These have roughly an equal mix of SHG and Grameen type groups. A few MFIs use a number of delivery channels and cannot be clearly classified in any of the above categories.

2.2 Overall microfinance outreach in India – an estimate

This study estimates an outreach of 35.8 million members/savers including 7.2 million borrowers under SBLP by end-March 2008. Data for the SBLP comes from statistics collated by NABARD and is based on the number of SHGs accessing bank loans during the year assuming 13 members/group on average. As

microfinance has expanded, so has the overlap between programmes, with up to 20% of SBLP households now estimated to be covered by MFIs.¹⁴ Exhibit 2.2 estimates the SBLP clientele.

Exhibit 2.2
An estimate of SBLP clientele

Year	Reported ('000s)		Estimated (million)	
	No. of SHGs linked	No. of SHGs financed	No. of Members (=savers)	No. of borrowers
1997-8	14.3	5.7	0.17	0.07
1999-2000	114.8	81.9	1.41	1.06
2002-3	717.9	255.9	8.28	3.33
2004-5	1,619.1	539.4	18.73	7.01
2006-7	2,925.6	686.4	30.10	8.92
2007-8	3,478.6	552.9	35.82	7.19

Note: The number of SHGs linked is the cumulative number of SHGs that have been linked under SBLP. The number of SHGs financed is the SHGs that have received bank loans during the year.

The estimation of number of members is undertaken assuming an average of 13 members per SHG linked and accounting for an overlap of 20% with MFI model for 2007-8 and 2006-7. Since all SHGs are required to have a bank savings account and save regularly to become eligible for credit, it is assumed that all SHG members are also savers. The overlap with MFIs in 2004-5 and 2002-3 is assumed to be less at 10% and for 1999-2000 and 1997-98 at 5%. The number of borrowers is calculated assuming 13 members per SHG financed during the year. It is also assumed that 5% of SHGs become defunct every year (EDA 2006, SHG Study).

It is evident that there is a huge decline in the borrower to member ratio of SBLP over the years from about 75% in 1999-2000 to just 20% in 2007-8. The main reason is that all SHGs are not eligible for loans (eligibility criteria include minimum six months of functioning, regular meetings and group savings in banks) or do not demand funds from the banks. Some SHGs become defunct as well. However, many SHGs continue functioning by savings in their group bank account and inter-lending among group members even if they do not obtain bank loans. In this context, SBLP has provided both savings as well as credit services to SHGs linked under this programme.

Exhibit 2.3 presents the client outreach of the MFI model on the basis of information provided by MFIs to M-CRIL, Sa-Dhan and MIX.

¹⁴ Srinivasan, N, 2008. "Microfinance India – State of the sector report." This report notes that NABARD normally uses an average of 15-16 members/SHG. Other studies have found the average to be 13 (NCAER, 2008; EDA/APMAS 2006).

Exhibit 2.3
Client outreach of MFI model

Year	No. of MFIs	Number of (million)		
		Members	Borrowers	Savers
1999-00	44	0.52	0.20	0.36
2002-03	94	0.92	0.78	0.59
2004-05	122	2.58	2.19	1.21
2006-07	169	8.20	6.97	2.62
2007-08	223	14.10	11.87	2.79

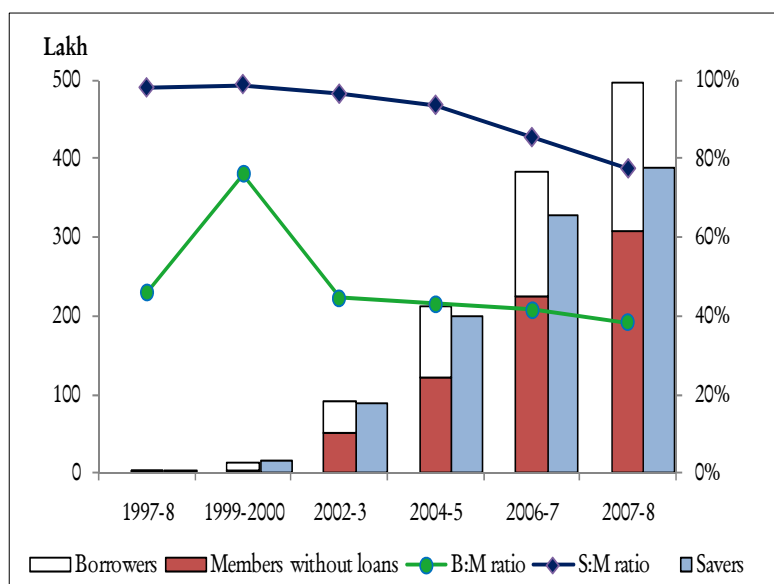
Note: The above information is based on MFIs providing information to M-CRIL, miX and Sa-Dhan. Information for 2002-3 and 2004-5 is based on M-CRIL and miX database and the information for 2006-7 and 2007-8 is based on M-CRIL and miX database and Sa-Dhan's Bharat Microfinance Report.

The data reported for MFIs is on number of existing borrowers at the year end. Borrowers are those members who have received a loan from the MFI. The difference between members and borrowers differ from model to model: lowest in individual banking wherein all members are borrowers; medium in Grameen wherein only new members (2-4 weeks old) do not have loans; highest in SHG model. It is assumed that, together across all models, numbers of borrowers are roughly about 85% of numbers of members. Number of savers is estimated on the basis of the assumption that MFIs adopting SHG models provide savings facilities to their members.

In the initial years most MFIs (about 75% in terms of membership) were adopting SHG model and this gradually declined every year to about 20% in 2007-8. The overall outreach of microfinance is estimated at around 5 crore (50 million) people (around 4.5 crore or 45 million households) by end March 2008 since around 10% of microfinance clients are assumed to belong to common households. This includes contribution of around 3.6 crore (36 million) people from SBLP and 1.4 crore (14 million) from MFIs.

It is known that almost all the people linked under SBLP are primarily savers which enable their SHGs to obtain loan from banks. The people linked with MFIs receive mainly credit services due to regulatory reasons that constrain MFIs from offering savings services to their clients. However, assuming that about 20% of MFI clients in 2008 also received savings services (proportion of members of MFIs that adopted SHG model) the number of microfinance savers in India is estimated at 38.6 million by end March 2008. This shows a predominance of SBLP over the MFIs in providing savings services. On the contrary, in terms of proportion of members who are borrowers the MFIs are far ahead of SBLP. NABARD data indicates that only 20% of the people linked under SBLP obtained loans in 2008. Overall about 19.1 million people were borrowers of microcredit. Exhibit 2.4 below presents the growth of overall outreach (SBLP & MFI) in India in the last ten years in terms of membership, number of borrowers and number of savers.

Exhibit 2.4
Growth of overall microfinance outreach in India



Year	Number of (million)		
	Members	Borrowers	Savers
1999-00	2.1	1.4	1.7
2002-03	9.2	4.1	8.9
2004-05	21.3	9.2	19.9
2006-07	38.3	15.8	32.7
2007-08	49.9	19.1	38.6

The data shows the very substantial outreach of SBLP, in 2008 accounting for 72% of total estimated outreach in terms of members covered. The MFI model has lower outreach. However, it now accounts for 62% of the total number of borrowers. One of the reasons for this anomaly is the more aggressive approach of the MFIs in lending in comparison with the banks. This may also be the reason for such a high overlap between these two models as access to loans seems better in the MFI model while savings facilities are provided mainly under the SBLP. Further discussions and analysis on outreach, operational and financial performance is presented in the subsequent chapters.

While SBLP accounts for around 72% of the total estimated outreach in terms of members covered, the MFI model has a higher coverage of total borrowers at around 62%. One of the reasons for this anomaly is the more aggressive approach of the MFIs in lending in comparison to the banks while the focus of SBLP is on savings. This has resulted in an overall low borrower to member ratio (B:M ratio) of 38% and a much higher

savers to members ratio (S:M ratio) of 78% by end March 2008. This is also evident from Exhibit 2.5 alongside that presents a comparison between average loan size and average savings per client of SBLP and MFI in 2008. This is not surprising given the regulatory restraints on deposit services by MFIs. Indeed, the apparent savings with MFIs are mainly by way of security deposits.

A more detailed discussion on outreach under SBLP and MFI models is presented in Chapters 3 and 4 respectively.

Exhibit 2.5
Average loan size & savings mobilised

	SBLP	MFI model
Average loan size per borrower (Rs)	3,535	11,480
Average savings per member (Rs)	8,441	191

2.3 Framework for analysis

The information available for SBLP and MFI model have been used to analyse the following aspects

- Outreach
- Operational and financial performance
- Sustainability
- Impact

2.3.1 SBLP

For analysis of the SBLP, the study team has largely relied on the data on SHG-Bank linkage as reported by NABARD. NABARD publishes an annual report which provides cumulative numbers of SHGs formed and loans disbursed. There is no comprehensive analysis of microfinance ratios or financial performance. But some information on SHG functioning and trends is available from various studies which we have drawn on for discussions in this report. The discussions on sustainability of SHGs and the impact of SBLP is largely based on a major study of SHG operations (EDA, APMAS 2006) that covered 214 SHGs in 9 districts across 4 states of India.

This analysis provides regional coverage of SBLP which is concentrated in the traditional microfinance region of South India. Though in the last few years the proportion of coverage in the southern region has been decreasing, it is still significant at ~48%. This study also analyses the involvement of the three different types of institutions engaged in SHG financing - commercial banks (mainly public sector banks), RRBs and cooperative banks.

2.3.2 MFI model

The progress of MFI model has been analysed from 2003 to 2008. For analysing the status of the MFI sector on various aspects of outreach, efficiency and productivity and financial performance the study team selected a sample from MFIs reporting their information to M-CRIL, MIX and Sa-Dhan. The MFIs (**Exhibit 2.3**) reporting their information to various institutions is the universe from which the sample was selected for analysis. The sample was selected to represent MFIs from various regions, adopting different microfinance methodologies, having diverse form of legal registration, experience (in terms of age) and outreach (in terms

of borrowers and portfolio outstanding). Sampling was also essential for analysing the progress of MFI sector as information was not uniformly available for all the reporting MFIs.

For analysis of the progress of microfinance sector in India, 90 MFIs were used for 2003; 84 MFIs for 2005, 58 MFIs for 2007 and 50 MFIs for 2008 that are representative of the MFI sector. Annex 1 presents the sample selected for analysis and its distribution on above parameters. A detailed description of operational and financial data of Top 20 MFIs in terms of outreach (who have made their information available public by reporting to MIX) for 2008 is presented in Annex 3.

2.4 Conclusions

The two broad microfinance approaches in India are the government run SHG Bank Linkage Programme and the MFI model which is privately managed by independent civil society institutions with some of them regulated by the RBI.

SBLP, initially promoted by MYRADA (in Karnataka) and PRADAN (in Tamil Nadu and in Bihar) and formally launched in 1992 by NABARD began to scale-up in the mid-1990s. Under this programme, NABARD refinances bank loans to SHGs through commercial banks but the credit risk is carried by the banks. This has stimulated the growth of SHGs nationwide making SHGs a dominant model in the delivery of microfinance in India.

The MFI model uses a variety of methodologies ranging from the very popular SHG methodology traditionally pursued in the country to Grameen and joint liability groups, as well as individual banking arrangements. Over the years, through an ongoing process of experimentation and innovation undertaken by Indian MFIs many now largely follow a mixed approach customised to their target segment and area of operation. However, the fastest growing MFIs in India all follow the Grameen methodology (or its variant based on the ASA Bangladesh approach).

In addition to the microfinance delivery methodologies, MFI management approach, services and performance are influenced by their legal form – ranging from not-for-profit Societies/Trusts and Companies registered under Section 25 of the Companies Act to NBFCs licensed by RBI.

The overall outreach of microfinance is estimated at around 50 million people (~45 million households) including 19.1 million borrowers by end March 2008. While SBLP accounts for around 72% of the total estimated outreach in terms of members covered, the MFI model has a higher coverage of total borrowers at around 62%. One of the reasons for this anomaly is the more aggressive approach of the MFIs in lending in comparison with the banks.

Chapter 3: Progress of the SHG Bank Linkage Programme

This chapter is largely based on information provided in the “Microfinance India – State of the Sector Reports” for 2006, 2007 and 2008¹⁵. Microfinance India is an annual event organised by Access Development Services and the ‘State of the Sector Report’ is part of this initiative. The chapter analyses the progress of SBLP which started in the mid-1990s in terms of its outreach, regional coverage, lending performance of institutions involved and savings mobilised by the SHGs.

3.1 Outreach

According to provisional information made available by NABARD in its annual report 2007-08, the cumulative number of new SHGs provided with bank loans increased to 3.48 million by end-March 2008 from 2.92 million by end-March 2007 – an increase of 19%. The cumulative number of SHGs provided with bank loans, however, also includes SHGs that have become defunct.

A study¹⁶ conducted on SHGs indicated that about 10% of the SHG members’ are dropout, 3.5% of SHGs became defunct and 3.3% of SHGs breakdown annually. Though there is no definitive information on this, the actual number of functioning SHGs probably does not exceed 2.5 million. Since 2001, there has been a considerable increase in the outreach of SBLP at 44% p.a. The number of incremental new groups provided with loans also increased every year steadily at an average growth rate of 29% p.a. until 2007 and a decline of 19% in 2008. During 2007-08, the number of incremental new groups provided with loans declined from 0.68 million in 2006-7 to 0.55 million. This fall in the number of new groups credit-linked with banks by about 0.13 million is attributed to the slowdown in the southern Indian states and slow momentum in other states of the country (Srinivasan 2008).

According to NABARD figures, around 4.4 million SHGs covering about 5.8 million poor households have been linked with banks through savings bank accounts. More than 90% of such groups are comprised exclusively of women. The cumulative bank loan disbursed rose to Rs22,268 crore (\$5,600 million) in FY08 from Rs18,040 crore (\$4,500 million) in FY07.¹⁷ However, loans disbursed to new groups during the year ending March 2008 was only Rs4,228 crore (\$105 million) compared to Rs6,643 crore (US\$165 million) a year earlier. While out of the Rs6,643 crore lent to SHGs during the FY07, Rs3,044 crore (US\$76 million) was to new groups, FY08 saw only Rs2,542 crore (\$62.5 million) being provided to new SHGs – a decline of 16%. The disbursement of repeat loans during the FY08 also declined from Rs3,599 crore (\$87.5 million) in FY07 to Rs1,686 crore (\$40 million).

The average loan size for new loans per SHG rose from Rs44,343 (\$1,109) in 2007 to Rs45,960 (\$1,149) in 2008 while the average loan size for repeat loans rose from Rs78,682 (\$1,967) to Rs90,195 (\$2,255) over the same period. A summary of progress of SBLP is presented in Exhibit 3.1

¹⁵ Ghate, Prabhu 2006 & 2007. “Microfinance India - State of the Sector Report” Srinivasan, N, 2008.

¹⁶ EDA, APMAS 2006.

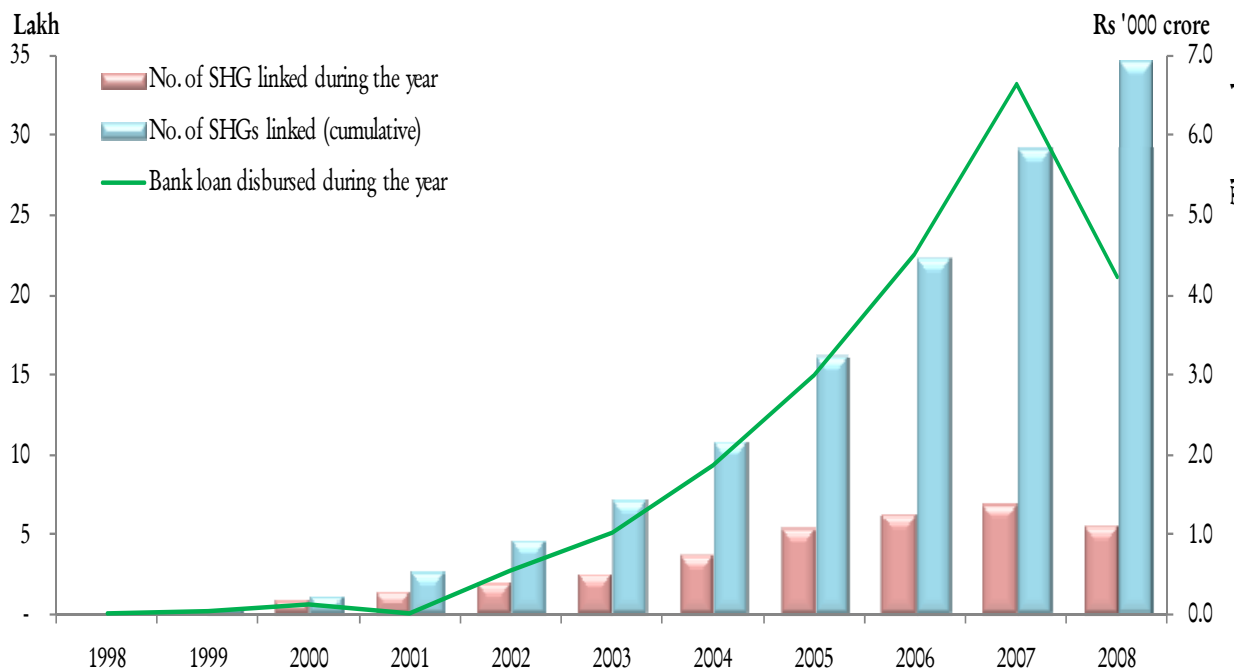
¹⁷ Henceforth, the notation FYxx stands for Financial Year xx so FY07 means April 2006 to March 2007.

3.2 Coverage

3.2.1 Regional exposure

Regional shares have undergone a gradual change over the years and the south is seen as losing its share to other regions of the country. The southern region saw a gradual decline in its share of SHGs linked to banks and in March 2008 for the first time ever, the share dipped below 50%, Exhibit 3.2. Despite this, the south still leads with a share of 48.2% of the loans provided by banks to SHGs. The Eastern & North Eastern regions together were a distant second at 22.7%. Rapid growth of SHG linkage in the state of Maharashtra has meant that the western region is now close to the central region's share at 10.8%.

Exhibit 3.1
Growth trends in SBLP

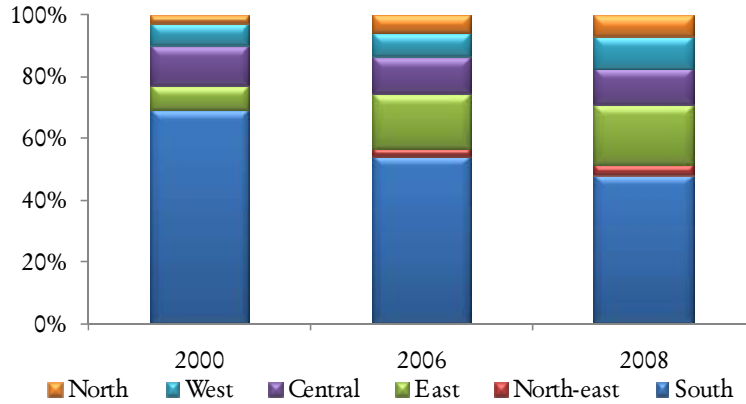


	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
No. of new SHGs linked during the year	5,719	18,678	81,780	149,650	197,653	255,882	361,731	539,365	620,109	686,408	552,992
No. of SHGs linked (cumulative)	14,317	32,995	114,775	263,825	461,478	717,360	1,079,091	1,618,456	2,238,565	2,924,973	3,477,965
Actual no. of SHGs linked (cumulative estimate)*	14,125	32,709	113,841	260,336	454,596	708,077	1,066,897	1,600,969	2,212,197	2,894,568	3,444,245
Rate of growth of loans to new SHGs (%)					32	29	41	49	15	11	(16)
No. of SHGs receiving repeat loans				21,630	41,413	102,391	171,669	258,092	344,502	457,410	186,883
Rate of growth of repeat loans					91	147	68	0	33	33	
Proportion of repeat loans in total loans					17	29	40	32	36	40	
Bank loan disbursed cumulative (Rs crore)	24	57	193	481	1,026	2,049	3,904	6,896	11,398	18,040	22,268
Bank loan disbursed during year (Rs crore)	12	33	136		545	1,023	1,855	2,994	4,499	6,643	4,228
disbursed to new groups (Rs crore)				290	453	691	1,158	1,727	2,330	3,044	2,542
disbursed as repeat loans (Rs crore)					92	332	698	1,268	2,169	3,599	1,686
Proportion of repeat loans in total disbursed (%)					17	33	38	42	48	54	
Average loan disbursed per SHG	16,596	17,297	16,814	19,379	22,919	27,005	32,013	32,019	37,574	44,343	45,960
Repeat loan sizes					22,215	32,425	40,660	49,130	62,960	78,682	90,195

Source: NABARD annual reports

* Based on assumption that about 5% of new SHGs become defunct next year (EDA, APMAS 2006.)

Exhibit 3.2
Region wise coverage of SHGs credit-linked to banks



in lakh

Region	March 2000		March 2006		March 2008	
	SHGs linked	% share	SHGs linked	% share	SHGs linked	% share
South	0.79	68.6	12.14	54.3	16.75	48.2
North-east	0.00	0.2	0.63	2.8	1.20	3.4
East	0.09	8.2	3.94	17.6	6.72	19.3
Central	0.15	13.3	2.68	12.0	4.06	11.7
West	0.08	7.0	1.66	7.4	3.75	10.8
North	0.03	2.8	1.33	5.9	2.31	6.6
All India	1.15	100.0	22.39	100.0	34.78	100.0

Source: NABARD annual reports; Press Information Bureau, Government of India, March 2007

All the regions have witnessed a slowdown in SHGs credit linked to banks in the last two years as shown by Exhibit 3.3. The Western region, driven by good performance in Maharashtra, experienced the highest growth of 63% in the last two years followed by Eastern/NE and Northern region. The Central region has also grown above the national level. However, in the current decade (as evident from Exhibit 3.2 above) the growth in the southern region has slowed down and the eastern region has grown comparatively faster.

Exhibit 3.3

Region wise growth rates of SHGs linked

Region	2007	2008	Average growth
South	25%	10%	19%
North-east	35%	28%	37%
East	24%	22%	26%
Central	63%	38%	63%
West	37%	27%	37%
All India	31%	19%	28%

In 2008 among the top states with SHGs linked under SBLP, Andhra Pradesh (AP) lost its primacy in the number of new groups linked to the banking system. Maharashtra topped with a share of 18.2% of new groups and had more than double the share of AP. The top two states are not from the south (**Exhibit 3.4**). As explained by the chairman, NABARD, the headroom for growth in the southern states is limited due to relative saturation of microfinance services.¹⁸ A detailed table outlining the region-wise growth of SBLP in the last two years is given in Annex 4.

Exhibit 3.4

Top five states in SHG linkage in 2007-08

Name of state	No. of new groups linked	% share
Maharashtra	100,569	18.2
Orissa	73,140	13.2
Tamil Nadu	54,498	9.9
West Bengal	49,832	8.5
Andhra Pradesh	40,098	7.3

3.2.2 Coverage in priority states

In 2005, NABARD identified 13 priority states accounting for 70% of India's poor for special efforts and location-specific strategies. Exhibit 3.5 shows that 8 out of the 13 priority states registered higher growth rates than the national average (18.9%) in terms of the number of SHGs credit-linked with banks. Four states – Assam, Chhattishgarh, Maharashtra and Orissa had healthy growth rates in excess of 30%, three states were between 20% and 30% while the remaining six states registered less than 20% growth in the number of credit-linked SHGs. The share of priority states in the number of SHGs linked rose from 47% in March 2007 to about 51% in March 2008. Clearly, the performance of priority states presents a mixed picture and there is a need for more intensive work in some states.

¹⁸ Srinivasan N, 2008.

Exhibit 3.5
Coverage in priority states (SHGs linked)

Name of State	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	Growth rate in 2008 (%)
Assam	3477	10,706	31,234	56,449	81,454	107,098	31
Bihar	8,161	16,246	28,015	46,221	72,339	93,410	29
Chhattisgarh	6,763	9,796	18,569	31,291	41,703	60,763	46
Gujarat	13,875	15,974	24,712	34,160	43,572	46,526	7
Himachal Pradesh	8,875	13,228	17,798	22,920	27,799	31,899	15
Jharkhand	7,765	12,647	21,531	30,819	37,317	42,605	14
Madhya Pradesh	15,271	27,095	45,105	57,125	70,912	83,336	18
Maharashtra	28,065	38,535	71,146	131,470	225,856	326,425	45
Orissa	42,272	77,588	123,256	180,896	234,451	307,591	31
Rajasthan	22,742	33,846	60,006	98,171	137,837	173,192	26
Uttar Pradesh	53,696	79,210	119,648	161,911	198,587	236,929	19
Uttarakhand	5,853	10,908	14,043	17,588	21,527	24,679	15
West Bengal	32,647	51,685	92,698	136,251	181,563	228,395	26
Total	249,462	397,464	667,761	1,005,272	1,374,917	1,762,848	28
Growth, %		59	68	51	37	28	

Source: NABARD annual reports

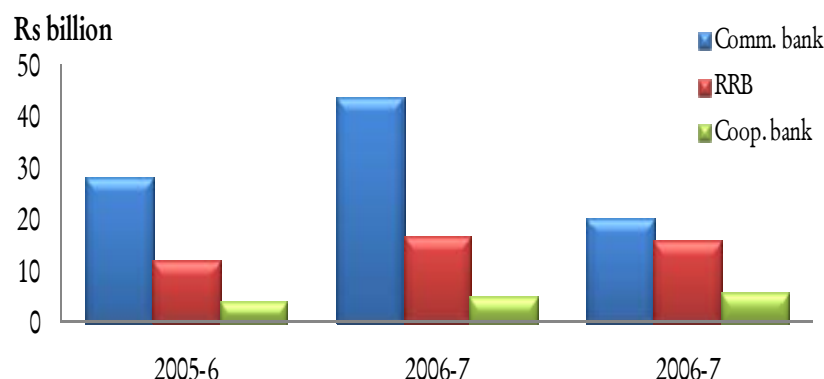
An analysis of SBLP data shows the wide disparities that exist between states in terms of SHG linkages. (This is discussed relative to poverty outreach in Chapter 5).

3.3 Institutional performance

3.3.1 Funding pattern of SHGs

Exhibit 3.6 shows the respective share of commercial banks, RRBs and cooperatives in financing SHGs. Commercial banks account for a major part of the SHGs linked and financed.

