Srinivasan

Microfinance India

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State of the Sector Report 2008

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Contents

List of Tables, Figures, Boxes, Abbreviations and Annexes vii
Foreword xiii
Preface xv
Prologue xvii

1. Overview—growth and consolidation 1
2. The SHG–bank linkage programme (SBLP): entering a phase of consolidation? 15
3. The microfinance institutions and the investment climate—is expansion the mission? 45
4. Banking correspondents and facilitators 69
5. Urban microfinance—fast and furious 73
6. Social performance and responsible microfinance 77
7. Competition—does the client benefit? 85
8. Micro-Insurance—a long way to go 89
9. Policy environment and regulation—high expectations! 101
10. Technology in microfinance 109
11. Some major institutional contributors 117
12. Future agenda 133

Appendix 137
Bibliography 153
About the Author 157

List of Tables, Figures, Boxes, Abbreviations and Annexes

Tables

1.1. Client outreach (in millions) 2
1.2. Estimate of microfinance clients for loans 5
2.1. Growth trends in SBLP 16
2.2. Regional shares in SHG linkage 16
2.3. Top five states in SHG linkage in 2007–08 17
2.4. Growth of SHGs linked in 13 priority states 17
2.5. Ranking of select states based on MPI and MPPI 18
2.6. Agency-wise shares of SBLP 19
2.7. Savings performance of SHGs 20
2.8. Comparison of savings between SHGs and SGSY groups 20
2.9. Loans to SHGs—Share of different banks in outstanding loans as on 31 March 2007 20
2.10. Proportion of groups financed to groups savings linked 21
2.11. Top RRBs in SHG linkage 21
2.12. Top district central cooperative banks (DCCBs) in SHG linkage 22
2.13. Range of recovery 26
2.14. State-wise spread of SHG federations 32
3.1. Indian MFIs in the top 50 lists 46
3.2. Top five MFIs by outreach and loan portfolio 46
3.3. Region-wise average loan size 2008 47
3.4. Market share of different forms of MFIs 47
3.5. Size of institutions and yield on portfolio 48
3.6. Age of institutions and yield on portfolio 48
3.7. Age of MFI and operational costs 48
3.8. Profitability of different forms of MFIs 49
3.9. Key business ratios 49
3.10. Legal form and leverage 50
3.11. Repayment schedule 64
4.1. Differences between BCs and BFs 70
5.1. Clients, loan volumes in urban areas 74
8.1. Insurance complexity and cost 91
8.2. Micro-Insurance products 92
8.3. Insurance coverage under *Sampoorna Suraksha* 97
10.1. Some technology solutions for MIS 115

Appendix Tables

A.1. Fact sheet on coverage and growth of SHGs and MFIs, March 2008 137
A.2. Details of MFIs reporting to Sa-Dhan Quick Data 138
A.3. Outstanding loans of bulk funders of MFIs 151
A.4. List of persons and organisations met 151

Figures

1.1. Microfinance coverage 3
1.2. Relationship between widening, deepening and costs 4
2.1. Regional coverage of SHGs 17
2.2. Agency-wise share of groups financed (2007–08) 19
2.3. Agency-wise share of groups financed (2006–07) 19
3.1. Region-wise client outreach and portfolio 46
3.2. Outreach-size, institution-wise 47
3.3. Equity raised by MFIs 56
3.4. Calculation of effective interest rate based on loan conditions and pricing 63
3.5. Calculation of effective interest rate based on loan conditions and pricing 65
8.1. Insurance penetration—global comparison 90
8.2. Insurance density—global comparison 90
9.1. Regulatory coverage of MFI clients 102

Boxes

Chapter 2

MPI and MPPI 18
A different cooperative bank 22
The charter 24
Everyone wants to become NBFC? 28
Lessons from Andhra Pradesh federating experience 31
Views of Committee on Financial Inclusion on Federations 33

Chapter 3

How SKS satisfies its humongous need for HR 52
First-of-its-kind portfolio sale 53

Chapter 6

Sarvodaya Nano Finance, an MFI with a difference 81

Chapter 8

Design of insurance products with the client as focus 93
Rainfall insurance for orange growers 94
Sampoorna Suraksha: a hybrid micro-insurance programme 97

Chapter 10

Financial Inclusion Technology Fund (FITF) 109
Eligible activities/purposes—FITF 110
PUSHTIKAR hand-held service—a low-cost model 111
Technology, inclusion and benefits transfer—The AP model 112
The EKO model of cellular banking 113
STEMS—another technology pilot from BASIX 114

Chapter 11

Bhamashah Financial Empowerment Scheme—Government of Rajasthan 118
The AP Experience 118
Centre for Microfinance Research—a new initiative by BIRD 124

Abbreviations

ABCO	Average Borrowers per Credit Officer
AICI	Agricultural Insurance Company of India Limited
ALW	A Little World
AMMACTS	Acts Mahila Mutually Aided Cooperative Thrift Society
AP	Andhra Pradesh
APMACS	Andhra Pradesh Mutually Aided Cooperative Societies
APMAS	Andhra Pradesh Mahila Abhivruddhi Society
APR	Annualised Percentage Rate
BC	Business Correspodent
BDS	Business Development Service
BIRD	Bankers Institute of Rural Development
CAB	College of Agricultural Banking
CASHE	Credit and Savings for Household Enterprise
CASHPOR	Credit and Savings for the Hardcore Poor
CBS	Core Banking Solution
CDF	Cooperative Development Foundation
CGAP	Consultative Group to Assist the Poor
CM	Computer Munshi
CMF	Center for Microfinance
CMR	Centre for Microfinance Research
CMRC	Community Managed Resource Centres
CRAR	Capital to Risk Weighted Assets Ratio
DCCB	District Central Cooperative Bank
DFID	Department for International Development+B1
DRDA	District Rural Development Authority
DWCD	Department of Women and Child Development
FIF	Financial Inclusion Fund
FINO	Financial Information Network & Operations Ltd
FITF	Financial Inclusion Technology Fund
FLDG	First Loss Deficiency Guarantee
FWWB	Friends of Women's World Banking
GCC	General Purpose Credit Cards
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HDFC	Housing Development Finance Corporation
HDI	Human Development Index
HR	Human Resources
HUDCO	Housing Urban Development Corporation
ICT	Information and Communication Technology
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IGS	Indian Grameen Services
IKP	Indira Kranti Patham
ILFS	Infrastrructure Leasing and Financial Services Limited

ILO	International Labour Organization
IPO	Initial Public Offering
IRDA	Insurance Regulatory and Development Authority
IT	Information Technology
JLG	Joint Liability Group
KBSLAB	Krishna Bhima Samruddhi Local Area Bank
KDFS	Kalanjiam Development and Financial Services
KFW	Kreditanstalt für Wiederaufbau
KYC	Know Your Customer
LAB	Local Area Bank
LIC	Life Insurance Corporation of India
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 Organisations
MIFOS	Microfinance Open Source
MIS	Management Information System
MIX	Microfinance Information Exchange
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
NE	North East
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
PDA	Personal Digital Assistant
PHC	Public Health Centre
PLR	Prime Lending Rate
POS	Point of Sale
POT	Point of Transaction
PPP	Purchasing Power Parity
PRADAN	Professional Assistance for Development Action
RBI	Reserve Bank of India
RGVN	Rashtriya Grameen Vikas Nidhi

RMK	Rashtriya Mahila Kosh
RRB	Regional Rural Bank
RV	Roshan Vikas
SBLP	SHG–Bank Linkage Programme
SC	Scheduled Caste
SCB	State Cooperative Bank
SEEP	Small Enterprise Education and Promotion
SERP	The 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
SNFL	Sarvodaya Nano Finance Limited
SPM	Social Performance Management
ST	Scheduled Tribe
STEMS	Single Terminal Enabling Multiple Services
TNCDW	Tamil Nadu Corporation for the Development of Women
UCB	Urban Cooperative Bank
UNDP	United Nations Development Programme
USP	Unique Selling Proposition
VO	Village Organisation

Annexes

1.1. Expectations from microfinance practitioner community—UN solutions exchange 11
2.1. Microfinance penetration 37
2.2. SHG–bank linkage programme—regional spread of physical and financial progress as on 31 March 2008 39
2.3. Federations—types, promoters and location 41
2.4. Public sector banks performance in SHG linkage—outstanding accounts and loans 41
3.1. MFI client and loan outreach 61
3.2. The role of interest rates 62
3.3. Private equity funds investing in Indian MFIs 65
3.4. Excerpts from master circular on Capital Adequacy issued to banks 65
11.1. List of microfinance resource agencies/service providers 125

Foreword

Based on the significant success of the first two reports, 'Microfinance in India—State of the Sector Report 2006' and 'Microfinance in India—State of the Sector Report 2007,' ACCESS was hugely encouraged to invest in bringing out the third edition of the report for 2008. The State of the Sector Report has truly come of age, becoming the single most important resource document for microfinance in India. Late last December, I received a call from both NABARD and SIDBI (the two apex institutions promoting the sector), requesting for 50 copies each of the 'State of the Sector Reports' for 2006 and 2007. I was told that these copies were required urgently as the members of the Parliamentary Standing Committee on Finance, who were examining the 'Microfinancial Sector (Development and Regulation) Bill', desired to refer to the documents to enable them to take a view on the pending bill. While the last two reports have remained among the five most downloaded sector documents globally as per the information on Microfinance Gateway, the ability to inform and influence policy enhances the value of these reports significantly. Although not very pleased by the author's critique of the bill in the report, the 2007 State of the Sector Report was released in October 2007 by the Union Finance Minister, Shri P. Chidambaram, at the Annual Microfinance India Summit organised by ACCESS Development Services.

Traditionally the report is brought out each year in time to be released at the Annual Microfinance India Summit. Given the growing popularity of the summit, which is attended by a very large global audience, it makes good sense to synchronise the release of the document at the event and organise a session that discusses the highlights of the report. In some manner, within the sector, as well as among the media, release of the State of the Sector Report has become an awaited affair. Although the earlier two reports were first brought out as in-house publications and subsequently published commercially by SAGE, the 2008 report is being brought out directly by SAGE this time, which should significantly increase its circulation. Given the great demand for its copies, ACCESS has taken a decision to distribute copies of the report as a part of the Conference Kit. This year's report balances well between continuity and change. Progress of the sector by models and methodologies continues to be captured in this year's report, with emphasis on new developments and updates. Apart from the overview, insightful analysis of trends in SHG–bank linkage and the MFI channel are part of the continued focus on core microfinance issues, as in the previous years. SHG federations have been covered in detail not as a separate chapter, but as a part of the SHG–bank linkage chapter. Social performance, urban microfinance issues, new technology initiatives and micro-insurance are also covered in detail in this year's report. Given the central role of formal financial institutions, this year's report has extensively covered the issues in commercial bank lending to MFIs, investment climate for equity and bulk debt providers. The challenges of human resources required by a growing sector are covered as part of the MFI chapter, as that is where the shortage of HR is being felt most. New topics included in the 2008 report includes policy environment, competition, business correspondents and facilitators and some perspective on emerging trends for the future. The 2008 report is richer with greater availability of data from RBI, NABARD, Sa-Dhan and others in the sector. Interesting inclusion is the interviews of key

policy makers from RBI, NABARD and SIDBI, which provide macro policy perspectives and unique insights for the sector.

An important 'change' in this year's report is the author. While Prabhu Ghate very deftly brought out the first two reports, accomplishing the complicated task of collating the full complexity of the sector into a highly readable annual format, the 2008 report has a new author, N. Srinivasan. I was in a bit of luck to 'grab' Srinivasan, who had just sought voluntary retirement from NABARD at the time when Prabhu was announcing his great exhaustion from the efforts in bringing out the first two reports. While I would like to acknowledge with gratitude, the painstaking efforts that Prabhu put into bringing out the first two high-quality reports, Srinivasan came in as a great just-in-time replacement. Given his long-term association at very senior levels with NABARD, it was easy for him to take the baton with effortless ease. With his experiences and insights, he has been able to sustain and strengthen the excellent quality of work done by Prabhu in the initial two years. The 2008 report has been put together by Srinivasan as a single author, consulting broadly with sector experts, institutions and practitioners.

There are many who supported the author and ACCESS in bringing out the State of the Sector Report 2008. I would like to thank Girija Srinivasan, C. S. Reddy, Doug Johnson, Chuck Waterfield and UN Solutions Exchange for the support given to the author. As for ACCESS, I am thankful to Sandeep Ghosh, Principal, College of Agricultural Banking, RBI; Prema Gera from UNDP, always available for discussions, and Annie Duflo at Centre for Microfinance, equally willing to share its knowledge resources for the report. I would like to thank Malcolm Harper, who was able to provide valuable long-distance inputs and critique a few chapters; Ajit Kanitkar from Ford Foundation and Adrian Marti from SDC; the two donors and Brijmohan, ACCESS Chairman, all three always anxious and eager to see incremental improvements in the report and always available for the review sessions on the report. I am also thankful to Neeraj Verma from the World Bank; Sridhar, Chairman, National Housing Bank; Anirudh Tiwari from IFAD; Mathew Titus from Sa-Dhan; Sanjay and Frances Sinha from EDA Rural Systems; Sachin Sachdeva from Aravali; Jaipal from CMF, Jaipur; Rukmani Parthasarthy from KFW and Iddo Dror from MIA for inputs, information and insights.

Finally, and most importantly, I am thankful to my small team in ACCESS, which quietly and without much fanfare coordinated the entire process. Particularly, I am thankful to Yeshu, who fixed and coordinated various meetings, downloaded and analysed key data, forwarded relevant information and made sure that the process was smooth right through. I would like to thank Lalitha for the meticulous travel and logistic support that enabled Srinivasan to move around the country effortlessly. The whole experience has been very enriching, certainly, for the author, and also for the ACCESS team. At the end, I am very happy that at ACCESS, we have been able to bring together another good document that will be of value to the sector.

Vipin Sharma
CEO, ACCESS Development Services, New Delhi

Preface

Prabhu's exceptional act in the last two years is a hard one to follow. As he pointed out in last year's Preface, despite best efforts, it is difficult to assert that the report is a comprehensive record of everything that happened in the sector. This year's report tries to update the several developments of the sector which were richly covered in the last year's report. Although the aspects covered remain more or less the same, there is a special focus on policy environment, competition issues and banking correspondent/facilitator framework. Interviews of Deputy Governor of Reserve Bank of India, Chairman of NABARD and Chairman of SIDBI enrich the report, giving a macro perspective. A new chapter to cover the activities of significant institutions that contribute to the development of the sector has been included. The SHG linkage chapter has been expanded with the additional information available from NABARD and SHG federation-related aspects have been included therein. A quick report from Sa-Dhan enabled an analysis of MFIs performance; a section on investment climate in the MFI segment has been added to this chapter. A short chapter at the end runs the risk of trying to gaze into the future.

My sincere thanks are due to Girija Srinivasan for the initial draft of the chapter on SHGs and federations, and C.S. Reddy for the section on SHG federations. I acknowledge the inputs provided by Doug Johnson for the section on Investment Climate in Chapter III and Ramesh Arunachalam for Technology Issues in Chapter X. I am deeply indebted to Usha Thorat, Deputy Governor, RBI; U.C. Sarangi, Chairman, NABARD and R.M. Malla, CMD, SIDBI, who readily agreed to be interviewed. Many organisations and practitioners helped me in gaining an understanding of the sector and the institutions. The many people whom I met over the last six months gladly spared their time, and the institutions that I visited willingly shared their resources to enable me to gather insights into the developments. I owe a debt of gratitude to many. My special thanks are to Marie Louise Haberberger of GTZ for offering her personal insights and sharing the studies and reports commissioned by GTZ; Sandeep Ghosh, Principal, College of Agricultural Banking, for scheduling an experience sharing workshop of private banks; Annie Duflo of CMF (IFMR) for sharing their research and study outputs and Sridhar, Chairman of National Housing Bank. I acknowledge the contributions made by Amar Singh, Anirudh Tiwari, A. Ramanathan, Chandra Sekhar Ghosh, Chris Murdoch, Christian Hass, C.S. Reddy, Frances Sinha, Gourishankar, Graham Wright, H.R. Khan, Iddo Dror, Jawahar Sarkar, Jayshree Vyas, K.C. Ranjani, K.K. Suresh, Marc Soquet, Mathew Titus, M. Balasubramaniam, Navin Anand, N.K. Maini, Prema Gera, Rajendra Kulkarni, R.M. Nair, R. Sowmithri, Sanjay Sinha, Suhasini Singh, Tilisa Gupta, Vanatha Reddy, Vijayalakshmi Das, Vijendra, Vinod Jain and V.N. Salimath during personal discussions. I acknowledge the permission given by Sa-Dhan, for using its data base and the information in its public domain documents. Chuck Waterfield of Microfin graciously agreed to permit reproduction of an excerpt from his note on interest pricing. The information base placed in public domain by RBI and NABARD has been of great use in this report. On my request the UN Solution Exchange ran two questions pertaining to the report, which produced an overwhelming response.

I thank Anand Kumar, Navin Anand and Prema Gera for building this collaboration between the practitioner community and the SOS.

The advisory group of Microfinance India comprising Adrian Marti, Ajit Kanitkar, Annie Duflo, Brij Mohan, Malcolm Harper, Prabhu Ghate, Satyamurthi, Vijayalakshmi Das, Sitaram Rao and Vipin Sharma were very supportive throughout, with ideas and suggestions. Ajit Kanitkar kept me on my toes by sending across many interesting pieces of information from the initial stage. Brij Mohan was a continuing source of inspiration and helped me navigate a couple of tight situations in accessing information for which I am extremely thankful.

Malcolm Harper, Ajit Kanitkar, Prabhu Ghate and C.S. Reddy provided valuable feedback on the first draft of the Overview chapter. Girija Srinivasan reviewed the draft of this report and provided critical feedback. My thanks are due to Vipin Sharma and his team in ACCESS who supported me in every manner possible. The flexibility and freedom afforded were invaluable. Vipin gave constructive feedback on the structure of the report besides being a source of motivation. Yeshu Bansal, apart from being the anchor, helped in processing of data and provided feedback on key chapters. Narendra Nayak carried out an e-survey of NGOs and compiled the list of service providers annexed to Chapter XI. R.K. Mukherji of ACCESS provided inputs for the chapter on MFIs. Bharat Parekh, Arabdha Das and B.N. Panda facilitated the meetings with MFIs and NGOs in Bhopal, Kolkata and Udaipur. Lalitha Sreedharan and her colleagues provided administrative and logistical support tirelessly for which I am very thankful.

Keying in such a long report and editing it is tedious. Praveen Shinde helped me with the typing of the initial draft from voice files, relieving me of tedium. I thank SAGE Publishers for their patience and perseverance with the draft.

It is difficult to list all those who had directly and indirectly supported me, but I have annexed a list of such individuals and institutions who contributed to the making of this report at the end. My sincere apologies to those whose names might have been inadvertently left out here or in the list annexed at the end.

Despite the best efforts put in, the information presented might not be complete. While I own the responsibility for all errors and omissions, I request the readers to point out the same so that at some point, the record can be corrected.

In drafting this report it has been very difficult to resist the temptation of going beyond describing sector trends and drawing inferences. I hope the readers would take the critical observations in some parts of the report as an input for introspection. It has been an exhilarating experience and a personally humbling one. I thank the sponsors of this report—Ford Foundation and UNDP—for providing this unique opportunity.

N. Srinivasan

Prologue

It was a cloudy afternoon in the hinterland of a state in north India. We, a group of microfinance 'professionals', were trying to find out how the clients of a microcredit institution were responding to the interventions. The microfinance institution (MFI) was doing a good job; bringing access to credit in a village where not much bank credit was available. Women, we are told emphatically, were for the first time being treated as priority clients. The MFI assured that they were doing well in terms of expansion, quality of loans and use of loans by the clients and that there were no problems for either the clients or the MFI. We probed further. We asked the assembled 40 odd women, 'Is there anything that you wish was different about the way the loan is provided; any little thing that would have made it easier for you?' Most of them shook their heads to signal that there was no such thinking. We persisted in silence for an answer. Though they had whispered conversations for a couple of minutes there were no reactions to the question. Then an old lady got up and started, 'I have something to say.' We asked, 'What?' She said, 'You see, I run a small bangles and cosmetics shop in the local market. I could not be running this shop but for the loan from the MFI. I started with a smaller loan and over two cycles of repayment, the loan had become Rs 10,000. With this I could start this shop.' So what was the problem, we wondered? She continued, 'I repay the loan instalments every week without fail. But I find that after six months, the repayments become more difficult for me. I have to borrow from elsewhere to keep up weekly instalments and around the tenth month I look for an external loan with which I can repay the balance of MFI loan and take a fresh loan.' We asked her why she suddenly finds it difficult to repay after six months of loan. She looked at us in amusement that how could we be ignorant of such a simple thing. Then she patiently explained, 'Initially when I stock my shop with Rs 10,000 worth of goods, there is a large range and variety. My sales are higher and cash inflow is higher. But after each sale, I am unable to replenish my stock as I have to meet my family needs and service the loan every week. By the sixth month my shop has half the stock I started with. With half the stock, I cannot maintain my sales volume at a high enough level. Very often the stock that I am left with is not the first preference of customers and cannot be sold at good profits. My cash flow declines and I am unable to meet all my commitments. This is what constrains my repayment.' We again asked her, 'What do you want the MFI to do?' She explained, 'Nothing extraordinary. They (MFI) should relend the repayments at the end of each month after every four instalments. This would ensure that I replenish my stock and my cash flow from sales remains high.' Enlightened on the need for revolving credit for even small trade and petty businesses, we returned. On the way back we asked the MFI as to why those types of needs were not assessed. The MFI official said, 'There is no real problem. Once they repay the instalments, we give a higher loan as per their need.' We persisted, 'Why not redesign the loan product?' The MFI official said, 'Changing the nature of the loan product and repayment periods would make it difficult for us to administer the loans. We have to invest in new software, new systems for portfolio tracking, train our staff and all this imposes extra costs. It will make our lives difficult. The present loans are fine and the people will adjust to it easily.'

Then, where is the 'need based' financial intermediation? Where is the customer? Are we putting institutions' interests first? Where do clients figure in microfinance? Are poor clients last in the long list of our objectives? How do we bring poor clients first in the list of priorities? Are we asking the right questions to our clients and looking for real answers?

This is the running theme of this year's State of the Sector Report.

Overview—growth and consolidation

1

Chapter

THE MACRO CONTEXT

The country's economy performed creditably with 8.7 per cent gross domestic product (GDP) growth during 2007–08 on the top of 9.6 per cent growth rate during the previous year. The agricultural GDP grew by 2.6 per cent, which was lower than the growth rate of 3.8 per cent that was achieved during the previous year. The poverty levels, however, have been declining gradually. The 61st round of National Sample Survey Organisation's (NSSO)[1] survey estimates that poor people constitute 27.5 per cent of the country's population. Poverty levels were higher in rural areas at 28.5 per cent when compared to 25.7 per cent in urban areas. The human development index (HDI) of the country had improved from 0.577 in 2000 to 0.619 in 2005, reflecting improvements in quality of life. Food insecurity continued to daunt, but a lower proportion of population at 1.9 per cent in the latest NSSO survey when compared to 4.2 per cent facing food insecurity, five years back. West Bengal (WB) and Orissa have higher proportions of vulnerable people facing food insecurity.[2] The optimism about future among vulnerable sections of people is incredible. While 96 per cent of a sample (surveyed by National Council of Applied Economic Research (NCAER) in a study for Max life) felt that they cannot survive beyond one year on their current income, 54 per cent of the sample felt financially secure for the future.

Banking sector grew at a healthy pace during most of the year. The overall savings rate was 35 per cent with household savings at 22 per cent and 47.5 per cent of savings was in financial instruments. The bank deposits with commercial banks increased by 17.4 per cent in rural centres and 26.6 per cent in urban centres during 2007–08. Credit growth was at 18.3 and 23.9 per cent, respectively, in rural and urban centres.

Several major initiatives have been rolled out during the year, which would have implications for the microfinance sector. Following the recommendations of the Committee on Financial Inclusion,[3] a nation-wide programme of financial inclusion, utilising the banking network to include all the excluded with a financial service need, has been initiated. The committee has examined several aspects closely related to microfinance sector. The Raghuram Rajan Committee on financial sector made significant recommendations such as creating a space for small private banks, use of Internet kiosks, village grocer, and so forth, as banking correspondents (BCs), liberalisation of BC norms, sharper focus of priority sector, lending on core poor, and liberalisation of interest rates with transparency and disclosure requirements. The rural credit cooperative reform gathered momentum with more states coming forward to sign agreements with National Bank for Agriculture and Rural Development (NABARD) and the centre.[4] The expert group on farmers' indebtedness[5] had submitted its report, based on which certain actions such as a debt-swap scheme to relieve informal sector debt have been initiated. The biggest surprise to rock the political economy domain was the waiver of farm loans for about 40 million farmers amounting to an estimated Rs 720 billion. Interestingly, neither the expert group nor the review group[6] recommended waiver of farm loans.

GROWING BY LEAPS AND BOUNDS

Microfinance has made great strides during the fiscal year that passed by. The self-help group-bank linkage programme (SBLP) has continued to make good progress, but at a slower pace. The SBLP covered an additional 0.552 million self-help groups (SHGs) during the year with an estimated membership of 7.18 million.[7] The cumulative number of groups ever linked to the banking system increased to 3.47 million and the estimated number of households covered to 45.1 million.[8] The microfinance institutions (MFIs) have recorded an increase of almost 4 million clients during the year, as reported by Sa-Dhan based on the information collected from 223 institutions engaged in microfinance. This growth in number of clients is accompanied by a growth in the outstanding portfolio of loans by almost Rs 25 billion.[9] The increase in SHG clients taken together with the expanded outreach of the MFIs has led to an overall increase of 11.15 million clients during the year. If the overlap between the banks and MFIs in respect of SHG lending is eliminated, still, a net addition of more than 9 million clients seems to have been achieved. Net of adjustments more than 54 million clients are estimated to have been reached by the microfinance sector in different forms, with an expansion of clientele by 9.9 million during the year.[10] This is the first time that the narrowly defined microfinance clientele has crossed the 50 million mark. There are several reservations about the data such as double counting of clients, multiple loan accounts of individual clients inflating the overall number of clients, counting of accounts rather than clients and reckoning of non-borrowing clients in the absence of full information are some of the deficiencies with the data reported. The numbers should be seen as approximate indications of trends and evaluated in a comparative sense along with past data rather than in an absolute sense (Table 1.1).

Table 1.1 Client outreach (in millions)

Segment	2006–07	2007–08	Growth in outreach
Banking system (SHGs)	38.02	45.20	7.18
MFIs	10.04	14.01	3.97
Total	48.06	59.21	11.15
Total adjusted for overlap	44.97	54.87	9.90

In the southern states, a point of saturation has been reached with families being in multiple groups, as also borrowing loans from more than one MFI. This leads to the same set of clients being counted by each SHG or MFI with which the client is linked. Precise numbers on the extent of such multiple loans are not available and difficult to estimate. A mechanism for compiling data on the numbers is necessary to produce reliable information for understanding and analysis.

The growth story is no doubt heart-warming. Never in the past has such sustained growth taken place comprising several different organisations in policy, operations and technical services acting in concert. The level of optimism in the last two years has rarely been witnessed. The notable feature of the growth story is the mutuality of needs, providers and users of the services; and their faith in the microfinance movement.

QUALITY OF GROWTH

But the expanded outreach and increased loan disbursement have to be seen in the context of the quality of what has been achieved. The quality dimension is basically examined from the width and depth of outreach achieved. The distribution of the microfinance services across the country and also the coverage of the most vulnerable sections of population are matters for closer scrutiny. The north, east and north-east still have considerable headroom to grow. In terms of coverage of the vulnerable, it is difficult to conclude that the most poor have been prioritised. Studies and anecdotal evidence point to the coverage of the upper strata of the poor and not so much to the ultra poor. In case of SHG linkage, except the government-sponsored programmes that are mandated to focus on poor, the other efforts do not prioritise the poorest. The study carried out by EDA Rural Systems and Andhra Pradesh Mahila Abhivruddhi Society (APMAS) in 2005[11] had found that only 51 per cent of its sample SHG members were poor. The NCAER[12] study carried out recently has found that in Uttar Pradesh (UP), Andhra Pradesh (AP) and Maharashtra, SHGs with majority non-poor members were as high as 63, 43 and 34 per cent, respectively. Poverty audits[13] carried out revealed that in five MFIs out of eight, the proportion of non-poor clients were more than the poor, with

coverage of non-poor ranging from 42 to 88 per cent of the clientele. Only in three MFIs the poor clients were more than non-poor. Both the SBLP and MFI segments expanded in the developed states. The growth in other states has been limited. The four southern states continued to have a major share of the stock of microfinance clients and growth. The Chairman of NABARD had expressed the view that while the slowdown in the southern states is understandable, the lack of vigorous growth in other states is disappointing.[14] The SBLP has hit a plateau in the southern states, with new groups linked being less than that of the last year, impacting the growth numbers for the country as a whole. The slowing of the pace in SBLP should provide the space and resources for consolidation and deepening of the financial services among the SHGs. In that sense, the lower growth rate should be seen as a positive development in the saturated southern states. The MFIs had most of their outreach and loan volumes in AP, Tamil Nadu and Karnataka (52 per cent of clients and 59 per cent of outstanding loans). There are six major states and all the north-eastern states in which MFIs have very few clients, constituting less than 1 per cent of total clients.

In terms of geographical coverage, well-endowed and high-growth areas have been prioritised. The expansion within such areas has also not consciously targeted the poor. The most vulnerable are not clients of choice, for most organisations engaged in SHG promotion or MFI lending. In poorly endowed, backward and remote areas, even the better-off among the poor do not get covered as these areas are not yet in the microfinance map. Hardcore poor remain excluded; so are remote areas (Fig. 1.1).

The very poor with no resources may not be fitting clients of the financial system till the time their capacities are built. The others are potential clients of the system. But banks and MFIs tend to cherry-pick their clients. The products and processes by design or default exclude the more vulnerable of the poor. Expansion into remote areas is fraught with risks and additional costs and long breakeven periods; hence the lack of focus on such areas. The financial inclusion initiatives focus on coverage of remote areas and the excluded people. The financial inclusion funds could be accessed by the banks and MFIs to part-fund their initial investment costs for expansion to remote areas. Where technology options are available for remote area banking, the costs of initial investment could be met out of Financial Inclusion Technology Fund.

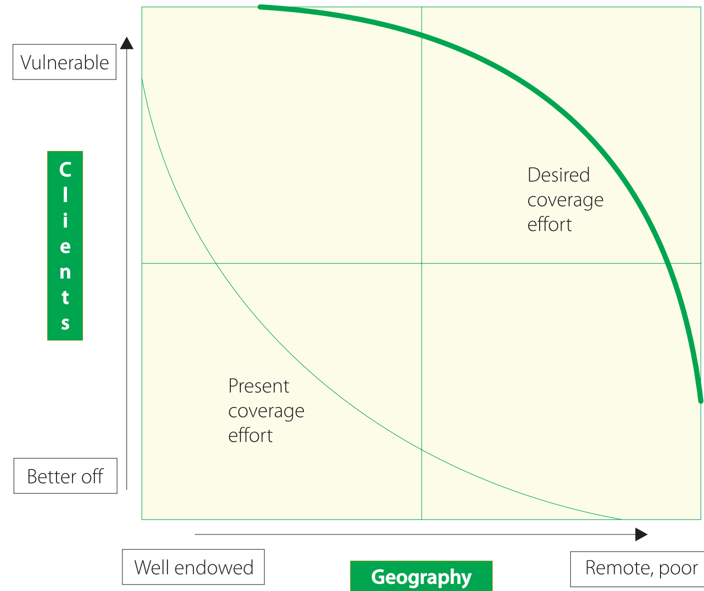


Figure 1.1 Microfinance coverage.

The other dimension of quality of expansion is the depth of services. The numbers reached have been significant and to some extent, the volumes have been substantial. But the expansion lacks depth. Needs fulfilment of the clients does not seem to have taken place. The total potential of each client in terms of a variety of loans, savings, insurance and other services has not even been surveyed by the institutions. The average loans per client in both MFIs and SHGs have been low; between Rs 3,500 and 5,000. The duration of the loan is short, typically 1 year or less. The small loan size and short duration do not enable most borrowers to do much except to ease liquidity problems. The IIMS Dataworks Research Report[15] on low-income workers indicates that the penetration of life insurance is only 19 per cent among the urban low-income population and 12 per cent among the rural counterparts. The Insurance Regulatory and Development Authority (IRDA)[16] has indicated that insurance penetration and density in India have a long way to go to catch up with the rest of Asia. The penetration ratio[17] for insurance in India was estimated at 4.80 in 2006, whereas for Asia it was 6.60 and for Europe at 8.30.

The insurance density ratio[18] in India was estimated at 33.2 in 2006 with comparable ratios for Asia and Europe at 154.6 and 1119.6, respectively. The country's low-level insurance coverage in terms of numbers and depth would translate to negligible levels of insurance coverage among the microfinance clients. The inference is that the microfinance market, by and large, is expanding horizontally covering the easier areas and the better-off clients, without deepening the engagement thereby entailing higher costs, which are passed on to the clients (Fig. 1.2).

The minimalist approach to expansion has cost and profitability implications for the MFIs and the banks. It would also have pricing and affordability implications for the borrowers from the sector.

The number of institutions providing microfinance has increased. The number of MFIs reporting to Sa-Dhan increased to 233 in 2008. As per information available with NABARD, by the end of March 2007, 334 MFIs had availed Rs 11.565 billion from the banking system and the outstanding loans to 550 MFIs were at Rs 15.845 billion.[19] There is an increased availability of funding from financial institutions as also donors. Continuing the trends seen in the last year, there is a heightened activity in the private equity and venture capital spheres.

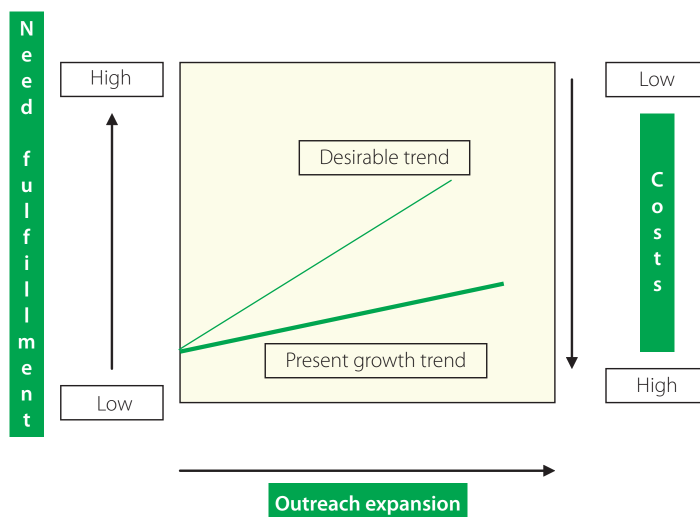


Figure 1.2 Relationship between widening, deepening and costs.

THE BROADER MICROFINANCE SECTOR

One of the macroissues relating to microfinance is its definition and scope. The tendency has been to assume microfinance as being limited to *lending* carried out by MFIs and through SHGs. Such a definition in the Indian context denies the role played by the state and banking system in achieving the social mandate of banking initiated in the early seventies. Savings services are an important part of finance and post office has achieved a considerably large outreach in savings in the rural hinterland. With its 1,55,000 offices across the country, the post office, at the end of March 2007, serviced 172.39 million deposit accounts, of which 64.34 million are savings accounts with outstanding savings of Rs 1.85 billion.[20] The savings accounts are the closest to the microfinance clients. An estimate made based on the available data reveals that the microfinance loan clients were more than 115 million across the country. The outreach of savings would be even larger, but difficult to estimate for want of disaggregated data on class of savers among the bank account holders as also issues of multiple accounts, which is more prevalent in savings accounts (Table 1.2).

The clientele of the narrowly defined microfinance sector (SHG and MHI clients) in case of borrowers is no more than 40 to 45 per cent of total clients.[21] Microfinance sector has the potential for significant improvement of its clientele as the excluded population is substantial. More of the excluded population is in the credit and insurance markets. The financial inclusion initiative is an opportunity that must be fully used by the MFIs and non governmental organisations (NGOs) to cover new areas and clients.

WINDS OF CHANGE

A much deeper structural change that is set to sweep the microfinance landscape is the transformation of NGOs into lending institutions. There is a strong movement towards the transformation of NGOs' promotional work in dealing with the poor into commercial microfinance operations through a variety of means.[22] Urban microfinance has caught the fancy of both MFIs and funders.[23] The industry leaders and mid-level NGOs/MFIs are foraying into urban markets with large business plans.

The regulation story has not reached a logical end. A conclusive microfinance bill that was expected to be in place during the year has not materialised. The bill is still a subject of parliamentary scrutiny at the hands of Standing Committee

Table 1.2 Estimate of microfinance clients for loans

Class of agency	No. of clients on 31 March 2007 (millions)
Commercial banks* (including RRBs) small loan accounts	38.6
Primary cooperative societies Borrowers (small, vulnerable)†	26.5
SHGs—members‡	39.9
MFIs—clients§	14.1
Total	119.1
Adjusted for over lap between banks and MFIs¶	114.7

*Basic statistical returns of commercial banks 2006–07, RBI.
†Progress of Primary Agricultural Credit Societies, 2006–07, National Federation of State Cooperative Banks.
‡Of the estimated cumulative no of SHGs linked of 3.478 million the accounts with outstanding loans are estimated at 3.408 million based on 2006–07 data on outstanding loan accounts of SHGs (98 per cent of linked accounts). At the rate of 13 members of per group (the average as per the NCAER study) and a drop-out rate of 10 per cent, the number of members is estimated at 39.9 million. The issue of multiple SHG membership is not tackled directly in this calculation. But in the adjustment carried out for overlaps, this would have been taken care of.
§The Bharat Microfinance Report, Quick Data, 2007–08—Sa-Dhan.
¶The client base of MFIs is at 14.1 million of which 7.26 million is that of MFIs following only SHG methodology and 2.84 million of MFIs that follow SHGs as one of the methods. 50% of clientele of SHG only MFIs and 25% of clientele of mixed method MFIs have been reduced from overall numbers of clients to account for the overlap between banks and MFIs and multiple borrowings from different MFIs. In any case the microfinance sector is likely to have more than 100 million borrower accounts.

on Finance which has yet to come out with its final recommendations.[24] A demand for an interest rate cap on MFI loans is one of the contentious points requiring resolution. Savings being not permitted is perceived as an opportunity missed by the non-banking financial companies (NBFCs) and other MFIs. In its present form the bill may not achieve much, except to introduce the MFIs in forms other than NBFCs to regulation and more importantly, to reporting of information which is scarce. No firm date on the bill becoming law has been set though reports of the bill coming up before parliament in the monsoon session are doing the rounds.

The Reserve Bank of India (RBI)[25] has made changes to existing norms on certain regulatory matters and announced new policies. It has also introduced a few policy drafts for discussion. The priority sector lending regulations has been revised with both positive and negative implications for microfinance. Banks have been advised to comply with priority sector norms under the pain of penalties and the window of placing funds with NABARD and Small Industries Development Bank of India (SIDBI) as a substitute has been closed. The inclusion of small loans given under no-frills accounts and debt-swap schemes under priority sector would help several clients who are financially excluded. Banks have been allowed to take microfinance assets on their balance sheet through a variety of options. This would improve the funds flow to MFIs. The introduction of BASEL II norms on the banking system requires the banks to assign higher risk weight on their credit exposure to MFIs. This would increase regulatory capital and hence the cost of funds of banks. Consequently, this would impact both availability and cost of funds for MFIs adversely. There have been changes in the norms relating to BCs and facilitators which have not been received well by the sector. While some banks have reported good progress under the BC/BF scheme, there have been demands for a relook at the norms for permitting all NBFCs to act as BCs, removal of distance restriction on location on BCs and the cap on lending rate in respect of small loans. The capital requirements of NBFCs[26] have been raised from the existing 10 to 15 per cent by April 2010. While this is a source of client comfort with stronger net worth and risk absorption capacities of NBFCs, their cost of funds would increase; and their growth rates could decelerate. The smaller NBFCs might find it difficult to mobilise the additional equity.

In a significant move, RBI had put up a discussion paper on changes to money-lending act and legitimising the money lenders' operations. A draft of a model law on money lenders for the state governments to adopt has also been placed in public domain by the RBI. Guidelines on use of cell phones for

banking through correspondents and facilitators have also been put on RBI Website for public comment. The RBI has taken keen interest in two knowledge management aspects of finance that have the potential for positive impact on the financial behaviour of microfinance clients—financial literacy and credit counselling. RBI has placed a policy paper[27] on its Website as a part of its efforts to improve the information availability with the public, and influencing the banks[28] to invest in setting up financial literacy and credit counselling centres for disseminating information to vulnerable sections of people.

DONOR AND COMMERCIAL FUNDING TRENDS

The beginnings of new funding instruments and new funding avenues are being seen in the market. The first large portfolio sale has been put through.[29] Equity placements are no longer exceptional and forbidding; they are tending to become familiar and even welcome. Bulk funds have been flowing into the sector from not only the traditional funders such as SIDBI and Friends of Women's World Banking (FWWB), but also the public sector, private sector and foreign banks. Large ticket loan deals are easier in the present environment of vigorous growth. Donor support continues to flow into the sector. In the recent past, more support is available for MFI-type operations rather than the traditional NGO–SHG-type operations. Recent entrants such as MicroSave, ACCESS and Opportunity International provide not only services but also enable access to grant funds for the services as well as institution building. International Finance Corporation (IFC), International Fund for Agricultural Development (IFAD), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), Kreditanstalt für Wiederaufbau (KFW), Department for International Development + B1 (DFID), United Nations Development Program (UNDP), World Bank, Ford Foundation and others continue to be active in the sector. GTZ has an ongoing technical assistance (TA) project with NABARD in rural finance which covers microfinance. IFC and KFW have announced a large (Rs 11 billion) fund allocation for supporting Indian microfinance. KFW has other interests in insurance and housing microfinance with other partners. World Bank is reportedly pursuing a major microfinance project in India. At the conclusion of its project collaboration with SIDBI, DFID is expected to announce the next project of a significant size for support to microfinance sector. Ford Foundation apart from funding studies and research has been supporting networks and knowledge management. Its recent initiative relates to setting up a network of knowledge institutions working on SHG-related aspects. IFAD has two microfinance projects in Maharashtra and Madhya Pradesh (MP) besides incorporating SHG-based rural finance components in its other projects. UNDP focuses more on financial inclusion and finance for livelihoods as part of its interventions in its focus states. Donor coordination however has not been much in evidence. The patience threshold of some donors seems to be high even in cases of mission drift.

TECHNOLOGY

On the technology front, use of handheld devices, variety of smart cards and mobile phone-based collection and payment processes have been experimented. Immense effort involving several banks in smart card-based benefits payments to bank accounts under the National Rural Employment Guarantee Scheme (NREGS) is being experimented in six districts of AP. A mobile-based transaction process piloted by EKO[30] has been fairly effective and seems to have potential for main stream application, once the surrounding regulatory issues are resolved. Vodafone, Airtel and Tata Telecom have been in the news promising financial services on their networks. A couple of technology providers [A Little World (ALW) and Fino] have set up Section 25 companies and have linked up with banks as BCs. A very recent development is the mega effort in Rajasthan, where under a scheme named Bhamasha Financial Empowerment Project, ILFS, BASIX and Bartronics are in the process of facilitating an opening of 5 million bank accounts of excluded people using smart card technology and setting up 15,000 IT-enabled Point of Sales to service the accounts. The state government provides a deposit of Rs 1,500 for each account, opened under the scheme with a budget provision of Rs 7.5 billion. Web-based initiatives that connect the funders with the recipients and individual lenders with individual borrowers have also been designed. *Capital connect*[31] *Rang de*[32] and Dhanax are some such initiatives, which deserve mention.

INSURANCE

Insurance has seen quite a few developments, in health and life risks. The Government of India (GOI) has introduced new schemes both in the life and health insurance sectors. A simplified insurance scheme covering hospitalisation and treatment of persons in the unorganised sector has been rolled out under which by paying a nominal sum of Rs 30, the families of such persons are covered up to an expenditure limit of Rs 30,000 per year. The scheme is implemented through both private and public sector companies with the operating agency being decided on the basis of an open tender process. In life insurance, the government has brought about a simplified life insurance scheme covering vulnerable sections of people with a low premium. The government has provided for subsidisation of the premium to the insurance companies directly from its social fund so as to keep the cost of cover low for the poorer sections of people. Life Insurance Corporation of India (LIC) has been asked to scale up Janashree Bima Yojana scheme to cover all women SHGs that are credit-linked to the banks. LIC has announced that it would write 40 million policies under the scheme. The Agricultural Insurance Company of India Limited (AICI) introduced a pilot in Karnataka during Kharif 2007 on weather insurance scheme and mainstreamed it over six states during Rabi 2007–08.[33] Under the micro-insurance regulations, 12 new life products and 8 non-life products have been filed by insurers. During 2006–07 more than 1,300 micro-insurance agents had been recruited. The number of micro-insurance policies underwritten were 0.12 million with a premium of Rs 23.1 million. LIC in pursuance of its rural obligations, had written 8.85 million policies for a sum assurance of Rs 609.7 billion. The number of policies and businesses were more than 20 per cent of LIC's overall numbers. IRDA had reported that during 2006–07, all but two insurers in life and non-life segments had met their social and rural obligations.

OTHER DEVELOPMENTS

Significant initiatives on financial inclusion have been announced. The setting up of two funds in the hands of NABARD has been formalised. The Financial Inclusion Fund and Financial Inclusion Technology Fund would support the different institutions with funding for expanding access. The rules and guidelines have reportedly been finalised and would be notified soon. Although the announced size of funds is of the order of Rs 5 billion each, the actual annual flow would be smaller. The availability of funds is at best a facilitating factor; government, banks and other institutions must come up with creative and practical ideas for achieving inclusion to apply the funds to good use. Reserve Bank has issued instructions to the banking sector on the measures needed to be taken by them to include all those with an effective demand for financial services. The BC/BF scheme, no-frills accounts, general credit cards, and the initiative on financial literacy and credit counselling have all been initiated by RBI.

A revamp of guidelines on the major poverty alleviation programme, the Swarna Jayanti Gram Swarozgar Yojna (SGSY) has been proposed and is the subject of discussion within the government circles.[34] In the poverty alleviation sphere, the GOI has announced a new policy proposal that aims at creating federations at the apex level as also at the state and district level, to provide an umbrella over all the SHGs that have been set up. This move, which has been proposed and placed in the public domain for discussion, has received mixed reactions. Several state governments have announced their own programmes and policies in the microfinance domain and for financial inclusion.

The biggest story in the financial sector which would impact microfinance as well, is that of the farm loan waiver. The amount, coverage and the manner of waiver would tend to put the microfinance operations under pressure. A significant number of the waiver client families are likely to be common clients of the microfinance sector as well. The clarification issued by the government that SHGs and members who had borrowed for farming purposes[35] would also be eligible for the waiver who has opened the sector to higher risks of a political nature. The timing of funding especially of the cooperatives and the RRBs could reduce loan disbursements in the rural areas during the current year and might increase the demand for loans from MFIs. The aftermath of waiver in the rural hinterland as per initial feedback is negative. Repayments have almost stopped and, consequently, not much

fresh loan disbursements have taken place. The objective of unclogging the credit pipeline seems difficult to achieve unless a concerted campaign is mounted to debrief the farmers on the need for maintaining the credit discipline and sustaining their credit cycle with the banks. With general elections to the parliament around the corner, such measures do not seem likely.

The apex development banks have continued with their intensive work in the sector. NABARD has announced its support to about 12 institutions out of its MFDEF in the form of quasi-equity. The refinance flow to SBLP increased to Rs 18.74[36] bn in 2007–08 from Rs 12.92 bn in the previous year. The bank has also announced a policy for supporting federations of SHGs, indicating a shift from its earlier stance that was not so positive towards federations that are carrying out financial intermediation. NABARD seems to have moved to embrace all the segments of the microfinance sector over the last two years, shedding the image of 'SHG only' bank. SIDBI has recorded considerable growth in its loan portfolio. Its outstanding loans to MFIs reached a level of Rs 9.58 billion in 2007–08 from Rs 5.48 billion by the end of March 2007. It has prioritised microfinance as a growth portfolio and has opened specialised microfinance branches in potential centres such as Hyderabad, Chennai, Bangalore and Kolkata to offer customised services and products to MFIs. But the bank has chosen to locate its branches in the saturated states for business reasons rather than greenfield states where development work has to begin. National Housing Bank has plans of providing housing loans to clients of microfinance. It has started working with select MFIs and banks for delivering customised products to microclients. FWWB, a special purpose microfinance bulk-finding institution has increased its portfolio of loans to MFIs, vigorously during the year. Its outstanding loans by the end of March 2008 were Rs 2.18 billion; more than double of the Rs 1.05 billion outstanding at the end of previous year. RMK, the other bulk funder had disbursed Rs 257 million during the calendar year 2007, against sanctioned loans of Rs 199.6 million, covering about 24,500 clients.

The last year's data (March 2007) released by NABARD on SBLP shows the vigorous savings performance on the part of the SHGs. Roughly, the savings to loan ratio was around 1:3.5. However, the average loans per member was still low. The reasons for this low credit intensity need to be probed. The NCAER[37] study brought out that SHGs are able to improve their savings rate and spend more on health and education. Income levels have risen, and poverty reduction at a rate of 10 per cent per annum is taking place. While recovery rates have declined, record keeping is a matter of concern. The costs of groups formation are not fully funded, which might keep committed NGOs out of the programme. A more detailed discussion of the findings is available in a later chapter.

Sa-Dhan has added to its membership and has been guiding the partners in the far-flung states to set up local networks to take care of coordination issues. MicroSave has had significant funding support and enlarged its range of services and the client list. A significant study of the savings market in the north-eastern states was placed in the public domain by MicroSave. ACCESS Development Services had 110 partners in its alliance with AMFA, with more than 2.4 million clients. Sa-Dhan had entered into collaboration with IIBF[38] for offering diploma courses in microfinance to the staff of member institutions. CMF, Jaipur and BIRD, Lucknow have entered into similar arrangements with IIBF. BIRD, Lucknow has set up Centre for Microfinance Research (CMR).

EMERGING IMPLICATIONS FOR THE CLIENTS

The major issues arising from the developments in the sector during the year are: the potential for mission drift in pursuit of vigorous growth, the high risks that are inherent in fast-paced growth of organisations that do not have adequate internal checks and controls, the aspirations of majority of NGO sectors to get transformed into MFIs and the impact that this could have on savings by people in their groups, the heightened interest in urban microfinance and the resultant competition increasing the risks of MFIs and their funders. The other issues are the relative ease with which the funds flow into the sector at the top end and the difficulties faced by the players in the middle rungs. There is a certain level of discomfort among banks in expanding their portfolio of bulk loans to the smaller MFIs on account of their perceptions of governance,

transparency, quality of information and reputation risk. Not surprisingly, the Banana Skins Survey[39] Report highlighted managing technology, management quality, corporate governance, staffing and competition as the key risks in Asian microfinance.

The inclusion initiative seeks to use the network of bank branches to add more clients to the system. RBI Annual Report 2007–08 mentions that 15.8 million 'no-frills accounts' had been opened under the financial inclusion programme till March 2008. The role of MFIs, NGOs, cooperatives and other such smaller players have not been overtly taken into account. Not only spatial gaps bedevil the banking network, but also the willingness barrier to serve small uneconomic clients. The large questions facing the financial sector is 'with not much expansion expected in the branch network in the rural and remote areas, what is the final shape of the financial architecture that would be able to fulfil the financial inclusion agenda? Are the NGOs, MFIs, cooperatives and BC/BF the final pieces in the architecture?' It does seem that the future is in branchless banking with technology substituting for physical banking network and BC/BF taking the place of bank staff. What are the limits to which technology and BC/BF would be allowed to stretch by the regulator, could well determine the speed of inclusion on the one hand and the avoidance of systemic risks on the other.

The farm loan waiver has caused concern in certain areas with clients of MFIs, voicing their disappointment at their loans not having been written off. The clients may naturally look at the banking system as a better choice for availing credit, especially in view of the potential for state support in times of natural calamities and other risks that farming community is faced with.

Overall, the year has not only been one of vigorous growth, increased interest and awareness levels on the part of institutions, initial attempts at improving the finances and governance, but also an increased risk potential that seems to come under greater scrutiny. But what happened to the clients? Certainly, more clients are served today than before. The growth in outreach points to the potential that exists. Are these clients being served well? The impression is that widening is targeted at the cost of deepening. The 'touch and move on' method of expansion of services could not only result in sub-optimal services to the clients, but also reduce profitability of MFIs. The slow growth of average loans in case of SHGs reveals a lack of enthusiasm for increasing loan volumes by banks. The reduced number of new groups linked to banking system indicates a loss of appetite for SHG clients. The slowing down might help in consolidation and deepening. Is this loss of appetite a transient problem or is it there to stay? We have to wait and watch out for the final data from NABARD and next year's developments. The congruence of policy intent, business interests, enterprise opportunity, technological edge and a virgin market make up for an exciting amalgam in the financial inclusion sphere. The inclusion objective is tough, but doable as long as all stakeholders keep the poor people first in their list of priorities.

INTERVIEW

The Deputy Governor of RBI, Mrs Usha Thorat, gave an exclusive interview to the author for the State of the Sector Report. In a freewheeling discussion, she gave insights into the policy thinking that is behind several aspects of the sector.

1. *Question*: **The number of microfinance clients during the year has increased and the estimate is, that it had touched the level of 50 million. Is this systemically significant for the Central Bank?**

DG, RBI: I presume you are referring to the number of MFI clients and SHG clients. Compared to previous year, there is certainly a significant growth. While the volumes involved may not be very significant, the social significance of this large number of accounts that primarily serve the poor and the vulnerable is quite high. But we should note that this 50 million is just a part of microfinance—not the universe of it.

2. *Question*: **Could you please explain what more is in microfinance? How much bigger is the sector?**

DG, RBI: While the SHG members financed by the banking system and the clients of microfinance institutions have reached the level of 45 to 50 million, we should also look at the small savings and loan accounts served by bank branches, as also by the cooperatives. Small loan accounts as well as savings accounts are numerous in the banking system. The post office has a good number of savings

accounts that serve small savers. We have urban and rural cooperative societies serving microclients. If we reckon the number of small loan accounts and the number of clients served by banks and cooperative societies, the overall microfinance sector would be much larger in size; it might exceed 100 million loan accounts. No doubt the narrowly defined microfinance sector—SHGs and MFI clients—has made an extra effort to reach out to people who have not been able to access services from the formal financial system.

3. *Question*: **Given the fact that a significant number of people are part of the microfinance sector, how does the Central Bank look at regulation of activities by the different players?**

DG, RBI: SHGs are linked to banks and banks are regulated by RBI. While the regulation over banks is prudential, NABARD has been overseeing the dissemination of best practices in SHG–bank linkage. When it comes to an MFI's activities, there are the NBFCs and the other MFIs. Perhaps, more than 75 per cent of the volume in lending is done by the NBFCs. As you know, NBFCs are under the direct regulation of the RBI. Of the other MFIs, institutions that may be borrowing from banks for on-lending may be quite large in number. Even these institutions, being clients of banks, would be subjected to due diligence exercised by the banks as part of a lender's discipline. Advisories to banks on conduct of business, by MFIs supported by them are issued from time to time by RBI. As you know, cooperatives are regulated by RCS, with cooperative banks regulated by RBI in addition to RCS. When the microfinance bill becomes law, the regulatory framework for MFIs is expected to be operated by NABARD. As things stand today, there will not be a separate and exclusive framework to supervise the microfinance entities, which cover a range of financial institutions. Let us explore our way through this framework.

4. *Question*: **The sector has been asking for permission to mobilise public savings. The RBI and the Government of India do not seem to be too keen to permit the MFIs to mobilise savings. Considering that the stronger need among the poor and vulnerable is for savings than credit, why not permit these institutions to provide savings services?**

DG, RBI: In the SHG bank linkage programme, there is an inbuilt mechanism for providing savings facilities for the poor. SHGs have also linked themselves to MFIs. Cooperative societies offer savings services to members, and the ongoing rural cooperatives reform should improve availability of savings services at the village level. Urban Cooperative Banks (UCBs) are typically credit-union-type institutions meeting savings and loan needs of local communities. Post office has more than 1.55 lakh branches that offer savings facilities, which are availed by many microclients. In the case of NBFCs, some of them are allowed to mobilise term deposits. But with all these, many people still remain excluded from savings services.

The need for savings services is a priority among the poor and vulnerable. Permitting a large number of small institutions to accept public deposits may not be the best way of meeting the needs of the poor and the vulnerable. Past experience with UCBs and NBFCs points to difficulties in ensuring that the depositors' interests are protected. Governance standards are difficult to monitor/enforce. This is one of the major reasons why the RBI introduced the BC framework. The BC's local knowledge and ability to reach the last mile can be used by the banking system to reach out to all those areas and people who are presently not being served satisfactorily. An intelligent and effective use of the BC/BF coupled with IT solutions should result in providing savings services with deposits, insurance and access to payment systems.

5. *Question*: **The RBI has been proactive in advocating the use of technology in banking. In the case of microfinance, quite a few options that are based on Internet and cellular phone technology are beginning to emerge. But some part of these technology solutions are in conflict with the existing norms of the Central Bank. Is there any other means of solving some of these problems?**

DG, RBI: RBI has been proactive in advocating the use of IT to expand penetration of financial services and also to improve the efficiency of payments and settlement systems. The paper on providing satellite connectivity for branches in remote areas is a case in point. In the case of BC framework, the RBI encourages IT-based solutions for financial inclusions that are inter-operable, have open standards and adhere to best industry practices. The requirements

of transparency, safety and internal control cannot be compromised in the case of technology solutions. Technology has to adapt itself to banking and client safety requirements; not the other way round.

