Case Studies on Select Micro-Finance Institutions in India

Executive Summary

Background and Objectives

The International Fund for Agriculture Development (IFAD) has been active in the field of poverty alleviation in India. As part of its program, it is considering a proposal to finance the SIDBI Foundation for Micro Credit (SFMC). Among other things, IFAD wanted to understand better the functioning of successful micro finance institutions (MFIs) in India. IFAD commissioned BASIX, a leading MFI, to carry out a study of selected MFIs, with special focus on demand projections and the movement towards financial sustainability, so that this could provide the background to assess the proposal from the SFMC.

Objectives of the Study

Study some of the more well established MFIs in India and

- prepare small caselets of twelve successful MFIs in India
- To make a detailed analysis of social technology, costs, risks, funds flow, etc. of four of the most successful/potential MFIs in the above set. To make the learnings and methodologies of the above micro finance institutions as a source for replication for similar other organisations to emulate.

Evaluate the business plan submitted to IFAD by SIDBI through a -Detailed financial and operational analysis of the Business Plan submitted to IFAD by SIDBI by ratio analysis, and bench-mark comparison with similar institutions elsewhere.

Methodology

The study broadly focussed on the following topics:

1. Evolution of the MFI and its mission statement
2. Legal status, ownership, governance and organisation structure
3. Areas of operations, size and growth over a period
4. Social Technology
5. Products for savings, credit and other financial services
6. Analysis of operating cost structure
7. Overall budget, sources of funding
8. Human resources (Managers and Staff)
9. Accounting policies including provisioning norms etc.,

10. Systems and procedures (accounting and audit, decision making authority at various levels, MIS etc.

Field visits were made to each of the MFIs and the reports were written based on information collected during personal interviews with staff and senior management, and analysis of financial information and management reports. The study consciously focussed on the financial viability and sustainability of the MFIs by understanding their cost and revenue structures and evaluating their business plans.

The study was partially constrained by the information available with the MFIs. In some cases, there was a lack of critical information. However, this was somewhat overcome by having the available data analysed by experienced staff at BASIX, and drawing inferences based on circumstantial evidence.

The case drafts are being circulated in the present form to the senior management of the MFIs for their approval before wider circulation.

Choice of Micro Finance Institutions

India has perhaps over 500 MFIs. Thus to select a few for a detailed study can be a difficult exercise. The following were the key considerations in the selection of MFIs for the study.

- Geographical areas of operation: (Rajasthan, Uttar Pradesh, Bihar, Orissa, Andhra Pradesh and Tamil Nadu)
- Social technology used: The self help group methodology (PREM); SHG federations or other forms of secondary groupings (Kosh - Gram Sabha Nidhi Foundations, ASSIST – Credit Unions, YCO – Mutually Aided Thrift and Credit Cooperative Society, MACTS); the Grameen methodology (SHARE, ASA); or direct individual lending (partially by both Lupin and BASIX)
- Legal form: Non-government organisations registered as Societies or Trusts (ASSIST, Lupin, ASA); Cooperatives (YCO Swayamkrushi); Non-Banking Finance Companies (BASIX, Kosh), Banks (SEWA Bank and RRBs)
- Unique institutions: People owned (Sarva Jana Seva Kosh Ltd, SEWA Bank, Swayamkrushi MACTS); Government-owned corporation (UP Bhumi Sudhar Nigam); corporate sector promoted NGO (Lupin); Regional Rural Banks (Cauvery, Jamuna and Krishna Grameen Bank)
- Size and scope for growth small institutions growing fast (ASA), established institutions with scope for more growth – SHARE, BASIX)
- Capacity building and wholesale micro-finance combined into one (FWWB, BASIX partly).

The study purposely includes three of the leading MFIs, which have adopted a diversity of methodologies and legal forms. Lessons from their experiences are important for the sector as a whole. It would be worth drawing some lessons from leading MFIs, combining various methodologies, legal forms and roles of lending and capacity building, sometimes through separate but related institutions.