Exhibit 3.6
Funding pattern of SHGs



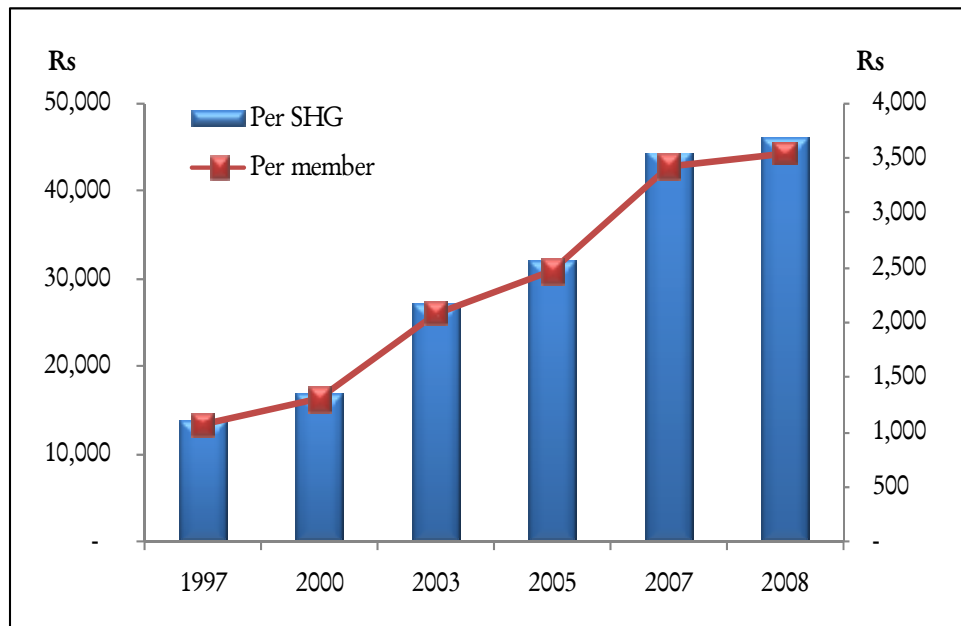
Agency	2005-06				2006-07				2007-08			
	New SHGs		Total loans		New SHGs		Total loans		New SHGs		Total loans	
	No. (‘000s)	%	Amount (Rs bill.)	%	No. (‘000s)	%	Amount (Rs bill.)	%	No. (‘000s)	%	Amount (Rs bill.)	%
Comm. Banks	345	56	28.3	63	407	59	44.1	66			20.4	48
RRBs	176	28	12.2	27	171	25	17.1	26			16.0	38
Coop. Banks	99	16	4.5	10	109	16	5.2	8			5.9	14
Total	620	100	4,499	100	686	100	6,643	100	553	100	4,228	100

The share of commercial banks in total funding of SHGs, however, has dipped from 66% in 2006-07 to 48% in 2007-08. The RRBs and the cooperative banks have significantly increased their share in loans given to SHGs, from 26% to 38% and from 8% to 14% respectively over the same period. Despite a much better performance of the cooperatives in 2008 as compared to 2007, the share of cooperatives continued to lag behind in spite of a large presence across all districts and the extensive network of constituent primary societies.

3.3.2 Average loan sizes and cost to client

Exhibit 3.7 shows the trends in average loans obtained by members of an SHG. The graph highlights the increasing trend. The average loan to an SHG member (assuming 13 members/SHG) is Rs3,535 (\$88.5). This compares with around Rs10,000 (\$270) per client in the MFI model (Chapter 4).

Exhibit 3.7
Average loan per SHG member



The SHGs obtain loans from bank at a declining interest rate of 12.5% to 14.0% p.a. However, the SHG onlends the bank loans to its members at a much higher cost of around 24% p.a. declining. The effective rate of interest (EIR) to clients would be even higher considering the bank-loans are savings linked. The interest paid by the bank on savings is about 3.5% p.a.

3.3.3 Savings by SHGs¹⁹

The number of SHGs saving with banks and the amounts thus saved are now available for the first time in the last fifteen years of SBLP. These are presented in **Exhibit 3.8**. The data shows that SHGs place a considerable part of their savings with the banking system. The loans of SHGs due to the banking system at the end of March 2007 were 3.5 times the savings of SHGs with banks. Banks had financed 70% of all groups linked with them, leaving 1.27 million SHGs yet to be financed. The fairly high level of savings of SHGs with banks is an indicator of healthy performance. The actual savings of the groups would be higher as the data does not account for group savings used for internal lending within the SHG to its members. The savings performance varies according to the type of bank as well as the type of groups linked. SHGs linked to RRBs have higher average savings, followed by those banking with commercial banks and the lowest average savings were reported by SHGs with cooperative banks.

¹⁹ Srinivasan N, 2008.

Exhibit 3.8

Savings performance of SHGs (2007-8)

Agency	No. of SGSY ²⁰ groups	Amount saved (Rs Million)	No. of Non-SGSY groups	Amount saved (Rs Million)	Total no. of SHGs	Amount saved (Rs Million)	Average savings per SHG
Comm. Banks	571,062	5245	1,722,709	1,3679	2,293,771	1,8924	8,248.43
RRBs	300,427	1887	882,638	9696	1,183,065	1,1583	9,788.14
Coop. Banks	84,828	443	598,920	4176	683,748	4620	6,756.88
Total	956,317	7575	3,204,267	2,7551	4,160,584	3,5127	8,441.12

The cooperative banks have not made full business use of the SHG clients when compared to the commercial banks and RRBs. The average loan size is much lower as also the average savings per group when compared to other types of banks. In terms of linkage cooperative banks have extended loans to only 39% of the SHGs linked with them, whereas commercial banks and RRBs have financed 82% and 61% of linked SHGs respectively (Exhibit 3.9).

Exhibit 3.9

Proportion of groups financed to group savings linked

Agency	Proportion of groups financed to groups linked (%)
Commercial banks	82
RRBs	61
Cooperative banks	39

3.3.3 Repayment rates

Until recently, full recovery and low transaction cost to the lender (on account of externalization of certain lending processes) were regarded as the unique features of SHG-bank linkage from the bank's perspective. Of late, there are indications that these unique features are slowly waning. The recovery data (Exhibit 3.10) reported by the banks to NABARD reveals that several banks have a recovery of less than 90%. Six commercial banks, 15 RRBs and 36 District Cooperative Banks have recoveries of less than 75%. The recovery from SGSY groups was lower; 10 commercial banks and 24 RRBs reported less than 75% recovery. Across all the states recovery rates have fallen. The intra-group loans are likely to face higher default rates as the groups always work towards keeping a default free record on the bank loan. APMAS found in one of its studies that SHGs, while maintaining a default-free record with banks, did not observe repayment discipline

²⁰ Swarnjayanti Gram Swarozgar Yojna (SGSY), started in April 1999, is a joint Centre and State initiative that aims to organize rural poor into SHGs, provide them training and capacity building services as well as with income generating assets. The scheme aims to provide targeted BPL households with a sustainable level of income and thereby bring them out of poverty within a period of three years.

when it comes to repayments on internal lending. The recoveries on internal loans with the SHG's own funds were as low as 30%. Poor repayment rates can be attributed to the following reasons:

- Availability of credit from competitive channels such as MFIs and finance companies
- Attainment of a peak in the loan size leaving little to aspire for in terms of a higher loan within the group
- Lack of close monitoring by promoting institutions and banks
- Negligent handling of groups in government sponsored programmes contaminating other groups
- Natural calamities which have adversely affected the cash flow of SHG members

Exhibit 3.10
Range of recovery

Agency	No. of reporting banks	No. of banks in the recovery range		
		95% and above	90-94%	less than 90%
Commercial banks	22	5	5	12
RRBs	73	20	13	40
Cooperative banks	170	25	63	82

Maintaining high recovery rates for SHGs is crucial to ensure that bank support continues in the future. A study by NCAER reveals that only 69.2% of the SHGs had an excellent repayment record, 7.6% had registered repayment rates in excess of 90% and 22.6% had repayment rates less than 75%. Arrears which totalled to 0.86% of outstanding loans were reported by 7.6% groups. SHGs in some states of the country, namely AP and Orissa, reported worse repayment figures as compared to others; the reasons cited were natural calamities, non-payment by buyers to SHG members and illness. Training and counselling of default prone groups and members is necessary through interventions by promoting agencies.

The EDA/APMAS study points out that one of the reasons for the decline in repayment experience are the recovery practices which rely heavily on bullet repayments (one time) and the incentive of access to further loans. This may work for smaller loan sizes and as long as the SHG can ensure future credit to its members. It also confirms the need for appropriate guidance, training and building capacities within the group.

3.3.4 Group sustainability

In this study of 214 SHGs, the findings on financial performance of SHGs were mixed in terms of profitability, return on capital and costs. It was found that financial statements are generally not prepared by the SHGs since most members are illiterate and are trained to keep their records simple and minimal. While only 28% of SHGs had some form of financial statement (income and expenditure statement, balance sheet, portfolio information) only 4% had good quality records.

Analysis, based on reconstruction of financial statements of 188 SHGs revealed that about 50% of the sample SHGs made profits the previous year and 20% made losses (status of 30% was not known). The study pointed out that financial sustainability of a group is dependent on a combination of factors including timely recovery of loans, pricing of loans, cost of financial service delivery and accumulation of capital. Portfolio

quality reflects the timely recovery of loans and contributes to profitability and ability of SHGs to recycle funds. Data available on the portfolio of sample SHGs indicated that around 45% of the groups defaulted more than once in a year amounting to 17% of the portfolio.

3.4 Conclusions

The overall outreach (bank-linked SHGs) under SBLP is around 3.5 million SHGs as on 31 March 2008, an increase of 19% over the previous year. However, this figure does not account for defunct SHGs and it is estimated that the actual number of SHGs currently linked under SBLP would be around 2.5 million. About 90% of these SHGs are comprised exclusively of women.

SBLP has witnessed high growth since its inception (about 174% p.a. in the current decade). However, there has been a decline in 2008 which has been mainly attributed to the slowdown in the southern states and the failure to gather momentum in other states of the country.

The cumulative bank loan disbursed under SBLP rose to \$5,600 million in 2008 from \$4,500 million in 2006-07. But loans disbursed to new groups declined in FY08 to \$105 million from (\$165 million) a year earlier. However, average loan size per SHG member remains low at Rs3,535 (\$88.5).

SBLP continues to be concentrated in the southern region with a share of 48.2%. However, the regional shares have undergone a gradual change over the years and the south is no longer dominant in the programme. In the current decade the eastern region has grown comparatively faster than other regions. This also indicates that microfinance is spreading to other parts as the southern region is becoming saturated and growth potential is limited.

The coverage of priority states by SBLP has shown a mixed picture. While the coverage has increased (8 out of the 13 priority states registered higher growth rates than the national average), a closer analysis shows wide disparities between states in terms of SHG linkages.

SHGs received total funding of Rs4,228 crore (\$1,060 million) in 2007-8. SHGs have been funded by commercial banks, RRBs and cooperative banks through refinance by NABARD. While commercial banks are the main funders, their share dipped from 66% in 2006-7 to 48% in 2007-8. RRBs and cooperative banks were able to increase their shares during this period indicating their greater involvement.

SHGs place a considerable part of their savings with the banking system. The loans of SHGs due to the banking system at the end of March 2007 were 3.5 times the savings of SHGs with banks. Banks had financed 70% of all groups linked with them, leaving 1.27 million SHGs, yet to be financed. The fairly high level of savings of SHGs with banks is an indicator of healthy performance. In 2007-8, the savings mobilised by SHGs amounted to Rs35 billion (\$880million) at an average Rs8,441 (\$212) per SHG.

The cooperative banks have not made full business use of the SHG clients when compared to the commercial banks and RRBs. In terms of linkage, cooperative banks have extended loans to only 39% of the SHGs linked with them whereas commercial banks and RRBs have financed 82% and 61% of linked SHGs respectively.

The recovery performance of banks lending under SBLP has dipped. The reported data to NABARD shows that several banks have a recovery of less than 90%. Studies have shown that the intra-group loans are likely to face even higher default rates as the groups always work towards keeping a default free record on the bank

loan. A study by NCAER reveals that only 69.2% of the SHGs had an excellent repayment record. The EDA study points out the need to reform the recovery practices through capacity building of the group. Good recovery (and, therefore, portfolio quality) has an important correlation to the long-term sustainability of the group.

Chapter 4: Outreach of MFI model

This section presents the analysis of outreach achieved by the MFI model. **Exhibit 4.1** below provides an idea of the overall outreach of MFIs in India that report their information on borrowers, portfolio outstanding and savings mobilised to M-CRIL, MIX and Sa-Dhan. The overall outreach in 2008, based on the data of 223 MFIs is about 14 million members including about 12 million borrowers, having a portfolio of Rs59.5 billion (\$1,490 million) and savings of Rs2.4 billion (\$61 million).

Exhibit 4.1
Overall outreach of MFIs

Year	No. of MFIs	Number of (million)			Portfolio O/s Rs Million	Savings balance Rs Million
		Members	Borrowers	Savers		
1999-00	44	0.52	0.20	0.36	710	310
2002-03	94	0.92	0.78	0.59	2,488	1,457
2004-05	122	2.58	2.19	1.21	8,747	950
2006-07	169	8.20	6.97	2.62	26,750	2,121
2007-08	223	14.10	11.87	2.79	59,540	2,434

Note: The above information is based on MFIs providing information to M-CRIL, miX & Sa-Dhan – extension of **Exhibit 2.3**.

For in-depth analysis of financial performance and sustainability, this study has used data for rated MFIs that are representative of the main proportion of the MFI sector. The rating data is validated and consistent, and has been used to analyse and present a picture of trends in outreach under the MFI model.

The selection of MFIs has been done to represent various regions (South, East & North East, North and West), microfinance methodologies (Grameen, SHG & individual banking), legal forms (NGO, NBFC, Section-25 Companies and others), age groups (<3 years to 10 years & above) and portfolio sizes (<Rs0.5 crore, US\$0.125 million to Rs25 crore and above, US\$6.25 million). An explanation on sample selection and its distribution on these parameters are presented in Annex 1.

This chapter presents an analysis of the distribution of MFI members and borrowers, loans outstanding and savings mobilised region wise, model wise (Grameen, SHG and IB) and by legal form based on the data of select MFIs.

4.1 Membership

The MFI model has grown tremendously since 2003. Although direct comparison of the sample MFIs in different periods is not possible, a comparison of the 2008 status with past years shows that the outreach has increased by more than five times in the last five years. This means that each year the membership coverage under the MFI model has grown by over 70% on average. At present (2008) the sample MFIs provide financial services – either loans or thrift deposit facilities – to nearly 10.8 million clients (often referred to as

members), more than 75% (over 8.1 million) of whom are in the southern part of India as shown by the regional distribution in Exhibit 4.2.

In terms of model and legal forms, Grameen organisations accounted for about ~78% of membership while NBFCs covered 65% of outreach. This proportion has been growing over the years, which is evident from the fact that in 2003 the SHGs and NGOs accounted for the majority of microfinance coverage. In the initial microfinance experience in India, most organisations started off as multi-service NGOs to support government initiatives (including, IRDP, SGSY and later NABARD’s SBLP). Later with the advent of wholesale microfinance funding from SIDBI, some of them started their own direct lending programmes to SHGs that they had promoted. More recently, having realised the potential of the microfinance sector a number of such organisations have transformed (and more are transforming) into for-profit entities and adopting the Grameen model to meet their growth requirements and to become self sufficient. It is for this reason, the importance of SHG programmes in the sample (MFIs lending to clients through SHGs rather than the joint liability groups of the Grameen methodology) has declined from 63% of membership in 2003, to 47% in 2005, 32% in 2007 to just 19% at present.

Exhibit 4.2
Distribution of MFI clients in India

...by region				
Regions	2003	2005	2007	2008
South	1,513,940	2,319,668	4,058,232	8,131,779
East & NE	135,723	389,774	1,297,056	2,379,991
West	215,801	64,230	21,353	156,742
North	45,686	104,551	211,461	101,800
...by model				
Models				
G	278,427	1,292,260	3,001,664	8,461,984
IB	67,285	65,492	770,970	252,372
Mixed	344,124	180,817		
SHG	1,221,314	1,339,654	1,815,468	2,055,956
...by legal form				
Legal form				
NGO	1,032,021	1,448,081	1,666,054	2,612,482
NBFC		1,081,780	3,402,286	7,044,980
Sec-25		219,232	130,207	605,524
Others	879,129	129,130	389,555	507,326
Overall	1,911,150	2,878,223	5,588,102	10,770,312
Top 10	400,333	1,559,941	3,314,692	7,117,591

Note: Regional distribution in later years is only broadly reflective as many south based MFIs (though still with a very high proportion of membership in the South) have started operating in other regions as well.

Exhibit 4.3 presents the outreach of MFIs in India in terms of borrowers. The observations are similar to the growth of membership in India with south based MFIs, Grameen organisations and NBFCs having the largest share of the outreach in 2008.

The overall number of borrowers has grown from 0.7 million to 9.2 million at present – an increase of over 12 times. A comparison with the growth in membership with borrowers indicates that over the period more members have been able to obtain loans. The ratio of borrowers (or active clients) to total members is largely dependent on the extent of dormancy accepted within a methodology. For instance, Grameen organisations have a high average of >90% (in all years in 2003) of members as active clients. This is because the conventional Grameen methodology does not allow a member to remain dormant for more than 2 weeks. Members who do not take the next cycle of loan must drop out of the programme. On the other hand, SHG-based MFIs tend to have much lower active client to member ratio (47% in 2008 and was a low 25% in 2005). In SHG MFIs the focus is on group solidarity and thrift so not all members need to be borrowers concurrently. Also, the SHG MFIs need to accumulate a pool of savings after group formation, which increases the gestation period before they have access to borrowings.

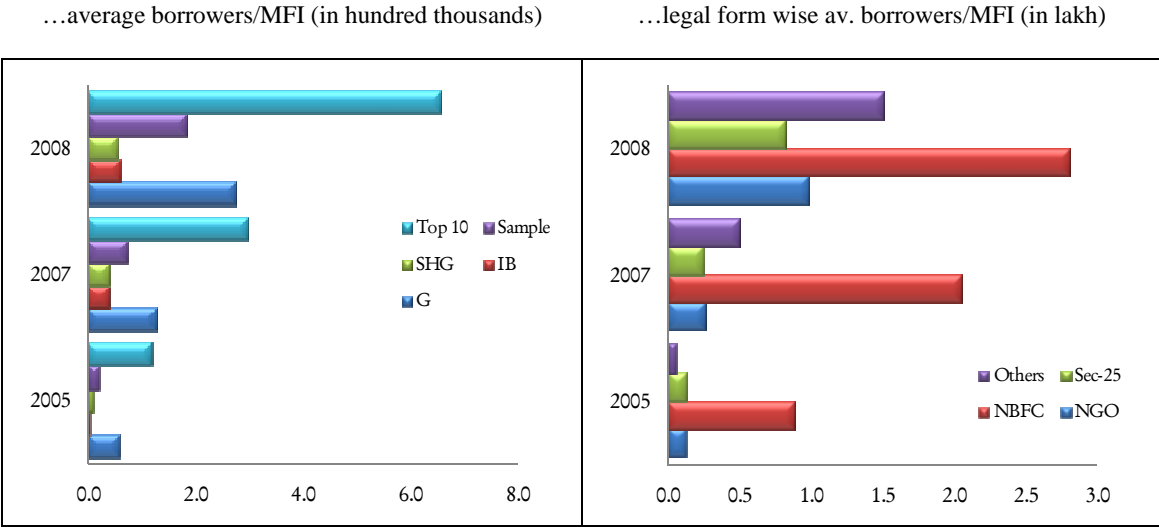
Exhibit 4.3
Distribution of MFI borrowers in India

...by region				
Regions	2003	2005	2007	2008
South	559,418	1,435,608	3,430,551	6,741,522
East & NE	48,949	203,499	786,899	2,197,234
West	69,927	39,078	13,250	98,880
North	20,978	78,053	66,268	124,517
...by model				
Models				
G	256,748	1,093,370	2,891,306	7,951,396
IB	27,554	49,581	311,681	244,803
Mixed	116,771	119,589		
SHG	298,199	493,698	1,093,981	965,954
...by legal form				
Legal form				
NGO	307,680	713,796	897,343	1,688,932
NBFC		888,586	3,073,062	6,446,161
Sec-25		105,177	126,262	576,792
Others	391,592	48,679	200,301	450,268
Overall	699,272	1,756,238	4,296,968	9,162,153
Top 10	321,251	1,173,561	2,967,378	6,556,407

Overall, Indian MFIs serve an average of 183,000 borrowers per MFI at present – a tremendous improvement from just 7,770 borrowers/MFI in 2003. It is interesting to note the growth of the typical MFI in India. The average borrower outreach of MFIs in India is still substantially lower than the Top 10 MFIs (655,641). For many MFIs in the region, their development objectives mean thrift deposit services and empowerment through

the promotion of governance capabilities and these are at least as important as lending to their members. This is particularly so for the SHG model with many programmes actually placing as much emphasis on social issues and developing governance capabilities as on providing financial services. For this reason, there is a significant difference between the membership of these institutions and the number of persons participating in their programmes as borrowers. Exhibit 4.4 presents the growth of the sector by model and legal form in terms of average borrowers/MFI and change in borrowers to member ratio over the last five years.

Exhibit 4.4
Growth pattern



In the context of the current proposal to bring societies, trusts and cooperative MFIs under a separate regulatory framework from that of NBFCs, the information above needs consideration. It shows that as many as 65% of the total number of MFI members in India will be excluded by the new regulatory regime (discussed in detail in Chapter 7). While MFIs registered as societies, trusts and cooperatives will be able to offer thrift services to their clients, a substantial proportion of clients, those served by NBFCs, will not have such services available to them because of the restrictions of the rules applied by the Reserve Bank of India to all NBFCs (whether or not they are MFIs).

4.2 Loans outstanding

Indian MFIs (that made their data available) had a total portfolio outstanding of Rs4,533.5 crore (\$1,136.2 million) on 31 March 2008. The southern region still accounts for ~74% of the sample’s portfolio in 2008. This proportion has decreased consistently over the years while the proportion of the eastern region has increased significantly indicating the spread of microfinance activity in this part of the country. About 80% of the sample’s portfolio is with MFIs using the Grameen model, while the SHGs represent 10% of the total. Equally important, the Top10 MFIs have owned more than 60% of the total portfolio of sample MFIs (as well as serve more than 70% of the borrowers) over the last five years. This is an indication of the polarised nature of the MFI sector in India in terms of size, a scenario which is changing but very slowly over recent years.

There are a small number of large MFIs that are very strong and expanding fast, but the urge to grow fast is also now spreading to some of the medium sized institutions.

It is also evident that NBFCs comprise a majority of the portfolio outstanding. The share of NBFCs in portfolio outstanding has grown from 50.5% (2005) & 71.3% (2007) to 76.0% currently. This shows the ever increasing outreach of NBFCs. The growth in NBFC share has been at the expense of NGOs and other commercial MFIs, whose share has reduced from 45% (2003) and 24.3% (2005) to the present 19.0%. This is attributable both to the faster growth of better managed NBFCs than the average NGO and to the fact that some of the leading NGOs have been transforming to NBFCs in recent years. **Exhibit 4.5** shows the distribution of portfolio across region, models and legal forms.

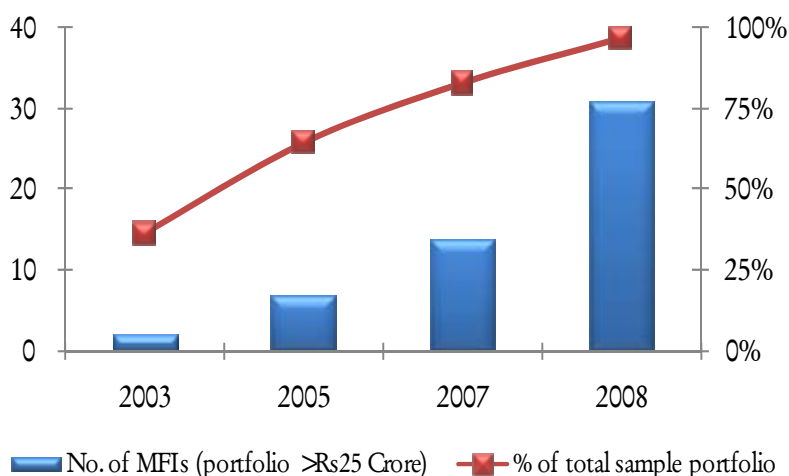
Exhibit 4.5
Distribution of portfolio (Rs million) of sample MFIs

...by region				
Regions	2003	2005	2007	2008
South	1,831	5,948	11,492	33,373
East & NE	200	440	1,860	8,039
West	278	540	102	1,492
North	23	549	1,075	2,392
...by model				
Models				
G	869	3,383	7,708	36,455
IB	239	986	2,403	4,303
Mixed	576	535		
SHG	649	2,573	4,418	4,537
...by legal form				
Legal form				
NGO	885	3,036	3,153	7,262
NBFC		3,781	10,359	34,402
Sec-25		306	625	2,266
Others	1,448	354	392	1,365
Overall	2,333	7,477	14,529	45,295
Top 10	1,474	5,008	9,197	2,9027

Exhibit 4.6 illustrates the extent of concentration of microfinance portfolios in India amongst the larger MFIs. Of the total of 50 MFIs in the detailed sample for 2008, 26 (52%) service just 27% of the total MFI outstanding portfolio while the largest 10, with portfolios in excess of Rs290 crore (\$70 million), account for

over 64% of the total. This shows the concentration of the portfolio in a few MFIs. The average portfolio size of these MFIs is more than 3 times that of the total sample. The reasons for this situation are related to the efficiency and financial performance of different MFIs and are discussed later. This has been the case in earlier years as well. In 2003, only 2 MFIs had portfolio outstanding greater than Rs25 crore and accounted for 36% of the total sample portfolio which increased to 64% (held by 7 out of 84 MFIs) in 2005, 83% (held by 14 out of 58 MFIs) in 2007 and 97% (by 31 out of 50) in 2008. It should also be noted that the number of large MFIs is also growing every year, most of them being NBFCs adopting the Grameen methodology.

