SAMN | South Asian Microfinance Network

# Prospects For Investment In South Asian Microfinance

Presented at the Second Annual Convergences 2015 Forum on Microfinance
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# Foreword

The microfinance sector in South Asia has experienced exceptional growth in recent years with notable progress in quality and diversity of products as well as outreach. Nevertheless, with approximately 50% of global demand in South Asia, the outreach of microfinance in the region remains very low, estimated at less than 10% of the market, including less than 3% in Pakistan and 2% in Afghanistan. In India alone, more than 300 million potential clients still lack access to financial services. It is clear that in order to continue, and even accelerate, the expansion of access to financial services for the poor, new sources of funding must be developed for growing MFIs in the region. While the global financial crisis presents very real risks of reduced levels of investment in the sector, it even further strengthens the need for clear facilities for investment as well as robust MFIs who can present commercially sustainable operations to investors.

Developed through the Financing Development project funded by the European Commission's Asia Invest grant line, the South Asian Microfinance Network (SAMN) seeks to foster increased investment in regional MFIs through capacity building and networking with local and European investors, researchers, consultants, and other practitioners. The network is initially being set up by ACTED, and its partners, in Afghanistan, India, Pakistan, and Sri Lanka and currently represents 18 MFI partners in the region.

Presented at Second Annual Convergences 2015 Forum, the report 'Prospects for Investment in South Asian Microfinance' serves as an introduction to our network, partners, and the investment landscape in the region.

We would like to thank our partners, ACCESS Development Services and Rural Support Program Network (RSPN), along with our associates, Standard Chartered Bank, Microfinance Investment Support Facility for Afghanistan (MISFA), OXUS Development Network and Tiare Group, for their support in developing this report, and setting up the South Asian Microfinance Network. Finally, we would like to thank the European Commission for funding the Financing Development project.

We expect that this report will be useful in introducing the investment climate in the region and attracting attention to our network partners. For more information about SAMN please visit our website at **www.samn.eu.**

SAMN
Paris, 2009

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Finally we are grateful to the European Commission for the funding support that allowed us to bring out this publication.

# ABBREVATIONS

| | |
|---|---|
| ADB | : Asian Development Bank |
| AFN | : Afghani |
| AFS | : Ariana Financial Services |
| AISA | : Afghanistan Investment Support Agency |
| AKAM | : Aga Khan Agency for Microfinance |
| AKRSP | : Aga Khan Rural Support Program |
| AMA | : Afghanistan Microfinance Association |
| ANDS | : Afghanistan National Development Strategy |
| BAB | : BRAC Afghanistan Bank |
| BASIX | : Bhartiya Samruddhi Investments and Consulting Services |
| BOI | : Board of Investment |
| CAGR | : Compounded Annual Growth Rate |
| CBOs | : Community Based Organizations |
| CBSL | : Central Bank of Sri Lanka |
| CDC | : Capital for Development |
| CFIs | : Commercial Finance Institutions |
| CGAP | : Consultative Group to Assist the Poor |
| CRBs | : Co-operative Rural Banks |
| CRR | : Cash Reserve Ratio |
| CSO | : Central Statistical Organization |
| DAB | : Da Afghanistan Bank |
| DFID | : Department for International Development |
| DMFI | : Deposit taking Microfinance Institutions |
| ECB | : External Commercial Borrowing |
| EIU | : Economist Intelligence Unit |
| EPF | : Employee Provident Fund |
| EU | : European Union |
| FDI | : Foreign Direct Investment |
| FEMA | : Foreign Exchange Management Act |
| FIPB | : Foreign Investment Promotion Board |
| FMFB-A | : First Microfinance Bank Afghanistan |
| FMO | : Financierings-Maatschappij voor Onvikkelingslande (Netherlands Development Finance Company ) |
| GDP | : Gross Domestic Product |
| GoA | : Government of Afghanistan |
| GoI | : Governement of India |
| GoP | : Government of Pakistan |
| GTZ | : Gesellschaft für Technische Zusammenarbeit |
| HDI | : Human Development Indicator |
| IFAD | : International Fund for Agriculture Development |
| IFC | : International Finance Cooperation |
| IMF | : International Monetary Fund |
| INR | : Indian Ruppe |
| IRDA | : Insurance Regulatory Development Authority |
| IRDP | : Integrated Rural Development Program |
| JLG | : Joint Liability Group |
| KfW | : Kreditanstalt fur Wiederaufbau |
| LCB | : License Commercial Bank |
| LIBOR | : London Interbank Offered Rate |

| | |
|---|---|
| LMPA | : Lanka Microfinance Practitioners Association |
| LOLC | : Lanka Orix and Leasing Company |
| LSB | : License Specialized Bank |
| MF | : Microfinance |
| MFB | : Microfinance Bank |
| MFI | : Microfinance Institution |
| MIGA | : Multilateral Investment Guarantee Facility |
| MISFA | : Microfinance Investment Support Facility for Afghanistan |
| MIX | : Microfinance Information Exchange |
| MoF | : Ministry of Finance |
| MRRD | : Ministry of Rehabilitation and Rural Development |
| NABARD | : National Bank for Agriculture & Rural Development |
| NBFCs | : Non Banking Financial Company |
| NBFIs | : Non Banking Finance Institutions |
| NDTF | : National Development Trust Fund |
| NGO | : Non Governmental Organization |
| OSS | : Operational Self Sufficiency |
| PAR | : Portfolio at Risk |
| PKR | : Pakistan Rupee |
| PMN | : Pakistan Microfinance Network |
| PPAF | : Pakistan Poverty Alleviation Fund |
| PRISM | : Program for Increasing Sustainable Microfinance |
| PSB | : Public Sector Bank |
| RBI | : Reserve Bank of India |
| RDBs | : Regional Development Banks |
| ROA | : Return of Asset |
| ROE | : Return on Equity |
| RRB | : Regional Rural Bank |
| RRDBs | : Regional Rural Development Banks |
| RSPN | : Rural Support Program Network |
| RSPs | : Rural Support Programs |
| SBLP | : (SHP) Bank Linkage Program |
| SBP | : State Bank of Pakistan |
| SBS | : Samrudhi Bank Societies |
| SHGs | : Self Help Groups |
| SIDA | : Swedish International Development Cooperation Agency |
| SIDBI | : Small Scale Industrial Development Bank of India |
| SLR | : Statutory Liquidity Ratio |
| TCCS | : Thrift and Credit Co-operative Societies |
| UAE | : United Arab Emirates |
| UK | : United Kingdom |
| UPAP | : Urban Poverty Alleviation Program |
| US | : United States |
| USAID | : United States Agency for International Development |
| VAT | : Value Added Tax |
| WB | : World Bank |
| WCCU | : World Council of Credit Unions |

# Project Introduction

## INTRODUCTION

The South Asian Microfinance Network (SAMN) is an initiative launched in mid-2008 by ACTED alongside a number of South Asian and European Microfinance stakeholders to promote economic development by facilitating investment into tier-II MFIs in South Asia. SAMN is among the first initiatives of this kind, providing a regional platform to facilitate coordination and cooperation between the European financial sector and the microfinance sector in South Asia. As the global economic crisis reduces the access by MFIs to sources of financing, with significant impact on their operations, SAMN plays a key role in enhancing new linkages between potential investors and MFIs. In addition, the network serves as a knowledge base to its members, providing a comprehensive source for microfinance and investment related research, news, issues and opportunities.

SAMN is formed under ACTED's Financing Development project funded by the European Union's Asia-Invest budget line. Asia-Invest is an initiative by the European Commission to promote and support the co-operation between EU and Asian companies by facilitating mutually beneficial partnerships in order to increase trade and investment flow between the EU and Asia.

## NETWORK PARTNERS

SAMN provides a platform for linking South Asian MFIs with regional and European investors, consultants, researchers, donors, and other practitioners. The network initially focuses its work in Afghanistan, India, Pakistan, and Sri Lanka, partnering with 18 regional MFIs under the Financing Development project. In the near future, SAMN will expand across the region into Nepal, Bangladesh, and Myanmar, opening membership to other qualified MFIs and MF stakeholders in order to become a comprehensive resource and networking center for microfinance across South Asia.

As the network's principal objective is to facilitate increased foreign investment in regional MFIs, SAMN has targeted strong tier-II MFIs for membership, as these organizations can most effectively capitalize on the network's services to increase their access to commercial investment. At this stage, we still do not include the many very innovative, community-based tier-III MFIs in the region, as these organizations often lack the operational foundations and growth plans required for attracting commercial investment in the near term. SAMN excludes the small group of commercialized tier-I MFIs, which already have access to abundant capital from commercial sources.

SAMN will also bring together a variety of other important MF stakeholders in South Asia and Europe. The network will become a link for international investors interested in the region offering comprehensive information on regional investment regulation as well as detailed assessments of, and contacts to, investment-ready MFIs. The network has already established partnerships with 3 international investors, Standard Chartered Bank, Oxus Development Network, and Tiare Group, and is actively pursuing links with other interested investors. To continue facilitating the development of our partners and the sector, members of the network will also include a variety of MF experts, including top researchers and research institutes, MF-related NGOs, and an international roster of consultants with expertise in South Asian MF, which will include a consultant rating system. We have also developed linkages with other important MF stakeholders including apex organizations (such as project associate MISFA), national MF networks, donor organizations, and other service providers.

## NETWORK COMPONENTS

To help develop the regional MF sector and increase international investment, SAMN offers its members 4 types of services:

- **Facilitation of Investment:** SAMN is a point of entry for international investors interested in South Asia, with regularly updated and distributed guidelines on regional investment regulations and procedures, tailored advice and consultancy to investors, provision of detailed assessments, business plans, and other information on SAMN MFI partners, and regional investment events to introduce investors to our partners.

- **Capacity Building:** Focusing on increasing investment readiness and absorption capacity, SAMN offers partner MFIs expert trainings through our roster of consultants and network associates, exposure visits to leading regional MFIs as well as European banks, and access to our online MF resource center.

- **Resource Center:** The network is a focal point for information on regional MF providing a regularly updated website (www.samn.eu) with news, events, original MF research, info on partners, and links to other resources, a monthly newsletter including interviews with sector leaders and reviews of important MF events and issues, sponsorship of regional MF and investment conferences and events, and links to MF think-tanks and research institutes.

- **Related Initiatives:** SAMN members is also eligible for participation in related MF initiatives being implemented by ACTED and our associates, including Babyloan, an internet lending platform linking individuals in Europe to specific MFI clients seeking loans, and Octopus, a free open source loan tracking software.

## OBJECTIVE OF THE REPORT

This report serves as an introduction to SAMN and the Financing Development project. It is particularly targeted to potential investors in South Asian microfinance, with an overview of investment conditions, regulations and procedures in each project country as well as a brief look at each of our MFI partners.

# Network Partners and Associates

### PROJECT MANAGEMENT

ACTED is a French-based international relief and development agency founded in 1993 and operating in more than 23 countries. SAMN is one of the various global initiatives by ACTED to contribute to the development of the Microfinance sector.

### IMPLEMENTING PARTNER

ACCESS is an Indian non-profit company, initially promoted by Care India, specializing in technical assistance in microfinance and rural livelihoods. ACCESS provides technical assistance, capacity building and incubation services to Community Based Institutions (CBIs) and MFIs.

### IMPLEMENTING PARTNER

Rural Support Programmes Network (RSPN) is a leading network of Rural Support Programs (RSPs) promoting economic development in Pakistan. RSPN offers capacity building, advocacy and networking for its member RSPs.

### ASSOCIATE

Microfinance Investment and Support Facility for Afghanistan (MISFA) is an independent apex organization coordinating with 15 partners that makeup the microfinance sector of Afghanistan.

### ASSOCIATE

Standard Chartered is a leading international bank operating in more than 70 countries with current portfolio of US$ 170 million in MF in 13 countries of Asia and Africa with 41 partners.

### ASSOCIATE

ODN (OXUS Development Network) was founded by ACTED in 2005 to strengthen its MF intervention. It is a French company which provides technical backstopping and financing to MFIs.

### ASSOCIATE

TIARÉ GROUPE offers multidisciplinary consulting services addressing the needs of large asset holders. The group's activities range from asset management to major risk coverage.

# Afghanistan

## COUNTRY INVESTMENT GUIDELINES

- Land Area: 652,100 sq km
- Population: 24.5 million (2006, ADB estimates)
- Main Towns: Kabul (2.5 million), Kandahar (450,300), Herat (349,000)
- Languages: Pashtu and Dari (Persian)
- Currency: Afghani (AFN)
- Fiscal Year: 21st March – 20th March
- Development Indicators[1]:

| | | |
|---|---|---|
| Population below poverty line[2] | : | 42 % (2007) |
| Literacy rate (15-24 years old) | : | 28.0% (2000) |
| Mortality rate (child<5) | : | 257 per 1000 live births (2006) |
| Life expectancy | : | 45 years (2004) |
| HDI rank | : | Not available |

[1] Figures are from the Asian Development Bank Afghanistan Fact Sheet 2008 unless otherwise stated
[2] IMF Country Report No. 08/153, May 2008

# ECONOMIC AND FINANCIAL BACKGROUND[3]

## Economic Overview

| Indicator | 2005 | 2006 | 2007 | 2008 | 2009[4] |
|---|---|---|---|---|---|
| Nominal GDP[5] (US$ m) | 6,489 | 7,723 | 9,596 | 12,850 | n/a |
| GDP/head[6] (US$) | 246 | 290 | 391 | 524 | n/a |
| Real GDP growth (%) | 16.1 | 8.2 | 11.5 | 7.5 | 9.0 |
| Consumer price inflation (Kabul, av %) | 12.3 | 5.1 | 13 | 24[7] | 7.2 |
| Exchange rate (av US$) | 49.7 | 49.9 | 49.8 | n/a | n/a |
| Total external debt (% of GDP) | 184.2 | 170.9 | 21.7 | 17.8 | n/a |
| FDI (US$ m)[8] | 271 | 231 | 317 | 437 | n/a |
| FDI (% of GDP)[9] | 4.2 | 3.4 | 3.3 | 3.4 | 3.4 |

The years of war and conflict beginning in the 1970s until the collapse of the Taliban in 2001 have devastated the economy of Afghanistan. Since 2001, the economy has grown steadily, driven by inflows of foreign aid[10] led by construction, telecommunications, trade and agricultural sectors. Unfortunately this growth has not led to significant poverty reduction and employment creation[11].

While analysing the Afghan economy, it is important to note that 80-90% of its economic activity is informal and that illegal opium production has a significant share in the economy of the country. Further, international aid to Afghanistan accounts for 50% of Gross Domestic Product (GDP) and contributes to 90% of public spending. The revenue base remains low, figuring at 7% of GDP in 2007-08 and stemming from export and import taxes.

### Economic structure

For 2006-07, the share of agriculture, industry and services in Afghanistan's GDP figured at 32.6%, 28.2% and 39.2% respectively. However, agriculture has additional importance as it generates 70% of employment in the country and has externalities associated with the manufacturing and the service sector. The principle agriculture products are wheat, maize, barley, sugarcane, fruits, nuts and cotton. The northern province of Kunduz and the southern province of Helmand are the main areas of agriculture production. Agriculture output is volatile due to frequent draughts and lack of agricultural support systems such as irrigation, extension service and storage.

The industrial base is low and is concentrated in a few urban areas. The construction sector provides the main contribution to industrial growth as a very high portion of aid money has subsidised the building of the country's infrastructure. The manufacturing sector mostly consists of textile, carpet, leather, dried fruit production, mineral-marble production and other small scale activities which are located in Kabul, Herat and Mazar-i-Sharif. Industrial parks are being promoted in the major cities, and some industries, including a few international companies, notably Coca Cola, have set up their operations. However, the security situation remains a big challenge.

The service sector mostly consists of telecommunications, banks and trade activities.

### Exports and imports

The main exports for Afghanistan are carpets, and dried and fresh fruits. The imports mostly consist of machinery and equipment, food, household items, metal and petroleum products. Pakistan is the most important trading partner, accounting for 23% of exports and 37% of imports in 2007. Other important trading nations are India, the US, Turkey, Russia and

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3 All figures are from EIU Country Profile Afghanistan 2008 and EIU Country Report 2009 unless otherwise mention
4 IMF Country Report No. 08/153, May 2008
5 Excluding opium production
6 Figures from EIU Afghanistan Profile 2008. For 2006 and 2007 calculated with population of 24.5 million
7 According to DAB the inflation rate was at 8.9 % in February 2009
8 Figures for 2005 and 2006 are from South Asia Economic Report, Foreign Direct Investment in South Asia, ADB, December 2007 and calculated for 2007 and 2008
9 Figures for 2005 from IMF Country Report No. 08/72, February 2008; and rest are from IMF Country Report No. 08/153, May 2008
10 According to Afghanistan National Development Strategy 2008-13, foreign aid has averaged approximately 60% of GDP in last five years
11 Based on National Risk and Vulnerability Assessment (NRVA) 2007 indicates the poverty rate at 42%, or 12 million people living below the poverty line

Germany. European Union (EU), United States (US), Canada and India give preferential treatment to Afghan products and offer discount rates on import duties. Afghanistan runs large current account deficits averaging 70% of GDP in 2005-08. However, if foreign aid grants are included, current accounts move towards a surplus of 0.8% of GDP.

### Doing business

The World Bank (WB) report 'Doing Business 2009 Afghanistan', which assesses the business environment in 181 countries through quantitative indicators, ranks Afghanistan in 162nd position, further declining from the 2008 ranking. While the country ranks reasonably well in entrepreneurial terms (22nd), employing workers (30th) and ease of paying taxes (49th) low ranking scores are found for protecting investors (181st), ease of closing business (181st) and access to credit (178th). The weak judicial system and poor security environment in the country pose major obstacles to businesses and investments.

### Monetary situation

The monetary policy has focused on containing inflation and ensuring a stable exchange rate, which in turn has succeeded in achieving both. The inflation has come down from 52.1% in 2002-03 to more acceptable levels in the past five years. However, inflation rates are sensitive to international prices due to heavy dependence on food and fuel imports. Inflation rose to 20.7% in March 2008 with soaring international prices. Inflation is projected to decline with global financial crisis and growth in agriculture production. The exchange rate against the US$ has remained stable; however, this may have a negative impact on domestic industrial growth by encouraging imports and discouraging exports.

### Impact of global financial crisis

According to the International Monetary Fund (IMF), Afghanistan would not be so severely hit by the global financial crisis as it has a very basic banking system and banks are not directly exposed to bad foreign debts. There could be some negative impact on exports due to the economic slowdown in the trading countries. A larger impact is expected on two fronts: remittances from Afghans working abroad will certainly shrink with the global downturn and FDI is likely to decrease due to a general risk aversion. However, positive fallout of the crisis could be lower prices of food and fuel, which the country imports.

## Financial Sector Overview

### Key reforms

Prior to 2003, the banking sector was barely operational and the financial sector was largely informal. In 2003, the Afghan Central Bank (Da Afghanistan Bank - DAB) restarted its licensing activities for the formation and establishment of new local and foreign commercial banks and branches. The DAB has been very active all over the country and is now progressively withdrawing from commercial banking operations in cities where other banks have begun to operate.

As part of the Afghanistan National Development Strategy (ANDS) 2008-2013, the Government of Afghanistan (GoA) has prioritized removing bottlenecks in the financial sector. GoA is committed to strengthen both the legal and regulatory framework by implementing four pending laws (secured transactions, mortgages, leasing and negotiable instruments) by enforcing prudent regulations in the banking sector. Regulations on risk management, credit, market liquidity and operations are under preparation. The GoA also plans to restructure and privatize two state-owned banks (Bank Millie and Pashtany Bank), to launch a credit information bureau and a financial dispute resolution tribunal, and to establish an adequate insurance law.

### Financial services providers

Today, the country counts 16 commercial banks licensed by the DAB. Further, a new leasing and financing company, as well as an equity fund to invest in local businesses have also started operating in the country.

There are 15 Microfinance Institutions (MFIs) providing microfinance (MF) services to 439,821 clients in 24 provinces (out of 34 provinces) as of February 2009.


Financial inclusion

Although the financial system has grown quickly, it is still under-developed and its role in economic activity remains very limited. While exact numbers are not available, only a small segment of the population has access to formal financial services and the banking sector is mainly based in urban areas, offering only basic services. According to a WB survey, only 30% of businesses have bank accounts and many use hawala[12] transfer systems[13]. Informal moneylenders and exchange dealers continue to be active players in the financial system and provide both cash and noncash payments.

## THE MICROFINANCE SECTOR

### History and Evolution

The first programs of MF in Afghanistan were initiated from the humanitarian activities of few international Non Government Organization (NGOs). In the early nineties, such MF initiatives were limited to the efforts of a handful of development NGOs that introduced this service on a very small scale in their areas of operation.

In 2003, the MF sector received a major boost when the GoA together with the WB, Consultative Group to Assist the Poor (CGAP), UK Goverment Department for International Development (DFID), Swedish International Development Agency (SIDA), United State Aid for Internaltional Development (USAID), Novib, the Governments of Denmark and Canada established the Microfinance Investment Support Facility for Afghanistan (MISFA) – an apex institution to pool diverse donors' funding mechanisms and to offer a streamlined flexible support to MFIs in Afghanistan. Initially, MISFA came under the Ministry for Rural Rehabilitation and Development (MRRD), and in 2006 was transformed into a company owned by the Ministry of Finance (MoF) and governed by an independent board of directors elected by donors. The shares of MISFA are non-dividend distributing and are currently owned by the MoF. The board has 2 members nominated and approved by MRRD and MoF, 3 members from the donors and two Afghan private sector members nominated by GoA.

To date, these donors, led by Canada and the UK, have provided more than US$ 100 million to the agency and the WB has further committed US$ 30 million in June 2008 to improve the MF sector in the country. The initiative has proven to be very successful in developing the MF sector in the country. 15 MFIs have emerged to render much needed financial services to the low income population, supported by MISFA funding and capacity building programs. Amongst the MFIs, Bangladesh Rural Advancement Committee (BRAC) Afghanistan is the largest player in the market with 140,366 active borrowers.

The Afghanistan Microfinance Association (AMA) acts as a network of MFIs operating in Afghanistan. It aims at promoting a sustainable MF sector through capacity building of MFIs, advocacy, lobbying and awareness raising, to establish itself as a voice of the MF sector. Registered in 2007, AMA currently has 13 permanent members and 2 associate members but is still in a nascent stage.

| Snapshot of Microfinance Sector in Afghanistan on February 2009 (Source : MISFA) | |
|---|---|
| Number of MFIs | 15 |
| Provinces Covered | 24 |
| Districts Covered | 113 |
| Clients | 439,821 |
| Active Borrowers | 339,657 |
| Share of Rural Clients | 31% |
| Share of Female Clients | 63% |
| Gross Loan Outstanding (US$) | 103,861,799 |

### Types of MF Providers

There is no comprehensive legal framework for the MF sector in the country and there are no prudential regulations for MFIs.

[12] Hawala is a system of money transfer where customers entrust money to hawala bankers or operators (hawaladars), who facilitate money movement worldwide through personal connections, leaving a minimal paper trail

[13] EIU Country Profile Afghanistan 2008

The types of institutions active in the MF sector are:

a) Deposit taking Microfinance Institutions (DMFI): Registered and regulated by DAB under DMFI license. To date no MFI has applied for this license. These can take two forms:

   i) Limited liability companies: Registered under Afghan Investment Support Facility (AISA). They are not regulated except for normal company law according to Commercial Code of 1955

   ii) Corporation/Company: Registered under AISA and not regulated except for company law according to Commercial Code of 1955

b) MFIs that do not take deposits and operate as general companies/corporations. All MISFA partners are registered under these forms. These can take two forms:

   i) Limited liability companies: Registered under Afghan Investment Support Facility (AISA). They are not regulated except for normal company law according to Commercial Code of 1955

   ii) Corporation/Company: Registered under AISA and not regulated except for company law according to Commercial Code of 1955

c) NGO MFIs: MFIs registered as an NGO with the Ministry of Justice. Currently no MISFA partner is registered under this form.

d) Credit Unions: They are registered with AISA but are not regulated. Currently there are 20 Islamic Investment Financial Cooperatives supported by World Council of Credit Unions (WOCCU) with funding from MISFA and others.

e) Microfinance Banks (MFBs): They are registered and regulated by the DAB under the commercial banking license. There is no specific clause or regulation for these banks and they are considered as normal commercial banks for licensing, regulation and supervision purposes. There are currently two MFBs operational in the country and they have received significant financial support from MISFA via loan facilities.

   i) First Microfinance Bank Afghanistan (FMFB-A) is promoted by the Aga Khan Development Network. FMFB-A was the first private commercial bank to be licensed and incorporated in Afghanistan in 2003. Since its inception, the Bank has grown rapidly and is now operating 13 branches in 7 provinces. FMFB-A has disbursed a total amount of US$ 60 million to over 40,000 borrowers.

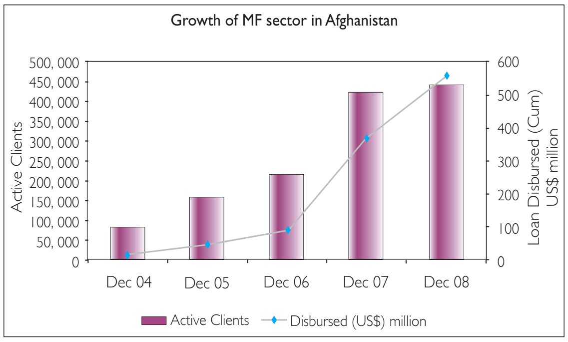
   ii) BRAC Afghanistan Bank (BAB) is a commercial bank registered with DAB offering financial services to small enterprises in Kabul and other major cities. The Bank is sponsored by BRAC. It has one branch and three sub-branches in Kabul.

It is important to note that all MFIs that are financed by MISFA have to register with Afghanistan Investment Support Agency (AISA). The role of MFIs outside the MISFA network is insignificant.

## Major Highlights

### In terms of growth

Since its inception, the MF sector has made substantial growth in terms of active borrowers, loans disbursed, size of loans as well as provinces and districts covered.




According to a research study from the Institute of Development Studies, the growth of the sector has led to increased business activity, employment opportunity and assets as well as improved socio-economic status for women.

### In terms of products and services

The credit services are the main products for all the MFIs with variation in characteristics such as lending methodology, amount and purpose across the MFIs and provinces. According to a MISFA impact study[14], 89% of the loans were used for productive purposes. 53% of surveyed households used their loan to expand their business and 28% for start-ups.

[14] Microfinance in Afghanistan: A Baseline and initial impact study for MISFA, September 2007

Although savings products are not very common, they are offered by few MFIs while made compulsory by others. Voluntary savings are forbidden by law as only mandatory savings can be mobilized, otherwise MFIs fall under DMFI regulation.

MISFA considers Islamic microfinance as a great opportunity and is paying close attention to its development. Currently 4 out of 15 MISFA partners offer Sharia compliant products and consider them as very promising not only for clients but also for community leaders and authorities.

Active banks in MF space, i.e. FMB-A and BAB, are targeting micro and small business owners. Other services such as micro-leasing, micro-insurance and micro-remittances are unknown.

### Achieving sustainability

At the beginning of 2009, the Operational Self-sufficiency (OSS) figures for the sector stood at 79%. It is suggested that MFIs in the country have achieved growth at the expense of profitability and sustainability. The MFIs incur high operational costs due to the security environment, small size loans, poor infrastructure and high cost of top management, all contributing to limit their ability to achieve sustainability.

Another cause for concern for the sustainability of MFIs is the recent trend in rising Portfolio at Risk (PAR). Broadly, PAR>30 increased from 3% in September 2007 to 10% in October 2008. In Jan 2009 the PAR>30 is at 11%[15] for the sector as a whole. Some explanations given for the increase in PAR are due to the lack of human resource capacity, deteriorating national security, lack of internal control and unconsolidated growth.

### Trends in regulations

The only MF specific regulation is applicable to DMFIs. Any MFI that mobilizes voluntary deposits is required to register and be regulated under the DMFI articles published by DAB. However, it is important to note that no MFI has applied for DMFI licence to date.

The two commercial banks with focus on MF come under the DAB regulation and supervision as applicable to commercial banks.

In the absence of any specific regulatory authority for the MFIs, MISFA is taking the lead role in not only funding the MFIs, but also in guiding them in reporting, governance structure etc. MISFA monitors and reviews the performance of MFIs in a very proactive manner. MISFA regularly takes detailed reports from member MFIs on indicators such as clients, outstanding loan balance, rural and women ratio, geographical spread and staff among other things and publishes them on its website. MISFA is also instrumental in enhancing transparency in the sector and encourages MFIs to report on the Microfinance Information Exchange (MIX) market.