- SEWA Bank which does direct lending in urban Ahmedabad and SHG Federation lending in rural districts, and provides insurance services on an agency basis. It also does housing finance promotion through a Trust and capacity building through FWWB.
- BASIX, which lends to individuals directly, to joint liability groups, to SHGs, to SHG Federations, to CDFIs, and to MACTs. BASIX encompasses an NBFC and is about to get a Local Area Bank license. It also does technical assistance and capacity building through Indian Grameen Services (IGS) which is a non-profit company.

- SHARE, which is an NGO registered as a Society and apart from doing direct Grameen style lending through that, has established the Sneha MACTS in Ranga Reddy district and recently, SHARE Microfin Ltd., an NBFC. Thus it is going through the transformation process that we have advocated earlier. SHARE's experience needs to be watched carefully for lessons.

Finally, a word should be mentioned about at least four other leading MFIs, which were not included in the study for various logistical reasons. These are:

- MYRADA, which works largely in Karnataka and has been a pioneer in the SHG movement, establishing a network of village level Sanghas for savings and credit over a decade ago. Recently, it has established Sanghamitra Financial Services, a Section 25 non-banking finance company (NBFC).

- CDF or the Cooperative Development Foundation, which exclusively works in the Warangal and Karimnagar districts of Andhra Pradesh (AP), forming women's thrift and credit cooperatives under the AP Mutually Aided Cooperative Societies (MACS) Act, 1995. The CDF promoted MACS have a unique characteristic – they only use their member funds and do not borrow at all from outside.

- PRADAN, again one of the pioneers of the SHG movement, which works in Bihar and Rajasthan, and whose Tamil Nadu operations were spun off in 1998 to the DHAN Foundation. PRADAN's approach is to link SHGs with banks, and later establish strong local CDFIs in the form of SHG federations and link them with banks. DHAN has taken this approach to a highly evolved stage with its "Kalanjiam Foundations" which are further federated at the block level.

- The Rashtriya Gramin Vikas Nidhi, (RGVN) which works in the North-Eastern states as well in Orissa, Bihar, etc. The RGVN runs three Grameen style Credit and Savings Projects in Assam, Meghalaya and Orissa respectively.

Summary of the 12 MFIs visited for the IFAD Study

Sl. No	Name	Period of Operation	Credit Delivery	Group Size	Avg. Loan Size	Lending Rates	Re-payment Rates	Cumulative Borrowers/ Members	Cumula-tive Disbursement	Loans Outstanding	Estimated Credit Demand for 2-3 years	Remarks
		Years			Rs.				Rs. in Million			
1	SEWA Bank	25	Credit union/bank	-	10000	18%	95%	200,000	n.a	86	0	India's only MFI licensed as a bank.
2	BASIX	3	Various	-	7000	24%	95%	20,000	130	60	100	Professionally managed MFI with aggressive growth plans.
3	SHARE	7	Grameen	5	3000	15% flat	100%	14,000	130	43.9	100	Promising growth, transforming to NBFC
4	Kosh	10	SHG	10-15	5000	14%	67%	100,000	225	100	30	Unique. Fund manager for people's federations at village level
5	PREM	17	SHG	15-20	2000	10% to 30%	90%	20,000	n.a	20	5	First federation of SHGs in Orissa
6	ASA	10	Grameen variation	5	4500	15% flat	98%	6,000	23	7	60	Promising. Needs to increase operations to become viable
7	Lupin	11	SHG, direct	15-20	4000	12%	90%	2,000	11.5	0.6	5	Micro-credit is one of the several programs. Potential for

												more focussed management.
8	FWWB	17	Wholesaler	n.a	400000	13.50%	88%	146	80	40	30	Wholesaler: clients widespread. Capacity building is strong.
9	YCO	13	SHG	10	5000	various	78%	6,300	9.8	4	4	Organised a MACTS
10	Adithi	11	SHG	10-20	5000	12% flat	90%	5,000	10	7.5	15	Operates in Bihar, planning to set up a cooperative bank
11	ASSIST	14	SHG	15-20	3000	12%	n.a.	4,000	n.a.	4.5	20	Planning to set up a MACTS
12	UPBSN	3	SHG facilitator	20	9000	12	n.a.	40,000	n.a	n.a	n.a	UP Govt owned. Path breaking work at ground and policy level
13	Jamuna Grameen Bank	2	SHG	20	6000	12%	100%	852	0.6	0.4	0	RRB trying to increase its SHG portfolio
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Summary of Findings and Recommendations for SFMC