Exhibit 4.6
Portfolio size distribution of MFIs



Portfolio class (Rs crore)	2003			2005			2007			2008		
	N	LO	LP	N	LO	LP	N	LO	LP	N	LO	LP
<0.5	42	7.4	.2	18	4.4	.2	12	5.8	.5	1	0.02	0.02
0.5 to <2.5	25	26.8	1.1	32	40.1	1.3	11	11.6	1.1	5	7.5	1.5
2.5 to <5.0	13	41.8	3.2	11	40.2	3.7	8	32.0	4.0	4	13.8	3.4
5.0 to < 10.0	4	30.5	7.6	10	73.8	7.4	5	37.8	7.6	3	16.4	5.5
10.0 to < 25.0	4	41.8	10.5	6	107.9	18.0	8	161.3	20.2	6	105.7	17.6
>=25.0	2	85.0	42.5	7	481.4	68.8	14	1,204.5	86.0	31	4,386.1	141.5
Overall	90	233.3	2.6	84	747.7	8.9	58	1,452.9	25.1	50	4,529.5	90.6

Note:

N – Number of MFIs

LO – Loan outstanding (Rs Crore)

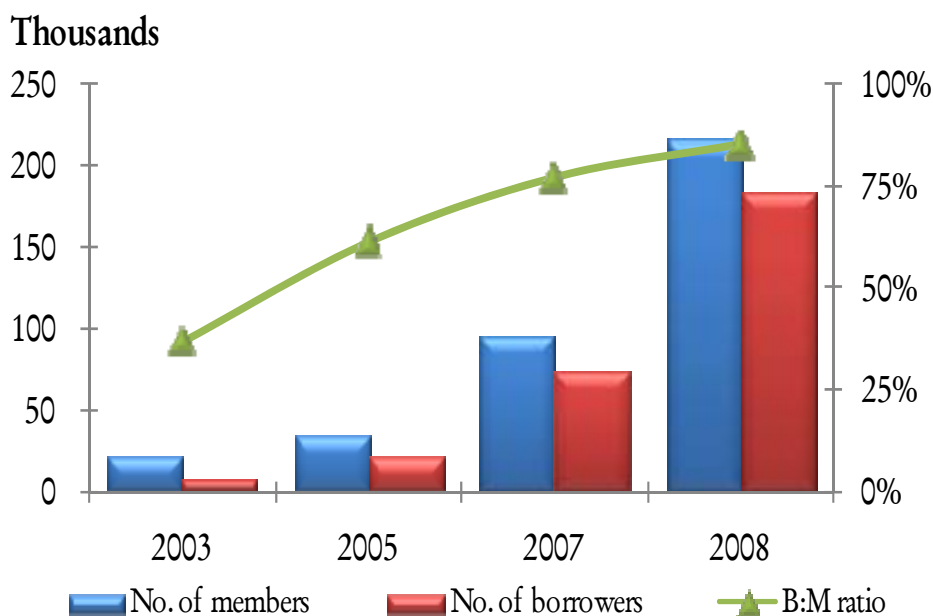
LP – Loan portfolio per MFI (Rs Crore)

4.3 Growth of outreach

Since the samples for the 2003, 2005, 2007 and 2008 are not the same, a direct comparison cannot be used for determining growth of outreach in Indian microfinance. However, it does provide a good indication on how the sector has grown. For the India sample, the average member's base/MFI has increased at an average of 59% p.a. while the borrowers grew at 88% p.a. in the last five years – Exhibit 4.7. Due to this the borrowers to members ratio has increased significantly leading to better efficiency (discussed in the next chapter) of operations. However, as discussed in Exhibit 4.4, in terms of borrowers to members ratio the NBFCs and Sec 25 companies are far ahead as compared to other legal structures. This shows the emphasis on having high borrower to member ratio by organisations with these legal structures. Having high borrowers base is an important measure of cost control enabling the organisations progress towards sustainability.

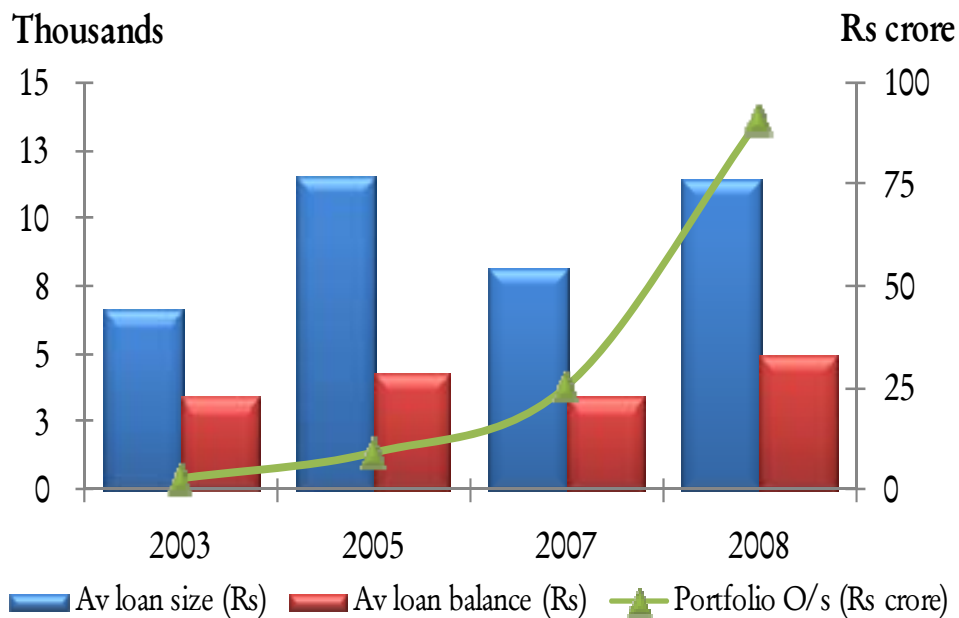
Like-wise for the overall sample, the average loan size increased from Rs6,562 per borrower in 2003 to Rs11,480 in 2008 while the average loan balance per borrower increased from Rs3,336 to Rs4,944 during the same period (Exhibit 4.8). The average loan size and loan balance remains higher for organisations adopting the IB model followed by NBFCs. In terms of legal form, NBFCs have higher average loan size and loan balance as compared to other legal forms as well as the India sample. This is attributable to more emphasis on productivity and profitability by NBFCs.

Exhibit 4.7
Growth of borrowers and members



The average portfolio outstanding/MFI of the sample MFIs has grown at 70% p.a. in the last five years. The portfolio of Grameen organisation and the NBFCs have grown at a much faster rate in comparison to organisations adopting other methodologies and legal forms. There was a dip in 2007 mainly because of a temporary crisis that the sector faced due to political interference in the southern region during the year 2006-7, which affected the portfolio of a number of large MFIs. Overall, the average loan size in India is expected to grow as the credit requirements of the target clientele has gone up substantially and many MFIs are planning to introduce products (mainly based on individual lending) customised to client needs.

Exhibit 4.8
Growth of loan size and portfolio



4.4 Average loan outstanding and GNI per capita

The size of the average loan balance held by borrowers of Indian MFIs as a proportion of Gross National Income (GNI) per capita is around 13.% (Exhibit 4.9). According to the MiX definition of ‘poverty lending’ as below 20% of per capita GNI, all MFIs are in this category except for IB model with larger loan sizes.

Exhibit 4.9

Average loan balance compared with GNI per capita

...by model				
Models	2003	2005	2007	2008
G	13.3%	9.6%	7.8%	12.1%
IB	34.1%	61.8%	22.7%	46.4%
SHG	8.6%	16.2%	11.9%	12.4%
...by legal form				
Legal form				
NGO	11.3%	13.2%	10.3%	11.3%
NBFC		13.2%	9.9%	14.1%
Sec-25		9.0%	14.5%	10.4%
Others	14.5%	22.6%	5.8%	8.0%
Overall	13.1%	13.2%	9.9%	13.0%
Top 10	18.0%	13.3%	9.1%	11.7%

Note: GNI per capita in 2008 (US\$950); 2007 (US\$830); 2005 (US\$720); 2003 (US\$530)

As discussed in Chapter 5, direct poverty assessment gives a more varied picture of depth of outreach.

4.5 Thrift deposits

The sample of 50 Indian MFIs (used for 2008) had raised a total of Rs205.9 crore (US\$51.6 million) in thrift deposits as on 31 March 2008. These are the deposits accepted formally – and taken onto their balance sheets – by the MFIs in the sample from their members.

Exhibit 4.10 provides the distribution of aggregate deposits (member savings) across models for the sample MFIs since 2003. The low contribution of the SHG model in 2008, of 1.9% of the total for the sample, is misleading. Savings forms the crux of empowerment and are collected to give members the experience of financial transactions as a means of developing self-governance capabilities. However, this analysis heavily understates the amount of savings actually mobilised by SHGs promoted by MFIs since it does not include the amount that is retained by each self-help group for internal circulation and, therefore, not recorded by the MFI in its accounts. It is estimated that the actual level of savings by members of SHG MFIs – both with the MFI and the SHG – is around three times the figure recorded in the MFI’s accounts.

The magnitude of MFI thrift deposit services is, of course, limited by the fact that in India not all MFIs are able to offer deposit services. Organisations registered as non-bank finance companies (NBFCs) that are regulated by the central bank, the Reserve Bank of India, may offer such services only after obtaining an investment grade rating from a recognised corporate rating agency. Only a few NBFC MFIs have been able to get such ratings so far and even these can only accept deposits under highly restrictive conditions. In addition, a number of other MFIs – 30 of the 50 in the 2008 sample (even some of those registered as societies and trusts) – do not provide thrift deposit facilities to their members since such services are technically illegal under the RBI Act, unless specifically permitted by the central bank. However, NBFCs do collect security deposits (usually interest free) from their clients’ upto a certain (10-15%) proportion of the loan disbursed, which is refunded at the end of the loan term. Such deposits have been treated as savings for the purpose of analysis in 2008. As a result, the Rs205.9 crore (\$51.6 million) of savings formally mobilised by the MFIs in the sample amount to just 4.5% of the total amount of loan outstanding to clients. This represents a decline in the savings to portfolio ratio from the 8.1% of the 2007 sample and indicates the effect of regulatory pressure on the willingness of MFIs to offer deposit services to low income clients.

Exhibit 4.10

Distribution of thrift deposits of MFI clients (Rs Million)

...by model				
Models				
G	177	213	531	1536
IB	557	416	472	434
SHG	588	116	176	88
Overall	1,457	863	1,179	2,059
Top 10	360	517	541	1,044

In terms of average deposits mobilised per MFI, the trend since 2003 has been downwards mainly as a result of this regulatory pressure even though many of the MFI are not regulated by the RBI. Exhibit 4.11 indicates, all the methodologies have low average savings per member except for the individual banking model/other commercial organisations (mostly cooperatives which have comparatively higher dependence on member

savings for their financing needs). Each of the bars reflects the nature of the methodologies and the legal framework in which the organisations operate.

Exhibit 4.11
Average thrift deposits (Rs) per member

...by model				
Models				
G	637	165	177	182
IB	8,275	6,356	612	1,721
Mixed	392	651		
SHG	481	87	97	43
Overall	762	300	211	191
Top 10	900	332	163	147

Average deposits of Rs191 (\$4.8) per MFI client in India in 2008 are minuscule when compared with the global benchmark of \$251 reported by MIX. The deposits collected by the Top 10 are even lower at Rs147 (\$3.7) per member, a negligible fraction of the global benchmark of US\$319.0 for financially sustainable institutions. The low savings orientation of the Top10 results from their registration as NBFCs that are not allowed by the RBI to raise deposits. The amounts still carried by these companies on their balance sheets are made up of limited amounts of cash security against advances. As in the case of average loan balance, these small numbers are partly also an indication of the low levels of income of Indian MFI clients in nominal dollar terms.

SHG programs usually have voluntary deposit schemes in which the members themselves determine the amount of the recurring savings deposit. Since the disposition of this amount is determined by the group rather than by the individual saver, this often results in minimalist norms and leads to deposits that are far lower than the members' savings potential. Deposits form just 4.0% of the average SHG MFIs' portfolio, though (as indicated earlier) this excludes the far larger amounts revolved internally by SHG members.²¹

In the case of the Grameen organisations, on the other hand, the limited savings per member is due to the credit-led nature of the model. This leads Grameen MFIs to fix relatively small (5-20%) proportions of loan amounts as compulsory deposits by borrowers. Interestingly, for the individual banking model, the average savings per member is high on account of the cooperative institutions. These organisations are able to offer a set of savings products and the collection of deposits is an integral part of their business model. This provides a pointer to the likely impact of a facilitative regulatory framework on the financing of microfinance in the country; such a framework could enable client savings to form the bulk of funds deployed in microfinance.

²¹ Issues of deposit orientation of MFI models and their relationship with regulation and resource mobilisation are further discussed in Chapter 7

Overall across regions, models and legal form, the (already low) thrift deposits mobilised per member has declined steeply and as a result it is not a significant part of the financing strategy of MFIs. However, IB organisations having legal forms of cooperatives or local area banks that are allowed to mobilise deposits from members, savings still form an important part of sources of funds.

4.6 Conclusions

The overall outreach in 2008, based on data of 170 MFIs is about 11.86 million borrowers, having a portfolio of Rs5,571.6 crore (\$1,396.4 million) and savings of Rs243.4 crore (\$61.0 million). Since 2003, the outreach of the MFI sector has grown exponentially – borrowers at 42% p.a., portfolio at 104% p.a.

In terms of model and legal forms, Grameen organisations accounted for about ~78% of membership while NBFCs covered 65% of outreach. This proportion has been growing over the years, which is evident from the fact that in 2003 the SHGs and NGOs accounted for the majority of microfinance coverage. The main reason has been the transformation of the MFIs into commercial entities and adopting Grameen model to meet their growth requirements.

Like SBLP, the outreach of MFIs is also concentrated in the traditional southern region, with about a 75% share. However, in the last couple of years many south based MFIs have started to operate in other regions as well and it is expected that the share of the south would decline in the years to come.

The ratio of borrowers (members with loans) to members is largely dependent on the extent of dormancy accepted within a methodology. The Grameen model has a high active average greater than 90% while for the SHG model this is around 50% because of a longer gestation period after which the member becomes eligible for loans.

NBFCs comprise a majority of the portfolio outstanding. The share of NBFCs in portfolio outstanding has grown from 50.5% (2005) & 71.3% (2007) to 76.0% currently. The NBFCs also have about 70% share of the borrowers. In this context, the proposal to bring societies, trusts and cooperative MFIs under a separate regulatory framework from that of NBFCs would mean regulatory exclusion of a major proportion of microfinance clients.

The microfinance portfolio seems to be concentrated among the larger MFIs. The Top 10 MFIs account for over 64% of the total portfolio. The reasons for this situation are related to the efficiency and financial performance & the model and legal forms of the MFIs. Most of the Top 10 MFIs are NBFCs adopting Grameen model for operations.

The size of the average loan balance held by borrowers of Indian MFIs as a proportion of GNI (a quick indicator of depth of outreach) per capita has improved to 13.0% in 2008 from 9.9% in 2007. The Top 10 MFIs record a slightly lower loan size-GNI ratio of 11.7%, and has consistently dropped over the years. NBFCs have the highest loan size-GNI ratio of 14.1%, higher than 13.0% for India. It shows their emphasis on having large loan sizes than other models from the very first loan cycle.

The magnitude of thrift deposit service, in India is limited by the fact that not all MFIs are able to offer such services. Most NBFCs, which cover more than 70% of the MFI sector, are not allowed by RBI to mobilise

deposits. However, NBFCs do collect security deposits (usually interest free) from their clients upto a certain (10-15%) proportion of the loan disbursed which are refunded at the end of the loan term. Overall, deposit mobilisation has seen a downward trend mainly as a result of regulatory pressure even though many of the MFIs are not regulated by the RBI.

Chapter 5: Impact of microfinance

This Chapter discusses the impact of microfinance in terms of depth of outreach (who are the clients? to what extent is microfinance serving the poor and excluded?) and the evidence for change resulting from microfinance over time.

Social data is not so systematically reported as financial data. Therefore, for key data – to profile clients, as well as to assess change – we have to rely on sample data with varying scope and coverage. Client profile data is drawn partly from the MiX 2008 (% women) and Sa-Dhan 2008 (caste), also from samples obtained through social ratings and other studies (for poverty assessment). The main sources of data on change come from two large studies of the SBLP (NCAER, 2008; EDA/APMAS, 2006) and a baseline/endline study of MFIs (EDA 2004, AFC 2008). The methodologies vary and are not entirely robust, in that the GTZ study is based on recall, whilst the SIDBI endline study (based on longitudinal data with a non-client comparison group) does not take account of dropouts, and provides limited analytical data.

In the context of overall declining poverty rates in India and the relatively small (micro) size of micro-credit the data indicates moderate depth of outreach, and varied use of micro-credit with evidence for some poverty reduction. The potential for women’s empowerment effects seems stronger in the more developed southern states. Evidence for increasing overlap – and competition - within microfinance is emerging in some areas signalling a risk of client over-indebtedness in future.

5.1 Poverty in India

There has been a significant growth in per capita GNI in India of around 6% p.a. during this decade. Poverty rates have decreased though the overall poverty ratio remains significant. The poverty line in India is linked to the cost of food estimated to provide 2,400 calories in rural areas and 2,100 calories in urban areas. This level was initially set in 1978 by the Planning Commission of the Government, is adjusted for different costs of living in rural and urban areas, and by state, and can be updated adjusting for inflation applying the appropriate Consumer Price Index (CPI).

In 1985, when the World Bank published its international standard poverty lines, the India national poverty line was close to the ‘US\$1/person/day’ at purchasing power parity (PPP). Since 1995, when the ‘US\$1/day’ was adjusted upwards to ‘US\$1.08/day’, the international line for extreme poverty has been just above the national poverty line for India.

The poverty rates (% living below different ‘poverty lines’) are derived from household expenditure data collected by the National Sample Survey Organisation (NSSO) which conducts annual rounds of large samples across the country. The latest data for 2005-06 is available from the 62nd round of the National Sample Survey. Exhibit 5.1 shows the different poverty lines, and the estimated household poverty rates in 2006, showing higher levels of poverty in rural areas, compared to urban.

Exhibit 5.1
India poverty lines

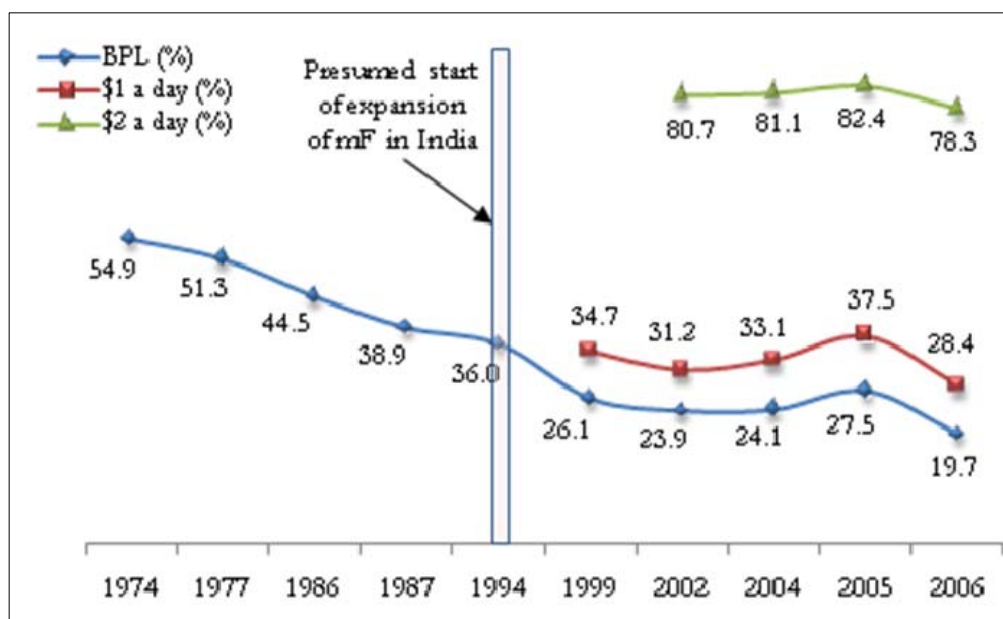
Poverty lines	Rs/person/day @ 2006 prices	Household/m	Household poverty rate		
			All India	Rural	Urban
National poverty line	14.25	2,351	17.0%	17.5%	15.4%
US\$1.08 at PPP	15.38	2,538	25.4%	30.8%	10.0%
US\$2 at PPP	30.75	5,074	74.9%	84.1%	48.9%

NSSO Round 62 data for 2005/6 (in Schreiner, Mark, 2008. *A Simple Poverty Scorecard for India*)

Exhibit 5.2 shows estimated poverty rates declining quite steadily from 55% below the national poverty line in 1974, though the data is not entirely comparable across the years, as the methodology for measuring poverty has changed from time to time. In terms of the international poverty line, 28% of the population, (25% of households) still remain below the US\$1.08 line.

The start of growth of microfinance in the country in the mid-1990s coincided with the beginning of economic liberalization.

Exhibit 5.2
Decline in population poverty rates, 1974-2006



NSSO Rounds 62 (2005-06) as in Schreiner, 2008. www.Indiastat.com (for data before 1994)

Change in poverty is complex, and substantially influenced by indirect interventions: changes in policy and governance, investments in infrastructure and education as well as slow change in social structure and culture.

The rest of this chapter explores the potential contribution of microfinance as a direct intervention, in terms of enhancing the access of poor people to financial services, and the evidence for improvement in quality of life and other development indicators.

5.2 Poverty outreach of microfinance

5.2.1 Geographical outreach

A regional analysis of microfinance spread across the country, as discussed in Chapters 3 and 4, reveals a higher concentration in the southern states. The southern states have historically been the hub of microfinance activities, though in recent times, microfinance has spread more substantially in the eastern and northern regions. A part of this has been as the large MFIs initially established in the south have expanded their outreach to different, and less developed areas of the country. Poverty in the southern states is lower than in the north and east – and it is clear that the microfinance focus (both MFIs and SBLP) has been in the states with lower poverty rates.

This is reflected in the ‘Microfinance Penetration Index’ (MPI) and the ‘Microfinance Poverty Penetration Index’ (MPPI) applied in the 2008 Microfinance India Sector Report²². The MPI compares distribution of microfinance clients to distribution of total households in the country. The MPPI compares the distribution of microfinance clients to the distribution of total estimated poor households. As shown in

Exhibit 5.3, both values are well over 2 for the southern region; under 1 in all other regions, lowest in the Central region. MPPI is lowest in the Eastern state of Bihar (0.2), and the Central states of Madhya Pradesh (0.27), Jharkhand (0.28) and Uttar Pradesh (0.31). (State-wise data is given in Annex 4)

Exhibit 5.3

Poverty rates by region compared to distribution of microfinance clients

BPL = Below (national) Poverty Line

Regions	% population BPL within region	Regional distribution of BPL households 2004-5 (%)	Regional distribution of mF clients 2008 (%)	MPI*	MPPI*
Total number (million)		60.3	59.2		
South	6.3	7.4	49.7	2.32	3.22
East & NE	31.0	32.0	23.6	0.86	0.91
West	6.7	32.0	10.9	0.75	0.80
Central	27.1	13.6	10.6	0.42	0.32
North	4.0	15.4	5.3	0.40	0.71
India	19.7	100	100	1	1

Adapted from the Microfinance India State of the sector Report 2008 * See footnote

²² Srinivasan, N. 2008.

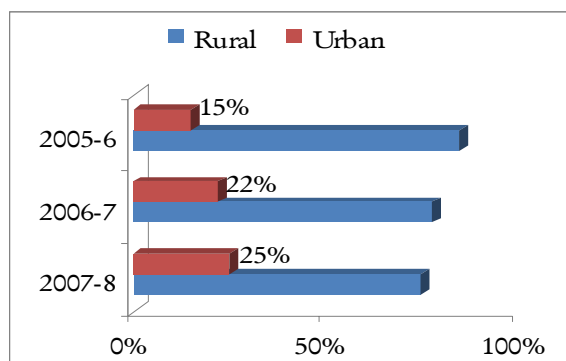
These indices need some revision downwards to the extent of overlap between microfinance clients (discussed at the end of this chapter) and to reflect the fact beginning to be documented that microfinance clients are not exclusively from households below the poverty line (discussed in the next section).

Rural-urban outreach

Microfinance in India has historically been a rural programme, with some pioneering exceptions in key metropolises (Ahmedabad - Sewa Bank, Chennai – Working Women’s Forum and Mumbai – Annapurna Mahila Mandal). The SBLP remains 100% rural.

MFIs currently are estimated to be catering to 75% rural clients, 25% urban – beginning to catch up with the All India population ratio (29% est.) as new MFIs have begun operations in urban areas. **Exhibit 5.4** shows the MFI trend.

Exhibit 5.4
MFIs - Increasing urban outreach



Sa-Dhan, 2008

5.2.2 Who are the clients?

Different social communities

The caste system in India divides society into different communities, of whom the Scheduled Castes (SC) (or Dalits) and Scheduled Tribes (ST) are traditionally seen to be marginalised and discriminated against. Some microfinance programmes (NGO SHPAs in the SBLP and MFIs) specifically target the marginalized segments in their outreach. Many target the ‘Backward Castes’ (BC). Exhibit 5.5 compares data available for caste distribution of microfinance clients, and indicates significant outreach to more marginalised communities relative to population incidence.

Exhibit 5.5
Microfinance outreach – by caste (percent)

	Data source	SC	ST	BC	Minorities	General	Total
SBLP	EDA/APMAS 05	30	25*	28	5	12	100
MFIs	Sa-Dhan 08	30		70			100
	AFC 06	26	1.9	45	27.1		100
All India	Census 01	16	8	35	12	29	100

* Higher proportion reflects sample representation of two states (Orissa and Rajasthan) with larger ST communities

Outreach to women

Women are the main clients of microfinance in India: 94-95% overall. The smaller number of men are mainly in individual model (or joint liability group) MFIs (Exhibit 5.6).

Exhibit 5.6

Proportion of women as microfinance clients (2008)

	Data source	Total clients	% women
SBLP	NABARD	45.2	95
MFIs	The MiX	10.2	94
SHG/Grameen		9.8	97
Individual Banking		0.4	47

Note: MFI clients covered in Sa-Dhan 2008 total 14.1 million, but women/men breakup not given

5.2.3 Poverty assessment of clients at entry

It has been typically assumed that microfinance is for the poor and clients may be assumed to be from households living below the poverty line – or one of the poverty lines! This assumption is linked to the ‘micro’ size of credit being appropriate for low income households. Accordingly, analysis of ‘depth of outreach’ has conventionally been based on the average loan outstanding relative to per capita national income, with a ratio of 20% taken to represent broadly ‘poverty lending’ (as discussed in Chapter 4.4).

Direct poverty assessment however tells a more varied story, but suggests deeper outreach in the SBLP than in MFIs. Data presented here is based on poverty measurement of new/recent clients to microfinance, reflecting depth of outreach at entry (older clients may experience change in poverty level over time and must therefore be covered separately). Data for the SBLP indicates substantial poverty outreach with an estimated 58% of new SHG members below the national poverty line; another 26% borderline or ‘vulnerable non-poor’ and 15% non-poor (EDA/APMAS 2006, NCAER 2008).

For MFIs, Exhibit 5.7 presents data benchmarked to the international poverty ‘lines’, through measurement of per capita household income, or use of the Progress out of Poverty Index.²³ The data comes from social ratings or poverty audits undertaken by M-CRIL since 2006. Compared to All India poverty rates, this data for MFI clients indicates poverty outreach roughly approximate to the national incidence – slightly lower at ‘\$1/day, higher at the over \$2/day level. Clearly MFIs are catering to clients from a range of income levels, including both poor and non-poor. Moreover, some MFIs do not have an orientation to target the poor, but serve higher income groups with lending to small enterprises.

²³ The Progress out of Poverty Index is a tool that statistically benchmarks household poverty levels based on scoring of 10 robust indicators derived from the National Sample Survey. It was developed by Mark Schreiner with support from the Grameen Foundation. www.progressoutofpoverty.org

Exhibit 5.7

Benchmarked poverty assessment of MFI new clients (per cent)

Poverty lines	All India (households)	Sample MFIs	Stated MFI poverty orientation	
			yes	no
Number of MFIs		18	15	3
< '\$1'/day at PPP	25.4	19.8	22.6	4.7
\$1-\$2 a day	49.5	43.7	44.4	38.7
>\$2/day	25.1	36.4	33.0	56.6

M-CRIL, 2005-8. n= 2,124

5.3 Loan use – and size

The impact of microcredit in terms of its contribution to the household will depend at least partly on how microcredit is used, as well as the amount involved. Sample data shows a similar pattern of use for both SBLP and MFIs with 62% of micro-credit applied for directly productive investment, 38% for other household investment (**Exhibit 5.8**) Credit is fungible and may be used for different purposes (within the same loan).