6. *Question*: **RBI has recently introduced a scheme on financial literacy and credit counselling for the banks to adopt. What was the need for introducing this, and where does RBI see this moving in the future?**

DG, RBI: Financial markets/products/services have become increasingly complex, and the common person is finding it increasingly difficult to make informed choices. Given the social and economic profile of our country, there is a large section of people who are resource-poor and who operate at the margin and are vulnerable to persistent, downward financial pressures. With no established banking relationship, the un-banked poor tend to get pushed towards expensive alternatives. The challenges of household cash management under difficult circumstances, with few resources to fall back upon, could be accentuated by the lack of skills or knowledge to make well-informed financial decisions. We, therefore, felt that financial literacy can help such people prepare ahead of time for life-cycle needs and deal with unexpected emergencies while availing sustainable credit at affordable rates for income-generating, education and essential emergency purposes.

As for credit counselling, taking cognisance of high debt level causing stress among the vulnerable sections, the RBI came up with this idea. Credit counselling centres set up by banks should be strictly based on 'arm's length' principle and should not be a marketing outlet for bank's products. These centres should be available to offer guidance to all those who seek its help (not necessarily the clients of the bank) through any means such as personal visits, phone and the Internet. Further, the centres could also launch campaigns to educate borrowers on how to reduce the cost of debt and help them review alternatives available with a view to bringing down their debt burden. These centres would need to be manned by committed professionals having requisite empathy, knowledge and experience. Some banks have already set up a few credit counselling centres and some others have started the financial literacy programmes. Ideally, RBI would like to see that the entire country is covered by these initiatives, and, at least, one credit counseling centre is set up per district to start with.

7. *Question*: **What do you think of the future of microfinance sector?**

DG, RBI: Economic growth per se is not meaningful, unless it is inclusive. For achieving inclusive growth, access to financial services is a critical precondition. This is where the growth of financial sector will help the nation greatly. Development of microfinance sector is one of the important means for facilitating inclusive growth. Our efforts are to encourage the microfinance sector to grow and reach out to as many people as possible, keeping in mind the need to ensure that the rates of interest are reasonable and recovery practices fair and transparent.

ANNEX 1.1
Expectations from microfinance practitioner community—UN solutions exchange[40]

The UN Solutions Exchange ran a question on its Web discussion platform at the request of the author for generating responses from the practitioners on their expectations and inputs into the report. The following is a consolidated gist[41] of the responses.

Responding to a request for inputs on the State of the Sector Report 2008, respondents shared a range of documents and suggestions on various aspects of microfinance such as savings, credit, micro-insurance, microfinance-regulations, legal entity for federations of SHGs, innovations, capacity building and the role of IT in microfinance.

In the context of the changing Indian scenario, respondents felt that the term 'microfinance' needs to be redefined, by considering various aspects such as— needs of microfinance, different players of microfinance, extent of assistance and types of financial services. Respondents shared information on innovative ways of

debt and equity capital structuring; focusing on reducing cost of capital for MFIs; and suggested for accessing mainstream capital markets and other set of investors such as insurance companies, pension funds and so forth. Focusing on the issue of accessibility, timeliness and affordability of microfinance services for financial inclusion, respondents stressed on linking second-line potential grassroots lenders and service providers such as credit advisors, department stores, insurance agents, input distributors and so forth, with technically sound formal agencies, having professional expertise in microfinance. They also cited an example of a joint venture microfinance initiative in Gujarat and Maharashtra, involving three types of organisations—a private company, an established microfinance organisation and a non-profit institution.

Discussing on the issue of outreach of micro-insurance, members felt that insurers need to create the right market-mix, using appropriate delivery channels. NGOs and their SHG federations are well-positioned to function as distribution network partners for insurance. They also highlighted a unique training model, developed by a national-level insurance academy, which emphasises mutual micro-insurance. Members raised number of questions related to regulating micro-insurance sector and problems prevailing in the sector. Members suggested coverage of remittance services. On the issue of savings, discussants suggested examining two papers written on savings. Members quoted an example of an NGO in Kerala, which provided a number of avenues to enable their clients as well as the larger community to invest in development financing. Respondents have also shared an example of an emerging MFI in Bihar, adopting the Grameen Bank model of Bangladesh.

Looking at private equity players and venture capital companies, members opined that they could help MFIs to open new branches, scale up existing ones and hire qualified professionals, which would contribute to the overall growth of MFIs. A national-level MFIs-support organisation providing a common platform (capital connect) to reduce asymmetry in information flow among social entrepreneurs, investors and lenders was referred to. Respondents also shared experiences of Uttarakhand, where a leading NGO has established a women's SHG federation in the form of a multi-purpose autonomous cooperative society. Grameen Foundation's approach that combines microfinance, technology and innovation to empower the world's poorest people to escape poverty too came under the discussion.

Members also suggested that the State of the Sector Report should give due importance to MFIs exhibiting problems, so that the lessons learned can be utilised for the development of microfinance sector.

Following recommendations were made by the discussants:

- Projecting Indian brand of microfinance at the international level, without sacrificing local need-based innovations and experiments.
- Applying an all-inclusive approach with a provision of different microfinance intermediation services and also, all business development services (BDSs) for income-generating employment and activities.
- Early introduction of regulation for MFIs, through microfinance bill.
- Enhancing opportunities for members to have access and mediate his savings to the pool of investment that fetches him the highest rate of interest.
- Stratification of MFIs using different assessment tools—'organisational assessment' tool for emerging MFIs and 'rating' for expanding and mature MFIs.
- Introduction of social accountability and social performance management (SPM) audit for MFIs and other agencies engaged in microfinance.
- Sharing of knowledge at the regional and national level on the best practices related to technology.
- Management processes and governance that are useful for drawing a pro-poor future strategy.
- Bringing out an All India Annual Publication on important statistics on microfinance.
- Leveraging IT with smart solutions to add value for both financial institutions as well as clients, resulting in a reduced transaction cost.
- Introduction of long-term microloans, facilitating a longer engagement with the clients and also introducing 'microloans through Web' model of microcredit, which aims at combining the existing, institutionalised microcredit with individual philanthropy.
- Rationalisation of the interest rates charged by MFIs and greater transparency.

Members stressed the need to link with livelihood initiatives and application of 'cluster approach', where the tools such as 'value chain' and 'supply chain' are appropriately used, for profitable value addition.

Introduction of Lead MFI system for planning and providing non-financial support and promotion of triangular partnerships—public, MFI and community partnerships were proposed. Members recommended improved focus on urban poor for microfinancial and other interventions. Members also urged for making microfinance a gender-neutral movement.

Finally, on framework of the report, respondents suggested inclusion of a separate section on the development of policy through decentralisation of economic power in the context of the growth of MFIs. Additionally, they advised studying the policy perspectives of mainstream banks and development finance agencies for the next 5 to 10 years. Discussants also felt that including key performance indicators for MFIs in the report, especially on financial, social, management, governance systems and IT systems, would be useful. Finally, respondents suggested of disaggregating the report into various issues or aspects of microfinance to ensure focused actions on various aspects by different players of microfinance.

NOTES

1. National Sample Survey Organisation, Government of India.
2. The information is excerpted from the Economic Survey 2008 and Annual Monetary Policy Statement of RBI 2008–09.
3. The committee was headed by Dr C. Rangarajan, Chairman of the Prime Minister's Economic Advisory Council.
4. As on 1 July 2008, 25 states have signed up to initiate cooperative reform. (Source: www.nabard.org)
5. The committee was headed by Professor Radhakrishna, Director of Indira Gandhi Institute of Development Research, Mumbai and set up by the Government of India.
6. A review group to suggest practical measures for adoption from the expert groups on farmer's indebtedness was set up by NABARD in consultation with GoI.
7. Information on number of groups is provided by NABARD in its annual report of 2007–08, National Bank for Agriculture and Rural Development, Mumbai. The data is provisional.
8. NABARD normally uses an average membership of more than 16 per SHG. But the average member base was found to be 13 per group in the NCAER study. This has been used to quantify the clientele of SBLP.
9. Cited from Bharat Microfinance Quick Report on MFIs 2008.
10. The client base of MFIs is at 14.1 million; of which, 7.26 million is that of MFIs following only SHG methodology and 2.84 million of MFIs that follow SHGs, as one of the methods. About 50 per cent of clientele of SHG only MFIs and 25 per cent of clientele of mixed method MFIs have been reduced from overall numbers of clients to account for the overlap between bank and MFI data.
11. The Lights and Shades, A study of SHGs in India 2006, by EDA Rural Systems and APMAS.
12. Impact and sustainability of SHG–bank linkage programme 2007, supported by GTZ study carried out by the National Council of Applied Economic Research.
13. The poverty audits were commissioned by SIDBI.
14. An interview with Mr U.C. Sarangi, Chairman, NABARD is carried in Chapter II.
15. Towards an inclusive financial system, Financial Services Demand and Utilisation by India's Low Income Workforce 2007, by IIMS Dataworks Research Report, New Delhi.
16. IRDA Annual Report 2007–08.
17. The penetration ratio expresses the volume of premium as a percentage of GDP.
18. Insurance density ratio expresses the volume of premium to population.
19. Status of Microfinance in India—2006–07, NABARD.
20. India Post Annual Report 2007–08.
21. Please refer to Annex A 1 at the end of the report for detailed information on clients, outreach and loan volumes.
22. A survey of more than 50 NGOs indicates that 80 per cent of NGOs that have formed and linked groups want to become MFIs, preferably NBFCs. See separate box in Chapter II for more details of the survey.
23. An interview with the Chairman and Managing Director of Small Industries Development Bank of India is carried at the end of Chapter III, which captures some of the sector developments in commercialisation and urban microfinance.
24. Annual Report 2007–08 of the Ministry of Finance, Government of India.
25. At the end of this chapter, an exclusive interview with Mrs Usha Thorat, Deputy Governor, RBI is

carried that dwells on sector-wide issues as well as regulatory aspects.

26. Circular issued on 1 August 2008—RBI/2008-09/116 DNBS (PD). CC. No. 125/03.05.002/2008–09.
27. Report on Financial Literacy and Credit Counselling Centres, April 2008, Reserve Bank of India.
28. Even before RBI's progressive initiative, some banks such as Bank of India and ICICI bank had set up their credit counselling centres.
29. Grameen Capital has structured a deal for sale of BISWA's portfolio amounting to Rs 235 million to a private sector bank with a first and second-loss guarantees up to 50 per cent of the value of portfolio.
30. See the chapter on technology for a brief description of this interesting model, run by EKO India Financial Services limited, New Delhi.
31. Launched by EDA Rural Systems, Gurgaon in April 2008.
32. Launched by Niyati Technologies, Chennai and Sen-Sei Technologies, Bangalore.
33. Cited from the action-taken report of Ministry of Finance, GoI (2008).
34. National Rural Poverty Elimination Programme, Ministry of Rural Development (SGSY division) GoI.
35. Clarification issued by the Ministry of Finance on 18 June 2008 states 'paragraph 3.1 of the scheme would also include loans extended to SHGs of individual farmers even if the disaggregated data is maintained at the level of the SHG and reflected on the books of accounts of the SHG. However, it must be ensured that the disaggregated data is maintained to the satisfaction of the lending institution concerned.'
36. As per NABARD's Annual Report 2007–08, the SHG linkage programme was refinanced to the extent of Rs 16.15 billion and the SGSY programme was refinanced to the extent of Rs 2.59 billion.
37. The study was carried out under the GTZ-NABARD's Rural Finance Technical Assistance Project.
38. Indian Institute of Banking and Finance, Mumbai.
39. Carried out by the Centre for Study of Financial Innovation, supported by Citibank and CGAP.
40. This note is based on a more detailed one prepared by Dr Navin Anand, Resource Person and Moderator, Poverty Communities—Microfinance, UN-SE and his team. The author is thankful to UN-SE for its permission to quote the consolidated reply in this report.
41. The following practitioners contributed to the discussion: 1. Rahul Rawat, 2. G.K. Agarwal, 3. Shashi Shrivastava, 4. Arabinda Mitra, 5. Harish Chotani, 6. Vijay Pratap Singh Aditya, 7. Aparna Vishwanatham, 8. Shannjit Singh, 9. Baladeb Sen, 10. Navin Anand, 11. Neela Mukherjee, 12. Chhaya Kunwar, 13. Iddo Dror, 14. Ajaita Shah, 15. Gurusamy Gandhi, 16. Toms K. Thomas, 17. Ravi Chandra and 18. Kiran Kulkarni.

The SHG–bank linkage programme (SBLP): entering a phase of consolidation?

2
Chapter

GROWTH CONTINUES BUT SLOWLY

As per the provisional information made available by National Bank for Agriculture and Rural Development (NABARD) in its annual report 2007–08, the number of new groups credit-linked with banks declined to 0.552 million during the year,[1] compared to 0.68 million, groups in the previous year. The cumulative number of groups that have borrowed from a bank at least once has increased to 3.48 million by the end of March 2008 from 2.92 million, at the same time last year (Table 2.1). The number of members of such groups increased to 58 million as indicated by NABARD; but with a smaller average number of members of 13 per group, the membership is estimated at around 45 million. The fall in the number of new groups linked by about 0.13 million is attributed[2] to the slowing down of self-help group (SHG) linkage in the southern states and the failure to gather momentum in other states. The extent of finance availed by these new SHGs amounted to Rs 42.28 billion. The average loans to new groups increased by Rs 1,500 to Rs 45,900, and repeat loans to existing groups increased by Rs 11,500 to Rs 90,100 when compared to the previous year. The information relating to repeat finance (so far 0.19 million groups have been reported as having availed Rs 16.8 billion) is still very preliminary, and hence might not be a useful basis for trend analysis and comment. Going by the proportion of number of groups that had availed repeat finance in the previous years,[3] the number of groups that had availed repeat finance during 2007–08 could be around 0.58 million and the amount of loans availed were around Rs 40 billion. The final data at the end of the year (March 2008) is expected to show that the number of groups financed during the year (new and the existing taken together) was around 1.1 million; with the flow of loans, however, being more than Rs 80 billion as against Rs 65.7 billion in the previous year. The change in the reporting format introduced in July 2007[4] by the Reserve Bank increased the availability of more pieces of critical information, but in the process left out the state-wise disaggregated information from commercial banks. With marginal changes to the formats, the information could be generated.

The regional shares are undergoing a gradual change. The share of southern states in the number of groups linked to the banks declined to 48.2 per cent in March 2008, the first time ever that its share was less than 50 per cent. The last three years' progress shows that while southern region is losing its share (about 6 per cent between March 2006 and 2008), the western and northern regions are improving their shares. The central region had a lower share in March 2008 when compared to March 2006.

The eastern region (26.5 per cent) had caught up with the south (27.6 per cent) in the share of new groups linked in 2007–08. Growth rate of new groups linked was the best in western region with 38 per cent, driven by good performance in Maharashtra.

Table 2.1 Growth trends in SBLP

	2002	2003	2004	2005	2006	2007	2008
No. of new SHGs provided with bank loans (cumulative)	4,61,478	7,17,360	1,079,091	1,618,456	22,38,565	29,24,973	3,477,965
Of which in southern region (cumulative)	–	–	–	9,38,941	12,14,431	15,22,144	16,74,811
Percent in southern region (%)	–	–	–	58	54	52	48.1
No. of new SHGs financed during the year	1,97,653	2,55,882	3,61,731	5,39,365	6,20,109	6,86,408	5,52,992
Of which in southern region	–	–	–	–	2,75,490	3,07,713	1,52,667
Percent in southern region	–	–	–	–	44	45	27.6
Rate of growth of loans to new SHGs (%)	32	29	41	49	15	11	(-) 16 decline
No. of SHGs receiving repeat loans	41,413	1,02,391	1,71,669	2,58,092	3,44,502	4,57,410	1,86,883 provisional and incomplete
Rate of growth of repeat loans	91	147	68	50	33	33	Data incomplete
Proportion of repeat loans in total loans	17	29	40	32	36	40	Data incomplete
Bank loan disbursed cumulative (in crores)	1,026	2,049	3,904	6,896	11,398	18,040	22,268
Bank loan disbursed during year (in crores)	545	1,023	1,855	2,994	4,499	6,643	4,228
Of which, disbursed to new groups (in crores)	453	691	1,158	1,727	2,330	3,044	2,542
Of which, disbursed as repeat loans (in crores)	92	332	698	1,268	2,169	3,599	1,686 Provisional & incomplete
Proportion of repeat loans in total disbursed (%)	17	33	38	42	48	54	Data incomplete
Average loan sizes—new	22,919	27,005	32,013	32,019	37,574	44,343	45,960
Repeat loan sizes	22,215	32,425	40,660	49,130	62,960	78,682	90,195*

*Based on the information available on number and amount of repeat loans, which is provisional and incomplete.

Against the all India growth rate of 19 per cent, the south had a much lower growth rate of 10 per cent (Table 2.2, Fig. 2.1).

Among the states, Andhra Pradesh (AP) lost its primacy in the number of new groups linked to the banking system. Maharashtra topped with a share of 18.2 per cent of new groups and had more than double the share of AP. The top two states are not from the south (Table 2.3).

As explained by the chairman, NABARD, the headroom for growth in the southern states is limited. But the growth in the 13 priority states did not come up to the expectations, indicating the need for intensive work. The growth rate of SHGs linked was better than the national average in 7 of the 13 states. Chattisgarh, Maharashtra, Assam and Orissa had healthy growth rates while other states did not justify the *priority* tag (Table 2.4).

Table 2.2 Regional shares in SHG linkage

	SHGs linked (March 2006)		SHGs linked (March 2007)		SHGs linked (March 2008)	
Region	**No. of groups**	**% share**	**No. of groups**	**% share**	**No. of groups**	**% share**
Northern north	1,33,097	6	1,82,018	6	2,30,740	6.6
Eastern region	62,517	3	91,754	3	1,19,857	3.4
Eastern region	3,94,351	18	5,25,881	18	6,72,289	19.3
Central region	2,67,915	12	3,32,729	11	4,05,707	11.7
Western region	1,66,254	7	2,70,447	9	3,74,561	10.8
Southern region	12,14,431	54	15,22,144	52	1,674,811	48.2
All India	22,38,565	100	29,249,73	100	3,477,965	100

The 13 priority states, which had a share of 47 per cent of SHGs linked to banks in March 2007, have a higher share of about 51 per cent of the SHGs in March 2008. There is a need for more effective strategies in states like Gujarat, Uttar Pradesh, Jharkhand, Uttarakhand and Madhya Pradesh (MP).

NABARD has brought out its annual statistical report on the status of microfinance in India for the year 2006–07, a few months ago. The coverage of information is much more comprehensive than ever in the past. The information made available now includes: (1) number of groups savings linked and amount of their savings with bank, (2) rates of repayment, (3) bank-wise data on the performance of SHGs and Swarna Jayanti Gram Swarozgar Yojna (SGSY) groups and (4) financing of microfinance institutions (MFIs) by banks. A notable omission is the state-wise consolidated information on number of groups linked and the amount of disbursements made. Reserve Bank of India (RBI) and NABARD had changed the reporting format, which now focuses on collecting information bank-wise on a larger number of aspects. In the case of commercial banks, which account for a significant part of the SHG portfolio, the information is reported for the bank and as a result, state-wise information is not available. A change in reporting format is necessary to get state-wise information from those institutions that cover more than one state. The report could be enriched with some of the insights of NABARD derived from its ongoing monitoring and studies.

MICROFINANCE EXPANSION AND PENETRATION[5]

An analysis of the progress of the SHG–bank linkage, state-wise, normally gives rise to the concern that some states have a high proportion of linked groups whereas the other states lag behind. Comparison of absolute number of groups would lead to such a conclusion as it does not examine these numbers in the local context of population as well as at the poverty level. With a view to examine the numbers more analytically, two indices, Microfinance Penetration Index (MPI) and Microfinance Poverty Penetration Index (MPPI), have been developed and presented as annexes to the report.

These indices attempt to capture the client mobilisation effort in the context of its significance to

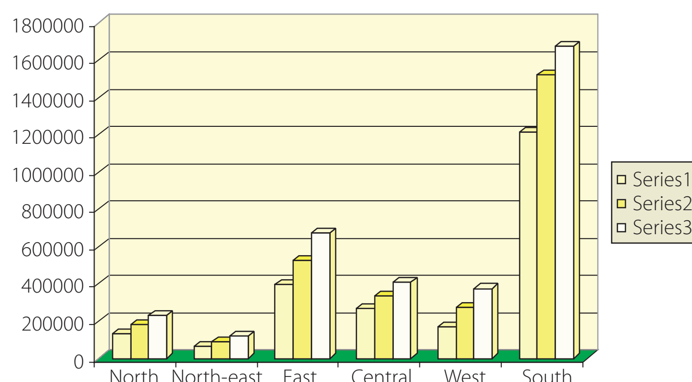


Figure 2.1 Regional coverage of SHGs.

Table 2.3 Top five states in SHG linkage in 2007–08

Name of state	No. of new groups linked	% share
Maharashtra	1,00,569	18.2
Orissa	73,140	13.2
Tamil Nadu	54,498	9.9
West Bengal	49,832	8.5
Andhra Pradesh	40,098	7.3

Table 2.4 Growth of SHGs linked in 13 priority states

Name of state	Cumulative number of SHGs credit linked in the state					
	2004	2005	2006	2007	2008	Growth rate in 2008
Assam	10,706	31,234	56,449	81,454	1,07,098	31
Bihar	16,246	28,015	46,221	72,339	93,410	29
Chhattisgarh	9,796	18,569	31,291	41,703	60,763	46
Gujarat	15,974	24,712	34,160	43,572	46,526	7
Himachal Pradesh	13,228	17,798	22,920	27,799	31,899	15
Jharkhand	12,647	21,531	30,819	37,317	42,605	14
Madhya Pradesh	27,095	45,105	57,125	70,912	83,336	18
Maharashtra	38,535	71,146	1,31,470	2,25,856	3,26,425	45
Orissa	77,588	1,23,256	1,80,896	2,34,451	3,07,591	31
Rajasthan	33,846	60,006	98,171	1,37,837	1,73,192	26
Uttar Pradesh	79,210	1,19,648	1,61,911	1,98,587	2,36,929	19
Uttarakhand	10,908	14,043	17,588	21,527	24,679	15
West Bengal	51,685	92,698	1,36,251	1,81,563	2,28,395	26
Total	3,97,464	6,67,761	10,05,272	13,74,917	17,64,856	28
Percentage growth	59	68	51	37	28	

the states' population and the number of poor. The penetration index brings out that states like Rajasthan, Himachal Pradesh, Assam, Orissa and Mizoram have done well in terms of linkage of

MPI and MPPI

The share of each state in the population of the country was worked out: (a) The share of each state in the total number of poor (per 2004–05 estimate) was also worked out, (b) The number of microfinance clients in the state was computed by adding the SHG members in each state with the number of clients of MFIs. The share of each state in microfinance clients was calculated, (c) The intensity of penetration of microfinance (MPI) was computed by the dividing the share of the state in microfinance clients by the share of the state in population (c/a). MPPI was derived by dividing the share of the state in microfinance clients by the share of the state in population of poor (c/b). A value of more than 1 indicates that groups mobilised were more than proportional to the population. Higher the number above 1, better the performance. Lower the score from 1, which is the par value, poorer is the performance of the state.

SHGs when seen in the context of proportion of poor in these states (Table 2.5).

Needless to say AP leads in all measures of performance. The surprise is that Orissa and Himachal Pradesh find a place among the top five. There are several states such as Haryana, Punjab, Bihar, Jharkhand, MP, Uttar Pradesh, which have very low penetration of SHG with the index being 0.35 or less. These states need to be prioritised with

Table 2.5 Ranking of select states based on MPI and MPPI*

Name of states	MPI	Name of states	MPPI
	Top 5		
Andhra Pradesh	3.03	Andhra Pradesh	5.27
Orissa	2.68	Himachal Pradesh	3.33
Tamil Nadu	2.18	Tamil Nadu	2.66
Karnataka	2.15	Karnataka	2.37
Kerala	1.29	Kerala	2.36
	Last 5		
Punjab	0.08	Bihar	0.20
Jammu & Kashmir	0.08	Haryana	0.26
Haryana	0.13	Punjab	0.27
Bihar	0.30	Madhya Pradesh	0.27
Gujarat	0.35	Jharkhand	0.29

*The calculations are based on data as on 31 March 2008.

different and innovative measures, which would fast-track microfinance linkage.

Another issue that has been discussed in the public domain is the comparative growth rates of the MFI sector and the SHG–bank linkage programme. An analysis of the information reveals that even among MFIs a very large number adopt the SHG model of delivering of financial services. In fact, 155 out of 223 MFIs that have reported information to the Sa-Dhan Quick Report have adopted the SHGs as either the exclusive or one of the means of delivery of financial services. Of these, 92 exclusively used the SHGs. Of the total 14 million clients reported by MFIs in the Sa-Dhan Quick Report, 7.2 million clients are with MFIs that follow the SHG model exclusively. SHGs seem to be occupying a larger space in microfinance, regardless of the nature of the financing institution. The point to note here is that the microfinance sector should be seen as an inclusive one that embraces all methodologies and instruments found effective in each local context. Looking at the widespread adoption of SHG, Grameen and individual models by the MFIs and banks, the debate over which is superior seems to be more at academic and research levels; not with the practitioners. As both banks and MFIs predominantly utilised SHGs for delivery of financial services, adequate resources should be spent on strengthening the SHGs and improving the efficiency of institutions that are involved in promotion and nurturing of groups. But a fast commercialising microfinance sector would tend to move towards individual loans eventually, as has been the experience in the other markets. The capacity-building of groups should take into account this eventuality and train the members to take decisions on whether the groups would recommend names of individual members for loans to banks and under what conditions. The possibility of individual loanee-retaining group membership and servicing the bank loan through the group without any liability on the group needs to be explored. The SHGs can become facilitators for banking services in such cases, which should be encouraged.

AGENCY-WISE PERFORMANCE

Commercial banks continued to account for a major part of SHGs linked and financed. The Regional Rural Banks (RRBs) even in the midst of their

Table 2.6 Agency-wise shares of SBLP

Agency	During 2006–07				During 2007–08			
	New SHGs		Total loans		New SHGs		Total loans	
	No.	%	Amount (Rs billion)	%	No.	%	Amount (Rs billion)	%
Commercial banks	4,06,707	59	44.101	66	–	–	20.425	48
RRBs	1,70,783	25	17.089	26	–	–	15.995	38
Cooperative banks	1,08,878	16	5.242	8	–	–	5.855	14
Total	6,86,368	100	66.432	100	5,52,992	100	42.275	100

amalgamation and consolidation exercises continued linking of SHGs. Though the cooperatives had turned in a much better performance than the last year, the share of cooperatives continued to lag behind despite larger presence across all districts and the extensive network of constituent primary societies (Table 2.6; Figs 2.2 and 2.3).

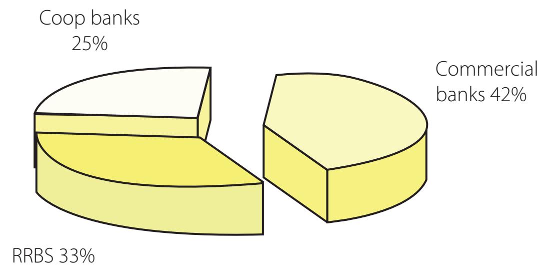


Figure 2.2 Agency-wise share of groups financed (2007–08).

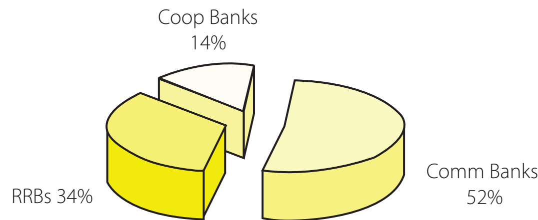


Figure 2.3 Agency-wise share of groups financed (2006–07).

SAVINGS BY SHGs

More comprehensive information on agency-wise performance was made available for the year 2006–07 by NABARD, as explained earlier. The number of SHGs saving with banks and the amounts thus saved are available for the first time in the last fifteen years of SBLP (Table 2.7).

The data shows that SHGs place a considerable part of their savings with the banking system. The loans of SHGs due to the banking system as at the end of March 2007 were 3.52 times of the savings of SHGs with banks. Banks had financed about 70 per cent of all groups linked with them, leaving 1.27 million SHGs, yet to be financed. The fairly high level of savings of SHGs with banks is an indicator of healthy performance. The actual savings of the groups would be higher as the amounts saved with banks do not take into account the savings used for internal lending within the groups. The savings performance was not uniform across groups. The savings behaviour seemed to vary according to the type of bank as well as the type of groups that were linked. SHGs linked to commercial banks had higher average savings, followed by those banking with RRBs and the lowest average savings were reported by SHGs with cooperative banks. There were differences between SGSY groups and non-SGSY groups in savings and again bank-specific differences in savings behaviour were evident (Table 2.8).

While commercial banks were able to attract higher savings from SGSY groups, the RRBs were able to get higher savings from normal SHGs. Similar is the case with cooperative banks. A study of this phenomenon is likely to throw up interesting facets in savings-related decision-making among groups and their members (Table 2.9).

The average lending by commercial banks per group was the highest with cooperatives lending the lowest average amounts as reflected in the outstanding loans. Of the outstanding SHG loan accounts, 23 per cent were SGSY accounts, with a 26 per cent share of loan volumes. However, the significance of SGSY seems to be declining as a proportion to incremental business; of the groups financed during 2006–07, SGSY groups had a 17 per cent share accounting for 21 per cent of loan

Table 2.7 Savings performance of SHGs

Agency	No. of SGSY groups	Amount saved (billion)	Non-SGSY SHGs	Amount saved (billion)	Total no. of SHGs	Amount saved (billion)
Commercial banks	5,71,062	5.245	17,22,709	13.679	22,93,771	18.924
RRBs	3,00,427	1.887	8,82,638	9.696	11,83,065	11.583
Cooperative banks	84,828	0.443	5,98,920	4.176	6,83,748	4.620
Total	9,56,317	7.575	32,04,267	27.552	41,60,584	35.127

volumes. But the pressure from the government implementing machinery resulted in higher loans being given by all types of banks to SGSY groups (Table 2.10).

The cooperative banks have not made full business use of the SHG clients when compared to the commercial banks and RRBs. The average loan size has been much lower and also the average savings per group when compared to other types of banks. Even in terms of linkage, cooperative banks have extended loans to only 39 per cent of SHGs banking with them, whereas the commercial banks and RRBs financed 82 and 61 per cent of linked SHGs, respectively. With an extended network in the hinterland, cooperatives need to perform better.

COMMERCIAL BANKS

An analysis of the data relating to March 2007 in the RBI's database[6] reveals that there were 1.465 million active SHGs loan accounts with the public sector commercial banks. The average loan per SHG across all public sector banks was Rs 40,000. The highest average loan given was by the State Bank of Mysore and Canara Bank at around Rs 73,000. There were banks, which gave as low as Rs 22,500 per group, which translates to an average loan of Rs 1,500 per member of the group. The highest growth rate over the last five years was achieved by the State Bank of Travancore with a 340 per cent growth in number of groups linked and 255 per cent growth in loan amounts outstanding. State Bank of India had the largest number of SHGs linked. The total number of groups linked to the state bank was 7,68,000 and the loan outstanding in these accounts was Rs 24.2 billion. Indian Bank and Indian Overseas Bank occupied the second and third place respectively, with 93,000 groups each but with loan amount outstanding of Rs 575 billion and Rs 549 billion, respectively.

An analysis of the numbers also reveals that the top six banks had as much as 77.5 per cent share in the number of groups and 71.4 per cent share in the loan outstanding. The remainder of the banks had a much smaller share of the overall SHG lending portfolio. While vigorous growth rate seems to be encouraging, a look at overall numbers of the banking sector reveals that the performance is not all that exemplary. The total number of accounts at 1.465 million, as at the end of March 2007, of all the commercial banks, works out to an average of 40 accounts per branch, which is a very small number. The total amount of loans outstanding at Rs 58.85 billion was hardly 0.32 per cent of the gross bank credit flowing from

Table 2.8 Comparison of savings between SHGs and SGSY groups

Agency	Average savings per SHG	Average savings per SGSY groups
Commercial banks	7,000	9,000
RRBs	10,000	6,000
Cooperative banks	6,000	5,000

Table 2.9 Loans to SHGs—Share of different banks in outstanding loans as on 31 March 2007

Agency	No. of normal SHGs	No. of SGSY groups	Average loan per normal SHG	Average loan per SGSY groups
Commercial banks	13,52,216	4,58,137	44,000	48,000
RRBs	5,57,243	1,72,012	35,000	46,000
Cooperative banks	2,24,993	47,241	26,000	44,000

Table 2.10 Proportion of groups financed to groups savings linked

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

commercial banks to the economy. Even as a proportion of the priority sector lending, the SHG loans constituted 0.93 per cent, which is insignificant to attract any attention from the corporate level of the banks. The redeeming feature, however, is the expanding SHG portfolio of loans to SHGs. Some of the banks have priced the loans to SHGs well below prime lending rate (PLR).

Among the private sector banks, ICICI bank, Dhanalakshmi bank and Federal bank had more than 10,000 SHGs credit-linked by the end of March 2007. HDFC bank, through the business correspondent (BC) network, has acquired more than 30,000 SHGs as clients by the end of March 2008. Its business model using BCs targets SHGs. It has set up 12 specialised SHG branches, which focus on financing SHGs through its BC/BF network.

The interest of commercial banks in the SHGs has not been uniform and consistent over the years. There are banks where the number of groups linked had declined in between, perhaps on account of shift in focus of the bank. Unless microfinance becomes one of the corporate objectives, it would be difficult to assume that banks would be keenly interested in lending to groups and achieving consistently high growth rates in engaging the rural poor in such participatory programmes. Seen from this point of view, the intensity of purpose shown by the union government as also by the state governments in the SBLP seems to be well-placed. The fixing of targets, review at the level of finance minister and announcement of new schemes to encourage deepening of the SHG–banking programme are aimed at ensuring that the interest of banks does not flag.

REGIONAL RURAL BANKS

In the case of RRBs,[7] only 25 per cent of the banks had a significant SHG portfolio. Five banks had between 7,500 and 10,000 loan accounts, 4 had between 10,000 and 20,000 accounts and 11 banks had more than 20,000 accounts (Table 2.11).

Not all the top five RRBs come from the south. Compared to commercial banks, the RRBs average per branch linkage of SHGs is better at 55. More banks are involved in the programme as seen by a large number of RRBs (26) having between 2,000 and 7,500 accounts. The amalgamation exercise that consolidated the number of RRBs from 196 to 96 has been a distraction in the client acquisition and business expansion efforts of the banks. With the post-merger blues behind them, the current year must see a more vigorous effort from RRBs.

COOPERATIVE BANKS

The cooperative banks are late entrants into microfinance and SHG–bank linkage. In the initial years, the cooperative credit structure even believed that SHG linkage could destroy the primary cooperatives. In many states, the act and rules of cooperative societies did not permit enrolment of SHGs as members of cooperatives. As non-agricultural loans were rarely extended, SHG loans were few and exceptional. Some District Central Cooperative Banks (DCCBs) took up the challenge and showed the way for others. In the last two years, there has been a surge of interest among the cooperative banks. As at the end of March 2007, seven DCCBs had more than 5,000 SHGs linked to them (Table 2.12). Cooperative banks being under the influence of the state governments have performed better in SHG linkage wherever the state had played a positive role. The top five states in cooperative bank linkage of SHGs are Tamil Nadu (58,070, SHGs), Maharashtra (47,190), West Bengal (40,160), AP (30,560) and Karnataka (25,760). The DCCBs in Chandrapur—Maharashtra, and Bidar—Karnataka, are examples of a committed leadership not only pursuing SHG

Table 2.11 Top RRBs in SHG linkage

Top five RRBs in SHG linkage (March 2007)	No. of linked groups
AP Gram Vikas Bank, AP	99,978
Utkal Gramya Bank, Orissa	67,385
Bangiya Gramin Bank, WB	59,194
Andhra Pragati Gramin Bank, AP	45,169
Baroda Eastern Gramin Bank, UP	27,132

Table 2.12 Top district central cooperative banks (DCCBs) in SHG linkage

Top five in SHG linkage (March 2007)	No. of groups linked
Visakhapatnam DCCB, Andhra Pradesh	21,750
Chandrapur DCCB, Maharashtra	13,672
Kolhapur DCCB, Maharashtra	8,443
Villupuram DCCB, Tamil Nadu	7,990
Tiruchirapalli DCCB, Tamil Nadu	6,973

linkage in their own banks, but also influencing other districts and even states. But the conservative mindset and an extreme caution in providing loans for non-land-based activities still inhibit SHG loan expansion. In terms of availability of personnel on the ground, there is no competition to cooperatives. This strength has to be leveraged especially in the post-reform business expansion phase by the cooperative banks.

A different cooperative bank

Repco Bank, Chennai, is one of its kind. It is a multistate cooperative society, promoted by the Ministry of Home Affairs, Government of India, to help the refugees returning to India from other countries resettle. The bank operates in Tamil Nadu, AP, Karnataka, Kerala and Puducheri. This bank has taken to microfinance over the last few years. It has set up a Repco Foundation for microfinance. While the foundation undertakes formation, monitoring and continued handholding of groups, the banks provides the saving and credit linkage. Out of its 38 branches it has linked more than 11,000 SHGs and financed 6,000 groups. The bank reports having disbursed more than Rs 800 million to 1,00,000 families. Unlike many other banks, Repco offers three-year term on its loans.

The foundation is provided costs of formation monitoring and other services by the bank. The bank links groups formed by other non governmental organisations (NGOs) also. The bank has introduced two mobile branches in mountainous Nilgiris district of Tamil Nadu. It partners UTI Mutual Fund for pension products and LIC for life insurance to clients. It has also introduced handheld devices for the field staff to transact more efficiently. It offers housing loans and recently it has partnered National Housing Bank for a microhousing loan product for clients.

There are a few urban cooperative banks that are active in microfinance. Maan Deshi Mahila Co-operative Bank-Satara, SEWA bank—Ahmedabad, Repco Bank—Chennai, Jalgaon Janata Sahakari Bank—Jalgaon, Sangli Urban Cooperative Bank, Sangli and a few others are also involved in linking SHGs. There are urban credit societies in Maharashtra that finance SHGs. Some of these urban credit societies act as federations of SHGs also. Some of these are intensively active and provide quality services beyond banking to their clients.

SHGs' INTERFACE WITH BANKS

SHGs face problems in dealing with banks. In the midst of rapid upscaling of the SHG linkage, several groups and NGOs report denial of loans or delay in dealing with their proposals. The initial loan volumes are low. Often the banks require the groups to place all their savings with the bank, leaving little scope for internal lending of member's savings. The repeated visits, documentation requirements, lack of time on the part of branch staff to visit the groups in their villages and the lack of continuity of branch staff add to the woes of the groups. Some banks have set up dedicated microfinance cells/departments to sort out the problems that arise in the field. Stronger NGOs are able to interact with banks better and provide solutions. But a large number of groups promoted by others face problems in dealing with banks. These difficulties in securing bank linkage and sustaining the linkage over successive cycles of funding increase the borrower's transaction costs. Banks must find the time to analyse the reasons for these problems and design solutions that work seamlessly in the field.

Banking in the modern era is about producing profits, which necessarily means that larger volumes and bigger clients have to be pursued. SHGs do not seem to enjoy the perception of high networth clients who could bring in large business volumes. But it is nobody's case that the credit needs of SHGs are being fully met by the banking system. As seen from the widely varying average loans given by different banks, there is considerable headroom in terms of increasing the volume of credit to SHGs. The issues before the banking sector are

(1) improving performance of the banking system in achieving its social mandate through lending to vulnerable and poor, (2) making the product and processes of serving the rural poor more effective, (3) enhancing the credit coverage through higher and adequate loans in a timely manner and (4) enlarging their exposure to the microfinance institutions, which would enable their expansion and bring the financial inclusion agenda to the forefront.

QUALITATIVE ASPECTS

Clients' drop-out from SHGs

The phenomenon of members' dropout from SHGs has been a subject of several discussions. However, data relating to dropout rates, the reasons for dropout and significance of dropout rates to the sector have been more a matter of conjecture. In the National Council for Applied Economic Research (NCAER) study, this phenomenon was looked into. Incidence of members' dropout was reported by 43 per cent of the SHGs. The dropout rate was 8.2 per cent of members.[8] The reasons that were offered for the dropout were migration, dissatisfaction with the SHGs, member becoming defaulter, illness and other reasons. The most significant of the reasons was the dissatisfaction of the members of SHGs with 43.5 per cent members reporting the same. Migration was the next most important reason adduced by about 29 per cent members. Lack of financial capacity was cited as the reason by 15 per cent who had turned as defaulters. The Lights and Shades Study had found that migration was cited as the major reason for dropout (40 per cent) followed by financial weakness (27 per cent) and conflict with the group (20 Per cent).

On the other side, new members were being admitted into the existing SHGs, and 29.2 per cent of SHGs contacted had admitted new members. The situation relating to members dropout does not seem to be that alarming. The incidence of dropout was not as high as what has been feared in the sector. The inability of the group to satisfy the members fully with its services being a major cause provides a line of thinking for the practitioners on the nature of improvements needed for retaining the members. Migration as an issue also brings to fore the precarious livelihood scenario of the people in areas where income opportunities are scarce. In such areas, formation of SHGs needs to be done with greater care. Means of retaining members in the local area have to be first examined and brought in as an entry norm before the groups are formed. The level of incidence of dropouts seems to be within manageable limits, and the NGOs and self-help promoting institutions (SHPIs) should be in a position to address the same.

The quantitative aspects of the programme have taken the focus away from the qualitative aspects. The SHG promotional efforts do seem to have been diluted when compared to the diligence with which they were being carried out earlier. Variety of means are adopted for SHG promotion that involve, apart from NGOs, the staff of banks, government departments, part-time, casual staff of governments and PRIs, a variety of individuals under individual rural volunteer (IRV) scheme and others. The staff from organisations other than NGOs do not normally have the development outlook and not trained to be so. The group mobilisation efforts tend to be routine in such cases, and the quality of groups, is not at a satisfactory level. While the bank staff and IRVs concentrate on bank linkage-related competencies in the SHGs promoted by them, the government functionaries prepare the groups to receive the government schemes and implement the same. There are differences in the orientation of groups promoted by different departments of the state government, such as women and child development, rural development, agriculture and so forth. Very often, different concepts and cost structures are used for formation of groups by the different departments; but these efforts lack a coherent mission. The lack of field-level coordination and the keeping of groups close to the department without external exposure makes the groups unidimensional, bereft of core competencies to leverage their strength for securing an overall development of members. The large number of unlinked groups formed by different functionaries in quite a few states is testimony to the indifferent quality of groups promoted.

In dire contrast is the quality of groups promoted by NGOs with a mission. Such groups are in demand, and the members get maximum benefits through training and through increased level of economic and social activities. Banks are willing to pay for formation of such groups and continued

handholding. Bank of India, Canara Bank, Indian Bank and SBI have policies for remunerating NGOs for formation and nurturance of SHGs that are linked with them for financial services. This should become a normal mode of group formation and linkage than an exception. The use of BC model by HDFC to link quality SHGs and remunerating the NGOs by contracting them as BCs, is a sound one that is likely to be adopted by other banks.

The management information system (MIS) on promotion and linkage of groups is weak and needs improvement. Double-counting of groups, same members becoming members of multiple groups with a view to avail loans from many sources, more than one NGO claiming the proximity to the same SHG, are some of the field-level problems that impacts the numbers and renders the data inexact. Poaching of groups by NGOs and banks add to the field-level problems. At times, competitive pressures result in established groups being broken-up and new groups formed with the same or slightly different membership. The targets given by the state government in terms of number of groups lead to smaller groups with fewer members, than was the case some years back. The smaller groups increase the per group cost of formation and linkage and administrative overheads all around. The original premise of bundling the demand and service delivery of a viable number of people does not hold well in such conditions.

A CHARTER FOR SHGs

A group of NGOs intensively involved in SHG promotion, had a series of consultation meets on the problems faced by SHGs and promoting NGOs in the face of high expectations from governments and banks. They have drafted a charter of SHGs, which is proposed for wide adoption through a campaign.

The charter*

- Microcredit can only constitute one small input towards women's empowerment and poverty alleviation. The state remains accountable to ensuring basic entitlements such as those related to health, education and employment to all citizens.
- Promoting agencies will provide sufficient time and resources to SHGs—to enable them to emerge, in solidarity, as strong women's collectives are striving for justice, equity and empowerment.
- This would also require adequate investment in capacity-building, human resources development and infrastructure, along with clear institutional frameworks for implementation, monitoring and evaluation.
- The agenda of women's rights will include intra-household equity issues, such as those related to control over resources and the burden of savings and repayment.
- Adequate investment will be made in education so that long-term and substantive inputs are provided to SHG members. Women will be enabled to build capabilities such as literacy, understanding structural inequities and negotiating entitlements vis-à-vis the family, community, state and other institutional players.
- Livelihoods interventions through SHGs will be designed, based on a comprehensive mapping of local needs, resources and viability. Other than the production and marketing of products, options related to service delivery and natural resources must be explored.
- In this process, institutional and state support must be available to women in SHGs—whether it is with regard to production and marketing of products, provisioning of services, natural resource development or employment generation.
- The state must make available data related to investment and impact of SHG programmes.
- The state must not instrumentally use the labour and time of SHG members to meet its programme targets. SHGs must not be used as vote banks by politicians.
- Promoting agencies will ensure that poor women are not cutting down on their basic needs to save or repay.
- There will be a cap on interest rates. The burden of high-interest rates, which benefit sponsoring agencies, banks and MFIs, should not be transferred onto poor women.

*The charter was finalised in a meeting of 10 NGOs in Bhopal in January 2008.

IMPACT STUDY BY NCAER

During the year, a major impact study on the SHGs linkage project was carried out by NCAER commissioned by Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) and NABARD.[9] Several interesting findings that were brought out confirmed many positive aspects of the programme. Some of these are the excellent coverage women (80 per cent SHGs were exclusively of women) and the disadvantaged people. Poor [as identified through the below poverty line (BPL) list] exclusively constituted 60 per cent of all SHGs. These groups on an average, reported a growth of 6.1 per cent per annum in their incomes. They were able to spend 5.5 per cent more per annum each year, on education and health. The average loan amount borrowed grew at 20.5 per cent per annum, whereas their savings increased by 14.2 per cent. The SHGs have shown that the poverty reduction rate was quite high at 10 per cent per annum for their members. Improved social empowerment was reported by 92 per cent of groups. The non-performing assets (NPAs) as a percentage of outstanding loans declined from 4.2 per cent in 2002 to 1.2 per cent in 2006.

One of the significant features was that 55 per cent of the members of SHGs were either farmers or agriculture labourers. One of the issues raised by the SHPIs[10] was the cost of formation and nurturing. On an average, NGOs incurred Rs 8,700 per group; banks incurred Rs 3,575 per group for promotion. The maintenance expenses were around Rs 1,100 per annum for NGO and Rs 960 per annum for the banks. NABARD's present level of support at Rs 3,000 per group for not only promotion but also for handholding, for a three-year period was in no way adequate even for the low-cost models of banks, not to mention the intensive service models of NGOs. The costs mentioned are averages of locations where already considerable work on propagating the concept has been carried out. The costs of taking the SBLP to states with low growth would be higher. Recognising the special problems of hilly districts in north-eastern states, NABARD had changed its guidelines to permit five member SHGs and increase its grant support of Rs 5,000 per group to the NGOs functioning as SHPIs in such districts. The problems of hilly districts and harsh terrain being common, the higher support level should be extended to all such districts.

The positive findings of the study related to regularity of meeting, regularity of savings and rotation of leaders. While across the country, maintenance of records was reported to be good; in Uttar Pradesh, 33 per cent of sample groups were found not to maintain the SHGs books or passbooks of members. In Orissa, 2.5 per cent of the sample studied did not maintain their books and 7 per cent of groups did not maintain member's passbooks. Almost 95 per cent of external funds to SHGs for lending came from banks. In Karnataka, only 90 per cent of the funds came from banks and the rest came from other sources for lending to members. Groups leveraged their own funds with 19 times, banks funds, for lending to their members. The average increase per annum in external funds for SHGs was about Rs 25,000.

GROUP MORTALITY

The data on outstanding SHG loans released by NABARD indicates that the mortality rate of SHGs is low. Out of 2.92 million groups that had been linked to banks till March 2007, 2.84 million had outstanding loans with banks. More than 97 per cent of the groups linked to banks continued to operate and borrow from banks.

A study by Beland[11] and others in 2007 found in a sample of 1,102 Professional Assistance for Development Action (PRADAN)-promoted groups, that 10 per cent of groups formed between 1998 and 2006 were no longer active in three tribal districts of Orissa and Chhattisgarh. Navin Bhatia[12] of RBI in a study, in Rajasthan reported high incidence of SHGs' breaking-up.

The Lights and Shades Study estimated that the proportion of defunct and broken groups was 7 per cent in a sample of 214-SHG (six year old) taken across four states in 2006. Group mortality rates were perceived to be higher by several industry watchers. But the macroinformation relating to credit-linked groups indicates that the mortality rates are low. But the mortality rates would be much higher in case of groups that have not been linked to banks for a long time.

REPAYMENT RATES

A review of the available data provided by banks in the NABARD's statistics as also the evidence

gathered by the different studies at the micro-level by NCAER and EDA—Andhra Pradesh Mahila Abhivruddhi Society (APMAS) indicates that the Unique Selling Proposition (USP) of high repayment rates is waning. The recovery data reported by banks to NABARD reveals that several banks have a recovery of less than 90 per cent. Six commercial banks, 15 RRBs and 36 District Cooperative Banks had recoveries of less than 75 per cent (Table 2.13).

The recovery from SGSY groups was lower; 10 commercial banks and 24 RRBs reported less than 75 per cent recovery.

Across all the states the recovery rates have fallen. The intra-group loans are likely to face higher levels of default as the groups always work towards keeping a default-free record on the bank loan. While the programme expanded fast on the premise of low default rates and peer pressure offering high quality collateral, the repayment rates reflect a different picture. With large number of linked groups and large amounts given as loans, the repayments need to be kept at a high level. Hence the emphasis should be on continued handholding by the SHPI for a period of five years or more from formation. Greater savings mobilisation to achieve a 50 per cent level of loans might ensure that member pressure on others is tangible and effective. APMAS found in one of its studies that SHGs, while maintaining a default-free record with banks, did not observe repayment discipline on the loans made out of SHGs' own resources. The recoveries on internal loans with SHGs' own funds were around 30 per cent. With such low intra-group recoveries the conclusion that peers has turned to collusive indiscipline rather than maintaining pressure for positive credit culture is inevitable.

The reason for the fall in recovery in a supposedly peer-monitored credit product needs to be examined. Some of the common reasons adduced for fall in recovery rates are:

Table 2.13 Range of recovery

Agency and no. of reporting banks	No. of banks with recovery of 95% and more	No. of banks with recovery between 90 and 95%	No. of banks with less than 90% recovery
Commercial banks, 22	5	5	12
RRBs, 73	20	13	40
Cooperative banks, 170	25	63	82

- Fatigue with the long run of the programme and the stagnation in loan levels and features.
- Availability of credit from competitive channels such as MFIs and finance companies.
- Loan size having reached its limit leaving little scope to aspire for a higher loan.
- Lack of close monitoring and handholding by promoting institutions and banks.
- Negligent handling of groups in government-sponsored programmes contaminating other groups.
- Real sector problems such as natural calamities reducing cash flows of SHG members.

Unless the recovery levels are restored to comfortably high levels, continued bank support in future might be jeopardised. The analysis of information in the impact evaluation study of NCAER reveals that only 69.2 per cent of the SHGs had an excellent record of recovery. Another 7.6 per cent of the groups posted recovery rates in excess of 90 per cent, and 22.6 per cent groups had recoveries of less than 75 per cent of demand. Arrears were reported by 7.6 per cent groups, which were outstanding for more than twelve months, that amounted to 0.86 per cent, of outstanding loans. AP- and Orissa-based SHGs had reported much lower repayment rate when compared to the rest of the country. The reasons for lower repayment rates and arrears were cited as natural calamities, buyers blocking payments to SHG members, illnesses and other reasons. In Orissa, 27 per cent of SHGs had reported arrears reflecting the fragile nature of the local economic activity and the vulnerability of the group members in that region. Training and counselling of default prone groups and members is necessary and the promoting agencies should prioritise such interventions.

While the numbers and the growth rate are healthy, there are matters of concern that needs to be addressed. The large numbers contain a risk potential that could escalate through a contagion effect. Systemic risk mitigation measures are necessary. The groups formed on the foundation of savings, are unable to graduate into stronger savings-based institutions. Barring stray exceptions, no innovations and changes have been introduced in savings products and processes. Voluntary withdrawable savings, fixed maturity deposits and recurring deposits and so forth, are some of the products that people need as part of savings services,[13] which could have been introduced. Even the

compulsory savings are taken by some banks as a security deposit, denying the groups the opportunity of making small loans to members, out of their own resources. The opportunity of generating a significant income on account of the high margin in lending out of member savings has been lost in such cases. Account-keeping quality and cash management on a day-to-day basis are the significant factors that have impeded the expansion and deepening of savings services.

SHG LOANS AND LIVELIHOODS

The increasing numbers make it difficult for bank staff to effectively monitor the functioning of the group and track the utilisation of loans. There are reports of elite capture of loans and also utilisation of the loan amount in some states[14] for profitable money lending. Further, the inability of these small loans to lift people out of poverty has been a key drawback. Enterprise activity requires higher outlays that could generate a poverty-alleviating income. Even with a higher average disbursement reported during the year 2007–08, at around Rs 3,600 per SHG member, it is very difficult to envisage generation of a poverty-alleviating income. Applying simple input/output ratios, one would require a minimum investment of around Rs 50,000 per family to generate a return of around Rs 10,000, which when taken together with the existing income level might be able to bring the family out of poverty. SHGs, especially when they are mature should be guided to undertake productive and income-generating activities. This would need a large order of mobilisation of people and resources. It would also require identification of livelihood and enterprise opportunities that would support the large number of SHGs, which have already achieved access to finance. Unless enterprise and livelihood activities[15] are supported, the microfinance access to SHGs would merely have a liquidity-smoothing effect, and it will not be able to meet the objectives of poverty eradication. The other issue that impacts the members of SHGs is the inability of individual members to get large loans from the banking system through the groups. Viable means of ensuring access for larger loans to enterprise-minded members of SHGs need to be found.

The mature groups need to graduate into value-adding enterprise activities. With the initial investments made in group mobilisation, and the confidence gained by the group members over time; unless the members are able to improve their income levels so as to cross poverty line, the SBLP cannot claim to target empowerment. Recognising the need for sustainable incomes, livelihood options are being generated by the governments as in the case of AP. NABARD has initiated a pilot—Micro Enterprise Development Programme (MEDP) to make mature groups take up enterprise activity either as a group or individually. In 9 districts, 14 NGOs act as micro-enterprise promotion agencies. More than 2,750 enterprises have been established under this pilot in the nine districts. But the effectiveness of such pilots would be known only when they upscale to significant levels, consistent with the large requirements. Navin Bhatia,[16] in his study, concludes that 'The amount and frequency of loans availed by SHG members may appear to be low but in relation to their savings, it varies from two to three times of the total savings. For the poor persons who have been exposed to bank finance for the first time in their lives, this amount could be considered adequate. However, for SHGs that continue to sustain beyond a certain time period, say five years, the amount of loan should increase considerably to enable members to graduate to the economic activity stage.'

Even with the spread of the programme across states, banks still delay and defer linking SHGs with credit. There are states in which thousands of SHGs have been formed and languishing without credit linkage for more than two years.[17] The groups have been generally formed under the state government programmes by the state government functionaries or NGO partners. Banks have been wary of linking these groups as the government support may not materialise for such large numbers. The quality of the groups is perceived by the banks to be suspect. But the economic cost of such unlinked groups is enormous as the government machinery has spent time and money on formation of such groups. Means of upgrading the capacities of these groups and increasing the comfort level of banks in financing them should be explored, so that the sunk costs in these groups are recovered.

MICROFINANCE IN THE MOUNTAINOUS REGIONS AND SPARSELY POPULATED AREAS

There are special problems in group-based methods in microfinance in the sparsely populated areas and

harsh terrains, such as mountains and deserts. The costs of community mobilisation would be high and some of the standard designs relating to number of members in the SHG, frequency of meetings and so forth, may not work in such environments. UN Solutions Exchange ran a query (exclusively for the purpose of this report) on the special difficulties in such regions with a number of practitioners participating. The need for deeper engagement, developing livelihood options, setting up federations and so forth, were pointed out. NABARD[18] in response to the feedback from the field has reduced the minimum number of members in SHGs in hilly districts on north-eastern region to five. NABARD had also revised the grant support to NGOs engaged as SHPIs, in the hilly districts of north-eastern states to Rs 5,000 per group. However, these address requirements of the north-east only. The changes made by NABARD should apply to any geographical area similarly placed. Use of technology to overcome distances and appointment of local BC to enable transactions are prime requirements in such regions. The banking hygiene factors necessary in such regions must be studied closely, and suitable changes to be effected to facilitate financial inclusion in a sustained manner.