### In terms of funding

The majority of MFIs currently depend on MISFA funding. Aiming at building the equity and fund base of MFIs, MISFA provides debt on soft terms to finance their portfolio and grants to cover operating expenses, purchase of fixed assets and expenditures for training and technical assistance. Over the last five years (2003-08) it has provided approximately US$ 100 million in loans and US$ 43 million in grants to its member MFIs. Since its inception MISFA's financing strategy has been clearly designed and oriented to gradually reduce the proportion of grants and substitute them by debt financing, while MFIs stabilize their financial positions and gain the ability to raise commercial funding from various other sources.

### Unmet demand and market potential

Despite the considerable growth of the sector, a 2006 study from the WB[16] shows a large market potential for continued expansion. Considering the economically active population living below the poverty line, only 5% of their financial service demand was covered by MFIs in the country and only 8% of the projected credit requirements were met by the MFIs.

During the last five years, the sector has reached less than half a million clients (households) out of the projected 3 million households living below the poverty line, leaving major scope for expansion. In addition it is concentrated in the central, north-western regions and urban areas, leaving the eastern and specifically

[15] There are significant differences among MFIs in relation to figures such as PAR>30 and OSS
[16] World Bank, Microfinance In South Asia, 2006

many parts of the southern regions and rural areas underserved offring a great potential for increasing the outreach.

## Future Prospects

Huge unmet demand, institutional development of MFIs, support from MISFA, and positive legal framework for investment, all provide the sound base for growth of the sector. A major positive aspect in Afghanistan, unlike other countries in the region, is that the sector is not distorted with multiple credit programs supported and subsidized by government or donors. The MFIs have the liberty to fix interest rates and fees without any interference. Due to MISFA's continued efforts, MFIs follow CGAP's standards in reporting and information is available for all MFIs reporting to MISFA.

Despite encouraging trends, the MF sector in the country has still been experiencing a number of challenges and issues. The high operating costs and unstable security situation continue to pose major challenges for MFIs sustainability. Whilst the support from MISFA has met their funding requirements, MFIs have given less priority to external funding and therefore lack diversified funding sources and investment preparedness. In addition a shortage of qualified management adds to the above challenges.

At a sectoral level, there are not many specialized MF capacity-building providers, independent rating agencies or valuation agencies. MISFA has played an important role in building the sector and indeed conducts a variety of capacity assessments, ratings, and portfolio audits among other things through independent consultants and agencies as well as by MISFA's Technical Support Department.

Besides the above systemic issues, the MF sector in the country has also been adversely affected by some very critical external factors such as rising inflation rate, migration, natural disasters such as droughts, and a continuous insecurity in many regions of the country.

# FRAMEWORK FOR INVESTMENT IN MICROFINANCE SECTOR IN THE COUNTRY

## General Information

The GoA has taken significant steps in reforming the banking, legal and tax systems to create an investor-friendly business environment. It has enacted a liberal policy on domestic and foreign investment in 'Law on Private Investment in Afghanistan' – amended on December 6, 2005. Based on the provisions of this law and the Commercial Law, qualified domestic or foreign entities may invest in all sectors of the economy, including MF. Both domestic and foreign investments are treated equally in the country.

The High Commission on Investment is the Government's focal point and highest administrative authority on policy and implementation related to private investment. The High Commission on Investment has established AISA as a limited liability company assisting it in carrying out its duties. Another important agency from the investment perspective is the Government Office of Private Investment having authority to grant various tax waivers.

All investors, whether foreign or domestic, have the right to avail of the banking facilities in Afghanistan, including opening accounts in foreign currency and collecting loans and credit to advance investment in the country. The State does not have the right to confiscate or to seize domestic or foreign investment without due process of law and a court order from the appropriate level of jurisdiction.

As far as the transfers of funds are concerned, private foreign investors are allowed to transfer distribution of capital and profits out of the country, with a notification to the central bank, in any currency at the prevailing exchange rate.

The tax rate is 20% on net income and currently interest earnings are subject to 5% value added tax (VAT)[17].

## Domestic Debt Investment

### Legal framework

The legal framework for domestic investment

[17] Value Added Tax on interest earning is likely to go in 2009

remains the Commercial Law and the Law on Private Investment in Afghanistan. All legal form of MFIs (companies as well as MFBs) can take debt investment from domestic financial institutions.

### Status

MISFA is the biggest player in domestic debt investment, giving debt to its member MFIs at an annual interest rate of 5% in local currency[18]. Over the last five years (2003-08) it has provided approximately US$ 100 million as loan funds for 14 MFIs.

The commercial market for domestic debt is very weak for the MF sector. With the availability of soft loan from MISFA, the commercial rates offered by the Banks are not very attractive for MFIs. However, MISFA has adopted a very clear strategy towards commercial financing for MFIs, progressively reducing disbursement of grants and increasing loans. The trend towards commercial funding is likely to accelerate in the near future.

The first commercial debt agreement in the sector was between Bank Alfalah and BRAC Afghanistan in June 2008, worth US$ 1 million, with MISFA providing a First Loss Default Guarantee of 25% to Bank Alfalah against a perceived default by BRAC.

### Practical considerations

Domestic debt investment is an easier way to invest in an MFI in the country. Such investments are in the nature of mutual transactions and recipient MFIs or investors do not need any approvals from the registering authority.

## Foreign Debt Investment

### Legal framework

The legal framework for foreign debt investment remains same as for domestic debt investment.

### Status

Despite the liberal policy and low tax environment, not many foreign investments, commercial or social, have come forward to MFIs except for soft loans provided by a few international agencies through MISFA.

An MFI, Ariana Financial Services (AFS), has received loan support from KIVA. AFS has 350 KIVA clients with a portfolio of AFN 12 million (US$ 240,000). On average, AFS disburses AFN 900,000 (US$18,000) via KIVA to 50 borrowers each month.

### Practical considerations

The foreign debt investment market has low demand from MFIs and investors/banks. For foreign investors active in MF space, MFIs in Afghanistan are still not an attractive option as their balance sheets have high PAR>30 and low level of OSS amongst other things. At retail level, with low cost debt available from MISFA, most MFIs do not have much incentive to approach foreign debt investors in the short term.

## Domestic Equity Investment

### Legal framework

The legal framework for domestic equity investment is Commercial Law and the Law on Private Investment in Afghanistan – amended on December 6, 2005. All legal forms of MFIs (companies as well as MFBs) can take equity investment from domestic financial Institutions. However, as MFI growth has been largely funded by grants, the government seeks to ensure that MFIs do not distribute dividends to investors gained through these. Most MFIs have the status of Corporation and as per their statutes, until they have refunded all grants received from MISFA, they are not authorized to distribute dividends. According to their statutes, their entire surplus income at the end of the year must be converted to reserve funds in order to reinvest the funds in the company and to meet unforeseen contingencies. None of the assets or funds belonging to the company is permitted for transfer out of Afghanistan in any shape or form.

### Status

The equity market is non-existent in the country and until only recently a domestic equity fund (Afghan Growth Finance) mandated to invest in local business has come to light. In case of many MFIs some equity is provided by a parent organization. MISFA has no equity investment in MFIs and has only supplied grants for fixed assets, capacity building and operating expenses.

### Practical considerations

The recipient MFI must approach AISA for approval for any equity investment. For such companies, while nothing prevents them to pay dividends, all

[18] Earlier loans by MISFA were in foreign currency but they were later converted into local currency and the new repayment schedule was signed with all the member MFIs in the year 2007

MFIs financed by MISFA are forbidden to distribute dividends until all grants are refunded. This is not a law but can be found in the statutes of all MFIs. The transfer of grants to a for-profit institution and the creation of dividends related to grant funding to entities outside of Afghanistan is illegal. There is no tax waiver for equity investment.

## Foreign Equity Investment

### Legal framework

As law does not differentiate between a national and foreing investor, the legal framework remains same as for domestic equity investment.

### Status

To date, no foreign investment, social or commercial has come to MFIs. As mentioned above, for most company MFIs, equity is provided by the parent organization. To date MISFA has only supplied grants for fixed assets, capacity building and operating expenses.

The MFBs have had some equity investments. For example, FMB-A has equity investment from Aga Khan Agency for Microfinance (AKAM), Kreditanstalt fur Wiederaufbau (KfW) and the International Finance Corporation (IFC)[19].

BAB also has equity investment from the IFC, ShoreCap International and Stichting Triodos Doen. Multilateral Investment Guarantee Facility (MIGA) of the WB has issued a guarantee to ShoreCap covering its equity investment in BAB. An additional amount of US$112,500 is being guaranteed by the MIGA-administered trust fund, the Afghanistan Investment Guarantee Facility. The coverage is for a period of up to ten years against the risks of transfer restriction, expropriation, war and civil disturbance.

### Practical considerations

Recipient MFI has to approach AISA and obtain approval for any equity investment. as mentioned before, all MFIs financed by MISFA[20] are forbidden to distribute dividends until they refund the grants given to them by MISFA.

### KEY CONTACTS

| | |
|---|---|
| Afghanistan Investment Support Agency (AISA) | invest@aisa.org.af www.aisa.org.af |
| Afghanistan National Development Strategy (ANDS) | info@ands.gov.af www.ands.gov.af |
| Da Afghanistan Bank (DAB) | governor.office@centralbank.gov.af www.centralbank.gov.af |
| Microfinance Investment Support Facility for Afghanistan (MISFA) | info@misfa.org.af www.misfa.org.af |

[19] IFC has provided US$ 3.5 million standby revolving loan facility to FMF-BA to fund its loan portfolio
[20] MISFA does not provide grants to dividend distributing companies

# Ariana Financial Services (AFS)

AFS is part of a new generation of microfinance institutions operating in Afghanistan with a vision 'to be a sustainable, nationally recognized financial services institution whose activities are targeted towards reducing poverty and providing employment in Afghanistan'. In a transparent and sustainable manner, it seeks to provide high quality and fair priced loan products and business services to the economically active poor in order to increase their incomes, expand their businesses and improve their quality of life.

## KEY FACTS

- Legal Status: Joint stock company
- Foundation year: 2003
- Location: HQ in Kabul, operating in 28 districts of Kabul and Jalalabad with 4 branches
- Clients number: 12,300 (December 2008)
- Gross Loan Portfolio (GLP) : US$ 7,422,574 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 0 | 0.05 | 0.2 |
| Equity | 0.01 | 0.2 | 0.3 |

(US$=AFN 49.8)

## HIGHLIGHTS

- First MFI in Afghanistan to get funding through KIVA
- Banking like mode of operation
- Good MIS and Loan Tracking software

## CONTACT

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## PRODUCTS

- Group solidarity loans: based on solidarity group guarantee, focused mainly on female clients. Loan amount : US$ 100 - 200 per group member in the first cycle and an increase of 40% per loan cycle; Term: 3 - 18 months; Interest rate: 24 % flat
- Individual loans: based on house collateral and a guarantor whose income is more than the repayment amount, both males and females are target clients. Loan amount US$ 600 – US$ 3,000; Term: 6 - 24 months; Interest rate: 24% on declining basis
- Agro loans: based on house or land collateral and a guarantor, farmers and all agro related businesses are target clients. Loan amount US$ 1,000 - US$ 4,000; Term: up to 36 months with 3 months grace period; Interest rate: 12 % flat

## MARKET POTENTIAL AND GROWTH PROSPECTS

AFS is currently operating in two provinces – Kabul and Jalalabad. AFS intends to start operations in urban pockets of Laghman and Baghlan, east and north of Kabul. The total estimated demand for MF services in Kabul is about 780,000 leaving 650,000 estimated potential clients currently unserved. The market size in Jalalabad is estimated to be approximately 189,000 clients. AFS endeavors to become operationally and financially sustainable by 2011. AFS plans to reach 63,000 active clients and become a depositary MFI by 2013.

| KEY PERFORMANCE INDICATORS (US$) | Ariana Financial Services | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | |
| Number of Staff Members | 49 | 43 | 98 | 124 | 142 | 149 |
| Loan Officers | 0 | 16 | 38 | 64 | 64 | 100 |
| Productivity | | | | | | |
| Number of active borrowers | 4,328 | 6,217 | 10,312 | 12,300 | 13,400 | 14,800 |
| Average Loan Balance per active borrowers | 137 | 180 | 276 | 603 | 740 | 1,002 |
| Active Borrowers per Loan Officer | | 389 | 271 | 192 | 209 | 148 |
| Portfolio per Loan Officer | | 70,059 | 74,858 | 115,978 | 154,864 | 148,242 |
| Balance Sheet | | | | | | |
| Gross Loan Portfolio | 591,171 | 1,120,950 | 2,844,596 | 7,422,574 | 9,911,301 | 14,824,186 |
| Total Assets | 736,540 | 3,913,547 | 4,216,259 | 7,907,992 | 10,985,730 | 16,181,736 |
| Total Equity | 21,083 | 643,717 | 658,769 | 687,024 | 1,235,917 | 1,988,822 |
| Total Debt | 715,457 | 3,269,830 | 3,557,490 | 7,220,968 | 9,749,813 | 14,192,915 |
| Financing Structure | | | | | | |
| Equity / Asset Ratio | 0.03 | 0.16 | 0.16 | 0.09 | 0.11 | 0.12 |
| Debt / Equity Ratio | 33.94 | 5.08 | 5.40 | 10.51 | 7.89 | 7.14 |
| Gross Loan Portfolio / Total Assets | 0.80 | 0.29 | 0.67 | 0.94 | 0.90 | 0.92 |
| Overall Monthly Financial Performance | | | | | | |
| Annualized Return on Assets (ROA), % | -47% | -6% | -6% | -8% | 0% | 1% |
| Annualized Return on Equity (ROE), % | -1643% | -42% | -37% | -76% | 0% | 10% |
| Operational self-sufficiency, % | 33% | 72% | 74% | 74% | 100% | 104% |
| Revenue | | | | | | |
| Yield on portfolio, % | 29% | 42% | 33% | 28% | 32% | 34% |
| Expenses | | | | | | |
| Financial Expenses Ratio, % | 5% | 5% | 4% | 6% | 6% | 6% |
| Operating Expense Ratio, % | 66% | 17% | 18% | 26% | 23% | 23% |
| Portfolio Quality | | | | | | |
| PAR (>30 days), % | 1% | 5% | 7% | 5% | 2% | 1% |
| Risk Coverage Ratio, % | 162% | 48% | 28% | 132% | 120% | 179% |

# Child Fund Afghanistan Microfinance Ltd (CFA)

CFA provides families, the access to small capital as a tool for poverty alleviation and enhancement of family income in order to make a major impact on children's lives. CFA is a registered Microfinance Institution in Afghanistan with 4 branch offices in Baghlan, Kunduz, Takhar and Badakhshan provinces. CFA approach of concentrating in communities ensure that it reaches vulnerable populations and integrates microenterprise development with more traditional development programs whose focus is the well-being of vulnerable families.

## KEY FACTS

- Legal Status: Company
- Foundation year: 2002
- Location: North Eastern Afghanistan
- Clients number: 20,380 (December 2008)
- Gross Loan Portfolio (GLP) : US$ 3,541,841 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 0.5 | 0.5 | 0.5 |
| Equity | 0.88 | 0.98 | 0.98 |

(US$=AFN 49.8)

## HIGHLIGHTS

- Founded in 2002 by Christian Children Fund (CCF), an international NGO working in 33 countries with major emphasis on the wellbeing of children
- Reaching the vulnerable and entrepreneurial clients in rural communities.
- Already attained operational self-sufficiency and looking forward to financial self-sufficiency

## CONTACT

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## PRODUCTS

- Family business loan: This product is about 85% of CFA's total loan portfolio. Loan amount : 1st loan cycle of US$ 180 with annual increment of US$ 100 per cycle upon successful completion of the previous cycle and a maximum loan limit of US$ 570; Term: 12 months ; Interest rate: 18 % flat; Repayment: monthly
- Agriculture loan: Loan amount : 1st loan cycle of US$ 180 with annual increment of US$ 55 per cycle upon successful completion of the previous cycle. Term: 12 months; Interest rate: 20% flat; Repayment: two equal installments at the end of 6 and 12 months

## MARKET POTENTIAL AND GROWTH PROSPECTS

With only 5 MFI's operating in the Northeastern provinces of Baghlan, Kunduz, Takhar and Badakhshan covering approximately 75,000 active clients, there is a very high unmet demand among the population to replace the informal financial sector. CFA is already serving over 18,587 clients and is targeting to serve 37,600 families by the end of 2011. CFA is looking into the possibility of individual loans in order to meet the increasing demand from clients who require more personalized services and larger loan amounts to expand their businesses.

| KEY PERFORMANCE INDICATORS (US$) | CFA | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | |
| Number of Staff Members | 19 | 35 | 69 | 83 | 126 | 153 |
| Loan Officers | 12 | 21 | 37 | 51 | 77 | 96 |
| Productivity | | | | | | |
| Number of active borrowers | 7,100 | 10,430 | 20,380 | 18,587 | 29,200 | 37,600 |
| Average Loan Balance per active borrowers | 128 | 167 | 174 | 177 | 215 | 306 |
| Active Borrowers per Loan Officer | 592 | 497 | 551 | 364 | 379 | 392 |
| Portfolio per Loan Officer | 75,827 | 83,018 | 95,725 | 64,614 | 81,375 | 119,667 |
| Balance Sheet | | | | | | |
| Gross Loan Portfolio | 909,926 | 1,743,375 | 3,541,841 | 3,295,332 | 6,265,853 | 11,488,041 |
| Total Assets | 1,028,760 | 1,886,231 | 5,195,352 | 5,254,552 | 6,629,088 | 11,926,973 |
| Total Equity | 981,681 | 918,459 | 1,144,118 | 1,093,791 | 1,446,978 | 2,115,775 |
| Total Debt | 47,079 | 967,772 | 4,051,234 | 4,160,761 | 5,182,110 | 9,811,198 |
| Financing Structure | | | | | | |
| Equity / Asset Ratio | 0.95 | 0.49 | 0.22 | 0.21 | 0.22 | 0.18 |
| Debt / Equity Ratio | 0.05 | 1.05 | 3.54 | 3.80 | 3.58 | 4.64 |
| Gross Loan Portfolio / Total Assets | 0.88 | 0.92 | 0.68 | 0.63 | 0.95 | 0.96 |
| Overall Monthly Financial Performance | | | | | | |
| Annualized Return on Assets (ROA), % | 0% | 2% | 3% | 1% | 3% | 9% |
| Annualized Return on Equity (ROE), % | 0% | 3% | 10% | 3% | 16% | 45% |
| Operational self-sufficiency, % | 106% | 111% | 123% | 104% | 117% | 149% |
| Revenue | | | | | | |
| Yield on portfolio, % | 2% | 28% | 27% | 30% | 35% | 33% |
| Expenses | | | | | | |
| Financial Expenses Ratio, % | 0% | 8% | 5% | 9% | 7% | 8% |
| Operating Expense Ratio, % | 2% | 16% | 11% | 10% | 18% | 14% |
| Portfolio Quality | | | | | | |
| PAR (>30 days), % | 0% | 6% | 2% | 13% | 2% | 2% |
| Risk Coverage Ratio, % | 0% | 82% | 187% | 94% | 201% | 200% |

# Microfinance Agency for Development & Rehabilitation of Afghan Communities (MADRAC)

MADRAC is among the leading MFIs in Afghanistan, established in 2005 with the mandate to provide appropriate and affordable financial services to both men and women in rural and urban areas in Afghanistan. Completely run by local staff, MADRAC currently covers 8 provinces. It aims at enabling low-income Afghan households improve their economic condition through sustainable access to financial services

## KEY FACTS

- Legal Status: Corporation
- Foundation year: 2005
- Location: HQ in Kabul, operating in 18 districts of 8 provinces
- Clients number: 16,250 (July 2008)
- Gross Loan Portfolio (GLP): US$ 2,796,770 (July 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 1.0 | 0.3 | 1.0 |
| Equity | 0.5 | 1.0 | 0.5 |

(US$=AFN 49.8)

## HIGHLIGHTS

- MADRAC is one of the founders of AMA (Afghanistan Microfinance Association)
- MADRAC has developed and launched an Islamic financial product called 'Murabaha'
- Focus on rural area with recent expansion in urban and semi-urban areas

## CONTACT

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## PRODUCTS

MADRAC offers three loan products. All loan products have;- Loan amount : AFN 10,000 - AFN 60,000 (US$ 200 – US$ 1,200) in different cycles; Term : maximum 12 months; Interest rate: 20% flat per annum.

- Group loans: Core loan products
- Small Enterprise loans: Product targeting urban and semi-urban clients
- Murabaha: Unique non cash loans (goods and assets) in line with the Islamic principles

## MARKET POTENTIAL AND GROWTH PROSPECTS

The estimated market size in the MADRAC areas of operation is around 500,000 clients, implying tremendous opportunity for expansion. Although there is competition from other MFIs in urban areas, there are few competitors in rural areas where MADRAC focuses. MADRAC's share in the market is around 15%, and it plans to increase this further by offering diversified loan products, including agricultural and medium enterprise loans. MADRAC plans to cover 40 districts in 11 provinces through 28 branches and sub branches reaching 71,280 clients (45% women) with GLP of around US$ 16,266,666 by 2010.

| KEY PERFORMANCE INDICATORS (US$) | Microfinance Agency for Development & Rehabilitaition of Afghan Communities (MADRAC) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 39 | 101 | 160 | 149 | 220 | 280 | 330 |
| Loan Officers | 12 | 43 | 74 | 80 | 100 | 140 | 190 |
| Productivity | | | | | | | |
| Number of active borrowers | 2,730 | 11,152 | 15,358 | 16,250 | 26,000 | 3,000 | 50,000 |
| Average Loan Balance per active borrowers | 0 | 7 | 94 | 188 | 95 | 310 | 292 |
| Active Borrowers per Loan Officer | 228 | 259 | 208 | 203 | 260 | 271 | 263 |
| Portfolio per Loan Officer | 0 | 1,699 | 19,551 | 38,254 | 24,779 | 84,264 | 77,098 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 0 | 73,076 | 1,446,764 | 3,060,350 | 2,477,994 | 11,797,087 | 14,648,759 |
| Total Assets | 0 | 206,907 | 2,413,529 | 4,090,431 | 3,815,475 | 12,873,281 | 15,807,243 |
| Total Equity | 0 | -77,666 | 125,217 | 54,993 | -332,102 | 74,206 | 537,658 |
| Total Debt | 0 | 284,573 | 2,288,313 | 4,035,438 | 4,147,577 | 12,799,074 | 15,269,585 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | 0 | -0.38 | 0.05 | 0.01 | -0.09 | 0.01 | 0.03 |
| Debt / Equity Ratio | 0 | -3.66 | 18.27 | 73.38 | -12.49 | 172.48 | 28.40 |
| Gross Loan Portfolio / Total Assets | 0 | 0.35 | 0.60 | 0.75 | 0.65 | 0.92 | 0.93 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | 0% | -555% | -64% | -24% | -37% | 5% | 6% |
| Annualized Return on Equity (ROE), % | 0% | 1480% | -3529% | -869% | 1048% | -346% | 290% |
| Operational self-sufficiency, % | 0% | 2% | 42% | 43% | 27% | 138% | 151% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 0% | 40% | 81% | 26% | 19% | 49% | 35% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 0% | 28% | 16% | 7% | 17% | 7% | 5% |
| Operating Expense Ratio, % | 0% | 541% | 95% | 36% | 33% | 23% | 16% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 0% | 2% | 6% | 26% | 20% | 3% | 3% |
| Risk Coverage Ratio, % | 0% | 44% | 18% | 10% | 107% | 45% | 44% |

# Micro Finance Agency for Development (MoFAD)

MOFAD is a spun off from CARE International's microfinance program in Afghanistan. Started in 2004, MOFAD operates through 3 branch offices in 19 districts of Kabul Province, providing group and individual loans and targeting 100% women. MOFAD is 70% self sufficient with concrete plans to increase this above 100% in next 2 years to ensure the sustainable social empowerment of women in Afghanistan.

## KEY FACTS

- Legal Status: Joint stock company
- Foundation year: 2004
- Location: HQ in Kabul, operating in 19 districts through 3 branches
- Clients number: 10,236 (December 2008)
- GLP : US$ 2,583,971 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 0.1 | 0.15 | 0.3 |
| Equity | 0.06 | 0.06 | 0.06 |

(US$=AFN 49.8)

## HIGHLIGHTS

- 96% of the ownership of the company is with CARE International Afghanistan
- One of the fastest growing MFI
- Management has extensive experience in microfinance operations
- Follows Self Help Group (SHG) methodology
- Excellent rapport with the community due to development work done by its promoting organization

## CONTACT

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## PRODUCTS

- Group loan fund: This product is for groups with group guarantee and accounts for 94% of portfolio. Loan amount: AFN 10,000 (US$ 200) for 1st cycle and increase in AFN 10,000 (US$ 200 ) in subsequent cycle; Term: 12 months maximum; Interest rate: 18%
- Small enterprise loan fund: This product is mainly provided to individual entrepreneurs with the consent of a group and individual collateral and accounts for 6% of portfolio. Loan amount: AFN 10,000 - AFN 75,000 (US$ 200 – US$ 1,500) for 1st cycle, AFN 10,000 - AFN 150,000 (US$ 200 - US$ 3,000) for 2nd Cycle and AFN 10,000 - AFN 200,000 (US$ 200 – US$ 4,000) for 3rd Cycle; Term: 24 months maximum; Interest rate: 24%, Other fees: 2% service fee and 1% processing fee

## MARKET POTENTIAL AND GROWTH PROSPECTS

MoFAD plans to expand its coverage to both urban and rural areas in the Central, North and North-East parts of the country. The SHG methodology and 100% women coverage make MoFAD different from others. By the end of 2011, MOFAD plans to attain US$ 13,2 million outstanding portfolio.

| KEY PERFORMANCE INDICATORS (US$) | Microfinance Agency for Development (MoFAD) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 29 | 30 | 64 | 80 | 164 | 183 | 206 |
| Loan Officers | 9 | 13 | 18 | 30 | 82 | 91 | 104 |
| Productivity | | | | | | | |
| Number of active borrowers | 2,319 | 4,003 | 7,422 | 10,236 | 19,307 | 25,661 | 29,253 |
| Average Loan Balance per active borrowers | 79 | 229 | 240 | 252 | 216 | 302 | 345 |
| Active Borrowers per Loan Officer | 258 | 308 | 412 | 341 | 235 | 282 | 281 |
| Portfolio per Loan Officer | 20,458 | 70,398 | 98,852 | 86,132 | 50,939 | 85,221 | 96,983 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 184,119 | 915,171 | 1,779,339 | 2,583,972 | 4,176,999 | 7,755,077 | 10,086,187 |
| Total Assets | 511,401 | 2,285,587 | 3,548,412 | 4,084,104 | 6,033,609 | 10,013,236 | 12,640,617 |
| Total Equity | -127,710 | -83,205 | 472,393 | -1,833 | -351,514 | -350,717 | 122,200 |
| Total Debt | 639,111 | 2,368,792 | 3,076,019 | 4,085,936 | 6,385,123 | 10,363,953 | 12,518,417 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | -0.25 | -0.04 | 0.13 | 0.00 | -0.06 | -0.04 | 0.01 |
| Debt / Equity Ratio | -5.00 | -28.47 | 6.51 | -2229.55 | -18.16 | -29.55 | 102.44 |
| Gross Loan Portfolio / Total Assets | 0.36 | 0.40 | 0.50 | 0.63 | 0.69 | 0.77 | 0.80 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | -74% | -44% | -9% | -12% | -6% | 0% | 4% |
| Annualized Return on Equity (ROE), % | 298% | 584% | -139% | -195% | 173% | -3% | -411% |
| Operational self-sufficiency, % | 5% | 16% | 58% | 62% | 79% | 101% | 121% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 11% | 21% | 28% | 34% | 34% | 34% | 34% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 3% | 3% | 3% | 9% | 5% | 6% | 5% |
| Operating Expense Ratio, % | 75% | 49% | 19% | 22% | 24% | 20% | 17% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 5% | 1% | 1% | 10% | 13% | 2% | 2% |
| Risk Coverage Ratio, % | 78% | 239% | 139% | 50% | 75% | 90% | 117% |

# OXUS Afghanistan

OXUS Afghanistan is a part of the OXUS Group which between 2005-06 took most of ACTED's microfinance activities in Tajikistan, Kyrgyzstan, and Afghanistan. OXUS Afghanistan aims at reducing poverty through the provision of financial services to the working poor, acting for the enhancement of income and economic security for large numbers of urban and rural low income individuals through the delivery of sustainable and client oriented financial services.