Exhibit 5.8

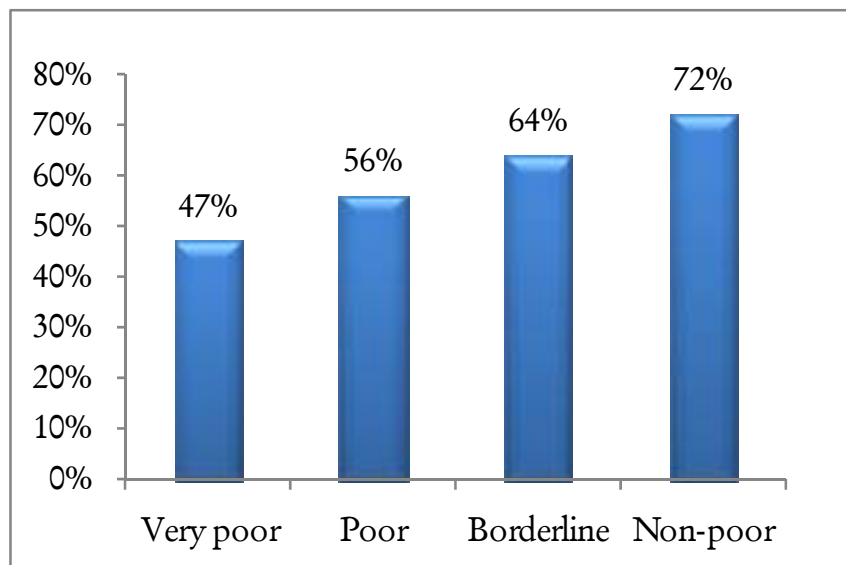
Reported use of micro-credit (% of loan amount)

Sources	SBLP NCAER-08	MFIs EDA-04
Directly productive investment	62	63
Agriculture/animals	33	27
Trade	14	19
Services	13	12
Manufacturing/crafts	2	4
Other household investment	38	37
Medical/schooling	14	8
House improvement	6	7
Other household needs (incl marriages/events)	10	19
Debt repayment	8	3
Total micro-credit	100	100

In terms of potential contribution to the household, micro-credit is used both to support enterprises (existing, sometimes new – reported for around 30% of new clients, EDA baseline, 2004) and to support consumption smoothening. Both types of contribution are important. In fact, loan use data analysed by income group indicates that poorer clients are likely to use less micro-credit for direct investment, and more for consumption smoothening (Exhibit 5.9).

Exhibit 5.9

Micro-credit use for direct investment by wealth rank



EDA 2004

The same baseline study has data to show that microfinance is not the only source of credit to the household, estimating that in the sample MFI clients, micro-credit represented 74% of household borrowings for direct investment, 38% of borrowing for other uses. After 3-5 years, the AFC follow up study showed a slight increase in the relative significance of micro-credit in total household borrowings – but it still represented 50% of borrowings for other household use.

Sustainable impact from micro-credit at the household level depends on continuing and increasing loan sizes over time, with regular repayments. NCAER (2008) data suggests a slight increase in use of micro-credit for direct investment after 5 years of bank linkage, with an increase in loan size to Rs4,834 on average. SHG members under SBLP also have access to their savings through internal group lending of funds. The same survey showed average annual savings/SHG member HH at Rs4,213. Over two-thirds of the SHGs covered pay interest on savings to members, at around 8% a year.

Most MFIs expect their clients to increase their loan amounts in each credit cycle which usually lasts 12 months (sometimes less). Micro-credit amounts can increase from an initial loan size of Rs3-5,000 up to Rs15,000 over 5-8 loan cycles. But some clients may exit. So before turning to data for impact, we look briefly at the question of exit from microfinance.

5.4 Exit

Clients are estimated to drop out of microfinance at the rate of 8% annually in the SBLP, and 11% annually in MFIs. Reasons for exit include issues with the microfinance service, also cases of migrations, and cases of graduation (fly-out rather than dropout):

- Dissatisfaction with the microfinance service: loan size, repayment terms, staff behaviour, frequency/length of group meetings
- Do not need another loan
- Problem with other group members
- Unable to make regular savings in SHG model; not allowed to withdraw savings when needed
- Unable to make regular repayments/defaulters
- Migration
- Graduation

Migration is given as the reason for dropout in around 25% of cases, reflecting limited local opportunities for employment. The AFC-2008 follow up study reported that 11% of MFI dropouts interviewed had graduated from microfinance to formal banking. Otherwise, the available data does not tell us whether dropouts have benefited or not from microfinance.

5.5 Changes over time – poverty reduction and asset increase for client households

Data for change over time comes from two studies: NCAER (with 2006 data) for a sample of SBLP clients, where change over time (average 5.4 years) is based on recall. SIDBI – EDA baseline study (2002-3 data) of a sample of clients in 25 MFIs compared to non-clients, and the SIDBI - AFC endline study (2005-6 data) of a sample of clients from 25 MFIs (i.e. including an additional sample into the earlier baseline). Neither of the studies provides robust statistical evidence for impact, in that the NCAER study does not have a non-client comparison group; whilst the AFC endline study does not take account of dropouts between baseline and endline, nor does it provide full comparison data with the non-client sample. The data available therefore is indicative of change that has taken place – rather than impact resulting from microfinance.

A study that does set out to establish impact – based on randomised evaluation – for one MFI (Spandana – Grameen model, urban microfinance) has recently been completed.²⁴ Its careful design and analysis adds to an understanding of how different types of client vary in their uses of micro-credit, and its likely effect, but given the short time frame (12-18 months) within which ‘impact’ is assessed, the specific results do not add substantially to the evidence from the other studies.

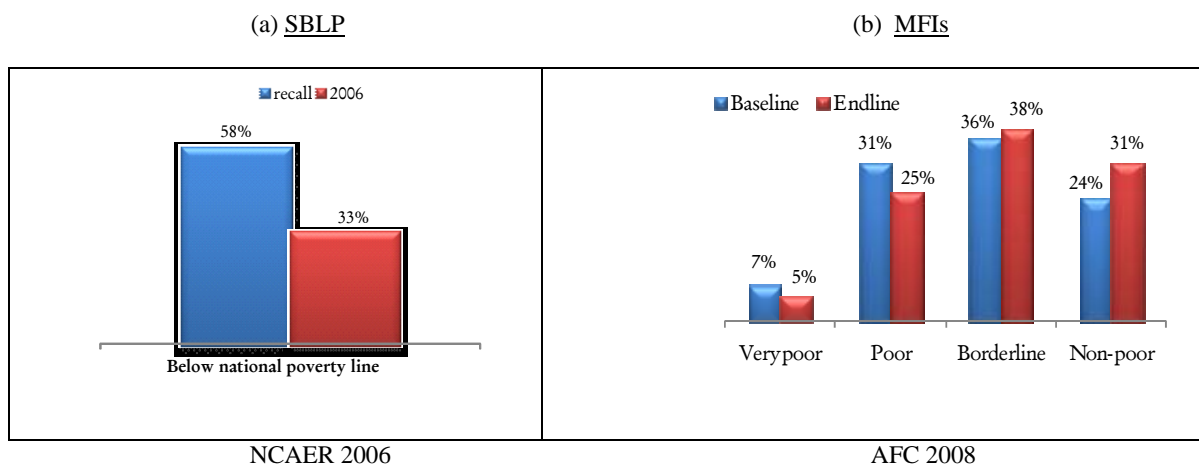
²⁴ Banerjee, Duflo et al, 2009. *The miracle of microfinance? Evidence from a randomized evaluation.*

Limited evidence for poverty reduction

For those who stay with microfinance, does it contribute to poverty reduction? Studies of both the SBLP and MFI programmes indicate some reduction in poverty over time.

The NCAER sample data shows a reduction in the proportion of SBLP client households below the national poverty line from 58% pre-linkage (based on recall) to 33% in 2006, after an average of 5 years in the SBLP. For MFIs, wealth rank data from the AFC follow up study indicates a reduction from 38% poor households (in the baseline) to 31% after 2-5 years. (Exhibit 5.10)

Exhibit 5.10
Data for poverty reduction



It is equally significant to note that it is still a substantial proportion of clients who remain in poverty. Continuing poverty over time is a feature that is captured in poverty profiling of older clients – indicating the varying effects of microfinance for different households.

Nevertheless, reported increase in household expenditure and incomes...

The different studies show some reported increase in household expenditure or income. For SBLP, the NCAER (recall based) data shows an increase in average household net income, and in average household expenditure on major consumption items – which at an estimated increase of 5-6% a year is 1-2 percentage points ahead of inflation during the period (Exhibit 5.11).

For MFIs, the EDA baseline captured interesting results by wealth rank. Overall, half of client households reported an income increase in the previous two years, compared to 38% of non-client households (Exhibit 5.12). The difference between client households and the comparison households is positive across wealth ranks, but is significantly higher for poorer client households (23 percentage points) compared to non-poor households (7 percentage points).

Exhibit 5.11

Changes in net income and consumption expenditure reported for the SBLP

SHG member Households	Reported pre-linkage	2006	Annual growth rate
Change in net incomes	34,786	47,934	6.1
Change in annual consumption expenditure:			
Food	14,288	18,705	5
Non-food	7,186	9,550	5
Medical	907	1,211	6
Education	846	1,135	6

NCAER, 2008

Exhibit 5.12

Households reporting income increase (in previous two years)

Households	Overall		Very poor		Poor		Borderline		Non-poor	
	N	%	N	%	N	%	N	%	N	%
Members	3,908	52%	309	41%	1,110	46%	1,347	48%	1,142	65%
Non members	1,419	38%	132	18%	426	29%	485	35%	376	58%
<i>Difference</i>	+14%		+23%		+17%		+13%		+7%	

EDA 2004.

... and in assets

The data shows some increase in ownership of assets for microfinance client households. 80% of SBLP clients report an increase in household assets, 62% report an increase in productive assets. Data for MFI clients shows higher level of acquisition of productive assets, mainly in the Grameen and IB – and a significant difference with non-clients, particularly with reference to productive assets (**Exhibit 5.13**). As noted earlier for reported income increase, the difference between client and non-client households was found to be significantly higher for poorer households.

Exhibit 5.13

Perception of change in household ownership of assets - SBLP (%)

SHG member Households	Productive Assets	Other Household Assets
Increase in ownership	62	80
No change	34	18
Decrease in ownership	2	2

NCAER, 2008

MFI client households acquiring assets through credit (%)

Type of asset	Any asset	Productive	Housing	Household
Client	74	88	70	35
Non-client	55	63	64	30
Difference (percentage points)	+19	+25	+6	+5

EDA 2004

Exhibit 5.14 illustrates the type of assets referred to here, and their varying values.

Exhibit 5.14

Type and value of assets acquired by MFI clients

Type of Assets	Value		
	Low (< Rs1,000)	Medium (Between Rs1,000 and Rs10,000)	High (> Rs10,000)
Productive	Tools, utensils, small animals (goats)	Desi cow/buffalo, goats, cycle, pushcart, rickshaw, shop repair, furniture/equipment for a IGA, sewing machine, embroidery machine, handloom	Good quality/crossbreed dairy animals, shop space, furniture, accessories for e.g. carpentry, printing, video game parlours, public telephone, auto rickshaw
Housing	minor house repair, electricity,	Paint/whitewash, tin sheets or re-thatching of roof, toilet, electric connection	Land for housing, house improvement/repairing /extension, boundary wall, bathroom & toilet, new house (> Rs75,000)

	Low (< Rs1,000)	Medium (Between Rs1,000 and Rs5,000)	High (> Rs5,000)
Household	Fan, radio, second hand cycle (old), kitchen items, wall clock, electric iron, plastic chair	Cycle, kitchen items such as pressure cooker, mixer-grinder, gas stove, second hand refrigerator; sofa set, plastic moulded furniture, store-well (steel), wooden furniture (table, chairs, bed, cupboard), jewellery, music system, telephone, black and white TV	Colour TV, furniture, sofa set, gold jewellery, fridge, washing machine, two wheelers (scooter, motor bike)

EDA 2004 NB: assets of value less than Rs300 not included; different value taken for 'high-cost' household items because they cost less than 'high-cost' productive or housing assets.

5.6 Women's empowerment

With the majority of microfinance clients being women, are there changes in terms of women's empowerment or gender equity? For some observers – and practitioners - the very fact that microfinance provides mainly women with access to financial services, is in itself evidence for gender equity. The most obvious direct changes for women, especially in a patriarchal Asian society, are:

- having savings in their name (at any rate as part of a group account under SBLP)
- direct engagement in credit disbursements and repayments, and
- opportunities for social mobilisation and skill development, especially through the group based model (SHGs in SBLP, and Grameen) with its mechanisms for training and women's leadership within the model.

Questions of women's empowerment go further to ask whether microfinance enhances women's skills, their role and status within the household, their enterprise opportunities and their role within communities. The NCAER study asked a series of (perception based) questions to women SHG members, with overall positive responses, as shown in Exhibit 5.15.

Exhibit 5.15

Women's perception of change - SBLP

Reported improvement/increase in:	%
Self confidence related to travelling	78
Self confidence in handling money	77
Ability to face family disputes	63
Ability to contribute to dealing with financial crisis in the family	72
Decisions on purchasing household items	62
Decisions on buying productive assets	52
Decisions on expenditure on family/social functions	67
Attendance in village committees	36

NCAER 2008

The EDA (2004) baseline study highlighted the variation in women’s engagement in enterprise activities financed by micro-credit. The study showed that whilst the majority (76%) of women clients are economically active, a proportion are not, but are engaged with housework and child care – and this proportion is higher in the north (34%) compared to the south (18%). In this context, it is interesting to see whether women are themselves engaged in or manage the enterprise for which they have taken a loan in their name. Based on the women clients’ responses, the data shows that over one-third of enterprises were managed entirely by women, and an equal proportion were managed by men. Around one-fourth involve women and men jointly (Exhibit 5.16). As expected, women’s engagement was higher in the south compared to the north; also higher in urban activities. The AFC (2008) follow-up study showed some increase in women’s management in the south (increasing to 47%) but no change for the northern sample.

Exhibit 5.16
Management of financed enterprises

Region	Number of financed enterprises with loan in women’s name	Managed by		
		Women	Jointly	Men
Overall	1,850	38%	23%	38%
South	1,076	42%	30%	27%
North	774	32%	13%	53%
Rural	1,498	33%	25%	41%
Urban	352	59%	15%	26%

EDA 2004

Data on ownership of assets purchased with micro-credit to women clients was also analysed in the EDA baseline survey. Conventionally, in Indian society, it is men who own productive assets and housing, both in terms of legal title and informal arrangements. Based on ownership reported by clients, the data shows that the conventional pattern continues but there has been a shift in comparison with non-clients, with a higher proportion of assets owned by women, and more jointly owned housing (Exhibit 5.17). As with economic engagement, women’s ownership of assets is higher in the south than in the north.

Exhibit 5.17
Ownership of assets purchased in previous two years

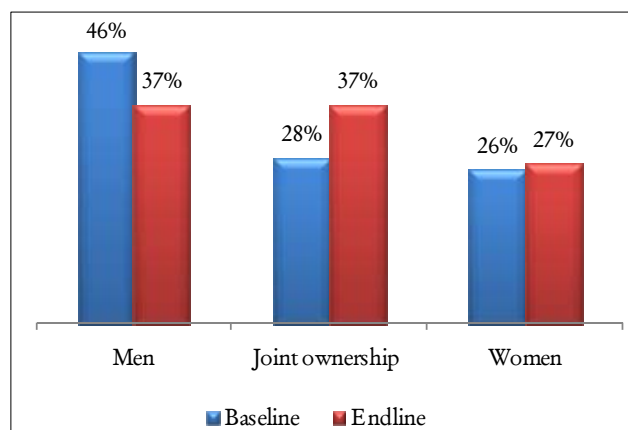
Type of asset	Clients				Non clients			
	Number of assets purchased	Owned by			Number of assets purchased	Owned by		
		Women	Joint	Men		Women	Joint	Men
Productive	1,407	38%	27%	35%	188	15%	36%	48%
Housing	786	15%	37%	48%	220	9%	30%	61%

EDA 2004

The AFC follow up study indicates some increase in joint ownership of assets (Exhibit 5.18).

Exhibit 5.18

Ownership of assets at household level (MFI clients)



AFC 2008

In general, the qualitative perceptions of change for women (reported for SBLP) appear stronger than specific data provides evidence for (as reported for MFIs). Broadly, microfinance for women is a good start for gender equity, with varying results depending on context (stronger in the south than in the north). SHPAs and MFIs also vary in the extent to which they specifically engage to support women's opportunities, beyond basic financial service provision.

This is reflected in the EDA/APMAS 2006 study which found examples of women's empowerment at the community level, as SHGs (under the SBLP) provide a platform for women to come together to engage with community issues. Such issues as, for example, electing one of their group members to the village *panchayat*, contributing to community action for improved schools, health care, road, veterinary care or taking action for social justice (domestic violence against women, dowry, bigamy, treatment of widows). Or coming together for group enterprise. The findings are summarised in Exhibit 5.19.

Exhibit 5.19

Examples of community empowerment for women members of SHGs - SBLP

Indicators of community empowerment	% of sample SHGs
<i>Total SHGs (n)</i>	214
SHGs with members elected to village panchayat	19%
Elected women representatives	44
- proxy	43%
- engaged/active	57%
SHGs engaged in community actions	30%
SHGs acted on social justice issues	12%
% effectiveness (women's own perception)	50%
SHGs involved in group enterprises	21%
Viable group enterprises	<50%

EDA/APMAS 2006

The study concluded that “Although the examples of SHG action that we found were not as numerous or as effective as hoped for, the fact that such initiatives happen at all can be seen as a good start in a traditional, patriarchal society which has usually marginalised women’s roles and agency”.

5.7 Education of clients’ children

The ability to send children to school is a critical indicator for the next generation. Does microfinance support clients to send their children to school, especially daughters? The AFC endline study reports that all children below 14 years were attending school in 57% of client households, which indicates a continuing schooling gap in 43% of client households.

The EDA baseline study provides additional details, finding that school enrolment of clients’ children at primary level (6-11 years) was significantly higher than non-clients’, particularly for poorer clients; but found less difference at secondary level (11-14, 15-17 years). The data also shows continuing gender imbalance for clients’ and non-clients’ children (Exhibit 5.20).

Exhibit 5.20

School enrolment of children (girls and boys, aged 6-14 years) by wealth rank category – MFIs

	Very poor & poor			Borderline		
	Client households	Non-client households	Difference	Client households	Non-client households	Difference
% girls	82	76	+6	89	87	+2
% boys	89	83	+6	90	85	+5

EDA 2004

Parents need lump sum amounts for the education of their children mainly at the beginning of the school year when payment has to be made for books and uniform. The baseline survey found that MFI contribution to schooling costs was 12%. Contribution from internal group loans in the SHG model (as in SBLP) was higher at 27%. It is only more recently that MFIs have begun to offer loans specifically for education. If the sector is substantially to contribute to education for the next generation, it is not only a question of financial services, but there may also be opportunities to mobilising parents so as to seek quality education for their children, and better accountability from the school system.²⁵

²⁵ IFMR working paper, 2005. *Linkages between microfinance and effective education with a focus on parental involvement.*

5.8 Microfinance – overlap and competition

As microfinance has expanded, both SBLP (with links to Government programmes) and MFIs, the sector has begun to see evidence of overlap and competition. Overlap between SBLP and MFIs has emerged most strongly in the two southern states of Andhra Pradesh and Tamil Nadu, which are the leading states in terms of number of clients under both models. Direct competition between MFIs is emerging in certain areas, particularly the southern states of Andhra Pradesh and Karnataka, and the eastern state of West Bengal, in both rural and urban areas.

The M-CRIL social ratings cover microfinance overlap and early ratings found overlap on average of 7% of households covered in the rating sample. In certain areas, the overlap goes much higher – up to 30%.

A qualitative in-depth study based on the ‘financial diaries’ of 20 urban households in Bangalore (southern state of Karnataka) over three months highlights the emerging risks from competition:

Multiple membership: A key finding of the diaries is that many households were borrowing systematically from several MFIs and SHGs. In the sample, all, except one of the households were indebted to multiple MFIs/SHGs, more than 90% were indebted to more than 2 MFIs/SHGs and 50% were indebted to more than 4 MFIs/SHGs. About 70% of the households also had loan repayments to finance companies, chit-funds and money-lenders.

Burden of loan repayment: As a result of multiple loans the debt-service burden of the sample urban poor households in Ramanagaram was high. In fact, loan repayments vie with expenditure on food in the weekly budgets of most households. On an average, households spend almost the same amount on repaying their loans as on food. Breaking this down further, 50% of households spend a higher proportion of their expenditure on loan repayments than on food. About 55% of households spend more than 30% of their total expenditure on loan repayments.

This raises important questions of whether this constitutes “over-lending” by the MFIs or “over-borrowing” by the households. Are MFIs “dumping money on borrowers”? Or is there an insatiable hunger for credit which they are fulfilling? Given their commitments on loan repayment, and after factoring in food, most households are able only to spend a very small fraction of their incomes on other important expenditure groups such as clothes, health, building up assets and education though almost all households have children at home who are studying.

Over indebtedness: Some households were also spending in excess of their net inflows. Only 10% of the households were able to have a net positive income, while about 30% had positive net inflows over three months. For the remaining households the size of their outflows (real household expenditures as well as servicing existing debts) was in excess of their income and borrowings. Although part of the explanation could be heavy festival related expenditure that occurred during the survey period, it does raise the question of the sustainability of debt of these households.

This is an area which requires research on a wider scale, and guidelines to SHPAs and MFIs on appropriate practices for lending.

5.9 Conclusions

In the context of overall declining poverty rates in India and the relatively small (micro) size of micro-credit the data indicates the following:

- Primarily rural outreach, though MFIs are beginning to expand into urban/city areas
- Depth of outreach (% new microfinance clients below the poverty line) at an estimated 58% below the national poverty line for SBLP (compared to the All India figure of 17% households below the national poverty line). Lower poverty outreach for MFIs, with data benchmarked to the international poverty lines (20% of new clients below the \$1.08 poverty line, 62% below the \$2/day line, compared to All India household poverty levels of 25% below the \$1.08 line, and 75% below the \$2/day line).
- Moderate coverage of marginal communities – Scheduled Castes and Scheduled Tribes – at around 30% compared to their 27% in the population
- An estimated 62-63% of micro-credit is used for direct productive investment; 37-38% is used for other household needs. Poorer clients are more likely to use credit for consumption smoothening
- Annual dropout rates of 8-11 % on average
- Some evidence for poverty reduction for those who stay with microfinance: 58% to 33% poor based on recall for the SBLP, 38%-30% comparing longitudinal wealth rank data for MFI clients. Continuing poverty for one-third of clients, after 5 years with microfinance.
- More evidence for poverty alleviation – in terms of reported increase in incomes, and in assets
- With women accounting for 94-95% of microfinance clients, a high proportion of women (around two thirds on average) report positively on qualitative indicators of empowerment. Quantitative data indicates variation in women’s engagement in financed enterprises, with some evidence for ‘loan-pass’ (38% of financed enterprises are managed by a husband or son) and not much change over time. Women’s ownership of assets in terms of perceived joint ownership with men in the households has increased.
- There are some interesting examples of women’s agency and empowerment at the community level, especially through the SBLP.
- Education of children does not follow automatically with microfinance, and continues to be a gap.
- Competition between MFIs, and overlap between MFIs and SBLP, is emerging in some areas of the country. Whilst overlapping membership limits the extent of financial inclusion that is being achieved at the household level, qualitative data signals the risk of over-indebtedness.

Chapter 6: Operational and Financial Performance of the MFI Model

This chapter analyses the operational and financial performance of the MFI model on the basis of select rated MFIs. As discussed in Chapter 4 (& Annex 1), the selected MFIs are representative (by region, models, legal forms, age and portfolio) of the MFI sector in India. The chapter covers the efficiency of microfinance operations, analyses the quality of portfolio and sources and uses of funds. Profitability and sustainability of the MFIs have also been analysed.

6.1 Efficiency of MFI operations

6.1.1 Cost efficiency

As financial service agencies operating in a low technology arena, microfinance institutions are heavily dependent on staff for ensuring efficient and effective operations. Staff productivity measured by the number of clients served per staff member is, therefore, an important factor determining the efficiency of MFIs and feeds directly into the determination of the average cost per borrower served.

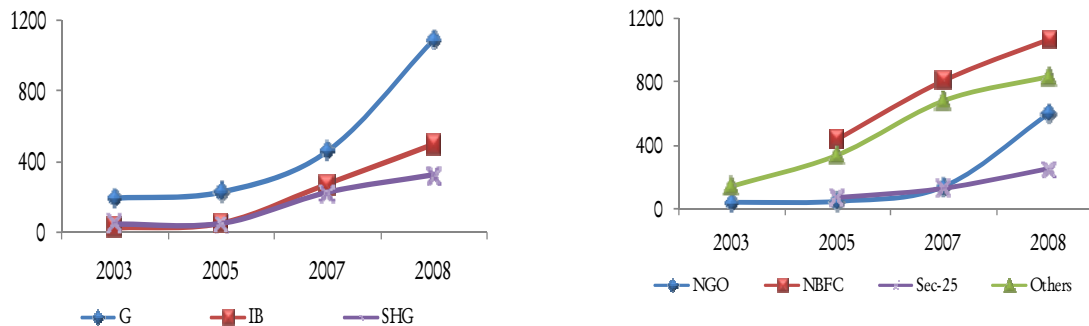
Staff productivity

Staff productivity in India has improved consistently over the years and has now reached a level that is considered to be amongst the best in major regions offering microfinance. The 50 MFIs in the 2008 sample have average staff strength of 782 per MFI as on 31 March 2008, a significant improvement from 326 in 2007, 96 in 2005 and just 64 in 2003. Overall, as Exhibit 6.1 shows, it is the Grameen organizations that have large complements of staff with an overall average of 1,090, but this is inevitable given that they are also the largest MFIs by numbers of clients. Also, among all the legal types, MFIs with a legal status of NBFC have average staff strength of 1,072.