JOINT LIABILITY GROUPS

Joint liability groups (JLGs) have been introduced as a mechanism for financing larger requirements in microfinance by banks (many MFIs adopt it in their lending formats). GTZ had recently carried out a study[19] of a pilot that was introduced among banks by NABARD in 2004–05. More than 1,000 JLGs had been financed by nine banks (commercial banks, RRBs and cooperative banks). The study found that farmers and agricultural labourers without collateral have found the mechanism to be very useful. The best practices noticed by the study related to differential pricing of JLG loans, strong repayment culture and simplified documentation. The JLG mechanism has been recommended for wider scale replication. The significant feature of the JLG financing by banks is that of higher loan size, which could suppot livelihood activities. Given the fact that even after three years of the pilot's work, the number of groups financed has not scaled up to a significant level, more intensive promotional work seems necessary.

WOULD THERE BE NGO SHPIs IN FUTURE?

NGOs that have been forming SHGs and JLGs and linking with banks are more in favour of starting up their own financial institutions. NGOs that finance their clients with bulk loans from banks are also planning to set up separate microfinance entities such as non-banking financial companies (NBFCs). To carry out their 'own account finance functions,' some NGOs have transformed themselves into companies and many others are on drawing boards to set up NBFCs. The supply side of the market is about to change, but apparently without adequate preparation. It is difficult to estimate whether the technical resources needed to facilitate and handhold such a transformation are available.

What are the reasons behind this mass movement? The SHPIs might justly feel that they are not adequately compensated for formation and nurtur-

Everyone wants to become NBFC?

A survey* covering 57 member organisations of ACCESS Microfinance Alliance (AMFA)† was carried out for the purpose of this report. The survey revealed that seven of these are already in NBFC or cooperative form. Of the remaining 50 institutions, 47 had plans to set up a dedicated microfinance entity. Twenty-three had NBFCs, and 22 had other forms of MFI in mind. These organisations had a clientele of almost 1.2 millions. Many of these mobilised savings were amounting to Rs 492 million. The business plans targeted an outstanding loan level of Rs 94 billion in three years. Most of them planned to raise equity, and all of them planned to raise loans to meet the business needs. While many felt a need for technical assistance and capacity-building, some had specific requirements such as systems improvement, IT investment and financial management expertise. While the survey has a limited sample, a larger and more rigorous survey is likely to bring out numbers in almost the same proportion.

*The survey was carried out by Narendar Nayak from ACCESS Development Services with support from Yeshu Bansal.

†ACCESS Microfinance Alliance is a network of 110 partners. More information is provided in a later chapter.

ance stage of SHGs. Once the group is formed, they find it difficult to satisfy the expectations of the SHG for finance as they have to depend on the banks. They watch helplessly when in their area of operation, the MFIs set up business and start lending to people and build their influence and image within a short period of time.

In some states, the NGOs are unable to register societies and trusts for carrying microfinance activities and hence, compelled to form companies. A company with its ability to attract external equity has a better basis for resource mobilisation. The recent amendments to the Income Tax Act has rendered the income of non-profit entities taxable and reduced the incentives for continued existence of societies, trusts and Section 25 companies in microfinance operation. The drive towards becoming MFI, no doubt, is influenced by two lines of thinking. The first is the perception that becoming an MFI would enable much faster growth rate and accelerated achievement of expanded outreach. The second is the perception that MFI–NBFC is a much better and visible form of organisation when compared to an NGO. The overall climate created by the commercial chatter that pervades the sector (entry of private equity funders, venture Capitalists and also, the requirements enforced by bulk-funding banks) seems to push the NGOs, towards becoming MFIs, that too into companies. While the transformation itself might be a mission of neutral measure, the sector has seen that pursuit of high growth rates and commercial rates of return on equity, tend to wean the institutions away from their original mandate. This is not to say that MFIs cannot be set up as pure-profit plays. But, when a socially committed NGO transforms into a for-profit company, forsaking its original mission and objective, it denies a past, built assiduously with community work; it results in a reduction in public goods, of a kind that is scarce. In such transformations (except a few, rare instances where the company that is formed is fully member-owned), the ethical dimension has to be closely examined. Funds are raised for a public cause and diligently applied in pursuit of the social mission of supporting vulnerable people, resulting in the formation of SHGs for access to financial services. Conversion of these SHGs into captive clients of a for-profit private company is tantamount to misapplication of public funds for private use. Original mission of public service that attracted grant funds is replaced by private profit with donors mostly remaining mute spectators. Donors need to closely look at the potential for misuse of funds in this manner and stipulate necessary conditions that would prevent such undesirable developments. The argument is not to deny support to for-profit entities. Small Industries Development Bank of India (SIDBI) provides a transformation loan, which examines several aspects of social performance. The distinction between profit-induced behaviour and social mission should be made by funders and donors, and appropriately dealt with, expending public funds.

SHGs AND THE POOR

The SHGs on account of their ownership seem to have served clients well. However, even SHGs cannot claim to be entirely inclusive of the poor. There are practices that tend to exclude the poor from SHGs. High savings requirements, frequency of meetings, elite leadership, demands on time for joint work, at times, of a political nature and lack of transparency, do act as entry and participation barriers. The bank linkage is in many cases shallow, providing a credit limit that is a year or two long, leaving little scope for the groups to invest in income-earning assets/enterprises. The small loan amounts also do not help. While banks are willing to provide larger loans under SGSY to groups, the reason why they do not do so in case of normal SHGs is difficult to understand. But there are several examples of groups that have secured livelihoods of members and pursued social empowerment agenda. There are also committed organisations such as PRADAN, DHAN, BAIF, Sevamandir and so forth, which have made a difference and offered examples to emulate. Community-based financial institutions such as Sarvodaya Nano Finance[20] offer an interesting and effective design of client-friendly business model. As the move towards federations quicken, community-owned and -managed models (with professional support) should be prioritised.

For all its spread and client coverage, the SHG model of microfinance did not gain acceptance, internationally for a long time. Its international recognition is both hesitant and recent. Al Fernandez[21] points out '*There are several reasons given by multilateral organisations, including the World Bank, for their rejection of the SHG model: it does not conform to the*

Grameen Bank model, which the World Bank supports strongly; it does not draw a clear line between social and economic matters; it is not managed professionally by NGOs; it is not sustainable as a financial model; it mixes subsidies and loans; financial analysts do not feel comfortable with unregistered groups managing credit; and SHGs provide loans for consumption smoothing rather than for income generation. Apart from requiring conformity with the Grameen Bank model and not accepting that other models of outreach and financial inclusion may coexist, the other criticisms are, in fact, valid. However, they are valid only if they are accompanied by a similar assessment of the strengths of the SHG model and an identification of practical actions that can mitigate the above lacunae. In any case, they fail to explain why the Microcredit Summit brought SHGs on board despite these problems. It must also be pointed out that the SHG model began in India with no support from major financial institutions based abroad, who thus could not take ownership. The Microcredit Summit consistently refused to recognise the SHG programme in India and to incorporate SHG members into its portfolio of achievements. Interestingly, last year, when the Microcredit Summit realised that it would not be able to achieve its target of reaching 100 million beneficiaries, it decided to add the Indian SHG membership to its portfolio.'

The Consultative Group to Assist the Poor (CGAP) in its study in 2007 recognises that the model has succeeded, but speculates that it might be due to directed lending and priority sector quotas imposed on public sector commercial banks. '*Indian commercial banks, most of which are government owned, began lending to SHGs because of government-imposed, priority-sector lending quotas.*'[22] The fact is that lending to microfinance was less than 1 per cent of the priority sector lending done by banks and less than 0.40 per cent of total credit of commercial banks as on 31 March 2007.

ARE SHG FEDERATIONS THE WAY FORWARD?[23]

The State of The Sector Report 2007 had a chapter on SHG federations addressing the question of 'SHG federations: financiers or nurturers?' This section is intended to be an update on the information on SHG federations and the emerging issues.

APMAS conducted a country-wide study on SHG federations and published a report on SHG federations in 2007. At that time, there were 69,000 SHG federations in India. The data collated by APMAS as on March 2008 indicates that there are more than 94,000 SHG federations in the country (information is lacking from some states). Almost all the SHG federations in the country have multiple objectives and play different roles (social, financial and livelihood promotion activities). A listing of known federation promoters and their location of operation is provided in the annexure 2.3.

More than 50 per cent of the SHG federations are involved in some form of financial intermediation, and the remaining are aspiring to get involved as soon as they become strong. An estimate by APMAS suggests that SHG federations manage more than Rs 15 billion for on-lending to SHGs and to undertake other livelihood activities that benefit their members. Many financial federations have demonstrated both operational and financial self-sufficiency by covering their costs. They have begun to offer savings and insurance services to their members. Majority of the SHG federations are performing the role of 'bridge financing' to the SHGs. Though SHGs have mandatory savings, there is a great need for a variety of savings services for the SHG members. Services such as insurance, remittances and pension could be other possible financial services that the SHG federations could take up. Opinion is divided on the advisability of federations taking up financial intermediation.

Though the Community Managed Resource Centres (CMRCs) promoted by Mysore Resettlement and Development Agency (MYRADA) with SHGs and other community-based organisations (CBOs) are not SHG federations in the strict sense, they have demonstrated that they can provide support services sustainably with user fees. SHG federations are recovering part of their operational costs through fees from SHGs. Some federations offer a wide-range of services acting as implementing agencies of government programmes. With limited capacities, providing multiple services with quality and efficiency can be difficult. There are several federations that have been prudently cautious about what they take upon themselves.

SPREAD OF FEDERATIONS

Regional spread of federations is not even, which is not surprising as these depend on the constituents,

the SHGs. Most federations are in the southern states where the growing number of SHGs demanded a higher order organisational structure to smoothen the different external interactions of the groups. But the existence of federations in some states that are relatively slow movers in the SHG linkage program is a positive development as the federations could provide a fillip to a faster growth of the movement (Table 2.14).

The user-defined business characteristics distinguish federations from other forms of MFIs. Of the available MFI models, those owned, managed, run and used by members seem to be most closely relevant to clients' needs. The plans, policies and strategies of such entities would be rooted in clients' needs and carry less of a profit orientation. Loan-terms, pricing and purposes are more likely to take into account the client requirements than in the case of MFIs that are external to members. The risk of the institution becoming too big to listen to clients is less. Ms Vijayalakshmi Das, CEO of Friends of Women's World Banking (FWWB) says[24] 'We do not need monoliths in microfinance. We need more of small 5,000 to 10,000 client MFIs that are community owned, like cooperatives. These are more likely to be viable and sustainable as they would carry low costs and serve their members well.' Experience shows that federations could usefully provide services such as

- Accounting, audit, rating and financial management services at SHG level
- Distribution of insurance products/anchoring mutual insurance
- Skills-training for livelihood activities
- Input linkages
- Market linkages through aggregation of products from members
- Infrastructure creation for common use by members
- Facilitating with dialogue with external agencies
- Social and cultural mobilisation—in education, health, marriage, rights and entitlements of women, etc, and in related areas
- Raising member awareness of technology, finance and markets

Lessons from Andhra Pradesh federating experience

- Having a strong foundation of good SHGs is a prerequisite.
- SHG federation promotion requires strong and sustained support from the promoters and significant funds.
- Strong pilots are required for upscaling the SHG federation model.
- Building a strong cadre of local professionals in the form of book-keepers, group animators, federation office bearers, community resource persons and so forth, would help sustain the movement in the long-run.
- Investments required for capacity-building and mentoring are critical.
- SHG federations can play multiple roles as per the requirements of their members, but they must be free to choose what they would like to do.
- SHG federations will have to deal with political interference and bureaucratic pressures, once they are given state funds.
- SHG federations could play an effective role as implementing agencies of various government schemes. However, such schemes should not be thrust on them.

ROLE OF THE STATE IN FEDERATIONS

The initial cost of promoting SHG federations is high. The funds for promotion of sustainable SHGs and SHG federations are available with Government of India, NABARD and state governments. These funds could be used to facilitate SHG federation promotion through NGOs and other civil society organisations. The state governments have become the promoters of SHGs and SHG federations. A number of state governments (AP, Bihar, Orissa, MP, Rajasthan, Tamilnadu, Uttar Pradesh and a few other states) are promoting SHG federations, at times by borrowing funds from the World Bank. In some of the states, state governments have done an exceptional work in promoting high-quality SHGs and SHG federations. However, these SHG federations are seen by state governments as agents for delivery of various welfare schemes and services of the government. This has resulted in co-option of the SHG federations by the state governments, undermining their autonomy. These entities carry high costs and after stoppage of project funds, the federations might find it difficult to cover their operational costs. The grant funds that support these federations also impose externally developed

Table 2.14 State-wise spread of SHG federations

	Regional spread of SHG—Federations as on 31 March 2008				
	Region/state	**No. of primary federations**	**No. of secondary federatrions**	**No. of tertiary federations**	**Total**
A	Northern Region				
	Himachal Pradesh*	0	0	0	0
	Rajasthan	630	24	0	654
	Haryana*	0	0	0	0
	Punjab*	0	0	0	0
	Region—total	630	24	0	654
B	North-eastern region				
	Assam	291	11	0	302
	Meghalaya	0	6	0	6
	Manipur	0	4	0	4
	Nagaland	0	1	0	1
	Region—total	291	22	0	313
C	Eastern region				
	Orissa	6,776	299	0	7,075
	Bihar	325	84	0	409
	Jharkhand*	7	1	0	8
	West Bengal	14,263	400	0	14,663
	Region—total	21,371	784	0	22,155
D	Central region				
	Madhya Pradesh	455	204	1	660
	Chhattisgarh*	0	0	0	0
	Uttar Pradesh	50	130	0	180
	Uttaranchal*	1	0	0	7
	Region—total	506	334	1	847
E	Western region				
	Gujarat	113	1	0	114
	Maharashtra	600	0	0	615
	Region—total	713	1	0	729
F	Southern region				
	AP	36,303	1,093	22	37,418
	Karnataka	2,453	36	1	2,490
	Kerala	14,379	1,050	0	15,429
	Tamil Nadu	14,680	130	0	14,810
	Region—total	67,815	2,309	23	70,147
	Grand total	91,326	3,474	24	94,845

*Federations are there. But detailed information is not available.

norms and rules on the constituents, with the possible result that these supposedly community-driven entities might end up as *parastatals*.

The Ministry of Rural Development, Government of India, has constituted a National Council for strengthening the SHG movement in the country.

The ministry is of the opinion that SHG federations are necessary for the growth and sustainability of the SHGs. As some of the state governments have not taken the initiative to promote SHG federations, the Government of India intends to seed the concept of the SHG federation from the top. While an *adhoc* national SHG federation with representatives from different states was proposed by the Ministry of Rural Development recently,[25] many of the key stakeholders in the sector were of the opinion that it is not appropriate to form such a body. The sense was that it must evolve, based on the needs of the SHGs and their federations in the states. However, there was a broad agreement among all the stakeholders to promote a *National Council* with representatives from GoI, state governments, banks, NGOs and other professionals in the sector.

Views of Committee on Financial Inclusion on Federations

- *The federation should be promoted among the matured groups.*
- *The federation's concept should be evolved based on the members' needs and priorities. The following aspects need to be considered before evolving federation promotion process:*
  - *Size is a critical factor to be taken into account, as it is a necessary condition for promoting a viable organisation.*
  - *All SHGs should belong to a specific area. A developmental block of a district is the ideal geographical area to promote one viable federation. Scattered SHGs in many blocks may not lead to a functional and viable federation.*
  - *The decision of promoting a federation should not be thrust upon the SHGs. The role of promoting agency should be to sensitise the members and the leaders of SHGs on the need for creating a federation.*
  - *The promoting agency should be professionally well-equipped in promoting a federation. It would be helpful to promote a local team that can work on the federation.*

HUMAN RESOURCES

Attracting professionals to work for SHG federations is proving more difficult than is the case with other MFIs in the sector who also suffer on account of scarcity of human resources. The state run federations provide '"project staff" for critical positions at the cost of the project, but such external funding of operational costs could become addictive; increasing costs and making breakeven difficult at the closure of the 'project.' The states would do well to keep in mind these issues in sustainability of federations in providing staff and administrative cost support. The federations should examine the range of services that are to be offered to clients and the complexity of their product range; then look at the profile of professionals necessary to run its operations. The remuneration should be market-based; otherwise, retention of talent would be difficult.

IMPACT OF HIGHER ORDER ORGANISATIONS ON SHGs

SHGs and SHG federations are independent; yet, interdependent organisations. The SHG federations are expected to play an enabling role. As the SHG federations are promoted by SHGs after several years of their existence, the assumption is that they would be able to maintain their autonomy. However, if the SHG federation demands loyalty and does not allow the SHGs to access bank loans directly or have relationship with other organisations for various services, the autonomy of SHGs may be undermined. As long as SHG federations play supportive roles like monitoring, training, grading, linkage and other support services, the SHG would feel helped. The entry and exit norms for the SHG federation should be well-articulated, transparent and known to all the SHGs. Freedom to SHGs to exit a federation and join another would provide the necessary autonomy.

THE WAY FORWARD

Federations are sought to be set up by government and NGOs in a move to consolidate their field operations. Effective consultations with the SHGs and their members are necessary before the SHGs are federated into a higher level organisation. The committee on financial inclusion[26] had proposed that federations should emerge only in response to members' needs.

ROLE OF FEDERATIONS

Livelihood promotion should be a part of the federation's agenda to ensure optimum utilisation

of financial services. Federations should play a much greater role in the areas of social empowerment. The savings and insurance services should be taken up on scale. The federations could embrace the business facilitator and correspondent model, and enhance their product range. Federations need to develop tailored products addressing members' needs, and charge service fees from members to sustain themselves. With the liberalisation of the insurance sector, SHG federations have a unique opportunity to play as the role of an agent and thereby, to mitigate the effects of risks faced/undertaken by the clients.

The financial federations should develop linkage with banks and other financial institutions to meet the credit demand of the members. For federations to attract mainstream funds, they must demonstrate excellence in governance, systems and sustainability. For financial federations to access commercial funds from banks and other financial institutions, they must get themselves rated by a credible rating agency. The rating will give an objective assessment of the strengths and weaknesses of the SHG federation and also the credit worthiness of the federation.

SHG federations have evolved as a model that promotes sustainability of the SHGs and provides the much-needed *own institutional base* for poor women to improve their quality of life. The SHG federation model has achieved significant scale and widespread acceptance but mostly with state support. The federations in becoming sustainable institutions, should ensure that the SHGs retain their autonomy and vibrancy. Federations should be professionally managed in the interest of owner members and their costs defrayed by the user members. Federations should seek to be self-sufficient in terms of meeting operational costs in the long-run, so that they are in a position to serve member's interests effectively.

INTERVIEW

Mr Umesh Chandra Sarangi, Chairman, NABARD spoke to the author exclusively on some aspects of the microfinance sector. The interview is reproduced verbatim.

1. *Question:* **What is the view of NABARD on the progress of the SHG–bank linkage programme during the last year?**

Chairman, NABARD: Though final data is yet to flow in, we discern a deceleration in the pace of growth, especially in the linkage of new groups. We are not happy with the progress achieved in the SHG–bank linkage programme during 2007–08. For the last several years, the number of new groups that were linked to the banking system has been increasing continuously. But during 2007–08, there has been a decline of more than 0.13 million in the number of new groups linked to banks. Saturation in four southern states is a major reason for the declining numbers in the south. In AP, more than 85 per cent of poor families are already covered; similar is the situation in Tamil Nadu, Kerala and Karnataka. There is not much headroom for growth from SHG–bank linkage programme in the south.

But NABARD had targeted 13 priority states in the other regions of the country. The growth rate in these states could have been much better. We need to think about the other means of focusing on these states and ensuring that a more vigorous performance is posted in the current year.

2. *Question*: **What are the steps that NABARD is taking to ensure that the programme expands faster during the current year?**

Chairman, NABARD: NABARD is taking help of SERP of AP to provide support in states like Uttar Pradesh and Bihar. The systems and structures adopted in AP would be brought over to these states with necessary modifications, to ensure that much more support right from the ground level for formation and linkage of groups to bank is available. Strengthening the NGOs in all these states to take up SHG formation/linkage will be prioritised. In some states like West Bengal, Rajasthan and MP, number of groups promoted is very high but number of groups linked with the banking system is very low. Greater focus on the unlinked groups would be given during the year and the means of linking these to the banking system quickly would be explored.

3. *Question*: **The microfinance development and equity fund has been in news for some time. What has been the innovative measures supported under this fund?**

Chairman, NABARD: The Micro Finance Development and Equity Fund (MFDEF) is being used to support a variety of interventions. We have provided quasi-equity support to around 12 MFIs so far, and more proposals are under consideration. There is a

special and unique programme involving the post office in SHGs linkage being tried out in five selective districts of Tamil Nadu. More than 2,000 SHGs has opened accounts, and 371 of these have taken loans to the tune of Rs 8.8 million. This is the first time that post office has given loans to anyone! The project has been extended to Meghalaya in the east Khasi Hills district. Depending on the experience and also how certain issues relating to payment of interest on these funds and also risk-sharing on these loans by the Department of Posts are resolved, we would upscale this programme. A social security system for SHG members is also supported under a project with an NGO in MP. A grant of Rs 0.8 million has been given to provide a single package insurance cover for both health and life. NABARD has supported MYRADA for developing software for NGO partners, engaged in promotion of SHGs. On a technology front, pilot project on processor cards has been initiated with two RRB partners. Alternative mechanism for book-keeping and accounting in SHGs through capacity-building of skilled youth, as computer Munshi, pilots on saving in kind through grain banks and financing through JLGs are some of the activities supported under MFDEF. The normal capacity-building support to the sector for training and promotion of SHGs continued during the year.

4. *Question*: **What do you feel about the current situation of federations and their future role? What is your comment on a reported move to set up apex-level federation by Ministry of Rural Development, Government of India along with state- and district-level federations?**

Chairman, NABARD: Federations should evolve as organisations that are expressions of internally felt needs within the system. If SHGs find a need for higher level organisations to provide them a kind of support which they themselves cannot manage, then federation type of structures emerge. There are roles that cannot be played by individual SHGs because of lack of numbers and business volumes, or because of cost inefficiencies attached with small groups. For example, distribution of insurance products or arranging specialised mutual insurance among groups is possible if the SHGs federate. There are services relating to input supply and market linkages, which federation-like institutions that aggregate demand can perform better. So in such cases, the SHGs would look for a higher level organisation and certainly federations would emerge. NABARD would be quite keen to support federations. While NABARD has already announced its policy for supporting the federations, it had some concerns regarding federations playing a financial intermediation role. Even this is under reconsideration.

But where federations are thrust from outside, they have a tendency to dominate the SHGs. We should be cautious about setting up such apex-level entities, before the SHGs make up their mind on what they want, by way of higher level support.

5. *Question*: **There is a negative perception of the widely prevalent money-lending practices in the political sphere. The RBI has studied the different aspects of money lending and has come out with a policy for registration and legitimisation of money lenders by state governments. A suggested money-lending act for states to enact has also been proposed. How will this impact the microfinance sector?**

Chairman, NABARD: Money lending should not be reduced to just being an underground activity. We should support any measure that puts an end to invisible money lending. It is time that we recognise the role of money lenders as the financiers of the last resort. When people want to borrow in an emergency, no formal institution would be available to provide this kind of support. Not even SHGs could meet some of these requirements quickly. Money lender is a person of the last resort and provides support in times of dire need. Let us regulate and keep track on what the money lender does. Let us try and make the money lender a part of the financial system, by making his behaviour and processes more acceptable. For this, we require support from the formal system, including supplementary financial resources to money lender for on-lending. Such a measure would stimulate competition between the different parts of the financial sector and different money lenders. There is a lot of evidence from the southern states that the mere presence of SHGs in different villages brings down the money lenders' rates of interest, as also reduces the rigour of their processes. Opening up competition among money lenders and between money lenders, the financial

system is the way to go. RBI's policy proposal is far-sighted, and I hope that the state governments would take full advantage of the scheme.

6. *Question*: **NABARD has recently monitored the implementation of a massive farm loan waiver programme. What are the likely short and long-term impacts of this programme?**

Chairman, NABARD: There are about 0.13 billion farmer households, of which 40 million are current borrowers; another 40 million are defaulters to the system and the remaining do not approach the formal system for loans. About half of the farmers using the financial system are not able to continue to avail services on account of their previous default. This lack of access makes their contribution to the economy very thin. These people borrow from informal credit system on desperate terms to keep up their livelihood activity. This will only increase their debt stress level and also reduce productivity in agriculture, as they would not be able to access adequate resources for improving productivity. They are in a vicious cycle of low financial resources, high-interest cost leading to reduced ability, to absorb any technology or investment risks. Hence, bringing the defaulter in was the core objective of this waiver. It provides farmers with access to banks and from this point of view, waiver should be seen as a welcome measure. But the reported decline in recovery across states as a result of this is a cause for concern. While it is too early to conclude that low recoveries would stay with the system, we will have to deal with this and see to it that all the borrowers whether benefitting from waiver or maintain the repayment discipline, from now on. A campaign on the use of credit might be needed to communicate with people and give the appropriate messages.

7. *Question*: **The MFIs have reported a healthy growth in their outreach as also loan portfolio during the last year. What are your views on the growth of this sector and its prospects?**

Chairman, NABARD: The MFIs serve the inaccessible areas and vulnerable, excluded people, and their growth is laudable. MFIs provide a critical solution to the problems of poverty alleviation. But one should remember that poverty issues come first and business later. If this is reversed, then we would have problems of a political and social nature interfering with institutional autonomy. The political and social functionaries should realise that service to society by financial institutions cannot come out of charity. They should be able to cover costs and post reasonable returns. Some of the practices that are followed by certain MFIs do not seem to be appropriate. The lack of transparency, the ill-designed products, inadequate communication with the clients and unfriendly methods of recovery are not consistent with the objectives of serving the poor. Too fast a growth rate is not very credible as a strategy. Fast growth especially in nascent institutions leads to systemic problems and HR issues, which are difficult to rectify at a later stage. Growth should be a measured and sustained process. There are views that when private equity is behind MFIs, they can determine what and how they will do as a business (thankfully, such views are in a minority). We should not forget that the clientele is not private; they have to be served to some minimum standards of quality and diligence. I have no doubt that the MFIs would rise to the challenge of responsible growth that effectively serves the poor. Networks such as Sa-Dhan are already doing the right things in this regard.

ANNEX 2.1
Microfinance penetration

Microfinance penetration index and microfinance poverty penetration index

State	Cumulative no. of SHGs linked (March 08)	No of SHG members	No of MFI clients	Total microfinance clients	Share of state to total	Population (000s)	% share of population	No. of poor—lakhs (2004–05)	% share of poor	MPI	MPPI
1	2	3	4	5	6	7	8	9	10	11	12
Northern region											
Himachal Pradesh	31,899	4,14,687	0	4,14,687	0.7	6,408	0.58	6.36	0.21	1.21	3.33
Rajasthan	173,192	22,51,496	83,873	23,35,369	3.9	61,525	5.59	134.89	4.47	0.70	0.88
Haryana	12,654	1,64,502	1468	1,65,970	0.3	23,029	2.09	32.1	1.06	0.13	0.26
Punjab	8,965	1,16,545	0	1,16,545	0.2	25,839	2.35	21.63	0.72	0.08	0.27
Jammu & Kashmir	3,529	45,877	0	45,877	0.1	10,387	0.94	5.85	0.19	0.08	0.41
New Delhi	501	6513	27761	34274	0.1	15718	1.43	22.93	0.76	0.04	0.08
Total (A)	230,740	2,99,9620	1,13,102	31,12,722	5.3	14,2906	12.98	223.76	7.42	0.40	0.71
North-eastern region											
Assam	1,07,098	1,39,2274	1,37,239	15,29,513	2.6	28,406	2.58	55.77	1.85	1.00	1.39
Meghalaya	1,211	15,743	0	15,743	0.0	2,450	0.22	4.52	0.15	0.12	0.18
Tripura	4,348	56,524	37,687	94,211	0.2	3,380	0.31	6.38	0.21	0.51	0.76
Sikkim	337	4381	0	4381	0.0	571	0.05	1.14	0.04	0.15	0.18
Manipur	2,683	34,879	651	35,530	0.1	2,289	0.21	3.95	0.13	0.29	0.46
Arunachal Pradesh	517	6721	0	6721	0.0	1160	0.11	2.03	0.07	0.10	0.16
Nagaland	1,200	15600	12	15612	0.0	2102	0.19	3.99	0.13	0.14	0.20
Mizoram	2,463	32,019	0	32,019	0.1	939	0.09	1.18	0.04	0.60	1.35
Total (B)	1,19,857	1,55,8141	1,75,589	17,33,730	2.9	41,297	3.75	78.96	2.62	0.78	1.12
Eastern region											
Orissa	307,591	39,98,683	15,77,600	55,76,283	9.4	38,626	3.51	178.49	5.92	2.68	1.59

(continued)

(*continued*)

Bihar	93,410	1214330	2,41,651	14,55,981	2.5	89,776	8.15	369.15	12.24	0.30	0.20
Jharkhand	42,605	5,53,865	1,15,444	6,69,309	1.1	29,000	2.63	116.39	3.86	0.43	0.29
West Bengal	2,28,395	29,69,135	15,40,927	45,10,062	7.6	84,599	7.68	208.36	6.91	0.99	1.10
Total (C)	6,72,201	87,38,613	34,75,622	12,214,235	20.6	24,2001	21.97	872.39	28.92	0.94	0.71
Central region											
Madhya Pradesh	83,336	10,83,368	2,29,300	13,12,668	2.2	65,605	5.96	249.68	8.28	0.37	0.27
Chhattisgarh	60,763	7,89,919	2,35,063	10,24,982	1.7	22367	2.03	90.69	3.01	0.85	0.57
Uttar Pradesh	2,36,929	30,80,077	5,33,041	36,13,118	6.1	1,80,990	16.43	590.03	19.56	0.37	0.31
Uttarakhand	24,679	3,20,827	16,798	3,37,625	0.6	9123	0.83	35.96	1.19	0.69	0.48
Total (D)	4,05,707	5,27,4191	1,01,4202	62,88,393	10.6	2,78,085	25.25	966.36	32.03	0.42	0.33
Western region											
Gujarat	46,526	6,04,838	4,16,375	10,21,213	1.7	54,226	4.92	90.69	3.01	0.35	0.57
Maharashtra	3,26,425	42,43,525	1,169,306	54,12,831	9.1	1,03,755	9.42	317.38	10.52	0.97	0.87
Goa	1,610	20930	0	20930	0.0	1463	0.13	2.01	0.07	0.27	0.50
Total (E)	3,74,561	48,69,293	15,85,681	64,54,974	10.9	1,59,444	14.48	410.08	13.59	0.75	0.80
Southern region											
AP	7,23,717	94,08,321	36,53,115	13,06,1436	22.0	80,147	7.28	126.1	4.18	3.03	5.27
Karnataka	3,46,636	45,06,268	19,63,373	64,69,641	10.9	55,822	5.07	138.89	4.6	2.15	2.37
Kerala	1,46,984	19,10,792	3,82,001	22,92,793	3.9	33,083	3	49.6	1.64	1.29	2.36
Tamil Nadu	4,54,975	5,91,4675	16,92,560	76,07,235	12.8	64,800	5.88	145.62	4.83	2.18	2.66
Pondicherry	2,499	32,487	13,161	45,648	0.1	1070	0.1	2.37	0.08	0.77	0.96
Other UTs	288	3,744	239	3,983	0.0	947	0.09	2.82	0.09	0.07	0.07
Total (F)	16,74,811	2,17,72,543	77,04,449	29,47,6992	49.7	2,35,869	21.42	465.4	15.43	2.32	3.22
Grand total	**34,77,965**	**4,52,13,545**	**1,40,68,645**	**5,92,82,190**	**100**	**11,01318**	**100**	**3017**	**100**	**1**	**1**

ANNEX 2.2
SHG–bank linkage programme—regional spread of physical and financial progress as on 31 March 2008

Region/state	Cumulative no. of SHGs provided with bank loan as on 31 March 2007	New SHGs provided with bank loan during 2007–08	No. of existing SHGs provided with bank loan during 2007–08	Cumulative no of SHGs provided with bank loan	Cumulative bank loan as on 31 March 2007	Total bank loan during 2007–08	Of which, amount of repeat bank loan to existing SHGs	Cumulative bank loan 31 March 2008
	Number				Rs Millions			
Northern region								
Himachal Pradesh	27,799	4,100	836	31,899	1,252	137	25	1,389
Rajasthan	1,37,837	35,355	3,588	173,192	3,895	1,254	0	5,150
Haryana	6,833	5,821	0	12,654	499	597	0	1,096
Punjab	6,454	2,511	0	8,965	357	264	0	620
Jammu & Kashmir	2,759	770	0	3,529	145	58	0	203
New Delhi	336	165	0	501	27	28	0	55
Sub-total	1,82,018	48,722	4,424	2,30,740	6,175	2,339	25	8,514
North-eastern Region								
Assam	81,454	25,644	38	1,07,098	2,218	575	1	2,793
Meghalaya	1211			1,211	34	0	0	34
Tripura	2,906	1,442	0	4,348	50	24	0	74
Sikkim	160	177		337	3	19	0	22
Manipur	2,683			2,683	113	0	0	113
Nagaland	447	70	8	517	19	3	1	22
Arunachal Pradesh	998	202		1,200	68	0	0	68
Mizoram	1,895	568	0	2,463	135	33	0	168
Sub-total	91,754	28,103	46	1,19,857	2,639	653	2	3,224
Eastern region								
Orissa	2,34,451	73,140	2,952	307,591	8029	3919	55	11,948
Bihar	72,339	21,071	0	93,410	2012	1039	0	3,051

(*continued*)

(*continued*)

Jharkhand	37,317	5,288		42,605	1507	424	0	1,931
West Bengal	1,81,563	46,832	11,915	228,395	4485	2266	307	6,751
UT of A & N Islands	211	77	34	288	13	6	5	19
Sub-total	5,25,881	1,46,408	14,901	672,289	16,046	7,655	366	23,701
Central Region								
Madhya Pradesh	70,912	12,424	56	83,336	2,166	874	0	3,040
Chhattisgarh	41,703	19,060		60,763	556	857	0	1,413
Uttar Pradesh	1,98,587	38,342	7,923	2,36,929	6,932	1,981	531	8,913
Uttarakhand	21,527	3,152		24,679	1,275	367	0	1,642
Sub-total	3,32,729	72,978	7,979	405,707	10,929	4,078	531	15,007
Western region								
Gujarat	43,572	2,954	0	46,526	2130	166	0	2,296
Maharashtra	2,25,856	1,00,569	32,093	3,26,425	6,936	3,795	1,205	10,731
Goa	1,019	591	69	1,610	83	94	5	178
Sub-total	2,70,447	1,04,114	32,162	3,74,561	9,149	4,056	1,211	13,205
Southern region								
Andhra Pradesh	6,83,619	40,098	83,133	7,23,717	71,210	12,400	10,205	83,610
Karnataka	3,17,636	29,000	25,002	3,46,636	18,091	4,081	2,118	22,172
Kerala	1,17,913	29,071	2,434	1,46,984	7,711	2,317	279	10,027
Tamil Nadu	4,00,477	54,498	16,802	4,54,975	38,106	4,697	2,119	42,803
UT of Pondicherry	2,499			2,499	351	0	0	0
Sub-total	1,522,144	152,667	127,371	1,674,811	135469	23,495	14,721	1,58,613
Grand total	**2,924,973**	**5,52,992**	**1,86,883**	**3,477,965**	**1,80,407**	**42,276**	**16,856**	**2,22,265**

ANNEX 2.3
Federations—types, promoters and location

Level	Names, with promoters and state in parenthesis
Basic unit	SHGs (most commonly in most states); saving groups and saving and credit groups (in the past); Self-help Affinity Group, SAG (MYRADA, Karnataka); NHG (Kudumbashree, Kerala); Boond Bachat Sangh (Sramik Bharati, UP); Surya Uthavi Kuzhu (Kalvikendra, TN); Kalanjiam (DHAN, TN rural); NHG (DHAN, TN urban).
Primary-level federations	The nomenclature variations are clearly visible in Primary-Level Federations in the country—for instance, VO (SERP, AP); Sankul Federation (PEDO, Rajasthan); Cluster Development Federations (Dhan Kalanjiam Foundation, TN); PLF (Kalvikendra, TN); Gram Vikas Sangh GVS (SMS, West Bengal); CLF (MARI, AP); MLF (ASP, AP); Indur Intideepam MACS (GRAM, AP); CLF (WDC and IDF, Bihar); Unnati Shil Sakh Sahakarita Mariyadhithi (Unnati, MP), ADS (Kudumbashree, Kerala), CFL (MAVIM, Maharashtra), PLF (TNCWD, TN)
Secondary-level federation	Mandal Samakhya (MS) (SERP, AP); Indu Intideepam DLF (GRAM, AP); CDS (Kudumbashree, Kerala); Pragathi Mutually Aided Cooperative Society (PSS, AP); Sangatitha (MARI, AP); Mandal (PEDO); Naidisha Nari Shakthi Mahila Swalambhan Sahakari Samithi Ltd (WDC, Bihar) This federation was registered under Bihar Self-Supporting Cooperative Act 1996. CDS (Kudumbashree); Federation of Kalanjiam Community Banking Programme (KCBP) (DHAN, TN); Boond Bachat Sangh Federation (Shramik Bharti, UP)
APEX-level federation	District-Level Movement (Kalvi Kendra, TN) Zilla Samakhya (SERP, AP); ASP State-Level Federation (ASP, AP)

ANNEX 2.4
Public sector banks performance in SHG linkage—outstanding accounts and loans*

	2004–05		2005–06		2006–07	
Name of bank	**No. of a/cs**	**Loan o/s**	**No. of a/cs**	**Loan o/s**	**No. of a/cs**	**Loan o/s**
	Lakhs	Rs crore	Lakhs	Rs crore	Lakhs	Rs crore
State Bank Group						
State Bank of India	3.44	872	5.41	1460	7.68	2420
State Bank of Bikaner & Jaipur	0.06	19	0.12	42	0.12	49
State Bank of Hyderabad	0.33	390	0.34	108	0.02	8
State Bank of Indore	0.05	7	0.13	24	0.14	36
State Bank of Mysore	0.06	45	0.11	85	0.23	169
State Bank of Patiala	0	–	0	–	0.01	8
State Bank of Saurashtra	0.03	1	0.03	3	0.01	1
State Bank of Travancore	0.14	64	0.35	121	0.54	151
Nationalised Banks						
Allahabad Bank	0.13	29	0.1	26	0.1	26
Andhra Bank	0.78	212	0.89	331	0.03	11
Bank of Baroda	0.18	92	0.22	112	0.21	103
Bank of India	0.18	89	0.29	124	0.3	187
Bank of Maharashtra	0.06	30	0.1	48	0.15	76
Canara Bank	0.18	90	0.25	139	0.32	235
Central Bank of India	0.25	87	0.32	116	0.4	191
Corporation Bank	0.07	27	0.09	65	0.26	119
Dena Bank	0.02	16	0.03	20	0.05	28
IDBI Ltd.	–	–	0	–	0.01	3
Indian Bank	0.42	187	0.62	350	0.93	575

(*continued*)

(*continued*)

Indian Overseas Bank	0.54	205	0.65	450	0.93	549
Oriental Bank of commerce	0.04	17	0.04	17	0.04	9
Punjab National Bank	0.34	173	0.51	233	0.72	295
Punjab & Sind Bank	0.02	11	0.02	13	0.02	14
Syndicate Bank	0.27	60	0.34	40	0.15	106
Union Bank of India	0.25	95	0.12	58	0.55	213
United Bank of India	0.19	20	0.26	44	0.3	60
UCO Bank	0.18	83	0.31	110	0.28	157
Vijaya Bank	0.04	15	0.05	34	0.15	85
Public Sector Banks	8.25	2936	11.7	4173	14.65	5885

*Based on RBI's data in trend and progress of banking 2006–07.

NOTES

1. As the data is provisional, there could be an upward revision of the number of groups and amounts when the data from all banks are received and collated by NABARD by the end of September 2008. The data excludes SGSY groups; does not seem to include all repeat loans given during the year.
2. Mr U.C. Sarangi, Chairman, NABARD, stated this in his interview, which is carried at the end of this chapter.
3. The last five years' data indicates that 22 per cent (2002–03), 23 per cent (2003–04), 23 per cent (2004–05), 21 per cent (2005–06) and 20 per cent (2006–07) of groups that had been linked to banks at the beginning of the year had availed repeat finance during the year. One could reasonably assume that during the year 2007–08, 20 per cent of the 2.92 million groups linked to banks at the beginning of the year would have availed repeat finance.
4. The circular reference is RPCD.CO.MFFI.BC. No. 103/12.01.01/2006–07, dated 20 June 2007. This is the first time that the need to generate and collate quality information has been felt and acted upon by RBI. Hopefully, it marks the beginning of a comprehensive database and information system in microfinance.
5. The penetration index is based on the SBLP and MFI clients' data. A table containing state-wise indices under MPI and MPPI is annexed to this chapter.
6. Table 6.2 appended to Trend and Progress of Banking 2006–07, RBI.
7. Of 96 RRBs, 12 had not reported detailed data on their operations to NABARD and hence, the analysis pertains to 84 banks in respect of which information was available.
8. The Lights and Shades Study conducted by EDA Rural Systems and APMAS in 2005 also reported a member dropout rate of 9.8 per cent.
9. The study was carried out in six states by NCAER under NABARD–GTZ Rural Finance Project. The author is grateful to NABARD and Marie Louise Haberberger of GTZ for permitting the findings to be carried out in this report.
10. Self-Help-Promoting Institutions.
11. Baland, Jean-Marie, Rohini Somanathan and Lore Vandewalle, 2008, 'Micro-finance Lifespans: A Study of Attrition and Exclusion in Self-Help Groups in India,' in Suman Bery, Barry Bosworth and Arvind Panagariya, pp. 158–210. New Delhi, Sage.
12. Revisiting bank-linked self-help groups—A study of Rajasthan state—RBI occasional paper, Monsoon 2007, by Navin Bhatia, DGM, RBI.
13. MicroSave had carried out a study of north-eastern states on demand for savings services. The need for different types of savings products to meet different savings objectives have been brought in the study report.
14. The *pavala vaddi* scheme (3 per cent per annum) under which Government of Andhra Pradesh subsidises the interest cost is particularly prone to such usage of loans by SHG members for lending to others. The SHGs charge a lower rate of interest to their members, and they are able to profitably lend to others.
15. Many NGOs of long-standing in the sector (such as BASIX, BAIF, PRADAN and DHAN) are working with SHGs to organise their livelihood activities and providing services for linking with markets for inputs and outputs. Some of them have formed producer companies or cooperatives to give a concrete form to the marketing effort.
16. Revisiting Bank-linked Self-Help Groups—A study of Rajasthan state—RBI occasional paper, Monsoon 2007, by Navin Bhatia, DGM, RBI.
17. The states of Madhya Pradesh, Maharashtra and Rajasthan for example, are estimated to have between 0.1 and 0.2 million SHGs that are not linked to the banking system.
18. Cited from Annual Report 2006–07 of NABARD, Mumbai.

19. Good practices in JLG financing by banks by N. Jeyaseelan and others, Rural Finance Programme India, GTZ, August 2008.
20. The chapter on Social Performance contains a description of Sarvodaya Nano Finance Limited and its operations.
21. Al Fernandez, Executive Director, MYRADA. His views are contained in 'History and spread of the self-help affinity group movement in India,' Occasional Paper 3, 2006, of International Fund for Agricultural Development.
22. Cited from sustainability of SHGs in India, Occasional Paper No 12, CGAP, 2007.
23. The author is thankful to Mr C.S. Reddy for co-authoring this section of the chapter. C.S. Reddy is a development professional, currently CEO of APMAS,which is active in study, research and capacity-building in the sector, especially on the community-owned and -managed financial institutions.
24. This was during a discussion with the author specifically for the SOS 2008.
25. Ministry of Rural Development convened a consultation workshop in May 2008 with participation from state governments, NGOs and academic institutions to discuss the feasibility of setting up national- and state-level federations of SHGs.
26. Report of the committee on Financial Inclusion (January 2008) headed by DrC. Rangarajan set up by Government of India.

The microfinance institutions and the investment climate[1]—is expansion the mission?

3
Chapter

INDIAN MFIs REACH THE TOP

The two lists of top microfinance institutions (MFIs) in the world from Mixmarket[2] and Forbes[3] contain a good number of Indian entities. While eight Indian MFIs made it to the top 50 in Microfinance Information Exchange (MIX) list with the highest at rank 4, seven MFIs made it to the top 50 Forbes list with the highest at rank 2. Except for the Kolkata-based Bandhan, which figures on both the lists within the top 10, no other MFIs figure in both the lists, within the top 50. The reasons are the different assessment parameters used by the evaluators. MIX market has used the criteria of outreach, efficiency and transparency. Forbes has applied the criteria of scale, efficiency, risk and return. While client coverage and efficiency are common to both the assessments, the differences are in MIXs, use of transparency and Forbes' use of risk (Table 3.1).

There is a lot of debate on the lists, the assessment methods, criteria and the number of better performing MFIs that are not in the lists. But a large number of Indian MFIs making their entry into both the lists even while the sector has the lowest interest rates (in global comparison) is a matter of satisfaction to all those in the sector. The lists have been drawn up based on 2006 data, and might be dated for drawing conclusions with implications for the future. The market dynamics have changed a lot since then, and so would the leadership positions.

The top five MFIs as per the client coverage and loan outstanding (as on 31 March 2008) are listed in Table 3.2. No assessments have been made in this listing, which is based on data reported in Quick Data published by Sa-Dhan.

There is no centralised database on the number of microfinance institutions that operate in the country. Estimates have put it anywhere between 800 and 1,200. National Bank for Agriculture and Rural Development (NABARD) has put out a list of MFIs on its Website, where 446 institutions have been named of which some may not be engaged in financial intermediation. New institutions are being set up at a rapid pace. These institutions look to exploit the market opportunities available for providing loans to small clients, and achieve the double bottom line of financial sustainability and socially relevant engagement.

FAST-PACED GROWTH

Sa-Dhan[4] brings out a comprehensive, annual document providing information on a number of microfinance institutions from which the data is collected. For the year-end, March 2008, Sa-Dhan has brought out the report, which provides information on 223 MFIs.[5] As per the Sa-Dhan's report,[6] the outreach and portfolio size of MFIs have been accelerating fast. The clients, outreach increased from 10.04[7] to 14.1 million over the year 2007–08, recording an impressive growth rate of 39 per cent; but this was lower than the growth rate of 53 per cent achieved last year, albeit on a smaller base. The loan portfolio outstanding was Rs 59.54 billion

Table 3.1 Indian MFIs in the top 50 lists

MIX top 50		Forbes top 50	
Rank	**Name of MFI**	**Rank**	**Name of MFI**
4	Grama Vidiyal	2	Bandhan (society and NBFC)
6	Bandhan Konnagar	13	Microcredit Foundation of India
7	Sarvodaya Nano Finance	15	Saadhna Microfin
8	Evangelical Social Action Forum	19	Grameen Koota
12	Spandana Spoorthy	23	Sharda Womens Association
21	Share Microfin	29	Asmitha Microfin
35	Basix	44	SKS Microfin
50	CMML		

CMML: Camel Mahila Macs Ltd.

Table 3.2 Top five MFIs by outreach and loan portfolio

Top 5 MFIs — by clients	No. (million)	Top 5 MFIs — by loan outstanding	Rs (million)
SKS Microfinance	1.88	SKS Microfinance	7,818
Share Microfin	1.29	Spandana	7,285
Spandana	1.19	Share Microfin	5,953
Bandhan	0.76	SKDRDP	3,370
Asmita Microfin	0.70	Asmita Microfin	3,360

SKDRDP: Shri Kshetra Dhamrmasthala Rural Development Project.

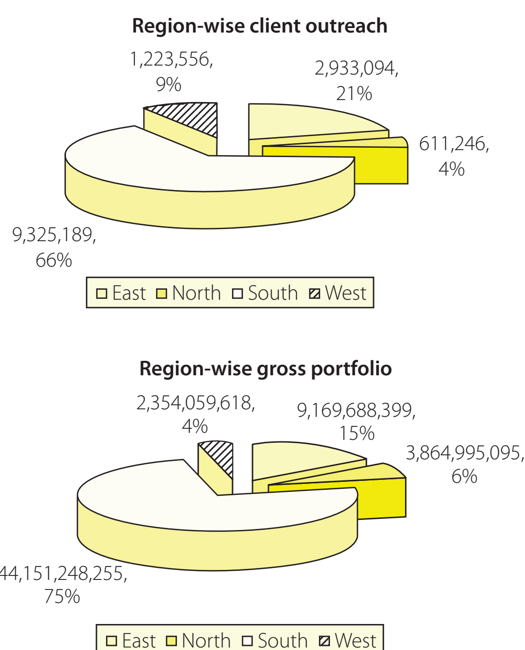


Figure 3.1 Region-wise client outreach and portfolio.

as at the end of March 2008, representing an increase of 72 per cent on a large base, which is remarkable, but a shade lower than the 77 per cent growth recorded in the previous year. The growth rate of loans outstanding was 1.8 times that of increase in clientele, indicative of the deepening taking place in the sector. The average loan outstanding per client increased from Rs 3,442 to Rs 4,222, by 22 per cent across all clients. While 80 per cent of the clients were women, more than 75 per cent of the clients had received loans of less than Rs 10,000.

QUALITY OF GROWTH

An analysis made from the data throws up some interesting features. The first is the skewed nature of the spread of microfinance[8] spearheaded by the MFIs, reflecting the trends noticed in the last few years in case of SHG–bank linkage programme (SBLP). The southern region had a much larger share of the outreach and volumes than the other three regions put together. As in the case of SBLP, the MFIs also have strong presence in the southern states of Andhra Pradesh (AP); Karnataka and Tamil Nadu, which accounted for almost 52 per cent of clients and 59 per cent of the portfolio outstanding. If we add the next three best states as of Orissa, West Bengal (WB) and Maharashtra, to the clients of the top three states, we find 82 per cent of clients and also the loan outstanding were accounted for, by these six states. The traditionally low intensity states such as Madhya Pradesh, Bihar, Uttar Pradesh, Uttaranchal, Chattisgarh and Jharkhand have not really seen a surge in microfinance activities, either under SBLP or under the MFI programmes. Northern and western regions having a share of 4 and 9 per cent, respectively, in terms of clients accounted for 6 and 4 per cent share in terms of loan portfolio. The south had a lion's share of 66 per cent of clients and 75 per cent of the portfolio (Fig. 3.1).

The loan size significantly differed from region to region. North recorded the largest average loan size of Rs 6,300 with the west having the lowest average loan size of Rs 1,900 (Table 3.3). The average loan size in the north was more than three times of the loan size in the western region. Surprisingly, the most mature southern region had a lower average loan size compared to the nascent north. The small loan size indicates that client acquisition is pursued more intensively than deepening the engagement

with the acquired clients. The portfolio growth is a function of not only the number of clients but also the average loan per client. A healthy loan average per client is likely to improve profitability and bring down the operational cost per unit of loan.

Table 3.3 **Region-wise average loan size 2008**

Region	Average individual loan size (Rs)
East	3,126
North	6,323
South	4,735
West	1,924

FORM OF ORGANISATION AND MARKET SHARE

Most of the large MFIs were typically non-banking financial companies (NBFCs) with 14 out of 22 registered as companies. The smaller MFIs were typically either societies or trusts; 70 per cent of all institutions were societies or trusts and in the case of small MFIs, 147 out of 188 were societies or trusts. In terms of legal form and market share, Sa-Dhan reports that almost 60 per cent of market share was taken by 25 NBFCs, whereas societies and trusts took up about 25 per cent of the market share though they were larger in number. The not-for-profit companies had 11.6 per cent market share (Table 3.4).

Table 3.4 **Market share of different forms of MFIs**

Legal form	No. of entities	Share of market (loan portfolio) %
NBFC	25	59.7
Section 25 companies	22	11.6
Society	104	18.8
Trust	31	6.8
Others	34	3.1

The growth rate has been the highest in the case of medium-sized MFIs with a portfolio of Rs 50 to 500 million. The smaller MFIs with a portfolio of less than Rs 50 million grew at the next fastest rate. The lowest rate of growth of 40 per cent was seen in the case of large MFIs with a portfolio in excess of Rs 500 million. In terms of client outreach, 10 per cent of the total number of MFIs, which were the largest, had 76 per cent of all the clients. The smallest ones which comprise 58 per cent of all the MFIs served 6 per cent of the MFI clients. In terms of gross-loan portfolio, the large MFIs accounted for 79 per cent of the outstanding loans. The small MFIs in contrast accounted for only 3 per cent of the outstanding portfolio (Fig. 3.2).

YIELD ON PORTFOLIO

The yield from the loan portfolio for all the reporting MFIs as calculated by Sa-Dhan stood at 21 per cent, and the cost ratio was 19 per cent. As for yield trends, 96 organisations reported an increase in yield on portfolio whereas another 96 reported a decline. Of the 96 organisations that reported an increased yield on portfolio, 66 had a growth in yield of more than 25 per cent. The large- and medium-sized MFIs reported a stronger growth in the yield on portfolio when compared to the smaller ones. An analysis of the yield on portfolio of the MFIs revealed that 29 per cent of all MFIs had an average yield in excess of 25 per cent.

The relationship between the size of institutions and the average portfolio yield was analysed. Across all classes of size, majority of MFIs were in the yield range of 10 to 25 per cent. Out of 226 MFIs, 36 had a yield of less than 10 per cent. Of this, 27 were small while 2 were large MFIs. Of the large- and medium-sized MFIs, 36 and 37 per cent, respectively, reported yields were above 25 per cent on their portfolio. The inference is that the larger MFIs tended to post higher yields on their portfolio, whereas the smaller ones were more inclined to price their loans lower (Table 3.5).

With increasing age, the yield on portfolio started declining apparently, reflecting that cost recovery is easier and high-interest rates are not necessary when loan volumes are built up. In respect

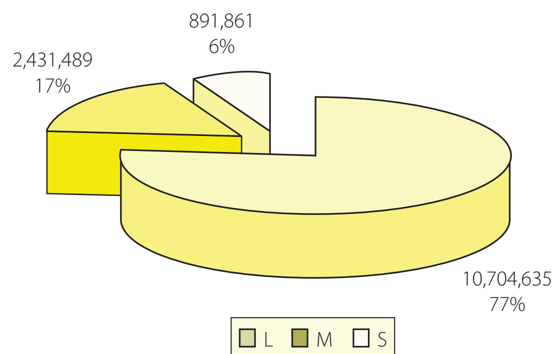


Figure 3.2 Outreach-size, institution-wise.

Table 3.5 Size of institutions and yield on portfolio

Size of MFI	MFIs with 25% or more yield (%)	MFIs with 10 to 25% yield (%)	MFIs with 10% or less yield (%)
L	36	55	9
M	37	51	12
S	25	57	18
Total	**29**	**55**	**16**

L: above Rs 500 mn; M: Rs 50 to 500 mn; S: up to Rs 50 mn.

of institutions that were more than ten years old, 21 per cent reported yield of less than 10 per cent compared to 12 per cent of institutions that were less than five years old, reporting yield of less than 10 per cent (Table 3.6).

OPERATIONAL COST

In terms of operational cost, 69 MFIs reported an increase whereas 121 reported a decrease. Overall, the operational costs have declined in a majority of institutions. The surprising feature is that mature MFIs have reported an increase in operational cost (Table 3.7).

Of the MFIs with less than five years of age, 31 per cent reported increased costs of operation whereas in the 5 to 10 years and above ten years age category, 45 and 36 per cent institutions reported increased operational costs. While this is contra-intuitive, the reason could be that the start-ups do not need to make the initial investments any more and hence, the decline. The increasing loan size also impacts the operational costs favourably. An analysis made by Intellecap[9] of 60 MFIs found that the average return on assets doubled from 1.8 per cent in 2003 to 3.6 per cent in 2007. Return on equity increased from 6.4 to 47.6 per cent over the same period. The margins also registered an improvement from 2.2 to 4.2 per cent.

Table 3.6 Age of institutions and yield on portfolio

Age (MF experience)	MFIs with 25% or more yield (%)	MFIs with 10 to 25% yield (%)	MFIs with 10% or less yield (%)
A	33	55	12
B	29	52	19
C	21	58	21
Total	**29**	**55**	**16**

A: 1 to 5 years; B: 5 to 10 years; C: Ten years.

Table 3.7 Age of MFI and operational costs

Age (MF experience)	No. of MFIs with reduced operational cost	No. of MFIs with an increased operational cost
A	60	27
B	32	26
C	29	16
Grand total	**121**	**69**

A: 1 to 5 years; B: 5 to 10 years; C: Ten years.

FINANCIAL PERFORMANCE

The Side by Side Report (2007)[10] of Sa-Dhan contains the financial analysis data 83 MFIs. On profitability, the report gives out Return on Gross Loan Portfolio (ROGLP) and Return on Equity (ROE). The Section 25 companies (non-profit) came out with the weakest performance. Cooperative MFIs turned in a strong performance (Table 3.8).

The non-profit companies had received more donations than the profits/losses posted by them. In case of societies and trusts, there is no concept of equity. The meager-retained surpluses being counted as equity, the ROE is at a high level, which is not a true measure of their performance. Only one entity under local area bank (LAB) category exists and hence, the data relates to that institution. Cooperative MFIs (not MACS) and NBFCs have performed reasonably on both measures of profitability. Sa-Dhan assesses the financial performance of the MFIs on a set of six ratios (Table 3.9).