## KEY FACTS

- Legal Status: Privately owned corporation
- Foundation year: 2005
- Location: HQ, Kabul, operating through 8 branches
- Clients number: 13,169 (March 2009)
- Gross Loan Portfolio (GLP) : US$ 3,667,907 (March 2009)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 0.1 | 0.2 | 0.5 |
| Equity | 0 | 0 | 0 |

(US$=AFN 49.8)

## HIGHLIGHTS

- Belongs to OXUS Development Network, with access to international capital markets
- 4th largest MFI in Afghanistan in terms of outstanding portfolio
- Recently named 5th fastest growing MFI in Asia by Mix Market
- Plan to transform into fully regulated Depositary MFI

## CONTACT

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## PRODUCTS

- Group loans:
    - 6 month group loan: offered in urban areas; Loan amount: AFN 10,000 (US$ 200); Term: 6 months; Interest rate: 10%
    - 12 month group loan: offered in rural areas; Loan amount: AFN 10,000 (US$ 200); Term: 12 months; Interest rate: 20%
- Individual loans: offered for SME in urban areas; Loan amount: AFN 25,000 - AFN 100,000 (US$ 502– US$ 2,000); Term: 6-18 months; Interest rate: 18%

## MARKET POTENTIAL AND GROWTH PROSPECTS

Very few banks operate outside Kabul and demand for financial services, especially microcredit, is very high. Unmet demand is especially large in mid-size cities and rural areas and OXUS plans to increase its coverage to a significant numbers of districts where no microfinance institutions is currently operating. By 2011, OXUS Afghanistan plans to have a total portfolio of US$ 35 million with 18 branches and 4 regional offices, offer affordable products including loans, savings, insurance, and mobile banking services and become sustainable with 120% operational self-sufficiency.

| KEY PERFORMANCE INDICATORS (US$) | OXUS Afghanistan | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| **Staffing** | | | | | | |
| Number of Staff Members | 40 | 92 | 136 | 157 | 225 | 320 |
| Loan Officers | 19 | 40 | 65 | 71 | 102 | 170 |
| **Productivity** | | | | | | |
| Number of active borrowers | 616 | 5,621 | 13,406 | 13,169 | 18,000 | 23,000 |
| Average Loan Balance per active borrowers | 137 | 143 | 192 | 279 | 278 | 348 |
| Active Borrowers per Loan Officer | 32 | 141 | 206 | 185 | 176 | 135 |
| Portfolio per Loan Officer | 4,444 | 20,061 | 39,519 | 51,661 | 49,020 | 47,059 |
| **Balance Sheet** | | | | | | |
| Gross Loan Portfolio | 84,437 | 802,440 | 2,568,744 | 3,667,907 | 5,000,000 | 8,000,000 |
| Total Assets | 171,823 | 1,701,014 | 4,297,984 | 6,311,588 | 6,797,311 | 8,855,711 |
| Total Equity | (172,098) | (195,553) | (330,088) | 578,811 | 947,311 | 1,155,711 |
| Total Debt | 343,921 | 1,896,567 | 4,628,072 | 5,732,777 | 5,850,000 | 7,700,000 |
| **Financing Structure** | | | | | | |
| Equity / Asset Ratio | -100% | -11% | -8% | 9% | 14% | 13% |
| Debt / Equity Ratio | -200% | -970% | -1402% | 990% | 618% | 666% |
| Gross Loan Portfolio / Total Assets | 49% | 47% | 60% | 58% | 74% | 90% |
| **Overall Monthly Financial Performance** | | | | | | |
| Annualized Return on Assets (ROA), % | -547% | -48% | -13% | -14% | -5% | 1% |
| Annualized Return on Equity (ROE), % | 546% | 243% | 145% | -594% | -43% | 6% |
| Operational self-sufficiency, % | 1% | 23% | 58% | 60% | 84% | 103% |
| **Revenue** | | | | | | |
| Yield on portfolio, % | 8% | 29% | 31% | 35% | 40% | 39% |
| **Expenses** | | | | | | |
| Financial Expenses Ratio, % | 3% | 5% | 6% | 11% | 7% | 9% |
| Operating Expense Ratio, % | 1114% | 121% | 44% | 41% | 38% | 28% |
| **Portfolio Quality** | | | | | | |
| PAR (>30 days), % | 0% | 2% | 3% | 15% | 3% | 2% |
| Risk Coverage Ratio, % | 0% | 189% | 142% | 78% | 333% | 412% |

# Parwaz

Parwaz was founded in 2002 as a microfinance institution and is currently offering a variety of loan products to women in Kabul. The mission of Parwaz is to empower the women of Afghanistan to rise from poverty by enabling them to build micro businesses, increase their income, reduce their vulnerability, and to become economic agents of change in their families, communities and country. Since last year, Parwaz has started the process of transforming its organizational structure and operating system modelling ASA Bangladesh.

## KEY FACTS

- Legal Status: Non profit corporation
- Foundation year: 2002
- Location: HQ in Kabul, operating through 8 branches around Kabul city
- Clients number: 14,708 (December 2008)
- Gross Loan Portfolio (GLP) :US$ 1,858,714 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 1.4 | 30.2 | 0 |
| Equity | 0.16 | 9.3 | 0 |

(US$=AFN 49.8)

## HIGHLIGHTS

- 2 year collaboration with ASA Bangladesh to provide consultancy and assistance in adopting ASA model
- Senior management with extensive experience in microfinance sector in Afghanistan
- Focus on urban women clients

## CONTACT

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## PRODUCTS

Parwaz currently targets 100% women in urban and peri-urban Kabul. All loans have - Interest rate: 24% flat

- Group loan: Loan amount : from AFN 10,000 (US$ 200); Term: 10 months
- Small enterprises loan (individual): Loan amount: AFN 20,000 - AFN 100,000 (US$ 400 – US$ 2,000); Term: 12 months
- Small enterprise loan (group) : Loan amount : AFN 100,000 - AFN 500,000 (US$ 2,000 – US$ 10,000); Term: 12-16 months
- House repair loan: Loan amount : AFN 20,000 - AFN 100,000 (US$ 400 – US$ 2,000); Term: 12 months

## MARKET POTENTIAL AND GROWTH PROSPECTS

Currently, Parwaz is focusing on urban areas of Kabul where there is a large demand for financial services. The demand is so large that despite efforts of continued expansion, Parwaz has not even reached 30% of its potential market in Kabul. In coming years Parwaz plans to move to provinces with high levels of security and market potential, especially in Northern Afghanistan.

| KEY PERFORMANCE INDICATORS (US$) | Parwaz | | | | |
|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 |
| **Staffing** | | | | | |
| Number of Staff Members | 20 | 55 | 120 | 289 | 439 |
| Loan Officers | 10 | 15 | 40 | 152 | 236 |
| **Productivity** | | | | | |
| Number of active borrowers | 3,317 | 7,138 | 14,708 | 45,105 | 91,107 |
| Average Loan Balance per active borrowers | 83 | 125 | 126 | 303 | 331 |
| Active Borrowers per Loan Officer | 332 | 476 | 368 | 297 | 386 |
| Portfolio per Loan Officer | 27,576 | 59,309 | 46,468 | 89,862 | 127,907 |
| **Balance Sheet** | | | | | |
| Gross Loan Portfolio | 275,758 | 889,629 | 1,858,714 | 13,659,032 | 30,186,030 |
| Total Assets | 404,995 | 1,468,848 | 4,628,257 | 14,152,204 | 30,950,508 |
| Total Equity | 128,195 | 398,858 | 780,935 | 2,917,024 | 10,071,283 |
| Total Debt | 276,800 | 1,069,990 | 3,847,322 | 11,235,179 | 20,879,225 |
| **Financing Structure** | | | | | |
| Equity / Asset Ratio | 0.32 | 0.27 | 0.17 | 0.21 | 0.33 |
| Debt / Equity Ratio | 2.16 | 2.68 | 4.93 | 3.85 | 2.07 |
| Gross Loan Portfolio / Total Assets | 0.68 | 0.61 | 0.40 | 0.97 | 0.98 |
| **Overall Monthly Financial Performance** | | | | | |
| Annualized Return on Assets (ROA), % | -31% | -27% | -10% | -9% | 4% |
| Annualized Return on Equity (ROE), % | -98% | -97% | -52% | -48% | 15% |
| Operational self-sufficiency, % | 27% | 42% | 58% | 77% | 111% |
| **Revenue** | | | | | |
| Yield on portfolio, % | 17% | 31% | 31% | 38% | 43% |
| **Expenses** | | | | | |
| Financial Expenses Ratio, % | 2% | 4% | 4% | 8% | 9% |
| Operating Expense Ratio, % | 41% | 44% | 20% | 33% | 29% |
| **Portfolio Quality** | | | | | |
| PAR (>30 days), % | 0% | 0% | 2% | 4% | 4% |
| Risk Coverage Ratio, % | 0% | 0% | 123% | 114% | 149% |

# India

## COUNTRY INVESTMENT GUIDELINES

- Land Area: 3,287,263 sq km
- Population: 1.13 bn (2007)
- Main Towns: Mumbai (16.4 million), Kolkata (13.2 million), Delhi (12.8 million), Chennai (6.4 million)
- Languages: Hindi (national language), 14 other official languages. English is widespread as second language
- Currency: Indian Rupee (INR)
- Fiscal Year: 1st April - 31st March
- Development Indicators[1] :

  Population below poverty line (national): 27.5% (2004)

  Literacy rate (15-24 years old): 76.4% (2004)

  Mortality rate (child<5): 76 per 1000 live births (2006)

  Life expectancy: 63.7 years (2005)

  HDI rank: 128 (2007-08)

[1] All figures are from Asian Development Bank – Database and Development Indicators, Basic 2008 Statistics

# ECONOMIC AND FINANCIAL BACKGROUND[2]

## Economic Overview

| Indicator | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| Nominal GDP (US$ bn) | 805.6 | 922.9 | 1,131.9 | 1,329.1 | 1,512.4 |
| GDP/head[3] (US$) | 750 | 840 | 1,020 | 1,180 | 1,330 |
| Real GDP growth (%) | 9.2 | 9.7 | 9.0 | 6.0 | 5.0 |
| Consumer price inflation (av, %) | 4.2 | 6.2 | 6.4 | 8.3 | 5.4 |
| Exchange rate (av, US$) | 44.1 | 45.3 | 41.3 | 43.5 | 50.4 |
| Total external debt (US$ bn) | 123.1 | 135.0 | 149.2 | 166.6 | 173.3 |
| FDI (US$ bn) | 6.7 | 17.5 | 17.0 | 18.0 | 20.0 |
| FDI (% of GDP) | 0.8 | 1.9 | 1.5 | 1.4 | 1.3 |

India has grown by leaps and bounds in recent years and has emerged as a major world economic power. After lumbering along at a pace of about 4-5% Gross Domestic Product (GDP) growth a year in the 1980s and 1990s, the economy has surged in this decade, posting an average annual growth of 8.5% since 2005. Economic reforms, strong domestic demand, domestic and foreign investment and increasing levels of foreign trade have all contributed to this growth.

However, underneath these impressive GDP growth rates lie huge regional and class disparities in economic performance and human development indicators. The western states of Gujarat, Maharashtra and southern states of Tamil Nadu, Karnataka and Andhra Pradesh have contributed to much of the growth, and industrial development and investment is primarily concentrated in these states. The India success story has far fewer tales from the northern and central states of Uttar Pradesh, Bihar, Madhya Pradesh, Chhattisgarh and Rajasthan; these states also have much less impressive human development indicators.

### Economic structure

For the past five years, the services sector has accounted for more than half of the country's GDP while the rest is shared between Agriculture and Industry with industry steadily increasing its percentage.

The share of the agriculture sector has been declining in GDP over the years and was only 17.8% in 2007-08. The growth in agriculture has been stagnating at around 2% due to a number of factors such as low investment, highly fragmented land holdings, lack of irrigation[4], depleting soil productivity and poor post-harvest infrastructure. Agriculture, however, remains very important as it employs about 60% of the country's workforce.

With close to 20% share of GDP, the industrial sector is small compared with the economies of East Asia[5]. Between 2003-07, the sector grew sharply with an average annual growth rate of 8.6% on the back of strong consumer demand and rising exports. Manufacturing accounts for more than 75% of industrial output.

The services sector is the largest and fastest growing segment of the economy. The much talked about Information Technology (IT) sector's share in GDP has increased from 1.2% in 1998-99 to 5.2% in 2007-08. In the last couple of years the retail sector has also grown significantly employing a large number of people entering the labour force.

### Exports and imports

India's trade/GDP ratio has increased dramatically from 15% in the 1990s to over 40% in 2007, although the level of integration remains low compared with other large emerging economies. The government aims to reach US$ 200 bn worth of exports in 2007-08 from US$ 155 bn in previous year.

India's main export trading partners are United States(US), United Arab Emirates (UAE), China and United Kingdom (UK) while import partners are China, US, Germany and Singapore. More recently Indian exports have surged beyond traditional markets of US and Europe in countries of Asia and Africa and new generation engineering and software exports are gaining importance. The main exports are

[2] The figures are from EIU Country Profile India 2008, EIU Country Report India 2009 and EIU Investment Prospects 2011, challenges of political risk, 2007
[3] The GDP is divided by the population.
[4] Only one third of crop land is irrigated and the rest depends on monsoon rains
[5] In East Asia, industry accounts for 30-40 % of GDP

engineering goods, petroleum products, textile, gems and jewellery, drugs and dyes, while main imports consist of petroleum products, electronics goods, gold and silver and machinery.

### Doing business

'Doing Business 2009 India'—a World Bank (WB) publication that assesses the business environment in 181 countries using quantitative indicators—ranked the country in the 122nd position, which is a decline of two notches from its 2008 position. While the country has achieved good ranking on getting credit (28th) and protecting investors (38th), it fares very badly on other indicators such as starting business (121st), dealing with construction permits (136th), employing workers (89th), registering property (105th), paying taxes (169th), enforcing contracts (180th) and closing business (140th). While India has been a popular destination for foreign investment in the region, it is much less favourable compared with China.

### Monetary situation

India's macroeconomic policy with its focus on price stability, supply of adequate credit to support growth and financial stability has delivered high growth with inflation under reasonable control. However, cross-border capital flows—both inward and outward—have ramped up and are likely to remain large and volatile, creating huge complications for monetary policy as these flows affect the domestic money supply and exchange rate.

### Impact of the global financial crisis

While the Indian economy is predicted to be less affected by the global financial crisis in comparison to other export-dependent economies of the region, the slowdown in the economy is imminent and incipient signs of slowdown are already visible. The third quarter (October-December) figures for 2008-09 show lower growth rates in many sectors including finance, insurance, real estate, business services, exports-imports and the manufacturing sector. The Central Statistical Organization (CSO) estimates real GDP growth for 2008-09 at 7.1%. Corporate investment—the major growth driver during recent years—is expected to shrink because of weakening profitability and confidence, and tightening of financing conditions from foreign and non-bank sources. As a result of the global crisis, the stock market index declined by over 50% in 2008. Analysts predict approximately 10 million job losses as a consequence of this down-turn.

The government has taken a number of steps to stimulate the economy, including increase in public spending, central bank's action on cutting policy rates, lowering the cash reserve ratio and the statutory liquidity ratio, and easing controls on capital inflows to ease monetary policy and stimulate bank lending.

## Financial Sector Overview

### Key reforms

The Indian financial system has made significant strides in recent years. Beginning in the early 1990s, the financial sector reforms have been pursued vigorously with measures such as deregulated interest rates, liberal branch-licensing procedures and reduction in Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio(CRR), increasing operational autonomy, disinvestment of public ownership in public sector banks, transparent entry norms for private and foreign banks and permission for Foreign Direct Investment (FDI) and portfolio investment in banking. These have led to improved efficiency and transparency in the financial sector.

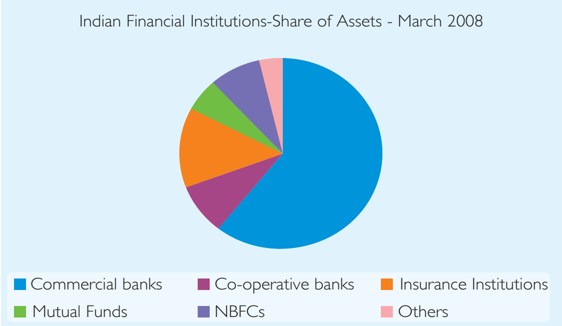
Post reforms, the asset shares of public sector banks have fallen and those of Indian private sector banks have increased though public sector banks (PSBs) still dominate accounting for three-quarters of industry assets. The new private banks which accounted for 2.6 % of the commercial banking sector in March 1997 have developed rapidly and accounted for nearly 17 % of the commercial banking assets by end-March 2008. In recent years, there is also considerable increase in the share of PSBs in the industry-wide profit.

### Financial services providers

India's financial system is comprised of financial institutions and financial markets. While financial institutions is made of scheduled banks, cooperative and rural banks, non-banking finance companies, housing finance companies, development finance institutions and insurance companies, the financial markets include equity markets, foreign exchange markets, government security, money market and bond markets.

The Reserve bank of India (RBI) is the central bank and regulator for financial and banking systems.

The banking system is, by far, the most prominent segment, accounting for over 80 % of the funds flowing through the financial sector. Commercial banks are the dominant institutions in the Indian financial landscape accounting for around 60% of its total assets. There were 170 scheduled commercial banks and 4 non-scheduled commercial banks in March 2008. Together, they have 77,773 offices around the country – 30,977



Source: India's Financial Sector Assessment Report, March 2009

in rural, 17,656 in semi-urban, 15,245 in urban 13,895 in metropolitan areas.[6]

Though PSBs account for around 70% of commercial banking assets, competition in the banking sector has increased in recent years with the emergence of private players as also with greater private shareholding of PSBs through listing of PSBs on stock exchanges[7].

The insurance sector in India is traditionally dominated by state owned insurance companies. Since the Government of India (GoI) allowed FDI in the insurance sector (up to 26%), a number of new joint venture private companies have entered and their share in the insurance market is rising. The life insurance industry has reported compounded annual growth rate (CAGR) of 25.2% during the period 2001-2008 while the non-life insurance segment has reported CAGR of 45.3% during the same period. The Insurance Regulatory and Development Authority (IRDA) is the regulatory authority for the insurance sector.

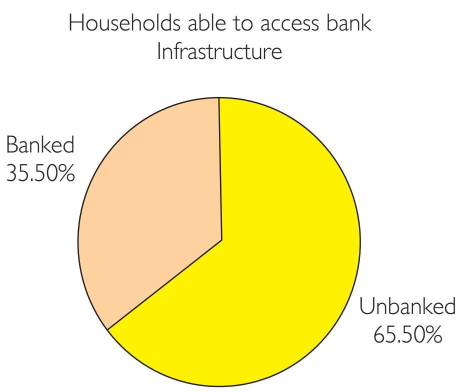
Non-banking Finance Companies (NBFCs) provide loans and hire-purchase finance, mostly for retail assets, and are regulated by RBI. NBFCs are witnessing robust growth mainly on the back of the high growth registered in the non-deposit taking segment.

## Financial inclusion

| Extent of Financial Exclusion in India | |
|---|---|
| Number of landholdings in India | 115.6 million |
| No of farmer households in the country | 89.3 million |
| No of households with access to credit (formal or informal) | 45.9 million |
| % farmer households with no access to formal source of credit | 73 |
| % of non-cultivator households with no access to formal credit | 80 |
| % of Central, Eastern and North-Eastern regions in all financially excluded farmer households in the country. | 64 |
| % of marginal and small farmers in all non-credit linked farm households | 87 |

The GoI has mandated requirements of a certain quantum of lending to government-favoured "priority sectors[8]" and interest rate ceilings for small loans, especially to the agricultural sector. The share of priority sector advances in total credit of Scheduled Commercial Banks was 32.9% in March 2008. In addition there is an extensive network of rural banks and cooperatives to provide financial services to the poor. However, there still remains a huge gap in servicing low income people through the existing financial system of the country.

According to the Report of the Committee on Financial Inclusion 2008[9], nearly three-quarters of farm households have no access to formal sources of credit and lack instruments to insure against adverse events but this problem is not limited to rural areas.




[6] RBI, Statistical Tables Related to Banks in India 2007-08
[7] Nine public sector banks, including the State Bank of India, the largest Indian bank are listed private ownership has become close to 40%
[8] Priority sector lending directs a total of 40% of adjusted net bank credit. Banks that fail to meet this target are required to deposit the shortfall with NABARD for which they receive below-market rates of interest (Source: Sa-dhan, Enhancing resource flow to the microfinance sector, march 2009)

Further, the report stresses that 'apart from the fact that exclusion in general is large, it also varies widely across regions, social groups and asset holdings. The poorer the group, the greater is the exclusion.'[10]

## THE MICROFINANCE SECTOR

### History and Evolution[11]

The evolution of Indian microfinance (MF) can be broadly divided into four distinct phases:

**Phase 1: The cooperative movement (1900-1960)**

During this phase, credit cooperatives were vehicles to extend subsidized credit to villages under government sponsorship.

**Phase 2: Subsidized social banking (1960s – 1990)**

With failure of cooperatives, Government focused on measures such as nationalization of Banks, expansion of rural branch networks, establishment of Regional Rural Banks (RRBs) and the setting up of apex institutions such as the National Bank for Agriculture and Rural Development (NABARD) and the Small Scale Industries Development Bank of India (SIDBI), including initiation of a government sponsored Integrated Rural Development Programme (IRDP). While these steps led to reaching a large population, improving financial services, the period was characterized by large-scale misuse of credit, creating a negative perception about the credibility of micro borrowers among bankers, thus further hindering access to banking services for low-income people.

**Phase 3: SHG-Bank linkage program and growth of NGO-MFIs (1990 – 2000)**

The failure of subsidized social banking triggered a paradigm shift in delivery of rural credit with NABARD initiating the Self Help Group (SHG) Bank Linkage Programme (SBLP), aimed at linking informal women's groups to formal banks. The program helped increase banking system outreach to otherwise isolated people and initiate a change in the bank's outlook towards low-income families from 'beneficiaries' to 'customers'. This period was thus marked by the extension of credit at market rates.

The model generated a lot of interest among newly emerging Microfinance Institutions (MFIs), largely of non-profit origin, to collaborate with NABARD under this program. The macroeconomic crisis in the early 1990s that led to the introduction of the Economic Reforms of 1991 resulted in greater autonomy to the financial sector. This also led to emergence of new generation private sector banks that would become important players in the microfinance sector a decade later.

**Phase 4: Commercialization of Microfinance: The first decade of the new millennium**

Post reforms, rural markets emerged as the new growth drivers for MFIs and banks, the latter taking interest in the sector not only as part of their corporate social responsibility but also as a new business line. On the demand side, NGO-MFIs increasingly began transforming themselves into more regulated legal entities such as NBFCs to attract commercial investment. MFIs set up after 2000 saw themselves less in the developmental mould and more as businesses in the financial services space, catering to an untapped market segment while creating value for their shareholders. This overriding shift brought about changes in institutions' legal forms, capital structures, sources of funds, growth strategies and strategic alliances.

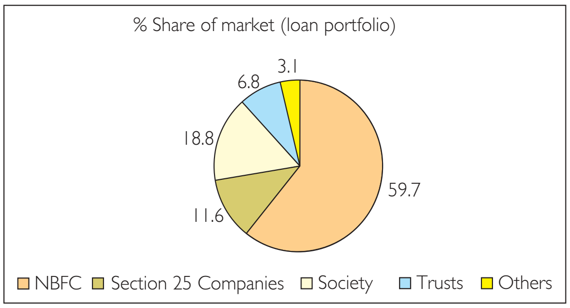
The MF sector as it exists today essentially consists of two predominant delivery models – the SBLP and MFIs. In the financial year 2007-08, MF in India through SBLP (21 million clients) and MFIs (14 million clients) served over 33 million clients[12], up by 9 million over the previous financial year. By 31st March 2008, the outstanding micro-credit portfolio of India MF was about US$ 4.4 bn, 75% are accounted for by SBLP, 20% by large MFIs and 5% by medium and small MFIs. However, approximately 90 million low income households remain under-served. Four out of five MF clients in India are women[13] .

9 Report of the Committee on Financial Inclusion, Jan 2008
10 ibid
11 This part is drawn from Intellecap, Inverting the Pyramid: the changing Face of Indian Microfinance, 2007
12 The total has been reduced by 15% of MFI-figure, assumed to be the overlap with SBLP
13 According to State of the Sector Report 2008, in addition to SBPL and MFIs, approximately 65 million clients are reached by commercial banks, RRBs and primary cooperatives.

## Types of MF Providers

The different legal forms under which MF can be provided in India are:

1. Commercial Banks
2. Cooperative Banks
3. Regional Rural Banks (RRBs)
4. Local Area Banks (LABs)
5. Cooperative Societies, SHGs and Federations
6. Societies
7. Trusts
8. Section 25 (Not-for-Profit) companies
9. Non-Banking Finance Companies (NBFCs)
10. Organizations under Business Facilitator/Business Correspondent guidelines of the Reserve Bank of India




Among these, the MFIs can take up the form of Society, Trust, Co-operative Society, Section 25 Company or NBFC. There is no centralized database on the number of microfinance institutions that operate in the country, however, estimates have put it anywhere between 800 and 1,200. The overwhelming majority of MFIs are societies and trusts, followed by cooperatives and section 25 companies. Among the large MFIs, most are NBFCs[14]. It is estimated that the top 20 MFIs account for 80% of the total portfolio. (Please refer to Annex 1 for details of legal structures of MFIs.)

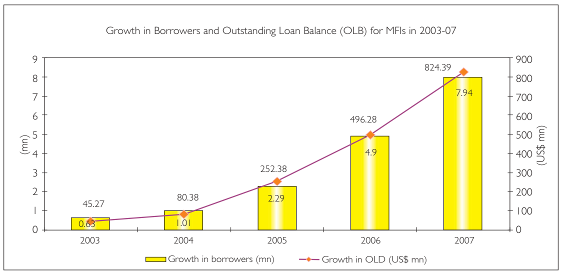
In the following sections, the report focuses on MFIs, since private commercial investment is more easier than for other legal forms.

## Major Highlights

### In terms of growth

| Growth of MFIs[15] | | |
|---|---|---|
| Indicator | 2006-07 | 2007-08 |
| Borrowers (million) | 10.04 | 14.1 |
| Loan outstanding (US$ million) | 680 | 1,172 |
| % Growth in borrowers | 53% | 39% |
| % Growth in loan outstanding | 77% | 72% |

Over the years MFIs in India have followed an excellent growth trajectory, four times the rate of growth of the national economy. In 2007-08, MFIs recorded an increase of almost 4 million clients as reported by Sa-Dhan based on information collected from 223 MFIs.




Source: Intellecap, Inverting the Pyramid, The Changing face of Indian Microfinance, 2007

### In terms of products and services

While the primary focus of microfinance activities until recently was to provide credit, MFIs are now offering a range of financial products including insurance (in partnership with large insurance companies), remittances, pensions and savings[16] to poor households.

There is a growing interest from the corporate sector in leveraging the MFI's established delivery channels to seek entry into rural and urban low income customer segments. As a result, many strategic alliances are being forged between MFIs and corporate players to offer non-financial products like safe drinking water solutions or environmentally friendly cooking stoves/ lanterns and other consumer products, these can be mutually beneficial by reducing transaction costs, augmenting institutional profitability and creating better access to products.

However, given the fact that NBFCs and other forms of MFIs are not legally allowed to offer savings and there are regulatory and practical hurdles in offering

[14] Practically promoter of other legal forms acquire a new NBFC and sell their MF portfolio to it as registering new NBFC is a very time consuming and uncertain process

[15] Figures from ACCESS Development Services, Microfinance in India State of the Sector Report 2008, 2009

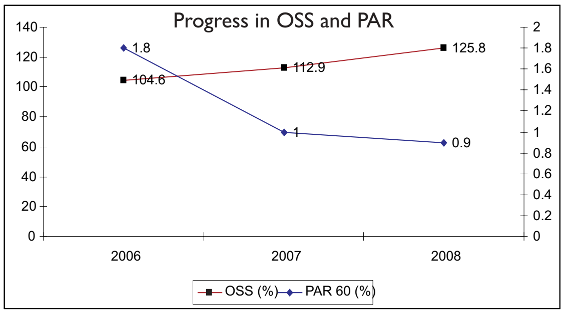
[16] Only cooperatives are legally allowed to mobilize saving from members

other services such as insurance, credit remains the main product category.

