Microfinance India

Microfinance India
State of the Sector Report 2009

N. Srinivasan

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Abbreviations

ABCO	Average Borrowers per Credit Officer
AICI	Agricultural Insurance Company of India Limited
AKMI	Association of Karnataka Microfinance Institutions
ALW	A Little World
AMC	Asset Management Company
AMMACTS	Acts Mahila Mutually Aided Cooperative Thrift Society
AP	Andhra Pradesh
APGVB	Andhra Pradesh Grameen Vikas Bank
APMACS	Andhra Pradesh Mutually Aided Cooperative Societies
APMAS	Andhra Pradesh Mahila Abhivruddhi Society
APR	Annualised Percentage Rate
ATM	Automated Teller Machine
BC	Business Correspodent
BF	Business facilitator
BDS	Business Development Service
BIRD	Bankers Institute of Rural Development
BIMARU	Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh
BPL	Below Poverty Line
BPO	Business Process Outsourcing
BSE	Bombay Stock Exchange
BSS	Bangalore Software Services
CAB	College of Agricultural Banking
CAGR	Compound Annual Growth Rate
CASHE	Credit and Savings for Household Enterprise
CASHPOR	Credit and Savings for the Hardcore Poor
CBS	Core-Banking Solution
CCPS	Compulsorily Convertible Preference Shares
CDF	Cooperative Development Foundation
CDMA	Code Division Multiple Access
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFSI	Centre for the Study of Financial Innovation
CGAP	Consultative Group to Assist the Poor
CGM	Chief General Manager
CIB	Credit Information Bureau
CIRM	Centre for Insurance and Risk Management
CM	Computer Munshi
CMF	Centre for Microfinance
CMF-IFMR	Centre for Microfinance-Institute for Financial Management and Research
CMR	Centre for Microfinance Research
CMRC	Community Managed Resource Centres
CRAR	Capital to Risk Weighted Assets Ratio
CRD	Centre for Rural Development
CSCs	Common Services Centres
DC	Deputy Commissioner
DCCB	District Central Cooperative Bank
DFID	Department for International Development

DGR-MoD	Directorate-General of Resettlement, Ministry of Defence
DRDA	District Rural Development Authority
DWCD	Department of Women and Child Development
EMI	Equated Monthly Instalment
EP	Established Player
FDI	Foreign Direct Investment
FIF	Financial Inclusion Fund
FINO	Financial Information Network & Operations Ltd
FIPB	Foreign Investment Promotion Board
FITF	Financial Inclusion Technology Fund
FLDG	First Loss Deficiency Guarantee
FMCG	Fast Moving Consumer Good
FO	Field Officer
FWWB	Friends of Women's World Banking
GCC	General Purpose Credit Cards
GDP	Gross Domestic Product
GPRS	General Packet Radio Service
GDS	Gramin Dak Sevak
GSM	Global System for Mobile
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HDFC	Housing Development Finance Corporation
HDI	Human Development Index
HR	Human Resources
HUDCO	Housing Urban Development Corporation
ICICI	Industrial Credit and Investment Corporation of India
ICT	Information and Communication Technology
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IGS	Indian Grameen Services
IIM-A	Indian Institute of Management, Ahmedabad
IKP	Indira Kranti Patham
ILFS	Infrastructure Leasing and Financial Services Limited
ILO	International Labour Organization
IOB	Indian Overseas Bank
IPO	Initial Public Offering
IPR	Intellectual Property Right
IRDA	Insurance Regulatory and Development Authority
IRMA	Institute of Rural Management
ISP	Independent Solution Provider
IT	Information Technology
JLG	Joint Liability Group
KBSLAB	Krishna Bhima Samruddhi Local Area Bank
KDFS	Kalanjiam Development and Financial Services
KFW	Kreditanstalt für Wiederaufbau
KGFS	Kshetriya Grameen Financial Services
KSMC	Karnataka State Minorities Commission
KYC	Know Your Customer
LAB	Local Area Bank
LIC	Life Insurance Corporation of India
LIFI	Low-Income Finance Institution
MACS	Mutually Aided Cooperative Society
MBT	Mutual Benefit Trust
M-CRIL	Micro-credit Ratings International Ltd
MFDC	Microfinance Development Council

MFDEF	Micro Finance Development and Equity Fund
MFI	Microfinance Institution
MFO	Microfinance Organisation
MIA	Micro Insurance Academy
MIFOS	Microfinance Open Source
MIS	Management Information System
MIX	Microfinance Information Exchange
MMMF	Money Market Mutual Fund
MP	Madhya Pradesh
MPI	Microfinance Penetration Index
MPPI	Microfinance Poverty Penetration Index
MSDF	Michael & Susan Dell Foundation
NABARD	National Bank for Agriculture and Rural Development
NABFINS	Nabard Financial Services
NBFC	Non-Banking Financial Company
NBFC ND-SI	Non-Banking Financial Company—Non-deposit taking-Systemically Important
NCAER	National Council for Applied Economic Research
NeGP	National e-Governance Plan
NFC	Near Field Communication
NGO	Non-Governmental Organisation
NOF	Net Owned Fund
NPA	Non-Performing Asset
NREGA	National Rural Employment Guarantee Act
NREGS	National Rural Employment Guarantee Scheme
NSSO	National Sample Survey Organisation
OER	Operating Expense Ratio
OSS	Operating Self Sufficiency
PACS	Primary Agricultural Credit Societies
PAR	Portfolio at Risk
PC	Personal Computer
PCO	Public Call Office
PDA	Personal Digital Assistant
PDS	Public Distribution System
PHC	Public Health Centre
PLR	Prime Lending Rate
PNB	Punjab National Bank
POS	Point of Sale
POT	Point of Transaction
PPP	Purchasing Power Parity
PRADAN	Professional Assistance for Development Action
PSL	Priority Sector Lending
PSS	Payment and Settlement Systems Act
RBI	Reserve Bank of India
RFA	Revolving Fund Assistance
RFID	Radio frequency identification device
RGVN	Rashtriya Grameen Vikas Nidhi
RIDF	Rural Infrastructure and Development Fund
RMK	Rashtriya Mahila Kosh
ROGLP	Return on Gross Loan Portfolio
RRB	Regional Rural Bank
RV	Roshan Vikas
SBI	State Bank of India
SBLP	SHG–Bank Linkage Programme
SC	Scheduled Caste

SCB	State Cooperative Bank
SEEP	Small Enterprise Education and Promotion
SERP	Society for Elimination of Rural Poverty
SEWA	Self-Employed Women's Association
SGSY	Swarna Jayanti Gram Swarozgar Yojna
SHG	Self-Help Group
SHPA	Self Help Promotion Agency
SHPI	Self-Help Promoting Institution
SIDBI	Small Industries Development Bank of India
SIM	Subscriber Identity Module
SKDRDP	Shri Kshetra Dhamrmasthala Rural Development Project
SMES	Small and Medium Enterprises
SNFL	Sarvodaya Nano Finance Limited
SOC	Sector's Own Controls
SPM	Social Performance Management
SRO	Self-regulating Organisation
ST	Scheduled Tribe
STPL	Small Ticket Personal Loan
STEMS	Single Terminal Enabling Multiple Services
TNCDW	Tamil Nadu Corporation for the Development of Women
UCB	Urban Cooperative Bank
UIA	United India Insurance
UNDP	United Nations Development Programme
UNSE	United Nations Solutions Exchange
UP	Uttar Pradesh
USP	Unique Selling Proposition
VO	Village Organisation
WB	West Bengal
WGC	World Gold Council

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Foreword

ACCESS was set up in 2006, as a mechanism to consolidate and build on the significant experiences of a successful Department for International Development (DFID) funded project (CASHE). Quite quickly, ACCESS transcended that narrow mandate to do much more. In these 3 years since ACCESS was set up, it has undertaken a few sizeable significant sectoral initiatives. An evaluation of these efforts clearly brings out the fact that 'Microfinance India—State of the Sector Report' has been among its biggest contribution to the sector.

The microfinance sector in India is growing at a blistering pace and is also evolving fast. Each year, new issues, new challenges are thrown up. In 2005, the sector was pleasantly surprised by the problem of plenty. A new set of supply-side players were demonstrating a new aggressive intent to park their excess liquidity in microfinance operations. Owing to this unprecedented phenomenon, many institutions recorded 100 to 200 per cent growth, and managing growth became the issue and the challenge. In 2006, an eyeball-to-eyeball confrontation between government programmes and MFI operations resulted in a precarious impasse that resulted in freezing of all the previous year's aggression, and led to restructuring of strategies among many banks. As an aftermath of the crisis, a strong need for a code of conduct for the sector emerged. The sector's engagement with the 'microfinance bill' and diverse opinions on its content, besides the roll out of several 'financial inclusion' initiatives, including the business correspondent model, were the headlines for 2007. And in 2008, while the sector breached the 50 million client mark, dark clouds on the sector loomed large due to the global economic meltdown, which, starting with the Microfinance India Summit, was the central discussion point in forums across the world. Did this spell the end of the golden era for the sector? The shadow of the global financial meltdown on the sector will perhaps continue to remain a key focus of 2009. Also, with the MFI channel progressing the way it has, would it be appropriate to continue to call it the 'alternate' channel? The recent crisis in Kolar has brought to the fore the need for greater emphasis on and significance of 'client protection', 'responsible finance' and 'business ethics'. Each year, there are new issues which require to be understood, analysed and assimilated. The value of the State of the Sector Report is located in its mandate and ability to chronicle all these milestones in the sector's evolution.

Early this year, while in the US, among others, I had a chance to visit the Consultative Group to Assist the Poor (CGAP) and the MIX Offices in Washington. Steve Rasmussen, Senior Advisor at CGAP, commented that every time he was in India, he would pick a few copies of the report, but they would soon disappear, and he couldn't easily get a copy in the US. At the MIX Office, Elizabeth, who had recently joined as the Asia Manager, said that the State of the Sector Report was the best source for her to understand the complex sectoral scenario in India. On another instance I was very happy to see Simon Desjardins from Shell Foundation, UK walk into our office at New Delhi carrying a copy of the State of the Sector Report. It surprised me to know that he could buy it on Amazon. Each year, prior to the official release of the report, different sections of the media jostle to get its exclusive pre-review rights. Clearly, over the 3 years, State of the Sector Report has emerged as the most comprehensive resource document on Indian microfinance with insightful and analytical narration on the sector's progress. While seemingly it has a huge value among an Indian audience, it has an equal value internationally. Both Ajit at Ford Foundation and Adrian Marti at SDC, the first two core sponsors of the report, were keen that the report should be made as accessible as possible to a larger section of the sector. Conceding the request, ACCESS included the report as a part of the delegate kit

for the 1,000 odd participants who attended the Annual Microfinance India Summit in 2008, where traditionally the report is released in addition to hosting it on the web as a downloadable document.

N. Srinivasan, given his long years at National Bank for Agriculture and Rural Development (NABARD) and his association with a very wide spectrum of apex level issues on access to finance, was able to bring significant new insights in his narration of the sector's progress in the 2008 State of the Sector Report. Several innovations were attempted in 2008 to garner greater information which were continued this year. The United Nations Development Programme's (UNDP) Solutions Exchange was creatively mobilised by Srini to seek information on sectoral innovations. In partnership with RBI's College of Agriculture Banking, a consultation meet was organised for the private sector and multinational banks to understand their plans and strategies for the sector. Several field visits were undertaken; personal interviews with policy makers, regulators, apex institution heads were conducted; small surveys were instituted and consultations with sector leaders were held. Given Srini's influence and respect within the sector, key data from major stakeholders was facilitated. Data from NABARD and Sa-Dhan significantly strengthened the statistical and analytical content of the report. Across the sector, the general view was that the State of the Sector Report was far more comprehensive, had far deeper analysis of trends and progress and contained much more statistical content. The rigour and thoroughness of Srini helped hugely in building the credibility of the report.

While the author of the report rightfully takes the maximum credit, there are several others who need to be thanked for making the report possible. Foremost, I would like to thank the key supporters of the report viz. Ford Foundation, UNDP, International Finance Corporation (IFC) and Citi Foundation. While Ajit has been a great resource to the report on a personal basis, Ford Foundation remains the strongest and most steadfast supporter of the report. Several rounds of discussions with Prema at UNDP and her spirited commitment added significant value to the report. Both IFC and Citi Foundation are the new co-sponsors of the document. Given their long-term commitment to the sector, their association with the report will strengthen its credibility. I'd like thank Alok Prasad and Aloka at Citi and Swapnil at IFC for their support. I would also like to acknowledge the very positive response to all our requests by Sandip Ghose and subsequently Kamala Rajan, Principal, College of Agriculture Banking, who helped to organise the Round Tables of Bankers. Navin Anand's enthusiastic offer of support by UNDP's Solutions Exchange helped to broaden participation of the sector in inputs for the report. This year, in association with Bankers Institute of Rural Development (BIRD), Solutions Exchange and UNDP also organised a stakeholder consultation for the report. I'm thankful to Anand Kumar, Navin, Ratnesh and S.K. Chatterjee, Director BIRD, for their support. Thanks are due to Mathew Titus for the useful data provided by Sa-Dhan; it contributed immensely to the analysis of the report. As always Justin and his team at Centre for Microfinance (CMF), Chennai provided significant support to the report with findings from research and studies carried out at CMF. Lastly, I'd like to thank Vijay Mahajan, who was generous in organising a consultation with MFI representatives at the BASIX office, which helped to provide perspectives on the sector from a MFI standpoint. Vijay can always be counted upon for any sectoral contribution. This incredible support from different stakeholders has been a huge positive factor in bringing together the diverse details of the sector's growth during the year.

Most importantly, I owe very much to my team at ACCESS for their adroit alacrity in supporting the report writing process. Yeshu Bansal from my team at ACCESS, as always, played the anchor role in supporting the process. Yeshu coordinated with the author, with the publisher, with different stakeholders, organised important stakeholder meetings, helped to access key information, collate data—all critical tasks that were performed with élan. This year, Yeshu was ably supported by Jaipooja who joined us this year at ACCESS. Pooja helped with key Sa-Dhan and NABARD data, the Karnataka visit and supporting the author with fine details. I'm also thankful to Lalitha who helped with all the travel and logistic support to the author, making his criss-crossing the country an effortless affair. It's a matter of great pride that a large task like this could be accomplished through a well coordinated process by a small team.

I hope the State of the Sector Report 2009 will have similar value for the sector as in the past and will also be of the same high quality in its narration and analysis.

Vipin Sharma
CEO, ACCESS Development Services, New Delhi

Preface

Very quickly one year has passed since the last report. It had been a tough year, not only for the sector, but for the report too: information was very late coming—Sa-Dhan data coming out at the end of June, a month later than last year; NABARD had more provisional data but it became available in the last week of August. Nevertheless, the cooperation received from the sector was unbelievable. Many willingly gave their time, spared resources and more importantly information for the report. The ownership of this report within the sector made it easy to get information. I have a lot of persons and institutions to thank. My thanks are due to CMF, Chennai, UNSE, CAB and BASIX for making the extra effort for the purpose of this report. I should thank Justin Oliver and his colleagues for providing full access to their studies and facilitating a visit to Kolar. Shreyas Gopinath from CMF did a review of software solutions for the purpose of this report. As in the last year Doug Johnson of CMF provided inputs on the equity and debt markets. Vijay Mahajan of BASIX hosted a roundtable of leading professionals to discuss sector trends specifically for the purpose of carrying it in this report. UN Solutions Exchange ran a query on practitioners' expectations from the report and information on innovations. The answers were followed up with a brainstorming meet of practitioners at BIRD, Lucknow in the last week of August which provided several leads for the report. I owe Anand Kumar, Navin and Ratnesh a lot for this. Sandip Ghose and later Kamala Rajan of CAB, RBI readily co-hosted along with ACCESS an experience-sharing workshop of Private and Foreign Banks that was rich with lenders' perspectives. Ganesh Rangaswami of Unitus provided inputs on a variety of aspects. Marie Haberberger, GTZ provided the preliminary draft of the inventorisation study of microfinance organisations (MFOs) among other inputs. C.S. Reddy provided information on federations from Andhra Pradesh Mahila Abhivruddhi Society (APMAS). I cannot thank all of them enough for sparing information, time and other resources.

The Chairman of NABARD, U.C. Sarangi, in the midst of a very busy day found time for this report; as did N.K. Maini, Executive director of SIDBI, sparing more time than he originally agreed to. Tarun Bajaj, Joint Secretary, Insurance shared his perspective on the micro-insurance market.

The roundtable at Hyderabad was organised with very little notice. Still, Vijay found time to chair the meet. Suresh Krishna, CEO, Grameen Koota, P.N. Vasudevan, MD, Equitas Microfinance, Dilli Raj, CFO, SKS Microfinance, Sankar Datta, CEO, The Livelihood School participated in the lively discussions which the readers will enjoy in the report. Graham Wright, MicroSave and Mathew Titus, Sa-Dhan could not attend the meet, but participated by providing written responses to the questions discussed. I thank all of them for their ready participation in the discussions.

There are several orgnisations and people that I had visited personally: Gouri Sankar, Manohara Raj, R.M. Nair, B.B. Mohanty, Kamala Rajan, S.K. Chatterjee, Anna Somos Krishnan, Vikash Kumar, Abhay Kanjikar, Raja Menon, Bani Saraswathi, P.N. Vasudevan, Gopal Ghosh, Madhuri Ghosh, Niraj Verma, Achla Savyasaachi, Dr Sudarshan, J.L. Samudre, Manab Chakraborty, Rukmini Parthasarathy, Nand Kishor Agrawal, Dr Y.S.P. Thorat, Dr Nachiket Mor, Sanjay Sinha, Ralf Radermacher, Alok Sinha, Rani Nair, R. Sowmithri, Navin Anand, Monika Khanna, Ratnesh, Rupalee Ruchimishta, V. Tagat, M.V. Patro, Royston Braganza, Sashi Srivastava and many others that I am unable to name for want of space. There are some who helped by sending information—Ajit Kanitkar, Oliver Schmidt, S.G. Anil, Rahul Tandon, Ramesh Bellamkonda, Bhalchander Vishwanath. I am thankful to them for their keen interest in the report. I seek forgiveness from those whose names might have been left out; their contributions have been no less.

Sa-Dhan had provided a considerable amount of information from their database and studies. Their consent for using the material in the preparation of the report has been invaluable. NABARD had made available the provisional information much earlier than in the previous years. The data flowing from these two streams forms the basis of the trends discussed in the report. The advisory group of Microfinance India comprising of Sitaram Rao, Y.C. Nanda, Brij Mohan, Malcolm Harper, Vijayalakshmi Das, Moumita Sen Sharma, Justin Oliver, Achla Sabyasaachi, Alok Prasad, Malini Thadani, Manoj Sharma, Marie Luise Haberberger, Vishal Mehta and Vipin Sharma was very helpful in keeping me on course with sound advice. The loss of Sitaram Rao was no doubt a blow to the sector, it was a personal loss for me; he was available at any moment for a discussion and for providing escape routes from impossible situations.

I thank the donors—UNDP, Ford Foundation, IFC and Citi Foundation—for offering total support and the freedom to decide the editorial policy. I thank CMF-IFMR and UNSE for being the research partner and knowledge partner respectively. Yeshu Bansal untiringly anchored my work from ACCESS. Jaipooja Shah ensured that I meet the right people and get the correct information in time. She was of immense help in processing most of the data presented in the report. Without Lalitha, I would have run into logistical nightmares. Vipin Sharma has the knack of finding easy solutions for difficult problems. My gratitude to Vipin for letting me do this task (which has a difficult process but an enjoyable result) for the second year running.

Pravin Shinde did the typing of the initial draft from voice files this year too. Girija Srinivasan reviewed a part of the report and provided critical inputs for which I am very grateful.

Prabhu Ghate is to be commended for his foresighted structuring of this report format in 2006. This year's report carries a lesser number of chapters, but hopefully more information. We do not have separate coverage on social performance, urban microfinance, competition, major institutions and business correspondents. These have been integrated into the relevant chapters. A topical addition is a chapter relating to the adverse developments in Karnataka. Financial inclusion and human resources warranted a closer look through separate chapters. I have not been able to fulfil all expectations on coverage on account of the constraint of space and time. I hope that the readers will forgive and find the presented information interesting and useful.

My thanks to many over there who had read the report last year and communicated their appreciation and expectations. If this report in any way informs, influences and makes a difference, it has done its job. With all humility let me say that the views in the report are all personal and as such I alone am responsible for errors of omission, commission and interpretation.

I value reader feedback and hope to receive it from many of you.

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Overview—Signs and pains of maturity

1
Chapter

THE MACRO CONTEXT

Last year's report flagged the high potential for growth as also the increased risk in the sector. The question was what happens when the latent risk becomes real? The other question was the continued availability of funding for fueling the rapid pace of growth. The sector during the current year began to experience the risks inherent in fast paced growth in a competitive environment. It also saw that funds flow could dry up, even when nothing fundamentally changes within the sector. But shrugging off such internal and external adversities, the sector continued to march on amidst trying conditions and post good growth rates.

Macroeconomic conditions were not as conducive last year for several sectors. Growth rates declined in the primary, secondary and tertiary sectors and stocks and real estate markets underperformed. The global meltdown, more particularly the financial sector with successive waves of bad news coming from sub-prime lending, a falling real estate market eroding the value of underlying mortgages, bursting of asset bubbles, losses in derivatives markets and massive frauds such as the failed Madoff investments impacted export demand and peripherally affected the Indian banks to the extent of their limited exposure. The real impact was felt with a time lag when recessionary conditions abroad resulted in reduced demand for export of goods and IT services which led to job losses in India. During the year 2008-09 the gross domestic product registered a growth of 6.7 per cent compared to 9 per cent posted during the previous year. Considering the global situation in which leading economies registered a decline in their GDP, the Indian story has been, commendable. The growth in agriculture had declined significantly to about 35 per cent of the growth rate registered in the previous year. Only a resilient services sector came to rescue. The large domestic market and the commendably swift actions of Government of India and Reserve Bank of India (RBI) in sustaining liquidity flows and greater public expenditure did ensure that growth rates did not plummet dramatically. A deft handling of monetary and fiscal policies made for soft landing of the economy in difficult global conditions.

Different surveys[1] show that business confidence is quickly reviving and is likely to lead to a higher growth rate during the current year than was considered feasible as recently as three months back. Banking sector continues to grow at a brisk pace registering credit growth in excess of 20 per cent as also savings growth in excess of 20 per cent. However, there seemed to be a marked shift towards public sector banks with the growth rate of private sector banks registering a decline from the last year. Foreign banks registered a fall in their growth rates of deposits and credit. The year saw a few significant initiatives being rolled out and more being promised. In accordance with the measures announced in the last year's union budget one of the biggest loan waiver programmes was implemented across the farming community with loans waived off to the extent of around Rs.700 billion benefitting more than 40 million farmers. Cooperative banking structure in some states had received partial recapitalisation under the cooperative reforms package (recommended by the Vaidyanathan Task Force).

In the midst of relative insulation of Indian economy from external shocks, the sting in the tail has been food price inflation arising from internal and natural causes. The tight food stocks at the end of last year became scarce with the failure of monsoon in parts of the country. The restricted sowing of grains, oilseeds, pulses and sugar cane consequent

to the failure of monsoon in the current year has raised fears of scarcities and influenced the already firm looking commodity prices to spiral upwards. The paradoxical situation is that on the wholesale price index measures, the inflation measured is negative while consumer prices of goods of essential mass consumption have been relentlessly going up over the past few months. With microfinance clients remaining vulnerable to price increases in mass consumption goods, the microfinance sector should expect to absorb shocks of customers' failure to generate surplus cash and manage the consequent risks. The impact would be greater in rain deficient geographies, but even in other areas the consumption to income ratio is bound to be high, impacting repayment rates. There are apprehensions in some quarters that large government borrowing programme might lead to higher interest rates and feed inflationary pressures, which would show up once the base effect of last year's high wholesale price index (WPI) inflation rates wear off in October 2009. The macro context is delicately poised from the point of view of microfinance institution (MFI) customers as also MFIs from the twin problems of food price inflation and expected tightening interest rate conditions in the third quarter of the year.

THE MICROFINANCE STORY

Micro finance sector seems to grow and with no fullstop in sight. The sector performed creditably in a year that experienced a widespread liquidity crunch. The Self Help Group (SHG)–bank linkage programme made remarkable progress during the year; provisional data[2] indicates that credit to more than 1.716 million SHGs would have been made available during the year[3]. The outstanding SHG loan accounts were 4.14 million representing an estimated membership of 54 million. The MFIs too have recorded an impressive increase of about 8.5 million clients during the year registering a growth of 60 per cent over the previous year. The data collected from 230 MFIs[4] by Sa-Dhan reveals that despite liquidity constraints faced by some MFIs, expansion in client outreach and loan portfolio was vigorous. The MFIs reported a total client base of 22.6 million as at the end of March 2009. The overall coverage of the sector as narrowly defined (outstanding accounts of members of SHGs and clients of MFIs) is estimated to have reached 76.6 million against 59 million last year.

After adjusting for overlaps the net client base of the micro finance sector is estimated at 70 million[5]. The adjusted growth in outreach is estimated to be 14 million clients which is about 50 per cent more than the 9.9 million new clients added during the previous year. This growth story has several positive and some not so positive elements. In terms of sheer numbers, more than 50 percent of low income households of about 130 million are covered by one or the other form of micro finance[6]. Outstanding loans of MFIs increased from Rs.59.50 billion to Rs.117.34 billion in 2008–09. In the case of loans outstanding loans in the books of banks against SHGs, the provisional information is that it has reached Rs.241.96 billion by March 2009 compared to Rs.170 billion in the previous year. The total outstanding microfinance loans amounted to Rs 359.39 billion posting a growth rate of 30% over the last year's level of Rs 229.54 billion. At the current level, microfinance constituted 1.29% of gross bank credit of Scheduled Commercial Banks; an increase of 0.27% over the last year which is no mean achievement in a year of general economic slowdown. The growth in the size of loans has been significant in the case of MFIs compared to the size of loans given by banks to SHGs. The growth in terms of number of clients with outstanding loans in absolute terms reveal that while MFIs added 8.5 million clients, they also added Rs.57.80 billion to outstanding loans. In the case of banks, the SHG loan outstanding has increased by Rs.71.5 billion with an addition of 6.9 million clients through 0.52 million more SHGs. The vigorous growth of MFIs and that too on a narrower organizational base highlights the potential at the bottom of the pyramid.

Possibly the current year is a watershed year in the micro finance sector as the client growth in the MFIs exceeded that of the banking sector in terms of SHG members[8]. At the current growth rates and higher per capita loans, MFIs might outstrip the SBLP in portfolio volumes in the next few years.

The emerging new reality is that the MFI channel is not the poor cousin anymore. There are initial signs that MFIs are crowding out the banks from the sector in southern states. Is this necessarily a good development for the clients will need serious examination in the coming years. The broadly defined microfinance sector including small accounts

Table 1.1 Client outreach (outstanding accounts)

(in millions)

Segment	2006–07	2007–08	2008–09	Growth- 2009 over 2008
Banking system	38.02	47.1	54.0	6.9
MFIs	10.04	14.1	22.6	8.5
Total	48.06	61.2	76.6	15.4
Total adjusted for overlap	44.97	56.0	70	14

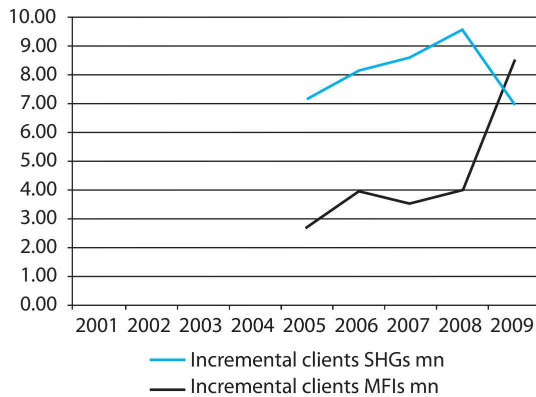

Figure 1.1 Addition of incremental clients by SBLP and MFIs[7]

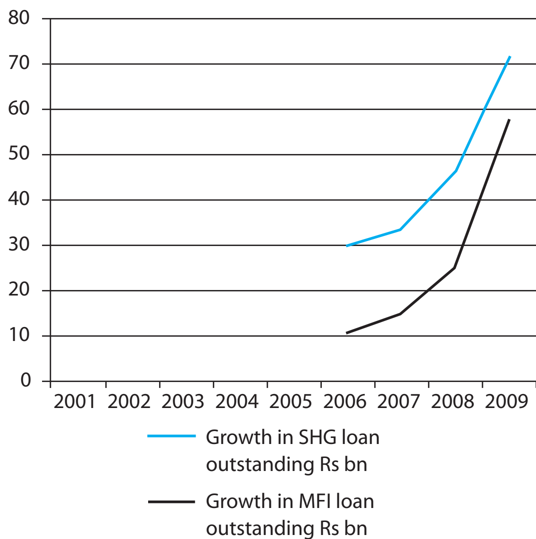

Figure 1.1 Growth in outstanding loans[1]

of commercial banks, small and vulnerable borrowing members of the Primary Agricultural Societies, SHG members and MFI customers had more than 135 million clients by end March 2008, an increase of about 15 million over the previous year. The number of accounts is more than double the number of poor households at 61.4 million. But still many excluded poor households exist on account of multiple accounts being held by some poor households and many non-poor households having greater access to multiple loans.

QUALITY OF GROWTH

The expanded outreach in loan disbursement has been achieved by a number of MFIs which also

Table 1.2 Estimate of microfinance clients

Class of agency	No of clients on 31 March 2008 (millions)
Commercial banks (including RRBs) small loan accounts	41.00
Primary cooperative societies Borrowers (small, vulnerable)	28.54
SHGs–members	47.1
MFIs–clients	14.1
Total	130.74
Adjusted for overlap between banks and MFIs	135

Note: The data relating to SHG members as on March 2008 has been updated on the basis of latest data from NABARD. Commercial Banks Small Loan accounts data estimated on the basis of priority sector loan accounts for 2008 in the absence of specific data for March 2008.

established benchmarks in quality of lending as well as the processes adopted. However, there have been certain concerns caused by intense competition, unbridled expansion tactics and borrower fatigue which the sector had to battle during the year. The aftermath of entrenched default in some parts of Karnataka seems set for a protracted reconstruction process. It must be added that the size of the problems are small constituting a portfolio share of less than 0.5 per cent and confined to a few geographical locations. But the possibility of a virulent spread to other regions, among other institutions is worrisome.

The regional skew was continuing to be addressed by both the banking sector and by the MFIs. Northern states turned in a better performance growing at 232% as also the southern region. Eastern and North eastern regins had moderate growth rates while Central and western regions showed a decline in the number of groups with loans. . Concentration of micro finance in southern states has intensified competition for client acquisition as was observed in the last year's report. While competition intensified in the southern region, some competitive practices have been reported from the east and north regions. In some locations the intense competition coupled with other undesirable practices has resulted in concerted action by the clients to withhold repayments of their loans to MFIs. The banking system in such locations has also reportedly suffered collateral damage. The underlying issues and motivations of this development have been discussed separately in a later chapter. MFIs have penetrated in to more underdeveloped districts. Sa-Dhan reports that MFIs have reached 234 of the 331 poorest districts identified by

[1]Data in respect of SHG outstanding loans were estimated for the years 2005 and 2006 as there were not available in the published data sets of NABARD.

the government[9]. MFIs have a significant proportion of clients (34 per cent) from disadvantaged sections of the society. Women formed 93 per cent of total MFI clients. The SBLP has registered a decline in the number of women SHGs from 82.5 per cent in March 2007 to 80.4 per cent in March 2008.

The microfinance penetration index[10] shows that still the gaps exist in the Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh (BIMARU) states and northern region. While in UP and Bihar initiatives to accelerate the pace of SHG linkage have been undertaken, the task would take some time and more resources to complete. MFIs have not spread to some of the states in the north-east such as Nagaland, Arunachal Pradesh and Mizoram. They have shown good performance in Madhya Pradesh, Uttar Pradesh, Maharashtra and West Bengal compared to the SHG bank linkage programme. What is surprising is that the MFI lending has exceeded the volume of bank lending to SHGs in Karnataka, which is intensively covered by banks and MFIs. In case of Andhra Pradesh (AP), the lending and outreach have reached extraordinary levels. *Putting together the data in respect of SHG lending and MFI lending relating to 2008–09, one arrives at more than 20 million microfinance clients having been financed to the tune of Rs 123 billion in AP. The number of households in AP is about 16 million. Statistically more than 125 per cent of all households in AP are covered by microfinance loans. If only poor families had been targeted, then each family had been financed eight times (the number of poor households is about 2.52 million) under microfinance. The average debt outstanding is estimated at Rs 49,000 per household, which is about eight times the national average MFI loan outstanding and about 11 times the average member-level loan outstanding in case of SHGs. There is a clear indication of fierce competition and multiple lending in all the three states. The intensive coverage of microfinance in Tamil Nadu, AP and Karnataka (see table 1.3) needs greater in-depth study and analysis. The concentration risk in developed geographies is growing.*

Table 1.3 Concentration of financing in southern states

Aspects	Karnataka	Andhra Pradesh	Tamil Nadu
No. of households (04–05) mn	11.16	16.02	12.96
No. of poor households (mn)	2.77	2.52	2.91
No. of borrowing SHG's members 2009 (mn)	4.09	15.81	7.49
No. of MFI clients 2009 (mn)	3.22	4.94	2.34
Total microfinance clients	7.31	20.75	9.83
Microfinance clients as % of poor households	263	823	337
Microfinance clients as % of total households	65	129	76
Total outstanding microfinance loans=SHG loans 2009+MFI loans 2009.	56.24	123.86	46.34
Average loans outstanding per poor household (Rs)	20303	49150	15924

The average loan size had increased significantly especially in case of MFIs and the proportion of clients that is offered lower size of loans has come down significantly. This is a welcome development as it improves the chances of clients getting viable size of loans to pursue livelihood activity and moderates the temptation for multiple borrowing. It also improves the profitability and the revenue to cost ratio per client in the case of MFIs and banks. But still the average loan sizes are too low compared with the requirements of livelihood activities that can produce a poverty-mitigating income for households. We should take cognizance of the fact that efforts continue on part of MFIs and bank to incrementally deepen their engagement with clients as reflected in the increasing average loan sizes.

Insurance coverage has been increasing, but not in the explosive manner of credit. Unlike in case of credit, insurance sector has not been able to come up with dedicated microinsurance institutions[11] that focus on small clients and their risk mitigation needs. The Insurance Regulatory and Development Authority (IRDA) has indicated that the insurance density at 46 (though an improvement from 38 in 2006) still has a long way to go compared to the advanced financial markets. The penetration ratio estimated for India in 2007 was of 4.7 per cent which was lower than the level achieved in 2006 at 4.8 per cent. The mainstream insurers are having to go downmarket and work on customizing insurance products. A number of new products have been rolled out and insurance companies have come forward with meaningful products in the last two years to increase the coverage. Interaction in the field with customers and potential customers for designing insurance products is increasingly evident; this would lead to greater product fit with client requirements. However poor claim settlement processes bedevil microinsurance. With all the problems of high covariant risks, mutual insurance arrangements seem to strike a positive chord among the micro customers.

The overall assessment on coverage is that the effort to cover remoter and underdeveloped geographies is increasing, but there is still a lot of catching

up to do. In terms of clients, most of the MFI sector is yet to shift to poor as first choice clients. Credit coverage still dominates, followed by insurance and savings almost invisible in the third place.

Several institutions had to accept less than 100 per cent repayment rates as part of their operations. Rescheduling of loans by MFIs has begun in a small way in certain locations, recognising the realities of customers' livelihood risks. Greater focus on improving livelihoods and income earning capacity of borrowers has become part of the MFIs approach towards the customers. Some product redesign attempts are underway. KGFS[12] a start-up, with an excellent pedigree is testing out a slew of innovatively designed products. Much of these efforts are aimed at addressing portfolio quality issues and mitigating long term risks in financing the same household over several cycles, with successively higher loans.

POLICY ENVIRONMENT

The microfinance bill placed before the previous parliament 3 years back lapsed along with the term of the previous Lok Sabha[13]. The same bill has been revived and is reportedly being taken up during the winter session of the parliament in the current year for passage into law. Little more than minimal drafting changes are expected. The bill in its present form might not secure the objectives of regulation of the sector[14]. A new Payment and Settlement Systems Act came in to force. This would regulate activities of MFIs and impact the financial inclusion sphere. The RBI made incremental changes to some of its guidelines relating to banking correspondents. In a significant development the RBI introduced guidelines for issuance of prepaid instruments which could intensify the penetration of finance in several rural pockets. Further RBI had allowed drawal of cash against debit cards in merchant establishments in a path-breaking initiative. This could see emergence of card-based savings products and enrolment of more merchant establishments by banks. Two important working reports had been released in August 2009; (1) the report of the working group to review the Business Correpondent Model[15] and (2)the report of the working group on the Lead Bank Scheme[16]. The recommendations made by these working groups have been strikingly positive and seek a regulatory push to financial inclusion.

The clarifications issued on equity held in MFIs by Indian companies in which there is majority foreign ownership led to a search for domestic equity. The opening up of priority sector lending window to microfinance sector through a variety of instruments has led to some vibrant action in the market, benefiting MFIs in their resource mobilization efforts.

The two working group reports on Lead Bank Scheme and Banking Correspondents (BCs) have recommendations that have the potential to alter the microfinance landscape significantly. Competition from banks through better partnerships with several types of BCs might limit the growth pace and even erode the clientele of microfinance sector as banks could offer the entire range of products. Whether the MFIs would find ways of becoming correspondents of banks (there is a clear suggestion favouring the same) to retain their customers has to be seen.

The union Budget 2009 has proposed to introduce a Food Security Act that would make below poverty line households food secure. It has also mooted restructuring of the Swarna Jayanti Gram Swarozgar Yojana (SGSY) as National Rural Livelihood Mission with the objective of poverty eradication by 2014–15. It envisages that at least 50 per cent of all rural women in India should become members of SHGs over the next 5 years. Rashtriya Mahila Kosh (RMK) would see it corpus being raised from Rs 1 billion to Rs 5 billion over a 3 year-period. In terms of banking network , it would mandate the State Level Bankers Committees to formulate an action plan for providing banking facilities in under-banked/unbanked areas in the next 3 years, with a provision for grant funding investments in such infrastructure. These announcements would be mostly implemented through public sector institutions and government agencies. With the evidence of significant coverage in microfinance, the government has to open up the space to non-governmental organisations (NGOs) and MFIs. In terms of cost, efficiency and speed they offer the best chance of accelerated implementation on the ground.

THE CHANGING LANDSCAPE

As reported last year the move towards transformation of NGOs into own- account lending institutions has gathered pace. Urban micro finance has become a magnet for several large and small MFIs. However, the growth posted in urban locations during the year had been moderate compared to rural business. Some of the aggressive growth plans that were designed in the last year have in fact been realised by some institutions. Many small institutions had to scale down their business plans in the absence of bank funding. The transformation story is still evolving and one has to wait for a couple of

years more to see how the response to some of the regulatory initiatives taken by RBI in recent years impacts the already competitive marketplace.

Some of the new institutions that entered the sector have professional promoters, clear vision backed by sound business models. These institutions are able to find both equity and bank funding. Comparatively, MFIs with parentage of NGOs find it difficult to expand; access to banks' funds is a limitation which they need to crack. Banks are not too comfortable with their past record as a socially oriented institution and the key personnel behind transformation in such cases.

Banks have greater comfort in exploring different alternatives for engaging business correspondents in pursuit of financial inclusion. Eight million accounts have been opened by banks using the banking correspondents so far (which is about 50 per cent of the new customers acquired by the microfinance sector). If this gathers momentum, the competition for the microfinance customer is bound to be severe. The guidelines issued on mobile banking have not led to the kind of explosive activity expected by sector watchers. Neither banks nor technology providers have been goaded in to trying out a number of alternatives for giving shape to mobile based banking. The muted response has led to very few pilots and there seem to be a great deal of inertia on the part of banks which are required as the financial and transactional backbone. The suggestions made by RBI on legitimising money lending through appropriate changes to the statute and bringing in different forms of control and supervision has not received much attention.

MFIs have found a greater need to collaborate on sectoral aspects even as they compete for customers and market share. A clutch of MFIs have joined hands to set up 'Alpha Microfinance Consultants' which has reportedly mobilised Rs 28 million initially from the members for being used to acquire a stake in a credit information bureau or set up a new one. International Finance Corporation (IFC) and Omidiyar Network are in the process of carrying out market research through Access Development Services for setting up a credit bureau for microfinance sector.

FUNDING TRENDS IN THE SECTOR

Equity flows were brisk especially in the third quatrter of the year with about US$ 130 million having been mobilised by the MFIs. The year witnessed liquidity crises in the banking system for a short period of time as a result of the aftershocks transmitted from the west. The severity of the financial sector melt down was much less in India which was significant enough to affect flow of funds to sectors and institutions that were perceived to be high risk. Among MFIs the large ones did not have a major problem in accessing finance from the banking sector. Though some of the private sector and foreign banks reduced their exposure to some extent, Public Sector Banks, Small Industries Development Bank of India (SIDBI), Industrial Credit and Investment Corporation of India (ICICI) Bank, and Housing Development Finance Corporation (HDFC) Bank stepped in to fill the gaps. However, the tier II and tier III MFIs faced difficulties in raising funds. The problem was acute in the second and third quarters of the year. The constraints eased to a large extent in the last quarter.

A substantial number of sanctions and disbursements took place in the month of March. The balance sheet of many MFIs showed that they had very high cash and bank balances and their loan portfolio was much smaller than the outstanding borrowings. While this gives a misleading picture of availability of funds, it also creates space for misapplication of funds. Pursuit of year-end performance goals of banks should not distort the assets and liability structure of the MFIs who would be holding large amounts of cash which they cannot utilise at a time. A detailed discussion of the extent of this problem and some of the underlying reasons are in a later chapter. Both **National** Bank for Agriculture and Rural Development (NABARD) and SIDBI had reported significant increase in their exposure to micro finance. While SIDBI has more than doubled its outstanding loans, NABARD has shown an increase of about Rs 10 billion in its disbursement towards SHG linkage refinance to banks raising the share of microfinance to almost 25 per cent of total refinance disbursed in a year, compared to less than 15 per cent two years back. The Micro Finance Development and Equity Fund (MFDEF) with NABARD reported disbursal of small amounts of quasi-equity to 13 agencies amounting to Rs 113 million. SIDBI had introduced a new line of lending to MFIs to enable them to finance micro enterprises, graduating out of MFI clients. Friends of Women's World Banking (FWWB), the other bulk funder disbursed more than Rs 4 billion and had a year-end outstanding portfolio of Rs 2.9 billion; 34 per cent increase over the previous year. The government on its part has announced its intention to restructure RMK and provide much larger resources (Rs 5 billion) in its recent budget proposals. With significant funds

availability and a restructured institution in place tier II and tier III MFIs have a lot to hope for.

IFC last year announced Microfinance Initiative For Asia (MIFA) in partnership with Kreditanstalt für Wiederaufbau (KFW) for providing funds to the sector. World Bank and KFW are appraising projects for providing funds ranging from US$ 200 to 500 million for microfinance through one of the apex development banks. Department for International Development (DFID) is on the verge of launching a new poverty reduction initiative called Poorest States Inclusive Growth for four states viz, Orissa, Madhya Pradesh, Bihar and Uttar Pradesh, that will have a significant microfinance component. This programme with an outlay of about 36 million GBP is expected to significantly impact the underserved status of atleast four states. Overall these factors will positively impact the fund availability position within the sector.

Despite the reported liquidity constraints banks and financial institutions lent more than Rs 100 billion in bulk funds. New entrants from the banking system increased the availability of bulk funds and also widened the choice of instruments. The year saw compulsorily convertible preference shares, non-convertible debentures, securitised debt assignments and portfolio purchases being used in resource mobilisation. Grameen Capital had led the development of the market for new financial products and mostly private sector banks supported such offerings.

TECHNOLOGY

More work on technologies for financial inclusion has been underway. The use of smart cards, biometrics and mobile based transaction devices are being experimented with varying degrees of success. The EKO[17] experiment on mobile banking has gone further ahead in partnership with State Bank of India. Unitus facilitated a successful small-scale pilot on mobile banking through a partnership between mChek and Grameen Koota. Indian Bank has tested out biometric-based rural ATMs in their specialised branches for SHGs. But the comfort level of MFIs with the different technologies on offer is at best mixed. Failure of cards, card terminals and the software has been reported. The manual override of procedures adopted in case of technology failure is fraught with risks of misuse and fraud. Further, some of the technologies that offer smart card-based financial inclusion have been found to be expensive. A comparative analysis of some of the software solutions available is presented in a later chapter in the report. Banks and institutions are trying out effective low-technology (and no-technology[18]) solutions in an effort to control the costs and improve the reliability of operations in the field. A recent consultation meet[19] on financial inclusion questioned the reasonability of assumption of short break even periods especially when high technology is involved in the processes.

STUDIES AND ASSESSMENTS

While there had not been too many large-scale studies in the sector during the period under review, there have been a couple of study reports that appeared causing concern. One report suggests that the impact of microfinance on the poor has not been as positive as the sector would believe. Another report goes to suggest that as an instrument of poverty alleviation, microfinance does not come out as a clear choice. Centre for Microfinance's (CMF's) study of Spandana customers in Hyderabad slums was unable to find unequivocal evidence that microfinance lifts people out of poverty. The findings indicate that microfinance is a great tool for smoothening consumption and relieving seasonal liquidity crises that visit poor families; and that it obviates the need to resort to high-cost borrowing from informal sources. The longitudinal impact study commissioned by SIDBI came to an end last year. The report finds that some of the intuitive hypotheses on impact of microfinance are supported. What is counter-intuitive is that the hypothesis 'Microfinance is an effective strategy for extending financial services to the poor…' is only partially supported. The hypothesis that microfinance contributes to women's empowerment is also found to be only partially supported by the study. Skoch Foundation carried out a study[20] that found that only a little over 10 per cent of newly opened no frills accounts were actually used. GTZ had commissioned an inventorisation of MFIs and microfinance organisations (MFOs) in the country. More than 750 MFIs have been identified and brought into a database for the first time. This is more than three times the number of MFIs that report to Sa-Dhan's quick report. Further work on improving the data quality is ongoing. This inventory holds promise of bringing more information on the numerous smaller operations in microfinance to the table.

FINANCIAL INCLUSION

The financial inclusion initiative gathered momentum during the year. Several pilots of different types

have been launched in an effort to reach the excluded population in a search for cost-effective solutions. More than 8 million savings accounts have been opened, but on the credit side not much information is available. Financial inclusion is dominated by savings-side efforts and use of banking correspondents, especially those with technology solutions. The RBI has been making incremental changes to the banking correspondent arrangements. A working group set up by RBI had recommended some sweeping changes to the BC framework. It is agreeable to let banks collecting reasonable service charges from the customers so as to compensate the BCs adequately. It has suggested inclusion of many new types of correspondents such as

(i) individual kirana/medical /fair price shop owners;
(ii) individual Public Call Office (PCO) operators;
(iii) agents of small savings schemes of Government of India/insurance companies;
(iv) individuals who own petrol pumps;
(v) retired teachers;
(vi) authorised functionaries of well run SHGs linked to banks and
(vii) non-deposit taking NBFCs in the nature of loan companies whose microfinance portfolio is not less than 80 per cent of their loan outstanding.

The working group report has taken in to account the views from the sector in ample measure. Implementation of the recommendations by RBI would be watched with keen interest.

The quality of the inclusion effort has not been exemplary. A study carried out by RBI concluded that better focused efforts are possible and that most included accounts are not operational. The Skoch Foundation's study also concluded that only 11 per cent of newly opened accounts are operational and found that the cost of customer acquisition is so high that it cannot be easily recovered out of incremental business arising from such customers. There were studies carried out by researchers of CMF and a multi-state review of inclusion by RBI, all of which confirmed the assessment that present inclusion effort is more about form than about substance. The two funds[21] set up for promoting inclusion have commenced funding of projects; but these are but a trickle[22] compared to the requirements of the mammoth task ahead. A global initiative of GTZ, funded by Bill and Melinda Gates foundation became operational under the name of Alliance for Finance Inclusion. It has plans of being active in the policy influence sphere.

EMERGING DEVELOPMENTS

There have been sporadic adverse developments reported from different parts of the country. Increasing defaults, concerted action to refuse repayments and frauds have been the subject of such reports from Karnataka, UP, MP and Orissa. Kolar district in Karnataka has become the nucleus of a fairly well organised and concerted resistance from clients for making repayments. The fact that this resistance is spearheaded by religious leadership is a cause for utmost concern. The potential for this event being used as a precedent has to be minimised through quick and decisive action. One of the positive fallouts of this politico-religious interference is the bonding of MFIs to take concerted action on several aspects. There also been reports that some MFIs have been facing considerable difficulties in securing repayment of loans in the states of Orissa and MP. In Uttar Pradesh a fast growing MFI has encountered major problems in its portfolio growth and sustaining the quality of its portfolio. This reportedly has been caused by a number of factors that directly relate to its own planning for growth and processes adopted. In the SHG lending, UP has reported a disproportionately high level of non performing assets. MP, Maharashtra and Bihar also have disproportionately high levels of NPA compared to their share of SHG loans. On a positive note, the Side by Side report 2008 finds that the current repayment rates have increased to 99 per cent in 2008 from 97 per cent in 2007, reflecting a healthier trend in portfolio quality. But the portfolio involved default in Kolar district alone at Rs 0.6 billion would add 0.5 per cent to the NPAs when measured against outstanding loans at the country level. There have been reports from some states that use of agents by the MFIs had led to alienation of clientele in the post-loan disbursement stage resulting in deterioration of portfolio quality. All these point to the learning that while planning for fast paced growth has its place, planning for good processes that should accompany the growth strategies is equally important. Along with client acquisition, client retention and sustaining client loyalty should also be targeted. The last year's report did point out some of the underlying problems of aggressive expansion and virulent competition that might result in adverse developments.

It must be emphasised that some of the new institutions have grown well while doing good to their clients. Their growth rates have been above industry average and their ability to adopt transparent and effective processes with the clients has been commendable. Equitas Microfinance, Chennai has been

profiled later in the report as one of those fast growing MFIs with appropriate systems and processes that balance commercial interests with customer concerns. There are a few stories of transformation of institutions in the making which makes the sector feel comfortable to the extent of sensitivity and responsibility shown to clients' comfort.

The continued interest of equity investors and bulk funders in the microfinance sector signals that inspite of some of the problems that are faced the overall health of the sector is good. Professionally managed institutions continue to command a premium in the market. Even tier II MFIs have managed to mobilise equity at attractive terms. The confidence of investors in the sector is also continuing to be high. So these make for comfort in dealing with the sector over a longer period of time.

Corporate India (such as ITC, Hindustan Unilever, Godrej, BP energy, Philips, Shell, Eureka Forbes, Metro) seems to have intensified its interest in microfinance clients. Some efforts at providing markets for goods and services produced by microfinance clients have been made and mainstreamed. A unique partnership has evolved between ACCESS and Unilever in an attempt to provide access to clean drinking water to poor MFI clients. Some others seem to be customising products for the rural markets (Godrej refrigerators, BP energy smokeless stoves) and marketing the same through the MFIs. MFIs apart from becoming agents of the corporate sector also provide loans to the customers to facilitate the transactions. The impact of these agency arrangements coupled with financing has to be carefully figured out. Whether the customer is served better and whether the incremental debt contributes to better livelihoods are issues that need examination.

GLOBAL TRENDS

Globally microfinance sector experienced shocks induced by the meltdown. A survey carried out by Microfinance Insights[24] brought out that deposit-taking MFIs registered growth of client deposits. Remittances were reported to have declined and bad debt provisions increased. MFIs had to concentrate more on risk management and diversification of funding sources. Investors in MFIs reported that they engaged in tighter monitoring and tightened due diligence on potential investee companies. In a cross-regional comparison investors rated Eastern Europe and Central Africa as well as Sub-Saharan Africa as high-risk markets. South Asia was rated as the least risky market for investments.

An inter regional comparison shows that south Asia, East Asia and the Pacific region posted the highest rate of growth in terms of client outreach to poor during the period 2002 to 2008. Sub-Saharan Africa, Middle East and North Africa region had the slowest growth rate. Cost per loan was the lowest in Asia and the highest in Eastern Europe and Central Asia. The MixMarket 2007 benchmarks show that

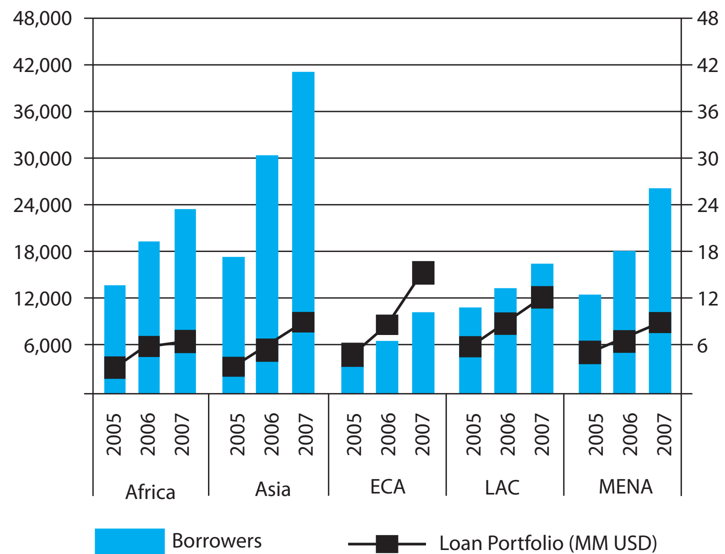

Figure 1.3 **Growth in outreach and loan volumes**

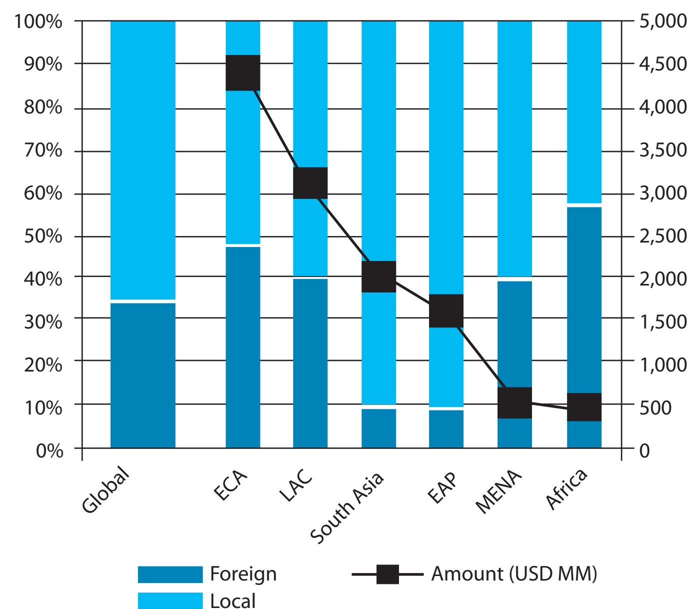

Figure 1.4 **Source of funds—foreign and domestic**

Source: MIX 2007 MFI benchmark. Data represent totals for each region. EAP= East Asia and the Pacific; BCA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa. Notable exclusions: BRI (Indonesia).

South Asia had the highest client outreach among the regions as also portfolio volumes in 2007. South Asia had a high level of domestic funding in microfinance which seems to have significantly helped the sector to absorb shocks arising from the global meltdown.

Within Asia, India emerged as the largest microfinance market, thanks to its size and high proportion of poor. While sector-specific microfinance regulation exists in countries like Bangladesh, Pakistan, South Africa, Kenya and Uganda, India is yet to introduce a law. The market opportunities in Indian market are rated to be high, with several international and national funders willing to invest. The Indian MFIs have enjoyed a better valuation for their equity compared to their counterparts elsewhere in the world.

The MIX Market database (2007) provides interesting comparisons across countries. On a range of financial ratios, a comparison was made to understand the position of Indian MFIs. The data across countries are not exactly comparable as they come from only those MFIs that report to MIX market which in some countries is a small minority. The number of institutions reporting, their client base and other related aspects could give a slant to data that might not be typical of the entire sector. Table 1.4 should be viewed with this caveat in place. Bangladesh MFIs with a large client base and loan volumes still struggle to cover their operational costs, even after 15 years of functioning. Brazil and Mexico are countries where MFIs are profitable, but on high interest rates and high average loans. Indonesia has average loans that are more than 10 times that of Bangladesh. Pakistan MFIs continue to struggle to cover costs. Indian MFIs with the lowest yield to gross portfolio, manage to cover costs even on low average loan size. The inference is that Indian MFIs have efficient systems and are able to manage their businesses on thin margins. The challenge would be to find funds for increasing the average loan size which could significantly improve return on assets and operational self sufficiency.

Table1.4 Indian Microfinance—a global comparison

Country	OSS	ROA	Profit margin	Average Loan US $	Yield on gross portfolio
Kenya	118.1	–1.0	–0.2	463	31.3
Uganda	116.1	2.7	9.4	325	53.7
Bangladesh	106.6	–0.3	–1.2	80	24.3
Pakistan	85.1	–6.6	–47.4	187	27.9
Philippines	113.0	0.5	6.7	288	38.5
Brazil	133.6	6.4	19.4	820	41.5
Mexico	113.2	3.0	10.2	468	62.8
Indonesia	142.8	3.1	15.4	915	22.5
India	111.4	0.7	7.9	146	21.2

CONCLUSION

The microfinance sector is delicately placed in the larger political economy. It has to learn to adjust to new realities of aftershocks of the meltdown that affect its clientele. It has also to cope with the possibility of hardening interest rates and lack of head room to re-price its loans to poor clients. The sector has to meet political (and religious) expectations and at the same time deal with customer fatigue resulting from worn out loan products and processes. But the way it has harnessed the growth potential is remarkable. To do what the sector has done with efficiency and low costs to customer (in comparison with the institutions outside India) is a laudable achievement. The sector has no inclination to pause and celebrate its achievements. Also it has little time to reflect and learn from its past performance. The competition for market share and new geographies has led the MFIs to work at dizzying speeds. The realisation that competition could also have negative fallouts comes as a rude shock. Mitigation of political risk (which includes politico-religious risk well) is occupying the centre stage. Perhaps the time has come to abandon unbridled competition to come together for formulating sector-wide strategies that protect institutions and regulate their conduct. Regulatory stance on microfinance has to change. The existing microfinance bill is far from adequate in scope and coverage. The recent problems of the sector demand a better regulatory dispensation than what is proposed. As for MFIs, along with external risk containment, internal policies on client acquisition, customer relationship and incentive structures also need to be set right. The need to do a good job of microfinance was always known; doing it well in the interests of the customer has become imperative now.

ANNEX 1.1
Practitioners' roundtable—issues facing the sector

A roundtable of practitioners was organised specifically for the purpose of this report on 10 August 2009 in Hyderabad, chaired by Vijay Mahajan, CEO, BASIX with participation from Suresh Krishna, CEO, Grameen Koota, P.N. Vasudevan, CEO, Equitas Microfinance, Dilli Raj, CFO, SKS Microfinance and Shankar Datta, Director, The Livelihood School. The roundtable was moderated by the author. In addition Mathew Titus, CEO, Sa-Dhan and Graham Wright, Programme Director, MicroSave India participated through written responses to the issues discussed. The discussions are carried in this section to give a snapshot of developments in the sectors from a practitioner's point of view. The roundtable was a joint initiative of Access Development Services, Alpha Microfinance forum and BASIX.

N. Srinivasan (NS): I welcome you all to this roundtable. This is to take stock of what is happening in the sector through the eyes of some of the most active minds in the sector. We intend to carry the transcription of the discussions in the State of the Sector Report 2009. Vijay has kindly agreed to chair and lead the discussions. Thanks for your positive response and your presence here this morning. **To start off can we share the microfinance story that we admire the most. What is it about the sector that makes us get excited? Where did we feel that this is how microfinance should be done?**
Suresh Krishna (SK): I think we can say that we are able to create opportunities for people by providing access to financial services. Multiple opportunities are there today on account of many institutions providing bank services in many parts of the country. I think what they have achieved in last 10 years is good. Not long ago, there was no formal institution providing any service, now 5 to 10 entities provide services to the low-income households in some remote locations.
Dilli Raj (DR): I think of an inspiring story of one of our field staffs. It is about Satyendra, a 22-year-old who was threatened by robbers. He decided to lay down his life rather than part with the cash collections for the day that he was carrying. If he had decided to part with that Rs 72,000 he could have saved his life. He paid with his life to save customers' money. His commitment is inspiring. But it is also very painful that he had to lose his life because we have been talking about mobile banking, technology and policy framework that would make cash transactions hassle free but before anything arrived he had to pay with his life. So this is truly inspiring.
P.N. Vasudevan (PNV): I will say that basically microfinance itself is inspiring in the sense that we don't have to do actually anything more than providing money on reasonable terms to those who don't have access. Many times we get a little rhetorical that we want to bring people out of poverty and all that. Even if we don't lift people out of poverty, if we just provide money on a reasonable and timely basis to people who don't have access it would be great. Otherwise they are left to borrowing on very adverse terms. It is not just the interest rate; it is also the enormous pressure from the moneylender. If they can access an alternative that is reasonable then it is a great service. Doing just that is a very attractive and relevant proposition. After meeting a client you always come back with a very satisfied and happy feeling that you have been able to help somebody seriously.
Shankar Datta (SD): Policy has positive view of microfinance today. Capital has started coming in. Large number of people has got into the sector including hardcore professionals. Microfinance getting mainstreamed in more ways than one is a gratifying feeling.
Vijay Mahajan (VM): I am excited that microfinance is unfolding in multifarious ways, geographical expansion, new products, going well beyond micro credit to micro-insurance and savings surrogate products. Geographically microfinance is no more a south Indian game. It has roots now even in the east—Orissa, Bihar and West Bengal—even in the north-eastern region. So in front of our eyes, many critics of microfinance have melted away. And between the two models the SHG model and the MFI model we can claim that 50 million mutually exclusive households have got covered. Organisations like SKS and Equitas have shown to the whole sector what kind of growth potential is possible provided you adopt suitable methods. When we started in this sector I was always thinking in terms of lakhs; but new institutions think in terms of millions. While it is true that we should do something collectively about multiple lending, remember that till 2–3 years ago, customer had no choice. So now customers have a choice of more than 2–3 MFIs and that will truly lead to inter-MFI competition. In a year when macrofinance melted, we kept the microfinance

flag flying. I believe based on international data that India is the one country where microfinance continued to grow. So it's a fantastic year; we should feel very happy. But more importantly we have shown the mainstream financial sector that there are people in the world of finance that have grown 50, 60, 100 per cent with high portfolio quality and in a financially sustainable way.

Graham Wright (GW): There are two institutions that are admirable. Equitas has expanded rapidly with a very efficient, IT-based system that has excellent and robust processes. Equitas is constantly seeking to improve its product offering and make its systems even more efficient. It is a balanced organisation in that while pursuing returns for its shareholders, it has a very firm commitment to a double bottom line with its trust which is focusing on food security, education, the handicapped and other socially relevant issues.