In four out of six ratios, the performance had deteriorated in 2007, compared to 2006. The operational self-sufficiency (OSS) declined by about 3 per cent, portfolio at risk (PAR) increased by 1.2 per cent, OCR increased by 0.7 per cent and a marginal decline seen in average borrowers per credit officer (ABCO). The entry of new institutions could have contributed to this. The Sa-Dhan benchmarks also require a re-look. The concept of current replacement ratio (CRR) assumes that all loans should be short-term and that the entire portfolio has to be turned over, every year. Such a business model would increase staff costs and render portfolio building, a difficult exercise as each year the MFI has to virtually relend the last year's loans and make some more fresh loans to achieve business growth. Ideally, MFIs should have a mix of long- and

short-term loans, not only from a business point of view but also from a client point of view, which would need some loans to be long-term. Before fixing a current replacement ratio (CRR), some studies are required to determine a suitable mix of short- and long-term loans by MFIs. The CRR should be based on the findings of the study and at a lower level. Similarly, operating cost ratio (OCR) and total cost ratio (TCR) benchmarked at 20 and 30 per cent, respectively, seem very high. With the initial analysis of 2008 data of 223 MFIs showing TCR to be 19 per cent, a benchmark TCR of 30 per cent is not justified. At such high costs, it is difficult to position MFIs as serving the poor clients. The costs also depend on the average size of loans, which are low. The engagement with clients should be deepened to secure a reduction in costs. In the context of falling costs and yields, the OCR and TCR benchmarks require a review.

PROFILE OF CLIENTS AND GEOGRAPHIES

As for the profile of clients, while 85 per cent of all the clients were women, in certain forms of organisation the proportion of women clients was much lower. Section 25 companies, societies and trusts reported a lower percentage of women clientele when compared to non governmental organisations (NGOs) and NBFCs. It is reported by 95 MFIs that more than 25 per cent of their clients came from the urban areas. The increasing influence of MFIs in urban microfinance is clearly evident. The proportion of urban clients across these 95 organisations ranged from 33 to 100 per cent.[11]

MFIs expanded geographically across many states during the year in search of economies of scale and scope; 47 MFIs covered more than one state. Six of them are present in more than 5 states; 19 of them in 3 to 5 states and 22 covered 2 states. In most cases, plans for expanding the outreach to more and more states were on the drawing boards. The aggressive growth of the sector especially in last two years has given rise to certain apprehensions. To quote Sanjay Sinha,[12] 'aggressive growth diversifies the geographical risk but it intensifies the operational risk. Small Industries Development Bank of India (SIDBI) is of the view that consolidation of the MFI sector is on the cards. Within the next few months we should see some initial mergers between institutions.'

Table 3.8 Profitability of different forms of MFIs

Legal form	ROGLP %*	ROE %†
Cooperatives	2.4	6.5
Societies & trusts	1.8	31.8
LAB	1.0	5.1
NBFCs	0.9	5.0
MACS	0.3	1.8
Section 25 companies	−2.3	−18.6

*ROGLP: net profit—donations/gross-loan portfolio.
†ROE: net profit—donation/total equity.
MACS: Mutually Aided Cooperative Society.

Table 3.9 Key business ratios

Key ratios	Ratios 2007	Sa-Dhan benchmark
OSS	101.4%	At least 100%
PAR	2.95%	Less than 10%
CRR	96.46%	Minimum of 90%
OCR	16.12%	Less than 20%
TCR	22.65%	Less than 30%
ABCO	231	250 to 350

The 22 MFIs identified as large[13] on the Sa-Dhan Quick Report had a healthy growth rate. Two of these (SKS microfinance and Bharati Swamukti Samaste) grew more than 100 per cent in terms of both client outreach and loan portfolio. Six of these MFIs had more than 50 per cent of their portfolio in the urban area. Eleven of these institutions had a faster growth rate in urban client outreach than the total growth rate.

The growth story is no doubt encouraging. There seems to be an unlimited demand for credit waiting to be satisfied.[14] Friends of Women's World Banking (FWWB), in its annual report 2007–08[15] observes that '*The positive side of this growth is that, out of the 47 new organisations appraised in the preceding year and a half, 17 are promoted by experienced professionals and well-qualified young "social entrepreneurs," and there is high potential of scaling up of operations to have a good quality portfolio. However, several small organisations are struggling to improve their Operational Self-Sufficiency above 50* per cent,' But then, it is not a bed of roses, doing microfinance.

PROBLEMS FACED BY MFIs

The MFIs face problems, some common across the sector and some unique to a particular set of institutions depending upon the form, size and business model. The common problems range from availability of funds, increasing resource costs, higher risks, limitations on HR availability and also a passive policy environment. The specific problems relate to low access to commercial funds for not-for-profits and poor soft fund support to for-profits. Federations seem to face problems in raising resources forcing them to become state-dependent, except in the case of mutually aided cooperatives.

Banks do not seem to have a continuing long-term interest in the microfinance institutions. The flow of funds is hesitant and could dry up any time impairing the ability of MFIs to carry on their business. When credit availability to the client is disrupted, then the credibility of MFIs suffers in the field. In the not very distant past, a decision of one of the major banks to stop loans to MFIs on account of certain internal reasons had created a very difficult situation for the partner MFIs in the field. While MFIs assume that their credit facilities with banks would continue to be enhanced year after year, the banks face difficulties in increasing the credit exposure beyond a point on account of risk management policies. With only book debts of MFIs available as collateral, banks were wary of expanding their loan exposure, and the recent increase in risk weight on loans from 100 to 150 per cent to unrated institutions would make the banks even more cautious.

The recently introduced capital adequacy norm for the NBFC–MFIs has been discussed intensely in the sector. The 15 per cent capital adequacy stipulated[16] is felt to be rather high by some practitioners, who are concerned at the increased cost of capital and the overall cost of funds that might result. However, there are others who feel that 15 per cent CAR fairly reflects the level of risk that is inherent in the business and the need for a larger quantum of promoters' funds being brought into business. Larger MFIs such as SKS Microfinance Spandana or Share Microfin do not see the additional equity as a major issue. But smaller entities without recourse to external equity will find this increased CAR to be a stumbling block to their growth aspirations.

Table 3.10 Legal form and leverage

Legal form	Debt equity ratio (debt as multiple of equity)
MACs	249
Societies/trusts	44
Section 25 companies	13
NBFCs	9
Cooperatives	1

FUNDS FOR LENDING

The Indian MFIs are highly leveraged and in some cases, precariously. The debt to equity ratio for 83 MFIs taken for detailed analysis by Sa-Dhan in its Side by Side Report 2007 was 15. But the leverage differed from one legal form to another apart from MFI's specific differences (Table 3.10).

A rudimentary analysis of the information available for the year 2008 reveals that 30 MFIs operate with a debt equity ratio of up to 40. Sixty per cent of all MFIs have leveraged their owned funds twenty times or more. The Indian leverage ratios are perhaps the highest in the world. The leverage ratio in the Philippines is around 4 and in Cambodia, it is as low as 1. Given the fact that dependence on borrowed funds is dominant, the leverage should be reduced and more of owner's funds should be brought in.

The high leverage enjoyed by MFIs becomes possible through borrowing from multiple banks; at times, not making full disclosure to the lenders. Available bank funds are typically short-term. The maximum period for which loans are available is for two years with rare exceptions.[17] The lack of long-term resources for MFIs compels them to provide very short-term credit to their clients; which is not appropriate for undertaking investment in income-generating assets. As these loans given by the banks and financial institutions have regular repayment obligations, the counter-party loans given to the clients typically carry weekly instalments. There is a tendency among some lending banks to sanction and disburse loans to MFIs around the end of the accounting year in pursuit of their targets. This leads MFIs to draw and deploy the funds sub-optimally for a period, till they find better avenues for deployment in loans to the needy clients. In some exceptional cases, the loans taken from the

banks were invested back with them in short-term deposits at much lower interest. The hidden cost adds to the already increasing cost of funds.

The hardening interest rates and the inflationary conditions have the potential of impacting the profits and balance sheets of MFIs. Rising fund costs and client expectations of declining interest rates from growing MFIs are at the two extremities of the pricing continuum. When the high leverages are taken into account, it seems difficult for MFIs to continue to absorb the incremental costs of borrowing. The market should expect to see a resetting of MFI interest rates following the banks' resetting their rates.

RISKS AND CHALLENGES

The emergence of new MFIs and rapid scaling-up in several regions is a welcome development from many points of view. A matter of serious concern is the initial set of assumptions made at the time of designing the MFI and its business model. Quite a few of the new MFIs assume breakeven within a period of three years, with turnover targets running into a few billion rupees. This kind of very high growth is possible only when lending funds, skilled staff and sound internal systems are in place with potential to scale up along with increasing business. The returns to equity assumed are significantly high. Equity placement at a premium even before commencement of business is under negotiation in some cases. But for the fact that these institutions are designed as MFIs, these business projections would not be an issue for debate. But high profitability and high growth are based on the basic assumption of ability of MFIs to charge high-interest rates. Such business models need careful appraisal by the investors and funders from systems and HR availability angles.

Keyman risk is the biggest single risk facing the larger MFIs. Most MFIs especially the larger ones are driven by a committed individual or at best, a small group. If these persons, especially the promoters, exit from the institution; then, what would happen to the business and to its clients, is a question that needs to be answered satisfactorily. Eight large MFIs had more than half a million clients (two of these had more than 1 million clients and one has reached 2 million clients recently). Such large number of clients is entitled to warranties of continued quality of service from the MFIs, regardless of who the owners and funders are. The keyman has to ensure that there is a proper chain of command, and a good second- and third-line of management, which is able to run the business professionally. But the evidence of such second- and third-lines of management within the institutions is hardly available. This is an area of concern not only in India, but all over Asia. The Banana Skins Survey[18] 2008 listed management quality, corporate governance and staffing as the key risks at ranks 2, 3 and 4 out of the top five risks that are facing the microfinance sector in Asia. Apart from recognising the criticality of management and governance in MFIs, more needs to be done, to ensure that institutions do not deny their past when there is a change in ownership.

Governance standards in the microfinance sector, especially in NBFCs (with some exceptions), have not received favourable comment. Mission drift, cousin boards, lack of transparency, failure to induct independent professionals on boards, weak audit systems, lack of independent review of audit outputs and lack of client protection/grievance redressal mechanisms are some of the concerns with regard to governance. There are some MFIs that have taken significant measures to improve governance and have provided good models for others to emulate. In the recent past, the larger MFIs have been making conscious efforts to improve different aspects of governance. The induction of private equity has made significant contributions to this change. But there is still, a long way to go.

Human resources are scarce in the sector and the Banana Skins Survey highlights this as a key risk. Sa-Dhan has estimated the HR requirements at 2,40,000, of which those at area manager levels was 6,500 over the next five years. The competencies at the base level are not extraordinary. The requirements relate to diligence, proper people-friendly attitude, and adherence to systems and procedures. But raw recruits need to be trained and schooled in the base-level skills of finance and microfinance. Industry-ready personnel who would hit the ground running are not available. A combination of theoretical training and a practical internship is a must to produce competent field staff. As for higher levels, it is difficult to get experienced people in large numbers. The MFIs with expansion plans should recruit persons with educational background

How SKS satisfies its humongous need for HR*

SKS serves 2.4 million clients (in July—one does not know how much more, by now) in 15 states through 1,065 branches. It is not in news that SKS has been growing at a frenetic pace. It has been opening more than 100 branches each month, in the last few months. It adds 1,500 clients in each branch.

One is curious to know how it expands so fast both in terms of physical number of branches as also new clients acquired. How does it manage its HR needs in a sector, where most institutions complain that they do not have quality staff?

SKS has invested in an elaborate HR to function. The head office unit handles the policy and strategy, and the regional and other units implement these policies uniformly across the different locations. An assembly line approach to recruitment, training and placement of personnel is adopted by SKS. On the first saturday of every month, across the country in all the locations where SKS is present, a recruitment test is held. The recruitment targets people who have passed higher-secondary school. Ten percent of the candidates attending the process are selected after being tested in arithmetic, public speaking and a written test. Those short-listed are put through a month-long training. They typically join SKS on the 15th of the month, and are initially subjected to classroom training. They learn to work on computers and also the terminology and processes used in the operations of SKS. They are then attached to a loan officer and the loan officer is incentivized to train the new recruits. The trainees have to pass a test after a month of training. Those who do not clear the test will have to take the same test, after another month. After passing the test, the recruits become operational as loan officers.

For every five loan officers there is a branch manager. A unit manager supervises five branch managers. Up to seven, unit managers are supervised by an area manager. Regional managers have to deal with 10 area managers. Zonal managers are in charge of two regions and report to the vice-president at head office.

As for the higher level, the SKS has started recruiting management graduates. They started with an intake of twenty, three years back, which increased to 40 and then to 90. These recruits are made to work in each position starting from loan officer up to the unit manager's position. They have to pass tests after training in each position. Finally, they are taken at branch manager level and above.

Technology and a good software take care of loan-processing and accounting in the back office. Each loan officer deals with 150 clients. The staff is provided incentives apart from a basic salary. The incentives are linked to productivity, efficiency and quality parameters. There is no incentive linkage to ticket size and repayment rates, to ensure avoidance of inappropriate lending and unethical recovery practices. There is a gentle pressure on underachievers; they prefer to quit over time.

SKS also faces attrition of staff mostly in the lower levels. At the base level of loan officers, the attrition rate is around 25 to 30 per cent and in the case of assistant branch manager, it is about 15 per cent. At higher levels of hierarchy, attrition is reportedly low. The ongoing recruitment throughout the year and a certain amount of redundancy in recruitment, ensure that SKS does not suffer from want of staff.

*Based on discussions with Mr M.R. Rao, COO, SKS Microfinance Pvt. Ltd., Hyderabad.

and other industry experience in managing human resources and customer relationships. Indian Institute of Banking and Finance (IIBF)[19] and Sa-Dhan have partnered in a project to offer a certificate course and a diploma course in microfinance. IIBF also has partnered with Centre for Microfinance, Jaipur to offer a certificate course in microfinance. NABARD also offers financial assistance to those taking up a certificate examination in microfinance in the Yashwant Rao Chavan Open University. More such initiatives are needed to meet the large HR needs of the sector. The HR recruitment and training model of SKS microfinance provides some insights into the level of mobilisation that MFIs have to undertake in their quest for fast growth.

Financing institutions and investors have highlighted that the poor quality of information that is available in the MFI sector renders their decision-making risky and conservative. Few MFIs have a core banking solution which produces the kind of information that is required on a variety of business- and finance-related parameters. In many institutions, accounting and record-keeping is on manual systems; in cases where computers might be used, no standard software that takes care of accounting and information generation, is in place. Investments in technology are more seen as a function of availability of grants than a business requirement. In a fast-commercialising microfinance sector, investment in appropriate technological solutions to

take care of accounting and Management Information System (MIS) requirements is a prerequisite. Availability of commercial funds (equity, venture capital funds and bulk loans) might become contingent on fulfilment of IT enablement of accounting and operational processes.

ALTERNATIVES TO LOANS

Over the last two years, institutions have been observed to be moving from soft funds to commercial funds; and in commercial funds, from loans to private equity. The depth in the market in terms of capacity to absorb equity is very shallow. While there is a clear need to diversify the sources of fund in this debt-dependent sector, it does not mean a move towards equity. Securitisation of portfolio, structured-debt instruments, portfolio buyouts and even bond issues are some of the liability products that are under development. Axis bank, ICICI bank and Development Cooperative Bank have already bought portfolios from MFIs. Stanchart has been working on structured debts and bond issues. But these resource-raising measures, by and large would be available only to large and mature MFIs.

One of the problems that have been agitating the sector is the uneven playing field between the MFIs and banks. A number of poverty alleviation programmes and other developmental schemes are implemented through the banking system. Routing of concessional credit and subsidy schemes of government through the banks places them in a better position to acquire more clients, and also reduce the credit risk that is inherent in lending to vulnerable sections of population. MFIs argue that they should also be made eligible to receive and distribute poverty alleviation schemes of the government.

INTEREST PRICING AND TRANSPARENCY

Interest rate and loan-pricing continue to dominate the discussion in microfinance and MFIs. Clients have no alternative, but to pay the rate of interest as fixed by the MFIs for want of alternative sources of finance. Some cases of high-interest pricing, taking advantage of almost monopolistic conditions and the desperation of borrowers have been witnessed. The government action in AP a couple of years back has clearly brought out that the threshold of tolerance is not very high when it comes to high-interest rates. High-interest rates not only encounter resistance from clients but also invite unwanted political attention. That is what happened in AP, when the microfinance institutions and Sa-Dhan had to work very hard to contain the fallout. The pricing of the loan product differed from one MFI to the other, and the clients have great difficulty in knowing the real cost of credit.[20] The loan terms are complicated and opaque, with a result that the borrower is unable to make a comparison and take an informed judgement on the affordability of the loan. The borrowers more often than not are influenced to look at the affordability of the instalment of repayment rather than the interest cost of credit. There is a need for transparency in interest pricing. The difference between a flat rate charge and declining balance interest charge has to be explained in terms of financial cost of the borrowing.[21] Practices such as taking a security deposit, collecting an instalment of loan in advance,

First-of-its-kind portfolio sale

In March 2008, Grameen Capital India structured and arranged a US$5.9 million (Rs 235.1 million) sale of agricultural loan assets of Bharat Integrated Social Welfare Agency (BISWA), to a leading private sector bank. These assets help the domestic banks meet their regulatory requirements of priority sector lending, under the critical 'Direct Agriculture Loans' category. Domestic banks in India are required to extend 13.5 per cent of their advances directly to agriculture sector or face penalties.

Structure of the transaction: BISWA offered a pool of assets amounting to US$5.9 million (Rs 235.1 million) for sale under this transaction, as per the bank's selection criteria. The loans thus identified were of a three months minimum seasoning and a residual maturity of not more than twelve months from the date of purchase. BISWA provided First Loss Deficiency (default) Guarantee to the extent of 5 per cent of the pool. Grameen Capital also arranged for a crucial Second Loss Guarantee piece from one of its investors, IFMR Trust. BISWA has also signed a management- and collection agreement with the bank and would continue to service these loans and channel the recoveries to the bank even after the portfolio sale.

charging a variety of loan-processing and monitoring fees and so forth, have their own implication on the financial cost-of-credit to the borrower. These needs are to be factored in and analysed for giving greater information to the clients. In an attempt to bring greater transparency to interest-rate setting, formation of a new non-profit organisation has been announced in the Micro Credit Summit Conference in July 2008. This platform named Microfinance Transparency (MFT) would place all interest rates of all MFIs on a standard format and make the results comparable as annual percentage rates paid on declining balance. The rationale for its formation as explained by MFT '... goal of MFT is to promote transparency on product pricing information; MFT also operates on the foundational principle of transparency. All operational rules, all calculations, all data sources are made public. MFT also operates on the principle of reporting objective facts. No judgments are to be made, no rating scores given, nor are profits of MFIs to be reported.'

The obligation of having to repay every week that too, on very small loan sizes which average around Rs 5,000 does not serve the poor well in terms of poverty alleviation. A viable loan size required to bring people above poverty line would be around Rs 50,000, if we take into account a capital to output ratio of 4:1.[22] Inadequate loan size compels borrowers to find additional sources of funds, provides space for competitors to enter and encourages multiple borrowing. Multiple borrowing may not solve the problems of the client fully, but would certainly impair the asset quality of MFIs and alienate the client over time.

A little heard of a development that is not so positive is the aspiration among small entrepreneurs to set up MFIs to make it big. Inspired by the success of Bandhan in Kolkata, six to eight MFIs had come into existence in the last two years with small initial investments (Rs 1 to 2 million) made by ex-staff of the MFI. After acquiring upto 2,000 clients and mobilising their savings in some cases, the MFIs could not sustain their operations. Support in the form of grants to underwrite their operational deficits and bulk loans for on-lending were not forthcoming. The initial expectations, based on the experience of successful MFIs were belied. The MFIs had to close down. The reason why this is brought into the report is that the sector must discourage attempts by individuals and institutions that are not mission driven; that were not well-planned. The facility with which savings are mobilised by such institutions from their so-called 'members' is a cause for concern. The regulatory void in this part of microfinance makes it difficult to control such behaviour as there is no jurisdiction for any authority over such entities and their activities.

There is an undercurrent of high risk of a non-financial nature running throughout the sector. Fast-paced growth with focus on the creamy layer of the poor and the preference for uniform products (without taking into account the comfort of the clients) has led to a certain type of lending which almost excludes the most vulnerable and the core poor. Though social performance and double bottom-line considerations weigh with theMFIs, the lack of diversity in products has to be addressed, to effectively bring in poor as the clients of choice. The urge for transforming into NBFCs is compelling as it is perceived to give a better image in the market.[23] Performance of a social mission and achieving profitability that would satisfy equity investors seem to be in conflict. In the words of one of the industry leaders 'microfinance without a development mission is a waste of time and resources.'

Last year, the Intellecap group introduced a franchise model of microfinance (Intellecash) that offers comprehensive solutions to the MFIs, without a lengthy start-up time. The progress of this model would be watched keenly as it holds the promise of standardisation and sustained quality.

> The **IntelleCash Microfinance Franchise Package** provides an end-to-end solution to the challenges faced by start-up entrepreneurs in building a MFI. IntelleCash is a collaborative effort between Intellecap and CASHPOR. It was launched on 30 April 2007. The franchising initiative aims to reach out to 10 million clients, and estimates of adding US$1 billion of outstanding loans through 60 IntelleCash franchisees across India by 2010.

In keeping with the theme of the current year, we should examine the clients' comfort with the MFIs. A large number of people, many of them poor, finding first time access to formal finance is a major positive development. Some institutions consciously target the poor and have selection processes that make targeting of poor very effective. But with many others, acquiring poor clientele is more a chance rather than

conscious targeting. In some cases, the processes and in some others, the product designs tend to exclude the poor. Even the non-poor are not too comfortable with the fit of the products to their needs. While interest rates are higher in real and nominal terms than what is obtained in banks, there is evidence of decline in the rates with time and volumes. But the fast-paced growth demands higher internal accruals for ongoing investments and remains a reason for interest rates, not falling fast enough. The readiness required for equity funding demands high profitability, which militates against significant reduction of interest rates. Competition has introduced clients to multiple borrowings with attendant consequences, which are mostly adverse to both the clients and MFIs. Sequential, multiple borrowings are used for repaying different loans in succession. This indicates that loan sizes are low-compelling and additional-borrowing, and that repayment terms are inappropriate requiring other loans to meet repayments.

The inability to hike loan size per client is a significant reason for high operational costs and the consequent pressure on interest rates. The choices made by MFIs of widening over deepening, and prioritising client numbers over adequate loans are not in the best interests of clients.

There are special programmes for targeting the ultra poor, run by some large and leading MFIs with donor funding. But these are far too small to create any impact and run the risk of ending up as corporate social responsibility (CSR) publicity exercises. Frances Sinha[24] comments that such special programmes, which are not mainstream activities of MFIs 'are at best a distraction.' Funders and donors that support MFIs should demand more commitment to clients and social performance than in the past. They should put in place safeguards to arrest mission drift, consequent on change in form and infusion of equity. Regulation could play an effective role in ensuring good governance and upgrading accounting, audit and reporting systems. Sa-Dhan must take its excellent work on code of voluntary conduct forward and ensure compliance. It should also promote transparency in communication regarding loan terms and interest-pricing.

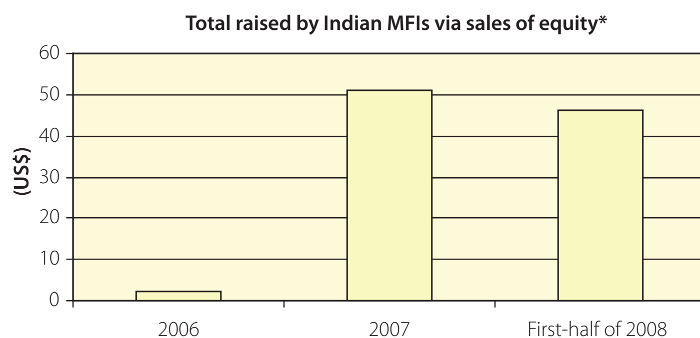
THE INVESTMENT CLIMATE

The invest climate has changed considerably over the course of 2007 and the first-half of 2008. Two new local, microfinance-focused investment funds (Aavishkaar-Goodwell and Grameen Capital India) were created. Two international investment funds (Legatum and Sequoia) entered the Indian microfinance sector. Existing funds already focusing on the Indian microfinance sector significantly increased their asset base (Lok Capital raised an additional US$10 million to bring their total assets under management up to US$22 million;[25] Bellwether raised an additional US$2.4 million to their total assets under management up to US$20 million.[26]). In addition, a number of mainstream private equity and venture capital funds (India Equity Partners, Gaja Capital and Reliance Capital) are increasingly looking at microfinance as an investment focus area.

The year 2007 also witnessed some of the largest equity deals in Indian microfinance. In March 2007, Sequoia Capital, a US-based venture capital firm, Vinod Khosla, and the Unitus Equity Fund invested US$11.5 million in SKS microfinance in what was, by far, the biggest equity deal in the history of Indian microfinance. The deal was also notable for being 'the first, pure for-profit private equity play' in Indian microfinance and for its exit clause requiring SKS either to have an initial public offering (IPO) or to be acquired within five years.[27] A month-and-a-half later, Legatum, Aavishkaar-Goodwell and Share Microfin Ltd. announced a staggering US $27 million deal, which made Legatum the majority (51 per cent) owner of Share Microfin's equity.[28] Not to be outdone, SKS has since then followed up with another round of equity sell-offs, which netted the MFI, a total of US$37.3 million.[29]

In the shadow of these major deals, many smaller equity investments took place. Overall, the total amount mobilised via equity sell-offs by Indian MFIs had increased 25-fold from 2006 to 2007 and looks set to increase even further in 2008 (Fig. 3.3).

Even with all these developments, the Indian MFI equity scene is nowhere near to reaching its investment potential or fulfilling its burgeoning requirement for equity. With the overall sector growing at a scorching pace, MFIs would need to sell much more of their equity to investors, to maintain current low levels of capital adequacy.[30] Yet recent regulatory changes in the sector imply that equity financing will not just keep pace with other forms of financing, but will increase and fill new gaps. The RBI has



*Source: Microcapital monitor (http://www.microcapital.org/microcapital-monitor/), fund Websites and various news sites.

Figure 3.3 Equity raised by MFIs.

mandated that all non-deposit-taking NBFCs—the legal form of choice for most large MFIs—increase their capital adequacy ratios from 10 to 15 per cent by April 2009.[31]

Even when equity is ready to flow, there are few institutions that have the necessary readiness to receive and absorb equity. The critical requirements for receiving and absorbing equity in MFI are: (1) information base and transparency, (2) governance standards, (3) investment readiness in the form of business strategy, (4) professional management and (5) revenue models. There is a view that the investments made today in the sector are more experimental than calculated business decisions. The lack of a market-based exit route and also the difficulty of producing high returns render equity investments in most of institutions, risky. The political risk remains a key concern for many investors. All investors approached for comments, ranked political risk as one of their top concerns. A repeat of the AP crisis that occurred in 2006 would send severe jitters through the investment community.

Based on the registrations in the Capital Connect[32] platform, Aparna Viswanatham[33] had the following observations to make:

Easily accessible/online market places in general lead to improvement in efficiency. And there has been a wide affirmation of the thought that an online market place for social enterprise capital would help investors and enterprises, alike. Comfort with the use of an online interactive portal among enterprises seems to be good.

Apart from funding known MFIs, investor interest exists

- for entities active in areas beyond traditional microfinance
- for transacting in structured instruments

Analysing the enterprise registrations that are currently underway

- we find a dispersion of entities spread across the world—India, East Europe, Latin America, South-East Asia
- considerable interest has been from entities that are not located in large cities
- interest in offloading original promoter equity is also evident.

Other challenges to expanding equity investments arise from regulation. While MFIs in India are registered under a variety of legal forms, equity investments are effectively restricted to MFIs registered as NBFCs. Due to the minimum capital requirement of Rs 20 million for registering a new NBFC, along with the other legal requirements, converting an MFI into an NBFC from another legal form remains a difficult task. In addition, while larger MFIs in other countries have recently come to depend on deposits as a source of funds, it looks increasingly unlikely, that the RBI or government will lift restrictions which effectively prevent MFIs from accepting deposits from clients.

The investors on their part have several objectives. Some have social objectives and target a low return in exchange for achievement of social objective. There are some that are entirely commercial and target high rates of return. The return expectation ranged from 5 to 30 per cent on the equity investment. The other material factor is the holding period for such equity investment. This varies from 3 to 7 years. In a growing market, which is building volumes and serving reportedly, the vulnerable sections of the poor; a three-year investment threshold and a 30 per cent return on equity appear unrealistic. In fact, it will be unachievable except through charging high rates of interest from the poor clients. Though double bottom lines are desired in an investee, the equity funders look to financial performance as a non-negotiable outcome. The equity funds have investors backing them and have to post decent returns to keep them interested. The risks in equity investments are higher than in loans as the equity generates a return only after all other claimants are paid, and any capital appreciation and exit possibility depends on good financial performance. For the other stakeholders, contractual payments do not depend on financial performance (except some types of staff incentives). Hence, equity investors feel that their return expectations should not be envied as

there is a real risk of total investment failing to recover even the capital. But there are other views on equity investments targeting the mature MFIs. Vijay Mahajan[34] points out 'Globally 3 to 4 billion dollars have been spent to bring the field to where it has reached now. For extreme profit-seeking investors to now cherry pick that part of this field which gives a high return, without any care as to what it does to the poor, is not acceptable.'

The investors, especially the bulk funders from the banking sector are extremely wary of the reputation risk that might arise from inappropriate behaviour on the part of the MFIs. This leads them to take extra precautions in terms of specific areas of governance, financial management and in some cases even interest pricing. Some institutions insist that the borrowing MFIs should cap their rate of interest to clients. Some others seek a seat on the board of the MFIs, in which the investments are made or the loans are extended. Overall, the investment climate is adversely impacted in the short-term by the introduction of changes to capital adequacy norms that have mandated a risk weight of 150 per cent to bank loans extended to unrated institutions.[35] MFIs which are not rated would become unattractive, as clients to the lending bank. As this pushes up the level of capital required to carry such exposure on their balance sheet, the banks would tend to increase the interest rate of such loans and also reduce the quantum thereof. This would adversely affect the growth plans of many of the existing MFIs.

This brings us to a discussion on the practice of rating of MFIs. As far as the Central Bank is concerned, banks can, in case of MFIs where the exposure is more than Rs 50 million, accept ratings carried out by those agencies that are approved by RBI. Presently, CRISIL, CARE, ICRA and Fitch are the rating agencies whose ratings are recognised by Reserve Bank, and the financing banks can make use of the same for their risk assessment of larger borrowers and lower[36] the risk weightage on loans. M-CRIL has been present in the industry for a long time and has considerable experience of intense involvement in rating of the MFI sector. Yet, its ratings have not been recognised for this purpose (in the case of loans of Rs 50 milion and more) by the Central Bank. The ongoing discussion between M-CRIL and the RBI[37] should produce positive results bringing much-needed relief, both to MFIs and the lending banks. But the point is that the MFIs should commission ratings every year in their own interest so that they are in a position to access bank funds and raise comfort levels of investors and clients. The present trend of MFIs making the rating exercise an optional extra that is contingent on availability of donor funds must cease. The MFIs should get themselves rated in their own interest and should know from an independent source, the health of their organisation. There are signs that MFIs are more ready to get ratings done on their own. Sanjay Sinha estimates that in 2008, about 50 MFIs would pay for their rating when compared to 20, which paid in 2007. The pressure from financing banks for rating reports (prodded by the credit risk assessment requirement under Basel II norms) is a factor in this move towards getting external ratings done.

Some of the banks have gone ahead with a deeper examination of the risk involved through portfolio study and systems audit-looking to the risks faced by the sector. ABN AMRO has taken up conduct of portfolio audit jointly with a couple of other banks. Such studies apart from providing information to lenders could provide valuable feedback to the MFIs.

INFORMATION ASYMMETRY

One of the problems facing the lender is the lack of full information about the borrowing institutions. Many MFIs have multiple borrowing relationships with multiple lenders. The terms at which these loan contracts are concluded differ from bank to bank. But information relating to the underlying quality of asset as also the operational aspects is not uniformly known to all the lending institutions. While each institution seems to have a part of the information, a totality of what the borrowing institution is about, is rarely available. Ratings referring to the position at a point of time can be too dated in a fast-developing microfinance sector. There have been attempts in the recent past to pool the information through an informal forum of lenders. The informal forum exchanges information about the MFIs, quality of asset, business models as also the processes that are adopted. Instances of deviant behaviour on the part of MFIs are beginning to be shared across like-minded lenders. The lenders increasingly feel the necessity for a more formal arrangement under which, sensitive information

could be pooled and shared to make appropriate decisions. Further, more lenders together could jointly carry out portfolio audit; systems audit, and also place a common representative on the board of the MFIs to protect their interest. This, according to banks, is an acute necessity on account of the high leverages and high-debt dependence of MFIs on the banking system. There are suggestions for introduction of common reporting formats on which MFIs could provide periodic, operational and financial information to all the lenders. Any special requirements of individual banks could be separately met as such requests are likely to be rare. This would save time on the part of the MFIs and the banks. Similarly, there is a move for a set of common minimum standards in financial and operational disciplines that would be insisted upon by all lenders so that the scope for MFIs arbitraging on these conditions between different lenders is avoided.

The entry of equity and venture capital funds carries certain risks for the lending banks. There have been cases where the contract for acquisition of equity has sought to deny the rights of the basic lenders, who were lending to the concerned MFIs much before the equity providers came into play. The conflict of interest between different categories of funders such as equity investors and bulk funders need to be sorted out in a smooth and uniform manner, through a lenders forum of the type that is being proposed by banks (especially in the private sector). The private sector banks and the foreign banks are quite active in financing the MFIs rather than the SHGs. These banks have their own system of appraisal and audit as also dedicated personnel for management of microfinance portfolio. The feeling of these banks is that the sector is suffering from shortage of qualified professionals, weak information systems, weak accounting standards, multiple lending to same borrower by different MFIs, absence of credit information bureaus, relatively loose regulation, and unrealistic targeting by MFIs that are yet to mature. The private sector banks' involvement in financial terms is captured in Annex A2.

Investment in Indian microfinance has increased dramatically, over the past year and a half. Despite this dramatic rise, investment will need to increase even faster if it is able to plug the gaps in financing, which have resulted from recent regulatory moves by the RBI and the overall growth of the sector. Intellecap has projected that the Indian MFIs would cumulatively require funds of the order of Rs 243 billion, of which equity capital would be Rs 21.6 billion and Rs 223 billion would be the loans.[38] This level is about 5.5 times of the volumes expected to have been reached in 2008. Significant obstacles to the scaling-up of investment in Indian microfinance remain; yet, the strong growth in the supply of microfinance investment funds is an encouraging sign that market participants are up to the challenge. Clients would be better served through improved governance, efficiency and access to large source of funds. But the tendency to extract commercial returns and possible opaque pricing models would keep away the poorer clients. To remain rooted to the objective of serving the poor and vulnerable, MFIs need to revisit their original objectives and ensure mission fidelity. Growth, profits and high corporate image gain considerable value when accompanied by mission achievement.

INTERVIEW

Mr R.M. Malla, Chairman and Managing Director (CMD), SIDBI, agreed to answer questions on the state of the microfinance sector and the role of SIDBI in developing the MFIs. Following is the text of the interview, exclusive to state of sector (SOS) 2008.

1. Question: **The growth of the sector has been vigorous. SIDBI had provided considerable financial and non-financial support to the sector. Which initiatives of SIDBI would you deem to be critical and innovative?**

CMD, SIDBI: The microfinance sector in India has traversed a significant distance during the last decade. It has evolved from informal origins and moved towards more formal structures and is in the process of being mainstreamed into the formal financial system. SIDBI was the first apex institution to support the MFI-lending route for delivering microfinance services, which today is a major channel for reaching out to the poor and financially excluded. During the last nine years, SIDBI has taken several initiatives that have contributed to the overall growth of the sector. One of the most important initiatives is the capacity-building intervention for the

MFIs/intermediaries and the sector. We have been providing focused and need-based capacity-building support and technical assistance to our partner MFIs, since the year 1999, when the sector was in a nascent stage. It gives us a sense of great satisfaction that a number of successful MFIs, today, have been nurtured with our capacity-building support. We have created, nurtured and developed over 100 institutions, so far. We are also extremely grateful to the Department for International Development (DFID), UK, which has been our partner and has provided funding support for the capacity-building initiatives.

We also place emphasis on building the capacities of other stakeholders such as training institutions, consultants, technical service providers, microfinance networks, etc. In order to strengthen the supply side of trained manpower, we have provided support to premier management institutes for courseware development on electives in microfinance. We have also been regularly sponsoring staff of MFIs for various thematic training programmes both within the country and overseas. The innovative Young Professionals' Programme (YPP) of SIDBI is an initiative to strengthen the HR pool of MFIs, by providing a steady supply of professionally qualified manpower from business schools and other professional courses. Pioneering the concept of rating for MFIs in India is another major contribution of SIDBI for bringing about a degree of professionalism in the sector. Today, rating is widely accepted by MFIs and lending banks. We have been able to design and offer demand-driven products and services for the sector. The Transformation Loan product that was introduced in the year 2002 was a novel and innovative product for encouraging our partner MFIs to move towards transformation into more formal, for-profit entities that would enable them to sustain their growth. The product received overwhelming response from the sector, and facilitated number of partner institutions to transform. We are also providing equity support to MFIs.

In order to cater to the needs of graduated clients of MFIs, SIDBI has introduced Micro Enterprise Loan (MEL) product, which would support livelihood promotion. With a view to reducing regional imbalance in the spread of Micro Finance programme, special effort is being made to incubate start-up MFIs in underserved regions, besides encouraging well-established MFIs in South India to spread their wings in other states. Keeping in view of our domain knowledge of the sector, we are now starting loan syndication for the larger MFIs. This would eventually lead to involvement of more banks in financing this sector; thereby, diversifying the resource base of the MFIs.

2. *Question:* ***There seems to be an increased interest in urban microfinance. How does SIDBI view urban markets? What adjustments need to be made by MFIs entering urban markets?***

CMD, SIDBI: Over the last two decades, growing 'urbanisation' or migration to cities has resulted in a sharp upswing in the urban population. With increasing urbanisation, addressing the issue of urban poverty is becoming a major concern for all stakeholders.

We see tremendous business opportunities in urban microfinance and are, formulating our strategy to expand our outreach in these areas. This includes provision of financial support to existing partner MFIs to expand their coverage to nearby urban cities; financial and capacity-building support to new MFIs promoted with exclusive focus on urban microfinance, providing capacity-building support to technical service providers to identify/incubate start-up NGOs/MFIs in urban areas; and provide handholding support to them in their initial years of operations and so forth. Presently, about 20 partner MFIs of SIDBI across the country are offering microfinance services to the urban poor. Besides, under our MEL scheme, which caters to the financial requirements of micro-entrepreneurs through the channel of mid-sized NBFCs, around seven partner MEL intermediaries have been supported, which are reaching out to small services and entrepreneurs in the urban areas.

As part of our Microcredit Scheme, we can also offer micro loans up to Rs 2 lakh per client for housing purposes. This is an area of potential growth on which we propose to concentrate in future. Urban microfinance has its own complexities which should be carefully considered while designing products and programmes for the urban poor. The delivery mechanisms need to be innovated constantly. Challenge also lies in designing suitable products that would meet the needs of the floating population.

There are certain other key elements that are essential if the urban microfinance movement is to succeed in achieving its objective. These include increased availability of on-lending funds and equity capital for MFIs, funding their initial costs along with capacity-building mentioned earlier. Bank branches in urban areas need to downscale to cater to this segment, by offering micro-enterprise and business loan products, specifically targeting small businessmen, vendors, micro-entrepreneurs—either directly or through intermediaries. NBFCs are another possible channel for reaching out to them. Technology has a major role to play in keeping costs down while scaling up the microfinance model. The key is to find the right balance between technology, cost and methodology to deliver microfinance. The concept of branchless banking is one such initiative in this direction. In addition to credit, access to other financial services such as savings, insurance remittance and money transfer facilities should emerge as the key thrust area for all urban microfinance interventions. Addressing housing shortage is of strategic importance for poverty alleviation in India. There is a need to design client-friendly housing loans products keeping in view, the profile of these clients.

3. *Question:* ***The effort at regulation appears to have come to a standstill. Even if the bill becomes law, NBFCs would be left out (or continue with RBI's supervision) and credit only MFIs (non-NBFC), left out of any regulation altogether. Considering that small borrowers outnumber savers in the clientele of microfinance, should not regulation ensure borrower protection as a priority instead of protection of only savers? What kind of regulatory regime would fit in with sector's requirements in your view?***

CMD, SIDBI: The sector has grown at a rapid pace during the last few years, and the growth momentum is likely to continue in future. In this background, it is essential that a conducive policy and a regulatory framework are put in place that would facilitate the growth of the sector, while at the same time protect the interests of the borrowers and savers with sound principles of transparency, ethical practices and prudential norms. The tabling of the microfinance regulatory bill is a positive development for the sector. There is a need to immediately introduce a regulatory mechanism, that would, to begin with, not only facilitate regulation in the form of risk-based supervision of large-and medium MFIs, but would also foster growth of microfinance initiatives at the grassroots level.

4. *Question:* ***The heightened activity on the private entity (PE) and venture capitals (VCs) has caused excitement in the market. How does this impact the existing bulk funders such as SIDBI? Over the long-term, what might be the impact of equity of MFIs being held by private entities (PE funds and VC funds)?***

CMD, SIDBI: SIDBI has been a bulk provider of loan funds to the microfinance sector along with capacity-building grant support. However, recognising the critical need to infuse capital in large- and medium MFIs, SIDBI has been making equity investments through the SIDBI Growth Fund of Rs 50 crore already set up. So far, the bank has committed quasi-equity/equity investment, including transformation loan, amounting to over Rs 30 crore in about 20 MFIs. Alongside, a number of private equity and venture capital funds have entered the sector, and have begun making investments in larger MFIs. This is a very positive development for the sector considering that an estimated amount of over Rs 1,900 crore is required as equity capital for the MFIs by the year 2010, so as to achieve the targeted growth and have adequate regulatory capital.

On the other hand, with increased equity participation by private equity and venture capital funds, the microfinance sector could be facing a threat of mission drift and increased commercialisation, particularly where high premium is offered on the equity. This is an area of concern, and we are carefully monitoring the developments as a long-term player in the market. The microfinance programmes started with the underlying objective of poverty alleviation and reaching financial services to the poor and needy. There has to be, therefore, a judicious balance between serving the social agenda of poverty alleviation and commercial motive of profit-driven investments. An Investors' Forum could possibly address the issue to some extent.

5. *Question:* ***To what extent bulk funders interests are protected in the current market situation of multiple credit lines availed by larger MFIs? What is the level of information-sharing in the sector on***

issues of governance, transparency, code of conduct and portfolio quality?

CMD, SIDBI: With the growing success of microfinance programmes, both public and private sector banks have, during the last few years, actively started financing the microfinance programmes to tap the huge unmet/latent demand for microfinance. While provision of on-lending funds is definitely a key input for growth, building the credit absorption capacity of the intermediaries and clients is even a more critical issue. The microfinance sector has to grow on a strong foundation. The MFIs need to proactively manage the growth-related issues. On the other hand, it is essential that lenders come together on a platform that would be able to protect their interests while at the same time, sharing information on issues of mutual interest. A Lenders' Forum needs to be constituted primarily with this very objective. The Forum could, besides sharing information, also evolve a code of conduct for the banks/financial institutions (FIs) to follow in their common interest and for a healthy and balanced growth of the sector.

6. *Question:* ***What is SIDBI's view about the future of the sector?***

CMD, SIDBI: Microfinance programmes have amply demonstrated that they are an important vehicle for achieving the twin objectives of poverty alleviation and financial inclusion. The sector has immense potential. What needs to be done is to follow a concerted approach by all the stakeholders. The future growth of the sector hinges on three key components; equity, technical assistance and risk-based supervision. MFIs need capital infusion to give strength to their balance sheets, thereby helping them to leverage debt funds. Technical assistance is critical—not only for the medium and lower end of the MFIs but also for the top-end institutions, although it would differ in content and scope. Risk-based supervision would address the issue of rapid growth of the sector, affording due comfort to lenders. Microfinance programme should take a conscious step to go beyond credit. A holistic approach needs to be followed for offering other financial and non-financial services such as remittances and money transfers, insurance, pension, housing, livelihood support services and capacity building of end-users and clients. A conducive and enabling regulatory regime that fosters the growth of such services to the poor needs to be created.

On its part, SIDBI would continue to provide a comprehensive package of services like capacity-building, equity and term loans to ensure holistic growth of the sector. It would play a proactive role in bringing all the stakeholders together to bring in the desired level of transparency in the sector, as also ensure information-sharing amongst all the lenders/investors on a real-time basis.

ANNEX 3.1
MFI client and loan outreach

State-wise client outreach			State-wise loan portfolio	
Name of the state	**Number**	**%**	**Amount**	**%**
Andhra Pradesh	36,53,115	25.97	19,445,023,878	31.75
Karnataka	19,63,373	13.96	11,038,481,244	18.02
Tamil Nadu	16,92,560	12.03	5,754,100,628	9.40
Orissa	15,77,600	11.21	5,323,529,239	8.69
West Bengal	15,40,927	10.95	5,298,597,926	8.65
Maharashtra	11,69,306	8.31	3,840,548,354	6.27
Uttar Pradesh	5,33,041	3.79	3,469,441,228	5.67
Gujarat	4,16,375	2.96	6,40,302,867	1.05
Kerala	3,82,001	2.72	1,277,305,126	2.09
Bihar	2,41,651	1.72	9,08,233,80	1.48

(*continued*)

State-wise client outreach			State-wise loan portfolio	
Name of the state	**Number**	**%**	**Amount**	**%**
Chhattisgarh	2,35,063	1.67	1,156,423,043	1.89
Madhya Pradesh	2,29,300	1.63	1,045,350,073	1.71
Assam	1,37,239	0.98	4,58,701,844	0.75
Jharkhand	1,15,444	0.82	5,19,308,567	0.85
Rajasthan	83,873	0.60	3,80,384,265	0.62
Tripura	37,687	0.27	1,27,942,065	0.21
Delhi	27,761	0.20	4,39,341,552	0.72
Uttaranchal	16,798	0.12	71,710,412	0.12
Puducherry	13,161	0.09	28,785,907	0.05
Haryana	1,468	0.01	11,250,000	0.02
Manipur	651	0.00	4,560,000	0.01
Andaman Niccobar	239	0.00	1,786,389	0.00
Nagaland	12	0.00	48,000	0.00
Arunanchal Pradesh	0	0.00	–	0.00
Himachal Pradesh	0	0.00	–	0.00
Meghalaya	0	0.00	–	0.00
Punjab		0.00		0.00
Grand total	**1,40,68,645**	**100.00**	**61,241,156,410**	**100.00**

Annex 3.2
The role of interest rates

Chuck Waterfield[39]

The textbook definition of interest is ‘the charge for the use of money over time.’ This is a reasonable and intuitive approach to the calculation of interest. However, many finance institutions use a variety of techniques to mask the actual cost of the loan. In response, governments have passed consumer protection laws, such as the United States ‘truth-in-lending’ act, which distil the mixture interest and fee calculation methods down to a basic, consistent measure called the ‘Annual Percentage Rate,’ or APR. In the microfinance industry, this is often called the ‘effective interest rate.’ Both terms will be used throughout this explanation, but they are considered synonyms here, even though economists consider ‘effective interest rate’ to be a different calculation. In Figure 3.4, you will see that in the table to the left, we have a $3,000 Peso loan for 16 weeks, with 48 per cent annual interest charged on a ‘declining balance.’ The graph on the right shows the ‘net loan balance’ (in red) and the ‘interest rate balance’ (in green). As you can see, each week, interest is calculated on the amount actually held by the client in the previous month. Interest in the first week is charged on $3,000. Interest in the second week is charged on $2,813. Interest in week 16 is charged on $188. This is both logical and intuitive, matching the textbook definition of interest.

The next figure shows an expected repayment table for such a loan. The circled column displays the ‘cash flow’ from the perspective of the client. She receives $3,000. She pays $215.19 the first week, of which $27.69 is interest. The interest amount is calculated as: 48 per cent annual interest rate/52 weeks *$3,000 = $27.69. The total payment is 213.46 the second week, and continues until the loan is repaid. The bottom line shows that 48 per cent is the APR for this loan. It is calculated using an ‘Internal Rate of Return’ (IRR)

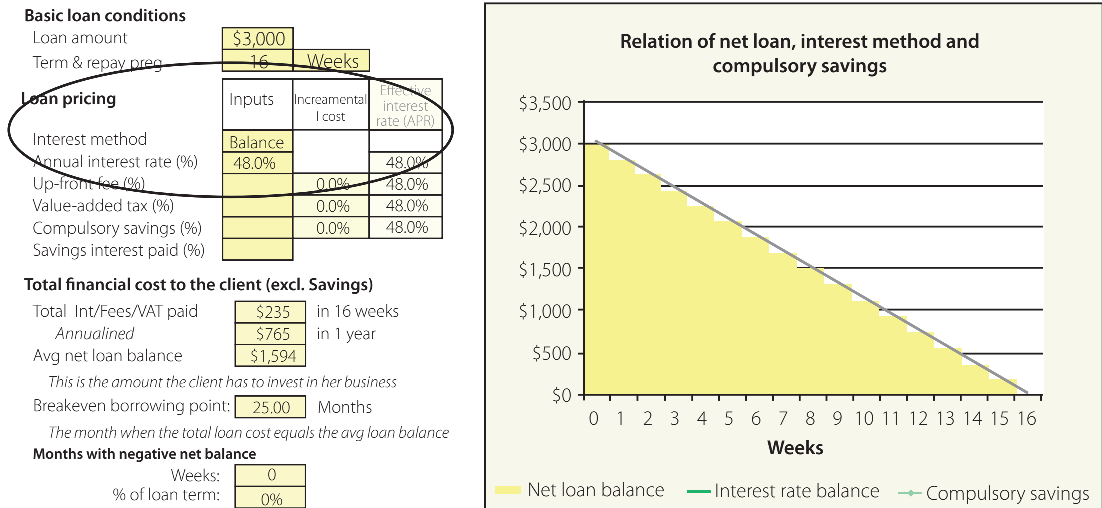


Figure 3.4 Calculation of effective interest rate based on loan conditions and pricing.

formula, a well-known approach in finance to determine what the break-even return is for such an 'investment,' and it does give what we expect—48 per cent—since we were calculating a 48 per cent annual interest rate charge consistently in every week (Table 3.11).

Understanding the flat rate method Many MFIs do not calculate interest rate charges based on the actual amount owed by the client. They instead use a method called 'flat interest,' a method not invented by but very commonly utilised by the microfinance industry. In this approach, the quoted interest rate is charged on the *original* loan balance, even though the client does not have (and often *never* had, as we will see) that much money at her disposal. The next figure shows the green 'Interest Rate Balance' line as a flat line. In week 1, interest is charged on $3,000 and the client has $3,000. Each week, the client pays back part of the loan, but interest is still charged on the original loan amount. In week 16, the client has only $188 to invest in her business, but she is still charged interest on $3,000. Clearly, there is no textbook definition that can rationalise why interest should ever be charged this way in a fair system. Why did such a system appear in lending? The answer is obvious and cannot be debated: it allows the institution to charge nearly twice as much interest for the quoted interest rate as with the declining balance method. The institution is able to advertise a low nominal interest rate and charge a much higher APR. As shown in the table to the left, 48 per cent flat interest results in an APR of 86.8 per cent. In other words, charging 86.8 per cent using the declining balance method would generate an equivalent cost of the loan (Fig. 3.5).

A general rule known by financial managers is that when flat interest is used, the APR is almost twice as much as the quoted interest rate. It will be clear from Figure 3.5. APR interest is the charge for the use of money over time, or the diagonal red area — the area shaded in red shows the length of time that the client has different amounts of money. With the green, flat interest line you can visualise a rectangular box. If you visualise the red area as a diagonal straight line, then you can see that the line divides the green rectangular box in half. Thus, interest is being charged on twice the amount actually held by the client. However, because of the stair-step approach of the red area, the area of the red is slightly more than half the area of the green, rectangular box. Thus, the APR is slightly less than double the nominal rate.

Table 3.11 Repayment schedule*

Month 11	Balance	Principal	Interest	Commission	Vat	Cashflow just interest	Cashflow incl comm	Cashflow incl vat	Savings	Interest	Widhdrawal	Savings balance	Cashflow
	Loan cost and cashflow							Compulsory savings					
0	3,000			–	–	3,000,00	**3,000,00**	**3,000,00**	–			–	3,000
1	2,813	187.50	27.69	–	–	(215.19)	(215.19)	(215.19)	–	–	–	–	(215)
2	2,625	187.50	25.96	–	–	(213.46)	(213.46)	(213.46)	–	–	–	–	(213)
3	2,438	187.50	24.23	–	–	(211.73)	(211.73)	(211.73)	–	–	–	–	(212)
4	2,250	187.50	22.50	–	–	(210.00)	(210.00)	(210.00)	–	–	–	–	(210)
5	2,063	187.50	20.77	–	–	(208.27)	(208.27)	(208.27)	–	–	–	–	(208)
6	1,875	187.50	19.04	–	–	(206.54)	(206.54)	(206.54)	–	–	–	–	(207)
7	1,688	187.50	17 31	–	–	(204.81)	(204.81)	(204.81)	–	–	–	–	(205)
8	1,500	187.50	15.58	–	–	(203.08)	(203.08)	(203.08)	–	–	–	–	(203)
9	1,313	187.50	13.85	–	–	(201.35)	(201.35)	(201.35)	–	–	–	–	(201)
10	1,125	187.50	12.12	–	–	(199.62)	(199.62)	(199.62)	–	–	–	–	(200)
11	938	187.50	10.38	–	–	(197.88)	(197.88)	(197.88)	–	–	–	–	(198)
12	750	187.50	8.65	–	–	(196.15)	(196.15)	(196.15)	–	–	–	–	(196)
13	563	187.50	6.92	–	–	(194.42)	(194.42)	(194.42)	–	–	–	–	(194)
14	375	187.50	5.19	–	–	(192.69)	(192.69)	(192.69)	–	–	–	–	(193)
15	188	187.50	3.46	–	–	(190.96)	(190.96)	(190.96)	–	–	–	–	(191)
16	–	187.50	1.73	–	–	(189.23)	(189.23)	(189.23)	–	–	–	–	(189)
		3,000	235	0	0	**48.0%**	**48.0%**	**48.0%**	0	0	0		**48%**

*The table shows the repayment schedule and cashflow for the loan, given the conditions as indicated on the cost-to-client sheet.

Basic loan conditions

Loan amount	$3,000	
Term & repay preg	16	Weeks

Loan pricing	Inputs	Increamental l cost	Effective interest rate (APR)
Interest method	Balance		
Annual interest rate (%)	48.0%		86.8%
Up-front fee (%)		0.0%	86.8%
Value-added tax (%)		0.0%	86.8%
Compulsory savings (%)		0.0%	86.8%
Savings interest paid (%)			

Total financial cost to the client (excl. Savings)

Total Interest/Fees/VAT paid	$443	in 16 weeks
Annualined	$1,440	in 1 year
Avg net loan balance	$1,594	

This is the amount the client has to invest in her business

Breakeven borrowing point:	13.28	Months

The month when the total loan cost equals the avg loan balance

Months with negative net balance

Weeks:	0
% of loan term:	0%

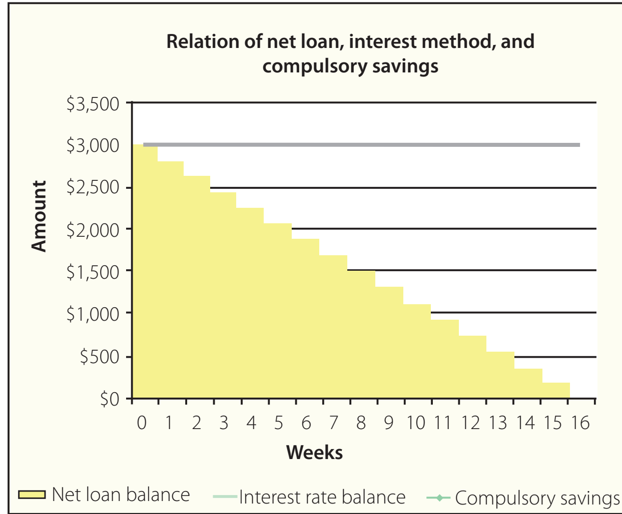


Figure 3.5 Calculation of effective interest rate based on loan conditions and pricing.

ANNEX 3.3
Private equity funds investing in Indian MFIs

Fund	Assets under management	Investments in India to date
Aavishkaar-Goodwell	Undisclosed	Share, Grameen Koota
Lok Capital	US$22 m	Satin Creditcare, Janalakshmi, Spandana
Unitus Equity Fund	US$56 m	SKS, Ujjivan, Mokshayug, Grama Vidiyal
Bellwether	US$20m	Ujjivan, MAS Financial, Sonata, Arohan, BISWA, MIMO, Janalakshmi, Trident, Sahayata, Paras Capfin
Grameen Capital India	US$1.2m	
Others funds and investors which have invested in the Indian microfinance sector or declared their intention to do so in the future:		
Sequoia Capital, Legatum, ACCION, Vinod Khosla (private individual), Reliance Capital, Silicon Valley Bank, Columbia Pacific, JM Financial Fund, Blue Orchard, Michael and Susan Dell Foundation		

ANNEX 3.4
Excerpts from master circular on Capital Adequacy issued to banks DBOD.No.BP.BC. 11/21.06.001/2008-09, dated 1 July 2008

The claims on non-deposit taking systemically important non-banking financial companies (NBFCs-ND-SI), other than AFCs, will attract risk weight as furnished in the table below:

Rated NBFC-ND-SI	(Irrespective of the amount)
BBB and above	125%
Below BBB	150%
Unrated NBFC-ND-SI	
Below threshold	125%
Above threshold	150%

Excerpts from RBI notification DNBS.200/CGM (PK)-2008, dated 1 August 2008, on Capital Adequacy for NBFC–MFIs.