In terms of methodology, most large MFIs apply the Joint Liability Group (JLG) methodology.

### Achieving sustainability

There is considerable focus in recent years on achieving sustainability among all forms of MFIs. The discourse of sustainability along with increasing commercialization has led this change. According to Sa-dhan's Side by Side Report, 2008, the Operational Self Sufficiency (OSS) and Portfolio At Risk 60 (PAR) has improved for all forms of MFIs in the last three years[17]. While these figures indeed speak well for the MFIs as a whole, there are large variation among MFIs depending on size, legal forms and geographic location. Also 'several small organizations are struggling to increase their OSS to above 50%'.[18]




### Trends in regulations

At the policy level, MFIs have achieved greater legitimacy with the government as an important mechanism for financial inclusion, and increasingly MFIs are mentioned in relevant policy documents.

A key highlight of policy change is the Microfinance Sector Development and Regulation Bill 2007 tabled in the Parliament. The Bill, if enacted, would form the first legal document that defines 'microfinance', sets down exclusive guidelines for the Indian microfinance industry and a promotional and regulatory framework for MFIs, especially those carrying out MF in a non-profit form. However, the impending dissolution of Parliament in May 2009 could result in the current bill lapsing, in which case the initiative would have to be redone.

### In terms of funding

A striking development in funding is the growth of the commercial debt and equity market. The commercial banks along with government apex institutions like SIDBI are major sources of debt funding to MFIs[19]. Debt funding requirements are high due to the restriction to raise funds through savings[20] . 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 MFIs' specific differences. MFIs need both short and long term debt capital to fuel their projected growth.

The equity market is also increasingly attracting investment from social and commercial investors as well as venture funds[21]. While short term on lending funds remains the key driver of the up-scaling process, MFIs are also looking at long term quasi-equity to partially fund their institutional building process.

'However this cannot dilute the fact that investment capital has reached very small numbers of MFIs and the majority of MFIs are not even in the target area because of their legal form.'[22]

### Unmet demand and market potential [23]

| Services | Demand (US$ bn) |
|---|---|
| Credit | 59.8 |
| Credit among Below Poverty Line | 5.7 |
| Credit among Small and Marginal Land Owners | 27.1 |
| Credit among Agriculture Labour | 15.0 |
| Credit among Microentrepreneurs | 8.8 |
| Credit among Urban Low Income Population | 3.2 |
| Savings | 3.0 |
| Insurance | 0.5 |
| Remittances | 9.5 |
| Micropensions | 0.5 |
| Total | 73.3 |

[17] Calculated data is from 142 MFIs in 2008, 101 MFIs in 2007 and 83 MFIs in 2006
[18] FWWB, Annual Report 2007–08
[19] NABARD Act does not permit refinancing to NBFCs or other MFIs – a serious restriction as many MFIs can have limited access to market capital
[20] Among all legal forms only cooperatives are legally allowed to mobilize savings
[21] Please refer to section on equity investment for more details
[22] SA-dhan, Enhancing resource flow to microfinance sector, 2009, pg 45
[23] Figures from Intellecap, Inverting the pyramid, the changing face of Indian microfinance, 2007

According to an estimate by Intellecap, assuming the entire poor population in India as potential microfinance clients, the market size for microfinance in India appears to be in the range of 57.9 to 77.3 million clients translating to an annual credit demand of US$ 5.7 bn to US$ 19.1 bn. If other occupational groups are included then potential client size becomes 245.7 million. At a more conservative estimated demand of US$ 40 bn, the sector has reached less that US$ 2 bn, representing a potential to increase current portfolio by a factor of 10.

## Future Prospects

The MF sector in India has grown phenomenally in the past few years. Some of the leading MFIs, such as SKS, Share, Spandana, Ujjivan and BASIX are setting the pace for the sector with innovations in products, processes, funding structure and linkages with financial institutions. With increasing focus on financial sustainability, there is a positive trend towards commercialization, professionalization, increasing efficiency and transparency among other things.

However, beyond these large MFIs, there are hundreds of medium and small MFIs which are operating on a small scale with great need for training in building their institutional capacity to run MF on sound financial principles.

While the fact that many states and regions of the country are not served by the MFIs represents an opportunity for future growth. It also highlights that the MFIs have not been able to reach those areas. Internally, MFIs face enormous challenges in finding and retaining skilled human resources[24]; Sa-Dhan has estimated the human resource requirements at 2,40,000[25] .

Externally, the MF sector is always under scrutiny due to perceived 'high interest rates' by the political class and many policy makers. Populist policies such as waiver of loans and capping on interest rates MFIs can charge are big challenges for long term growth of the sector.

# FRAMEWORK FOR INVESTMENT IN MICROFINANCE SECTOR IN THE COUNTRY[26]

## General Information

The legal framework for investment in MFIs is regulated by a number of laws as applicable to legal status of MFIs (Society Registration Act 1860, Indian Trust Act, NBFCs, Cooperative Society Act of 1956, Companies Act 1956 and RBI Regulations for NBFCs) and various notifications and circulars that are issued by RBI.

In case of foreign debt investment, External Commercial Borrowing (ECB) guidelines issued by RBI from time to time have to be taken into consideration. For foreign equity, the Ministry of Commerce's 'Manual on FDI in India' along with various circulars, press notes, notifications issued from time to time have to be taken into account. Additionally, Foreign Exchange Management Act (FEMA) is also applicable to govern foreign investment.

To make foreign investment in India attractive, investment and returns on investment are freely repatriable, except where the approval is subject to specific conditions such as lock-in period on original investment, dividend cap, foreign exchange neutrality, etc. as per the notified sectoral policy.

Net income earned by debt investors is taxed as per income tax laws (30%-40%) while dividend distribution tax is 15%.

## Domestic Debt Investment

### Legal framework

There are no obvious regulatory obstacles to any of the legal entities involved in MF, leveraging their market position to obtain debt finance from domestic capital markets. Societies/trusts need to incorporate the power to borrow from commercial sources explicitly in their memorandums of association/trust deeds along with the specific inclusion of provision of microfinance services.

[24] CSFI, Microfinance Banana Skins Report 2008
[25] Access Development Services, State of the Sector Report 2008, 2009
[26] The figures mention in this section are taken from Sa-dhan, Enhancing resource flow to the microfinance sector, 2009
[27] Sa-dhan, Enhancing resource flow to the microfinance sector, 2009
[28] These figures are collected before the financial crisis hit. GoI has stressed that banks are expected to keep access to borrowing un-curtailed for MFIs

### Status

The market for domestic debt is essentially driven by the RBI stipulation that 40% of bank lending has to be for priority sectors, which includes MF. Currently all commercial banks are offering on-lending funds at interest rates ranging from 8.5% to 13.5% per annum to MFIs (2007-08 figures). Lending is offered at both fixed and floating interest rate terms. PSBs are important players in MFI bulk lending. For example the State Bank of India (SBI) lent US$ 2.3 bn to 120 MFIs[27] so far. In 2007-08, MFIs borrowed US$ 1.1 bn with MFI borrowing expanding by 261% since 2006.[28]

Private banks (including foreign banks) provide one-third of MFI debt funding. Public banks, government lending and development agencies provide about the same.

The main debt financing instruments are term loans of between 24-36 months. Together with term loans of over 36 months, they represent about two-thirds of bulk lending to MFIs surveyed. Other instruments are senior debt, subordinate debt and concessional loans.

### Practical considerations

The legal framework for Societies, Trusts and Cooperatives does not have any stipulations on leverage capacity. The ability to leverage the institution's capitalization depends largely on the appetite of the lender for risk and also on the creditworthiness of the institution, decided either by an independent or in-house appraiser of the lending institution. The NBFCs have capital adequacy norms decided by RBI and this effectively delimits the leverage capacities for such legal forms.

Given the high debt equity ratio of MFIs, and RBI benchmark of capital adequacy ratio (10-15%) for NBFCs, the market for debt investment is rather limited for investors.

## Foreign Debt Investment

### Legal framework

Foreign debt investment comes under a circulars issued by Government/RBI from time to time under External Commercial Borrowings (ECB).

As per the latest guidelines issued by RBI in July 2008, ECB can be accessed via two routes, i) Automatic Route ii) Approval Route:

Automatic route: A borrower may enter into a loan agreement complying with ECB guidelines with a recognized lender for raising ECB under this route without prior approval from RBI. No legal form of MFI is an eligible borrower under this route.

Approval Route: NGO MFIs fall under this route. As per the guidelines, NGOs engaged in microfinance activities will be allowed to access ECB for Rupee expenditure permissible end-uses, provided they:

(i) have a satisfactory borrowing relationship for at least three years with a scheduled commercial bank authorized to deal in foreign exchange, and

(ii) can produce a certificate of due diligence on 'fit and proper' status of the board/committee of management of the borrowing entity from the designated Authorized Dealer (AD).

NGOs can borrow up to US$ 100 million during a financial year. The designated AD bank has to ensure that at the time of drawdown the forex exposure of the borrower is hedged. Further minimum maturity period of such borrowings is three years. There are All-in-Cost ceilings vary depending on maturity and are linked to LIBOR.

Issuance of guarantees, standby letters of credit, letters of undertaking or letters of comfort by banks, financial institutions and NBFCs relating to ECB is not normally permitted. A designated AD bank has general permission to make remittances of instalments of principle, interest and other charges in conformity with ECB guidelines issued by Government/RBI from time to time.

Borrowers need to submit an application to RBI through AD which is considered by Empowered Committee of RBI. The borrower can draw-down the loan only after obtaining loan registration number from RBI.

Recently as per latest notification from RBI, in addition to NGO MFIs, NBFCs undertaking microfinance activities are now allowed to raise short term ECBs with certain restrictions under the approval route. Additionally, pricing cap is removed temporarily.

### Status

While it may have become somewhat easier for NGO MFIs (Societies, Trusts, Cooperatives) to get foreign debt investment, regulations for NBFC-MFIs – whose outreach makes up the bulk of total MFI clients in the country – remains restricted.

### Practical considerations

NBFCs have recently been allowed to access ECB; until now only NGO-MFIs could seek commercial ECB under approval route. Given that most large professional MFIs are NBFCs, the investors have very a limited market to make an equity investment. The legal form of NGO-MFIs and balance sheets of most NGO-MFIs do not give comfort to investors. Consequently there is quite limited activity on this type of investment.

## Domestic Equity Investment

### Legal framework

Practically, only the NBFCs legal form falls within the realm of domestic equity investment since other legal forms of MFIs are an unattractive proposition to equity investors owing to their not-for-profit constitution that prohibits the distribution of dividends; because of their prohibition on distribution of dividends. However, on account of this Section 25, companies are also not an attractive option for such investment.

As per the local Income tax act, any amount declared, distributed or paid by a domestic company by way of dividend shall be chargeable to dividend tax as 'dividend distribution tax' (so the Investor does not directly get taxed on the dividend payout). The current tax rate is 17% which includes applicable surcharge and education fees.

### Status

The NBFC MFIs have seen many such equity investments in the last few years. NABARD, SIDBI, Bellwether, Oiko Credit are examples of active players in the MF equity market. In the financial year 2007-08, Indian MFIs added about US$ 285 million to their 'net owned funds', out of which approximately US$ 68 million came from equity investors. However, 80% of the increase is accounted for by the largest 21 MFIs

### Practical considerations

Institutions operating in good market positions with growth potential, strong management and governance, appropriate legal form and those which are transparent about financial reporting, are most likely to attract equity investors. 'However, it is fair to say that the equity markets are not transparent for MFIs and investors. They approach each other on a more random basis with small and remote MFIs having difficulty in entering the deal'.[29]

Of all legal forms that MFI assume, NBFC is the only one that can provide comfort to investors. All other legal forms carry restrictions that make investment tedious or outright unattractive[30]. Hence investment MFIs are increasingly transforming into NBFCs to attract equity.

## Foreign Equity Investment

### Legal framework

Foreign equity investment is applicable only to Section 25 companies and NBFCs. Section 25 companies are allowed to obtain FDI as equity. However, on account of their not-for-profit constitution, prohibiting the distribution of dividends, they are not an attractive option for such investment. NBFCs can obtain foreign capital in the form of equity as per guidelines of the Foreign Investment Promotion Board (FIPB) under automatic route in compliance with RBI guidelines. Under these guidelines, investment of any amount is permissible subject to the following limits:

- FDI up to 51%: US$ 0.5 million to be brought up front

- FDI between 51% and 75%: US$ 5 million to be brought up front

- FDI between 75% and 100%: US$ 50 million out of which US$ 7.5 million to be brought up front

### Status

Investments from IFC, KfW, CDC, FMO, ACCION, Goodwell MDC, DB, Lok Capital, Aavishkaar Goodwell India Microfinance Development Company, Michael and Susan Dell Foundation and Unitus Equity Fund have so far facilitated equity support to Indian MFIs. Overall, the total amount mobilized via equity

[29] Sa-dhan, Enhancing resource flow to the microfinance sector, 2009 pg 36
[30] ibid

sell-offs by Indian MFIs increased 25-fold during 2006-2007 and looks set to increase even further in the coming years.

| Print-Media reported MFI-equity investment, 2008-09 | | |
|---|---|---|
| MFI | Equity (US$ million) | Source |
| SKS Microfinance | 72.62 | Sandstone Capital |
| Spandana | 19.84 | Valiant Capital Partners |
| Ujjivan | 18.65 | Unitus Equity Fund (UEF) managed by Elevar Equity, Bellwether Microfinance Fund, Michael & Susan Dell Foundation, A W Holdings |
| Grama Vidiyal Micro Finance Pvt Ltd (GVML) | 2.92 | Unitus Equity Fund L.P & Venture capitalist Vinod Khosla |
| Equitas | 9.92 | Private investors |
| BASIX | 2.16 | IFC, Shore Bank, ICICI and HDFC |
| Total | 126.11 | |

**Practical considerations**

Long-term capital gain, earned by a foreign investor from a transfer of shares held for more than 12 months, is taxed. The tax rate is capped at 10%. Capital gains tax is often relieved under applicable tax treaties (for instance some of the jurisdictions commonly used for investment into India are Mauritius, Cyprus and the Netherlands because of their favourable tax treatment).

Further, it is important to note that the legal position on foreign investment, debt as well as equity, is very dynamic and RBI frequently issues notifications and circulars. Investors should refer to latest notifications and circulars for any possible policy change.

## KEY CONTACTS

| | |
|---|---|
| National Bank of Agriculture & Rural Development (NABARD) | www.nabard.org mcid@nabard.org |
| Small Industries Development Bank of India (SIDBI) | www.sidbi.com |
| Reserve Bank of India (RBI) | www.rbi.org.in |
| Insurance Regulatory and Development Authority (IRDA) | www.irdaindia.org irda@irda.gov.in |
| Ministry of Commerce and Industry | cim@nic.in http://dipp.nic.in/ |

# Credible Microfinance Private Limited (CMPL)

CMPL was established to give finance to poor women to earn a living through their own income generation activities. Bharat Integrated Social Welfare Agency (BISWA), Credible's parent organization, started its microfinance services through Self Help Group (SHGs) in the district of Sambalpur, Orissa in the year 1995. Gradually its operation expanded to 30 districts of Orissa. In November 2006, to facilitate future expansion, BISWA bought a Non Banking Financial Company (NBFC), Credible Microfinance Pvt Ltd. BISWA would slowly transfer the microfinance operation of BISWA to the NBFC.

## KEY FACTS

- Legal status: NBFC under Central Bank supervision
- Foundation year: 2006
- Location: Sambalpur, Orissa
- Clients number: 299 (March 2009)
- Gross Loan Portfolio (GLP): US$ 1,443,889 (March 2009)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 3.8 | 7.6 | 11.8 |
| Equity | 0.2 | 0.2 | 0.2 |

(US$=INR 50.4)

## HIGHLIGHTS

- Bulk lending to NGOs, mutual benefits trusts (MBTs) and Self Help Groups (SHGs) promoted by BISWA
- Equity investment (49% of equity) and debt fund from Bellwether Microfinance Fund
- Large client-base through promoting institution
- First registered NBFC in Orissa

## CONTACT

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## PRODUCTS

CMPL offers three types of loans. Currently all loans products are monitored by BISWA staff and offered to women. Loan amount: US$ 10 – US$ 500; Term: 12-15 months; Interest rate: 20% per annum; Processing fee : 2.5%; Repayment: monthly. Types of loans are:

- Agriculture loan
- Income generating loan
- Livestock loan

## MARKET POTENTIAL AND GROWTH PROSPECTS

BISWA is operating in 30 district of Orissa, working with 30,017 SHGs. Given that BISWA's microfinance operation would be progressively transferred to CMPL, implies a huge secure market in coming years. CMPL targets 8,325 active clients by 2011.

| KEY PERFORMANCE INDICATORS (US$) | Credible Microfinance Private Limited | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 0 | 0 | 6 | 8 | 6 | 7 | 8 |
| Loan Officers | 0 | 0 | 2 | 2 | 2 | 2 | 3 |
| Productivity | | | | | | | |
| Number of active borrowers | 0 | 0 | 7 | 34 | 299 | 6,300 | 8,325 |
| Average Loan Balance per active borrowers | 0 | 0 | 88,147 | 11,284 | 4,829 | 646 | 1,016 |
| Active Borrowers per Loan Officer | 0 | 0 | 4 | 17 | 150 | 350 | 297 |
| Portfolio per Loan Officer | 0 | 0 | 308,513 | 191,829 | 721,950 | 2,036,207 | 2,818,649 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 6,036 | 29 | 617,027 | 383,658 | 1,443,899 | 4,072,414 | 8,455,948 |
| Total Assets | 102,514 | 59,988 | 660,761 | 577,093 | 1,467,900 | 4,116,568 | 8,391,547 |
| Total Equity | 91,710 | 51,848 | 274,759 | 274,066 | 559,265 | 860,042 | 1,219,584 |
| Total Debt | 10,805 | 8,140 | 386,002 | 303,027 | 908,635 | 3,256,526 | 7,171,963 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | 0.89 | 0.86 | 0.42 | 0.47 | 0.38 | 0.21 | 0.15 |
| Debt / Equity Ratio | 0.12 | 0.16 | 1.40 | 1.11 | 1.62 | 3.79 | 5.88 |
| Gross Loan Portfolio / Total Assets | 0.06 | 0.00 | 0.93 | 0.66 | 0.98 | 0.99 | 1.01 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | 1% | 0% | -8% | 0% | 3% | 4% | 3% |
| Annualized Return on Equity (ROE), % | 1% | 0% | -17% | 0% | 8% | 14% | 15% |
| Operational self-sufficiency, % | 125% | 132% | 46% | 100% | 116% | 123% | 121% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 100% | 27% | 8% | 16% | 29% | 25% | 19% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 0% | 0% | 3% | 4% | 15% | 15% | 12% |
| Operating Expense Ratio, % | 5% | 1% | 12% | 9% | 7% | 5% | 4% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Risk Coverage Ratio, % | 0% | 0% | 100% | 100% | 100% | 100% | 100% |

CMPL lends to BISWA groups and there for client and borrower number represents SHG number

# Gram – Utthan (GU)

Established in 1990, GU aims at enabling the poor and disadvantaged for qualitative changes in their lives through an empowerment process. GU is operational in 6 districts of Orissa, namely Kendrapara, Cuttack, Khurda, Jajpur, Dhenkanal and Bhadrak covering 21 Blocks comprising of 1204 villages. GU has recently obtained a Non Banking Financial Company (NBFC), which is an regulated entity under Central Bank. GU would slowly transfer its entire microfinance portfolio to new entity.

## KEY FACTS

- Legal Status: Society
- Foundation year: 1990
- Location: HQ in Kendapada Orissa, operating in 6 coastal districts of Orissa
- Clients number: 66,503 (March 2009)
- Gross Loan Portfolio (GLP): US$ 11,451,807 (March 2009)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 14.1 | 20.1 | 29.3 |
| Equity | 0.2 | 0.6 | 0.9 |

(US$=INR 50.4)

## HIGHLIGHTS

- Funders include Oikocredit, FWWB, ABN AMRO, HDFC, AXIS, ICICI, IDBI,NABARD,DCBL and SIDBI
- Strong field presence due to developmental activities
- Excellent diversification of funding sources
- Currently transforming into NBFC

## CONTACT

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## PRODUCTS

- Loans: GU offers a wide range of loan products for agriculture, housing and education among others. Loan amount: INR 5,000 - 40,000 (US$ 100 - US$ 790); Term: 6 to 36 months; Interest rate: 18%; Other fee: 0.5% loan processing fee plus 1 % insurance amount

- Insurance: GU has tie-uo with Bajaj Allianz for life and asset insurance. For life inusrance premium is INR 15 (US$ 0.3) for accidental death cover of INR 25,000 (US$ 490) and asset insurance is offered at premium INR 3.50/ thousand (US$ 0. 07 )

## MARKET POTENTIAL AND GROWTH PROSPECTS

Only 10% of the population in 7 coastal districts in the state of Orissa are currently covered by microfinance programmes and given the high average population density (1078 per square km), the market potential is very high. Competition is minimal in the operational area. By the end of 2011, GU plans to have 31 branches, reach 100,000 clients and offer new products.

| KEY PERFORMANCE INDICATORS (US$) | Gram-Utthan | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 59 | 74 | 174 | 216 | 283 | 315 | 350 |
| Loan Officers | 43 | 58 | 120 | 136 | 161 | 175 | 200 |
| Productivity | | | | | | | |
| Number of active borrowers | 11,576 | 17,433 | 41,353 | 57,317 | 66,503 | 85,000 | 100,000 |
| Average Loan Balance per active borrowers | 59 | 93 | 118 | 133 | 172 | 200 | 254 |
| Active Borrowers per Loan Officer | 269 | 301 | 345 | 421 | 413 | 486 | 500 |
| Portfolio per Loan Officer | 15,883 | 28,089 | 40,501 | 56,157 | 71,129 | 97,281 | 127,159 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 682,971 | 1,629,180 | 4,860,091 | 7,637,375 | 11,451,807 | 17,024,096 | 25,431,727 |
| Total Assets | 893,840 | 2,805,841 | 5,822,714 | 8,978,532 | 13,074,267 | 18,744,950 | 27,403,584 |
| Total Equity | -5,163 | 4,721 | 16,820 | 138,660 | 566,371 | 1,630,628 | 3,421,793 |
| Total Debt | 3,524,757 | 2,801,120 | 5,805,894 | 8,839,872 | 12,507,896 | 17,114,322 | 23,981,792 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | -0.01 | 0% | 0% | 2% | 4% | 9% | 12% |
| Debt / Equity Ratio | -682.75 | 59330% | 34517% | 6375% | 2208% | 1050% | 701% |
| Gross Loan Portfolio / Total Assets | 0.76 | 58% | 83% | 85% | 88% | 91% | 93% |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | -4% | -1% | -1% | 2% | 2% | 3% | 3% |
| Annualized Return on Equity (ROE), % | 645% | 11455% | -315% | 145% | 64% | 42% | 31% |
| Operational self-sufficiency, % | 71% | 88% | 94% | 111% | 113% | 118% | 122% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 12% | 15% | 17% | 17% | 20% | 20% | 20% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 0% | 0% | 3% | 4% | 15% | 15% | 12% |
| Operating Expense Ratio, % | 5% | 1% | 12% | 9% | 7% | 5% | 4% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 1% | 1% | 1% | 1% | 1% | 1% | 1% |
| Risk Coverage Ratio, % | 0% | 133% | 145% | 126% | 274% | 351% | 469% |

# Mahashakti Foundation

Mahashakti Foundation was founded by a leading NGOs of Orissa, Friends Association for Rural Reconstruction (FARR) in 2004. Mahashakti aims to be a sustainable and established MFI by enabling the poor to change the quality of their lives for a better and secured tomorrow. Mahashakti is working in both rural and semi urban areas of Orissa with focus on low-income people in the five districts of Orissa covering 15 blocks comprising of 293 villages.

## KEY FACTS

- Legal Status: Indian Trust Act 1882
- Foundation year: 2004
- Location: HQ in Kalahandi, Orissa , operating in 5 districts of Orissa
- Clients number: 10,614 (December 2008)
- Gross Loan Portfolio (GLP) : US$ 979,690 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 0.3 | 0.5 | 0.8 |
| Equity | I | I | I |

(US$=INR 50.4)

## HIGHLIGHTS

- Promotes the SHG model in rural areas and the Grameen model in semi-urban areas
- Client-friendly and competitive loan products
- Already achieved 100% OSS
- Large market demand in operational area
- Rated by CRISIL with rating of 5 in band of 1-8, highest being 8

## CONTACT

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## PRODUCTS

- Small business loan and Mahila udyogi loan: Each loan product constitute 30% of portfolio. Term: 58-82 weeks; Interest rate: 14% flat; Repayment: monthly
- Seasonal business: Accounts for 30% of loan portfolio. Term: 12 months; Interest rate: 12% flat. Repayment : monthly
- Livelihood development loan: Account for 10% portfolio. Term: 18-24 months; Interest rate: 12% flat. Repayment : monthly
- ICICI Lombard health insurance and Janashree Bima Yojana insurance: group policies, yearly premium, validity up to one year, premium amount of US$ 2/person

## MARKET POTENTIAL AND GROWTH PROSPECTS

Market demand is very high in the operational areas of Mahashakti and estimated at 300,000 potential clients. More than 40% of potential clients are involved in trading and processing businesses and have daily, weekly, or monthly cash flow. This represents a good prospect for Mahashakti's products. Mahashakti plans to reach 100,000 by 2015.

| KEY PERFORMANCE INDICATORS (US$) | Mahashakti Foundation | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | |
| Number of Staff Members | 45 | 52 | 57 | 72 | 92 | 117 |
| Loan Officers | 23 | 28 | 31 | 40 | 57 | 80 |
| Productivity | | | | | | |
| Number of active borrowers | 1,278 | 5,472 | 10,614 | 17,310 | 29,245 | 42,824 |
| Average Loan Balance per active borrowers | 60 | 79 | 92 | 105 | 151 | 170 |
| Active Borrowers per Loan Officer | 56 | 195 | 342 | 433 | 513 | 535 |
| Portfolio per Loan Officer | 3,343 | 15,505 | 31,603 | 45,502 | 77,387 | 91,203 |
| Balance Sheet | | | | | | |
| Gross Loan Portfolio | 76,887 | 434,141 | 979,690 | 1,820,069 | 4,411,055 | 7,296,215 |
| Total Assets | 80,189 | 473,828 | 1,059,507 | 1,924,811 | 4,564,402 | 7,508,387 |
| Total Equity | 4 | 6,146 | 39,293 | 204,606 | 491,616 | 892,366 |
| Total Debt | 80,185 | 467,681 | 1,020,214 | 1,720,206 | 4,072,786 | 6,616,021 |
| Financing Structure | | | | | | |
| Equity / Asset Ratio | 0.00 | 0.01 | 0.04 | 0.11 | 0.11 | 0.12 |
| Debt / Equity Ratio | 21059.21 | 76.09 | 25.96 | 8.41 | 8.28 | 7.41 |
| Gross Loan Portfolio / Total Assets | 0.96 | 0.92 | 0.92 | 0.95 | 0.97 | 0.97 |
| Overall Monthly Financial Performance | | | | | | |
| Annualized Return on Assets (ROA), % | 0% | 1% | 2% | 2% | 5% | 5% |
| Annualized Return on Equity (ROE), % | -5167% | 85% | 62% | 23% | 50% | 42% |
| Operational self-sufficiency, % | 97% | 107% | 112% | 109% | 127% | 128% |
| Revenue | | | | | | |
| Yield on portfolio, % | 6% | 16% | 18% | 23% | 26% | 23% |
| Expenses | | | | | | |
| Financial Expenses Ratio, % | 4% | 10% | 9% | 16% | 17% | 16% |
| Operating Expense Ratio, % | 6% | 4% | 7% | 5% | 3% | 2% |
| Portfolio Quality | | | | | | |
| PAR (>30 days), % | 0% | 0% | 1% | 1% | 1% | 1% |
| Risk Coverage Ratio, % | 0% | 0% | 60% | 232% | 331% | 400% |

# Sonata Finance Private Limited

Sonata is the leading MFI operating from one of the poorest states of India – Uttar Pradesh (UP) and Madhya Pradesh (MP). The vision of Sonata is to help build a society in which there is an opportunity to develop the minimal socio-economic conditions needed to live a life of dignity. To make this happen, Sonata has the mission to identify and motivate poor women in a cost-effective way and deliver them micro finance services in a transparent, timely and efficient manner. Sonata commits to being professionally managed, operationally sustainable and financially profitable.