KGFS has been quietly working in Tanjore on what is third generation microfinance—and is (we hope) the real future of microfinance in India. It puts the client very firmly at the centre of everything—thus optimising client satisfaction. Both sustainability of KGFS (as dropout and delinquency will be minimised) and the developmental impact of the financial services offered are ensured. And the financial services offered are set to comprise a suite of 14–15 credit, savings, insurance and remittance products—thus responding to all the needs of the poor rather than simply asking them to manage with credit alone.

Mathew Titus (MT): Microfinance has expanded into urban and into remote hill areas. Both have been fascinating and manifold fruitful ventures, with many learnings and innovations. Both are still relatively small in comparison to the whole sector, but they have opened our minds to the possibilities that have been neglected so far.

DR: Like Vijay and Shankar said, mainstreaming of microfinance is an exciting development. Sophisticated instruments are now used for resource mobilisation. We started with commercial paper and got it rated. Now it carries the highest safety rating. The endorsement from the peers in the mainstream financial sector that makes this exciting.

NS: Last year almost possibly 8 million new clients were added by MFIs and an equal number by SHG programmes. The client growth rate across the MFIs is about 60 per cent. When we are growing at this dizzying pace are there any quality issues that accompany this? What are the downside risks?

PNV: Any growth is both good and risky. Life is represented only by the growth. Growth is something that you cannot wish away. Growth has lot of risk associated with it. We have to plan on how we manage the risk. If you are growing at a very fast pace, problems just come very fast. When you are busy growing you are not looking at the problem though it is also growing all the time. You suddenly realise at some point that the problem is hurting you badly. We have had this STPL loan segment (Small Ticket Personal Loan). Citicorp and GE Money were involved for 10 years; they built good volumes, made lot of money and expanded all over the country. They were doing very well. Suddenly in 2006 some 6–7 new banks and FIs hit the same market and in 2 years, by 2008, everyone including first two players has gone out of the business. Just 2 years it took for a 10 years business to come to a complete halt. In microfinance as you just said the market has grown by 50 per cent in just one year on top of may be 30 per cent growth of the previous year. We are growing so fast that many new players want to enter—L&T, Karvy, etc.

DR: I am for open entry and competition. I will therefore welcome new entrants. But we need to also think about why we created this sector. What is the implication of everyone wanting to come in? Will it lead to closure of the sector like what happened to STPL?

I just want to share two perspectives. First, even with this high growth we probably cater to 10–15 per cent of the underserved market. If it is software or telecom sector, people would have written us off as a failure but in microfinance we are celebrating because of social dimension. Look at the commercial dimension. If you are not competitive down the line in 1½–2 years, all of us will be much more vulnerable to competition. You can see formidable competition in Reliance, Bharti. They would not find it difficult to come in with 2,500 branches, the required HR and last mile cash handling. They will come well organised with good capital budget and fantastic execution skills. So what is the answer? The answer is that if you should grow and reach a critical mass in terms of customer base and business volumes, then you can optimise your cost structure. If the large players come they will cut the price. It is good for the customer and you can respond only if you are well prepared. Growth is more in a response to the social need. The second perspective from my management experience is that any business or any social movement or any institution grows on just four engines. There is capital, technology, people and market. Start with market, it is there of course. If we look at capital, it is available. So long as you have a viable business model capital is available. Technology is

available; all we need is orientation and of course a budget. As for people the sector is in a position to get mainstream talent. So all the four engines are available and if you could balance them, which is a fine art you could grow to the potential of the market.

SD: If I can add one more engine, that is the support systems. You see when an industry grows the support system also will have to grow. When the green revolution was taking place in this country one very important thing that was starting was agriculture universities that produced a stream of B.Sc. Agriculture people. Now that also facilitated the green revolution. So, similarly, I think microfinance today is at a stage when we have to start doing something similar. Universities will have to wake up and start offering B.Sc. Microfinance, the IT companies will have to have a separate division focusing on microfinance. If we don't pay attention to support systems we will face bigger problems in the future.

SK: It is good that so many new players are in and a lot is happening. One concern is that if there is too much free flow of money and without checks and balances on whom we are lending to and how much people are borrowing then the whole thing will collapse. We have no control and not much information about the customers. We must all work on the credit bureaus that we have been talking about.

VM: 28 NBFC players in the sector have come together and have established Alpha Microfinance Consultants. It will invest in a credit bureau with the specific purpose of influencing that bureau to be more microfinance oriented. Then other credit bureaus would also become more microfinance oriented as a competition strategy. We suffer from a systemic bias against MFIs. Quality of credit that we are offering is much beyond investment grade but we still get a poor rating. We are taking steps to remove the negative bias and similarly the industry association Sa-Dhan is also taking some steps.

GW: There is a feeling that the portfolio quality of some of the larger MFIs is not quite as good in the difficult geographies such as UP. This, MicroSave (and several other industry leaders including late Sitaram Rao) believes, is driven by the rush for growth, the emphasis on sales rather than relationship with the clients … Much of this problem can be traced back to three drivers:

- The easy availability of large-scale debt funds, as a result of priority sector lending requirements, has meant that banks are pushing funds at MFIs; this in turn attracted the attention and investment of commercial equity funds seeking annual returns of 30–40 per cent as they saw an opportunity to leverage relatively small scale equity investments.
- These commercial equity funds' demand for large returns that can only be realised by capital growth which requires the very rapid expansion of the MFIs' portfolio. Most commentators believe that they are not sustainable. MicroSave's work has shown that the processes in several of the larger MFIs vary across geographies—and that internal audit, controls and compliance management are often inadequate.
- Another driver of the rapid growth is the need to disguise growing portfolio at risk through rapidly expanding denominators in preparation for the public offering of the shares ... and exit for the commercial equity funds.

MFIs should focus on consolidating their processes and systems before embarking on any further large-scale expansion. In addition, it is essential that some more transparency is brought into reporting on portfolio quality and provisioning issues.

MT: Sa-Dhan observes that the steep growth has exposed the limitations of skilled manpower. Sa-Dhan has geared its HR-intervention to introduce certificate examinations and educational courses with reputed bodies such as IIBF and educational institutions.

The second big issue is group quality. Bankers and MFI practitioners agree that the approach to group formation is directly related to portfolio quality particularly in case of SHGs. Yet, in the SHG-arena a lot of laxity is observed, as SHGs are 'downgraded' to lending vehicles. Some SHG-practitioners are seduced by the steep growth of the JLG model. The growth trajectories of the two models must be different; otherwise, either is not living up to its potential.

Sa-Dhan emphasises particularly, that expansion of scope (and eventually scale) of micro-savings would address some of the concerns, as it would reduce re-financing risk and would press the MFIs towards organisational models that are savings and credit led, and thus inherently more focused on long-term client–MFI relationships (which quick-trained, disbursement-oriented credit officers might not always be).

NS: The financial sector meltdown has been talked about for more than a year now. We heard lots of stories as to how the liquidity has been squeezed. What is your perception of how this meltdown impacted the liquidity flows and other aspects?

VM: Over last year to this year the sector has grown almost 60 per cent which shows that even though rest of the economy had liquidity crisis, money actually came in to microfinance sector. The reasons probably are high returns, high quality portfolio and low risks. For most of the banks this is a much better option than actually pumping money into other sectors. This is a very positive side actually and also a blessing for microfinance. While poor did not gain from the boom times, they lost little in the bust. But there are certain sectors which have actually been affected like sericulture, handicrafts and exporting units such as diamonds, textiles etc. The impact on these people might kick in with a time lag.

SD: We have been writing a chapter for the State of India's Livelihood Report. There also we have done a review of this and indicators are showing that India is actually on a good revival path. In the last quarter of 08–09, revival has started.

PNV: As Vijay was saying the bottom of the pyramid is insulated, the people there neither benefited nor suffered. The 8 per cent + growth over 5 years that we had does nothing for 60 per cent growth rate in microfinance. If you think India has arrived, it has done so for 1/3 of the population. Of 16 lakh families in Chennai, 11 lakh still reside in a one room house; 9 lakh families don't have a basic banking account even though in Chennai within any given half km radius you will have multitude of branches and ATMs. I think the meltdown has not had much of an impact on customer except the impact of inflation on food prices. That is a cause for concern. If the food price remains high, it takes away part of family's surplus and its ability to save or repay.

From the service providers' point of view, actually it is a good thing to happen to the sector. Because it just brought the sector out of its complacency. Many new and old MFIs with ambitious expansion plans had to rework the same as they were not able to raise funds. The consequent slowing down brought in sobriety to the market.

DR: The mainstream financial sector had no time to focus on the microfinance sector earlier. In fact every MFI, in the midst of fund raising efforts, was unable to close capital issues, both debt and capital. We at SKS raised liquidity of 75 million dollars and that too just one month after the meltdown story broke. We pointed out that our customers are not part of mainstream of economy and that investments in MFIs are a good hedge against risks elsewhere. That message has gone well and the funders have rerated risks in the sector. Now in the midst of other risky exposures, microfinance sector is attracting notice with its low risks.

NS: But then tier II, tier III institutions complained that they had real problems. They are attributing their liquidity problems directly to financial sector meltdown. Are we saying that big institutions have been able to survive as they could show that they are a very good risk hedge? But for the smaller ones, we need some other arguments?

VM: General sentiment in the financial sector was low. The response was like 'call back as many loans as possible; do not sanction new loans'. It has nothing to do with microfinance but a general sentiment. Secondly when RBI announced its norms of capital adequacy everybody forgot the dates; they were focusing on adequate equity today, two years ahead. Banks started asking for capital adequacy literally for every disbursement. All MFIs then went towards raising capital. That's why there is a differentiation between the bigger one and smaller ones. Bigger ones were in the right size range to get PEs and VCs interested. The smaller ones had to wait for the MIVs and others. With liquidity measures taken by RBI, bankers regained confidence to come back to the sector.

GW: Many MFIs were struggling to attract the funds they required in the third quarter, but in the final quarter of the year many banks (under pressure to meet their priority sector lending requirements), including the public sector banks, have started lending to MFIs. MFIs and experts expected tighter credit conditions in the new financial year, from April 2009. The entry of the public sector banks (that hitherto only lent to self-help groups) is a very important step forward and likely to lead to increased demands for further efficiency and reduction in interest rates. Smaller and medium-sized MFIs do indeed often struggle to identify funds, but the larger ones are either using an ever-broadening range of financial instruments to obtain capital and/or remain able to attract the funding they require to finance their massive expansion.

MT: On the supply side (i.e. refinancing), the sector has not been affected so far, and we are optimistic that it will not be affected significantly. Obviously, there is anecdotal evidence of bank loan sanctions being somewhat less. But overall, the picture of earlier years prevails that small MFIs and SHG-federations are facing difficulty, while large and fast growing MFIs are increasingly dealing with a range of lenders. The contraction of financial flows might delay the innovation of a financing/investment model for SHG-federations. However, we are hopeful that MDEF would finally step up to narrow that gap. We feel that on

the demand side, clients' income has been affected. Diminished local and export sales led to lower demand for labour. Reduced income flows and loss of economic activity have been the drivers of all the incidents of MFI problems that have been recently reported. But the field problems are not on account of MFIs, which are by and large doing a great job.

NS: During this year some events have taken place in places like Lucknow, Mysore, Kolar. May be they are smal events which have not come into the radar but they have been happening in many parts of the country. How do we see these—as isolated incidents that should not be put together or draw a larger conclusion that these are actually symptoms of some kind of fatigue that is setting in?

DR: Basically these are external disturbances that do not change the underlying credit quality or the credit behaviour of the consumers. It will happen again and of course not in the same shape. You don't have a crystal ball in front of you to guess what would happen where. The real answer to me appears is in evolving concentration norms. We should be able to have normative exposure caps that avoid concentration of risks. For example, no single branch should exceed 1 per cent of my total portfolio or say 3 per cent to 5 per cent of net worth. We should link it to the net worth rather than portfolio outstanding. If you have this kind of concentration norm then, without the crystal ball, you can say that yes it could be Kolar, Mysore, Lucknow, wherever it is; but at end of the day this cannot impact us too much. If we do not set such norms and come to grief, the regulator might step in and their norms could be very stringent and inflexible. You can have a transition path very clearly so start with the soft risk limits and over a period of time you will gain the experience to set the hard limits.

VM: To disperse the geographical risk when MFIs try to go to different states and locations, the boards feel that the institutions are stretching thin and wide. I always I feel that there is too much covariant risk in rural areas due to weather, politics and all types of other things. When you have 150, 200, 300 customers per village you worry that the headman's single word can turn it sour for you. But then we can't forever be going far and wide as it costs lot more money. As a sector we need to figure out what is the balance between higher density efficiencies, on the one hand, versus the event risks.

SK: I think Kolar, Mysore and Lucknow are different events. Kolar is completely different than Mysore and Lucknow. In the future, these might recur elsewhere. But these all are not the same one, each one has a different background. Kolar events took place because of the religious entity actually coming in and trying to interrupt our services. Mysore was more on account of a communal clash and its aftermath. It has nothing to do with MFIs and conflicts between MFI and the borrowers. Lucknow is completely different. While Kolar dues are getting delayed pending a resolution, loans in Mysore are coming back; moving towards normalcy. These are isolated instances that happened and I think we are all figuring out how to take care of that. One common thing that we are seized of is the leveraging of the client in all instances. But how far excessive debt is rampant has to be studied. Some Muslims do have problem with microfinance, but they are a very minor percentage. A detailed study needs to be done to understand what actually had happened in Kolar and why.

VM: I think MFIs have all learnt a lesson from this. Those with a very vigorous approach to expansion would now avoid concentration risk.

SD: Though I agree to this final solution, I think we need to strengthen the support systems. Discussions that Sa-Dhan team has had with Anjuman Committee in Kolar indicates that the basic problem was the irrational behaviour of the MFI staff, excessive financing, indiscriminate loans, coercive recoveries and all that. I do not think that corporate offices or leaders of MFIs would like to do business this way. It is not an intentionally chosen methodology. It is just that communication between the senior management and field has failed. So this norm that we are talking about is necessary but we don't have a system for that. If all the MFIs become self-regulated and maintain that kind of norm it would have been great. There is need for a system and inter-MFI dialogue. Otherwise I don't see these events as three different cases. As Vasu was saying this is a part of the growing process.

DR: I want to emphasise that the norms must come through self-imposed discipline not by external regulations.

VM: Unless there is an enforcement mechanism—a place for reporting violations and a review of the violations—the norms may not work. There should be sanctions against violating MFIs. When we have the credit bureau—suppose while giving loan the MFI finds from the bureau that in one case where already 5 MFIs have loans with total exposure of Rs 80,000, it still decides to give another 30,000—then problem is not of the credit bureau; it is the MFI's own policies that cause the problem. So we will have to audit certain

policies and get their boards to certify that they have adopted those policies and educated their staff. We should have a self-regulating organisation (SRO) that should be able to send a supervision team. You have a Sa-Dhan code of conduct stuck on your front office, but everything goes. You know nobody is serious about compliance with the code. We are not interested in that kind of code of conduct. And one of the reasons we have created Alfa Microfinance Consultants is to have a special purpose vehicle to provide some of the SRO support function. Sa-Dhan NBFC forum can be the SRO. But Sa-Dhan doesn't have the bandwidth. In our website, we will name violators and their violations. If you do not comply, we will put your name and announce that we are no more reporting this organisation's data as it is a repeat violator. Or in the worst case will write to your lenders. We should be able to do something more than just wring our hands if we set up the SRO.

PNV: Fundamentally there is a problem of multiple lending. Religion is the excuse that people are trying to take advantage of. I think as a sector we should be concerned about the real reasons. It is fine that we have an internal norm of spreading our asset base but that is not the solution. It is just an individual company's response for its survival. What about the customer who suffers from over borrowing? As a sector we have to have this industry body going. We need the SRO for proper self-regulation and the faster we get it, the safer and better off the customer will become. And then with the customer we all become much safer. Because you know we also have to realise that it is not just staff. There is a customer at the end of it. She borrowed Rs 70,000 or 1,70,000. Against the capacity to repay may be Rs 40,000 or something like that. And she commits suicide and all the MFIs there run into a problem. But forget the MFI, look at the customer. Because of lack of responsible lending from our side, we have just knocked down one living being. We have to be worried about the consumer.

DR: We need to clearly define what is multiple lending and at what point it is over leverage.

VM: I think the point is valid that no single solution is silver bullet. There are problems of over leverage and multiple lending. It is a problem that is now becoming widespread and we need to control it. There have been several solutions. I illustrate 5 levels. One is starting with household level. I have cultivated the habit of providing basic financial literacy to these people. Unless financial literacy starts at the household level, all of us can keep having our policies but to no avail. Customer is the one who has to take care that she doesn't borrow beyond her capacity. Then there is the MFI with its own incentive system, policies, portfolio risk and other issues. It should get its policies right and ensure staff comply with the policies. Then, third level is lenders. Lenders must ensure that there is discipline in their borrowing MFIs. And then fourth is equity investors. After all most of the equity investors are multiple investors. They should enforce discipline in the investee MFIs and caution against fast paced growth in their own interest. Finally there is a regulatory level. RBI through prudential regulation could set the agenda for risk management. And then there is government. I put government at one step above regulation because in some way government can create new law and create an atmosphere of what is legitimate and what is not. So we all need to get little more aggressive abut this. This is not as if every time we do something that we get results. The credit information bureau is an afterthought. Just as the portfolio concentration norm will be another after thought. But none of these is going to solve the total problem. We just need to create a better emphasis and have proactive mechanisms in place.

NS: A week back I was in some of these areas in Kolar, talking to field people. The feeling I returned with was this: 'Customers who have been with us ensuring 100% repayment don't suddenly take a holiday the moment there was an excuse. Mysore had just 10 days of curfew, field staff could not do two weeks of visits. Quite a lot of customers have thought it fit not come back for centre meetings. Kolar problems do not seem to have adversely impacted other financial institutions. It is only restricted to MFIs. Is the diligence with which we acquire clients is still there? We try to service, maintain and sustain them is probably one of the issues. The second issue is that credit bureau as a response would succeed only if my field staffs are informed and trained. If 25 per cent of all borrowers had more than 6 loans in a particular location and I did not know of it, no credit bureau information will come to our rescue.

VM: Our initiatives bring two things together: there is an adoption of a norm by every MFI who is going to sign that MoU and that they will not knowingly lend more than a certain limit including their proposed loan to one household. Unless that norm is enforced it is not of much use; so the credit bureau will help in enforcing the norm.

SK: It is not the MFIs that are over leveraging; there are other unorganised local lenders mimicking the microfinance model who exploit the customers. There is nobody in district administration or other authorities

who can differentiate between an organised, registered microfinance entity from the local moneylenders. What we have already done in Kolar is worth stating here—branches, branch managers meeting together and exchanging information, providing list of negative borrowers and staff. Second one is, also, all of us together have actually capped the loan size in a kind of unwritten norm. We also created a grievance redressal procedure—anybody can walk in and give a complaint and the lead MFI in the area would seek a solution. Selectively we are also rescheduling loans in deserving cases, giving more time.

GW: The problems in Kolar/Mysore and Lucknow are, in some sense, driven by the internal processes of the MFIs. In Kolar one MFI has developed a system with 25–50 members in a group. Credit officers cannot monitor groups of this size and this leads to members being inducted into the group by the more mature members on the promise of a commission. Once the mature members vanished with the money, the proxies were pressurised to pay-up and eventually the Muslim organisation stepped in with the perfect excuse not to repay. The space for such an intervention probably was provided by the weakness in the MFIs systems and all operators in the area were affected. The problem has also been exacerbated by the very rapid growth of MFIs competing to serve clients in Karnataka and Andhra Pradesh. This has meant that the poor have moved from having no access to credit (except from extortionate moneylenders) to being able to access loans from 3–4 MFIs at the same time. This change has occurred in the space of 2–3 years, It might be that the poor took loans from as many MFIs as were offering them, *because* they were available, without really understanding the implications of having to repay all these loans and the stress that this would occur in the lean season. In their pursuit of growth, MFIs' staff do little or no due diligence and simply leave this to the groups. They should have found out about the existing debt burden of the borrowers. In the medium term, this will, MicroSave believes, hasten the move to individual lending. With individual lending one MFI will seek to assess, understand and respond to the full credit needs and servicing ability of the client so that she does not have to patch together several loans and attend several different meetings each week.

In Lucknow again, in the bid to grow at a breathtaking pace, backed by large loans provided by the banks, the MFI expanded … but without any systems. Credit officers of the MFI, to get higher incentives, appointed agents to form groups and disburse money. These clients did not go through any form of group formation process and were just provided access to money, typically Rs 10,000 as a first cycle loan. Problems were clearly manifest even in April 2008, but fearing losing out to the competition, none of the banks were willing to conduct the type of independent and invasive due diligence to provide early warning—this may prove to be only the first of such instances. The MFI promoters had only invested about a lakh of rupees in the venture and the rest was all money from donors and banks. Most of the problems have been caused by systems of the MFIs, or rather the lack of systems … not by clients.

MT: The situation in Karnataka has been tense for several months, due to a specific mix of political, economical and structural factors, accentuated by the global recession. Sa-Dhan has intervened following the escalation of events from Kolar. In the meeting with the Karnataka State Minorities Commission (KSMC), its chairman Mr Khusro Quraishi said that '… there are many poor people in the community who are deprived of resource to beat poverty and if these legal MFIs stop lending to the community, this will be utilized by fake and illegal money lenders, which will cause un repairable damage to the community.'

Beyond Karnataka, we see no reason to consider any fatigue on the side of the customers. There is an unmet demand for micro-credit and for other financial services. The HLCFSR-report points out clearly the degree to which the poorer sections are excluded and faced with dysfunctional financial services. Indian MFIs are contributing significantly to reducing financial exclusion, and they do so under unfavourable conditions.

There have been a few incidents of distorted action by MFI staff which points to the need to improve training systems of MFIs. Sa-Dhan is producing a guide for MFI-managers in that regard. There are certainly concerns about the HR of the sector operating at its outer capacity limit. These issues are being addressed.

Our major concerns are 'fake and illegal moneylenders' that pretend to be microfinance companies but are not. It is necessary to shed light on both the scope of such fake MFIs and the motives of those perverse agents.

NS: We have discussed the high growth rates of the sector. How do we look at the protection systems available for the customers—issues like lender's liability when it comes to dealing with customers, setting up grievance redressal machinery for aggrieved clients? How do you look at the scenario on customers' protection?

VM: We can interpret client protection in a narrow way which is things like pricing and under financing, coercive recovery processes, etc. But recognising the risks in the livelihoods of our customers and proactively mitigating that risk is a much greater contribution to protection. The financial means to do that is insurance. But there are many non-financial means one has to adopt. Take livestock insurance for an example. But current high mortality rates in livestock make it unviable for the insurers. Before insuring, you have to vaccinate the animals. There are so many livestock customers and, on the other hand, there is veterinary department waiting to fulfil their target of vaccination. Bring these two together and you have risk reduction through non-financial means. So things like transparency in rates and fairness in pricing and non-coercive recovery drives are one set of protection mechanisms. The other set is that we should recognise the risk in the life and livelihood of the customers and link with them appropriate government schemes that mitigate problems before insuring them financially. In fact this is also a beautiful way of making government schemes work.
DR: The suggestions from Vijay are path breaking. The commercial implication of doing this is the political risk mitigation for the MFI as it is seen as partnering government programmes. A veterinary department or health department working with the MFI would speak up in its favour when some other arm of the government takes some unjustified action against the MFI.
PNV: In Equitas, we have target for reaching 50 per cent of the customers other than through finance. So the medical camps, free eye care, vocational training, special coaching for children of customers are some of the ways we reach the customers outside of credit.

We have an internal ombudsman system. All customers are given cards indicating the contact information regarding the ombudsman and officials within Equitas who can be approached for grievances. We actually wanted to have an external ombudsman like RBI ombudsman. But we didn't know exactly what we are getting into. So we thought we just test it out and run it for some time. When sector SRO is up and running it can provide common ombudsman services for the sector.
VM: Vasu told me that day in Chennai about government hospitals, those hospitals have targets which we can help them meet with advantages for our clients.
PNV: Any hospital which runs PG courses has to have 30 per cent of the clients served free in Tamil Nadu. We tied up with one eye hospital; already issued 15,000 free lifetime eye care cards for our customers which entitle a customer for lifetime free checkup, free spectacles and free cataract operations. Another 2.5 lakh cards are under issue. We also arrange a lot of medical camps. Every month about 7–8 thousand people attend general medical camps. We run a small skill development programme also.
GW: This varies significantly between MFIs … in many cases, clients are of secondary importance, the drive for quantity rather than quality is over-riding. But, faced with competition, growing numbers of MFIs are looking in detail at customer satisfaction … and in some cases social performance. Other MFIs (for example Equitas) are indeed trying to add a social service dimension to their range of products, and still others (for example KGFS) have truly put the customer at the centre of their business—thus significantly enhancing the developmental impact of the services they provide. Some MFIs try to deliver livelihood services alongside their microfinance programmes, but this is notoriously difficult to do … and customers often complain about having to pay for livelihood services that they do not value.

There are always hundreds of steps that an MFI *could* take to improve customer service; the challenge is to identify which steps the MFI *should* take. As part of the ongoing service improvement process, MFIs can analyse the high impact, low cost steps available in order to identify the 'quick wins'. Few MFIs in India have reached the level where they are really following this structured type of approach.
MT: Customer protection in microfinance is more effective than in most other sectors—especially if we are to see the low-income customer market—because of the group mechanism. Through the group, members improve their understanding of issues, as well as their confidence to speak out. In addition in southern India, awareness and competition have given customers choices and comparisons. The drawback is that the borrower is usually in a vulnerable position vis-à-vis the lender; expanded scope of micro-savings and other financial products would counter-balance this vulnerability.

Obviously, there is a lot of scope for improved customer protection in India, in the financial and banking sector, and also in the microfinance sector. Sa-Dhan code of conduct offers a robust platform, which has been recognised by the Chairman of the Banking Codes and Standards Board of India.
NS: Now we move to the question on social side of microfinance. How concerned are we about the image that we convey outside and kind of reputation issues that are involved? What do we do about the negative perception in some quarters especially among government and of course a good part of political class?

VM: A beautiful cake has been baked with lot of good ingredients and somehow while putting the icing on, you used toothpaste. So the whole cake got ruined. Otherwise 95 per cent of what MFIs do with 95 per cent of their customers—including minimalist micro credit—is entirely beneficial. Problem is that the 95 per cent never gets talked about. Those who run the MFIs hardly talk about their positives. And the others concentrate on the negatives—'oh interest rates are high, repayment rates are unrealistic, you are coercing your borrowers, there is no transparency…' and so on. We need to talk about the positives and do it in a way that people will believe. We should constitute a Council of Media Practitioners and a Council of Financial Institutions. These will meet once in six months. We will collectively at Alfa or Sa-Dhan spend the money on these meetings. Council of Financial Institutions will meet in Mumbai, Council of Media Practitioners will meet in Delhi. We talk to them for 60 minutes to tell our story. Rest of the time is for them to ask questions and 10–20 people from the sector would answer the questions, to deal with charges and take in their suggestions. In case of media we need to build a rapport with the channel heads and channel editors. Even if they want to paint us into black they can make it less sensational. We should celebrate every event in the sector positively.

The information that we put out—both quality and ease of access—determines out image. The State of the Sector Report should also be available as a concise readable summary, which we can distribute freely and quickly so that a real picture of the sector reaches decision makers. They then need not go by news reports and rumours.

GW: As elsewhere in the world, social performance management in India has grown in importance, but remains largely external and donor-driven. This may well be because of the perception that it is primarily focused on depth of outreach measurement indicators. Effective social performance management will have to yield real value-add for the MFIs, in terms of improving their business and *both* components of the double bottom line through providing actionable information about client and staff needs and perceptions. Ultimately, the goal of SPM must be to improve MFIs' ability to serve and meet the needs of their target clients. By aligning key systems—strategic planning, human resources, staff incentives, audit, MIS etc.—an MFI can better achieve the objectives of both its business plan and its mission:

- **Strategic planning:** to ensure that a business plan contains social as well as financial targets
- **MIS:** to adjust MFIs' information systems to collect and report on those indicators of value to all stakeholders
- **Human resources:** to better align functions of training, appraisal and incentives with an organisation's mission
- **Operations:** to ensure that products, client targeting, outreach and policies and procedures are appropriate
- **Audit:** to ensure adequate safeguards are in place, to protect both clients and the MFI from fraud and abuse

In India, social performance management describing the way MFIs respond to the needs of the poor, as well as the nature of their clients, will also be essential to manage the growing political risk. With the entry of foreign, commercial, private equity funds into the Indian microfinance market, the level of latent political risk has risen significantly. These funds are looking for capital growth of 30–40 per cent per annum and when they sell their shares to realise these type of returns, the negative publicity and backlash that is likely to occur will make the controversy surrounding Comportamos look benign.

MT: Recent studies, one of them in Hyderabad (AP), have demonstrated with academic rigour the merits of microfinance in terms of starting and expanding micro-enterprises, and change of consumption pattern from tobacco/alcohol to durable goods. Effects of microfinance on overall poverty were hardly visible, but the study-period of 1–1.5 years is likely to be too short for those to unravel.

The studies of the SHG–bank linkage programme carried out by NCAER-GTZ show substantial progress for SHG-members on all relevant indicators (net income, asset accumulation, employment, consumption expenditure). Increased education and health expenditures per SHG-member household, as shown by the impact studies, are the results of increased incomes. However, two notes of caution need to be made. First, the average annual growth rate of members' household (HH) incomes (6,1%) is slightly below the average growth rate of the gross domestic product and certainly considerably below the growth of the income of the middle classes in India. Second, although the share of member HHs living below the poverty line has been remarkably reduced, even in groups successfully operating for more than five years a third of all HHs still live below the poverty line according to the study of Haberberger/Ramakrishna.

Sa-Dhan has taken up the theme of social performance assessment and tracking in the microfinance sector, with its forthcoming Bharat Report geared to present a variety of approaches and perspectives.

NS: Any thoughts on the future?

VM: According to me, there are 3 challenges, scale, scope and sustainability. Broaden the scale, widen the scope and ensure sustainability including environmental sustainability. Take care of the 3S to secure the future of the sector.

DR: I will talk about 5 Cs: Confluence, Consolidation, Critical Mass, Cross Border, Cross Sell. NBFCs have fantastic credibility in lending well but are disadvantaged in terms of funding. We should find ways of working together to reinforce each other's strengths rather exploiting weaknesses. The institutions should complement the other. The mechanisms of confluence could be mobile banking, business correspondents, assignment transactions, where we collaborate with others for what they can offer and in turn offering something they are not good at. That is confluence.

Cross sell of course is not mis-selling. Microfinance is one sector in which operating cost overwhelms the funding cost. Elsewhere operating cost is fraction of funding cost. So you have to optimise your cost structure by using the network and staff to distribute other financial and non-financial products. From a customer's perspective that reduces the operating cost. Consolidation again is to ensure that the capacity is not fragmented. This is very critical to optimise low cost. We talked about common plans, we talked about collaboration at the industry level. But consolidation happens in such a way that it ultimately controls your costs and lowers the cost per user. On the other hand, we have got capacity fragmentation. Consolidation comes from cost and viabililty considerations.

Fourth is critical mass. Reaching critical mass in terms of outreach and covering a significant part of population is key to becoming a significant sector. We should be able to go across border say to Afganistan, China. If software sector can go abroad, then microfinance with its low cost technology can also go abroad.

PNV: Five years on I would like to see that all MFIs put together are educating the largest number of poor children. I would like to see the sector providing access to health care services to the largest number of people compared to any other network of institutions and providing livelihood training and livelihood linkage support services.

VM: The industry is coming together and Sa-Dhan is set to change in significant ways. We have also created a secondary network structure; not in any way to complete but to compliment Sa-Dhan's efforts. I am delighted at the response from the MFIs. The initial round of casual discussions produced Rs 3.8 crore commitments with most of the cash already in. Every MFI has gone back to their board and the boards have approved the coordinated action. So I think it just shows that sector is capable of collective action provided the intent and clarity of purpose is there.

PNV: Actually I think that the ability to come together is the major reason for hope in the sector.

GW: Three years from now MicroSave would hope to see a more rounded sector, capable of offering the full range of microfinance services—savings, credit, insurance and remittances. The front end will probably comprise of mobile phone based solutions at least for individual lending, savings, insurance and remittances.

However, there is a high risk that the exit of commercial equity funds could create a political storm that the industry still remains unprepared to handle, with newspaper headlines screaming, 'Foreign Funds Make Crores on the Backs of India's Poor' and the politicians and bureaucrats responding by clamping down on interest rates and individual institutions. This is why a focus on a market-responsive approach that puts the client at the centre of the business is so essential. Only that way can the double bottom line prosper. MFIs or other industry player will have to start documenting some of the results of microfinance. The future of the industry depends on it.

MT: Sa-Dhan compiled an estimate based on a supply-side survey of 12 large MFIs. Their cumulated on-lending-projections indicate that India's MFI-portfolios could expand by a factor of 12 over the next 5 years.

In March 2008, the sample stands for about 40 per cent of loan portfolio with loan portfolio of Rs 2,475 crore and 5.1 million clients. Projected growth of 12 times over this level points to an exciting future. Qualitatively Sa-Dhan is looking at a more wholistic sector: savings will possibly be provided together with more regulated micro-insurance, pension and remittance services.

Sa-Dhan emphasises particularly that expansion of scope and eventually scale of micro-savings would address some of the concerns, as it would reduce re-financing risk and would press the MFIs towards organisational models that are savings and credit led, and thus inherently more focused on long-term client–MFI relationships.

NS: On this optimistic note let us conclude this roundtable. Let me thank all of you who are quite busy people for taking the time off and sharing your thoughts. These views would be most helpful to the readers of SOS 2009 in getting a well rounded view of the developments in the sector.

NOTES

1. RBI's review of credit policy in August 2009 cites surveys made by NCAER and Dun and Bradstreet. www.rbi.org.in
2. The data on SHGs is provisional. As in the case of previous years final data would be available in NABARD publication Status of Microfinance later in the year.
3. This includes repeat loans to existing groups. Data on repeat finance to groups is not separately any more in NABARD data sets.
4. Bharat Microfinance Report–Quick Data 2009; Sa-Dhan, New Delhi.
5. There are overlaps between MFIs in reporting client data as customers have borrowed from more than one MFI in areas where there is intense competition. Overlaps also exist between banks and MFIs in case of SHG lending. Multiple membership of SHGs in southern states is another source of potential overstatement of client numbers. While it is difficult to accurately determine the overlaps, the overall number of clients have been reduced by 10 per cent. This would be equivalent to nearly 33 per cent of clients reported by MFIs and 13 per cent of clients under SHG linkage.
6. But actual coverage of poor is neither guaranteed nor clearly evident from several studies. Those below poverty line form a significant part of banks' and MFIs' customer base, but microfinance caters to non-poor and transient-poor in large numbers. In AP the combined coverage of microfinance loans exends to 125 per cent of all households!
7. Data on SHG clients are provisional. The other data have been sourced from websites of Reserve Bank of India (www.rbi.org.in) and National Federation of State Cooperative Banks (www.nafscob.org 30 August 2009) apart from Sa-Dhan's quick report 2009 and NABARD's Status of Microfinance in India 2007–08.
8. These are provisional data made available by NABARD.
9. The poorest districts are those identified for the purpose of National Rural Employment Guarantee Scheme.
10. See Chapter 2 for an explanation of how microfinance penetration index (MPI) and microfinance poverty penetration index (MPPI) are computed. See annex to Chapter 2 for state-wise MPI and MPPI.
11. The regulatory regime in insurance has no space for small insurance institutions on account of various considerations. The nearest substitute is that of mutual insurance arrangements, which by and large are unidimensional and run as projects than as businesses.
12. Kshetriya Gramin Financial Services is promoted by IFMR Trust through one of its holding companies. Three small units have started operating, one each in Tnajavur, Ganjam and Rishikesh. See annex 9.3 for a description of their vision of inclusion,
13. Lok Sabha is the lower house of Indian Parliament comprising popularly elected representatives with legislative competence.
14. See the chapter on policy environment for a detailed discussion.
15. This internal group was headed by Mr Vijayabhaskar, CGM, RBI
16. The working group on Lead Bank Scheme was chaired by Mrs Usha Thorat, Deputy Governor, RBI.
17. This was reported last year as a project undertaken with Centurion Bank of Punjab, later taken over by HDFC Bank. The pilot was terminated shortly thereafter on account of change of ownership as also some regulatory concerns.
18. See the chapter on technology for a description of Equitas Microfinance's proprietary stickers.
19. A policy retreat on banking correspondents was held jointly by Access Development Services, Consultative Group to Assist the Poor (CGAP) and College of Agricultural Banking in May 2009 at Pune.
20. Sameer Kochar. 2009. Speeding Financial Inclusion. Skoch Development Foundation, 2009.
21. Financial Inclusion Fund and Financial Inclusion Technology Fund, set up with NABARD have been provided an initial corpus of Rs 150 million each
22. Against the announced corpus of Rs 5 billion each, the contributions made have been Rs 150 million each to the Financial Inclusion Fund and Financial Inclusion Technology Fund.
23. Microfinance Insights is a bimonthly journal brought out by the Intellecap group. This survey result is carried in the March/April 2009 issue.

SHG–bank linkage programme—continuing with consolidation

2

Chapter

NABARD provisional data for 2008–09 has indicated that 1.71 million groups had been financed including those which had availed repeat finance. The disbursements made during the year to SHGs reached a new high at Rs 127.06 billion, up from Rs 88.49 billion last year, an increase of 43 per cent. The number of outstanding SHG accounts increased to 4.145 million. Thus the banking sector has added 6.9 million clients through membership of SHG into formal finance. The total number of members linked to the banking system through the SHGs is estimated to be around 54 million.

In terms of the information relating to the previous year, the final data sets have been released for 2007–08 by NABARD which indicate that the total number of outstanding loans in the name of SHGs was about 3.62 million with a total outstanding of almost Rs 170 billion. The year 2008 also saw the number of groups saving with banks exceed 5 million with a total savings of Rs 37 billion. The 25 per cent increase in numbers of savings linked groups from 2007 to 2008 was not accompanied by an equally vigorous growth in the amounts saved. At the end of March 2009 provisional information indicates that the disbursement during the year to SHGs would have been about Rs 171.4 billion and the outstanding at the end of March 2009 has reached a level of Rs 241.9 billion. While these numbers are impressive in the context of the situation a few years back, it would be sobering to take into

Table 2.1 Growth trends in SBLP

	2002	2003	2004	2005	2006	2007	2008	2009
No. of SHGs provided with bank loans (cumulative till 2007—outstanding loan accounts from 2008)	461,478	717,360	1,079,091	1,618,456	2,238,565	2,924,973	3,625,941	4,145,191 (provisional)
Of which in southern region(cumulative)	—	—	—	938,941	1,214,431	1,522,144	1,861,373	2,283,992
Per cent in southern region(percent)	—	—	—	58	54	52	51	55
Average loan size new groups	22,919	27,005	32,013	32,019	37,574	44,343	46,800	74,000 (avg disbursement)
Repeat loan sizes	22,215	32,425	40,660	49,130	62,960	78,682	Data set discontinued	Data setdiscontinued

Note: The data sets made available by NABARD have undergone a change. From 2008 onwards the information relating to new groups financed, repeat loans and the cumulative number of groups linked would no more be available. Data relating to number of groups given loans during the year and number of outstanding loans would be available. The data relating to 2009 is not fully available. The provisional data reported in the annual report of NABARD has been used in the estimates.

account the performance of the MFIs on a much narrower institutional base. In terms of clientele, the MFIs have acquired more than the SBLP during 2008–09. Perhaps the current year may mark the beginning of MFI model outpacing the SHG model in other parameters too.

SAVINGS BY SHGS

One of the important contributions made by the NABARD publication 'Status of Micro finance in India 2007–08[1]' is the quantification of savngs made by SHGs. The number of SHGs that were having a savings account with the banking system had increased from 4.16 million in 2007 to 5.01 million in 2008 and further to 5.99 million in 2009. This impressive increase of about 25 and 20 per cent in the number of savings in group over a one year period indicates that there is still a lot of momentum in the programme. In terms of actual amount saved, the increase was from Rs 35.12 billion to Rs 37.85 billion and further to Rs 54.47 billion in 2009. The incremental savings outstanding of Rs 16.62 billion in 2009 over 2008 was a phenomenal growth of 44 per cent. New groups bring in savings very slowly and incrementally. With 25 per cent of the groups having come in new over a year's period, one does not expect a high average level of saving across all the groups. It is with time that the savings level increase and as such the high level of growth in amount saved should be a welcome phenomenon. Table 2.2 provides a summary of the savings accounts of SHGs.

The average savings levels across agencies had been compared. The average savings in the case of commercial banks increased to Rs 7,800 in 2009 from a level of Rs 7,400 in the previous year. In the case of regional rural banks (RRBs), the average savings increased to Rs 12,300 from a level of Rs 8,400 in the previous year. In the case of cooperative banks the average per savings per group was higher in the year 2009 at Rs 8,400 compared to Rs 7,000 in the previous year. The agency-wise shares of the number of groups that have saved with banks and also the share of each type of agency in the SHG savings are presented in the Figures 2.1 and 2.2.

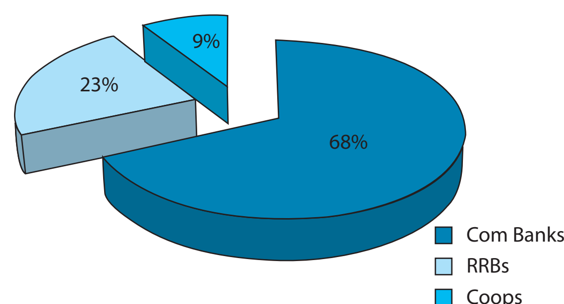

Figure 2.1 Share of different types of banks in number of savings SHGs March 2009

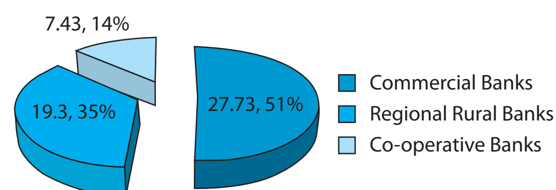

Figure 2.1 Share of different types of banks in amounts saved by SHGs March 2009

The average savings per group vary widely across states. A comparison of average savings in mainstream states in 2008 (that have at least 25,000 groups) reveals that the range was between in Rs 2,425 in Chhattisgarh and Rs 9,998 in Punjab. Andhra Paradesh (AP), West Bengal (WB), Gujarat and Tamil Nadu showed high average savings while, Assam, Uttarakhand, Rajasthan and Bihar showed low average savings. Annex 2.1 contains the average savings, loans and loans to savings ratios in the different states. The savings performance of SHGs has to be understood in the context of the limitations of the product that is on offer. It is an inflexible and regimented form of saving under which the saver can neither increase nor reduce the amount voluntarily nor can fail to save in each interval (weekly, fortnightly or monthly as decided by the group). Further the amount saved cannot be withdrawn; at best a loan can be taken, subject to availability and group decision. But the inflexibility has been built in to ensure that the saving habit is formed under the threat of some sanctions; and to be fair to the programme it has been effective in building up the individual member's corpus over a period of time. The members of mature groups in Karnataka, AP and elsewhere have between

Table 2.2

Name of the Agency	Total Savings of SHGs in the Banks as on 31 March 2009		
	No. of SHGs	Amount of Savings (Rs.) mn	Average Amount of Savings per SHG (Rs)
Commercial banks	3,549,509	27,729.8	7,810
Regional rural banks	1,556,608	19,299.2	12,400
Co-operative banks	882,902	7,436.3	8,420
Total	5989019	54465.3	9,090

Rs 25,000 and 40,000 in their accounts which is achieved through a combination of continuous savings and their share of interest and margin on financial intermediation by the group between the bank and members.

REGIONAL SPREAD AND SKEWED DISTRIBUTION ACROSS STATES

The southern region continues to lead in terms of share in client outreach as well as loan disbursement and outstanding. The share of southern states increased to 55 per cent from 52 per cent between 2008 and 2009. Share in loan outstanding in southern region increased to 69 per cent in 2009.

However, some of the states in other regions such as WB, Orissa, Uttar Pradesh (UP), Uttarakhand and Assam have been posting better growth rates. The focus on the 13 priority states seems to have yielded some positive results but in select states such as Orissa, WB and Maharashtra. However, growth in states, such as Maharashtra, has already started decelerating. It's also a fact that in some states the MFIs provide tough competition to SHGs. The only proposition that stands in favour of SHGs is the facility afforded for saving and building member's own corpus over a period of time. The MFI lending models provide credit more quickly and also a higher amount to most of the members. The waiting period prior to credit linkage, the necessity to compulsorily save money and the need for attending extended meetings periodically, make the MFI model a more desirable proposition for new entrants to the financial sector.

Two of the top five states in terms of number of groups with loans from banks were located outside the southern region. WB and Maharashtra were in the third and fourth position respectively. Kerala surprisingly does not find a place among top five states. The top five states in terms of loan outstanding accounted for 74 per cent of total loans in the country. AP with 36 per cent share and Tamil Nadu with 14 per cent share of total loans left little for other states. In terms of average loans outstanding, Karnataka occupied the top position with Rs 1,10,300 per group which was 88 per cent more than the national average of Rs 58,370 per group.

Manipur was at the lowest place with Rs 20,000 per group. AP was placed fifth in terms of average size of outstanding loans to SHGs. In the absence of clearer numbers of membership in the groups, it is difficult to carry the analysis further, except to say that in southern region the loan size tended to be far higher than in the rest of the country.

Table 2.3 Regional shares in linkage

Region	SHGs linked March 2007		SHGs with outstanding loans March 2008		SHGs with outstanding loans March 2009	
	No of groups	% share	No of groups	% share	No of groups	% share
Northern Region	182,018	6	134,783	3.81	166,087	4
North Eastern Region	91,754	3	103,424	2.85	117,609	2.8
Eastern Region	525,881	18	753,048	20.76	893,126	21.6
Central Region	332,729	11	326,763	9.01	326,602	7.9
Western Region	270,447	9	446,550	12.31	357,775	8.6
Southern Region	1,522,144	52	1,861,373	51.33	2,283,992	55.1
All India	2,924,973	100	3,625,941	100	4,145,191	100

Last year's (2008) provisional data has been updated with final data. The differences in data in some regions is on account of classification of some states differently last year. The overall difference between provisional and final data is about 4%.

Table 2.4 Top 5 states in SHG linkage in 2008-09

Name of State	Groups with outstanding loans	Percentage share	Loan outstanding Rs million	Percentage share
Andhra Pradesh	1,216,879	29.4	88207	36.5
Tamil Nadu & U.T. of Pondicherry	576,350	13.9	34454	14.2
W.Bengal	453,294	10.9	10486	4.3
Maharashtra	317,392	7.7	13148	5.4
Karnataka	315,150	7.6	34763	14.3

Of loans disbursed by banks to SHGs in 2008–09 of Rs 127.07 billion, 59 per cent went to two states, AP and Tamil Nadu. Against an all India average disbursement of Rs 74,000, the average loan disbursed in Haryana, UP and Uttarakhand exceeded Rs 1,00,000. Haryana with average disbursement of Rs 1,43,000 led the pack. On the other extreme, Maharashtra had average disbursement per SHG of Rs 31,300.

The loan to savings ratio[2] was low in Gujarat, Kerala, WB, Himachal Pradesh and Maharashtra reflecting a strong component of savings. In Chhattisgarh, Haryana, Uttarakhand and Bihar, the loan to savings ratio was high. The multiple in Chhattisgarh was 20.7 and 19.7 in Uttarakhand. While high

loan to saving ratios seem to indicate the confidence of the banks in lending to groups, at higher ranges they could increase the risks significantly.

The programme is 15 years old. Still only a few states have been able to utilise it for widening and deepening coverage. It is difficult to figure out why the lessons of well performing states have not been taken to other states even after such a long period of time. With national level institutions, banks, NGOs and civil service involved in the programme, the failure to utilise the programme for its best benefits in all the states indicates managerial deficiencies as also a weak mission. The strategies for expansion in slow growth states have never been clear and not well coordinated between NGOs, banks and state governments. At times the contrarian positions taken by state run projects and banks have hampered widening of SBLP. A most telling statistic is the number of SHGs that remain unlinked for years—more than 2 years in some states. Madhya Pradesh (MP), UP, Rajasthan, Bihar and Jharkhand reportedly carry a total of more than 0.8 million groups that are formed but not linked. The economic costs of formation of such groups remain unrecovered on the one hand and on the other an expectant population has been kept waiting for a financial service—and this too in the midst of the ongoing quest for achieving financial inclusion.

The lack of committed and skilled NGOs for group formation, inadequacy of funds for formation of groups, inadequacy of remuneration to NGOs and the erosion of enthusiasm in banks for acquiring SHG customers are cited as the major reasons. While MFIs take a lead in marketing of their products and services, in case of SHGs most banks are not really convinced that financing groups makes commercial sense and hence exhibit muted interest at best and indifference at worst. Three different stakeholders (NGOs, banks and state government) have to come together to give a fillip to the SBLP, but often the relationship between the three has been adversarial. Leadership from a credible organisation is required if the stakeholders have to be brought to common ground from which concerted action can take place. NABARD should be able to play this role. NABARD claims the head of the table in SBLP, having been involved ever since the first group was linked; it should come out with a well articulated strategy for expansion in slow-growth states as also a road map for consolidation and strengthening the SBLP in the high-growth states.

NABARD has reported the initiation of special measures in some of the low growth states. A project for promoting and credit linking 22,000 groups is underway in UP, with a network of 1,100 cluster level and 44 block level federations. The project is designed on the lines of the AP model. More than 7,800 groups have been formed and 2,900 groups financed under the project. In Arunachal Pradesh, support has been extended to the state government to implement its Microfinance Vision 2011. In Tripura, linking of 11,500 existing groups and formation of 35,000 new groups over a 3-year period has been envisaged under a State Support Project by NABARD.

NABARD has also been supporting formation of groups through NGOs, banks, individual rural volunteers, farmers clubs and the like. As at the end of March 2009, NABARD had cumulatively sanctioned Rs 788 million for the purpose of which Rs 328 million had been utilised by the grantees. Of the 0.44 million SHGs that were to be promoted, 0.21 million groups had been promoted and credit linked. During 2008–09 the fresh sanctions were of the order of Rs 177 million for promotion of almost 60,000 groups. While this grant support addresses a critical gap, it is not sufficient to provide a direction to the programme. Groups formed with NABARD's support constituted 4 per cent of all savings linked groups by March 2008 and estimated to be even less significant by March 2009. With a large majority of groups being formed under several other projects and funding, it would be difficult for NABARD to give a decisive direction to NGOs and even more of a problem to convince the banks to provide linkage. This is an aspect that NABARD should examine for taking remedial action.

The compensation package for formation of groups should be refined to prioritise the slow growth states. The waiting periods for opening bank accounts of formed groups and the first credit linkage in several locations have been unconscionably long. Discussions with banks to design hassle-free processes that would facilitate bank linkage would go a long way in speeding up progress. Precious resources are spent by the NGOs in convincing banks to open bank accounts which could have been used in forming new groups and strengthening the fledgling ones. Using the mechanisms of Block Level Bankers Committee and District Level Consultative Committee of banks, solutions to banking problems of SHGs should be found for which NABARD is well placed in terms of mandate, intent and manpower in the districts. Some NGOs have expressed the view that the sanctions for grant funds from NABARD take too long and cost ineffective in terms of the effort required to process their proposals. This is an aspect that should be taken up for simplification.

MICROFINANCE PENETRATION

In the current report the provisional data sets relating to SHG linkage and MFI client outreach data relating to March 2009 has been incorporated. There is a significant change in the microfinance penetration index (MPI) and microfinance poverty penetration index (MPPI) in several states. To facilitate a comparison, the data for the years 2008 and 2009 has been provided in the Annex 2.1 at the end of this chapter.

MPI and MPPI

These two indices were presented in the last year's report for the first time. The calculation of the index was carried out as follows:

The number of credit clients of MFIs and members of SHGs with outstanding loans to banks were computed and each states share to the country's total mf clients was worked out. The intensity of penetration of microfinance (MPI) was computed by dividing the Share of the State in microfinance clients with share of population. Intensity of Penetration of Microfinance among Poor (MPPI) was derived by dividing the share of the state in microfinance clients by share of the state in population of Poor. Since the microfinance clients are in the numerator, a value of more than 1 indicates that clients acquired were more than proportional to the population. Higher the score is above 1, better the performance. Lower the score from 1 which is the par value, poorer is the performance in the state.

Table 2.5 Ranking of select states based on MPI and MPPI

Top 5		Top 5	
Name of State	**MPI**	**Name of state**	**MPPI**
Andhra Pradesh	3.84	Andhra Pradesh	6.68
Uttarakhand	2.46	Himachal Pradesh	2.75
Tamil Nadu	2.24	Tamil Nadu	2.73
Orissa	2.13	Karnataka	2.14
Karnataka	1.94	Kerala	2.13
Last 5		**Last 5**	
Nagaland	0.06	Jammu Kashmir	0.08
Punjab	0.13	Nagaland	0.09
Haryana	0.15	UP	0.15
Gujarat	0.16	Bihar	0.16
UP	0.18	Gujarat	0.27

The MPI and the MPPI reveal that the southern region is leading in penetration, perhaps beyond the point of saturation in some states. Eastern region is placed next best on MPI and north-eastern region is placed second best on MPPI. Northern region is the worst placed on MPI while central region is worst placed in MPPI. Jammu and Kashmir, Punjab and Haryana have to make progress in penetration in general terms. Bihar and UP have considerable work to do in poverty penetration through microfinance as they are hardly reaching 17 per cent of average national penetration.

The low microfinance penetration levels are not concerns merely at the bank/MFI levels. The tardy performance in specific states should be a major issue before the state authorities. If an effective instrument of doorstep financial access for the poor, performing well in other states, is not able to make a dent in any specific state, then the authorities should study the reasons and propose solutions. It is easier to blame the banks and MFIs for non-performance, but the reason for their local non-performance in a state or a district is difficult to explain away. Existence of favourable conditions for microfinance to take root and thrive should be examined and the needful done by the state authorities. An annual study of the microfinance climate could be carried out by institutions such as NABARD, SIDBI or Sa-Dhan and the comparative analysis sent across all the states so as to create a competitive environment, and goad states into action.

High levels of penetration are also a cause for concern as they indicate that the debt levels could exceed the repayment capacity of the poor households. Some locations that had repayment problems have been found to have unsustainable levels of lending at the household level. There is a need to closely study the ground situation in such states that have a high penetration ratio.

AGENCY WISE PERFORMANCE

Complete data sets relating to performance of different banks has been made available by NABARD for the year 2007–08. Table 2.6 provides the bank-type wise details of loans outstanding at the end of March 2009. The individual bank wise data for the year 2009 is expected later in the year.

Commercial banks have a lion's share of the number of SHGs provided with credit during the year (55 per cent) as also the amount of loans (64.4 per cent) that had been disbursed. The RRBs with a much smaller network and footprint have supported the SHGs more than the cooperative banks had managed. RRBs had 26.5 per cent share of loans

Table 2.6

Agency	Outstanding loans of SHGs as on March 31, 2009	
	No. of SHGs	Amount of O/S Loans (Rs. mn)
Commercial Banks	2,834,995	170,436.8
Regional Rural Banks	936,612	50,234.9
Cooperative Banks	373,584	21,288.9
Total	**4,145,191**	**241,960.8**

disbursed with a share of 26.5 per cent of the number of SHGs that were provided loans during the year. Cooperative banks have been late starters with significant problems that differ from state to state. On account of this, their progress has been slow. However, there are some states in which the cooperative banks have taken a leadership position (such as Maharashtra, WB and Orissa with regard to SHG linkage. Commercial banks appeared to have better risk perception with regard to SHGs as seen in their higher average loan size. Cooperatives appear hesitant in financing the informal groups, most likely on account of their resource constraints. The average loan disbursed by cooperative banks to SHGs was about Rs 37,300 which was 45 per cent of the average size of loan provided by commercial banks. Conservatism in lending did not seem to help the cooperative banks which had a higher level of non-performing assets (NPAs) than RRBs.

Commercial banks

Commercial banks had 59 per cent of SHGs that were saving with banks and 51 per cent of amounts saved. Public sector banks have been in the forefront of SBLP. Within the public sector banks there was high variability in the appetite for SHGs. State Bank of India (SBI) had been consistently leading the client outreach and portfolio volume charts riding on the back of its large network. The top five banks in terms of disbursements, outstanding loans both in terms of outreach and loan volumes are listed in Table 2.7. The same set of banks, Indian Bank, Indian Overseas Bank and Andhra Bank seem to frequently figure in the different top lists. While the other banks do link groups, the appetite in their case seems to below.

Table 2.7

Top commercial banks in SHG Linkage March 2008			
Top five banks—disbursements to SHGs—no of groups	Top five banks—disbursements to SHGs—amount disbursed	Top five banks—no of groups with outstanding loans	Top five banks—amount of loans outstanding
State Bank of India	State Bank of India	State Bank of India	State Bank of India
Indian Overseas Bank	Indian Overseas Bank	Andhra Bank	Indian Bank
Canara Bank	Indian Bank	Indian Bank	Andhra Bank
Bank of India	Andhra Bank	Punjab National Bank	Indian Overseas Bank
Andhra Bank	State Bank of Hyderabad	Indian Overseas Bank	Central Bank of India

The average loans disbursed from banks to groups was examined. The variation between banks with the lowest average loan and that with the highest loan average was very high. The highest average loan among banks was seven times more than the bank with the lowest average. Given that the risk profiles and financial requirements are more or less similar it is very difficult to explain the differences in risk perceptions and the consequent credit decisions between banks. In case of loans outstanding, the lowest average loans were one-fifth of the highest average loans. Indian Bank, Union Bank of India and Corporation Bank tended to provide large average loans while United Bank of India provided smallest average loans. The small size of loans have implications for banks' profitability as the transaction costs remain fixed while income depends on size of loans disbursed.

SBI in its Annual Report 2008–09 highlights that it had credit linked 1.37 million SHGs with loan volume of Rs 80.5 billion. It has launched SHG-specific products such as SHG credit card and SHG gold card. Indian Bank has reported that it had credit linked 90,421 groups with a loan disbursement of Rs 10.5 billion during 2008–09 representing a 29 per cent increase over the previous year. The outstanding loans to SHGs are of the order of Rs 1,350 crores. The bank had opened 25 'Microsate' branches dedicated to microfinance.

HDFC Bank among private sector banks has been very active in SHG financing. It has been successfully using the NGOs as banking correspondents to deliver credit to SHGs. By March 2009 HDFC Bank had linked 41,680 SHGs with loans of about Rs 5.5 billion. It had also set up eight dedicated branches for servicing SHGs and has plans to set up 15 more in locations where its SHG finance is concentrated. The bank has developed internally a low cost Anywhere Banking Terminal for BC use to facilitate the transactions with the SHGs. Other private sector banks active in SHG lending had small exposure,

consistent with their size of operations. ICICI Bank had a significant number of SHGs linked (more than 31,000 in March 2008), a legacy from the merger with Bank of Madura Limited. Federal Bank, Dhanalakshmi Bank, INGvysya Bank and Lakshmi Vilas Bank had credit linked SHGs.

Regional rural banks

RRBs reported a share of 26 per cent of SHGs that had savings and 35 per cent of amounts saved, reflecting a good savings mobilisation performance. RRBs had share of 26.5 per cent of groups which were disbursed loans and 26.5 per cent of loans disbursed during 2008–09. The average savings made by SHGs with RRBs was Rs 12,300, higher than in the case of commercial banks and cooperative banks. Average outstanding loan per group was highest in case of RRBs at Rs 53,600. RRBs had disbursed loans to only 60 per cent of the 1.55 million groups that had savings accounts. The loan volume outstanding was 2.6 times the saving, which was less than the commercial banks' leverage multiple of 6.14. While being more liberal than the cooperative banks, RRBs were conservative compared to commercial banks.

While two RRBs from AP figured in the list of top five RRBs by number of groups linked and loan volumes outstanding, RRBs from Orissa and WB had also done well.

There is a lot of room for RRBs to expand their SHG portfolio. In states such as Punjab, Haryana,

Table 2.8

Top five RRBs in SHG linkage (March 31, 2008)	No of groups with outstanding loans	Top five RRBs in Loan outstanding	Outstanding loan (Rs million)
AP Gram Vikas Bank, AP	106,356	AP Gram Vikas Bank	6,063
Andhra Pragati Grameena Bank, AP	67,843	AP Pragati GB	5,259
Utkal Gramya Bank, Orissa	70,251	Cauvery Kalpataru GB	3,262
Cauvery Kalpataru GB, Karnatka	50,747	Utkal Gramya Bank	2,951
Bangiya GB, W. Bengal	46,735	Bangiya Gramin Bank	2,497

Rajasthan, UP, MP and Bihar, RRBs can gain significant market and market share by concentrating on SHGs. SHGs offer a safer and high margin business as the average loan size for groups could be higher than individual loans. The merger of RRBs into larger entities provides them with better access to resources and manpower. The sector would expect to see much greater support from rural banks to SHGs in their quest for higher profits, lower risks and enhanced inclusion of excluded people. RRBs have been functioning as self-help promoting institutions (SHPIs) with grant support from NABARD. Ninety-three RRBs have targeted formation of more than 35,000 groups with grant sanctions of Rs 27.7 million.

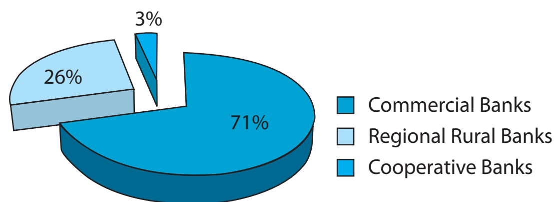

Figure 2.3 **Share of different types of banks in SHG credit linkage by number of groups March 2009**

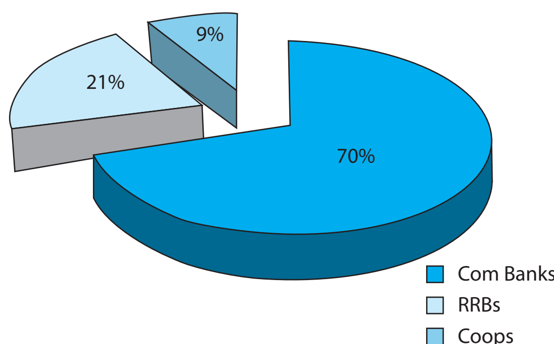

Figure 2.4 **Shares of different types of in SHG bank linkage by amount of loans March 2009**

Cooperative banks

Cooperative banks had been late entrants to microfinance through SHGs. The performance of cooperative banks has to a large extent been influenced by the state government policies. States like Rajasthan, Orissa, WB, Maharashtra, Karnataka, Kerala and Tamil Nadu seem to have provided a supportive environment for cooperative banks in financing SHGs. The other state cooperatives have not made much headway. Cooperative banks had a share of 16 per cent of SHGs that saved, but accounted for a share of only 14 per cent of volume of savings. Cooperative banks have a share of 13 per cent of borrowing groups, but only 9 per cent of loans outstanding. The average savings at 6,600 per SHG is the lowest among different types of banks. Average outstanding loans per group have also been lowest in case of cooperative banks at Rs 29,700. The loan given and outstanding in case of cooperative banks was low at two times of savings. Cooperative banks came across as extremely conservative and seem ill at ease dealing with SHGs. The lack of trust in SHGs

appears to stem from lack of awareness as also low risk taking capacity. NABARD should take an active role especially in the reform process of cooperatives to ensure that financing groups become an important objective.