Exhibit 6.1

Average staff employed by rated MFIs

...by model				
Models	2003	2005	2007	2008
G	195	229	460	1,090
IB	29	55	274	496
Mixed	55	72		
SHG	50	53	226	324
...by legal form				
Legal form				
NGO	42	48	139	597
NBFC		437	808	1,072
Sec-25		77	132	256
Others	143	339	678	831
Overall	64	96	326	782
Top 10	143	435	1,079	2,368



Average staff employed by rated MFIs by model and by legal form respectively

For measuring the efficiency of human resource utilisation, staff productivity ratios – clients per member of staff and outstanding portfolio per member of staff – are the two key indicators. This analysis does not use the client-to-loan officer ratio and portfolio-to-loan officer ratio. The reason for this is the difficulty of classifying staff as loan officers across MFIs. Many MFIs give field officers responsibility for all functions related to microfinance groups. In this situation the definition of who is a loan officer is clear. In other MFIs, however, field officers are responsible for group formation and record keeping but branch-based tellers make disbursements and collect repayments as well as performing other branch office functions. This is just one example where the distinction between loan officers and other staff becomes unclear.

Staff productivity by models as well as the institutional form is depicted in Exhibit 6.2. In 2008, while individual banking programmes are the most efficient in terms of average portfolio per staff member, Rs21.7 lakh (~US\$54,500), it is the Grameen model in which the staff serves the largest number of borrowers (252) but, as discussed above, for much smaller loans. Also, across the various legal forms, it is the NBFC, which is most efficient in terms of portfolio per staff member (~US\$35,000) whereas section 25 company leads the table in terms of borrowers per staff (321). This is mainly because most of the NBFCs and section 25 companies follow Grameen model, which resulted in high staff productivity.

Exhibit 6.2
Staff productivity

...by model								
Models	2003		2005		2007		2008	
	BS	LS	BS	LS	BS	LS	BS	LS
G	146	5.0	251	7.8	273	7.3	252	11.5
IB	119	10.3	89	17.8	142	11.0	124	21.7
Mixed	142	7.0	166	7.4				
SHG	103	2.2	206	10.7	179	7.2	175	8.2

...by legal form								
Legal form								
NGO	103	3.0	256	10.9	190	6.7	166	7.2
NBFC			203	8.7	253	8.5	262	14.0
Sec-25			172	5.0	191	9.4	321	12.6
Others	144	5.3	187	13.6	148	2.9	181	5.5
Overall	122	4.1	219	9.3	228	7.7	234	11.6
Top 10	225	10.3	270	11.5	275	8.5	277	12.3

Note:

BS: Borrowers per staff

LS: Loan portfolio per staff (Rs lakh)

Grameen institutions have, as a group, shown the greatest concern for efficiency and become the most competitive MFIs in India today with staff productivity increasing from 146 in 2003 to 252 in March 2008. The low staff productivity of the individual banking MFIs (~124) is a result of the need of comparatively lower number of staff to service the credit products. Across the various legal forms, NBFCs and the Section 25 companies lead the table in terms of staff productivity (262 and 321 respectively), as most of them follow the Grameen model of microfinance.

SHG MFIs, as a group, emerge as relatively inefficient serving just 166 borrowers per staff member who services a portfolio of Rs7.2 lakh (\$18,000). The staff productivity has slightly decreased from 179 borrowers per staff member since 2007. The average staff productivity of SHG programmes is much higher in terms of client members served. This figure incorporates not only large numbers of clients who are savers and, therefore, receive a useful service but also, unfortunately, an at least equally large number of dormant clients and is, therefore, questionable. The relatively low productivity of the SHG model is largely on account of the intensive staff inputs required in the initial years of developing the self-governance capabilities of client groups. While this is understandable, it is also an important factor affecting the cost efficiency of SHG MFIs.

The sample average of 234 borrowers per staff member is somewhat lower than the Top10 average of 277 borrowers per staff member though the averages for the number of members served are 276 and 301 respectively. The portfolio serviced by average MFI staff is Rs11.6 lakh (US\$29,000), about 6% lower than the Rs12.3 lakh (\$30,700) per staff member of the Top10. These productivity numbers for 2008 represent similar productivities for 2007. However, the staff productivity with respect to the individual banking model has declined by 24% since 2007. This represents a significant decline in the rate of growth of productivity and suggests that the scope for further productivity growth may now be limited.

Cost per borrower

The average operating cost per borrower for the different MFI models & institutional forms is depicted in Exhibit 6.3. The cost of delivering the bulk of micro-loans in India has decreased by around 10% to Rs457 (\$11.40) per borrower per annum since 2007. This is the upper end of the cost incurred across 50 MFIs serving nearly 93% of clients that make up the Grameen and SHG-based service providers. It is slightly higher than the average cost incurred by the Top10 institutions. The Indian numbers make international microfinance seem highly extravagant with only Bangladesh and Nepal at comparable levels. These figures, however, are expressed in absolute terms and do not take into account differences in standards of living across the region.

Since the cost per borrower reported in the 2003, 2005 and 2007 were Rs548, Rs581 and Rs504 respectively, this represents a decrease in the average cost of servicing Indian MFI clients (despite an inflation rate of the order of 5-10% during this period). The cost has further declined to Rs457 during the 2008. In case of the Grameen model these numbers represents a marginal increase in the cost per borrower to Rs442 from Rs425 during 2007 whereas the average number of active borrowers has increased by 118% during the same period. Since the Grameen MFIs are the largest and fastest growing in India, this is a clear indication of the economies of scale in microfinance.

The cost per borrower in the case of IB in India is higher, as it requires better contact with clients on account of significantly larger average loan size and no group security. More stringent loan appraisal and frequent visits (particularly to delinquent clients) add to the cost of servicing such loans. The cost of serving individual loans stood at \$40.50 increased from \$36 during 2007. Across the various institutional forms, the cost of serving a client is high in case of NBFCs (\$13) as most of them also offer individual loan products to select clients apart from Grameen loans. Most of the NGO-MFIs follow SHG model and hence the cost per borrower is low at \$8.

Exhibit 6.3
Cost per borrower (Rs)

...by model				
Models	2003	2005	2007	2008
G	605	590	425	442
IB	1,363	2,407	1,460	1,617
SHG	362	360	386	287
...by legal form				
Legal form				
NGO	537	375	300	321
NBFC		619	530	514
Sec-25		737	749	342
Others	557	500	435	295
Overall	548	581	504	457
Top 10	660	500	473	417

6.1.2 Operational efficiency

For the purpose of analysis, operating expenses include four components – personnel expenses, travel costs, depreciation and other administrative expenses – with the **operating expense ratio (OER)** measuring the total of these expenses as a proportion of average outstanding portfolio over a one year period. The operating expense ratio does not include the financial expenses or risk costs (loan loss provision) incurred by an MFI.

The OER of MFIs in India has improved over the years and across all types of MFIs (model and legal form wise) as shown in **Exhibit 6.4**. The weighted average OER in 2008 for sample MFIs is 11.1% (lower than the 15.9% of the 2003 sample) and that for the Top10 MFIs in the sample has decreased to 11.8% (from 22.4%). These ratios are well maintained and represent the high operating efficiency of the Indian MFI as compared to those internationally, owing to the economies of scale Indian MFIs have achieved over the years.

Exhibit 6.4

Operating expense ratios as a proportion of gross loan portfolio of Indian MFIs

...by model								
Models	2003		2005		2007		2008	
	WA	TA	WA	TA	WA	TA	WA	TA
G	25.2%	33.4%	16.3%	21.1%	16.7%	16.4%	12.4%	19.4%
IB	12.1%	12.8%	15.9%	10.6%	20.5%	24.5%	8.5%	12.5%
Mixed	20.5%	36.1%	13.3%	13.5%				
SHG	18.5%	63.8%	14.1%	20.3%	11.2%	23.2%	6.0%	13.3%
...by legal form								
Legal form								
NGO	23.6%	59.9%	18.2%	17.7%	10.4%	22.3%	8.7%	13.1%
NBFC			15.0%	14.3%	14.5%	13.0%	11.7%	15.4%
Sec-25			28.1%	38.0%	35.0%	40.4%	11.7%	32.3%
Others	15.6%	16.4%	5.6%	10.2%	9.6%	11.8%	10.1%	11.9%
Overall	19.9%	50.7%	15.6%	18.5%	15.9%	20.7%	11.1%	16.8%
Top 10	22.4%		10.8%	12.3%	13.1%	11.6%	11.8%	10.8%

Note:

WA: Weighted average represents the future trend that could be achieved

TA: Typical average represents the current performance

The typical Indian MFI – as measured by the simple average across MFIs – had an OER of 16.8% decreased from 50.7% in 2003. There was a dip in OER in 2007 which is mainly attributable to a large amount of write offs (of unrecoverable portfolio) by the bigger MFIs caused by the political fallout in some districts of Andhra

Pradesh (considered the hub of Indian microfinance). The improvement in 2005 was attributable to the progress made by Grameen MFIs as they had a high OER of 25.2% in 2003, which reduced to 16.7% in 2007. The weighted average operating efficiency of Grameen MFIs has further improved to 12.4% in 2008 and this performance is attributed to the improvement in operating efficiency across the category. The overall improvement in operating efficiency is attributed to improved staff productivity and economies of scale the Indian MFIs have achieved over the years.

Better operating efficiency has also resulted in a reduction in cost per borrower (discussed in the previous section). It is directly related to the push for growth in outreach that has occurred over the past two years, resulting in growth rates in excess of 80% per annum in the number of borrowers served. The leading MFIs have competed to be seen in the less developed parts of the country. This trend to reach the under-served areas has resulted in increased outreach along with improved efficiency.

Amongst the MFI models, individual banking MFIs are the most efficient on average in terms of operating expenses. This is primarily because of the bigger loan size being offered to the single client as compared to the small loan amount being given to the group members in a typical Grameen methodology. However, the cost of serving a client in the individual banking model is higher in comparison with the typical Grameen model. The low weighted average for SHG MFIs results from the apparently more efficient ones externalising their promotional costs. Thus their self help group promotion costs are incurred by other organisations – the government or NGOs – while only the portfolio servicing costs are accounted for by the MFI. This anomaly of the Indian microfinance system is common to both the MFI sub-sector and the bank-SHG linkage programme and is yet to be resolved.

Across the various institutional categories, NGOs (13.1% in 2008) are the most efficient on average in terms of operating expenses, as they mostly follow the SHG model. The NBFCs, which typically follow the Grameen methodology has maintained its average OER at 15.4% and is expected to improve further because of the greater outreach they have achieved over the years. The Sec-25 companies which also follow Grameen methodology are not able to expand as fast as the NBFCs and therefore have not benefitted from economies of scale.

It is apparent that even the 11.1% operating expense ratio for the Top10 is within the “best practice” range for microfinance where transaction costs relative to loan sizes are well known to be substantially higher than the 3.0-4.0% (of advances) reported as operating expenses by the commercial banking sector in the country. These far lower average expense ratios typical of the formal banks mean they are able to limit their interest rates on loans well below those of microfinance. The lower interest rates of the banking sector convey the impression that it ought to be cheaper for MFIs to service their loans as well. However, the average size of a commercial bank loan is several multiples (10-20 times) the Rs5-6,000 (US\$70-80) loan balance typically serviced by Indian MFIs.

6.2 Portfolio quality

While efficiency is important, it would be counter-productive if MFIs reduced the follow up of clients in order to save cost since this would result in a decline in portfolio quality and a consequent increase in loan losses. Database analysis indicates that the Grameen organisations in India have been the best performers with Portfolio at Risk (PAR₆₀) in the previous years, except in 2007 when PAR₆₀ rose to 8.4% owing to the political problems that occurred in South India, as mentioned earlier. The portfolio quality based on analysis

of PAR₃₀ of the sample MFIs in 2008 stands at 2.1%. This shows a significant improvement from 2007. This better performance of Grameen organisations is attributed to the small 5-member group structure and to better group discipline maintained through deployment of significant resources by the MFI and strong delinquency management efforts. Hence, this good portfolio quality was often maintained at high cost (typical OER 19.4%). Looking at the sample information (**Exhibit 6.5**) across various institutional types, NBFCs and Sec-25 companies are among the best performers (PAR₃₀ of 3.2% and 2.1% respectively) as most of them follow the typical Grameen methodology with enforcement of greater credit discipline among the clients by the field staff.

Though overall SHG MFI performance on portfolio quality remains relatively weak, they have improved considerably over the past few years as reflected from PAR₆₀ of 20.3% in 2003, to PAR₃₀ of 2.2% in 2008. The Top 10 average PAR₃₀ is just 2.6% and has improved significantly from PAR₆₀ of 12.2% during 2003. This performance is attributed to better delinquency management and adherence to the credit policy by the field staff of the Indian MFIs. Indian PAR ratios are better than those reported globally. PAR₃₀ of IB MFIs is higher at 8.7% in 2008 mainly due to the payments process followed by them. In one of the large IB MFIs cheque system of payments was followed and there were many cases of bounced cheques which led to a comparatively higher PAR₃₀.

Exhibit 6.5

Portfolio at risk (>60 days), by microfinance model and institutional type

...by model				
Models	2003	2005	2007	2008
G	1.2%	0.9%	8.4%	2.1%
IB	23.6%	7.8%	6.0%	8.7%
SHG	20.3%	9.8%	1.3%	2.2%
...by legal form				
Legal form				
NGO	14.0%	9.8%	2.7%	1.1%
NBFC		2.3%	7.1%	3.2%
Sec-25		6.1%	2.6%	2.0%
Others	11.0%	10.9%	13.6%	8.3%
Sample	12.2%	4.7%	6.4%	2.9%
Top 10	4.1%	1.4%	4.6%	2.6%

Note: For 2008 the PAR is presented by PAR>30 days

6.3 Sources of funds for MFIs

Debt has become the dominant source of finance for Indian MFIs. The share of debt in MFI finances although reduced from 75.3% in 2007, is still very high at 71.9% in 2008. Like-wise the share of client savings and grants has also reduced over the years. The regulation is highly restrictive in the matter of raising MFIs providing deposit services and using these to access client savings. Also due to increased awareness of microfinance institutions as profit making entities, the reliance on grant funding has been reducing. However, with improved profitability and financial sustainability, retained surplus is becoming an increasingly important source of funds now contributing 7.9% of total funds compared to its negative 4.2% contribution in 2003. However, with the current financial crisis and increasing financial cost ratio, it would be interesting to see if MFIs are able to sustain the increase in retained surplus in the coming years. Exhibit 6.6 shows the change in the sources of funds over the years.

The Top10 in 2003 to 2005 accounted for 56% of the total financing of the sample. This has now increased to as much as 65%. Similar to the India sample, the share of institutional debt in the Top10 has also reduced markedly from 80.2% to 74.7% of the funding. Just 5.3% of top10 funds are accounted for by equity while, client savings have reduced further from 4.6% to 2.6% of the total.

In practice, concern about the legality of deposit services offered by MFIs (and pressure from the banking services regulator, the Reserve Bank of India) has led to the service being segregated from lending activities. This is clearly from the fact that client savings as percentage of portfolio are just 2.9% for NBFCs as against 7.9% and 33.8% for NGO & other commercial MFIs. Deposit services are now confined to community-based institutions/associations such as SHGs and mutual benefit trusts while MFIs continue to offer credit and other services.

6.4 Uses of funds by MFIs

The allocation of funds by Indian MFIs has been highly productive in recent years. Of the total resources deployed in microfinance by the sample MFIs, over 77% was deployed in loans to clients (Exhibit 6.7). The deployment of resource in assets has also improved over the years from around 65% in 2003, 73% in 2005, and 74% in 2007 to the present level. The Indian Top10 also recorded a good performance with asset deployment in portfolio being 76.5% s. However, the cash assets of both total sample and Top10 MFIs at around 12.5% & 15.6% underscores the fact that asset utilisation still has scope for improvement. Ideally, cash deployment should be around 8%-10%.

Exhibit 6.6
Change in the sources of funds for microfinance operations

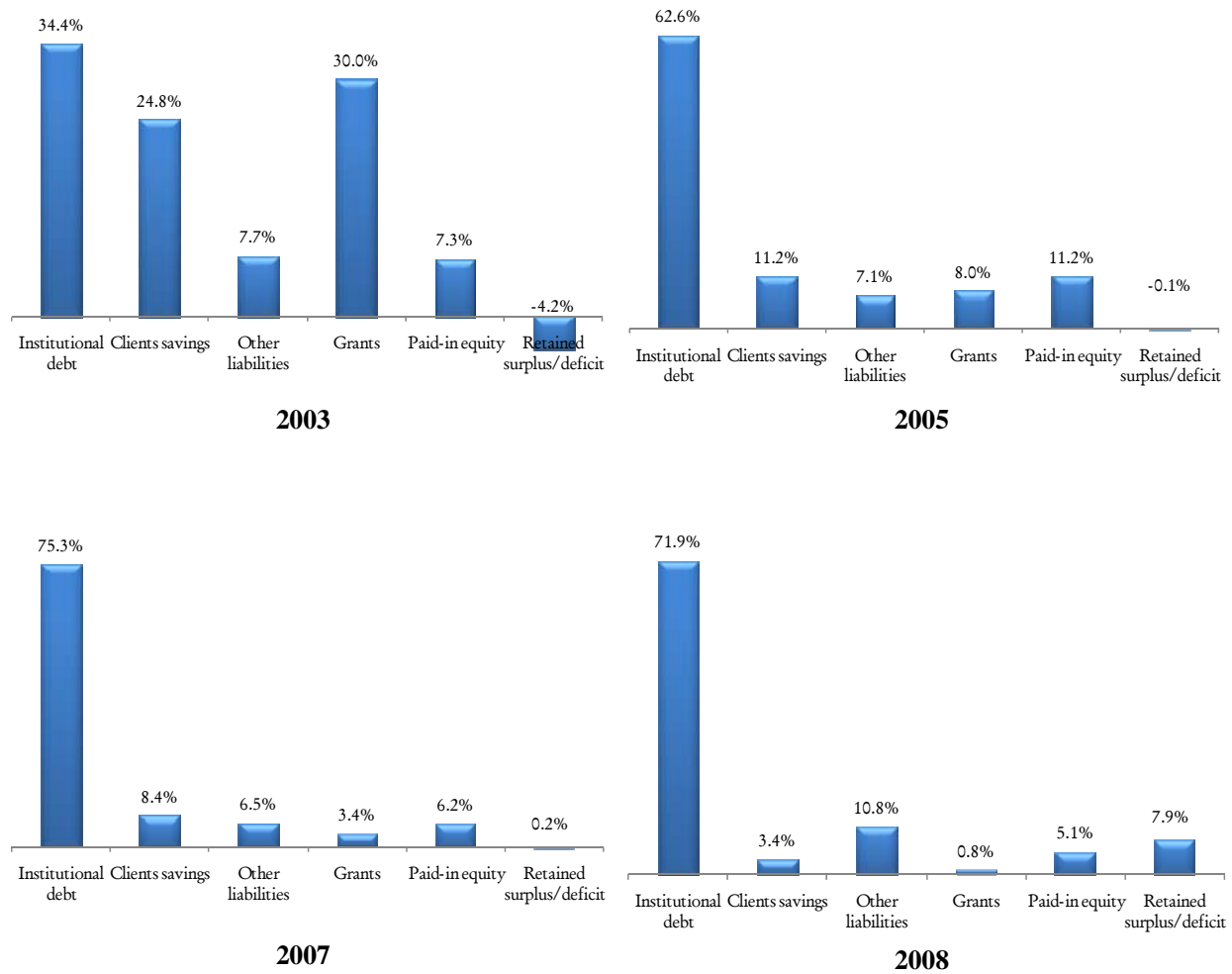
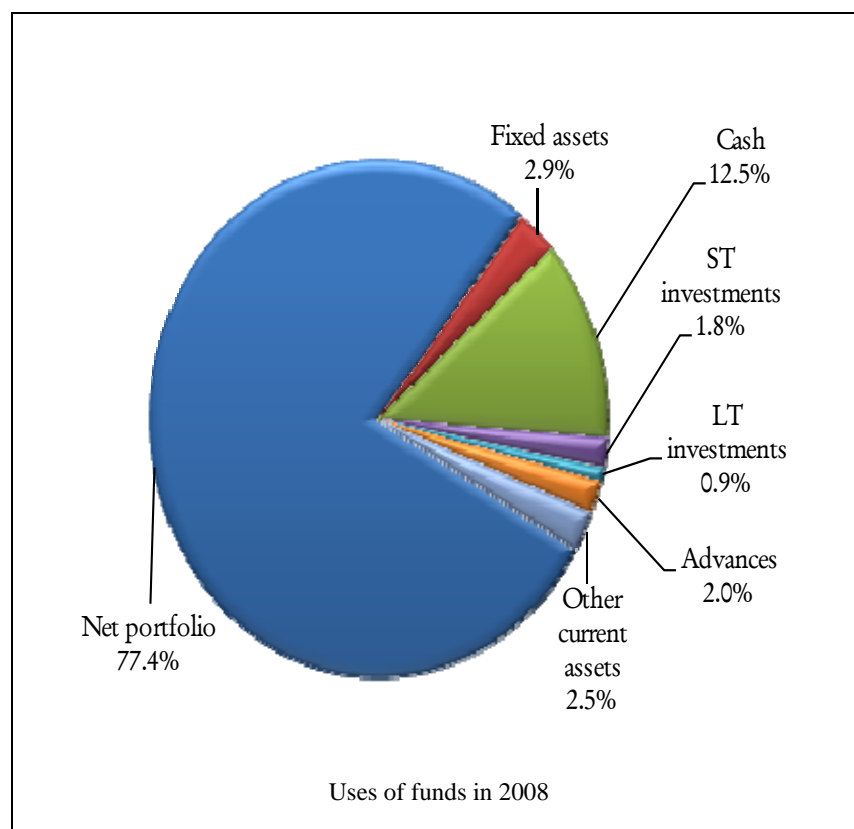


Exhibit 6.7
Utilisation of funds for microfinance operations

Uses	2003	2005	2007	2008
Net portfolio	65.3%	73.6%	74.6%	77.4%
Fixed assets	5.9%	6.3%	3.4%	2.9%
Cash	6.8%	6.1%	9.9%	12.5%
ST investments	10.8%	5.2%	5.2%	1.8%
LT investments	6.6%	5.3%	1.5%	0.9%
Advances	2.8%	1.7%	2.1%	2.0%
Other current assets	1.8%	1.8%	3.2%	2.5%



The efficient, effective and prudential management of these assets is dependent on a number of factors including

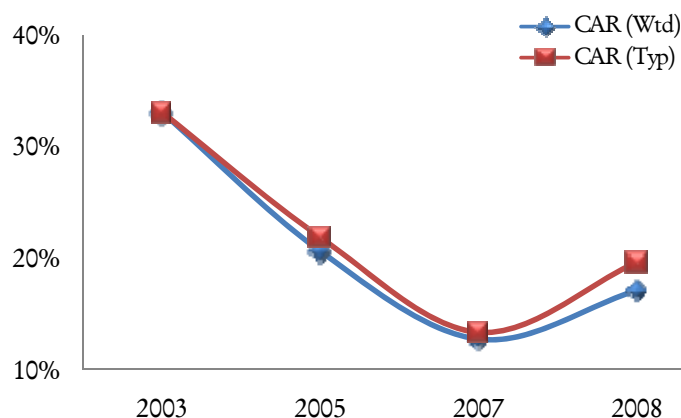
- minimisation of the need for fixed assets relative to total assets
- maximisation of investment of financial resources either in the loan portfolio or, at least, in high return, long term investments, and
- asset-liability matching in order to limit the risk associated with the MFIs' financial assets to levels consistent with the organisation's own funds or net worth.

Capital adequacy

For ensuring prudential management, banks in India are expected to maintain Capital Adequacy Ratios (CAR - net worth as a proportion of risk weighted assets) of 9% and NBFCs of 15%. The relative lack of financial management experience of MFI managers, however, means that, for microfinance, a minimum 15-18% ratio is generally regarded as more appropriate. Exhibit 6.8 shows the decline in capital adequacy ratio of Indian MFIs as the capital structure shifted from a grant funded to a debt funded one. By 2007 average capital adequacy ratios of Indian MFIs had declined to 12-13% - marginal in terms of the prudential requirements for such institutions. However, since then, the inflow of significant amounts of equity from private equity investors into the largest institutions and also into some medium-sized start-ups has led to an improvement in this ratio to the more appropriate level of 17-18%.

Exhibit 6.8

Capital adequacy ratios of Indian MFIs by model



Before the private equity funds, a number of microfinance focused social investment funds – Bellwether, Lok Capital, Unitus and others – had already made some investments in the Indian microfinance sector. Even the International Finance Corporation (IFC) has taken an interest. As a result, the equity constraint had already eased somewhat – particularly for start-up MFIs established by professionals. However, the institutional framework – and the minimum capital requirements for transformation of NGOs into NBFCs – continues to be a problem and this, naturally, limits the extent to which MFIs can raise equity as only those registered as companies can do so.²⁶ Overall, some 50% of the MFIs in the sample for 2008 had CARs less than the appropriate 15% level, which is an improvement from 2007 wherein 65% of MFIs had CAR below 15%.

6.5 Returns to MFIs

Interest rates

In India (like elsewhere), interest earned on portfolio has been the major source of income for the microfinance sector, regardless of the region, model or legal form adopted by the MFIs. The income earned by the MFI's major asset (that is loan outstanding) should be its main means of attaining viability. Interest rates offered by MFIs on loans varied from MFIs and there is no particular trend – some MFIs offer flat rates while others calculate interest on a declining balance basis. Many MFIs also take upfront charges like processing fee which adds to the overall income from portfolio. For the purpose of analysis, this report uses Annual Percentage Rate (APR)²⁷ to measure the changes in the expected interest income by MFIs. This is

²⁶ Even cooperatives are limited to raising share capital from their members alone.

²⁷ It represents the income the MFI should earn on the loan. It includes interest, fees, commissions and the calculation method on the loan principal stated in an annualised figure. It does not include forced savings and effects of compounding.

It is very difficult to calculate APR for the sector as a whole (region, model and legal form wise) as the MFIs have multiple products and various combinations of charges (flat/declining method, weekly/fortnightly/monthly repayments, varied tenures and upfront charges). APR has been estimated on the basis of information available on major product line of rated MFIs.

also a measure of the cost to the clients as the calculation includes not just the rate of interest but any other upfront fee charged on the loan amount. However, the effective rate of interest (EIR) for clients of MFIs that also collect loan linked refundable security deposits is a bit higher than the APR, indicating a higher cost to the clients.

Interest rate settings by MFIs for lending have always been based on covering the operational costs. Interest rates have seen a significant decline since 2005. The weighted average APR dropped from 30.1% in 2003 to 26.1% in 2007. In 2005, the interest rates have been higher mainly because of the higher operational costs as the sector had started to grow and there were inefficiencies in the MFI systems. As the MFIs gained experience and increased their scale of operations they were able to lower their operational costs. This is clear from a high weighted OER of 19.9% of sample MFIs in 2003 in comparison to 11.1% in 2008 as shown in Exhibit 6.4. The cost per borrower also came down from Rs548 in 2003 to Rs457 in 2008 (Exhibit 6.3). These factors have directly impacted the interest rates charged by the MFIs. The political pressure since 2006, after the MFIs came under attack from politicians and bureaucrats in traditional operational areas of Andhra Pradesh and Karnataka questioning recovery practices and interest rates, has also been a factor in the decline in the interest rates. The enforcement of Moneylenders Act in some states on a few institutions on interest rates related issues also has some impact in reduction of interest rates in some regions. Exhibit 6.9 shows the model wise change in APRs of Indian MFIs.