## KEY FACTS

- Legal Status: Non Banking Finance Company (NBFC) under supervision of Central Bank
- Foundation year: 2004
- Location: HQ in Allahabad (UP), state office in Jabalpur (MP).
- Clients number: 94,335 (March 2009)
- Gross Loan Portfolio (GLP) : US$ 10,433,567 (March 2009)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 5.8 | 18.8 | 38.5 |
| Equity | 5.3 | 5.3 | 11.2 |

(US$=INR 50.4)

## HIGHLIGHTS

- Highly qualified, experienced and dedicated management team
- Support from Bellwether, Sonata's main shareholder
- One of the fastest growing start-up MFIs in India
- Received debt from many private banks such as HDFC, ABN-AMRO, Axis, ICICI and apex institutions SIDBI and FWWB

## CONTACT

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## PRODUCTS

- Income generating loan: This is the only loan product offered by Sonata and is restricted for income generating activities. Interest rate: 17.5% and 18 % flat per annum respectively in MP and UP, other fee: upfront 3 % loan amount in UP and INR 100 (US$ 1.9) per loan in MP.

- Insurance: Insurance is provided through tie ups with the Life Insurance Corporation, ICICI Prudential, and Birla Sunlife. Members pay a premium of INR 100 (US$ 1.9) per year for life insurance coverage of INR 30,000 (US$ 595) for natural death and INR 75,000 (US$ 1,488) for accidental death.

## MARKET POTENTIAL AND GROWTH PROSPECTS

Sonata's target market is women in rural, semi-urban and urban areas of central-eastern UP and MP. While there is a huge potential market for microfinance services in UP and MP, only 5 large and 2 start-up MFIs are present in UP and only 4 in MP in Sonata's operational areas. This, coupled with Sonata's fast track growth model, should enable Sonata to meet its ambitious growth targets of serving over 345,759 clients by 2011. Sonata plans to offer individual and housing loans in near future.

| KEY PERFORMANCE INDICATORS (US$) | Sonata Finance Private Limited | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 0 | 37 | 104 | 270 | 557 | 1,138 | 1,742 |
| Loan Officers | 0 | 24 | 72 | 171 | 320 | 640 | 940 |
| Productivity | | | | | | | |
| Number of active borrowers | 0 | 692 | 11,393 | 44,387 | 94,335 | 201,903 | 345,759 |
| Average Loan Balance per active borrowers | 0 | 91 | 88 | 105 | 111 | 116 | 144 |
| Active Borrowers per Loan Officer | 0 | 29 | 158 | 260 | 295 | 315 | 368 |
| Portfolio per Loan Officer | 0 | 2,634 | 13,897 | 27,142 | 32,605 | 36,715 | 53,103 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 0 | 63,213 | 1,000,614 | 4,641,203 | 10,433,567 | 23,497,571 | 49,916,398 |
| Total Assets | 59,017 | 254,684 | 1,500,762 | 5,334,702 | 11,304,717 | 25,022,733 | 52,688,897 |
| Total Equity | 58,159 | 96,241 | 264,065 | 1,121,448 | 5,419,451 | 6,027,620 | 13,664,178 |
| Total Debt | 858 | 158,443 | 1,236,698 | 4,213,255 | 5,885,267 | 18,995,113 | 39,024,719 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | 0.99 | 0.38 | 0.18 | 0.21 | 0.48 | 0.24 | 0.26 |
| Debt / Equity Ratio | 0.01 | 1.65 | 4.68 | 3.76 | 1.09 | 3.15 | 2.86 |
| Gross Loan Portfolio / Total Assets | 0 | 0.25 | 0.67 | 0.87 | 0.92 | 0.94 | 0.95 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | 1% | -14% | -10% | 0% | 3% | 3% | 4% |
| Annualized Return on Equity (ROE), % | 1% | -28% | -50% | 1% | 8% | 11% | 16% |
| Operational self-sufficiency, % | 110% | 17% | 53% | 102% | 116% | 122% | 127% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 0% | 8% | 25% | 28% | 30% | 29% | 30% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 0% | 5% | 7% | 10% | 10% | 10% | 10% |
| Operating Expense Ratio, % | 14% | 18% | 22% | 13% | 14% | 14% | 13% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Risk Coverage Ratio, % | 0% | 0% | 0% | 71% | 101% | 101% | 103% |

# Village Financial Services Private Limited (VFSPL)

**Village Financial Services Private Limited (VFSPL) is the first microfinance company in the eastern India with a Non Banking Financial Company (NBFC) status. VFS as an NBFC started microfinance operations in the financial year 2005-2006, building on the microfinance program done by the Village Welfare Society since 1995. VFSPM aim to strengthen the socio-economic condition of the society by providing financial and other support services mainly to the poor and women in a sustainable manner**

## KEY FACTS

- Legal Status: NBFC under supervision of the central bank
- Foundation year: 2006
- Location: HQ Kolkata, West Bengal, operating in 5 districts of West Bengal through 14 branches
- Clients number: 66,000 (March 2009)
- Gross Loan Portfolio (GLP) : US$ 6,062,597 (March 2009)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 6.9 | 31.7 | 52.6 |
| Equity | 0.02 | 2.5 | 4.3 |

(US$=INR 50.4)

## HIGHLIGHTS

- First 9001 : 2000 ISO certified Microfinance company in the world.
- Funding from agencies including FWWB, DCB, ICICI, HDFC, Axis Bank and ABN-Amro
- Excellent portfolio quality and operational sustainability
- Nominated for assessment in CII Exim Bank Business Excellence Award, 2008

## CONTACT

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www.village.net.in

## PRODUCTS

General loan: VFSPL offer only one loan products for income generating activities. The target customers of VFSPL are exclusively poor women, who are engaged in small income generating activities, willing to start IGA or up-scaling their IGA. Loan amount: INR 3,000 (US$ 60) to INR 12,000 (US$ 230); Term: 12 months; Interest rate: 15% flat plus 10% cash security on loan amount, Repayment: weekly

## MARKET POTENTIAL AND GROWTH PROSPECTS

In the VFSPL operational area, the demand for first time loans as well as loan capacity for income generating activities is increasing rapidly. However, only 20% of demad is currently met by the microfinance sector. This represents an excellent opportunity to expand into under served areas of West Bengal. VFSPL plans to have 100 branches with 1 million borrowers in next five years. In the near future, VFSPL plans to launch new products including top–up, educational, and house repair loans.

| KEY PERFORMANCE INDICATORS (US$) | Village Financial Services Private Limited | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | |
| Number of Staff Members | 90 | 64 | 143 | 202 | 480 | 840 |
| Loan Officers | 17 | 28 | 62 | 120 | 800 | 1400 |
| Productivity | | | | | | |
| Number of active borrowers | 11,699 | 17,466 | 47,717 | 66,000 | 276,000 | 504,000 |
| Average Loan Balance per active borrowers | 50 | 62 | 72 | 92 | 92 | 103 |
| Active Borrowers per Loan Officer | 688 | 624 | 770 | 550 | 345 | 360 |
| Portfolio per Loan Officer | 34,270 | 38,639 | 55,634 | 50,522 | 31,780 | 37,025 |
| Balance Sheet | | | | | | |
| Gross Loan Portfolio | 582,583 | 1,081,886 | 3,449,300 | 6,062,597 | 25,424,260 | 51,834,387 |
| Total Assets | 780,675 | 1,281,071 | 4,278,512 | 6,864,705 | 26,359,952 | 53,671,090 |
| Total Equity | 201,709 | 226,263 | 367,617 | 1,383,246 | 3,996,779 | 8,647,965 |
| Total Debt | 578,966 | 1,054,808 | 3,910,895 | 5,481,459 | 22,363,173 | 45,023,125 |
| Financing Structure | | | | | | |
| Equity / Asset Ratio | 0.26 | 0.18 | 0.09 | 0.20 | 0.15 | 0.16 |
| Debt / Equity Ratio | 2.87 | 4.66 | 10.64 | 3.96 | 5.60 | 5.21 |
| Gross Loan Portfolio / Total Assets | 0.75 | 0.84 | 0.81 | 0.88 | 0.96 | 0.97 |
| Overall Monthly Financial Performance | | | | | | |
| Annualized Return on Assets (ROA), % | 0% | 2% | 2% | 2% | 4% | 5% |
| Annualized Return on Equity (ROE), % | 2% | 11% | 17% | 14% | 23% | 34% |
| Operational self-sufficiency, % | 184% | 116% | 117% | 117% | 126% | 142% |
| Revenue | | | | | | |
| Yield on portfolio, % | 2% | 33% | 28% | 27% | 28% | 28% |
| Portfolio Quality | | | | | | |
| PAR (>30 days), % | 0% | 0% | 0% | 0% | 0% | 0% |
| Risk Coverage Ratio (%) | 100% | 100% | 100% | 100% | 100% | 100% |

# Pakistan

## COUNTRY INVESTMENT GUIDELINES

- Land Area : 795,095 sq km
- Population : 160.14 million (2007)
- Main Towns : Karachi (10.1 million), Lahore (5.6 million), Faisalabad (2.3 million)
- Languages : Urdu (national language), English, Punjabi, Pashto, Sindhi, Balochi
- Currency : Pakistan Rupee (PKR)
- Fiscal Year : 1st July – 30th June
- Development Indicators[1]:

    Population below poverty line (national): 23.9% (2004)

    Literacy rate (15-24 years old) : 65.1% (2005)

    Mortality rate (child<5): 97 per 1000 live births (2006)

    Life expectancy: 65.1 years (2004)

    HDI rank: 136 (2007-08)

[1] Asian Development Bank – Database and Development Indicators, Basic 2008 Statistics

# ECONOMIC AND FINANCIAL BACKGROUND[2]

## Economic Overview

| Indicator | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| Nominal GDP (US$ bn) | 109.9 | 127.3 | 145.7 | 171.2 | 146.7 |
| GDP/head (PPP) (US$) | 2,152 | 2,316 | 2,480 | 2,679 | 2,722 |
| Real GDP growth (%) | 7.7 | 6.2 | 6.0 | 6.0 | 1.4 |
| Consumer price inflation (av,%) | 9.1 | 7.9 | 7.6 | 20.8 | 16.3 |
| Exchange rate (av, US$) | 59.5 | 60.3 | 60.7 | 70.8 | 81.5 |
| Total external debt (US$ bn) | 33.17 | 35.90 | 38.80 | 43.1 | 45.2 |
| FDI (US$ bn)[3] | 2.2 | 4.3 | 2.8 | 2.6 | 2.8 |
| FDI (% of GDP)[4] | 2 | 3.3 | 2 | 1.7 | 1.6 |

From 1999 to 2007, the Government of Pakistan (GoP) introduced several measures in the economy such as privatization, reform in banking and utility sector and policy changes to reduce red-tapism. This, along with foreign inflows to Pakistan, substantial debt rescheduling as agreed with International Monetary Fund (IMF) and rise in foreign remittances after crackdown on unofficial money transfers led to a high real Gross Domestic Product (GDP) growth (more than 7% a year for the period), an improved business climate and increased Foreign Direct Investment (FDI).

However, many of these gains were not accompanied by concomitant increase in the production capacity of the economy and reversed quickly in 2008. A rapid downfall in the economic situation – high current account deficit (8.4% of GDP in 2007-08), low foreign exchange reserves (US$ 3.4 bn in October 2008), surging fiscal deficit (7.4% of GDP in 2007-08) and slowing FDI and GDP growth (5.8% in 2007-08) – is attributed to a number of factors such as high inflation (25% in October 2008) caused by increasing cost of food and oil, the global financial crisis, decreasing remittances, overspending in election year and a worsening security climate[5].

### Economic structure

Pakistan has a low production base though the service sector which has been growing significantly in recent years. In 2007, the share of agriculture, industry and services in the GDP was 20.6%, 26.6% and 52.8% respectively.

The agriculture sector is reliant on a few major crops such as cotton, wheat, sugarcane and rice with excessive dependence on cotton. The sector, while providing livelihoods for two-third of the country's population living in rural areas, is affected by problems of small landholding, low productivity, unsustainable cropping, inadequate irrigation and government administered prices among others.

As far as manufacturing is concerned, the sector is mainly concentrated in cotton-based manufacturing aimed at export markets. Factors such as lack of skilled work force, poor physical infrastructure and political instability continue to be big hurdles to manufacturing.

The services sector (mainly trade, transportation, communication and private services) has grown strongly on the back of a flourishing financial sector. However, the bulk of it consists of internal trade and sub-sectors such as tourism, shipping and retail remain underdeveloped.

### Exports and imports

Pakistan traditionally runs a current account deficit and is very vulnerable because bulk of imports consists of oil and food imports. The exports are dominated by the textile sector (two-thirds of all exports) and face stiff competition from other countries in the region. The current account deficit was 5% of GDP in fiscal year 2005-2006 and 2006-2007 and reached 8.4% GDP in 2007-2008[6]. The deteriorating external account has been due to both decreasing proportion of exports growth in total growth and increase in imports led by high oil prices. Pakistan's imports from China represent 16.2% of the total imports. There is also an important correlation to the United States (US) economy because 18% of the exports are directed to the US.



[2] Economist Intelligence Unit reports: EIU country profile 2008: Pakistan and EIU country report: Pakistan
[3] Figures taken from: World Investment Prospects to 2011 – FDI and the challenges of political risk, EIU, 2007
[4] Figures taken from: World Investment Prospects to 2011 – FDI and the challenges of political risk, EIU, 2007
[5] IMF Country Report No. 08/364, December 2008
[6] Ibid.

### Monetary situation

In order to restore macroeconomic stability, the IMF and the GoP agreed in November 2008 on an emergency financing package of US$ 7.6 bn for 23 months. This includes austerity measures consisting of reductions in energy subsidy, a strict monetary and fiscal policy and the implementation of tax policy and administrative measures[7].

The Pakistan Rupee depreciated by 23% in the ten months to October 2008, reflecting investor's fears of poor political prospects , rising prices and slowing economic growth[8]. In 2009, inflation still remains high, mainly due to the surge in food prices[9].

A weakness in the economy is the large fiscal deficit. Even during the good economic growth period of 2001-07, the fiscal deficit rose to 5% of GDP during 2005-2006 and amounted to 6% of GDP during 2007/2008[10] due to increasing government expenditures, particularly defence spending, large energy subsidies and a low tax revenue base.

### Impact of global financial crisis

Given the external climate in the aftermath of the global financial crisis, investments could continue to decrease. The export sector, and particularly the textile sector, is expected to remain under pressure due to decreasing demand of Pakistani exports following slowdown in the economic activity of Pakistan's trading partners.

## Financial Sector Overview

### Major reforms

The massive privatization of the financial system beginning in 1990s was aimed to create an efficient, transparent and competitive banking sector while strengthening the supervisory capacity of the central bank, the State Bank of Pakistan (SBP). Steps like abolishment of credit ceilings, autonomy to the banks to establish market rates, increase in minimum capital requirements and the obligation of external ratings were taken. The SBP underwent considerable internal reforms to be able to supervise the new legal financial environment.

The achievements have been quite successful as State participation in the sector has decreased from 80% to 20% and banks have doubled their total assets since 2000[11]. The profits of banks have improved with the banking sector posting some of the highest returns in its history (2.1% for return on assets (ROA) and 24.2% on return on equity (ROE) for the year 2006)[12]. On the whole, the health and stability of the banking sector have improved considerably and the financial sector is considered as one of the main driving forces of economic growth.

### Financial services providers

Commercial banks, with 70% share in the financial sector's assets, dominate; other players include Non-Bank Financial Institutions (NBFIs), microfinance (MF) providers and insurance companies.

By end 2007, a total of 36 commercial banks were active in the country, operating through 7,500 branches. Low interest rates prevailing until a couple of years back, together with aggressive action towards consumer finance, have increased credit portfolios and hence the profitability of the banks. However, the increase in profitability has not given banks much incentive to move from urban markets to rural areas. Indeed, a majority of the banking activities is concentrated in Karachi and other urban centres.

Like commercial banks, NBFIs concentrate their operations in large urban areas. They offer a wide range of financial services as investment banks, leasing companies, insurance providers, mutual funds and Islamic financial institutions.

The Microfinance (MF) providers embrace a wide range of institutions. While Microfinance banks (MFBs), multi-sectoral Non Government Organizations (NGOs), specialized NGOs and Rural Support Programs (RSPs) can be considered as major actors in the MF sector, a few commercial financial institutions (CFIs), commercial banks, Government-owned institutions

[7] Ibid.
[8] Monthly Report December 2008 Pakistan, The Economist Intelligence Unit 2008
[9] The State of Pakistan's Economy, first quarterly report for 2009
[10] An Analysis of Pakistan's Macroeconomic Situation and Prospects, ADB Economic Working Paper Series, December 2008.
[11] CGAP CLEAR Report Pakistan, April 2007
[12] Microfinance Industry Assessment, Report on Pakistan , PMN, December 2008

and cooperatives also provide MF services. Further, the networks of informal systems are extremely developed in the rural areas and they offer credit and savings services.

### Financial inclusion

Even though the financial sector has grown impressively in the last decade, this development has not reached all regions of the country and all segments of the population equally. A large proportion of the poor population does not use formal financial services. According to an Asian Development Bank report[13], access to formal and semi-formal financial markets in Pakistan covers no more than 10% of the potential market at the low end.

Looking at a commonly used indicator to measure financial penetration, population per bank branch, recent estimates suggest that the country's population per branch is among the highest of the region with one bank to serve 20,000. Considering the number of borrowers as a percentage of population, it stood at 6.7 million (4.2% of the population) in 2007 while the number of savers are 25 million (15% of population). According to SBP figures, while 67% of total population resides in rural areas, only 14% of rural population is banked[14].

| Financial Penetration (Rural vs. Urban) | | | |
|---|---|---|---|
| | Rural | Urban | Total |
| % of Population | 67.0 | 33.0 | 100.0 |
| Poverty Incidence | 28.1 | 14.9 | 23.9 |
| % of Bank Branches | 33.0 | 67.0 | 100.0 |
| % of Total Population (>19 years having bank accounts) | 14.0 | 74.0 | 37.0 |
| % of Deposits (number) | 25.0 | 75.0 | 100.0 |

In order to promote financial inclusion, the GoP and SBP have launched various initiatives. A key initiative is the Financial Inclusion Program launched with the support of UK Goverment Department for International Development (DFID) in 2008. Other initiatives undertaken towards financial inclusion are the National level Microfinance Strategy (cfr. Section 2 for more detailed information), the Annual Branch Licensing policy (obliging all commercial banks with 10 branches or more to open at least 20% of their branches outside big cities), the Basic Accounts policy (requiring all commercial banks to offer a Basic Banking Account targeted at the low income people) and the promotion of the Post Office Network.

# THE MICROFINANCE SECTOR

## History and Evolution

The MF sector in Pakistan dates back to the 1960s when initiatives such as the Comilla project first experimented with community level credit. A number of new initiatives emerged during the following decade including the Orangi Pilot Project in Karachi and the Agha Khan Rural Support Program's (AKRSP) rural credit and savings projects in the country's Northern Areas.

The major boost to the sector came in the late 1990s when MF was recognized as a key component of mainstream financial sector by the Government and the SBP. This led to a number of positive developments in the sector such as the establishment of the first specialized microfinance NGO (Kashf), the first urban microfinance program (Urban Poverty Alleviation Program - UPAP), the first formal Microfinance Bank (MFB) and the setting up of a national association of MF providers, the Pakistan Microfinance Network (PMN).

A more concerted effort for the promotion of the sector began in 2000 with the establishment of an apex funding body - the Pakistan Poverty Alleviation Fund (PPAF) funded by the World Bank (WB) and other leading donors. This combined with the new MF law 'Microfinance Institutions Ordinance 2001' under SBP gave sound basis to the sector.

## Types of MF Providers

The provision of MF services in Pakistan comes from a multitude of providers such as MFBs, multidimensional NGOs, specialized NGOs, RSPs, Commercial Financial Institutions (CFIs), commercial Banks, cooperatives and informal Providers. However, as MFBs and RSPs/NGOs cover the major part of the market, the remaining part of the guidelines will focus on them.

### Microfinance Banks

Legal space was originally created for MFBs under Presidentially sponsored legislation Microfinance INstiturion Ordinance 2001. The underlying legal structure of a MFB is shareholding company under the Companies Ordinance 1984. Howerver, as

[13] Low Income Households' Access to Financial Services - International Experience, Measures for Improvement, and the Future, Nimal F. Asian Development Bank, 2007
[14] CGAP CLEAR Pakistan, April 2007

financial institution they are regulated by SBP under Microfinance Institutions Ordinance 2001 and Prudential regulations for MFBs. Currently, there are 6 MFBs in the country (4 at national level and 2 at district level), having around 115 branches. As of September 2008, the MFBs provided loans to 600,000 borrowers, amounting to 33% of total active borrowers in the country.

While there are significant legal and regulatory distinctions between commercial banks and MFBs, the latter are subject to the same quality and control standards. The MFBs have to comply with strict weekly, monthly and quarterly reporting requirements and must meet loan loss provision, minimum capital, liquidity and reserve requirements set by SBP. To help the MFBs to build their overall equity and increase their sustainability, growth and outreach and to encourage NGOs to transform into MFBs, a 5 year tax exemption was granted to MFBs in 2007. The MFBs are considereed a separeate class of bank from mainstream commercial banks. Notabley MFBs do not appear eligible to broow on the interbank market nor are they members of the clearing house system.

The MFBs are legally allowed to offer financial products other than credit; however, not many MFBs offer them. The common approach used by MFBs is the group-lending methodology but they are slowly diversifying into individual methodology.

### RSPs/NGOs

RSPs provide microfinance and other development services to local community organizations. Through community organizations, regulations allow them to offer credit, savings which are deposited in commercial banks in the name of the community organizations, and recently introduced insurance facilities. RSPs mostly target poor and rural local communities. Currently 9 RSPs with a national level network, the Rural Support Program Network (RSPN), are working in the country. They covered 39% of active borrowers in September 2008.

NGOs are not-for-profit charitable institutions that are either specialized in microfinance or serve multiple charitable objectives. The multidimensional NGOs MFIs have 5% share of active borrowers in September 2008. Currently five specialized MFIs are operating in the country, reaching 22% of the active borrowers. While the law does not allow them to intermediate deposits, some do mobilize savings by the public. The most commonly used methodology is group-lending.

Both RSPs and NGOs do not have to follow strict minimum capital, loan loss provision and reserves requirements as these are stated neither in the Societies Registration Act nor the Trust Act. The RSPa/NGOs can be formed under three legal forms: Not for Profit limited companies, Societies or Trusts.

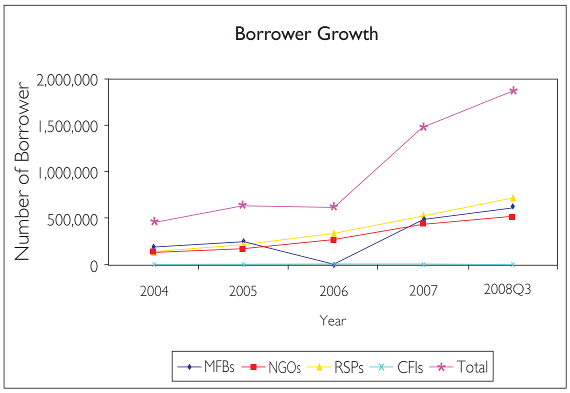
| Legal form | Not for profit limited company | Society | Trust |
|---|---|---|---|
| Registration, Licens-ing and Regulation authority | Securi-ties and Exchange Commission Pakistan | Provincial Regis-tration authori-ties | Provincial Regis-tration authori-ties |
| Legal Basis for Regula-tion | Companies Ordinance, 1984, Sec-tion 42 | Societies Registra-tion Act, 1860 | Trust Act, 1882 |

## Major highlights of the sector

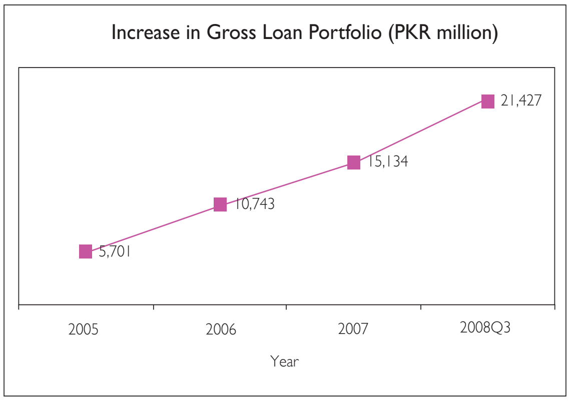
### In terms of growth

The MF sector in Pakistan has shown impressive growth over the past few years and has emerged as one of the fastest growing sectors in the country. During 2007, it expanded outreach by 47% and continued to expand at 13% during Q3-2008. At present, MF providers reach almost 90% of the districts of the country. Given that the sector has set the target of reaching 3 million active borrowers by 2010, it is expected that if the environment remains favourable, this goal will be met. See the tables[15] below for trends in growth for PMN member organizations[16].

### In terms of products and services




[15] Performance Indicators Report & Micro WATCH Issue 9: Quarter 3, PMN, September 2008
[16] Since PMN membership covers over 95 per cent of the sector's outreach, these tables provide a comprehensive overview of sector




Since early stages, the MF market is dominated by credit products. MF providers generally adopt the Grameen methodology, offer small loans on 6-12 month terms, using group guarantee and bi-weekly repayments. The weak diversification of products presents huge scope for improvements.

While a positive trend in savings product is observed, beyond compulsory savings the product is largely underdeveloped. RSPs are the dominant group in terms of active savers with a share of 83% of the total clients (12% for MFBs). The insurance product has shown enormous growth since last year. The MFBs, NGOs and RSPs have 26%, 33% and 41% share of policy holders respectively.

### Achieving sustainability

Despite a steady growth achieved in past years, the sustainability of MF providers is an issue. The MFIs are heavily depended on donors and subsidized credit from PPAF, however, the MFIs have often failed to take the opportunity of donor funds to improve efficiency, raise commercial capital or intermediate funds. The subsidies are being passed on to clients, not exposing them to the real cost of obtaining credit. Long term management vision and strategy for achieving sustainability is often lacking or weakly implemented and the interest rates charged are often not high enough to cover the costs.

### Trends in regulations

The financial, legal and regulatory framework is very supportive of the MF sector. The establishment of the Microfinance Institution Ordinance 2001, a specialized law for MFBs, has widely contributed to the development of the sector and provides the regulatory framework for the MF sector. The legislation provides NGOs with incentives to transform into supervised depository institutions. More recently, the SBP in consultation with PMN, Consultative Group to Assist Poor (CGAP) and other international agencies prepared the National Microfinance Strategy, which was approved by the Prime Minister in 2007. This strategy has fixed a target of 3 million active borrowers by 2010 and 10 million by 2015. To achieve this goal, the strategy recognizes 4 essential topics: commercialization, sustainability of operations, private domestic capital and the building of the human resource base. In parallel, SBP has launched three key MF Sector Development Initiatives aimed at easing liquidity constraints of microfinance providers in view of the tighter liquidity conditions and surging inflation. Those initiatives launched in December 2008 cover:

i) The Microfinance Credit Guarantee Facility to increase the flow of credit to the MF sector
ii) The Institutional Strengthening Fund to improve human resource quality
iii) The Improving Access to Finance Services Fund which has the objective to enhance the capacity of the MF sector and promote financial literacy

Despite favourable regulatory framework for the MF in Pakistan, some limitations remain. For example, aspects of the Microfinance Ordinance (such as the loan ceiling) prevent MFBs from further growth; the minimum capital requirements are not adjusted; the lack of nationwide supply side data prevents regulators and policy makers from considering all market players, etc.

### In terms of funding

As an apex fund, PPAF disburses loans, provides grants on a cost-sharing basis and supports capacity building activities to MFIs and other poverty alleviation organizations. However, its structure and incentives raise several challenges towards the sustainability of the sector. PPAF does not prevent MFIs to pass on the subsidized wholesale interest rate to their clients, which impede their way towards sustainability and prevents their independent growth. Furthermore, its rigid disbursement procedures are not always adapted to MFIs needs. Concerns regarding cheap funds available from PPAF are even more relevant considering the very limited commercial wholesale market of Pakistan.