Table 2.9

Top five CCBs in SHG linkage (31 March 2008)	No of groups with outstanding loans	Top five CCBs in loan outstanding	Outstanding loan (Rs million)
Hooghly, WB	24,620	Khurda, Orissa	586
Khurda, Orissa	20,596	Hooghly, WB	508
Kolhapur, Maharashtra	19,280	Murshidabad, WB	294
Chandrapur, Maharashtra	12,197	Villupuram, Tamil Nadu	292
Hassan, Karnataka	10,661	Hassan, Karnataka	206

Table 2.10 Range of recovery in SHG loans

Agency	Total no. of banks reporting recovery data	No. of banks based on percentage distribution of recovery performance of bank loans to SHGs as on 31 March 2008			
		95% and above	80-94%	50-79%	Less than 50%
Commercial banks (Public sector)	25	11	6	8	0
Commercial banks (Private sector)	8	7	0	1	0
Regional rural banks (RRBs)	70	22	25	17	6
Co-operative banks	226	113	39	51	23
TOTAL	329	153	70	77	29
Percentage of banks		46.5	21.3	23.4	8.8

Cooperative banks from Maharashtra, Orissa and WB as also Karnataka made it to the list of top five banks in credit linkages by number of groups and loan volume. Surprisingly, AP, Tamil Nadu and Kerala do not figure. One of the reasons is that the cooperative banks can at best operate in one district unlike RRBs that operate in multiple districts and commercial banks that operate in multiple states. In some states the statute and regulations under the cooperative law do not facilitate linkage of groups. In other higher level structures such as federation of SHGs has been found difficult.

Urban cooperative banks such as SEWA Bank and Mann Deshi Mahila Cooperative Bank have also been active in not only credit linkage but in providing a host of accompanying services to the members.

Cooperative banks also act as SHPIs. They form and link self groups and monitor their performance with their own staff or the staff of Primary Agricultural Credit Societies (PACS). Four state cooperatives, two cooperative societies and sixty district central cooperative banks act as SHPIs, with plans of promoting 32,000 SHGs. NABARD had sanctioned Rs 33 million in grants out of Micro Finance Development and Equity Fund (MFDEF).

QUALITATIVE ASPECTS OF SHG LENDING

Last year the phenomenon of client dropout from SHGs, low levels of lending to SHGs, the gap between number of saving groups and borrowing groups and also the perceived reluctance on part of banks to deal with numerous small SHGs were documented. While the public sector banks led by SBI have been active in positively engaging the SHGs there have been certain areas of discomfort. The discomfort arises from competition that exists in the market from the MFIs. Because of the pressures from the government sponsored programmes for linking groups promoted by them and also the falling repayment rates, it has been difficult for commercial banks to be totally involved in all locations in SHGs financing. The southern markets which seemed to have unlimited potential have now hit a roadblock. Retaining existing customers in southern markets probably is a greater challenge for banks than penetrating new markets in other states. An analysis made in the earlier chapter brings out the fact that the MFIs have been able to make considerable inroads in those states where banks have a fairly extensive SHG finance portfolio.

The low average loan is another factor that prevents the members of SHGs from taking up enterprise activities. The loans disbursed in 2008–09 averaged Rs 74,000, but ranged from Rs 37,300 in case of cooperative banks to Rs 86,000 in case of RRBs. Cooperative banks have continued to disburse smaller loans. It appears that they are still not comfortable with the idea of lending to informal groups that work on the lines of cooperatives with better integration of savings and credit. The case for improving awareness at decision-making levels of cooperatives is clear. The capacity-building effort addressed at cooperative banks, especially those that already link SHGs,

should be different; it should focus on risk assessment of lending to groups and realistic appraisal of credit requirements of groups. With the large network of primary societies in position at the village level, co-operative banks are uniquely placed to form, link and service groups with considerable advantages. Some banks in Maharashtra, Karnataka and Tamil Nadu have been able to leverage their village presence. But others in several states have not been able to qualitatively engage SHGs for their benefit. The ongoing reforms of cooperative credit structure offer a unique opportunity to mainstream microfinance into cooperative's portfolios. At the member level the average loan disbursed could be as small as 3,600 or as large as Rs 6,200. These levels of loans are not capable of supporting investments that could produce a decent income for sustaining a household. However, Al Fernandes[3] points out that SHG members borrow in several cycles and, over five cycles in 5 to 8 years, the total loan flow could be from Rs 20,000 to Rs 35,000 per member. At this size of loans, investments in activities for earning significant additional incomes are enabled. But then such a model, while adequately mitigating risks of lender, takes a long time to provide succour needed by poor families.

The original set of disciplines adopted by the SHGs become increasingly difficult to maintain. Regularity in attendance, timely repayment and prioritisation of member needs do not seem as important as these were a few years back. A study commissioned by NABARD, Karnataka in Tumkur and Mysore covering 900 respondents revealed that (1) loans are being equally divided among the members as they do not want to take a credit risk on others, (2) default rates show an increasing trend after farm loan waiver and (3) meeting attendance is not regular as members perceive the opportunity cost of time spent in meetings to be high.

Individual banks (both commercial and regional rural segments) in many cases had a higher risk perception and gave smaller size loans. Inadequate loans tend to encourage multiple borrowing and access to informal sources of funds. This increases the risk of default, which the banks desperately want to avoid. Such under-financing has been a major reason for MFIs also financing the same borrowers that are members of SHGs. Banks do need to rethink their risk containment policies that seek to reduce loan amounts without examining the consequences.

The continuing pressure of government sponsored programmes for formation of groups tended to split existing groups and reduce the average number of members in groups. Smaller groups push costs of intermediation as also costs of group

Table 2.11 Phjsical Progress under SGSY since Inception

(thousands)

Years	Silf-help Groups (SHGs) Formed	No. of SHGs Passed Grade-I	No. of SHGs Passed Grade-II	SHGs Taking up Economic Activities	SHG Swaioz-garis Assisted	Individual Swaroz-garis Assisted
1999-2000	292	125		29	35	586
2000-2001	223	214	74	26	319	687
2001-2002	434	176	54	31	365	573
2002-2003	399	190	95	36	414	412
2003-3004	392	205	91	51	578	325
2004-2005	266	220	106	68	789	327
2005-2006	276	211	92	80	873	278
2006-2007	246	222	156	138	1472	220
2007-2008	305	251	117	181	1154	254
200 8-2009 (up to October 2008)	298	201	62	46	557	117
Total	3134	2014	948	685	6869	3772

Source: Ministry of Rural Development, Government of India, 2008.

maintenance. The current emphasis on number of groups should give way to number of members as an indicator of outreach. Efficiency and productivity of SHPIs should be measured on number of members per group and costs incurred per member rather than costs per group.

SHGs are potent vehicles of knowledge dissemination. There are NGOs that have fully utilised the social capital of groups to deliver more than finance to strengthen the livelihoods of members and in the process securing the repayment of loans. Basix, Dhan Foundation, PRADAN, SIFFS, SEWA and Hand in Hand are some organisations that stand out in the provision of what is termed as 'credit plus' services[4]. But the social capital is not fully leveraged in many other groups for want of continued mentoring by a committed NGO. In many cases the design involves the promoting NGO exiting the project even as the SHGs mature enough to be able to get some members to benefit from expanded or new livelihood activities. In most other cases (with notable exceptions) where banks, government departments or individual volunteers promote groups there is no scope for the social capital being utilised functionally. This failure to make use of groups to secure their livelihoods and beyond represents an economic loss. Looking to the successful projects of the NGOs listed earlier, one wonders at the indifference to such large numbers of groups that could easily have been made to graduate to a higher level with marginal increments in capacity-building investments. U.C.

Sarangi, Chairman, NABARD, points out that group formation with a clear livelihood agenda can bring about better coordinated action by the groups; NABARD's Micro Enterprise Development Programme aims at orienting mature SHGs towards enterprise activity. NABARD's learning is that not all activities can be made into enterprises. A cluster approach rooted in a common local activity is better suited. NABARD, according to Mr Sarangi, is now targeting small farmers groups for improving the technology of cultivation that would improve productivity and incomes; the adoption of technology being funded through SHG loans.

In the last year's report a reference was made to the AP government's '*pavala vaddi*' scheme under which the loans to SHGs by banks was at a rate of 3 per cent per annum. The state government subsidised the banks, the difference between their normal rates and the mandated lower rates. Other states too have been designing low interest schemes based on the AP model such as Karnataka which has a 4 per cent interest rate scheme. While in the short term the SHGs and members have reasons to be happy, this will spoil the credit culture in the long run. The loan volumes in AP are at a high, presumably driven by the low rates. Anecdotal evidence indicated that SHG members in turn lend to others; micro moneylending has become the livelihood option of at least some SHG members. When low interest regimes come to an end (as they must), repayment discipline is bound to suffer. Further such low interest schemes distort the market and make the field uneven between different players in the microfinance market as also between the poor households.

OTHER INTERVENTIONS

NABARD's partnership with post office progressed further during the year. The initial pilot's success in Tamil Nadu led to expansion of the same to Meghalaya. The project involves NABARD providing a bulk loan (Revolving Fund Assistance, RFA) at 6 per cent to post office which would link SHGs and provide credit out of the revolving fund at 9 per cent. Of the interest income earned, post office would retain two-thirds and pass on the remaining one-third to NABARD. The initial RFA to post office in Tamil Nadu was Rs 3.4 million and to Meghalaya was Rs 0.5 million. Till March 2009, post office has opened savings accounts of 2,835 SHGs and provided credit to 889 SHGs amounting to Rs 21.3 million. The impediment to rapid scaling up of this project is that the Indian Postal Act does not permit the post office to borrow or take credit risk. Based on an interim review, expansion of this project to 10 states with Rs 100 million RFA has been approved.

Under its programme of Promotion of Micro enterprises, NABARD had enlisted the support of 14 NGOs in nine different states to provide a package of services (called 3M, Micro-credit, Micro-market and Micro-planning). 11,000 members from 1,100 SHGs had been identified for being developed as micro-entrepreneurs. NABARD reports that more than 6,100 enterprises have been set up with credit of Rs 53.5 million. Such interventions that integrate livelihoods, income generation and credit are the key to holistic development of microfinance clients and the local economy. The challenge for NABARD is in upscaling this to a level to cause significant impact.

NABARD continued to be a significant provider of capacity-building funds and ideas to the sector. More than 2,30,000 persons at different levels were trained at a cost of Rs 187 million during 2008–09. Bank and government officials, NGO and MFI functionaries as also SHG members participated in these events.

Commenting on the future agenda, Mr Sarangi, Chairman, NABARD, indicated that correction of regional imbalance, capacity building of SHG members, promotion of livelihoods, improving average loan size and introduction of insurance products are the priorities in the year ahead.

REPAYMENT RATES

Across the country Rs 4.23 billion was involved in defaulted loans of SHGs, forming 2.9 per cent of total loans outstanding as per reports received by NABARD from 271 banks. Commercial banks reported NPA level of 2.1 per cent, RRBs 4.5 per cent and cooperative banks 4.8 per cent for the year ended March 2008. Eleven public sector commercial banks out of 25 have reported that they had recoveries of 95 per cent or more. Including the private sector, 18 out of 33 banks have recoveries above 95 per cent. Six banks had recoveries between 80 and 94 per cent and eight of them had recoveries between 50 and 79 per cent. Across all banks (329 of them have reported data) 46.5 per cent had recoveries of more than 95 per cent. Nine per cent of banks had recoveries less than 50 per cent which is a matter of concern. UP reported highest amount of NPAs at Rs 1.18 billion, accounting for 28 per cent of all NPAs in the country. Six states (UP, Tamil Nadu, Karnataka, AP, Maharashtra and Orissa) accounted for 78 per cent of NPAs. While the southern states had higher volume of loans outstanding resulting in absolute volumes of NPA being higher, in case

of UP and Maharashtra the high NPA share was carried on low loan shares. A comparative analysis of state –wise share of loans outstanding and NPA levels (Annex 2.3) show that states with high penetration levels had low NPA levels.

The programme which had traditionally enjoyed recoveries closer to 98 per cent for more than a decade seems to have fallen victim to the fatigue of continuous cycles of lending and recovery. The surrounding climate of waivers of farm sector loans and multiple lending available under MFIs seem to have influenced the SHGs as reflected in increasing defaults. The manner in which SHGs are financed, monitored and serviced requires re-examination. The original enthusiasm with which banks engaged SHGs is not evident in many branches. Financing of the groups has become routine without adequate human inputs into the relationship building efforts. This is a critical reason for the declining repayment rates.

Competition and easier availability of loans from other sources also leads customers to believe that default to the SHG bank might not entirely disrupt their livelihoods. There has been active encouragement to default in the aftermath of the massive farm loan waiver under which even SHGs that taken loans for agricultural purposes were covered. From the banks' point of view financing MFIs could fetch a higher rate of return with lower transaction costs. Banks have introduced[5] credit products for MFIs and microfinance organisations (MFOs) that would take bulk loans for on-lending to SHGs.

Last year's report pointed out that intra-group recoveries are very poor, based on information from AP. No concerted action on improving the internal repayment environment within SHGs has been so far mooted. Elite's capture of bank loans within groups, frauds and corruption have also been some of the problems faced in some groups. Better awareness and member control over the groups functioning can solve these problems to a large extent. APMAS[6] has mooted the idea of Sector's Own Control to improve the quality of functioning of SHGs. This entails account keeping, auditing and dissemination of accounts and audit information to members in transparent manner. Training a cadre of personnel and equipping the SHGs and members to get the best out of transparent presentation of audit outputs are the main pillars of this programme.

ROLE OF NGOS IN SBLP

The enchantment of NGOs with SBLP seems to be on the wane as reported last year, more and more NGOs would like to do own account lending. Many of these NGOs which have a significant number of SHGs are quite willing to the risk of forming an MFI[7] which would access resources from banks and on lend it to the groups. Banks are more than willing to provide funds to such institutions as they are able to provide bulk loans instead of having a number of small accounts on their books. While the risk gets concentrated with the hands of banks it does increase staff productivity. But this path to expansion and shifting of portfolios from banks to MFIs is fraught with risks not only for the bank but also for the customers. The cost of intermediation by the MFI would have to be borne by the customers who earlier were able to gain the intermediation margin which got added to their corpus. The SHGs would possibly pay a much higher price for the loans that they would now receive from the MFIs/NGOs instead of from banks as in the past.

On the other hand, the NGOs involved in the Swarna Jayanti Gram Swarozgar Yojna (SGSY) and other such programmes find it difficult to operate in an autonomous environment to provide the best services for the groups. While the compensation for formation of groups is higher under SGSY, the realisation of funds from the government has been tardy and often entailing indirect costs. This does put off some of the committed NGOs from partnering the government.

THE GOVERNMENT PROGRAMME—SGSY

Swarna Jayanti Swarozgar Yojana (Golden Jubilee Self-employment Scheme) is a key poverty alleviation programme of the government which provides credit and capital subsidy through SHGs as a priority to help people living below poverty line to improve their economic condition. The promotion of groups and provision of credit and subsidy have been carried out under rigid targets that are fixed every year. The quality of implementation of the programme is a mixed one, leading to indifferent outcomes. Groups are at times not of the desired quality on account of deficiencies in capacity-building efforts.

SGSY groups constituted 20 per cent of total groups financed during the year and accounted for about 21 per cent of loans disbursed. In terms of loans outstanding, SGSY groups accounted for 28 per cent, while having a share of 25 per cent of number of groups with outstanding loans. SGSY groups fared poorly in repayment rates. NPAs in SGSY loans at 5.72 per cent were almost double the NPAs of all groups at 2.9 per cent. Only 38 per cent of reporting banks had recovery rates of above 95

per cent in respect of SGSY groups as against 46.5 per cent banks with recovery rates of above 95 per cent in case of all groups. While 32 per cent banks had recovery of less than 80 per cent in case of all SHG loans, almost 50 per cent banks reported less than 80 per cent recovery. Banks by and large are reluctant to lend SGSY groups on account of issues with group quality and at times faulty selection of livelihood activities.

The data relating to formation of SHGs under SGSY indicates that since the inception of the programme 3.13 million groups had been formed and assisted. But these groups do not seem to have a long existence which is quite common in other groups. In terms of groups that continue to borrow from banks, only 0.92 million groups are reported to be having outstanding loans from banks in March 2008. The whereabouts of the remaining 2.4 million groups is not clear. Formation of these groups carried heavy costs. If the groups cannot last beyond the duration of the loan given by the bank, the entire design effort behind the programme needs a rethink. Further, groups that took up economic activities were 0.68 million, 21 per cent of total number of groups formed and supported. In a programme that has the objective of poverty alleviation, only 21 per cent groups taking up livelihood activities does not give a good message about the implementation focus.

The Government of India, aware of the lacklustre performance, had appointed a high powered committee to examine Credit Related Issues under SGSY[8]. The committee in its report had made recommendations for setting up a national level agency for self-employment and a National Rural Livelihoods Mission, a state level umbrella organisation to promote rural livelihoods, a federal structure for SHGs, adoption of Kudumbasree and Indira Kranti Patham models, setting up of a dedicated unit under District Rural Development Authority (DRDA) for SHG formation/strengthening and increasing the upper limit of capital subsidy as well as the revolving fund. The government's intent to create a National Rural Livelihoods Mission was announced in the union budget 2009.

A dedicated livelihood mission might be able to make greater headway than the SGSY if a qualified HR is committed and a conscious effort is made to bring on board competent civil society organisations. While dedicated personnel from the government systems do contribute to the performance, continuous implementation support and hand-holding required at the field is possible only through NGOs. Despite a well-articulated voluntary sector policy as part of the eleventh five year plan, governments have reservations in bringing voluntary sector players as partners.

SHGS AND FEDERATIONS

APMAS, Hyderabad, compiled a comprehensive database on the SHG federations which was made available in the last year's report. In this year's report this database has been updated. At as the end of March, more than a 1,00,000 federations in different states were in existence. The southern region led by AP has the maximum number of these federations followed by the eastern region comprising mainly WB and Orissa. Being people based organisations, federations have several advantages but suffer from the disadvantage of not having a professional managerial and administrative set-up. Federations would critically require support for improving their managerial abilities as also systems and processes. The separation between the member user and professional manager has to be achieved to a considerable extent before federations could proceed with financial intermediation agenda. Federations have the ability and capacity to provide livelihood activity support for the members and the group. The federations are in a unique position to organise members' production of goods and services, aggregate the same and negotiate with higher level markets on equitable terms. Fragmented marketing of small volumes of individual production has been the bane of the rural small holders. The income possibilities that exist in aggregation and bulk sale of goods and services have been lost for want of honest brokers. The federations with their higher level reach at the district and state level and the rural network in the form of groups could play a very significant role in improving the income earning capacities of their members. If this is rendered feasible by the federation they would have rendered a service far beyond what microfinance could have provided.

The data on federations (made available by APMAS, Hyderabad) is provided in Annex 2.4. More than 0.1 million federations exist of which about 97 per cent are primary federations. The meso level federations (labelled secondary federations) are about 3,150 and the apex federations (tertiary) are 52. Orissa, WB, AP, Kerala and Tamil Nadu account for more than 90 per cent of all federations; AP alone has more than 41,500 federations—no doubt an offshoot of the MACS Act having been enacted in the state in the nineties. As stated earlier some of these financial federations and others provide different services to members. Federations bring in a structure to the widely flung SHGs and seem to provide

an umbrella of protection and support. But the costs of running federations would need to be collected from SHGs and this has been a bone of contention. Federations that have come up in response to the needs expressed by the SHGs do not encounter any problems. Federations imposed from the top, unless they demonstrate value to the SHGs, face problems of raising resources for their upkeep.

Sector Own Controls (SOC)[9]

SHGs and their federations appear to have the potential for being highly self-reliant and sustainable for which, they need an effective and efficient control system. SHGs and/or their federations are currently dependent on external agencies for financial, human and material resources. In order to be self-reliant and sustainable, SHGs and their federations need to strengthen internal capacities, improve systems, increase accountability and manage financial, human and material resources for optimal gain to members. APMAS in collaboration with DGRV (Germany) and state government initiated the pilot of an appropriate Self Regulation for the SHG structure in Kamareddy cluster of Nizamabad district in AP.

The overall objective of SOC is to ensure that SHG members set their agenda and manage and control the processes, so that the SHG system successfully and sustainably works for the benefit of SHG members. Representatives of Mandal Federations and the SHPI, including APMAS arrived at the following objectives for the campaign –

Aim at economic and social development of the members
Member savings protection
Sustainable growth of thrift and credit services
Financial Literacy among the members
Sustainable democratic and ,legal institution
Institutional growth and resources protection
Equality among the members
Profitability of institution
Institutional accountability

The focus of the SOC is on building capacities of leaders and members in the following key aspects to achieve the objectives.

1. Standardized bookkeeping in use
2. Standardized reporting in use
3. Agreed best practices, performance standards and organized monitoring
4. Framing of policies on accounting, business and management, and active implementation of policies.
5. Systematic audit and monitoring of fund security
6. Systematic election
7. Capable and own staff
8. Continuous education/awareness and training
9. Clarity on general body (GB), representative general body (RGB) roles of village organisations (Vos) and Mandal Samakhya (MS)
10. Legal compliances

The overall outcomes expected from the pilot activities are as follows:

- Each mandal of the cluster will have a Resource Pool among the members and would able to deliver services based on the requirement.
- All the SHG Federations in the cluster would be able to establish performance standards, accounting and internal controlling systems.
- The cluster would become demonstration point for other federations across the country
- APMAS along with SHPIs develop strategy for scaling up SOC in other places of the country.

SHGs and SHG Federations will be able to effectively deal with key issues/problems that are affecting their sustainability and self management.. As a result quality of SHGs and SHG Federations will improve.

As per APMAS's study, SHGs and federations should take charge of their orderly conduct and transparent working. With DGRV, Germany and Society for Elimination of Rural Poverty (SERP, of AP government) as partners, APMAS has taken up an ambitious project labelled Sectors Own Control to make the groups and federations raise their standards of accounting, audit and dissemination of information to members.

Despite NABARD's policy guidelines that seek to provide financial and other assistance to federations (which we mentioned in the report last year), there has not been much action in this area. NABARD had for long been not comfortable with the idea of federations coming on the top of SHGs for a variety of reasons including concentrated risk in financing aggregation of SHGs, lack of assets in the hands of federations, the past of record of credit cooperatives and the possibility of SHGs losing their autonomy.

NABARD had sanctioned a grant of Rs 1.15 million to one federation for training, capacity building and member development during the year. Such a miniscule effort amidst more than 100000 federations that exist in the country does indicate that NABARD's priorities are elsewhere and not on federations despite their being community based organisations.

The Committee on Credit Related Issues under SGSY had recommended that federations of SHGs should be allowed to evolve, endorsing the government's move to set up state-sponsored federations on the lines of the AP model. While the idea of federations coming up as result of SHG's needs for higher level structure, aligning the same with state's objectives and programmes is not well conceived. Such higher level structures introduce government's way of working with all rigidities of parastatal institutions. The costs of delivery of services would also be high and when government funds dry up the federations would have to either squeeze the groups or cease activities. People-based organisations should not be subjected to such vicissitudes of government policy and funding. A great deal of caution is needed in proceeding further with replication of AP model in other states; in any case before an objective evaluation of costs, benefits and outcomes of AP model is undertaken the move for state-sponsored federations should not be taken up.

While an institutional structure would certainly help the SHGs in improving their capacities, the higher order institutions in the form of federations should not disempower the groups. Often it has been the experience that higher order institutions usurp the decision-making powers available at the grass root, drain finances and seek to capture resource allocation decisions. Getting governance right in such organisations is often the toughest task.

In 2006 a network of federations (International Network of Federations of Self-Help Groups[10]) was established with the backing of Dhan Foundation Madurai. INFOS had been active in knowledge building and advocacy activities among the members. Forty federations from different states have taken membership of INFOS. APMAS, based in Hyderabad, has been providing knowledge dissemination and capacity-building services to federations and has carried out studies of costs, procedures, governance and other aspects of federations.

SBLP—CONCLUSION

The SBLP continues to grow. The questions on deceleration raised in last year's report based on provisional data on whether SBLP is shrinking has been replied in the negative, but this growth trend will last only for a short time. The long-term trend is that growth rates will slow down. Competition from MFIs is another reason why the SHG customer base will not grow vigorously. The federations seem to provide the structure necessary to small groups to negotiate on better terms when dealing with banks and governments. The price for federating is the loss of autonomy and sharing of resources. The movement away from linking with banks to own account lending through setting up of MFIs by NGOs will gather more momentum. The move to reduce interest rates on loans to SHGs, though welcomed by the members of SHGs has the potential of damaging the programme over the long run. Increasing state control over the SHG linkage programme through state and national federations, low interest rate schemes and subsidy linked schemes might prove inimical to the future of the microfinance sector. As for states with low penetration of microfinance, state-specific vision plans and strategies are needed. NABARD is the obvious choice for leadership in shaping such visions and guiding the state-specific strategies. Today, inspite of the coverage of 65 million people in active savings by SHGs the financial inclusion strategies at the national level do not look at SHGs as a potent instrument. NABARD should highlight the potential of SHGs to achieve accelerated financial inclusion that truly provides access to savings and credit to disadvantaged sections of people.

ANNEX 2.1
State wise average savings and loans March 2008

Region/State	Average savings/ group	Average loans disbursed	Average loans outstanding	O/s Loan to savings ratio
Northern Region				
Haryana	5792	101235	97949	16.9
Himachal Pradesh	7313	95801	35044	4.8
Punjab	9998	81165	69656	7.0
Jammu & Kashmir	7269	38353	93297	12.8
Rajasthan	4695	46450	34442	7.3
New Delhi	9275	15147	11728	1.3
North Eastern Region				
Arunachal Pradesh	2665	68814	37868	14.2
Assam	3874	43651	32126	8.3
Manipur	4631	42820	30784	6.6
Meghalaya	2182	63601	43999	20.2
Mizoram	18768	115346	49069	2.6
Nagaland	3497	71411	54666	15.6
Sikkim	3689	65843	59329	16.1
Tripura	5673	63228	40242	7.1
Eastern Region				
Bihar	4760	76361	52278	11.0
Jharkhand	5530	45552	28329	5.1
Orissa	6639	54763	42975	6.5
West Bengal	8914	42878	26973	3.0
A & N Islands (UT)	1525	16156	24898	16.3
Central Region				
Chattisgarh	2425	39034	50208	20.7
Madhya Pradesh	6101	58051	35608	5.8
Uttar Pradesh	5987	72060	52790	8.8
Uttarakhand	4358	95180	86050	19.7
Western Region				
Goa	6961	65392	35925	5.2
Gujarat	8433	45831	26476	3.1
Maharashtra	4795	42798	20397	4.3
Southern Region				
Andhra Pradesh	9644	95470	66638	6.9
Karnataka	8020	82969	59990	7.5
Kerala	7518	60864	23730	3.2
Tamil Nadu/Puducheri	8350	70187	56542	6.8
GRAND TOTAL	7556	72076	46884	6.2

ANNEX 2.2
Microfinance Penetration Index and Microfinance Poverty Penetration Index

State	No of out-standing SHG loans 09	No of SHG members	No of MFI clients 09	Total microfinance clients	Share of state to total	Population (000s)	% share of population	Number of poor – lakhs 2004-05	% share of poor	MPI 08	MPPI 08	MPI 09	MPPI 09
1	2	3	4	5	6	7	8	9	10	11	12	13	14
Northern Region													
Himachal Pradesh	32752	425776	3,574	429,350	0.58	6408	0.58	6.36	0.21	1.21	3.33	1.00	2.75
Rajasthan	97917	1272921	242926	1,515,847	2.04	61525	5.59	134.89	4.47	0.7	0.88	0.36	0.46
Haryana	14888	193544	33908	227,452	0.31	23029	2.09	32.1	1.06	0.13	0.26	0.15	0.29
Punjab	16923	219999	1804	221,803	0.30	25839	2.35	21.63	0.72	0.08	0.27	0.13	0.41
Jammu & Kashmir	912	11856	0	11,856	0.02	10387	0.94	5.85	0.19	0.08	0.41	0.02	0.08
New Delhi	1597	20761	67947	88,708	0.12	15718	1.43	22.93	0.76	0.04	0.08	0.08	0.16
TOTAL (A)	164989	2144857	350,159	2,495,016	3.36	142906	12.98	223.76	7.42	0.4	0.71	0.26	0.45
N. Eastern Region													
Assam	88918	1155934	163005	1,318,939	1.77	28406	2.58	55.77	1.85	1	1.39	0.69	0.96
Meghalaya	2396	31148	2898	34,046	0.05	2450	0.22	4.52	0.15	0.12	0.18	0.21	0.31
Tripura	10401	135213	76619	211,832	0.28	3380	0.31	6.38	0.21	0.51	0.76	0.92	1.36
Sikkim	3917	50921	5945	56,866	0.08	571	0.05	1.14	0.04	0.15	0.18	1.53	1.91
Manipur	3410	44330	3005	47,335	0.06	2289	0.21	3.95	0.13	0.29	0.46	0.30	0.49
Arunachal Pradesh	4872	63336	0	63,336	0.09	1160	0.11	2.03	0.07	0.1	0.16	0.77	1.22
Nagaland	680	8840	12	8,852	0.01	2102	0.19	3.99	0.13	0.14	0.2	0.06	0.09
Mizoram	2278	29614	0	29,614	0.04	939	0.09	1.18	0.04	0.6	1.35	0.44	1.00
TOTAL (B)	116872	1519336	251484	1,770,820	2.38	41297	3.75	78.96	2.62	0.78	1.12	0.63	0.91
Eastern Region													
Orissa	314710	4091230	1462450	5,553,680	7.47	38626	3.51	178.49	5.92	2.68	1.59	2.13	1.26
Bihar	83494	1085422	400223	1,485,645	2.00	89776	8.15	369.15	12.24	0.3	0.2	0.25	0.16

Jharkhand	40824	530712	183321	714,033	0.96	29000	2.63	116.39	3.86	0.43	0.29	0.37	0.25
West Bengal	453384	5893992	2366397	8,260,389	11.11	84599	7.68	208.36	6.91	0.99	1.1	1.45	1.61
TOTAL (C)	892,412	11601356	4412391	16,013,747	21.53	242001	21.97	872.39	28.92	0.94	0.71	0.98	0.74
Central Region													
Madhya Pradesh	82191	1068483	551235	1,619,718	2.18	65605	5.96	249.68	8.28	0.37	0.27	0.37	0.26
Chhattis-garh	65827	855751	397757	1,253,508	1.69	22367	2.03	90.69	3.01	0.85	0.57	0.83	0.56
Uttar Pradesh	107106	1392378	812702	2,205,080	2.97	180990	16.43	590.03	19.56	0.37	0.31	0.18	0.15
Uttarakhand	111686	1451918	64291	1,516,209	2.04	9123	0.83	35.96	1.19	0.69	0.48	2.46	1.71
TOTAL (D)	366810	4768530	1825985	6,594,515	8.87	278085	25.25	966.36	32.03	0.42	0.33	0.35	0.28
Western Region													
Gujarat	37105	482365	111521	593,886	0.80	54226	4.92	90.69	3.01	0.35	0.57	0.16	0.27
Maharashtra	313635	4077255	2208784	6,286,039	8.45	103755	9.42	317.38	10.52	0.97	0.87	0.90	0.80
Goa	3278	42614	2200	44,814	0.06	1463	0.13	2.01	0.07	0.27	0.5	0.46	0.86
TOTAL (E)	354,018	4602234	2322505	6,924,739	9.31	159444	14.48	410.08	13.59	0.75	0.8	0.64	0.69
Southern Region													
Andhra Pradesh	1216879	15819427	4949393	20,768,820	27.93	80147	7.28	126.1	4.18	3.03	5.27	3.84	6.68
Karnataka	315150	4096950	3229378	7,326,328	9.85	55822	5.07	138.89	4.6	2.15	2.37	1.94	2.14
Kerala	175613	2282969	310646	2,593,615	3.49	33083	3	49.6	1.64	1.29	2.36	1.16	2.13
Tamil Nadu	573851	7460063	2348452	9,808,515	13.19	64800	5.88	145.62	4.83	2.18	2.66	2.24	2.73
Pondicherry	2499	32487	21805	54,292	0.07	1070	0.1	2.37	0.08	0.77	0.96	0.73	0.91
Other UTs	854	11102	4170	15,272	0.02	947	0.09	2.82	0.09	0.07	0.07	0.23	0.23
TOTAL (F)	2,284,846	29702998	10863844	40,566,842	54.55	235869	21.42	465.4	15.43	2.32	3.22	2.55	3.54
GRAND TOTAL	**4,179,947**	**54,339,311**	**20,026,368**	**74,365,679**	**100**	**1101318**	**100**	**3017**	**100**	**1**	**1**	**1.00**	**1.00**

ANNEX 2.3
State-wise share of loans and NPAs 2008

Region/State	Share of NPAs (%)	Share of Loans (%)
Northern region		
Haryana	0.62	0.63
Himachal Pradesh	0.23	0.74
Punjab	0.33	0.32
Jammu & Kashmir	0.32	0.13
Rajasthan	1.69	1.47
New Delhi	0.00	0.04
North eastern region		
Arunachal Pradesh	0.15	0.10
Assam	2.67	1.42
Manipur	0.48	0.15
Meghalaya	0.46	0.11
Mizoram	0.09	0.08
Nagaland	0.24	0.04
Sikkim	0.03	0.07
Tripura	0.24	0.12
Eastern region		
Bihar	3.26	2.27
Jharkhand	1.73	0.95
Orissa	6.56	7.16
West Bengal	0.75	5.37
A & N Islands (UT)	0.01	0.01
Central region		
Chattisgarh	0.40	1.82
Madhya Pradesh	5.01	1.12
Uttar Pradesh	27.96	3.60
Uttarakhand	1.21	4.85
Western region		
Goa	0.00	0.59
Gujarat	0.44	5.37
Maharashtra	8.41	0.89
Southern region		
Andhra Pradesh	10.96	31.68
Karnataka	10.90	8.17
Kerala	1.72	4.76
Tamil Nadu & UT Pondicherry	13.15	15.98

ANNEX 2.4
REGIONAL SPREAD OF SHG - FEDERATIONS AS ON 31 MARCH 2009[1]

	Region/State	Promoters	No. of Primary Federations	No. of Secondary Federations	No. of Tertiary Federations	Total
A	**Northern Region**					
1	Himachal Pradesh	RUCHI	1			1
	State total		1	0	0	1
2	Rajasthan	PEDO	70	8		78
		Department of Women & Child Welfare				0
		Pradan	306	4		310
		Ibtada	19	2		21
		BCT		1		1
		Hanuman Van Vikas Samiti (HVVS)	9			9
		CECOEDECON		12		12
		Progress	6			6
						0
		Sakhi Samithi		1		1
	State total		410	28	0	438
3	Haryana	Resource Development Centre			7	7
		Swashakthi				0
	State total		0	0	0	7
4	Punjab					
	State total		0	0	0	0
5	Jammu & Kashmir					
	State total		0	0	0	0
	Region-Total		**411**	**28**	**0**	**446**
B	**North Eastern Region**					
6	Assam	Bosco Reach Out		1		1
		Prochesta		1		1
		Assam Mahila Samatha Society	158	18		176
		Sonali SHG Unnayan Samiti	54	6	1	61
		Mahila Shakti Kendra		1		1
		Other		1		1
	State total		212	28	1	241
7	Meghalaya	(IFAD Promoted Federation) GISIKSAN SHG FEDERATION		1		1
		Turshaphrang Women Self Help Group Federation		1		1

(*continued*)

	Region/State	Promoters	No. of Primary Federations	No. of Secondary Federations	No. of Tertiary Federations	Total
		Other		4		4
	State total		0	6	0	6
8	Tripura					0
	State total		0	0	0	0
9	Sikkim					0
	State total		0	0	0	0
10	Manipur	VVD - Imphal		1		1
		VVD - Ukrul		3		3
		Other		1		1
	State total		0	4	0	4
11	Nagaland	Eleutherous Christian Society		1		1
	State total		0	1	0	1
12	Arunachal Pradesh					0
	State total		0	0	0	0
13	Mizoram					0
	State total		0	0	0	0
	Region-Total		**212**	**39**	**1**	**252**
C	**Eastern Region**					
14	Orissa	CYSD	39			39
		Mission Shakthi	6573	314	17	6904
		Tripti	1020	38	10	1068
		People's Rural Education Movement				0
		Fellowship (15 GPLFs, 14 Coops & 1 Society)	30			30
		PRADAN	90	4		94
		Awareness Macs	7			7
		BISWA	238			238
		CENDERET	22			22
		Other NGOs (Swayam Sree, Gramodhav, FARR)*	25			25
	State total		8044	356	27	8427
15	Bihar	Women Development Corporation	170	72		242
		Jeevika piloting 10 Vos, 2 BLFs	271			271
		Bihar Mahila Samakhya Society	45	9		54
		Pradan	20	1		21
		All NGOs	100			100

(*continued*)

	Region/State	Promoters	No. of Primary Federations	No. of Secondary Federations	No. of Tertiary Federations	Total
	State total		606	82	0	688
16	Jharkhand	Mahila Samakhya, Jharkhand	13	0		13
		Pradan	306	4		310
	State total		306	4	0	310
17	West Bengal	Panchayat Raj & Rural devt.	12739	30		12769
		Swayamsidha social welfare Development	295	39		334
		Sreema Mahila Samiti (Gram Vikas Sangha (AVS) and Aanchalik Unnayan Sangha (AUS)	18	3		21
		Pradan	55	1		56
		Bagnan - 1		1		1
		SPADE		1		1
		Other NGOs	350	6		356
	State total		13457	81	0	13538
	Region-Total		**22413**	**523**	**27**	**22963**
D	**Central Region**					
18	Madhya Pradesh	Action for Social Advancement		1		1
		Pradan	85	3		88
		Asha Niketan Welfare Centre	6			6
		Centre For Advanced Research and Development	70			70
		Indian Farm Forestry Development Coop. Ltd. (IFFDC)		150		150
		Indore Diocese Social Service Society (VLF - 58, PLF-19)	77			77
		Jabalpur Diocese Social Service Society (VLF - 11, PLF-7)	18			18
		Khandwa Diocese Social Services	3			3
		Kripa Social Welfare Society (VLF-43)	43			43
		Manav vikas Seva Sangh (VLF - 213, PLF-20, BLF-2, DLF-1)	233	2	1	236
		ASRA	5			5

(*continued*)

	Region/State	Promoters	No. of Primary Federations	No. of Secondary Federations	No. of Tertiary Federations	Total
		P & RD dept. (SGSY) - activity based fed		51		51
		DPIP (17 Producer Companies & 7 Cooperative Societies)	24			24
		Swashakthi				0
	State total		564	207	1	772
19	Chhatisgarh	Pradan	38			38
	State total		38	0	0	38
20	Uttar Pradesh	Grameen Development Service	20			20
		Pratham Samaj Sevi Sansthan	4			4
		PANI	175	1		176
		Uttar Pradesh Volun-tary Health Association (UPVHA)	2			2
		Grameen Development Service (GDS)				0
		Vinobha seva ashram -	5			5
		Shramik Bharati	7			7
		Mahila Samakhya, Uttar Pradesh	19			19
		Rajiv Gandhi Mahila Vikas Pariyojana	500	15		515
		Swashakthi				0
	State total		732	16	0	748
21	Uttaranchal	REWAIN Women SHG Federation	1			1
		Mahila Samakhya, Ut-taranchal	6			6
	State total		1	0	0	7
	Region-Total		**1335**	**223**	**1**	**1565**
E	**Western Region**					
22	Gujarat	SEWA (cooperatives)	14	1		15
		Aga Khan Rural Support Programme (AKRSP)	22			22
		Mahila Samakhya, Gujarat	26			26
		Others	51			51
	State total		113	1	0	114
23	Maharashtra	Mahila Samyukta Samity	600			600
		Swayam Shikshan Prayog	11			11
		Chaitanya	3			3

(*continued*)

	Region/State	Promoters	No. of Primary Federations	No. of Secondary Federations	No. of Tertiary Federations	Total
		Rajaramabpu Dnyan Prabodhini, Islampur, Sangli	1			1
		Other	18			18
	State total		600	0	0	615
24	Goa					
	State total		0	0	0	0
	Region-Total		**713**	**1**	**0**	**729**
F	**Southern Region**					
25	Andhra Pradesh	IKP	35525	1099	22	36646
		MEPMA	4382	8		4390
		MYRADA	32			32
		GRAM (Cooperatives)	20	1		21
		MARI	14	1		15
		PEACE	5			5
		PSS	18	1		19
		Youth Charitable Organisation (Women's Registered Associations)	180			180
		Navajyoti	3			3
		Krushi	7			7
		ASP	85	1		86
		AP Mahila Samatha Society	28			28
		Other NGOs(YIP, CEED, COVA, etc)**	100			100
	State total		40399	1111	22	41532
26	Karnataka	Myrada	281			281
		Donbosco	24			24
		Nisahay	12			12
		IDF	255			255
		Grama	6			6
		Grama Vikas	15	1		16
		SJM	5			5
		Govt.	301			301
		Sri Kshetra Dharmasthala Rural Development Project	1434	8		1442
		Mahila Samakhya, Karnataka (2005) - Social Federations	38			38
		Karnataka Grameen Mahila Maha Okkuta	160	24	1	185

(*continued*)

	Region/State	Promoters	No. of Primary Federations	No. of Secondary Federations	No. of Tertiary Federations	Total
		OUTREACH (Cluster Level Associations and Primary level Federations)	128	4		132
	State total		2659	37	1	2697
27	Kerala	Kudumbasree	17000	1058		18058
		KAIROS	35			35
		Kottappuram Integrated Development Society (KIDS) – VLF	5			5
	State total		17040	1058	0	18098
28	Tamil Nadu	Women Development corporation (IFAD-Mahalir Thittam')	12618			12618
		DHAN Foundation	2000	130		2130
		MYRADA	12			12
		ASSEFA-Sarvodaya Nano Finance Ltd.(Sarvodaya Mutual Benefit Trusts)	55			55
		Community Develop-ment Society	7			7
		TRUPA	4			4
		Universal Welfare Foundation	20			20
		AVVAI Village Welfare Society	1			1
		Dhan foundation	11			11
		Centre for Agricultural and Rural Development Services (CARDS),	1			1
		Rural Education for Development (RED),	1			1
		Navajeevan Trust & Centre for Peoples Education (CPE)	1			1
		SEVA	1			1
		Hand in Hand	1			1
		M.S.Swaminathan Foundation	1			1
		VBEDS	1			1
		CERD	1			1
	State total		14736	130	0	14866
	Region-Total		**74834**	**2336**	**23**	**77193**
	GRAND TOTAL		**99918**	**3150**	**52**	**103148**

Note: Above information is collected by APMAS from websites, through telephone calls and field visits. Federation are there in the states of Himachal Pradesh, Haryana, Chattisgarh and North East states, but data is not available

* Approximate figures, few of the NGO have promoted federation, which now have been changed to MFIs

* *Approrximate figures

ANNEX 2.5
Commercial Banks—outstanding SHG accounts and loans March 2009

(Rs lakhs)

		Commercial Banks				Total	
		Public		Private			
Sl.No.	Region/State	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount
A	***Northern Region***						
1	Haryana	12742	9684	107	89.18	12849	9772.86
2	Himachal Pradesh	19682	4105	200	238.17	19882	4343.50
3	Punjab	7643	5813	2	0.3832	7645	5813.19
4	Jammu & Kashmir	288	94			288	93.93
5	Rajasthan	44896	20101	1291	683.22	46187	20784.30
6	New Delhi	1597	1249			1597	1248.53
	SUBTOTAL	86848	41045.36	1600	1010.95	88448	42056.31
B	***North Eastern Region***						
7	Assam	47552	18294	5	1.91	47557	18296.28
8	Meghalaya	1794	396			1794	396.17
9	Nagaland	2144	817			2144	816.80
10	Tripura	3917	3873			3917	3872.74
11	Arunachal Pradesh	2456	684			2456	684.32
12	Mizoram	680	9			680	8.63
13	Manipur	4566	2260			4566	2259.73
14	Sikkim	932	273	1	0.1887	933	273.19
	SUBTOTAL	64041	26605.76	6	2.10	64047	26607.86
C	***Eastern Region***						
15	Bihar	49145	28006	10	0.82	49155	28006.84
16	Jharkhand	40824	19033	0	0	40824	19033.39
17	Orissa	164978	70970	5292	2938.9982	170270	73909.14
18	West Bengal	262414	56232			262414	56231.83
19	A & N Islands (UT)	211	47			211	46.54
	SUBTOTAL	517572	174287.92	5302	2939.82	522874	177227.74
D	***Central Region***						
20	Chattisgarh	24722	9930	6	4.8585	24728	9934.70
21	Madhya Pradesh	45336	24773	33	15.4729	45369	24788.63
22	Uttarakhand	16022	8652	308	223.2	16330	8874.80
23	Uttar Pradesh	111628	90612	217	74.13	111845	90685.90
	SUBTOTAL	197708	133966.37	564	317.66	198272	134284.03
E	***Western Region***						
24	Gujarat	32630	8929			32630	8929.41
25	Maharashtra	243810	108740	12948	7419.6028	256758	116159.68
26	Goa	2235	1856			2235	1855.79
	SUBTOTAL	278675	119525.28	12948	7419.60	291623	126944.89

(*continued*)

		Commercial Banks				Total	
		Public		Private			
Sl.No.	Region/State	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount
F	***Southern Region***						
27	Andhra Pradesh	871207	645681	7780	3775.0814	878987	649456.47
28	Karnataka	168204	89438	15178	104739.69	183382	194177.29
29	Kerala	132000	73176	12192	1612.66	144192	74788.47
30	Tamil Nadu & UTP	437563	262125	25607	16700.9	463170	278825.77
	SUBTOTAL	**1608974**	**1070419.66**	**60757**	**126828.33**	**1669731**	**1197248.00**
	GRAND TOTAL	**2,753,818**	**1565850.36**	**81,177**	**138518.47**	**2834995**	**1704368.82**

NOTES

1. Status of Microfinance in India is an annual publication of NABARD containing primarily data on progress of SHG–bank linkage programme and some information on financing of MFIs by banking sector. 2007–08 report was released in March 2009.
2. See Annex 2.1 for state-wise details.
3. Al Fernandes is the Executive Director of MYRADA and a pioneer in the SBLP. These views were expressed in the Microfinance India Conference on 12 November 2008.
4. The State of India's Livelihoods: The 4P Report (Chapter 6—Civil Society Initiatives) gives examples of the work done by civil society organisation in integrating livelihoods and finance.
5. SBI, for example, had introduced a new scheme for NGOs and MFIs during 2008–09 as mentioned in its Annual Report 2009.
6. Andhra Pradesh Mahila Abivriddhi Society, a knowledge organisation that works in the SHG domain providing training, consulting and carrying out research studies. It also compiles information of federation of SHGs and undertakes advocacy on community-based approaches in microfinance.
7. The last year's survey indicated that more than 85 per cent of NGOs that were SHPIs wanted to set up MFIs or were already in the process of doing so.
8. The committee was chaired by Prof. Radhakrishna, Director of Indira Gandhi Institute of Development Research, Mumbai. The report was submitted in February 2009.
9. Reproduced from the documentation of APMAS, Hyderabad
10. T.Narendar, executive, INFOS provided the information in response to the query on the UN solution exchange.
11. The data on federations has been provided by APMAS, Hyderabad. The data is not exhaustive, but covers most federations that exist.
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Microfinance institutions—coming of age

3
Chapter

'When we started I used to get excited talking about the **potential** of the sector in terms of lakhs of customers and crores in portfolio. Now this new breed of microfinanciers has come in and comfortably talks about **having** millions of clients and billions in loans'—Vijay Mahajan, during the roundtable discussions in Hyderabad.

He is not alone in his admiration for the way the sector has grown in the last few years. From a small portfolio outstanding of Rs 8.97 billion in 2005, the MFI segment has grown 13 times in 4 years to end the year 2009 with Rs 117 billion in outstanding loans. The growth rates in four successive years are commendable in comparison with any sector of the economy. The icing on the cake is that the poor, women and disadvantaged have been the predominant clientele. Of all game changers in the last 5 years, microfinance is perhaps the most revolutionary in terms of approach and outreach. Though it appears fairly simple today with the benefit of hindsight, no one could have predicted that a dominantly commercial approach to providing tiny financial services to people who appeared ill placed to use the same would one day cover 22 million households! All this has been done without significant state support in terms of funds or policy; with little donor funding. Commercial sources of funds have been accessed for the most part and lent on commercial terms to customers (to the consternation of many observers) with very positive outcomes. Rarely have there been movements of this scale where a commercial approach was well used to produce development outcomes on the poor.

Last year (2007) eight Indian MFIs had made it to the top 50 in the MIX market list[1]. The 2008 list contains seven MFIs with SKS Microfinance occupying second place. Some of the others have slipped down from the previous year's ranking. In the global top 100, ten Indian MFIs find a place.

In the Indian microfinance sector SKS Microfinance not surprisingly occupies the top position both in terms of client coverage and loans outstanding with a scorching pace of growth. A surprising entry is that of Equitas Microfinance which has come up to the 10th place within 18 months of commencement of operations. The leader table of top

Table 3.1 MFIs in the MIX top 50 list

Name of MFI	Ranking in 2008	Ranking in 2007
SKS	2	1
Cashpor	4	Not ranked
Sarvodaya Nano Finance	12	14
ESAF	14	13
Spandana Spoorthy	22	6
Adarsh Welfare Society	46	185
CReSA	48	11

Table 3.2 The top 10 MFIs by outreach (Rs billion)

Name	Outreach (no.)	Loan os	Own funds	Borrowings
SKS Microfinance	35,20,826	24.6	6.6	19.9
Spandana Spoorthy	24,32,189	18.7	3.1	14.8
Share Microfin Limited	15,02,418	12.2	1.7	9.7
Bandhan	14,54,834	5.3	0.5	6.9
Asmitha Microfin Ltd.	8,78,455	7.1	0.8	7.1
SKDRDP	8,07,170	4.9	0.2	5.4
Bhartiya Samruddhi	5,74,293	2.6	0.6	4.0
(ASA) Grama Vidiyal	3,62,624	2.0	0.5	1.6
BISWA	3,52,352	1.7	0.5	1.8
Equitas Microfinance	3,39,158	2.9	1.1	1.8
Total	1,22,24,319	82.0	15.6	73.0

five remained the same with Spandana moving into second position ahead of Share. There was considerable variance in the growth rates of the top five. In client acquisition, Spandana reported the highest growth at 104 per cent over 2008. Share Microfin had the slowest growth rate of 16 per cent. In loan outstanding, both SKS and Spandana had 214 per cent growth over the previous year. Bandhan by comparison was a moderate climber with 91 per cent growth in both clients and loan volumes. It is true that 91 per cent growth in the current context is moderate.

Table 3.3 Comparative performance of top five MFIs

	Clients (No. mn)		Growth rate (%)	Loans (Rs bn)		Growth rate (%)
	2008	2009		2008	2009	
SKS Microfinance	1.88	3.52	87	7.81	24.6	214
Spandana	1.19	2.43	104	5.95	18.7	214
Share Microfin	1.29	1.50	16	7.28	12.2	67
Bandhan	0.76	1.45	91	2.78	5.3	91
Asmitha Microfin	0.70	0.88	26	3.36	7.1	111

The portfolio growth was driven more by larger loan size than by client acquisition in the case of four out of five leaders. Asmitha Microfin had the highest average loans at Rs 8,130 followed by Share at Rs 8,060. Bandhan continued to maintain its average loan size at Rs 3,650 over the last 2 years. The average loan size leaped by 70 per cent in the case of SKS and 54 per cent in case of Spandana. This is clear evidence that microfinance is finally deepening and not only widening.

As in the last year the Bharat Micro Finance quick report[2] brought out by Sa-Dhan has been a valuable source of primary information. In the current year's report 233 MFIs have reported information. [An inventory commissioned by Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) has collected information on 788 microfinance organisations (MFOs) that are functional. More information on the inventory is carried later in the chapter.] According to the Quick Data, the sector added 8.5 million clients during 2008–09 reflecting a growth of 60 per cent in client outreach. The loan portfolio rose to Rs 117.3 billion reflecting a 97 per cent increase over the last year. The MFIs continued to grow in size. From 21 in the previous year the number of large MFIs (those with an outstanding loan portfolio of more than Rs 500 million) increased to 27. Nine MFIs which were small crossed the Rs 50 million threshold during the year 2008–09. But growth was not happening all across the sector. While 122 MFIs expanded client outreach, 46 MFIs faced a decrease in the number of clients. The gainers added 8.2 million clients and the others lost 0.35 million clients. The frequency distribution of number of MFIs that increased or contracted their clientele shows that 47 MFIs had growth rates exceeding 100 per cent and 17 MFIs lost clientele by more than 50 per cent.

Table 3.4 Growth in client outreach—a frequency distribution

Growth range	No. of MFIs
Increase	122
0–25%	24
25–50%	23
50–100%	28
More than 100%	47
Decrease	46
More than 50%	17
25–50%	14
1–25%	15

The average loan size has also increased significantly. Per capita loan outstanding, from an average of Rs 4,200 increased to Rs 5,200, by about 24 per cent. While 20 per cent of clients had loans exceeding Rs 10,000 in the previous year, during the current year 38 per cent of borrowers had loans exceeding Rs 10,000. Proportion of small loans of less than Rs 5,000 had declined reflecting that MFIs were beginning to deepen their engagement with the clients. Sa-Dhan also reports that of the poorest districts identified by the Government of India[3] more than 70 per cent are being served. The MFIs at the end of March 2009 served 13.2 million rural borrowers in terms of geographical coverage. As for gender profile of coverage, 16.8 million female borrowers were served by MFIs. Hardly 7 per cent of active clients of MFIs were men. Of the total borrowers from MFIs 7.6 million were from socially disadvantaged groups of which 2.9 million were from minority groups.

For the purpose of analysis, MFIs have been categorised according to size and age. Large MFIs are those with a loan business of more than Rs 500 million, medium MFIs are those with Rs 50 to 500 million business and those with less than Rs 50 million business categorised as small. In case of age of MFIs, those functional for less than 5 years are classified A, those between 5 and 10 years classified as B and those functional for more than 10 years classified as C. There were 96 MFI in class A, 85 in class B and 41 in class C. Size wise 27 large, 65 medium and 138 small MFIs were in business.

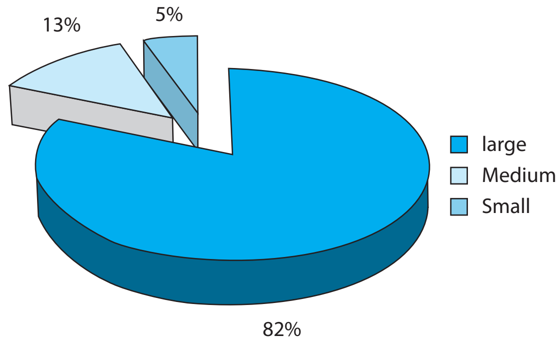


Figure 3.1

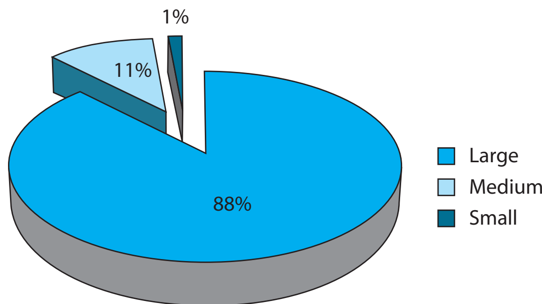


Figure 3.2 Share of loan volume—size wise

Large MFIs had a disproportionately large share of clients (82 per cent) while medium and small MFIs had 13 per cent and 5 per cent of clients. The sector is thus divided between a few with extensive outreach and depth and 138 very small MFIs with about 5 per cent of clients. There are vast differences between the two in terms of policy climate, HR, funds, technology and capacity building needs. It would appear that barring the customer, these institutions have nothing in common.

The large MFIs had a share of 88 per cent of loan portfolio. Sixty per cent of all MFIs which were small shared a miniscule 1 per cent of loan portfolio. Medium MFIs accounting for 28 per cent of all MFIs had a share of 11 per cent of loan volumes. The distribution of business between a small number of large MFIs and a very large number of small MFIs is bound to make for unequal competition in the field. The competition is not confined to customers, but also for resources and staff. In terms of the different legal forms, 34 non-banking financial companies (NBFCs) had a share of more than 76 per cent of the overall outstanding loans. There are 133 societies accounting for a little less than 10 per cent of the outstanding loan portfolio. This very clearly brings out the wide differences between societies as a form which remain very small in terms of both client outreach and loan portfolio and the NBFCs which have enormous ability to grow.

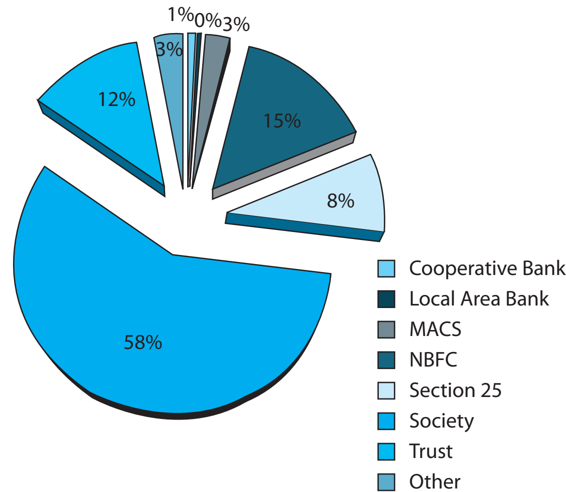


Figure 3.3 Market share of different forms of institutions—loan volumes

In the last year we had reported that most NGOs involved in SHG promotion had plans of setting up their own MFIs and lending to their SHG members. The transformation of NGOs into MFIs is ongoing. The reverse of this process has also been seen emerging[4]. Most MFIs on attaining a certain scale become conscious of the need to take up development work and hence set up an NGO to carry out development programmes. Some of the MFIs which came out of NGOs use the parent organisation to continue to do development work.

PROFITABILITY

Of the 230 MFIs that reported information, almost one out of three was making a loss. Profits were reported by 84 per cent of the large MFIs and 80 per cent of medium MFIs. Only 58 per cent of small MFIs were profitable. Small does not seem to be the right size for viability. Mutually aided cooperative society (MACS) form of organisation in MFIs had the best profit record with 83 per cent MACS reporting profits.

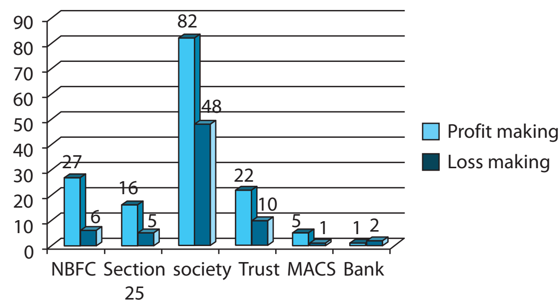


Figure 3.4 Profit/loss making MFIs—by form of organisation (2009)

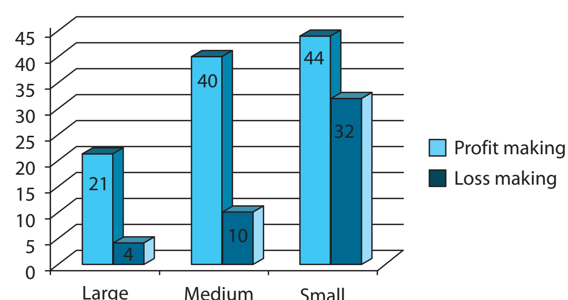


Figure 3.4A Profit/loss making MFIs—size wise classification

But with a sample of only six, it is too facile to conclude that this form of business is better suited for profitable working than all other forms. Profit was reported by 81 per cent of NBFCs. Seventy-six per cent of section 25 companies were profitable in 2009. Company form (both for-profit and non-profit) appeared to be performing better than others, possibly on account of ease of scaling up and ability to establish funding and other linkages. Societies, a popular form of MFIs, were the least profitable with only 63 per cent reporting profits. The impossibility of bringing in equity and the lack of returns for the investor in society form had possibly made funding costlier in this form.

Table 3.5 Size of institutions and yield on portfolio

Size of MFI	No. of MFIs with 25% or more yield	No. of MFIs with 10–25% yield	No. of MFIs with 10% or less yield
Large (Rs 500 mn + portfolio)	13	11	3
Medium (Rs 50 to 500 mn)	26	26	13
Small (less than Rs 50 mn)	42	38	58

Table 3.6 Age of institutions and yield on portfolio

MFI's age	No. of MFIs with 25% or more yield (%)	No. of MFIs with 10–25% yield (%)	No. of MFIs with 10% or less yield (%)
A Up to 5 years	48	25	26
B From 5 to 10 years	21	30	34
C Above 10 years	12	19	10

An analysis of yields across different sizes of MFIs shows that 48 per cent of large MFIs produced a high yield of more than 25 per cent. Only 11 per cent of large MFIs had yields below 10 per cent. In the case of medium and small MFIs only 40 per cent and 30 per cent respectively earned above 25 per cent yield on portfolio. Twenty per cent of medium and 42 per cent of small MFIs had yields of less than 10 per cent. Large MFIs are more likely to target high yields with almost one out of two reporting more than 25 per cent yield. Even with adequate business volumes and large client base, the large MFIs were seemingly unwilling to reset their interest rates at lowers levels. The smaller ones seemed to maintain low yields even at a loss. Yield levels did not strongly correlate with age. One out of four mature MFIs had low yields of less than 10 per cent. The remaining were in the mid to high ranges of yield. Similar was the position in case of young MFIs of less than 5 years age. The 5 to 10 year old MFIs were more likely to have lower yields than others. One would expect that MFIs in operation over a long time would have been able to lower costs and thus set lower rates of interest. Reduced operational cost was reported by 22 out of 36 MFIs with more than 10 years of operations. In the case of young MFIs of less than 5 years age, 31 out of 61 posted a reduced operational cost. One could conclude that with age the interest rates could be moderated but not necessarily brought down to the lowest possible level in the industry.