Capital Adequacy: Most of the MFIs are under capitalised. This is mainly due to their legal form – most are Societies/ Trusts, which do not have any concept of equity. This will restrict these MFIs' ability to seek adequate debt in the long run. Moreover, there is no cushion to absorb loan losses, though some have built reserve funds at various levels. Though the apex financial institutions are aware of this problem, till recently they have not done much about it. In fact most lending schemes to MFIs, such as by the RMK and FWWB, are structured to suit only NGOs registered as Societies/Trusts. The SFMC may address this problem by insisting that larger MFIs must move to an appropriate legal structures, such as cooperative societies or companies, which must be well capitalised.

Asset Quality: The overall asset quality of the MFIs in the study seemed good given the country's background on credit indicipline and poor loan repayment rates. However, the asset quality could be further improved by tightening the loan appraisal process and regular monitoring. The lack of data to monitor asset quality was glaring. The SFMC can substantially improve asset quality by focussing on the financial management skills of the MFIs in their capacity building program.

Management: The MFIs have dedicated top quality individuals as their CEOs, who in most cases are the founders of the respective organisations. Many of them have a background in development and social work and thus have felt the need for financially qualified staff to work in their organisations at senior levels. Many of the institutions are involved in a multiplicity of programs and cannot strictly be called MFIs, but rather development agencies with a micro finance program. The institutions which had only micro finance as their focus, had better managed programs than the ones which had micro finance as a small part of their development activities. Moreover, most of them do not have governance structures for decision making and monitoring at the top level. The SFMC's proposal to have mentors and Project Advisory Committees should supplement the governance structures of MFIs.

Earnings: All the MFIs except two (SEWA, BASIX) were making losses from their micro finance operations. This is mainly due to the fact that the lending rates, cost of funds, operating costs and loan losses were not following a financially consistent model in the MFIs operating structure. An MFI with a loan loss of up to 30% was charging 14% p.a. simple interest without any provisioning. Another was charging a 15% flat interest rate (equivalent to up to 30% depending on the loan structure) with a 98% repayment rate, but had a high operating cost of 40%.

Liquidity: The asset profile of the MFIs is usually short term, mostly less than eighteen months. Given the low debt in most of them, liquidity does not seem a constraint. However, for better liquidity management SFMC should consider giving lines of credit rather than term loans. This would result in better funds management and savings in interest costs.

A Guide to the Future

In this section, we look at some of the lessons from the case studies and draw attention to the issues that need to be addressed by the SIDBI Foundation for Micro-Credit (SFMC).

Encouraging Diversity: One of the striking features of the study is the enormous diversity of methodologies and legal forms that are being used by MFIs in India. As the field matures, the SFMC needs to consider supporting an appropriate level of diversity in:

- **Lending Methodologies:** The SFMC needs to support a range of lending methodologies, including lending to
  - individual borrowers
  - individuals organised in joint liability groups (JLGs)
  - self-help groups (who on-lend to their members)
  - SHG federations
  - other innovative lending methodologies, such as trade intermediaries
- **Organisational and Legal Forms:** The SFMC needs to support a range of these, including:
  - At the small scale or early stages, NGOs and people's organisations (federations) registered as Societies or Trusts. This is possible, say till Rs 25 lakhs outstandings.
  - Later, as the program grows, Cooperatives (Urban Cooperative Banks such as SEWA Bank), and micro-finance NBFCs such as those established by BASIX and SHARE,
  - Formal financial institutions such as Regional Rural Banks (RRBs) and Urban Cooperative Banks (UCBs) and when licensed, Local Area Banks (LABs).
- **Financing Mechanisms:** The SFMC needs to innovate a variety of financing mechanisms to support the funding needs of MFIs at different stages of evolution:
  - Bulk term loan to Community-based Development Finance Institutions (CDFIs) which can be SHG Federations registered as Societies/Trusts or Cooperatives, for on-lending to their members.
  - Guarantees to banks for lending to CDFIs (no need for guarantees for bank lending to SHGs, since NABARD is promoting that channel through 100 percent refinance).
  - Equity support to MFIs which are incorporating as companies, whether as NBFCs or Local Area Banks. These are few in number today, but they need to be multiplied.