According to PMN estimates, the sector requires additional funding of approximately US$ 750 million in order to reach its target of 3 million active borrowers by 2010.

There is now widespread acceptance that this gap cannot be filled through donor funding and MF providers have to start looking at commercial sources of funds. On this matter, three major facts are highlighted by PMN: (i) Savings are growing but will take time to accumulate and MFBs will have to look for alternative funding in the short term, (ii) debt will be the major funding source, being expected to account for US$ 0.5 bn in 2010 while the whole projected capital structure of MF (consolidated MFI/MFB assets) is estimated to be around US$ 1 billion in the same year. Debt composition is expected to come from Commercial Bank Loans, Capital Markets, Specialized MF Investment Vehicles and other concessional Funding, (iii) the need for equity funding will also rise by 2009-2010. Indeed, MFBs are likely to be constrained by the capital adequacy ratio requirement of 15%.

Some encouraging initiatives are being undertaken to meet these funding needs. The Program for Increasing Sustainable Microfinance (PRISM) was launched in July 2008 and is being managed by PPAF. It will promote equity fund, credit enhancement, technical assistance, knowledge management and policy dialogue. On the part of SBP, a funding window has been set up which aims at meeting the short liquidity requirements of both specialized MF NGOs and MFBs. The SBP is also considering providing risk participation in commercial finance and helping specialized MFIs and MFBs to lower the cost of borrowing through a refinancing window.

### Unmet demand and market potential

The SBP estimates that there are 25 to 30 million potential clients across the country looking for financial services. The combined outreach reported by present players in MF sector stands near 1.6 million active clients which is a meagre coverage of the potential market.

## Future Prospects

The MF sector has grown impressively over the past years. The level of poverty and rural population in the country suggest a huge scope for expanding outreach and growth of MFIs. The high geographical coverage of MFIs, the telecommunication infrastructure and recent developments in mobile banking technology as well as the physical infrastructure from state-owned institutions such as the Post Network offer promising opportunities to reach poor clients effectively. The growing role of PMN as an active network providing transparent information and advocacy work offers promising prospects.

However, in comparison with other South Asian countries, the MF sector in Pakistan is still at an early stage of development and some key challenges remain. A major concern is the funding gap. Indeed, all estimates agree that unavailable debt funds and equity investments could be a major hurdle to growth. On the regulations front, issues remain such as the bar on accessing foreign funds and the inability of MFBs to pledge their assets for accessing commercial debt. Another challenge for the future of the MF sector in Pakistan is the need for an increased focus and understanding of sustainability elements such as human resource and institutional capacity, financial soundness and funding structure, from all the actors. Regarding external factors, the macroeconomic context such as increasing political uncertainty and the global economic downturn is also likely to affect growth prospects of the sector.

# FRAMEWORK FOR INVESTMENT IN MICROFINANCE SECTOR IN THE COUNTRY[17]

## General Information

Pakistan has a liberal investment policy and the foreign investment is open in many sectors of economy including the financial sector. The foreign investment is protected by Foreign Private Investment (Promotion and Protection) Act, 1976 and Protection of Economic Reform Act, 1992. The GoP offers attractive investment packages and foreign equity's participation can be upto 100% in many sectors. The transfer of capital and profits are allowed.

The foreign investor has to consider Foreign Exchange Regulation Act, 1947. Under the Act, the regulations are issued by the GoP and the SBP in the form of notifications which are published in official gazette.

The corporate Income tax is 38 % and 35% for other companies. Dividends are taxed at 10%. If a foreign or domestic debt investment is made in Pakistan, the interest payments will be subject to withholding tax of 10%. For a foreign entity the tax rate would depend on the terms of double taxation treaty between Pakistan and donor country of the foreign investment.

## Domestic Debt Investment

### Legal framework

The investor has to consider a number of laws to depending on the legal structure of MFIs. They are:

- Microfinance Institutions Ordinance 2001
- Prudential Regulation for MFBs
- Societies Regulation Act 1860
- Trusts Act 182
- Companies Ordinance 1984
- Income Tax Ordinance 2001
- Banking Companies Ordinance 1962

As per legal framework all legal forms of MFIs (Societies, Trusts and MFBs) can take debt from the domestic market. However, there are certain restrictions as well as regulations on lender, both on commercial Bank and PPAF that makes lending to MFIs and MFBs rather limited.

### Status

In the funding structure of MF providers[18], the commercial liabilities are limited to very few. For example in case of MFBs, only Khushhali Bank and Tameer Microfinance Bank have commercial liabilities and the average 'commercial liability to GLP' ratio for all MFBs take together is 13%. For RSPs, only National Rural Support Program (NRSP) and Punjab Rural Support Program (PRSP) have commercial liabilities and average 'commercial liability to GLP ratio' for all RSPs is 21.4%. For NGO MFIs, only Orangi Pilot Project and ASASAH have commercial liabilities and for this group of MFIs 'commercial liabilities to GLP' average is 28.2%. This clearly shows that not much commercial debt has come to MF providers.

The SBP, while playing a facilitation role in the MF sector also gives debt to MF providers to provide liquidity to the market. SBP has recently established a US$ 150 million credit facility, Microfinance Credit Guarantee Facility to increase the flow of credit to the microfinance sector. The facility aims to incentivize banks/Development Financial Institutions (DFIs) to channelize funds to MFBs/MFIs. The facility will provide credit guarantees of up to 40% of the funding provided by Banks/DFIs and aims to develop market and graduate poor borrowers to mainstream financial service providers. Banks/DFIs will lend to MFBs at the SBP policy discount rate plus 200 bps. This facility is expected to help raise local currency funds for eligible MFIs/MFBs.

There are three domestic debt instruments currently available to facilitate transactions between lenders and borrowers in the market.

i) Standard Bank Debt: a range of debt offering syndication, credit lines and terms loans. MFBs face tighter restrictions to this market since the Commercial Banks offering standard bank debt are not permitted to lend unsecured

ii) Term Finance Certificates(TFCs): TFCs are issued as either fixed or variable interest rate. TCFs are regulated by the SECP and must follow certain procedure with an Information Memorandum. Microfinance TFCs in the current environment would probably be focused on the unlisted market, with MFBs only having the option of unsecured and RSPs and NGOs issuing secured.

[17] This section is compiled by PwC Pakistan
[18] PMN, Achieving Efficiency, Pakistan Microfinance Review, 2007

iii) The Pakistan Poverty Alleviation Fund (PPAF): offers a one year line of credit for MF providers. This credit line requires the pledge of loan portfolio to which leaves only NGOs and RSPs eligible for this financing as MFBs can not pledge their loan portfolio as per Prudential Regulations for MFBs. PPAF offers debt at interest rate of 8%

iv) 10%. PPAF loans come with certain restrictions which includes a cap on the on-lending loan size of PKR 30,000.

Some examples of debt investment in MFIs are:

Khushhali Bank obtained US$ 150 million from the ADB. The interest rate varies between 3.42% and 3.51%. Khushhali Bank has also got loans from commercial banks which carry an interest rate of 9.25% to 9.6%

Asasah received a loan from PPAF carrying an interest rate of 8% in 2006, a loan from First Elite Capital Modaraba (FECM)[19], a loan from Orix and Crescent Leasing on an interest rate of 24%-26%, a subordinated loan from Deutsche Bank Ltd for US$ 50,000 for 5 years at 2%. The loan is deposited in Union Bank Limited, who has issued a guarantee to FECM against Morabaha Finance (senior loan) in lien of the deposit.

#### Practical considerations

The lending interest rates offered by commercial banks are dependent on KIBOR[20] + 200-300 bps. Indeed the commercial lending interest rates has been very high and are currently close to 15%. The MFIs find these rates very high to lend it effectively and profitably to their low income clients. Also it is important to note that Commercial Banks also face many constrains in lending to MFIs as they can not lend significant funds without security. The commercial bank can only lend unsecured up to PKR 2 million funded exposure.

### Foreign Debt Investment

#### Legal framework

In addition to regulations mentioned in domestic debt investment, Foreign Exchange Regulation Act, 1947 and Foreign Exchange Manual issued by SBP come under consideration.

As per Chapter XIX, Clause 17, Section B of Manual:

- maximum interest rate LIBOR + 1.5%
- exchange rate fluctuation will be borne by the borrower
- No prepayment is allowed
- Remittance of interest is subject to deduction of taxes. Currently it is fixed at10%.
- Repatriation of interest and principal would be permitted as per the repayment schedule approved by SBP

According to SECP, not-for-profit associations guidelines, Section 4.2 'The Company shall not appeal, solicit, receive or accept funds, grants, contributions, donations or gifts, in cash or in kind, from foreign sources except with the prior permission, clearance or approval from the relevant public authorities as may be required under any relevant statutory regulations and laws'.

Clearly, for MF providers there are many obstacles in accessing foreign debt.

#### Status

No latest information is available on any recent activity on this space.

#### Practical considerations

The foreign exchange regulations make it difficult to access foreign debt investment and any such proposal has to go to SBP for the approval. In current scenario, SBP is not very supportive of such financial instruments, however, it is possible to get waivers from the SBP.

For NSCs, the rules on raising foreign currency debt are ambiguous. Apparently they need approval from SBP on foreign currency loans.

For MFBs can have only unsecured debt financing options as per MFB prudential regulations. First, there are restriction on offering shares as security for debt and two, they can not create a floating charge on the undertaking or any of its assets or part thereof, unless the creation of such floating charge is certified in writing by SBP as not being detrimental to the interest of the depositors of such institution.

### Domestic Equity Investment

#### Legal framework

The equity investments are governed by Microfinance Institutions Ordinance 2001, The Companies Ordinance 1984 and the rules and regulations as

[19] This loan has guarantee of Union Bank against deposit account of US$ 50,000, personal guarantees of directors/ subscribers of Memorandum of Association and FECM has first charge on present and future receivables and assets of the company

[20] Karachi Interbank Offered Rate (KIBOR) are currently between 12-15 % depending on tenor

imposed by SECP. Given the non-profit nature of RSPs and NGO MFIs, the only legal form that is attractive for equity investor is MFBs.

#### Status

MFBs have got attention of many equity investor and MFBs such as Khushhali Bank, First Microfinance Bank, Pak-Oman microfinance banks, Rozgar Bank and Tameer Bank have received equity investment.

#### Khushhali bank

It has more than 15 multinational banks of private, public and multinational banks as Habib Bank Ltd, Mybank Ltd, National Bank of Pakistan, RBS ltd, Citibank and Standard Chartered.

#### First microfinance bank

The main shareholders include the Aga Khan Rural Support Program (46%), the Aga Khan Fund for economic development (24%) and International Finance Corporation (30%).

#### Pak-Oman microfinance bank

Pak-Oman investment company (a joint venture between govt. Of Pakistan and sultanate of Oman) has 33% shareholding.

#### Rozgar microfinance bank ltd

The major equity holders include Pak Kuwait Investment Co. (pvt.) Ltd., Arif Habib Securities Ltd and National Investment Trust.

#### Practical considerations

As per the Prudential Regulations for MFBs', no less than fifty-one per cent of the paid up capital shall be subscribed by the promoters or sponsor members and the shares subscribed to by the promoters or sponsor members shall remain in the custody of State Bank and shall neither be transferable nor encumbrance of any kind shall be created thereon without prior permission, in writing, of the State Bank'. Hence only 49% private equity investment could come to MFBs.

Further, the maximum equity which a commercial bank can acquire in listed shares of a company or a MFB can not exceed 5% of its paid up capital.

## Foreign Equity Investment

#### Legal framework

The equity investments are governed by Microfinance Institutions Ordinance 2001, The Companies Ordinance 1984 and the rules and regulations as imposed by SECP. Additionally, Foreign Exchange Regulation Act 1948 and Foreign Exchange Manual issued by SBP are also taken into the consideration.

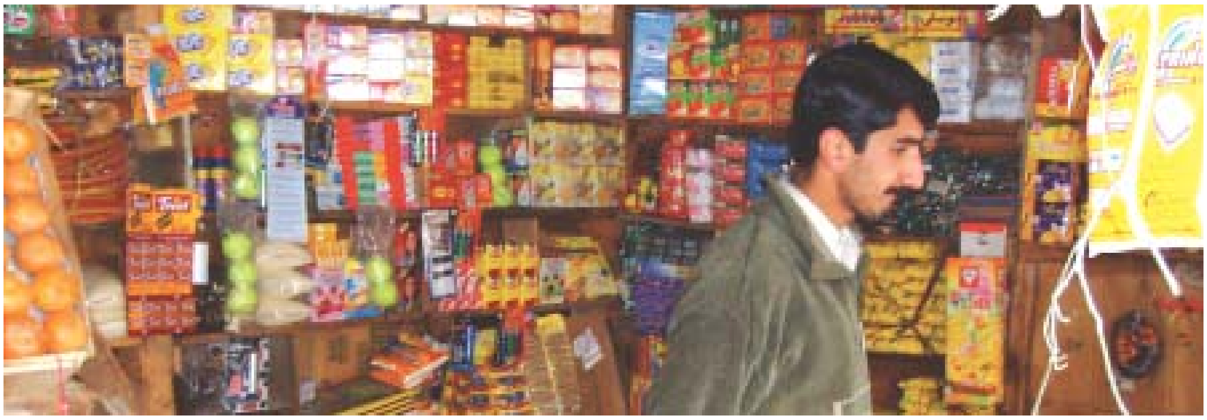
Given the non-profit nature of RSP and NGO MFIs, the only legal form that is attractive for equity investor is MFBs. There is no restriction on the level of foreign equity investment.

#### Status

In 2008 Telenor Pakistan acquired 51% share in Tameer Microfinance Bank for a foreign direct investment of US$12.5 million through a direct rights issue.

## KEY CONTACTS

| | |
|---|---|
| State Bank of Pakistan (SBP) | info@sbp.org.pk<br>www.sbp.pk |
| Pakistan Microfinance Network (PMN) | info@pmn.org.pk<br>www.microfinanceconnect.info/index.php |
| Pakistan Poverty Alleviation Fund (PPAF) | www.ppaf.org.pk |
| Security and Exchange Commission Pakistan (SECP) | enquiries@secp.gov.pk<br>www.secp.gov.pk |



PAKISTAN

# ASASAH

ASASAH is a specialized microfinance institution with the objective to improve the quality of life of financially poor and socially deprived women by identifying economic opportunities. ASASAH offers financial services such as loans, saving, insurance and leasing. ASASAH started microfinance program with credit and savings products in 2003 and launched insurance products in 2006.

## KEY FACTS

- Legal Status: Not-for-profit company limited by guarantee
- Foundation year: 2003
- Location: HQ in Lahore, operating in 10 districts in Punjab province through 29 branches
- Clients number: 25,129 (December 2008)
- Gross Loan Portfolio (GLP) : US$ 2,640,025 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 5 | 0.07 | 0.12 |
| Equity | 0 | 0 | 0 |

(US$=PKR 81.5)

## HIGHLIGHTS

- 98% of funding is commercial
- Key relationships with Deutsche Bank, First Elite Capital Modarba, Orix Leasing Pakistan Limited, Kiva, Pakistan Poverty Alleviation Fund and Grameen Trust Bangladesh
- Member of Pakistan Microfinance Network
- Regularly rated by JCR-VIS (local credit rating company)

## CONTACT

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www.asasah.org

## PRODUCTS

- Loan Products: ASASAH offers three types of loan products. All loan products have - Term: 12 month; Interest rate: 20% flat
  - Productive loan: Loan amount: US$ 120 - US$ 310; Processing fee: US$ 1
  - Small business finance: Loan amount: US$ 230 - US$ 1250; Processing fee: 1% of loan amount
  - Livestock: Loan amount: US$ 230 - US$ 860; Processing fee: 1% of loan amount
- Savings: ASASAH has recently inked a memorandum with Tameer Microfinance Bank Limited under which ASASAH's borrowers savings will be channelled through Tameer bank
- Insurance: All borrowers are insured with life insurance coverage, premium: 1% of loan amount
- Leasing: Offered through Orix leasing Pakistan, Term: 2-3 years; Interest rate: 16%-18%

## MARKET POTENTIAL AND GROWTH PROSPECTS

The target group is low income women in urban areas. There is large market among working women in urban area of Punjab where ASASAH operates. As per the business plan, ASASAH is targeting over 500,000 clients by 2011.

| KEY PERFORMANCE INDICATORS (US$) | ASASAH | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| **Staffing** | | | | | | | |
| Number of Staff Members | 78 | 323 | 285 | 233 | 203 | 354 | 533 |
| Loan Officers | 44 | 194 | 150 | 100 | 86 | 173 | 272 |
| **Productivity** | | | | | | | |
| Number of active borrowers | 6407 | 12512 | 27711 | 23,730 | 34,551 | 53,111 | 84,884 |
| Average Loan Balance per active borrowers | 127.42 | 146.17 | 132.18 | 134 | 149 | 155 | 159 |
| Active Borrowers per Loan Officer | 145.61 | 64.49 | 184.74 | 237 | 402 | 307 | 312 |
| Portfolio per Loan Officer | 18554.51 | 9427.14 | 24419.33 | 31,888 | 60,026 | 47,476 | 49,552 |
| **Balance Sheet** | | | | | | | |
| Gross Loan Portfolio | 816,398 | 1,828,864 | 3,662,900 | 3,188,817 | 5,162,240 | 8,213,282 | 13,478,042 |
| Total Assets | 968,113 | 3,720,623 | 5,328,120 | 4,369,026 | 6,977,457 | 11,728,437 | 20,284,756 |
| Total Equity | -138,936 | -99,939 | -94,364 | -315,206 | 507,547 | 1,135,927 | 2,479,375 |
| Total Debt | 1,107,049 | 3,820,561 | 5,422,484 | 4,684,232 | 6,469,910 | 10,592,511 | 17,805,380 |
| **Financing Structure** | | | | | | | |
| Equity / Asset Ratio | -0.14 | -0.03 | -0.02 | -0.07 | 0.07 | 0.10 | 0.12 |
| Debt / Equity Ratio | -7.97 | -38.23 | -57.46 | -14.86 | 12.75 | 9.32 | 7.18 |
| Gross Loan Portfolio / Total Assets | 0.84 | 0.49 | 0.69 | 0.73 | 0.74 | 0.70 | 0.66 |
| **Overall Monthly Financial Performance** | | | | | | | |
| Annualized Return on Assets (ROA), % | -10% | -16% | -12% | -6% | 1% | 4% | 6% |
| Annualized Return on Equity (ROE), % | 73% | 308% | 570% | 147% | 65% | 44% | 49% |
| Operational self-sufficiency, % | 70% | 56% | 66% | 82% | 108% | 117% | 128% |
| **Revenue** | | | | | | | |
| Yield on portfolio, % | 29% | 35% | 39% | 40% | 21% | 36% | 38% |
| **Expenses** | | | | | | | |
| Financial Expenses Ratio, % | 15% | 10% | 11% | 11% | 5% | 8% | 7% |
| Operating Expense Ratio, % | 19% | 26% | 25% | 23% | 9% | 14% | 13% |
| **Portfolio Quality** | | | | | | | |
| PAR (>30 days), % | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Risk Coverage Ratio, % | 0% | 0% | 0% | 7410% | 6357% | 10309% | 10316% |

# Development Action for Mobilization and Emancipation (DAMEN)

DAMEN is focused on providing cost effective microfinance services to marginalized communities (women only) in order to enhance their economic role. In addition to this and independently of its MF operations, DAMEN is engaged in financial and operational support to the provision of primary education and basic health through community based schools and health centres in rural areas around its field offices.

## KEY FACTS

- Legal Status: Society
- Foundation year: 1992
- Location: HQ in Lahore, operating in 5 districts of Punjab province with 20 branches
- Clients number: 36,897 (December 2008)
- Gross Loan Portfolio (GLP): US$ 4,595,803 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 7.6 | 12 | 22 |
| Equity | | | |

(US$=PKR 81.5)

## HIGHLIGHTS

- Presence of on-line Loan Tracking System
- Executive Director of DAMEN is on finance committee of Pakistan Microfinance Network
- Rated by M-CRIL in 2006 and Pakistan Centre for Philanthropy in 2007
- Good repute and credibility in the operational area due to development work

## CONTACT

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## PRODUCTS

- Group Loan: this is mainly provided for trade & business, tailoring centres, livestock or handicraft & embroidery. Loan amount: US$ 122 - US$ 370; Term: 12-18 months; Interest rate: 33 % per annum on declining balance method; Processing fee: 2% of loan amount; Repayment: monthly;
- Insurance: DAMEN provides insurance coverage to all borrowers in collaboration with Eastern Federal Union Insurance company of Pakistan Insurance. The premium is paid out of the loan processing fee that is collected upfront from the clients

## MARKET POTENTIAL AND GROWTH PROSPECTS

DAMEN has the advantage of working in peri-urban areas where good economic opportunities and demand for microfinance services are always evident. DAMEN plans to increase its client number to 55,000 by 2011.

| KEY PERFORMANCE INDICATORS (US$) | Development Action for Mobilization and Emancipation (DAMEN) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 133 | 195 | 198 | 200 | 200 | 219 | 280 |
| Loan Officers | 98 | 99 | 99 | 98 | 99 | 109 | 149 |
| Productivity | | | | | | | |
| Number of active borrowers | 15,568 | 25,478 | 32,623 | 36,897 | 44,000 | 44,400 | 55,000 |
| Average Loan Balance per active borrowers | 100 | 110 | 126 | 125 | 161 | 239 | 272 |
| Active Borrowers per Loan Officer | 159 | 257 | 330 | 377 | 444 | 407 | 369 |
| Portfolio per Loan Officer | 15,956 | 28,365 | 41,673 | 46,896 | 71,559 | 97,188 | 100,570 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 1,563,677 | 2,808,158 | 4,125,671 | 4,595,803 | 7,084,348 | 10,593,477 | 14,984,943 |
| Total Assets | 2,154,677 | 4,026,181 | 5,852,395 | 6,483,668 | 8,852,470 | 13,365,644 | 23,888,691 |
| Total Equity | 470,034 | 593,391 | 902,643 | 912,691 | 1,210,282 | 1,312,615 | 1,754,026 |
| Total Debt | 1,684,644 | 3,432,791 | 4,949,753 | 5,570,977 | 7,642,187 | 12,053,030 | 22,134,665 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | 0.22 | 0.15 | 0.15 | 0.14 | 0.14 | 0.10 | 0.07 |
| Debt / Equity Ratio | 3.58 | 5.79 | 5.48 | 6.10 | 6.31 | 9.18 | 12.62 |
| Gross Loan Portfolio / Total Assets | 0.73 | 0.70 | 0.70 | 0.71 | 0.80 | 0.79 | 0.63 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | -6% | -8% | -1% | 1% | 4% | 1% | 2% |
| Annualized Return on Equity (ROE), % | -29% | -47% | -5% | 9% | 27% | 9% | 29% |
| Operational self-sufficiency, % | 74% | 75% | 97% | 106% | 116% | 103% | 111% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 25% | 32% | 35% | 29% | 34% | 39% | 32% |
| Expenses | | | | | | | |
| Financial Expenses Ratio (%) | 7% | 10% | 8% | 7% | 11% | 18% | 13% |
| Operating Expense Ratio (%) | 18% | 22% | 19% | 14% | 13% | 13% | 8% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 6% | 7% | 2% | 1% | 1% | 1% | 1% |
| Risk Coverage Ratio (%) | 52% | 61% | 150% | 294% | 726% | 697% | 1080% |

# Sindh Agricultural and Forestry Workers Coordinating Organization (SAFWCO)

SAFWCO was registered in 1986 and started microfinance operations in 1994. SAFWCO is a multi service organization working in microfinance, health, education, enterprise development and social development. It aims to be leader in poverty eradication through political and socio-economic empowerment of communities in the region on sustainable basis'. SAFWCO has expanded microfinance outreach from 4 villages in 1992 to serving 19,294 clients in 2008 in 4 districts of Sindh Province in Pakistan.

## KEY FACTS

- Legal Status: Society
- Foundation year: 1986
- Location: HQ in Hydrabad, operating in 4 districts of Sindh province
- Clients number: 20,098 (December 2008)
- Gross Loan Portfolio (GLP): US$ 2,318,722 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 2.4 | 3 | 3.7 |
| Equity | 0 | 0 | 0 |

(US$=PKR 81.5)

## HIGHLIGHTS

- Long presence in community
- Good potential market
- Good microfinance experience among senior management
- Relationship with Pakistan Microfinance Network, Citigroup Foundation, Financial Sector Strengthening Programme (FSSP), Consultative Group to Assist the Poor (CGAP) and The Pakistan Poverty Alleviation Fund (PPAF)

## CONTACT

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## PRODUCTS

SAFWCO offers five types of loan products. 75% of total loan portfolio concentrated in livestock (47%) and agriculture (28%). All loan products have interest rate: 20% flat, processing fee: 2% of loan amount.

- Agriculture loan: Loan amount: US$ 370 (maximum), Term: 6 months
- Regular loan: Loan amount: US$ 370 (maximum), Term: 3-18 months
- Livestock loan: Loan amount: US$ 370 (maximum), Term: 12-18 months
- Festival loan: Loan amount: US$ 100 - US$ 370, Term: 12 months
- Eid-Ul-Zuha Loan: Loan amount: US$ 100 - US$ 150, Term: 3 months

## MARKET POTENTIAL AND GROWTH PROSPECTS

SAFWCO is operational in 84 Union Councils of four districts of Sindh. SAFWCO has formed more than 1,000 Village Development Organization and has access to over 40,000 households. The current microfinance programme outreach is reaching only 39% of the potential clientele that exists within the operational area of SAFWCO, leaving excellent opportunities for expansion.

| zz | Sindh Agricultural & Forestry Workers Coordinating Organization (SAFWCO) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 63 | 110 | 115 | 143 | 143 | 150 | 150 |
| Loan Officers | 28 | 44 | 47 | 64 | 64 | 77 | 92 |
| Productivity | | | | | | | |
| Number of active borrowers | 8,965 | 14,059 | 17,529 | 18,043 | 21,523 | 29,703 | 40,487 |
| Average Loan Balance per active borrowers | 81 | 105 | 106 | 109 | 110 | 110 | 111 |
| Active Borrowers per Loan Officer | 320 | 320 | 373 | 282 | 336 | 386 | 440 |
| Portfolio per Loan Officer | 25,925 | 33,442 | 39,614 | 30,661 | 37,139 | 42,599 | 49,030 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 725,894 | 1,471,460 | 1,861,842 | 1,962,286 | 2,376,875 | 3,280,087 | 4,510,727 |
| Total Assets | 1,062,654 | 1,801,524 | 2,277,527 | 2,565,654 | 2,950,197 | 3,993,561 | 9,717,930 |
| Total Equity | 254,913 | 293,320 | 506,240 | 556,596 | 704,103 | 792,592 | 1,070,690 |
| Total Debt | 807,741 | 1,508,204 | 1,771,287 | 2,009,058 | 2,246,094 | 3,200,969 | 4,333,451 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | 0.24 | 0.16 | 0.22 | 0.22 | 0.24 | 0.20 | 0.11 |
| Debt / Equity Ratio | 3.17 | 5.14 | 3.50 | 3.61 | 3.19 | 4.04 | 4.05 |
| Gross Loan Portfolio / Total Assets | 0.68 | 0.82 | 0.82 | 0.76 | 0.81 | 0.82 | 0.46 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | -21% | -14% | -3% | -4% | 1% | -10% | -3% |
| Annualized Return on Equity (ROE), % | -87% | -72% | -13% | -17% | 2% | -46% | -23% |
| Operational self-sufficiency, % | 41% | 55% | 79% | 84% | 102% | 74% | 86% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 21% | 22% | 12% | 25% | 33% | 34% | 33% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 5% | 6% | 1% | 6% | 6% | 7% | 4% |
| Operating Expense Ratio, % | 31% | 25% | 11% | 18% | 19% | 31% | 18% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 4% | 4% | 5% | 2% | 2% | 2% | 2% |
| Risk Coverage Ratio, % | 56% | 46% | 30% | 43% | 51% | 51% | 51% |

# Sarhad Rural Support Programme (SRSP)

SRSP aims at reducing poverty through a participatory community mobilization approach. Contributing to the overall vision of the organization, the microfinance program of SRSP strives to reduce financial vulnerability of the disadvantaged by providing them with access to institutional microfinance services. SRSP has introduced a refined version of the Village Banking (VB) model for the first time in Pakistan and plans to expand this model under the Mudraraba mode of Islamic financing.