Across models, it is evident that Grameen and IB MFIs charge a higher interest rate in comparison to the SHGs. This is mainly to do with their legal forms – while most of the Grameen and IB organisations are for-profit, the SHG model has been adopted mainly by the not-for-profit entities. Also the operational costs (as reflected by cost per borrower and OER in Exhibits 6.3 and 6.4) of SHG model has traditionally been lower in comparison thereby allowing lower interest rates. It is expected that as the MFIs grow further & gain more experience, with better economies of scale and improved operational efficiencies the interest rates would further come down in the years to come.

Exhibit 6.9
APR of Indian MFIs

Models	2003		2005		2007	
	WA	TA	WA	TA	WA	TA
G	38.8%		33.3%	32.7%	27.6%	33.8%
IB	27.7%		27.1%	24.6%	32.3%	25.5%
Mixed	28.4%		24.5%	24.8%		
SHG	17.4%		20.4%	20.0%	16.9%	20.4%
Overall	30.1%		29.3%	24.0%	26.1%	26.5%
Top 10	36.8%		27.8%	28.2%	27.8%	31.2%

Note APR for 2008 could not be calculated due to insufficient information

Return on assets

The weak financial viability of sample Indian MFIs, apparent in the 2007, seems to have improved. This becomes clear in considering the returns they earn net of all costs – operating and financial. **Exhibit 6.10** provides a good indication of the situation. The overall sample MFIs including the generally efficient Grameen MFIs have registered losses this year as well but are in a better position than in 2007. The individual banking models registered a simple average RoA of 3.7%. This is primarily on account of low operating cost and large loan size being offered to individual clients as compared to the typical Grameen model where the loan amount is relatively small and the field staff have to spend time forming and organizing weekly/monthly group meetings, which involves some cost. The Top 10 in the sample has an average RoA of 2.2% improved from -0.7% in 2007.

Exhibit 6.10
Return on total assets of MFIs

...by model								
Models	2003		2005		2007		2008	
	WA	TA	WA	TA	WA	TA	WA	TA
G	0.7%	-16.2%	3.0%	0.8%	-3.7%	-3.9%	3.3%	-2.8%
IB	2.9%	-2.5%	3.5%	-0.6%	3.5%	-3.6%	4.4%	3.7%
Mixed	-0.9%	-12.1%	0.3%	-3.0%				
SHG	-2.5%	-27.6%	-0.6%	-9.4%	0.0%	-16.8%	0.3%	-2.4%
Overall	1.5%	-13.6%	2.1%	5.2%	0.0%	-9.8%	3.0%	-2.1%
Top 10	2.1%	2.3%	4.8%	3.0%	0.0%	-0.7%	2.6%	2.2%

As the analysis for typical MFIs indicates, a large number of MFIs in 2008 have become profitable. Out of the sample, almost 72% of the organizations have an average RoA in the range of 0% to <3%. This is a much improved performance when compared to 2007, where almost 62% of the sample organizations had a negative RoA. This shows that over the past two years most of these organizations have grown and gained experience and have learned better management of operating and other expenses and at the same time keeping control of portfolio quality.

The profitability performance of Indian MFIs needs to be seen in the context of their much lower (24.6%) yield relative to the global benchmark (30.2%). Indeed, to the extent that the international yield is 1.23 times that of Indian MFIs it is laudable that the weighted average RoA of Indian MFIs is a healthy 3.0%. The relative efficiency (low OER) of Indian MFIs plays the key role in this.

6.6 Sustainability of MFI operations

Operational Self Sufficiency (OSS) measures the ability of an MFI to meet all its operational and financial costs out of its income from operations. Financial Self Sufficiency (FSS) measures the extent to which its income from operations covers operating costs after adjusting for all forms of subsidy, loan loss provisioning and the impact of inflation. The FSS is an approximate indicator of the impact of subsidies on an organisation's sustainability.

Indian MFIs have become increasingly sustainable over the years. From Exhibit 6.11, it is evident that the weighted average OSS and FSS of the Indian MFIs have increased significantly to 122.4% and 115.4% respectively as compared to 92% and 87% respectively during 2007. The OSS and FSS for the typical MFIs have also improved in the last two years, owing to better management of operating and other expenses by the large and relatively young organizations. Over the last two years, the Indian microfinance industry has gained experience and has become more commercially oriented. The presence of a large number of professionals joining the sector has also made a difference. In the recent past, many start-ups have been established by professionals rather than by development practitioners.

It also shows that the SHGs organizations as a group are operationally not self-sufficient. However, their performance on sustainability parameters has improved significantly from 67% in 2007 to 90% in 2008. This improved performance has been observed across the microfinance model. Though the weighted average OSS does represent the trend that the sustainability ratios are taking, the *typical* MFI figures are representative of the current status of most of the MFIs in the sample.

Exhibit 6.11
Sustainability performance of MFIs

...by model								
Models	2003		2005		2007		2008	
	OSS	FSS	OSS	FSS	OSS	FSS	OSS	FSS
G	102.7%	90.5%	112.0%	109%	87.0%	83.0%	123.4%	116.2%
IB	129.3%	110.5%	121.0%	115%	112.0%	106.0%	129.4%	123.8%
Mixed	95.6%	80.6%	102.0%	85%				
SHG	63.8%	54.5%	79.0%	69%	86.0%	82.0%	105.5%	98.5%
Overall	88.2%	76.8%	108.0%	102.0%	92.0%	87.0%	122.4%	115.4%
Top 10	109.2%	128.8%	119.0%	111%	89.0%	85.0%	121.5%	114.2%

With the decline in grant funding of Indian microfinance (discussed earlier), there are no longer substantial differences between the OSS and FSS of Indian MFIs. The FSS ratio for the SHG model continues to be low; the 98% average in 2008 indicating that without grants and subsidised funds, the organisations are effectively able to cover just all of their cost, this is a significant improvement over the 55% FSS recorded in the 2003. Following from the increase in profitability of the Top10 Indian MFIs, their sustainability ratios have also improved significantly.

Exhibit 6.12 presents the regional variation in the sustainability of MFIs. For all practical purposes, this exhibit provides a good picture of the relative performance of MFIs in India by region. Thus, a number of MFIs based in south India – some of the largest in the country – have achieved or are close to operational sustainability. Looking at the sample information below, the performance of the MFIs in the west and the east have improved considerably over the past two years as most of them have achieved operational sustainability. The FSS of the MFIs in the North have improved from 45% in 2003 to 78% in 2008 and the OSS has improved from 51% to 88%. This improvement is perceived primarily because two large commercial NBFCs that are highly profitable institutions that are in the process of downscaling into microfinance operations while the other MFIs perform poorly.

Exhibit 6.12
Sustainability performance by region

...by model								
Models	2003		2005		2007		2008	
	OSS	FSS	OSS	FSS	OSS	FSS	OSS	FSS
South	65.0%	49.0%	87.6%	70.1%	75.1%	66.9%	108.4%	102.0%
East & NE	54.0%	44.0%	74.2%	69.8%	82.2%	76.2%	121.8%	113.7%
West	47.0%	36.0%	93.3%	83.5%	91.3%	83.5%	111.1%	100.7%
North	51.0%	45.0%	70.0%	60.2%	51.6%	41.2%	88.6%	78.5%

The overall picture of sustainability is quite encouraging. It is still the case in 2008 that significant proportions of the ~9.2 million borrowers covered by the MFIs in the sample are served by viable (and at least near sustainable) institutions. **Exhibit 6.13** shows that nearly 98% of borrowers are served by 82% of MFIs with OSS in excess of 90%. It is apparent that the outreach of MFIs functioning efficiently is still quite substantial in relation to the sector as a whole. This is a positive outcome in that it has considerably enhanced the effective availability of micro-finance for low income families. The coverage of borrowers by inefficient (<80% OSS) MFIs accounted for less than 2% of borrowers in 2008 as compared to 30% during 2007.

Exhibit 6.13
Proportion of borrowers served by OSS class of MFIs

OSS Class	2003	2005	2007	2008
<80%	23.0%	18.0%	31.0%	1.7%
80 to <90%	7.0%	3.0%	19.2%	0.1%
90 to <100%	20.0%	4.0%	10.3%	0.5%
>=100%	50.0%	75.0%	39.5%	97.8%

A summary of operational and financial performance of the select rated MFIs which reflects the status of the MFI sector in India is presented in Annex 5.

6.7 Conclusions

Staff productivity in Indian MFIs has improved consistently over the years and has now reached a level that is considered to be amongst the best in major regions offering microfinance. The productivity measured in terms of portfolio handled per staff and borrowers per staff was Rs11.6 lakh (\$29,000) and 234 borrowers respectively. The NBFCs and Grameen model were the most efficient in comparison with other legal forms and models.

The operational efficiency of Indian MFIs, measured by OER, has improved over the years and across all types of MFIs. The weighted average OER in 2008 is 11.1% (lower than the 15.9% in 2007). This emphasises the high operating efficiency of the Indian MFI as compared to those internationally, owing to the economies of scale Indian MFIs have achieved over the years. Better operating efficiency has also resulted in a reduction in cost per borrower which was about Rs457 (\$11.5) in 2008.

Analysis also indicates that Indian MFIs have been able to maintain a good portfolio quality in 2008 after a major fall in 2007. Grameen organisations in India have been the best performers with PAR₃₀ of 2.1% while IB seems to have a riskier portfolio with PAR₃₀ at 8.7%. Across various institutional types, NBFCs and Sec-25 companies are among the best performers as most of them follow the typical Grameen methodology.

Debt has become the dominant source of finance for Indian MFIs. The share of debt in MFI finances was high at 71.9% in 2008. The share of client savings and grants has reduced over the years. One reason is the increased awareness of MFIs as profit making entities which should have low reliance on grants. Another reason is the regulatory restriction on most MFIs in the mobilisation of deposits.

The allocation of funds by Indian MFIs is very fairly productive. Of the total resources deployed in microfinance by the sample MFIs, nearly 77% was deployed in loans to clients in 2008. The allocation of funds to loans has seen an increasing trend over the years.

The financial viability of MFIs has also improved. Overall the MFIs registered a weighted average RoA of 3.0% reflecting good profitability from microfinance operations. The overall picture on sustainability is quite encouraging. Analysis of OSS and FSS indicates that the Indian MFIs have become more sustainable. This is mainly attributed to better management of operating and other expenses by the large and relatively young organizations.

Chapter 7: Regulation in microfinance

This chapter examines the coverage and scope of microfinance regulation in India. The salient features of the existing regulatory norms for various types of institutions engaged in microfinance are presented and the scope of the draft microfinance regulation bill (introduced in parliament in 2007) and how it would affect the growth of the Indian microfinance sector, if approved, is discussed. Initiatives on self-regulation are also covered.

7.1 Existing microcredit regulatory regime

In one way or another, almost every country in the world has seen the need to adapt its structure of financial services to improve outreach to the many as yet “unbanked” people and enterprises. This has been the genesis of thrift institutions, local savings associations and cooperatives across the world over the past century and more. The same need motivated the rise of formal microfinance institutions in developing countries since the Grameen Bank came into being in the 1970s. Microfinance across the world began variously as the activity of informal savings and credit groups, moneylenders, donors, and NGOs. In many developing countries, microfinance activity has grown to the point where financial regulators see the need to frame a policy, and eventually to integrate some portion of the microfinance spectrum into the framework of regulated financial services.

India is in some ways a peculiar case when it comes to microfinance regulation and supervision. It is not only its sheer size that makes it different from other countries; the involvement of formal public sector banks is also much stronger than anywhere else. Further, as discussed earlier in this report, in recent years, MFIs in India have increasingly transformed from NGOs to non-bank finance companies. This means that, by default rather than by design, a relatively (and increasingly) large share of the microfinance sector is under the purview of the central bank, the RBI.

7.1.1 Regulatory norms

Microfinance was taken up in India mainly as a development initiative rather than as a commercial activity during the early 1990s. The NGOs that took up such activities were registered either as societies, trusts or Section 25 (not-for-profit) companies. They continued in this legal form for sometime although there were some cooperatives and one cooperative bank was engaged specifically in microfinance. As the scale of operations began expanding in terms of microfinance activities and the desire to undertake microfinance on a for-profit basis grew, larger organizations felt the need to transform their legal status. As a result, increasing numbers of MFIs in India started to transform to for-profit NBFCs.

As discussed, in Chapter 2 (and Annex 1 & 2), the Indian microfinance sector has a variety of legal forms engaged in delivering microfinance services to the clients. Of these only NBFCs are regulated by the RBI and Section 25 companies are covered by RBI rules. As a result of central bank regulation, the microfinance NBFCs face a number of regulatory constraints and are limited to providing credit services to low income families, although their transformation has provided significant impetus to the scale-up of operations since

commercial banks are more willing to lend to NBFCs as corporate entities than they are to work with NGOs with their indeterminate liability structure. Other institutions like Societies, Trusts, Cooperatives continue to be regulated by their respective Registrars and Acts specifically formulated for them. However, when it comes to financial intermediation the RBI can supersede any norm under these Acts to protect the rights of clients. Exhibit 7.1 presents the existing regulatory norms for various legal forms of institutions undertaking microfinance.

7.1.2 Initiatives in the field of microfinance regulation

A number of recent initiatives have covered the regulation of microfinance which can be taken as a sign of a deeper interest in the sector by national level institutions. The need for a suitable policy framework for the development and promotion of the microfinance sector in India was starting to be felt in the late 1990s. Various critical issues such as ways to scale up microfinance in India, the division of roles between existing mainstream financial institutions, development banks and newly emerging microfinance institutions (MFIs) and the need for an appropriate policy and regulatory framework for their operations were engaging the attention of microfinance practitioners, the Government and the RBI. It was in order to address such issues that, in November 1998, a high-powered Task Force on Supportive Policy and Regulatory Framework for Microfinance was set up by NABARD at the instance of RBI. The Task Force consisted of senior officials from GoI, RBI, NABARD, banks and chief executives of prominent NGOs implementing various microfinance models in the country. The objectives of the Task Force were

- to come up with suggestions for a regulatory framework that brings the operations of the MFIs into the mainstream,
- to assess the possible role of self-regulatory organisations and to explore the need for a separate legal framework for microfinance.

The Task Force made a number of recommendations, one of which was a common definition²⁸ of microfinance. Partly as a result of the Task Force recommendations, GoI established a Rs500 crore Microfinance Development and Equity Fund (housed at NABARD) to support the growth of the sector and the RBI issued a circular to the commercial banks accepting lending by them to MFIs as fulfilling the norms for meeting their (40%) requirement for lending to the priority sector. This circular was instrumental in encouraging banks to be more liberal in their lending to MFIs.

Later in October 2001, at the behest of the Prime Minister's Office, seven working groups comprising government, NGOs and banking sector representatives were set up, one of them with the mandate of exploring the legal & regulatory challenges faced by the Indian microfinance sector. In December 2002, the reports of six of the seven working groups were finalised. The association of microfinance institutions (MFIs) Sa-Dhan – as one of the members of the group examining regulatory issues – prepared a report summarising the group's results (Sa-Dhan 2002a). This report suggested various ways to make the current legal framework more microfinance-friendly. Some of these needed immediate attention; some were for the longer term. In

²⁸ Microfinance is defined as: "Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards". Mahajan and Ramola, among others, have criticized this on the grounds that "very small amount" has only been defined for credit (and only unsatisfactorily); cf. Mahajan and Ramola, 2003.

addition, the document indicated a way forward for the debate with a strong emphasis on gathering information about the sector as a pre-condition for better regulation²⁹.

7.1.3 The microfinance bill

The government's approach to the draft reflects an attitude similar to that of most people towards street children; everyone agrees that they need nurturing but no one wants to do anything about it.³⁰ It would be unfair to say that the Indian microfinance sector is not governed by any authority or regulation. As indicated above, all entities providing financial services to the poor are directly or indirectly regulated. The SHG-linked bank groups are under the indirect supervision of RBI as the norms of SHG lending have been designed by RBI. Also the banks with whom these SHGs are linked are governed by prudential and other regulations that emanate from the Banking Regulation Act that gives the RBI this responsibility. Similarly, all 7,000+ NBFCs in the country are directly regulated by RBI. However, only about two dozen of these are engaged in microfinance and their special needs, in terms such as the provision of deposit services to (otherwise) financially excluded families that are not directly addressed.

Thus, there has been the lack of a holistic regulatory policy for microfinance. As in the case of microfinance NBFCs, RBI has followed generic norms for regulating institutions involved in financial intermediation refusing, so far, to recognise microfinance as a separate sub-sector. The MFI network, Sa-Dhan, advocated for a microfinance bill with the backing of several of its members which are large MFIs and microfinance support institutions having eminent personalities. Considering that microfinance is practised differently from the conventional banking system, in 2005 the finance minister accepted the need for a Microfinance Act for India. The bill was introduced in parliament as the Micro Financial Sector (Development and Regulation) Bill, 2007 on 20 March 2007. Though the original draft of the bill was submitted by Sa-Dhan, in the course of consideration by the government the draft underwent considerable modification.

The draft Microfinance Bill would empower NABARD to regulate the microfinance sector in India. NABARD may grant approval to microfinance organizations to collect thrift (deposits) if it has been in existence for at least 3 years, has net own funds of at least Rs5 lakhs and if NABARD is satisfied about the 'general character' of the management of microfinance institutions. Every MFI granted approval to offer thrift services would be required to create a reserve fund out of transfers to the fund of not less than 15% of its net profit or surplus every year, and would need to prepare financial statements by the end of the year, in such form as may be specified, to be audited by an approved auditor³¹. Most crucially, however, the bill proposes to cover the regulation of NGOs and cooperatives offering microfinance services; it does not cover the operations of microfinance NBFCs. This matter is discussed further below.

The regulatory stance of protecting savers from systemic and institutional risk has been taken as an overarching consideration under the bill. A large number of small deposit taking institutions are difficult to regulate so the bill attempts to ensure that they will have strong systems, adhere to prudential practices and bring in a reasonable minimum of quasi-equity capital. Apart from providing these prudential norms, the bill requires the regulators to achieve much broader non-prudential objectives. This would be done by promoting "orderly growth of microfinance sector so as to ensure greater transparency, effective management, good

²⁹ GTZ, 2004. "Emerging Scenarios for Microfinance Regulations in India"

³⁰ Sinha, S., M-CRIL, 2006. "Microfinance Regulation for Financial Inclusion: The *street child* needs nurturing"

³¹ Ghatge, P, 2007.

governance³²” The bill states some of the measure which would ensure effective implementation of these features including

- Setting benchmarks and performance standards
- Facilitating the development of credit rating norms
- Specifying accounting and auditing standards
- Facilitating institutional development through training and capacity building
- Supporting sector related studies
- Documenting and disseminating information relating to fair practices
- Laying out a code of conduct
- Promoting consumer education

Another objective of the bill is consumer protection where the powers would be given to Micro Finance Ombudsmen to redress grievances. The bill propagates the creation of a national database in the public domain and dissemination through national dissemination network. This would be done with MFOs submitting their accounts and duly audited returns at the end of each year. This will apply to all organizations providing microfinance services, thereby falling under the purview of the bill.

The bill provides for the setting-up a Micro Finance Development Council to advise the regulators on – policy formulation, schemes and other measures required for the establishment of orderly growth and development of the sector. The council would consist of a sector expert as the Chairman, 7 official members and 6 non-official experts who would have experience in banking and microfinance.

The other objective is the continuation of the Micro Finance Development and Equity Fund which will receive grants and (now also) donor funds to on-lend to MFOs in the form of equity and quasi-equity. The Fund would also facilitate grants in capacity building and pay for other functions of the regulators. Finally, in order to legitimize the operations of MFOs, the bill would enhance the legal status of NGO-MFIs and would in effect protect them from arbitrary state government action. The bill, however, would not protect the MFOs from action under the state-level Usurious Moneylending Acts.

7.3 Probable impact of the microfinance bill

7.3.1 Severe limitation on deposit services for microfinance clients

As discussed in the earlier chapters, in the Indian microfinance sector, NBFCs and Section 25 companies dominate among all the other legal forms of institution. Also, in recent years, many NGO-MFIs have transformed their legal status into NBFCs to attract higher investment and to diversify their portfolio. NBFCs and Section 25 companies consist of over 75% of the sector in terms of portfolio and 70% in terms of total number of borrowers³³. The microfinance bill specifically excludes such microfinance NBFCs from coverage on the grounds that these are already regulated by the RBI. Thus, the provisions of the bill that would enable institutions covered by it to offer thrift (deposit) facilities to their borrowers based on certain strict prudential norms, do not apply to microfinance NBFCs.

³² Ghate. P, 2007.

³³ M-CRIL, 2007.

The RBI does not recognise microfinance NBFCs as a separate category as it does leasing, investment and also are hire-purchase companies. As a result, it is not in a position to make any special provisions for microfinance NBFCs – such as, for instance, allowing them to collect deposits from low income clients up to a reasonable proportion (say, 65%) of the funds lent by them to such clients (so that there is net lending by the MFI and it does not have surplus depositor funds to manage). This means, essentially that if the present draft of the microfinance bill were to be passed by Parliament it would not encompass over 70% of the present MFI clients and would essentially exclude them from benefiting from deposit services.

Yet, there is a huge demand for deposit services amongst low income families in India both in rural areas as well as in urban slums breaking the notion that such families are too poor to save and that credit is the only financial service appropriate for them. The SHG-Bank linkage programme is an example of how women make consistent regular savings and in urban slums the poor have actually been found to be willing to pay for the door-step collection of savings. Indeed, it is interesting to note that SEWA Bank – a cooperative bank in Ahmedabad that is specifically focused on serving women in urban slums – has deposits equivalent to three times its loan portfolio.

7.3.2 Including cooperatives

Cooperatives (not registered as banks) are included in the bill and are defined to include all cooperatives except those engaged in agriculture operations³⁴. India has had a large thrift cooperative movement which at one time was one of the strongest in the world. Mutual organizations in the form of cooperatives are anyway allowed to accept savings from their members. The term thrift has been used extensively by cooperatives for several decades and has been further popularized by the Cooperative Development Foundation (CDF), an advocacy NGO in Andhra Pradesh (AP). CDF was instrumental in taking forward the reform of the cooperative movement and lobbied with the AP government to enact the progressive Mutually Aided Cooperative Societies Act (APMACS Act) in 1995. Similar provisions were made in 6 other states and a central multi-state act was formed to provide for a new type of “mutual benefit” cooperative which would be much closer to cooperative principles than traditional cooperatives in South Asia that are subject to significant degrees of government control.

It is now nearly two years since the bill has been in the public domain and there has been no consensus in terms of what needs regulating, who should regulate and how it should be done. Although the Standing Committee on Finance of the previous Parliament was not able to reach a conclusion, there were indications that the capping of interest rates was being discussed at the behest of the Communist parties, something which would do more harm than good to the microfinance sector. Now that there is a new Parliament in place in India, the bill is likely to be considered afresh presenting Sa-Dhan and other stakeholders with a new opportunity to try to rectify some of the flaws in the current draft.

³⁴ Ghate. P, 2007.

7.4 Self regulation: Sa-Dhan's core values and code of conduct³⁵

Sa-Dhan propagates self regulation to its MFI members. It has formulated a code of conduct that lays down core values and fair practices for microfinance institutions to provide services in a manner that benefit and respect clients. The core values include

Integrity: To serve low income clients and their families in providing short term and long term access to financial services that are client focused, designed to enhance their well-being and delivered in a manner that is ethical, dignified, transparent, equitable and cost effective.

Quality of services: Clients deserve fair and efficient microfinance services and shall be provided in a convenient, participatory and timely manner

Transparency: Provide clients with complete and accurate information and educate them about the financial services offered

Fair practices: Not to provide unethical and deceptive services to clients and provide microfinance services including lending and collection of dues, committed to fair practices, which balance respect for client's dignity and an understanding of a client's vulnerable situation, with reasonable pursuit of recovery of loans.

Privacy of client information: To safeguard client information and not disclose details for information exchange

Integrating social values into operations: Provide high standards of governance, participation, management and reporting while working for low income clients

Feedback mechanism: Provide clients channels for formal and informal feedback to improve services

MFIs are expected to sign up to these core values through a compliance agreement. Sa-Dhan has a compliance mechanism whereby MFIs are required to adhere to the values or face a variety of penalties. The Code of Conduct has served the purpose enabling MFIs to understand the values their charters require them to adhere to but Sa-Dhan's compliance mechanism is still in the process of being activated. As a mechanism of self-regulation the code is yet to acquire any real momentum.

³⁵ Sa-Dhan. "Core values and voluntary mutual code of conduct for microfinance institutions"

7.5 Conclusions

The fast growth of the Indian microfinance sector has largely taken place in spite of regulatory constraints rather than because of facilitation by regulators. The only facilitative measure of regulators in recent years has been the RBI circular recognising loans by commercial banks to MFIs as “priority sector” lending. Facilitated by the advent of the rating of MFIs by institutions such as M-CRIL, this has opened the gates for the flow of funds from the banking sector to MFIs. On the other hand, this measure has also accelerated the transformation of MFIs to NBFCs specialising in microfinance. The RBI’s strict ban on the provision of deposit services by NBFCs without investment grade ratings means that a large proportion of MFI clients (unserved also by the banking system) have no access to deposit services.

The provisions of the draft microfinance bill for enabling deposit services by NGO MFIs to their clients would, if enacted, limit the service to a small proportion of microfinance clients. Further, it would mean that smaller, less well managed institutions have legal permission to accept the savings of low income clients while larger NBFCs – with better prudential management capacity – are not allowed to accept deposits. The experience with deposit mobilisation by microfinance oriented institutions like SEWA Bank (and the more recent experience of Grameen Bank’s savings services in Bangladesh) shows that the entire design of the bill follows an inverted logic which limits financial inclusion in India to the detriment of low income families.

Chapter 8: Challenges Facing the Microfinance Sector

There have been significant advances in recent years and the concept and practice of microfinance has now developed deep roots in many parts of the country. Impact assessment being rather limited so far, it is hard to measure and quantify the effect that this experience has had on the poverty situation in India. Without doubt, a lot needs to be accomplished in terms of outreach to make a serious dent on poverty. However, the logic and rationale for group-based microfinance has been established firmly enough to assert that microcredit has graduated from an “experiment” to a widely-accepted paradigm of development finance in India.

Scaling up of programmes to provide access to increasing numbers, especially the poor, and to this effectively and responsibly is no mean task. The most convincing feature of microfinance that justifies its relatively higher costs (than banking³⁶), is the near-perfect repayment rates. The expansionary zeal of microcredit practitioners should be balanced with the quality of loans – a momentous challenge. The emerging challenges for microfinance are as follows:

- Requirement of deposit services to facilitate saving by clients
- Deepening outreach
- Social reporting
- Financing microfinance – sector slowdown due to global crisis
- Capacity building – ever growing need
- Need for micro-credit plus initiatives
- Competition
- Regulations

This chapter discusses the above issues

8.1 Deposit services (MFI sector)

Deposit services constitute the neglected daughter of the family of financial services because of the sustained discrimination against and frequent disregard for the need for such services, despite their productive and reproductive role in financial services. This is evident from different nomenclature used at both the international (UN International Year of Microcredit, MicroCredit summit) and national levels in India (Priority Sector Lending; Annual Credit Policy; Credit/deposit ratio).