Table 3.7 Trends in operational cost and age of MFIs

Age	No. of MFIs with reduced operational cost	No. of MFIs with an increased operational cost
A	31	30
B	32	35
C	22	14

The Side by Side report 2008[5] of Sa-Dhan provides an analysis of the key ratios of performance of MFIs. The analysis presents a wholesome picture of performance. Across the sample of the institutions covered Operational Self Sufficiency improved by 13 per cent to reach a level of 125 per cent. PAR 60 days declined by 10 per cent over the previous year that stood at half the level obtained in 2006. This in part is attributable to the ever-increasing new loans that increase the denominator for calculation of PAR levels. Current recovery rate has improved and operating cost ratio has declined. There is a healthy increase in the average clients per credit officer. The only blemish in an otherwise pretty performance picture is the marginal increase in total cost ratio by 0.2 per cent. In terms of total costs, MFIs seem to have hit the floor for the time being. Any further cost reduction across the sector would depend on game changing technology use or design of a different product or lending model.

The SBS report however warns that the rosy picture is partly due to the excellent performance of the

Table 3.8 Financial ratios of select MFIs, 2008[xxiii]

Standards Ratios	Ratios for the 2008-Sample	Ratios for the 2007-Sample	Ratios for the 2006-Sample
Operational Self Sufficiency (OSS)	125.8%	112.9%	104.6%
Portfolio at Risk (PARGO)	0.9%	1.0%	1.8%
Current Repayment rate (CRR)	99.1%	97.9%	94.0%
Operating cost Ratio (OCR)	8.5%	9.7%	15.4%
Total Cost Ratio (TCR)	17.6%	17.4%	23.4%
Active Borrowers per credit officer (ABCO)	411	339	239

large MFIs. When the performance is broken into size wise categories, the numbers are not good for small and medium MFIs. The sustainability of small MFIs is particularly in question. A further caveat is that the numbers of 2008 were prior to the meltdown and therefore do not reflect the hardening financial costs experienced in the last year. Even after factoring the meltdown effects, the larger MFIs are expected to have happy performance ratios. One of the key drivers of good numbers is the healthy growth. Some problems in PAR, productivity and cost of operations might remain concealed under the large new numbers that flow in month after month. For example, at a 200 per cent growth of portfolio, a 100 per cent growth of PAR would not show even as a small blip. It would be necessary to separate the growth effect from the normal business effect. If the incremental numbers arising from new locations in terms of clients, loans, costs, revenues and PAR are segregated from the total numbers and the ratios are worked, it might then reveal the state of progress in normal times. Such an analysis is not to be seen as an academic exercise, but a business continuity planning strategy.

REGIONAL SPREAD

The state wise position of client outreach and loan portfolio outstanding is presented in Annex 3.1 at the end of this chapter. The dominance of southern part of India over the microfinance sector continued. One out of every two MFI clients still was from southern states. While eastern and northern parts show considerable expansion, western part has not made significant progress. A comparison of growth rate reveals that number of active borrowers grew the fastest in northern states and the slowest in western region. The growth rate in outstanding loan portfolio per borrower (the average per capita loan) grew fastest in the western region followed by the north. Southern region has traditionally seen lower average loans and the trend continued during the year 2008–09. Another significant feature observed from the current year's data is the relative slow down in urban microfinance. Urban borrowers increased by 1.2 million during the year compared to 5.3 million borrowers in the rural areas.

Southern region had a share of 54 per cent clients, but accounted for 58 per cent of loans. Not unsurprisingly AP, Karnataka, WB, Tamil Nadu and Orissa are the top five states in terms of total client outreach. WB has more MFI clients than Tamil Nadu which is considered to be an intensively competitive microfinance market. In terms of average loan size Delhi (though not a typical microfinance environment) claims the top spot with an average of Rs 16,600 per client. Gujarat, Haryana, UP and Rajasthan occupied the next four places in terms of size of average loans per capita. Maharashtra has an average loan size of Rs 2,600 per client which is less than half of the national average of Rs 6,000 per capita.

Haryana with a growth rate of 2,200 per cent led the new client acquisition chart followed by Manipur (which more than quadrupled its client base), Uttaranchal, Rajasthan and MP. In loans, Haryana again led the list with a growth rate of 3,000 per cent followed by Rajasthan, Uttaranchal, MP and Manipur. States like Chhattisgarh, Tripura and Bihar also showed vigorous growth in loan outstanding. The north-eastern states added more than 76,000 clients during the year which is a welcome development. Sikkim and Meghalaya appeared on the microfinance radar during the year. Most of the high growth rates are recorded on narrow bases, but the noteworthy point is that some of the less developed states have started to show a positive response to MFIs. If these growth rates stabilise, we might see a more even spread of microfinance and improved access to financial services in those areas that have traditionally experienced exclusion.

QUALITY OF GROWTH

One of the concerns expressed in the last year's report related to mission drift. Arguments have been put forward that more underserved districts are covered and a significant proportion of clients belong to the disadvantaged groups to highlight the social orientation in geographical expansion and client profiles. While these are welcome developments, these are not sufficient to prove the customer

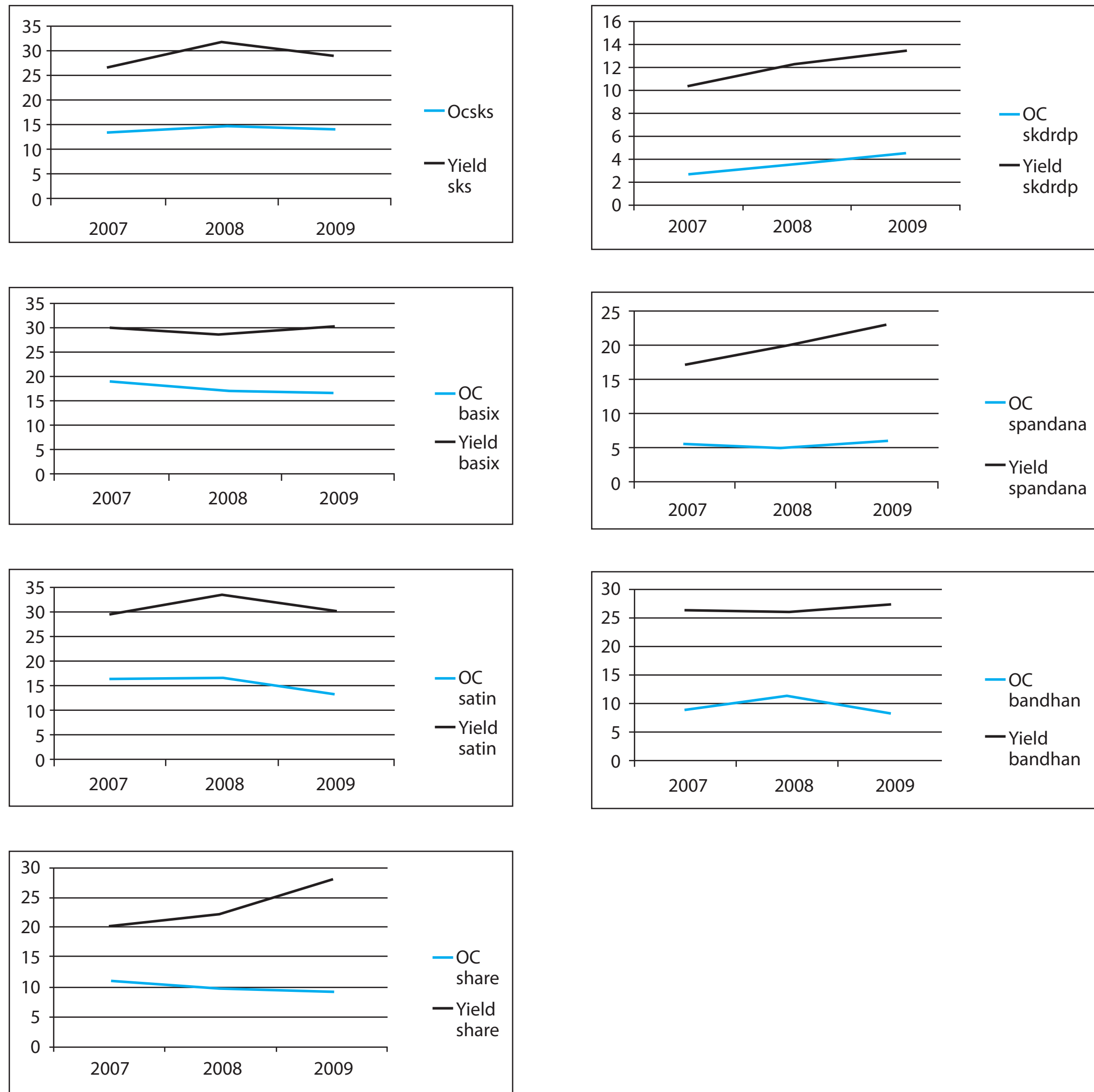


Figure 3.5 Cost and yield trends in select MFIs

relevance and fit of microfinance as is in practice. The pressure on the largest MFIs to produce high returns on equity could adversely influence their social orientation. Balancing the high return on equity necessitated by high premium on shares and the social mission which looks at client comfort has been very difficult. The interest rates were expected to decline significantly with increasing scale of operations with operational costs reductions being passed on to customers. However, evidence on the ground does not suggest that the decline in interest rates charged to the borrower has been commensurate with the increase in scale both in terms of outreach and in terms of portfolio growth. With sector

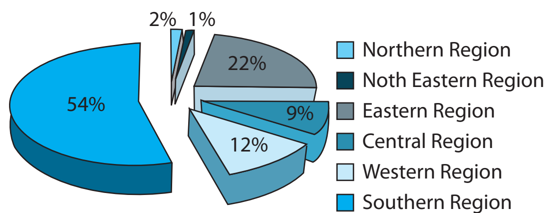


Figure 3.6 Regional shares in client outreach

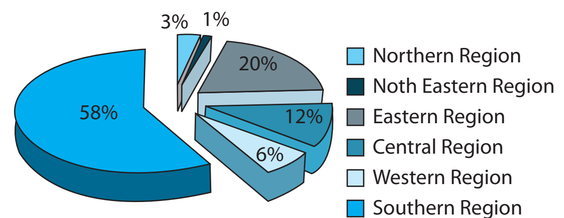


Figure 3.7 Regional shares in loans outstanding

operating self sufficiency (OSS) hovering around 125 per cent (up from 105 per cent 2 years back) there is some room for reduction of interest rates, but we see no movement in that direction barring a few exceptions. Over a period the pricing structure of some of the leading MFIs has remained more or less the same. The political risk in keeping interest rate high in the face of an ever expanding portfolio size is pretty high.

The figure shows that of the seven MFIs in which cases operating cost and yield trends have been tracked only two show a reduction of interest rates in response to cost decreases. In some others even when costs declined, the yield rates went up, reflecting that there was no attempt to align the yield to costs.

The increased loan size seen in the current year will be welcome in the borrowers' hands. The need is to cover borrowers' requirements adequately and at the same diversify risks. Small loans keep the borrower underfinanced leaving scope for others to lend making the simultaneous service of multiple loans difficult. The seeds of default and borrower indiscipline actually are sown in underfinancing by MFIs with a view to limit risks. On the product side, we are yet to see launch of significantly new ones on a large scale. The weekly EMI products have become so convenient to most MFIs that it might be difficult to shift to other products that carefully consider cash flows of customers and the purpose for which they borrow. Some of the 'new' products[6] introduced are mere clones of the same basic genes with change of name and period of loan.

Competition among MFIs in certain locations has led to problems which were discussed in the previous year's report. Aggressive competition has resulted in excessive financing and lowering of not only the disciplinary standards but also the due diligence requirement while acquiring new clients. A combination of several factors (discussed in a separate chapter later) has contributed to default of loans of Rs 600 to 750 million by the customers in a few districts in Karnataka[7]. The proximate reason for these loans not being repaid by the borrowers is a call given by religious leaders against repayment of loans which have been termed as contrary to the religious law and good practices. What gave the space for entry of religious leaders in finance is a question for which answers must be found.

In some locations, MFIs have reportedly resorted to employing agents for client acquisition and initial loan disbursement. In such cases the agents are not full-time employees of the MFI. Their engagement has more to do with an attempt to reduce costs to the company. However, the risk posed by such agents is rather high. Some of the MFIs have found to their disadvantage that employing of agents could actually translate into much higher risk and higher levels of default. Staff incentives also are a factor in the decline in quality of growth. The customer concerns that might be part of the corporate philosophy of MFIs are rarely reflected in the incentive structure provided to staff. Staff in most institutions is rewarded for accomplishing benchmarks in client outreach, portfolio growth and maintaining low levels of PAR. The incentives do not have underlying social characteristics of achieving growth either in outreach or in credit portfolio. This tends to bring in a model which looks at customers as so much revenue per annum rather than so many livelihoods stabilised which was the core philosophy behind many MFIs at their start-up.

The recovery methods adopted have also come for considerable criticism. Achieving 100 per cent recoveries and a default-free record does not seem to be ideals to be pursued. Such high recoveries are achieved on the foundation of extreme hardship to a few borrowers who simply are not in a position to repay. Placing such borrowers under extraordinary pressure leads to alienation of their friends and relatives also from the MFIs. Practices such as removal of livelihood and household assets, preventing members from leaving meeting venue till all repayments are completed, MFI staff sitting in the house of borrowers for long hours even when knowing that the borrowers find it beyond their control to repay have led to marked sense of disenchantment among the customers. While such aggrieved customers are small in number, it is time to think of better alternatives that do not make the customers worse off. Actions aimed at lowering the social standing of the customer have to be taken with extreme caution. Otherwise over the long term the disaffection caused among borrowers leads to concerted action as has been seen in UP, Karnataka and other places.

GOVERNANCE

The quality of governance in the MFIs has visibly improved during the year. However, these institutions still depend on one or two promoters. Independent directors have been brought in in some large MFIs while in others such appointments are yet to be made. Even after induction of independent directors there have been reservations about the quality of information made available to such directors. Some directors in informal discussions

lament that what is valued by the promoters is not their views but their presence in meetings. Having a few good names on the board does improve the image of the MFIs but improvement of functioning of the MFIs is possible only when such directors are fully made use of in providing advice and guidance. There are MFIs that have brought in a number of independent directors and seriously pursue them for advice. The directors are compensated adequately for their time making possible the flow of expectations and informed action both ways. Audit committees have been set up under independent directors with clear terms of reference. In the recent past, it has been seen that more and more of second line management is inducted in the large and mid tier MFIs. Positions such as chief financial officer (CFO), chief information officer, heads of HR functions and chief technology officer are being filled in. The keyman risk that was apprehended in the previous years seems to be declining. In those institutions with investment by private equity investors, greater transparency and a more methodical approach to governance have been witnessed. The quality of management information system (MIS) in such institutions has vastly improved providing an example to other MFIs which are in the process of moving up to tier I.

The economic downturn has been a blessing in disguise. It has had a sobering impact on MFIs and has very clearly brought out that the financial market does not support operations that do not have intrinsic quality. The sub-prime crisis which snowballed into a full blown financial sector meltdown has clearly impacted institutions which did not have an appropriate form and which did not have good governance standards. The funder's risk perceptions became high in such a scenario squeezing out liquidity flow thereby forcing institutions to scale down their growth plans.

The entry of new generation MFIs with new ideas in the sector has been welcomed by several people. These MFIs have promoters who have professional background, having run banks and financial institutions. These new generation MFIs bring in adequate owned capital, have rigorous client selection processes and are expected to be professional in operations. Their methods of managing social performance have been found to be practical. On the flip side there are also certain types of MFIs that have entered microfinance such as those who are engaged in trading or even money lending of a certain kind. It has been difficult to separate these kinds of promoters from those who are seriously into microfinance.

While some organisations have invested in adequate systems and HR development to ensure that their growth momentum is carried without any hindrance, other MFIs have followed suit without making the necessary investments. In such cases there have been systemic and procedural failures leading to higher default rates and lower revenue collections. The higher default rates are more due to excessive growth rates mounted on systems geared for a lower scale of operations. There is a need for some MFIs to look at the right size at which they should operate with their existing systems which are sound for a given scale.

CHALLENGES AND RISKS

The problems of MFIs described in the last year's report continued during the year under review. Scarcity of funds, increasing resource cost, increasing risks and limited HR availability continued to plague parts of the sector. Further, self-inflicted problems of intense competition and lowering of diligence standards put pressure on MFIs operations in some locations. In certain locations intense competition has resulted in high default rate and reduced portfolio quality. Some small MFIs with concentrated exposure in such competitive markets are nearing collapse. Their collapse may not open up the market space, but would queer the pitch for others. Financial markets are behavioural rather than physical in character; hence the problems of one institution visit the others with customers often mimicking the behaviours of their peers. The regulators in the financial sector have nightmares of systemic failure arising from herd behaviour of customers, where a collapsing institution has a domino effect. The institutions in microfinance would do well to factor in the peculiarities of financial markets and take collective action.

As commented last year in the report, high growth rates continued to pose risks. When growth takes place without accompanying controls and appropriate systems and processes, the probability is that the quality of operation is not uniformly good across all locations. The equity placement at a premium exerts great pressure on MFIs to expand fast and post high rates of return. But maintaining interest rates high even as fast expansion is taking place invites a political intervention risk. A continuing problem is the transparency levels of MFIs when it comes to dealing with the clients. Though the code of conduct has been adopted and supposedly under implementation in all the MFIs, very few actually communicate the terms of loans to their clients.

Clearer communication to customers on interest rates and loan structure as well an explanation of why the interest rate is at its present level would go a long way to reduce misgivings. Better informed customers would take conscious decisions while accessing loans especially for consumption. Vijay Mahajan in the roundtable discussions pointed out that staff in the field is not asked to understand the code of conduct and implement the same. The actual rates of interest at which loans and other services are delivered are hardly made available in many cases. In the absence of such information, clients do take decisions that are not in their own interest. Studies had revealed that the borrowers could have taken a different decision had they known the real price of their loans.

Last year's report referred to small MFIs that had come up in and around Calcutta and subsequently closed down for want of adequate business volume and funding. During the current year, the field visits show that there are several small size money-lending operations which have chosen to label themselves as MFIs. These MFIs are small garage operations and possibly adopt predatory lending practices. In Kolar where there had been significant problems at least eight MFIs that have not been heard of by any in the sector were found to operating with very high rates of interest being charged to the clients[8]. Similar instances have been reported in UP and Bihar. This development wherein moneylenders style themselves as MFIs and use lending practices that bring the entire sector to disrepute is a highly disconcerting one. ***If not for any other reason at least for this reason of identification as MFI, a registration process seems necessary.*** Whether the registering authority is regulatory or voluntary is not an issue but the authority should verify the credentials of those who want to be MFIs. The customers are subjected to know your customer (KYC) norms, but the service provider does not seem to be under any obligation to identify him/herself.

The effect of entry of equity funders had been analysed in the last year. The further exploration into the area did reveal that there is a conflict of objectives between bulk lenders and equity holders. How this conflict will be resolved is as yet unclear. Unless the institutions which have both received equity funding and bulk lending sit together with all the stakeholders and come to common conclusions, the conflicts will continue to simmer.

The issue of ratings was discussed last year too. There have been no significant changes in terms of RBI approach towards rating of banks' exposure to MFIs and recognition of rating agencies. However, the decision to implement the credit risk assessment framework under Basle norms has reportedly been fixed at April 2011. SIDBI has promoted a rating agency that had been rating loan exposure for medium and small enterprises. It has now commenced rating of MFI exposures as well.

Last year we had referred to the issue of the only sector-specific rating agency in microfinance domain not being recognised by RBI. Micro-credit Ratings International Ltd (M-CRIL), the only specialist microfinance rating agency, had carried out ratings of 43 out of 233 MFIs that reported information to Sa-Dhan. CRISIL had carried out ratings of 56 MFIs. All other rating agencies together had carried out ratings of 38 MFIs. A comparison of the ratings made by a few rating agencies reveals that, while M-CRIL adopts an institutional risk model by which a comprehensive analysis of risk exposure in the institution is made, the others take a loan view of the risk. In the case of MFIs, a large part of resources are borrowed. A risk assessment based on one of the loans to be given by one of the lenders is not a very appealing prospect. The totality of the institution's business model, its approach to risk mitigation and the procedures that it adopts on the field has to be examined for rating. Such a rating would suitably inform banks and others on whether exposure to the rated institution is desirable.

Another issue relating to the rating is the lack of familiarity of some of the mainstream rating agencies. There are instances where MFIs have been rated a notch below similarly placed MFIs for the reason that they were non-profit companies. The form of business as a rating factor is difficult to fathom. A further issue is the treatment of assigned debts by rating agencies. As part of a sale of portfolio, a leading MFI had assigned the debts to the purchasing bank. The rating agency insisted that the assigned debts, even after sale of the portfolio, constituted risk assets in the hands of MFI for the purpose of computation of regulatory capital. On such a computation it found the capital held to be less than the regulatory requirement and consequently downgraded the MFI. This treatment of sold portfolios does not appear to be correct. This has considerable mischief potential as the benefit of turning over the portfolio many times is entirely lost for MFIs if they have to maintain regulatory capital against assets that have been sold.

Last year's report had dealt with elaborately on information asymmetry in the sector. Lending banks continue to have reservations about quality of information and timeliness of reporting. Quite a few MFIs including some large ones have been entirely factual in reporting information. Some of the

information which is critical for the banks to come to conclusion is at times withheld. Some information is packaged in such a form that no intelligent conclusion can be drawn from there. With different lenders, the same MFIs adopt different approaches on information sharing. There also appear to be different sets of information available within the same MFI; one for the purpose of internal review and another for the purpose of providing to the lenders. There have also been reports that the donors and grant funders receive different profiles of cost and profitability than that made available to lenders and the equity holders. All these do not speak highly of the governance standards adopted in the institutions concerned. The reliance on data reported by the institutions being high, it is incumbent on the MFIs to produce uniform quality data consistently over a long period of time. And this data should come from the actual records which should be the same whether it is for internal review or for public dissemination.

Discussions with sector observers revealed that mission drift is one of the key aspects of functioning of MFIs that is attracting attention. No more is the focus on the small and poor clients. The emphasis is more on those clients who could take larger loans and who can keep up higher EMIs. The promoters of MFIs themselves are under pressure to justify the high premium on equity and look for ways to augment return on assets and equity. Discussions with some of the equity investors reveal that they do not apply any pressure on the promoters for short-term results as they have a longer term interest in the company's performance. But then the institution and the promoters subject themselves to a higher pressure than warranted, resulting in faster growth than what is sustainable and higher yield levels than what the customers could afford. Another disturbing feature is that the interest rates have remained more or less the same or in some cases have marginally gone up to keep pace with higher cost of funds. The assumption that an institution would reduce its interest rate as it gains volume has by and large been belied (see Figure 3.5).

The last year's data shows that it is not growth all the way for all the MFIs. A reduction in client outreach has been faced by 46 MFIs to the extent of 0.35 million. Three large MFIs also faced this reduction in client outreach reflecting the fact that one has to find the right size of operation rather than try to attain a larger size than feasible. The search therefore should be on building a suitable model, finding the right size for a given institution and the number of locations from which they should operate. Looking to the last year's developments both on the funding side and in the expansion prospects of MFIs, it seems that some mergers and amalgamations in the sector are most likely. Some of the smaller ones which already have faced severe funding problems and higher levels of PAR may be forced to close down. In some other cases they may be taken over by existing larger players that want to expand their market share. This development should be seen as a natural process of evolution of the sector and should be supported through appropriate policy measures. But smaller institutions that serve local clientele have a place. These institutions, typically community owned, without designs of becoming big, can play a positive role in the lives of their clients in a way that a large multi-location MFI cannot do. Community owned and managed institutions have been successful in different contexts. Since people own and run them they do not suffer from the urge to grow too fast and too huge. Through suitable policies the emergence and consolidation of such institutions must be encouraged. These institutions would provide competition to the large MFIs with the benefits accruing to the customers. The example of Swakrushi Thrift Cooperatives[9] group in AP is worth recounting here. There were 446 thrift cooperatives of which 272 were women thrift cooperatives. These had been federated into associations. The total membership at the end of 2008 was more than 1,55,000. The total owned funds of these societies was Rs 643 million. More than 86,000 loans had been issued during 2008 for Rs 526 million. Thrift through a variety of savings instruments was possible for the members. Group insurance covered more than 1,04,000 members. The societies were declaring bonuses to the members. Individually these thrift societies were small and owned by less than 350 members on an average in the cooperative mode. Despite their size they were in a position to offer savings (a portfolio of voluntary withdrawable types), credit and insurance services, which is better than what most MFIs can offer. The average loan at 5,260 compared favourably with many MFIs and SHG loans.

The high operating costs is a dampener for the sector, limiting its ability to grow. An interesting fact brought out by the Side by Side report 2008 (Sa-Dhan) was that the operating cost ratio was the least in case of those MFIs that followed SHG model. It was a maximum in case of MFIs that followed joint liability group (JLG) model of lending at 19 per cent. The difference of 8 per cent in operating cost ratio between the SHG model of delivery and the JLG model of delivery is significant. There is a need

to look more closely at the chosen models of delivery of microfinance by MFIs and those with the best chance of offering lower rates of interest to the clients through cost reduction should be preferred.

Table 3.9 Yield and cost ratios by lending model type, 2008

(%-points)		2008	2007	Change
SHG	Portfolio Yield	18%	20%	–2
JLG	OCR	11%	15%	–4
Hybrid	Portfolio Yield	24%	24%	0
	OCR	19%	27%	–8
Individual Lending	Portfolio Yield	20%	18%	2
	OCR	12%	12%	0
	Portfolio Yield	17%	21%	–3
	OCR	10%	11%	–1

Based on a quick survey, Sa-Dhan in its Side by Side report 2008 concludes that SHG lending model comes at the least cost to the customer and the individual lendings at the maximum cost. But SHG lending involves greater time spent by the customer on group processes and compulsory savings—also low average loan size. In terms of average loan size the JLG model falls in between Individual loans and SHG loans, but turns out to be the most expensive in terms of cost as a proportion of loans. The customer does not have a choice between the different models and has to go with what is offered by the locally available MFIs. With the cost differential being high, the customer should really have a choice of trading the cost of his time with lower interest rate possible in SHG models.

Table 3.10 Operational costs under different lending models

Model	Average loan size	Average interest and other charges paid by customer (Rs)	Cost as % of loan
Individual loans	8,307	1,821	22
JLG	5,006	1,244	25
SHG	3,412	596	17

The SBS makes the following significant observation based on its quick survey of costs of different models of lending.

In a scenario of shortage of financial resources, customers take up loans at whatever rates under whichever available models of lending. Whether customer has a menu of choices in terms of institutions or products is the question that begs an answer. For the present, in some locations the product and process designs are cartelised and it is difficult to access a different product or lending process. Hopefully competition and the pressure to drive down costs and interest rates which would lead to a rethink of lending models.

Under all lending methodologies, growth of borrowing from banks has been con¬siderable - per client, SHG-lenders doubled their bank-borrowings since 2005/06, However, it is the JLG-approach which has proven to reach out fastest to a growing number of clients and thus channel mg bank-lending to the poor, In 2007/08, 40 JLG-MFIs reach about 55 lakhs clients, compared to 84 SHG-MFIs reaching 37 lakhs clients. Accessing credit through joining a JLG is more costly than through an SHG, But the JLG offers higher loan sizes and, according to anecdotal evidence, quicker service delivery. Neither JLG nor SHG meets the demand credit, leave alone other financial services (savings, insurance, remittance); that is way particularly in Southern India, clients are increasingly found to join both,

The Banana Skins survey of 2009 has concluded that at the global level, worsening business environment, threats to funding and liquidity and damage to MFI reputation are the three major risks. Credit risk and profitability risk moved up significantly from the last year's levels. In respect of Asia the top risks that were identified during the survey were liquidity, governance, management quality and computerisation. The fastest growing risk in Asia was seen to be competition, credit risk, mission drift and political interference. Most disturbing feature of the survey finding was that MFIs were less prepared in the current juncture to meet the risks compared with the position last year. While the survey is significant in that it collates views from microfinance sector personnel from a variety of backgrounds, across the world it does have its limitations. The survey conclusions are dominated by opinions coming from a context very different from the ones in which microfinance actually operates. Of the more than 400 respondents to the survey 207 were from countries where microfinance of a kind that operates in the developing countries is not commonplace. Barring India with 28 respondents and Pakistan with 13 respondents none of the other developing countries had a significant contribution to

the survey results. This of course is a failure on the part of microfinance professionals to contribute to creation of a knowledge base that is relevant for the sector. The survey organisers should perhaps design better ways of collecting views from the developing countries and ensure that significant numbers from such countries contribute to the survey.

The risks in Indian microfinance could be classified as competition, over indebtedness of customer, lack of quality systems and processes in MFIs and mission drift. HR availability and quality training are concerns. Easy funding availability is not a positive factor as the hard questions are not asked of the investee companies in the rush to conclude deals.

INSTITUTIONS BELOW THE RADAR

While the microfinance sector discussions focus on MFIs (which are about 250 in public knowledge) there are several operations on varying scales providing financial services across the country. These were defined as MFOs for the first time by the microfinance bill. Typically these are run by NGOs that had a client base through an earlier development project and continued to engage the customers. GTZ had commissioned the inventorisation of such MFIs for the first time. Information from the exercise has been made available by GTZ for the purpose of dissemination through this report.

A total of 786 MFOs have been identified through the inventory. Andhra Pradesh has the maximum of 484 MFOs. Tamil Nadu had 102. The inventory has no entries from Uttaranchal, Chhattisgarh, Himachal Pradesh, Haryana, Punjab and the entire North-East. Ninety-five per cent of MFOs operate in one state only. Four per cent operate in more than one state. Sixty-eight per cent MFOs operate in just one district. Of the 766 MFOs that reported information, 444 are less than 5 years old. A very large number, 426, were registered under the MACS Act as independent cooperatives. There were 192 societies also functioning as MFOs.

SHG lending was the dominant model with 432 MFOs adopting the same. The cluster of JLGs as the model was adopted by 355 MFOs. Of this 148 used both SHG and cluster models. Seventy-three MFOs acted as business correpsondents and facilitators. In all the MFOs employed 52,600 staff of which more than 39,000 were for microfinance operations. Most of these MFOs were small; 513 MFOs had less than 10 staff and another 171 had between 11 and 25 staff. While 627 CEOs were reported to have been trained, 392 were reported to have no experience of microfinance. The outstanding loans of these MFOs (excluding four large MFOs who are part of the Sa-Dhan database as well) were reported to be above Rs 60 billion. The inventory fills a gap in the information on the operations of very small institutions.

INNOVATIONS

There have been several new ideas and pilots brewing in the microfinance sector. A few have been showcased in this section as they have the potential for replication.

A. Rickshaw Bank[10]

Eight million livelihoods depend on this low cost, all weather, environment friendly vehicle; but rarely those who pull it in rain or sunshine own it. The owners were collecting rentals from the pullers, leaving barely little for them to make ends meet. One institution decided to do something about it. The Centre for Rural Development (CRD) designed a rickshaw loan.

An improved, ergonomically efficient vehicle was designed with participation of IIT, Guwahati. This rickshaw was made available on lease (hire purchase) to rickshaw pullers. The condition was that they should be in JLGs of five members and function in a cluster—called a garage—of five JLGs. The loan of Rs 10,500 included not only cost of the vehicle, but 2 years licence and insurance costs. The insurance covered not only the rickshaw, but the puller's life and third party injuries/death due to accident.

A small instalment of hire rental of Rs 25 per day is charged over 520 days over 18 to 24 months. The overall recovery made is Rs 13,000. CRD generates revenue by hiring the rear of the rickshaw for advertisements. The revenue from this source is Rs 5,000 per annum which is utilised towards a part of the loan, making it possible to collect only Rs 13,000 against interest and principal from the rickshaw puller. After all instalments are paid the rickshaw become the property of the puller. The lease rental charged is no more than the hire paid to owners by pullers otherwise. While some of the soft part of interventions are being grant funded by America India Foundation, banks have come forward to provide loans. State Bank of India (SBI), Punjab National Bank (PNB), ICICI Bank and HDFC Bank are prominent funders. More than 4,000 rickshaws in four locations have been financed and more than 1,500 have repaid their entire loans to claim ownership of the rickshaws. PNB has agreed to finance 1,000 rickshaws each in 100 cities on account of its poverty targeting, environment friendliness and promotion of self-employment. Already product

diversification is taking place with hand carts and solar powered rickshaws having been designed.

B. Savings through credit and inflation proof![11]

While conventinal logic advises people to begin with savings in order to become credit worthy, this product reverses the logic—it provides credit to make peole save, using their ambition to own gold. World Gold Council (WGC) India, initiated a pilot programme in South India wherein good quality gold was made affordable and accessible to poor households through a gold linked microfinance scheme. Under this scheme, a consumer could approach the MFI in their vicinity, book gold at the current prices and after making a initial down payment of 10–15 per cent, can avail of easy instalments ranging over a period of 12/18/24/36 months. The gold is held safely with the MFI till all the instalments are paid up. The scheme has the follwing merits:

- inculcates habit of saving by showing the outcome of saving beforehand;
- access to good quality certified gold from a credible organised player;
- purchases available in denominations as low as 0.5 gm or 1 gm;
- protects the value of savings against inflation and
- benefits of storage in a secure environment at the MFI's office.

For the lenders the loan is secure with the gold in their custody. Overwhelming acceptance of this scheme led to the programme being extended to all four states in South India. SKS and KGFS have been operating this reverse saving product, with loans to ensure that people save.

Saving in the form of physical assets has the advantage of indexing the value of savings to inflation. Especially in times of inflation, financial savings tend to erode in value. The important part of this innovation is the choice of gold as a vehicle of savings which would be inflation proof.

C. Pregnancy loan[12]

Women at the time of delivery need money for hospitalisation, medicines, transport and other necessities related to child birth. The poor families find it difficult to put together the cash required, rendering the woman anxious when she should be joyous. Hand in Hand, Tamil Nadu came up with a design of a loan product meeting the requirement of pregnant woman.

A pregnant woman requiring a loan should register for the same as soon as she gets to know of her pregnancy. She should start saving regularly from then onwards till the date of delivery a fixed sum at periodic intervals. When she is to be hospitalised, Hand in Hand would provide a loan equivalent to five times of the savings, up to a ceiling of Rs 3,000. An authorisation is taken from the borrower in favour of the person who is take to the cash from the MFI and uses it for the necessary expenses. This is to prevent the money going into the wrong hands.

An institution is not normally held out as an innovation. Equitas is another of those new generation MFIs promoted by professionals with a social commitment. We found it useful for presenting in the report for wider understanding of their model of microfinance.

Equitas—an institution with the same vision but a different approach

Equitas Micro Finance India Pvt. Ltd. is an 18 months old institution operating out of Chennai. It has acquired 0.45 million customers in the short period of 18 months with more than 105 branches and disbursements of about Rs 3.3 billion during the year 2007–08. It is perhaps the fastest growing start-up MFI in the world. It reached the 10th all India position in client outreach. Its financials are impressive with a capital adequacy ratio of 45 per cent attributable to the equity infusion that has taken place at high premium levels. Its net worth is the fourth largest in the country. But then this is not about the growth and expansion story. This institution says that it has a customer-centric focus and wants to remain rooted to the customers' requirements rather than its own sustainability and profits. What is the difference that Equitas makes to the sector?

First is that of getting its governance right. Its board has majority independent directors than from the promoter group and investors therein. It has some leading personalities in its board who lend not only credibility but also substance to its governance practices. Second, it has introduced high levels of transparency, especially in communicating its rates of interest to borrowers in a manner that they can understand and take decisions on. The third is the kind of risk management structures it has put in place to reduce operational risks arising from abuse of processes as also failures of HR.

(continued)

It has aggressively pursued cost efficiency through a variety of measures. The customer acquisition process is so carefully done with multi-level verifications that the selected customers are more likely to remain good customers with the institution. It has introduced application tracking processes which track each stage of the movement of any new customer's application making it possible for it to arrange for funds and also locate any loopholes in the system. Its back office operations have been centralised in one place with high level of technology support that makes for easy recording of customers information and also easy tracking of further operations on the account both at the client and at the branch level. The branches are paperless and are not required to do any kind of accounting. The interface with the customers has been made free of any technology by introducing systems and mechanisms that are easily understood both by staff and the customer at the same time providing adequate measure of control to the institutions. A proprietary use of a system of pre-printed stickers that acknowledge repayment of loans by the customers provides a large measure of comfort to all those involved in the transaction. An SMS-based system that reports collection made at every cluster brings in real-time information to the company making its cash handling systems much simpler. The entire cash handling had been outsourced to a professional agency making the company a zero cash balance company at the end of each day and removing the hassle of cash transaction from the hands of field staff. The field staffs thus are able to focus on customer acquisition and carrying out transactions. At the field level, there is segregation between people who acquire customers and those who have to maintain the relationship. This segregation enables the company to offer a fairly high work load commensurate with the capacity of the field staff. The IT investments made by Equitas in real-time collection monitoring forms tracking system and forms processing are so effective that it is able to locate problems almost instantaneously and resolve the same.

But then this is not where the story of Equitas ends. It has set up a trust to look after matters of concern for the customers. It is testing out models on providing vocational training to members so that they could pursue income generating activities with the help of its loans. It also is testing out providing intensive coaching to the children of its members during the non-school hours so that they could excel academically and make a mark in their lives. Equitas also is involved in the health sphere conducting health and hygiene camps such as eye camps. It has partnered with a leading eye care hospital to provide lifetime free eye care to the members of Equitas. Eventually it aims at covering more than 50 per cent of its clients through its socially oriented interventions that would strengthen their livelihoods and lead to overall improvement. It is committed to pass on any savings that it could make out of increased scale of operations to the clients by reducing rates of interest. Its rate card both for loans and the insurance facility is provided to all its members. It very clearly indicates the interest rates, premium on insurance, agency commission accruing to Equitas etc. The issue that Equitas would face is that of finding viable markets for its clients that should accompany the livelihood activities it proposes to provide. Further, it would also face the issues of retaining the kind of systems and control which have been introduced in its initial phase to the next phase in which it hopes to expand to a much larger size in numerous locations. Its present strength, that is human resources, has to be kept up. The ability of senior management team (which is very professional) to interact with each and every new entrant has to be sustained. How this would be rendered possible over numerous branch locations is a question that Equitas would naturally think of and solve as it has done all along.

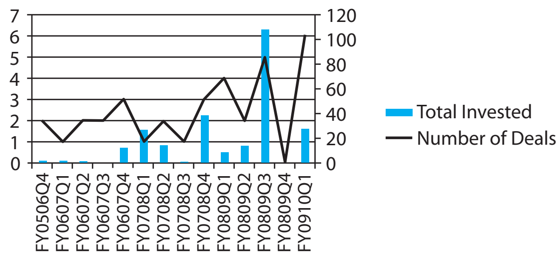
Recently it has been trying to provide substantial support to its members on a small scale pilot in providing groceries of daily consumption at very low effective rates that are feasible through bulk procurement and retailing. If this experiment succeeds, it holds a great promise for its clients in terms of cost saved on their normal livelihood requirements. While one wishes all success to Equitas, one also wishes that more such institutions come which make a difference to people not only through loans but also through customer-centred approaches.

INVESTMENT CLIMATE

The financial sector meltdown in foreign shores impacted Indian microfinance with a time lag. In the second and third quarters of 2008–09 MFIs were running from pillar to post. Dilli Raj[13], CFO of SKS Microfinance stated that even the large MFIs with live proposals for equity and senior debt found it difficult to close the deals. Private sector banks and foreign banks took a conservative view of exposure to microfinance sector, sought to limit existing commitments and delay taking on new exposures.

The large MFIs had the financial and organisational strength to negotiate both equity and debt by selling a story of being a good risk hedge. But the smaller and medium MFIs found the going tough.

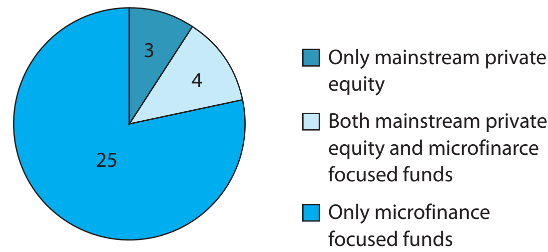
The first two quarters of the year saw low equity flows. Equity flows strengthened in the third quarter with almost all major players finding investors subscribing to equity at high premium. Grama Vidiyal, SKS Microfinance, Spandana, ESAF, Asomi Finance, Equitas and Sahayata are some of the MFIs that reported equity infusion. Investment inflows increased phenomenally to unprecedented levels in the third quarter of fiscal year 2008–09, driven largely by massive deals between the largest MFIs and mainstream private equity players. But in the final quarter of the fiscal year there were no equity deals. Contrary to the trend for the financial sector overall, investment in microfinance rebounded in the first quarter of fiscal year 2009–10.[14] As of the time of publication, investment looks set to increase even further with both Spandana and Share Microfin, two of India's largest MFIs, having announced that they are close to finalising big deals.[15]



*Based on data gathered from publicly available sources.

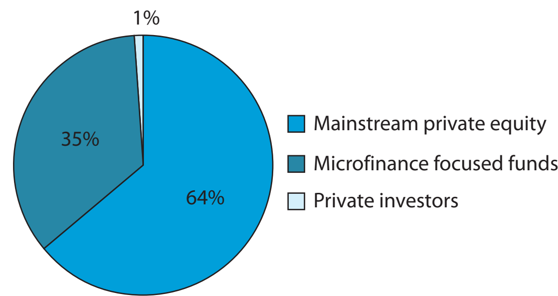
Figure 3.8

Perhaps the most significant development in the past year was the entrance of mainstream private equity players. Previously, investment in MFIs remained largely limited to microfinance-focused funds such as Lok Capital, Bellwether or Blue Orchard along with private individuals such as venture capitalist Vinod Khosla. Towards the end of the 2008, several mainstream private equity players with no previous experience in microfinance, including Legatum, Sequoia and Sandstone Capital, invested in Indian MFIs. Several other actively researched potential investments though did not end up finalising any deals. While microfinance-focused funds still dominate in terms of the overall number of deals consummated, private equity players, despite the small number of deals they have been involved in, have actually invested more overall in the sector.



*Based on data gathered from publicly available sources. Investments by private individual are not included due to the relatively small size of these investments.

Figure 3.9



*Based on data gathered from publicly available sources. Investments by private individual are not included due to the relatively small size of these investments.

Figure 3.10

In the midst of all the foreign equity flowing, there is a hunt for domestic equity on account of policy clarifications. Press Notes 2 and 4 (2009) brought about significant clarifications in terms of guidelines for calculation of foreign investment (direct and indirect) in Indian companies and downstream investment by Indian companies. One of the key clarifications was that downstream investments by any Indian company that has majority (51 per cent or more) foreign ownership or control would be treated henceforth as 'indirect foreign investment' rather than 'domestic' as was the case until now.

This, coupled with the minimum capitalisation norms for automatic foreign direct investment (FDI) in NBFCs[16] engaged in specific activities allowed (microcredit is one of them) has led to a greater need for domestic investors in microfinance companies.

Grameen Capital India is reportedly working on mandates from several companies to raise domestic equity. The likely sources that Grameen Capital is targeting are high networth individuals (HNIs), foundations and domestic venture capital-private equity (VC-Pes). Grameen Capital is presently in advanced stages of closing a secondary sale of shares of an MFI to a domestic investor.

Public issue of shares is one of the ways in which domestic equity can be raised. The much awaited first initial public offering (IPO) has not seen the light of the day. The stock market conditions have remained very poor during almost the entire year which possibly is one of the reasons why the first IPO from an MFI did not come to the market. For the equity funders, there is still no market-based exit available. Divesting of holding in favour of other investors is only feasible option which is being exercised. The promoters holding have been becoming thinner and thinner. In the case of the largest MFI the promoters' equity levels have become pretty small even though the promoter group had not divested any part of its holding.

One of the likely problems that would visit the sector when the first IPOs come out is the valuation-based negative publicity. A recent valuation of one of the large MFIs put it at US$ 0.5 billion. By that reckoning it is not difficult to envisage even larger MFIs being valued at around US$ 1 billion. As long as the equity is placed with PEs/VCs and MIVs, there are no major issues. Once an IPO is made and trading on the exchange floor commences, a 'Compartamos'[17] like situation might develop. 'Capitalists making private profits out of poor man's hard earned money' would be the subject of media discussions. Political interference capping interest rates and bringing the sector under heavy handed regulation is most likely. This might shut out further private equity flows. Even as investors are willing to offer a good valuation, in the interests of future of the sector and other MFIs that need to grow, the promoters seeking to go public must do so responsibly.

Vijay Mahajan pointed out in the roundtable discussions[18] that rating agencies seem to look at the assigned debts which form part of the securitised portfolio sold to MFIs as risk assets still carried in the books of MFIs. Their capital adequacy calculations are based on the entire balance of loans originated by the MFIs and outstanding in some form rather than looking at only those assets that are still on the books of the MFIs. This has led to incremental capital requirement being asked for and in case the capital adequacy ratio (CAR) is below the mandated levels on such computation, then the rating assigned is unfavourble to MFIs. This is an aspect which has to be discussed threadbare with rating agencies as also the regulator and a suitable solution found. Otherwise MFIs would be required to maintain regulatory capital in respect of even those parts of portfolio that have been sold, pushing up their already high financial cost.

One of the issues in relation to equity placement in MFIs has been the valuation of equity. The MFIs equity valuation seems to be at pretty high level when compared with other financial institutions in the sector. What justifies the higher valuation of MFI equity is the growth prospects that they have. Anurag Agrawal[19] has argued that the huge market that is available, the ability to price loans at reasonably attractive rates and the growth prospects of MFIs constitute a legitimate base from which the higher valuation become feasible. However, the caution is that over next 2 to 3 years these valuations would come down and would see levels that are on par with other financial institutions which operate outside of microfinance sector. The fact is that in the absence of a market based valuation process it is difficult to figure out whether the present valuations are high or low. But certainly the high valuations help the MFIs in securing equity badly needed for leveraging funds to sustain their loan operations.

Across the world, the price to earning valuation is between 1.4 and 1.9 times of the book value. In the case of Indian MFIs the equity valuation is at 3 to 4 times of book value. This is driven by the fact that on lending funds are freely available and the MFIs are able to post a return on equity of 20 to 30 per cent. But as one of the commentators says, 'In such a heated invest climate, the investors are getting cautious. They are cautious about going overboard with fancy book value multiples. The risk is multiplied for every successive investor who is investing a larger dose of capital at a higher price.' Indian equity still trades at a premium to global MFIs and would continue to do so in the short to medium run. As Anurag Agrawal says the price to book value is not a suitable valuation model especially in the Indian context. The price to discounted cash flow could be more suitable in the Indian microfinance sector.

JP Morgan and Consultative Group to Assist the Poor (CGAP) in a collaborative publication seek to demystify equity valuations of MFIs which are often very young and without a sufficient financial track record. The conventional methods of valuation are felt to be unsuited; the book suggests discounted cash flow of terminal value of investment or a discounted value of residual income as the preferred methods of valuation. The current valuations of MFIs globally are at seven times the earning or more. While these valuations are set to decline, they would still be higher than the mainstream financial sector.

Compulsorily convertible preference shares (CCPS) made entry into the equity market through Equitas making the initial offering of Rs 50.12 million in August 2008 which was later converted into

Equity valuation in MFIs—JP Morgan's conclusions[20]

- MFIs will certainly be affected by the financial crisis across the globe, but the sector is fundamentally sound.
- Private equity valuations for MFIs have varied widely over the past few years.
- Publicly listed low-income finance institutions (LIFIs) have outperformed traditional banks.
- Investors should not value MFIs the same way they value traditional banks.
- Book value and earnings multiples are the most widely used valuation tools but the residual income method[21] is also recommended.
- Microfinance valuations should benefit from a lower beta than banks, in our view, but they also deserve a discount for the limited liquidity of the equity.
- Transaction value and net income growth are the main drivers of valuation.

equity in March 2009. While the initial equity issue to the first institutional investor was at a premium of Rs 8 per share, the premium went up to Rs 47 in March 2009 when CCPS were converted. A further lot of shares were issued to another institutional investor at a premium of Rs 55. The meteoric rise in valuations for well performing institutions is a positive story that should gladden the practitioners.

LOAN FUNDS

Bank lending made a pleasant turn in the last quarter of the fiscal when apart from the traditional banks some new entrants to microfinance sector came forward to provide bulk funds. The funding was in the form of not only loans but also non-convertible debentures, portfolio buyouts and securitised loan sale. In the last quarter of fiscal 2008–09, many banks including some new entrants to microfinance came forward to provide the resources, with the result that resources availability from banks and financial institutions reached the Rs 100 billion mark. During a major part of the year SIDBI did a yeoman job of keeping liquidity flowing; it ended the year with a more than 100 per cent increase in loan outstanding to the sector to cross Rs 200 billion. Friends of Women's World Banking (FWWB) increased its outstanding to Rs 2.93 billion, an increase of 50 per cent over last year. Karnataka Bank, Kotak Mahindra Bank, Dhanalakshmi Bank and a couple of others entered the MFI sector. HDFC bank increased its portfolio to exceed Rs 25 billion in outstanding loans. ICICI Bank re-entered the MFI funding space and rapidly scaled up its exposure. But it was more into portfolio buyouts and purchase of securitised debt. ICICI Bank increased its exposure to microfinance to more than Rs 25 billion by March 2009. Axis Bank, Yes Bank and Development Credit Bank also provided significant funding support. Among public sector banks Indian Overseas Bank (IOB), Canara Bank, State Bank, State Bank of Travancore, Syndicate Bank and Bank of India kept the sector in sufficient liquidity. StanChart, RBS-ABN Amro and Citibank were among the leaders in foreign banks. All this reflect the renewed confidence of mainstream institutions in MFIs. The issue of listed, tradable non-convertible debentures (NCDs) is another positive development in the sector. SKS has placed rated NCDs worth Rs 750 million with banks and others and the NCDs are tradable in the debt segment of Bombay Stock Exchange (BSE).

On the question of borrowed funds from banks, there were some emerging concerns. MFIs have been shopping around for loans and have been trying to arbitrage on the financial disciplines underlying the loans. The banks on their part have willingly played into the hands of MFIs by providing competitive offers to the MFIs. Despite the liquidity crunch reported for a part of a period, the year-end position reflects that banks have more than adequately financed the MFIs. The last quarter rush on the part of banks to sanction and disburse bulk funds to MFIs is creating an unhealthy trend. An analysis of the position brought out that more than 60 MFIs have unutilised borrowings of higher quantum than what they had given out as loans. The total amount of borrowing overhang was about Rs 4.5 billion. The mismatch was very pronounced in quite a few cases. The excess borrowing in the hands of MFIs at the end of March 2009 compared to their lending forms was anywhere between 30 per cent of the outstanding loans and 240 per cent of outstanding loans. In the worst case for every Rs 100 of loans outstanding, the MFI had Rs 240 in cash that was borrowed and not used. Considering a yearly disbursement budget, normally the float funds in the hands of an MFI should not be more than 10 per cent of the yearly disbursements, barring some seasonal spikes nearing major loan repayment dates. This is an area which could give rise to risk of misapplication of funds and possible misuse. Small institutions handling unallocated cash of more than 200 per cent of the entire loan portfolio that is outstanding could possibly come to grief if the funds are misapplied. Banks and MFIs need to sit together and find solutions for avoiding such crowding

of sanctions and disbursements especially in March every year.

Another related problem is that of banks playing both sides of the balance sheet. It has come to notice that the year-end disbursements made by the banks are taken back as deposits from the MFIs by the bank creating a two-sided effect on their balance sheets. While this might look good for a short period of time it does not help the MFIs in any way which would suffer from higher costs and also higher risks in handling such float funds. They would also have to carry higher regulatory capital. Perhaps there is a need for a regulatory analysis of some of the banks which adopt such practices and guide them towards a more orderly procedure of sanctions and disbursements that would keep the MFIs fully funded throughout the year.

With new instruments in the markets, new problems are seen to emerge. MFIs originate loans at fairly high rates of interest. When these loans are sold as part of a portfolio to the banking system, they become a part of priority sector lending. Interest rate restrictions applicable on loans up to Rs 2,00,000 would seem to apply on the underlying customer level loans bought through these transactions. How this dichotomy between the bought out portfolio and self-originated loans of the banks will be resolved is a moot question. A further problem is of KYC in respect of loans that are sold to the banks. MFIs need to adopt KYC acceptable to RBI even as they originate the loans so as to avoid additional documentation nearing the date of portfolio sale.

While the large MFIs had access to funds on a large scale the tier II and tier III MFIs struggled in accessing funds. SIDBI, public sector banks and FWWB came to their rescue. The not-for-profits leveraged their net owned funds 6.8 times; whereas for-profit MFIs leveraged their equity only 3.8 times. This differential in leverage tells the story of why banks are shy of not-for-profits which populate the medium and small size MFI segments. With risks being re-rated on a continuous basis throughout the last year, high leverages are not going to be welcome, especially when the demand for funds is unlimited. The not-for-profits must increase owned funds and quasi-equity to improve their access to loans. Further the profitability and viability of the small and medium MFIs should improve. With ticket sizes on the increase, it would be difficult for banks to lend to loss making institutions even if they are socially useful.

Over the last few years, the 'originate to distribute' approach has opened up an additional source of capital for the Indian microfinance sector. Microfinance loan pools created by MFIs can almost entirely be classified towards priority sector lending (PSL) advances (regulatory requirements for all banks operating in India), both under indirect PSL (cash credit/term loan facilities by banks to MFIs) or direct PSL (assignment, sell downs, investing in securitised assets etc.) often qualifying as direct agricultural exposure for domestic banks.

Among others, Grameen Capital has helped MFIs identify this as a unique opportunity by pioneering innovative approaches on asset segregation, transaction structuring and pricing. Within the last 12 months, it has completed portfolio assignment transactions with MFIs totaling Rs 2.8 billion. A two-stage portfolio assignment transaction was structured for SKS Microfinance and IndusInd Bank in July 2008 worth Rs 1.8 billion comprising agriculture related microloans. Grameen Capital India and SKS Microfinance completed an assignment of 'microfinance loans to the weaker sections' to a first time entrant private bank in November 2008 of Rs 250 million.

Grameen Capital

Grameen Capital India provides investment banking services to microfinance and other companies at the bottom of the pyramid space and enables them to develop wider access to the capital markets, primarily the domestic capital markets, through innovative debt and equity solutions, credit rating/enhancement arrangement and capital advisory services and reduce cost of capital. It is promoted by Grameen Foundation, IFMR Trust and Citicorp Finance. Since its launch in January 2008, Grameen Capital India has made significant progress in facilitating greater flow of debt and equity capital totaling over Rs 7 billion in closed or pipeline transactions.

It also structured a portfolio assignment transaction for Bandhan, to the tune of Rs 750 million of microloans to IndusInd Bank.

It is not as if financing was entirely left to brick and mortar banks. There is some competition from the virtual world, though very light at this point of time. Last year we had reported the developments relating to setting up of Capital Connect, DhanaX and Rang De. Some of these initiatives have moved forward. Capital Connect, a B2B portal reports having 110 members on its web platform, located in 27 countries with a foot print over 51 countries. There have been active demands for both equity and loans.

The offers for loans from investors were less than the demand (reflecting the liquidity constraints in the global markets as noted by Capital Connect). The minimum and maximum loans on offer ranged between $10,000 and 3 million. In case of equity the range was from $8,000 to 3 million. It has commenced offline match making as well.

Rang De, till recently, had been able to connect 1,016 borrowers to 405 remote lenders. The loans amounted to Rs 5.8 million of which Rs 2.0 miilion has been repaid with 100 per cent on time payment record. DhanaX, while active on the P2P lending platform, has not put out any data. The volumes are small as these institutions are in the nascent stage. Globally more than 40 P2P platforms are active. A listing done in October 2008 placed both Rang De and DhanaX in the 20th position with seven others. But the business models of these platforms are sound and have growth potential. The largest P2P lending platform is Virgin Money in USA with a portfolio size of $370 million, followed by Prosper ($178 mn) and Kiva (the microfinance platform, $47.7 mn). Mudhal, a chennai based start-up, also has aspirations of making it big using the same P2P platform.

An innovative variant of the P2P platform is that of United Prosperity that uses guarantees to leverage the social investors willingness to find local loans for the needy borrowers. United Prosperity based in the US works to multiply the impact of social investors' money through 'loan guarantees'. United Prosperity claims to be the world's first person-to-person loan guaranteeing web platform.

United Propserity (UP)—a social enterprise initiative

Small entrepreneurs cannot provide collateral since they are often very poor. MFIs lend to the poor without collateral but they in turn (especially the smaller MFIs) need guarantees to borrow from banks. The general public can help the entrepreneurs earn a better livelihood by providing cash collateral—a guarantee—UP. The guarantee allows the entrepreneurs to access a microloan through a partner microfinance institution of UP. On loan repayment the money is returned to the guarantor. The MFI is better able to raise loans from banks as the underlying loans are guaranteed.

Maximum impact: Due to UP's innovative guarantee model, US$ 1 in guarantee could lead to US$ 2 to US$ 5 in loan to the entrepreneur—thus maximising the impact.

Local relationships: UP creates social and financial relationships between domestic banks, MFIs and poor entrepreneurs rather than encouraging dependence on foreign assistance.

Mitigates foreign exchange risk: Since the loans from the bank to the MFI, and from the MFI to the entrepreneur are in local currency, foreign exchange risk is mitigated. Only in the exceptionally rare event of default, when the guarantee is called, will a cross-border foreign exchange transaction take place.

Operations began in India in May 2009 with Ajiwika, an MFI in Jharkhand, India and HDFC Bank. To date we have raised funds for over 100 entrepreneurs living from nearly 100 guarantors from 15 countries. Over time UP propose to expand to other regions.

ADDING VALUE TO MICROFINANCE?

The Bottom of the Pyramid had become a popular market segment not only for the MFIs, but to other corporates in fast moving consumer goods (FMCGs), white goods and brown goods sectors. A raft of alliances is taking place between the MFI and corporate India. Godrej has designed a small-sized fridge (called Chotukool) for the rural areas with inputs from rural people. The fridge is expected to cost much less than the urban cousins, around Rs 3,200. Godrej has dispensed with the normal sales channels; the rural people help Godrej sell the product. Sakhi Retail, an arm of Swayam Sikshan Prayog, SSP (NGO-MFI), has tied up with Godrej for sales of this fridge in Maharashtra through SHG volunteers. The SHG member earns Rs 150 for each fridge sold and Sakhi Retail earns Rs 100. Godrej had 101 such retailers in 77 villages to help it with sales and marketing.

A similar partnership between Hindustan Unilever and ACCESS Development Services supports the MFI partners of ACCESS to provide watercredit to its clients to help them procure the water purification device. This is a water filter designed to work in remote locations without electricity and priced low. The MFIs not only distribute the water filters to the members but also provide them loans. Based on the success of this product marketing, ACCESS is exploring a similar BOP strategy for energy ef-

ficient devices that will impact quality of life at the level of the client. BP energy has partnerships with Covenant Centre for Development in Madurai and SSP in Maharashtra for marketing of smokeless, fuel-efficient stoves that run on biomass pellets. The SHG members again are the sales force, who apart from selling the stoves can also sell the pellets as and when required. SKS Microfinance sells Nokia handsets and AirTel simcards as also groceries for its small-grocer customers, sourced from Metro hypermarket. ICICI Lombard, Max Newyork Life and Bajaj Allianz have tie ups with many NGOs and MFIs to underwrite insurance policies of different types. The important part of these partnerships is the customisation of the product to suit the rural context and psyche. Godrej designed a fridge that can work in demanding surroundings as did Hindustan Unilever and Eureka Forbes with their electricity-free water filters. Nokia is learning from the customers as to what are their priority features in a handset (a torch and radio). The insurers have built in new features such as reimbursement for medical expenses in health policies, a significant savings element in life policies, etc.

What are the gains in such partnerships and do they add value? The rural customer gains access to products and services that improve quality of life. Some of the customers of MFIs gain opportunities to earn incomes in providing sales and logistics services for the goods sold. The MFIs are able to utilise the idle capacity of field staff and produce an additional revenue stream. In some cases people gain awareness of some relevant aspects of livelihoods—such as need for insurance and importance of clean water. The corporate partner gains entry into a new market which apparently has a large future potential. It seems to be a win-win situation for all. But there are also problems.

When the marketed goods and services fail, the response from the producers is tardy and falls short of expectations of the customers. The MFIs have to face the flak from the customers. Anecdotes of failure to settle insurance claims on time alienating clients of MFIs and customers demanding compensation from the MFI for malfunctioning goods supplied through its partnerships have been around. Further the field officers' focus is shifted from finance which is the core function to sales, distribution and servicing of other products. At times financial discipline is compromised when customers resist repayment of loans taken for some of these products, if they fail to function. In such situations the field officers come under tremendous pressure. There are also instances when the MFIs found that the costs of meeting unexpected developments relating to marketing and after-sales service exceeded the revenue from such partnerships.

What are the economic costs of such marketing partnerships for the customers is a question that needs to be probed. Some of the products sold are bought because they are made available and with the help of marketing tactics they are made to look indispensable. The bundling of loans with availability of the product does induce the customers to take 'buy' decisions which they otherwise might not have. A comfort or luxury product is sold as a necessity, through a contrived marketing effort in which the MFI also plays partner. The functionality and improvement in quality of life are not assessed neutrally by all the MFIs and marketers to decide whether it is fair to escalate the debt burden of rural people. While smokeless stoves reduce drudgery and promote ecological balance, refrigerators fail to score as ideal goods[22] that the rural poor must have. While low-cost water filters might improve health, there are other alternatives using better natural materials at a community level that cost even lower. Some of the other distribution channels being introduced replace some existing person of small means, whether it is the grocer or the work-bull owner who rents it out. The displacement effect of some of the services has to be studied. A final question is that of where is the money coming from for this BoP market. Unless ways are found to put cash in the hands of the people in the rural areas, there would be no incremental purchasing power. Once the small financial capacity that exists at the dead storage level of their savings and surpluses is used up, the demand would come to a halt. Looking at livelihoods and enabling people to earn higher incomes should be the starting point of marketing. Microfinance plus should have a livelihoods face, not a marketing face.