## KEY FACTS

- Legal Status: Company, under section 42 of companies ordinance 1984
- Foundation Year: 1989
- Location: HQ in Peshawar, operating in 5 districts of NWFP through 10 branches and 98 unions
- Clients number : 8,201 (December 2008)
- Gross Loan Portfolio (GLP) : US$ 540,665 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 0.08 | 0.11 | 0.13 |
| Equity | 0 | 0 | 0 |

(US$=PKR 81.5)

## HIGHLIGHTS

- Funding from USAID, Novib, SDC, Pakistan Poverty Alleviation Fund
- Strong relationships with Pakistan Microfinance Network
- Potential to scale up VB Model in difficult and remote areas

## CONTACT

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## PRODUCTS

SRSP offer 3 types of loan products. All loan products have – Repayment: monthly; Processing fee: US$ 12

- General loan: Loan amount: PKR 12,000 (US$ 150); Term: 15 months ; Interest rate : 26% flat
- Flexible loan: Loan amount: PKR 10,000 (US$ 120), Term: 10 months; Interest rate : 10.8%;
- Group loan: Loan amount: PKR 100,000 – PKR 600,000 (US$ 1,220 - US$ 7,360); Term: 10 months; Interest rate : 12%

## MARKET POTENTIAL AND GROWTH PROSPECTS

There is a lack of access to business financing at a reasonable cost in the North Western Frontier Province (NWFP) The success of the VB model has given SRSP the confidence to replicate it in the most remote union councils, which are currently uncovered by most MF providers. There is a high potential for setting up VB in NWFP. SRSP plans to reach 20,000 clients by 2011.

| KEY PERFORMANCE INDICATORS (US$) | Sarhad Rural Support Programme (SRSP) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 22 | 25 | 36 | 53 | 65 | 96 | 127 |
| Loan Officers | 14 | 16 | 22 | 31 | 40 | 60 | 80 |
| Productivity | | | | | | | |
| Number of active borrowers | 1,004 | 3,828 | 7,174 | 10,847 | 8,201 | 15,000 | 20,000 |
| Average Loan Balance per active borrowers | 113 | 89 | 99 | 94 | 112 | 102 | 123 |
| Active Borrowers per Loan Officer | 72 | 239 | 326 | 350 | 205 | 250 | 250 |
| Portfolio per Loan Officer | 8,138 | 21,327 | 32,140 | 32,789 | 23,006 | 25,562 | 30,675 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 113,935 | 341,239 | 707,090 | 1,016,449 | 920,245 | 1,533,742 | 2,453,988 |
| Total Assets | 767,534 | 901,033 | 1,185,815 | 1,564,663 | 1,170,146 | 1,963,215 | 3,154,940 |
| Total Equity | 464,124 | 185,168 | 290,702 | 435,467 | 249,901 | 429,473 | 700,952 |
| Total Debt | 303,411 | 715,865 | 895,113 | 1,129,196 | 920,245 | 1,533,742 | 2,453,988 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | 0.60 | 0.21 | 0.25 | 0.28 | 0.21 | 0.22 | 0.22 |
| Debt / Equity Ratio | 0.65 | 3.87 | 3.08 | 2.59 | 3.68 | 3.57 | 3.50 |
| Gross Loan Portfolio / Total Assets | 0.15 | 0.38 | 0.60 | 0.65 | 0.79 | 0.78 | 0.78 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | -5% | -11% | -11% | -4% | -4% | 1% | 5% |
| Annualized Return on Equity (ROE), % | -9% | -28% | -49% | -16% | -15% | 4% | 22% |
| Operational self-sufficiency, % | 58% | 57% | 63% | 83% | 82% | 103% | 125% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 13% | 28% | 27% | 26% | 19% | 25% | 25% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 3% | 7% | 7% | 9% | 11% | 14% | 12% |
| Operating Expense Ratio, % | 10% | 18% | 23% | 15% | 11% | 11% | 8% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 0% | 0% | 0% | 7% | 3% | 2% | 1% |
| Risk Coverage Ratio, % | 0% | 53% | 78% | 27% | 100% | 100% | 100% |

# Urban Poverty Alleviation Program (UPAP)

UPAP is an autonomous operating division of National Rural Support Programme (NRSP), a Not for Profit Company established in 1991. UPAP is a specialized urban programme run under the supervision of NRSP, which is one of the largest RSPs in terms of outreach and number of clients in Pakistan. UPAP started its operations in 1996 and is currently working in Rawalpindi, Faisalabad, Karachi, Multan, Sialkot, Gujranwala, Sargodha, Jhang, Khanewal, Muzaffargarh and Lahore.

## KEY FACTS

- Legal Status: Not-for-profit company limited by guarantee. UPAP is autonomous program of NRSP
- Foundation year: 1996
- Location: HQ in Islamabad, operating in 14 districts of Punjab and Sindh through 184 settlement offices
- Clients number: 104,623 (June 2008)
- Gross Loan Portfolio (GLP) : US$ 12,947,780 (June 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 3 | 3 | 4.6 |
| Equity | 0 | 0 | 0 |

(US$=PKR 81.5)

## HIGHLIGHTS

- Autonomous operating division of NRSP, Pakistan's largest MFI
- Founding member of Pakistan Microfinance Network
- Utilizing customized, Oracle based loan tracking software
- Access to diversified commercial funding
- Good portfolio quality, PAR (>30 days) at 0.1 %

## CONTACT

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## PRODUCTS

UPAP has only one loan product called group loan and is meant to be used for income generating activities. It is Designed for groups with a minimum of 3 members.

- Group loan: Loan amount: PKR 15,000 – PKR 30,000 (US$ 180 – US$ 360); Term: 12 months; Interest rate : 35% on a declining balance, Processing fee : 1% of loan amount

UPAP offers life insurance product, which is mandatory for all UPAP clients to buy by paying a one time premium at the time of loan disbursement.

## MARKET POTENTIAL AND GROWTH PROSPECTS

UPAP is targeting low income groups, particularly women of urban areas and has potential to offer more diversified loan product meeting clients need. The potential market in operational areas of UPAP is approximately US$ 9,2 million, which suggests very high growth potential. Through its current branch infrastructure, UPAP plans to increase number of clients to 186,551 by 2011.

| KEY PERFORMANCE INDICATORS (US$) | Urban Poverty Alleviation Programme/ National Rural Support Programme (UPAP) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | | | | |
| Number of Staff Members | 305 | 450 | 706 | 1,109 | 1,163 | 1,240 | 1,300 |
| Loan Officers | 254 | 365 | 598 | 911 | 982 | 1,000 | 1,120 |
| Productivity | | | | | | | |
| Number of active borrowers | 23,866 | 35,966 | 53,388 | 104,623 | 121,891 | 143,627 | 186,551 |
| Average Loan Balance per active borrowers | 118 | 119 | 137 | 124 | 118 | 122 | 119 |
| Active Borrowers per Loan Officer | 94 | 99 | 89 | 115 | 124 | 144 | 167 |
| Portfolio per Loan Officer | 11,054 | 11,749 | 12,271 | 14,213 | 14,684 | 17,471 | 19,752 |
| Balance Sheet | | | | | | | |
| Gross Loan Portfolio | 2,807,593 | 4,288,553 | 7,338,348 | 12,947,780 | 14,419,668 | 17,471,261 | 22,122,124 |
| Total Assets | 2,992,876 | 4,606,612 | 7,931,482 | 13,777,953 | 15,150,938 | 18,357,287 | 23,244,010 |
| Total Equity | 1,205,175 | 2,069,936 | 3,710,086 | 3,328,003 | 3,672,017 | 4,929,339 | 6,898,771 |
| Total Debt | 1,787,701 | 2,536,677 | 4,221,396 | 10,449,951 | 11,478,920 | 13,427,947 | 16,345,239 |
| Financing Structure | | | | | | | |
| Equity / Asset Ratio | 0.40 | 0.45 | 0.47 | 0.24 | 0.24 | 0.27 | 0.30 |
| Debt / Equity Ratio | 1.48 | 1.23 | 1.14 | 3.14 | 3.13 | 2.72 | 2.37 |
| Gross Loan Portfolio / Total Assets | 0.94 | 0.93 | 0.93 | 0.94 | 0.95 | 0.95 | 0.95 |
| Overall Monthly Financial Performance | | | | | | | |
| Annualized Return on Assets (ROA), % | -1% | 1% | 3% | 6% | 5% | 7% | 9% |
| Annualized Return on Equity (ROE), % | -3% | 3% | 5% | 20% | 21% | 28% | 33% |
| Operational self-sufficiency, % | 95% | 106% | 112% | 127% | 118% | 126% | 136% |
| Revenue | | | | | | | |
| Yield on portfolio, % | 19% | 23% | 26% | 31% | 35% | 36% | 36% |
| Profit margin ratio, % | -6% | 5% | 10% | 21% | 15% | 21% | 26% |
| Expenses | | | | | | | |
| Financial Expenses Ratio, % | 2% | 3% | 4% | 7% | 12% | 13% | 13% |
| Operating Expense Ratio, % | 17% | 17% | 17% | 16% | 16% | 15% | 13% |
| Portfolio Quality | | | | | | | |
| PAR (>30 days), % | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Risk Coverage Ratio, % | 0% | 0% | 0% | 0% | 0% | 0% | 0% |

# Sri Lanka

## COUNTRY INVESTMENT GUIDELINES

- Land Area: 65,610 sq km
- Population: 20.11 million (2007)
- Main Towns: Colombo (2.45 million), Gampaha (2.15 million), Kurunegala (1.524 million)
- Languages: Sinhalese, Tamil, English
- Currency: Sri Lankan Rupees (SLR)
- Fiscal Year: 1st January – 31st December
- Development Indicators[1] :

  Population below poverty line (national): 22.7% (2002)

  Literacy rate (15-24 years old): 95.6% (2004)

  Mortality rate (child<5): 13 per 1000 live births (2006)

  Life expectancy: 71.6 years (2005)

  HDI rank: 99 (2007-08)

[1] Asian Development Bank – Database and Development Indicators, Basic 2008 Statistics

# ECONOMIC AND FINANCIAL BACKGROUND[2]

## Economic Overview

| Indicator | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|
| Nominal GDP (US$ bn) | 24.40 | 28.28 | 32.35 | 48.81 | 45.29 |
| GDP/head (US$)[3] | 1,130 | 1,290 | 1,460 | 1,620 | 1,750 |
| Real GDP growth (%) | 6.2 | 7.7 | 6.8 | 5.7 | 3.2 |
| Consumer price inflation (av %) | 11.25 | 10.0 | 15.8 | 22.6 | 10.2 |
| Exchange rate (av US$) | 100.5 | 103.9 | 110.6 | 108.3 | 117.0 |
| Total external debt (US$ bn) | 11.3 | 11.4 | 12.2 | 13.5 | 13.8 |
| FDI (US$ bn)[4] | 0.3 | 0.5 | 0.3 | 0.3 | 0.3 |
| FDI (% of GDP)[5] | 1.2 | 0.8 | 0.9 | 0.8 | 0.8 |

Sri Lanka has achieved strong Gross Domestic Product (GDP) growth at an average of 6.5 % for the past 5 years. The economy of the country was liberalised in the late 1970s, much ahead of other developing countries. However, in subsequent years, policy reforms slowed down and witnessed inconsistent evolution due to frequent change in the government. The government continues to play a major role in the economy with presence in energy, transportation, financial sector, agriculture and employment.

An important factor related to the economy show that an estimated 1.6 million Sri Lankans work overseas, mostly in the Middle East. Remittances sent by migrant workers are the second biggest foreign exchange earner after garments (US$ 2.2 bn in 2007) and support the balance of payments by stimulating domestic private consumption accounting for approximately two thirds of GDP (67% in 2007).

### Economic structure

In the economic structure of the country, agriculture, though declining in share of GDP, remains critical as over a third of workforce is employed in agriculture and has externalities associated with manufacturing and services. The main agriculture crop is rice that accounts for one fifth of total agriculture output. The growth in agriculture is low compared to industry and services (average real growth rate 2.8% in 2003-2007) and is stifled by factors such as fragmented holdings, lack of support services such as research and extension, poor pre- and post-harvest infrastructure and government intervention through subsidy and price setting. The plantation sector produces three export crops, tea, rubber and coconut and accounts for approximately 20% of export revenue. Agriculture, including plantation, is concentrated in southern, central, north-western and Sabaragamuwa province, accounting for approximately 60% of output.

The industrial sector is export oriented[6] and dominated by manufacturing which has more than 60% share in industrial output. Three activities generate nearly 90% of outputs by value: textile and garments (21.7%), food, beverages and tobacco (46.7%) and chemicals, petroleum rubber and plastic products (18.6%). However, the sector is heavily dependent on imported machinery and inputs, linking it closely with international prices and exchange rates. Mining accounts for 2% of GDP and approximately the same ratio in export earning. Precious and semi-precious stones are the main output of mining.

The service sector has more than 50% share in GDP (58% share in GDP during 2003-07) and is the main driver of growth with average 7.1 % a year in 2003-07. Telecommunication, trading, port and financial services are main contributors to the growth. Geographically, industry and services are concentrated in the western province, accounting for 50% of GDP, 55% of industrial and 57% of services output.

### Exports and imports



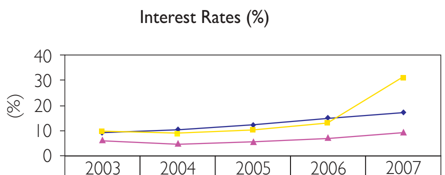
[2] Figures from EIU Country Profile Sri Lanka, 2008 and EIU Country Report Sri Lanka, 2009
[3] Figures from EIU, World Investment Prospects to 2011–FDI and the challenges of political risk, 2007
[4] ibid.
[5] ibid.
[6] Sri Lanka has export-oriented industrialization strategy and export industries have many incentives. However, domestic investment is hampered by high cost of credit and foreign investment due to conflict and political environment

The share of imports and exports in GDP averaged 41.3% and 32.3% respectively in 2003-07. The main exports are garments and textile, tea, precious and semi-precious gems and petroleum products. Main imports consist of inputs and capital goods for the manufacturing industry (80% of imports). Demand from United States (US) and the European Union (EU) together accounts for 60% of Sri Lanka's merchandise exports and 90% of its garments, making the country heavily dependent on their demand and vulnerable to trends in world trade. Main importing partners are India, China and Singapore. Due to its large propensity to import, Sri Lanka's trade deficit has been lingering over the years.

### Monetary situation

The domestic revenue (15% of GDP)[7] is weak due to inadequate tax collection and various exemptions on taxes and import duties. This combined with the large government machinery, populist economic policies and large defence spending has led to persistent budget deficit averaging 8% of GDP during 2003-07.

The economy is also characterized by persistent high inflation. In recent years, increase in inflation is caused by rise in international oil prices (fuel, transport and electricity), depreciation of the SLR, rising government expenditure on defence and increase in domestic food prices due to drought. Domestic prices are actually very vulnerable to imported inflation caused by the depreciation of the SLR. Annual average inflation in 2008 was 22.6%[8] .




| | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|
| Lemding | 9 | 10.2 | 12.1 | 14.7 | 17 |
| Deposit | 6 | 5.1 | 5.6 | 6.8 | 9.1 |
| Money-market | 9.7 | 8.9 | 10.2 | 12.9 | 30.9 |

In 2007, lending, deposit and money-market interest rates were 17.0%, 9.1% and 30.9% respectively.

### Doing business

The Foreign Direct Investment (FDI) inflows have remained stagnated due to an unfavourable political and security climate. Looking at the World Bank (WB) 'Doing Business 2009 Sri Lanka' report which assesses the business environment in 181 countries through quantitative indicators, Sri Lanka's position is 102 out of 181 countries. The country's best rankings are for starting and closing a business (29th and 43rd respectively). Regarding investor protection, the country ranks in the 70th position. Worse rankings concern paying taxes and dealing with construction permits, 164th and 161st respectively.

### Impact of global financial crisis

The global financial crisis would have multiple impacts on the country. While the domestic financial markets are largely immune to crisis with little exposure to US sub-prime assets, the tightening of global credit markets carry negative repercussions on Sri Lanka's efforts to tap international finance to fund fiscal deficit[9]. The export would be badly affected with slowdown in the economies of the EU and the US. A drop in remittances is most likely with the economic slowdown in the Middle East and related job losses for Sri Lankans working there. Together, these would lower the GDP growth. The current account would be under pressure with lowering of remittances coming from overseas Sri Lankans and a decrease in foreign investment. To arrest this impact government has announced a stimulus package that includes incentives for export sectors, financial relief for tea producers, tax on tea imports, subsidy for cinnamon exports, fertilizer subsidy, suspension of surcharge on electricity and economic service charge for a year among other things.

[7] IMF Public Information Notice No. 08/140, Article IV Consultation with Sri Lanka, October 2008
[8] The rate of inflation as measured by the Colombo Consumers Price Index, dropped to 7.6% in Feb 2009
[9] Sri Lanka has increasing reliance on dollar dominated short term commercial debt to fund fiscal deficit

## Financial Sector Overview

### Key reforms

Beginning in the early 1990s, the financial sector in Sri Lanka has undergone several reforms aimed at strengthening institutional framework and decreasing government direct involvement in financial delivery. These reforms have led to important legislative and regulatory changes, better capacity for financial sector supervisions, improved system, process and performance and strengthening of central banking operations. However, the state continues to dominate the financial system with two large state-owned commercial banks. The state-owned banks account for nearly half of banking system assets and quarter of total financial sector assets. These banks are not due to be privatized but they would soon operate under a strictly commercial basis.

The Central Bank of Sri Lanka (CBSL) focuses on maintenance of macro-economy and financial system stability. The CBSL has improved its capacity over the years in supervision and enforcement and has taken steps in implementing risk management, BASEL II, for tight corporate governance in Banks. The CBSL regulates and supervises commercial and specialized banks, finance and leasing companies and primary dealers and introduction of Acts on anti money laundering and financial transaction reporting

### Financial services providers

The financial sector consists of a wide variety of actors.

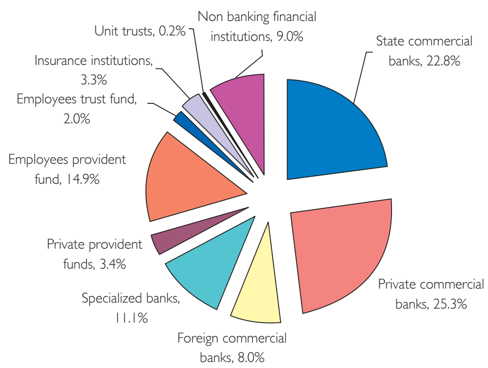
Banking sector: The banking sector has grown over the years and accounts for two-thirds of the sector assets in 2007. The banking sector includes:

- Licensed Commercial Banks (LCBs): There are 23 LCBs. Among LCBs, the two largest (Bank of Ceylon and People's Bank) banks are state-owned, 9 privately owned and 12 are foreign bank branches.

- Licensed Specialized Banks (LSBs): There are 16 specialized banks consisting of long-term lending institutions, development banks, savings banks, regional development banks etc. They are mostly state owned with market share of about one fifth of LCBs. The single largest LSB is the state owned National Savings Bank.

- Finance Companies: There are 31 finance companies, which are funded by bank borrowing and debentures. Registered finance companies engage mainly in purchase, leasing and real estate business.

Structure of the Financial System 2006




Source: Central Bank of Sri Lanka

The LCBs and LSBs operate through network of 4,830 branches. With growing competition among in the banking sector, there is an increase in services such as credit cards, telebanking, internet banking and ATMs. The performance of the banking sector has also improved according to indicators from an International Monetary Fund (IMF) assessment[10], however, some major problems remain, such as heavy dependence of government on banks to meet its financial needs that is crowding out private investment, high interest rate environment, weakness among state owned commercial banks, limited risk management among banks and lack of debt recovery framework.

Pension Sector: The pension sector is dominated by Employee Provident Fund (EPF) which is managed by CBSL. EPF represents about 15% of total assets in the financial system.

Insurance Sector: The insurance sector is underdeveloped with total insurance premium representing only 1.5 % of GDP. Further, only 10% of the population is reported to benefit from any form of insurance. There are 16 insurance companies. Recently the sector has undergone profound change with privatization of state owned insurance companies and setting up of Insurance Board of Sri Lanka as independent supervisor.

Equity and debt markets: The stock market has performed well over the years and current market capitalization is approximately 30% of GDP. The corporate debt market is small.

Other players in financial sectors are primary dealers of government securities, investment banks, savings



[10] IMF, Financial System Stability Assessment Update – Sri Lanka, November 2007

and loans associations, cooperatives, microfinance (MF) providers, venture capital companies, trusts and a large number of informal money lenders.

In analysis of financial sector, it is important to reiterate that with "its management of the two main providers of financial services, the Government controls nearly 40% of all financial sector assets. Moreover, government debt represents largest single exposure to the financial system accounting for nearly quarter of banks assets (loans and investment) and more than 90% of investment of pension and insurance institutions"[11] . As a result, the share of credit to the private sector is only one third of GDP.

### Financial inclusion

In terms of outreach of financial services, it is quite extensive with 82.5% of households having accessed financial institutions for savings (75%) and credit (47%)[12]. Sri Lanka performs reasonably well in terms of rate of deposit accounts and loans compared to other countries in the region. While there are 1118 and 364 deposits and loan accounts respectively per 1,000 people in the country, India has 443 and 78 deposits and loan accounts. Further, there are 16 branches and 17 ATMs per 1,000 sq km in Sri Lanka while in India, figures amount to 23 and 7 respectively [13]. However, overall figures hide the disparities at various levels. For example 25% household in estate sector have not utilized financial services of financial institution compared to 17.5% and 15% of rural and urban households respectively. Moreover, branches of LCBs are concentrated in Western Province. At the end of 2007, there were 678 banking outlets of LCBs in the Western Province out of a total branch network of 1,697 in the whole country.

# THE MICROFINANCE SECTOR

## History and Evolution

In Sri Lanka, the origin of Microfinance (MF) could be traced back to the early 1900s when the British Government passed legislation to set up thrift and credit co-operative societies (TCCS). The TCSS were engaged in procurement of inputs and distribution of products and were dominated by landlords and village headmen.

Post-independence, the government concentrated largely on agriculture credit, particularly for paddy (rice) cultivation. The credit facilities were granted mainly through the two state banks, the Bank of Ceylon and Peoples Bank on a subsidized rate and loans were written off in many instances due to political pressures.

The other important developments in evolution of MF sector were establishment of the Co-operative Rural Banks (CRBs) in 1964, revival of TCSS under federation of SANASA in late 1970s, establishment of 17 Regional Rural Development Banks (RRDBs) in 1985 and their subsequent consolidation in 1998-99 into 6 Regional Development Banks (RDBs) , Janasaviya programme in late 1980s and Samurdhi Development and Credit Scheme in 1996.

Late 1980s and 1990s saw the entry of several local and international Non-Government Organizations (NGOs) into MF. Initially NGOs combined MF with social development activities; however, in recent years these organizations are increasingly separating MF from other activities.

In the evolution of MF sector in the country, the role of post tsunami aid is critical as a substantial amount of fund were channelleged to the MF sector. While this scaled up the MF sector, it also has some very detrimental impacts for the sector.

## Types of MF Providers

Currently over 10,000 outlets of various institution types are providing microfinance services[15].

Licensed Commercial Banks (LCBs): 6 out of the 23 commercial banks of the country provide financial services to the low income and poor sections. Hatton National Bank (HNB), the only private commercial bank with a significant MF portfolio, has disbursed over LKR 3.5 bn to 70,000 clients since 1989. MF client base of LCBs (excluding 2 state owned banks) is 935,000.

Licensed Specialized Banks (LSBs): Among LSBs six RDBs and SANASA Development Bank are key players in MF sector. LSBs are supervised by CBSL. The RDBs have 215 branches while SANASA has 36 branches. The RDB has 86% business in MF and client base is estimated to be 1.85 million people. The SANASA

11 ibid.
12 GTZ, Outreach of financial services in Sri Lanka – A look at the demand side from a microfinance perspective, April 2008
13 World Bank, Getting Finance in South Asia, phase IV, 2008
14 The Government of Sri Lanka has recently announced plans to merge all six RDBs into one development Bank which would operate nation-wide
15 Based on Island wide survey of Microfinance Institutions commissioned by GTZ-Promis in 2006-07. All the figures in this section are taken from GTZ Promis, Microfinance Industry Report: Sri Lanka (draft), November 2008

bank is owned by TCCS and serves as the apex bank for SANASA system, also engaging in direct retail level activities. RDBs serve a higher income population segment with over 50% of their clients falling into LKR 5,000 – 20,000 range of monthly income.

Registered Finance Companies: The finance companies provide some credit to the working poor, but tend to concentrate on asset acquisition as a form of collateralization or charge up to 33 percent for larger working capital loans. The Lanka Orix and Leasing Company (LOLC) is the only registered finance company that provides MF services. Last year, LOLC formed a new company called LOLC Microcredit. LOLC had 20,000 MF clients in 2008. Registered Finance Companies are supervised by CBSL.

Samrudhi Bank Societies (SBSs): The 1038 outlets of Samrudhi banks are supervised by the Samrudhi Authority under the Government of Sri Lanka. These institutions are direct providers of MF services on behalf of the government. They have 2.3 million members and another 227,000 non-member clients. SBS have approximately half of the clients with monthly income of less than LKR 3,000.

Cooperatives: They make up the vast majority of the reported 10,000 MF outlets in Sri Lanka. These include 1,684 (CRBs and women cooperatives) branches, approximately 8,440 TCCS[16] under SANASA system and various local cooperative offering financial services. They are the only MF institutions that are authorized to mobilize savings from members without oversight of CBSL. They are regulated by the Department of Cooperative Development. Total membership of SANASA TCCS is estimated as 866,611 (end of 2006). According to CBSL, CRBs reach around 4-5 million people.

MFIs[17] (NGOs/Companies): The MFIs include legal bodies registered under social services act or companies act[18]. They have expanded geographically and programmatically on the backs of affiliated societies and their community based organizations (CBOs) or self-help groups. They mainly consist of around 200 national and international NGOs. According to data collected by a GTZ survey among 3,000 households in early 2007[19], such institutions accounted for 10% of all the loans provided and only for 2.4% of deposits. As expected, their share in terms of value is very low. Some prominent examples are SEEDS[20], LakJaya, Agro Microfinance, SEWA Finance etc. They are largely unsupervised, though the outreach of this group is estimated to be one million.

The government has an overwhelming role in MF sector through major retail level providers – Samrudhi Banks, RDBs, CRBs and two state commercial banks. According to Mahinda Chintana[21], 65% of microcredit in Sri Lanka is provided through the government.

| MFI Type | No of outlets |
|---|---|
| LSBs<br>RDBs (6)<br>SANASA Bank (1) | 215 branches<br>36 branches |
| LCBs and Registered Finance Companies | 1,200 |
| Samrudhi Bank Societies | 1,038 societies |
| Cooperatives<br>CRBs and Women Development cooperatives<br>SANASA/TCCS | 1,684<br>3,794 active societies |
| MFIs (NGOs/companies) | 2,500 |
| Total | 10,467 |

At meso level, there is the Lanka Microfinance Practitioners Association (LMPA) which has a membership of around 80, consisting primarily of MFIs but also some meso level service providers. The association has been in existence since 2006 but is still very much in the early stages of development. The association is supported by GTZ and Plan Sri Lanka.

16 50% of SANSA societies are estimated to be inactive
17 In this report MFIs mean NGOs/Companies unless otherwise stated
18 The Companies Act allows for the following legal forms: Private Limited Company, Public Limited Company, Peoples Limited Company, Limited Guarantee (Liability) Company or a Non-Residential Company
19 GTZ, Outreach of financial services in Sri Lanka – A look at the demand side from a Microfinance perspective, April 2008
20 The SEEDS project has grown from a Government-founded semi-independent organization under the guidance of the government founded charity Sarvodiya
21 Mahinda Chintana, Vision for New Sri Lanka, A Ten Year Horizon Development Framework 2006-2016, Discussion Paper

## Major Highlights of the Sector

### In terms of growth

Over the years, the MF providers have significantly increased their outreach. Between 2000 and 2004, the loan portfolio outstanding has almost doubled and the number of loans has grown by 37%. The savings offering has also grown, the volume of deposits having more than doubled.

The largest MFI have grown between 25 and 40 percent per year post tsunami, although most are attempting to limit their growth to 10 or 15 percent now.

It is important to note that the total client base of MF providers is difficult to estimate as many of them do not maintain records on a client basis and therefore total number of accounts overestimates the client outreach of the institutions. This is further complicated for the MF sector as a whole, due to individuals having accounts with multiple institutions.