Savings services can be a useful entry point for the unbanked to build up a history with the formal financial institutions before customers are entitled to other financial services. With the greater spotlight on knowing the customer and the fact that poor households do not have a salary slip, utility bills, clear land titles or unique identity papers, a regular savings record could be the first building block to membership of the formal financial sector. What is more, with savings services, poor customers need to trust the financial institution and not the other way round.

³⁶ Though the transaction costs of banking add substantially to the stated interest rates in the formal sector.

The Indian microfinance sector is tilted towards credit and other aspects of financial services provisions and does not take into consideration savings and insurance. Although there are institutions that are innovating and experimenting with insurance products through MFIs as a delivery channel, deposit services remain a distant dream for practitioners. The SHG-Bank linkage programme has made some progress in providing poor clients an opportunity to save and, as women form the majority of the client base, the initiative supports their empowerment. As discussed above, savings is an integral part of the range of financial services. Data from the SHG-Bank linkage programme shows an increase in the overall savings amount deposited by clients but the overall amount is too low to be able to meet any emergency. Clients mostly save in order to meet predictable events mostly in the form of life cycle needs. Technically, savers have the right to withdraw their savings under the SHG-Bank linkage programme. However, bankers mostly lend to SHGs at a multiple of the savings that the latter deposit with the bank.

The provision for NBFCs to mobilize savings will lower the cost of funds and also improve their ability to service clients in a much better and comprehensive manner. Their present investments in networks and systems are restricted to one line of financial intermediation and that is the provision of credit. With small additional investments they would be able to offer savings services. If this provision is given to the NBFCs they would be able optimally to utilize their resources for providing more complete financial services to vulnerable sections of society.

8.2 Deepening outreach

A general understanding is that all microfinance programmes are for the poor and members attached with the programme are primarily in the “low income” category. Direct poverty assessment (shown in Chapter 5) reveals that, whilst the SBLP and MFIs (probably to a lesser extent) do include clients below the poverty line at entry, they in practice cater to a wider market including the non-poor. This has implications both for product design (what is appropriate for different income levels) and for keeping track of mission – to reach the poor and excluded.

Poverty penetration of microfinance (MFIs as well as the SBLP) is at relatively low levels. This is indicative of the challenges in reaching below poverty line (BPL) populations – such challenges are related to their location in areas with limited infrastructure, the small size of their needs which increases the unit cost of operations and the challenge of financial literacy that also affects the cost to be incurred by the service provider.

8.3 Social reporting

Microfinance is a ‘double-bottom’ line sector with financial and social goals. Financial sustainability is essential for further growth, and has been the focus of attention – management and reporting – with the development of well defined indicators and ratios. Social reporting has been a gap – apart from the rather mixed findings emerging from attempts to assess impact. New initiatives around social performance have served to define the dimensions in practical ways as a basis for reporting and as part of internal management

in microfinance.³⁷ The dimensions include aspects of process (clarity of mission and social values of responsibility, social goals and objectives, alignment of governance, human resources and management information systems to track achievement and monitor compliance) and results (including client profile at entry, client satisfaction, client awareness of product terms, client dropout, and tracking change over time).³⁸

In response to a growing demand for accountability on social performance, MFIs and other stakeholders are increasingly examining processes and tools, including social indicators that measure the degree to which MFIs are effectively putting their social missions into practice. Social performance management and reporting by MFIs inform them about their client targeting, depth of outreach and other social aspects so that their operations are well aligned to their mission and objectives. This is a relatively new management area for the MFIs and it is a challenge for them to emphasize and pursue this while maintaining adequate focus on profitability and sustainability of operations. As social reporting is a new concept, stakeholders are just beginning to develop the skills and resources necessary to mainstream it.

8.4 Sector slowdown due to the global economic crisis

The global economic downturn has had its effect on the Indian microfinance institutions as well. This is particularly true for smaller MFIs that have experienced a slowdown in obtaining credit from commercial banks. Smaller MFIs, who anyway had limited access to sources of funding, are finding it difficult to mobilize funding from banks. Faced with the banks' reduced willingness to lend on account of the global crisis, some MFIs have struggled to maintain liquidity and continue client loan cycles without interruption. Also larger for-profit MFIs are experiencing a credit crunch as they are unable to raise debt in the short term from local commercial banks to fuel their growth ambitions. Some MFIs are also suffering since they are unable to raise the equity required to raise debt in the context of lower debt-equity norms employed by banks.

Microfinance Insights, a bi-monthly magazine, conducted a survey early this year and identified 8 risks in Indian microfinance – Exhibit 8.2 – which various stakeholders perceive due to the financial meltdown in the microfinance sector. MFIs highlighted external issues such as liquidity and the high cost of debt as their most significant risks, investors and commercial lenders are concerned with internal risks such as management and inadequacy of internal controls. Across stakeholder groups, liquidity emerged as the most frequently listed risk.³⁹

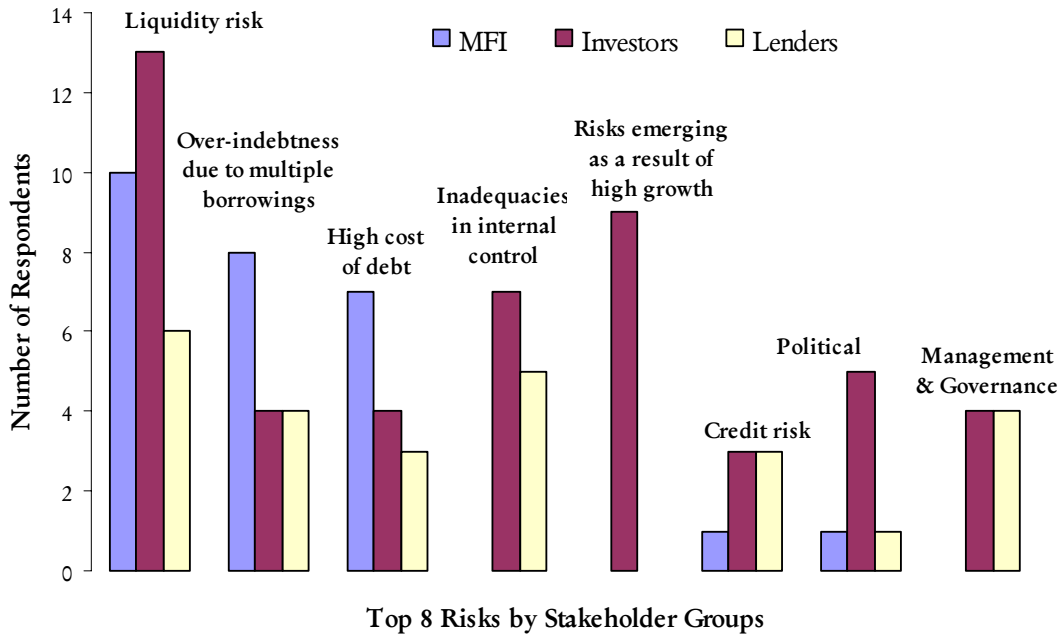
The liquidity risk has the ability to hamper the refinancing of existing clients, leading to a rise in the current default rate. So if future credit is at stake it will affect the current repayment of loans.

³⁷ See for example www.microfinancegateway.org Social Performance as a Hot Topic

³⁸ Sinha, Frances, 2006. "Social Rating and Social Performance Reporting in Microfinance: Towards a Common Framework". The SEEP Network

³⁹ Microfinance Insights, https://www.microfinanceinsights.com/articles_new.asp?member=nonmembers&id=400

Exhibit 8.2
Top 8 risks by stakeholder groups*



*Source: Exploring the Contours of Risk in Indian Microfinance; Prameshwar, Devyani; Sabharwal, Karan; Aggarwal, Neha; Microfinance Insights; Vol 11, March/April 2009

8.5 Capacity building

Capacity building and improving understanding of techniques for improving microfinance management is the key to effective microfinance operations and eventually for achieving the prime objective of financial inclusion. In the recent past capacity building and investment in human resources in India have increased but the quality and quantity of such services do not necessarily match the current requirements of the sector.

The effective bridging of capacity building gaps requires regular intervention in a number of areas like keeping pace with the fast growth of the sector, geographical spread and diversity and local language constraints. Capacity building service providers must also cope with issues like relevance of content, the subsidy orientation of some service providers and the high attrition rate of MFI staff. In spite of high personnel allocation ratios MFIs continue to limit their investments in their own staff capacity. Some of the current capacity building gaps are in the areas of governance, human resource management, risk management and social performance management.

There is also the lack of specialized low cost agencies for providing customized capacity building to the field staff of MFIs. Field staff requirements have grown manifold due to the growth of the sector in recent years. The MFIs have, so far, relied on in-house and on-the-job training methods for this purpose but in the long run this may not be cost effective.

8.6 Micro-credit plus

One of the biggest challenges in development is the simultaneous development of investment potential and improvement of skill levels of the borrowers. As microcredit alleviates the credit availability problem, the need for improving the skill levels and market linkages of below poverty line families as small producers grows. Microcredit alone cannot be expected to be a panacea for all developmental problems. In some sense, its role is similar to that of credit in the general economy. It is a string that can hold back progress, but it is almost impossible to push on a string. There is a very real need for investments in infrastructure, technology transfer, skill development and market linkages that enable small producers to obtain higher returns from their efforts. This is the best way of facilitating and enabling poverty reduction. This is a challenge that is being addressed in some way by occasional donor funded programmes or by government funded NGO programmes but it is yet to be addressed systemically on a national scale. The principles of self-help and microcredit hold the key to economic and socio-cultural freedom for India's millions of poor, opening the gates of a hitherto untapped reservoir of human enterprise.

8.7 The problem of multiple lending

With an increasing number of MFIs mushrooming in the Indian microfinance space and with the high growth rates of the large MFIs, there is an increased incidence of client over-indebtedness on account of multiple lending to them. Although there has not been enough research on the direct relationship of competition and over-indebtedness, it has been observed that the same clients are members of more than one MFI in many parts of the country. This could be leading to clients accessing more debt funds than they have the capacity to repay. Such observations have been made mostly in urban areas where there is a high density population and MFIs are able to achieve economies of scale. There is another aspect of efficiency in tracking loans, which is linked to competition and over-crowding. The IIM Bangalore study, cited in Chapter 6, corroborates these observations. Their main findings highlighted multiple borrowings and over-indebtedness as a result of competition.

8.8 Regulation

NABARD has been entrusted with the regulation of the microfinance sector under the draft Microfinance Bill. Yet NABARD as an agency is also an implementer even though it does not directly finance clients under SBLP; the regulatory responsibility will still entrust it with the dual functions of implementer and regulator, leading possibly to a conflict of interest.

A larger concern is of leaving a large part of the microfinance sector (serviced by NBFCs and Section-25 Companies) uncovered by microfinance regulation. This will not allow these MFIs to provide deposit services to clients for their savings. As discussed earlier, savings services are not only essential for the clients

but also a very important source of financing for MFIs. This becomes more relevant in today's times of recession when commercial borrowings have become more limited.

NBFCs that are systemically important (having total assets size of greater than Rs100 crore (\$25 million)) are to achieve a capital level of 12% of risk-weighted assets by April 2009⁴⁰ (now increased to 15% by 2010 in the latest RBI master circular on prudential guidelines for capital adequacy and market discipline). Many feel that this limit is too high for NBFCs working in the microfinance domain when compared to norms set for the banking sector. This is apparent from the high recovery rate of microfinance-NBFCs stipulating a 15% Capital to risk weighted Assets Ratio (CAR) is almost a penal measure. Small MFIs have difficulty in achieving this target set thereby hampering their operations of providing financial services to the poor.

8.9 Conclusion

The Indian microfinance sector has grown by leaps and bounds during the first decade of the 21st century. A lot of changes have been witnessed during the last ten years on how the microfinance institutions function. Many transformed to for-profit legal forms (NBFCs) and the MFIs continue their efforts to become more efficient and productive. SBLP has also grown exponentially and is considered the single largest microfinance programme globally. However, in the quest for growth and expansion somewhere the essence of microfinance reaching out to the poor has lost its focus. There are other challenges as well, including deposit services for microfinance clients, social reporting, capacity building, tackling funding requirements and managing the negative effects of competition, enabling micro-credit plus services and ensuring a supportive regulatory environment. If these challenges could be addressed, it would go a long way in making the Indian microfinance sector more inclusive, vibrant and sustainable.

⁴⁰ Srinivasan N, 2008.

ANNEXES

Annex 1

Selection of MFIs for in-depth analysis of outreach and performance

It is estimated that there are about 800 institutions (including non-profit institutions, mutually aided cooperative societies and non-bank finance institutions; excluding primary agriculture cooperatives) involved in providing microcredit services under the MFI model. However, there are only about 200-250 MFIs that have a high degree of focus on microfinance and they provide financial and operation information to different institutions (like M-CRIL, miX and Sa-Dhan) for various purposes. Exhibit A1 below provides an idea of the number of MFIs, with a high degree of focus on microfinance, reporting their information on borrowers, portfolio outstanding and savings mobilised.

Exhibit A1

Overall outreach (based on MFIs reporting information)

Year	No. of MFIs	Number of (million)			Portfolio O/s	Savings balance
		Members	Borrowers	Savers	Rs Million	Rs Million
1999-00	44	0.52	0.20	0.36	710	310
2002-03	94	0.92	0.78	0.59	2,488	1,457
2004-05	122	2.58	2.19	1.21	8,747	950
2006-07	169	8.20	6.97	2.62	26,750	2,121
2007-08	223	14.10	11.87	2.79	59,540	2,434

Note: The above information is based on MFIs providing information to M-CRIL, miX and Sa-Dhan. Information for 1999-00, 2002-03 and 2004-05 is based on M-CRIL and miX database and the information for 2006-07 and 2007-08 is based on M-CRIL and miX database and Sa-Dhan's Bharat Microfinance Report. For 2006-07 and 2007-08 the information on savings mobilised is based on 119 and 76 reporting MFIs respectively. The table below maps the no. of unique MFIs reporting to various sources.

Year	Data from no. of unique MFIs reporting to:		
	M-CRIL	MIX	Sa-Dhan
1999-00	44	-	-
2002-03	90	4	-
2004-05	84	38	-
2006-07	58	61	50
2007-08	40	36	147

While the above table provides an overall idea on outreach, an in-depth analysis of the status of the MFI sector on various aspects of outreach, efficiency and productivity and financial performance was not possible

as information was not uniformly available for all the reporting MFIs. It was therefore, essential for the study team to select a sample of rated MFIs from the MFIs reporting their information for the years 2002-03, 2004-05, 2006-07 and 2007-08 to undertake an in-depth analysis. The MFIs selected for 2008 included a mix of rated MFIs and those reporting to MIX. The MFIs (as in above table) reporting their information to various institutions is the universe from which the sample was selected for analysis.

The sample was selected to represent MFIs from various regions, adopting different microfinance methodologies, having diverse form of legal registration, experience (in terms of age) and outreach (in terms of borrowers and portfolio outstanding). Exhibit A2 below shows the sample selected for analysis. These MFIs represent 77% of All India MFI clients, 81% of All India MFI portfolio and 85% of All India savings mobilised. It is evident that the sample has been selected to have a high representation of the sector in terms of borrowers, portfolio and savings mobilised. It also indicates that the outreach of the MFI sector is highly concentrated in the top 30-35% of the MFIs.

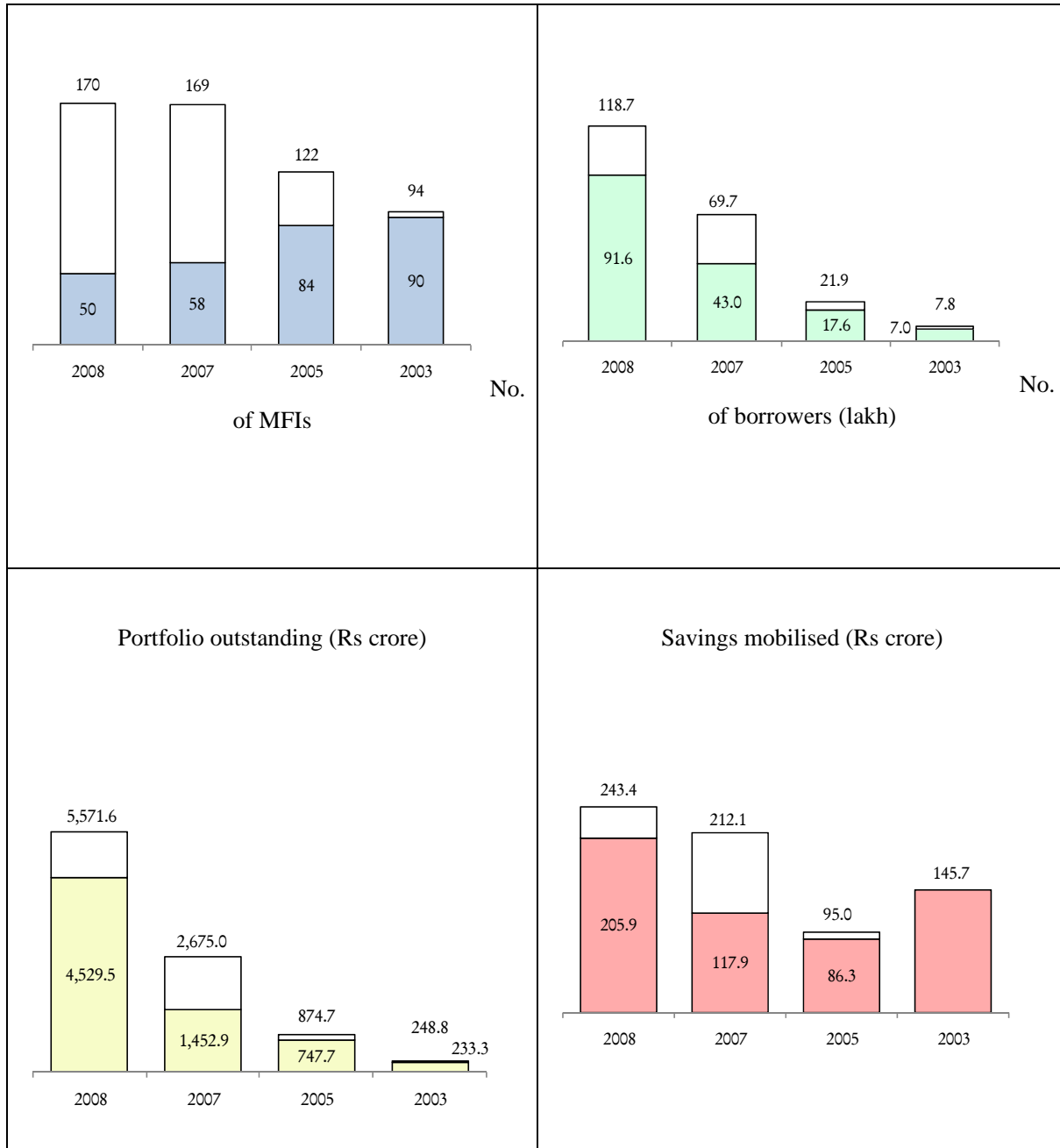
The sample for analysis of the progress of microfinance sector in India included 90 rated MFIs for 2003; 84 rated MFIs for 2005, 58 rated MFIs for 2007 and 50 MFIs (including 35 rated MFIs) for 2008 that are representative of the MFI sector. The classification of the sample was undertaken by: Region; Microfinance methodology; Form of legal registration; Age of MFI and portfolio size. The classification is explained in Exhibit A2.

Regional distribution of MFIs

This analysis provides a comprehensive regional picture of microfinance in India. The sample selected for analysis over the years have a large representation of MFIs based in south India as they provided a substantial proportion of client coverage in Indian microfinance. While the leading MFIs across India with the south continuing to be important, due to concentration of MFIs in the region, the eastern region catching up rapidly as the next preferred location. Exhibit A3 presents a broad regional analysis of the sample. In 2008, south based MFIs are represented 58% of the sample while eastern MFIs 28%.

Exhibit A2

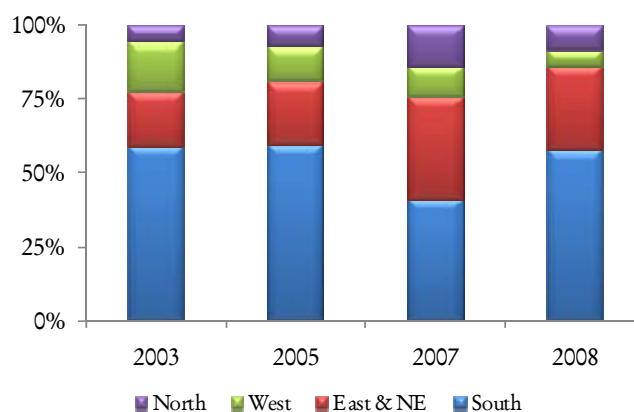
Sample (in comparison to total) for analysis of MFI sector



Note: Shaded portion represents sample data

Exhibit A3

Regional distribution of sample Indian MFIs



Regions	2003	2005	2007	2008
South	53	50	24	29
East & North East	17	18	20	14
West	15	10	6	3
North	5	6	8	4
Sample	90	84	58	50

Note: The entire sample in years 2003 to 2007 has been selected from MFIs rated by M-CRIL. In 2008 the 28 sample MFIs were rated by M-CRIL, 7 were covered by EDA for various assignments and 15 MFIs had reporting data to MIX for the financial year 2007-08

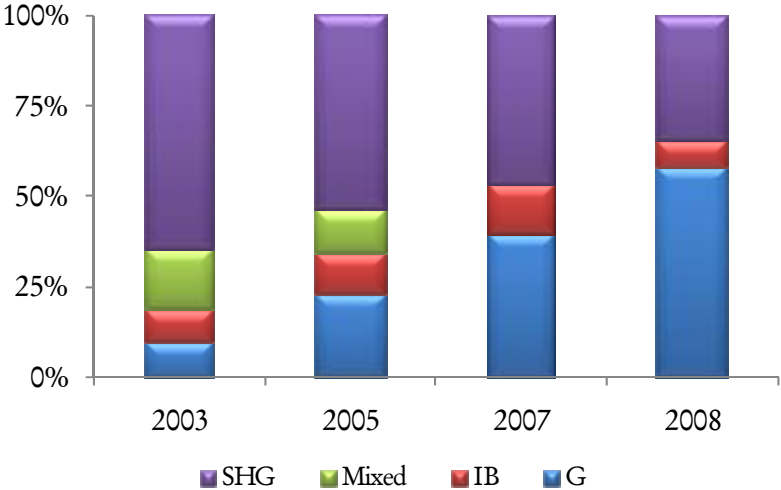
With the establishment and growth of MFIs in other parts of the country – particularly in the east – there is no longer a preponderance of MFIs in south India used in this analysis and the number of MFIs from the east is also increasing. The distribution in the table (broadly) reflects the distribution of microfinance activity in India. This regional concentration naturally means also a concentration of clients served by MFIs. This results in nearly 3/4th of all clients served by MFIs in India being located in the South.

Institutional characteristics

There are many SHG-based microfinance programmes but, in recent years, most of the new MFIs have been established using the Grameen model. There has been a tendency for MFIs increasingly to adopt the Grameen (G) model since this is seen by many as a means of accelerating their growth and progress towards sustainability. By and large, however, Indian MFIs have been innovating, experimenting with and growing out of the conventional mould of SHG and Grameen operations, to cater to the needs of their markets more effectively. A result of this has been introduction of individual loan products by many MFIs to suit the growing credit needs of the target population that have graduated from the conventional microfinance coverage. In fact a large proportion of MFIs are now practicing ‘Mixed’ model which has a base model of either G or SHG combined with an individual product. From 2007 onwards the analysis is based on the three main models and the mixed models have been distributed to G or SHG based on the main methodology used

by the MFI. The distribution of sample Indian MFIs based on microfinance models is shown in **Exhibit A4**. The distribution of sample among various models is based on the core microfinance model adopted by an MFI. This distribution is a broad reflection of the pattern of microfinance undertaken through microfinance institutions (as opposed to the SHG-bank linkage programme) in India.

Exhibit A4
Distribution of sample Indian MFIs by microfinance model



Models	2003	2005	2007	2008
G	9	19	23	29
IB	8	10	8	4
Mixed	15	10		
SHG	58	45	27	17
Sample	90	84	58	50

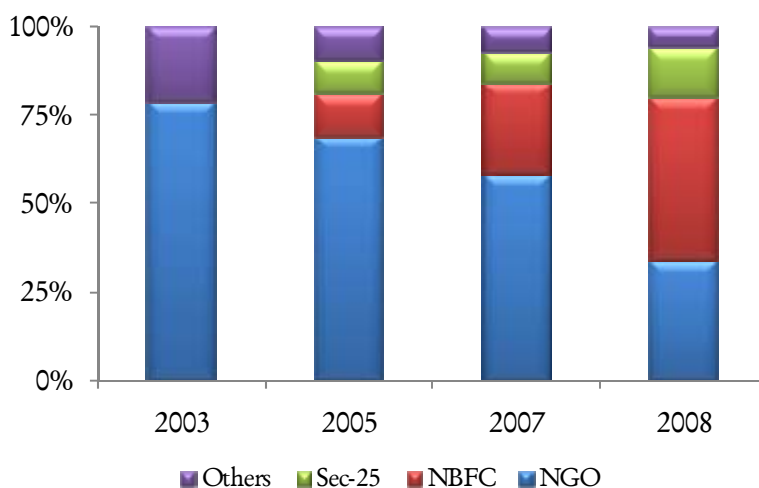
Distribution of MFIs across legal forms

In the “universe” of MFIs in India, the early MFIs were all established in the 1970s, when cooperatives were still seen as the most appropriate means of ensuring outreach to the poor in a just and fair manner. It is for this reason that the oldest MFIs in India are all cooperatives, classified here as individual banking models. It is also interesting to note that most of these are in the western region where the cooperatives have, traditionally, been more effective than those in other parts of the country. It is, perhaps, partly on account of this preference for cooperatives that the number of MFIs in western India is relatively small. More recently, a number of Mutually Aided Cooperative Societies (MACS) have been established in Andhra Pradesh but few of these need external support and, therefore, do not seek ratings or other forms of exposure to national and international observers.

Though there is a trend, India-wide, towards for-profit and formal registration of MFIs as finance companies, not-for-profit institutions continue to be substantial in terms of numbers of organisations in the provision of microfinance services. The not-for-profit institutions (societies, trusts and section-25 companies) form 48% of the overall sample in 2008. However, the Top 10 MFIs are dominated by the for-profit organisations (NBFCs and other commercial MFIs) – a common feature of all years.