ANNEX 3.1
MFI clients and loans State-wise[24]

Region/state	MFI clients (no.)	Loan outstanding (Rs lakhs)
Northern region		
Haryana	33,908	3,588
Himachal Pradesh	3,574	321
Punjab	1,804	2,341
Jammu & Kashmir	0	0
Rajasthan	2,42,926	22,426
New Delhi	67,947	11,315
Sub-total	3,50,159	39,991
North-eastern region		
Assam	1,63,005	7,740
Manipur	3,005	142
Meghalaya	2,898	185
Sikkim	5,945	397
Tripura	76,619	3,256
Nagaland	0	0
Arunachal Pradesh	0	0
Mizoram	0	0
Sub-total	2,51,472	11,721
Eastern region		
Bihar	4,00,223	24,447
Jharkhand	1,83,321	12,144
Orissa	14,62,450	82,412
WB	23,66,397	1,19,776
A & N Islands (UT)	4,170	87
Sub-total	44,16,561	2,38,866
Central region		
MP	5,51,235	32,631
Chhattisgarh	3,97,757	26,542
UP	8,12,702	76,437
Uttaranchal	64,291	2,974
Sub-total	18,25,985	1,38,584
Western region		
Goa	2,200	1,595
Gujarat	1,11,521	12,160
Maharashtra	22,08,784	57,999
Sub-total	23,22,505	71,753
Southern region		
AP	49,49,393	3,56,528
Karnataka	32,29,378	2,14,805
Kerala	3,10,646	14,649
Tamil Nadu & UTP	23,70,257	1,19,410
Sub-total	1,08,59,674	7,05,393
Grand total	2,00,26,356	12,06,308

NOTES

1. 2008 MIX Global 100 Composite: Rankings of Microfinance Institutions, December 2008, brought out by Microfinance Information Exchange.
2 Bharath Microfinance Report–Quick Data 2009 brought out by Sa-Dhan, New Delhi. Sa-Dhan is a network of MFIs.
3 Under the National Rural Employment Guarantee Scheme Government of India has listed 331 districts as poorest, in which the wage employment is guaranteed to rural poor.
4 This was pointed out by Hemanth Kumar Pamarthy of Hand in Hand in the roundtable of practitioners held by UN solutions Exchange in Bankers Institute of Rural Development (BIRD), Lucknow.
5 The analysis covers 142 MFIs out of about 220 that report information to the Bharat Microfinance Report Quick Data.
6 Education loans, emergency loans, hospitalisation loans, consumption loans etc. have been introduced. The loans period might vary in such cases from the basic product, but the weekly EIs remain as also the other product features.
7 In a later chapter a detailed account of the happenings in Karnataka are described.
8 They were also not known to Association of Karnataka Microfinance Institutions which has a database of all MFIs.
9 Source: www.cdf-sahavikasa.net...%20-%2031_12_2008%20final.pdf
10 Author acknowledges the permission given by Mr P.K. Sarmah of CRD for carrying this case in this report.
11 Source: A note from the representative of World Gold Council.
12 Based on a presentation made by Hand in Hand.
13 During the roundtable discussion with industry leaders in Hyderabad on 10 August 2009.
14 According to the Hindu Business Line, despite the significant drop in equity inflows to the microfinance sector in the last quarter of fiscal year 2008–09, MFIs fared significantly better than other types of financial institutions when it came to equity investments. See http://www.thehindubusinessline.com/2009/07/18/stories/2009071851490400.htm
15 http://www.business-standard.com/india/storypage.php?autono=363806
16 Please see http://dipp.nic.in/publications/fdi_policy_2006.pdf for details.
17 Compartamos is a Mexican MFI that went public a couple of years back at a high valuation. The high interest rate charged by Compartamos was thought to be at the root of its profitability which influenced the equity valuation. The MFI and its promoters came in for trenchant criticism from several quarters for profiteering at the cost of poor clients.
18 Annex 1.1 at the end of Chapter 1 contains the roundtable discussions.
19 The driving factor for MFI valuations in India, Anurag Agrawal, Sr VP, Intellecap in Microfinance Insights, July–August 2009.
20 Excerpted from 'Shedding Light on Microfinance Equity Valuation: Past and Present'—a joint publication of JP Morgan and CGAP by Nick O'Donohoe, Elizabeth Littlefield, Frederic Rozeira de Mariz, Xavier Reille and Christoph Kneiding.
21 Residual income analysis.
The residual income model is a hybrid that starts with the current book value and adds the present value of expected future residual income. Residual income is the difference between net income and the opportunity cost to shareholders to invest in the MFI's equity (calculated as the cost of equity multiplied by book value). The main advantage of this method over pure DCF is that the terminal value represents a smaller part of the total valuation. It is useful in situations where the firm is either not paying dividends or irregular in paying them. For young, growing MFIs that will start generating a positive free cash flow only in the future, it is easier to use the current book value as a base for valuation. However, the method may not be appropriate for companies that will see their capital structure change dramatically, in particular in the case of an MFI that increases its leverage or is expected to make acquisitions. (Source: 'Shedding Light on Microfinance Equity Valuation: Past and Present'—a joint publication of JP Morgan and CGAP by Nick O'Donohoe, Elizabeth Littlefield, et al.)
22 The study on impact of micro credit carried out by CMF-IFMR , Chennai of clients of Spandana argues a contrarian point of view. It says that 'mere presence of an additional source of credit has a major impact in the decisions households make, resulting in what might be considered "smarter" investment in durables rather than quickly consumed temptation goods'. Comments by Justin Oliver, Executive Director, CMF, in the CAB-CMF Microfinance Conference, Pune – January 2009.
23 From Side by Side report 2008, Sa-Dhan.
24 There are some collation errors across states and the totals do not match with Quick Data. The variance is about 2.5 per cent.

The tough classrooms of Karnataka—lessons on customer protection and competition[1]

4

Chapter

There was nothing to suggest on the evening of 31 January 2009 that there was anything wrong with the operations of MFIs in Kolar[2]. On 3 February 2009 when the MFIs staff went on their usual rounds for centre meetings and cluster meetings they were met not by women borrowers but by gangs of youth. MFIs staff members were told in no uncertain terms to get out of the locality and never to return for recovering loans. Some were slapped and beaten up. At the end of July 2009 Rs 600 million was reportedly involved in defaults. What is that had transpired in this short period of two days that vitiated the credit climate in Kolar?

The Anjuman Committee[3] of Kolar had sent a communication to different mosques in the district to give out a message[4] as part of the prayers that no borrower from any MFIs in the district would transact with those MFIs in future. They should neither borrow from MFIs nor repay either principal or interest on loans that had already been borrowed. Any further transactions with MFIs could invite religious and social sanctions from the other members of the Muslim community with the full force of the Anjuman Committee behind the sanctions. The message was given out during the prayers in different mosque congregations. Apart from the message there were means of enforcement that were adopted which comprised youth coming in groups to different borrower neighbourhoods and advising them with dire consequences for those who might be tempted to violate the fiat. The threatened consequences were stoppage of neighbourly visits from others, boycott of social functions in the family, denial of last rites for the deceased in the mosque, denial of a place for burial in the sacred graveyard and finally excommunication from religion. Faced with these threatened consequences many of the borrowers had expressed helplessness and said that they cannot repay even the existing loan unless the Anjuman Committee relaxes its pronouncement.

This pronouncement did not come out of the blue. It was in response to developments that took place over a period of time in the town. Some complaints against MFIs[5] had reportedly been received by the Anjuman Committee. There were some isolated but significant problems reported in the months of November and December that some borrowers exhibited severe symptoms of over indebtedness. One borrower[6] who had managed to run a debt level of Rs 0.7 million (using proxy borrowers from the neighbourhood) failed in his business enterprise and as a result attempted to commit suicide. Reportedly he was closely connected with certain leaders[7] of the Muslim community. This made the religious leaders take note of debt-induced distress. They were concerned that if a person of good means is reduced to such a state and has to take his own life then what would happen to the other poor borrowers. This attempted suicide apparently proved to be the last straw. The Anjuman had been moved to issue the pronouncement that taking loans on interest, repaying loans with interest is against the tenets of Islam and whoever does the same in future would be declared *persona non grata*.

The pronouncement, even with the reported complaints, was not justified. In one sweep a large number of poor people lost their link with livelihood sustaining credit access. The Anjuman Committee was in no position to make any alternative arrangements nor did it seem that it was concerned with it. But there is little to be gained in examining the role of Anjuman Committee. The focus of enquiry is therefore on how space was created to allow entry of political and religious leadership in microfinance. The effect of the pronouncement was total in Kolar. Repayments immediately stopped

and people failed to turn up for cluster meetings. MFI staff members were not even able to reach meeting places and were prevented from reaching the meeting venues. In some cases when the staff tried to meet families individually the local youth warned them to keep away. A few cases of violence had been reported. After the pronouncement there had been attempts made by individual MFIs and in a group to meet the Anjuman Committee and see a resolution. Initially Anjuman Committee was not keen to meet the MFIs. After a time the MFIs and Association of Karnataka Microfinance Institutions (AKMI) (see Annex 4.1 for a description of role and functions of AKMI) went to meet the deputy commissioner (DC) of police for a solution of the problem. But before he could come to grips with the problems he was transferred. The new DC took a while to understand the nature of the problem by which time the election code of conduct for Lok Sabha polls had come into force. The DC did not take further action to resolve the problem as there were possibilities that it might escalate into a local election issue. The Anjuman Committee refused to discuss the problem directly with the MFIs because of the MFIs' seeking the intervention of DC.

At the time of visit to the district, it was learned that on an intervention from the Kerala State Minorities Commission[8], the Anjuman Committee and the MFIs were likely to meet shortly to find a solution to the problem. The reasons offered by the Anjuman Committee for issuing their fiat were:

- Lending and borrowing on interest is unislamic.
- The process adopted by MFIs for lending made the women interact with men from outside which again is culturally not acceptable to Muslims.
- Women very often were attending meeting after meeting (because they had borrowed from more than one MFI) which make them neglect their children and families. At times they could not offer 'Namaz' on account of their involvement with the MFIs. Access to finance that makes women neglect their families or religion could not be upheld by the Anjuman Committee.
- Women took loans without informing their husbands, as loans were easily available. For identification in such cases they produced third parties as husbands. The deceit and duplicity employed was corrupting family life and corroding religious values.
- Recovery methods employed by the field staff in the event of default was entirely unacceptable as they entered homes and did not leave until the repayments were made. The continuing unescorted contact between the MFI staff (especially men) and the Muslim women during day time when the men of the household were engaged elsewhere was contrary to social norms of the community.
- The rate of interest charged by some MFIs was very high leading to distress in the local area.
- Repayments went beyond the capacity of the borrowers (especially women) and the forcible recovery measures compelled them to undertake jobs and activities that were not desirable.
- In general, the MFI activities in the area bred immoral, irreligious behaviour.

A combination of all these reasons, according to the Anjuman Committee, led it to issue the Kolar that none should transact with MFIs in future.

A brief background of the state and Kolar district would inform us better of the context in which the problems came up. Karnataka is a heavily banked state with a bank branch for every 11,000[9] of population. The total population of 55.82 million also contained 13.89 million poor[10]. In terms of households, there were 11.16 million, of which 2.77 million were poor. In this already heavily banked state 27 MFIs operate; 18 of them have their headquarters within the state[11]. At the end of March 2009 the number of microfinance accounts was estimated at 7.31 million, an increase of 2.34 million from the previous year. If we assume that each house had a microfinance loan, then 65 per cent of all households had been covered. If the loans covered poor households only, then each poor household had 2.63 accounts. Here two facts need to be considered. The microfinance loans almost exclusively go to the women. Microfinance loans do not go to the poorest; they tend to go to the borderline poor and near poor. This implies that the number of loan accounts per borrower is likely to be more than two. If at the state level number of loan accounts exceed number of poor families, at specific locations of intense competition, multiple loans would be rampant.

The average MFI loan size in Karnataka was Rs 6,600, about 10 per cent higher than the national average. By all accounts the state seems to enjoy the attention of the mainstream and microfinance sectors.

Table 4.1 Microfinance in Karnataka

	Customers (mn 2008)	Loans 2008 (Rs mn)	Customers (mn 2009)	Loans 2009 (Rs mn)	Loan growth rate (%)
SHG	3.01	13,896	4.09	34,763	150
MFI	1.96	11,038	3.22	21,480	95
Total	4.97	24,934	7.31	56,243	125

Priority sector accounts in the state numbered 3.08 million accounts. Even allowing for housing loans, small and medium enterprises (SMES) and the like, still 2.5 million small accounts were in the state accounting for bank loan outstanding of more than Rs 30 billion. If we factor in the normal growth recorded by banks, by March 2009 the loan outstanding in Karnataka priority sector loans would be not less than Rs 36 billion. It would be fairly clear that Karnataka is heavy on debt. Additional infusion of credit without looking in to repaying capacity and purpose would aggravate the problems of the customer.

Kolar district thrives on agriculture. While rural households were 0.18 million, 0.36 million people directly depended on agriculture. The poor households numbered 0.14 million. The district depended on rains for 70 per cent of its cultivable land mass. Ground water has been excessively exploited in four out of five blocks with no further reserves for pumping out. In a cycle of 5 years droughts visited the district for 3 years. If rains fail, as they did last year in parts of the district, the local economy will contract. Its handicrafts and silk industry in the non-farm sector depended on external markets which were not strong during the last 18 months. Kolar economy was in a declining phase. In the microfinance sphere 23 MFIs and 45 NGOs operated in the district. The credit deposit ratio of banks in March 2008 was 304 per cent! Banks were expecting to disburse Rs 3 billion in priority sector loans during 2008–09 in the district. This is the backdrop in which MFIs expanded loans by 95 per cent in 1 year in the state of Karnataka.

Apart from Kolar town there are other locations in Karnataka where problems had been noticed. The locations reported to be having problems were Arsikere, Chennapatna, Tumkur, Malur, Chitlagadda, Kunigal, Ramnagaram, Gowripalaya in Banglore, Mysore, Srinivasapura and Mulbagal. In Tumkur a youth organisation by the name of Jai Karnataka had been asking for protection money to be paid by the MFIs so that they could operate there without any hindrance. Gangs of youths at times came and interrupted the work of the MFI staff and prevented them from carrying out their tasks from time to time. In Mysore some staff of MFIs were beaten up requiring hospitalisation for a few days in the month of February 2009. Subsequently when two murders (not connected to MFIs) of persons belonging to different communities took place one after the other, a curfew was imposed by the local authorities for a period of 10 days in one of the localities in Mysore city. As a result two consecutive weekly centre meetings did not take place. At the end of curfew when the field staff tried to hold centre meetings they found that the attendance in the meeting was very low and repayments even lower. Since then there had been reluctance from the borrowers to repay the loans or to attend the meetings. Here the non-repayment is not related to one religious minority or one community. In Ramnagaram, problems of a different kind have been faced. There were a number of people who had borrowed had migrated from the area fearing the heavy debt burden.

It is not that the MFIs had been functioning in a flawless and professional manner or that the blame is entirely on the religious committees and politicians as well as borrowers. The information that has been reported and gathered from the field points to several problems in the functioning of MFIs. The problems are in nature of product deficiencies, process infirmities, flawed incentive structure for staff, inadequate training and capacity building and also failure to understand the external environment. A major issue was that of intense competition that has eroded the discipline required in financing. In the last years' State of the Sector report, the negative impact of competition had been dealt with in detail. Some of the apprehensions expressed at that time seem to have come true. The same customers have been able to borrow typically from three MFIs and significant numbers had borrowed from six institutions or more. A survey[12] points to 25 per cent of borrowers having taken loans from six MFIs. Very few clients had borrowed from only one MFI. How such multiple borrowing escaped the notice of loans officers is the question that requires some clear answers. Some of the MFIs state that they have nothing but the declaration made by the borrowers to go by in terms of the extent of her/his borrowings. This is not a believable proposition as all the competing MFIs operate in the same locations and villages; they do overlap the staff of the other MFIs during their visits to different centre meetings. The fact that other MFIs operate in the same neighbourhood cannot and should not escape the attention of the field staff of MFIs. The only conclusion that could be drawn from the fact that 13 different organisations had been operating in some of these neighbourhoods and yet most MFIs staff claims that they had no knowledge of multiple borrowing amounts to collusion of the worst kind between staff of different MFIs.

One of the extreme examples quoted was that of a lady who has borrowed Rs 4 million from different MFIs using several individual women as members of group. These members had contributed to a

chit fund run by the women entrepreneurs with the help of money they borrowed from the MFIs. When some of these members defaulted on their commitments to the chit fund, the entrepreneur who ran the chit fund disappeared from the scene. This led to widespread default by many members to different MFIs to the tune of Rs 4 million. It was understood that quite a few women were willing to lend their name as proxy borrowers for a fee of Rs 500. It is surprising that such developments could have taken place in a lending process that was expected to be based on familiarity and close relationship with the clients. The chances are that such occurrences were within the knowledge of MFI staff and they chose to overlook the same. Graham Wright[13] of MicroSave observes

> The problem has also been exacerbated by the very rapid growth of MFIs competing to serve clients in Karnataka and Andhra Pradesh. This has meant that the poor have moved from having no access to credit (except from extortionate moneylenders) to being able to access loans from 3–4 MFIs at the same time. This change has occurred in the space of 2–3 years, … the poor took loans from as many MFIs as were offering them, because they were available, without really understanding the implications of having to repay…

A third matter of concern is that there were failures of certain types of activities which constituted the common livelihood in these areas. They reported that failure of the local silk industry and the handicrafts enterprises introduced pressures on the cash flows of borrowers. The resultant inability to repay was not adequately recognised. The insistence on repayment in every such case possibly led to a reaction forming in the minds of borrowers who used the first available excuse to stop repayment to the MFIs. While a few borrowers still remain committed to the MFIs and would be willing to continue their repayment, there is also a percentage of customers who are unlikely to come forward to repay on their own. The artificial construct of 100 per cent repayment and 0 portfolio at risk (PAR) has now to be reviewed. Microfinance borrowers like any other borrower can have down turns and problems of liquidity. MFIs should find ways of dealing with such problems of customers without becoming insensitive to the same on the ground that once a concession is made to one client all others would invariably follow suit.

The products that were marketed had been uniformly the same barring minor variations in the interest rates, service charges and the like. Most loans that had been taken were to be repaid in weekly instalments. It was very clear from the nature of livelihood activities pursued by the clients that their cash flows were not weekly and also not uniform. Sericulture-related activities require a type of loan whereas street hawking and vending require different type of loan. These differences—in occupations pursued, the levels of investment required, the time taken for recovery of the investment value from these livelihoods and the kind of cash flows which in most cases are seasonal and fluctuating—were not reckoned in product design. The processes that were adopted involving regular meetings, combined oath taking, obtaining guarantee of all group members for the performance of individual members worked well when the loan sizes were small and taken from only one MFI. When multiple loans became possible, borrowers became involved with several groups. With the increased loan sizes and borrowing from multiple sources through different groups, the members were more and more wary of guaranteeing other's repayment. The number of guarantees to be given increased exponentially on account of multiple memberships. But the customers gave guarantees on each other's loans on the pain of denial of further facilities from the MFIs. There have been cases where customers had to sell off household assets or borrow from moneylenders in order to pay off their guarantee obligations on behalf of group members. The dictat from Anjuman Committee in some ways was a blessing that came to the rescue of most of these borrowers. The idea that any amount of loans could be given with a group guarantee and that group guarantees can be enforced through different methods stands discounted. Again to quote Graham Wright[14]

> […] *MFI has developed a system with 25–50 members in a group. Credit Officers cannot monitor groups of this size and this lead to members being inducted into the group by the more mature members on the promise of a commission. Once the mature members vanished with the money, the proxies were pressurized to pay-up.*

The issues in Kolar as described by the MFIs are external. Some of the observations made by the MFIs are that individuals from AP (AP) came over to Karnataka to lend money at high rates of interest. These transactions had been carried out under the names of different MFIs which are not known to mainstream MFIs operating in Kolar. There were also some money-lending operations which had been carried by local persons with high net worth.

Some of these operations had been adversely impacted by the extensive presence of MFIs in the district. The stoppage of their profitable business made these lenders to take all possible actions to ensure that they restrict, if not altogether stop, the operations of MFIs in the district. They were instrumental in convincing the Anjuman Committee to issue the *fatwa*.

There are those who opened MFIs under different names in order to mimic the functioning of MFIs but with highly questionable lending practices. A survey made among different clients brought out that 23 MFIs were operating in the Kolar district whereas there were only eight MFIs that are members of AKMI. Some of the MFIs that are operating in Kolar have not been heard of but these have through their unfair practices marred the reputation of all those in the sector.

Another issue was that the farm loan waiver had created envy among the borrowers of MFIs. While their neighbours and friends had borrowed at lower rates of interest from banks and had been rewarded with waiver of loan when they actually defaulted, the borrowers of MFIs had not been able to gain from the munificence of the government even when they were keeping up their repayments week after week. This in some ways had led the borrowers to willingly accompany the decisions taken by the Anjuman Committee not to repay.

The failure of certain local economic sectors that provided employment and income also added to the problems. That downturn in silk and handicrafts which are quite labour intensive had reduced incomes all around. With loans easily available from MFIs, women increasingly refused to take up low wage labour such as in silk reeling and spinning. The resultant decline in production and increase in wages reduced the profitability of silk-based small enterprises rendering their ability to repay loans difficult. All these together had a combined impact that was greater than the individual power of any of these reasons to impact the MFIs.

The result of this event is that for over six months there has been no new credit flowing into the affected areas. This stoppage of credit flow has impacted some of the seasonal and perennial livelihood activities such as the mango business in summer as also mulberry cultivation which had a compounded problem of drought. This affected the repayment capacity even more than would have been otherwise. The resultant consequence is that people have to look for jobs in factories nearby or migrate to other areas in search of wages. In either case the borrowing members are unlikely to be attending the weekly cluster level meetings. It was also reported that children have been pulled out of private schools and admitted in government schools during the new academic session commencing in June as the families found schooling in better schools unaffordable with the reduced cash flows.

For all adverse impacts on the local economy and people, the response of the government authorities in Kolar and Ramanagaram was found to be inadequate. The response ranged from superficial interest to inaction. But in Chitlagadda town the DC of police had decisively intervened[15] and ensured a quick settlement of the problem. But there are other areas in which the government had not been equally decisive. A point of note here as reported by NABARD is that the SHG–bank linkage programme (SBLP) did not face any collateral damage. The SHGs continue to function and banks continue to lend and recover their loans. Some of the large organisations involved such as Gramin Mahila Okkuta, Shri Kshetra Dharmasthala Rural Development Project (SKDRDP), MYRADA, Sanghamitra and others have been on the job of forming, linking and servicing SHGs. Some of these NGOs which also provide loan on their own account to SHGs such as Sanghamitra and SKDRDP have not had any major problems.[16]

An interesting development was in the town of Bangarapet where after the *fatwa* was announced, the women went to the Masjid and requested that the Masjid should make alternative arrangements to provide them with the loans or allow them to continue relations with MFIs. With this combined effort of women to put a stop to further actions being taken by the Masjid, the women were able to continue to transact with the MFIs there. It was reported by more than one MFI that still some recoveries were tickling in but then for the customers to come forward and repay the due instalments it may take more time and some kind of agreement with the Anjuman Committee.

COPING STRATEGIES

One of the MFIs was thinking in terms of coping with this situation by shifting to collateralised individual loans. It felt that larger loans of Rs 25,000 given to individual and secured through collateral assets offered a better route to doing business and viability. But in such a case the objective of the MFIs in beginning its operation (to facilitate access for the poor) will stand defeated.

MFIs were slow to agree on a joint platform of action, presumably driven by unwillingness to commit to any collaborative measures (information

sharing, coordinated recovery, self-limitation and/or more rigorous loan appraisal standards) towards multiple borrowing. The MFIs have joined hands for taking concerted action. They have initiated an exercise to exchange list of borrowers to identify multiple borrowings and defaulters to multiple institutions. Hopefully this would lead to setting up of a credit information bureau. They have also decided to reduce concentration of credit risk in different locations. Exclusive Muslim women groups are not likely to be encouraged for some time in future. The ceiling limits on loans have been reduced in an effort to reduce the overall debt burden even if multiple lending takes place. A grievance mechanism to handle customer complaints has been put in place. A lead MFI has been identified for each location which would operate the grievance machinery—receive complaints from customers regardless of which MFI they have borrowed from and offer a solution within a given timeframe. In cases of customers with excessive debt, rescheduling of loans with longer repayment periods are to be offered. Already some MFIs have started rescheduling loans on a case by case basis on request from borrowers. The AKMI has resolved to adopt a uniform code of conduct among the members on how to deal with the situation. It has taken up the matter with RBI and the government and is also working with Sa-Dhan to find solutions to the impasse in Kolar.

AKMI also set up a dedicated cell to handle the problems and facilitate the coordination between the MFI members. A common format for sharing of information about borrowers has been designed; several MFIs have already submitted information on the format. The process of matching names and identifying multiple borrowers is underway.

The response to the crisis in Kolar was tardy from several fronts. The MFIs themselves did not take note of the underlying seriousness of the problem even as it reared its head in October and November 2008. Each disturbance in a different part of the state was seen as a one-off incident and not indicative of fundamental problems. Even now Kolar is seen as a different problem and not to be cast in the category of other adverse developments relating to borrower resistance in the state. This failure to understand a worsening credit environment in the midst of a contraction in local economic activities not only delayed a response, but also focused on the symptoms rather than the causes.

The information flow from field and branches to controlling offices and headquarters of the MFIs was slow and perhaps incomplete. Whether the reluctance to be the bearer of the bad news prevented the field from reporting problems promptly has to be examined by the MFIs concerned.

While AKMI seems to have acted with alacrity, the role played by Sa-Dhan has to be more critically examined. Sa-Dhan had few meetings and field visits, and tried to get the policy establishment involved; but no concrete actions emerged. With its national footprint and links with RBI and Government of India, one would have thought that a higher level involvement should have been procured by Sa-Dhan. There was perhaps a mix of short-term actions and long-term strategies in the bag with no clear prioritisation. Setting up of a Credit Bureau (a long-term project) gathered more steam during this period than any other measure.

The state authorities not only did not act in most locations, but in fact raised questions[17] about legitimate MFI operations. The threatened use of Money Lending Act against MFIs was unfortunate. The quality of engagement of MFI community with the state authorities seems to be very weak for such a response came in a state where microfinance has such strong and long roots.

Whether the lending banks were involved in finding a solution is not on record. One hopes that they were and did their best behind the scenes. The reported response of some of the large MFIs to the problem was less than adequate. Ignoring the problem as it constituted a very minor part of the total portfolio was not the best way of dealing with a development which could easily snowball.

WHAT DOES KARNATAKA TEACH US?

Kolar is a unique episode in that nowhere else in the country a religious pressure has been applied on customers of MFIs to renege on their obligations. But there have been incidents of concerted action to withhold repayments in different pockets. Kolar reminds us of some lessons from AP that the sector has forgotten. Regardless of the proximate cause reported, the underlying reason for such a development is seen to be the fatigue that has set in among the borrowers arising from excessive debt. A combination of borrower wants and expectations and the MFIs' ambitions on expansion had lead to an excessive debt level that was not applied for income generation by the borrowers. Whereas the over-indebtedness surfaced in multiple borrowing, the cause of borrower distress is contraction or collapse of the clients' (or households') economic activity—many of them in the silk business. When the income stream dried up, the multiple loans became unbearable. MFIs hastening to press for repayment as soon

as recovery problems occurred may have further accelerated the crisis, and probably desperation, of the client.

The sector has not perfected the loan ***product*** with group guarantees ensuring repayments in perpetuity. Unless done within limits and with self-discipline, any product would have limitations. The best products are likely to be those well delivered after a sound appraisal.

The ease of availability of loan from different MFIs has led a significant proportion of borrowers to avail loans beyond their repayment capacity. The different enquiries made by diverse institutions such as Sa-Dhan, senior officers of individual MFIs, AKMI, representatives from World Bank, Grameen Capital and the like revealed that the debts incurred by some borrowers remained far beyond their ability to service. The MFIs had either not learnt the right lessons in transacting with their customers or had chosen to ignore the same. Pursuit of a market share and a high growth rate has clearly proved detrimental to the MFIs and much more so to the customers. Basic disciplines in financing such as borrower appraisal, verification of antecedents and assessment of existing economic condition of the customers had been compromised. A relationship between the loans and the purposes for which they were borrowed as well as means of securing repayment had not been established in credit decisions.

The incentive structure designed for the staff did not emphasise the qualitative aspects of lending. One of the MFIs had a procedure by which the amount not recovered would be deducted from the staff's salary. This places the staff under intense pressure and in turn they exert enormous pressure on the customers with unpleasant consequences. Customer service did not seem to be a priority. The code of conduct accepted by the MFIs remained on the walls of their head office and at times in the branches as well but rarely found a place in the processes adopted towards customers. The training of staff possibly did not focus on the behavioural issues in financial intermediation and did not adequately prepare the staff to deal with borrowers aspiring for excessive levels of debt. The politico-religious and other external interventionists found a space to enter and in providing the space possibly the MFIs had caused themselves the greatest damage. The future operations of MFIs would never remain secure from these kinds of interferences and MFIs would constantly keep looking behind their shoulder even as they try to carry on with their legitimate business.

What happened in these locations would erode the credibility of MFIs in the customers' eyes. Apart from that there is a loss of protection that has resulted from these events for the customers. Access to flow of credit and responsible behaviour from the lenders are two critical issues in customers' protection. The lenders did not exercise due caution in appraising the loan requests and providing finance. The superficial and negligent processes adopted for assessment of borrowers actually make the lenders are more liable for the events that have taken place than the customers themselves. The lenders and their staff are expected to have superior skills of appraising requirements and financing according to repayment capacity as well as cash flows of borrowers.

The risks, if any, of lending are carried normally by the lenders. But by the lenders' action if the enterprises and livelihood activities of customers are placed in jeopardy the lenders liability would continue to operate. In Kolar, though the external interventions have caused the disruptions to credit flow, the blame for providing the space for external forces to enter should squarely be placed at the doors of MFIs. The lessons for future are that the MFIs should look very closely in to their products, processes and staff. The entire chain of activities from customer selection to securing repayment has to be examined from the point of view of adequacy of protection to the customers. Unless the customers remain secure from acts of the MFIs or of people who are external to the relationship between the MFI and the customers it's difficult to envisage a trouble-free future for microfinance. The state is unlikely to come to the rescue of commercial organisations in a dispute with religious bodies, especially those of minorities.

Zero PARs and 100 per cent recoveries have to be treated with caution. The likelihood that some borrowers might have problems of loan service has to be accepted and MFIs geared to respond to the same in a manner other than forcible recovery, such as rescheduling of loans and postponing of instalments.

PATH AHEAD

Growth with responsibility is probably the theme that should occupy the time of MFI boards. How to prioritise the customer's concerns so that s/he does not feel alienated is the continuing issue that MFIs need to address. Looking inwards, MFIs should

- strengthen their client acquisition systems to include assessment of economic profile to KYC criteria;
- improve and codify risk-management policies with exposure norms on geographic, religious, community and activity coverage;

- tighten credit decision-making processes with focus on customer debt levels and debt servicing capacity;
- provide adequate information in an understandable form to customers as to their rights, obligations as also loan terms;
- reframe staff incentives with greater attention to portfolio quality and customer service;
- invest in sound internal control/information systems that pass on critical information to senior management without loss of time;
- develop a debt restructuring/rescheduling protocol to deal with exceptional problems faced by a few borrowers who default for reasons beyond their control and
- establish a grievance mechanism for the customers.

On the external front MFIs should

- develop an effective environment-scanning system in each major area of operation;
- develop and intensify interactions with other MFIs and networks to avoid unfair competition practices;
- engage in exchange of information on customers, defaults and other trends with other MFIs;
- establish and sustain rapport with state and local authorities;
- engage the local political and religious leadership through the customer community;
- provide information about the local area operations transparently[18] and
- work jointly on lender liability code and make it public.

This is not an exhaustive list of actions. While there would be more actions to take, a list of actions not to be taken should also be drawn up. The responsibilities of MFIs as individual entities and as a sector have to be understood and accepted by all. The mutually accepted disciplines should also be enforced among the MFIs in the local areas by a peer body (such as the AKMI in Karnataka). The training of staff is a critical aspect of how customers perceive the MFIs. It is necessary that MFIs pay much more attention to training and in that sharply focus on behavioural aspects of finance and customer service.

ANNEX 4.1
Association of Karnataka Microfinance Institutions (AKMI)

The Karnataka MFIs are large in number and have an extensive outreach throughout Karnataka. The institutions have local problems of a common nature and also issues that they have to settle mutually inter-se. The national level network, i.e. Sa-Dhan, is too far away at Delhi to be able to help the local MFIs to solve their problems. Some MFIs got together to study the formation of a local network that would closely work on their issues. The MFIs had been advised by Sa-Dhan to set up a local level unit and carry on the work relating to networking between the different institutions. Thus, 13 founder members got together and formed an Association of Karnataka Microfinance Institutions (AKMI).

The association has been set up with the objectives of (1) working towards presenting the MFIs in a positive light in the state, (2) presenting local problems to the government on a common platform, (3) adopt a common code of conduct for members and (4) share information among the members on issues such staff, fraudulent transactions and other developments of interest to members. The association has a code of conduct in place which is reportedly more stringent than that of Sa-Dhan. The association looks into issues of poaching of staff from the member organisations, coaching of clients of member organisations, sharing of information relating to errant borrowers as also errant staff. Information relating to multiple borrowing by some of the members as also loan misuse is also shared. The cooperation between the MFIs extends to not only exchange of information but also blacklisting of those clients who misuse loans, staff who mis-represent their background during recruitment and engaged in fraudulent transactions. Presently the AKMI has more than 30 members and is expanding. It has been able gain visibility and is a regular invitee to meetings convened by RBI, state government and NABARD. It's hoping to be an active industry-level platform in the state which is able to solve the problems of members and present the government and other policy establishments with quality information relating to the working of MFIs in the state.

NOTES

1. Author gratefully acknowledges contributions made by Oliver Schmidt of Deutsche Gesellschaft fur Techniche Zussammenardeit (GTZ), on secondment to Sa-Dhan. Author is also thankful to Veena Jayaram and Shreyas Gopinath of CMF-IFMR for sharing information from their in-depth study of the crisis and willingly accompanying the author for the field visit to Kolar. Discussions with Justin Oliver, ED, CMF during the field visit were very useful.
2. Kolar is a district town, about 80 km from Bangalore.
3. Anjuman Committee is a body comprising of representatives of different Masjids in a particular locality. It discusses maters of religious importance. In Kolar, political persons are members of Anjuman Committee.
4. This is called a *fatwa*, which means a religious fiat.
5. Subsequent enquiries with the Anjuman Committee revealed that there were about a dozen complaints, most of which were in respect of MFIs that were not part of AKMI and not known to the mainstream MFIs.
6. A nick name 'Sardar' was mentioned in the field.
7. Tipu Youth Committee, a local social organisation is stated to have taken up the matter with religious elders.
8. This is a statutory body constituted by the state government to protect the interests of religious minorities.
9. RBI banking statistics, 2008.
10. Census of India Statistics.
11. Bharat Microfinance Report, Quick Data 2009, Sa-Dhan.
12. A survey carried out by Grameen Koota staff was cited during the discussions. The survey covered 200 borrowers of which 105 were defaulters.
13. This was part of the response to the roundtable questions. See Annex 1.1 Practitioners' roundtable discussions at the end of Chapter 1.
14. This was part of Graham Wright's response to the roundtable questions. Please see Annex 1.1 at the end of Chapter 1 for details.
15. The police officials reportedly told the local religious leaders that disrupting a legitimate business and inciting people to renege on their commercial contracts under duress of religious sanctions is a criminal offence and could invite police action. This put a stop to further intervention from the religious platform.
16. Officers of NABARD, Bangalore had observed this.
17. A letter was reportedly issued by a government official in Ramanagaram to RBI warning that the MFI lending should stop!
18. For a sector that has a business in the public domain, it was strange to see a lack of information on what was happening for a long time. The contagion risk potential no doubt played significant part in the information not becoming public too soon.

Policy environment of microfinance—need for change

5
Chapter

Last year the report had expressed the doubt whether the microfinance bill will become law given the dissensions within the sector and strong contrarian positions within the standing committee of Finance. The bill was not taken up in the last parliament session and it lapsed. But the new government has reportedly chosen to place the same bill before the parliament possibly in the winter session of the current year for being passed into law with reportedly minor changes. If the reports circulating on the imminent passage of this bill into law are true, it would be a beginning for regulation of the sector, though partial. In its present form the microfinance bill will not really regulate any significant part of the sector. Only microfinance organisations that mobilise thrift from their members would be required to register with NABARD for carrying on their operations. The Microfinance Diagnostic[1] prepared for International Finance Corporation (IFC) and Kreditanstalt für Wiederaufbau (KFW) observes that

> *By excluding NBFCs and S25 companies, the Bill will also deprive more than half of borrowers from the protection of the ombudsman envisaged under the bill, and the sector as whole from the benefits of universal performance standards in respect of microfinance activities. RBI will need to ensure that standards are uniform, keeping in mind the form related differences among MFIs. The Bill does not provide the sector with a form of registration uniquely suited to microfinance. It leaves NGO-MFIs with no alternative between remaining NGOs and having to raise enough capital to become NBFCs.*

The others operating on the ground only on the credit side are not subject to regulation under this bill. Further, a larger part of the microfinance sector represented by MFIs would continue to be under the regulation of RBI which is more based on self report and management information system (MIS). RBI has kept the credit-only non-banking financial companies (NBFCs) in a relaxed oversight mode. Only deposit-taking institutions have stringent regulatory oversight procedures. But neither RBI nor the Government of India seem to be focusing on enabling savings through the microfinance bill; the limited facility for collection of thrift to be made available appears risky, exposing poor to save with institutions that do not offer deposit protection through DIC[2] cover.

The poor and the disadvantaged clients require effective savings services. The bill does not facilitate the same. The registered microfinance organisations under the bill would be able to mobilise only the compulsory non-withdrawable regular savings practiced by members of SHGs. Voluntary withdrawable savings which offer much more scope for poor to save seasonal surpluses is rendered difficult. The entry barriers to savings services have led MFIs to choose roundabout means of offering savings surrogates. Savings-linked insurance products aimed at the rural poor have been launched by insurance companies such as Max Newyork Life in partnership with MFIs and NGOs. A reverse saving product where the MFI provides a loan for purchase of gold and the borrower repays the loan to own the gold at the end of a predetermined period is popular in southern parts of India. While this is innovative, it robs poor people of the flexible uses of saved money and imposes certain costs that are avoidable if financial savings were permitted.

Regulation of the MFIs is limited to those in NBFC form and those licensed as banks. Of NBFCs, the non-profit section 25 companies have been only asked to file information regularly; no other regulatory exercises are undertaken. Regulation of for-profit NBFCs takes place through prudential norms,

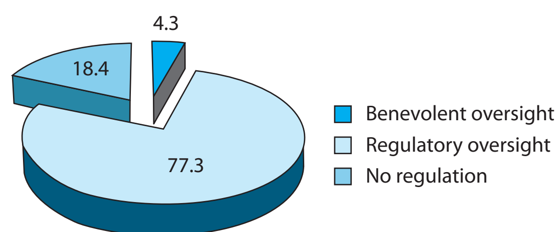


Figure 5.1 (A) Extent of MFI sector under regulation—by loan volume (%).

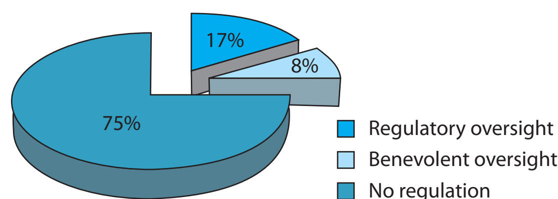


Figure 5.1 (B) Extent of regulation—by institutions supervised (%).

governance codes, information filing requirements and, where necessary, supervisory visits.

The other forms of organisations such as cooperatives including mutually aided cooperative society (MACS), societies and trusts are not on the financial sector regulatory radar. By loan volumes 77 per cent of the MFI sector is under RBI's direct regulation. But 75 per cent of MFIs are functioning outside regulation. These are typically societies and trusts having a small client base and limited loan volumes.

Traditionally the regulatory stance has been savings protection; hence the reluctance to bring credit-only MFIs under stringent regulation. On the other hand, entry barriers to savings even for those NBFC MFIs that are under RBI ensure that RBI need not expand the list of well regulated entities. On both counts there are issues that need to be considered. There is a critical shortage of access points to safe savings. This is well recognised in the ongoing financial inclusion efforts. But banks are not really equipped to deal with millions of additional accounts. Even with the best of technology, human interface and physical cash cannot be avoided in rural banking transactions in the near future. How to expand meaningful access (not of the inoperative no-frills-account types at distant branches) is a matter for policy to answer. If the banking correspondent route is preferred for its relative safety in terms of a banking backbone and well ordered systems then the network of MFIs could be permitted to act as correspondents for savings. This would significantly cut costs of establishing a BC network and reduce costs of operation of MFIs on the credit side. This would ensure that BCs also have appropriate systems and have the resources to make the necessary infrastructure investments. This might answer the savings access issues much better than whatever else is presently offered.

But it still does not answer the issue of why credit from some forms of orgnisations should be kept outside the pale of regulation. As pointed out in the last year's report small borrowers are a vulnerable lot and they need protection from the capricious conduct of lenders. Developments in some parts of the country point to the dire need for a supervisor. Fly-by-night operators set up money-lending operations, label themselves MFIs and mimick their procedures in a bid to gain legitimacy. The processes and terms of use in such institutions place the borrowers in considerable hardship. When the problems escalate, the other genuine MFIs operating in the area suffer collateral damage. In Kolar[3] this phenomenon was evident. Even the genuine MFIs at times develop a myopic vision of the markets and customers leading to undesirable business practices. In such cases the customers' interests should be protected. Logically it would be difficult to argue against the customers of MFIs getting systemic protection that is available to borrowers from banks. As a class how these two sets of borrowers are different is not clear. While banks are subject to regulation on account of their savings function, all bank customers including borrowers enjoy protective cover of regulator. RBI itself notes[4] that

> Traditionally, deposit taking NBFCs (NBFCs-D) were subjected to prudential regulation on various aspects of their functioning while the non-deposit taking NBFCs (NBFCs-ND) were subject to minimal regulation. In the light of the growing integration of the financial sector, it was felt that all systemically relevant entities offering financial services ought to be brought under a suitable regulatory framework to contain systemic risk.

The regulatory exercise is limited to stipulating a capital requirement, periodic asset-liability management exercise and increased disclosures in the annual accounts. The orientation is still systemic risk and customer protection. If as a class, borrowers are protected by regulation, then it would be difficult to discriminate borrowers from one set of institutions. Public policy would conclude that in terms of size and vulnerability, the customers of microfinance deserve systemic protection more.

It might be convenient to look at such problems of MFIs and their customers as management issues of institutions concerned. MFIs today use loans availed from banks to the extent of 85 per cent of

their resources. Last year's funds flow from banks and financial institutions to MFIs was more than Rs 100 billion and it is set to rise further. When public deposits with banks are deployed in MFIs, the safety of banks assets is a further consideration that should influence a decision on regulating the 'credit-only' operations. Regardless of the regulatory boundaries the financial sector is getting closely integrated. A significant problem in the microfinance segment will have a contagion effect on mainstream banks.

The need to regulate entry of institutions in the credit space needs no further emphasis. A registration process should be introduced to do a preliminary examination of the antecedents of aspiring entrepreneurs in microfinance. The registered entities should be required to file annual information on their operations. The very existence of registration requirement would drive away a number of those with dishonest intentions. Further the annual information would provide an idea of the size of the sector and its significance. The numbers and geographical spread might make the task look complex and huge, but technological solutions are available to deal with such initial difficulties. The microfinance bill can be modified suitably to include all MFIs—regardless of the form—under regulation. As for choice of regulator a decision may be taken as to whether s**elf-regulatory organisation** (SRO) being proposed by the sector with the backing of a supervisory board comprising officials seconded by RBI, NABARD and SIDBI could be entrusted with the task. Credit information bureaus (CIBs) could provide further strength to the due diligence processes in customer acquisition and credit decisions. Banking Codes and Standards Bureau of India (BCSBI) could develop necessary codes for adoption. Customer protection levels should be enhanced by requiring the sector to set up grievance mechanisms backed by an ombudsman arrangement as in the case of banks. The policy objective of regulation here is clearly to protect the consumer and through that to ensure the stability of institutions in the financial sector.

PAYMENT AND SETTLEMENT SYSTEMS ACT 2008 (PSS)

An important piece of legislation that will regulate part of activities in microfinance and financial inclusion is the Payment and Settlement Systems Act, 2007 (the PSS Act, 51 of 2007). The PSS Act and the two regulations, i.e. (1) Board for Regulation and Supervision of Payment and Settlement Systems Regulations 2008 and (2) Payment and Settlement Systems Regulations, 2008 came into effect from 12 August 2008. The Act stipulates that no one other than Reserve Bank shall commence or operate a payment system, except under and in accordance with an authorisation issued by the Reserve Bank as per the provisions of the PSS Act. All persons operating a 'payment system', or desirous of setting up a payment system as defined in the PSS Act, need to apply for authorisation to the Reserve Bank. The Act will govern introduction and deployment of all technology enabled products in future. A separate board set up for the purpose will regulate participants' actions relating to payments. The Act will supervise, for example, prepaid and other cards, payment gateways, money transfers, mobile payments and ATM network. RBI had issued the mobile banking guidelines last year[5] under Payment and Settlement Systems Act 2008. RBI has permitted 29 banks have so far to operate mobile based payments services. Mobile based banking is possible only with a bank in the background. RBI has also notified guidelines on prepaid instruments that permit organisations other than banks to issue such instruments. A recent permission from RBI was for issue of mobile wallet based prepaid instruments.

The technology products that enable payments and remittances would not be regulated from Banking Regulation Act. The separation of payments from banking referred to in the last year's report has come through. The boundary issues between banking and payments have to be sharply defined so that institutions do not get trapped in regulatory overlap.

GAPS IN POLICY ON MICROFINANCE AND INCLUSION

Medium and small MFIs have faced problems during the last year. The community owned institutions such as federations find it difficult to borrow bulk funds for the affiliated SHGs. While NABARD provides refinance to banks, its direct lending to MFIs is very little. SIDBI does provide a variety of loan facilities but the availability is limited. Compared to the funds availed by the sector SIDBI's offer last year was about 10 per cent. Since this is area of development finance, MFIs should have access to a refinance facility. This facility should not only provide funds to the small and medium MFIs and community owned institutions, it should also operate as a last resort facility for MFIs. The facility could be set up in the public sector and made merit based without discretionary allocations. This would go a long way in ensuring funds flow to the sector even during periods of recession and financial meltdown.

In many states the microfinance environment is deteriorating on account of negative perceptions of the states. Though the MFI sector has expanded and now covers 22 million people the official response in many states is covert hostility if not contempt. MFIs are thought to be moneylenders in a different uniform. Arrest of MFI staff under usury Act, issuances of notices under money-lending Act and threats to initiate action under other laws[6] have been experienced by the sector. In the field, MFIs in some states report having been harassed by several state authorities ranging from sanitary inspectors to charities commissioners. While there could be no cause for complaint against legitimate exercise of power by state authorities in due performance of their roles, the demands made on MFIs have not been just. Government authorities have a role in ensuring that the microfinance environment in the state remains positive. They should ensure that organisations working with disadvantaged people are not hassled in the field.

MFIs use a commercial approach to effectively reach a large number of people in manner unmatched by other high cost, subsidised programmes. The awareness levels of state machinery engaged in district development and enforcement of statutes relating to money lending should be raised to gain a proper appreciation of the role and operations of MFIs. To this end the centre should have a regular and intense dialogue with states on issues relating to legitimacy and relevance of MFIs. Currently state governments also run their own independent microfinance programmes. State governments could multiply the impact of the resources they deploy towards microfinance if they partner with MFIs. Hence they should be actively encouraged to support microfinance operations of MFIs. This measure will put an end to intrusive and at times abrasive interference of local state officials.

The governments (centre and states) have several schemes that offer capital and interest subsidies to borrowers from banks. Such **selective application of subsidies** through banks distorts the market, influences borrowers in their choice of banks and increases transactions costs of the customers. MFIs with their network reach the rural hinterland. They have the systems to handle government funds responsibly. If the government has to pass on subsidies or transfer other benefits to people, the MFIs would be a suitable vehicle. The governments should make MFIs eligible to participate in its schemes. This would ensure that the government policy is institution neutral.

The current policy and strategy on financial inclusion target opening of savings account to meet mandates set by the RBI. As a result most banks end up doing the bare minimum of opening a no-frills account which quickly becomes inoperative. The focus of policy in this sphere should change to make continuing access and use of financial services by the newly included clients. Financial inclusion measures have ignored MFIs. These institutions have the network and human capacity in the hinterland to provide financial services. When banks opened 33 million no-frills accounts with their infrastructure and the BC/BF network, MFIs have added 12.6 million clients in the last 2 years. But unlike the accounts with banks (of which only about 11 per cent are operational[7]) all accounts with MFIs are operational as these are loan accounts. Hence, the policy bias in favour of banks is not well held. Measures to recognise the role played by MFIs and incentivise them to put in greater efforts in financial inclusion would help the excluded population more than the other ongoing efforts.

FILLING A VOID—CREDIT BUREAUS

The problems in Kolar have opened the eyes of the sector for creating a pool of information on financial behaviour of borrowers. The lessons from a limited exchange of information among the MFIs had been found rewarding and there has been a movement forward on setting up a CIB. As stated by Vijay Mahajan in his roundtable discussions, a clutch of MFIs have already had initial discussions and pooled Rs 28 million in an investment vehicle—Alpha Microfinance Consultants—for taking equity position in a CIB. Discussions are on with some new entrants with necessary permission from RBI who are about to set up CIBs. The thinking is that by taking a seat on the board the MFIs would be in a position to make the CIBs orient themselves to the requirements of MFIs. But the issue needs deeper examination

Where intense competition exists in a small area and multiple institutions operate with the same set of customers, multiple lending is inevitable but excessive lending is avoidable. It is difficult to make the staff accountable for finding complete information relating to a borrower's liability given the constraints of time, cost and effort. Such information relating to a borrower's different liabilities and past record of the borrower in servicing his or her liabilities should ideally be available to the field staff and the credit manager to facilitate their decision

on both customer acquisition and lending. CIBs are eminently equipped for providing such information.

A few MFIs have already started work on pooling resources and setting up a credit bureau or taking equity position in an existing credit bureau to cater to the specific information requirements of MFIs. IFC and Omidiyar network in collaboration with Access Development Services have commenced a market research study leading to finalisation of a proposal for setting up/working with a CIB that would look after the interest of the microfinance sector. While the initiatives are timely several preparatory and intermediary level efforts are seen as necessary. While the immediate driver of this move towards a credit bureau is the multiple lending crisis in Karnataka and to a lesser extent the past problems in AP, a majority of MFIs working in different locations across the country are yet to become sensitive to the needs of such an arrangement. The larger MFIs and the most affected MFIs in specific geographies have thought it fit to pool their resources. But unless most of the MFIs operating in the sector participate in the credit bureau activities, the information base created would not provide a sustainable solution to the problems of lack of information. To this end the MFIs should strive to include all those in the sector. Then information of a comprehensive nature about borrowers from MFIs would be available. Bringing in smaller MFIs would possibly pose some challenges. The issues in the case of smaller MFIs are

- lack of awareness about the benefits arising from membership of a credit bureau;
- lack of information capture from the borrowers that would be critical for decision;
- limited use of technology platforms for capturing and analysing data;
- lack of skills of staff for application of information available from such third-party arrangements and
- inability to absorb the initial investment and training cost as well as subsequent operational cost of uploading data to the credit bureau and paying for report generation in respect of the borrowers.

Therefore the small MFIs would need capacity building as also fund support in order to participate effectively in the credit bureau. The other large challenge is that of influencing all the institutions to subscribe to a common set of standards and parameters relating to information collection, capture, processing and uploading to the credit bureau. Accepted definitions of several terms need to be arrived at. Further a code of conduct that would bind the institutions on safe and disciplined lending and imposition of sanctions on MFIs exhibiting deviant behaviour should be evolved. The bureau should be backed by a strong enforcement mechanism that disciplines members. Vijay Mahajan in the roundtable discussions outlined the thinking on adherence to disciplines: '[W]e will name violators and their violations. If you do not comply, we will put your name and announce that we are no more reporting this organization's data as it is a repeat violator. Or in the worst case we will write to your lenders.'

The credit bureau can facilitate qualitative credit decisions through provision of information that would otherwise normally not be available with MFIs. The credit bureau would not obviate the need for having in place sound competition policies, risk management policies and credit decision parameters. The work which is at the very initial stages is expected to result in something concrete which the MFIs could take advantage of in a period of about 2 years. Needless to say that a platform of this sort should enjoy the trust of all the participants and needs to be in a neutral sphere where the small MFIs do not perceive a threat coming from others who presently offer stiff competition. Alex Counts[8] in an interview, speaking on credit bureaus had this to say, 'I think that it should not be the local Microfinance Association and it should not be the government. It should most likely be professionally run, but managed by people who are widely respected who know banking and microfinance. Perhaps a mix of academics, bankers, retired people in the microfinance sector ….' The issues in policy are the separation of credit bureau ownership from governance and management, incentivising entry of all MFIs, linking of bank and MFI customer databases, evolving norms of behaviour for bureau members, sharing of data across all bureaus, design of a mechanism for enforcing discipline and establishing an organic link between bureaus, disciplining mechanism and the regulatory mechanism. A significant part of the solutions designed should be blessed by the financial sector regulator.

DEVELOPMENTS AND CHANGES IN REGULATION

Reserve Bank of India

The RBI has made a few changes to its policy relating to microfinance and financial inclusion during the year. Mobile banking guidelines have been in-

troduced permitting banks to offer mobile phone-based transaction services which could use correspondents as the intermediary between the bank and customers. The important point of note is that a bank is the backbone of the mobile banking service, not the telecom service providers as has been the case in some other countries. Guidelines for issuance of prepaid instruments have also been notified which allows both banks and non-banks to issue instruments of different types that could be exchanged for goods, services and selectively cash. In a recent notification RBI has conveyed that it will permit such instruments to be issued in electronic form through the mobile wallets but not for settling person-to-person transactions or cash settlements. In a path-breaking announcement, RBI also has allowed debit card holders to draw cash up to Rs 1,000 from merchant establishments having point of sale machines. This possibly is a very initial step towards introducing the Brazilian model of using small-scale shops and vending outlets of different kinds as outposts of banks. The banks correspondents has been suffering from the limits placed on the distance from the bank branch up to which the BC can operate. The distance has now been increased from 15 to 25 km, providing a much larger area of operation for the correspondents. However, the other issues such as the ceiling on small loans being charged not exceeding the prime lending rate (PLR) of branch remain, which according to bank reduces the scope for compensating the BCs adequately.

The Working Group[9] set up by RBI to review the BC arrangements had submitted its report. The group has taken into account a wide variety of problems and come up with solutions. The important suggestions are

- expanding the list of eligible persons and entities for appointment as banking correspondents—to include grocers and others as is in the Brazilian model as also NBFCs and MFIs;
- allowing banks to collect service charges from customers serviced through correspondents and
- suggesting that banks bear the initial costs of BCs relating to infrastructure and technology.

The High Level Committee[10] to review the Lead Bank Scheme had finalised its report. The report contains several suggestions on financial inclusion and microfinance apart from recommendations for revamping the Lead Bank Scheme. The important suggestions of this report are

- A sub-committee of the **District Level Consultative Committee** (DLCC) in district should come out with a road map to provide banking services through a banking outlet at least once a week at every gram panchayat. In the first instance, a banking outlet may be made accessible to each village having a population of over 2,000, at least once a week on a regular basis. Savings, loan, remittance and insurance products backed by financial education should form a part of achieving deeper financial inclusion.
- A monitoring system may be instituted by the DLCC to periodically assess the position regarding achieving the road map and report the same in each meeting of the DCC.
- RBI may review the extant guidelines on BCs to expand the category of persons who can be made eligible to act as BCs. Retail outlets like public distribution system (PDS) and fertiliser distributors as BCs may be examined by RBI, from the policy, regulatory and consumer protection perspectives. RBI may consider allowing banks to use mature SHGs group leaders as BCs with IT solutions in place to ensure requisite safeguards.
- Although permitted, primary agricultural credit societies (PACS) are not being used as BCs. Concerted efforts may be made for using PACS as BCs where such PACS are running well.
- NABARD may make a detailed review of the SHG–bank linkage programme and come up with revised guidelines to facilitate migration of members of mature groups to become micro entrepreneurs and increase the scale of lending through such groups.

These two reports add a lot to the regulatory thinking on issues relating to microfinance and inclusion. The hope is that RBI takes cognizance of the suggestions in their entirety.

In the meanwhile there were some issues[11] that are entering the regulatory radar. Using the latitude given by the norms in fulfilling priority sector lending targets a large number of instruments has been introduced in the market through which banks can finance MFIs and take part in microfinance lending. Portfolio buyouts have been in fashion during the year. When banks buy the portfolios the clients are taken on banks books from the MFIs. But the interest rates that were originally charged by the MFIs remain. These rates happen to be well above the PLR of the banks concerned. The regulatory stance in such a case is not clear. Banks might fall foul of

the regulatory cap on interest rates on small loans in case of portfolio buyouts.

Another issue relating to portfolio purchases is that the continuing work done by MFIs to monitor the borrowers (post-sale) could constitute a service for the purpose of service tax. The payments made by the banks to MFIs are taken into account in MFI books as shared interest. MFIs at a future might be called upon to pay service tax on their earnings. This issue should be taken up for a quick resolution with tax authorities and RBI in order to avoid an accumulated tax burden falling on MFIs at a future date.

Gujarat High Court held in a recent case that a bank that originates a loan has no right to sell the same to another institution. Such a sale of loan, according to Gujarat High Court was violative of Banking Regulation Act 1934 and the borrower had no obligation to repay the loan to the new holder of the debt. The decision has been stayed by the Supreme Court and one has to wait for a final ruling. Though Banking Regulation Act does not extend to MFIs, the basic principle that borrower is not obliged to pay the loan to the transferee of the asset causes disquiet in the portfolio sale and debt assignment cases. Banks might have second thoughts on structuring portfolio buyouts without recourse, till a final decision is pronounced by the Supreme Court. There is a regulatory role involved in clarifying the nature of transactions under the Banking Regulation Act.

One of the more important issues is that of customer protection. MFIs now cover 22 million clients. This is roughly a third of the SHG members that are being covered by the banking system. While the banking system has certain basic customer protection instruments and mechanisms in place, the MFIs do not have such systems. The clients stand to lose from unfair practices and also failure of the lending institutions. The happenings in Lucknow, Kolar, Mysore and in parts of Orissa show that the MFIs could cause damage to their customers. The failure of such institutions or their style of operations that invite external interference disrupts the livelihood and economic activities carried out by customers. The concepts of lenders liability and restraint from undesirable practices have to be brought in and built into the corporate ethic of MFIs. Systems of recording grievances and handling the same require to be introduced. Association of Karnataka Microfinance Institutions has brought grievance handling procedure wherein the customers could record their grievances and be assured of action as well as response thereof. Equitas has an internal ombudsman mechanism to handle customer grievances[12]. Mimo Microfinance[13] had tried out customer satisfaction surveys to identify problems. Similar initiatives are needed in other locations and MFIs.

Insurance Regulatory and Development Authority

Most issues in micro-insurance regulation have been dealt with in the last year's report. The alignment of micro-insurance regulations and social/rural sector business norms will make way for simplification of compliance with the norm. The continuing exclusion of for-profit NBFCs from acting as micro-insurance agents adversely impacts the take off of micro-insurance products. In light of such a ban the MFIs have to think of devious ways of distributing microfinance policies to their customers. The recent proposals of RBI working group on banking correspondents has suggested that NBFC MFIs may be considered for appointment as correspondents by banks. IRDA could think on similar lines and relax its conditions on appointment of for-profit MFIs as insurance agents.

The present entry norms do not provide space for MFI-like institutions in the insurance sphere. The result is that mutual and informal insurance agreements are concluded outside the regulatory radar. Since the authority has a development role as well (in its name) suitable means of providing space for smaller players to enter micro-insurance should be thought of. The example of the microcredit market shows that special purpose institutions with focus on poor can do an excellent job. For their resources they look up to the mainstream banks. There is no reason why insurance market cannot benefit from such a dispensation. The limited capacity to supervise a large number of small institutions should not block developments that can serve people better.

NABARD

NABARD introduced a new scheme for capital support to start up MFIs with potential to scale up their activities but lacking in capital, infrastructural facilities and managerial skills. Microfinance organisations (MFOs) and MFI-NBFC, identified as 'start-ups' on the basis of area of operation, client outreach, lending model, borrowing history, etc., are eligible for support. A 7 year subordinated loan of up to Rs 5 million would be available at a rate of interst of 3.5 per cent. It carries a 2 year moratorium in the initial period of the loan. This is likely to be of

interest to start-ups in their initial period and which do not grand designs of expansion.

NABARD has also introduced a scheme for grant support for rating of MFIs. MFIs seeking equity support or bulk loans, but do not have any current rating, would be provided grant equivalent to the cost of rating by reputed agencies, subject to a ceiling of Rs 0.3 million. Initially the scheme is valid for 1 year.

SIDBI

The Micro Enterprise Loan Scheme-Direct Credit launched by SIDBI during the last year provides need-based composite loan (ranging from Rs 50,000 to Rs 5 lakh) to micro enterprises directly for acquiring capital assets and also for their working capital/marketing related requirements. These loans can be disbursed by MFIs to their eligible clients. The loans would be covered under the credit guarantee operated by Credit Guarantee Trust for Medium and Small Enterprises (CGTMSE). The scheme is currently operated by the seven specialised microfinance branches.

GOI Clarifications on Foreign Direct Investment

Government of India had issued two press notes 2 and 4 in February 2009, clarifying issues relating to companies in India with foreign equity making investments in downstream companies. The significant implication of reading Press Note 4 in conjunction with Press Note 2, therefore, is that foreign investors could invest less than 50 per cent in an 'Indian Operating-Cum-Investing Company' controlled by Indian residents and use it to make downstream investments in other Indian companies, without needing prior Foreign Investment Promotion Board (FIPB) approval and without having the indirect foreign ownership counted for foreign direct investment (FDI) caps purposes. Press Note 2 and Press Note 4 of 2009 are welcomed not just by foreign investors but by Indian industry as well. Private equity funds are certainly likely to view this move positively as the time taken for closing deals will be considerably shortened.

POLICY INFLUENCE[14]

Sa-Dhan has completed 10 years of policy advocacy work as a network organisation. It has been collating information from the members, aggregating expectations, influencing policy and evolving member code of conduct and interacting with the external world. Of the network organisations available in India this is the largest and most popular with 200 members. Projecting and protecting the members' interest are the key tasks of Sa-Dhan. Sa-Dhan is the only source of information on major part of the Indian microfinance sector. It has tried to keep the policy establishment engaged and sector's interest presented in the necessary quarters. Among its achievements in the past decade[15] are:

- building and presenting a comprehensive database and analysis on performance of MFIs;
- convening an annual policy conference;
- evolving financial performance standards for MFIs;
- dealing with the crisis in AP;
- drafting an acceptable voluntary code of conduct;
- capacity building of member institutions and
- studies and documentation.

The increasing size of the sector and emergence of many MFIs has resulted in a surge of expectations among the members. At times the expectations from the members were divergent and conflicting. Managing unanimity of views had been a difficult task in recent times. The large MFIs have expectations that differ significantly from the small ones. The for-profits, non-profits and community owned institutions constitute three different schools of thought in issues relating to regulation, prudential norms and code of conduct.

A large proportion of Sa-Dhan's funding is from donors and grant funders who are not members. There has been a feeling that Sa-Dhan has to meet the donors' expectations first before dealing with members. The larger MFIs are willing to pay a larger share of Sa-Dhan's budget in accordance with their size in the sector, but in exchange would like a greater say in the functioning of Sa-Dhan. The smaller ones are not comfortable with this proposal. Added to this is the problem of voting membership. The byelaws stipulate that an institution joins as an associate member and after 3 years could be admitted to primary membership. But there are only 37 primary members as the process of admitting eligible associates into primary membership has not been taken up, perhaps due to oversight. The proposals coming up for voting in the General Body are decided by the 37 members though the total membership is more than 200.