### In terms of products and services

MF providers provide a wide variety of products. Micro-credit: Micro-Credit includes loans for consumption, income subsistence and micro-enterprise start-up and expansion. They are provided with or without physical collateral and lending methodologies vary including individual, small group and village banking models. According to the latest GTZ study based on household surveys, around 20% of loans are less than LKR 20,000 and almost 65% are less than LKR 50,000. Over 50% of the loans have an annual interest rate between 10% and 20%; 30% of the loans have an interest rate below 10%, implying a high number of loans at concessionary rates.

Micro-saving: According to a recent survey conducted by GTZ[22], the state banks (People's Bank and Ceylon Bank) are generally considered safe and are the most popular as far as savings are concerned, accounting for 75% of household savings. Looking at the poorest segment of the population, Samrudhi Banks are the main source of finance for savings products. Cooperative and SBS are authorized to mobilize savings from members without oversight of Central Bank. MFIs need to get an authorization from Central Bank in order to mobilize savings but this is not strictly followed and many require clients to save as a condition for getting a loan. According to GTZ study, over 80% of the households receive an interest rate below 10% which is less than inflation rate.

Micro-insurance: Micro-insurance reaches 1.46 percent of the population. The primary players in the market are HNB, Ceylinco Insurance and Sanasa Bank providing life, property, mortgage, loss of income and disability insurance. Currently, MFIs can only provide insurance as an agency of a licensed insurance provider. The high capital requirements which are a pre-condition for engaging in insurance business exclude MFIs from obtaining licenses for these activities.

Micro-leasing: The primary market for micro-leasing is purchase of trishaws, motorcycles and hand tractors. This is reasonably well provided for by both commercially minded microfinance providers and finance companies in the urban areas. Registration with CBSL under the Finance Leasing Act of 2000 is mandatory to carry out leasing activities. The leasing companies cannot mobilize savings or deposits. They can provide micro leasing, hire purchase and micro loans under a leasing license.

### Achieving sustainability

There is limited focus on sustainability as the sector has been protected by a large amount of subsidized funding from government and foreign donors alike, although the latter source is now much reduced. Most government-led MF programmes have subsidized interest rates, weak repayment rate and high recurrent costs, and are far from achieving sustainability. While Government supported or subsidized loans offer rates ranging from 8% to 18%, the sustainable rates are considered to start as high as 33%.

An important hindrance to the sector's sustainability is the low concern to the portfolio quality. Many MF providers are not familiar with Portfolio at Risk (PAR) and are unable to calculate it with their manual system. As a result, the average PAR(>30 days) reported by RDBs ranges between 6% and 9% while MFIs report a PAR(>30 days) between 5% and 25%, being closer to 25%[23].

Loan loss provisioning is either not practiced at all (this applies mostly to unregulated NGO-MFIs) or, as in the case of regulated entities such as the RDBs, CBSL prescribed provisioning rates for banks are followed.

Measurement of performance and portfolio quality is made difficult by the fact that most MFIs are not

[22] GTZ, Outreach of Financial Services in Sri Lanka – a look at the demand-side from a microfinance perspective, April 2008
[23] Permaratne S.P., Policy Analysis Paper on Draft Proposals for Regulating MFI in Sri Lanka, May 2007

computerized, making it difficult to obtain timely and quality information. There is an encouraging trend towards transparency as MFIs look towards commercial funding sources in order to grow. Currently 15 Sri Lankan MFIs report to the Microfinance Information Exchange (MIX) market, up from 8 in 2006. The LMPA initiative to build a sector database is a welcome step towards making the sector more transparent and introducing some measure of standardization.

### Trends in regulations

In order to establish a conducive environment for the MF sector, a Microfinance Institutions Act was drafted by the CBSL. The Microfinance Act attempts to bring Company Act and Social Services Act registered and unregistered microfinance providers under the regulatory authority of the Monetary Board of the CBSL. While specialized banks and finance companies remain exempt from the stipulations of this Act, the cooperatives are excluded from most of the Microfinance Act.

The draft legislation calls for all microfinance organizations, regardless of their current legal status, for a national level non-profit registration under the Company Act with the option of also registering under the Social Services Act Number 31 of 1980. The minimum loan start-up capital is LKR 50 million for national registration.

Currently a draft MFI Act has been withheld for further amendment and it is not clear when the amended act would be submitted to the Parliament for approval. Till then, there is a lack of supportive legal, regulatory framework and institutional options for transformation of MFIs. The MFIs (NGOs/companies) could transform into banks or finance companies, but the minimum capital requirement is very high and the set up is not suitable for the majority of MFIs.

### In terms of funding

Savings remains an important funding source for MF providers such as Samrudhi and CRBs.

There are 3 wholesale funding agencies operating. These are the government owned National Development Trust Fund (NDTF), Stromme Microfinance, backed by the Stromme Foundation of Norway, and Consorzio Etimos, a funding agency based in Italy. The 2006 CLEAR Review[24] cites underutilized apex funds as a challenge facing the sector, stating that disbursement of the main apex funds is low, indicating limited interest or absorption capacity of MFIs. According to Consultative Group to Assist the Poor (CGAP), the total MF budget of donors was nearly US$ 200 million in 1999-2005. Post Tsunami, a large number of international NGOs, bilateral, and multilateral agencies are involved in funding MF with approximately US$ 85 million committed.

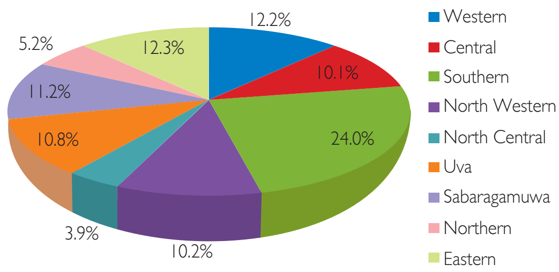
With most of the post-Tsunami commitments coming to an end, Sri Lanka's microfinance sector has seen a considerable reduction in donor funding since 2007. Local commercial funding institutions, which could play a role as wholesale lending agencies are, on the whole, reluctant to get involved in MF due to high risk perception association with the sector. While a large number of off-shore microfinance funding agencies are available, the restrictive legal environment and the long and cumbersome process of obtaining approval from the Controller of Exchange serve as deterrent factors for many potential off-shore funders. Against this background, funding becomes the key issue especially for MFIs (NGO/Companies) which are restricted by law from accepting public deposits and further restricted from obtaining off-shore debt and equity funding due to prevailing exchange control restriction.

### Unmet demand and market potential

With 22% poverty in the country of 20 million, there is a large market for MF products among low income population. A recent study from GTZ 'Outreach of Financial Services in Sri Lanka – A look at the demand side from a Microfinance Perspective' indicate that Sri Lankan financial sector is essentially an MF market with over 80% of households having total borrowings less than 100,000 LKR.

While the MF sector has made significant achievements to reach a large share of poor households considerable gaps remain. Coverage in the estates/plantations or inland areas and the North is often low. The MF outlets are more widespread in Southern provinces (24% of total) while the north and eastern area

MF outlets by Province




[24] CGAP, Country-Level Effectiveness and Accountability Review, Sri Lanka, February, 2006
[25] GTZ, Outreach of Financial Services in Sri Lanka – a look at the demand-side from a microfinance perspective, April 2008

(3.9% of total) are very much underserved. Also 90% of MF outlets are concentrated in rural areas; approximately 10% in urban areas and 1% in the estate sector. This also points to the fact that there is unmet demand and market potential in those areas is still to be tapped.

Approximately 50% of Sri Lankan households do not have access to credit and this unmet demand for microfinance in Sri Lanka is estimated at Rs. 125 bn[25].

## Future Prospects

The Sri Lankan MF sector is large and diverse in terms of outreach and institutional types, offering a wide variety of financial services. Given regional differences in outreach of MF services in the country, there is huge scope for expanding MF services.

On challenges, there is an inappropriate donor intervention and pervasive government presence. Following the fact that the MF sector is highly fragmented and diversified, sector data is largely unavailable. Indeed, the available performance data is often inconsistent across institutions and often does not comply with standards. "Thus while a number of MFIs are reported to be doing well, a large number of them have low recovery rates and several hundred of CRBs and TCCs are poor performing. The continuation of this over an extended period of time could result in collapse of institutions and loss of public confidence in these community-based institutions"[26].

To an extent at meso level there is a network of MFI providers in LMPA supported by Plan International and GTZ. The network has more than 80 members but is underfunded and offers very few services to its members.

With decreasing development aid, the MFIs would increasingly look for commercial funding to meet their funding requirement and this would give promising prospects to the sector to grow professionally under sound commercial framework.

# FRAMEWORK FOR INVESTMENT IN MICROFINANCE INSTITUTIONS IN THE COUNTRY

## General Information

The Board of Investment (BOI) is an autonomous statutory agency and the primary government authority responsible for investment, with focus on foreign investment. The BOI acts as a facilitator for investment. It is intended to provide "one-stop" service for foreign investors, with duties including approving projects, granting incentives, and arranging services such as water, power, waste treatment and telecommunications. However, microfinance falls outside of the businesses targeted by the Board of Investment (BOI). The CBSL is the Government's focal point and highest administrative authority on policy and implementation related to private investment in financial sector.

For foreign investment the following acts also come under consideration:
- Exchange Control Act, Foreign Exchange Manual, Central Bank of Sri Lanka, December 2001
- Finance Act No 11, of 2006, Certified as on March 2006

The corporate income tax is 35%. The foreign investors are allowed to transfer their profit and capital outside the country after getting an approval from Foreign Exchange Department of CBSL. In addition to these is 10% withholding tax on interest earned. Sri Lanka has double taxation treaty with most countries and any request for paying of taxes has to be put to Department of Inland Revenue.

## Domestic Debt Investment

### Legal framework

The legal framework for domestic investment remains the Finance Act. All legal forms of MF providers including MFIs (companies, NGOs and cooperatives) can access debt investment from domestic Financial Institutions.

### Status

The government, through its funds such as National Development Fund, Shsahana and Isuru, is the biggest player in the domestic debt. They lend to a large number of MFIs. There are many microfinance targeted loans schemes that are available from CBSL as it is keen to promote microfinance in the eastern areas. The LCBs act as intermediary for these loans and smaller MFIs can apply for these loans.

The private commercial market for domestic debt is not very active in the MF sector. In the presence of soft loans available from Government funds, the commercial rates offered by Banks are not very attractive for MFIs. However, some banks such as People's Bank have given such loans to MFIs such as SEEDS.

SEEDS obtained LKR 100 million from Peoples Bank

[26] World Bank, Microfinance in South Asia, December 2006

in 2008. Under this SEEDs gave corporate indemnity of Sarvodaya movements and promissory note as collateral. The interest rate varies between 20-25% for bulk loans.

### Practical considerations

The domestic debt investment channel offers a promising mechanism to invest in the MFI in the country. Any domestic investor can register itself under society or companies act and enter debt investment in local currency.

## Foreign Debt Investment

### Legal framework

The legal framework for domestic investment includes the Finance Act and Exchange Control Act.

### Status

At present borrowings of a short term nature from abroad are generally not permitted while borrowings of a medium and long term nature are considered very strictly on case by case basis by Controller of Exchange taking into account the terms and conditions of loans. The major factors considered when approving such loans are whether the interest rate is comparatively low in terms of prevailing rate for local borrowings and whether such borrowings can be repaid out of foreign exchange earning for the borrowers without any significant bearing on the country's foreign exchange reserves.

In the present macro-economic context of low foreign reserves and balance of payment crisis, it is unlikely that CBSL would make any changes in this policy. Further, the Exchange Board regulations specifically bar foreign companies formed for the purpose of lending.

### Practical considerations

Technically speaking, all legal form of MFI Providers, (MFIs, cooperatives etc.) can have debt investment from foreign financial institutions. However, any such request has to go to Central Bank; in practical sense, MFI registered as NGOs, companies and cooperatives are not allowed to get debt from external sources.

The way to obtain a foreign debt investment is through intermediation of banks. Foreign investors can deposit required amounts in a commercial bank which can then give debt in local currency to MFIs. Central Bank usually takes 3-4 months to give such approvals.

## Domestic Equity Investment

### Legal framework

The legal framework for domestic equity investment remains the Financial Act. Among legal forms, MFIs registered as companies or financial companies are allowed to have equity investment from domestic Financial Institutions.

### Status

Presently the domestic equity market in MF sector is very weak and there are not many examples of such investment.

## Foreign Equity Investment

### Legal framework

Non-licensed financial institutions cannot take foreign equity investment and therefore NGOs, companies and cooperatives do not qualify for such investment. The microfinance is classified as a money lending business and therefore restricted from obtaining offshore equity into such business. This has a negative impact on a number of better performing MFIs, which are unable to access offshore equity capital which would enable them to scale up their operations.

The minimum capital requirement to start a finance company is LKR 200 million and the foreign entity can have 40% equity in the finance company.

### Status

To date the only foreign investment to come to the MF sector is the Netherlands Development Finance Company (FMO) investing in LOLC. LOLC launched LOLC Micro Credit Company with a US$ 10 million loan and equity injection from the FMO. FMO has invested US$ 2 million in equity, US$ 1.5 million as a convertible loan and US$ 6.5 million as a senior loan. FMO owns 20 % of LOLC Micro Credit. This is the first Sri Lankan MFI) to have foreign shareholding.

## KEY CONTACTS

| | |
|---|---|
| Central Bank of Sri Lanka(CBSL) | www.cbsl.gov.lk |
| GTZ | www.microfinance.lk |
| Lanka Microfinance Practitioners Association(LMPA) | shakila@seeds.lk |
| Board of Investment (BOI) | www.boi.lk |

# Agro Micro Finance (AMF)

Agro Micro Finance (AMF) is a well known name in the Sri Lankan microfinance sector. AMF is registered as a company incorporated under the Companies Act No. 17th of 1982 & new Companies Act No. 7 of 2007, to provide microfinance services in Sri Lanka. AMF plans to become a well rooted sustainable microfinance institution in Sri Lanka by providing services efficiently and by empowering people and communities through innovative financial, business development and capacity building services.

## KEY FACTS

- Legal status: Company, limited by guarantee
- Foundation year: 2000
- Location: HQ in Nugegoda, Western Province. Operating in 7 districts of Sri Lanka
- Clients number: 5,615 ( December 2008)
- Gross Loan Portfolio (GLP) : US$ 1,506 062 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 0.26 | 0.43 | 0.7 |
| Equity | 0.26 | 0.43 | 0.7 |

(1 US$= SLR 117)

## HIGHLIGHTS

- Funded by USAID, ETIMOS, Relief international, UNDP, NDTF & GTZ - ProMis
- Good operational self sufficiency
- Very good experience of microfinance among senior management
- Well structured organizational structure
- Computerized MIS System (Micro Banker Software) in all 7 branches.

## CONTACT

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www.agromicro.org

## PRODUCTS

The Agro Microfinance has a number of Loan Products :

- APLE (Anti Poverty Lending Scheme): Term 2 year; Interest rate: 18%
- Paddy loan scheme: Term 6 months; Interest rate: 18%
- RANDORA (Society Solidarity Group Loan Scheme): Term 2 years; Interest rate: 18%
- Athamaru (individual loan): Term 1 month; Interest rate: 6% (monthy)

## MARKET POTENTIAL AND GROWTH PROSPECTS

AMF plans to start operations in one new district next year and open another two branches in two existing districts in next three years. Achieving the 100% of FSS and introducing innovative products which provide 'credit-plus' services is another vital goal of the organization. The MFI has taken special steps to increase the recovery rate, including strengthening internal audit and updating the operational and credit manuals. AMF plans to change the delivery mechanisms and introduce new systems with collection centers to facilitate an increase in active clients to 12,000 by the end of 2011.

| KEY PERFORMANCE INDICATORS (US$) | Agro Micro Finance | | | |
|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 |
| Staffing | | | | |
| Number of Staff Members | 47 | 62 | 60 | 72 |
| Loan Officers | 11 | 13 | 11 | 12 |
| Productivity | | | | |
| Number of active borrowers | 2,249 | 2,658 | 4,496 | 5,886 |
| Average Loan Balance per active borrowers | 151 | 171 | 202 | 244 |
| Active Borrowers per Loan Officer | 204 | 204 | 409 | 491 |
| Portfolio per Loan Officer | 30,885 | 35,032 | 82,718 | 119,741 |
| Balance Sheet | | | | |
| Gross Loan Portfolio | 339,745 | 455,421 | 909,898 | 1,436,887 |
| Total Assets | 426,807 | 663,872 | 1,089,824 | 1,560,473 |
| Total Equity | 302,709 | 381,813 | 832,425 | 869,181 |
| Total Debt | 124,098 | 282,059 | 257,399 | 691,292 |
| Financing Structure | | | | |
| Equity / Asset Ratio | 0.71 | 0.58 | 0.76 | 0.56 |
| Debt / Equity Ratio | 0.41 | 0.74 | 0.31 | 0.80 |
| Gross Loan Portfolio / Total Assets | 0.80 | 0.69 | 0.83 | 0.92 |
| Overall Monthly Financial Performance | | | | |
| Annualized Return on Assets (ROA), % | -5% | -9% | -3% | -7% |
| Annualized Return on Equity (ROE), % | -7% | -14% | -5% | -11% |
| Operational self-sufficiency, % | 84% | 68% | 89% | 81% |
| Revenue | | | | |
| Yield on portfolio, % | 34% | 26% | 29% | 31% |
| Expenses | | | | |
| Financial Expense Ratio, % | **0%** | **3%** | **2%** | **6%** |
| Operating Expense Ratio, % | **1%** | **3%** | **3%** | **7%** |
| Portfolio Quality | | | | |
| PAR (>30 days), % | 0% | 0% | 21% | 21% |
| Risk Coverage Ratio, % | 0% | 0% | 26% | 39% |

# LOLC Micro Credit Ltd (LMCL)

Lanka Orix Leasing Company (LOLC) is a quoted public company that provides financial services such as finance lease, hire purchase, consumer finance, operating lease, fleet management and loans. LOLC was created in 1981 and started microfinance operations in 2003 by disbursing solar loans. Microfinance became a separate business unit within the company in 2007 and was later registered as a separate legal entity LMCL in 2008. LMCL is registered with the Central Bank under Finance Leasing Act, No. 56 of 2000.

## KEY FACTS

- Legal Status: Non Banking Financial Company (NBFC)
- Foundation year: 2008
- Location: HQ in Rajagiriya, operates nationally through 23 branch offices, 11 post office centres and 11 petrol pump centres
- Clients number: 21,500 (December 2008)
- Gross Loan Portfolio (GLP): US$ 20, 091, 218 (December 2008)

| FUNDING NEEDS (US$ mn) | 2009 | 2010 | 2011 |
|---|---|---|---|
| Debt | 20.2 | 27.8 | 41.7 |
| Equity | 4 | 6.7 | 8 |

(1 US$= SLR 117)

## HIGHLIGHTS

- Subsidiary of LOLC, member of ORIX – Japan
- Alliance with Sri Lanka's post to operate MF centers
- Only institution in Sri Lanka who serves clients through retail, groups & intermediary partners
- First MFI in Sri Lanka to get foreign investment from FMO (Netherland Development Bank)

## CONTACT

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## PRODUCTS

LOLC offers a range of loan products targeting different markets including 3-wheeler, solar, hand tractor, motorbike, pawn brokering, agricultural equipment, small business, and cultivation loans.

All loan products have – Term: 12-48 months; Interest rate : 35%

## MARKET POTENTIAL AND GROWTH PROSPECTS

LMCL targets both rural and urban areas but focus more on rural areas. It is the first MFI to have foreign investments through FMO. 80 % of loan clients are women and 70 % are rural clients. By 2010, LMCL plans to be the leading micro finance provider in Sri Lanka, be operational in all districts of Sri Lanka including the North & the East and increase outreach to 100,000 active clients. It plans to go public in 5 years and apply for a Fitch rating in a near future.

| KEY PERFORMANCE INDICATORS (US$) | Lolc Micro Credit Ltd | | | |
|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 |
| Staffing | | | | |
| Number of Staff Members | 85 | 85 | 120 | 200 |
| Loan Officers | 70 | 70 | 100 | 175 |
| Productivity | | | | |
| Number of active borrowers | 21,500 | 25,000 | 50,000 | 100,000 |
| Average Loan Balance per active borrowers | 934 | 919 | 689 | 499 |
| Active Borrowers per Loan Officer | 307 | 357 | 500 | 571 |
| Portfolio per Loan Officer | 287,017 | 328,087 | 344,655 | 285,043 |
| Balance Sheet | | | | |
| Gross Loan Portfolio | 20,091,219 | 22,966,066 | 34,465,453 | 49,882,573 |
| Total Assets | 20,049,938 | 23,275,154 | 36,176,017 | 51,974,675 |
| Total Equity | 3,931,624 | 4,503,032 | 6,788,667 | 8,081,632 |
| Total Debt | 16,118,314 | 18,772,121 | 29,387,350 | 43,893,043 |
| Financing Structure | | | | |
| Equity / Asset Ratio | 0.20 | 0.19 | 0.19 | 0.16 |
| Debt / Equity Ratio | 4.10 | 4.17 | 4.33 | 5.43 |
| Gross Loan Portfolio / Total Assets | 1.00 | 0.99 | 0.95 | 0.96 |
| Overall Monthly Financial Performance | | | | |
| Annualized Return on Assets (ROA), % | 0% | 0% | 5% | 3% |
| Annualized Return on Equity (ROE), % | 0% | 0% | 13% | 17% |
| Operational self-sufficiency, % | 0% | 0% | 119% | 117% |
| Revenue | | | | |
| Yield on portfolio, % | 0% | 0% | 28% | 30% |
| Expenses | | | | |
| Financial Expense Ratio, % | 0% | 0% | 18% | 19% |
| Operating Expense Ratio, % | 0% | 0% | 6% | 5% |
| Portfolio Quality | | | | |
| PAR (>30 days), % | 0% | 0% | 0% | 0% |
| Risk Coverage Ratio, % | 0% | 0% | 2289% | 4430% |

# ANNEXURE 1: Details on Common Legal Forms of MFIs in India

| | |
|---|---|
| Societies | Societies can be registered under the Societies Registration Act, 1860 or under respective State Acts. A society can be registered by any seven persons associated for any literary, scientific or charitable purposes by subscribing their names to a memorandum of association and filing with the registrar. Registration does not require any minimum initial capital contribution and can be obtained easily.<br>• Difficulty to determine ownership makes banks uncomfortable in lending large sums<br>• Cannot raise equity so scalability is an issue<br>• Cannot accept public deposits<br>• Exempt from Income Tax if registered under Section 12A of the Income Tax Act<br>• Need registration under FCRA to be able to accept foreign grants |
| Trusts | Public Trusts can be established under the respective State regulations. Private trusts can be established under Indian Trusts Act 1882.<br>• Difficult to attract commercial equity and loans<br>• There is no minimum capital requirement and registration is fairly easy<br>• Can not accept public deposits<br>• Exempt from Income Tax if registered under Section 12A of the Income Tax Act<br>• Need registration under FCRA to be able to accept foreign grants |
| Cooperative Societies | Cooperative Societies can be registered under<br>• Co-operative Societies Act 1912, or<br>• Relevant State Co-operative Societies Acts, or<br>• Relevant State Mutually Aided Co-operative Societies Act, or<br>• Multi-state Co-operative Societies Act, 1995<br>Primarily regulated by Registrar of Co-operative Societies<br>Can access equity as well as deposits from their members and can lend to their members<br>Membership generally restricted to individuals, other co-operatives and government (including government corporations)<br>Mobilisation of equity is restricted as co-operative societies can raise equity only from their members. The principle of 'one person one vote' acts as a disincentive to equity mobilisation from the members<br>Reluctance from banks to invest in co-operative societies due to non-equity based ownership and political interfernce. |
| Section 25 Companies | Section 25 Companies are promoted for the purpose of promotion of commerce, arts, religion, charity or any other useful purpose<br>They are prohibited from payment of dividends<br>RBI has exempted NBFCs licensed under section-25 of the Indian Companies Act from registration, maintenance of liquid assets and transfer of profit to Reserve Funds, provided<br>• They are engaged in micro-financing activities (Rs. 50,000 for small businesses and Rs. 125,000 for housing)<br>• They do not mobilise public deposits<br>• Section-25 NBFCs find it difficult to mobilise equity owing to restrictions on payment of dividends<br>• Can mobilise foreign grants if registered under FCRA<br>• Exempt from Income Tax if registered under Section 12A of the Income Tax Act |
| Non-Banking Finance Companies (NBFCs) and Systemically Important NBFCs | Companies registered under Indian Companies Act 1956 can apply to RBI to carry on the business of an NBFC.<br>All non-deposit taking NBFCs having asset size of Rs. 1 bn (Rs. 100 crores) or more as per last audited balance sheet are considered as systemically important NBFCs.<br>Non-deposit taking and systemically important NBFCs are subject to capital adequacy regulations, single/group exposure norms and disclosure pertaining to derivative transactions<br>Capital Adequacy Ratio (CAR) requirement is now 12% and will be increased to 15% from April 2009 for systemically important NBFCs<br>NBFCs are required to have net owned funds of Rs. 20 million (although MFIs are increasingly taking the option of buying NBFCs registered before 1999, when capitalisation requirements were Rs. 2.5 million)<br>Ownership can be defined precisely and they can raise equity<br>Mobilisation of public deposits, though allowed, is almost impossible given strict guidelines of the RBI<br>Banks are comfortable lending to NBFCs which are well-capitalised and well-performing<br>NBFCs are for-profit entities and are taxable<br>NBFCs are subject to prudential regulations regarding income recognition, asset classification and provisioning, prudential exposure limits and accounting/disclosure requirements provided<br>• they are mobilising public deposits, or<br>• they are systemically important |

## ANNEXURE 2: Key Performance Indicators

| | | |
|---|---|---|
| Average Loan Balance by Active Borrowe | Measures the average outstanding loan balance per active clients. This is a driver of profitability and also a measure of how much of each loan is available to clients. | Gross Loan Portfolio / Number of Active Clients |
| Active Borrower per Loan Officer | Measures the average caseload of each loan officer, or average number of clients managed by one loan officer. This is a driver of productivity | Active Clients / Number of loan officers |
| Portfolio per Loan Officer | Measures the average portfolio amount managed by a loan officer. | Gross Loan Portfolio / Number of Loan Officers |
| Equity / Assets ratio | Measures the proportion of assets that are funded with equity. A high ratio means that the leverage of the company is low. | Total Equity / Total Assets |
| Debt / Equity ratio | Measures the leverage of the company. | Total Liabilities / Total Assets |
| Gross Loan Portfolio / Total Assets | Measures the proportion of loans to customers in the total assets of the company. | Gross Loan Portfolio / Total Assets |
| Annualized Return on Assets (RoA) | Measures how well the MFI uses its assets to generate returns. | (Net Operating Income after taxes) * 12 / Period Average Assets |
| Annualized Return on Equity (RoE) | Calculates the rate of return on the Average Equity for the period. It is frequently used by investors. Result will depend on the leverage of the company, i.e. if the MFI is mainly financed by capital or by debt. | (Net Operating Income after taxes) * 12 / Period Average Equity |
| Operational Self-Sufficiency (OSS) | Measures how well an MFI can cover its costs through operating revenues. | Financial Revenue / Total Financial and Operating Expenses |
| Yield on Portfolio | Indicates the MFI's ability to generate cash from interest, fees, and commissions on the Gross Loan Portfolio. | Cash Received from Interest, Fees and Commissions on Loan Portfolio / Average Gross Loan Portfolio |
| Financial Expenses Ratio | Measures the financial expenses as percentage of the average assets. This ratio depends on the cost of financing as well as the proportion between debt and equity. | Total Financial Expenses / Period Average Assets |

| | | |
|---|---|---|
| Operating Expenses Ratio | Measures the operating expenses as percentage of the average assets. This ratio should go down as the MFI is growing and reaching sustainability. | Total Operating Expenses / Periode Average Assets |
| Operating Expenses / Gross loan portfolio | Measures the operating expenses as percentage of the loan portfolio and allows comparison between MFIs no matter the composition of their assets. | Operating Expenses / Period Average Gross Loan Portfolio |
| Portfolio at Risk (PAR) > 30 Days Ratio | All outstanding balances of past due loans with no repayment during the last 30 days | PAR > 30 Days / Gross Loan Portfolio |
| Risk Coverage Ratio | Measures the proportion of doubtful loans that is covered by a provision. | Loan Loss Reserve / PAR > 30 Days |

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