Increasing Interest Rates: As can be seen from the Annexure, based on the data from SEWA Bank, SHARE and BASIX, that for MFIs to breakeven, the average lending rates have to be in the range of 24% plus. Only a few of the MFIs studied have reached breakeven. In the interim, most of the MFIs operate on grant funds and low interest long term loans. The operating deficit for most MFIs were due to their low volumes which can be corrected by increasing volumes. MFIs were acutely aware of the problem and but did not always have clear plans to rectify the situation. This was partly because many of the existing sources of funds come with restrictions on onlending rates. The SFMC should clearly not have any such restrictions.

NGO MFIs were adopting rates of interest from 12% to 15% p.a. Most of these MFIs had restrictions on their on-lending rates imposed by their bulk lenders, RMK or SIDBI. Others had to keep their interest rates in line with banks, which lend to SHGs at 12-14 percent. They are unable to increase their rate mostly due to these constraints rather than acceptability of the borrowers, who are quite willing to pay interest rates between 24 to 36% p.a. as could be seen from the rates charged by SHGs to their members. Grameen replicators such as SHARE and ASA were charging a higher rate of interest than the others - they lend at 28% (15% flat). It was also observed that the breakeven volume for a branch in the Grameen type of methodology should be in the order of 10-15 million, assuming that they charge 28% interest.

Analysis of costs indicate that interest rates of 27% are needed for sustainable operations of MFIs who are lending directly to individuals and 24% to those who are lending to SHGs. These figures are based on cost of funds – 12%, operating costs – 9% through SHGs and 12% direct, and loan losses – 2-3%. Currently MFIs are either making up for operating deficits with grants or using low or no-cost funds to increase spread. As this situation is not sustainable, most bulk lenders may have to remove any on-lending rate restrictions. It is to be noted that the RBI has recently removed on-lending rate restrictions on MFIs.

Capacity Building: The case studies show that all MFIs require capacity building inputs, although the level varies across them. Hence careful assessment of each of them is called for, not just from the lending risk point of view but also for capacity building. SFMC should therefore think of capacity building partly as a risk mitigating mechanism. Almost all the MFIs have crossed their "infant mortality stage" and are well set on their way to steady growth. Some MFIs may become viable only when they reach an asset size, which their current staff will be unable to manage their operations without significant upgradation in capacity.

The capacity upgradation is of two kinds: first, many of the NGO MFIs need to simply hire more qualified and professional staff, for which they may need operational support till their outstandings reach a level where these costs can be fully absorbed. Second, all MFIs need technical assistance in the form of better computerised management information systems, particularly for tracking loan portfolios and delinquency management. They also need to upgrade their appraisal and fund management skills. The SFMC can play an important role in providing both of these types of capacity building inputs.

Some of these capacity building inputs can be provided to the individual MFIs but a more effective route would be to do it through various emerging networks of MFIs. The most notable of these is Sa-Dhan, which has the membership of all the major MFIs. There is also the India Collective for Micro-finance, established largely among RMK related NGO MFIs. There are also a couple of other smaller networks such as AIAMED in Delhi and INDNET which is a network of Grameen replicators. The advantage of providing capacity building inputs to and through these networks is greater outreach at a lower cost, as well as better acceptance by MFIs. Moreover, comparison among peers leads to acceptance of standards and spread of best practices in a more natural manner, than when it comes from apex lending institutions such as the SFMC. Hence the SFMC may consider capacity building of the MFI networks as well. In addition, capacity building in the form of exposure to micro-finance may have to be given to senior officials of formal financial institutions and regulatory agencies, including the RBI and GoI.

Shifting operations to an appropriate legal form: Beyond a certain size of operations, an MFI which is registered as a Society or Trust may find itself in difficulty in terms of raising adequate funds for lending, accepting savings and also from the point of view of the Income Tax Act. Many of the NGO MFIs which are beginning to achieve a loan outstanding level of Rs 25 lakhs and above, are facing these constraints and need to shift their activities to more appropriate legal forms such as cooperatives, NBFCs or banks.