There has been criticism of the response time to problems posed by the members. The working through sub-committees ensured involvement of several members in Sa-Dhan's work, but the work of the sub-committees required better coordination.

Information sharing with members and the other stakeholders as also transparency levels could have been better. While a code of conduct was adopted as a result of the hard work by Sa-Dhan, the enforcement mechanism was rated weak to non-existent. Use of IT based solutions for surveys, discussions, information dissemination and opinion making in the public domain was low.

Sa-Dhan is today in the cross roads. It has to find ways of taking all the different segments of members along. In the last Annual General Meeting there had been considerable difference of opinion between large commercial MFIs and the others. Proposals on restructuring of Sa-Dhan could not be voted upon reflecting the chasm between two different sets of member institutions. For the future of the sector the members should find ways of uniting to move ahead on an agreed agenda. A network is as effective as its members allow it to be. With the customer being common, MFIs of different shapes and hues should be able to find common ground to work on in the larger network and special interest groups to pursue more specific issues. As Oliver Schmidt[16] says,

> Sadhan could become an apex that encompasses three special interest segments – the for-profit MFIs, the non-profit MFIs/MFOs and the mutual interest community based MFIs. On larger themes all the three segments can unite and present a common agenda; the narrower special interests can be pursued within the groups with support from the Apex.

CONCLUSION

In conclusion we observe that the regulatory effort both in finance and insurance seeks to limit the number of market participants at the edge of the sectors so that numerous small players do not enter and stretch the resources of the regulator. Inclusive finance is difficult for mainstream banks and insurance companies to practice. Over a short period of time they could be pressurised into compliance with priority sector norms, inclusion agenda, social and rural sector mandates. But it is difficult to envision sustained inclusion efforts coming from mainstream institutions that are not positioned as business strategies. It is necessary to recognise this reality and permit the smaller players to enter; and link them with the larger ones in meaningful ways so that financial and systems capacities of large institutions and nimble, low-cost approaches of smaller players can synergistically combine to provide improved access to poor.

NOTES

1. The India Microfinance Diagnostic 2008 was prepared for IFC-KFW by Frankfurt School of Finance and Economics—authored by Rauf Khalaf, Kathrin Haerdle and N. Srinivasan
2. Deposit Insurance Corporation's cover is available only to deposits held with banks.
3. Please see Chapter 4 for a detailed account of Kolar problems.
4. In the Annual Report 2008–09, RBI has dealt with the issue of supervision over NBFCs.
5. 'Mobile Banking Transactions in India – Operative Guidelines for Banks' issued by RBI on 8 October 2008.
6. Describing the ground situation in Uttaranchal and UP, representative of Mimo Microfinance said that every minor official in the block and district has the penchant to enforce something or other against the MFIs. The favours asked ranged from money, jobs for kith and kin, loans to friends and relatives and donations for festivals, etc.
7. Cited from a study made by Skoch Foundation; Speeding Financial Inclusion by Sameer Kochhar, Skoch Foundation 2009.
8. Alex Counts is the President of Grameen Foundation, USA. The interview is on the website www.indianmicrofinance.com
9. The committee was headed by Shri.Vijaya Bhaskar, CGM, RBI.
10. The High Level Committee was chaired by Smt. Usha Thorat, Deputy Governor, RBI.
11. The two issues relating to portfolio sale were brought to notice by Dr Ramesh Bellamkonda of Bangalore Software Services (BSS), Bangalore.
12. P.N. Vasudevan has talked about this in the roundtable. See annex to Chapter 1.
13. Mimo Microfinance is based in Uttarakhand and operates in UP also.
14. The author acknowledges the inputs given by Oliver Schmidt of GTZ for sharing his note, Ten Years of Sa-dhan – A Critique, for this section of the report.
15. A detailed account of Sa-Dhan's activities is available in an excellently produced souvenir: Journey of a Decade: Building the Sector of Community Development Finance – Sa-Dhan 2009.
16. From Oliver Schmidt's unpublished note, Ten Years of Sa-Dhan – A Critique, and Abhijit Subudhi. 2009. 'Why Should MFIs Join Hands with Sa-Dhan? Open letter to Sa Dhan', *Dhanei KGFS*, 20 August, posted on www.indianmicrofinance.com

Human resources and capacity building

6
Chapter

Microfinance Banana Skins 2009[1] finds that across the globe, staffing is not as significant a risk that it was in 2008. Its ranking as a risk has slid down from 5 to 14 in 2009. But in Asia it is still ranked at 7, while in Far East and Africa it is at 6 and 2 respectively. The surmise is that recession took pressure off competition for staff and reduced poaching, improving supplies. But the Indian conditions are very different from what Banana Skins had found. Both management quality and staffing continue as significant concerns.

The microfinance sector employs more than 1,00,000 people at different levels. The Bharat Microfinance report containing quick data for 2009 has provided the information relating to number employed for the first time. As part of Sa-Dhan's database 62,000 staff are in direct employment with the 233 MFIs. The inventory of microfinance organisations[2] commissioned by Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) informs that more than 39,000 staff were employed by these institutions in microfinance activities. One significant finding in the inventorising exercise was that 627 out of 788 chief executive officers (CEOs) of MFIs were trained, but only 392 had experience of running finance operations. By self-report, 161 MFOs had CEOs who were neither trained nor experienced.

The MFIs had 60 per cent of their staff in the field and the remaining were supervisory staff. Looking to the size of clientele and the portfolio that had been reported by these MFIs, the average clients per staff is around 360 and the average portfolio per staff member is around Rs 1.9 million. The Side by Side Report 2008[3] does point out that the average case load of credit officers has been registering a healthy increase from 239 in 2006 to 339 in 2007 and further to 411 in 2008. Given that a mix of models is employed by different MFIs and most of these have group-based approaches, the client coverage per staff member seems to be low. Similarly the average portfolio of Rs 1.9 million is perhaps too low to cover the costs. While the averages would be different in case of individual MFIs, the smaller ones would typically have the problem of either low volumes per staff or understaffing. The need for improving HR productivity has been emphasised from different points of view in several studies and reports. From the numbers that are now available it is clear that both deepening in terms of higher loan volumes per staff and widening in terms of larger number of clients per staff have to be achieved. The ratio of supervisory staff to field staff seems fairly high when compared with other similar organisations that have a highly decentralised model of functioning in the hinterland. This needs to be rectified by rationalising the supervisory level. A resetting of the organisational structure, staff delegation, expanded span of control and use of information and communication technology (ICT) for monitoring would result in containment of costs and improvement of productivity.

The sector is expected to grow fast at a compounded annual growth rate of 76 per cent over the next decade[4]. This kind of growth would entail a larger number of people joining the MFI sector in various capacities. Projections based on these growth rates and normative workloads indicate that the staff strength could almost double in 3 years from now. Availability of qualified manpower to serve the sector has been a problem for several MFIs especially that are not large enough to set up their own systems of recruitment and training. Large MFIs[5] have good systems and processes for both recruitment and the training of staff on an ongoing basis. For smaller MFIs this causes problems. Availability of

local manpower in several remote locations has been poor and the compensation that MFIs are willing to offer for entry level staff has been low. Staff once recruited does not tend to stay on for a long period of time. The intense competition within the sector has ensured that those who pick up some experience of even less than a year tend to be taken away by other MFIs entering the same location. The entry of new institutions in competitive markets bids up the salary level and increases the cost of operation of MFIs pushing the break-even point beyond the originally assumed dates. There is competition for staff from outside the sector too.

The training arrangements available in the sector have not been uniformly good. There are a handful of organisations that offer high quality training at different levels such as MicroSave, Centre for Microfinance-Institute for Financial Management and Research (CMF-IFMR), Bankers Institute of Rural Development (BIRD), Micro Insurance Academy (MIA), Tata-Dhan Academy and EDA Rural Systems. But their capacities are inadequate to cover all needy staff with training. There are several other institutions that offer training to MFI staff but with mixed results. Sanjay Sinha of M-CRIL observed that institutions with poor domain knowledge and experience of microfinance sector have set up training facilities and, because of tied grant arrangements, provided training to staff of MFIs. The staff that gets turned out by such institutions could cause more harm than good to the MFIs in the initial period. Often they have to be retrained and reoriented.

Issue in training staff does not relate only to providing skills. But the available training courses in most cases whether offered by the MFIs themselves or by third-party institutions rarely go beyond skills training. The orientation of staff to work with the poor and in a rural context has to be appropriately set. The need to engage clients in a manner that retains their loyalty and commitment to the MFIs has to be inculcated. MFIs, to be effective in a competitive market, should not only be able to prevent erosion of clientele, but also deepen and widen their services. This is possible only when the human resources of the organisation apply themselves skillfully to the task. Some of the problems that have been noticed in Karnataka, UP, parts of AP and Orissa are attributable to failure of HR. While the skills might be available to an adequate extent, the competence required to do financial intermediation effectively has not been in evidence as seen from the results. The failure to take the external environment into account in the local areas of operations has been a very large factor in the failure of credit discipline. Staff training on these issues apart from mechanical skills of filling application forms, computing repayments and holding meetings should also emphasise quality customer service, ongoing monitoring of the local area and tracking the upturns and downturns in their economic situation from time to time.

As for training courses, there are many options available before the sector, but the widely dispersed MFIs do not have information about the quality of the institutions or the trainers. In the case of training of financial cooperatives BIRD with support of GTZ has undertaken an ambitious project of certification of institutions, courses and trainers. This certification would aim to standardise the institutional processes, course design and the trainer's state of practice. A strong institutional partner (Bankers Institute of Rural Development, Lucknow) sets the benchmark required for certification and on an ongoing basis measures achievement of benchmark by institutions and trainers concerned. A similar dispensation in case of microfinance sector is a dire need. Although variety of institutions offer microfinance-related courses in different parts of the country standardisation of courses and also benchmarking the quality of trainers as well as institutional arrangements is critical. Knowledge organisations such as CMF-IFMR, BIRD and MicroSave could be entrusted with the responsibility of evolving the standards and establishing processes by which the standards could be disseminated and enforced among the different training and academic institutions. This process might be time consuming, but is very necessary in the long-term interest of the sector.

TRANSFORMATION REQUIREMENTS

Transforming MFIs have their own requirement in terms of capacity building and HR development. Apart from improving the knowledge and skill levels of the staff the institutional capacity to reorient itself and become functional in a market savvy manner is a vital requirement. MicroSave as a partner of ABN-Amro[iv] Foundation is carrying out a project that targeted 42 MFIs transforming from being small operations into professional MFIs. The methodology adopted is a combination of coaching, mentoring and handholding. The identified MFI is taken sequentially through goal setting, strategic planning, process mapping, product review and designing, preparation of different manuals on operations, accounts, audit and human resources. As part of strategic planning, the MFIs are made to review the form of organisation, governance structures

and resource plans. MFI staff are trained in relevant courses in classroom as also on the job and off the job during the visit of MicroSave professional staff to the MFI. The interventions are carried out with participation of the staff of MFI so that the changes brought about are owned and applied by the staff. The duration of this process is 18 months. An assessment of the project carried out midway during its implementation found that this had significant beneficial impact on the MFIs covered. The changes that were introduced in governance and in organisational structures as a result of these interventions were found to be beneficial in the case of most of the MFIs covered. Such programmes that hand-hold transforming institutions and start-up institutions for an extended period of time would serve the sector's interest well. Funders especially those providing grants for capacity building would be well advised to look at such integrated long-standing arrangements for improving capacity of institutions.

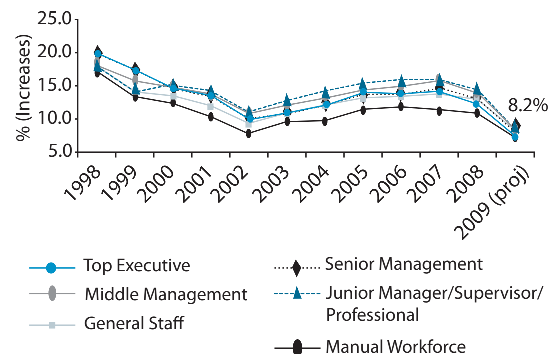
There are concerns relating to how the grant funds allocated for capacity building are applied in the sector. It has been noticed that these grants are tied to specific courses or institutions ignoring the capacity of the training institution to deliver quality programmes in the field. Frequently, wrong kind of staff is sent by the MFIs for such courses. On return the staff are placed in inappropriate positions where the training has been of little use. These grant funds being public contributions should not be misapplied. It has to be ensured that the grants are closely linked to institutional requirement for improving capacity and provided to undertake benchmarked training courses which will actually provide a beneficial outcome.

The other trend relating to training is the thinking in many MFIs that it is a waste of time and the money spent is a cost and hence to be incurred grudgingly. This might be due to the bad experience of senior MFI staff that attended poor quality courses. Relevant and quality courses build skills and improve productivity. The choice of a course, institution and staff are all critical. Post-training utilisation of the staff is also a factor that determines application of learning. In the absence of a strong HR function, MFIs tend to ignore best practices in training and building skill sets of staff. Even in respect of grant-funded courses, MFIs must match the course with the staff that needs it most. Another feature observed especially in smaller MFIs is the tendency on the part of CEO or his deputy to attend all the training courses that are offered to the institution. This takes the CEO away from the institution for significant amount of time and deprives someone else in the organisation that actually needs the training. An annual exercise of preparation of a training plan based on identified gaps in skill sets and identification of which staff needs what course would in most cases avoid the trap of CEO believing that he/she should be trained in any type of course first before others in the organisation get trained. Allocating a budget each year for training would signal to the staff that the organisation values in human resources.

REMUNERATION—IS IT GOOD ENOUGH TO GET THE BEST?

The sector has been facing increasing compensation levels over the last 4 years. The industry except for certain small parts is not well organised in terms of its compensation structure. Even large organisations find it difficult to set remunerations for new staff at middle and senior management levels. Since hierarchical levels and accompanying compensation packages have not stabilised in the sector, it has been difficult to find the balance between employee's expectation and employer's affordability without losing the staff to competition. The incentive systems that have been worked out seem to emphasise certain areas of functioning to the detriment of the overall institutional performance and at times image. A recent survey commissioned by Unitus and carried out with the help of Hewitt Associates fills a critical gap in knowledge relating to salary structures in the sector. It brought out that the economic slowdown in the year 2009 had led to smaller increases in salaries across all levels of staff.

The overall salary increase in fiscal 2008–09 was of the order of 7.2 to 8.8 per cent at different levels of staff compared to a salary increase range of 10.8 to 14.3 per cent in 2008. The survey also found



Reduction in salary increase budgets across all employee levels

Source: Hewitt Salary Increase Survey 2008–09.

Figure 6.1 Salary increases in microfinance sector

that variable pay structures were not much in vogue. The reward strategies had not been framed in most parts of the sector. Salaries were fixed more in relation to inflation and market factors and were really not set in comparison to a formal review of market information. A defined salary structure did not exist and pay ranges across different levels in the hierarchy were not defined. The survey recommended that a compensation strategy should be formulated with the following aspects being part thereof: pay philosophy, salary structure, pay delivery and salary review. It also recommended that a regular review of market data to ensure that the salaries are at par with other institutions in the same field. It also advised that more employee benefits need to be introduced in order to reduce attrition of staff.

Table 6.1 Conclusions drawn from Hewitt Salary Increase Survey 2008–09

Business Trends and Challenges	People Management Implications

• Projected CAGR of 76% over the next decade
• Client base expected to grow to 40 crore from the current 10 crore
• Private equity fund in the sector grew by 242% in 2008-09 - greater exposure to institutional funding requires greater transparency and structural changes
• Adverse effect of the economic meltdown due to greater linkage with the international capital markets - reduced fund flow from banks
• Initiatives by the Government to increase liquidity and reduce foreign exchange rates expected to improve funding situation for MFIs as well
• Evolving organizations - NGOs, NBFCs, co-operative banks all operating in this space, and organizations exploring different forms to help them meet their objectives
	• Ensure steady talent supply to support growth plans
	  • Quantity - greater nos. to drive growth
	  • Quality - change in profile of people hired to meet newer challenges
	• Capability building for existing talent -to ensure they are equipped to drive growth
	• Structures that can sustain large scale organizational growth and changes in the external environment
	• Employee Retention
	• Standardization of Policies and processes
	  • Ensure uniformity of employee experience as organizations grow
	  • Market aware to attract a wider talent pool

On the issue of incentives to staff, there is a need for rethink in many MFIs. The existing incentives have a bias towards customer acquisition and not on quality of service or of portfolio. While targeting growth, sustainability of growth should also be targeted. In the absence of suitable weights to depth of portfolio, quality, customer retention and real repayment performance (as differentiated from group members making up shortfalls), the incentives push MFIs into a higher business orbit, but without support systems. Some of the field problems have in fact been influenced by the incentive structures. This is an aspect deserving serious rethink.

STAFF PROFILE AND SKILL SETS

Management quality and governance are key issues that need attention. While CEOs accept the need for good governance practices, their perception of what constitutes good governance needs clarity. The need to look at governance from other's perception is hardly recognised. Governance workshops or conclaves for CEOs and key board members of MFIs are a dire necessity. CEOs should be sensitised to go beyond appointing independent directors and setting up audit committees, to invest in suitable processes, establish transparency and institute off-channel review mechanisms. The need is to make CEOs and promoters shift from the stance 'what ***we do*** is good enough governance'.

The requirement of skilled personnel in institutions is growing and in a variety of disciplines. Over the last year there have been several instances where MFIs recruited second line of management to positions such as Chief Finance Officer (CFO), Chief Information Officer (CIO) and Chief Operations Officer (COO). The keyman risk which was highlighted in the last year's report has become less pronounced. The expansion of institutions has necessitated recruitment of more staff at senior level. A welcome development is the willingness of professionals from mainstream institutions to join MFIs. There is a greater willingness on the part of professionals to join MFIs at reduced remuneration. The thrill of joining a nascent movement in its expansion phase and the satisfaction of working in socially relevant

segment of business explains[6] the voluntary lowering of remuneration expectations. But with passage of time, the professionals would demand market parity for which MFIs should be prepared. One practice area that still remains neglected is insurance. While most MFIs tend to distribute insurance product of one or more types among their clients, the arrangement required for post-sales servicing of client has not been of high quality. The claims rejected are large in number. The resultant loss of credibility in insurance leads to client dropout and loss of risk cover for the client. Trained personnel who could look at insurance marketing and servicing as a profitable line within MFIs need to be recruited. They should ensure that the insurance product becomes viable to the customers rather than only boosting revenues of the MFIs.

With increasing focus on deepening on the back of the large client growth experienced by many MFIs, the finance function has become more complex and demanding. The new products and multiple funding institutions warrant strengthening of financial management function. Large MFIs have been able to bring qualified professionals from other sectors and industry; the medium and small MFIs do not have the same attraction for professionals to join in. The industry needs to find finance mangers to raise resources and manage assets and liabilities as also liquidity. Providing custom designed training courses for existing finance managers of smaller organisations is a practical way of building up competency levels.

The technology function in MFIs also requires professional support. The competence required to take decision on appropriate IT solutions, implementation of the same and troubleshoot in case of technical problems is not available in house in many MFIs. While a few institutions have professionals in place in others this is a function of common sense of one of the senior managers. But investments in technology should no more depend on common sense alone; it should take in technical expertise.

A question that has come sharply into focus especially in the wake of recent developments in Kolar is the ratio of women staff to men in the MFIs. With MFIs financing 93 per cent women while in the staff men dominate. Women clients would be at ease with women staff and might find it much easier to relate. The problems associated with men staff engaging in forcible recoveries probably would be much less pronounced if women were to carry out these tasks. The gender sensitivity shown in selection of clientele also should be reflected in selection of staff. Such a gender sensitive policy in staffing would stand the MFIs in good stead especially in geographies and communities which remain secluded and where it is culturally not acceptable for women to transact with men.

KNOWLEDGE ORGANISATIONS

There are knowledge organisations[7] which function in the sector that contribute to capacity building of human resources and institutions. Some of the more prominent ones are Centre for Micro Finance-IFMR, Indian School of Microfinance for Women, College of Agricultural Banking, Bankers Institute of Rural Development, MicroSave[8], Intellecap, Tata-Dhan Academy and Centre for Micro Finance, Jaipur. These organisations provide training courses that addressed CEOs and senior officials of MFIs. Some of them also provide specialised courses for staff of MFIs as well as entry level courses for field officers. But these being very small in number, would not be able to cater to the overall requirement of the sector. Meaningful linkages with local training institutions should be established by these large institutions and ensure quality programme are delivered at each location so that the HR requirement of the sector are met. As described earlier, the standardisation and certification processes can be used to ensure that quality is maintained across all institutions and MFIs. The field staff are the most scarce resource. The possibility of utilising the National Skill Development Mission to turn out skilled credit officers for both the SHG and joint liability group (JLG) lending streams should be explored by some of the large training institutions and Sa-Dhan.

INNOVATIONS FROM THE FIELD

Kshetriya Grameen Financial Services (KGFS)—CEOs selection and training

IFMR Trust selected CEOs for the different units of KGFS for a full-time residential management education programme for officers from the three wings of the Indian armed forces, offered by the Indian Institute of Management, Ahmedabad (IIM-A) and Symbiosis, Pune, in collaboration with the Directorate-General of Resettlement, Ministry of Defence (DGR-MoD). The programme aims at providing training to officers of the Indian armed forces, whether in short commission or regular commission, so that they can meet corporate needs after retirement. The first lot of KGFS CEOs are from this background. After appointment, they were trained in at IIM-A, followed by an induction programme at IFMR Trust. MicroSave India later provided inputs on

products, sales, marketing and HR. As part of the induction programme CEOs lived with a rural family in order to better understand local nuances and customs, typical spending habits, etc.

COOs of KGFS undergo an induction programme on microfinance, followed by a round of training on external communications. IFMR Trust is using inputs from various resource organisations, such as IFMR's Centre for Micro Finance, to design programmes for other KGFS-related needs.

LOAN AND REWARD FOR COMPETENCE DEVELOPMENT

In order to encourage staff to attain personal formal certification in microfinance, Hand in Hand, Tamil Nadu has introduced a scheme that provides part of the cost, part loan and a reward on successful certification. The staff members are supported to take up the diploma course in microfinance offered by Indian Institute of Banking and finance, Mumbai. The MFI provides 27 to 55 per cent of the course fee of Rs 5,500 and the balance as loan to the staff member depending on the level in the hierarchy. (Senior management staff do not get any subsidy from the MFI and the junior most staff get the highest level of subsidy of 55 per cent.) On passing the diploma examination a reward of 27 to 45 per cent of course fee is offered. The loan is recovered in instalments from the staff members. For the staff in the entry level, the course comes free when they pass the examination—the share of fee paid by the MFI in the beginning and the reward at the end equals the course fee.

TRAINING THE BRANCH MANAGERS—THE UNITUS WAY

Technical skills courses on how to do the job of lending and recovery hve been available for branch managers of MFIs. Branch managers handle a variety of roles and people. These roles require soft skills realting to dealing with people at large and leading the staff of the branch. Unitus identified this gap and designed a course which is delivered in partnership with NIS Sparta after pilot testing the same. Presently this course is available for partners of Unitus.

Unltui Daksh

- Professional training program for microfinance branch managers offered by Unitus and NIS Sparta
- Program launched in June 2009.
- Designed and piloted in a collaborative effort between Unitus, its mlcrofinancc institution partners, and NIS Sparta, over the course of 2008 and 111 of 2009
- Currently being provided to 7 microflnancc Institutions with Interest with several players across the industry

Structure

- Consists of 3 levels of instructor led courses
- Duration of the program - 8 days

Objectives

- Objective Is to provide management training, targeted to enhance specific skill sets of managers.
- The training encompasses:
  - Managerial and Interpersonal communication
  - Teamwork
  - Performance coaching

One might conclude by saying that the sector, in the midst of its pursuit of growth and expansion, should not forget the people who are helping it grow and prosper. Many MFIs would benefit by setting up a separate HR function that takes care of recruitment, compensation, career planning and training. In the absence of this the HR policies would tend to be ad hoc resulting in higher levels of attrition. A compensation policy, an annual training plan, commitment of a training budget and a periodic look at the competencies that would be required for an expanding business are necessities for MFIs to remain competitive in the market. Contrary to popular perception, good governance is also a subject of training and reflection; the CEOs and boards should invest adequate time on getting it right.

NOTES

1. This is an annual survey carried out by Centre for the Study of Financial Innovation (CFSI), UK.
2. Regulagadda, Ramakrishna. 2009. An Overview of MFOs in India, GTZ-NABARD.
3. Effective Microfinance Sevices—Side by Side Report 2008, Sa-Dhan.
4. As projected in Compensation Forum Study of Microfinance Institutions by Unitus and Hewitt Associates, 2009, specially made available by Unitus for the purpose of this report.
5. SKS was profiled in last year's report for its recruitment and induction system.
6. Altruism Reloaded: Seeking Work with Impact by Sarika Bansal is an interesting read—*Microfinance Insights*, May/June, 2009.
7. Appendix Table A.5 at the end of the report contains a list of service organisations in the sector.
8. MicroSave's Applied Microfinance Institute course is a highly regarded one.

Micro-insurance in a macro market

7

Chapter

The subject of insurance for microfinance clients was discussed in the last year's report with particular reference to the huge market potential and the lack of suitable products for the customers. The current developments in the insurance sector point to more organisations and insurance companies getting interested in expanding insurance services for the poor. Insurance Regulatory and Development Authority (IRDA) has a clear view on the subject of what is micro-insurance, who can provide the same and what type of intermediary could be engaged for the purpose. Micro-insurance as now defined results in limited coverage of risks of those who are poor and also disadvantaged. The limits that have been envisaged[1] do not seem to be high enough to provide adequate cover (Rs 30,000 in the case of life, asset and health insurance and Rs 50,000 in case of death due to accident) even to poor segments of the population.

The insurance density and insurance penetration ratios are furnished in the Tables 7.1 and 7.2. In the case of India, the insurance density increased from 38 to 46 with life risks enjoying a higher density than non-life risk. While the density is low, asset and health insurance that form part of non-life insurance do not seem to be priorities. In the sample of developing countries non-life density has been more than 50 per cent of life density. In Brazil, non-life insurance density is more than life insurance density. The frequent disruption of livelihoods and the distress of people following calamities are directly related to this low risk cover in the non-life part. The increase in insurance density in India has been lower at 21 per cent than that of China (30 per cent) and Brazil (25 per cent).

In the case of insurance penetration quite a few countries have reported a reduced penetration level in 2007 compared to the previous year while the world average has remained constant. The insurance penetration ratio in India declined from 4.8 in 2006–07 to 4.7 in 2007–08. The reasons for this decline are as yet not known and not commented upon in IRDA Annual Report[4].

Table 7.1[2] **Insurance density**[3]**—comparison across select countries**

Country	Life	Non-life	Insurance density (2007)	Insurance density (2006)
S. Africa	719	159	878	855
China	44	25	69	53
Brazil	95	107	202	161
Thailand	70	59	129	110
India	40	6	46	38
UK	5,730	1,383	7,113	6,466
USA	1,922	2,164	4,086	3,923
Switzerland	3,159	2,581	5,740	5,519
World	358	249	607	554

Table 7.2 **Insurance penetration**[5]**—comparison across select countries**

Country	Life	Non-life	Insurance penetration (2007)	Insurance penetration (2006)
S. Africa	12.5	2.8	15.3	16
China	1.8	1.1	2.9	2.7
Brazil	1.4	1.6	3	2.8
Thailand	1.8	1.5	3.3	3.5
India	4	0.7	4.7	4.8
UK	12.6	3.1	15.7	16.5
USA	4.2	4.7	8.9	8.8
Switzerland	5.7	4.6	10.3	11
World	4.4	3.1	7.5	7.5

The IRDA continued to supervise and monitor compliance with the social and rural sector obligations relating to issuance of policies. In the case of rural life insurance all the insurance companies in both public and private sector had met the requirement. Life Insurance Corporation (LIC) had underwritten more policies than what was set out in the guidelines. In the case of social sector life policies again all insurance companies had met the targets prescribed by IRDA. In the case of rural non-life policies two private sector insurance companies and one public sector company did not write the required number of policies. In the case of social non-life insurance one private sector and two public sector insurance companies could not meet the targets prescribed. IRDA's report does not contain details of how the non-compliance would be dealt with.

The progress in micro-insurance has been significant during the year 2007–08. In case of life insurance more than 13 million lives had been covered. A lions share of policies issued were by the LIC of India. The total premium collected for issuance of micro life policies amounted to more than Rs 2.2 billion. Under the guidelines issued by IRDA dedicated micro-insurance agents have been hired by the insurance companies. In the country, 4,584 micro-insurance agents are operating of which 4,166 has been hired by the LIC of India.

Table 7.3 Micro life insurance[6]

Category of insurer	No. of individual lives covered	Premium receipts (Rs mn)	No. of group lives covered	Premium receipts (Rs mn)
Public sector (LIC)	8,64,615	162.1	1,13,67,126	1,925.6
Private sector	83,153	20.7	8,74,901	87.1
Total	9,47,768	182.8	1,22,42,027	2,012.7

One of the largest insurance coverage efforts has been reported by LIC which has 4.26 million policy holders under its 'Aam Admi Bima Yojana'.[7] The LIC of India being the only public sector organisation in life insurance has performed much better than all the other insurance companies put together. In the case of non-life insurance, mostly health and crop related risks have been covered. Unfortunately there is not much information available as to the number of policies issued and extent of coverage in the non-life area. The information available from some of the larger players who act as distributors of insurance for the companies has been compiled and presented later in this chapter. In terms of increasing interest of insurance companies one could cite the number of new policies that have been filed during the year 2007–08. Nineteen micro-insurance life products are available from 11 different insurance companies from both public and private sector filed with the IRDA.

State Bank of India (SBI) announced recently the launch of a new life policy named SBI Gramin Shakti. This close ended policy carries a premium of Rs 361 per annum which the insured member should pay for 5 years. The policy period is for 5 years and the sum assured of Rs 30,000 is paid to the policy holder's nominees in case of death. If the policy holder survives the policy he/she is refunded 50 per cent of the premium. This is expected to receive wide support from the communities by SBI. Similar products have been custom designed by other insurers also.

NON-LIFE

In the non-life sphere the health insurance products have been the most sought after. Cattle insurance, accident insurance and asset insurance policies are also written though not to the extent of health policies. Crop insurance is in a separate category with Agricultural Insurance Corporation of India being the monopoly provider. Weather index-based insurance is available from a few insurers such as AICI, ICICI Lombard and Iffco Tokyo Marine. Unlike in the case of life segment, information on number of policies written and premium collected is not available. United India Insurance (UIA), a public sector non-life insurer reported that in 2008–09 their premium income from micro-insurance policies was about Rs 850 million, a 28 per cent increase in the 2 year period from 2007. According to UIA 2.4 million poor rural women were covered under accident insurance. The different Government of India sponsored health insurance policies suffer from lack of a committed distribution network. Beyond the scheme announcement and marketing flyers there is no active strategy to inform the potential customers of the different features of the scheme. While Government of India has the national health insurance scheme and the universal health insurance scheme, problems of marketing and distribution of these products continue to hinder their progress.

HEALTH INSURANCE

The National Health Insurance Scheme (RSBY) introduced sometime back has been rolled out in 15 states and 2 Union Territories. So far 5.9 million below poverty line households have been covered

(Annex 7.1 provides state wise details of coverage). Bihar, UP, Kerala and Maharashtra states have found significant numbers enrolling under the scheme. In the other states the launch process is underway. The scheme offers cashless facility for treatment including hospitalisation for a payment of as little as Rs 30. Smart cards are issued as an identification device that would prevent frauds.

In contrast, different organisations working with communities both in rural and urban areas have been able to show significant progress in health coverage. The interventions by NGOs and MFIs fall into two types. One is that of partnering with a main line insurance company and distributing its health insurance products among clientele with or without customisation. The other mode is that of a self-funded scheme wherein the participants mutually insure the risks of each other by pooling their premium payments. The largest self-funded scheme which is supported by co-funding by a state government operates in Karnataka under the name of Yashaswini. The Cooperation Department of Karnataka government started this scheme more than 5 years back. As of March 2009 it covered 3.05 million customers collecting a premium of Rs 276 million. The claims paid out during the year 2008–09 were of the order of Rs 361 million. The scheme on the self-funding basis by only the insured is not viable. The co-contribution made by the Government of Karnataka to the tune of Rs 250 million has ensured that it remains viable. The significant point is that Yashaswini is linked to a network of 135 hospitals and provides average of up to Rs 2,00,000 with a sub-limit of Rs 1,00,000 for surgery. The premium is low at Rs 140 per annum with a 15 per cent discount if a family of five enrolled entirely under the scheme.

Another significant initiative in health sphere is the 4 years old PREM operating in Orissa. For the premium of Rs 30 per person it offers cover up to Rs 5,000 per annum towards hospitalisation expenses and 50 per cent of cost of medicines. The scheme in order to avoid moral hazard and adverse selection requires that a family should entirely cover itself under the scheme. Uplift India based in western Maharashtra has a mutual insurance scheme entirely funded by the participants. For a premium of Rs 10 per person, the scheme provides cover up to Rs 15,000 per year. It covers 62,800 people through six NGOs and MFIs as its partners. Uplift India also requires that entire family should be covered by health insurance to avoid adverse selection issues. Dhan Foundation with more than 15,000 members operates a health insurance scheme that is mutual assurance in nature. Hospitalisation benefits of Rs 10,000 per family per annum as also compensation for wage loss is provided at a premium of Rs 250 per family of five or Rs 200 per individual.

Sri Kshetra Dharmasthala Rural Development Project (SKDRDP) operating in Karnataka has an interesting model. It has 1.09 million clients comprising 0.29 million families. It charges a premium of Rs 800 per family for giving a maximum benefit of up to Rs 25,000 towards hospitalisation and medical care. Of the premium collected roughly 60 per cent is passed on to a health insurance company which will arrange for cashless hospitalisation for those who require the same. The remainder of the premium is retained by the MFI to settle those claims rejected by the insurance company. The ceiling limits on such rejected claims are Rs 5,000 or 60 per cent of the bill amount and further coverage of accidental death and permanent disability to the tune of Rs 25,000.

Table 7.4 Health insurance schemes[8]

Name of scheme	Clients (mn)	Premium collected (Rs mn)	Claims paid (Rs mn)	Features
Yashaswini, Karnataka—Mutual	3.05	361	464	Co-funded by Government of Karnataka Tied up with 135 hospitals 0.2 mn ceiling on cover Rs 140 per person per year premium
PREM, Orissa—Mutual	0.15			Premium of Rs 30 per person Entire family to enrol Hospitalisation expense up to Rs 5,000 and 50% of cost of medicine
Uplift, Maharashtra—Mutual	0.062	6	1.1	6 NGO/MFI partnersRs 100 premium per person Entire family to enrol Rs 15,000 maximum cover 100% of hospitalisation expenses in public facilities
Kadamalai Federation, Dhan Foundation, Tamil Nadu—Mutual	0.015			Rs 250 per family or Rs 200 per person premium Hospitalisation expenses up to Rs 10,000 per familyCashless treatment facility Wage loss cmpensation
SKDRDP, Karnataka—partly mutual, some risks with insurance company	1.09	132.6	126.9	Rs 800 premium per familyRs 25,000 cover per family Accidental death cover, Rs 25,000 Disability cover, Rs 25,000

The localised small mutual insurance schemes seem attractive and competently manage risks of the customers. But the risks that are covered are covariant across majority of clients, especially in health. Epidemics could result in high payouts and if the claims are not met, the customers will lose their trust. Last year's report had suggested pooling of resources as well as risks across different locations so that covariant risks of a single location do not force the mutuals to suspend operations.

The most interesting scheme is run by Karuna Trust in the tribal areas of Karnataka. Karuna Trust has been operating primary health centres of the Karnataka government in 26 different locations on an experimental basis with funding from the government. The health insurance scheme of Karuna Trust is run in collaboration with National Insurance Corporation. The Karuna Trust's health insurance cover carries a very small premium of Rs 20 per person with no exclusions as to diseases and medical conditions (it includes HIV/AIDS and pregnancy). The cover is available to the extent of Rs 25,000 per insured person but is subject to the condition that the persons should get treatment carried out in government hospitals. The focus of Karuna Trust is to ensure that the huge public investment made in health care by the state should be made to yield results. Presently the scheme covers more than 15,000 people and eventually it intends to expand the coverage to around 60,000. Out of a total premium of Rs 1.5 million collected last year the insurance company had to pay out claims of Rs 1.2 million. Over the last 3 years the scheme has stabilised. Karuna Trust has been operating as the implementing agency with a significant role in claim processing and recommendations to the insurance company. Underwriting has been simplified by a mere entry in a register maintained on a prescribed format duly signed by the insured customer. No other complicated formats require to be filled up ensuring that the procedure is least time consuming and carries low cost.

LIVESTOCK INSURANCE—USEFUL INNOVATION

KGFS has in collaboration with a mainline insurer, customised a cattle insurance product. Animals are screened before writing the policy and the details of the animal are captured in electronic form. The animal is identified through a RFID tag which contains details of the animal as well the policy. The health record of the animal is continuously updated using a software called the 'HERDMAN'. (Vaccinations and deworming are carried after identifying the animal through the RFID tag which automatically updates the animal-related information in the server.) In case of a claim KGFS will settle the claim and seek reimbursement from the insurance company. KGFS has an indemnity agreement with the insurance company for compensating the company if the claim settlement was done wrongly. With all these systems in place, KGFS was able to negotiate a reduction of about 30 per cent of premium. This product goes beyond insurance by taking care of health management, facilitating quick settlement of claims.

CUSTOMER EXPECTATIONS

Despite the involvement of NGOs, the customers still have bad claims experience. In some schemes the attrition rates are high, but concealed by new client acquisition. The design of schemes takes into account the comfort level of the scheme operator, which is natural. But the levels of income and ability to pay are very different even among the poor. The caps on claim payments and the floor premium levels are not acceptable to the customers. Drawing from a survey of seven locations in Tamil Nadu, Karnataka and Maharashtra, David Dror of Micro Insurance Academy concludes that uniformly capped products are not useful for all in poor communities. The different income levels among poor call for different types and size of products. It was found that the people were willing to pay between 1.12 and 2.64 per cent of their income as health cover premium. Their preference was for private health care and not public facilities.

The scenario relating to risk coverage for rural communities looks promising in terms of the interest shown by several organisations both in the financial sector and in the service sector. However, there are certain fundamental issues that need to be addressed in more concrete terms. The insurance cover available in most cases is compulsory, having been sold by the MFI or NGO acting as the distributor. The customer rarely has made an informed choice of a particular policy or even a type of risk. The insurance is mostly to cover the credit risk of the lending organisation than to mitigate any identified risk of the customer. In a few cases the commission income to the distributor has been a major consideration; not whether the policy is the best suited product for the customer. While there are a few products custom designed for specific needs after considerable study, many products sold in the micro-insurance

market suffer from deficiencies. The staff of MFIs/NGOs do not have full knowledge of the products as also the claim processes. The delay in settlement of claims or refusal thereof alienates the customer. Client dropouts increase costs to the company as well as to the consumer.

From the insurance company's side the cost of distribution and marketing[9] of small insurance policies has been prohibitively high as a proportion to the premium revenue. Making use of a wide variety of trained intermediaries to push down cost is a priority. Selling large volumes and types of policies is also a necessity to cross manage risks through diversification which is possible only through organised marketing efforts. Capacity building of a variety of staff in the distribution network and awareness creation in the people on necessity for insurance of their needs should be carried out. Building a suitable premium structure which is affordable, transparent and designing payment schedules that would accompany cash flow of the insured customer has to be emphasised. The products have to be designed in such a way that the customer gets maximum benefit. Introducing customers to insurance should take place in such a manner that they see it as an essential part of their financial and livelihood management. The products and processes in the small size insurance policies especially in the rural areas should try and adapt to local conditions which could differ from place to place. In the absence of specific customisation the policies may not be popular with the clients and might result in client dropout.

Centre for Micro Finance (CMF) had carried out a study[10] of barriers to household risk management. The study went into product and behavioural issues in risk management. Low participation is typical in the Indian market with 5 to 10 per cent households buying insurance. But the study found that if information is provided to the households, especially through visits by the insurance marketers, the proportion of buying households increases to 20–30 per cent. Additional information creates a need in households to obtain risk cover. The study concludes that insurance is price sensitive as also liquidity sensitive. Lack of funds is the reason given by 64 per cent of those without insurance. Building trust and confidence increases demand for insurance. Higher levels of literacy influence demand for insurance significantly. Endorsement by credible third parties increases probability of insurance purchase by 40 per cent. The findings confirm the assessment in other studies that person-based marketing, raising customer awareness and testimonial based selling have better chances of increasing purchase of insurance products.

TECHNOLOGY IN INSURANCE

There have been cases where service quality issues in terms of delay or denial of claims have alienated large segments of people from specific types of insurance products. Use of information technology (IT) for lowering the cost of operation is not an option but a necessity. On the role of technology, there is an increasing recognition that the cost could be driven down and the speed of the processes could be increased. Smart card-based technology ensures that the client-based information is collected and recorded in a manner that could not be changed at the time of incidence of claims. Products like RFID tags especially in the case of animal insurance would be of great comfort that prevent frauds, rampant in such schemes.

The time lag between actual collection of premium and deposit of the same with insurer is considerable. During this period claims could arise, which would make the settlement very difficult. Mobile technologies do offer a solution to such problems. Through a hand-held printer in the hands of the insurance agent or the field officer, receipt for the premium amount could be issued. The mobile phone through the SIM card could arrange to transfer the data instantly to the server of the insurer. With the availability of date and time stamping features the chances of frauds are reduced considerably under such a model.

The National Health Insurance Scheme mandates that biometric cards should be issued with the thumb print for each person insured. The biometric identification avoids the problems of fraud and moral hazard. In the case of weather insurance, automatic weather stations that measure humidity level and temperature apart from rainfall transmit the same to the data servers in the insurers' premises. These remote monitors reduce measurement problems and take care of fidelity of data transmission. There are more such technologies that are feasible and evolving. Technology solutions have the potential to cut down the underwriting risks and also reduce the cost of both writing policies and settling claims.

An industry level effort at coordinating the different initiatives necessary for pushing the agenda of risk management for the disadvantaged people forward is lacking. While there is a Sa-Dhan that networks microfinance activities of MFIs and collates information from the entire sector there is of no such

network organisation in the micro-insurance sphere. For want of information and also for want of assessment of the impact of different pilots and experiments done all over the country the sector is unable to learn from its performance which takes place in an isolated manner. There is a need to set up an industry level network to collect information from different companies, products and partners and facilitate its sharing. The sector level learning has been valuable in the growth process of the microcredit segment of microfinance. There is every reason to believe it to be true of micro-insurance also.

Six projects have been sanctioned to institutions in India by the Microinsurance Innovation Facility of International Labour Organization (ILO) during the calendar year 2008. The grantees are NGOs, academic research institutions and insurance companies. Some of the projects are for testing out pilots; one is for mapping the micro-insurance scenario and another for studying impact of insurance on poor. Solidarity approaches that involve groups of people have the best chance of not only lowering cost but also mitigating adverse selection as well as moral hazard problems.

REGULATORY ISSUES

The current regulation requires a minimum capital of Rs 100 crores ($25 mn) to establish an insurance company irrespective of the type of product offered. This sets up a high entry barrier. The microcredit market benefited from free entry and it has been able to expand exponentially, covering more than 22 million clients. The smaller institutions could bring in cost-effective distribution and service models that might be difficult for mainstream institutions. IRDA needs to rethink the entry norms and facilitate the entry of niche microinsurers for the benefit of small clients. As for mutual insurance schemes, there has been no specific regulation. Considering some of the numbers that are under mutual schemes, IRDA should examine the best manner of keeping track of such schemes and ensure orderly conduct.

The definition of micro-insurance has to be re-examined. The cap is so low that most micro clients would fall outside the current defintion. A realistic appraisal of risk mitigation needs should form the basis of the definition and it should be subjected to periodic review.

ANNEX 7.1
National Health Insurance Scheme—coverage of households[11]

S. No.	State	Total BPL families	BPL families enrolled till date
1	Andhra Pradesh	—	—
2	Bihar	18,49,442	8,63,630
3	Chandigarh	8,000	5,407
4	Chhattisgarh	5,44,533	73,516
5	Delhi	4,58,600	41,990
6	Goa	6,951	3,505
7	Gujarat	11,27,894	6,79,198
8	Haryana	10,87,501	7,02,672
9	Himachal Pradesh	91,733	80,242
10	Jammu and Kashmir	—	—
11	Jharkhand	10,90,079	3,37,404
12	Karnataka	—	—
13	Kerala	26,72,322	11,42,961
14	Madhya Pradesh	—	—
15	Maharashtra	16,25,259	5,84,375
16	Nagaland	90,400	23,504
17	Orissa	—	—
18	Punjab	3,09,233	1,11,549
19	Rajasthan	—	—
20	Tamil Nadu	2,21,752	1,17,762
21	Uttar Pradesh	24,58,254	8,63,723
22	Uttarakhand	1,04,525	53,940
23	West Bengal	6,30,659	3,08,975
	Total	1,43,77,137	59,94,353

NOTES

1. As defined in the micro-insurance regulations of IRDA.
2. Data source for Tables 7.1 and 7.2: IRDA Annual Report 2007–08.
3. Insurance density is measured as ratio of premium (in US$) to total population.
4. IRDA Annual Report 2007–08 hosted in its website www.irda.org
5. Insurance penetration is measured as ratio (in per cent) of premium (in US$) to GDP (in US$).
6. Based on the annual report of IRDA, 2008.
7. Means 'Common Man's insurance scheme'.
8. Compiled from different Web based sources.
9. According to Mr Tarun Bajaj, joint secretary, Insurance, GOI, the marketing and distribution costs hold the key to mainstreaming of incusrance among the rural clients. He rightly says that efforts both on processes and technology should concentrate on cost control.
10. Shawn Cole, Xavier Gine, Jeremy Tobacman, Petia Topalova, Robert Townsend and James Vickery. 2009. 'Barriers to House Hold Risk Management', Working Paper Series No. 29, CMF.
11. Data source—Government of India website.

Technology in microfinance and inclusion[1]

8
Chapter

Being the technology back office to the world has its advantages. The Indian microfinance sector has access to a surfeit of technology for its different operations ranging from client acquisition to regulatory filings. The range of software available is wide in utility, sophistication and cost. But technology must be easily usable, serve business and be cost effective. Dr K.C. Chakraborty, Deputy Governor, in a recent seminar pointed out that the focus should be to simplify the technology which can operate on any platform. He went on to define the expectations from technology—that the solution to the business needs should be user-friendly without much third-party or IT vendor intervention or support requirement for operating the same.

Managing technology ranks as the sixth highest risk in Asia's top 10 risks[2], though globally it has been pushed down by other pressing concerns from 8th position last year to 15th position in 2009. It is not so much the complexity of the technology alone that is the problem. It is the emergence of new technologies and the fact that a competitor could derive advantage in the market by using the same whereas it might be unaffordable presently that causes anxiety. Many MFIs find it difficult to keep up with the developments in technology given the costs of acquisition and migration. The fear in keeping up with the latest advancements is that of being left behind by others. The IT managers (and the CEOs) have the onerous task of deciding on the right kind of technology solution for their business. The developments in the last 2 years have been rapid—from personal computer (PC)-based accounting and information systems, technology solutions have become mobile with a variety of cards, point of sale and handheld terminals and mobile phones. The first difficult decision is to say 'yes or no' to recent developments in technology, not knowing what might be the strategic implications for business. The decision maker is called upon to choose between technology solutions and affirm that it would not become obsolete before the investment costs are recovered. With many software solutions floating in the market and with apparently similar features but significant cost differentials, MFIs look for more information and also ideas on the kind of questions that should be answered by the vendors before the software is acquired. Outsourcing technical support, including critical business software, is also emerging as a solution—where the businesses trade off the uncertainties involved in making investments against uncertainties of placing critical business processes in the hands of an external service provider.

There are low-technology and no-technology solutions being adopted in the interface with the rural customers. The HDFC Bank found early in its banking correspondent network that the smart cards are not that smart. Card based solutions did not work reliably in the field. The manual overrides that became necessary on account of technical failures of card or the terminal exposed the customer and bank to risks of fraud. This was due to the fact that customer did not know what to expect if the established process does not work. HDFC Bank went to back to basics and issued normal photo identity cards to customers in place of smart cards and reset the transaction processes with adequate authentication safeguards. Sreema Mahila Samity in West Bengal also reported that the smart cards took a long time for getting issued, created problems by cross reporting customer information to an unrelated bank branch and did not work on the terminals supplied. Puduaru KGFS[3] in Thanjavur also found that fingerprint-based biometrics are difffcult to operate on rural fingers. They had to revert (fully or partly) to manual systems. Equitas Microfinance solved

the problem before it occurred by using a stylised sticker[4] that does the job of hand-held devices at a fraction of the cost. Further the time taken for meeting at the centres has been cut down by 10 minutes to 20 minutes only. Collections from the field are reported through SMS by the field officer within 15 minutes of centre meeting; a central server of Equitas receives this information and makes it available over Internet to branch and area managers for tracking of collections. No cards and terminals are used in the transaction between the customer and field officer. There have been reports that biometrics often fail and have to be manually overridden. In quite a few cases the field officers operate the cards on behalf of the customers who are quite willing to press their thumbs and fingers wherever the field officers point. Customer protection in such cases is compromised and poses risk of frauds. Periodic audit of functioning of technology enabled processes in the field should become part of audit and control systems of MFIs.

This year's report does not cover smart card, PoS machines and hand-held devices as these have become commonplace in the sector. Mobile based technologies are effectively being used in some cases which might hold the key for low cost, real-time information capture from the field.

MOBILE TECHNOLOGY

The Payment and Settlement Systems Act, 2007 (the PSS Act, 51 of 2007) and the two regulations, i.e. (1) Board for Regulation and Supervision of Payment and Settlement Systems Regulations 2008 and (2) Payment and Settlement Systems Regulations, 2008 have come into effect from 12 August 2008. This Act is likely to govern introduction and deployment of all technology enabled products in future. The Act

Mobile computing—Atom's way for Sahayata

Sahayata Microfinance, Rajasthan was using a basic transaction recording system for the collection/disbursements, which was unable to cope with the rising volume of business.

Sahayata's Field Officers (FO) are assigned a specific territory for collection/disbursements; they are on move within the territory and as a result transactions put through by them was not recorded on the Sahayata's backend immediately.

Atom's mobile based 'm-collections' solution connected mobiles to the Sahayata's backend via general packet radio service (GPRS) to enable the real time data recording. It was cost effective because it did not require additional hardware. Most FO's were carrying the Java MIDP 2.0 enabled handsets; the only additional requirement was the GPRS connectivity. This application supports both global system for mobile (GSM) and code division multiple access (CDMA) technology which provides the better reach to any of the geographical locations having the mobile connectivity.

FOs login into the mobile application and can navigate and retrieve details through different menu options provided as Disbursements, Collections and Prepayments. On confirmation of disbursement and collection, updated details will be sent by mobile application and same is updated by existing system. The access to the backend through mobile is controlled by unique ID and a PIN number for each of them. The server at the back end controls the information flow to the mobile handsets based on the ID and PIN number of the FO. The FO could ask for details of disbursement to be made and collections to be received in respect of each group.

BENEFITS

Sahayata initially started with the basic transaction recording system wherein FO used to maintain the transaction details register while he is on the move in field, and used to update or feed in the details once he used get the access to the system. It was very unorganised and lacked scalability. Mobile based m-collection solution has benefited Sahayata in the following ways:

- cost effective without major investments in technology,
- scalability,
- ease of use not requiring extensive training of field staff and
- compatibility with the existing system.

This model can be scaled-up in the multiple ways suiting needs of MFIs and small help groups for various collection and disbursement needs.

will regulate prepaid and other cards, payment gateways, money transfers, mobile payments and Automated Teller Machine (ATM) networks. RBI issued the mobile banking guidelines last year[5] under Payment and Settlement Systems Act, 2008. RBI has permitted 29 banks have so far to operate mobile based payments services. Mobile based banking is possible only with a bank in the background. RBI also has notified guidelines[6] on prepaid instruments that permit organisations other than banks to issue such instruments. A recent initiative from RBI was regarding issue of mobile wallet based prepaid instruments for which eligible institutions would be permitted on application.

Mobile based transaction solutions have been tested out in some locations by some banks and MFIs. Atom Technologies, Mumbai has come up with solution that enables recording of transactions in real time using mobile phones.

mChek pilot with Grameen Koota and Unitus

mChek, a mobile payments company, launched a pilot project with Unitus and its partner Grameen Koota, a Karnataka-based MFI. Project goals were to test the benefits of mobile payments for microfinance including

- reduction in operating and cash management costs;
- increased customer and MFI agent security;
- increased speed and convenience and
- increased ability for low-cost expansion for the MFI.

The pilot was successfully launched in December 2008 with one Grameen Koota centre (20 customers) in an urban branch in Bangalore and subsequently scaled up to five. mChek gave mobile phones and prepaid SIM cards to *each* member in the first centre. Members who didn't have their own phone could use the SIM cards with their group leader's phone to perform transactions. Each SIM card is associated with a bank account via the mChek platform. Members make deposits and withdrawals into their mChek accounts through their group leader (the group leaders are given a small loan by Grameen Koota to help them with liquidity). Group leaders, in turn, make deposits and withdrawals at the bank branch. They earn a commission for each deposit and withdrawal performed through them. For the present, Grameen Koota is settling the transactions until the team gets a bank on board. Members using mobile phones do *all* transactions (disbursements, repayments, loan processing fees, fines, etc.) with Grameen Koota.

Members benefit as they have a safe and secure place to save, i.e. their bank account, which they can access locally and conveniently. Group leaders benefit from the additional income through commissions. The bank/MFI benefits as it is able to acquire and service these customers quickly without their thronging the bank branch.

The learning by mCheck and Grameen Koota

- **Reduction in operating and cash management costs:** Based on the current pilot, Grameen Koota estimates that just removing cash from the system will reduce group meeting times by around 40 per cent. The primary Kendra Manager for the pilot reports that meetings which normally take 30 minutes only take 15–20 minutes with mChek. In addition, branch operating costs will go down by around one full-time employee and the branch will no longer need a cash-counting machine and vault. Finally, branch cash insurance costs would go down. These assumptions will be more fully tested once the pilot scales up to the entire branch.
- **Increased customer and MFI agent security:** As customers get comfortable with the mChek system, they find it more secure than cash. They realise that they can save and pay securely using mChek and don't have the risks associated with handling cash. Similarly, the loan officer in the pilot is happy using mChek as he doesn't have to carry large amounts of cash.
- **Increased speed and convenience:** As mentioned earlier, even without modifying the current processes, group meetings are shorter as cash dealings are avoided. In addition, group members can access their money anytime through their group leader.
- **Increased ability for low-cost expansion for the MFI:** This has not been tested thus far as Grameen Koota's processes for customer acquisition have not been modified.

The biggest success of the pilot has been in proving that mobile payments can be successfully integrated into an Indian MFI's operations and providing a model for scaling up.

As stated earlier Equitas relies on mobile SMS solutions for capturing information in collections (as in the case of Sahayata). The collected information is procssed through a server to provide

real-time information to senior officials for tracking of recoveries.

Mpesa

The Kenyan Mpesa has been a widely quoted model in mobile banking. This model offers a money transfer product which also enables customers to store value on the mobile up to a maximum of Kenyan shillings 50,000. Fees are payable for transfer of funds and withdrawal, but not on deposit. No interest is paid on money stored in the mobile. It operates through agents of mobile company who normally sell airtime, handsets and other products of the mobile service operator. There were 4 million customers by June 2008. Since the scheme is operated by Safaricom, a telephony operator, the Central Bank of Kenya required it to place the customers' stored funds in a trust account which was of the order of Kenyan shillings 36.1 million in 2007. There is no deposit protection on the funds stored on the mobile. But Safaricom is a joint venture between Vodafone (40 per cent share) and Government of Kenya (35 per cent share); hence there is an implied guarantee perceived by users of the system. Transfer of funds attracts charges at two ends—one at the remittance end and other when the receiver withdraws the money. On small value remittances the cost could be high as a proportion.

SOFTWARE SOLUTIONS REVIEW

IFMR–Centre for Micro Finance, Chennai recently reviewed some of the software and management information system (MIS) systems specifically for the purpose of this year's report[7]. The study attempts to identify key features that a MIS needs to have and examines how the selected MIS systems stack up against them.

Indian MFIs have traditionally emerged from NGOs and other social organisations that mostly had minimalist technology systems. The increased competition and growth of the sector has led most of the MFIs to consider technology a key source of gaining competitive advantage. In a marked departure from the past, MFIs increasingly view technology as an investment rather than an expense. The new-age MFIs that have been set up in the recent past have built their systems and processes with a technology backbone right from day one and, hence, have spent lesser time in getting their staff and systems up-to-speed with the MIS systems. But, most MFIs in the medium and small range suffer from the lack of information on the nature, type and features of MIS systems.

WHAT TO LOOK FOR IN A MIS SYSTEM

The essential features of the process of installing and using a MIS successfully for a MFI:

What to look for in the software solution:

- Alignment with business model: It is important that the MIS possesses features that are aligned with the MFI's operational model such as JLG, SHG or individual lending.
- Space and scope to add products: Indian MFIs are set up with the objective of being an inclusive financial services provider. In cases where they work with a mandate to offer savings, insurance and other financial products, it is essential that the MIS system is able to support these products apart from the core micro-credit features.
- Integration: In cases where MFIs have legacy accounting or HRMS systems, MIS systems are required to integrate with these pre-existing systems. Accounting integration, especially, is critical.
- Reporting: The most crucial element of a MIS from the manager's perspective, regular and accurate reports of operational and financial parameters serve to inform and advise usefully. It is essential that MFIs understand that all of their reporting needs are met by the MIS with suitable leverage to customise reports rather than having to rely only on preset reports in-built within the MIS.
- Usability: Usability includes features that enable the end-user of the application to quickly migrate to using the MIS for his or her daily operational requirements. This typically would start with the initial data-migration processes, familiarisation with the system and finally, a hands-on training feature that ensures the user is comfortable with the MIS.
- Security: An expectation from MIS systems is to provide a level of security and integrity to the existing processes of the MFI. For example, cash reconciliation at field locations with the accounting entries is a crucial check-off point for MFIs. Additionally, a MIS system also needs to ensure security of data while transit, audit trails of changes effected and authentication of members during transactions
- Upgradability: Whether the software could be upgraded in tune with changes in hardware design and computing technologies is a critical aspect. At times custom built software had to be discarded by MFIs as they would not work in a new hardware environment or in new operating systems.

What to look for in the vendor:

- Ability to offer customer support: A crucial component of a MIS offering is the nature and degree of support offered by the vendor to ensure that the MIS is up and running at all points once the installation is complete. Features that form a part of this requirement include the duration of support, committed response times to problems and a procedure to log bugs located within the system.
- Past record: A non-functional requirement is to examine the vendor's past record in implementation in other MFIs with similar working models. It is useful to check how the MIS has fared in MFIs with huge customer databases, vernacular languages, remote field operations etc. as is relevant to the MFI.

What else to consider:

- Cost structure: MIS systems are designed to speed existing systems and processes, reduce errors and improve productivity. They entail substantial investment for the MFI that often involves a long-term cost structure in line with the MFI's growth and subsequent needs. A MFI carefully needs to understand the cost and the structure of such costs of deploying a MIS system.
- Likelihood of obsolescence: Whether at the time of purchasing a software solution, it is at the edge of development or it is on a platform or frame that is likely to be shortly phased out is a question to be asked. In case of obsolescence, how could one protect the investment should be thought of.
- Process consulting: One of the tough challenges that vendors often cite, is the lack of readiness by the MFI to deploy the system in terms of data, process and system migration during installation. On the other hand, MFIs express dissatisfaction on the level of understanding and involvement by the vendor, often leading to sub-optimal installations. It is crucial that both the MFI and the vendor understand that an investment in a MIS system involves a consultative approach to be taken that ensures mapping of existing processes, management of change and acclimatisation of MFI staff to the new system. A MIS vendor stands to benefit by such a process due to the expertise gained in understanding the needs of a MFI better.

A comparison of some aspects of select software solutions in respect of which information was made available is presented in Table 8.1. As can be seen from the review, there is enough differentiation among just eight vendors based on the markets they serve. Each solution is influenced to a large extent by the expertise acquired by the vendor through previous installations. It is observed that most vendors now have sufficient understanding of the business models of MFIs and a fair level of standardisation in such solutions can be observed (six out of the eight surveyed support all the three major types of lending—individual, SHG and JLG). There is also uniformity in accounting systems and pricing models (thought not in the prices themselves). But, there are significant differences in the kind of support and training offered. Some of the vendors are more conscious of the different levels and types of training that needs to be provided to ensure acceptance by the MFI. Though the advent of connectivity means that almost any location can find some level of Internet connectivity, there are a lot of rural MFIs that work in areas of zero connectivity. Vendors need to ensure that the solution can work with limited or no connectivity as well.

Installations at times indicate the popularity of the software. Some of the popular software in use in the sector and the number of installations of each of these is presented in Table 8.2. Information on size of MFIs and the processes for which the solutions have been installed has not been reported.

TRENDS

Last year *Microfinance Insights* published[11] the results of an international survey on technology in microfinance that polled 243 MFIs in 65 countries. The survey in many ways is a goldmine of information to information and communication technology (ICT) solutions providers. Forty-six per cent of MFIs were not satisfied with the technology in use. Seventy-one per cent of surveyed MFIs did not have a separate IT department and yet 62 per cent of MFIs had computerised all their branches. High cost of implementation and staff training was rated by the maximum number of MFIs as a key challenge followed by low connectivity of networks and lack of institutional capacity to absorb change. Ninety-three per cent MFIs spent up to 25 per cent of annual revenue on technology solutions. Customers felt finding adaption to new technology to be more difficult than the staff of MFIs. Fifty-five per cent MFIs felt that MIS was a critical factor in lowering operating costs and improving reporting. About the future, 77 per cent MFIs desired to offer branchless banking services.