Systemically important NBFCs with assets of above Rs 100 crores would be required to maintain 12 per cent of risk-weighted assets in the form of capital by the end of March 2009, and 15 per cent of risk-weighted assets in the form of capital by the end of March 2010.

Disclosure in balance sheet should include Capital to Risk-Weighted Assets Ratio (CRAR), exposure to real estate, and maturity pattern of assets and liabilities. A set of three returns on asset–liability profiles have also been prescribed.

NOTES

1. Author gratefully acknowledges the significant contributions made by Doug Johnson and Vidur Gupta, CMF, IFMR to the Investment Climate part of this chapter. Substantial part of the text and data therein, has been drawn from their work, exclusively prepared for this report. The author is very grateful to Chuck Waterfield for his permission to use excerpts from his note on Role of Interest rates (annex to this chapter) from his Website www.microfin.com.
2. Details at www.themix.org.
3. Details at www.forbes.com.
4. Sa-Dhan is a national network of microfinance institutions. A description of its role and activities is available in a later chapter.
5. The Bharat Microfinance Report—Quick Report 2008, Sa-Dhan. The report contains data about operational and financial details of 223 MFIs of which, 196 are members of Sa-Dhan and 97 non-members. There are MFIs that have not reported to the Sa-Dhan database. Their data is not a part of the analysis and to that extent, allowances have to be made for the conclusions drawn in this chapter. But the volumes involved are not expected to be significant in the overall context of the sector, but the significance of what the institutions do, remains outside the report.
6. Some of the institutions reporting data do not seem to have their own clients, but have clients working in promotion, development and umbrella support. Significant numbers have been reported, for example, by Maharashtra Mahila Athik Vikas Mahamandal (MAVIM).
7. In the previous year's report, the number of clients was reported as 10.4 million, but revised to 10.04 million in the current year's report.
8. Annex 1, at the end of this chapter, contains the state-wise client out reach and loan portfolio details.
9. Inverting the Pyramid—The Changing Face of Indian Microfinance, Intellecap 2007.
10. Maturing Microfinance—Emerging Challenges, Side by Side Report 2007, Sa-Dhan.
11. There is a separate section on urban microfinance later in the report.
12. Sanjay Sinha is the CEO of Micro Credit Rating International Ltd., a service company engaged in MFI rating.
13. Sa-Dhan has categorised the MFIs as small (less than Rs 5 crores of loan portfolio), medium (Rs 5 to 50 crores of loan portfolio) and large (above Rs 50 crores of loan portfolio).
14. Mr M.R. Rao, COO, SKS MicroFinance says 'Mere presence of MFI in a location and visit of loan officers is enough. Not much marketing is needed. Staff with ordinary skill sets would be able to generate business volumes.'
15. Source: Annual Report 2007–08, Friends of Womens World Banking, Ahmedabad. Website: www.fwwbindia.org.
16. RBI/2008-09/116 DNBS (PD). CC. No. 125/ 03.05.002/2008–09, dated 1 August 2008.
17. SIDBI provides long-term loans to MFIs. NABARD has started providing quasi-equity funds that are long-term.
18. This survey was carried out by Centre for Study of Financial Innovations, supported by Citibank and CGAP.

19. Indian Institute of Banking and Finance is an industry-level body that caters to the capacity-building needs of bank staff and certification of their competencies. It offers diploma and certificate courses as well.
20. S. Mullainathan and Minakshi in a study on behalf of CMF, IFMR, found that among a sample of 200 microfinance borrowers, 58 per cent did not know of the interest payable as per the loan contract; 34 per cent about the correct installment amount and 86 per cent about the total interest on the loan amount.
21. Excerpts from a note on interest pricing and implications of flat rate and annual percentage rate by Chuck Waterfield is reproduced in the annexure to this chapter.
22. The draft guidelines proposed by the Ministry of Rural Development (under discussion, yet to be operationalised) for revamping the poverty alleviation progrmme, SGSY sets a minimum outlay of Rs 1,00,000 to bring families above the poverty line.
23. Please see Chapter II on the results of a survey of NGOs; more than 80 per cent of them wanted to become MFI, preferably in the company form.
24. Frances Sinha, Executive Director, EDA Rural Systems.
25. Lokcapital raises fund size to 22 m with investments. http://www.microcapital.org/news-wire-india-lok-capital-raises-fund-size-to-22m-with-investments-from-accion-responsability-developpement-international-desjardins-did/.
26. *Businessline*, news paper, 3 February 2007. http://www.thehindubusinessline.com/2007/02/03/stories/2007020303481600.htm.
27. http://www.vccircle.com/2007/03/29/sequoia-capital-invests-115-million-in-sks-microfinance-ipo-in-3-5-years/.
28. http://www.livemint.com/2007/05/16005006/Dubais-Legatum-invests-Rs125.html.
29. http://www.microcapital.org/microcapital-story-sks-microfinance-raises-37-million-in-equity-sale/.
30. As there is no law or regulation in India requiring organisations, which provide microcredit to formally register or provide basic statistics on outreach, accurately assessing the growth of the overall sector is a difficult task. As a crude proxy, we may use the growth in the total number of clients for all MFIs reporting to the MIX market. According to this measure, the Indian microfinance sector as a whole, grew at a compound annual growth rate of over 100 per cent between the years of 2001 and 2006.
31. Annexure 6 provides a gist of the RBI circular on the subject.
32. Capital Connect is a Web platform for investors and investees to meet each other to prospect for investment deals. More information is provided in a later chapter.
33. Aparna is an executive with EDA rural systems. This information was shared on the UN Solutions Exchange in response to a question on innovations for reporting in the SOS 2008.
34. Vijay Mahajan, founder and MD of Basix, in an interview carried in Microfinance Insights, June 2007.
35. Annexure 6 contains excerpts from the RBI notification on the revised risk capital requirements.
36. The Central Bank has specified that 'while applying risk weights to exposure/limits of Rs 5 crores and above, if such exposure is rated by any of the recognised credit rating agencies, the risk weights varies with the rating of the exposure. A better rated exposure attracts a better risk weight.' Master circular on Capital Adequacy issued to banks by Reserve Bank of India, DBOD.No.BP.BC.11/21.06.001/2008–09, dated 1 July 2008.
37. Sanjay Sinha, M-CRIL, explained 'The RBI has said that they would like to see default data in relation to the rating grades awarded by us and they will then consider adding our name to the list. We are in the process of collecting the necessary data from the leading lenders to MFIs.'
38. Inverting the Pyramid—The Changing Face of Indian Microfinance, Intellecap 2007.
39. CEO of MFI solutions and creator of Microfin, the financial projection and business-modeling software, used by MFIs world over. He is also founder-moderator of the discussion list— 'Microfinance Practice.'

Banking correspondents and facilitators

4

Chapter

INCREASING ADOPTION

The Reserve Bank of India's (RBI) internal working group headed by H.R. Khan,[1] had in a far-sighted move suggested setting up of a banking correspondent (BC) and banking facilitator's (BFs) network for expanding financial services to rural areas, remote locations and uncovered people. The scheme which has since been operationalised is under different stages of roll-out by different banks. The RBI scheme has been a response to the need of achieving financial inclusion and providing sustainable financial services access to those who remained excluded, despite the efforts taken by the vigorously expanding banking system. BC and BF network is also seen to offer the required network expansion necessary for dealing with small and vulnerable clients whose financial services requirements are very small. Thus, the BC/BF appear to connect very well with the proposed microfinance expansion movement and also the government's objective of achieving total financial inclusion. The RBI issued the necessary instructions to enable banks to appoint BCs and facilitators. The difference between BC and BFs is explained in Table 4.1.

The correspondents are permitted to carry out transactions on behalf of the bank as agents. The BFs can refer clients, pursue the clients' proposal and facilitate the bank to carry out its transactions, but finally the responsibility of putting through transactions rest with the bank staff. Quite a few banks have utilised the scheme for expanding their operations. The SBI among the public sector banks have taken the lead in trying to recruit as many BFs and correspondents as possible. They already have recruited retired bank officials, ITC and post office under the BCBF scheme. In the case of private sector banks, ICICI Bank and HDFC have taken the lead in making full use of the scheme. Several other banks in the public and private sector such as Indian Bank, Canara Bank, Union Bank of India, Corporation Bank, Punjab National Bank, Oriental Bank of Commerce, Andhra Bank, Axis Bank and the like, have made use of the scheme and appointed BCs and facilitators. In many cases, NGOs and MFIs of the eligible categories have been contracted. In quite a few cases, even individuals such as village grocers, dealers in agricultural inputs and in the case of SBI, retired bank officials have been used as facilitators. Some corporate entities such as ITC also have been enrolled as facilitators in some locations. Post office has tied up with SBI as BF, offering several services.

TECHNOLOGY DIMENSION

The BCs offer savings, credit, insurance and remittance services depending on the location and sophistication of the correspondent set-up. One of the key determinants of how comprehensive the BC service would be is that of the use of technology. Quite a few banks have taken to utilising the handheld device-based technology with or without biometric recognition capability. At the point of sale, the handheld devices are maintained and made use of for putting through transaction after the initial account opening formalities and know your customer (KYC) requirements are complied with. Small deposits and withdrawals are enabled through handheld terminals at the point of sale,

Table 4.1 Differences between BCs and BFs

Business correspondents	Banking facilitators
Who can be Society/trust NGOs Cooperative societies including MACS Not-for-profit companies Post office	Apart from those eligible as correspondents Community-based organisations IT-enabled rural outlets of corporates Insurance agents PRIs, village knowledge centres, KVKs, agri-business centres and KVIC/KVIB units
What can they do Identify clients and activities Processing of applications Formation of groups Disbursal of small value loans Recovery of loans Small deposit collection Sale of insurance products Handling small remittances	The first three activities of BCs are the following: Verification of primary client information Creation of financial literacy and debt counselling Follow-up for recovery of loans
Role Can put through transactions as agents of bank and can bind the bank in financial transactions	Cannot put through transactions and cannot bind the bank in financial transactions, as they are not authorised to deal with money

manned by BCs. There are cases where more sophisticated devices are used such as smart cards, which are authenticated with embedded biometric codes. The clients in such cases are able to bring the smart card and make use at the point-of-sale terminal, which matches the finger print of that client, and after authentication, thereof, put through the required transactions. A variant of this is the mobile phone-based biometric-enabled smart cards. SBI has introduced this under the brand name 'Bank in a Box'. The cellular phones come with a small printer which could also produce a receipt and are enabled to read biometric codes. This is made use of for authenticating the transactions made by customer. There are some BCs and facilitators who had set up information kiosks that are fitted with personal computers, card readers and biometric-enabled point-of-sale terminals. BASIX is the one of the early users of this mode of correspondent banking. These kiosks handle a variety of transactions from saving, credit, remittance and insurance distribution.

In Andhra Pradesh, a pilot is being run by several banks that have opened accounts of beneficiaries of NREGS scheme, which are smart card-enabled. The payments under NREGS are credited to the clients' accounts directly by the bank, and the clients are able to withdraw from or deposit into this account using their smart card. This pilot has the potential for replication in respect of all beneficiaries and NREGS on a nationwide scale. The HDFC has a hub-and-spoke model, whereas the Oriental Bank of Commerce has tried out a cluster-based model.

MICROFINANCE GOING MOBILE

Centurion Bank of Punjab[2] had made use of services of EKO, a mobile technology solution provider as a BC. EKO, acquired over 2,000 clients in Delhi, who are able to put through transactions through cellular phones, using cash points that were opened in different choice locations in the city. These cash points were typically mobile phone and prepaid card retailers, local grocers and such ubiquitous entities. Very small deposits could be easily made and small amounts could be withdrawn from the cash points, with the results of transactions getting updated through the cell phones. But the regulatory comfort in this kind of scheme was low, as the BCs appointed franchisees in turn. Control over the amount collected by way of deposits was not in the hands of either the bank or the BC and hence, the arrangement was not found to be feasible. RBI does not want to take any chances with savings and remittance moneys that were received. But such mobile-based solutions are snapping at the heels of the MFIs and at the edge of financial inclusion efforts. There is no doubt that more stable arrangements that would satisfy the regulatory norms would soon be found and made operational.

REGULATORY AND OTHER CONSTRAINTS

The BCs and facilitators scheme does face a few constraints. The first is the physical constraints of spacing and location. The RBI has made it clear in the recent instructions that BCs should not be located more than 5 km away from the linked bank branch in metros and not more than 15 km away in rural area. However, the freedom to increase this distance limit has been given to the district-level consultative committee of bankers[3] (DCC). This is not seen as a satisfactory solution to the problem by several BCs and banks. Larger size institutions with

multilocation operations are unable to transact as a single correspondent, if the 5 and 15 km criteria are applied. At each location, they would have to look for a nearby branch of the same bank with which they have agreed to become a correspondent. But RBI's point of view is that that the correspondent should normally be in such a location that the bank branch is in a position to regularly monitor the client comfort and supervise the working of correspondent. This is seen as a prime requirement by RBI, without which it feels that the quality of services and the fidelity of transactions cannot be ensured. It is with this point of view that RBI has imposed physical distance restrictions that would make it possible for the branch staff to carry out the necessary oversight functions over BC.

The other operational issue is that of handling of cash as also movement of staff of the BCs over large areas. Technology today enables the staff of BC to cover much wider area of operation. On account of technology, real-time information about the financial status of client in terms of account balances, repayments received and the pending issues, if any, are all available readily. The accounting of transactions could be carried out in the field and ported back to the server in the bank branch or head quarters of the bank or at the end of the day or as frequently as may be found convenient. But, technology does not as yet, provide a solution for cash handling.

Some banks report that they find it difficult to pay adequate compensation to the BCs, on account of the restriction on interest rates on small loans. Banks are permitted to charge only up to the level of their prime lending rate (PLR), in case of small loans of up to Rs 2,00,000 even in case where BCs or facilitators are used. Banks argue that the BC has to be adequately compensated, and this cost pertains to providing services at the client's doorstep and thus, should be charged extra from the client. But the counter argument is that the cost of operations of the bank decline drastically when BCs are used, and the avoided costs are to be passed on to BC. The banks must be in a position to post a decent yield net of this cost even if they charged only up to PLR. RBI also points out that in case loans to SHGs, small and vulnerable people, rate of interest charged by the banks are at sub-PLR levels.

From the regulators' point of view, one of the concerns is that of ensuring that large players entering into alliance with banks as correspondents do not keep the banks at arm's length and put through transactions, which the banks are not in a position to monitor. Large commercial entities might use the BC route for backdoor entry into para-banking activities. This has perhaps been the reason behind restriction on the non-banking financial companies (NBFCs) from becoming BCs. But non-profit NBFCs have not been restricted from becoming BCs. Financial Information Network & Operations Ltd (FINO) and A Little World, two for-profit technology providers, have set up non-profit companies and offer services as BCs. As a result, the operations of the BCs remain out of direct regulation of RBI, which was possible had they been for-profit companies.

POTENTIAL TO BE EXPLORED

The impact of post office has still not been fully felt on the banking scenario, although a few agreements, including a large alliance with SBI have been concluded. National Bank for Agriculture and Rural Development (NABARD)[4] and the post office have been implementing a pilot in Tamil Nadu, where SHGs are credit-linked to the post office. This pilot is to be expanded to the other states. The potential of post office to provide service among the rural areas is yet to be harnessed. Post office distributes financial products such as insurance and mutual fund products in select locations. But before post office becomes a very effective distributor of financial services on behalf of banks, it is necessary that the capacities of post offices and technology investments at the grass-root offices are improved considerably. This would enable the banks to gain more than 1,55,000[5] postal outlets in the rural area.

The network of primary, agricultural cooperative societies in the rural areas offers another channel of BCs, which is not fully explored. The 1,00,000 societies with the basic financial knowledge already contained therein are a rich resource. The ongoing reforms in the cooperative sector would render many of the societies financially sound. This should encourage the banking system, including the higher level cooperative banks to look at the Primary Agricultural Credit Societies (PACS) as BCs, for those lines of financial services that are not already handled by the banks. This would de risk the societies; provide them an additional revenue

stream, while retaining both control and profits with the banks. Between post offices and the primary societies it is possible to add more than 2,00,000 points of sale in the rural finance.

A FINANCIAL ARCHITECTURE FOR INCLUSION

The RBI as a part of the financial sector reforms is engaged in a restructuring of the banking system. The commercial banks have more or less reached the limits of their voluntary expansion in the rural areas. Any further addition to branch network would strictly be a function of demand and viability. The cooperative banks are also in the midst of reform where efforts are likely to be made to consolidate the primary society network to a more reasonable level based on their viability and sustainability. Further, network expansion in the cooperative banking too seems improbable, if not impossible. The objective of financial inclusion would be difficult to pursue without frontline points of presence and staff. If the financial inclusion of all excluded people has to happen, especially in the remote and sparsely populated rural areas of the country, a suitable financial architecture is required. The architecture would not permit physical presence of the banks as investment costs would be disproportionately high compared to the likely business volume and profits. The last mile of financial architecture is likely to be in the form of Cooperative societies, MFIs, NGOs, the post office, the BCs and facilitators in all different forms and, even, the legitimised village money lenders. This, perhaps, is the reason why the RBI has spawned the idea of BCs and facilitators and also suggested that the money lenders be legitimised and brought into the financial sector framework under controlled and guided conditions.

NOTES

1. He is presently Executive Director, Reserve Bank of India and earlier Principal, College of Agricultural Banking, when he headed the committee.
2. Recently the bank was merged with HDFC bank.
3. This is a committee headed by the district collectors in which all banks, government departments and NGOs are members. This usually prepares a credit plan for priority sector lending and fixes bank-wise targets for government-sponsored programmes. It coordinates banking-related activities in the district.
4. NABARD Annual Report 2007–08.
5. India Post Annual Report 2007–08, Government of India, Department of Posts, New Delhi.

Urban microfinance—fast and furious

5
Chapter

MARKET DEMAND AND SUPPLY

While rural microfinance has been given a lot of importance in terms of funds flow and studies, the urban microfinance had been neglected for long. The recent interest in urban areas is escalating and the last year's report carried a detailed treatment of the subject. With plenty of poor and vulnerable people living in the urban areas and more of rural population migrating to urban and semi-urban areas in search of livelihoods. Access to finance has been a critical need. This need has been met by a variety of players in the past. The IIMS Dataworks Research Report states that 58 per cent of urban with low-income workers had no financial savings. Life insurance had penetrated only 19 per cent of low-income urban households. The gap in financial services in urban areas, though less than in rural areas, is huge. A number of finance companies, a few urban cooperative societies and banks, as also several credit and savings mechanisms have been present in the urban areas, but, still, the level of exclusion has been high. Now the microfinance institutions (MFIs) seek to fill in the void and provide the service for the urban poor.

Sa-Dhan for the first time, has tried to collect information relating to MFI clients and volume of loans in urban areas. The data reported by Sa-Dhan brings out that one out of every four clients on the books of the MFIs that have reported information to Sa-Dhan is urban (Table 5.1).

The large MFIs had 22 per cent of their clients from the urban areas whereas the medium-sized MFIs have 40 per cent of their clients from the urban areas. This actually shows that there is considerable interest in urban microfinance on the part of medium-sized institutions, which would grow up into large-sized operations in the near future. The size of average loans in urban microfinance has been much higher than in the case of rural microfinance. While in the case of rural microfinance clients only 25 per cent have managed to access large loans, 40 per cent of clients of urban microfinance had loans of more than Rs 10,000. In terms of overall growth rate, the 22 largest MFIs grew by 26 per cent in their loan portfolio; whereas, the urban loan portfolio of these 22 large institutions grew by 40 per cent showing that urban microfinance has become an area of focus for the large- and the medium-sized MFIs. Not only the MFIs, but also the banking system has woken to the potential of microfinance clients in the urban areas.

BANKS' INVOLVEMENT

Special products have been designed and rolled out focusing on the urban clientele in the vulnerable segment. Smart card- and mobile phone-enabled microfinance products are available at select locations from banks such as Corporation Bank, HDFC, State Bank of India, Axis Bank and Union Bank of India. Punjab National Bank has rolled out a scheme targeting rickshaw pullers, in and around urban centres in Uttar Pradesh and Bihar. Similar projects targeting vendors and street hawkers have been rolled out by few other banks. It has been difficult to bring together the information on urban microfinance initiatives in the case of the banking sector as also MFIs. Several players that were active have possibly not reported to Sa-Dhan the details of their

Table 5.1 Clients, loan volumes in urban areas

	Urban	Total
No. of clients (millions)	3.40	14.1
No of new clients during 2007–08 (millions)	1.07	3.97
Loans outstanding (billions)	17.13	59.54

Source: Bharat Microfinance Report, Quick Data 2008, Sa-Dhan.

engagement. In the case of banks, no separate database exists on their urban microfinance operations.

The Reserve Bank of India (RBI) on its part is also concerned with the high exclusion levels in the urban area. Mrs Usha Thorat, Deputy Governor, States that the urban banking system does not really cover the urban areas in a manner that would bring in the excluded to access financial services. The RBI feels a need for banks to deal with excluded population in the urban area. While in the rural areas the banking system has the mechanism of district credit plans, for urban areas there are no similar exercises. The RBI is likely to look into this and come out with suitable methods of ensuring that the excluded population in urban areas is covered by the financial sector.

THE MARKET DYNAMICS

Urban microfinance while holding considerable growth potential is not a market that is easy. This market is beset with several problems and difficulties. The context of urban microfinance is very different from that of rural microfinance. The client profile, their expectations and the processes required to be effective in urban areas are very different. Unlike in the rural areas, where the clients have a known habitat and could be expected to be located at any point of time, the urban microfinance clients typically have a very temporary address and are mobile. The slums, in which most of the migrants and poor live, are subject to disturbance and people often are forced to evacuate. Further, the livelihoods not being steady in the urban area, people tend to shift from one part of the city to another or from one city to another depending on the location of their livelihood. These changes in residence create problems for compliance with the know your customer (KYC) norms as well as client-tracking and monitoring.

The second part of the problem is that of reluctance of urban clients to subject to the kind of discipline that is required both in the case of Gramin and self-help group (SHG) models. Periodic and regular meetings, group-based decision-making and so forth, are difficult as time has much more value in the urban areas. These clients could ill afford to disrupt their daily livelihood activity for attending meetings just to retain financial services access. The processes and methods of bringing them in and making them participate in the financial services have to be different.

Informal centres of powers that exist in urban areas impose additional costs on microfinance operations. More often than not, the MFIs have to pay a 'rent' to these power centres operating in the different parts of the city. Some of the MFIs operating in certain cities have informally stated that payment of such rents are necessary to ensure that the operations of MFIs are smooth, and support is available at the time of recovery of amounts in chronic default.

The competition for the same clients in the same areas has increased. Urban microfinance market has a multitude of institutions and more new MFIs continue to enter. Not only institutions that are set up as MFI but even others operate in such urban areas. Companies such as Fullerton Financial Services have successfully utilised the urban market and posted a high growth rate. The competitive behaviour has led to deterioration in standards of discipline as also returns. The competition introduced the borrowers to the possibility of multiple borrowing. In the assessment of many MFIs, the urban microfinance market has an excellent growth potential. Cities such as Bangalore, Chennai, Hyderabad and Kolkata have shown vigorous growth with several, large institutional players entering the market. Start-up MFIs backed by professionals have also commenced operation in some of these centres.

Gramin Koota,[1] (NGO MFI) in Karnataka has a significant, urban microfinance portfolio. As per its assessment, the urban areas are more difficult to work in microfinance as the bonding between the people is not strong; familiarity with each other among the urban clientele is also relatively limited. But then, scaling-up of urban micro finance is much easier and the outreach can be expanded very fast.

In the rural setting, scaling-up and growth is comparatively slow, but the groups and the portfolio would remain relatively, low risk. The requirement of the average urban micro finance clients is much

larger as they tend to use the loans to run their small enterprise activity. For example, Grameen Koota's clientele have a wide variety of livelihood activities running auto rickshaw, vending of plastic pots, garments, tyre re-treading, selling milk and milk products and so forth. All these enterprise activities in the urban areas required financial resources far in excess of what the MFIs could afford to provide. While a part of the requirements of business came from the clients themselves, another part was borrowed from other sources. The MFI was required to keep a close watch over the repayment behaviour of the borrower, so that the competitive borrowing from elsewhere does not interfere with the repayment performance of its own loan.

MFIs operating in the urban area eventually tend to experiment with individual lending. Given the difficulties of assembling groups together and the requirement of large-sized loans by the clients, MFIs choose to take individual clients and provide them loans. Bandhan, Grameen Koota and SKS have started providing individual loans. As the market matures more loans would be individual.

Urban areas have the advantage of being technology-friendly in terms of infrastructure and adaptation skills. The cell phone densities and Internet connectivity ideally place the urban areas, for expansion of services, based on technology. Some of the pilots tested involving smart cards and cell phones have been in urban areas. The business correspondent/business facilitator (BC/BF) networks would also find it easier to work in the urban areas in view of higher population density. These are the reasons why the MFIs look at the urban areas with optimism.

HOUSING FINANCE

Another important aspect of urban microfinance is the requirement of a wide variety of services apart from savings and credit. Even in respect of savings, a wide variety of products are required that would enable the clients to save whatever surpluses they attain. The temptation to spend daily surpluses is rather high in an urban area, which has different distractions. In the urban markets, one of the important needs that are emerging is that of housing. The first thing that a settler in an urban area looks for is shelter. Housing microfinance in the urban area has really not taken off in a big way because of large volume of loans required and long period of repayment. The REPCO Bank in Chennai and National Housing Bank have jointly introduced a pilot to test out a housing microfinance product, recently. SEWA Bank has a loan product for housing, for its members. While other similar products are available from other MFIs as well, the overall supply is inadequate to meet the demand. Centre for microfinance (CMF) in one of its reports[2] on housing microfinance points out, 'Although consumer demand for housing remains high, the financing options available for low-income households, especially for those employed in the informal sector, are limited. . . . MFIs provide an innovative channel to finance housing for the poor. However, the ability for MIFs to provide housing continues to be difficult, mired in concerns over scarce funding, legal risks arising from informal land title, lack of collateral and insufficient knowledge about construction. . . . A sector-wide analysis of housing microfinance is particularly relevant for stakeholders interested in entering this sector and developing cost-effective housing finance.'

INSURANCE

Urban poor face a risky existence. Health risks impact urban population in the vulnerable sections much more than in the rural areas. Epidemics and diseases arising from insanitary conditions in the urban slums force the people to spend more on their wellness. Health insurance for such people is a prime requirement. Mutual insurance scheme in the health area that have been successful are more in the urban slums than in the rural areas. This is a pointer to the willingness of urban population to pay to get health cover. The health insurance cover available under the GoIs scheme for unorganised workers is timely and relevant. The NGOs and MFIs need to take effective steps to distribute the same among their clients to strengthen their livelihoods and mitigate health risks. Asset insurance in the urban areas especially of their livelihood assets is a dire requirement. The insurance companies should look at the clients' needs in urban areas more closely and customise products that would help them mitigate their risks. VimoSEWA[3] has an integrated insurance product that covers key-risks of the household. SKDRDP[4] also provides a comprehensive insurance cover named Sampoorna Suraksha. These types of products make it easier for

policies to be marketed with high levels of client acceptance.

REMITTANCES

Another area of focus is that of remittances. The predominantly migrant, urban population, having come from the rural areas, periodically sends money home. Remitting money home is a hassle for people who do not have a bank account at both ends (at migrated city and the back home village) and who are unable to access banks easily. The post office-based remittance services are of high cost and time-consuming. Hence, migrants look for better means of transfer of money from the city to their homes in the rural area. Some of the experiments that have been carried out using the banking correspondent (BC) network, as also individualised efforts from some NGOs such as Adhikar already exist. But these are small-scale experiments that need to become mainstream. Mainstreaming of remittance facility that would run on back-bone of national payment system has to be looked at as a necessity. Delinking of payments transfer from banking services might enable other service providers such as cell phone companies to offer remittance services using simple and effective technology, such as mobile phones. As indicated in a later chapter on technology, Vodafone, Airtel and Tata Telecom have taken interest in offering such payment services over their cell phone networks. The bill payment services that were already offered on cell phones show a practical way of collection; the delivery of remittances only needs to be carefully designed.

CLIENTS IN THE URBAN SPACE

The micro clients face severe problems in their interface with the financial system. The KYC norms require a proof of identity and residence, which urban poor are hard to put to provide. The migrants have no papers of any kind, either from the place of their origin or their current residence. They will remain excluded from formal finance unless concrete steps such as a voter identity card or a migrant identity card is issued to them. The Rajasthan Mission on Livelihoods[5] and Ajeevika Bureau[6] have initiated issue of such migrant cards to people who migrate to other places in search of work. The cards were successful as identity proof, leading to the state government now supporting a wider scale replication of the effort.

Banks in the urban areas look out for larger clients. Even with introduction of no-frills accounts, small clients, unless backed-up by someone of good standing, find it difficult to enter banks. While MFIs can and do fill this space, they fulfil only credit needs. Savings by the poor would continue to suffer till more effective solutions using BCs are found. As for MFIs in urban areas, staff attrition rates are higher. So would client attrition rates be with the onset of competition. The silver lining in the risk-prone urban microfinance terrain is that start-up MFIs are able to place their equity at a premium!

NOTES

1. Based on discussions with Mr K.K. Suresh, MD and Ms Vanatha M. Reddy, Director of Grameen Koota.
2. Report on Low Income Housing in India: Challenges and Opportunities for Microfinance for Habitat for Humanity India 2007—by Aparna Krishnan, Minakshi Ramji and Yusuke Taishi, CMF, IFMR.
3. A description of VimoSEWA product is furnished in Chapter IV.
4. A description of SKDRDP's product is available in Chapter IV.
5. Rajasthan Mission on Livelihoods is a state-promoted society (supported by UNDP) that works on livelihood-related issues in Rajasthan.
6. Ajeevika Bureau is an NGO working on livelihoods and migrants issues, based in Udaipur, Rajasthan.

Social performance and responsible microfinance

6

Chapter

INCREASING INTEREST

The last year's report contains a detailed treatment of what constitutes social performance and the context in which the Indian microfinance institutions (MFIs) are placed in this regard. Considerable interest has developed in social performance management as an area for study and research. Small Industries Development Bank of India (SIDBI), Sa-Dhan and several others have taken the debate on social performance forward, bringing to centre stage the need for institutions to engage in socially responsible behaviour as also balancing the needs of profits from business with the needs of society. Internationally, Imp-Act Consortium[1] is working with more than 30 partners around the world with the aim of supporting MFIs to manage their own social performance management systems. The issues in social performance are discussed more in the context of MFIs that too those with a commercial orientation. Terminology such as *double bottom line and social investing* have become part of every day usage, to signal the need for profit-oriented MFIs, to balance the achievement of social mission along with their profitability.

The basic issues in social performance are threefold. The first of these is whether the design of institutions looks into what mission these institutions aim to accomplish and whether the mission has a socially relevant theme. Second, the products and the processes that actually lead the MFIs to produce results: whether they intend to be socially relevant; do the processes reflect such a consideration and whether results achieved actually indicate meaningful execution of the original intent. The third part is of managing social performance; that is, setting of the agenda by the board of governance, staff management processes to produce performance that has a social purpose, and the manner in which staff and other partners are engaged by the institutions to reflect the social sensitivities. EDA Rural Systems[2] has done considerable work on social ratings and performance, commissioned mostly by SIDBI. Today, social performance assessment has moved a considerable distance from the poverty audits that were used as proxies. Social performance examines the mission of the organisations, their strategies, the way the strategies are executed on the field, the results achieved and the attitude towards the clients. Social performance management today basically looks at processes of client selection, products that are offered and their fit for vulnerable sections of people.

INDUSTRY RESPONSE

The Sa-Dhan code of conduct,[3] which was introduced as a voluntary measure, was a very good beginning; communicating to the member MFIs, the need for socially relevant behaviour while conducting business. In Sa-Dhan's view, the concept of downward accountability should be practiced by the MFIs. According to Sa-Dhan, the set of social objectives that an MFI should have are: (1) reaching the poorer segment among unserved, (2) disseminating knowledge that would help them understand financial services and enable them to make informed choices, (3) providing financial services in a manner that the clients are able to benefit and (4) built-in elements of qualitative

nature, which in turn, ensure that the processes of financial services are optimal and appropriate. The Sa-Dhan code of conduct emphasises values such as integrity, transparency, fair practices, governance, feed back and grievance mechanism.[4]

The balance between financial sustainability and social mission has to be a cardinal principle of management of MFIs. But which of these is primary is an issue, and how much of what is acceptable is a management decision that should be taken by the board and the senior management of the MFIs. Some of the donors emphasise fulfilment of social mission as a primary (if not the only) concern in the microfinance sector. The Susan and Dell Foundation, and Opportunity International are examples of funders who make social performance an integral part of their overall support to the MFIs. The MFIs are encouraged to undertake social rating; more and more MFIs, as a result, seek to be rated on their social performance. SIDBI has been in dialogue with the MFIs on the need for internalising social performance aspects in their processes and products. It pioneered the commissioning of poverty audits and the social ratings. It has also tried to ensure good standards of governance, which take into account the overall context in which the MFIs operate including the social context.

IMPRESSIONS FROM THE FIELD

Evidence on the ground on products, processes and performance results of several MFIs indicates that there is still some way to go before the social performance issues are fully internalised. A critical issue is that of the exclusion of deserving poor from becoming clients. The entry norms for clients tend, even today, to exclude a large number of very poor and most-needy people from access to the MFIs services. The client profile of many MFIs will reflect that non-poor and borderline poor form the majority. The poverty audits carried out in eight institutions indicate that only two MFIs[5] had a clear poverty focus and the strategies necessary to target the poor in client selection. One MFI had almost equal number of poor and non-poor as clients. Five other MFIs had large majority of clients from the non-poor[6] and borderline poor categories. But the mission of these organisations clearly stated that they prioritise the poor and the underserved.

Exclusion of poor is not unique to MFIs; it is evidenced in SHG–bank linkage program (SBLP) where the self-selection processes that are practiced for choosing members of self-help groups (SHGs) end up in the not-so-poor-becoming members of SHGs. These groups also set high benchmarks for other groups to be formed in the same locality that makes it difficult for the very poor to become members. The higher requirements of periodic savings, the need for frequent meetings and the socio-cultural differences between the local populations tend to keep the neediest among the rural poor away from the SHGs. While targeting women has been a significant achievement of SHG mobilisation, targeting the poor is not. While more than 80 per cent of groups are exclusively of women, only 51 per cent were poor as per the Lights and Shades study. The National Council for Applied Economic Research (NCAER) study found that Andhra Pradesh and Uttar Pradesh samples had 46 and 64 per cent of SHGs with non-poor members in majority. The client selection and acquisition processes in SBLP and MFIs thus require a review.

The design of staff incentives for new client acquisition and the rapidity with which the client acquisition is to be completed are matters for reconsideration. Staffs in the interest of ensuring that their future performance is not discounted on account of low repayment increase the minimum acceptable status of clients, well above that of the poor. The acquired clients are normally the easiest ones to access by means of distance and proximity from the non governmental organisations' (NGOs) field office or the branch of the MFI. A combination of these two factors results in a client selection that is socially sub-optimal. The incentive structures drive business in a direction that is not socially oriented.

In the case of banks, the know your client (KYC) norms create hassles for opening accounts and result in exclusion of needy clients. The documentation requirements not only impose additional costs but also valuable time. Recognising the impact of such cost-and-time issues on the poor and underserved people, Reserve Bank of India (RBI) had relaxed the KYC norms and made them bear a part of the costs associated with no-frills accounts,[7] which are intended to the instruments for achieving financial inclusion.

PRODUCT DESIGN—DO CLIENTS MATTER?

The fit and relevance of products with the client's requirement and the types of businesses and enterprises are not part of design considerations. Most MFIs offered a single-standardised product that entails the client availing a lumpsum at a point of time and repaying the same over 25 to 50 equated installments. The client businesses very often experience cash flows, which vary in amount and time in accordance with the seasonality of the livelihood activity. In certain types of activities such as farming or goatery, the inward cash flow of the client comes in bulk at a point of time, rather than steady flows in regular intervals. Certain types of businesses such as petty trade and street vending require continuous infusion of cash to keep the inventory levels at a satisfactory level. But the credit products that are offered as a rule do not take into account many of these requirements of the clients. The clients in their eagerness to access credit of any sort continue to deal with the MFIs on terms that may not match their requirement. The design of these products is not only uncomfortable for the clients but also impose additional costs on the clients who very often resort to borrowing from other informal sources to keep up the regularity of payment. They want to be in a position to avail a larger loan when the existing loan is repaid. The evidence relating to this day-to-day occurrence in the field is before the functionaries of MFIs. But not much has been done to redesign the product in a manner that makes sense to the clients and makes MFIs responsive to their needs.

As regards loan repayment and default monitoring, MFIs denied further new credit to all members of the group, if anyone in the group defaulted. The reasons for the default are never examined but are used to improve the product design. This forces the non-defaulting members to arrange for alternative sources of funds so that the defaulting member's dues are cleared. Denial of credit to non-defaulting members is the least-offensive method of recovery that is followed. Other more forceful methods are also being employed. The failure to understand the issues facing the borrower and causing them to default on account of flawed design should be seen as issues in social performance. Vijay Mahajan[8] comments '. . . MIFs want nearly 100 per cent repayment and they are getting it because poor people are paying out of cash flows from other activities. To say that the MFI has got 99 per cent repayment is not by itself any great virtue, because if the people are engaged in several activities, they have been given a loan and lost the asset (such as livestock death or crop failure), and are now paying you out of wage work, that is not the purpose of founding microfinance.' How flawless repayment rates are maintained by some institutions on a hollow foundation is a subject matter for study and internalisation.

DONORS/FUNDERS' ROLE

From the donors and funders' perspective, there are issues related to the social performance that need examination. There have been quite a few cases of transformation of donor-funded NGOs into MFIs. In these cases, public funds have been converted into private assets that pursue profit as a core business objective. There is a failure of social consideration and a reduction in the public goods made available originally with donor funding. Even the bulk funders have a certain role to play when it comes to social performance. This role is critically required in the area of interest pricing. Interest pricing has to cover costs and generate a reasonable profit margin; it should also ensure that the borrowers do not feel over-priced. The borrower should be left, in no doubt, as to what exactly is the price that she pays to the MFI on the loan. On both counts there have been failures in several institutions. The rates of interest have been fairly high in many institutions. Seven for-profit MFIs and 11 non-profit MFIs have reported a portfolio yield[9] of more than 30 per cent during 2007–08. Some of these have reported yields of 37 per cent on portfolio. Thirty-six MFIs have yielded rates between 25 and 30 per cent. While there has been a reduction across the sector in the yield on portfolio, the reduction is far too slow. A question for examination is whether institutional sustainability is prioritised over borrower sustainability.

The need for transparency in interest pricing is a matter that requires a lot more attention. The basis for interest pricing such as a flat rate or a declining balance rate has to be made clear. The implications of these different bases in terms of the annualised interest rates should be made known to the

borrower. Practices such as collecting interest at weekly or monthly intervals, taking advance repayment of the first installment while disbursing the loan, collection of security deposits, charging of processing and monitoring fees, are aspects of interest pricing that need to be brought into a single calculation. The borrower should be made aware of the effective rate of interest. While Sa-Dhan's code of conduct dwells on transparency and quite a few MFIs exhibit this code in the head office, the code is not part of the toolkit used by the field staff.

A significant feature is the effort on the part of certain funders to ensure that the ground-level rates are not too high. National Bank for Agriculture and Rural Development (NABARD)[10] deals with only those MFIs for the purpose of support that charged interest of not more than 25 per cent per annum on a declining balance. Indian Overseas Bank (IOB)[11] stipulates as part of its loan conditions to MFIs, that they cannot have a spread of more than 10 per cent on the loans taken from IOB. But many others including SIDBI do not impose conditions relating to either a margin or a ceiling on interest rates as they feel that this is a business decision best left to the MFIs. The thinking is that MFIs have to compete in a market where others also offer similar products and the competition would discipline the interest rates.

GETTING THE DESIGN AND MISSION RIGHT

Setting up institutions to function as non-profit entities does not translate into social performance. When such institutions fail on measures of productivity and efficiency (the non-profit nature does not provide them a licence to incur losses), there is an erosion of public goods. The performance data on MFIs compiled by Sa-Dhan for 2006–07[12] shows that of all forms, non-profit companies had the lowest ratios on yields. The return on gross-loan portfolio was negative at 2.3 per cent and return on equity was negative at 18.6 per cent whereas all other forms of MFIs had posted positive returns on both counts. Social performance is not merely intent; nor just a set of processes; it is also about efficiently achieving results.

In social performance the form of organisation is not a critical factor. But if the institution is a community-owned and community-managed one, it has a much better chance of being socially responsive and relevant. But leadership matters even in community-owned institutions to deliver socially significant results. Sarvodaya Nano Finance, a community-owned for-profit non-banking financial company (NBFC) has several learnings to offer that go beyond financial intermediation.

Many institutions have come to the conclusion that the ultra poor are not viable clients and that such people need different sources of support and not microfinance loans. Some MFIs run a separate project targeting the ultra poor. Such projects involve grant funding to provide the initial push to the poor, and when they become bankable they become clients to the MFI. But such projects are very small in size in comparison with the clientele of the MFIs concerned and appear more like public relations exercise. These are possibly not even falling in the category of Corporate Social Responsibility as often these projects are funded by donors.

GOVERNANCE

Governance practices impact social performance as also the internal climate of institutions. Some of the MFIs have set a very high standard of governance in terms of constitution of their boards. Independent boards that are capable of taking decisions both in the interest of business and the society are a prime requirement. But quite a few MFIs have failed to pay attention to constituting the board in a manner that could handle the issues arising professionally. Cousin boards tend to look more closely at business requirement than the social requirement. The MFIs cite a dearth of knowledgeable people to man their boards. Sa-Dhan could play a role by maintaining a database of professionals, willing to serve on boards after carrying out a due diligence of their suitability.[13] Audit and grievance redressal functions have not been considered important for board level attention. There are reported instances where NGO–MFIs transformed in to NBFCs had sought to transfer all assets and liabilities with the NGO to the NBFC. Such transfers were sought to be effected even without the consent of the lending bank, not to mention the consent of the clients. Such practices reflect poor quality governance and scant respect for the clients and other partners. The sector must guard itself against recurrence of such events and protect the clients and other partners.

Sarvodaya Nano Finance, an MFI with a difference

Sarvodaya Nano Finance Limited (SNFL) is a rare for-profit company in microfinance that is community-owned. The company which was born in the year 2004–05, is today operating in six states—that is, Bihar, Jharkhand, Madhya Pradesh, Rajasthan, Maharashtra and Tamil Nadu. In Tamil Nadu it has a large footprint.

The unique feature of SNFL is its shareholding structure and participation of people in its equity. SHGs have been formed into federations of SHGs named Sarvodaya Mutual Benefit Trust. There are 106 mutual benefit trusts as at the end of March 2007. These mutual benefit trusts mature into strong community-based entities that pursue a development agenda. They provide skill training, access to inputs, linkage to markets and take up interventions in the areas of education, health, social awareness and community marriages. These federations also manage milk-chilling units and facilitate marketing of milk produced by the members. The federations focus on their use whatever surplus they are able to generate for the development of the community, rather than distributing the dividend to members. SNFL is a company that is held by the mutual benefit trusts to the extent of 99.94 per cent of its equity. The equity holding of individuals has a nominal of 0.06 per cent, which was necessary to bring the company into existence.

As of March 2008, the grass-root clientele was 0.52 million, and the total loan portfolio had grown to Rs 885 million. The business model adopted by Sarvodaya is to finance the mutual benefit trusts, which in turn provide loans to the SHGs. The SHGs deal with their members, regular savings and also provide loans. The recovery performance of Sarvodaya has been exceptional with recoveries at a very high level and non-performing assets at less than 0.01 per cent. The SNFL borrows from all leading banks to meet its fund requirement and its cost of funds is possibly the lowest in the sector. The strong financials and its commitment to being a socially relevant financial institution have ensured that it is able to negotiate the lowest rates from the lending banks. The unique features of SNFL are many. The first is that of capacity-building support services. The company sanctions grant for building capacity of the mutual benefit trusts in the form of computer systems with software, a computerised management information system (MIS), accounting, training of field staff as also the members of SHGs. The Sarvodya Mutual Benefit Trust (SMBT) staff is trained in appraisal loan applications and preparation of business plans. Further, training in accounts and audit to chief executive officers and accounts of trusts are also regularly provided. The office bearers of SHGs receive training on running the group and making them stronger. The livelihood promotion initiative of the company supports women SHGs by financing their different income-generating activities. Presently, SNFL focuses more on dairy, an activity that is remunerative and suited to women's daily routine of work. In terms of non-financial support services, the mutual benefit trusts steadily increase their relevance to the local community. The SHG members are provided skills in their livelihood activities, besides being helped to take up new activities with handholding support of the MBTs. Sarvodaya Learning Centres or evening schools in the existing schools have been set up for the benefit of the children of local community. Health camps and eye camps are regularly arranged. Market yards are being established to enable people market their produce.

An important aspect of the work is the community marriages that are being organised by the mutual benefit trusts. One of the biggest challenges for rural poor families is the marriage of the girl child. The marriage expenses runs to thousands of rupees regardless of the status of the bride or the groom or the location in which the marriages are to be held. The demand for dowry from the girl and her parents is an abhorrent and continuing practice that plunge families into debt. The typical rural women in Indian situation do not get married on their own nor culturally is it an acceptable practice. Against this background, the members of SHGs started addressing the issue in a serious manner and with the help of SNFL and SMBTs, came up with the idea of community marriages. Discussion within groups and other levels highlighted the need for a platform in which these marriages would be conducted with low cost and with the respect of the community. The idea of mass marriages being celebrated by the community came to be adopted by SNFL groups. Each year, 40 to 50 girls of marriageable age are identified from different religions and castes and a search for suitable grooms is carried out. A rigorous process is employed in which the SHGs form themselves into different committees for identifying and matching of the prospective brides and grooms. After checking the antecedents and the financial and social behaviour, the SHGs reach a level of satisfaction where they deem a match to be appropriate. A common date is chosen for solemnizing all the weddings in the area. As it is a multi-religious wedding, the different traditions and culture are taken care of by bringing in different religious priests to solemnize the marriages. Leaders from different walks of life attend the mass marriages and bless the couples. The entire expenditure for these marriages is met by the local contribution. Most of the contributions come from the SHGs themselves. In 2006–07 more than 800 such marriages were performed. A total expenditure of Rs 7.6 million-was incurred and was met out by contributions from the SHGs and also

(*continued*)

by others. In the normal course, these 800 marriages if arranged individually, would have the costed the families between Rs 40 and 100 million and rendered them financially insecure. More than 10,000 women participated in the marriage celebrations. Apart from avoiding any financial burden to the parents, the couples get a set of household utensils, the brides are enrolled as SHGs members and they become eligible for loan from mutual benefit trust for starting a microenterprise. This idea of mass marriages that has been implemented in, is a very significant, socially relevant example of battling the tyranny of socio-cultural customs. The most important change that SNFL has brought about is the change in mindsets; it made the communities to think of getting married in such mass events as a matter of pride. This was not so; as earlier, mass marriages were viewed in disdain.

In the field of education, the evening schools have contributed to a much higher proportion of children, passing with a greater percentage of marks in different public examinations. The pass percentage in two schools improved to 91 and 86 from less than 50, achieved in the earlier years. The evening schools also impart social values and sense of ethics to children. Some of the local schools have recognised this contribution of SNFL functionaries in public functions. SNFL and its affiliates are now gearing up to address issues of quality of life. The themes that they would focus on are education for the next generation, health and risk mitigation.

In a very true sense, SNFL is unique; it looks far ahead of a commercial agenda. MIX market has ranked SNFL at No. 7 of the list of top 100 MFIs in its database. But purely on social performance, it deserves to be much higher.

SOCIAL PERFORMANCE MEASUREMENT

MFIs who are on the job of managing their social performance commission internal assessments or external ratings. The social performance assessments are made through rating instruments and tools that look into the existing client profile, the current processes and products. They do not adequately examine the context in which the MFI is operating. These ratings and assessments may fail to throw out the real issues in social performance on account of the insular nature of enquiry. In short, social performance measurements need to improve. The best tools that could help the MFIs in measuring social performance are a sound demand assessment based on a market survey of their target clients and design of products to meet these demands with clients' participation. Such processes are time-consuming and expensive but should be seen as investments in building a long-lasting relationship between the institution and the clients. Social performance is not much more than being aware of a type of clients, their livelihoods and what serves them best. It is not much more than ensuring client comfort by providing the best possible service at the least feasible cost.

CLIENT PROTECTION

With increasing clientele and geographical expansion the MFIs are not in a position to deal with client expectations. Deficiency in service is not unique to microfinance, but the absence of systems for handling customer complaints is a problem. Client grievances are handled in an *ad hoc* manner on account of lack of systems. MFIs should set up internal grievance redressal systems and procedures, and make it known to the clients. Client protection mechanisms also should be set up at the industry level. In banking and insurance, the concept of ombudsman has been introduced. In microfinance too, a robust and accessible protection mechanism is necessary. The microfinance bill might be able to deliver on this critical need.

GENDER INEQUITY?

One of the aspects of social performance is that of integrating gender concerns into microfinance operations. On account of the overwhelming of women clients in the microfinance sector, there is an assumption that 'gender' is not an issue. But there is a different view that gender concerns have not really been brought into play in the microfinance operations despite a large part of the clients in the sector being women. Uma Ramaswamy and Anuradha Prasad[14] observe '. . . what stands out poignantly is that the persistent drive for savings and credit . . . has diverted attention away from the more pressing issues of women's lives. The increasing emphasis on microfinance by policies, financial institutions and funding agencies has visibly shrunk the spaces of NGOs—to work deeply on issues relating to women's empowerment.' They add further 'In the name of providing services, MFIs have squarely transferred all transactions costs to the poor women. More importantly, the poorest are being charged the highest rate of interest more in fact than any

other class of borrowers. This is patently unjust especially considering that the poor are a low risk category with high loan recovery rates.'

There is greater awareness of the need for socially responsible behaviour in the sector. The political interest in the sector has ensured that responsibility to the society is not lost sight of. The pace of growth in the sector at times, diverts attention from the social agenda. But with an intense interest of industry watchers and researchers, social performance as a theme has come to stay. Networks such as Imp-Act consortium have taken the agenda forward and are refining assessment methods, strategies for internalisation and capacity-building of the sector to manage and exceed social expectations. If social performance is ensured then the *poor will be the first*.

NOTES

1. The Imp-Act Consortium was originally an action-research programme (2001–04) funded by the Ford Foundation, now has six partners: CARD Mutually Reinforcing Institutions (CARD), EDA Rural Systems (EDA), Freedom from Hunger (FFH), the Institute for Development, Evaluation, Assistance and Solutions (IDEAS), the microfinance centre for Central and Eastern Europe and the New Independent States (MFC), and the Microfinance Council of the Philippines (MCPI).
2. EDA Rural Systems is a technical services organisation that provides consulting services. The author gratefully acknowledges the inputs provided by Mrs Frances Sinha, CEO, on the theme of social performance.
3. This code of conduct was a response to the Andhra crisis, where the state acted against the MFIs for allegedly, exploitative practices. Sa-Dhan after dealing with the crisis brought in the code of conduct for adoption by members.
4. Maturing Microfinance, emerging challenges—Sa-Dhan 2007.
5. The client-targeting of Cashpor and Bandhan have been found effective in acquiring clients who are poor.
6. The highest proportion of non-poor was 88 per cent in one of the MFIs.
7. Savings accounts was intended for people of limited means, with no minimum balance requirements. The banking system added more than 4 million such accounts during the year 2007–07.
8. Founder and MD of BASIX, in an interview to Microfinance Insights, June 2007.
9. Sa-Dhan's benchmark is 25 per cent on this ratio.
10. Based on discussions with Mr Ramanathan, CGM, NABARD and others.
11. Based on the inputs provided by Mr Elangovan, GM, IOB.
12. Maturing Microfinance, Emerging Challenges 2007, Sa-Dhan.
13. Prime Securities Group invited qualified people from different walks of life to register on its directors database hosted on its Website. This database was useful to companies to meet their requirements of independent directors, mandated by the listing agreements with the stock exchanges. This database continues to exist and could be used by companies for selecting suitable board members.
14. Integrating social justice dimensions of women's empowerment in microfinance—Uma Ramaswami and Anuradha Prasad, 2007.

Competition—does the client benefit?

7

Chapter

THE ENVIRONMENT

Competition pervades the entire sector in both the SHG–bank linkage program (SBLP) and microfinance institution (MFI) segment in the better-developed and, relatively, less-developed geographies. The competition is in respect of market share, clients, funding and also for staff. In some cases, competition is to prove to the others that 'We are the best.' The free market conditions in the booming microfinance sector provide the ideal backdrop for intense competition among the different players in the market.

In the SBLP, competition takes place among non governmental organisations (NGOs) and also among banks. NGOs compete within the same area to mobilise people in the groups and to have a larger number of groups mobilised so that they become significant players in the eyes of donors, funders and lending banks. When the service area concept was in place, competition between banks for financing in the different villages was avoided. However, with the virtual removal of the service area approach to rural lending, bank branches exhibit highly competitive behaviour for financing self-help groups (SHGs). The earliest signs of competition in SHG linkage came when SBI approached the NGOs regardless of their area of operation, to link their SHGs with state bank branches by offering an incentive of Rs 500, per group linked. Subsequently, other banks such as Canara Bank and Bank of India also started providing this kind of incentive, and the incentive amounts have gone to a higher level. The competition for acquiring client has come to stay in the SBLP. But this is limited to certain states and groups formed by well-run NGOs. In some states as stated earlier, thousands of SHGs formed under the state governments' behest languish, for want of linkage.

COMPETITION FROM GOVERNMENT PROGRAMMES

In some states, the government programmes offering subsidies and larger loans wean established SHGs away from their promoters. Groups are encouraged to split and reform to avail the government-offered benefits. The average size of SHGs has been on the decline over the last few years on account of competitive pressures, where showing a large number of groups (rather than clients) is seen as better performance. In Andhra Pradesh, on account of competition from the state-sponsored federations, there is a continuing pressure on federations sponsored by NGOs to keep their constituent SHGs within their fold. This leads to SHGs being denied free access to external services except through the federation, which increases costs and impairs timely availability of services.

COMPETITION AMONG MFIs

In the case of MFI sector, there are multiple levels at which competition has become a part of business environment. While competition is severe between the MFIs, there is also competition between MFIs and NGOs. MFIs and banks compete for clients in the same market especially in the more-developed geographies. In the southern states, the competition has several players and takes several forms. Basically there are two areas in which competitive behaviour

is witnessed. The first is that of client acquisition and the second is that of staff. There is competition among banks for financing Tier I MFIs. Banks also face a kind of competition with equity funders and bulk fund providers from the non-banking sector. The implications of competition in these aspects would be discussed later.

Graham Wright,[1] based on a study of the microfinance markets in Bangladesh, Bolivia and Uganda has pointed to the need for MFIs to shift their thinking in competitive situations, even as they emerge from the pre-competitive stage. MFIs have to (1) aim for market share gains, (2) add an external focus that scans the environment, (3) design coping strategies for the possibility of adverse effects on portfolio and (4) invest in market and client demand assessments, when they enter a competitive phase.

In the competition for clients and staff what are the forms that competitive behaviour takes is an interesting study. In the case of competition for clients, typically the institutions try and woo existing clients over or acquire new clients, to improve upon the client acquisition rate. MFIs very often offer an improved product that would entail:

- higher loan amounts
- a longer repayment period
- the lower rate of interest
- shorter time taken to process the loan application and
- shorter waiting period for a client to take a loan after enrolment
- possibility of multiple loans and also add-ons such as insurance cover for risks such as accidents and so forth.

Competition for client acquisition occurs mostly from a new institution entering the space occupied by another institution. This results in competitive offers to clients from existing institutions and the new one. As long as this competition results in improved product design, better customer service and lower costs, competition would be functional. But there are certain adverse impacts that take place leading to wastage of time and resources of the MFIs.

Staff-related competition also impacts the MFIs. When a new institution enters the market or expands in a particular location, the staff of other MFIs in the area becomes a target. Higher salaries and better incentives are offered to staff apart from a better designation and higher level positions. Career prospects are improved and a place of choice for the selected staff is also offered. Better training and the overall improved growth path are often shown to the staff to help them shift loyalties. Such movement of staff is normally not a simple change from one MFI to another. The staff also takes away their knowledge of the internal working of the MFI and at times even the client base. The familiarity with local clients is likely to be made full use of for shifting the client's loyalties.