Exhibit A5 shows the distribution of sample MFIs across legal forms. Also interesting in this context is the rural-urban orientation of MFIs. Microfinance activity in India has been historically seen more a rural than an urban activity. However, in the recent years it has been observed that microfinance coverage in India has been fast increasing in the urban areas. Of the sample of 50 MFIs in 2008, 20 (40%) had significant urban orientation. This compares with the trend of 20 out of 58 institutions (35%) in 2007 and 25 out of 84 (30%) in 2005 that had a significant urban orientation.

Exhibit A5
Distribution of sample MFIs by legal form



Legal form	2003	2005	2007	2008	Top 10 (2008)
NGO	71	58	34	17	1
NBFC		10	15	23	7
Sec-25		8	5	7	1
Others	19	8	4	3	1
Sample	90	84	58	50	10

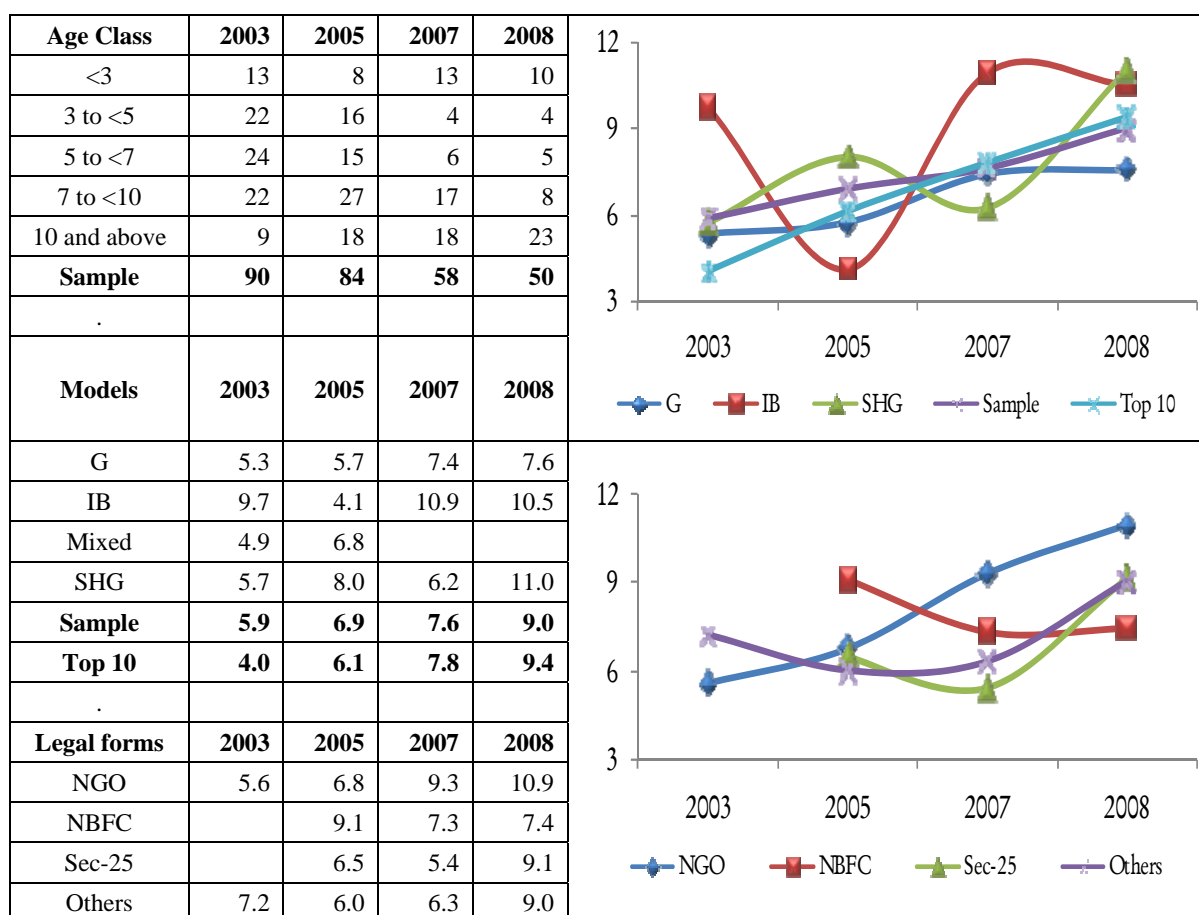
Experience of sample MFIs

The Grameen organisations have lower overall average age in almost all years. In comparison the traditional SHG organisations have higher overall average age. Similarly NGOs have greater experience in comparison to other legal forms as shown in **Exhibit A6**. This is mainly because a number of newer MFIs (mainly NBFCs) are largely adopting the Grameen model. NGOs that were practicing SHG model are comparatively older organisations which are reflected by the sample. However, most of these organisations (all models) are now mature institutions with mixed methodologies to suit an increasingly diverse client base.

In terms of age class in the initial years, the representation of the lower age class MFIs (3 to 7 years) has been higher but as the sector matured, for proper analysis the representation of higher age class MFIs (>7 years) has increased. However, there has been adequate representation of all age groups.

Exhibit A6

Distribution and average age of different types of (sample) MFIs

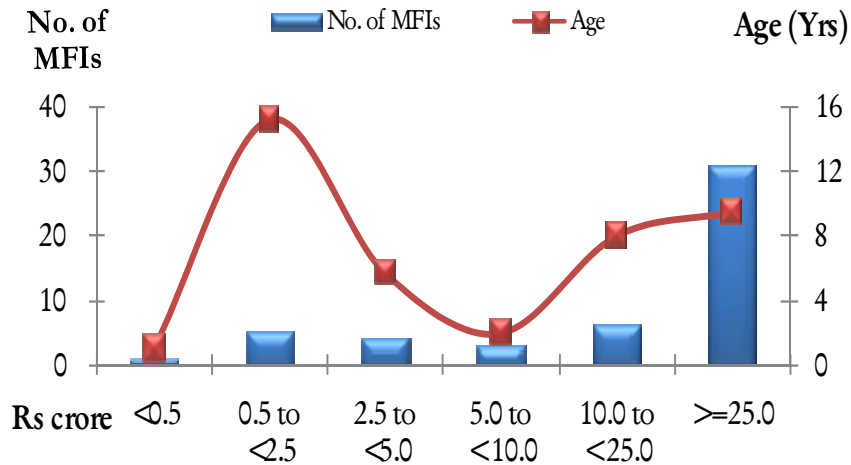


Distribution of sample MFIs in terms of portfolio class

MFIs in the sample have been classified by the size of their outstanding portfolios, as shown in **Exhibit A7**. There is a natural bias of the rating (& therefore sample) exercise towards large MFIs because it is only those

that have reasonable performance that need (or opt for) a rating. Despite this, the 2004 sample had 67 out of 90 (74% of the sample) with portfolios below Rs2.5 crore (US\$0.55 million). In 2005, 50 out of 84 (60%) and in 2007, 23 out of 58 (40%) had portfolios less than Rs25 crore. However, progressively numbers of larger MFIs in the sample have increased as they represent a large proportion of the sector. This also indicates polarisation of the sector towards larger MFIs.

Exhibit A7
Distribution of sample MFIs by portfolio class



Portfolio class (Rs crore)	2003	2005	2007	2008
<0.5	42	18	12	1
0.5 to <2.5	25	32	11	5
2.5 to <5.0	13	11	8	4
5.0 to < 10.0	4	10	5	3
10.0 to < 25.0	4	6	8	6
>=25.0	2	7	14	31
Sample	90	84	58	50

On the other hand that there is no real correlation between portfolio size and the age of an MFI. Up to a portfolio of Rs5.0 crore (around US\$1.25 million), following common business sense, as MFIs gain more experience those that continue to operate well also tend to expand. MFIs grow more rapidly from roughly the fifth to sixth year of operations at which stage their portfolios can range from Rs1-2 crore (US\$250,000-500,000). The number of commercial sources of funds now available to MFIs has supplemented this portfolio

expansion in recent years and the take-off point for rapid growth has now declined significantly. The most successful MFIs (37 of the 50 covered in 2008) have grown beyond the portfolio size of Rs5.0 crore (US\$1.25 million). Beyond this stage, their size depends mainly on the microfinance potential of their operational areas and the capabilities of their managements; the correlation between age and size is no longer relevant. The data set of MFIs for March 2008 has 31 MFIs with portfolios in excess of Rs25 crore (US\$6.3 million) and 7 in the Rs10-25 crore (US\$2.5 to 6.3 million) range. This is partly an indication of the rate of growth of Indian MFIs – a feature that is discussed later in this report.

Annex 2

Institutional approaches followed by MFIs in India

Institution Type	Description	Most common delivery model
Society ⁴¹	Registered under the Societies Registration Act, 1860 – technically established by a group of 7 individuals with the common objective of engaging in a charitable activity with a public (non-commercial) purpose	SHG
Trust	Registered under the Indian Trusts Act, 1882 – for microfinance, mainly public charitable trusts with no individuals specified as beneficiaries	SHG
Saving & Credit Cooperatives (SCC)	Established under the Multi-State Cooperatives Act of 1911 or state cooperatives laws by groups of individuals agreeing to undertake joint activities such as pooling their savings for the purpose of on-lending within or outside the group. These cooperatives operate on a for-profit basis in theory and distribute profits on the basis of an equal contribution to equity by all the members. Such cooperatives are subject to significant degrees of control by state level Registrars of Cooperatives.	Individual banking
Mutually Aided Cooperative Societies (MACS)	“New model” cooperatives so called simply to distinguish them from the cooperatives established under the conventional cooperative laws. Such cooperatives are not subject to any significant degree of state control. The bye laws of MACS must adhere to cooperative principles and contain names, objectives, eligibility as well as termination criteria for membership, division of profit and other details that govern the relationship of members amongst themselves. Unlike the conventional cooperatives, in MACS the ultimate authority of the cooperative society vests in its general body which consists of all its members. Membership is voluntary and open to all those who can make use of its services and are willing to accept the responsibilities of membership.	Individual banking
Urban Cooperative Banks (UCB)	For profit institutions registered under the Cooperative Societies Acts of the respective states or the Multi-State Cooperative Societies Act of 2002. It must have at least 3,000 members and paid up capital and reserves of at least Rs1 lakh. UCBs have the Reserve Bank of India as their regulatory and supervisory authority for their banking operations while administrative and managerial supervision is under the jurisdiction of state level cooperative departments or the central government (for multi-state cooperatives)	Individual banking
Not for profit companies (Sec-25 Company)	Under Section 25 of the Companies Act, 1956 established with a purpose such as the promotion of commerce, science, art, religion, charity or any other useful purpose and, therefore, regarded as a non-commercial entity earning profits but not allowed to distribute dividends. Such companies are not required to be registered with the Reserve Bank of India provided they do not accept deposits.	Grameen
Non-Bank Finance Companies (NBFCs)	For profit companies established under the Companies Act, 1956 and required to raise a minimum equity capital of Rs2 crore and to register as NBFCs with the RBI	Grameen

⁴¹ In practice, there is no significant difference between these two types – Society and Trust – of institutional registration (from the perspective of institutional motivation and MFI management)

Annex 3

Operational and financial details of Top 20 MFIs (in terms of outreach) reporting to MIX

	Name of MFI	Year of establishment	No. of branches	No. of members	No. of borrowers	% of women borrowers	No. of dropouts	Portfolio (Rs)	PAR 30	Member deposits (Rs)
1	SKS Microfinance Private Ltd	1997	–	–	1,629,474	100.0	–	7,747,404,038	0.15%	0
2	Spandana Sphoorty Financial Ltd	1998	–	–	1,188,861	96.5	–	4,715,385,290	4.43%	0
3	SHARE Microfin Ltd	1992	–	–	989,641	100.0	–	5,115,019,889	3.13%	289,275,161
4	Bandhan-Konnagar	2001	427	8,66,381	757,903	100.0	91,984	2,782,790,695	0.10%	457,719,189
5	Asmitha Microfin Ltd	2002	242	–	585,806	100.0	–	2,757,681,611	0.63%	0
6	Sarvodaya Nano Finance Ltd	1996	112	525,470	154,772	100.0	–	894,036,312	2.70%	0
7	KAS Foundation	2003	–	–	398,861	68.9	–	812,863,521	9.11%	0
8	Bhartiya Samruddhi Finance Ltd	1997	–	–	305,438	50.9	–	1,969,379,000	1.21%	296,749,000
9	Cashpor Microcredit	1997	193	–	354,930	100.0	–	1,380,936,655	1.76%	0
10	BWDA Finance Limited	2003	21	292,729	210,721	93.0	–	851,415,659	2.45%	0
11	Hand in Hand	2005	150	295,190	63,533	100.0	2,952	236,318,287	2.78%	95,623
12	Grama Vidiyal Micro Finance (P) Ltd	1996	91	261,060	224,105	100.0	–	1,156,154,276	0.40%	123,112,918
13	Bharat Integrated Social Welfare Agency	1995	–	–	246,430	99.3	–	1,160,918,113	0.53%	32,898,244
14	Semam Microfinance Investment Literacy and Empowerment	2005	71	232,393	125,405	100.0	69,479	664,329,000	0.37%	0
15	Microcredit Foundation of India	2003	–	–	187,473	100.0	–	821,085,261	0.27%	0
16	Evangelical Social Action Forum	1992	–	–	145,712	98.0	–	788,789,348	2.35%	0
17	Bharatha Swamukti Samsthe	1997	47	142,613	134,527	99.8	–	884,143,689	0.00%	82,000
18	Sanghamithra Rural Financial Services	1995	44	–	130,048	98.0	–	485,589,423	0.00%	0
19	Grameen (Koota) Financial Services Pvt Ltd	1999	–	–	117,647	100.0	–	816,272,492	0.00%	0
20	Krishna Bhima Samruddhi Local Area Bank Ltd	1999	–	100,448	45,207	46.5	–	517,993,837	5.90%	434,200,986

Source: Based on financial statements and operational details of MFIs reporting to MIX Market. As on 31 March 2008.

Annex 4

Microfinance penetration (MPI and MPPI)

State	Cumulative no. of SHGs linked (March 08)	No. of SHG members	No. of MFI clients	Total microfinance clients	Share of state to total	Total households* (000s)	% share of households	No. of poor – households ('000s) (2004-05)	% share of poor households	M P I	M P P I
North-eastern region											
Himachal Pradesh	31,899	414,687		414,687	0.7	1,281.6	0.58	127.2	0.2	1.20	3.32
Rajasthan	173,192	2,251,496	83,873	2,335,369	3.9	12,305.0	5.59	2,697.8	4.5	0.70	0.88
Haryana	12,654	164,502	1,468	165,970	0.3	4,605.8	2.09	642.0	1.1	0.13	0.26
Punjab	8,965	116,545		116,545	0.2	5,167.8	2.35	432.6	0.7	0.08	0.27
Jammu and Kashmir	3,529	45,877		45,877	0.1	2,077.4	0.94	117.0	0.2	0.08	0.40
New Delhi	501	6,513	27,761	34,274	0.1	3,143.6	1.43	458.6	0.8	0.04	0.08
Total (A)	230,740	2,999,620	113,102	3,112,722	5.3	28,581.2	12.98	4,475.2	7.4	0.40	0.71
North-eastern region											
Assam	107,098	1,392,274	137,239	1,529,513	2.6	5,681.2	2.58	1,115.4	1.8	1.00	1.40
Meghalaya	1,211	15,743		15,743	0.0	490.0	0.22	90.4	0.1	0.12	0.18
Tripura	4,348	56,524	37,687	94,211	0.2	676.0	0.31	127.6	0.2	0.05	0.75
Sikkim	337	4,381		4,381	0.0	114.2	0.05	22.8	0.04	0.14	0.20

State	Cumulative no. of SHGs linked (March 08)	No. of SHG members	No. of MFI clients	Total microfinance clients	Share of state to total	Total households* (000s)	% share of households	No. of poor – households ('000s) (2004-05)	% share of poor households	M P I	M P P I
Manipur	2,683	34,879	651	35,530	0.1	457.8	0.21	79.0	0.1	0.29	0.46
Arunachal Pradesh	517	6,721		6,721	0.0	232.0	0.11	40.6	0.1	0.11	0.17
Nagaland	1,200	15,600	12	15,612	0.0	420.4	0.19	79.8	0.1	0.14	0.20
Mizoram	2,463	32,019		32,019	0.1	187.8	0.09	23.6	0.0	0.63	1.38
Total (B)	119,857	1,558,141	175,589	1,733,730	3.0	8,259.4	3.76	1,579.2	2.6	0.78	1.12
Eastern region											
Orissa	307,591	3,998,683	1,577,600	5,576,283	9.4	7,725.2	3.51	3,569.8	5.9	2.68	1.59
Bihar	93,410	1,214,330	241,651	1,455,981	2.5	17,955.2	8.15	7,383.0	12.2	0.30	0.20
Jharkhand	42,605	553,865	115,444	669,309	1.1	5,800.0	2.63	2,327.8	3.9	0.43	0.29
West Bengal	228,395	2,969,135	1,540,927	4,510,062	7.6	16,919.8	7.68	4,167.2	6.9	0.99	1.10
Total (C)	672,001	8,736,013	3,475,622	12,211,635	20.6	48,400.2	21.97	17,447.8	28.9	0.94	0.71
Central region											
Madhya Pradesh	83,336	1,083,368	229,300	1,312,668	2.2	13,121.0	5.96	4,993.6	8.3	0.37	0.27
Chhattisgarh	60,763	789,919	235,063	1,024,982	1.7	4,473.4	2.03	1,813.8	3.0	0.85	0.58
Uttar Pradesh	236,929	3,080,077	533,041	3,613,118	6.1	36,198.0	16.43	11,800.6	19.6	0.37	0.31

State	Cumulative no. of SHGs linked (March 08)	No. of SHG members	No. of MFI clients	Total microfinance clients	Share of state to total	Total households* (000s)	% share of households	No. of poor – households ('000s) (2004-05)	% share of poor households	M P I	M P PI
Uttarakhand	24,679	320,827	16,798	337,625	0.6	1,824.6	0.83	719.2	1.2	0.69	0.48
Total (D)	405,707	5,274,191	1,014,202	6,288,393	10.6	55,617.0	25.25	19,327.2	32.0	0.42	0.33
Western region											
Gujarat	46,526	604,838	416,375	1,021,213	1.7	10,845.2	4.92	1,813.8	3.0	0.35	0.57
Maharashtra	326,425	4,243,525	1,169,306	5,412,831	9.1	20,751.0	9.42	6,347.6	10.5	0.97	0.87
Goa	1,610	20,930		20,930	0.0	292.6	0.13	40.2	0.1	0.27	0.53
Total (E)	374,561	4,869,293	1,585,681	6,454,974	10.8	31,888.8	14.47	8,201.6	13.6	0.75	0.80
Southern region											
AP	723,717	9,408,321	3,653,115	13,061,436	22.0	16,029.4	7.28	2,522.0	4.2	3.02	5.27
Karnataka	346,636	4,506,268	1,963,373	6,469,641	10.9	11,164.4	5.07	2,777.8	4.6	2.15	2.37
Kerala	146,984	1,910,792	382,001	2,292,793	3.9	6,616.6	3.00	992.0	1.6	1.29	2.35
Tamil Nadu	454,975	5,914,675	1,692,560	7,607,235	12.8	12,960.0	5.88	2,912.4	4.8	2.18	2.66
Pondicherry	2,499	2,487	13,161	45,648	0.1	214.0	0.10	47.4	0.1	0.79	0.98
Other UTs	288	3,744	239	,983	0.0	189.4	0.09	56.4	0.1	0.08	0.07
Total (F)	1,675,099	21,776,287	7,704,449	29,480,736	49.7	47,173.8	21.42	9,308.0	15.4	2.32	3.22

State	Cumulative no. of SHGs linked (March 08)	No. of SHG members	No. of MFI clients	Total microfinance clients	Share of state to total	Total households* (000s)	% share of households	No. of poor – households ('000s) (2004-05)	% share of poor households	M P I	M P PI
Grand total	3,477,965	45,213,545	14,068,645	59,282,190	100.0	219,920.4	9.85	60,339.0	100.0	1.00	1.00

Adapted from Srinivasan 2008. Base data at www.nabard.org * Average household size taken as 5

Formulae for MPI and MPPI:

State MPI = $\frac{\text{Share of microfinance clients in the state (in proportion to total clients of MFI and SHG models)}}{\text{Share of the households in the state (in proportion to total households in India)}}$

State MPPI = $\frac{\text{Share of microfinance clients in the state (in proportion to total clients of MFI and SHG models)}}{\text{Share of the poor households in the state (in proportion to total poor households in India)}}$

NOTE: The data is before adjustment for overlap between microfinance clients. And the MPPI does not take into account the varying poverty profile of microfinance clients

Annex 5

A summary of operational and financial performance of rated MFIs

Parameters	All India				Top 10 MFIs				Trend
	2003	2005	2007	2008	2003	2005	2007	2008	
Sample									
No. of MFIs	90	84	58	50	10	10	10	10	↓
Average age (years)	5.9	6.9	7.6	9.0	4.0	6.1	7.8	9.4	↑
Outreach									
Number of members (lakh)	19	29	56	108	4	16	33	71	↑
Number of borrowers (lakh)	7	18	43	92	3	12	30	66	↑
Average members/MFI	21,235	34,265	96,347	215,406	40,033	155,994	331,469	711,759	↑
Average borrowers/MFI	7,770	20,908	74,086	183,243	32,125	117,356	296,738	655,641	↑
Number of staff	5,712	8,027	18,874	39,084	1,430	4,348	10,790	23,678	↑
Portfolio o/s (Rs Million)	2330	7480	1,4530	4,5300	1470	5010	9200	2,9030	↑
Average loan size (Rs)	6,562	11,509	8,117	11,480	6,235	7,364	6,548	9,900	↑
Average loan balance (Rs)	3,336	4,257	3,381	4,944	4,589	4,268	3,099	4,427	↑
Savings mobilised (Rs Million)	1460	860	1180	2060	360	520	540	1040	↑
Savings per member (Rs)	762	300	211	191	900	332	163	147	↓
Savings to portfolio ratio	62.4%	11.5%	8.1%	4.5%	24.4%	10.3%	5.9%	3.6%	↓
Credit performance									
Portfolio at risk (>60 days overdue)	12.2%	4.7%	6.4%	2.9% [^]	4.1%	1.4%	4.6%	2.6% [^]	≈
Efficiency and productivity									
Average members per staff	335	359	296	276	280	359	307	301	↓
Average borrowers per staff	122	219	228	234	225	270	275	277	↑
Average portfolio per MFI (Rs Million)	26	89	251	906	147	501	920	2903	↑
Average portfolio per staff (Rs lakh)	4.1	9.3	7.7	11.6	10.3	11.5	8.5	12.3	↑
Borrower/member ratio	36.6%	61.0%	76.9%	85.1%	80.2%	75.2%	89.5%	92.1%	≈
Earnings/expenses									
Portfolio yield (weighted)	18.8%	25.2%	24.8%	24.6%	33.5%	23.9%	24.4%	25.9%	↑
Portfolio yield (typical)	18.7%	19.1%	19.6%	23.0%	33.5%	24.8%	22.7%	23.7%	↔
Financial cost ratio		10.3%	9.1%	9.8%		7.9%	9.0%	10.5%	↑
Operating expense ratio (weighted)	19.9%	15.6%	15.9%	11.1%	22.4%	10.8%	13.1%	11.8%	↓
Operating expense ratio (typical)	50.7%	18.5%	20.7%	16.8%		12.3%	11.6%	10.8%	↓
Loan loss provision		1.8%	5.2%	0.9%		1.4%	2.8%	1.0%	↓
Total expense ratio		27.7%	36.0%	21.9%		20.2%	23.1%	23.2%	≈
Operating cost per borrower (Rs)	548	581	504	457	660	500	473	417	↓
Profitability and sustainability									
Return on assets (weighted)	-1.5%	2.1%	0.0%	3.0%	2.1%	4.8%	0.0%	2.6%	≈

Parameters	All India				Top 10 MFIs				Trend
Return on assets (typical)	-13.6%	-5.2%	-9.8%	-2.1%	2.3%	3.0%	-0.7%	2.2%	≈
Operational self sufficiency (weighted)	88.2%	108.0%	92.0%	122.4%	109.2%	119.0%	89.0%	121.5%	≈
Operational self sufficiency (typical)	73.9%	88.0%	81.0%	110.7%	97.3%	124.0%	103.0%	118.8%	↑
Financial self sufficiency (weighted)	76.8%	102.0%	87.0%	115.4%	128.8%	111.0%	85.0%	114.2%	≈
Financial self sufficiency (typical)	60.8%	77.0%	73.0%	103.3%	96.2%	110.0%	95.0%	111.9%	↑
Yield minus TER		-2.7%	-16.4%	2.8%		3.7%	-0.4%	2.7%	≈
Leverage									
Capital adequacy ratio (weighted)	33.1%	20.6%	12.7%	17.1%	35.0%	14.8%	11.1%	17.7%	≈
Capital adequacy ratio (typical)	33.1%	21.9%	13.4%	19.7%	37.1%	19.8%	9.4%	14.5%	≈
Debt : Equity ratio			14.2	5.2			10.5	5.4	↓
Asset allocation									
Loans to total assets	62.1%	73.6%	75.0%	77.4%	77.3%	85.2%	79.2%	76.5%	↑
Cash	5.6%	6.1%	10.0%	12.5%	7.0%	6.3%	8.8%	15.6%	↑
Investment	23.5%	10.5%	1.9%	2.7%	9.0%	3.4%	5.1%	2.0%	↓
Fixed assets	5.0%	6.3%	3.4%	2.9%	4.4%	2.3%	1.9%	2.6%	≈
Others	3.8%	3.5%	2.7%	4.5%	2.3%	2.7%	5.0%	3.3%	≈
Sources of funds for microfinance									
Institutional debt	34.4%	62.6%	75.3%	71.9%	32.8%	70.0%	80.3%	74.7%	↑
Clients savings	24.8%	11.2%	8.4%	3.4%	31.0%	4.6%	4.6%	2.6%	↓
Other liabilities	7.7%	7.1%	6.5%	10.8%	2.9%	6.0%	6.1%	8.7%	↑
Grants	30.0%	8.0%	3.4%	0.8%	12.6%	4.7%	2.2%	0.3%	↓
Paid-in equity	7.3%	11.2%	6.2%	5.1%	13.7%	13.8%	6.4%	5.3%	↓
Retained surplus/deficit	-4.2%	-0.1%	0.2%	7.9%	7.0%	0.9%	0.4%	8.2%	↑
Uses of funds for microfinance									
Net portfolio	65.3%	73.6%	74.6%	77.4%			78.5%	76.5%	↑
Fixed assets	5.9%	6.3%	3.4%	2.9%			1.8%	2.6%	↓
Cash	6.8%	6.1%	9.9%	12.5%			8.7%	15.6%	↑
Short-term investments	10.8%	5.2%	5.2%	1.8%			4.4%	1.6%	↓
Long-term investments	6.6%	5.3%	1.5%	0.9%			0.3%	0.4%	↓
Advances	2.8%	1.7%	2.1%	2.0%			2.2%	1.2%	↔
Other current assets	1.8%	1.8%	3.2%	2.5%			4.1%	2.0%	≈

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