Classification of vendors

As the sector evolves, the vendors can be broadly classified into two categories—first, independent solution providers (ISPs), usually start-ups or small

Table 8.1 Software solutions[8]—a comparison

	Atyati	Evolvus	FINO	Grameen Foundation	Infrasoft	Jayam Solutions	Snowwood
Product	GANASEVA	MicroBeans	Flexicube + SARAL	MIFOS	OMNI-Enterprise	FIMO	MFASYS
Base location	Bangalore	Bangalore	Mumbai	Seattle, Washington USA	Mumbai	Hyderabad	Chennai
First installed	2008	2008	2007	2006	2009	2004	2007
Installations till date	7	9	20	16	2	26	4
Base system	Independent	core-banking solution (CBS)	Independent	Independent	CBS	Independent	Independent
Initial training (in days)	7	3	5	3	11	7	7
Connectivity	Online	Online	Online and offline	Online	Online and offline	Online and offline	Online and offline
Remarks	Focused IT solution provider in the rural space with an evolving product in the MF space	Small-size IT firm with presence in the banking space and a new MFI product	Medium-size IT solution provider in the rural space, customised CBS for MFIs	Open-source solution for MFIs, ideally suited for MFIs with a strong technical expertise and a flexible model	Medium-size IT firm with a CBS solution for banks and a tailored solution for MFIs	Small-size IT firm with a long presence in the MFI market, ideally suited for small, growing MFIs	Small-size IT firm with significant play in the mobile technology space
General recommendations on suitability	MFIs with diverse interests in financial inclusion and other rural payments	MFIs with reliable connectivity features and working with standard micro-credit models	Older and bigger MFIs with evolved products interested in introducing new technologies such as smart cards	MFIs with strong IT expertise to manage open-source flexible systems that can change with business objectives	Growing and big MFIs with capacity to invest time and resources in a complex system	Small and growing MFIs with unique needs that can be met by tailor-made installation	Small and medium MFIs interested in exploring integration with mobile technologies

organisations that have developed solutions for MFIs from scratch and second, established players (EPs) that have traditionally focused on banks and other big financial institutions, who now attracted by the size and prospect of the microfinance sector

Table 8.2 Installations by vendors

Name of vendor[9]	No. of installations	Name of vendor[10]	No. of installations
Atyati	7	Basix Satguru	19
Evolvus	9	Cranes	8
FINO	20	Elister	7
Grameen – MIFOS	16	Force Ten	6
Jayam	26	Others	14
Snowwood	4		

have customised their core-banking solution (CBS) to meet MFI requirements. It is important to note this trend because of the trade-offs between the two. Most IT managers from MFIs concur that ISPs are generally willing to customise for each MFI, provide robust support and are quick to install and deploy. On the other hand, there is some uncertainty about the capabilities of the solution and vendor as the MFI expands across size, geography and product range. ISPs are either unable to upgrade their offering to meet these requirements and/or are forced to offer sub-optimal support and maintenance.

Most growing MFIs face this trade-off during some point in their growth path. The decision to change from one system to another, especially from a solution offered by ISPs to a more complex system of the EPs, is a difficult decision. It needs to be carefully aligned with the MFI's objectives and business strategies. A typical transition and installation period for

a CBS-like solution is 1 year. If the decision is taken too late, the business objectives suffer since the existing system might be unable to cope with the scale and the transition process can be hurried, at the cost of a problem-free migration. If the decision is taken too early, the MFI might be committing to a huge investment and amortising the cost too soon without realising the potential benefits.

Emerging technologies

There is considerable interest in various aspects of technology that appear exciting. Mobile devices, smart-card solutions, score-cards and analytics are some examples of such innovations that promise value addition. But none of these innovations have yet revolutionised the working of MFIs as was hoped. Majority of MFIs are operating at a stage that requires a simple, reliable and convenient solution that can immediately help improve their processes rather than technologies that are at the cutting edge. A couple of interesting installations/pilots have been featured earlier in the chapter.

Consultative approaches

A common concern expressed by many of the vendors was the misplaced expectations of MFI managers. MFIs expect a solution that can be installed and taken care of by the vendor with little or no involvement by the MFI staff. Not only is this not feasible, such unrealistic expectations often force vendors to adopt ways to work around the installation that, in the long run, leave the MFI dissatisfied. Pricing happens to be a sore point and at times is the only factor considered if the MFI managers are not clear about the utility of a MIS system; as to what costs it would avoid and how it would improve productivity. On the other hand, it is also unrealistic of vendors to expect their clients to be geared up to adopt a MIS solution. It therefore is important to adopt a consultative process for installing a MIS, as has been mentioned earlier, that involves various stages of discussion, process transitions, training and at least some amount of initial hand-holding.

THE INCLUSION SPHERE

In the context of technology for inclusion there have been several expectations from the fund set up for the purpose. Skoch Foundation in its study recommended that existing technology should be leveraged to make the process of inclusion easier. The core of its recommendations was that technologies should help spread branchless banking so as to unbanked areas in a low cost and high impact mode.

Some of the suggestions made in the Skoch report are worth recording here.

- e-Kiosks in villages could be a source of operating a remittance system. The 1,00,000 common services centres (CSCs) set up under the National e-Governance Plan (NeGP) may be allowed to be part of this network.
- Mobile telephony can provide the last-mile connectivity for financial inclusion in partnerships with banks. The public banks need to be activised to roll out the services and market the same to make it popular. The marketing concepts used by the by telcos are a good example to follow.
- The fastest way to speed up universal financial access is perhaps to piggyback on the mobile operators. There was an opinion that if telcos are directly allowed to handle financial transactions the inclusion objectives would be achieved faster.
- Encourage multi-bank platforms which can communicate with each other to enable a nation-wide affordable remittance system.

The use of Financial Inclusion Technology Fund (FITF) so far has been very limited. The contribution has been of the order of Rs 150 million against the Rs 5 billion announced. The sanctioned projects under FITF[12] are very few and this might be on account of the time taken for finalising the norms and the governance mechanism for operation of the fund.

Sanctioned projects under FITF

- Smart card-based pilot project in Tirunelveli district of Tamil Nadu, covering 500 SHG (6,000 customers) to help Pandyan Grama Bank and NGO in registering, lending and micro-financing SHG.
- Project on smart cards in Medak, Mahbubnagar and Warangal districts of Andhra Pradesh (AP) to facilitate payments to the beneficiaries of National Rural Employment Guarantee Scheme (NREGS) and social security pensioners, opening of 'No Frill Accounts' of other rural households by Andhra Pradesh Grameen Vikas Bank (APGVB). Services are being extended through Business Correspondent Model with the help of a biometric card and mobile device. This will cover 13 lakh beneficiaries in 1,115 villages.
- Pilot project to establish financial inclusion hubs aiming an 'e-branch' facility offering multiple financial products and services in 10 PACS in AP.
- Pilot for installing four ATMs, one in each district of Tripura by the Tripura Gramin Bank for technology upgradation to reach out to the excluded population.
- Impact study of 100 per cent achievement under Financial Inclusion in Kanyakumari district.

Of the four projects that are for technology, one is for mainstreaming and other three are pilots. The fund being large and for enabling use of technology for accelerating inclusion, more funds should flow to projects for mainstreaming of known and effective technologies rather than pilots. While pilots are relevant to explore the potentials, given that inclusion has to be achieved soon, the fund should not become pilot centric. A sense of urgency in use of the funds would help institutions in the field to rapidly scale up their operations and enable achievement of the objectives of the government.

Reserve Bank of India has cautioned that with increasing technology, the risks also increase. IT audit of financial institutions is a critical need according to RBI. Information systems audit, as also a risk management system, should be in place in financial institutions as they deal with several customers whose interests should not be compromised. In conclusion, one should admire the introduction of paperless branches by Equitas. They have set up a back office facility in Chennai which serves as the business process outsourcing (BPO) backbone for the entire organisation. The BPO handles customer verification before acquisition, know your customer (KYC) verfication, capture of customer-related information from the application through an Optical Mark Recognition software, implementation of Froms Tracking System, generation of customer ID, maintenance of loan account, generation of stylised stickers to account for repayments and tracking of collections against dues on a real-time basis. The integration of different elements has been done imaginatively with a view to produce quality outputs that are directly actionable. Each process and the accompanying technology improve productivity and cut costs. Equitas assures that every process and system in place is scalable and will take care of future growth. How did it get technology right? The time invested in finalising what it needed and getting the need fulfilled from vendors are perhaps the key aspects.

NOTES

1. Author is thankful to Shreyas Gopinath of IFMR–Centre for Micro Finance for significant support for this chapter. He had carried out a comparative analysis of some of the commonly used software and provided a useful first draft.
2. Microfinance Banana Skins 2009—Centre for the Study of Financial Innovation, UK.
3. Puduaru Kshetriya Gramin Financial Services, Thanjavur, Tamil Nadu.
4. This sticker and process associated with it are being patented for the intellectual property right (IPR) content.
5. ‘Mobile Banking Transactions in India—Operative Guidelines for Banks’ issued by RBI on 8 October 2008.
6. Guidelines for prepaid payment instruments in India were issued by RBI on 27 April 2009.
7. The review was carried out by Shreyas Gopinath with the support of others in CMF.
8. There were other software solutions providers who did not respond to the request for information due to paucity of time. These are Gradatim, Technical Development solutions, Craft Silicon/Cranes Software and Temenos.
9. Information gathered by Shreyas Gopinath, CMF.
10. As reported in A quick guide to Management Information Systems for MFI-Managers, Sadhan 2008.
11. *Microfinance Insights*, volume 8, September/October 2008. Published by Intellecap.
12. NABARD Annual Report 2008–09.

Financial inclusion

9
Chapter

Even with near total control over the banking sector for more than two decades, financial inclusion of all needy segments of population has not been possible. The recognition that more active interventions are needed to bring marginalised, disadvantaged and poor sections of people to financial services has led the policy establishment to take a variety of actions in the recent past. The estimate of coverage of the population through financial services made by Reserve Bank from different study reports and surveys bring out[1] that 40 per cent of adult population has access to savings account, 10 per cent to life insurance and 0.6 per cent to non-life insurance. 5.2 per cent villages have a bank branch, while 97.7 million small farmers are covered by farm credit. Over 33 million no-frills accounts (NFAs)[2] have been opened ever since this product came into being. In spite of this the exclusion levels among people is estimated to be of the order of 40 per cent. A large proportion of those not included are poor and disadvantaged. A broader definition of financial inclusion looks at providing not only savings services but also credit, insurance and remittances. Insurance penetration has been traditionally low in the country. Remittances still take place through informal channels; in most cases on account of lack of options.

The reasons why inclusion levels are pretty low are fairly clear. Limited network presence of banks in the hinterland is a major reason. Even where the network presence is established a delivery mechanism in the form of staffing and processes employed for customer acquisition/servicing have not been of the desired quality. This again derives from banks not having a clear business model to ensure that the small customers are brought to the portals of the bank with a view to convert them into long-term customers of some significance over time. The technology options that were designed and implemented in the urban areas and for high net worth clients have not reached the rural areas. Low investments in technology and limited availability of technology solutions that can cost-effectively meet the requirement of adding a large number of clients to the banking system have been one of the critical barriers to inclusion.

Through its efforts RBI has ensured that banking system takes up the inclusion agenda seriously. Banks are experimenting with a variety of technologies for the bottom of the pyramid customer. A large number of correspondents have been enrolled and used in extending services. Within a short period of about 2 years, RBI, by showing policy intent and introducing practical ideas, has made the sector vibrant. The setting up of the committee on financial inclusion paved the way for looking at various options. The subsequent policy changes in BC framework, use of technology, introduction of mobile based banking, roll out of a scheme for financial literacy/counselling and the setting up of two financial inclusion funds improved the inclusion sentiment. The expectations of the sector and benefitting people also went up as a result. How to meet the rising expectations within a given time frame and cost effectively is the challenge.

The inclusion story is being marketed by the government and the RBI to the financial sector as the new paradigm of banks' continued relevance. This assumes that overall development and inclusive growth across the country require the financial sector to take much larger view of its customer acquisition potential. It also assumes that technology for such a massive expansion of banking clientele has arrived and is available or likely to be available in the near future. The third and a much larger assumption

made is that poor are eminently bankable and could constitute a viable clientele for the banking system. The issue, however, is that the banking system is hesitant to operate on the basis of this new paradigm. Many, while paying token compliance to the policy pronouncement on the need for inclusion, do not strategise their efforts to ensure that it actually results in improved business prospects. More than any other reason, disconnect between policy, strategy and business objectives has adversely impacted the pace and quality of inclusion.

Through a clutch of measures such as new financial instruments (NFAs, general credit cards, Swarojgar Credit Cards etc.) new regulatory dispensation (such as relaxed KYC) and new support mechanisms (constitution of Financial Inclusion Fund and Financial Inclusion Technology Fund, schemes for financial literacy and credit counselling) RBI sought to accelerate financial inclusion. The RBI also required the state level bankers committee to prioritise certain districts in each state for total financial inclusion. For total financial inclusion, 431 districts were identified, and by March 2009, 204 districts have reported achieving total financial inclusion.

Inclusion efforts today have a savings bias. While savings is a primary service need, credit and insurance are also necessities. Risk management is a domain in which poor and rural have low awareness. Inclusion should be more inclusive in its product and service offerings. A new generation institution (Kshetriya Gramin Financial Services (KGFS) promoted by the Institute for Financial Management and Research (IFMR) Trust) is looking at financial services in its entirety so that its business remains relevant to the local population. (See Annex 9.3 for a description of KGFS and its operations). This is the kind of effort required of all participants in the national task, so as to make a difference to the people and at the same time realise the full business potential.

BRANCHLESS MODELS OPERATED BY BANKS THROUGH CORRESPONDENTS

The banking correspondent and facilitator models were introduced in 2006 by the Reserve Bank on the basis of recommendations of the Khan committee. While banking correspondents are financial service agents that can put through cash transactions on behalf of the bank, the facilitators can provide client identification, acquisition, verification, collection and provision of information, etc. While a correspondent can provide all the services that a facilitator does, a facilitator can provide only non-financial services. But both these types of agents are not authorised to take decisions on KYC norms and credit proposals.

While progress of adoption of banking correspondent/banking facilitator (BC/CF) models was very brisk in the last year, several interesting developments in the banking correspondent model have taken place. Banks have been able to hire a number of banking correspondents in several states. While in some cases, these correspondents are large organisations (NGOs and non-profit companies); in others retired bank officials, small NGOs, MFIs and the like have also been engaged by banks. SBI has several correspondents contracted in different states. State Bank has also engaged India Post as its BC in several states. Many public sector banks and private sector banks have engaged BCs. In the initial stage, the BCs are engaged in urban and semi-urban areas. Only in a few cases, rural areas have been targeted through the BCs. But the banks have strategised expansion in the rural areas once the BC hiring procedures and accompanying technology solutions stabilise.

The regulator's guidelines on using BCs have influenced the growth and processes in use. The bank, as per RBI's instructions, has to carry in its books all transactions that have been put through on its behalf by the BC at the end of each day or next working day[3]. Further the area of operation of the BC should not be further than 15 km from the location of the bank branch in non-metropolitan areas and no further than 5 km[4] from branches in metropolitan areas. RBI requires the banks to be able to supervise the work of the correspondents periodically. Such ongoing monitoring, according to RBI, would be possible only when the correspondents operate within a reasonable distance from the branch. The distance criterion is seen as a customer-protection measure as it is expected to control agent risks, through better and closer monitoring of the correspondents' work. The distance restriction has the unintended consequence of limiting the inclusion potential that a correspondent could achieve through better mobility and high-end technologies. Given that the banks remain responsible for the acts of omission and commission of their agents, the monitoring arrangements are best left to the discretion of banks. Banks would be able to offer compliance with the distance restriction as a sufficient excuse for failure of BCs to provide satisfactory service.

Limits on ticket size per transaction (Rs 10,000) through the BC have also been introduced. These

limits on transactions would evolve and increase/decrease in the light of experience and strength of demand from clients. If the banks utilise the services of correspondents to carry out customer services and put through transactions manually, the end of the day accounting would be time consuming and error prone. Thus, technology has become a critical element of use of BCs by banks. Technology assisted BCs not only ensure back-office accounting and seamless porting of data to banks' servers at the end of the day, they also ensure that customers get a better protected, error free service on par with what they might get from a fully computerised bank branch.

Banking correspondent/facilitator network employs eligible individuals, NGOs, non-profit companies and others. The BCs acquire clients for the banks and enable small transactions to be put through. As explained earlier in most cases the correspondents are supported with technology products and solutions that enable the bank to comply with RBI regulation on keeping the transaction accounts current at the close of business each day. Financial inclusion taking place especially in the remote and poor areas is increasingly powered by high technology.

Banks have taken up several pilots and initiatives to achieve objectives of financial inclusion. State Bank of India, Indian Bank, Union Bank of India, Punjab National Bank, Andhra Bank in the public sector and ICICI Bank, HDFC Bank, Axis Bank in the private sector have taken interesting steps for new customer acquisition. New technologies such as biometric rural ATMs, card-based systems, mobile telephony based banking, physical mobility based banking by staff, Kiosk based models have all been tried out. Technical service providers have launched not-profit companies to facilitate the banks' work. Organisations such as BASIX, Financial Information Network & Operations Ltd (FINO) and Zero Mass Foundation have provided critical services to banks as also to governments. An important part of the inclusion story is the involvement of the state. Governments have been involved in finding the synergies between inclusion and benefits transfer to people without leakages. The Andhra Pradesh (AP) pilot on National Rural Employment Guarantee Scheme (NREGS) payments through smart card based savings accounts has worked reasonably well enough for banks to try and upscale the same. The HDFC Bank's BC model of using NGOs for reaching SHGs has been successful in terms of both outreach and portfolio quality achieved. Its hub and spoke model of mobile bank staff providing services in the rural areas has also been a good learning experience.

INCLUSION EFFORTS—A CRITIQUE

While there are very successful efforts in the field, there are also problems. The picture that one gets from the ground on the quality of efforts is not always rosy. The studies commissioned by RBI[5] in several states on the quality of financial inclusion brings out that neither the inclusion levels were high enough to claim success nor was the effort sustained enough to ensure that the new clients actually used the facilities available. RBI in its instructions to banks notes that 'although the State Level Bankers Committees (SLBCs) have declared several districts as 100% financially included, actual financial inclusion has not been to that extent in all the districts. Further, most of the accounts that have been opened as a part of the financial inclusion drive have remained inoperative due to various reasons'. In Ganjam district, 65 per cent of those desiring to have an account were able to open an account while in Hoogly district of West Bengal (WB) it was 51.2. Srikakulam in AP, Gandhinagar in Gujarat and Rajsamand in Rajasthan have included 70, 71 and 92 per cent of those desirous of inclusion. However, of those who managed to open accounts a significant proportion did not or could not transact on the same. While in Rajsamand 52 per cent had no transactions in their account, in Hoogly 25 per cent of no-frills accounts owners did not visit the bank branch. Srikakulam reported 97 per cent as having no transactions while Gandhinagar reported 33 per cent only as having transactions. In Himachal Pradesh financial inclusion initiatives seem to have had a better outcome with 98 per cent of the sample surveyed having been included and 38 out of 72 blocks achieving 99 per cent inclusion.

A study by CMF-IFMR[6] found that in Cuddalore, Tamil Nadu, a full inclusion district, 25 per cent of households remained excluded after full inclusion was declared. This was about 47 per cent of excluded before the project was taken up. The reason for their exclusion was reported to be unwillingness. The study found that unwillingness of households to open accounts was a function of the banks that surveyed the area. To quote from the report

> [T]he team randomly selected some households within a 1 km distance from the branches to find out the reasons for unwillingness. Everyone agreed that the signature on the survey form was theirs. But

they were not aware that those officials who carried out the survey came for opening a bank account. They said that the surveyors had asked for their ration card and filled details from it without informing that they could open a bank account. They signed the survey forms thinking that the process was for some government scheme that would come in the future. It is therefore premised that the unwillingness was on the part of the bank to open the accounts rather than the other way round.

On usage of the new accounts the study found that 72 per cent of the accounts had zero or near zero balance even after 1 year. Eleven per cent of the accounts had a balance of Rs 200 and at least one transaction during the year. Many dormant account holders did not know the reason for opening of the account; they had assumed that it is for some future government scheme. One of the significant conclusions[7] of the study was that the new accounts with low balances of less than Rs 1,000 can be a viable proposition for the banks.

Recommendations of Cuddalore study

Financial awareness on opening and operating accounts must precede and accompany the inclusion initiative.

A tolerance limit for unwillingness may be fixed as an acceptable criterion for declaring a district as fully financially included.

Best practices of banks and branches that achieved 100 per cent willingness from excluded households should be documented and disseminated.

There should be ongoing cost studies on opening and maintaining accounts to look at breakeven scenarios.

A study of financial inclusion in Gulbarga[8] found that the inclusion drive in the district more than doubled the number of people with bank accounts. But after the drive was completed one-third of the poor were still without bank accounts. On a limited sample of 172 who opened bank accounts, only 64 opened NFAs of which only half were financially excluded. The interesting findings from the study were: only 4 per cent households opened the accounts for saving; 68 per cent opened it to receive NREGS wages. Among the account holders, 84 per cent said that Panchayat officials helped them open accounts. Ninety per cent did not know that banks open NFAs for anyone.

Skoch Foundation found that around 11 per cent of the newly opened accounts under different initiatives (especially in the form of no-frills accounts) actually see transactions. The remainder of the accounts, due to different reasons, does not become active. A point of note here is that opening of the account seems to be the sole criterion on which performance is measured. Once the account is opened, it is deemed that the goals of inclusion have been realised. The fact that the account should be operational and used by the holder to save, borrow and remit money does not seem to matter. Unless the account becomes a fulcrum of economic activity for the holder, the objectives of inclusion would stand unrealised.

The strategy of financial inclusion looks at the banking sector as the only feasible option to connect people with affordable and quality services. Persuading the banking sector to include all those with a requirement is a mammoth task. Even if they are compelled to accept the responsibility for including all people with a financial services requirement it is difficult if not impossible to make them provide effective quality services to included clients. Both network and staff problems would continue to bog the banks. Providing access and ability to transact on the account to the customer is the substance of inclusion. The ability to transact comes from easy access to the branch or the point of sale and willingness of those who are at the branch or point of sale to take the extra step towards meeting the customers' requirements. Looking to the past and the quality of the existing services available from the banking system in general, it is difficult to envisage the staff taking the extra step to make the poor customers comfortable.

INSTITUTIONAL INCLUSION OPTIONS

There are institutions that have a much better distributed network presence in the rural hinterland and are in a position to take financial services to the doorsteps. We refer to the primary cooperative credit societies at the bottom most tier of the cooperative credit structure with more than 90,000 points of presence and the MFIs which have become ubiquitous in many parts of the country (including some which are acknowledged to be difficult and remote). The post office with its 1,20,000 rural branches is another institution having not only the network presence but also staff who are close to the rural population. SHGs are also not reckoned as part of the inclusion accounting, even though they

offer services that are deep in terms of both savings and credit (and mostly insurance too) with nearly 100 per cent clients actually using the accounts. The combined presence of these three types of institutions is at least four times more than the rural branches of the commercial banking system. But the performance of the SHGs, post office, primary agricultural credit societies (PACS) and MFIs is not taken into account for the purpose of financial inclusion. But a comparative analysis of operations of savings in the different types of institutions and banks come out as the least effective. SHGs come out as the best options in making customers save and use their accounts.

The institutional strategy of inclusion needs serious re-examination. The new strategy should focus on those institutions which have the presence and the capability to expand presence in rural areas with low volume business coming infrequently from the clients. Banks are not best option for primary financial intermediation in such locations. It is best left to lower cost institutions which could be incentivised for bringing in the customers to transact on whatever financial framework that is established. On the issue of SHGs' role in inclusion, the national seminar of SHG federations had some interesting observations and suggestions. It felt that SHGs are far better equipped to achieve the objectives of inclusion and that they should be suitably supported. The need for accounting SHGs and their members in the inclusion arithmetic was emphasised. The number of regularly saving members in SHGs at 78 million in March 2009 is too large to be ignored in any reckoning of financial sector's influence.

Post office and financial inclusion[11]

Post office has the largest and strongest network in rural India and offers a solution because of the established network in rural areas, traditional expertise in handling money and banking, reliable cash management expertise and quality accounting procedures. Being a state organisation is a great advantage especially for savers.

Table 9.1 Savings account usage in different institutions[9]

	Bank Accounts	**Post Office Accounts**		**SHG Accounts**	
	Accounts 1yr & less	**All Accounts**	**Accounts 1yr & less**	**All Accounts**	**Accounts 1yr & less**
Average Balance	Rs. 18£	Rs. 234	Rs. 92	Rs. 2438	Rs. 1682
% of respondents making regular deposits	5%	6%	2%	99%	92%
Frequency of deposits (as a % of those making regular deposits)	36% No fixed schedule/weekly	67% Monthly	—	57% monthly 42% weekly	54% weekly 44% monthly
Amount of last deposit	Rs. 474	Rs. 118	Rs. 94	Rs. 50	Rs. 50
% of hh who never made a deposit	57%	71%	56%	0%	0%
Top reason for not making regular deposits	56% Use account only to receive govt, assistance	78% Use account only to receive govt, assistance	64% Use account only to receive govt, assistance	83% make regular deposits in other accounts	100% make regular deposits in other accounts
% of hh who make regular withdrawals	51%	19%	31%	53%	50%
Frequency of withdrawals (as a % of those making regular withdrawals)	55% As and when govt, assistance is deposited	61% As and when govt, assistance is deposited	73% As and when govt, assistance is deposited	86% As required	85% As required
Typical withdrawal	78% Irregular Amounts	83% Irregular Amounts	100% Irregular Amounts	50% Iregular Amounts	42% Irregular Amounts

National Seminar on Financial Inclusion[10]

- Include the excluded: SHGs and SHG federations shall play an important role in identifying the left out poor and include them in the SHGs to access to financial services across various regions and context.
- Usage of existing financial services by SHGs federations: SHGs and SHG federations shall closely work with formal financial institutions to access adequate, timely financial services at affordable cost.
- RBI to consider SHG's account as an individual member's account in the financial inclusion process. This perspective is to be taken into the definition of financial inclusion.
- Financial inclusion services include savings, credit and insurance. Banks shall design specific products according to the various needs and context.
- Financial inclusion does not mean only opening an account; it necessarily means getting credit at affordable rate of interest.
- Schemes and approaches of government are mostly one time and subsidised. Such approaches shall to be modified for long tem and sustainable operation.
- The present approach of the government to waive loans creates a negative impact. For poor instead of loan waiver social investment is needed to come out of poverty. Funds earmarked to be used for capacity building, creation of common infrastructure and interest subsidy.
- Sustaining SHGs and SHG members for generations is a critical need; cross-guarantee mechanisms to be introduced and practiced for sustainability.
- Context-specific products to be evolved at the federation level for effective financial inclusion by the bankers.
- To promote SHGs in far flung areas, adequate incentives to be offered to the promoting NGOs. Network can build the knowledge and capacity of the NGOs for quality enhancement.
- Financial inclusion technology fund to be routed through SHG federations to ensure proper maintenance and monitoring system for ensuring overall quality of SHGs.

There are four significant attempts at financial inclusion in post offices:

- NABARD SHG model in Tamil Nadu
- India Post–SBI tie up
- Goa model with Corporation Bank
- 'India Post - Uttaranchal Gramin Bank' tie up in Uttarakhand

Post office can play a major role in financial inclusion provided there is a good model that creates value for both India Post and the bank. The post office can open up its 0.12 million rural branches to be extension counters of banks, virtually double the number of rural branches of banks.

Some of the prerequisite for the success of post office as a correspondent would be that banks should not treat branch post offices to be competitors. The postal staff should be well trained by the banks. Investments in IT based process management for control and monitoring operations should be made. At a national level strong managerial and technology support of central institutions like RBI, NABARD, Ministry of Rural Development (MORD), MoF and Planning Commission should be provided.

Some possible impediments are that banks may not like post offices in rural areas taking up the role of financial inclusion for it reduces the potential for growth of banks in the long run; severing of bank–customer relationship caused by post office becoming the BC may not be relished by banks and the traditional practices followed by post offices would require a huge effort to reform the management.

RBI and NABARD should take critical decisions on prioritising the choice of post office as a BC by banks and provide support from Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF) to upgrade the staff and systems of post office. At stake is a large network of rural post offices that could partner the banking system with marginal investments.

Financial inclusion technology

The banking correspondent framework that was introduced by RBI has been progressing and the pace seems to have increased in the recent past; it made very slow progress in the initial 2 years. Many technology options have been designed and piloted to ensure that the banking correspondents operate under safe and efficient conditions wherein the back-office accounting is also enabled on an almost real-time basis. However, the technology cost of banking correspondent has not been found

to be easily affordable. A high cost per transaction makes it difficult for adopting technology as a basis to do correspondent banking. Estimates made by the Skoch Foundation put the cost of providing financial access to 110 million household using plastic cards at Rs 13.3 billion. This is on account of not only the cost of issue of cards but also the costs incurred on transactions. The financial inclusion promotion and technology funds have a substantial corpus of Rs 10 billion which should be sufficient to cover this cost if the funds are fully utilised to support technology adoption.

At the micro level the study in Cuddalore referred to earlier computed costs and estimated the breakeven requirements of business.

Costs computed in the Cuddalore study

Cost of opening a no-frills account (Rs)	50.45
Cost per transaction (Rs)	13.40
Breakeven level of deposit balance at four transactions per annum (Rs)	688

These calculations do not include branch and bank overheads.

But in the field quite a few of the card based experiments have failed to deliver on the promises they started with. At times, the institutions have piloted models that are not appropriate in the local context. Biometric cards have faced problems of clean finger prints and failure of biometric features requiring manual override of transactions by the correspondent staff. Such events in the field erode the protection level available to the customer as transactions and cash accounting take place outside of the banking systems. The more important point is the recovery of costs in case of wrong choices made. The costs of technology are also sought to be recovered within a very short period of time. While new branches and new institutions plan for viability over a period of 5 to 7 years, the banking correspondent arrangements are not seen as an investment in expansion of business. Typically breakeven within a year or two is targeted. Some of the initial costs are not seen as long-term investment but as current cost and if not recovered within the year, they are seen to be loss making efforts. The thinking with regard to financial inclusion has to change, as a business with a long-term focus that would breakeven over a period of time.

Funding inclusion

The financial inclusion initiatives especially those carried out through the banking correspondents are not likely to recover cost as long as they attend only to saving services. Even in case they attend to a comprehensive range of requirement of savings, credit, remittances and insurance it might take a while for these operations to recover cost and breakeven. Inclusion being a public policy objective sought to be implemented through commercial establishments such as banks, the policy stance should possibly be that any gap in costs and viability would be reimbursed. There is a price to pay for the policy objective that aims at serving poor and disadvantaged through commercial establishments. One could incentivise these institutions to acquire customers at a much faster pace than has been possible so far. In such a case the requirements for reimbursement of deficits should also state that transactions in the account and regularity of contact would be a critical criteria rather than mere opening of the accounts. There is a need to ensure that financial inclusion does not remain as an exercise where reports generated and happiness sheets are produced. Financial inclusion must result in tangible benefits to the customers in terms of real access to financial services. The emphasis should not merely be on NFAs which are a poor proxy for meaningful inclusion. The emphasis should also be on providing credit to those who deserve the same and an improved coverage of population in various insurance schemes that have been brought out by the government schemes or by insurers. A combination of risk mitigation and regularity of transactions in accounts would lend credibility to the financial inclusion initiatives and make the access to the financial system more meaningful for the clients.

The two funds that has been announced by the government a couple of years back have been operationalised. During the year as against a total corpus of Rs 5 billion that was announced for each of these funds Rs 150 million had been actually released. NABARD has reported that four projects have been sanctioned till March 2009 under the financial inclusion fund. These are mostly focused on financial literacy and credit counselling. One project on information and communication solutions has also been supported. Under financial inclusion technology fund five projects have been sanctioned, which include two smart card pilots, opening of financial inclusion hubs in primary cooperative societies, setting up ATMs in regional rural bank (RRB) branches in the North-East and an impact study. Apart from this, NABARD also reports that it has developed a training model for bankers on financial inclusion as well as a handbook which have been circulated to the key players in the sector. In terms

of these two funds, the announcements had been made but the actual performance and usage of the funds have not lived up to the initial promise. The urgency expressed in achievement of inclusion objective is not fully reflected in the operationalisation of two major funds which were intended to support and facilitate the financial sector's ability to fulfil a national promise.

CLIMATE AND ARCHITECTURE

The flip side of the inclusion initiatives is the hit banks took under loan waiver schemes which seem to have caught the fancy of several state governments as well. With millions of new clients entering the system and availing facilities including that of credit, mass waivers (which have become epidemic) make the banks distinctly uncomfortable. The enthusiasm of the banks to undertake the credit side of financial inclusion would be understandably dampened in a climate of expectation of imminent waiver. If meaningful inclusion has to take place, announcements relating to waivers and postponement of repayment of loans (regardless of who pays for the waivers) should cease. It is unfair to ask banking system to include the poor and the marginalised on one hand and ask them to waive loans given to such sections of people on the other.

The financial inclusion policy should also look at the financial architecture that exists in the country and conceptualise the future architecture needed to take care of the full service requirement of all those who are potential customers. The expectation that the present financial system with its network and human resources would cover a substantially expanded client base which could be a 150 per cent more than the existing numbers in far flung and remote areas is not well founded. The forms of organisation that might be needed to undertake intermediation in several local contexts and the need for new institutions being set up, their linkages with the existing financial sector participants as also issues relating to service standards, service quality and customer protection need to be thought through in an integrated manner. As the client numbers, volume of transactions and amounts involved increase, the present network might show severe signs of strain. Much before this happens, a blue print for smoothening of transaction load and lessening of the strain on the existing players need to be prepared. Acceptance of those players who are not deemed to be part of the mainstream financial sector such as MFIs, primary societies and even post office branches might become necessary. Practical means of bringing these in some ways to the mainstream financial sector have to be designed.

In case of insurance, emergence of more players could improve insurance penetration. Using the same logic as in the case of banking system the report has argued that space for smaller insurance firms should be created—in an earlier chapter. The issue in insurance is also one of product relevance and fit. There are critical issues relating to client drop-out which tends to increase acquisition costs and inclusion more difficult than in case of savings and loans. However the inclusion mandate today does not consider insurance to be a dire requirement compared to bank accounts. But the risks that poor face in their lives and livelihoods warrant greater consideration.

REGULATORY ISSUES

In the last year's report issues relating to banking correspondent and banking facilitator arrangement were dealt with in some detail. The BC framework had been introduced as a mechanism to further the financial inclusion objective. There were certain regulatory issues which were raised. RBI has introduced incremental changes. One of the important changes extends the area of operation of banking correspondent by requiring that the banking correspondent should be placed within a radius of 25 km[12] from the bank branch to which it is attached. This should provide the necessary stability and a viable geographical area coverage for BCs that would facilitate cost recovery.

But the announcement of mobile banking guidelines is a shot in arm for the banking correspondents and banking facilitators' framework. Some pilots are already on to merge mobile technology-based transactions platform with that of the banking correspondents. MFIs also use mobile technology in transaction reporting and collection tracking. In the chapter on technology some of the mobile based pilots had been highlighted. The pilot on mobile banking using correspondents reported in the last year involving EKO Aspire Foundation has gained further ground with a new partner in SBI.

RBI also announced the guidelines on issuance of pre-paid instruments. This again has considerable potential for facilitating faster expansion of financial inclusion. A recent notification that debit card holders could draw cash from merchant establishments that have point of sale machines for honouring debit cards has further opened the door of technology based options for clients in rural areas. If banks are able to enroll merchant establishments

in rural areas and provide them with point of sale machines then rural people would be able to draw money from their account in small sums of Rs 1,000 or less. Eventually this could move towards the direction of the Brazilian model of using small business enterprises such as grocery shop, mobile airtime resellers and lottery ticket vendors to become transaction outlets for banks.

RECENT DEVELOPMENTS

Two high powered working groups of RBI had submitted their reports in the recent past which promise to change inclusion landscape. The committee headed by Mrs Usha Thort, DG, RBI has recommended that the State Level Bankers Committee should take more responsibility for achieving financial inclusion. A sub-committee of the District Level Coordination Committee (DLCC) in district has been entrusted with the task of preparing a road map to provide banking services through a banking outlet at least once a week at every gram panchayat. The committee desires that 'a banking outlet may be made accessible to each village having a population of over 2000, at least once a week on a regular basis. Savings, loan, remittance and insurance products backed by financial education should form a part of achieving deeper financial inclusion'. A clear call for regulatory changes was also made by the committee for review of the extant guidelines on BCs to expand the category of persons who can be made eligible to act as BCs. It recommended that retail outlets like public distribution system (PDS) and fertiliser distributors as BCs may be examined by RBI from the policy, regulatory and consumer protection perspectives. It stressed the need for concerted efforts for using PACS as BCs where such PACS are running well.

The Working Group[13] set up by RBI to review the BC arrangements had submitted its report. The group has taken into account a wide variety of problems and has suggested solutions in line with the expectations of the sector. The need for appointing those with cash handling requirements as BCs has been endorsed and the list of suggested entities as BCs reflects this. Only on the question of including common service centres as BCs (Skoch Foundation's suggestion), the Working Group has resevtions. Credit-only non-banking financial company (NBFC) MFIs would hopefully be able to become BCs and realise their full potential while serving the customers in the savings area as well. The committee has recommended allowing banks (not BCs) to collect reasonable service charges from customers so that they can remunerate the BCs better. But it has fought shy of recommending the removal on cap on interest rates. But this recommendation does answer the cost and remuneration problems.

The suggestions for banks absorbing the initial set up costs of BCs and some hand-holding costs would improve the enthusiasm on the part of new entities to become BCs. It is difficult to envisage banks offering an interest free overdraft. A more transparent mechanism is the increased remuneration and reimbursement of some initial costs which has been suggested. A presumptive 'no objection' for location of BC outside 25 km distance from the branch has been recommended, if the DCC does not decide on an application from a bank for three months. The suggestions on establishing customer protection mechanisms are welcome and timely. The problems of customers at the hands of BCs and technology in use have been documented in Consultative Group to Assist the Poor's (CGAP, India) background paper on customer protection in branchless banking[14]. Banks should be able to access FITF funds for technology investments in BCs once the group's recommendations are accepted. Overall the group has considered the representations made by the sector and has tried to ease the difficulties. The sector awaits RBI's acceptance and operationalisation of both the reports. One of the issues that remain was the subject of discussion in the policy retreat[15] on banking correspondents in CAB, RBI, Pune. Registration and supervision of BCs by an authorised body was felt to be a critical requirement by banks and other practitioners. Some norms as to the entry requirements and financial soundness were seen as necessary. The problem of non-serious players joining as BCs and leaving after a short period has been faced by some banks. Replacement of a BC in the field is a vexatious problem. A registration and supervision body would discourage the non-serious players and those with questionable intentions, besides giving the banks a bogeyman to point to in case of disorderly conduct.

The inclusion agenda is exciting. The regulatory changes in the offing augur well for the sector. If an inclusive institutional choice accompanies the financial inclusion initiative, there are all round gains to be made. By making post office, MFIs, PACS and SHGs/their promoters as strong partners, a large capacity could be added. The field, as seen in the studies, requires that the potential customers' awareness is raised. For this as many partners as are available would be needed for a meaningful interface with the large numbers excluded.

ANNEX 9.1
Details regarding number of BCs appointed and accounts opened by banks

Sr. No.	Banks	No. of BCs appointed	No. of accounts opened
1	Allahabad Bank	Nil	Nil
2	Andhra Bank	3	4,05,000
3	Bank of Baroda	3	33,827
4	Bank of India	10	71,000
5	Bank of Maharashtra	NR	NR
6	Canara Bank	1	1,603
7	Central Bank	1	1,210
8	Corpn Bank	3	4,56,655
9	Dena Bank	1	14,146
10	Indian Bank	2	23,000
11	IOB	3	1,131
12	Oriental Bank of Commerce	3	21,433
13	PNB	14	27,04,345
14	P&S Bank	Nil	Nil
15	SBI	24	25,74,139
16	State Bank of Bikaner and Jaipur	Nil	Nil
17	State Bank of Hyderabad	1	16,057
18	State Bank of Indore	1	61,632
19	State Bank of Mysore	2	2,159
20	State Bank of Patiala	1	1,140
21	State Bank of Saurashtra	Nil	Nil
22	State Bank of Travancore	1	699
23	Syndicate Bank	5	695
24	Union Bank	3	16,54,464
25	United Bank	1	998
26	UCO Bank	1	1,048
27	Vijaya Bank	1	626
	Total	85	80,47,007

ANNEX 9.2
India Post–Uttaranchal Gramin Bank tie-up[16]

Objectives

Uttarakhand Post has entered into a business tie-up with Uttaranchal Gramin Bank with the following twin objectives:

- collection of high-end deposits on behalf of the bank and
- disbursement of bank loans and collection of the repayment instalments (EMI) through Savings Bank Passbook Account and with the help of Gramin Dak Sevak (GDS) staff.

Presently the scheme has been started as a test case in five post offices linked to an equal number of bank branches with a network of about 95 branch post offices.

Main features

For collection of high-end deposits: Customer will be identified by joint marketing of Uttarakhand Gramin Bank and the post office. Customer will be asked to open a savings account in the post office where he or she will deposit the money. Subsequently the customer will be asked to fill up the deposit forms and complete other formalities as required by the bank. The postmaster will send duly completed papers to the designated branch of the bank along with cheque in favour of the manager of that bank, corresponding to the amount of the deposit made by the customer. In case of more than one deposit on any day, the cheque with the list of depositors and papers would be sent. After scrutiny of all papers the bank will open an account for the customer and send the required passbook/fixed deposit receipt to the post office for delivery to the customer. At the end of the term customer will apply for closure of the account in the post office. The paper will be sent to the designated bank from where final sanction of the payment will be sent to the postmaster who will make the payment to the customer through the savings bank account.

For disbursement of loan and collection of repayment: The customer will be identified by the post office. Application for loan and other formalities will be completed from the customer by the post office GDS staff. The post office will confirm the identity of the customer and send the papers to the designated branch of the bank. The bank branch will process the papers and after satisfying itself, the bank will sanction loan and send the cheque of loan sanctioned to the postmaster. The postmaster will open a savings bank account of the customer and deposit the loan amount in that account. The customer can withdraw amount at his or her ease. Monthly repayment EMI will be received by the postmaster by cheque for the savings bank account and further transferred to the designated bank on monthly basis along with required MIS. In case the repayment is stopped, the postmaster will provide the service of soft recovery by inquiring the reasons for non-payment and conveying it to the bank authorities. Account will be closed after last EMI is received.

Advantages of the scheme

For the rural public: Rural public will get banking services that includes high-end deposits, loans and repayment facility right at their doorstep through vast network of around 2,500 rural post office branches in Uttarakhand.

For the bank: The bank will be able to deliver banking services in the rural areas at a relatively much lower establishment cost, thus achieving objective of 'financial inclusion'. Around 6,000 strong GDS force that provides postal services in rural areas will assist the bank in regular recovery of the loans. The bank can improve its business in the rural areas with the credibility of India Post in the rural area.

For India Post: The business prospects of the department will revive. India Post gets an opportunity to be socially relevant especially in the rural area and instrumental in the 'rural financial inclusion'. Post Office SB Scheme as an instrument of transaction between the bank and the customer remains alive.

ANNEX 9.3
A small full-service institution with different concept of inclusion

IFMR Trust Holdings rolled out the concept of a local MFI on a national scale after considerable work on the drawing board. The first of these Puduaru Kshetriya Gramin Financial Services (PKGFS) is just more than a year old, in Thanjavur, Tamil Nadu. Why does this find a mention in this year's report? It is positioned as a full-service institution in the rural space where the exclusions levels are high. By choice the location of branches of each KGFS will be in villages where there are few or no bank branches. The emphasis is on remote areas as it makes business sense for the branch to look at all the households as potential customers in a virgin market.

Ideally each branch will cover 10,000 population or 2,000 households. It will not segregate the customers into poor and non-poor. All those in the area would be potential customers and each customer would be able to access a suitable financial product of which there are 14 today.

The products fall under four categories:

- Loan products: Joint liability group (JLG) loans, loans against mortgaged jewellery (called 'jewel loans' in the Indian banking industry), retailer loans and loans for rural industries like brick kilns, coir units, and rice and dal mills.
- Insurance products: Personal accident insurance, cattle insurance, weather insurance and life insurance.
- Investment products: Savings instruments that provide safety, liquidity and reasonable returns, fixed deposits of public sector finance companies and a gold accumulation plan that helps customers accumulate their savings in the form of jewellery, and pension plan annuities.
- Services: Sale of certified gold coins and remittance services to enable efficient delivery of money sent by migrant members of village households.

Most of these offerings are being made on behalf of mainstream financial institutions regulated by different bodies and laws. Of these 14 products and services, six are already being offered in rural Thanjavur through 15 PKGFS branches. While JLG, jewel and retailer loans are being provided directly by PKGFS, the company is a re-seller for certified gold sold by a reputed public limited company. PKGFS is also an intermediary for a personal accident insurance product offered by a reputed private sector insurance company. Leveraging its approximately 10,000-member-strong customer base, PKGFS has negotiated very attractive premium rates for accident insurance cover of INR 25,000 and above.

IFMR Trust Holdings has developed a savings surrogate through money market mutual fund (MMMF) products. A system has been worked out with benefits comparable to bank savings accounts, by acting as an intermediary for a reputed asset management company (AMC). The cutomer can withdraw investments in MMMF as if it is a savings account—KGFS pays out the cash and takes reimbursement from the AMC after a day. A reverse saving product for buying gold is also available (see Chapter 3 for a description of how this works). The most surprising fact is that the loans to JLGs are without group guarantees and are priced at 16 per cent[17] on declining balance and no other charges. Each financial product carries innovations that make it attractive to the customer.

Three KGFS are in place in diverse environments, Thanjavur in Tamil Nadu, Ganjam in Orissa and Rishikesh in Uttaranchal. There are 28 branches presently—20 in Tamil Nadu, 4 in Orissa and 4 in Uttaranchal. 20,000 customers are acquired who hold 30,000 accounts. 4,000 have invested in MMMF scheme. 9,000 JLGs have availed about Rs 100 million and 9,000 loans against jewellery have been given to the tune of Rs 100 million. By March 2010 the branches would scale up to 100 and further to 300 by the third year. What is the national plan of KGFS? The model is built is a scalable one either as a total financial institution or in modules of each product line. IFMR Trust would very much like some others to see the model and create KGFS in other states on their own. It also provides training to other MFIs on specific products and enable them offer such products to their customers. The trust is also working on a franchisee model in which IFMR trust would provide the initial support and operational experience along with a CEO to any willing investor. The plan is to have 300 KGFS operating in different parts of the country once the first three provide encouraging results.

This model is different on account of its total coverage of people and comprehensive range of products. Its back-office systems and HR practices are markedly different (KGFS do not require English competence in its staff!). Its branch location reverses the logic of remote areas and finds an untapped market, achieving

multiple objectives. There is no compelling hurry to breakeven in the first 3 years. The customer has been at the centre of its design—of products, processes, HR policies and control systems. It does not want a monolith to have an all-India foot print. It would custom build small MFIs in each location, but loosely link them with critical and common services. This is a model worth watching, better emulating.

NOTES

1. 'Pushing Financial Inclusion – Issues, Challenges and the Way Forward', presentation by Dr K.C. Chakrabarty, Deputy Governor at Skoch Summit on 17 July 2009.
2. No-frills accounts are savings bank accounts that are basic—without minimum balance requirements and without cheque drawing facilities—introduced by RBI to reduce barriers for poor in accessing banks.
3. RBI's circular dated 25 January 2006.
4. This was subsequently revised to 25 km.
5. RBI cicular instructions to banks RPCD.CO.MFFI. BC.No. 85/ 12.01.015/ 2008-09 dated 22 January 2009 contains an annex providing details of the findings of different studies.
6. Cost-Benefit and Usage Behaviour Analysis of No Frills Accounts: Study Report on Cuddalore District 2009. This study was jointly carried out by S. Thygarajan of College of Agricultural Banking (CAB), RBI and Jayaram Venkatesan of CMF.
7. More intensive work needs to be done to carry the hypothesis forward and come to some definitive conclusions.
8. Minakshi Ramji. January 2009. 'Financial Inclusion in Gulbarga: Finding Usage in Access', Working Paper- by, CMF-IFMR.
9. Reproduced from Minakshi Ramji. January 2009. 'Financial Inclusion in Gulbarga: Finding Usage in Access', CMF-IFMR.
10. The seminar was of SHG federations, organised by INFOS (a network of SHG federations), Madurai in July 2008.
11. Based on inputs provided by Vivek Kaul, India Post.
12. RBI circular /2008-2009/455 DBOD.No.BL.BC.129 /22.01.009/2008-2009 dated 24 April 2009.
13. The committee was headed by Shri. Vijaya Bhaskar, Chief General Manager (CGM), RBI.
14. The paper is under publication at the time of drafting this report. N. Srinivasan. 2009. 'Customer Protection in Branchless Banking', Background Paper – India, CGAP.
15. The Policy Retreat was a joint event organised by Access Development Services and College of Agricultural Banking, RBI, Pune. A summary of the event is carried in Yeshu Bansal and N. Srinivasan. 2009. 'Business Correspondents and Facilitators: The Story So Far', *CAB Calling*, 33 (April–June)..
16. Based on a write up provided by Vivek Paul of India Post through the UN Solution Exchange—microfinance community—in response to a query on experiences and innovations on microfinance and financial inclusion for the purpose of this report.
17. The interest rate currently is 12 per cent on declining balance. It is proposed to be reset at 16 per cent from 1 October 2009.

Future agenda—dealing with challenges of growth

10
Chapter

As the sector comes of age, the expectations change. So far the sector was seen as a growing infant, trying to make a mark and gather strength. In a year of problems to the other segments of the economy, microfinance has performed creditably without a pause in its growth rates. The formal financial sector in India and abroad has taken a positive view of microfinance as can be seen in the vigorous equity and loan funds flows. Continued expansion is not a challenge anymore. Resources, be it finance, technology or human resources, are available for the asking; and sector is able to command these resources with ease. Expansion with responsibility and inclusive growth along with the customers are the challenges. The sector should address social relevance of its existence and fulfilment of the original mission. While the sector earns the admiration of investors and markets, it should retain the respect of the customers.

The fast paced growth processes have entailed additional costs that are not easily discernible, but which nevertheless impact the MFIs. Improving efficiency and productivity of operations is an area of utmost importance. Even with maturity, MFIs do not seem to be able to effect cost reductions. This is more due to paucity of time to examine the processes with a view to streamlining the same. Internal controls and operational risk management are becoming important given the large foot print and an overstretched chain of command. Managing competition is another aspect that has emerged as a serious concern. In the absence of a code on orderly market behaviour or fair practices in competition, problems of a kind not seen before have emerged. Evolving code of fair practices seems overdue. Staff training, especially on the behavioural aspects of finance and client management is a focus area. Product redesign is overdue to answer the diverse needs of customers. It is difficult to be able to run with only one product and hope to retain the customers forever.

At the sector level containment of political risks has emerged as a key concern. Through voluntary self-restraint and self-regulation enforced through a peer monitoring network, the MFIs can present a united front that is willing to work in the customer's interests. The recent initiatives in creating a special purpose vehicle for setting up a credit bureau are in the right direction. The lenders and investors must look beyond the short term. Institutional sustainability of the investee over a long time is the best guarantee of recovering investments with profits. Short-term profiteering behaviour has to be moderated as it places the institution under great risk of a strategic nature. Business plans with short breakeven periods, pricing formulae that take more out of customers than what they can earn and expansion plans that seek to enter crowded markets are examples where the investors and lenders should exercise caution.

Policy environment is set to change for the better in the financial inclusion domain and branchless banking. The question is whether a better organised banking correspondent network would offer stiff competition to the MFIs. With their financial muscle, banks are in a position to invest in technology and recruit agents to extend their business. But is their heart in small customers and low-margin high-volume business? The next 2 years would determine the architecture of rural and microfinance decisively. Small players in microfinance continue to have a role to play. Community-owned institutions have shown the resilience to withstand competition, liquidity constraints, market failures and even loan waivers. There is a lesson in that for institutional design for sustainability.

In some ways the microfinance that is seen is not recognisable as the one that was there in the initial days. The sector must change with passage of time. While products and processes can change (hopefully for the better), can the concern for the customer change? MFIs justified their entry on the argument that banks do not finance the poorest and are not empathetic to their requirements. Is the MFI sector better able to deal with poor customers today than the banks? Many MFIs started financing the poor but somewhere they lost the customer focus and along with that the mission too. The goals do not any more seem to be making credit access affordable; nor is it accompanying the livelihoods of people. It is no more about improving income generation in the hands of the customers. Book value multiples, price to earning ratios and enterprise valuations dominate the discussion. High interest rates are justified as necessary to find more mainstream funds for further growth.

The initial problems seen in Karnataka, UP and in some other states might be small but strongly indicative of customer resistance to the model of microfinance in practice. These are the initial warnings for the sector, though for some of the smaller institutions it might be the final warning. There have been double bottom line considerations put forth justifying that it is possible to achieve commercial sustainability and at the same time be socially relevant. But the sector in most parts has a convenient definition of social relevance. Reaching out to more people is increasingly seen as being socially responsible behaviour, rather than making a difference to the customer's lives. The increasing profitability of operations do not lead to reduced interest rates for the customers; but fuel greater expansion. The pursuit of expansion as the only goal and high enterprise valuation as the mission can invite heavy-handed regulation and political intervention.

What are the priorities for the MFIs as they scale up to next level?

- Bring social agenda back into microfinance and rediscover the joy of making a customer happy.
- Redefine social performance management as a core concern with a customer focus—not with an institutional focus.
- Take the next large step towards livelihood finance so that customers can also grow with the institution.
- Innovate to move away from the single product basket.
- Invest in self-regulation so that competitive behaviour does not destroy basic disciplines and orderly market conduct.
- Establish customer protection mechanism to avoid their going to external institutions for grievance redressal.
- In short, prioritise customer sustainability even while pursuing commercial sustainability of the organisation.

The sector is thankful for a positive outlook from the central government. The expectations from the government are that it would reinvigorate the SHG linkage programme and seek qualitative returns from it. The fatigue that has set in terms of loan defaults, non-adherence to some of the core principles and indifference on the part of some banks to take on SHG clients have to be dealt with. The government sponsored programme (that would now become National Rural Livelihood Mission) should get a real makeover beyond the name change. It should end being combative against the SHG linakge programme and the MFIs. It should seek to add value to what other players in the market do to improve access to the poor. In fact the government should open up the subsidy programmes for implementation through banks and MFIs alike without any discrimination.

Since the poor are being effectively served, though through commercial organisations, the state should create a positive environment in which the MFIs can operate. The centre should take steps to counsel the states on the role and space given by the centre and RBI to MFIs and highlight the legitimacy of their operations. Vexatious state action should be discouraged. Use of moneylenders' legislation and Usury Acts against MFIs do not serve the poor. It should be realised that if formal institutions are shackled by the state, the informal credit markets gain space to work at their vicious best.

Regulation of microfinance should be on a more rational basis of sector regulation. The present bill requires re-examination and modification. While retaining the capital based entry barriers, the procedural barriers should be lowered. Regulation should also address governance, market conduct and customer protection issues apart from enforcing prudential norms. Self-regulatory mechanism might be a way out for lessening the burden on the central bank. But the involvement of RBI in some advisory capacity would still be required in the regulatory body regardless of its form.

On the inclusion front, the MFIs, cooperative societies and post office must get their rightful place. They are better equipped to deliver results in terms of their network and human resources. The financial inclusion funds should be prioritised in favour those who could cost- effectively achieve the tasks within the shortest possible time and create deep relationships with newly acquired customers. The financial inclusion funds should be invested quickly to achieve early results. With a short-time horizon for achieving inclusion, the fund cannot be planned to be operational in perpetuity.

There is still no clarity on what the government and RBI have in mind for rural and microfinance in terms of an architecture. A clear plan and an accompanying strategy seem to be dire necessities. An assessment of the market demand, the requirement of service providers to meet the demands, inventory of resources, identification of most appropriate institutional forms, role of technology and a road map for ensuring that the desired architecture is in place in a given time frame should form part of the plan and strategy. The policy changes and policy innovations in rural and microfinance are incremental and ad hoc. Mixed signals on agent banking, MFIs, technology based banking, small financial institutions, cooperatives and the like are transmitted from time to time. But what is the place of all or any of these and their relative significance to rural and microfinance is never explained. The policy signals fail to point to any clear direction. In the absence of a clear architecture the growing sector would present a *fait accompli* that might prove difficult to deal with. The costs of resetting an already big and grown sector would be high and painful. The rural customers, both included and excluded, are owed an explanation of how we intend to provide them all with reliable and affordable access to financial services and by when.

The microfinance sector has grown to a size that is too big to ignore any more. It is in a position to offer significant value to customers if the institutions take a long-term view. The hard job of overcoming inertia has been completed. No more can the sector ask for forbearance from customers and other stakeholders on account of being young and weak. Now it is time to deliver on the promises. Let us move to realise our mission.

Appendix

Table A.1 Fact sheet on coverage and growth of SHGs and MFIs, March 2009

Outreach

1	Total number of SHG members currently linked	54 million*
2	Total number of MFI borrowers	22.6 million†
3	Growth of outreach of the SHG programme in 2008–09	15%
4	Growth of outreach of MFIs, 2008–09	60%

*4.14 million SHGS with outstanding loans—with 13 members per group (provisional data).
†Sa-Dhan estimate of 22.6 million members served by 233 MFIs as reported in Sa-Dhan's Quick Report 2009.

Loan outstanding

10	Loans outstanding under the SHG programme, March 2009 (Rs bn)	241.96*
11	Loans outstanding under the MFI model (Rs bn)	117.34†
12	Growth of loans outstanding under the SHG programme (Rs bn)	71.97
13	Growth of loans outstanding of MFIs in 2008–09 (Rs bn)	57.80‡
14	Average loans outstanding, SHG members Rs	4490§
1 5	Average loans outstanding, MFI borrower	5190¶

*Provisional data from NABARD 2009.
†Based on Sa-Dhan Quick Data 2009.
‡Based on Sa-Dhan Quick Data 2009.
§Derived from NABARD provisional data.
¶Average derived from Sa-Dhan Quick Data 2008.

Estimate of broad microfinance clients

Class of agency	No. of clients in March 2008 (millions)
Commercial banks (including RRBs) small loan accounts	41.00
Primary cooperative societiesborrowers (small, vulnerable)	28.54
SHG-members	47.1
MFI-clients	14.1
Total	130.74
Adjusted for overlap between banks and MFIs	135

Note: The data relating to SHG members as on March 2008 has been updated on the basis of latest data from NABARD. Commercial Banks Small Loan accounts data estimated on the basis of priority sector loan accounts for 2008 in the absence of specific data for March 2008.