NEGATIVE FALLOUTS

The negative fallouts that follow from the competition are manifold. Multiple borrowings are rendered possible when many institutions compete for clients in the same area. Andhra Pradesh, Tamil Nadu and Karnataka with mature microfinance markets have a number of multiple borrowers. Estimates made to study this phenomenon put the present stage of multiple borrowers in given localities as anything from 10 to 20 per cent. The multiple borrowers try and keep up a cycle of repayment by borrowing from one to repay the other.[2] Fraudulent transactions are on the rise[3] as in the heat of competition the rigour of financial discipline and the verification of the clients are relaxed. High costs of marketing usually accompany competition as the client attrition levels start climbing. The falling client loyalty rates impact MFIs more as client acquisition is the most-expensive phase of the interaction between an MFI and its borrowers. The likelihood of default also increases as competition takes energy of the staff away from monitoring and tracking of the clients and their performance through negating the competition strategies of other MFIs.

In the case of staff, competition pushes up the cost of human resources for the MFIs, increases the attrition rate of staff. For example, in the case of SKS Microfinance Pvt. Ltd., field staff attrition level is as high as 25 to 30 per cent while at the supervisory level the attrition rate is around 15 per cent.[4] Higher redundancy in staff has to be dealt with and repeated recruitments to maintain the operations become necessary. Appropriate positioning and placement of staff becomes very difficult in a competitive situation where fluidity of staff is high. On account of the fluidity of staff, frauds and operational risks increase.

In the case of competition among banks and funders, the standards relating to the financial discipline get lowered.[5] The client MIFs bid up the loan sizes and bid down the financial discipline and terms and conditions. In the case of MFIs that face competitive lending from different banks, there are some which have accounts with as many as 15 banks with 4 to 5 loan sanctions always remaining unutilised. These unutilised sanction letters are used to secure better terms from other banks and also for lowering of the financial discipline standards imposed on them.

The lack of exchange of information which comes to prevail in the sector as the banks feel the heat of competition also leads to decision-making under conditions of uncertainty. The adversarial positions adopted by different banks trying to finance the same set of MFIs lead to significant problems as MFIs take advantage of the relative lack of cohesion among lenders and funders.

The overall situation relating to competition in the sector can be summarised by looking at three dimensions. The first is that of improved client comfort, the second of improved efficiency and productivity in the MFIs and the third is that of increased sharing of information resources across the financiers. When interest rate declines and product design features improve, the client comfort increases dramatically. If competition leads the MFIs to improve upon the product, offer better features to clients and reduce rate of interest, then the market has performed its most dynamic function. The client becomes the king and the financial institutions become service providers, who earnestly try to satisfy the customer.[6] However, the flip side of this is, too much competition could pamper the customer and result in higher cost for the MFIs as also the risks that accompany multiple loans and the lower standards. Eventually, the higher costs would impact the clients.

The competition also makes MFIs look for ways and means of lowering the cost of client acquisition as also processing of the loan and other transactions in an efficient manner. The improved productivity and introduction of technology to make possible a cost-competitive operation will stand the MFI in a good stead as they expand in other locations as also improve upon their outreach. The depth they achieve by diversifying product range and offering better terms to the client would ensure that the revenue per client and revenue per staff improve making the MFIs more profitable. As regards the competitive situation in financing of MFIs, the banks are already trying to form informal platforms of lenders[7] in which information could be shared that is critical for orderly development of the sector. These informal platforms could ensure that the lenders act in a coordinated manner and reduce information asymmetry. But the customers have everything to look forward to in the competitive conditions that are seen in several locations. But clients in remote locations will have to wait for the mature markets to be saturated before they start reaping the benefits of competition.

The consequences of the competition[8] are that clients would be more demanding and would apply their freedom to choose MFIs according to their personal comfort. More of individual loans are bound to result at the cost of group-based loans.[9] The Ugandan experience showed that groups broke up and MFIs had to introduce individual lending methodologies. MFIs would search for larger loan opportunities and at that stage more enterprise loans are likely. The impact on interest rates would be salutary with borrowers making choices in favour of lower-priced and better-featured loans. International experience shows that competition helps the markets, institutions and clients to mature faster. How to determine unfair competition and deal with the same are questions that are occupying the sector in the mature markets. Industry-level efforts are needed and a voluntary code of competition behaviour is necessary. Sa-Dhan which successfully brought in the code of conduct relating to clients should develop a competition code as well for adoption among members.

The competitive pressures faced by the sector are just the beginning. In a virgin market, business growth has not so far been a major issue. The market, not being too familiar, mostly did not get attention from large players. With a better appreciation of the size and potential of the market available today, larger players are taking a serious look. Futures group, Reliance group and so forth, are on the learning mode and would enter the market with financial and technological muscle. They would directly compete with larger MFIs. The cell phone companies are likely to offer stiff competition to the detriment of medium and small

MFIs. The technology-led business correspodents (BCs) are likely to impact the MFIs on account of their ability to offer savings services. Even in the rural sector, if the potential of post office and cooperative credit societies is harnessed, we should see much greater competition in the times to come.

NOTES

1. CEO, MicroSave India.
2. A study by Karuna Krishnaswamy, CMR, IFMR (2007) has concluded that there is no negative relationship between multiple borrowing and repayment performance. Over a 3-year time frame of loan disbursal records, multiple borrowers had a lower-or equal arrears rate compared to their single-borrowing counterparts in the same villages or colonies. The study also found that all MFIs, except one operating in urban locations only, had equal or better repayment rates in more-competitive branch locations than in less-competitive ones. Competition and multiple borrowing in Indian Microfinance Sector, CMF working paper series, Sept 1007, by Karuna Krishnaswamy. Published by Centre for Microfinance, Institute for Financial Management and Research, Chennai. (Competition in microfinance, Doug Johnson, Karuna Krishnaswamy.)
3. A large number of frauds that take place do not get reported or analysed. MFIs do not have the time to pursue such cases and look at lasting solutions; hence they sack the staff involved and at times, the same staff are hired by another MFI in a higher position! Information-sharing on frauds and fraudsters has started in the Association of Karnataka Microfinance Institutions after such incidents increased.
4. As indicated by Mr M.R. Rao, COO of SKS microfinance.
5. The sub-prime lending in US market is attributed to the competition for business volumes among banks that reduced the quality thresholds in bank's investments and standards of appraisal.
6. Anecdotal evidence suggests that money lender's interest rates have declined in areas where SHGs and MFIs have become operational. Money lenders are also impacted by the competition.
7. Mr R.M. Malla, in his interview (at the end of Chapter III) has expressed the need for a formal forum of lenders.
8. This is based on *MicroSave's Focus Note 8*, by Graham Wright.
9. Already some MFIs that operate with group-based products (such as BWDA Finance Ltd., Grameen Koota, Bandhan) have introduced individual loan products.

Micro-Insurance—a long way to go

8
Chapter

THE VOID IN THE MARKET

The IIMS Dataworks Research Report on financial services demand and utilisation has surveyed low-income work groups in rural and urban areas, to understand the demand and supply characteristics of financial services, including insurance. As regards, preferred means of saving only 15 per cent of the low-income work group, expressed their desire to invest in life insurance-related instrument. While 86 per cent of the low-income work group sample was aware of the life insurance and related product, only 14 per cent actually used life insurance policies as the means of risk mitigation as also savings. The self-employed persons in the primary sector were interviewed on their retirement plans for financial security. Hardly 6 per cent of these self-employed workers were preparing for retirement and making fallback arrangement for old-age. Of urban low-income workers 19 per cent and of rural low-income workers 12 per cent use life insurance as a vehicle of savings. If the savings aspect of life insurance is delinked, then insurance ownership would perhaps decline to much lower level. One of the main reasons why the low-income workers do not have life insurance was that they perceived it to be unaffordable. Seventy-seven per cent of urban workers and 81 per cent of rural workers comprising an overwhelming 80 per cent of all workers felt that life insurance was not affordable. Of those who bought life insurance, the motivations were security of family for 31 per cent of the people, investment for future in case of 19 per cent, meeting medical and unforeseen emergency for 17 per cent people and old-age security for 10 per cent. While 19 per cent felt it to be inadequate, 58 per cent of those who had life insurance cover, felt the existing cover to be adequate.

The study carried out by National Council for Applied Economic Research (NCAER)[1] for Max Newyork Life was an enquiry into the financial behaviour of rural and urban populations and the market for life insurance. The study found that people expressed financial optimism about the future, but without a sufficient basis. There was high awareness of life insurance but ownership was very low. While 78 per cent of surveyed sample of 3,15,000 were aware of life insurance, only 24 per cent had actually taken insurance. Most insurance holders were male (86 per cent of life insurance holders). The inference was that insurance is a function of education and affluence and mostly, an urban phenomenon. The market potential is huge, given the high levels of awareness (Fig. 8.1).

The insurance penetration and density ratios[2] are used to measure the width and depth of the market. The Indian market is thin and shallow when compared to more mature markets. While penetration is better in the Asian context, the density is not comparable even with countries having a lower penetration. Risk and vulnerability reduction have been the core issues in dealing with the poor. Even minor disruptions to their livelihoods in the form of loss of life, loss of limbs, loss of income-generating assets and unforeseen large expenses relating to recurring and non-recurring events impose a heavy burden on the poor (Fig. 8.2). The risks that are posed by even minor disruptions are fairly large; as in the context of their asset and income levels, the

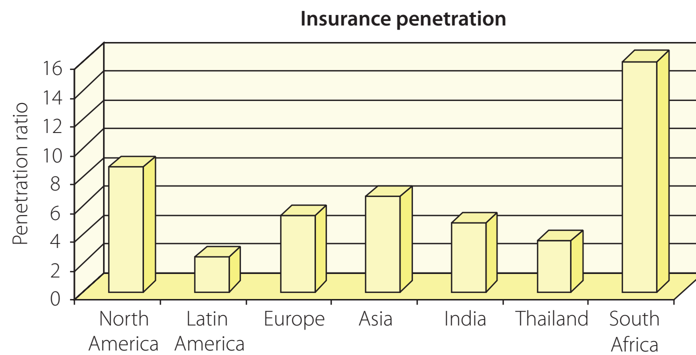


Figure 8.1 Insurance penetration—global comparison.

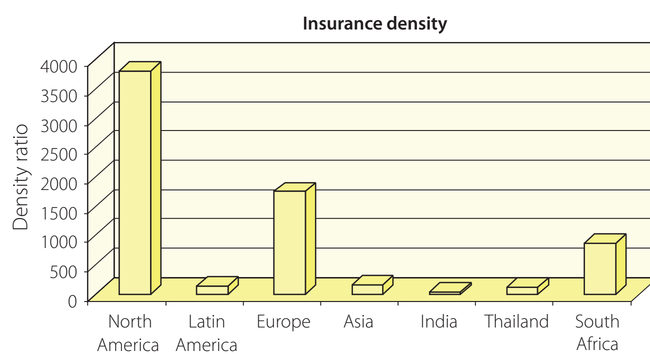


Figure 8.2 Insurance density—global comparison.

financial implications are pretty tough. Microfinance has so far been able to deal with the uneven liquidity flow through provision of savings and credit products to the clients. This smoothening of liquidity also, at times, supports finance for livelihood activity. However, this rarely goes beyond smoothening consumption and providing some kind of working capital for livelihood enterprises. The risks that are faced both by the individuals and their businesses are rarely covered. Mitigation and management of risks of ill-health and ensuring old-age security are the larger issues that impact the lives of poor, much more. The requirements of externally driven mitigation arrangements arise from the precarious nature of livelihoods of poor and the lack of capacity to absorb risks.

NATURE OF DEMAND FOR MICRO-INSURANCE

The insurance requirements of vulnerable sections of population have been studied in some detail and plenty of literature thereon is available. It is fairly well-known that the risk mitigation requirements are fairly small but spread over a very large number of people in the Indian context. The clients may or may not be fully aware of their risk situations. Introducing the risk mitigation products among such clients is a challenge in marketing. Convincing people initially to pay from their scarce financial resources to risk-proofing, an event that may or may not take place is a very difficult task. The rural poor look to a greater 'value for money' proposition, even in purchasing insurance cover. This means that the premium paid for buying insurance is seen more as an investment with a return expectation, rather than a price paid for ensuring that a risk does not greatly impair their financial and physical capacities. This introduces challenges in product design and pushes the insurer to bundle more than risk cover (such as savings, annuities and so forth) in their product. The moment an element of return on premium is introduced in the product, it becomes complex, thereby increasing the premium and rendering it expensive for the low-income vulnerable people (Table 8.1).

The expectations of the rural population from a risk mitigation product are that the premium should be small and affordable, the means of collection of premium should be friendly and distributed over a period according to their period of cash flow, which tends to be lumpy. The product should produce periodic returns so as to encourage the client to continue to renew the policies. Facile access to the product, both in terms of buying the policy as well as making claims, easier settlement procedures and availability of locally credible persons to explain and convince the advantages of such products are necessary conditions that would encourage people to insure their risks.

In India, the social security-based insurance policies have had a reasonably long run. The Life Insurance Corporation (LIC) has been in the market with insurance policies that address the low-income groups, with partly subsidised premium. However, despite a long run, not many policies had been underwritten even in this segment with the best of efforts of the LIC. In recent years, the ground situation has changed positively for insurers. Competition and emergence of a clutch of insurance companies have resulted in reaching of greater information to people, thereby creating a climate for selling policies.

Table 8.1 Insurance complexity and cost

Complexity increase cost		
Type of insurance	**Protection provided**	**Complexity of product**
Crop insurance	Poor crop yields due to specified causes Natural disaster recovery	Highly complex
Health	Medical costs for illnesses and injuries	
Annuities, endowment and whole life	Savings accumulation, retirement Premature death	Complex
Property	Damage, destruction and theft of household assets	
Term life	Loan principal and interest paid	
	Benefit paid to beneficiaries	Moderate
	Burial costs	
Disability (for loans)	On-going loan payments if borrower becomes seriously disabled	
Credit life	Loan principal interest paid on death of borrower	Simple

Source: Preliminary Donor Guidelines for Micro-Insurance, CGAP working group on microfinance, 2003. (www.microfinancegateway.com)

REGULATION

The insurance regulation and development authority that was set up came out with a framework, for focusing on the clients in the vulnerable categories, by stipulating rural and social sector obligations. The rural and social sector policies are close to the micro-insurance products in terms of focus and design. The Insurance Regulatory and Development Authority (IRDA) norms require that any company that is in the business of insurance and licensed by IRDA has to make a minimum business in rural and social sectors.

For the insurance companies that were in operation when IRDA came into being (i.e., LIC and the General Insurance Corporation Group of companies), the minimum levels of business to be achieved in rural and social sector are higher. Life insurers had issued 4.34 million policies in the rural sector and 5.48 million policies in the social sector.

IRDA notified the micro-insurance regulations in 2005 to facilitate the insurance companies to sharpen their focus on poor and vulnerable people. Micro-insurance is defined in terms of size of cover in Schedule 1 to the notification of IRDA, dated 10 November 2005 (Table 8.2).

The regulations permit offer combined products from life and non-life streams as long as the relevant insurance companies are acting in collaboration to offer such products. During 2006–07, the first full year after micro-insurance regulations were notified, 6 life insurance companies filed 12 microlife insurance products. Four non-life insurers filed eight products. Micro-insurance agents numbering 1,311 were recruited and trained. 1,18,000 policies were written with a premium income of Rs 23.1 million. Although it is a small beginning, the signs are encouraging. The committee on insurance distribution channels had made certain recommendations to encourage micro-insurance coverage. It has suggested that apart from self-help groups (SHGs), non governmental organisations (NGOs) and microfinance institutions

Rural sector	**Norms**
Life insurers	18 per cent policies underwritten by 7th year
	20 per cent of policies underwritten by 10th year onwards
Non-life insurers	5 per cent of premium by 7th year
	6 per cent of premium by 8th year
	7 per cent of premium from 9th year onwards
Social sector	**Norms**
All insurers	25,000 policies in 7th year
	35,000 policies in 8th year
	45,000 policies in 9th year
	55,000 policies in 10th year

Table 8.2 Micro-Insurance products

Item	Type of cover	Min. amount of cover	Max. amount of cover	Min. term of cover	Max. term of cover	Min. age at entry	Max. age at entry
1	Dwelling & contents, or livestock or tools or implements or other named assets/or crop insurance against all perils	Rs 5,000/asset/cover	Rs 30,000/asset/cover	1 year	1 year	NA	NA
2	Health insurance contract (India)	Rs 5,000	Rs 30,000	1 year	1 year	Insurers' discretion	
3	Health insurance contract (family) (option to avail limit for individual/float on family)	Rs 10,000	Rs 30,000	1 year	1 year	Insurers' discretion	
4	Personal accident (per life/earning member of family)	Rs 10,000	Rs 50,000	1 year	1 year	5	70

Note: The minimum number of members comprising a group shall be at least 20 for group insurance.

(MFIs), Urban Cooperative Banks and Regional Rural Banks should be permitted to distribute micro-insurance products. It has also suggested a minimum commission of Rs 100 per policy, so that agents find small-value policies remunerative.

The IRDA norms provide both legal and policy framework for the rural areas to benefit from formal insurance initiatives. As per the International Labour Organisation (ILO) report prepared in 2004, 80 listed insurance products addressed the needs of social and rural sector. Of these, 45 covered only a single risk. The other products covered a package of risks with 20 per cent covering two and 80 per cent covering three risks. The majority of products cover life- and accident-related risks. As of 1 July 2008, 18 different micro-insurance products have been approved by IRDA in the life insurance sphere. The non-life area of micro-insurance has not been found very attractive by the insurance companies. The lack of information on the extent of risk and the kind of cover that would be effectively needed by the rural population has been seen as constraints by the insurance companies. Barring health insurance, the other aspects of non-life insurance have not had a smooth landing. In health insurance, as per information compiled by ILO, in 2005, there were 54 NGOs/MFIs and others working with communities and covered more 5 million clients. The problems faced in health insurance have been adverse selection, misuse of hospitalisation facility and collusive fraudulent behaviour in some areas. PREM in Orissa has overcome the problem of adverse selection by making the enrolment of all families in a village compulsory, before admitting the members to the scheme benefits. But a solution to problem of dropouts is yet to emerge. The claim incidence increased exponentially in some areas (Yesahswini[3] experienced an increase of 18 times in 1 year and Self-Employed Women's Association (SEWA) experienced a 100 per cent increase) and claim payouts also ballooned. Dropouts made it even more difficult for the schemes to become viable (Yeshaswini in Karnataka faced a dropout of one-third of its clients—from 2.1 million to 1.4 million in 1 year). While more vulnerable poor understand the need for cover and enroll themselves, continued coverage is seen as an option rather than a necessity.

The problem of dropouts is a reflection of dissatisfaction with product design and comfort with the processes. The challenge is in design of products with an affordable premium but with an effective cover that would attract the poor. Insurers should invest in market surveys and try to understand client preferences in choosing and sustaining insurance policies. Max Newyork Life had commissioned a study through NCAER to understand the savings and insurance behaviour of clients. This was followed up by the senior management of the company visiting the rural areas to gain first-hand information

on what kind of needs of people need to be taken into account in designing a life insurance product.

In the case of asset insurance—especially relating to income-generating assets, the insurance companies have been raising the issues of adverse selection and moral hazard during both underwriting and claim settlement stages. The potential clients have significant difficulties in terms of resistance from the insurance companies when it came to settlement of claims. In the case of cattle insurance, many of the insured clients have had to face denial of their claims on account of various reasons leading to loss of trust in the insurer and credibility in the insurance products ability to cover the risks.

INTEGRATED INSURANCE FOR THE MICROCLIENTS

SEWA insurance under the name VimoSEWA[4] has a gender-sensitive approach to covering risks of its women members. The unique feature of its scheme is the integrated nature of the cover offered. VimoSEWA provides coverage for the death of an insured woman and her husband, hospitalisation and asset loss. Life policies cover both natural death and accidents. Health cover is optionally available to the husband and children of the insured woman. SEWA undertakes preventive and promotional activities to promote health consciousness among the member households. Asset loss cover reimburses losses on account of natural calamities such as floods, fire, earth quake and man-made disasters, such as violence.

Members are encouraged to open fixed deposits with interest income, sufficient to cover the premium. They also have the option of paying the premium annually. SEWA has different insurance companies as partners (LIC, New India Assurance, ICICI Lombard and AVIVA). The insurance cover extends to more than 1,40,000 members of SEWA. The schemes were not popular in the initial years. Renewal rates were as low as 15 per cent in 2002 but increased to 42 per cent in 2005. Renewal rates were higher in rural areas than urban areas. The major reasons identified by VimoSEWA for dropout were:

- Lack of regular contact with the member/field worker.
- Lack of systematic follow-up by the field worker.
- Lack of understanding of reasons for rejection of claims.
- Dissatisfaction with the quality of service/product.

Design of insurance products with the client as focus

Max Newyork Life and ACCESS Development Services have joined hands in designing a savings-cum-life insurance product (named Max Vijay) to be distributed through the ACCESS microFinance Alliance (AMFA) network partners. With an initial payment of Rs 999, the policy can be purchased with a cover of Rs 50,000. The client can save small amounts on this policy account (as low as Rs 10 per day and as high as Rs 2,500) through the MFI or its network of partners. Local retail merchants would be provided with point-of-sale (POS) terminals, which could accept savings and provide receipts. Savings is rendered easily and does not require the client to visit a bank branch. While shopping with the grocer or input supplier, who also has the POS terminal, the client could deposit savings into the account. The policy has ten-year validity and does not lapse. The policy is sold over the counter and no underwriting is involved. On the savings made by the clients, Max envisages a return of 6 to 10 per cent. The policy is available in two higher ranges of Rs 1,500 and Rs 2,500, with higher covers of Rs 75,000 and Rs 1,00,000. ACCESS would provide dedicated staff in the five states, where this policy would be distributed through AMFA; staff members of each partner MFI would be trained and, exclusively used for distributing the product. The partner MFIs would receive a commission on the policies sold. More than half a million policies have been targeted over the next three years. The design of the product combines the need of rural microclients for savings and risk mitigation. It provides the flexibility to the insured on when and how much they would save under the policy. It does not a require payment of a fixed amount premium at periodic intervals.

A significant achievement has been that of persuading the insurance companies to allow VimoSEWA to process claims in house, without referring the claims to concerned insurance companies, which would delay settlement.

With all the positives, the scheme is not viable. The deficit is funded by donors such as Deutsche Gesellschaft für Technische Zusammenarbeit

(GTZ). The administrative costs must decline and the membership should increase to achieve viability. Equity issues have also come to surface with only 40 per cent of members of the scheme being poor. These are being addressed by SEWA.

CROP INSURANCE

Crop insurance does not squarely fall into the micro-insurance category. But it is a part of farmer's risk framework with a potential to reduce vulnerability, arising from unpredictable weather conditions. From the late eighties, the country has experimented with insuring crops from the adverse impact of weather and other natural calamities. Crop insurance introduced on a pilot stage had matured into a pan India insurance product. The National Agricultural Insurance Scheme in its present form provides cover for a variety of crops notified for each local area by the respective state governments. The scheme is compulsory in nature for all loanee farmers and optional for those who have not taken loans. Banks are expected to collect premium for the notified crops in their area of operation and pass on the premium to the Agricultural Insurance Company of India. Crop-cutting experiments are carried out in each block as per standard procedure. Based on the assessed yield levels, the liability to pay a claim is finalised. Based on the assessed crop damage, the claim payout, if any, is announced and payments are made to the bank account of farmer through which the premium was paid. While the scheme appears to work efficiently with a significant ease of access and settlement, there are plenty of deficiencies that would afflict both the insurer and the insured. As far as the insurer is concerned, the premium is collected for the notified crop whether or not the loanee wants such cover. Second, for the individualised damage in a single farm or in a group of farms in a local area, there is no way of establishing crop damage. As the unit for crop damage assessment is a block which spans over a few hundred villages, and very few crop-cutting experiments being taken up within that (a minimum of 16), it is difficult to assess damage and compensate for localised losses, which might have very well occurred on account of natural calamity. It is well known that rainfall precipitation is highly localised and within a short distance there could be considerable variability. Pest attacks similarly could be concentrated in a small geography, leaving a wider area as big as a block, virtually untouched. The failure of the scheme to settle localised claims arising from natural calamities, which is supposed to be mitigated by it, leads to loss of credibility among the farming community. However, there are states such as Rajasthan and Gujarat where the crop insurance scheme has performed exceedingly well. In the case of Gujarat, the insured are very knowledgeable and aware of the nature of product, and they are able to take the best advantage of the scheme. In the case of Rajasthan, the perennial deficiency in water and rainfall lead to claim payment in most years. The crop insurance had been a boom to farmers who otherwise, lead a marginal existence in the state. In Rajasthan, too, the western Rajasthan districts in the arid and semi-arid conditions have benefited most, from the crop insurance schemes.

Rainfall insurance and weather insurance have been piloted in many parts of the country. Agricultural Insurance Company of India (AICI) has now mainstreamed the rainfall insurance scheme after its

Rainfall insurance for orange growers

ICICI Lombard and Government of Rajasthan have launched a scheme for insuring orange growers from the risks of rainfall. The scheme covers three perils: (1) Adequacy of rainfall over three consecutive days for initiation of orange flowering, (2) Regularity of rainfall during the post-flowering stage and (3) Occurrence of consecutive dry days during initiation of flowering. The norms for extent of rainfall and number of days are set out clearly. Data on rainfall and its extent are provided by credible third parties. Farmers have the option to cover one or more perils. The premium for all perils per acre is Rs 990. Government of Rajasthan provides a subsidy to farmers taking insurance cover. The total sum assured with the three perils put together is Rs 15,000.

The scheme has been designed taking into account the key risks that affect the productivity of orange and the cover is customised to suit orange grower's requirements. The scheme is popular among orange growers in and around Jhalawar, Rajasthan.

initial pilots in Karnataka. ICICI Lombard had designed a special scheme called rainfall insurance scheme for orange growers in Rajasthan, in collaboration with the state government.

ASSET INSURANCE

In the case of the small and the vulnerable, asset insurance normally refers to insuring the income-generating assets, such as farm machinery, pump sets, cattle, poultry birds and the like. Insurance of plantation crops and fruit crops are also demanded. However, the institutional response to this demand has been perfunctory and not positive. In a large number of such cases, the cover is limited to cost of cultivation rather than the expected yield. Cattle insurance is one of the biggest markets in rural India that offers a large potential for insurers. Depending on the region and location, cattle insurance also poses high risks to the insurer. From the side of the clients, getting an animal insured under policy, has been a major hassle. The efforts at identifying the animal, getting hold of an agent to underwrite the cattle's life and also to prove the death of the cattle at the time of making a claim, entail extraordinary cost and efforts. There are master policies issued by insurance company in efforts to reduce the cost of underwriting, and such policies are normally taken by banks, cooperative societies and also by the departments of state government. However, the claim settlement performance under master policies has not been uniformly good. While well-run cooperative societies that offer a veterinary health support have a positive experience in claim settlement, with best efforts in some states; the government departments have failed to ensure settlement of claim on the death of animals. The insurance companies have not been happy with the proof and certification offered for the the death of animals. Qualified veterinarians have not been available in adequate number, in many of the states, to certify the true causes of death of animals. The criteria and process of identification of insured animal's death have been weak and prone to manipulation. The tagging of ear is the most popular method of identifying an insured animal. There are several cases, where the ear had been cutoff; and the tag preserved and produced to the insurance company, whereas the animal itself might have been sold to another farmer. This kind of morally hazardous behaviour for claiming insurance payments have made the insurance companies wary of entering into underwriting contracts.

The AICI, apart from crop insurance and weather insurance products, has not introduced products relating to agricultural and allied sectors. Agricultural assets, cattle, plantations and farm machinery are some aspects of the farmer's life that need risk cover. The efforts of AICI seem confined to those products where the government support for underwriting losses is available.

The world bank study of National Agricultural Insurance Scheme (NAIS, February, 2007) found the basic structure of the scheme to be appropriate. However, it had certain suggestions for improvement in three critical aspects of the scheme—fixing of the premium rates, management of the scheme and crop damage assessment. Transitioning of the NAIS to an actuarial proposition for premium determination has been suggested in view of its benefit potential for the farmers. The study found that a sound risk-rating technique was critical for assessing the true cost of risk. The reason for the unsuccessful performance of crop insurance scheme world over, was on account of the complexity of the basic risk and lack of adequate risk-modelling technologies. Therefore, the study suggested that AICI should consider an experience-based approach for rating purposes.

The United Nations Development Programme (UNDP) had supported a study of micro-insurance,[5] which was carried out over 2006 and 2007. The report studied micro-insurance-related issues in the states of Rajasthan and Tamil Nadu and provides valuable information for operational-, strategic- and policy-level discussions. The six issues that arise from the report are:

- The specific reason for low demand for insurance despite intense need for the same among the microclients, is the lack of marketing effort.
- The challenges in product design have not been fully solved resulting in a mismatch between needs of the poor and the available products.
- Affordability of price and the availability of subsidy influence the market for insurance. The premium calculations based on secondary data, macroaggregates and exaggerated margins have led to high premium rates, and thereby encounter resistance of the insured.
- Distribution of insurance has been faced with difficulties and it was one of the most critical

reasons for lack of effective coverage. Rural markets carry high cost, and unless intensive effort is taken up with appropriate investment in marketing, it would be difficult to penetrate rural market.
- Unsound procedures inhibit the development of the micro-insurance sector.
- The perspectives of the insured and the insurer differ greatly leading to low level of customization of product and low demand for product on offer.

The differing stances from which micro-insurance has been approached by the suppliers and clients has led to very slow growth. One of the major observations that have been made in this regard has been the fact that micro-insurance is not a product; it is not a process, but a market segment. Understanding this market segment and customizing a product that could be sold to the clients therein, are of the essence. Failing this, Micro-insurance may not make much headway.

The Consultative Group to Assist the Poor's (CGAP) study of life insurance[6] of microfinance clients brought out some significant learning. Insuring women has a positive impact on the family. The mere act of insuring women's lives does not ensure their peace of mind. They need to have a say in the selection of the beneficiary of their insurance policy. Quite a few instances were observed where the claim payout on the death of wife was used to find a new bride by the widowed husband. The NGOs and the MFIs have to launch awareness campaign to ensure that the children of the women are chosen as the beneficiaries for such policies. Further, women can enjoy better security when the male member's life is ensured and the woman is named as the beneficiary. The study also found that the reasons for product efficiency were less-dependent on the delivery model than on the simplicity of the product itself. The partnership model can be made more efficient through better relationship management, but the products have to be simple and the MFI has to assume some responsibility for claims-processing. In the partnership model, the MFIs need to negotiate hard with the insurance companies to get good products and friendly processes at an affordable price for the clients. The insurance companies though mandated to fulfil the rural and social sector targets laid down by IRDA are still stop short of customizing products for small clients, unless they are persuaded to do so by active MFIs and NGOs.

Discussions with practitioners reveal that the practices in the market need to improve. There is less information made available to the insured as well as distributing MFI partners. The claim settlement norms are opaque. There are undesirable practices reported such as paying lump sum advances to MFIs towards commission. MFIs and NGOs require dedicated staff to handle the insurance business, as the product has certain complexities that are not part of general understanding of all the staff. Many MFIs and NGOs fail to invest in this competence, and treat insurance as another task that anyone could do.

Many new policies written do not get renewed. The reasons for client dropout are not fully investigated. New clients are enrolled to meet business targets. Such practices defeat the objective of providing effective risk cover to the poor but enable the insurer to fulfil the social and rural sector obligations.

MUTUAL INSURANCE SCHEMES

Mainline insurance companies through the agent–partnership models have been striving to deliver insurance products to both the rural and the social sector. Essentially, this model of delivery has not resulted in a very satisfactory arrangement as regards the kind of products that are needed by the clientele. Iddo Dror of micro-insurance Academy[7] opines that 'There are too many *poor* products; too little products for the poor'. Schemes of insurance that closely address the needs of very small and vulnerable client would logically be community-owned and community-managed. The mutual insurance schemes belong to this genre where a group of people manage their risks by pooling the same and paying a premium into the pool. In India, there are a few organisations that have facilitated their clients to enter into mutual insurance arrangements. These do not fall under the insurance regulation of the IRDA—as such schemes are specific and limited to a group of members, who insure their risks mutually without involving third parties in underwriting. Monitoring by community of all the poor members of the scheme improves the administration and curbs risky behaviour on part of the insured. People-based localised committees to set-

tle claims take very tough decisions on claims that would avoid moral hazards.

The cost of administration of mutual schemes is low compared to the partner-agent model. It is estimated[8] that of the premium paid to an insurer, 40 per cent is towards insurance costs and the remainder of the 60 per cent goes towards marketing, agent's commission and other expenses. The extra costs that are imposed just because a mainline insurance company is involved in designing and distributing the product may be considered unacceptable in several contexts. A mutual insurance scheme could offer reduced premium, make insurance affordable; and if necessary, could be implemented with reduced benefits—but cover all possible sections of the population. Some pilots in mutual insurance have been implemented and based on the experience upscaled into larger programmes by Dhan Foundation, SEWA, Uplift India and certain other MFIs/NGOs. 'Micro Insurance Academy (MIA), New Delhi, and the Cooperative Development Foundation (CDF), Hyderabad, are assisting 20 Women's Thrift Cooperatives (WTCs), incorporated under the Andhra Pradesh Mutually Aided Cooperative Society (MACS) Act, having a membership of around 5,000, in designing a self-funded and self-managed health insurance package, which will be grounded on 1 January 2009. This is a pilot project. Based on the lessons learnt from this pilot project, the cooperative-based microhealth insurance scheme will, hopefully, get expanded to 275 WTCs, having a membership of over 1,00,000. This health insurance will cover all members of a cooperative member. This health insurance product will be one of the several saving, credit and insurance products that a WTC is already offering to its members.'[9]

Sampoorna Suraksha: a hybrid micro-insurance programme

Sampoorna Suraksha, introduced by Shri Kshetra Dhamrmasthala Rural Development Project (*SKDRDP*) *is unique in that it covers not only hospital and other medical costs but also a full range of other risks, including maternity expenses, loss of earnings during convalescence, funeral expenses, losses arising from floods and other natural calamities, damage to housing and standing crops, and general accidents.*

The annual premium is Rs 190 for the first member of a family, and Rs 115 for every additional member of the same family. Out of this premium, 65 per cent is paid to the insurance company, and this company then reimburses the costs of treatment carried out by the members of a chain of hospitals. The payment provides a maximum family cover for medical costs of Rs 5,000 per person. This sum can be drawn on for any medical risk that is covered by the policy. A benevolent fund has been created from the remaining 35 per cent of the premium, which is administered by SKDRDP. From this fund Rs 5,000 is paid, within 24 hours, in case of the death of a family's main breadwinner; and in case of accidental death, this is increased to Rs 20,000. Generous payments are also made from the benevolent fund in the case of full or partial disability, and for maternity expenses. If the main breadwinner is ill and cannot work, a daily allowance of Rs 50 is paid up to thirty days, even if he or she is staying at home and does not have to be treated in hospital. If an insured family's home is damaged by a natural calamity, Rs 1,000 can be paid for repairs. All these payments are made from the benevolent fund. *Sampoorna Suraksha* is marketed as a mutual security and support fund (Table 8.3).

Table 8.3 Insurance coverage under _Sampoorna Suraksha_

Year	Families covered	Lives covered	Premium (million)	Claim settled (million)	Network hospitals
2004–05	54,000	1,86,000	15.40	35.40	76
2005–06	77,000	1,96,000	28.20	32.80	41
2006–07	1,46,000	4,00,000	57.43	66.24	48
2007–08	3,68,002	8,92,492	106.90	23.05	80

Note: Settlements from 1 April 2007 to 31 August 2007 are included.
Source: SKDRDP Annual Report, 2007.

Dhan Foundation runs mutual insurance schemes covering crops (through rainfall), health and life. The schemes are piggy back on their development interventions and cover most families that are part of their projects and institutions.

These schemes work under a principle that a basic insurance cover is agreed upon and the premium is collected from among the participants in the scheme. The premium is pooled into an insurance fund. Claim settlements take place to the extent of the funds available. The claims do not in any case, exceed the overall accumulation from contributions made into that fund. The claims are settled by a committee comprising the members of the community of those poor insured. As no external parties are involved, the scheme is not seen as a drain on the resources or as a transfer of wealth from the poor to the insurance companies.

However, one of the major problems in the mutual insurance scheme is their small size. The smallness of the size and also the localised area of operation render the arrangement highly risky. The occurrence of risks that are covariant across the entire local geography would tend to push claims beyond the capacity of the mutual schemes to absorb. Once claim payouts do not happen to the extent originally promised, the credibility of such schemes would be destroyed. This would not only spoil the current market for insurance but could also keep the people away in the future from any kind of risk mitigation mechanism. There is a need to either reinsure the risks by the mutuals or link with other similar mutual schemes across the country. Both these options are not easy ones. Reinsurance is not easily available within the country, and it could be expensive in the absence of data on the track record of the past performance of the scheme (the scheme being very nascent), and no historical record is available to establish an actuarial rate for fixing either insurance or reinsurance premium. As for linkage with other similar mutual insurance schemes across the country, a coordinating body might be required. An independent entity that is in a position to match the different schemes that are run across the country, and try and bring them together to pool information and also set apart some of the premium that is collected into a common fund. Then the risk of different geographies would be diversified, and the pooled risk would be a better risk and manageable one than the risk of local area from small populations. The mutual insurance arrangements are estimated to have a share of less than 5 per cent of the overall micro-insurance. At this level, it is not significant, and considerable development work is needed to diversify the risks and make it popular.

ROLE OF THE STATE

The governments at the centre and states have played a significant role in ensuring that the social objectives are met in risk mitigation arrangements through a range of interventions. Several insurance schemes that cover the poor and vulnerable are initiated by the governments utilising the public sector insurance companies. Currently, the life insurance cover is available on nominal terms with an educational scholarship for children of the family covered under the Janshree Bhima Yojana. The Aam Aadmi Bhima Jojana is to cover all credit linked self-help group (SHG) members, and the LIC has already announced a coverage of about 40 million families under this, scheme. The National Health Insurance Scheme union budget announced in the 2008 is a sequel to the earlier schemes—universal health insurance and unorganised sector health insurance. At a nominal premium of Rs 30, hospitalisation costs up to Rs 30,000 are covered per family, per year. The crop insurance scheme is funded by the Government of India. The government is making use of a social fund placed with LIC, to subsidise the premium payments on social sector policies and bring down the cost of policies for the poor. In a way, the government is creating a market in insurance for the insurers to exploit in the coming years. The state governments on their part subsidise the premium paid by the poor for participation in group insurance policies under different programmes. In terms of coverage of people under the social sector and micro-insurance products, more has been done by the governments than by the insurers' efforts. The dependence on governments for ramping up the numbers is unlikely to be a sound business strategy. If the market potential of insurance for the poor is to be realised, insurance companies have to invest much more in understanding the clients and marketing of suitable products.

The microclient is underserved by the insurance companies today. Product customization is very low and marketing of existing products that do not suit the poor is attempted by insurance companies. With size of policies being small, insurers do not view micro-insurance as a viable business segment. There are indications that insurers are moving towards group-based microproducts and outsourcing the non-critical tasks to MFIs/NGOs. A slew of newly designed products have been rolled out. With IRDA playing a more development-oriented role, the micro-insurance market is set to expand over the next few years.

NOTES

1. How India earns, spends and saves, by NCAER for Max Newyork life, 2008.
2. Source: IRDA Annual Report, 2006–07, Hyderabad.
3. Yeshasvini Health Insurance Scheme is managed by Yeshasvini Cooperative Farmer's Health Care Trust that is run by the state government and a third party administrator to provide cashless hospitalisation. The cover is available up to Rs 0.2 million.
4. Source: From strength to strength, SEWA insurance, by Shalini Sinha for ILO, SEWA and Plan International.
5. Building Security for the Poor, UNDP 2007.
6. Micro-insurance and microfinance institutions, Evidence from India, by James Roth and others 2005; CGAP.
7. A recent initiative to provide and manage knowledge in community-based approaches to risk mitigation, capacity-building and consulting. The organisation is based at New Delhi.
8. Estimate made by the micro-insurance Academy, New Delhi.
9. Mr Rama Reddy of Indian Cooperative Union, in his posting on the UN Solutions Exchange, provided this information.

Policy environment and regulation—high expectations!

9
Chapter

REGULATION

Regulation has been an intensely debated aspect of the microfinance sector's functioning. There have been extreme views on the current state of regulation and the proposed future framework. The microfinance bill that had been in the public domain for more than a year does not seem to reach a conclusive stage. After several announced deadlines, the bill seems to have entered a comatose phase. The divisions within the sector as to what needs regulation, which should regulate and how it shall be done, are, yet, unresolved. As there is no consensus emerging from the sector on the regulatory aspects, the standing committee and finance have not been able to reach a conclusion. The available information on the discussions indicates that an interest cap is being debated, which if introduced may not serve the sector well. Given the other developments that have taken precedence over the problems of the microfinance sector, it remains to be seen whether the bill will become a statute during the current year.

Although the debate on regulation seems determined to continue, the microfinance sector is not in a regulatory vacuum. Significant part of the clientele of microfinance is with institutions that are under direct or indirect regulation (Fig. 9.1).

The self-help groups (SHGs) linked to banks are, in Reserve Bank of India's (RBI) viewpoint, under the indirect regulation of RBI as the norms for engagement with SHGs as clients have been stipulated by RBI. Further, the banks are regulated by RBI under the Banking Regulation Act. As regards microfinance institutions (MFIs), of the reported clientele of 14.1 million, 9.56 million are subject to the direct supervision of RBI as non-banking financial companies (NBFCs) (both for-profit and non-profit). About 4.53 million clients served by trusts, societies and cooperatives are outside regulatory coverage. Even out of these, cooperatives such as Mutually Aided Cooperative Society (MACS), dealing exclusively with members, do not fall within any regulatory ambit. The regulatory effort in bringing a new bill thus, addresses a small number of clients. In fact the effort should be on unifying, improving and consolidating the present regulatory framework and apply it across all MFIs,[1] without any form-related distinctions on prudential norms.

The non-banking financial companies engaged in microfinance are regulated by the Reserve Bank of India (RBI). In the case of not-for-profit companies, there is more of benevolent oversight that exempts them from any kind of regulatory exercise, except that of filing information in the appropriate returns. In the case of other non-banking financial companies in microfinance, the RBI treats them on par with other NBFCs.[2] The sector norms relating to capital adequacy, prudential requirements, issues relating to governance, borrowing and lending norms, apply evenly on these NBFCs. Some of the problems arising from regulation that these NBFCs are facing have been raised in various platforms by the industry practitioners. One of these relates to the difficulties in accessing commercial borrowing

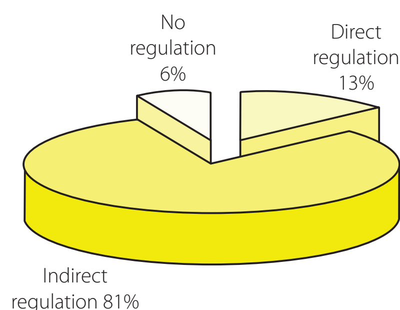


Figure 9.1 Regulatory coverage of MFI clients.

in foreign currency. The other relates to the high level of capital that has now been stipulated for NBFCs. The NBFCs that are systemically important are to achieve a level of capital of 12 per cent of risk-weighted assets by April 2009 and 15 per cent by April 2010.[3] Many in the sector feel that this is a very high level when compared to the limits set for the banking sector. According to them, when the risks are lower as demonstrated by the very high level of recovery by NBFCs in microfinance, stipulating a 15 per cent Capital to Risk Weighted Assets Ratio (CRAR) is almost a penal measure. NBFCs, especially the smaller ones, might find it difficult to raise these additional capital funds and, as a result, the business growth might suffer. The other possible development is that the increase in the cost of capital would raise the interest rates for the clients. Such a development might limit the growth of NBFC sector, thereby delaying the achievement of objectives of financial inclusion. The capital adequacy norm applies to those NBFCs that have an asset base of at least Rs 1 billion. But looking to the vigorous growth in the last two years, many NBFCs would reach this limit sooner than later and consequently, deal with the raising additional equity.

SAVINGS REGULATION

Restriction on savings imposed on the sector is a matter that hinders the NBFCs. Permission to NBFCs to mobilise deposit, under whatever conditions, would tend to bring down their cost of funds, and also improve their ability to service the clients in a much better and comprehensive manner. NBFCs have established the appropriate networks with investments in infrastructure and systems of maintaining continuing contact with the clients. But all this effort is restricted to carrying out only one line of the financial intermediation, that is, of credit. With marginal additional investments, they would be in a position to offer savings services. If they are permitted to carry out the other line of financial intermediation that is of mobilising savings, the network resources available through the medium of NBFCs would be optimally utilised and the overall economic cost involved in providing financial services to vulnerable sections of people could be significantly brought down. Regulation should take into account this economic aspect of the NBFC systems' capacities to serve vulnerable sections of people.

Protection of depositors' interests and ensuring safety of savings is the cornerstone of regulatory stance in the banking regulation. Even in the case of microfinance sector, this regulatory stance of protecting savers from systemic and institutional risk has been taken as an overarching consideration. One of the features of the microfinance sector is the preponderance of borrowers when compared to savers. In terms of funds utilised, there is almost a 1:4 ratio between savings and credit in the sector as a whole. This sector for want of financial resources is always a net user of resources from outside the client base. The systemically important numbers in microfinance are that of borrowers and not savers in terms of resources handled. Savers postpone current consumption and, for sacrificing the current use of resources, are rewarded with certain rate of interest; and for this sacrifice, they receive protection from the regulator. The small borrowers do not have any past resources; when they take a loan, they virtually mortgage their future to the lender. Vulnerable sections of people will be much more affected if credit availability is disrupted or credit terms are altered to their detriment. Unlike in the case of saver, small borrowers lose a part of their future if credit relationship is impaired. In such a context, protection from the regulator should possibly address the requirements of borrowers more than the savers. *The regulatory stance in respect of microfinance sector should be reformulated to encompass the interests of small borrowers* who have more to lose if the linkage with credit institution is disrupted. How best to protect the interest of small borrower is an aspect that needs to be studied. This protection should take a few important aspects into consideration, such as interest rate, continued availability

of credit, quality of service, loan terms and also enforcement of security. From a regulator's perspective,[4] having numerous small institutions mobilising savings is not desirable. Deposit-taking entities should be strong, have sound systems and capacity to bring in regulatory capital. Supervision and regulation costs in case of small deposit-taking entities would by far outweigh the benefits. The introduction of business correspondent (BC) model by RBI is to address the needs of small savers, with adequate safety for deposits, which a bank can provide.

PRUDENTIAL NORMS

The adoption of Basel II norms and the prudential regulation of banking system, based on the same, have certain implications for the microfinance sector. Banks have been asked to assign 150 per cent risk weightage on their loans to MFIs in the absence of any risk assessment of their portfolio. In case of MFIs that are rated, the risk weightage could be set lower based on the level of rating that had been awarded to the MFIs concerned. Of the four Indian rating institutions presently recognised by RBI, only one has developed competence in MFI ratings. The others also need to develop the expertise. Other rating institutions such as Micro-Credit Ratings International Ltd (M-CRIL), need to be recognised by RBI so as to increase availability service providers to the sector.

One of the means by which the risks can be mitigated both at the clients' and at the institutional levels is the adoption of insurance schemes that cover deposits and credit. The NBFCs are not eligible to be admitted to the Deposit Insurance Corporation Scheme, which exclusively covers deposits in banks. This scheme could be extended to cover NBFCs and other MFIs, which can be permitted to mobilise deposits after due diligence, and the regulation of these institutions could be entrusted to the Deposit Insurance Corporation itself.[5] Further, the credit provided by the banks to MFIs could be brought under the Credit Guarantee Fund for Small Industries (CGSTI) Scheme operated by a subsidiary of Small Industries Development Bank of India (SIDBI). This would go a long way in reducing the risk perception in the operation of the MFIs on both legs of their financial services.[6] This would bring down the risk weightage at the hands of bank and reduce the cost of capital and also help them to take a more optimistic view of their exposure to the sector. Otherwise, the capital to risk-weighted assets ratio (CRAR) and risk-weighted norms in the short- to medium run are likely to bring down the level of resources available from banking system to the MFIs, and also increase the rate of interest on such loans.

As the microfinance bill has not yet been passed into a statute, a regulatory void, though small, continues to exist. The non governmental organisation (NGO) MFIs and other non-company entities are by and large ignored and, at best, left to the state governments' desire to regulate. The lack of regulation of these entities also implies a certain lack of information on the volume and the nature of their activities which makes it difficult to judge when they become systemically important. There are reported incidences of frauds and misappropriations in some of these institutions. These are not taken seriously and are ignored as an unavoidable part of a growing sector. However, unless frauds are seriously viewed at the MFI and higher levels, the clients' interest may be compromised. The absence of regulation of non-company MFIs also results in uneven regulation and provides opportunities for the new start-up institutions to carry out jurisdictional arbitrage and settle for the minimum tolerable standards. Some of these have acquired a large number of clients that have assets equivalent to the systemically important NBFCs as defined by RBI. Mission drift is a small threat when compared with the transfer of assets and liabilities that take place between NGOs and MFIs, within the same group and movement of costs and profits across different books of accounts. As these happen in the regulatory void, remedial action, if at all feasible, is slow and protracted.

REMITTANCES

Remittances are an area of interest to the vulnerable sections of people; and as a consequence, to MFIs/ NGOs. Given the high level of migration in search of livelihoods, remittance of money from the point at which the migrants earn to the point at which it is spent by their families is a critical requirement. Today, the available remittance facilities are unsatisfactory, costly and are also difficult to access. With core banking solutions being put in place by the banking system and a decent branch network in

several parts of the country, one would assume that it would be easy to transfer money across the country. But the last-mile problems in opening accounts by migrants—either in the original habitat or in the place where they have migrated to, process of withdrawing money out of bank accounts in the rural branches and the reluctance of banks to entertain small money transfers, have reduced the functionality of banks' remittance services. Even with financial inclusion initiatives, the migrants may find it difficult to comply with 'know your customer' (KYC) requirements to open accounts. Some NGOs have tried to bridge this gap between the clients and the banking system. Institutions like Adhikar based in Orissa have set up remittance facility; enabling the clients to use the NGO's bank account for remitting their funds to the families, back home. Money is paid into the NGO's bank account by the migrant near his work place. The NGO transfers the money to its account at the paying centre; cash is withdrawn by the NGO's staff and delivered by hand at the residence of the recipient. However, regulatory implications of such movement of funds are unclear.[7] The moment an amount is accepted from a person for being delivered in some other place it is considered as deposit and the service is technically reckoned as a banking service. Without an appropriate licence, no entity can accept a deposit or provide a banking service. While Adhikar is providing this service on a small scale, expansion of this and replication of this by other entities would depend upon the clarification from the regulator. From the regulator's point of view, a solution for the problem of remittances could be found by segregating banking services from payments system. Non-bank entities with the ability to set up a secure network could then be permitted to offer only remittance services through participation in the national payments system.

THE BC/BF NORMS

The banking facilitators (BFs) and banking correspondents (BCs) scheme is on the take-off mode. Quite a few banks have set up their BCs and appointed a number of BFs in many states. There are certain teething problems that are faced. The restriction on the rate of interest that could be charged to the ultimate borrower at the level of prime lending rate (PLR) in case of loans up to Rs 0.2 million has restricted the remuneration that could be paid to the correspondent and the facilitator. Banks report that they are unable to absorb the cost of the BC/BF within the rate of interest that they are permitted to charge. The low rates of remuneration offered to the BC/BF would tend to limit the quality of service and interest among the more organised entities from entering into arrangement with the bank. But the arguments put forth by banks on interest rate restrictions do not seem to be tenable. While banks are permitted to charge up to the PLR in respect of advances of Rs 0.2 million, there is no cap on PLR or its resetting. Banks are free to set their PLRs and charge their clients at any rate above or below PLR as per their risk rating. When the BC-led microfinance business is miniscule compared to their overall lending, the loss apprehension is exaggerated. Even if the loss potential were real, mitigation is within the banks' locus of control through resetting of PLRs.

A recent notification restricting the distance between the location of the BC and the location of the bank branch has caused much consternation among the banks and larger BCs. In metropolitan areas, this distance has been limited to 5 km and in the rural areas it is 15 km. This has been imposed keeping in mind the requirement of regular monitoring of BC by the branch staff (as they are the principals to the clients serviced) and ongoing contact with the clients. In case of difficulties in specific area or region, the District Consultative Committee comprising bankers has been authorised to relax the distance criterion. The distance restriction has become a hindrance for engaging larger institutions with a wider network as BCs. Some of the existing private sector banks and foreign banks operate typically from few branches but try to serve the hinterland through a variety of means. The BCs and BFs could be the most appropriate medium of expanding their outreach. But if the correspondents are to be located within a 15- or 5 km distance from the branch, the banks will not be able to expand their services and meaningfully participate in financial inclusion. There are several states in which financial exclusion has resulted on account of the distances involved and sparse population spread over a very large area of the state. States like Rajasthan, the north-east and parts of other states like Madhya Pradesh suffer from harsh

terrain, low-density population and long distances, and lack of good roads between villages. In such locations, a 15-km restriction would be counter-productive and would tend to include as clients, only those people within a short distance of the bank branch. In the interest of achieving the objectives of financial inclusion, the distance restriction needs to be reviewed and amended suitably.

A recent modification to the BC guidelines[8] permits appointment of sub-agents by the correspondent, subject to some conditions. However, individuals hired as correspondents are not permitted to appoint sub-agents. Another change[9] in guidelines stipulates that the Section 25 companies appointed as BCs should be 'stand-alone' companies, or those in which the equity investment by the NBFCs, banks, telecom companies and other corporate entities or their holding companies, in not excess of 10 per cent. The concern of the regulator seems to be the prevention of backdoor entry and consolidation of banking activities through the correspondent route.

RBI's ROLE

The priority sector lending norms announced by the RBI are forward-looking in terms of banks lending to microfinance sector. The instruments available to banks for fulfilling their priority sector lending obligation to provide considerable leeway for bulk funding of MFIs. Portfolio buyouts, inter-bank participation certificates, structured debt instruments and bulk loans to MFIs are available to banks as means of financing. The regulator has been proactive in terms of leading changes in policy. There are a number of new initiatives that have been piloted and placed in the public domain for discussion before operationalising into policy. A scheme on financial literacy and credit counselling has already been introduced by the RBI after an internal group's extensive study, of the position prevailing in the country. The scheme provides the banking system to invest in creating the necessary machinery to provide financial literacy to people, especially in the rural areas, and also offer both curative and preventive counselling. These measures are intended to inform the public about usage of financial services and managing personal finance in a functional and effective manner. Another important step taken by the RBI is its enquiry into money lending and bringing it under a framework which legitimises its operation under controlled conditions. The recommendations that have been made by the group that studied these aspects merit serious consideration. A suggested money lending act in a draft form has also been placed for the use of state governments.[10] The important suggestions that have been made in this committee's report are: (1) introduction of registration of money lenders rather than licensing them and (2) providing flexibility to the state government for capping the rate of interest that could be charged. The money lenders should be required to maintain proper accounts and also provide receipt to their clients. There is a suggestion for setting up an alternative dispute resolution mechanism on the lines of Lok Adalat[11] or Nyay Panchayat. The thinking by the regulator on the issue of regulating money lending is a far-sighted one and would improve the ground conditions for access to emergent and immediate finance for all people, who in spite of best efforts of financial inclusion may find themselves outside.

On the technology framework, the regulator has already placed a set of draft guidelines on permitting the use of cellular phones for putting through banking transactions. These guidelines take into account the technological aspects, the security aspects and also the banking aspects. Based on the feedback received, these guidelines have been modified and placed for a second round of feedback.[12]

RBI has been very proactive and leading the thinking on development of the microfinance sector. Over a sustained period of time,[13] RBI has been showing tremendous commitment to improve the policy and regulatory framework that would help in growth of this sector on orderly lines that would be helpful to the clients. The sector's views on issues in regulation as stated earlier are mixed. One of the industry leaders has opined 'Regulation upholds financial apartheid'.[14] Another industry practitioner has stated that the regulation lacks confidence in its ability to supervise institutions—which is why, a large part of the sector is sought to be kept outside the ambit of the regulatory oversight.

An unbiased reading of the situation appears to be that a deliberately weak regulatory effort has been designed to let the microfinance sector have the flexibility to grow. Once the growth is achieved and the institutions become significant in size and

outreach, they would be subjected to regulation. This is already seen in the gradual tightening of prudential norms on NBFC–MFIs. A comprehensive, regulatory effort on a small part of the financial sector without commensurate benefits does not seem justified. The steadfast refusal of RBI to enter into micro-regulation, coupled with forward looking policy initiatives reflect that the regulator is playing more of a development role.

MIS—NEED FOR CONTINUING IMPROVEMENTS

During the last year, the RBI has also introduced new reporting formats[15] for the banks to provide information on the microfinance sector. The revised reporting requirement would improve the quality of management information system (MIS) and availability of information which would greatly improve the understanding of the sector. Based on this new set of returns, National Bank for Agriculture and Rural Development (NABARD) was able to add significant information to its annual statistical volume on the state of microfinance sector.[16] The important additions to the time-series data reported by NABARD as a result of this RBI initiative were (1) savings of SHGs with banks, (2) number of SHGs with outstanding loans and the amounts, (3) banks-wise information on groups linked, loans given and the recovery position, (4) loans to MFIs by the different banks and (5) Swarna Jayanti Gram Swarozgar Yojna (SGSY) groups linked, loans extended and recovery of loans. However, state-wise information on groups linked is missing from this set of data, which is also needed.

The information base on the MFIs' operations and performance needs to be strengthened. Regardless of whether the MFIs are brought under regulation or not, the need for setting up a reporting system covering all institutions engaged in microfinance is necessary.