A recent example is that of SHARE, which was originally a Society and has now promoted both a mutually aided cooperative society and a non-banking finance company. Other organisations, such as BASIX and Cashpor Financial and Technical Services (CFTS) have established themselves as NBFCs right from the outset, based on an a priori analysis of the legal and regulatory framework. MYRADA has also established Sanghamitra as a Section 25 Company, to be further registered as an NBFC. Among the case studies, YCO has established a mutually aided cooperative society and ASSIST has plans to do the same.

This shifting of micro-finance activities from non-profit legal forms to cooperatives or companies is in line with the recent recommendations of the Task Force on Micro-finance. The SFMC should consider extending equity support at that stage to such MFIs.

Working with formal financial institutions (FFIs): While there is no doubt that most of the innovations in micro-finance have come from MFIs, it is time to mainstream these efforts. As the case study on the efforts of three RRBs shows, FFIs can and are taking interest in this field. The example of the SEWA Bank also shows that Urban Cooperative Banks (UCBs) can profitably lend to micro-finance customers and also provide saving services to a large number of the poor at low cost. Because RRBs and UCBs can raise deposits at relatively lower costs and upto a much higher multiplier of their net owned funds, these FFIs may not require loans from the SFMC. However, they would still need capacity building inputs in the form of exposure visits for their senior staff to convince them of the viability of micro-finance as a business proposition and once convinced, various forms of technical assistance.

Conclusion:

After the pioneering efforts of the last ten years, the microfinance scene in India has reached a take-off point. The establishment of the SIDBI Foundation for Micro Credit has happened at the right time. The SFMC can play a very significant role in taking MFIs to the next orbit of significance and sustainability. For this, the SFMC needs to adopt innovative and forward looking policies, based on the ground realities of successful MFIs.

It is hoped that this collection of cases of MFIs, covering different types of approaches and legal forms, including NGOs, SHG Federations, cooperatives, non-banking finance companies urban cooperative banks and regional rural banks, will help the SFMC decision-makers appreciate the challenges that MFIs are facing and come up with a facilitative policies and products from SFMC.

Study Team:

The study was carried by a team from BASIX as follows:

1. **Advisor:** Mr Vijay Mahajan, B Tech (IIT- Delhi), MBA (IIM-Ahmedabad) Managing Director, BASIX, with over 20 years of experience in rural development. He was the Founder Executive Director of PRADAN, a well known NGO for rural livelihood promotion. He guided the choice of MFIs, specification of data to be collected, analytical methodology and the writing of the final report. He has visited ten of the MFIs earlier.

2. **Team Leader:** Mr S Viswanatha Prasad, MMS (BITS - Pilani),

   Vice President - Strategic Initiatives, BASIX. He has over 11 years experience in Project Finance and Financial Services. He guided the study team and visited eight of the MFIs during the study. He supervised the data analysis and writing of the draft and the final reports. He specially focussed on the financial analysis.

3. **Consultants:** The following individuals studied one or more MFIs:

- Dr Sankar Datta, BSc (Ag&AH), PGDRM(IRMA), Ph.D (Rural Economics),

  Vice-President-Operations, BASIX, Hyderabad. He has over 15 years experience in rural

  development and micro-finance.

- Mr B V Narasimham, PGDM (XIMB),

  Executive, BASIX, Mahabubnagar Unit. He has five years experience in research and

  implementation related to rural livelihoods and rural financing.

- Mr B Srinivas, B.E (Mech.), MBA,

  Executive-Operations, BASIX, Hyderabad (Head Office). He has three years' experience in rural financing.

- Mr Subhankar Sengupta, PGDRM (IRMA),

  Executive, BASIX, Nirmal Unit. He has over two years experience in rural financing.

- Ms G Nagasri- B.Com (Hons), MBA,

  Executive, BASIX, Hyderabad (Head Office). She has over two years experience in

  doing financial analysis and supervising operations.

Ms Nagasri was responsible for collating the final report and Ms Vasundhari was involved in the word processing aspects of the report.

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