Table A.2

Name of organisation	States	Outreach	Loan portfolio (Rs lakhs)	Delivery model	Legal form	Total borrowing (Rs lakhs)	Net owned fund (Rs lakhs)	Yield on portfolio (%)	Operating cost ratio
Action for Social Advancement	MP	3,761	140	SHG, Grameen	Society/ trust	107	26	23.70%	11.00%
Adarsa	Orissa	3,456	35	SHG	Society	43	1	24.60%	11.30%
Adarsh Shiksha Samiti	Rajasthan	267	6	SHG	Society	Na	Na	Na	Na
Adarsha Welfare Society	AP	31,108	2,688	SHG	Society	2,571	319	17.80%	3.80%
Adhikar Microfinance Private Limited	Orissa	54,189	304	JLG	NBFC	321	273	Na	Na
Agradut Polly Unnayan Samity	WB	3,421	161	Grameen	Society	98	0	17.50%	10.50%
Agricultural Science Foundation	Karnataka	9,000	685	JLG	Society	1,200	54	19.80%	3.40%
Ajiwika Society	Bihar, Jharkhand	10,753	716	JLG	Society, Section 25	714	40	23.10%	14.80%
Aman Microfin	Jharkhand	345	16	SHG	Society	15	2	0.00%	0.00%
ANMACTS (Future Financial Services Ltd.)	AP, Karnataka, TN	153,742	11,828	JLG	NBFC	9,880	2,894	24.10%	5.50%
Annapurna Financial Services Private Limited	AP, Maharashtra	81,042	4,508	SHG, JLG	NBFC	3,250	0	19.60%	0.00%
Aparajita Mahila Singh	MP	2,500	83	SHG	Society	37	47	0.00%	0.00%
Arasan Rural Development Society	TN	8,882	231	SHG	Society	438	0	0.00%	0.00%
ARCOD	TN	1,570	34	SHG	Society	0	30	0.00%	0.00%
Arman Financial Services Limited	Gujarat	6,351	1,460	JLG	NBFC	979	733	30.07%	11.89%
Arohan Financial Services Ltd	WB	86,237	4,191	JLG	NBFC	3,443	906	29.68%	14.32%
Arunabhashree Society	Bihar	1,423	48	SHG federation	Society	0	0	0.00%	0.00%
Ashajyothi Mahilabhyudaya Society (AMS)	AP	1,712	75	JLG	Society	65	13	0.00%	0.00%
Asmitha Microfin Ltd.	AP, Bihar, Goa, Gujarat, Jharkhand, KA, MP, MH, Orissa, RJ, TN, UP, WB	8,78,455	70,711	Grameen	NBFC	71,164	8,646	27.70%	9.20%
Bajkul Sports Association	WB	10,208	315	Grameen	Society	220	70	26.50%	10.90%
Bal Mahila Vikas Samiti - Vama	MP	2,895	152	SHG	Society	152	20	24.00%	12.40%

Bandhan	Assam, Bihar, Delhi, Haryana, Jharkhand, MH, Meghalaya, Orissa, Tripura, UP, WB	14,54,834	52,807	Individual lending through group formation	NBFC	68,690	5,300	27.40%	8.45%
Banki Anchalika Dibasi Harijan Kalyana Parishad	Orissa	7,871	215	SHG	Society	217	0	0.00%	0.00%
Batika	Bihar	200	7	SHG	Society	4	3	22.00%	10.40%
Bazaari Global Finance Ltd.	Rajasthan	2,894	530	SHG	Society	125	524	0.00%	0.00%
Belghoria Janakalyan Samity	WB	2,806	115	SHG	Society	120	7	32.10%	18.90%
Bharat Integrated Social Welfare Agency (BISWA)	Bihar, Chhattisgarh, DL, Jharkhand, MP, Nagaland, Orissa, RJ, UP, Uttarakhand, WB	3,52,352	17,128	SHG	Society	18,538	5,133	21.40%	4.90%
Bharat Sevak Samaj (BSS)	Kerala	51,424	400	SHG	Trust	0	0	3.70%	2.10%
Bharatha Swamukti Samsthe (BSS)	Karnataka	1,68,475	10,936	JLG	NBFC	8,049	2,046	33.50%	11.40%
Bhartiya Samruddhi Finance Limited	AP, Chhattisgarh, DL, Jharkhand, KA, MP, MH, Orissa, RJ, Sikkim, Uttarakhand, WB	5,74,293	26,212	JLG	NBFC	40,460	6,732	30.00%	16.40%
Bhartiya Micro Credit	UP	1,211	66	SHG	Society	85	16	0.00%	0.00%
Bhoruka Charitable Trust	Rajasthan	80	5	SHG	Trust	0	0	15.80%	14.10%
Bihar Development Trust	Bihar	945	48	Grameen	Trust	58	17	28.10%	37.10%
Brain Society	Kerala	842	12	SHG	Society	25	1	0.00%	0.00%
Bright Association for Noble & Decent Human Understanding (Bandhu)	Orissa	9,521	105	SHG	Society	205	0	19.60%	11.20%
Budhhanath Jubak Sangha	Orissa	4,030	101	SHG	Section 25	158	8	0.00%	0.00%
Bureau of Obligate and Accompanier for Rural Development (BOARD)	Bihar	321	14	SHG, JLG, Grameen	Trust	13	1	26.90%	13.20%
BWDA Finance Limited (BFL)	A&N Islands, Pondicherry, TN	2,63,968	10,198	JLG	NBFC	11,167	1,919	18.10%	6.00%
Camel Mahila MACTS Ltd	AP	7,614	455	SHG	MACS	309	156	0.00%	0.00%
Cashpor Micro Credit	Bihar, UP	3,19,859	18,221	Grameen	Section 25	13,326	347	2.70%	21.90%
Centre for Action and Rural Reconstruction (CARR)	Orissa	1,551	37	SHG	Society	39	3	26.60%	13.00%

(*continued*)

Name of organisation	States	Outreach	Loan portfolio (Rs lakhs)	Delivery model	Legal form	Total borrowing (Rs lakhs)	Net owned fund (Rs lakhs)	Yield on portfolio (%)	Operating cost ratio
Centre for Development Orientation and Training	Bihar	3,463	183	SHG, JLG	Society	333	14	22.00%	10.90%
Centre for Promoting Sustainable Livelihoods (CPSL)	Bihar, MP, UP	6,673	33	SHG	Society	17	14	0.00%	0.00%
Centre for Rural Reconstruction through Social Action (CReSA)	AP	35,274	2,286	JLG	Society	2,406	45	33.80%	14.40%
Centre for Youth and Social Development (CYSD)	Orissa	9,112	130	SHG	Society	290	206	0.00%	0.00%
Chaitanya Institute for Youth and Rural Development (Chinyard)	Karnataka	4,003	153	SHG	Trust	150	12	11.50%	1.90%
Christian Association for Medical mission and Peoples development (CAMP)	AP	1,267	33	SHG	Society	14	36	0.00%	0.00%
Community Development Centre	TN	42,495	1,743	SHG	Trust	1,724	170	20.40%	5.20%
Community Services Trust	TN	6,609	222	SHG	Society	12	25	5.50%	44.70%
Creation Welfare Society	Bihar	442	22	SHG	Society	27	5	18.10%	9.80%
Credible Microfinance Pvt. Ltd	Orissa	4,544	257	JLG	NBFC	150	150	0.00%	0.00%
Dar Credit & Capital Limited	Rajasthan	1,250	395	Individual lending	NBFC	17	902	0.00%	0.00%
Darbar Sahitya Sansad (DSS)	Orissa	4,866	74	SHG	Society	52	5	16.90%	3.40%
Deepalaya	DL, Haryana, Uttarakhand	9,016	729	SHG	Society	0	0	6.10%	5.40%
Development Organisation for Village Environment (DOVE)	AP	22,863	1,083	SHG	Society	937	144	24.10%	4.40%
Dibakar	WB	1,276	32	SHG	Society	0	14	0.00%	0.00%
Disha India Micro Credit	UP, Uttarakhand	5,002	171	JLG	NBFC	240	6	0.00%	0.00%
Ecumenical Church Loan Fund of India	MH, TN	17,842	518	SHG		562	0	17.00%	19.30%
Equitas Microfinance India Pvt Ltd.	AP, MH, TN	3,39,158	28,801	JLG	NBFC	18,370	11,288	22.24%	10.39%
Evangelical Social Action Forum (ESAF)	Chhattisgarh, Kerala, MP, MH, TN	145,701	7,294	SHG	Society	0	0	23.20%	0.00%

Forum for Rural Environment and Economic Development (FREED)	Kerala	44,450	692	SHG	Society	2,028	11	13.60%	1.10%
Fullerton India Credit Co. Ltd.	AP, KA, MH, RJ, TN	33,000	3,300	Individual lending	NBFC	0	0	0.00%	0.00%
Gram Swaraj Seva Trust	Maharashtra	396	17	JLG	Trust	0	21	31.60%	31.30%
Gram Utthan	Orissa	66,503	4,204	SHG	Society	7,768	113	25.40%	7.10%
Grama Siri	AP	23,048	1,002	SHG	Society	926	136	0.00%	0.00%
Grameen Development Services (GDS)	Bihar, RJ, UP	5,500	253			0	0	0.00%	0.00%
Grameen Financial Services Pvt. Ltd.	KA, MH	2,11,562	18,130	Grameen	NBFC	19,445	1,782	0.00%	0.00%
Grameen Mahila Syamsiddha Sangh (GMSS) - Chaitanya	Maharashtra	3,816	378	SHG	Society	277	20	20.60%	10.40%
Grameen Sahara	Assam	4,200	232	SHG, JLG	Society	222	2	25.40%	11.60%
Growing Opportunity Finance	TN	46,846	2,100	JLG	Section 25	1,763	908	0.00%	0.00%
Guidance Society for Labour Orphans and Women (GLOW)	TN	5,016	266	SHG	Society	267	14	31.50%	13.70%
Guide	AP	5,400	152	SHG	Society	85	0	6.00%	3.70%
Harijan Adivasi Shikshan Prashikshan Kalyan Sansthan	Bihar	500	4	SHG	Society	0	4	0.00%	0.00%
Hindustan Cooperative Credit Society Ltd.	Maharashtra	4,907	1,148	SHG	Society	214	185	30.30%	12.40%
Hope Foundation	Jharkhand, Kerala, Orissa, TN, WB	21,503	627	SHG	Trust	557	50	27.40%	22.50%
Hope Integrated Rural Development Society	AP	2,839	136	Hybrid	Society	193	21	42.10%	13.40%
Human Development Centre	WB	7,725	239	SHG	Society	188	15	20.70%	9.00%
Humana People to People, India	Rajasthan	1,664	117	SHG, JLG, individual lending	Section 25	96	22	26.20%	26.60%
Indian Association for Savings and Credit (IASC)	Kerala, TN	21,728	1,869	SHG, JLG	Section 25	2,006	97	0.00%	0.00%
Indian Institute of Community Development	Uttarakhand	9,450	3	SHG	Society	0	5	0.00%	0.00%
Indian Institute of Rural Development (Arth Finance)	MP, RJ	13,295	757	SHG	Society	669	283	21.00%	9.00%

(*continued*)

Name of organisation	States	Outreach	Loan portfolio (Rs lakhs)	Delivery model	Legal form	Total borrowing (Rs lakhs)	Net owned fund (Rs lakhs)	Yield on portfolio (%)	Operating cost ratio
Indur Intideepam Mcs Federation Ltd.	AP	20,753	1,608	SHG	MACS	1,523	292	15.10%	2.90%
Initiatives for Development Foundation (IDF)	Karnataka	74,645	3,538	SHG	Trust	3,570	258	16.60%	6.10%
Innovative Microfinance for Poverty Alleviation and Community Transformation (IMPACT)	AP, Gujarat, Kerala, TN	7,025	537	SHG	Society	365	268	0.00%	0.00%
Institute of Rural Credit and Entrepreneurship Development (IRCED)	KA, MH	842	49	SHG, JLG	Society, Trust	53	13	20.00%	8.30%
Institute of Women's Banking	AP	16,737	1,151	SHG	Society	1,145	17	0.00%	0.00%
Ishara Foundation for Finance and Rural Development	UP	14,421	1,498	SHG	Section 25	2,079	155	29.80%	4.90%
Jaago Samajik Arthik & Harit Vikas Sanghatan	UP	824	37	Grameen	Section 25	61	2	43.50%	62.70%
Jagannatha Financial Services Limited	AP, Chhattisgarh, MP, MH	92,133	2,894	JLG	NBFC	2,074	324	0.00%	0.00%
Jan Sewa Parishad	Jharkhand	66	19			12	13	0.00%	0.00%
Jan Vikas Samiti	Bihar	22	1	SHG, JLG	Society	0	1	0.00%	0.00%
Janalakshmi Social Services	Haryana, KA, RJ, TN	43,137	2,966	SHG, JLG	Section 25	2,436	761	36.20%	31.10%
Janodaya Public Trust	Karnataka	17,352	1,310	SHG	Trust	750	138	0.00%	0.00%
Jeevan Jyoti Kala Kendra	Bihar	1,037	41	SHG	Society	83	4	0.00%	0.00%
Kalighat Society for Development Facilitation (KSDF)	WB	3,203	151	SHG, JLG	Society	118	14	12.50%	37.00%
Khandagiri Madhyamika Mahila Samabaya Sangha Ltd.	Orissa	11,571	46			40	20	16.80%	6.00%
Kotalipara Development Society (KDS)	WB	65,650	1,403	SHG	Society	7	27	40.60%	22.50%
Kottapuram Integrated Development Society (KIDS)	Kerala	5,780	152	SHG	Society	101	0	0.00%	0.00%
Krishna Bhima Samruddhi Local Area Bank (KBSLAB)	AP, KA	55,148	6,375	Individual lending, JLG	Local area bank (LAB)	8,707	1,085	29.30%	13.40%
Krushi	AP	33,158	2,554	SHG	Society	8,678	321	19.70%	4.70%

Krushi Vikas Gramin Prashikshan Sanstha	Maharashtra	603	8	SHG, JLG	Society, Trust	7	0	34.50%	32.40%
Kurinji Social Welfare Society	TN	5,517	187	SHG	Society	350	0	0.00%	0.00%
Kushal Manch	Gujarat	1,200	72	SHG	Society	116	1	0.00%	0.00%
Liberal Association for Movement of People (LAMP)	Bihar, DL, Jharkhand, Orissa, WB	32,775	364	SHG	Society	305	16	12.90%	10.80%
Lok Biradari Trust	MP	2,382	120	JLG	Trust	120	13	30.60%	13.10%
Mahasemam	TN	1,11,581	3,398	Grameen	Trust, NBFC	3,049	412	39.10%	17.80%
Mahashakti Foundation	Orissa	17,364	788	SHG	Society	708	31	20.40%	6.90%
Mahila Vihas Prathamika Sanchaya Samabaya Ltd.	Orissa	367	15	SHG	Society	0	23	4053.20%	7.10%
Mahila Kalyan Samiti	Jharkhand	1,676	69	JLG	Society	934	0	124.70%	0.00%
Manab Sewa Sangh	Assam	1,255	49	SHG	Society	47	2	9.50%	9.50%
Manidham Grameen Savings Cum Credit Services (MGSCS)	AP, TN	16,642	304	Grameen	Section 25	450	56	19.00%	9.50%
Mansi	Bihar	115	2	SHG	Society	4	0	60.10%	85.20%
Margdarshak Development Services Pvt. Ltd.	UP	5,014	290	SHG	Section 25	349	14	27.86%	17.15%
Mass Care International	Bihar	265	12	SHG	Society	2	10	15.90%	26.70%
Mahila Arthik Vikas Mahamandal Ltd. (MAVIM)	Maharashtra	3,36,000	0	SHG	Section 25	0	0	0.00%	0.00%
Mimoza Enterprises Finance Pvt Ltd. (Shah Sandhu Finance Co. Pvt. Ltd.)	Haryana, Himachal Pradesh, UP, Uttarakhand	44,258	2,600	JLG, Grameen	NBFC	2,377	475	29.80%	28.73%
Mother Teresa Mahila MACCS Ltd.	AP	4,900	349	SHG, JLG, Grameen	MACS	11	380	14.10%	1.20%
Nav Bharat Jagriti Kendra (NBJK)	Bihar, Jharkhand	9,570	513	SHG, JLG, individual lending	Society	163	36	22.20%	9.10%
Navachetana Foundation	Karnataka	10,061	421	SHG, Individual Lending	Society	402	35	25.40%	12.10%
Navchetna - Yavatmal	Maharashtra	1,373	7	SHG, JLG	Trust	60	10	34.00%	16.80%
Network of Entrepreneurship and Economic Development (NEED)	Bihar, UP	24,895	1,730	SHG, JLG	Society	136	191	26.31%	10.95%
New Life	TN	25,420	68	SHG	Society	54	21	15.40%	13.60%

(*continued*)

Name of organisation	States	Outreach	Loan portfolio (Rs lakhs)	Delivery model	Legal form	Total borrowing (Rs lakhs)	Net owned fund (Rs lakhs)	Yield on portfolio (%)	Operating cost ratio
Nidan	Bihar, Delhi	12,712	105	SHG	Society, Section 25	85	46	17.60%	18.20%
Nirantara Community Services	Karnataka	6,310	316	Grameen	Society	387	8	35.90%	17.20%
Nirmaan Bharati Samajik and Arthik Vikas Sangathan	MP, UP, Uttarakhand	51,248	2,202	JLG	Section 25	2,473	0	30.40%	19.90%
Oazoane - The Society for Development of Human Activities and Environment	A&N Islands, TN	5,728	238	SHG	Society	197	41	10.80%	3.50%
Omalur Block Women Welfare Uplift Organisation (OBWWUO)	TN	1,240	24	SHG	Society	3	6	0.50%	4.00%
Organisation for Development Coordination (ODC)	Orissa	7,500	199	SHG	Society	156	43	21.90%	7.40%
Orissa Rural Infrastructure Development Association (ORIDA)	Orissa	400	20	SHG	Society	10	1	107.70%	4.20%
Outreach	AP, KA, TN	4,130	201	SHG	Society	0	245	11.00%	10.90%
Pahal Community Microfinance Services	UP, Uttarakhand	975	47	SHG	Society	90	14	19.30%	0.00%
Parath Samiti	MP	1,686	66	SHG	Society	50	5	31.90%	23.90%
Parmarth Samaj Sevi Sansthan	MP, UP	5,319	0			0	0	0.00%	0.00%
Payyavoor Community Development Project	Kerala	4,212	113	SHG	Society	0	73	0.00%	0.00%
People's Action for Development and Credit Union (PADACU)	Kerala, TN	1,858	99	SHG	Trust	271	100	29.70%	23.20%
People's Action for National Integration	UP	4,988	298	SHG	Society	55	146	6.80%	6.50%
People's Action for Transformation	Tamil Nadu	13,626	619	SHG	Trust	425	79	26.00%	8.70%
People's Activity and Rural Technology Nurturing Ecological Rejuvenation (PARTNER)	AP	3,594	133	SHG	Society	124	30	0.00%	0.00%
People's Forum	Orissa	36,912	1,510	SHG	Society	1,646	203	16.50%	4.50%
People's Voluntary Integral Service Organisation (PEVISO)	TN	8,100	0	SHG	Society	150	5	0.00%	0.00%

Planned Social Concern	Rajasthan	3,167	232	Grameen	Section 25	45	31	27.90%	18.30%
Pragathi Seva Samiti	AP	22,126	1,904	SHG	Society	4,884	579	10.00%	2.40%
Prakruthi Foundation	Karnataka	4,673	73	JLG	Society	55	22	0.00%	0.00%
Prayas JAC	Bihar, Delhi	949	112	SHG, JLG	Trust	91	37	14.30%	5.60%
Prayas (Organisation for Sustainable Development)	Gujarat	3,231	129	SHG, JLG	Society, trust	103	26	32.50%	16.10%
Priyasakhi Mahila Sangh	MP	1,550	136	SHG	Society	50	10	27.10%	16.40%
Prochesta	Assam	8,610	67	SHG	Society	65	12	11.40%	10.20%
Pushtikar Laghu Vyaparik Pratishtan Bachat and Sakh Sahakari Samiti	AP, Maharashtra, Rajasthan	6,511	5,978	SHG	Any other	729	5,076	25.70%	0.40%
Rajapur Seva Niketan	WB	2,417	149	SHG, JLG	Society	158	0	8.40%	6.20%
Rashtriya Seva Samithi (RASS)	AP, TN	40,755	5,169	SHG	Society	4,750	729	17.90%	2.20%
RGVN NGO Microfinance Program (NGOMF)	Bihar, Chhattisgarh, Orissa, Sikkim	12,344	844	SHG	Society	1,033	1,471	0.00%	0.00%
RGVN - Credit & Savings Program (CSP)	Assam	65,052	3,608	SHG	Society	3,839	184	0.00%	0.00%
Rores Micro Entrepreneur Development Trust	Karnataka, TN	38,140	2,054	JLG	Trust	1,108	372	32.80%	6.10%
Roshan Vikas Foundation	AP	1,684	236	SHG	MACS	269	22	1.50%	21.50%
Rural Agency for Social and Technical Advancement (RASTA)	Kerala	1,255	70	SHG	Society	320	0	0.00%	0.00%
Rural and Urban Innovative Social Entrepreneurship (RISE)	UP, Uttarakhand, DL	1,427	74	JLG	Section 25	97	22	30.03%	38.14%
S.E. Investments Ltd.	DL, GJ, RJ, UP	1,48,584	27,172	SHG	NBFC	15,145	6,760	23.10%	4.40%
Saadhana Microfin Society	AP	84,908	5,054	Individual lending	Society	5,846	733	29.60%	10.50%
Saath Charitable Trust (Ekta)	Gujarat	968	73	JLG	Trust	0	0	25.50%	9.90%
Saath Charitable Trust (Sakhi)	Gujarat	2,553	49	SHG	Cooperative bank	0	0	13.70%	20.30%
Sahara Utsarga Welfare Society	WB	84,641	4,117	SHG	Society	7,469	768	32.90%	9.30%
Sahara Uttarayan	WB	63,846	2,650	Individual lending	Society	5,120	262	30.30%	10.20%
Sahayata (Shree Hari Fintrade Pvt. Ltd.)	Rajasthan	29,159	1,930	Grameen	NBFC	1,727	2,361	29.70%	37.00%
Saija Finance Private Limited	Bihar	2,554	113	JLG	NBFC	83	31	0.00%	0.00%

(*continued*)

Name of organisation	States	Outreach	Loan portfolio (Rs lakhs)	Delivery model	Legal form	Total borrowing (Rs lakhs)	Net owned fund (Rs lakhs)	Yield on portfolio (%)	Operating cost ratio
Sakhi Samudaya Kosh	Gujarat, Maharashtra	9,073	419	SHG	Society	394	61	0.00%	0.00%
Samagra Gram Vikas Sanstha 'Sagras'	Maharashtra	4,281	40	SHG, JLG, Grameen	Society, trust	61	31	32.90%	14.60%
Samajik Vikas Sansthan	Bihar	100	3	SHG	Society	3	0	19.80%	5.00%
Samarthan Weakling Development Foundation	Jharkhand, WB	1,293	90	SHG, JLG	Section 25	201	4	23.70%	16.30%
Sambhav Microfinance Institute	MP, UP	2,847	152	SHG	Society	146	4	31.90%	15.20%
Sampada Trust	Maharashtra	19,991	787	SHG	Trust	677	250	19.60%	3.80%
Samrudhi Microfin Society	Karnataka	468	16	SHG	Society	26	0	0.00%	0.00%
Samta Jan Kalyan Parisad	Bihar	205	7	SHG	Society	5	2	0.00%	0.00%
Samuha	Karnataka	15,746	810	SHG	Society	989	51	16.60%	7.80%
Sangamam Women's Multipurpose Thrift and Credit Society	Karnataka, Pondicherry, TN	26,116	515	SHG	Society	484	424	17.50%	18.20%
Sanghammithra Rural Financial Services	AP, Karnataka, TN	1,29,363	5,784	SHG	Section 25	5,668	784	16.00%	3.80%
Sanghatitha Mahila Macs Federation Ltd.	AP	17,300	394	SHG	MACS	357	125	34.70%	3.70%
Sanginee Secondary Cooperative Ltd.	Orissa	8,468	222	SHG	Society	226	17	35.80%	9.30%
Sanjivani Mahila Bachat Sangh	Maharashtra	745	11	SHG	Society	0	0	0.00%	0.00%
Sarala Women Welfare Society	WB	46,334	1,834	SHG	Section 25	1,450	159	20.90%	4.60%
Sarva Jana Seva Kosh Ltd. (SJSK)	Pondicherry, TN	40,850	1,205	SHG	Section 25	0	1,731	0.00%	0.00%
Sarvodaya Nano Finance Limited	Bihar, Jharkhand, MP, RJ, TN	1,70,873	9,355	SHG	NBFC	6,425	1,861	12.70%	2.60%
Satin Creditcare Network Limited	Chandigarh, DL, HR, PB, RJ, UP, Uttarakhand	56,498	7,596	Individual lending	NBFC	7,796	1,677	30.00%	13.40%
SATRA	Assam	3,464	105	JLG, individual lending	Society	80	0	15.70%	0.60%
Seba Rahara	WB	5,962	176	SHG	Society	108	46	26.80%	11.70%
Semam Microfinance Investment Literacy & Empowerment Ltd. (SMILE)	TN	1,39,546	7,070	JLG	Trust, NBFC	5,189	834	31.90%	15.80%
Seva Mandir	Rajasthan	2,830	79	SHG	Trust	46	130	0.00%	0.00%

Sevashram	Kerala	0	323	SHG	Society	309	30	0.00%	0.00%
Sewa Bank	Gujarat	1,15,944	4,400	SHG	Cooperative bank	na	776	15.00%	10.00%
Shalom Trust	Kerala, TN	29,978	2,287	JLG	NBFC	2,386	562	25.90%	13.80%
Shardas Women's Association for Weaker Sections (SWAWS)	AP, MH, Orissa, TN	1,10,735	5,931	JLG	NBFC	2,454	2,086	26.40%	7.50%
Share Microfin Limited	AP, Bihar, Chhattisgarh, DL, GJ, HR, HP, Jharkhand, KA, MP, MH, RJ, TN, UP, UK, WB	15,02,418	121,693	JLG	NBFC	96,877	17,290	28.00%	9.00%
Shikhar Development Foundation	DL, HR	4,537	303	JLG	Trust	303	5	34.72%	76.67%
Shramik Bharti	UP	9,852	440	SHG	Society	11	453	0.00%	0.00%
Siri Microfin Society	AP	4,126	357	JLG	Society	400	30	20.00%	4.70%
SKS Microfinance Pvt. Ltd	AP, Bihar, Chhattisgarh, DL, GJ, HR, HP, Jharkhand, KA, Kerala, MP, MH, Orissa, PB, RJ, UP, UK, WB	35,20,826	2,45,639.9	JLG	NBFC	1,98,681.5	66,485	28.90%	13.90%
Social Education and Voluntary Action (SEVA)	AP	8,763	547	SHG	Society	455	38	24.00%	2.90%
Social Welfare Agency & Training Institute (SWATI)	Orissa	2,145	19	SHG	Society	3	2	12.70%	9.50%
Societal Upliftment and Rural Action for Job and Empowerment (SURAJE)	Bihar	585	14	SHG	Society	13	7	39.60%	22.90%
Society for Integrated Development of Riverine Belt (SIDRIB)	Bihar	140	4	SHG	Society	4	4	32.00%	53.10%
Society for Model Gram Bikash Kendra	WB	8,881	354	SHG	Society	257	21	31.40%	17.80%
Society for the Promotion of Youth & Masses (SPYM)	Haryana	3,167	25	SHG	Society	25	9	0.00%	0.00%
Sonata Finance Private Ltd. (SONATA)	MP, UP	76,632	4,481	Grameen	NBFC	3,075	823	32.30%	11.90%
Spandana Spoorthy Innovative Financial Services Limited	AP, Chhattisgarh, KA, MP, MH, Orissa, RJ, TN	24,32,189	1,86,831.4	JLG	NBFC	1,47,611.9	31,481	23.10%	6.00%

(*continued*)

Name of organisation	States	Outreach	Loan portfolio (Rs lakhs)	Delivery model	Legal form	Total borrowing (Rs lakhs)	Net owned fund (Rs lakhs)	Yield on portfolio (%)	Operating cost ratio
Sreema Mahila Samity	WB	65,128	1,177	SHG	Society	1,724	247	18.10%	5.40%
Sri Kshetra Dharmasthala Rural Development Project (SKDRDP)	Karnataka	8,07,170	49,164	SHG	Trust	53,614	2,203	13.50%	4.60%
Sri Vardhan Socio Development Foundation	Gujarat	812	55	JLG	Trust	50	17	0.00%	0.00%
Srijan Foundation	Jharkhand	305	13	SHG, JLG	Trust	21	0	40.50%	21.50%
Star Microfin Service Society (SMSS)	AP	33,523	2,174	Grameen	Society	2,167	278	29.70%	10.60%
Support	Jharkhand	2,132	106	SHG, individual lending	Trust	233	2	17.10%	9.80%
Swadhaar Finserve Private Limited	Maharashtra	8,234	566	Individual & group lending	NBFC	25	930	26.49%	114.43%
Swayamshree Micro Credit Services (SMCS)	Orissa	48,411	1,909	SHG	Society	1,391	370	17.60%	3.10%
The Activists for Social Alternatives (ASA) Grama Vidiyal	Pondicherry, TN	3,62,624	20,308	Individual lending	NBFC	16,237	4,842	30.70%	14.50%
The Payakaraopeta Women's Mutually Aided Cooperative Thrift and Credit Limited	AP	33,202	2,683	JLG	MACS	2,788	548	38.40%	8.20%
Trust Microfin Services	Bihar	2,140	119	SHG, JLG	Trust	163	14	21.80%	4.90%
Ujjivan Financial Services Private Limited	DL, HR, Jharkhand, KA, MH, Orissa, RJ, TN, UP, WB	2,61,671	16,901	Grameen	NBFC	6,717	9,652	26.80%	21.10%
Ullon Social Welfare Society	WB	982	104	Individual lending	Society	196	7	28.50%	9.60%
Unnati Mahila Sangh	MP	4,315	95	SHG, JLG	Society	0	1	17.70%	4.70%
Utkal Mahila Swayam Sahayak Samabaya Ltd. (UMaSS)	Orissa	974	50	SHG, Grameen	Any other	5	13	0.00%	0.00%
Uttarakhand Microfinance and Livelihood Promotion Cooperative Institution	Uttarakhand	505	10	SHG	Society	0	501	42.10%	338.60%
Vedika Credit Capital Ltd.	DL, Jharkhand	15,271	1,748	JLG	NBFC	1,063	1,054	32.60%	18.50%
Vikas Center for Development	Gujarat	5,010	207	SHG	Trust	144	106	17.40%	9.10%
Vikas Deep	Bihar	20	1	SHG	Society	1	0	0.00%	0.00%

Village Financial Services Pvt. Ltd.	WB	77,206	3,294	JLG	NBFC	3,441	660	25.30%	12.00%
Village Micro-Credit Services (VMCS)	WB	54,377	2,348	JLG, individual lending	Section 25	2,303	25	27.50%	12.90%
Vivekananda Sevakendra-Sishu Uddyan (VSSU)	WB	9,240	526	JLG, individual lending	Society	497	0	12.50%	3.20%
Volunteers for Village Development	Manipur	779	31	SHG	Society	75	3	0.00%	0.00%
Welfare Services Ernakulam	Kerala	30,980	926	SHG	Society	463	36	15.33%	4.37%
WSDS - Institute of Innovative Technology Transfer & Environment	Manipur	2,226	112	SHG	Society	191	0	0.00%	0.00%
Youth Council for Development Alternatives (YCDA)	Orissa	516	7	SHG	Society	6	0	6.10%	15.90%
Yukti Samaj Sewa Society	MP	763	31	SHG, JLG	Society	38	0	33.30%	24.90%
Institutions not part of database									
Helping Hand									
Belstar Finance									
Nightingale									
ICNW									
Suryodaya									
Mann Deshi									
KDFS									
CCD Kalasam									
SIFFS									

TABLE A.3

	Apex financing institution/bank	No. of MFIs		Loan outstanding			
S. No.	31 March 2006	31 March 2007	31 March 2008	31 March 2007	31 March 2008		
1	SIDBI	100		548	950	117	294
2	FWWB	102	113	104	218		2,137
3	Maanaveeya Holdings	24	NA	50	NA		NA
4	ICICI Bank	NA	240	1,392	959		2,650
5	HDFC Bank	66	110	300	720		2,654
6	ABN-Amro Bank	27	29	161	293		273
7	Yes Bank	7	NA	62	200		303*
8	Standard Chartered Bank	12	15	38	215		435
9	ING Vysa Bank	19	20	61	394		474*
10	DCB	NA	NA	NA	150		265
11	Axis Bank	65	81	270	500		758
12	Karnataka Bank	NA		554	NA		110
13	Kotak Mahindra						105*
14	Citi						116*
15	HSBC						NA
11	Public sector banks	NA		195	NA		876*
12	Others	NA		25	NA		

- Position as on 30 September 2008 as per NABARD provisional data.
  SIDBI data as per Annual Report 2008–09.
  FWWB data as per oral communication.
  Others as recorded during the workshop in CAB, RBI on 18 July 2009.

Table A.4 Progress under microfinance—bank loans outstanding against SHGs State wise - Agency wise position as on 31 March 2009

(Amount in Rs lakh)

Sl. No.	Region/state	Commercial banks		Regional rural banks		Cooperative banks		Total	
		No. of SHGs	Bank loan	No. of SHGs	Bank loan	No. of SHGs	Bank loan	No. of SHGs	Bank loan
A	Northern region								
1	Haryana	12,849	9,772.86	2,039	2,178	0	0	14,888	11950.86
2	Himachal Pradesh	19,882	4,343.50	6,889	2,434.46	5,981	2,855	32,752	9633.33
3	Punjab	7,645	5,813.19	8,297	1,025.74	2,039	646	17,981	7484.53
4	Jammu & Kashmir	288	93.93	213	182.44	411	180	912	456.58
5	Rajasthan	46,187	20,784.30	23,930	7,713.01	27,840	8,157	97,957	36654.63
6	New Delhi	1,597	1,248.53					1,597	1248.53
	Sub-total	88,448	42,056.31	41,368	13,533.65	36,271	11,838.50	1,66,087	67428.46
B	North-eastern region								
7	Assam	47,557	18,296.28	33,844	11,015.32	7,477	3,543.82	88,878	32855.42
8	Manipur	1,794	396.17	1,616	312			3,410	708.17
9	Meghalaya	2,144	816.8	719	225.48	252	97.04	3,115	1139.32
10	Sikkim	3,917	3,872.74			58	62.86	3,975	3935.60
11	Tripura	2,456	684.32	7,419	2,588.40	526	432.9	10,401	3705.62
12	Nagaland	680	8.63	0	0	0	0	680	8.63
13	Arunachal Pradesh	4,566	2,259.73	114	41.04	192	1.79	4,872	2302.56
14	Mizoram	933	273.19	1,334	1,025.53	11	94	2,278	1392.72
	Sub-total	64,047	26,607.86	45,046	15,207.77	8,516	4,232.41	1,17,609	46048.04
C	Eastern region								
15	Bihar	49,155	28,006.84	34,289	17,476.16	0	0	83,444	45483.00
16	Jharkhand	40,824	19,033.39	0	0			40,824	19033.39
17	Orissa	1,70,270	73,909.14	1,29,422	46,001.71	15,018	3,598	3,14,710	1,23,508.91
18	West Bengal	2,62,414	56,231.83	95,609	36,617.06	95,271	12,016	4,53,294	1,04,864.99
19	A & N Islands (UT)	211	46.54			643	264.99	854	311.53
	Sub-total	5,22,874	1,77,227.74	2,59,320	1,00,094.93	1,10,932	15,879.15	8,93,126	2,93,201.82

(*continued*)

(Amount in Rs lakh)

Sl. No.	Region/state	Commercial banks		Regional rural banks		Cooperative banks		Total	
		No. of SHGs	Bank loan	No. of SHGs	Bank loan	No. of SHGs	Bank loan	No. of SHGs	Bank loan
D	Central region								
20	MP	24,728	9,934.70	6,240	2,365.46	3,970	955	34,938	13254.94
21	Chhattisgarh	45,369	24,788.63	17,162	6,076.56	3,296	293	65,827	31158.01
22	UP	16,330	8,874.80	87,553	49,607.36	3,223	1,054	1,07,106	59536.42
23	Uttaranchal	1,11,845	90,685.90	4,740	2,573.67	2,146	1,827	1,18,731	95086.26
	Sub-total	1,98,272	1,34,284.03	1,15,695	60,623.05	12,635	4,128.55	3,26,602	1,99,035.6309
E	Western region								
24	Gujarat	32,630	8,929.41	3,127	1,160.95	1,348	848.13	37,105	10938.49
25	Maharashtra	2,56,758	1,16,159.68	10,647	3,774.18	49,987	11,555.68	3,17,392	1,31,489.5434
26	Goa	2,235	1,855.79			1,043	785.34	3,278	2641.13
	Sub-total	2,91,623	1,26,944.89	13,774	4,935.13	52,378	13,189.15	3,57,775	1,45,069.1677
F	Southern region								
27	AP	8,78,987	6,49,456.47	3,23,259	2,28,567.23	14,633	4,051	12,16,879	8,82,074.7028
28	Karnataka	1,83,382	1,94,177.29	84,467	43,460.86	47,301	1,09,995	3,15,150	3,47,632.8855
29	Kerala	1,44,192	74,788.47	10,341	5,955.77	21,080	13,831	1,75,613	94575.45
30	Tamil Nadu & UTP	4,63,170	2,78,825.77	43,342	29,971.50	69,838	35,745	5,76,350	3,44,542.139
	Sub-total	16,69,731	11,97,248	4,61,409	3,07,955.36	1,52,852	1,63,621.8202	22,83,992	16,68,825.175
	Grand total	28,34,995	17,04,368.82	9,36,612	5,02,349.89	3,73,584	2,12,889.58	41,45,191	24,19,608.29

Table A.5

Sl. No.	Name of the service providers with address	Form and nature of the organisation	No. of professional staff	Geographical coverage	Types of services provided	Types of clients served
1	Andhra Pradesh Mahila Abhivruddhi Society (APMAS) Plot No. 20, Rao & Raju Colony, Road No. 2 Banjara Hills Hyderabad-500034 (AP)	Society: Technical services	80	Andhra Pradesh & other states	CB on federation promotion & management; rating of federation; livelihoods; research studies	NGOs/MFIs/ federations/banks/ govt. departments/ donors
2	National Institute of Rural Development (NIRD) Rajendranagar, Hyderabad-500030 (AP) Tel: 91-40-24008473/466/526 Fax: 91-40-24015277	Society: Academic	30	Andhra Pradesh & other states	Thematic training programmes on microfinance and other development topics; research studies; information dissemination	NGOs/ MFIs/SHPIs/ support agencies/ donors/banks & FIs/ line departments/ ministries
3	BASIX 501-502, Nirmal Towers Dwarakapuri Colony Punjagatta Hyderabad-500082 (AP) Tel: 91-40-30512500/501 Fax: 91-40-30512502 Email: info@basixindia.com Web: www.basixindia.com	Section 25 company: Technical Services	210	Pan-India	Livelihood financial services; agriculture BDS; institutional development services; loan funds support; software; knowledge generation & value addition	NGOs/MFIs/banks/ state govts/donors/ corporates
4	Intellecap 3-6-307/2, Beside HDFC House Hyderabad Main Road Hyderabad-500029 (AP) Tel: 040-2322 2461	Private Limited Company; For-profit: Technical consultancy services	50	Pan-India & abroad	Short training courses as well as various consulting services to different market segments	NGOs/MFIs/banks/ donors/corporates/ govt. departments/ investors
5	Indian School of Business (ISB) GachibowliIIIT Campus, Opposite Infosys, Hyderabad, Andhra Pradesh 500032	Non-profit: Academic	25	Andhra Pradesh & other states	Research, microfinance elective	NGOs/MFIs/SHPIs/ govt. departments
6	RASS Annamaiah Marg, AIR Bypass Road, Tirupati-517501 Tel: 91-877-2242404 Fax: 91-877-2244281 Email: rassorg@gmail.com	Society: Academic	35	Andhra Pradesh	Training programmes on microfinance & microentreprises	NGOs/MFIs/SHPIs/ MAC
7	JAYAM Solutions Pvt Ltd Prasanka Towers, Flat No-507, K.P.H. Colony, Kukatpalli, Hyderabad-72 (AP)	Private Limited Company, For-profit: IT services	56	Pan-India	Software Package & IT Services	NGOs/MFIs/SHPIs
8	Elister IT Solutions India Pvt Ltd, 303-Aditya Trade Center, Ameerpet, Hydrabad-500038 (AP)	Private Limited Company, For-profit: IT services	75	Pan-India & abroad	Software Package & IT Services	NGOs/ MFIs/ SHPIs

(*continued*)

Sl. No.	Name of the service providers with address	Form and nature of the organisation	No. of professional staff	Geographical coverage	Types of services provided	Types of clients served
9	Micro Credit Summit Campaign (Dr. DSK Rao-Regional Organizer for Asia Pacific) 404, Apurupa Elegance, 7-1-222, Ameerpet Hyderabad-500016 (AP) Tel: 91-40-66614196 Fax: 91-40-23755238 Email: dskrao@yahoo.com Web: www.microcreditsummit.com	Part of the Global Micro credit Campaign Network	10 at global level but 01 for the Asia Pacific region	Global	Event organisation—microcredit summit; thematic training programmes on microcredit & microfinance	NGOs/ MFIs/bankers/ consultants/donors/ line departments
10	ACCESS Development Services, 28, Hauz Khas Village New Delhi-110 016 Tel: 91-11-26510915 Fax: 91-11-26850821 Web: www.accessdev.org	Section 25 Company: Technical, consultancy and network	45	Pan-India	MFI Incubation; State Visioning on microfinance; Sector building through Microfinance India; Alliances & Networking; Sustainable Livelihood Services	NGOs/MFIs/ NABARD, SIDBI and other FIs/ Ministries/ Govt Departments/ Donors/ Corporates
11	Sa-Dhan 12&13, 2nd Floor, MPTCD Building, Special Institutional Area Saheed Jeet Singh Marg, New Delhi-110067 Tel: 91-11-26966518/ 26852436 Email: info@sa-dhan.org	Society: Network	27	Pan-India	Policy advocacy; thematic training programmes on microfinance; micro-insurance; governance; documentation; information dissemination	NGOs/MFIs/SHPIs/ support agencies/ donors/banks & FIs/ line departments/ ministries/banks/FIs/ line departments
12	Sambodhi Research & Communications Pvt Ltd B-136, 3rd Floor, Left Wing, Kalkaji, New Delhi-110019	Section 25 Company: Research and consultancy	22	Pan-India	Thematic training programmes on microfinance and other development topics; research & consultancy	NGOs/MFIs/support agencies/donors/govt. departments
13	PARIVARTAN O-2, Third Floor, Lajpat Nagar-2, New Delhi-110024 Tel: +91-11-40560734, 65492502, 9312510925 Email: contact@parivartan.org.in Web: www.parivartan.org.in	Society: Academic	20	New Delhi; Uttar Pradesh; Madhya Pradesh	Thematic training programmes on microfinance and other development topics; research studies	NGOs/MFIs/SHPIs/ govt. departments/ donors
14	Micro Insurance Academy SUB (Sarvajan Unnati Bodhini) Charitable Trust D-127, Panchasheel Enclave New Delhi-110017	Trust: Technical, advocacy	22	Pan-India	Studies; training and advisory services for micro-insurance units serving the poor.	NGOs/MFIs/SHPIs/ corporates/govt. departments/ students/academic institutes/insurance companies

15	Institute of Rural Management (IRMA), Anand Post Box No. 60 Anand-388001, Gujarat Tel: 91-2692-260181/186 Fax: 91-2692-260188 Email: bcp@irma.ac.in	Trust	22	Pan-India	Research; training materials' development; Ph.D. programmes; short courses; thematic training programmes on microfinance	NGOs/ MFIs/ development professionals/ students/academic institutions/govt. departments/ corporates/donors
16	Indian Institute of Management Ahmedabad (IIMA), Vastrapur City Ahmedabad-380015	Non-profit: Academic	90	Pan-India	Microfinance elective within a degree programme	NGOs/ MFIs/ development professionals/ students/academic institutions/govt. departments/ corporates/donors
17	Indian School of Microfinance for Women, 2nd Floor, Shukum Arcade, Near Medisurge Hospital, Mithakhali Ahmedabad-380 006	Trust: Academic	10	Pan-India	Thematic training programmes on microfinance; financial literacy; curriculum development; action research; knowledge networking & management	NGOs/ MFIs/ development professionals/ students/academic institutions/govt. departments/ corporates/donors
18	International Center for Entrepreneurship and Career Development (ICECD) E1/41, Sterling City, Bopal Ahmedabad-360058	Society: Academic	44	Gujarat	Management training; insurance; market research and enterprise development	NGOs/MFIs/individual entrepreneurs/ corporates/govt. departments/donors
19	EDA Rural Systems 602-Pacific Squire 32 Milestone NH 8 Gurgaon-122001 Tel: 91-1242309707, 4050739 Fax: 91-1242309520 Web: www.edarural.com	Private Limited Company, For-profit: Technical consultancy	15	Pan-India & abroad	Thematic training programmes on microfinance & microentreprise	NGOs/MFIs/INGOs/ donors/govt. departments
20	M-CRIL 602-Pacific Squire 32 Milestone NH 8 Gurgaon-122001 Tel: 91-1242309707, 4050739 Fax: 91-1242309520 Web: www.edarural.com	Private Limited Company, For-profit: Technical ratings	11	Pan-India & Abroad	Rating of MFIs	MFIs/NABARD/SIDBI, banks/Fis/donors/ government
21	M2i, 206-A Sushant Tower Sushant Lok II Sector-56 Gurgaon-122 033 Tel: 91-124 3244041	Private Limited Company, For-profit: Consultancy	10	Pan-India	Mentorship, training, diagnostic assessments, loan portfolio audit, business planning, microfinance programme implementation	NGOs/MFIs/donors/ line departments

(*continued*)

Sl. No.	Name of the service providers with address	Form and nature of the organisation	No. of professional staff	Geographical coverage	Types of services provided	Types of clients served
22	V. Nagarajan & Co Open House, D-2058 Palam Vihar Gurgaon-122017 Tel: 91-124-4078742/43 Email: nsb_ca@yahoo.co.in	Private Limited Company, For-profit: Consultancy	50	Pan India & abroad	Microfinance auditing-internal & statutory; transformation of NGOs into MFIs; software; management consultancy	MFIs/NBFCs/donors
23	Indian Institute of Management Bangalore (IIMB) Bannerghatta Road Bangalore	Non-profit: Academic	104	Pan-India	Microfinance elective; microfinance incubator; research and materials development	NGOs/MFIs/ development professionals/ students/academic institutions/govt. departments/ corporates/donors
24	SAMPARK N-80, Ground Floor 2nd Main Road, 1st Block Koramangala Bangalore-560 034 Tel: 91-80-25530196	Society, Non-profit: Research and studies	16	Karnataka & other states	Impact assessment of microfinance programmes	NGOs/MFIs/SHPIs/ donor agencies/govt. departments
25	CRISIL W-101, 1st Floor Sunrise Chamber 22 Ulsoor Road Bangalore-560042	Private Limited Company, For-profit: Rating	21	Pan-India & abroad	MFI ratings; social ratings; sector studies & reviews	MFIs/NABARD & other FIs/donors
26	GRADATIM Gradatim House 129, 10th Cross Indira Nagar, Bangalore Tel: 91-44-40429292 Email: s@gradtimin.com	Private Limited Company, For-profit: IT insurance	100	Pan-India & abroad	Software package & IT services for microfinance and micro-insurance	NGOs/MFIs/SHPIs/ NBFCs/FIs/RRBs
27	Atyati Technologies, 3005 8th Cross 12th 'A' Main Hall 2nd Stage, Bangalore-560008	Private Limited Company, For-profit: IT services	70	Pan-India	Software package & IT services	NGOs/MFIs/SHPIs/ NBFCs/FIs/RRBs
28	Mahila Chetna Manch, Kalyani Hostel Compound, Tulsi Nagar, Bhopal (MP)	Society: Technical services	4	Madhya Pradesh	Technical assistance for microfinance	NGO-MFIs/CB-MFIs/ govt. departments
29	IGS-BASIX TH-17 Akash Ganga Colony, Trilanga, Bhopal (MP)	Section 25 Company: Technical services	5 (Bhopal Team)	Madhya Pradesh	Technical assistance on microfinance and livelihoods	NGO-MFIs/CB-MFIs/ livelihood promotion organisations/govt. departments
30	Madhyam Foundation N-3/202 Ekamra Kanan Road Bhubaneswar-15 (Orissa) Tel: 0674-2557029 Email: mfsupport@sify.com	Trust: Training	10	Orissa & other states	Microfinance Training; Institutional Development; Intermediation between MFIs and Donors	MFIs/ Donors & Support organizations/ Govt. Departments
31	Institute of Cooperative Management (ICM) Unit-viii Bhubaneswar-751012 Orissa	Cooperative: Training	12	Orissa	Training programme on cooperative management; research studies; academics	Cooperatives/line departments/students

32	Center for Development Research & Training (CENDERET) Xavier Squire, Bhubaneswar-751013 Orissa	Development wing of Xavier Institute: Academic	30	Orissa	Thematic trainings; microfinance and microentreprise; research study; academics; intermediation between NGOs, MFIs & donors	NGOs/MFIs/donors/ line departments/ students
33	CYSD E-1, Institutional Areas Gangadhar Meher Marg Bhubaneswar - 751 013 Orissa Tel: 91-674-2301725/2300983 Fax: 91-674-2301226 Web: www.cysd.org	Society: Training	20	Orissa	Capacity building; training on development including on microfinance	NGOs/MFIs/SHPIs
34	Centre for Microfinance C/O IIHMR 1-Prabhu Dayal Marg Jaipur-302011 Rajasthan Tel: 91-141-2791431/32/33/34	Non-profit: Technical services	9	Rajasthan	Handholding services for community-based MFIs; research studies; impact assessment; policy retreats	NGOs/CBMFIs/state & central govts/donors
35	Institute of Financial Management & Research (IFMR) 8th Floor, West Wing Fountain Plaza Khaleel Shiraz Estate 31/2 A, Pantheon Road Egmore, Chennai-600 008 Tel: 91-44-4289 2725 Fax: 91-44-4289 2799 Email: cmf.westmaster@ifmr.ac.in	Trust: Academic, research and technical services	18	Pan India	PG diplomas on management, financial engineering; development finance; research studies	NGOs/MFIs/ development professionals/ students/academic institutions/govt. departments/ corporates/donors
36	The Center for Microfinance (CMF) 8th Floor, West Wing Fountain Plaza Chennai-600 008	Non-profit: Research and technical services	36	Pan-India	Research studies; impact assessment; policy retreats	NGOs/MFIs/state & central govts/donors
37	Dhan Foundation 18, Pillaiyar Koil Street S.S. Colony, Madurai-625010 Tamil Nadu Tel: 91-452-2610794, 2610805 Email: dhan@md3.vsnl.net.in	Trust, NGO: training	50	Tamil Nadu & other states	Training-cum-exposure programmes on microfinance; federation training; policy advocacy	Federations/ SHPIs/MFIs/banks/ corporates/line departments
38	Tata-Dhan Academy Boy's Town Campus, Pulloothu Madurai-625016 Tel: 0452-2475214	Non-profit: Academic	26	Tamil Nadu & other states	Two-year programmes on the Basics of Development; Management; Communication; Leadership and Institution Building; short training programmes on microfinance and other topics; research studies	NGOs/MFIs/ development professionals/ academic institutions/ govt. departments/ corporates/donors
39	International Network of Alternative Financial Institutions India, 25 A, Bharati 5th Street, SS Colony, Madurai-625010 Tel: 91-452-2300490 Email: indiainafi@eth.net	Section 25 Company: Network	5	Pan-India	Thematic training programmes on microfinance; research studies; product development; policy advocacy	Member NGOs and MFIs (80)/microfinance practitioners/donor agencies

(*continued*)

Sl. No.	Name of the service providers with address	Form and nature of the organisation	No. of professional staff	Geographical coverage	Types of services provided	Types of clients served
40	Alegion Insurance Broking Ltd St. Ebbas Avenue 117 P.S. Sivaswamy Salai Mylapore, Chennai	Public Limited Company, For-profit: Broking and training	150	Pan-India	Technical & advisory services on insurance; consultancy; intermediation between MFIs and insurance companies; product knowledge & dissemination	NGOs/MFIs/ SHPIs/Ministry of Social Justice & Empowerment/ corporates/ insurance companies
41	Microfinance Consulting Group, 240-A, Lloyds Roads (Basant Road), Gopalapuram, Chenai-600086, (Tamil Nadu)	Non-profit: Technical services	20	Pan-India & abroad	Thematic training programmes on microfinance & microinsurance; business planning & internal auditing	NGOs/MFIs/SHPIs/ NBFCs/FIs/RRBs/govt. departments/donors
42	Margadarshak C-1253, Aravali Marg Indranagar Lucknow-226016 (UP)	Society: Technical services	15	Uttar Pradesh	System development; study & assessment	NGOs/MFIs/SHPIs/ donors/government
43	MicroSave B-52, Kapoortala Crossing Mahanagar Extension Mahanagar, Lucknow-226006 Tel: 91-522-2335734 Fax: 91-522-4063773 Email: info@microsavetraining.org	For-profit: Technical services	40	Pan-India	Short training courses; consulting; product design & development; market research; process mapping for MFIs	NGOs/MFIs/SHPIs/ NBFCs/donor agencies
44	Bankers Institute of Rural Development (BIRD) Sector-H, LDA Colony B272 Kanpur Road Lucknow-226 012 Tel: 91-522-2421047 Email: bird@sancharnet	Society: Academic	15	Pan-India	Training programmes for RRBs and other bankers; training-cum-exposure programmes to other countries	RRBs and other/bank officials/NGOs/MFIs/ govt. departments
45	Coromandal Infotech India Ltd, I & II floor B-66, Sector-63, Noida (UP)	Private Limited Company, For-profit: IT services	30	Pan-India	Software package; IT services	NGOs/MFIs/NBFCs
46	Micro pension Invest India Micropension Services Pvt Ltd D26, Sector-3 Noida-201 301 (UP) Tel: 91-120 4232123 Fax: 91-120 423212	Private Limited Company: Technical services	14	Pan-India	Planning & advisory services on micro pension and micro-insurance	NGOs/MFIs/SHPIs/ NBFCs/FIs/RRBs/ govt. departments/ corporates/insurance companies
47	SPADE 52, Garfa Main Road (1st floor) Kolkata-700 075 Tel: 033-24185452	Society: Training	80	West Bengal	SHG training, manual development	SHPI/ SHG/ ministries/ NGO/ MFIs
48	Service Centre 58A, Dharmatala Road Kolkata 700 042 Tel: 033-24427311/ 24734364	Society: Training	70	West Bengal	SHG training, manual development	SHG/ NGOs/ SHPI/ MFI/ ministries
49	Rural Development Consortium BF-45, Salt Lake City Sector-1, Kolkata 700064 Tel: 033-23375930	Society: Training	15	West Bengal	SHG training, manual development	SHGs/ SHPIs/ NGOs/ MFIs/ SHG ministry

50	REACH-INDIA Self-Help Solutions 20D Belvedere Road 2nd Floor, Alipur Kolkata-800027 Tel: 91-33-2479-2450/2452 Web: www.reach-india.net	Trust: Technical services	20	West Bengal & other states	Thematic training programmes on microfinance, microentreprises, health, education etc	NGOs/ MFIs/ SHPIs/ SHGs-federations
51	Syscon Solutions Pvt. Ltd BB-127, Salt Lake City Kolkata-700064	Private Limited, For-profit: IT services	25	West Bengal & other states	Software package & IT services	NGOs/ MFIs/ SHPIs/ NBFCs/ federations/ govt. departments
52	Reach India	Non-profit	East and North-East	Training and capacity building	SHGs/ SHPIs	
53	Trust Microfin	Trust, Non-profit: Support services	Incubation activities; financial intermediation; training; capacity-building; hand-holding; enterprise development services; social services	Small MFIs		
53	FINO C-401, Business Square, Opp. Popular Car Bazaar, Andheri Kurla Rd. Andheri East Mumbai - 93. Tel.: 40973466/ Fax: 40973300	Technological Services Company	100	Pan-India	Software packages and IT services	NGOs/ MFIs/ SHPIs/ SHGs-federations
54	Centre for Microfinance Research (CMR) Sector-H, LDA Colony Kanpur Road Lucknow-226 012 Email: bird@sancharnet.in	Research	5	Pan-India	Research activities; publications and sharing of outcomes and best practices; policy-planning and advocacy through conferences & seminars	
55	ASSIST, 28, Hauz Khas Village, New Delhi - 110 016; Tel.: +91 11 26510915 Fax: +91 11 26850821	Trust, support services	12	Pan-India	Research activities; technical assistance to institutions; consultancy services; impact assessment studies; due deligence and assessment of institutions	NGOs/ MFIs/ SHPIs/ NBFCs/federations/ govt. departments/ funding agencies / financial institutions
56	BE Foundation, #34/9, New BEL Road, Chikkamaranahalli, Bangalore-560008 Ph No-91-80-41156990, 41267001 Fax No-91-80-41156992 Email:-info@bel.org.invisit: www.bef.org.in	Technological services company	50	Pan-India	Software packages and IT services	NGOs/ MFIs/ SHPIs/ SHGs-federations

APPENDIX TABLE A.6

UN Solutions Exchange—members' expectations and guidance on preparation of the state of the sector report

A query was raised on the solutions exchange, microfinance and poverty community requesting members for their views on the structure, content and presentation of SOS 2009 as well innovations and interesting examples at work. The replies received from 28 members had been consolidated by the moderator and his team. Following the query and responses,UNSE and UNDP arranged a roundtable of practitioners to discuss the issues on 29 August 2009. The author was invited to moderate the roundtable which produced a rich harvest of information. The information and the discussions have been taken into the report at appropriate places. While the views and information provided by the members have been made use of in different parts of the report the consolidated reply is produced here.

Members appreciated this year's theme, 'Doing Good and Doing Well: The Need for Balance', and provided wide-ranging suggestions for strengthening the report. Members highlighted that microfinance is not only a financial instrument, but a powerful tool to address the multiple dimensions of poverty. Moreover, microfinance has emerged as a means to achieve the Millennium Development Goals.

Framework and Structure of Report

Responding to the issues, thematic areas and structure of the report, members suggested that there is a need to assess the demand and supply of microfinance so that year to year growth can be tracked. In this respect they realised the importance of measuring the performance of the schemes that have a focus on the SHGs like SGSY and utilisation of various funds—Microfinance Development and Equity Fund, Financial Inclusion Fund and Financial Inclusion Technology Fund. They also mentioned that the report could capture the statistical abstract on SHG–bank linkage programme (SBLP) and number of MFIs working in different states to track the regional balance. Further, members suggested including the following points in the report:

- RBI/NABARD circulars issued on microfinance during the period of the report;
- voices of the poor from the field and sharing the perception of the clients on the current microfinance delivery practices;
- interview of successful people/practitioners in addition to the regulators and apex institutions;
- an exclusive chapter on 'Microfinance and Gender', focusing on the role of microfinance in empowerment of women;
- impact of mass loan waiver by the government on microfinance operations and repayments under SHGs and MFI lending;
- policy, standards and governance issues of the MFIs;
- a separate chapter on the transparency issues of the microfinance, financial and social performance of the MFIs and net cost of borrowing to the poor;
- role of public–private partnership in context of microfinance and
- sectoral contribution by the apex banks like RBI, NABARD, SIDBI and by various networks and resource organisations.

Referring to the importance of moving beyond credit-only approach and adoption of 'innovative microfinance models' by various organisations, members suggested including a new chapter on innovations. Moreover, they suggested highlighting innovative, cost-effective enterprises/services and convergence of microfinance services for improving livelihoods. Further, report could focus on the new approaches and innovative models adopted by various organisations—Housing Microfinance, Health Financing, Micro Pensions and MF and Skill Development. Members also highlighted the important role played by the Internet based investment marketplace platforms like Rang De and DhanaX. They also shared that many organisations like Sanghamitra, Hand in Hand Microfinance, RASS, SKS, Bandhan, Asmita, Sarvodaya Nano Finance, Sewa Bank, MYRADA and Margdarshak have done a commendable work and their microfinance interventions could be included in the report as case studies.

Highlighting the importance of the 'community initiatives' in the microfinance sector, members informed the establishment of a Section 25 Company set up by an organisation involved in catalysing social security for the unorganised. Referring to the importance of the regulatory and supervisory systems developed by

the SHGs and federations members shared the pilot in AP. Moreover, they also shared about INFOS, a network of Microfinance SHG federations with 40 SHG federations as network members across the nation.

Members viewed that financial inclusion has been a priority and many steps have been taken to realise this. Branchless banking, business correspondent (BC) and business facilitator model are few such initiatives. However, referring to a national study, members shared their concerns on the viability of the BC model. Members suggested highlighting the problems faced by the BCs and recommended changes in the current policy guidelines.

Sharing about the announcements that have an impact on the microfinance sector, members informed that the corpus of Rashtriya Mahila Kosh has been hiked from 100 to 500 crores. Also, 4,000 crores from Rural Infrastructure and Development Fund (RIDF) would be channelised for refinancing the loans to micro and small enterprise sector. Moreover, Government of Andhra Pradesh has introduced a pension scheme for the SHG members, with an in-built mechanism of insurance in it.

Sharing the concern over the growing commercialisation, members were interested in knowing whether MFIs are client focused and are sensitive to the need of the borrowers. Referring to the current economic downturn members viewed that there is a need for the MFIs to reflect their business portfolio, consolidate their business and review their carrying capacity. They also viewed that there is a need to study the changes of migration pattern, loss of opportunity in household work and loss of jobs in export-oriented sectors and accordingly design the microfinance services and products.

Members viewed that for the upliftment of the poor, credit-only approach won't be sufficient. For doing well it is important that the report should highlight the innovative and cost-effective enterprises that are working along with providing the financial services to the clients. Moreover, members also highlighted the need of including the strategies for strengthening the equity base of the MFIs, to avoid the risk of taking over of good MFIs by other companies for purely commercial purposes.

In a nutshell, members viewed that over the years microfinance has became a commercialised activity. They also suggested that we cannot afford to lose sight of basic objectives of microfinance to include the poor as well. It is important that microfinance sector have a proper balance between profitability and serving the poor. Members stressed that the report could highlight the new microfinance products and services introduced by the organisations and mechanisms to reach people with special needs.

(The consolidated report was prepared by Navin Anand, Moderator and Monika Khanna, Research Associate of the UN Solutions Exchange Microfinance and poverty community of practice. The following members contributed to the discussions:

Akhil K. Srivastava, Antardrishti, Agra, UP, Rahul Mittra, Margdarshak, Lucknow,

N. Jeyaseelan, Helping Hand Micro Finance Services, Tamil Nadu, Ram Kumar Atri, Bharat Shodh, New Delhi, Prabhat Labh, CARE USA, Tanzania, Santanu Sengupta, Study & Jobs Worldwide (SJW), Kolkata, Supriti, Consultant, Bangalore, Vivek Kaul, New Delhi, Suman K. Apparusu, University of East Anglia, Hyderabad, Pradeep Mohapatra, UDYAMA, Bhubaneswar, Baladeb Sen, Consultant, Chennai (Response 1; Response 2), Smita Premchander, Sampark, Bangalore, Subhash Wadhwa, International Consultant, – Microfinance and Livelihoods, Mumbai, J.S. Tomar, Cashpor Micro Credit, Varanasi, UP, Milroy Paul, Habitat for Humanity India, Chennai, T. Balasubramanian, Mudhal Inclusive Growth Foundation, Chennai, Islam Hussain, PAHAL, Nainital, Uttaranchal, P. Rajarethinam, JORA Development Support Services Pvt. Ltd., Chennai, Hemantha Kumar Pamarthy, Hand in Hand Micro Finance Limited, Chennai, K.P. Soma, Gender and Development Consultant, New Delhi, Raj Kumar Pandey, GoI-UN Joint Program for Convergence, UNICEF, Lucknow, C.S. Reddy, Andhra Pradesh Mahila Abhivruddhi Society (APMAS), Hyderabad, Sameer Kochhar, Skoch Development Foundation, Gurgaon, Kumar Shailabh, Uplift India Association, Pune, Arabinda Mitra, Ghoragacha Swanirvar Samiti, WB, Debraj Bhattacharya, Institute of Social Sciences, New Delhi, T. Narendran, INFOS, Madurai, G.K. Agrawal, Rural and Microfinance Consultant, Mumbai, Oliver Schmidt, Sa-Dhan, Hyderabad)

APPENDIX TABLE A 7

List of organisations and persons met

NABARD, Mumbai—U.C. Sarangi, Chairman, B.B. Mohanty, CGM, A.K. Srivastava, CGM
SIDBI, Lucknow—N.K. Maini, ED, Mr Sahu, CGM, Bhavana Srivastava, AGM
SIDBI, Chennai—R.M. Nair, GM
GTZ—Marie Luise Haberberger
KFW—Rukmini Parthasarathy; Nandkishor Agrawal
Ministry of Finance—Tarun Bajaj (Joint Secretary, Banking & Insurance)
MIA—Ralf Radermacher
World Bank—Niraj Verma
UNDP—Ratnesh; Navin Anand
Sa-Dhan—Achla Savyasaachi
IFC—Anil Sinha
M-CRIL—Sanjay Sinha
PFRDA—Ms Rani S. Nair
CAB—Sandip Ghose, CGM , Kamalarajan, CGM
Grameen Capital Services—Royston Braganza, Shashi Shrivastava
Planet Finance—Anna Somos Krishnan, Executive Director; Saheba Sahni, Programme Manager
NABARD, Bangalore—M.V. Tagat, Chief General Manager, M.V. Patro, GM , R. Sundar, GM, C.P. Mohan, GM
NABARD- DDM, Kolar—Jayprakash L. Samudre
BSS—Abhay Kanjikar
Grameen Koota—Suresh Krishna, MD
Unitus—Ganesh Rengaswamy, CEO, India; Shubha Gupta, HR Specialist, Jhunjunwala, IT expert
Microfinance Focus—Vikash Kumar, Naagesh Naaraayana
Karuna Trust—Dr Sudarshan
IFMR, Bangalore—Shreyas Gopinath, Veena Jayaram
RORES—Kolar field officers
Grameen Koota—Kolar field officers
StanChart— Gouri Sankar
Sarvodaya NanoFinance—R. Sowmithri, CEO
CMF- IFMR—Justin Oliver, Doug Johnson, Minakshi Ramji and others
CIRM-IFMR—Rupalee Ruchimishta
Equitas—P.N. Vasudevan, MD
ICICI Foundation—Nachiket Mor, President
Gram—Samson
HDFC Bank—Manohara Raj, Michael Andarde, Vimal Tripathi,
Raja Menon
Sreema Seva Samithy—Bani Saraswathi
Bagnan Mahila Bikash Cooperative Credit Society—Gopal Ghosh, Madhuri Ghosh

List of SOS-specific activities

Experience sharing workshop of private sector and foreign banks at CAB, Pune done jointly with ACCESS Development Services on 18 July 2008
Roundtable of microfinance practitioners at Basix, Hyderabad jointly by ACCESS Development Services, Basix and Alpha Microfinance Consultants on 10 August 2009
Brainstorming Roundtable of UNSE microfinance and poverty community members—arranged by UNSE and UNDP at BIRD, Lucknow on 29 August 2009
Query on the UNSE platform in the microfinance and poverty community—asking members to share their views on structure, content and presentation of SOS 2009 and also information on new models, innovations and experiments. The query elicited 28 responses.

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