MICRO-INSURANCE AND IRDA

Insurance Regulatory and Development Authority (IRDA) has defined the social sector in terms of classification of people and their vulnerability. In case of rural sector, the definition is based on census classification on the size of population in a given location. IRDA had introduced the concept of priority sector in insurance through its social and rural sector obligations for insurers. It has actively pursued compliance with the obligations and periodically reset the level of obligations. The last round of resetting was in 2007. The obligations in their present form require writing a certain number of policies, and proportion of premium to be mobilised in the social sector or rural sector as defined.

Micro-insurance is specified in the form of products in life and non-life categories with limits of sum assured.[17] The obligations of social sector could be fulfilled by underwriting risks of vulnerable sections of people mainly in the unorganised sector. Micro-insurance policies would qualify for social sector obligations and rural obligations in case the insured are in the rural areas.

The present emphasis of social and rural sector norms on percentage of the policies written would encourage insurers to cover a large number without depth. The consequence is that people despite access to insurance would not be adequately covered. A premium-based norm is more likely to achieve effective coverage. Further, sub-limits for coverage under the several categories, such as health, accident, assets and so forth, should also be imposed. In social sector obligations, the small number of policies that insurers have to underwrite seems to be a token effort on the part of the IRDA. With low insurance penetration among the unorganised sector workers and vulnerable households, a few thousand policies under social sector norms would not make a difference. Such absolute number-based norms would need to be reset from time to time wasting the resources of the regulator. This norm should shift to a significant percentage of policies sold; so that on an ongoing basis, the norm remains valid.

In health insurance problems of cashless policies, engendering poor quality from the health service providers have surfaced. These issues need regulatory attention. The denial and delay of claim settlement has made some lines of insurance very unpopular. This is also an aspect where regulator's active interest would be needed.

CLIENT COMFORT

Are clients' interest best served in the present regulatory regime is the question that this report seeks to examine. The regulation over formal institutions that cover 94 per cent of the current clientele

seems to fulfil the minimum conditions of client comfort. But grievance redressal and client protection systems are not fully in place. One would also expect that the regulator sets tougher standards of governance for the MFIs under its direct regulation in a bid to improve client satisfaction levels. To fully serve the interests of microfinance clients, the stance of regulation should include protection of small borrowers as well. Insurance regulation may need to become more demanding on the social sector performance and enable access to risk mitigation products for the poor. In micro-insurance, more than regulation, development is the role that is required to be played actively. Product development is a critical issue in insurance and the insurers should be persuaded by IRDA to invest more resources to meet needs of micro clients.

NOTES

1. Amitabh Varma, Joint Secretary, Financial Sector, GoI stated in the Sa-Dhan Policy Conference (April, 2008) that the government is keen on functional regulation rather than institutional form-related regulation.
2. These NBFCs are termed as non-deposit-taking—systemically important (ND–SI) by RBI. NBFCs that have assets of Rs 1 billion and more as per their audited financial statements are treated as systemically important, even if they do not mobilise public deposits.
3. The notification was issued after inviting comments on a draft placed for discussion in June 2008. Circular reference: RBI/2008-09/116 DNBS (PD). CC. No. 125/03.05.002/2008–09 dated 1 August 2008.
4. Please see the interview by Mrs Usha Thorat, DG, RBI in Chapter 1.
5. The Decree on Microfinance in Vietnam makes it compulsory for licensed deposit taking MFIs to take deposit insurance cover with the State Deposit Insurance Company. The deposits of cooperative credit societies (called Peoples Credit Funds in Vietnam) are also covered by deposit insurance.
6. The Portfolio Risk Fund maintained by SIDBI addresses the issues to some extent and mitigates the risks of MFIs.
7. While RBI is aware of this pilot, it has perhaps chosen not to take regulatory cognizance. RBI is perhaps interested to see the results after a period.
8. Circular of RBI/2008–09/142 DBOD.No.BL.BC. 36/22.01.009/2008–09 dated 27 August 2008.
9. Circular of RBI RBI/2008–09/141 DBOD.No.BL.BC. 35/22.01.009/2008–09 dated 27 August 2008.
10. Money lending is a subject on the 'states list' and the state legislatures only can enact laws on the subject.
11. Lok Adalats are people's courts that process and decide on common disputes quickly with simple procedures.
12. Please see 'press release' dated 19 September 2008 in Reserve Bank of India's Website, www.rbi.org.in.
13. From 1992 onwards beginning with SHG linkage pilots, RBI has been an active participant in developing the microfinance market.
14. Vikram Akula, CEO, SKS Microfinance during the Stanchard–ACCION Conference on cracking the capital markets.
15. RPCD.CO.MFFI.BC.No. 103/12.01.01/2006–07 dated 20 June 2007.
16. Status of Microfinance in India, 2006–07 by NABARD.
17. Please refer Chapter IV for details of social sector, rural sector norms as well as definition of micro-insurance products.

Technology in microfinance[1]

Chapter 10

Modern financial sector has much less to do with cash and more with recording of receivables and payables and that too in electronic form. The reduction in cash-handling and settlement of receivables and payables through accounting processes has made the advent of technology in finance not only easy, but also an imperative. The entry of technology has opened more options in the field of finance that lead to lower costs, greater efficiency, real-time information and better customer service. The exciting advances in the recent past relate to removing the challenge of distance as a factor in expanding services to remote locations. The ease with which technology deals with large numbers, long distances and complex requirements makes it an invaluable and integral partner of financial institutions and facilitator of financial processes; at the same time, it opens the institutions to operational risks.

The last year's report had explained the need for technology in microfinance and also some of the available options. It also gave certain pointers to the emerging developments in the use of technology in microfinance. The application of technology could enhance the efficiency and productivity in a variety of operations in microfinance. Typically, they are client acquisition, transaction-processing, financial decision support, book-keeping, accounting and also management information. The technology needs that emerge while expanding to distant locations are (1) transaction processing, appraisal, scrutiny of proposals and so forth (necessitating software-based solutions that could be off- or on-line), (2) transaction approval and authentication that payments and receipts transactions are, in fact, on behalf of the clients (necessitating biometric verification, signature/photo matching and the like, with necessary hardware and software) and (3) recording of transactions, account keeping and Management Information System (MIS) (requiring software solutions). The technology solutions need not be 'stand alone' for each of these set of needs, but integrated to work across all aspects of MFIs' operations, seamlessly.

FUNDING OF TECHNOLOGY

An important development in technology for microfinance is the in-depth study of the issues by the Committee on Financial Inclusion,[2] which brought out its report in January 2008. The committee, after examining the available technologies, called for low-cost technologies, considering the large numbers involved.

Financial Inclusion Technology Fund (FITF)

Technology Applications for Greater Financial Inclusion*

Extending outreach on a scale envisaged under NRFIP, would require the application of low-cost technology solutions, which have been discussed in a greater detail elsewhere in the report. This may also call for certain levels of funding support for rolling out such IT-based inclusive financial sector plan.

Essentially, the start-up costs are the initial investment costs comprising cost of the smart card, terminals to the BC and the CPU. The Committee is of the view that the Financial Inclusion Technology Fund can provide the necessary support for defraying technology application and hardware costs of technology adoption.†

*Quoted from para 4.35 of the committee's report.
†Quoted from para 9.07 of the report.

Eligible activities/purposes—FITF

- Encouraging user-friendly technology solutions;
- Providing financial support to technological solutions, aimed at providing affordable financial services to the disadvantaged sections of the society;
- Creating a common technology infrastructure with comprehensive credit information;
- Funding support to technologies facilitating the documentation for processing of loans;
- Providing viability gap/pilot project funding for unproven but potential technological interventions;
- Conduct of studies, consultancies, research, evaluation studies relating to technological interventions for financial inclusion;
- Promoting seminars, conferences and other mechanisms for discussions;
- Dissemination relating to financial inclusion and technological interventions;
- Publication of financial inclusion technology literature, publicity material, etc.;
- Capacity building of personnel of banks, post offices, state government, MFIs, NGOs, VAs, other stakeholders; and
- Any other activity as may be approved by the advisory board.

Eligible institutions for both the funds

- Financial Institutions, viz., NABARD, Commercial Banks, Regional Rural Banks and Cooperative Banks;
- NGOs, MFIs, SHGs, Farmers' Clubs, local-level associations, etc.;
- Service providers like insurance companies (providing micro-insurance services), post offices, railways, etc.;
- Any other organisation whose objectives are in conformity with the overall objectives of the FIF and are approved by the advisory board from time to time;
- Besides, training and research organisations, academic institutions and universities will also be considered eligible for FIF.

It has recommended the creation of a FITF, which as since been set up in National Bank for Agriculture and Rural Development (NABARD). The two funds would be of Rs 5 billion each. The objectives, coverage and eligible institutions have been indicated by NABARD (see box above).[3] The proposed funding would give a boost to technology adoption among banks, MFIs and others.

TECHNOLOGY AND BANKING

The banking system, driven by the financial inclusion initiatives of RBI/GoI, has taken to technology applications for designing cost-effective solutions to the problem of adding large number of clients. Indian Bank, Andhra Bank, State Bank of India, State Bank of Hyderabad, Union Bank, Axis Bank, HDFC and Canara Bank are some of the banks which are using smart card-based technology solutions. The other banks are also in various stages of testing of different solutions for their fit and relevance in the field. The Union Bank of India has appointed banking correspondents (BCs) such as Infrastructure Leasing and Financial Services Limited (ILFS), Drishti and Basix for client acquisition and other services. The correspondents bring technology (both software and hardware) customised to their operations, capable of working with the bank's systems.

The Corporation Bank has a model of branchless banking which makes use of a smart card, that works on the basis of radio frequency identification (RFID) technology. This 'near field communication' wireless device, which can be used in conjunction with mobile phone, is able to identify the customer with the help of biometric information captured on the smart card, which is compared with the actual finger print of the client. Transactions are processed based on this identification and they could be authenticated through printing of a receipt connected to the mobile phone. This is a fairly successful model, because of its reported low-cost and scalability. Corporation Bank's pilots are run in

**PUSHTIKAR hand-held service—
a low-cost model**

Pushtikar, a Jodhpur-based cooperative MFI, has introduced handheld devices to cover clients at their doorsteps especially for collecting periodic payments. This is an MFI, registered under the Multi-State Cooperatives Act, engaged in thrift and credit. It provides individual loans and also forms and finances women self-help groups (SHGs), through four branches. Hand-held devices (similar to credit card transaction machines, but without any reading capability such as magnetic strip or biometric) with a printer and inbuilt memory are used by their field staff. As indicated by the MFI, the device costs Rs 12,500 per machine (supplied by Albertsons). A total of 10 such devices have been bought and supplied to field staff by the MFI. The field staff have a regular schedule of visits. During their visits, they contact the clients especially, for recovering the installments of loans. Client's payment is recorded in the hand-held device which prints out a receipt mentioning the client's name, number, amount of loan repaid, including the current repayment and balance loan. The client-related information is already fed into the memory of the machine and on entering the client's account number, the required information could be printed out. Transactions could be made on the account and a receipt could be generated for the same. The staff member on return to the base branch at the end of the day, docks the machine to the server and transfers the data. Specific software has been developed by Pushtikar for porting the data from the handheld device to its servers. The software enables the posting of the individual accounts of clients on the server and also carries out other back-office accounting necessary to update the books of the branch, based on the transactions reported by the hand-held device. According to the MFI, this has brought considerable cost reduction in their operations. The risk of staff carrying cash has been covered through a Banker's Blanket Indemnity Policy. This is a low-cost solution that could be used in deposit-taking as well, with some additional security features.

Goa, Karnataka, Tamil Nadu and Andhra Pradesh (AP). The innovation made by Corporation Bank is that of making a survey of the villages that they want to cover; and during the survey, open an account and issue smart cards so that the 'know your customer' (KYC) norms can be easily complied without requiring the customer to take extraordinary efforts to produce documents that are difficult to procure.

State Bank of India has a mobile banking kit, which is described as a 'bank in a box'. This box comprises a cell phone, which acts as a point-of-sale machine, a finger print reader and a tiny printer. This is used for opening no-frills accounts that are on smart cards issued to clients. The smart card holds client details such as name, account number, the finger print and also the balance in the account. The smart card can hold details of 16 different types of accounts including the loan account. This has capability of putting through transactions both online and offline. At the beginning and the end of the day, the transactions could be ported to a base location server, which will update the client and the bank's books. State Bank of India already runs pilots in project in Mizoram, Meghalaya, AP and Uttarakhand.

The Institute of Development Banking Research and Technology (IDBRT), Hyderabad [set up by Reserve Bank of India (RBI)] has worked on several of these technologies, with a view to provide information to the banking and financial system. It has partnered the AP pilot on electronic benefits transfer. The IDBRT has also issued advisories to banks on types of software solutions that are required and also the issues relating to secure connectivity between the point of transaction and the base branch.

Low-cost options using field officers mobility and providing them handheld devices have also been tried out with success. While the technology is not high-end, it is effective and would be compatible with any software platform that is used within the institution for accounting and MIS. Such models would be useful to small institutions and banks.

ELECTRONIC BENEFIT TRANSFERS

There are also pilots underway to test 'leakage proof' routing of government benefits payments, electronically to beneficiaries' accounts. Under the

Technology, inclusion and benefits transfer—The AP model*

The model adopted in six districts of AP falls under the AP model. The scheme operates on the financial inclusion platform, created by banks through their BCs. Banks have been allotted specific mandals for bringing the unbanked population to the banking system. As banks do not have branches at remote locations, the services of BCs are utilised. These BCs organise enrolment camps at village level and collect information of the 'would be account holders' as also their biometric identification. After due diligence, as applicable for no-frills accounts, banks open the accounts in their books. The concerned government department communicates the list of social security benefits to ensure that all intended beneficiaries in a specific locality are brought under inclusive banking. Every account holder is issued a smart card, which contains the basic data of the account holder along with the biometric data and photograph. The BCs have been provided handheld devices that facilitates connecting to bank's database and carry out cash-in and cash-out function on behalf of the bank. A day or two before the due date of payment, the government gives a cheque to the bank along with the details of the beneficiaries. The bank credits the accounts of the beneficiaries enabling the BC to access the account balance through a mobile access device and disburse cash at gram panchayat level.

However, the model is not free from challenges—the biggest challenge being multiplicity of banks and multiplicity of correspondents in one area making the operation non-viable for any BC. The major grievance of the Government of Andhra Pradesh is that the process is slow and, even after one year of implementation of the pilot, up-scaling the Electronic Benefits Transfer (EBT) model has not been completed. Each bank has to undergo an elaborate process of selection of BC for a specific district; area is extremely time-consuming. However, this project being the first of its kind in the country, involved a learning process for all the participants namely government, banks, BCs and the beneficiaries. Considering the same, the project can be considered as progressing satisfactorily in creating confidence that the technology is robust to support banking outreach with the help of the BCs.

*Excerpted from the report of the committee on suggesting a framework for electronic benefits transfer, headed by Mr R.B. Barman, Executive Director, RBI.

National Rural Employment Guarantee Scheme (NREGS), a large pilot that transfers payments to the labourers through smart cards-based savings accounts is being tested by many banks in AP. This initiative achieves the other objective of financial inclusion of excluded people.

The RBI Committee on Electronic Benefits Transfers suggested the following for mainstreaming the AP model.

- Unique ID to be provided to each client to avoid frauds.
- Payment information to flow electronically to the government so that database is created automatically.
- Initial disbursements could take place at gram panchayat and subsequently, move to individuals at village levels.
- Pilot to be scaled up to cover entire AP by December 2008.

DIFFERENT MODELS IN CORRESPONDENT BANKING

Several models of linking remote populations with financial services exist today. Some MFIs maintain solutions, on the lines of core banking solutions of bank, which are available through softwares such as Financial Information Network & Operations Ltd. (FINO), which take care of the entire front and back office requirement of MFIs. FINO is enabled to work with smart cards and is functional in meeting requirements of client acquisition under the financial inclusion initiative. FINO reports that under its BC model, almost 4 million clients have been added. Some solutions follow the kiosk model where the customer has to walk in, to get served. The kiosk has point-of-sale terminals[4] that enable banking transactions to be put through. Some follow the mobile-based technology where a biometric-enabled smart card is used to transact with the help of a BC or a

bank official's mobile phone. There are cell phone-based solutions that use additional authentication procedures involving secure 'signature codes,'[5] not requiring additional investments in smart cards or readers for the same. There are others who work with handheld devices that work offline and at the end of the day, transfer data to the server at the base branch/office.

A Little World (ALW), another technology solutions provider, reports having brought in a new generation payment system, which is versatile and secure. It is named Zero—which is a mobile platform for inclusive banking. Zero Mass Foundation,[6] which operates on the ZERO platform, provides support for the field operations of banks in client acquisition and acts as a BC. Union Bank, Axis Bank, State Bank of Hyderabad, SBI, Bank of Baroda, Development Credit Bank and Canara Bank are participating in this model. ALW reports that clients are being added by it, at the rate of 25,000 per day, to the banking system with its BC entity. The smart card-enabled model propagated by Zero Mass is being used by the Government of Andhra Pradesh for making payment of the NREGS to the labourers.

Use of cellular phone operators' network for making transfer of money between two centres in real-time is a distinct possibility. However, care should be taken to ensure that these do not encourage hot money flows or result in frauds. The RBI is, however, apprehensive of indiscriminate use of mobile phone technology in the case of banking. Banking services should be offered by the banks or the BCs. This cannot be offered by cell phone companies or their franchisees as per RBI's current thinking. RBI has framed draft guidelines on use of mobile phone for banking[7] and has placed the same for public comment. The Solution Exchange and United Nations Development Program (UNDP)[8] hosted a discussion on the guidelines and their suitability for microfinance. Some of the important points made by the participants in the discussion are that the guidelines should permit voice-based authentication, so as to take into account the illiteracy in the rural areas. A secondary authentication is also thought to be necessary to ensure that frauds are kept to the minimum. Taking into account the fact that many of the rural people do not own a phone and may find it difficult to operate their own cellular phones, it was felt that the BCs' staff should be authorised to put through transactions on their phones on behalf of the clients. However, this should be controlled by a safeguard where under the BC staff, is provided a security code that has to be recorded before the transactions are put through.

RBI has placed the modified guidelines based on the feedback on its Website for a second round of feedback. The modified guidelines state that the

The EKO* model of cellular banking

The system has a simple design. The mobile phone of the customer serves as the bank account number. EKO has arrangements with many retailers (grocery shops, convenience stores, mobile recharge voucher sellers and so forth) to service the customers. To open an account, a customer needs to deposit an identity proof with an EKO retailer, who then hands over a booklet that contains a welcome letter, the product leaflet, a manual and a small signature booklet, which has 100 signatures. The signatures contain a 10-digit number that has four blank spaces, in which digits are to be filled in by the customer at the time of a transaction. The customer gives one of the signature tokens each time a transaction is put through. The customers after opening the account can go to any EKO retailer to make a deposit or withdrawal. It is convenient for the customers. According to EKO's study, each physical banking transaction for a customer costs a bank more than Rs 100; each ATM transaction costs more than Rs 15. 'This model costs very little to the bank, except for the commission paid to EKO as correspondent' says a company official. EKO mobilised more than 2,000 clients for Centurion Bank of Punjab. With that little pilot coming to an end, EKO is looking for larger partnerships. But the regulator has some reservations. Can a BC, who is an agent of a bank, further appoint agents, diluting the due diligence processes and making supervision by the principal bank difficult? This knot will unravel soon. The next few months should see more action on cellular finance becoming mainstream.

*Operated by EKO India Financial Services Pvt. Ltd., New Delhi.

STEMS—another technology pilot from BASIX

STEMS stands for Single Terminal Enabling Multiple Services, which is kiosk model, substituting for bank branch. STEMS is the outcome of the application of some of the learnings from another project* run by BASIX. STEMS attempts to solve the problem of infrastructure by locating the point of transaction (POT) at an existing internet kiosk. This tie-up is expected to result in a win-win situation for all the parties involved. The point-of-sale terminal would have Internet connectivity and power supply apart from an IT-savvy person being able to put through transactions. STEMS would be effective as part of BC arrangements. BASIX will be able to reduce transaction costs; the poorer sections will find it easier to get access to financial services, and the kiosk operator will not only earn commissions on the transactions, but will also be able to derive extra income from the BASIX customers by providing them other services, such as ordering supply of inputs, receiving information on market prices for commodities, accessing information from the Internet and so forth.

*SUDAMA was run with public call office operators as agents at points of transaction in Anantpur district of AP to handle small loans. It was a limited scale pilot with about 430 clients.

main objective of mobile banking would transfer money between different accounts in different banks and hence inter-operability would be a key requirement of technology. It has also suggested limits of Rs 2,500 per transaction and a cap of Rs 5,000 per client, a day. These small amounts would not facilitate loan disbursement and repayments.

CELLULAR FINANCE[9]—MOBILE PHONE-BASED BANKING

Vodafone and Airtel have announced their intentions of entering financial services in a bid to add to their revenue stream. Vodafone would try to introduce their successful MPESA model in India across its 2,200 distributors and 5,00,000 franchisees. Tata Telecom is also exploring the feasibility of offering such services. These are driven by international experience in Latin America, Africa and Philippines. While this would provide convenient service to clients, how much *cellular finance* would serve micro clients has to be seen.

A review of the ongoing developments in terms of technology and Information Technology (IT) solutions reveals that the emphasis is more on transaction-processing solutions, involving individual clients. The solutions offered are not customised to specific institutions but are customised to the specific set of applications and for a segment of clientele. Software for institutions that are engaged in promotion, linking and monitoring of SHGs has not been much in evidence during the current year. MYRADA with the support of NABARD, has developed NABYUKTI, a software to simplify the problems relating to generation of MIS in respect of SHG promotion and linking. This software is available from NABARD to all institutions that are engaged in SHG promotion. Ekgaon technologies also offers a software that takes care of accounting and MIS in case of SHG-based financial intermediaries.

The BC model provides the mechanism for establishing point-of-sale offices. Institutions such as BASIX have entered into collaboration with banks to set up physical infrastructure in the form of kiosks. These kiosks normally have an Internet connection, PC and point-of-sale terminal, which could access a variety of authentication hardware such as smart card, biometric card. These kiosks have been able to provide much more than financial services and help to local population in securing other essentials and also maintain contact with the external world through Internet connectivity. It is difficult to recover the cost within a short period of time. The proposed financial inclusion fund[10] should look at expanding such network of kiosks in the interest of financial inclusion and also in serving vulnerable people. The guidelines on the two funds, a financial inclusion, have recently been finalised. Banks and MFIs that are involved in financial inclusion initiatives could look forward to support for their technology-based initiatives from this fund.

Although technology is held to be the panacea for all problems of microfinance sector, available evidence suggests that technology may not be the solution in a few cases. In fact, technology investments have created new problems rather than

Table 10.1 Some technology solutions for MIS

Software package	Company/organisation	Cost	Approx. no. of MFIs using software	Approx. no. of Indian MFIs using software
FINO core banking solution	FINO	For core banking solution, only Rs 25 per account as annual maintenance fee	15	15
MIFOS	Grameen Foundation	Free	5	2
Delphix	BASIX	Free	50	50
Bankers Realm MFO	Craft Silicon	US$15,000 (minimum license cost)	34	0
Micro Financier	Java Softech	Not listed on Website	10	10
Salesforce.com	Salesforce.com	Free	Still in pilot usage	Still in pilot usage

providing effective solutions to the problems that were to be addressed. The technology providers tend to blame inadequate efforts on part of the buyer in internalising the new hardware and software to the business requirements. The technology buyers point to the inadequate customisation of technology to suit business requirements, once the technology is bought. Handholding of staff after introduction of new technology, investments in training and exposure to new technology environment, and understanding of new risks that arise in such transformations are the areas that need to be closely examined and addressed. While direct investment costs in technology might seem affordable, the internalisation process might impose more costs and in the transition period, could destabilise operations. These risks should be factored in while making technology investments. Some of these are summarised in a paper commissioned by CARE India.[11]

There is an increasing acceptance of technology in the field of microfinance. MFIs generate a significant amount of data and information from their respective technology trials but lack the ability and resources to manage and share this information between various stakeholders. There are significant gaps in understanding of respective domains. This is true with both microfinance institutions and technology providers. As a result, there is a need for greater product and service customisation for the microfinance sector. MFI decision makers do not understand technology adoption timelines and the expected financial returns. There is a great need for technology investment education within the microfinance industry allowing MFIs to make better informed technology procurement and implementation decisions. MIS is the only clearly established technology need.

MIS is an area that needs strengthening in the microfinance sector and IT can make a huge difference in this sphere. There are IT solutions that comprehensively address MIS needs. Some the available solutions are listed[12] in Table 10.1.

But the Indian microfinance sector has not been too conscious of the needs of quality MIS and the role of technology in upgrading the same. The CMF conducted a short survey[13] of the top management of 11 MFIs. All the chosen MFIs were engaged primarily in Grameen-style lending and all had a client base of over 50,000. A large proportion of the MFIs surveyed, still relied on extremely, rudimentary information systems. Three of them relied on Excel spreadsheets for their information management needs. Out of the remaining MFIs, four relied on custom-designed solutions but were built by local consultant who had no experience in microfinance. As a result, these custom solutions lacked the capacity to perform the basic functions required of a quality MIS. Another distressing sign observed was that very few of the managers knew with certainty the amount spent on IT within the MFI; most had no clear plan for upgrading their MIS.

COSTS AND RETURNS

A major aspect of technology adoption is the cost. Not much work has been done in comparing the costs of different technology solutions and examining the cost of providing services at the unit level—such as cost per client acquired or served, cost per transaction. Vijay Pratap Singh[14] comments, 'If

technology can reduce the cost of service delivery and administration of the product then margins could be reduced to make the product more affordable and attractive to clients. However, it is to be noted that technology alone cannot be a magic wand, able management practices also need to be in place. In our understanding, it is these two areas, which have remained weak, even after two decades of microfinance in operation.' CEOs and technology managers of MFIs are not in the best position to make these assessments on account of their own time and resource limitations. There is a dire need for such an exercise from a neutral agency so that the widely differing claims on efficiency and productivity are put to test. Such assessments should be periodic and regular, benchmarking exercises that could be used by the industry.

TECHNOLOGY TRAP

An issue that is not discussed much is the technology trap. After acquiring technology that fulfils the needs at a point of time, the MFIs get trapped by the same, even when it is no longer able to serve changing needs effectively. Expansion of business, change in product profile, change in methodology, change in loan sizes and higher order requirements arising from an expanded span of control are some of the areas that technology should be able to tackle in growing businesses. But there are cases of MFIs not being able to use current solutions effectively and being unable to discard and migrate to other solutions for a variety of reasons. Custom-built solutions particularly suffer from scalability limitations, mainly on account of inability of the MFI to project its future requirements while approving the technology architecture. Changing platforms, shifting industry standards and the rate of obsolescence compound the problems faced by the IT managers and the technology providers. Outsourcing technology with clear solution outputs rather than acquiring technology might be the way forward.

Clients are ill-served when organisations become prisoners of technology. The prologue to this report brings out how product diversification is stalled to clients' disadvantage on account of technology limitations of the MFI. While making technology investments, key considerations should be scalability, flexibility and ability to interface with other hardware and software platforms. Technology should adapt itself to institutional and client requirements; it should not demand that the clients and institutions should adapt to its limitations.

NOTES

1. The author is grateful to Mr Ramesh Arunachalam, Microfinance Consulting Group, for providing rich information and sharing his insights contained in the research note of Microfinance and Technology, Critical Issues, Lessons and Future Implications.
2. Committee on Financial Inclusion was set up by the Government of India under the chairmanship of Dr C. Rangarajan.
3. Cited from NABARD's newsletter for July 2008—www.nabard.org.
4. BASIX is testing STEMS, which is featured later in the chapter.
5. EKO has tested a pure cell phone-based pilot in Delhi, featured later in the chapter.
6. ZERO Microfinance and Savings Support Foundation is a Section 25 company set up by A Little World. As RBI's norms permit only non-profit companies to become banking correspondents, ALW seems to have set up ZERO Mass as a non-profit.
7. *MicroSave's Briefing Note* 47 by Graham Wright and others contains good summary of the customer value proposition in mobile phone-based banking (www.microsave.org).
8. A platform for practitioners to share learning; www.solutionexchange-un.net.in.
9. As mobile phone-based banking seems to be set to become a mainstream, it is necessary to distinguish it from the generic term 'e-banking'.
10. The committee on financial inclusion headed by Dr. C. Rangarajan had recommended this.
11. Evolution of Technology, Application in Microfinance, CARE, 2007.
12. Cited from CMF Focus Note: Management Information Systems in Indian Microfinance by Doug Johnson, 2008.
13. CMF Focus Note: Management Information Systems in Indian Microfinance by Doug Johnson, 2008.
14. Vijay Pratap Singh is with Ekgaon Technologies. This comment was made in the UN Solutions Exchange Discussion on inputs for SOS 2008.

Some major institutional contributors

11
Chapter

GOVERNMENTS

The increasing interest in microfinance on the part of the state governments is one of the more encouraging developments over the last few years. States have taken a variety of steps in the sector, apart from implementing poverty alleviation programmes such as Swarna Jayanti Gram Swarozgar Yojna (SGSY), skill-building for livelihoods, setting up federations of self-help groups (SHGs), providing grants towards start-up capital for individuals and groups, subsidising premium on insurance policies, and introduction of social safety nets such as provident fund and pension schemes. An analysis of the state government budgets for the year 2008–09 reveals several interesting steps that have been planned by the different states.

Government of Rajasthan has targeted financial inclusion of vulnerable populations as a major objective. The government proposes to provide a deposit of Rs 1,500 to each family, which opens a bank account in the name of an adult woman member. An allocation of Rs 7.5 billion has been made for this purpose. A major initiative in PPP has been taken in which Infrastrructure Leasing and Financial Services Ltd. (ILFS), BASIX and the state machinery are working together to get five million savings accounts opened in the names of hitherto, excluded people.

The Government of Maharashtra has announced the launch of the Tejaswini, a women empowerment programme with assistance from International Fund for Agricultural Development (IFAD), which aims at promoting and linking 62,675 SHGs over the next eight years. It also envisages setting up of federations of SHGs and creation of livelihood opportunities through capacity-building and appropriate linkages. The government has taken life insurance coverage under the Aam Admi Bima Yojana for all people in the age group of 18 to 59 from the landless families in the state.

The Government of Orissa has provided for a budget of Rs 5 billion to assist 0.1 million woman SHGs. Apart from this, it has enhanced the amount of pension, payable to vulnerable sections of population and Madhubabu Pension Scheme. An overall budget allocation of 2.27 billion has been made by the government for covering the old-age pensioners.

The Government of Tamil Nadu has set a target of promoting and linking 25,000 SHGs during 2008–09, covering 0.4 million members. The government has committed Rs 1.50 billion for providing revolving-fund assistance to 0.15 million SHGs during the year. Senior citizens living below poverty line and eligible for the pension scheme would get a pension of Rs 400 per month raised from the existing Rs 200. While 0.97 million persons to benefit from this, another 0.62 million widows and destitutes would also be provided pension. A total allocation of Rs 8.20 billion has been made by the government.

West Bengal has introduced a provident fund for agricultural labourers. The government would be providing a matching contribution to the provident fund of the labourers at the rate Rs 20 per month. A separate corporation has been set up by West Bengal for training SHGs, organising facilities for marketing and so on, with Rs 1 billion outlay. This corporation would prioritise employment generation for the SHG members. The government also proposes to expand the provident fund coverage to workers in

Bhamashah Financial Empowerment Scheme—Government of Rajasthan

Objective: Creation of a state-wide biometric smart card-based IT infrastructure and platform for service delivery to the rural poor:

Steps taken—

Appointment of two infrastructure service providers (ISPs)

Campaign and training to all those involved in the mobilisation

Outcomes targeted

- Enroll 5 million HH and issue smart cards.
- Establish Central Data Center and connectivity.
- Establish 15,000 banking PoS and 2,000 PoS at hospitals.
- Enroll 5 million clients in twenty days at 15,000 camps across the state.
- Open no-frills bank accounts for disbursement of entitlements.

ILFS and BASIX are partnering with the Government of Rajasthan in this time-bound programme for opening 44 million accounts in 29 districts. Bartronics has the responsibility for the remaining 0.6 million accounts in the other districts.

the unorganised sector from the present 1 million people to 1 million more by covering additional sectors. The Government of Andhra Pradesh (AP) has allocated a sum of Rs 2.5 billion for subsidising the interest on the loans taken by the groups from the banks. The effective rate of interest has been brought down to around 4 per cent in the state through the state's subvention.

The Government of Karnataka in the last year's budget had introduced a new social security scheme in the form of pension of Rs 400 per month, for people above the age of 60 belonging to small and marginal farmers, agricultural labourers and unorganised sector labourers. Its health insurance for farmer households, Yeshasvini is well-known.

There are other states, which have announced other schemes pertaining to the microfinance sector. The initiatives have by and large, been in promoting and linking SHGs to the banking system, providing

The AP Experience*

AP has been the leader in microfinance movements especially in the SHG–bank-linkage model. A strong state government support and a willing banking system with a large network have played a significant part in this. More than 7,08,000 groups have been formed in the state as of March 2008. The number of members that had been enrolled in the SHGs exceeded 8.8 million. The state not only did the mobilisation of people into groups but has also gone about setting up higher level institutions that could provide umbrella support for the SHGs. The typical higher level organisation that exists in the SHGs sphere in AP is mostly state-governed. The SHGs within a village are federated into a village organisation. In turn, village organisations within a mandal are part of a federation named Mandal Samakhya. The Mandal Samakhyas in a district are again federated at the district level under a Jilha Samakhya. The mandal and district-level federations, which are larger, and higher level federations are supported by the staff of the state government, appointed under the The Society for Elimination of Rural Poverty (SERP).

An issue that comes up with the strong state government support is whether the prevalence of subsidy pushes up the demand for microfinance. The average loan amount per group has gone up by almost 4 times in a 3-year period. A level of Rs 0.13 million per SHG is the present average lending to SHGs. There are reported instances of the loans being used by the members for lending to non-members at higher rates of interest, taking advantage of the low rate at which these loans are available. The numbers that have been pursued by the state have resulted in certain distortions in the field. This relates to smaller groups in order to show good performance in the eyes of the government. When the average membership per group declines to less than ten, the cost of maintaining, sustaining and servicing the group goes up, which is an avoidable waste of economic resources. Second, the increase in loan off-take is not matched by work in the livelihood development sector. Considerably, stronger work is required to ensure that the higher levels of loan taken by groups are applied towards livelihood and income-generating activities, which would help them better utilise the loans. The programme today seems to run on the back of a concessional interest scheme. The large loans are getting repaid faster. In most cases, the loans are repaid so that next round of even higher loans could be availed. When the state stops, the interest subvention (which must happen at some point of time) whether loans continue to be repaid is doubtful.

The introduction of a housing microfinance scheme along with this has been a recent phenomenon. The housing microfinance is made available to two select members of each SHG. The selection of these two members is done by the project staff and not by the SHG members themselves. The housing loan being much higher than the other; there is resistance among

group members to stand any kind of guarantee in respect of two members of the group who' were not selected by the group itself. This introduces a certain element of discomfort in the group's working and the group, financial behaviour. There is a risk of groups breaking up in view of large loan amount and longer repayment period, associated with housing loans.

The formation of federations by the state and affiliation of the SHGs to the federation, does not seem to have affected the autonomy of SHGs. APMAS in its study has found that the SHGs were functional and were able to transact with the respective federations on equal terms. As it is a state-run project, no vested interest interferes with the SHGs accessing financial services from the banks directly. Loyalty of SHGs to the federation was not compelled and in that sense, the SHGs had a sense of freedom. There are NGO-formed federations elsewhere in the state. These federations demand utmost loyalty from the SHGs. They were prevented from borrowing from banks directly. Both financial and non-financial services were to be accessed only through the federation by the SHGs. This kind of keeping of the SHG flock close together impacts the freedom of groups and prevents them from accessing better quality lower cost services from outside.

In forming federations and in running the federations, the issues relating to autonomy, efficiency and cost need to be taken into account. Issues relating to governance systems and asset quality have to be given serious consideration in the case of SHG federation. The capacities of the board of governance in these federations need to be built up. This requires a great deal of time and effort. Sustaining the quality of governance is an ongoing process. Interventions in governance are not one-time affairs. How to keep up with the expanded roles of the federation and sustain the larger volume and increase the range of services of federation are critical questions that need to be addressed in each federation. Appropriate systems, accounting, book-keeping, auditing, internal control, monitoring and compliance with legal requirements are priority considerations. Sustaining quality of internal systems and their ability to transparently provide information and minimise misuse of scarce resources are key requirements. Accountability to members should also be a systemic issue rather than a discretionary issue in governance. Asset quality is an area that requires urgent attention. While the SHGs have maintained decent repayment rates with the banks in respect of their borrowing, the internal repayment rate within the SHGs have been very low. Repayment rates have been reported to be as low as 31 per cent within the SHGs. More and more, the SHGs seem to be turning into credit management rather than through the entire range of financial services.

[*]Based on discussions with APMAS, NABARD regional office, AP and progress report on Indira Kranti Patham 2007–08, SERP, AP.

insurance cover to people and establishing safety nets in the form of provident fund and pensions. Most state governments have taken the lead in including the vulnerable sections under life, health, crop and cattle insurance schemes. In fact, the governments have provided the initial push in micro-insurance domain.

A drawback with the state's involvement is that its machinery is unable to monitor the outcomes of its support and ensure that end-results at the beneficiary's hands are sustained. This leads to successive doses of assistance to the same households over a period of time. Increasingly, governments engage NGO partners in scheme implementation and, even involve the private sector to improve the delivery efficiency of its initiatives. The linkage between government initiatives and institutional finance has been weak. Unless the microfinance institutions and the banks provide effective financial services to the benefitting population, the government's support could be in vain. When the government's support is leveraged with bank credit and other financial services; possibly, the benefiting population would be able to improve its livelihoods much faster than otherwise. There are some other aspects of the states involvement in the microfinance arena that hold concern for the sector. The first of these is a negative perception in the minds of government about MFIs at the political and the bureaucratic level. MFIs are perceived to be and treated as no better than glorified money lenders. MFIs' terms of loans, rates of interest and methods of operation are seen to be exploitative and not in tune with the needs of the rural poor. In some cases, the states have also taken the view that the MFIs are profit-seeking in their approach and do not necessarily serve the poorest of the poor. The need for providing support either from a policy environment point of view or a financial point of view has been questioned. The happenings at AP in Guntur district, a couple of years ago, the developments in Karnataka where staff of MFIs were jailed for undertaking lending activities, and the kind of typical comments made in certain states such as Madhya Pradesh and Rajasthan about the nature of involvement of MFIs in lending, do not augur well for the sector. This

clearly points to the need for a much better effort on the part of MFIs and the financing banks, to engage the political and bureaucratic establishment with much better communication. The need to put across a reasonable perspective of how MFIs function, their sources of funds, the risk profile and the cost of the operation needs to be brought home to states very clearly. Further, a measure of self-restraint on the part of institutions in both pricing and the methods of operation would go a long way in altering the perception of governments about the sector.

APEX INSTITUTIONS

National Bank for Agriculture and Rural Development

The Apex Rural Development Bank with assets of Rs 980 billion has played a pioneering role in SHG–bank-linkage programme. It has provided capacity-building support to the sector at every level over the last fifteen years. It claims that the most leading MFIs today have received their initial support from National Bank for Agriculture and Rural Development (NABARD). The Micro Finance Development and Equity Fund (MFDEF),[1] which is used for supporting the sector, has been joined by two other funds[2] for facilitating financial inclusion. The bank over the last two years has been taking keen interest in MFIs and federations, perhaps to shed its image of 'SHG only' bank. The recent departures made by the bank relate to announcement of support to federations of SHGs and equity support to MFIs. Non-banking financial companies (NBFCs) have been included in the list of institutions, eligible for refinance; opening one more avenue for MFI–NBFCs to avail bulk funds. While the bank has been providing funds for a number of pilots apart from promotional expenses of forming groups and capacity-building of the sector, it has been perceived to be conservative in use of grant funds. The bank is also seen as seeking *fail–safe pilots* for funding and not sufficiently oriented towards technology pilots. NABARD is proposed as the regulator of the non-company MFIs in the draft microfinance bill. NABARD had collaborated with SDC, IFAD and Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), on various aspects of microfinance for funds as well as technical assistance. The refinance support made available by NABARD in the initial years was a critical influence on banking sector's finance to SHGs. Till March 2008 cumulatively, NABARD has disbursed refinance of Rs 222.3 billion to banks, covering their finance to SHGs. Its disbursements of Rs 18.7 billion to microfinance during the year 2007–08 formed 3 per cent of its total loan disbursements of Rs 602 billion. While the business significance of microfinance is low for NABARD, its development potential drives NABARD to spare the time resources, necessary for the growth of the sector. It had provided cumulative grant support of Rs 254 million against sanctions of Rs 612 million for formation of 0.36 million SHGs of which, so far 0.17 million groups have been linked to banks. The grant support to SHG promotion at Rs 3,000 per group has been criticised as being inadequate. During the last year, NABARD has revised the grant support to NGOs engaged as self-help, promoting institutions (SHPIs), in the hilly districts of north-eastern states to Rs 5,000 per group. Although this is welcome, this needs to be extended to all hilly districts where terrain and distances are a problem. NABARD has taken a forthright stand on the interest rates by stipulating that MFIs seeking equity support from MFDEF should not charge more than 25 per cent on declining balance to their clients. It had announced some time back that it would set up a subsidiary NBFC to enter microfinance. In pursuance of the same, Karnataka Agri-Development Finance Co. Ltd. has been restructured into NABARD Financial Services Limited (NABFINS)[3] as a wholly owned subsidiary of NABARD. This is expected 'to facilitate setting-up of benchmarks and standards for the MFI sector. NABFINS will promote and continue providing microfinance, life insurance, general insurance services…' With its institutional development mandate and rapport with the state governments, it has the potential to expand on its already significant role in microfinance. In the financial inclusion initiative, the sector is looking forward to NABARD playing a leadership role.

Small Industries Development Bank of India[4]

This Apex Development Bank in the small industries development finance domain has assets of Rs 238 billion. The prime objective is to encourage finance flow to small industry segment through direct loans

and refinancing of banks and State Financial Corporations. It has been active in the microfinance sector for more than ten years, incubating several MFIs that occupy the top positions in the sector today. Small Industries Development Bank of India (SIDBI) apart from providing bulk funds to MFIs has also provided capacity-building support and engaged in sector-building activities through commissioned studies and research. It has concentrated on the MFIs in a bid to expand coverage of financial services to areas that have limited bank coverage. SIDBI provides short-term loans, long-term loans, transformation loans for non-profit MFIs that want to become NBFCs and operates a portfolio risk fund with contributions from Government of India. It also provides equity support to MFIs and has been a pioneer in this initiative. During 2007–08 it had disbursed Rs 7.13 billion and grants of Rs 70 million. The cumulative disbursements of SIDBI to the sector amount to Rs 16.6 billion. Its outstanding MFI loans of Rs 9.5 billion to MFIs constitutes 4 per cent of its outstanding loan portfolio at the end of March 2008. Its capacity- and sector-building initiatives have been well-received. In collaboration with Department for International Development (DFID) and IFAD, SIDBI has made a significant contribution to the development of the sector. It pioneered the concept of using technical service providers to nurture start-up and fledgling MFIs in their growth phase. Some critics point out that it did not take leadership of the sector and ensure that governance of MFIs was set on better lines. But SIDBI introduced the concepts of rating, social ratings and poverty audits in a bid to prepare the sector for financial and social performance. Its appraisals were seen as benchmarks by other commercial banks in their credit decisions. It had not influenced the debate on regulation on the microfinance bill in a manner expected by the sector. Ensuring continued availability of funding, especially of soft funds for the sector, would be a major challenge that SIDBI would like to take upon itself. It had proposed the hiving off its microfinance operations (as SIDBI Foundation for Micro Credit – SFMC) as a separate subsidiary, which is yet to find a concrete shape.

National Housing Bank[5]

The bank has been making efforts over the last 4 years in housing microfinance. In keeping with its mission of achieving shelter security, it refinances banks and provides bulk funds to housing boards, housing development corporations and private sector housing finance companies. Its plans include setting up specialised entities for housing microfinance. National Housing Bank (NHB) has committed equity in one of the first such entities set-up. Existing NBFCs are being persuaded by NHB to establish rural housing finance entities. MFIs/NGOs in trust, society and company forms. It provides a margin of 5 per cent on on-lending funds to the MFI. So far, 10 MFIs have been sanctioned an average of Rs 50 million as pilots. Most of these loans are in AP and Tamil Nadu. It plans to select 50 organisations and help them to specialise in housing finance.

NHB has been facing resistance from the microfinance sector for introduction of housing finance to the clients. The large amounts and long-term tend to make the MFIs wary of the product, even though housing, especially incremental housing[6] is a dire need among the microfinance clients. NHB would also like to link up with Indira Awaz Yojana to ease the problems of housing for the poor.

NHB has not been able to make much progress in the field of microfinance for housing. The lack of promotional funds in its hands limits its ability to carry out action research in this area and design suitable products. This is a need that has to be addressed.

Friends of Women's World Banking[7]

Friends of Women's World Banking (FWWB) is a bulk funder in the sector that started operations in 1989 as a charitable trust. During 2007–08, it had a partnership base of 113 organisations in 16 states with client coverage of 0.72 million. Its outstanding loans had almost doubled over the year and stood at Rs 2.18 billion. It is active in wholesale lending to MFIs, capacity-building, institutional support, research, studies and documentation. It has been active in the livelihood sphere in the recent past as also risk mitigation of vulnerable people. Its present form has perhaps prevented it from growing faster in accordance with the potential of the sector. Its size limits the exposure levels and rules out some of the larger funding possibilities. Sourcing funds from other larger financial institutions might be impacted on account of its trust form. Of the 16 states, it has a good presence only in 12. Its role in handholding the medium and small organisations has been commended by all. The professionalism that FWWB has brought to the market has been appreciated by its partners.

SA-DHAN[8]

It is the Association of Community Development Finance Institutions that has most systemically important MFIs in its network. The network has 223 members from different streams of microfinance sector, such as MFIs (majority of members), banks, apex financial institutions, technical service providers, consultancy organisations, bulk funders, private equity funds, venture capital funds, academic/research institutions and so on. The association works for its main constituency that is the MFIs. It seeks to present a consolidated and unified view of the members for policy dialogue and change. It works on knowledge management for its member community through conferences, seminars and training courses. It takes up problems of members for resolution—such as the AP crisis. It brings out periodic publications[9] as well as ad hoc reports. It commissions studies and research projects to enhance state of knowledge in the sector. Its annual policy conferences are attended by all those in policy and strategy positions in government and apex financial institutions. Its annual publications, the quick report and the side-by-side report, give a good insight into the working of the institutions in the sector. Some of the drawbacks pointed out by the sector have been the slow response to problems, which is more on account of the need to formulate a common view among the differing perceptions of members, low level of influence with policy-making bodies and difficulties in securing member cooperation. Its role in setting standards and disseminating a voluntary code has been appreciated in the sector and outside. But the monitoring of compliance with the code has been rendered difficult. The association is actively involved in improving its ability to scan the future and take timely action in the interest of members.

INTERNATIONAL NETWORK OF ALTERNATIVE FINANCIAL INSTITUTIONS

International Network of Alternative Financial Institutions (INAFI) came into existence as a network of invited-member organisations that follow the community-based models in microfinance. It has 16-member institutions including MYRADA, Sarvodaya Nano Finance and Dhan Foundation, being some of the industry leaders in this segment. It engages in knowledge management in community-based microfinance and client-focused outputs through seminars and conferences. It brings out publications. As an affiliate, Indian Network of Federations of Microfinance Self-Help Groups (INFOS) has also been set up, which is a network of SHG federations in microfinance. Capacity-building of members, training of staff and studies are some of the activities undertaken in both INAFI and INFOS. Dhan Foundation has taken a leadership position in ensuring that the networks are functionally effective. The small membership base and the exclusive nature of the networks limit their area and depth of influence.

UN SOLUTION EXCHANGE

This was launched as a knowledge-sharing initiative in 2005 for contributing to achieve of Millennium Development Goals. There are 11 communities of which, one is devoted to exchange of information and views relating to microfinance. With 1,970 members from differing backgrounds, the platform is a rich source of information on microfinance. Any member is free to raise questions and issues seeking suggestions or views relating to microfinance in this community. Since its inception, 36 questions have been discussed (some ongoing) and the members have offered their considered views enriching the information base. For purpose of this year's report (SOS 2008), members were requested to offer views and inputs on development, innovations in the sector in general and the special challenges of taking microfinance to remote and sparsely populated regions. The inputs from members for these questions have been of great help in drafting of the report. The platform could identify current themes on its own and initiate exchange of views instead of always waiting for members to propose questions. Physical presence in the form of regional workshops and events would add to the impact that the virtual presence of the platform has achieved.

INSTITUTE OF FINANCIAL MANAGEMENT AND RESEARCH—CENTRE FOR MICROFINANCE

Funded by the ICICI foundation, the Institute of Financial Management and Research (IFMR) is engaged in research and experimentation in the financial sector. It has partnered the Grameen Foundation for setting up the Grameen Capital.

IFMR has focused on quality research and knowledge dissemination in the sector. Setting up of the Centre for Microfinance (CMF) has been a particularly, laudable initiative.

The CMF has been engaged in several studies and research on various themes in microfinance and micro-insurance. It carries out assessments and evaluations of institutions and projects. Some of these studies have been excerpted in other chapters. Its focus on developing professionals in the sector, especially researchers have been laudable. It collaborates with a variety of partners to improve its relevance and add to the field-based knowledge. It also offers training courses[10] for microfinance practitioners.

ANDHRA PRADESH MAHILA ABIVIRUDDHI SOCIETY (APMAS)

APMAS is a techno-managerial consultancy organisation that has a vision of 'sustainability of SHG movement'. Since 2001, it provides consulting services relating to ratings, assessments, institutional design and business modelling. It undertakes capacity building, research and advocacy. It is more active in AP and also involved in specific projects in other states. It has several training courses for NGOs, MFIs, bank staff and government functionaries relating to SHGs and federations. It reports having trained more than 31,000 people directly in its training courses. It has been active in the SHG federation-related areas and has brought out a comprehensive document on federations. It is supported by four different external funders. Its recent initiative is that of forming a network of resource organisations in SHG-based microfinance to prepare a national action plan and concertedly work towards expanding the knowledge and training resource base. The other organisations in the network are Reach India—Kolkata, Chaitanya—Pune, CMF—Jaipur, Indian School of Microfinance for Women—Ahmedabad, SHG promotional Forum—West Bengal and Gramin Mahila Okkuta—Karnataka. The network initiative is being funded by the Ford Foundation.

REACH INDIA

Reach India is a service provider to the constituents of the SHG movement. It has been set up by Freedom from Hunger, in Kolkata. It provides training and related services to strengthen capacities of SHGs in the areas of book-keeping, governance, business and planning. The SHPIs are provided training in building quality groups, management systems, market research and internal assessment studies. Reach has set up field-based service centres in Assam, Bihar, Jharkhand, Orissa and West Bengal. Its focus is on east and north-east India.

ACCESS DEVELOPMENT SERVICES

ACCESS is a technical services provider that is two years old, formed as an exit strategy of CARE's successful credit and savings for household enterprise (CASHE) project on microfinance. In these two years ACCESS has developed into a competent, technical organisation, well-positioned to meet the requirements of the sector at the macro-, meso- and micro levels. Its Microfinance India platform commissions the state-of-the-sector report and organises the annual international conference on Indian Microfinance. The investment fair that accompanied the conference last year not only built capacities of MFIs in preparing their pitch books, but also brought the investors and potential investees together. The ACCESS Microfinance Alliance (AMFA) is a partner network with 110 members. It provides services to partners in HR, capacity-building, business-modelling, escort services and resource mobilisation. ACCESS typically works with smaller MFIs that find it difficult to obtain bank finance. It incubates small MFIs in their growth phase under a programme of SIDBI. The microfinance resource centres in five states strengthen the resources of the AMFA. AMFA has been able to attract considerable interest from banks, SIDBI, insurance companies and donors. Its partner list in terms of projects and events comprises apex banks, retail banks, international and domestic donors, international organisations and multilaterals. The work done through AMFA is a more involved, technical service provision model. The challenge before ACCESS is to manage the high expectations from it on account of the quality work done during the first year of its operation. Its ability to grow in a fast-growing sector with its mission of community-based development in tact, would be a test for its character. The presence in five states may not be sufficient as it approaches the future to occupy a larger space.

MICROSAVE INDIA

The Indian-based operation of the internationally acclaimed MicroSave is located in Lucknow. Its credo is providing practical, market-led solutions to assist clients to achieve their mission and objectives. The services offered include strategic business planning, marketing, product development, saving services-related processes, impact assessments and institutional strengthening. MicroSave has some of the best quality documentation in the form of toolkits, focus notes and briefing notes on a variety of issues relating to microfinance sector. Its recent study on savings behaviour and demand for savings products in the north-eastern states has been referred to in this report as the first comprehensive study in the north-east. It has several funding partners such as ABN AMRO, Cordaid, Gates Foundation, DFID, UNDP, CGAP, Ford Foundation, Omidyar Network, HDFC and ICICI Bank. In a cost-conscious market, MicroSave might seem expensive. But the quality of services and the attention to detail make its services valuable.

Centre for Microfinance Research—a new initiative by BIRD

A Centre for Microfinance Research (CMR) has been set up within BIRD to take up research activities in the field of microfinance for facilitating policy initiatives and improvements in design and delivery system of microfinance services. It has a vision of emerging as a centre of reference for information, knowledge and valued opinion related to microfinance sector.

Its mission is to 'strengthen the micro finance sector through supply of researched inputs that facilitate policy initiatives and improvement in design and delivery systems that provide poor with sustainable access to quality financial services'.

BIRD is collaborating with four institutions of repute to set up sub-centres of CMR, which would be funded by BIRD for five years. The partner institutions are:

- Indian Institute of Bank Management (IIBM), Guwahati
- Institute of Financial Management & Research (IFMR), Chennai
- Institute of Development Studies (IDS), Jaipur
- Chandragupta Institute of Management, Patna (CIMP)

INTELLECAP

Intellecap leverages its knowledge of industry and experience of consulting towards designing innovative business solutions for low-income markets. It works with entrepreneurs on the ground in a number of sectors in the developing world. It identifies and supports the best entrepreneurs through its ability to match them with leading investors for capital. Intellecap carries out business-focused research and undertakes capacity-building of client organisations. The two key practice areas are Social Investment Advisory and Strategic Consulting. It has a clutch of affiliates and subsidiaries that are active in microfinance. It was associated with some large, equity placements in Indian MFIs. It brings out a quarterly journal *Microfinance Insights* which has been well-received in the sector. It has a pro-market and commercial orientation that leads it to search for market-based solutions in microfinance and micro-enterprise.

TRAINING AND ACADEMIC INSTITUTIONS

Banker's Institute of Rural Development (BIRD), a society set up by NABARD has been active in the microfinance field for more than a decade. It provides training and consulting support and organises exposure visits in India and abroad for microfinance practitioners. Its clients include banks, government officials and NGOs/MFIs.

Indian School of Microfinance for Women, an organisation based in Ahmadabad, has taken a lead in financial literacy for the poor. Tata-Dhan Academy in Madurai, set up by the Dhan Foundation, offers a good variety of training courses including a Boulder-type course. CMF, Jaipur supported by Sir Ratan Tata Trust has been active in managing knowledge and building capacities of MFIs and also banks in microfinance. It has introduced a course in microfinance in collaboration with the Indian Institute of Banking and Finance.

NEW ENTRANTS

Opportunity International has announced setting up of its operations in India. It would provide equity and loans to MFIs, with preference to Tier II institutions. It has double bottom-line considerations and prefers formal-regulated NBFCs to other forms.

Reliance Capital, though not new to the finance sector, has made an entry into microfinance. It is testing the waters and making an effort to learn the intricacies of bulk-financing MFIs. It targets Tier II and Tier III institutions and has four MFIs in its portfolio.

Rangde has set up a kiva-type person-to-person lending portal, enabling individual lenders to get in touch with borrowers and make loans. It has 56 borrowers availing US$ 6984, in loans by June 2008. Capital Connect, another very differently positioned Web-based platform aims to connect investors with needy institutions that have been set up by EDA Rural Systems group. Capital Connect is positioned as a market place for social enterprise capital that enables structured interactions among its registered participants, leading to sharing of interest for buying/selling equity, lending/borrowing or partnering. After the filtration process by the user on Capital Connect, participants conclude deals independently.

There are many other institutions carrying out remarkable work in the sector that could not be covered due to constraints of space. It does not make their contributions any less valuable. Based on available information, a list of service providers has been compiled[11] and annexed to the chapter.

ANNEX 11.1
List of microfinance resource agencies/service providers

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	Mahila Abhivrudhi Society (APMAS) Plot No. 20, Rao & Raju Colony, Road No-2, Banjara Hills Hyderabad-500034 (AP)	Society Technical services	80	AP & other states	CB on federation promotion & management, rating of federation, livelihoods, research studies	NGOs/MFIs/fedeartions/banks/government 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	AP & 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 E-mail: info@basixindia.com Web: www.basixindia.com	Section 25 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 governments, donors, corporates
4	Intellecap 3-6-307/2 Besides HDFC House, Hyderabad Main Road Hydrabad-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, government departments, investors
5	*Indian School of Business (ISB)* AC6, Level 1 Gachibowli Hyderabad-500032 (AP)	Non-Profit Academic	25	AP & other states	Research, microfinance-elective	NGOs/MFIs/SHPIs, government 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
6	RASS Annamaiah Marg, AIR Bypass Road Tirupati-517501 Tel: +91-877-2242404 Fax: +91-877-2244281 E-mail: rassorg@gmail.com	Society Academic	35	AP	Training programmes on microfinance & micro-entreprises	NGOs, MFIs, SHPIs, MACs
7	JAYAM Solutions Pvt Ltd Prasanka Towers, Flat No-507, KPHB Colony, Kukatpalli Hyderabad-500072 (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
9	Micro Credit Summit Campaign (Dr D.S.K. Rao-Regional Organiser for Asia Pacific) 404, Apurupa Elegance, 7-1-222, Ameerpet Hydrabad-500016 (AP) Tel: +91-40-66614196 Fax: +91-40-23755238 E-mail: 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 programme 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.access.org	Non-Profit (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, government 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 E-mail: info@sa-dhan.org	Society Network	27	Pan-India	Policy advocacy, thematic training programmes on microfinance, micro-insurance, governance, etc., documentation, information dissemination	NGOs, MFIs, SHPIs, support agencies, donors, banks & FIs, line departments
12	Sambodhi Research & Communications Pvt. Ltd B-136, 3rd Floor, Left Wing, Kalkaji New Delhi-110019	Section 25 Research and Consultancy	22	Pan-India	Thematic training programmes on microfinance and other development topics, research & consultancy	NGOs/MFIs, support agencies, donors, government departments

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
13	PARIVARTAN O-2, 3rd Floor, Lajpat Nagar-2 New Delhi-110024 Tel: +91-11-40560734, 65492502, 9312510925 E-mail: contact@parivartan.org.in Web: www.parivartan.org.in	Society Academic	20	New Delhi, Uttar Pradesh, Madhya Pradesh	Thematic training programs on microfinance and other development topics, research studies	NGOs, MFIs, SHPIs, government 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, government 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 E-mail: bcp@irma.ac.in	Trust	22	Pan-India	Research/training materials' development, Ph.D. programmes, short courses, thematic training programs on microfinance	NGOs, MFIs, development professionals, students, academic institutions, government departments, corporates, donors
16	Indian Institute of Management Ahmedabad (IIMA) Vastrapur City Ahmedebad-380015 (Gujarat)	Non-Profit Academic	90	Pan-India	Microfinance elective within a degree programme	NGOs, MFIs, development professionals, students, academic institutions, government departments, corporates, donors
17	Indian School of Microfinance for Women 2nd Floor, Shukum Arcade Near Medisurge Hospital, Mithakhali Ahmedabad-380 006 (Gujarat)	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, government departments, corporates, donors
18	International Center for Entrepreneurship and Career Development (ICECD) E1/41, Sterling City, Bopal Ahmedabad-360058 (Gujarat)	Society Academic	44	Gujarat	Management training, insurance, market researches and enterprise development	NGOs/MFIs, individual entrepreneurs, corporates, government departments, donors

(*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
19	EDA Rural System 602-Pacific Squire, 32 Milestone NH 8 Gurgaon-122001 (Haryana) Tel: +91-1242309707, 4050739 Fax: +91-1242309520 Web: www.edarural.com	Private limited company For-Profit Technical Consultancy	15	Pan-India & abroad	Thematic training programs on microfinance & micro-enterprise	NGOs/MFIs/INGOs, donors, government departments
20	M-CRIL 602-Pacific Squire, 32 Milestone NH 8 Gurgaon-122001 (Haryana)	Private limited company For-Profit Technical Rating	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 (Haryana) Tel: +91-124 3244041	Private limited company For-Profit Consultancy	10	Pan-India	Mentorship, training, diagnostic assessments, loan portfolio audit, business planning, microfinance program implementation	NGOs/MFIs, donors/line departments
22	V. Nagarajan & Co Open House, D-2058, Palam Vihar Gurgaon-122017, (Haryana) Tel: +91-124-4078742/43 E-mail: 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 (Karnataka)	Non-Profit Academic	104	Pan-India	Microfinance elective, microfinance incubator, research and materials' development	NGOs, MFIs, development professionals, students, academic institutions, government departments, corporates, donors
24	SAMPARK N-80, Ground Floor, 2nd main Road, 1st Block, Koramangala Bangalore-560 034 (Karnataka) Tel: +91-80-25530196	Society Non-Profit Research and Studies	16	Karnataka & other states	Impact assessment of microfinance programs	NGOs, MFIs, SHPIs, donor agencies, government departments
25	CRISIL W-101, 1st Floor, Sunrise Chamber, 22 Ulsoor Road Bangalore-560042 (Karnataka)	Private limited company For-Profit Rating	21	Pan-India & abroad	Rating of MFIs, social ratings, sector studies & reviews	MFIs, NABARD & other FIs, donors
26	GRADATIM Gradatim House, 129, 10th Cross, Indira Nagar Bangalore (Karnataka) Tel: +91-44-40429292 E-mail: s@gradtimin.com	Private limited company For-Profit IT Insurance	100	Pan-India & abroad	Software package & IT services on microfinance and micro-insurance	NGOs, MFIs, SHPIs, NBFCs, FIs, RRBs

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
27	Atyati Atyati Technologies, 3005 8th Cross 12th `A' Main HAL, 2nd Stage Bangalore-560008 (Karnataka)	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 on microfinance	NGO-MFIs/CB-MFIs/government departments
29	IGS-BASIX, TH-17, Akash Ganga Colony, Trilanga, Bhopal (MP)	Sec 25 Company Technical Services	5 (Bhopal Team)	Madhya Pradesh	Technical assistance on microfinance and livelihoods	NGO-MFIs/CB-MFIs/livelihood promotion organisations/government departments
30	Madhyam Foundation N-3/202 Ekamra Kanan Road Bhubaneswar-15 (Orissa) Tel: 0674-2557029 E-mail: mfsupport@sify.com	Trust Training	10	Orissa & other states	Microfinance training, institutional development, intermediation between MFIs and donors	MFIs, donors & support organisations, government 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 micro-enterprise, research study, academics, intermediation between NGOs/MFIs and 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 Jeypur-302011 Rajsthan Tel: +91-141-2791431/32/33/34	Non-Profit Technical Services	09	Rajasthan	Handholding services for the community-based MFIs, research studies, impact assessment, policy retreat	NGOs/CBMFIs, state/central governments, donors

(*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
35	Institute of Financial Management & Research (IFMR) 8th Floor, West wing, Fountain Plaza, Khaleel Shiraz Estate, 31/2 A, Pantheon Road, Egmore, Chenai-600 008 (TN) Tel: +91-44-4289 2725 Fax: +91-44-4289 2799 E-mail: 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, government departments, corporates, donors
36	The Center for Microfinance 8th Floor, West wing, Fountain Plaza Chennai (TN)	Non-Profit Research and Technical Services	36	Pan-India	Research studies, impact assessment, policy retreat	NGOs/MFIs, state/central governments, donors
37	Dhan Foundation 18, Pillaiyar Koil Street, S.S. Colony Madurai-625010 (TN) Tel: +91-452-2610794, 2610805 E-mail: 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 (TN) Tel: 0452-2475214	Non-Profit Academic	26	Tamil Nadu & other states	2-year programmes on basics of development management, communication, leadership and institution-building, short training programmes on microfinance and other topics, research studies	NGOs, MFIs, development professionals, students, academic institutions, government departments, corporates, donors
39	International Network of Alternative Financial Institutions—India, 25 A, Bharati 5th Street, SS Colony Madurai-625010 (TN) Tel: +91-452-2300490 E-mail: indiainafi@eth.net	Section 25 Non-Profit Network	5	Pan-India	Thematic training programmes on microfinance, research studies, product development, policy advocacy	Member NGOs and MFIs (80), microfinance, practitioners, donor agencies
40	ALEgION Insurance Broking Ltd St. Ebbas Avenue, P.S. Sivaswamy Salai Mylapore, Chennai-4 (TN)	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

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
41	Microfinance Consulting Group 240-A, Lloyds Roads (Basant Road), Gopalapuram Chenai-600086, (TN)	Non-Profit Technical Services	20	Pan-India & abroad	Thematic training programmes on microfinance & micro-insurance, business planning & internal auditing	NGOs, MFIs, SHPIs, NBFCs, FIs, government 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 (UP) Tel: +91-522-2335734 Fax: +91-522-4063773 E-mail: 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, Kanpur Road, Lucknow-226 012, (UP) Tel: +91-522-2421047 E-mail: bird@sancharnet	Society Academic	15	Pan-India	Training programs for the RRBs and other bankers, training-cum-exposure programmes to other countries	RRBs and other, bank officials, NGOs, MFIs, government 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, government departments, corporates, insurance companies
47	SPADE 52, Garfa Main Road, 1st Floor Kolkata-700 075 (WB) Tel: 033-24185452	Society Training	80	West Bengal	SHG training, manual development	SHPI, SHG, ministry, NGO, MFI
48	Service Centre 58A, Dharmatala Road, Kolkata-700 042 (WB). Tel: 033-24427311/24734364	Society Training	70	West Bengal	SHG training, manual development	SHG, NGOs, SHPI, MFI, ministry

(*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
49	Rural Development Consortium BF-45, Salt Lake City, Sector-1 Kolkata-700064 (WB) 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 Kolkotta-800027 (WB) Tel: +91-33-2479-2450/2452 Web: www.reach-india.net	Trust Technical Services	20	West Bengal & other states	Thematic training programmes on microfinance, micro-enterprises, health, education, etc.	NGOs, MFIs, SHPIs, SHGs-federations
51	Syscon Solutions Pvt. Ltd BB-127, Salt Lake City Kolkotta-700064 (WB)	Private limited For-Profit IT Services	25	West Bengal & other states	Software Package & IT Services	NGOs, MFIs, SHPIs, NBFCs, federations, government departments
52	Reach India	Non-Profit		East and north-east	Training and capacity-building	SHGs, SHPIs
53	Trust Microfin	For-Profit			Incubation, capacity-building and handholding	Small MFIs

NOTES

1. Microfinance Development and Equity Fund has a corpus of Rs 200 crores, contributed by NABARD, RBI and public sector commercial banks. An advisory board provides recommendations on proposals for grant support from the fund.
2. Financial Inclusion Fund and Financial Inclusion Technology Fund of Rs 500 crores corpuses each, have been proposed. Initial contribution is reported to be around Rs 25 crores each. Guidelines for support under the funds are being finalised.
3. Annual Report 2007–08 of NABARD
4. Created by an Act of Parliament, equity held by banks and financial institutions.
5. This is based on discussions with Mr Sridhar, CMD, National Housing Bank and K. Muralidharan, General Manager, NHB.
6. Refers to the additions, extensions and major repairs to the living space.
7. Based on discussions with Mrs Vijayalakshmi Das, CEO, FWWB and FWWB Annual Report 2007–08.
8. Based on its Website and discussions with Mathew Titus, CEO of Sa-Dhan.
9. The Quick Report, the Side by Side Report and its journal *Sa-Dhan Patrika* are regular publications of Sa-Dhan.
10. CMF's immersion programmes in microfinance are well-received in the sector.
11. Compiled by Narendra Nayak, ACCESS Development Services, Delhi.

Future agenda

12
Chapter

AS THE SECTOR MARCHES INTO THE FUTURE . . .

Last year's Side-by-Side report by Sa-Dhan was titled 'Maturing Microfinance—Emerging Challenges'. The title seems very apt in that the sector, in spite of maturing is facing significant challenges; some challenges are of the MFIs' own making. Microfinance has gone beyond the takeoff stage and has shown vigorous growth in many parts of the country. Over the last few years, both the models of delivery, that is of banks providing finance to SHGs and MFIs providing finance through SHGs, joint liability groups (JLGs), Grameen groups and individuals, have posted very good growth rates and show impressive gains both in terms of outreach as also in terms of loan portfolio. The expansion with some exceptions lacks depth. Growth is confined to credit, with very little insurance and even, less savings coverage offered. Even in credit, increase in client numbers accompanied by increase in geographical coverage did not lead to deeper engagement with clients in terms of larger loans and diversified products. The shallow engagement with the clients on account of the 'touch and move on' business models rendered the operational costs high. The operational costs could have declined more rapidly if 'higher per client' business had been targeted. Consolidating the existing client base and fulfilling their financial services needs more comprehensively, 'hold the key' to lower costs, higher returns and client loyalty. The intense competition in the sector warrants better client retention strategies in terms of costs and products.

Commercial funds are available to a much larger extent than ever in the past. But funds do not flow freely everywhere. The larger MFIs, professionally run medium-sized ones and some of the smaller MFIs find it easier to access funds. SHGs do find it easy to get the first linkage in several states and even after linkage, the size of loans remains small. Equity funds have started flowing from large and small equity investors as also institutions like Small Industries Development Bank of India (SIDBI) and National Bank for Agriculture and Rural Development (NABARD). The capital requirements of existing companies and the long list of entities in different stages of transformation is high, and is set to escalate with the resetting of regulatory capital norms. The non-company MFIs require more capital funds in view of the very high leverage ratios. Considerable work has to be carried out by NBFCs to become equity-friendly and create a positive investment environment. It is difficult to predict the form and avenue of capital funds flows to the non-company MFIs. Quasi-equity and long-term loans might substitute for equity, but such investments may not figure high on the list of preferences of investors.

Mission Drift is more often mentioned in discussions. The admiration for the pace of growth is accompanied by unease at the manner and content of expansion. The yearning for organisational transformation in many cases does not seem to be a well-thought-out strategy of upscaling operations, but seems an image-makeover exercise. Community-owned and -managed forms seem to be out of fashion. Most transformations involving MFIs tend to result in erosion of public goods. The donors, funders and industry leaders need to have a serious rethink of the pattern of growth, which is tending to become unidimensional toward private profits. Community-owned financial institutions designed as 'for profits' would probably target double bottom lines better than privately owned forms.

The initial experiments with cell phone solutions promise a lot. They have the capacity to upscale rapidly, as both the infrastructure and software are not constraints. *Cellular finance* might emerge as an alternative to brick and mortar MFIs with significant competition for the medium and small MFIs. Technology and platform providers might take to finance rather than providing a space for MFIs to operate on their technology and infrastructure. In the business correspondent/business facilitator (BC/BF) sphere, such developments have already taken place where technology providers have set up entities to function as correspondents with multiple banks. Vodafone and Airtel have announced their intentions of entering the financial sector space. Such large players have the muscle required to roll out services across the country. Cell phone companies' familiarity with client acquisition in new markets and compliance with Know Your Customer (KYC) norms should place them at an advantage over other competitors.

Although the BC/BF is slow in taking- off, there are signs of faster growth. The initial learning period seems to have been a long one in which the banks have done their preparatory work. The regulatory norms on location of banking correspondents have come as a dampener. The BC arrangement has the potential to provide stiff competition to MFIs. BCs, operating as agents of mainline banks are in a position to offer a variety of services including the critical savings services. This provides them an edge over the MFIs. Banks are investing in technology to strengthen the BCs' capacity to provide efficient services to the clients and seamlessly work with the bank's own accounting and information systems. This might prove to be a critical difference in the market place where technology adoption among MFIs is not very high. When the competition intensifies, some of the larger MFIs may appoint BCs to survive. The MFIs in order to be ahead of the game and offer a viable alternative to clients should add other features to their present basket of services. The entry of large corporates is likely to intensify the competitive pressures. Apart from technical and human capacities, deep pockets might be needed to counter serious competition from large players.

Regulation is an aspect that would continue to be watched by the sector. While the NBFCs are being brought under increasing regulatory rigour, the NGO/MFIs are not subject to much regulation. The weak regulation attempted through passing the microfinance bill into a statute is not likely to protect the large number of clients that borrow from the NGO/MFIs. Regulatory stance must move from the position that only depositors' interests need to be protected. The small borrowers are equally active in the local economies, and they invest their future compared to savers who sacrifice only their past with the financial institutions. The millions of micro livelihoods that are critically dependent on continued availability of credit need to be protected. This would call for a significant change in the regulatory stance. The Central Bank of the country must design means for effectively regulating the credit activity that takes place in the vulnerable sections of the economy although they may not be systemically significant. Avenues for savings need expansion.

Savings has been an aspect of microfinance service that has by and large, been left to the working of SHGs to do. The MFIs neither actively pursue this nor those who pursue do so in a manner designed to produce best results. The regulatory clearances required to mobilise savings mostly preclude MFIs. The regulator has to take a view as to whether institutions set up at a great expense with adequate infrastructure and manpower should work to only one-half of their potential. The issues relating to depositor's safety needs are to be addressed separately through a mechanism of deposit insurance.

Micro-insurance despite the potential has a long way to traverse. The present market is more dependent on government initiatives. The insurer and MFI/NGO-led initiatives are far too small to be significant in the context of the size of the market. Life and health insurance products are receiving attention; while on other risks, there has not been much action. Even where the government has come out with good products, distribution to the potential clients has been difficult for want of partners across the country. The area of immediate action in insurance seems to be in recruitment of partners for distribution of insurance and marketing campaigns. MFIs stand to gain in distribution of insurance.

Clients, despite becoming large in numbers, are still in the fringes of the sector. Supply being severely limited when compared to demand, the market is dominated by the sellers. As the clients are from vulnerable sections, the presumption is that

they are unequal in dealing with any financial institution and would be subject to exploitation. Client protection in such markets is the responsibility of the state. Before the issue becomes a core concern of the State, the sector has to voluntarily introduce safeguards that improve client protection. Grievance redressal mechanisms within each institution and across the sector, are necessary. The code of conduct should be strengthened and mechanisms of compliance, put in place.

Shortage of human resources is undoubtedly the major problem that would impact the sector during the next two years. While few efforts have been taken to create academic courses at universities and management institutes, training courses for personnel to improve their industry readiness is not available in general. The institutions have to organise in-house training for the new recruits as well as existing staff. Industry-level investments in training including infrastructure, must be enhanced.

Microfinance has to develop a greater sensitivity to the needs of the poor clients. The small loans should give way to livelihood support loans of a larger size and longer duration. Only when livelihoods and incomes are targeted microfinance sector can claim that its mission is achieved.

Appendix

Table A.1 Fact sheet on coverage and growth of SHGs and MFIs, March 2008

Outreach

1	Cumulative number of persons in linked SHGs	45.20 million*
2	Total number of SHG members, currently linked	39.9 million†
3	Total number of MFI borrowers	14.01 million‡
4	Growth of outreach of the SHG programme in 2006–07	18%
5	Growth of outreach of MFIs, 2006–07	40%§

*3.478 million SHGs ever-linked at an average of 13 members each.
†Ninety-eight per cent of SHGs are currently assumed to be linked, based on the NABARD data on SHGs with outstanding loans at 2.84 million against groups ever-linked of 29.2 million as at end of March 2007. Ten per cent of members estimated to have dropped out.
‡Sa-Dhan estimate of 14.01 million members served by 223 MFIs, as reported in Sa-Dhan's Quick Report 2008.
§Based on Sa-Dhan Quick Data 2008.

Loan Outstanding

Loans outstanding under the SHG programme, March 2008	Not available
Loans outstanding under the MFI model	Rs 59,540 mn*
Growth of loans outstanding under the SHG programme	Not available
Growth of loans outstanding of MFIs in 2006–07	Rs 24,980 mn†
Average loans outstanding, SHG members	Rs 3,250‡
Average loans outstanding, MFI borrower	Rs 4,220§

*Based on Sa-Dhan Quick Data 2008.
†Based on Sa-Dhan Quick Data 2008.
‡Data pertains to 2007, as reported by NABARD in Status of Microfinance in India 2006–07.
§Average derived from Sa-Dhan Quick Data 2008.

Broadly Defined Microfinance Sector Clients—loans

Class of agency	No. of clients, March 2007 (millions)
Commercial banks* (including RRBs) small loan accounts (Rs 25,000 & less)	38.6
Primary cooperative societies borrowers (small, vulnerable)†	26.5
SHGs—members‡	39.9
MFIs—clients§	14.1
Total	119.1
Adjusted for over lap between banks and MFIs¶	114.7

*Basic Statistical Returns of Commercial Banks 2006–07, RBI. Progress of Primary Agricultural Credit Societies, 2006–07, National Federation of State Cooperative Banks.
†Progress of Primary Agricultural Credit Societies, 2006–07, National Federation of State Cooperative Banks.
‡Of the estimated cumulative number of SHGs linked of 3.478 million, the existing accounts are estimated at 3.408 million based on 2006–07 data on outstanding loan accounts of SHGs (98 per cent of linked accounts). At the rate of 13 members per group (the average as per the NCAER study) and a drop-out rate of 10 per cent, the number of members is estimated at 39.9 million. The issue of multiple SHG membership is not tackled directly in this calculation. But in the adjustment carried out for overlaps, this would have been rectified.
§The Bharat Microfinance Report, Quick Data, 2007–08—Sa-Dhan.
¶The client base of MFIs is at 14.1 million of which 7.26 million is that of MFIs, following only SHG methodology and 2.84 million of MFIs that follow SHGs, as one of the methods. Out of fifty per cent of clientele of SHGs, only MFIs and 25 per cent of clientele of mixed method MFIs have been reduced from overall numbers of clients to account for the overlap between banks and MFIs and multiple borrowings from different MFIs. In any case, the microfinance sector is likely to have more than 100 million borrower accounts.

Table A.2 Details of MFIs reporting to Sa-Dhan Quick Data

S. no.	Name of MFI	Location	Outreach	Gross-loan portfolio (lakhs)	Legal form	Delivery model	Borrowings (lakhs)	Net-owned funds (lakhs)	Operating cost ratios	Category (Outreach)	Category (GLP)
1	Gram Utthan	Orissa	74,142	3,727	1995	SHG	3,147	48	7%	L	M
2	Community Service Trust	TN	5,207	243	2005	SHG	248	3	20%	S	S
3	Bihar Development Trust	Bihar	200	3	2007	Grameen	5	5	–	S	S
4	Centre for Development, Orientation and Training	Bihar	580	40	2007	SHG, JLG	70	6	–	S	S
5	Disha Social Organisation	UP, Uttranchal	1,831	105	2006	SHG	115	4	14%	S	S
6	Mari-Sanghatitha Mahila Macs Federation Ltd.	AP	30,085	644	2005	SHG	580	111	4%	M	M
7	Jaago Samajik Arthik & Harit Vikas Sangathan	UP	18	1	2007	Grameen	1	1	–	S	S
8	Sharda's Women's Association for Weaker Section (SCCI)	AP, Orissa, TN, Maharashtra	74,175	4,267	1999	Grameen, individual lending	4,478	20	12%	L	M
9	SEARCH—KOPSA	TN	25,871	1,501	1989	SHG	1,796	425	6%	M	M
10	Glow	TN, Karnataka	3,801	175	2001	SHG, JLG	144	31	13%	S	S
11	People's Action for Transformation	TN	13,951	500	2003	SHG	500	37	7%	M	M
12	ASA Gram Vidiyal	TN	2,63,022	11,530	1994	Individual lending	9,114	1925	5%	L	L
13	PWMACs	AP	18,702	1,626	1997	JLG, individual lending	1,952	117	9%	M	M
14	Nirantara Community Services	Karnataka	3,422	153	2006	Grameen	213	1	33%	S	S
15	Sanghamithra Rural Financial Services	Karnataka, TN, AP	21,262	4,861	2000	SHG	4,246	675	3%	M	M
16	Kotalipara Development Society	WB	50,677	1,295	1997	SHG	737	123	15%	L	M
17	Mahashakti Foundation	Orissa	14,083	486	2004	SHG,JLG	659	408	7%	M	S
18	Pragati Seva Samiti	AP	42,216	4,147	2000	SHG	1,114	324	2%	M	M
19	Community Development Centre	TN	26,664	1,051	1998	SHG	1,046	0	4%	M	M
20	Star Microfin Service Society	AP	24,876	1,368	1997	Grameen	1,500	111	18%	M	M

21	Lok Biradari Trust—Indore	MP	2,253	81	2006	JLG	78	1	21%	S	S
22	NIDAN	Bihar	18,508	239	1996	SHG	345	36	3%	M	S
23	Bharat Integrated Social Welfare Agency	Orissa, Chattis-garh, Bihar, Jharkhand, WB	2,46,430	11,804	1995	SHG	11,322	840	1%	L	L
24	Rashtriya Seva Samithi	AP, TN	50,062	3,395	1989	SHG	3,227	414	2%	L	M
25	Social Education and Voluntary Action	AP	18,641	979	2002	SHG	568	77	2%	M	M
26	New Life	TN	24,549	78	1993	SHG	68	10	9%	M	S
27	Youth Council for Devel-opment Alternatives	Orissa	614	26	1997	SHG, JLG, Coop	23	0	8%	S	S
28	Institute of Rural Credit and Entrepreneurship Development (IRCED)	Maharashtra, Karnataka	10,170	41	2006	SHG, JLG	70	17	8%	M	S
29	Ajiwika Society	Jharkhand, Bihar	4,639	263	2005	JLG	309	25	22%	S	S
30	SURAJE	Bihar	262	12	2003	JLG	7	4	34%	S	S
31	Srijan Foundation, Hazaribagh	Jharkhand	84	3	2007	SHG, JLG	1	0	39%	S	S
32	Samarthan Weakling Development Foundation	Jharkhand	1,804	64	2006	SHG, JLG	64	0	19%	S	S
33	Siri Microfin Society, Kur-nool—AP	AP	3,900	336	2004	JLG	282	53	12%	S	S
34	Hope Integrated Rural Development Society	AP	3,170	115	2005	Grameen & SHG	157	7	13%	S	S
35	Grameen Mahila Swayam Siddha Sangh—Chaitanya	Maharashtra	16,125	167	1993	SHG	150	7	11%	M	S
36	Khandagiri Madyamika Mahila Samabya Sangh Ltd.	Orissa	9,547	48	2002	Wholesale	41	103	4%	S	S
37	Hope Foundation	Kerala, TN, Kharkhand, WB, Orissa	26,315	460	2005	SHG	435	15	20%	M	S
38	Nirman Bharti Samajik & Arthik Vikas	UP, Uttranchal	52,040	2,564	2006	JLG	2,830	184	5%	L	M

(continued)

S. no.	Name of MFI	Location	Outreach	Gross-loan portfolio (lakhs)	Legal form	Delivery model	Borrowings (lakhs)	Net-owned funds (lakhs)	Operating cost ratios	Category (Outreach)	Category (GLP)
39	Spandana Sphoorty Financial Ltd.	AP, Karnataka, TN, Maharashtra, Orissa, Chattisgarh, MP, Rajasthan	1,188,861	72,850	1998	JLG, individual lending	68,179	9405	6%	L	L
40	Mass Care International	Bihar, Jharkhand	1,200	26	2003	SHG, JLG, Grameen, individual lending	5	20	16%	S	S
41	Welfare Services Ernakulam	Kerala	31,078	681	2001	SHG	589	92	4%	M	M
42	Indian Institute of Rural Development	Rajasthan	3,236	199	2007	JLG	167	21	12%	S	S
43	Grameen Koota	Karnataka	1,39,114	8,265	1999	Grameen	9,012	1740	17%	L	L
44	PRAYAS (Organisation for Sustainable Development)	Gujarat, MP	2,943	140	2006	West	76	64	26%	S	S
45	Society for Model Gram Bikash Kendra	WB	7,856	132	2004	SHG	131	9	24%	S	S
46	The Max Wealth Trust	AP	30,577	2,209	2006	SHG, JLG	1,296	912	13%	M	M
47	Samuha	Karnataka	13,583	509	2006	SHG	472	68	7%	M	M
48	AMMACTS (Future Financial Services Ltd.)	AP, Karnataka, TN	1,64,666	8,428	1998	JLG	6,435	1424	9%	L	L
49	Nav Bharat Jagriti Kendra	Jharkhand, Bihar	10,744	491	1993	SHG, JLG, individual lending	251	321	11%	M	S
50	Saadhana Microfin Society, Kurnool	AP	76,580	3,244	2001	Individual lending, bulk lending	7,912	512	10%	L	M
51	Bhartiya Samruddhi Finance Ltd. (BASIX)	AP, Chattisgarh, Jharkhand, Karnataka, Maharashtra, MP, Orissa, Rajasthan	3,05,438	22,541	1997	SHG, JLG, individual lending	17,110	3123	17%	L	L
52	Krishna Bhima Samruddhi Local Area Bank Ltd.	AP, Karnataka	1,00,495	5,210	2001	JLG, individual lending	7,052	935	14%	L	L
53	ADARSA	Orissa	6,160	32	1998	SHG	32	1	10%	S	S
54	MANSI	Bihar	72	1	2007	SHG	3	0	44%	S	S

55	Bal Mahila Vikas Samiti (VAMA)	MP	2,530	192	2005	SHG	155	3	12%	S	S
56	Sahara Utsarga Welfare Society	WB	1,24,865	3,401	1999	SHG	1,325	350	8%	L	M
57	Opportunity Microfinance India Ltd.	Karnataka, TN, AP, Kerala, Orissa	16,954	456	2001	SHG	0	708	15%	M	S
58	Vardan Trust, Dahod	Gujarat	11,113	485	2003	JLG, Grameen, individual lending	490	100	11%	M	S
59	Creation Welfare Society	Bihar	941	9	2006	SHG, JLG	10	1	42%	S	S
60	Samita Jan Kalyan Parishad	Bihar	780	2	2006	SHG	2	0	25%	S	S
61	SUPPORT	Jharkhand	6,857	88	2005	SHG, individual lending	105	1	14%	S	S
62	Sreema Mahila Samity	WB	71,786	2,416	2000	SHG	2,627	171	5%	L	M
63	SWATI	Orissa	3,948	19	2001	SHG, JLG, individual lending	4	1	14%	S	S
64	Kalighat Society for Development Facilitation	WB	14,917	357	2002	SHG, JLG	329	17	11%	M	S
65	Village Micro Credit Services	WB	64,676	2,467	2005	JLG, individual lending	2,807	27	9%	L	M
66	Navachetana Foundation	Karnataka	22,730	320	2006	SHG, Grameen	298	23	13%	M	S
67	Bharat Sevak Samaj	Kerala	66,794	3,149	1999	SHG	0	385	4%	L	M
68	Trust Microfin Services	Bihar	2,812	103	1999	SHG, JLG	155	13	3%	S	S
69	Evangelical Social Action Forum	Kerala, TN, Maharashtra, Chattisgarh	2,22,123	7,066	1996	Grameen	6,180	475	13%	L	L
70	Mimo Finance (Shah Sandhu Finance Company Pvt. Ltd.)	Uttaranchal, UP, HP	15,542	573	2006	JLG	425	184	44%	M	M
71	Vivekananda Sevakendra-O-Sishu Uddyan	WB	68,723	831	1994	JLG, individual lending	479	523	6%	L	M
72	Sarvodaya Nano Finance Limited	TN, Bijhar, Jharkhand, MP, Rajasthan	5,23,385	8,853	2001	SHG	8,629	1548	12%	L	L
73	Bharatha Swamukti Samsthe, Bangalore	Karnataka	1,42,613	8,141	1999	Grameen	6,597	1328	9%	L	L

(*continued*)

S. no.	Name of MFI	Location	Outreach	Gross-loan portfolio (lakhs)	Legal form	Delivery model	Borrowings (lakhs)	Net-owned funds (lakhs)	Operating cost ratios	Category (Outreach)	Category (GLP)
74	BANDHU	Orissa	72,550	126	2000	SHG	195	0	83%	L	S
75	Gramin Jan Kalyan Parishad	Bihar	12,062	30	2005	SHG, JLG, individual lending	30	0	9%	M	S
76	Organisation for Development Integrated, Social and Health Action (ODISHA)	Orissa	14,350	379	2004	SHG	253	126	1%	M	S
77	Priyasakhi Mahila Sangh, Indore	MP	3,500	53	1999	SHG	14	5	21%	S	S
78	Sahabhagi Vikash Abhiyan	Orissa	11,221	148	1996	SHG	0	42	0%	M	S
79	Bajkul Sports Association	WB	15,124	402	1970	Grameen	322	53	10%	M	S
80	Initiatives For Develop-ment Foundation	Karnataka	28,618	781	2005	SHG	989	49	5%	M	M
81	SIDRIB	Bihar	100	2	2007	SHG	5	3	–	S	S
82	Planned Social Concern (PSC)	Rajasthan	2,668	148	2007	Grameen	28	140	30%	S	S
83	Saath Charitable Trust (Sakhi)	Gujarat	301	26	1994	JLG	39	4	12%	S	S
84	Saath Charitable Trust (Ekta)	Gujarat	632	65	1994	JLG	57	2	6%	S	S
85	Sarala Women Welfare Society	WB	19,838	514	2006	ASA	403	42	9%	M	M
86	Gramin Vikas Mandal, Bansarola	Maharashtra	14	2	2003	SHG	2	0	0%	S	S
87	Chetna Mahila Vikas Kendra, Pune	Maharashtra	115	5	2008	SHG	5	0	0%	S	S
88	Tiruvalla Social Service Society (Bodhana)	Kerala	8,943	98	1998	SHG	48	51	0%	S	S
89	Yuva Vikas Sangathan	Arunanchal Pradesh	–	–	2006	SHG	0	0	–	S	S
90	Indur Intideepam MACs Federation Ltd.	AP	18,645	1,925	2002	SHG	1,346	258	19%	M	M
91	Priyadarshani Mahlia Gramin Kalyan Sanstha	Maharashtra	4,401	119	2005	SHG, JLG	118	4	10%	S	S
92	Mahasemam Trust	TN	91,756	3,267	1999	Grameen	3,460	315	61%	L	M

93	SMILE Ltd.	TN	1,40,637	7,393	1999	Grameen	7,238	633	4%	L	L
94	Ujjivan Financial Services Pvt. Ltd.	Karnataka, Delhi, WB	68,033	3,657	2005	Grameen	2,451	967	38%	L	M
95	Darbar Sahitya Sansad (DSS)	Orissa	6,818	108	1995	SHG, JLG	218	3	15%	S	S
96	League for Education and Development (LEAD)	TN	29,683	161	1987	SHG	180	69	21%	M	S
97	Sangamam Women's Multipurpose Thrift and Credit Co-operative Society Ltd., Trichy	TN, Karnataka, Puducherry	41,052	406	2004	SHG	134	261	31%	M	S
98	BWDA Finance Limited (BFL)	TN, Puducherry	2,92,729	8,513	2003	SHG	8,259	1135	14%	L	L
99	Prochesta	Assam	39,810	58	2001	SHG	5	33	22%	M	S
100	BATIKA	Bihar	300	5	2007	SHG	4	2	20%	S	S
101	Agradut Polly Unnayan Samity	WB	3,033	121	1999	Grameen	68	2	41%	S	S
102	Cashpor Micro Credit	UP, Bihar	3,02,855	14,729	1997	Grameen	14,669	95	26%	L	L
103	Bandhan Financial Services Pvt. Ltd.	WB, Tripura	1,38,811	5,268	2006	Individual lending	3,254	1121	10%	L	L
104	Sakhi (an organisation for women)	Gujarat	1,596	62	2005	SHG, JLG	98	0	18%	S	S
105	Bandhan Konnagar	WB, Assam, Bihar, Jharkhand, Orissa, Meghalaya	7,57,887	27,828	2001	Individual lending	28,095	3556	21%	L	L
106	ANG Resources Ltd.	WB	34,280	1,297	2006	JLG, Grameen	1,195	172	20%	M	M
107	Tripura Rural Development Organisation	Tripura	42	0	2004	SHG, Individual lending	0	2	72%	S	S
108	Harindanga Ramakrishna Vivekananda Sangha	WB	5,110	190	2003	Grameen	143	47	22%	S	S
109	Outreach	AP, TN, Karnataka	2,920	187	2000	SHG	0	213	7%	S	S
110	Swayamshree Micro Credit Services	Orissa	28,585	1,373	2003	SHG	1,292	147	3%	M	M
111	Samajik Vikas Sansthan	Bihar	113	3	2007	SHG	3	1	7%	S	S
112	Jan Jagran Evam Punarawas Sansthan	Bihar	3,070	23	2003	SHG, JLG, Grameen	0	15	3%	S	S

(*continued*)

S. no.	Name of MFI	Location	Outreach	Gross-loan portfolio (lakhs)	Legal form	Delivery model	Borrowings (lakhs)	Net-owned funds (lakhs)	Operating cost ratios	Category (Outreach)	Category (GLP)
113	Bureau of Obligate and Accompanier for Rural Development	Bihar	296	8	1999	SHG, JLG, Grameen	2	0	2%	S	S
114	Humana People to People India	Rajasthan	1,458	71	2007	SHG, Grameen	50	5	27%	S	S
115	Margadarshak Develop-ment Services Pvt. Ltd.	UP	1,253	59	2007	SHG	72	10	52%	S	S
116	Village Financial Services Pvt. Ltd.	WB	44,717	1,718	2006	JLG	1,800	22	15%	M	M
117	Prayas	Jharkhand	1,050	64	2005	SHG, JLG	110	0	6%	S	S
118	Adhikar	Orissa	55,750	2,059	2004	Grameen, Self-Help Cooperatives	1,846	184	10%	L	M
119	Belgaharia Janakalyan Samity	WB	3,171	84	2006	SHG	80	3	17%	S	S
120	Mahila Kalyan Samiti, Dhori	Jharkhand	1,061	61	2004	JLG	67	1	137%	S	S
121	Shalom Trust	TN, Kerala	23,785	1,506	1998	SHG	1,829	39	10%	M	M
122	KAS Foundation	Orissa, AP, MP, Chattisgarh, Maharashtra, TN, WB, Puducherry	5,62,377	10,683	2003	SHG, JLG	5,025	0	7%	L	L
123	Ullon Social Welfare Society	WB	4,138	91	2000	Individual lending	0	195	7%	S	S
124	Mahila Vikas Prathamika Sanchaya Samabaya Ltd.	Orissa	823	18	2003	SHG	3	12	5%	S	S
125	Samhita Community Development Services	MP	1,005	44	2007	JLG	18	11	46%	S	S
126	Krushi Vikas Gramin & Prashikshan Sanstha, Talani	Maharashtra	670	19	2007	SHG, JLG	45	0	20%	S	S
127	Deepalaya	Delhi, Haryana, Uttranchal	8,627	148	2005	SHG	0	0	0%	S	S
128	Human Development Centre	WB	6,712	166	2001	SHG, individual lending	166	0	12%	S	S
129	Mata Deen Mahila Manch	Bihar	209	15	2005	SHG, JLG, Grameen	0	15	3%	S	S
130	Rajapur Seva Niketan	WB	2,870	148	2000	SHG, JLG	150	0	6%	S	S

131	Omalur Block Women Welfare Uplift Organisation (OBWWUO)	TN	1,045	99	2005	SHG	99	0	3%	S	S
132	Unnati Mahila Sangh, Indore	MP	2,966	85	1999	SHG, JLG	190	1	12%	S	S
133	Samagra Gram Vikas Sanstha `Sagras'	Maharashtra	2,905	42	2004	SHG, JLG, Grameen	36	18	6%	S	S
134	Vedika Credit Capital	Jharkhand, Delhi	20,482	1,341	2004	JLG, individual lending	903	1,025	17%	M	M
135	Mother Therisa Mahila MACCS Ltd.	AP	2,715	32	1999	SHG, Grameen, individual lending	29	48	4%	S	S
136	Yukti Samaj Sewa Society	MP	3,343	25	2008	SHG, JLG	33	0	28%	S	S
137	Sampada Trust	Maharashtra	20,894	607	2007	SHG	677	0	8%	M	M
138	Swadhaar Fin Access	Maharashtra	3,524	111	2005	JLG, individual lending	187	6	221%	S	S
139	Rashtriya Gramin Vikas Nidhi	Assam	44,722	2,695	1995	SHG, JLG	4,116	118	9%	M	M
140	Arman Lease & Finance Ltd.	Gujarat	4,231	1,598	1992	Individual lending	1,149	669	5%	S	M
141	Pipekara Kamala Seva Samity	WB	1,730	52	1998	SHG	19	4	5%	S	S
142	SE Investments Ltd.	UP, Rajasthan, Gujarat, Delhi	83,333	12,101	2006	Individual lending	12,144	3,420	1%	L	L
143	Cohesion Foundation Trust	Gujarat	3,181	17	2002	SHG	0	5	45%	S	S
144	Grameen Sahara	Assam	1,286	65	2006	SHG, JLG	70	0	25%	S	S
145	Aadarsha Welfare Society	AP	33,196	2,783	2003	SHG, JLG	2,735	211	2%	M	M
146	Centre for Action and Rural Reconstruction	Orissa	1,007	22	2006	SHG, JLG, cooperative	34	1	15%	S	S
147	Sambhav Micro Finance Institute	MP, UP	664	70	2007	SHG, JLG, individual lending	75	0	20%	S	S
148	Sonata Fiance Pvt. Ltd.	UP, MP	44,387	2,321	2006	Grameen	2,072	552	16%	M	M
149	Ecumenical Church Loan Fund of India	TN, Manipur, Nagaland, Maharashtra	10,303	513	1980	SHG	0	0	15%	M	S

(*continued*)

S. no.	Name of MFI	Location	Outreach	Gross-loan portfolio (lakhs)	Legal form	Delivery model	Borrowings (lakhs)	Net-owned funds (lakhs)	Operating cost ratios	Category (Outreach)	Category (GLP)
150	SKS Microfinance Pvt. Ltd.	AP, Bihar, Chattisgarh, Delhi, Gujarat, Jharkhand, Kerala, MP, Maharashtra, Orissa, UP, Uttranchal, WB, Rajasthan	1,879,258	78,186	1998	JLG	78,186	21435	14%	L	L
151	Confederation of Voluntary Associations (COVA)	AP	11,341	276	2001	SHG	22	70	7%	M	S
152	KRUSHI	AP	41,483	2,388	2002	SHG, JLG	1,500	72	4%	M	M
153	Asmitha Microfin Ltd.	AP, Orissa, Karnataka, Maharashtra	7,01,432	33,591	2002	JLG, Grameen, individual lending	30,308	3,795	10%	L	L
154	PAHAL	Uttaranchal, UP	533	39	2005	SHG, JLG, Individual Lending	75	5	12%	S	S
155	Manidham Grameen Savings & Credit Services (MGSCS)	TN, AP	15,763	585	2004	Grameen	438	43	6%	M	M
156	Mahila Arthik Vikas Mahamandal	Maharashtra	6,84,873	13,201	1994	SHG	0	0	0%	L	L
157	Social Action for Rural Community	Orissa	393	11	2000	SHG	10	1	30%	S	S
158	Satra	Assam	2,694	58	2004	JLG, individual lending	58	0	5%	S	S
159	Centre for Rural Reconstruction Through Social Action	AP	26,412	1,387	1997	Grameen	1,489	0	0%	M	M
160	Agricultural Science Foundation	Karnataka	16,448	361	2005	SHG, JLG	342	0	5%	M	S
161	Organization for Rural Survival	Tripura	20	1	2001	SHG	0	1	0%	S	S
162	Bhoruka Charitable Trust	Rajasthan	595	12	2003	SHG	105	0	0%	S	S
163	Vikas Centre for Development	Gujarat	8,145	258	2005	SHG	140	6	11%	S	S

164	Sevashram	Kerala	6,140	166	1995	SHG	128	27	4%	S	S
165	Hindusthan Cooperative Credit Society Ltd.	Maharashtra	1,325	296	2006	JLG	322	0	8%	S	S
166	Vaagdevi Mahila MACS Ltd.	AP	5,300	80	2001	SHG	15	86	7%	S	S
167	Mahalir Association for Literacy, Awareness and Rights (MALAR)	TN	24,541	231	1995	SHG	100	173	17%	M	S
168	PARATH Samithi	MP	9,231	37	2006	SHG	38	2	27%	S	S
169	Yuva Chetana Kendra	UP	6,225	73	2001	SHG	0	130	2%	S	S
170	Serve—Sewa	Jharkhand	1,060	27	2000	SHG, individual lending	20	15	2%	S	S
171	Uttarakhand Microfinance and Livelihood Promotion Cooperative Institution	Uttaranchal	25	2	2007	SHG, JLG	0	500	–	S	S
172	SKDRDP	Karnataka	5,74,968	33,706	1996	SHG	56,414	2,434	4%	L	L
173	Asian Institute for Rural Regeneration	Orissa	12,307	114	2004	SHG, JLG	110	4	12%	M	S
174	People's Action for Natinal Integration (PANI)	UP	4,220	281	2003	SHG	55	123	17%	S	S
175	Raghunath Pathagar (RNP)	Orissa	9,220	784	1999	SHG, JLG	549	235	6%	S	M
176	Asmita Institute for Development	Maharashtra	8,311	892	2002	SHG	0	0	0%	S	M
177	Manab Sewa Sangha	Assam	1,310	33	2002	SHG	35	17	21%	S	S
178	Share Microfin Ltd.	AP, Chattisgarh, Jharkhand, Karnataka, Maharashtra, MP, Orissa, Rajasthan, Bihar, UP, Uttranchal	1,289,328	59,530	1993	JLG, individual lending	51,612	99,461	10%	L	L
179	Nav Jagriti	Bihar	2,250	81	2002	SHG	26	2	5%	S	S
180	Kalangana Bazar Educational Trust (KBET)	Jharkhand	2,145	45	2006	SHG	65	0	15%	S	S
181	Navchetna-Yavatmal	Maharashtra	1,067	59	2001	SHG, JLG	0	0	0%	S	S

(continued)

S. no.	Name of MFI	Location	Outreach	Gross-loan portfolio (lakhs)	Legal form	Delivery model	Borrowings (lakhs)	Net-owned funds (lakhs)	Operating cost ratios	Category (Outreach)	Category (GLP)
182	People's Action for Development and Credit Union (PADACU)	TN, Kerala	632	39	2007	SHG	54	4	16%	S	S
183	Sahara Uttarayan	WB	41,762	1,370	2001	Individual lending	1,661	290	21%	M	M
184	DISHA	Maharashtra	9,607	149	2000	Grameen	93	72	24%	S	S
185	Rores Micro Enterpreneur Development Trust	Karnataka, TN	27,819	1,558	2005	JLG	1,492	61	19%	M	M
186	FGC—VVD	Manipur	636	45	2007	SHG	45	0	10%	S	S
187	Deepika Mahila Macs Ltd. (Crown Social Service Society)	AP	170	10	2001	SHG	31	0	8%	S	S
188	Melap Mahila Cooperative Credit Society Ltd.	Gujarat	513	9	1998	Individual Lending	5	0	7%	S	S
189	Janalakshmi Social Services	Karnataka	49,276	3,599	2006	SHG, JLG	3,322	12	18%	M	M
190	Orissa Rural Infrastructure Development Association (ORIDA)	Orissa	231	37	2006	SHG	37	0	4%	S	S
191	AMBA	Gujarat	8,643	256	2000	Individual lending	0	41	1%	S	S
192	Chaiduar Rural Development Centre	Assam	70	3	2007	SHG, JLG, individual lending	4	0	0%	S	S
193	Shramik Bharti	UP	15,543	437	1989	SHG	12	448	4%	M	S
194	CHINYARD	Karnataka	37,400	190	1996	SHG, JLG	150	1	20%	M	S
195	Annapurna Parivar Vikas Samvardhan	Maharashtra	10,000	600	1993	JLG	300	30	5%	M	M
196	Sanginee Secondary Cooperative Ltd.	Orissa	10,401	287	2001	SHG, JLG	182	3	4%	M	S
197	DOVE (Development Organization for Village Environment)	AP	8,583	819	2001	SHG, JLG	350	63	16%	S	S
198	Forum for Rural Environment and Economic Development (FREED)	Kerala	53,460	1,272	1992	SHG	690	0	1%	L	M

199	Ishara Foundation for Finance and Rural Development	UP	16,798	530	2005	SHG	579	46	6%	M	M
200	Gram Swaraj Seva Trust	Maharashtra	232	14	2003	JLG	0	26	33%	S	S
201	People's Forum	Orissa	32,807	1,215	2004	SHG	1,408	47	5%	M	M
202	Pustikar Laghu Vyaparik Pratisthan Bachat Evam Sakh Sahakari Samiti Ltd.	Rajasthan, Maharashtra, AP	13,687	461	1996	SHG	74	344	10%	M	S
203	Organisation for Development Coordination (ODC)	Orissa	19,554	218	2005	SHG, JLG	227	11	6%	M	S
204	Action for Social Advancement (ASA)	MP	12,876	141	2006	SHG, Grameen	198	4	11%	M	S
205	Satin Credit Care Network Ltd.	Delhi, Haryana, UP, Rajasthan, Punjab	19,648	3,962	1990	Individual lending	5,266	1,526	16%	M	M
206	Centre for Collective Development (CCD) Sahakara Mitra Sanstha	AP	3,000	50	2004	MACs Cooperative	50	0	0%	S	S
207	Samman Foundation	Bihar	150	2	2007	JLG, individual lending	0	0	20%	S	S
208	New Modern Rural Saving Cooperative Ltd.	Orissa	470	5	2005	SHG, individual lending	1	7	3%	S	S
209	Regional Rural Development Centre	Orissa	2,496	145	2006	JLG	174	16	111%	S	S
210	Jhansi Rani Mahila MACS Ltd.	AP	1,870	42	2000	SHG	0	0	4%	S	S
211	Kakatiya Mahila MACS Ltd.	AP	624	16	2000	SHG, individual lending	0	0	11%	S	S
212	Karra Society for Rural Action	Jharkhand	2,898	44	2006	SHG	50	–2	40%	S	S
213	Equitas Micro Finance India Pvt. Ltd.	TN	16,166	1,674	2007	JLG	675	1,160	29%	M	M
214	GUIDE	AP	9,845	289	2000	SHG, Grameen	148	13	0%	S	S
215	Cooperation Development Council	Orissa	19,252	890	2004	JLG, Grameen	890	–6	0%	M	M
216	Jan Sahyog Vindu, Hazribag	Jharkhand		–	2005	SHG, JLG	0	0	–	S	S

(*continued*)

S. no.	Name of MFI	Location	Outreach	Gross-loan portfolio (lakhs)	Legal form	Delivery model	Borrowings (lakhs)	Net-owned funds (lakhs)	Operating cost ratios	Category (Outreach)	Category (GLP)
217	SAHAYATA (Shree Hari Fintrade Pvt. Ltd.)	Rajasthan	2,236	113	2007	Grameen	250	134	100%	S	S
218	Chotanagpur Vikas Kendra	Jharkhand	190	9	2005	SHG, JLG, Grameen	3	0	4%	S	S
219	Institute of Integrated Resource Management	Assam	7,400	363	2001	JLG, Grameen	873	0	7%	S	S
220	Liberal Association for Movement of People (LAMP)	WB, Orissa, Delhi, UP	50,103	344	1999	SHG	201	176	1%	L	S
221	Gramotkrsh & Vikas Trust	Gujarat	1,870	7	1997	SHG, Grameen	7	0	33%	S	S
222	Dayanvikas Gramin Bahuuddeshiya Sanstha	Maharashtra	376	16	2002	SHG	17	20	150%	S	S
223	SEBA—RAHARA	WB	1,925	47	2006	SHG	50	0	15%	S	S
224	Shree Gajanam Gramin Kalyan Society	Maharashtra		–	2005	SHG	0	0	–	S	S
225	SEWA Bank	Gujarat	3,69,837	3,246	1974	SHG	175	0	0%	L	M
226	OAZOANE—The Society for Development of Human Abilities and Environment	TN, Andaman Niccobar	4,988	798	2002	SHG	808	2	14%	S	M

Table A.3 **Outstanding loans of bulk funders of MFIs**

Sl no.	Apex financing institution/bank	No. of MFIs		Loan outstanding	
	31 March 2006	31 March 2007	31 March 2008	31 March 2007	31 March 2008
1	SIDBI	100		548	950
2	FWWB	102	113	104	218
3	Maanaveeya Holdings	24	NA	50	NA
4	ICICI Bank	NA	240	1392	959
5	HDFC Bank	66	110	300	720
6	ABN AMRO Bank	27	29	161	293
7	Yes Bank	7	NA	62	200
8	Standard Chartered Bank	12	15	38	215
9	ING Vysa Bank	19	20	61	394
10	DCB	NA	NA	NA	150
11	Axis Bank	65	81	270	500
12	Other private sector banks	NA		554	NA
13	Public sector banks	NA		195	NA
14	Others1	NA		25	NA

Source: Private sector banks' presentations in RBI experience-sharing workshop in June 2008.

Table A.4 **List of persons and organisations met**

Name of organisations	Persons met
ABN-AMRO	B. Srinivas
Association of Karnataka Mcirofinance Institutions	V.N. Salimath
APMAS	C.S. Reddy, Raja Reddy
Arohan	Shubhankar Sengupta
Axis Bank	N.D. Biswas
Bandhan	C.S. Ghosh
Bankers Institute of Rural Development	R.S. Bhaduria
Citi Bank	Alok Prasad
College of Agricultural Banking, R B I	Sandeep Ghosh
CDF	Rama Reddy
Centre For Micro Finance, Jaipur	Jaipal Singh
DFID	Mahesh Mishra
EDA Rural Systems	Frances Sinha
EKO Financial Services Limited	S. Bharghava, Pooja
Ford Foundation	Ajit Kanitkar
FWWB	Vijayalakshmi Das, Tara Nair
Grameen Koota	K. Suresh, Vanatah Reddy
GTZ	Marie Louise Haberberger, G.V. Ramakrishna
HDFC Bank	K.Manohara Raj
IFMR–CMF	Annie Duflo, Doug Johnson, Minakshi Ramji
ICICI Bank	Govind Singh

(*continued*)

Name of organisations	Persons met
ICICI Lombard	Kamalnayani Sharma
IFAD	Anirudh Tiwari
ILO	Marc Socquet
Indian Overseas Bank	Elangovan
Intellecap	Vineet Rai
KFW	Christian Hass, Rukmini Parthasarathy, Nand Kishore Agarwal
M-CRIL	Sanjay Sinha
MicroSave	Graham Wright, M.K. Sharma, Madurantika Moulik
Ministry of Rural development, GoI	Amar Singh
NABARD	U.C. Sarangi, A. Ramanathan, Annie Koshy, R.N. Kulkarni, S.R. Aluru
Opportunity International	Chris Murdoch, K.C. Ranjani
Practitioners	Ajay Thanka, Girija Srinivasan, Prabhu Ghate, Sitaram Roa
Reach India	Alay Barah
Reliance Consumer Finance	K.V. Srinivasan, Tilisa Gupta
Repco Bank	M. Balasubramaniam, G. Manickasundaram
Reserve Bank of India	Usha Thorat, H.R. Khan, Vijendra, Rosemary Sebastian, H.K. Pandey
Sadguru Foundation, Udaipur	
Sa-Dhan	Brij Mohan, Mathew Titus
Sarvodaya Nano Finance Limited	R. Sowmithri
SDC	Adrian Marti, Sunita Chaudhary
SEWA Bank	Jayashree Vyas
SIDBI	N.K. Maini, R.M. Nair, S.N. Sadhwani, Surendra Srivastava, Bhavana Srivastava, Hemamalini
Shree Hari Fintrade Pvt. Ltd.	M.P.S. Likhari, Paritosh Sanadhya
SKS Microfinance	M.R. Rao
Standard Chartered Bank	Gouri Sankar, Zaitun Esmail
Trust Microfin Network	Vinod Jain
UNDP	Prema Gera, Pratigya Kalra, Navin Anand, Anand Kumar
Unitus	Sandeep Farias,Suhasini Singh, Muralidharan
World Bank	Neeraj Varma

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About the Author

N. Srinivasan has a background in Development Economics and Development Finance. He has three decades of experience in Development Finance in RBI and NABARD, where he was the chief general manager for seven years. He has provided professional support to many high-powered committees in agricultural finance and microfinance including Narasimham Committee on Financial Sector Reforms II, Expert Committee on Rural Credit, High Power Committee on Price Stabilisation for Plantation Crops, High Power Committee on Restructuring Financials of Cooperative Sugar Mills, Expert Group on Farmers' Indebtedness, Committee on Financial Inclusion and Vaidyanathan Committee I and II on Cooperative Banking Reform. He was a member secretary of the Task Force on agricultural credit for the Tenth Five Year Plan.

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Srinivasan~cover-final——Press.aiPage 1 11/5/2008 9:39:47 AM

Microfinance India: State of the Sector Report 2008 is a part of a series of annual reports on the microfinance sector in India which seeks to document developments, clarify issues, publicise studies, stimulate research, identify policy choices, generate understanding and enhance support for the sector. It is a comprehensive one-stop document that provides the latest data and a holistic view of the sector, combines analysis and description and integrates a variety of topics hitherto treated separately.

The book highlights recent developments in Self Help Groups (SHGs) and SHG–Bank Linkage Programmes (SBLPs), and focuses on microfinance with regard to the investment scenario in India. It also deals with the burgeoning field of urban microfinance, developments in micro-insurance, and the impact of new technologies on the microfinance sector. Additionally, it recognises the high demands which the state makes on microfinance institutions and discusses the need and relevance of new policy regulations. Complementing these analyses, statistical annexes provide essential data on the sector, strengthening its utility as a reference document. It contains extensive original material, and yet draws widely on the findings of other recent studies and reports, thereby emerging as a complete, detailed analysis of the status and the future of the microfinance sector in India.

N. Srinivasan has three decades of experience in Development Finance at RBI and NABARD, of which he was Chief General Manager for seven years. He was connected with several policy initiatives in Rural Development Finance. He was Member Secretary of the Task Force on Agricultural Credit for the Tenth Five Year Plan. He is presently a consultant in Rural Development and Development Finance, providing services to institutions such as The World Bank, International Fund for Agricultural Development in India and Vietnam, GTZ, UNOPS, UNDP, Government of India, and Asian Development Bank.

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